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Prophylactic Merger Policy

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PROPHYLACTIC MERGER POLICY

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I. Introduction

An important purpose of the antitrust merger law is to arrest certain practices in their "incipiency," by preventing business firm mergers that are likely to facilitate them. Many decisions involving both mergers and other practices had recognized this idea as an important purpose of the Clayton Act as early as the 1920s.[1] The Supreme Court doubled down on the incipiency idea in its *Brown Shoe* merger decision, where it expressed concern about a "rising tide of economic concentration" and attributed to Congress a desire to halt this trend "at its outset and before it gathered momentum."[2] Speaking of the legislative history of the 1950 Celler-Kefauver amendments to the merger statute,[3] it attributed to Congress a "provision of authority for arresting mergers at a time when the trend to a lessening of competition in a line of commerce was still in its incipiency," before they would "justify a Sherman Act proceeding."[4] The importance of *Brown Shoe* was not its recognition of

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[1] *See, e.g.*, United States v. E.I. DuPont de Nemours, & Co., 353 U.S. 586, 588 (1957) (merger case: "…it is the purpose of the Clayton Act to nip monopoly in the bud."). Even earlier the Supreme Court made similar observations about the Federal Trade Commission Act. *See* FTC v. Motion Picture Advert. Serv. Co., 344 U.S. 392, 394-95 (1953) (exclusive advertising contracts: "It is also clear that the Federal Trade Commission Act was designed to supplement and bolster the Sherman Act and the Clayton Act – to stop in their incipiency acts and practices which, when full blown, would violate those Acts, as well as to condemn as 'unfair methods of competition' existing violations of them."); Fashion Originators' Guild v. FTC, 312 U.S. 457, 466 (1941) (ascribing incipiency purpose to FTC Act in boycott case); FTC v. Raladam Co., 283 U.S. 643, 647-648 (1931) (consumer protection decision attributing incipiency test to Clayton Act). *See also* Hamilton Watch Co. v. Benrus Watch Co., 206 F.2d 738 (2d Cir. 1953) (noting incipiency rationale in merger case). Cf. Corn Prods. Refining Co. v. FTC, 324 U.S. 726, 738 (1945) (ascribing incipiency rationale to price discrimination provision of §2 of the Clayton Act, as amended in 1936 by the Robinon-Patman Act); Standard Fashion Co. v. Magrane-Houston Co., 258 U.S. 346, 356 (1922) (applying Clayton Act incipiency to exclusive dealing under §3 of the Clayton Act).

[2]Brown Shoe Co. v. United States, 370 U.S. 294, 317-318 (1962).

[3]Celler-Kefauver Act, Pub. L. No. 81-899, 64 Stat. 1125 (1950) (codified as amended at 15 U.S.C. § 18 (2012)).

[4]*See* S. REP. NO. 1775, 81st Cong., 2d Sess. 4-5 (1950) ("The intent here ... is to cope with monopolistic tendencies in their incipiency and well before they have

an incipiency rationale as such, which was already well established, but rather its reading of the legislative history of the 1950s amendments as giving Congress' imprimatur on a particular theory linking merger policy to market concentration.

Today *Brown Shoe's* particular application of an incipiency test seems excessive and ill conceived. The merger in question increased the defendant's market share from 5.6% to 7.2%,[5] in an unconcentrated market and would not receive so much as a second glance from the antitrust enforcement agencies today. As one commentator later observed, this incipiency test permitted the government "to halt mergers well before any adverse economic effects could be discerned through econometrics or other empirical techniques."[6]

Most importantly, the Court did not explain why an incipiency test would be necessary to address the particular problem it identified. In the future merger law could always be brought to bear if the relevant numbers became larger, and market share numbers are readily available. That is, once structural thresholds for identifying problematic mergers are identified there is no need to condemn mergers that fall below that threshold. There is no principle of either law or fact that precludes the courts from enjoining a merger once the threshold has been exceeded.[7]

This does not mean that incipiency tests are unimportant. Rather, they properly have a different use than the one that the Supreme Court identified in *Brown Shoe*.[8] The appropriate use of incipiency tests is to prevent certain bad outcomes early when antitrust rules make it difficult or impossible to prevent them later.

The language of the merger statute, §7 of the Clayton Act, is very

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attained such effects as would justify a Sherman Act proceeding.")

[5] *Brown Shoe,* 370 U.S. at 345.

[6] Stephen M. Axinn, *In search of Congruence Between Legislative Purpose and Administrative Policy*, 2003 COLUM. BUS. L. REV. 431, 436. An analogous criticism can be applied to some of the pre-*Brown* decisions involving practices other than mergers. See, e.g., Justice Frankfurter's dissent in *Motion Picture Advertising, supra*, 344 U.S. at 398-399, complaining that the exclusive contracts in question ran for one year and covered only about 6% of the country's theaters; as a result, they caused no competitive harm.

[7] Writing in response to the Celler-Kefauver Act, but prior to *Brown Shoe*, *see* Chicago School Professor Ward S. Bowman, Jr., *Incipiency, Mergers and the Size Question: Section 7 of the Clayton Act*, 1 ANTITRUST BULL. 533 (1955) (objecting that the incipiency test threatened to be overdeterrent).

[8] On the proper way to evaluate market structure in merger cases, *see* Herbert Hovenkamp and Carl Shapiro, Horizontal Mergers, Market Structure, and Burdens of Proof, ___ Yale L.J. ___ (2018) (forthcoming), currently at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3046224.

broad. It prevents mergers whose effect "may be substantially to lessen competition, or to tend to create a monopoly."[9] The thing that triggers it is an acquisition of either equity shares or productive assets.[10] Section 7 has no agreement requirement such as limits enforcement of §1 of the Sherman Act.[11] Nor is it limited by the severe constraints that the law has quite properly placed on the use of antitrust law to limit single firm conduct,[12] including conduct that seeks to enforce the patent laws.[13] Beyond that, §7 of the Clayton Act shares the general antitrust goal of identifying and preventing business mergers that enable the post-merger firm to reduce market wide output and impose higher prices on consumers. Its effects test is indifferent to the mechanisms by which a merger lessens competition, as along as the anticompetitive effect can be attributed to the merger.[14]

Incipiency tests for mergers are most valuable in cases where a merger is likely to lead to conduct or behavior that is both anticompetitive but also is difficult or impossible for antitrust law to reach once the merger has occurred. This can happen in a variety of situations, some of which have been recognized while others have not.

Antitrust merger law does not have a "regulatory" mandate, and this makes incipiency tests particularly important. Nothing in the statute or its legislative history suggests that Congress believed the federal courts should use ongoing supervision of post-merger firms in order to limit anticompetitive conduct. Some merger consent decrees have lost sight of this, seeking to control conduct that might occur long after the merger was consummated.[15] Consent decrees are contracts and can specifying whatever the parties want, provided that it is not independently unlawful. Nevertheless, such decrees can blur the important line between antitrust and regulation, sometimes thrusting general jurisdiction Article III courts into roles for which they are not well suited. The language of §7 authorizes courts to *condemn* mergers whose effect may be substantially to limit competition. It does not authorize them to supervise the behavior of post-merger firms as if they were

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[9] 15 U.S.C. §18.

[10] 5 PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶1201 (4th ed. 2016)

[11] 15 U.S.C. §1 (2012) (reaching "contracts, combinations, and conspiracies…"). *See* 6 & 7 PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW, Ch. 14 (4th ed. 2017)

[12] 15 U.S.C. §2 (2012). *See* 3 & 3A, *Id*., Ch. 7 (4th ed. 2015).

[13] *Id*., Ch. 7B.

[14] "…where … the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly." 15 U.S.C. §18 (2012).

[15] E.g., United States v. Comcast Corp., Civil Case No. 11-106 (RJL) (D.D.C. Sep. 1, 2011) (consent decree). *See* discussion *infra*, text at notes __.

regulated entities.

Today most mergers are challenged before they occur.[16] As a result, the feared post-merger conduct has not occurred either and courts are limited to evidence of predicted rather than actual effects. This fact makes it important to place some limits on merger law's prophylactic reach. First, the language of §7 requires causation -- a showing that the merger is what is likely to facilitate that feared anticompetitive conduct. Second, we need to be satisfied that this conduct, if it should occur, will be both anticompetitive and difficult to reach through direct application of the antitrust laws. Third, the merger must raise a significant risk that the conduct will occur. Finally, as with all merger cases, there must not be offsetting gains that serve to justify the merger notwithstanding these threats to competition.[17]

The range of behaviors for which merger law's prophylactic reach can be relevant includes the following:

1. A horizontal merger might facilitate coordinated interaction, which would be either difficult to detect as collusion, or difficult to challenge given the "agreement" requirement contained in §1 of the Sherman Act.[18]

2. A horizontal merger might create either a monopoly or else enable a post-merger firm to increase its price, or engage unilaterally in some other output limiting practice that is unreachable under §2 of the Sherman Act, given antitrust's broad tolerance for unilateral conduct.[19]

3. A vertical merger might facilitate a post-merger unilateral price increase, price discrimination, refusal to deal, or other exclusion that would be very difficult to reach when the conduct in question is that of a single firm.[20]

4. An IP acquisition, particularly of a patent developed by an outside inventor, might result in exclusionary enforcement that

[16] See 15 U.S.C. §18a (2012) (Hart-Scott-Rodino premerger notification).

