DCI Comments on Draft Merger Guidelines 2023

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September 18, 2023

Submission by the Dynamic Competition Initiative

An initiative supported by

DCI

September 18, 2023

Federal Trade Commission/Department of Justice

Re: FTC-2023-0043-0001 - Draft Merger Guidelines for Public Comment

Dynamic Competition Initiative

Comments of the Dynamic Competition Initiative (DCI) to the Department of Justice (DoJ) and Federal Trade Commission (FTC) Regarding Draft Merger Guidelines

Docket ID: FTC-2023-0043

Introduction

Dear Sir or Madam,

The Dynamic Competition Initiative ("DCI") welcomes the opportunity to comment on the Draft Merger Guidelines ("DMG").[1] Hereafter, we provide feedback to the Department of Justice ("DOJ") and the Federal Trade Commission ("FTC") regarding their recently released DMG. Our comments focus on the dynamic character of the competitive process and are based on recent economic literature concerning innovation. In providing these comments, we hope to assist the DOJ and FTC in crafting sound merger guidelines promoting long-term consumer welfare.

The DCI is a non-profit organization supported by the European University Institute, the Vrije Universiteit Amsterdam, and the University of California, Berkeley. Its mission is to ensure that creating and capturing value from innovation is taken seriously, not just nominally, in competition law enforcement and policy development.

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[1] This submission authored on behalf of DCI does not necessarily reflect the opinions of all affiliate members of DCI.

U.S. Draft Merger Guidelines – A Dynamic Competition Perspective

1. Process

On 19 July 2023, the FTC and the DoJ (the Agencies) released a draft update of the Merger Guidelines (the draft guidelines), which describe and guide the agencies' review of mergers and acquisitions to determine compliance with federal antitrust laws. The FTC press release states: "The goal of this update is to better reflect how the agencies determine a merger's effect on competition in the *modern economy*."[2]

The draft guidelines embody more than just a positive statement about merger policy. The draft guidelines deliver a normative statement about what U.S. merger law should be. The draft guidelines' aspiration to evolve merger law is legitimate. In the common law tradition, antitrust doctrine should constantly be reassessed in light of developments in economic knowledge. The Supreme Court has accordingly "felt free to revise [its] legal analysis as economic understanding evolves and to reverse antitrust precedents that misperceived a practice's competitive consequences."[3] The agencies have a key role in the process of incremental improvement of antitrust and merger law. As the Vertical Merger Guidelines acknowledge, issued and properly revised guidelines "may [a]ssist the courts in developing an appropriate framework for interpreting and applying the antitrust laws."[4]

2. Main changes introduced in the DMG

Before we consider new directions for merger law and policy, it is useful to describe the main changes proposed in the DMG. At the outset, substantial commonalities exist with the 2010 Horizontal Merger Guidelines and 2020 Vertical Merger Guidelines:

- Emphasis on market definition, the Herfindahl-Hirschman Index (HHI)[5], and entry barriers;

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[2] *FTC and DOJ Seek Comment on Draft Merger Guidelines* (2023) – DCI underlining.
[3] *Kimble v Marvel Entertainment*, LLC (2015) 576 US.
[4] U.S. Department of Justice and The Federal Trade Commission, *Vertical Merger Guidelines* (2020).
[5] Philadelphia National Bank had HHI higher than those suggested, see *United States v. Philadelphia National Bank*, 374 U.S. 321 (1963).

- Incipiency philosophy;[6]
- Uncertainty should not prevent merger intervention;[7]
- Preference for internal growth over external growth through mergers.[8]

That said, the DMG and previous guidelines differ in five respects. First, the DMG stray from the 2010 and 2020 guidelines' "prediction and control" approach by embracing a 'presumption and precaution' approach.[9] The agencies need not establish the *likelihood* of post-merger anticompetitive effects. The DMG considers that agencies can prohibit mergers on the basis of a mere eventuality of a substantial lessening of competition.

Second, unlike the 2010 and 2020 guidelines, the DMG do not require agencies to formulate and test a theory of harm.[10] The DMG accept to enjoy a merger on the basis of a conjecture. The DMG state that "the agencies do not seek to specify the precise actions the merged firms would take to weaken rivals"[11].

Third, merger analysis in the DMG focuses on concentration, size, and structure. That approach contrasts with the 2010 and 2020 guidelines that focused analysis on market power, anticompetitive ("net") effects, and consumer harm. As Carl Shapiro noted, the draft "abandons the focus on market power that has been fundamental to all merger guidelines for several decades."[12]

Fourth, the DMG lower the intervention threshold against mergers. The DMG establish merger liability when the post-merger HHI is over 1800 or when the merged entity enjoys a market share superior to 30%.