[17] On this point, *see* Herbert Hovenkamp, *Appraising Merger Efficiencies*, 24 GEO. MASON L. REV. 703 (2017).

[18] *See* discussion *infra*, text at notes __.

[19] *See* discussion *infra*, text at notes __

[20] *See* discussion *infra*, text at notes __.

would be impossible for antitrust to reach unless the patent is invalid or unenforceable.[21]

5. Acquisitions of small but highly innovative startups might enable a large firm to continue its domination of a market in the face of entry threats, but in ways that are not reachable as unilateral conduct.[22]

This paper discusses the legitimate and illegitimate rationales for incipiency tests, as well as important limitations. First it looks at some improper uses of such tests. Then it discusses appropriate uses, beginning with those that are relatively well recognized in the case law and literature and moving on to those that are largely unrecognized.

II. Improper Uses of Incipiency Tests

Incipiency tests are not justified in two situations. One is when we are unable to predict with sufficient confidence that a certain anticompetitive outcome will occur and that it can be attributed to the merger. The other is when the feared post-merger anticompetitive conduct is readily remedied by the antitrust laws if it should occur. In both these cases, concerns about possible anticompetitive outcomes down the road must give way to the promise of merger efficiencies.

Most mergers are lawful because they are thought to generate cost savings from economies of scale, integration, elimination of market transactions, or some other efficiency.[23] To be sure, once a prima facie case against a merger is established efficiency defenses are very difficult to prove. But the assumption that many mergers produce efficiencies is built into our prima facie case to begin with.[24] As a result, we do not want to condemn a merger based on mere speculation that it might lead to some anticompetitive outcome. Nor do we want to condemn a merger when some practice which may or may not occur later is readily remedied at that time.

Post-merger predatory pricing is a good example of a practice that does not become likely merely because a merger may make it structurally conceivable. Only a dominant firm can succeed in monopolistic predatory

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[21]*See* discussion *infra*, text at notes __; and Walker Process Equipment, Inc. v. Food Mach. & Chem. Corp., 382 U.S. 172 (1965).

[22]*See* discussion *infra*, text at notes __.

[23]*See* IVA PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW, Ch. 9E (4th ed. 2016); Hovenkamp, *Appraising Merger Efficiencies*, *supra* note __.

[24]*Id.*, 24 GMU L. Rev. at 708-711.

pricing as condemned by the Sherman Act.[25] But that hardly means that every firm with a minimum sufficient market share is likely to engage in predatory pricing. Predatory pricing is a risky strategy even for a dominant firm and very likely is relatively uncommon. As a result, a merger should not be condemned merely because it creates a firm with a sufficiently large market share to make predatory pricing factually plausible.[26] The same thing is true about a firm's acquisition of a patent portfolio that is likely to contain some weak patents. Ownership of an invalid or unenforceable patent is prerequisite to *Walker Process* liability for filing an infringement action based on a worthless patent.[27] Nonetheless, the mere acquisition of a portfolio that contains such patents hardly suggests that acquiring firm intends to do just that.

The other set of circumstances when prophylactic rules are unnecessary and counterproductive is when the feared post-merger practice is readily remedied with a more direct antitrust rule if it should occur. A good example here is the use of §7 to condemn mergers on the theory that they might condemn anticompetitive tying or reciprocity.[28] Most of the case law

[25] American Academic Suppliers, Inc. v. Beckley-Cardy, Inc., 922 F.2d 1317 (7th Cir. 1991) (Posner, J., only monopolist can engage in predatory pricing); 3 PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶¶725-727 (4th ed. 2015) (structural requirements of predation). Non-monopolistic predatory pricing intended to shore up a faltering oligopoly could be condemned under the Robinson-Patman Act, were it not for the severe constraints imposed by Brooke Group v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 226 (1993). *See* 3 ANTITRUST LAW, *Id.*, ¶726.

[26] *Cf.* Cargill, Inc. v. Monfort of Colo. Inc., 479 U.S. 104, 119 (1986) (refusing to condemn a merger on theory that post-merger firm would engage in aggressive pricing).

[27] Antitrust liability can also attach when the patent is valid but the infringement plaintiff knows that the defendant is not infringing. *See, e.g.*, United States v. Besser Mfg. Co., 96 F. Supp. 304, 312 (E.D. Mich. 1951), aff'd, 343 U.S. 444 (1952) (infringement plaintiff did not have good reason to believe that infringement defendant's technology infringed); Moore USA, Inc. v. Standard Register Co., 139 F. Supp. 2d 348 (W.D.N.Y. 2001) (refusing to dismiss Sherman §2 counterclaim allegation that patentee filed infringement claim while knowing that counterclaimant's product did not infringe); Ecrix Corp. v. Exabyte Corp., 95 F. Supp. 2d 1155 (D. Colo. 2000) (for purposes of filing antitrust claim, infringement defendant was entitled to discovery of factual basis for infringement allegations).

[28] Reciprocity resembles tying except that the two products move through the market in opposite direction. For example, a firm that both processes chickens and produces chicken feed might purchase chickens from growers only on the condition participating growers use its feed. See FTC v. Consolidated Foods Corp., 380 U.S. 592 (1965) (condemning merger on theory that it would facilitate compelled reciprocity). *See* HERBERT HOVENKAMP, FEDERAL ANTITRUST POLICY: THE LAW

suggests that unlawful tying requires a minimum market share in the range of 30% - 40%.[29] So a horizontal merger might create the requisite minimum market share to make unlawful tying possible.[30] Alternatively, a nonhorizontal merger, such as a union of complements, might create an opportunity for tying two products together.[31] Anticompetitive tying and reciprocity are readily detected, however. They cannot be done secretly. Further, very few people would argue that the existing rules for addressing these practices are underdeterrent. In addition, many instances of tying and reciprocity are competitively benign. As a result, condemning a merger on the theory that it might later lead to tying or reciprocity is doubly overdeterrent. First, it condemns a merger without knowing whether this particular conduct will occur and, secondly, without knowing whether it will be anticompetitive if it does occur.

III. Mergers Threatening Horizontal Coordinated Interaction

Merger incipiency analysis is most fully developed for the traditional horizontal merger that makes an industry more concentrated, thus increasing the likelihood of collusion or collusion-like behavior. If a merger of two competitors reduces the number of firms in a market from, say, four to three, the three-firm post-merger market might be more susceptible to traditional price fixing, or the firms might be in a better position to engage in tacit collusion. Because collusion is done in secret, it is not always detected and can be difficult to prove. Further, collusion-like behavior can be condemned only if the conduct satisfies the "agreement" requirement of §1 of the Sherman Act.

In this case, the Government Agencies' 2010 Horizontal Merger Guidelines recognize the danger. They state their purpose as interdicting mergers that might "create, enhance, or entrench market power or facilitate

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OF COMPETITION AND ITS PRACTICE §13.3a (5th ed. 2015).

[29] *See* 10 PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶¶1735-1736 (4th ed. 2018).

[30] A merger that created a firm with a 30% market share could result in a post-merger HHI under 1500, provided other firms in the market were very small. That would make the post-merger market "unconcentrated" under the 2010 Horizontal Merger Guidelines and the merger would be approved with "no further analysis," even though the 30% share could make anticompetitive tying possible. *See* United States Department of Justice and Federal Trade Commission, 2010 Horizontal Merger Guidelines §5.3 (2010), available at https://www.ftc.gov/sites/default/files/attachments/merger-review/100819hmg.pdf.

[31] *E.g.*, Spartan Grain & Mill Co. v. Ayers, 581 F.2d 419 (5th Cir. 1978); Betaseed, Inc. v. U & I, 681 F.2d 1203 (9th Cir. 1982). *See* 5 PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶1143 (4th ed. 2015).

its exercise."[32] They also articulate the incipiency concern that some mergers might facilitate collusion-like practices that are "not otherwise condemned by the antitrust laws."[33]

Horizontal merger law would be more difficult to justify if every anticompetitive instance of collusion-like behavior could be detected and remedied when it occurred. In that case the better approach would be to wait and see. We could permit the merger to go forward, thus allowing whatever efficiencies the merger creates, confident that if collusive behavior should ever occur the courts would be able to detect and prevent it.