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[6] Though previous guidelines emphasized incipient impacts on prices, while the DMG stresses effects on market concentration: H.J. Hovenkamp, "Prophylactic Merger Policy", *Hastings Law Journal* (2018); R.M. Steuer, "Incipiency", *Loyola Consumer Law Review* (2019).
[7] There is no aspiration in any of them to reach full certainty. However, while previous guidelines aspire to remove some uncertainty through analytics, the DMG relies on the presumption to infer unknown facts from known facts.
[8] The preference for internal growth is one sentence in a concurrent opinion.
[9] J.D. Wright, B.H. Kobayashi, A. B. Lipsky, A. Raskovich, J.M. Yun, "Presumptions in Merger Review: Global Antitrust Institute Comment on the DOJ-FTC Request for Information on Merger Enforcement", *George Mason Law & Economics Research Paper* (2022); also, A. Portuese, "The Rise of Precautionary Antitrust: An Illustration with the E.U. Google Android Decision", *Competition Policy International* (2019).
[10] Possibility theorems require empirical or formal evidence in the particular case.
[11] Draft Merger Guidelines, p. 14.
[12] C. Shapiro, "Why Dropping Market Power from the Merger Guidelines Matters", *ProMarket* – Merger Guidelines Symposium (2023).

Fifth, the DMG significantly curtails the possibility for the merging parties to raise an efficiency defense. This is done by insisting on the idea that from a social welfare perspective, internal growth dominates external growth. In addition, the DMG do not appear to allow an efficiency defense ever to succeed. The DMG require proof of offsetting price decreases to consumers, but at the same time allows themselves to enjoin mergers without evidence of price harms.[13]

Sixth, the DMG are backward-looking.[14] The focus is on protecting the existing competitive structure, on the implicit assumption that it is most conducive to future innovation. According to the DMG, merger analysis should begin with the question: "How does competition present itself in this market, and might this merger risk lessening *that* competition substantially now or in the future?" This differs from the previous guidelines that focused assessment on potential innovation that would prospectively prevail "in the absence" of the merger.[15] The previous guidelines were forward-looking.

Table 1. Draft Merger Guidelines and existing guidelines comparison

	DMG	HMG 2010 and VMG 2020
Approach	Presumption and precaution approach: "agencies do not seek to predict" but "assess the risk" "Preventative"	"Prediction and control" approach: "agencies usually rely to predict"
Presumptions	Conjectures: "the agencies do not seek to specify the precise actions the merged firms would take to weaken rivals"	Theories of harm: possibility theorems requiring empirical or formal evidence in a particular case
Focus	Heavy focus on concentration, size, and structure	Heavy focus on market power, anticompetitive ("net") effects, and harm to customers

[13] H. Hovenkamp, The 2023 Draft Merger Guidelines: A Review, *SSRN* (2023): https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4566082.

[14] "[I]n contrast to the 2010 Guidelines, do not say that a merger of firms trying to develop products which may compete in the future could generate significant efficiencies or similar benefits." In: L.B. Landman, "The Revised U.S. Merger Guidelines Adopt the Future Markets Model", *ProMarket* (2023).

[15] Which led to a focus not only on past competition but also on "anticipated future prices" and to explicit recognition that mergers "enable innovation."

Thresholds	Liability triggered by *any* increase in concentration when HHI > 1800; MS > 30% triggers a significant lessening of competition (SLC) test	Liability is triggered by a *significant* increase in concentration in highly concentrated markets. HHI < 2500 means “moderately concentrated”
Normativity	Preference against oligopoly (and monopoly)	Focus on short-term anticompetitive effects
Perspective	Backward-looking: “How does competition present itself in this market, and might this merger risk lessening that competition substantially now or in the future?”	Forward-looking: Assessment of potential innovation that would prospectively prevail “in the absence” of the merger

3. Potential entry

The DMG treatment of potential competition is problematic. Guideline 4 prohibits “potential entrant” elimination on the basis of a “presumption that new entry yields procompetitive effects.” The presumption is correct; the prohibition is not. The prohibition makes sense conditional on the acquired firm being the only potential entrant. However, if there is competitive pressure from other potential entrants, the lost “deconcentration” opportunity is not problematic.

Similarly, Guideline 4 embodies a double standard. The DMG state that potential competition is a “secondary source” of competition when merging parties invoke it as a defense. At the same time, the DMG consider that lost potential entry is sufficient to establish a significant lessening of competition (SLC) when invoked as an offense.