In his *Hospital Corp*. opinion, Judge Posner stated this rationale for an incipiency test.[34] He observed that a concentration-increasing merger among hospitals in Chattanooga Tennessee increased the likelihood of price coordination leading to lower output and higher prices. If such collusion should occur it might be both difficult to condemn and difficult to prosecute, given antitrust law's "agreement' requirement. Further,

> Section 7 does not require proof that a merger or other acquisition has caused higher prices in the affected market. All that is necessary is that the merger create an appreciable danger of [collusive practices] in the future. A predictive judgment, necessarily probabilistic and judgmental rather than demonstrable,

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[32]United States Department of Justice and Federal Trade Commission, 2010 Horizontal Merger Guidelines §1 (Aug. 19, 2010), available at https://www.ftc.gov/sites/default/files/attachments/merger-review/100819hmg.pdf.

[33]*See id*., §7.0:

> Coordinated interaction includes a range of conduct. Coordinated interaction can involve the explicit negotiation of a common understanding of how firms will compete or refrain from competing. Such conduct typically would itself violate the antitrust laws. Coordinated interaction also can involve a similar common understanding that is not explicitly negotiated but would be enforced by the detection and punishment of deviations that would undermine the coordinated interaction. Coordinated interaction alternatively can involve parallel accommodating conduct not pursuant to a prior understanding. Parallel accommodating conduct includes situations in which each rival's response to competitive moves made by others is individually rational, and not motivated by 24 retaliation or deterrence nor intended to sustain an agreed-upon market outcome, but nevertheless emboldens price increases and weakens competitive incentives to reduce prices or offer customers better terms. Coordinated interaction includes conduct not otherwise condemned by the antitrust laws.

[34]Hospital Corp. of Am. v. FTC, 807 F.2d 1381, 1389 (7th Cir. 1986) cert. denied, 481 U.S. 1038 (1987).

is called for.[35]

That "appreciable danger" formulation seems to state the threat about right. "Certainty' is too strict; "possibility" is not strict enough. Collusion or collusion-like behavior is a much more likely to result from a concentration-increasing merger than is a practice such as predatory pricing.[36] Mergers significantly increasing the likelihood of such behavior represent a realistic threat of post-merger anticompetitive conduct that the antitrust laws will not be able to discipline effectively in many instances.

IV. Horizontal Mergers Facilitating Unilateral Anticompetitive Effects

A small but important subset of mergers create a monopoly or dominant firm in the affected market.[37] Once such a firm has been created, its unilateral dealing and pricing decisions are virtually out of reach of the antitrust laws.[38]

A much larger subset of mergers falls into the general category of anticompetitive "unilateral effects" actions. Today the Agencies analyze more mergers under unilateral effects theories than they do under traditional coordinated effects theories. According to one paper by insiders, unilateral effects investigations at the FTC account for about three-fourths of the total.[39] The most frequently used of these theories applies when the merging firms offer relatively close substitutes in a product differentiated market. The merger facilitates a price increase by eliminating competition between them, forcing consumers either to pay more or else select a more remote substitute.[40] The price effects are said to be unilateral because only the post-merger firm charges the higher price; other firms in the market are generally unaffected. The theory does not require conjectures about what type of interdependent pricing the post-merger firm might engage in with other firms

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[35] *Id*. at 1389.

[36] *See* discussion *supra*, text at notes __.

[37] E.g., FTC v. Phoebe Putney Health Sys., 568 U.S. 216, 222 (2013) (merger gave one firm virtual monopoly in affected market); Northern Securities Co. v. United States, 193 U.S. 197, 322 (1904) (union of parallel railroad lines create monopoly).

[38] *See* discussion *infra*, text at notes __.

[39] *See* Malcolm B. Coate & Shawn W. Ulrick, *How Much Does the Choice Between Collusion and Unilateral Effects Matter in Merger Analysis* (FTC working paper, Nov. 15, 2017), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2995679.

[40] On the theory, *see* 4 PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶¶914-915 (4th ed. 2015).

in the market.

The theory for predicting a unilateral price increase from a merger is at least as robust as the theory for predicting price increases likely to result from coordinated interaction. While the link between market concentration and the dangers of coordinated interaction are well established, the precise mechanism that the firms will employ is typically unknown at the time the merger occurs. For example, a merger that reduces the number of firms in a market from four to three creates an "appreciable danger" of collusion-like behavior,[41] but until it occurs we would not know the precise mechanism of coordination or whether that behavior would satisfy §1's agreement requirement.

Significantly, however, merger policy does not require the court to know the precise strategy causing competitive harm. This is because the Clayton Act states an "effects" test – where "the effect of the acquisition may be substantially to lessen competition, or to tend to create a monopoly."[42] For unilateral effects cases the inference is more direct than in the case of coordinated effects. One hypothesizes a price increase of a given magnitude and then uses information about margins and cross elasticity of demand between the two merging firms as well as closer, non-merging substitutes. From this one can estimate the post-merger firm's profit-maximizing output and price.[43]

One of the most important justifications for prophylactic merger policy occurs when the feared anticompetitive conduct is that of a single firm. This is so in both cases involving merger to monopoly and those causing anticompetitive unilateral effects. Under United States antitrust law, a firm acting unilaterally has very little obligation to deal with either rivals or customers.[44] Further, unilaterally set prices are beyond antitrust's reach, provided they are not predatory,[45] and price discrimination is virtually never

[41]*See Hospital Corp.*, *supra*, 807 F.2d 1389.

[42] 15 U.S.C. §18 (2012). On the merger law's statement of a test that requires only a showing of harmful effects, *see* Fiona Scott-Morton and Herbert Hovenkamp, *Horizontal Shareholding and Antitrust Policy*, ___ YALE L.J. __ (2018), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3046203.

[43]The approach is laid out in Carl Shapiro, *The 2010 Horizontal Merger Guidelines: From Hedgehog to Fox in Forty Years*, 77 ANTITRUST L.J. 49 (2010); Joseph Farrell & Carl Shapiro, *Antitrust Evaluation of Horizontal Mergers: An Economic Alternative to Market Definition*, 10 B.E. J. THEORETICAL ECON. 1, art. 9, 14-15 (2010).

[44]E.g., Verizon Communic., Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398 (2004) (monopolist has no antitrust duty to interconnect with rival); United States v. Colgate, 250 U.S. 300 (1919) (firm has right to refuse to deal). *See* PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶¶770-774 (4th ed. 2015).

[45]Id., ¶720.

an antitrust violation.[46] While the Robinson-Patman Act may reach the simple practice of charging two dealers different prices, the statute is not designed to pursue most kinds of price discrimination, and does not even reach price discrimination in the provision of services such as video content.[47] In any event, the focus of unilateral effects merger policy is on mergers that threaten simple price increases, and these are unreachable under antitrust law when they are being imposed by a single firm.

Two rationales are offered to justify the lenient rules that antitrust applies to single firm conduct, mainly under the Sherman Act. First, in most cases a firm's unilateral pricing practices are not anticompetitive. That is, they do not create or enhance a firm's market power but rather reflect power that already exists. For that reason, the United States has never had a rule of no fault monopolization.[48] If a firm has market power the antitrust laws permit the firm to set its profit maximizing price, provided that it is acting unilaterally.

The second rationale for antitrust tolerance of a firm's unilateral pricing decisions as well as refusals to deal is at least as compelling. Administratively, it is very difficult to develop remedies against unilateral conduct that do not involve ongoing regulation of the firm in question. For example, a dealing order would require a judge to determine with some precision not only the price, but also precisely what asset must be shared and with whom. If costs or technology change in subsequent years, then the order would have to be adjusted. Such a dealing order requires ongoing supervision that virtually turns the firm into a public utility, except that it is regulated by a court of general jurisdiction rather than an agency.[49]

This is where merger policy can assist, under the same prophylactic rationale that justifies the antitrust concern with mergers that facilitate coordinated interaction. While antitrust is powerless to regulate a single firm's prices, it can interdict a merger that is likely to put the firm into a position where it is able to charge such prices.

V. Incipiency and Vertical Acquisitions

A vertical merger involves a buyer and a seller rather than two competitors. At least since the 1970s, the antitrust enforcement agencies have never challenged as many vertical mergers as horizontal ones, and over

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[46]*Id*. at ¶721. On the Robinson-Patman Act, *see* 14 HERBERT HOVENKAMP, ANTITRUST LAW, Ch. 23 (3d ed. 2012).

[47]Coverage of the Robinson-Patman Act is limited to "commodities." *See id*., ¶2314.

[48] *See* 3 PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶¶630-638 (4th ed. 2015).

[49] *See* 3B *Id*., ¶771.

the last three decades have been much less enthusiastic about doing so.[50] Reflecting this fact is that the most recent revision of the vertical merger Guidelines was 1984,[51] while the horizonal merger Guidelines have been revised regularly through 2010.[52]

The 1984 Guidelines were drafted at a time when antitrust policy was dominated by a Chicago School analysis that saw vertical mergers as rarely creating competitive problems. The purely vertical transaction itself does not make either the buyer's or the seller's market more concentrated, and does not increase the market share of either of the merging firms. In the longer run, a transaction that reduces the firm's costs may increase market share at either or both levels, but that shift in market share would usually be accompanied by an output increase and lower prices, rather than vice-versa. In any event, it is not the purpose of the antitrust laws to condemn cost-savings.

Today most vertical mergers are analyzed under an approach that looks for instances of anticompetitive input foreclosure or discrimination, or in some cases constraints on the development of innovative technologies. In general, input foreclosure refers to mechanisms by which a vertically related firm can raise the costs of rivals in the downstream market by reducing the availability of inputs or raising their price. Econometric techniques have been developed for analyzing these price effects.[53] As in the case of horizontal mergers, these methodologies try to identify the pricing strategies that will maximize the post-merger firm's prices. Cost-savings tend to lower the post-merger firm's profit maximizing prices, while input foreclosure tends to increase them. The ultimate question is whether the vertical acquisition is likely to lead to higher consumer prices.

If a vertical merger is anticompetitive under an input foreclosure or discrimination theory, the incipiency rationale applies. That rationale is the same as for unilateral effects from horizontal mergers; namely, antitrust rules do not typically reach a single firm's decisions about the price of its products or it willingness to share them with rivals. A coherent approach to vertical

[50] The last fully litigated case on the merits was Fruehauf Corp. v. FTC, 603 F.2d 345 (2d Cir. 1979), which the Federal Trade Commission lost on appeal.

[51] *See* United States Department of Justice, Merger Guidelines (1984), available at https://www.justice.gov/sites/default/files/atr/legacy/2007/07/11/11249.pdf. Vertical acquisitions are addressed in these Guidelines as "Non-Horizontal Mergers." *See* §§4, 4.2.

[52] *See* Department of Justice and Federal Trade Commission, *Horizontal Merger Guidelines* (2010), *supra* note __.

[53] *See* Serge Moresi & Steven C. Salop, *VGUPPI: Scoring Unilateral Pricing Incentives in Vertical Mergers*, 79 ANTITRUST L.J. 185 (2013) (VGUPPI stands for "vertical gross upward pricing pressure indices).

merger policy is therefore to condemn vertical mergers that are reasonably likely to facilitate a refusal to deal, price discrimination, or price increases that would be lawful if undertaken by a single firm.

In addition, the challenger must show that this refusal to deal or pricing practice would likely cause competitive harm if it occurred. Many instances of vertical integration by merger result in refusals to deal. For example, a manufacturer of lawn mowers that acquires its own dealer in a community is very likely to sell mowers through its newly acquired dealership, refusing to sell mowers to local independent dealers. Although this vertical merger might facilitate this refusal to deal, that does not establish that the refusal is anticompetitive.[54]

The fact that anticompetitive foreclosure or discrimination is not automatic does not mean that it never occurs, however. For example, a broadband internet provider that acquires substantial programming assets may be in a position to deny that programming to distributors on rival internet providers, or else charge them a higher price. The effect of the higher price could be either to increase consumer prices or else to induce them to switch away from a competitor's broadband service to that of the post-merger firm. These are essentially the government's allegations in the *AT&T/Time Warner Merger* case, which at this writing is in the pretrial stage. The government alleges mainly that the merger between AT&T, an internet provider whose assets include DirecTV, and Time Warner (TW) would enable the post-merger firm to force rival distributors of TW programming to pay a higher price than TW's current position would permit.[55] The complaint also alleges that the merger would slow the development of "disruptive," procompetitive innovations such as direct online video distribution. This includes Sling TV and other "skinny" bundles that offer programming directly over the internet rather than traditional cable.[56]

The 2011 merger between Comcast Corp. and NBC reflected

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[54] For several years vertical mergers were brought under the now largely defunct theory that the post-merger firm would favor its own subsidiaries at the expense of rivals. *See* Fruehauf Corp. v. FTC, 603 F.2d 345 (2d Cir. 1979) (rejecting this theory); United States v. E.I. Du Pont De Nemours & Co., 353 U.S. 586 (1957) (accepting government's acquisition that vertical ownership relationship between Du Pont and General Motors Corp would incentivize GM to favor Du Pont when it purchased seat cover fabrics and automobile paint, both of which were manufactured by both Du Pont and other firms.

[55] Complaint, ¶¶5-6, United States v. AT&T, Inc., Case 1.17-cv-02511 (D.D.C., Filed Nov. 20, 2017).

[56] *Id.*, ¶¶8-9 ("AT&T/DirecTV perceives online video distribution as an attack on its business that could, in its own words, 'deteriorate[] the value of the bundle.'"

analogous concerns about denial of access to programming.[57] The Comcast merger was resolved by a consent decree that permitted the merger but required the post-merger firm to share its programming and grant access to rival programming on fair and reasonable terms. The decree set up an arbitration mechanism to resolve disputes. Judge Richard Leon, the same judge currently presiding over the *AT&T* case, expressed considerable doubt about whether the arbitration scheme would work,[58] and there is evidence that it did not work all that well.[59] Nevertheless, Judge Leon approved the consent decree.

Coincidentally, the Federal Communications Commission's December, 2017 decision rolling back net neutrality will very likely increase antitrust scrutiny on such vertical mergers in this industry, at least if they involve a broadband provider.[60] The net neutrality rules that had been in place would have prohibited at least some of the vertical exclusion and discriminatory treatment that can result from a vertical telecommunications acquisition.[61] As a result, the lack of regulatory control will undoubtedly be relevant to consideration of the *AT&T Time Warner* case.

The argument that post-merger AT&T/TW will favor its own customers and discriminate against the customers of rivals may sound a little like rejected arguments from the 1970s. The concerns stated in earlier cases were that vertical mergers gave a firm's own customers preferential treatment over the customers of rivals.[62] There is one very important difference, however, although it is specific to communications mergers and perhaps a few others. The "favoritism" arguments in those earlier cases involved

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[57] *See* United States v. Comcast Corp., Civil Case No. 11-106 (RJL) (D.D.C. Sep. 1, 2011) (consent decree).

[58] Id. at 6-7.

[59] *See* Jonathan Berr, "Regulators in AT&T-Time Warner Deal Try to Avoid Repeating Past Mistakes," FORBES, Nov. 21, 2017, available on line at https://www.forbes.com/sites/jonathanberr/2017/11/21/regulators-in-att-time-warner-deal-try-to-avoid-repeating-past-mistakes/#5a57a95614e0.

[60] *See* https://www.fcc.gov/document/fcc-takes-action-restore-internet-freedom (Dec. 14, 2017).

[61] *See* Tim Wu, *Why Blocking the AT&T-Time Warner Merger Might Be Right*, New York Times (Nov. 9, 2017), available at https://www.nytimes.com/2017/11/09/opinion/att-time-warner-merger-fcc.html?mtrref=www.google.com&assetType=opinion (arguing that erosion of net neutrality will increase anticompetitive potential of the merger). See also Jon Brodkin, "Comcast Accused of Violating NBC Merger Commitment and Net Neutrality Rule, ARS TECHNICA (March 3, 2016), available at https://arstechnica.com/information-technology/2016/03/comcast-accused-of-violating-nbc-merger-commitment-and-net-neutrality-rule/.

[62] *E.g.*, *Fruehauf*, *supra* note __; *Du Pont*, *supra* note __.

durable goods for which there was a naturally finite supply.[63] By contrast, licensed films and television programming are nonrivalrous. Once these are produced they can be licensed out an indefinite number of times and there is no problem with allocation of shortages. For example, in *Fruehauf* the FTC argued that in time of short supply the post-merger firm would favor its own subsidiary at the expense of rivals. By contrast, once a TW asset such as *Wonder Woman* or the *Harry Potter* films has been created, the digital files can be licensed an indefinite of times. It post-merger AT&T/TW decides not to license *Wonder Woman* to a competing cable company or to charge it a higher price, it is manifestly not because *Wonder Woman* is in short supply and must be allocated among potential customers.

The Comcast consent decree referred to above[64] reflects a mechanism of resolving antitrust disputes in communications markets with a combination of antitrust and ongoing control. It has also been used in monopolization cases, such as the consent decree that broke up the AT&T telephone monopoly in the early 1980s.[65] That decree resolved an antitrust case by a combination of a structural remedy that broke the phone company into seven "Baby Bells," but also by ongoing oversight of interconnection disputes by a federal district judge,[66] which lasted until passage of the 1996 Telecommunications Act.[67]

As this history of antitrust regulation by consent decree suggests, antitrust and regulation represent alternative approaches to competition issues, and it is best not to confuse them.[68] Notwithstanding Judge Greene's

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[63]*E.g.*, *Fruehauf, supra* note __ (heavy duty truck wheels and antiskid brakes); *Du Pont, supra* note ___ (automobile fabrics and finishes).