4. Challenges

The DMG embody incorrect statements about technological change and innovation. Guideline 7 on “dominant position” entrenchment or extension by merger states that “the agencies take particular care to preserve opportunities for deconcentration during technological shifts.” However, technological shifts may lead to increased competition and concentration.[16] Digital industries characterized

[16] N. Petit, D.J. Teece, “Innovating Big Tech Firms and Competition Policy: Favoring Dynamic Over Static Competition”, *Industrial and Corporate Change* (2021).

by competition 'for' the market are a case in point. Technological shifts typically lead to the competitive succession of dominant designs.[17]

And Guideline 4 does not contemplate the possibility that a merger with a potential entrant will improve competition by allowing the target firm higher growth opportunities.[18] For example, most small pharmaceutical companies that will be treated as potential entrants under the DMG are unlikely ever to challenge incumbent firms. By contrast, mergers with larger firms allow small pharmaceutical companies to reach subsequent stages of drug development. In particular, integration into a larger firm will often be necessary to shoulder the heavy costs of clinical trials.

5. Innovation

The DMG do not appear in line with the recent empirical literature on competition and innovation.[19] The findings of recent empirical works are worth recalling (5.1.), before we examine their implications for merger policy (5.2).

5.1. Overview of the economic literature

The recent empirical literature highlights four important facts about firm size, industry structure, and innovation. First, economic concentration has increased over the past century. Economy-wide increases in concentration correlate with technological intensity, fixed costs, and output growth.[20]

Second, the economy is populated by a few "super firms" and a multitude of small-to-medium-sized businesses.[21]

Third, the firm size distribution plays an important role in innovations contributing to economic growth.[22] Large firms get less innovation from money

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[17] J.M. Utterback, W.J. Abernathy, "A dynamic model of process and product innovation," *Omega* 3.6 (1975).

[18] Federal Trade Commission v. Meta Platforms, Inc. (formerly Federal Trade Commission v. Facebook, Inc.).

[19] Innovation concerns were more prevalent in the 2010 and 2020 guidelines.

[20] S.Y. Kwon, Y. Ma, K. Zimmermann, "100 Years of Rising Corporate Concentration", *SAFE Working Paper No. #359* (2022).

[21] M. Clancy, The Size of Firms and the Nature of Innovation, *Substack* (2023) https://mattsclancy.substack.com/p/the-size-of-firms-and-the-nature.

[22] E. Argentesi, P. Buccirossi, E. Calvano, T. Duso, A. Marrazzo, S. Nava, "Merger Policy in Digital Markets: An Ex Post Assessment", *Journal of Competition Law & Economics* (2021).

spent on R&D or employment relative to small firms.[23] Similarly, large firms focus on incremental research, while small firms develop more groundbreaking innovations.

Fourth, small firms enjoy a lower survival rate compared to large firms, owing to higher capital constraints.[24]

In some sectors like digital, these trends appear exacerbated. Technology-specific increasing returns on the supply and demand side lead to a natural oligopoly or monopoly structure.[25] At the same time, new firm creation in Information, Communications and Technology ("ICT) sectors has been historically higher than any other industry sector of the economy.[26] We may, therefore, infer from empirical data that digital industries are characterized by competitive oligopoly or monopoly.

Besides, a high frequency of M&A is observed in digital industries. However, market power does not appear to be the main motive for mergers. Digital industries rely on non-patented innovation.[27] As a result, mergers constitute a dominant strategy for small firms to profit from innovation.[28]

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[23] U. Akcigit, W.R. Kerr, "Growth through Heterogeneous Innovations", *Journal of Political Economy* (2018).
[24] P. Aghion, T. Fally, S. Scarpetta, "Credit Constraints as a Barrier to the Entry and Post-Entry Growth of Firms", *Economic Policy* (Oct., 2007); "Startup Acquisitions Are Pro-Competitive If They Alleviate Financial, Technical, And Managerial Constraints Faced By The Target Firm" in: M. Ivaldi, N. Petit, S. Ünekbaş, *Killer Acquisitions: Evidence from E.C. Merger Cases in Digital Industries*, Dynamic Competition Initiative (2023), https://bit.ly/46lMZGr.
[25] A. Shaked, J. Sutton, "Natural Oligopolies", *Econometrica* (1983); D. Autor, D. Dorn, L.F. Katz, Ch. Patterson, J. Van Reenen, "The Fall of the Labor Share and the Rise of Superstar Firms", *The Quarterly Journal of Economics* (2020).
[26] Recent data suggests that the total number of firms in the entire ICT industry grew from 19,801 in 1978 to 142,052 in 2019. S. Georgousis, B. Heiden, N. Petit, "Gatekeepers, Superstars, or Disruptors? A Study of Rents in Digital Industries", *Dynamic Competition Initiative* (DCI) Working Paper 2-2023.
[27] J. Bessen, "The New Goliaths: How Corporations Use Software to Dominate Industries, Kill Innovation, and Undermine Regulation", Yale University Press (2022); F. Bostoen, L.M. Santos, A. van der Veer, *Not "Big is Bad" but "Closed is Bad". Reviewing The New Goliaths by James Bessen*, Dynamic Competition Initiative (2023), https://bit.ly/48ffc3A.
[28] K.J. Boudreau, L.B. Jeppesen, M. Miric, "Profiting from Digital Innovation: Patents, Copyright And Performance", *Research Policy* (2022).