[64]*See* note __.

[65]United States v. AT&T, 552 F. Supp. 131 (D.D.C. 1982), *aff'd mem. sub nom.* Maryland v. United States, 460 U.S. 1001 (1983). A similar consent decree terminated the Government's big §2 case against Microsoft. United States v. Microsoft Corp., 231 F. Supp. 2d 144 (D.D.C. 2002); State of New York v. Microsoft Corp., 231 F. Supp. 2d 203 (D.D.C. 2002) (approving settlement).

[66]The late Honorable Harold Greene. *See* Joseph D. Kearney, *From the Fall of the Bell system to the Telecommunications Act: Regulation of Telecommunications Under Judge Greene,* 50 HASTINGS L.J. 1395 (1999).

[67]Telecommunications Act of 1996, Pub. L. No. 104-104, 1996 U.S.C.C.A.N. (110 Stat.) 56 (codified in scattered sections of 47 U.S.C.).

[68]*See* Daniel A. Crane, *Bargaining in the Shadow of Rate-Setting Courts*, 76 ANTITRUST L.J. 307 (2009) (recalling, among other things, the history of rate setting under the ASCAP and BMI consent decrees that established what became the copyright royalty tribunal; also observing that even when a consent decree contemplates managed rates the parties are able to negotiate them in a significant majority of cases). *Accord* Daniel A. Crane, *Intellectual Liability,* 88 Tex. L. Rev. 253 (2009).

heroic work administering the AT&T breakup, antitrust is not a good vehicle for imposing ongoing regulatory restrictions on a firm's behavior. The "breakup" provision of the 1982 AT&T consent decree was very much an antitrust remedy, but the portion of the decree requiring ongoing supervision of interconnection disputes was not, and in the 1996 Telecommunications Act it was assigned over to the Federal Communications Commission and state telecommunications regulators.

The one important difference between the AT&T telephone case and the more recent vertical mergers is that AT&T was a single firm to begin with, and the action against it had been brought under §2 of the Sherman Act.[69] This made Clayton Act incipiency irrelevant. The AT&T consent decree expresses what antitrust can accomplish without a legislative assist in an action against a single firm. Eventually, however, Congress acted. The interconnection components of the consent decree were replaced by a regulatory provision that transferred these obligations away from a federal court and to federal and state agencies.[70]

Merger consent decrees with behavioral conditions are an attempt to avoid or at least soften the implications of the incipiency test by expanding the scope of antitrust so as to do things that antitrust could not accomplish on its own. Consent decrees are contracts, and as such they can impose much more specific and far reaching rules on the parties than would occur through ordinary antitrust litigation.[71] The one thing that they have difficulty providing, however, is closure.[72] Rather, they create ongoing obligations that need to be enforced until the decree expires.[73]

This does not mean that every unlawful merger must be completely blocked. Select, targeted spinoffs are in fact structural forms of relief that

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[69] The breakup occurred after one of the rare instances in which a court found a unilateral duty to deal, in this case under the "essential facility" doctrine, which the Supreme Court has never approved. *See* MCI Communications Corp. v. AT & T Co., 708 F.2d 1081 (7 Cir.), cert. denied, 464 U.S. 891 (1983).

[70] 1996 Telecommunications Act, *supra* note __.

[71] *See, e.g.*, Flying J, Inc. v. Comdata Network, Inc., 405 F.3d 821, 835-836 (10th Cir. 2005) (contract principles rather than substantive antitrust law controlled in interpretation of antitrust consent decree); United States v. Microsoft Corp., 147 F.3d 935, 945-947 (D.C.Cir. 1998) (same).

[72] The problem is not a new one. *See* Note, Flexibility and Finality in Antitrust Consent Decrees, 80 Harv. L. Rev. 1303 (1967) (noting problem of ongoing supervision in merger consent decrees).

[73] On antitrust consent decrees generally, *see* 2A PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶327 (4th ed. 2015); on the history, *see* Eric J. Branfman, *Antitrust Consent Decrees—A Review and Evaluation of the First Seven Years Under the Antitrust Procedures and Penalties Act*, 27 ANTITRUST BULL. 303 (1982).

ordinarily do not require ongoing judicial supervision. If a particular asset is likely to be a bottleneck, the appropriate solution may be to condemn the merger unless the firms agree to divest that bottleneck asset to a third party who will maintain it as a viable competitive presence. Or in the case of partial asset acquisitions[74] that leave both merging partners as separate ongoing concerns, the government might simply object to some asset transfers, leaving them with the original owner.[75] But in either case the goal is to leave a market structure that will sustain competition without the need for government oversight.

Another workable solution, although it superficially sounds more behavioral than structural, is insistence that certain IP rights be nonexclusive in perpetuity rather than exclusive. Nonexclusive rights give a firm everything it needs to operate its own business, enabling it to take advantage of expansion opportunities and up-to-date technology. The one thing that they do not grant is the right to prevent competitors from using that technology.[76] For example, the consent decree that broke up the telephone company provided for the compulsory licensing of AT&T patents on a nonexclusive, nondiscriminatory basis.[77] Antitrust consent decrees that require nondiscriminatory licensing of patents are in fact quite common.[78]

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[74]The 2010 Horizontal Merger Guidelines have a section on partial acquisitions, but it is devoted largely to partial stock acquisitions, which raise very different issues. *See* 2010 Horizontal Merger Guidelines, *supra* note __, § 13.

[75] For example, the recently proposed union of 21st Century Fox and Walt Disney Company is a partial asset acquisition, in which Fox will sell some but not all of its assets to Disney. If a particular transfer is found to be anticompetitive, the result may be to force Fox to retain that particular asset, leaving the rest of the merger to proceed. Fox may, of course, later sell that asset to some other firm. On the merger, *see* "Disney Buys Much of Fox in Megamerger That Will Shake World of Entertainment and Media," at https://www.washingtonpost.com/news/business/wp/2017/12/14/disney-buys-much-of-fox-in-mega-merger-that-will-shake-world-of-entertainment-and-media/?utm_term=.5b25155cc07c.

[76]*See* United States Department of Justice and Federal Trade Commission, Antitrust Guidelines for the Licensing of Intellectual Property (2017), available at https://www.justice.gov/atr/IPguidelines/download §4.1.2 ("A non-exclusive license of intellectual property that does not contain any restraints on the competitive conduct of the licensor or the licensee generally does not present antitrust concerns").

[77]United States v. AT&T, *supra* note __, 552 F. Supp. 131, 135. *See also id*. at 176 (explaining why it was now appropriate to eliminate compulsory nonexclusive licensing requirements in a previous antitrust consent decree entered in 1956).

[78]*See, e.g*. United States v. Nat'l Lead Co., 332 U.S. 319, 328 (1947) (approving elaborate consent decree requiring licensing of patent on nondiscriminatory terms).

In sum, in applying §7's incipiency test to a vertical merger the challenger needs to show four things, or in some cases five. *First*, that the acquisition makes particular behavior possible; *second*, that the post-acquisition market and the position of the firm creates a reasonable likelihood that this behavior will occur; *third*, that the behavior will be anticompetitive if it does occur, with the presumptive measure being lower output, higher prices, or reduced innovation; and *fourth*, that once the merger has occurred and the conduct has become that of a single firm, it will be much more difficult for antitrust law to detect and discipline. A possible fifth query, as noted above in the discussion of net neutrality, would be whether non-antitrust regulatory provisions are present and will police the feared conduct in a satisfactory manner.[79]

As the first two elements indicate, the fact finder must show not only that a merger makes certain conduct possible, but also that the post-merger firm would be likely to engage in it. In merger analysis this is ordinarily an objective exercise, querying whether a practice such as refusal to deal or price discrimination would be profitable for the firm in question. This is the way we analyze the analogous problem for horizontal mergers – that is, by querying whether a change in market position has increased the post-merger firm's profit maximizing price when measured against pre-merger levels.[80]

To give a simple example, after the proposed merger between AT&T and Time-Warner, the post-merger firm will own both DirecTV, currently an AT&T asset, and *Wonder Woman*, which is a TW asset. At that point it would be in a position to license *Wonder Woman* exclusively to DirecTV subscribers, thus excluding subscribers who obtain their programming from Comcast, Verizon, Dish Network, Mediacom, or several other suppliers of cable or wireless internet services. Subsequent to the merger, this refusal to license would be an ordinary unilateral refusal to deal, however, and antitrust law would presumably not require the post-merger firm to share *Wonder Woman* with anyone else.[81]

While the merger makes this refusal to license physically possible, however, it does not necessarily make it profitable. *Wonder Woman* promises to be a very high margin product, producing high license fees even though the marginal cost of distributing an already produced film is very low. Further *Wonder Woman* is presumably not worth more to existing DirecTV subscribers simply because subscribers to rival services are not able to get it.

[79] In the context of a §2 case, *see* Verizon Communic., Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 313 (2004) (declining antitrust liability because a regulator was present and its regime "was an effective steward of the antitrust function.").

[80] *See* the articles cited in note __, *supra*.

[81] *See* 3B Areeda & Hovenkamp, Antitrust Law, *supra* note __, ¶¶770-774.

If the strategy of refusing to supply *Wonder Woman* is to be profitable the profits must come from somewhere else. For example, *Wonder Woman* might be used as a lever to induce customers of other services to switch to DirecTV.

One could say the same thing about potential exclusion of a third party program sellers such as Netflix.[82] The merger might give post merger AT&T/TW an incentive to exclude Netflix from its DirecTV, forcing customers to watch TW programming instead. The elimination of net neutrality would likely make this particular exclusion lawful.[83] But exclusion of Netflix does not become likely simply because it is possible. The loss of revenue from defections of angry customers would very likely be considerable. On the other hand, a video streamer with a much smaller portfolio than Netflix might be vulnerable. It is also possible that post-merger AT&T/TW might raise Netflix's access costs rather than simply excluding it – a decision that abolition of net neutrality may make lawful. Whether that is profitable behavior is an empirical question.

There are other and perhaps more realistic dangers. For example, a world of concentrated cable and internet companies who are also vertically integrated into programming might lead to an oligopoly of programming "silos" in which each firm shares less content than it would if content were independently owned. This oligopoly would not be reachable under §1 of the Sherman Act unless the parties entered into a provable contract or conspiracy, but merger policy could prevent the situation from occurring in the first place. Absent that, the result could be that each internet service provider offers a smaller range of programming than it otherwise would, injuring customers by loss of variety.

VI. Anticompetitive Acquisitions of Patents or other IP Rights

A patent or other intellectual property right[84] creates a power to exclude, whether or not exclusion under the circumstances creates a product market monopoly.[85] The exclusion right is of course inherent in patent law

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[82] The ATT/TW complaint refers to these as "subscription video on demand" (SVOD) sellers, Complaint, supra note, ¶16.

[83]At least, that is Netflix' position. *See* Brett Samuels, "Netflix Rips Net Neutrality Repeal: 'This is the Beginning of a Longer Legal Battle,'" The Hill (Dec. 14, 2017), available at http://thehill.com/policy/technology/364937-netflix-rips-net-neutrality-repeal-this-is-the-beginning-of-a-longer-legal.

[84]On anticompetitive use of copyrights, *see* Professional Real Estate Investors, Inc. v. Columbia Pictures Indus., Inc., 508 U.S. 49 (1993) (PREI) (copyrighted motion pictures).

[85]On the relationship between patents or other IP rights and market power, *see* 2B PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶518 (4th ed.

and is the mechanism by which patenting encourages invention. If a patent, or even a portfolio of patents, should create a product monopoly antitrust nevertheless should keep its hand off, except in the relatively unusual situation where the patent owner attempts to enforce a patent that it knows or should know is invalid or unenforceable.[86]

However, patent law does not recognize a right to create a market monopoly through means other than those contemplated in the patenting process itself. The problem can arise when a firm assembles a market monopoly by acquiring patents from outside inventors, or perhaps by acquiring firms holding large patent portfolios.[87] If a process can be accomplished by two competing (i.e., substitute) patent portfolios, the Patent Act authorizes whatever amount of market power is created when one of those portfolios is created by invention. It does not authorize the amount of additional monopoly that is created, however, when the two portfolios of existing but competitively owned patents come under common ownership.

Maintaining that line is particularly important because in most cases the threat of market monopoly by means of merger is far greater than the threat of market monopoly through internal invention and patenting. While a very strong, market shifting patent can create a monopoly, most do not.[88] A merger, by contrast, is a simple act of transaction, not of invention. If three groups of assets, patents or otherwise, collectively dominate a market a simple set of purchases can turn them instantly into a market monopoly.

A firm can thus threaten competition by buying up all of the patents necessary for production in a particular line of commerce.[89] For example,

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2015). In Illinois Tool Works, Inc. v. Independent Ink, Inc., 126 S. Ct. 1281 (2006), the Supreme Court held that market power in an antitrust tying challenge could not be inferred from the existence of a patent or copyright, but must be proven.

[86] *E.g.*, Walker Process Equipment, Inc. v. Food Mach. & Chem. Corp., 382 U.S. 172 (1965) (patent infringement suit brought by patentee who knew the patent was unenforceable could violate §2 of the Sherman Act).

[87] *See* discussion *infra*, text at notes __. Cf. United States v. Winslow, 227 U.S. 202 (1913), in which Justice Holmes wrote the Court's opinion approving the merger of firms owning three complementary technologies for producing shoes (lasting machines, welt-sewing machines, and outsole-stitching machines), including their patents. The result was the creation of the United Shoe Machinery monopoly, which lasted roughly a half century. *See* CARL KAYSEN, UNITED STATES V. UNITED SHOE MACHINERY CORP.: AN ECONOMIC ANALYSIS OF AN ANTI-TRUST CASE (1956).

[88] *See* HERBERT HOVENKAMP, FEDERAL ANTITRUST POLICY: THE LAW OF COMPETITION AND ITS PRACTICE §3.9d (5th ed. 2015).

[89] *See* Erik N. Hovenkamp & Herbert Hovenkamp, *Buying Monopoly: Antitrust Limits on Damages for Externally Acquired Patents*, __ TEX. INTEL. PROP. L.J. ___ (2017) (forthcoming), available at

suppose that two inventors have developed the only two alternative processes for producing a particular type of microprocessor chip. Both are covered by portfolios of patents, each developed by the two inventors independently. These two owners could then either use the portfolios themselves or license them to others. Assuming that the manufacturers are not colluding and that the two alternatives are equally effective, the market could perform as competitively as we might expect from a two-firm market. It might be even more competitive if the two firms licensed their portfolios to third parties.

Suppose, however, that the owner of one of these competing patent portfolios should acquire the portfolio held by the other. This owner then continues to use its existing portfolio of patents but keeps the acquired portfolio unused. Alternatively, a non-practicing entity might acquire both portfolios and then license one or both of them. In both of these cases the acquisition would have created a market monopoly over the processes for making this chip, and in a way that is not authorized by the Patent Act. That is, the Patent Act authorizes inventors to patent their inventions and obtain whatever amount of exclusion the patent provides.[90] One patentee may also purchase or license patents from another.[91] However, there is no right in the Patent Act to make an acquisition that creates a monopoly.[92] While competitively harmless patent acquisitions are authorized by the Patent Act, patents are also "assets" that are subject to the merger laws.[93] In addition, if

http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2767098. *Cf.* Trebro Mfg., Inc. v. Firefly Equip., LLC, 748 F.3d 1159 (Fed. Cir. 2014) (permitting firm to acquire a patent from an outside inventor, keep it unusued, but then obtain an injunction against a competitor).

[90]35 U.S.C. §271 (defining scope of patent infringement).

[91]35 U.S.C. §261 (granting right to assign and license).

[92]That is, the right to acquire a patent does not entail a right to do so anticompetitively. *See* Herbert Hovenkamp, *Antitrust and the Patent System: A Reexamination*, 76 OHIO ST. L.J. 467 (2015).

[93]Automated Building Components v. Trueline Truss Co., 318 F. Supp. 1252 (D. Or. 1970) (acquisition of various assets including patent applications covered by § 7); Dairy Foods, Inc. v. Farmers Co-op Creamery, 298 F.Supp. 774 (D.Minn. 1969) (patent acquisition subject to §7); *Western Geophysical Co. v. Bolt Assoc.*, 305 F. Supp. 1248 (D. Conn. 1969) (exclusive patent license with an obligation to develop sublicenses after two years could be covered by Clayton Act § 7). *See also* Premerger Notification; Reporting and Waiting Period Requirements ("Notice of Final Rulemaking"), 78 Fed. Reg. 68,705-07 (Nov. 15, 2013) (FTC's revised requirement of reporting of significant acquisitions of exclusive rights in pharmaceutical patents). *See* Pham. Research & Mfrs. Of Am. V. FTC, 2015 WL 3556040 (D.C.Cir. June 9, 2015) (applying *Chevron* deference and approving FTC rule). On patents as "assets" covered by §7 of the Clayton Act, *see* United States Department of Justice and Federal Trade Commission, Antitrust Guidelines for the

one firm acquires another firm with a substantial patent portfolio, that merger is subject to condemnation under the merger laws.[94]

In *Intellectual Ventures* the district court dismissed a §7 lawsuit that raised these issues.[95] Intellectual Ventures (IV), a non-practicing entity, had acquired from third party inventors substantially all of the patents covering certain types of transactions in financial services industries. The value or validity of the patents was largely undetermined, although some were later found invalid.[96] The antitrust challenger alleged that IV's strategy was to obtain patent ownership blanketing the entire market, making it impossible for banks to do business in this market without licensing IV's patents.[97] For purposes of this strategy the acquired patents would have to be treated as substitutes, or competitors, so this was a horizontal merger.[98]

In rejecting an antitrust merger challenge by the infringement defendant, the court reasoned that once the merger occurred and IV owned all the patents in question, then it would have a legal right to enforce them. This right would be limited only by the restraints that antitrust or patent law impose on the bringing of infringement actions on unenforceable patents.[99] Since the only way competition could be lessened by the merger was through the bringing of infringement suits, the court reasoned, the merger was lawful because that right was protected by the *Noerr Pennington* doctrine, which

Licensing of Intellectual Property (2017), available at https://www.justice.gov/atr/IPguidelines/download §5.7 (2017); HERBERT HOVENKAMP, MARK D. JANIS, MARK A. LEMLEY, CHRISTOPHER LESLIE, AND MICHAEL CARRIER: IP AND ANTITRUST §14.01 (3d ed. 2016).