5.2. Implications for merger policy

Given the above empirical facts, the DMG's current hostility to scale and external growth appears misplaced. Innovation requires a vibrant market for corporate control. The multiple presumptions and lowered thresholds formulated in the DMG risk closing opportunities for middle market M&A where many small and medium-sized firms attempt to exit.[29] The proposed policy, in turn, will predictably dry up the availability of funding for small and medium-sized firms in venture capital markets. A systemic risk of innovation destruction can be expected.[30]

Similarly, the DMG's abandonment of a prediction of effects model towards a structural presumption model means that little attention is paid concretely to the more relevant question of the merged firm and its competitors' innovation capabilities.[31] Mergers can create incentives for competitors to innovate in order to keep up. They can also create opportunities for competitors if the merged entity reduces innovation. Finally, mergers can impede competitors' ability to innovate if the new entity controls infrastructure,[32] assets,[33] and skills that cannot be economically replicated.[34] Complementing the current merger framework with an analysis of the merged firm and competitors' capabilities could help get a better understanding of innovation impacts.[35]

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[29] National Center for the Middle Market, *Middle Market M&A. What Executives and Advisors Need to Know to Make the Most of Mergers & Acquisitions* (2018); J. Catmull, "Why Mergers And Acquisitions Activity In The Middle Market Remains Hot", *Forbes* (2023).

[30] Effects will be worse in the digital sector, where startup sunk costs may be higher (fewer startup patents to sell upon exit).

[31] T. Schrepel, "A Systematic Content Analysis of Innovation in European Competition Law", *Dynamic Competition Initiative* (DCI) Working Paper 1-2023, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4413584.

[32] Access to key infrastructure, such as cloud solutions, computational power, hosting services, repositories, communication protocols, etc., can be necessary for a product to function efficiently.

[33] Agencies could distinguish between the acquisition of an autonomous innovation (i.e., an innovation that can be commercialized without the need for complementary access/assets) and an architectural innovation (i.e., an innovation that requires complementary technologies), see D. Teece, "Economic Analysis and Strategic Management," *California Management Review*, Vol. 26, No. 3 (1984): 87.

[34] Agencies should want to analyze the track record and ability of the merged entities to complement each other, rather than simply focusing on "business stealing".

[35] T. Schrepel, "*A Systematic Content Analysis of Innovation in European Competition Law*," Dynamic Competition Initiative (DCI) Working Paper 1-2023 https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4413584.

6. Conclusion

The DCI agrees that merger guidelines can strengthen the application of antitrust by promoting economic innovation and protecting customers from harm.

However, in their current shape, the DMG do not seem to be a step in this direction. Merger guidelines adjusted to the modern economy, especially its still-increasing digital sector, need to present a model of administrative regulation and judicial intervention focused on dynamic competition and innovation.[36]

The main challenge of new merger guidelines is to formulate a framework that leaves enough space for competition, understood as a process leading to innovation while protecting the R&D efforts of the most efficient firms. We believe that it could be reached, as in the past, through dialogue between legal doctrine and a pluralistic approach to economic science.

In further work on the DMG, we suggest reaching for inspiration from advancements made through the last decade in the theoretical and empirical comprehension of the economy. In our submission, we present many of these studies and recommend them together with the ongoing work of our Initiative, especially research on Screening for Innovation[37] and Operationalizing Capability Audits.[38]

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[36] *See* N. Petit and D. J. Teece, "Innovating Big Tech Firms And Competition Policy: Favoring Dynamic Over Static Competition," *Industrial and Corporate Change* 30.5 (2021); D.J. Teece, "Towards A Dynamic Competition Approach To Big Tech Merger Enforcement. The Facebook-Giphy Example", *Competition Policy International* (2021).

[37] F. Lubinski, "Big Tech's Impact on Innovation Trajectories in Platform Markets: Understanding the Dynamic Relation Between Corporate Activities and Market Activities by Carmelo Cennamo, Yangyang Cheng and Claudio Panico – Review", *Dynamic Competition Initiative* (2023): https://bit.ly/46jf6pP; *FTC v. HJ Heinz Co.*, 116 F. Supp. 2d 190 (D.D.C. 2000).

[38] N. Petit, D.J. Teece, "Capabilities Checklist for Mergers with Nascent Competitors", *Journal of European Competition Law & Practice*, (2023): 135–136; J.P. Murmann, F. Vogt, "A Capabilities Framework for Dynamic Competition: Assessing the Relative Chances of Incumbents, Startups, and Diversifying Entrants", *Management and Organization Review*, (2022); N. Petit, D.J. Teece, "Innovating Big Tech Firms and Competition Policy: Favoring Dynamic Over Static Competition", *Industrial and Corporate Change* (2021).