[94]FTC v. CCC Holdings, Inc., 605 F.Supp.2d 26 (D.D.C. 2009) (enjoining acquisition combining two firms whose principal assets were patented, specialized software). *See also* FTC, To Promote Innovation: The Proper Balance of Competition and Patent law and Policy 2-3 (2003), available at http://www.ftc.gov/os/2003/10/innovationrpt.pdf.

[95]Intellectual Ventures I, LLC v. Capital One Financial Corp., 2017 WL 5970720 (D. Md. Nov. 30, 2017).

[96]*See Intellectual Ventures, LLC v. Capital One Financial Corp*., 850 F.3d 1332 (Fed. Cir. 2017) (finding patents in question invalid as directed toward abstract ideas).

[97]*Intellectual Ventures*, *supra*, 2017 WL 5970720 ("Capital One characterizes IV's business model as comprised of three components: *accumulate* a vast portfolio of patents purportedly relating to essential commercial banking services, *conceal* the details of those patents so that the banks cannot determine whether their products infringe any of IV's patents, and serially *litigate* to force the banks to capitulate and license the portfolio at exorbitant cost").

[98] Portfolios of patent would naturally include both substitutes and complements, but a strategy of eliminating alternatives would naturally apply to their competitive relationship.

[99]*Intellectual Ventures*, *supra* note __ at *11

creates a right to bring a lawsuit reasonably believed to be meritorious.[100] While *Walker Process* can condemn a lawsuit on a patent known to be unenforceable, both the Patent Act[101] and the First Amendment petitioning right recognized in *Noerr-Pennington* permit suits on patents reasonably believed by the enforcer to be valid and infringed.[102]

Factually, of course, that is true. Once someone owns a portfolio of patents it has a right to enforce any or all of them. But under the incipiency test, that is a reason for condemning the merger, not for permitting it. The Patent Act permits both the invention of monopoly-creating technologies and the transfer of patents; however, it does not permit the creation of monopoly by means of transfer rather than invention. Here the merger incipiency test is essential because, once the anticompetitive acquisition has occurred, the infringement lawsuits will be treated as the conduct of a single firm. In that case, an antitrust court is powerless to intervene except in the very narrow circumstances defined by the *Walker Process* doctrine.

Indeed, if taken seriously the district court's holding would effectively prohibit application of §7 of the Clayton Act to virtually any acquisition of rights in intellectual property. The mechanism by which such an acquisition "lessens" competition will always be the power to assert the acquired right against infringers, a right that the *Noerr-Pennington* doctrine protects.

It is worth noting that the right to enforce traditional property rights in court is also protected by the First Amendment petitioning immunity. For example, it protects the land owner's right to file a complaint against trespassers.[103] But that hardly means that all acquisitions of plant and equipment are immune from §7 simply because these property rights, once acquired, can be legally enforced.

The problem of anticompetitive patent or other IP acquisitions can often be best addressed by insisting that IP acquisitions that would otherwise violate §7 be limited to nonexclusive licenses. The acquisition of a non-exclusive license gives a firm, whether monopolist or not, all it needs to produce in the market in question, thus enabling it to use acquired patents to

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[100] *Ibid.*

[101] *See* 35 U.S.C. §271 (d)(3).

[102] *See* Eastern R.R. Presidents Conf. v. Noerr Motor Freight, Inc., 365 U.S. 127 (1961); United Mine Workers v. Pennington, 381 U.S. 657 (1965). On the use of the doctrine in antitrust litigation, *see* PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶¶201-208 (4th ed. 2014).

[103] *See, e.g.*, Venetian Casino Resort, LLC v. NLRB, 793 F.3d 85 (D. C. Cir. 2015) (casino owner's summoning of police officers to enforce state law of trespass to land protected by *Noerr*, provided that the walkway in question was really a part of casino owner's private property).

stay up to date with technology. What it does not do, however, is give the dominant firm a right to shut down or otherwise challenge the technology of others, as in the *Intellectual Ventures* litigation. The acquisition problem is doubly serious when the patents in question are not merely acquired from an outside inventor, but when they are acquired and *unused*.[104] The principal value of a patent license is to enable a firm to produce using the licensed technology. A nonexclusive license is all it needs for this purpose. Recognizing this, several merger decrees, both litigated and by consent, have conditioned acquisitions on the parties' agreement to turn patent assignments or exclusive licenses into nonexclusive licenses.[105]

To be sure, such an approach very largely undermines the *Intellectual Ventures* business model whenever the acquisitions in question are anticompetitive. But that hardly means that the original patent owners in question are left without a remedy. To return to the hypothetical situation of two competing patent portfolios for making a microprocessor,[106] a producer would still have to acquire licenses to one of these two portfolios, but it would have the right that is consistent with both patent law and antitrust law, which is to acquire that right in a competitive market in which the rival patentees could bid for that manufacturer's licensing business.

To summarize, a patent gives its own the right to profit from the patented technology by either practicing it or licensing it out in whatever market the patentee finds itself. It does not, however, create a right to create market monopoly by transfer as opposed to invention. The merger incipiency rule gives effect to this limitation.

VII. Acquisitions of Small but Highly Innovative Firms

A large firm's acquisition of a small, highly innovative firm can raise serious long run competition issues, even if the two firms are not competitors at the time of the acquisition. Such an acquisition may not have an immediate

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[104] On this problem, *see* Erik Hovenkamp & Thomas F. Cotter, *Anticompetitive Patent Injunctions*, 100 MINN. L. REV. 871 (2016). On the history of dominant firm strategies of filing infringement suits on externally acquired by unused patents, *see* Herbert Hovenkamp, *The Emergence of Classical Patent Law*, 58 ARIZ. L. REV. 263, 285-289 (2016).

[105] *E.g.*, Great Lakes Chem. Corp., 103 F.T.C. 467, 461 (1984) (consent decree; applying §7 to a patent acquisition and requiring a nonexclusive license as the remedy). *See also in re* Ciba-Geigy/Sandoz, 1996 WL 743359 (FTC #961-0055) (requiring merged firms to license several gene therapy patents to a different firm); in re *Boston Scientific Corp.*, 60 Fed. Reg. 12,948 (1995) (conditioning merger approval on royalty free license in order to avoid abuse of dominant position).

[106] *See* discussion supra, text at notes __.

impact on price. Further, many of them have an important efficiency justification – namely, that adding a complementary technology to the acquiring firm's product is good for consumers. For example, Facebook's 2014 acquisition of WhatsApp enabled it to expand its profile in the chat market, augmenting the value of its primary product.[107] Google's 2016 acquisition of Orbitera enabled it to compete more effectively with Amazon in the management of cloud-based software.[108] Since their founding the large internet tech firms, including Facebook, Alphabet (Google), Microsoft, and Apple have made more than 500 such acquisitions.[109]

While many of these acquisitions are economically beneficial, a few pose serious competitive risks.[110] Small, highly innovative firms can grow into larger ones, offering more competition in the market in question, but their acquisition by large incumbents eliminates that possibility.[111] The 2010

[107] *See* https://techcrunch.com/2015/02/19/crazy-like-a-facebook-fox/.

[108] *See* https://www.ciodive.com/news/google-acquires-orbitera-to-help-encourage-multi-cloud-environments/424071/.

[109] Wikipedia maintains lists of smaller firms acquired by large tech. companies – eg., Facebook, at https://en.wikipedia.org/wiki/List_of_mergers_and_acquisitions_by_Facebook (65 listed acqisitions as of Dec. 2017); Alphabet (Google), at https://en.wikipedia.org/wiki/List_of_mergers_and_acquisitions_by_Alphabet#List_of_mergers_and_acquisitions (more than 200); Microsoft, at https://en.wikipedia.org/wiki/List_of_mergers_and_acquisitions_by_Microsoft (more than 200); Apple, at https://en.wikipedia.org/wiki/List_of_mergers_and_acquisitions_by_Apple#Acquisitions (92 listed acquisitions as of Dec. 2017). In addition, eBay has acquired some 40 companies, https://en.wikipedia.org/wiki/List_of_acquisitions_by_eBay; Yahoo! has acquired 114, https://en.wikipedia.org/wiki/List_of_mergers_and_acquisitions_by_Yahoo!; Twitter has acquired more than 50, https://en.wikipedia.org/wiki/List_of_mergers_and_acquisitions_by_Twitter; and IBM has acquired several hundred, https://en.wikipedia.org/wiki/List_of_mergers_and_acquisitions_by_IBM#Acquisitions_since_2000.

[110] *See* Remarks of FTC Commissioner Terrell McSweeny, *Understanding Innovation and its Role in U.S. Merger Review* (March 16, 2017), available at https://www.ftc.gov/system/files/documents/public_statements/1176893/berlin_international_conference_on_competition_final.pdf.

[111] *See, e.g.*, United States v. Bazaarvoice, Inc., 2014 WL 203966 (N.D. Cal. Jan. 8, 2014) (enjoining acquisition of innovative competitor, although there were also concerns about elimination of price competition in a highly concentrated market); Complaint, In the Matter of Verisk Analytics, Inc., and EagleView Technology Corp., Dkt. No. 9363 ¶ 40 (Dec. 16, 2014), http://www.ftc.gov/system/files/documents/cases/141216veriskcmpt.pdf.

Horizontal Merger Guidelines contain a brief discussion of the issue, recognizing two dangers. First, an acquired firm might be involved in introducing 'new products that would capture substantial revenues from the acquiring firm."[112] Second is a "long-run effect" that might occur "if at least 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."[113]

Limiting acquisitions to nonexclusive licenses may be a workable antitrust solution in some cases. Such a license would permit the acquiring firm to take advantage of the acquired firm's technology, thus improving its own product or range of products, but without giving it a right to exclude others. Offsetting this, of course, is that many small firms will be worth much less if they are unable to transfer exclusive rights to their innovative technologies to a dominant firm. Further, acquisition of a nonexclusive license is necessarily a partial asset acquisition, leaving the selling firm with the untransferred assets. As a result such acquisitions may not provide the selling firms with an attractive means of exiting from the market.

Nevertheless, as noted before,[114] the right to transfer a patent does not entail the right to create a market monopoly. Acquisitions of innovative startups are valuable to society because they enable the acquiring firm to improve its product or keep up with technological change. However, when a large firm acquires a highly innovative small firm and then either shuts that firm down or fails to deploy its technology, this opportunity for gain is lost. In that case the principal consequence of the acquisition is to prevent the acquired firm's technology from reaching the market at all. As a result, antitrust law should give particularly close scrutiny to acquisitions of small firms whose assets are never deployed into the market. Also deserving close scrutiny are acquisitions of small firms whose product serves to duplicate the acquiring firms product rather than proving a valuable complimentary

(challenge to merger of highly innovative new entrant that could have offered greater competition to established firm).

[112]2010 Horizontal Merger Guidelines, *supra* note __ at §6.4. *See also* EU Guidelines on the Assessment of Horizontal Mergers under the Council Regulation on the Control of Concentrations Between Undertakings ¶¶8, 20, 38, 45 (2004).

[113]2010 Horizontal Merger Guidelines, *supra*, note __, §6.4. *See* Gordon M. Phillips & Alexei Zhdanov, R&D and the Incentives from Merger and Acquisition Activity, NBER Working Paper #18346 (2013), available at http://www.nber.org/papers/w18346 (data suggests that the prospect of acquisition induces smaller firms to innovate more in hope of selling out, but larger firms to innovate less because they would prefer to obtain new technology by merger rather than internal development).

[114] *See* discussion sup*ra*, text at notes __.

extension.

Post-acquisition use might not seem like a problem for §7 of the Clayton Act, which condemns acquisitions, but not post-acquisition uses. That leaves the Sherman Act. As noted previously, however, the antitrust laws have not been particularly helpful in limiting the right of firms to bring infringement suits on externally acquired but unused patents.[115]

Supreme Court case law has observed that mergers might not be anticompetitive at the time of the transaction but become so later on. Further, a government action for an injunction is not governed by the Clayton Act's four year statute of limitation, but rather by the equitable, judge-made doctrine of laches, which can permit such a lawsuit long after the merger has occurred.[116] The traditional rule is that the doctrine of laches as a limitation on equitable relief, as opposed to damages, does not run against the government, although it may bear on the type of relief to which the government is entitled. The courts generally look at the overall situation, shortening the period where it seems clear that the challenger could have acted earlier but did not do so, or lengthening it when the anticompetitive threat did not emerge until years after the acquisition occurred.[117]

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[115] *See* discussion *supra*, text at notes __; *and see* Trebro Mfg., Inc. v. Firefly Equip., LLC, 748 F.3d 1159 (Fed. Cir. 2014) (permitting such a lawsuit).

[116]*See* California v. Am. Stores, Co., 495 U.S. 271, 295-296 (1990) (government could bring equity challenge to merger even though time period for plaintiff had expired). Justice Kennedy concurred, but objected to the majority conclusion that laches might run more slowly against the government. Id. at 298. On the judge-made doctrine of laches governing equity suits in antitrust cases, *see* 2 AREEDA & HOVENKAMP, ANTITRUST LAW, *supra* note __, ¶320g.

[117]United States v. Pullman Co., 50 F. Supp. 123, 127 (E.D. Pa. 1943), aff'd, 330 U.S. 807 (1947) (noting that laches does not run against the government, but doubting that full remedial relief would be appropriate where the acquisition had occurred a half century earlier). *See also* United States v. E.I. DuPont de Nemours & Co., 353 U.S. 586, 622-624 (1957) (Burton, j., dissenting) (noting traditional position that laches does not run against the government). The rule does not apply to private plaintiffs. *See, e.g.*, Midwestern Machinery Co., Inc. v Northwest Airlines, Inc., 392 F.3d 265 (8th Cir. 2004) (laches barred eight-year delay in challenge to acquisition, at least where the transaction was known to plaintiff since it occurred); Ginsburg v. InBev NV/SA, 623 F.3d 1229, 1235 (8th Cir. 2010) (applying laches to completed merger where "the hardship and competitive disadvantage resulting from forced divestiture would be both dramatic and certain"). *Cf.* Julius Nasso Concrete Corp. v. Dic Concrete Corp., 467 F. Supp. 1016, 1024 (S.D.N.Y. 1979) (laches serves to bar a claim only if the delay prejudices a defense that was otherwise available).

Conclusion

Government equity suits against mergers seem to require the courts to peer into a crystal ball. Most mergers today are challenged before they occur, but even after they have occurred certain effects may take years to materialize. As a result, there is a degree of long range prediction in merger litigation that goes far beyond what is common in most areas of law.

The need to predict the future would not be particularly important if every practice that a merger threatens could readily be detected and condemned should it occur later. In that case we could rest easy, permitting the merger to attain whatever efficiencies it is likely to produce, knowing that anticompetitive consequences can be interdicted if and when they materialize.

But too many anticompetitive practices do not fall into that category. Often post-merger conduct is likely to be anticompetitive but antitrust law has inadequate tools for dealing with it directly. This is particularly true of two classes of cases. One is coordinated, interdependent pricing that threatens reduced output or higher prices, but that is not readily reachable under antitrust law's "agreement" requirement. The other is conduct that, once the merger occurs, becomes unilateral and is able to take advantage of antitrust law's general toleration for unilateral price setting and refusals to deal.

Finally, the extent to which a court in a merger case must predict a probabilistic future varies with the situation. In traditional merger cases concerned about collusion-like conduct, the feared impact could occur very soon after the merger transaction is completed. That is also true for most unilateral effects horizontal merger cases. Foreclosure from vertical acquisitions may take somewhat longer to materialize, and patent infringement suits based on monopolistic combinations of externally acquired patent may have an even longer timeline. The longest latency period is very likely the acquisition of small but highly innovative firms, which absent the acquisition might take several years to grow into meaningful rivals, assuming they ever do.

Offsetting this is that the government equity action calls for no other remedy than a preemptive injunction against the acquisition. There are no prison sentences, large fines, private damages actions or other costly remedies other than prevention of the transaction itself.[118] Further, in the latter two sets of cases involving patent rights and highly innovative firms, acquisition of non-exclusive rights may provide the full set of economic benefits that a producing firm requires.

[118] On the importance of defining the breadth of the offense inversely to the permissible remedy, see 2 AREEDA & HOVENKAMP, ANTITRUST LAW, *supra* note __, ¶303c.