

# “KILLER ACQUISITIONS,” BIG TECH, AND SECTION 2: A SOLUTION IN SEARCH OF A PROBLEM



PROBLEM

SOLUTION

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# CPI ANTITRUST CHRONICLE MAY 2020

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CPI Antitrust Chronicle May 2020

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## I. INTRODUCTION

“Killer Acquisition.” It’s an evocative term, particularly for such a technocratic field as antitrust law. Perhaps because it is so evocative, the term sometimes has been stretched well beyond its original meaning to refer to “acquisitions I think are anticompetitive.” But the term “killer acquisition” was originally coined by Colleen Cunningham, Florian Ederer, and Song Ma to describe something quite specific: an acquisition – in the pharmaceutical industry in the Cunningham study – in which an incumbent acquires an innovative company that is developing a competing product and shuts down that product development.<sup>2</sup>

Cunningham and her colleagues estimate that 6 percent of all acquisitions in the U.S. pharmaceutical sector (or 45 of acquisitions each year) are “killer acquisitions.”<sup>3</sup> Their study gives rise to the obvious question whether “killer acquisitions” are taking place in other industries – most notably tech. We may have a concrete answer to that question soon; the Federal Trade Commission has launched a study of past acquisitions by large technology companies. But for now, it seems unwise to extend the Cunningham team’s findings – even if accurate – to an entirely different industry where product development is less regimented and innovation more opaque.

That’s not to say that there cannot be anticompetitive acquisitions of nascent competitors by large technology companies – surely there can. But while a true killer acquisition almost certainly harms consumer welfare by depriving the market of innovative alternatives, it is difficult to generalize about acquisitions of nascent competitors in the tech space, many of which undoubtedly enhance consumer welfare by expanding distribution of innovative products.

The question becomes how do enforcers identify and block the *anticompetitive* acquisitions of nascent competitors? Some agency officials have suggested that Section 2 of the Sherman Act may provide the answer. But it’s not at all clear that Section 2 provides a path toward increased – or increasingly accurate – enforcement. To the contrary, the claimed advantages of challenging mergers under Section 2 are overstated, and the added complication, significant.

<sup>2</sup> Colleen Cunningham, Florian Ederer & Song Ma, *Killer Acquisitions* (March 22, 2019), available at <https://ssrn.com/abstract=3241707>.

<sup>3</sup> *Id.* at 5.

## II. PHARMACEUTICALS vs. TECHNOLOGY

While Cunningham and her colleagues caution that the “core insights” of their paper extend beyond the pharmaceutical industry,<sup>4</sup> unique characteristics of that industry suggest that their conclusions may have little purchase elsewhere.

For one thing, unlike in most other industries, publicly accessible databases track drug development projects, identifying both the condition to be treated and the mechanism of treatment. Incumbent drug companies can readily identify drug development projects that might compete with their own and also monitor the new drug’s progress through the famously long drug development and approval process. Indeed, Cunningham and her colleagues relied on these publicly available data sources to identify which acquisitions involved drug companies with potentially competing products in the pipeline.

Moreover, according to Cunningham and co., the threat of new branded or generic drug entry to an incumbent firm’s profits may be clear and calculable. Because the drug research, development, and approval process is so long and costly, pharmaceutical companies have “only a few years post-approval of monopoly profits before patent expiration and generic entry.”<sup>5</sup> If that’s right, shutting down a single nascent rival could allow an incumbent firm to take full advantage of its patent monopoly, making such acquisitions rather attractive.

Past enforcement actions against drug manufacturers fit neatly within this narrative. In 2017, for instance, the FTC forced Mallinckrodt to divest rights in hormone drug Synacthen, charging that Mallinckrodt’s subsidiary Questor acquired the drug to prevent the entry of a competitor to its own drug, Acthar.<sup>6</sup> The FTC’s complaint (which Mallinckrodt very quickly settled) relied partly on Questor’s submissions to federal drug regulators, as well as the obvious threat that Synacthen – marketed outside the United States as substantially similar to Acthar – posed to Questor’s considerable profits.<sup>7</sup>

In high-tech fields, however, it can be difficult to tell which innovations constitute a competitive threat. An incumbent search engine or social media platform can’t consult a government-run database to determine which garage-based start-up will be the next big thing. And innovative products tend to evolve over time. For example, Instagram was transformed from a photo-sharing app into a social media platform. Uber used to be a luxury car-hire service. And Android was a little-known software company before Google transformed it into the world’s most popular mobile ecosystem. On the flip side, it’s notoriously difficult to predict whether start-ups will thrive or fail. A venture-capital firm typically expects to lose money on at least a third of its investments, though some experts believe the failure rate of start-ups could be closer to 75 percent.<sup>8</sup>

The rewards of a true killer acquisition are less clear in the tech space. Technology innovation is fast moving and unless the incumbent wants to play an extended game of whack-a-mole, killer acquisitions may be a losing proposition. Even where incumbent tech firms acquire innovative newcomers, the incentives are not necessarily to shut the innovation down; technology innovations tend to be complementary to existing products or platforms. Thus, even when an incumbent acquires the nascent innovator, the incentives may be to foster the innovation and integrate it into the incumbent product.

The competitive effects of such an acquisition are also less clear than those of the true killer acquisitions that Cunningham purports to describe. Acquisition and integration of a tech innovation into an existing product might harm competition by eliminating a nascent player that would have challenged the incumbent, but it also might also improve the incumbent’s product and expand output.

This is precisely the sort of forward-looking evaluation called for by Section 7 of the Clayton Act – comparing what the market would look like with and without the proposed transaction. But there is growing concern that Section 7 is not up to the task in the case of nascent

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<sup>4</sup> *Id.* at 41.

<sup>5</sup> Cunningham *et al.*, *supra* note 2, at 17.

<sup>6</sup> Press Release, U.S. Fed. Trade Comm’n, “Mallinckrodt Will Pay \$100 Million to Settle FTC, State Charges It Illegally Maintained its Monopoly of Specialty Drug Used to Treat Infants” (January 18, 2017), <https://www.ftc.gov/news-events/press-releases/2017/01/mallinckrodt-will-pay-100-million-settle-ftc-state-charges-it>.

<sup>7</sup> Compl. ¶¶ 2, 6, 8, *FTC v. Mallinckrodt Ard Inc.*, No. 1:17-cv-00120 (D.D.C. January 25, 2017), [https://www.ftc.gov/system/files/documents/cases/170118mallinckrodt\\_complaint\\_public.pdf](https://www.ftc.gov/system/files/documents/cases/170118mallinckrodt_complaint_public.pdf).

<sup>8</sup> See “The Venture Capital Secret: 3 Out of 4 Start-Ups Fail,” *Wall St. J.* (September 20, 2012), <https://www.wsj.com/articles/SB10000872396390443720204578004980476429190>.

competitors.<sup>9</sup> Agency leaders have proposed dusting off Section 2 of the Sherman Act, which prohibits the unlawful acquisition or maintenance of monopoly power, as a merger enforcement tool. But is Section 2 better suited to the task?

### III. POTENTIAL ADVANTAGES OF SECTION 2

In the distant past (distant in antitrust terms, anyway) the government used Section 2 to block or undo transactions between competitors. Nowadays, however, Section 2 is far more commonly used to police exclusionary conduct by a single firm, while mergers are almost always reviewed under Section 7 of the Clayton Act. According to the Supreme Court, the legal tests under Section 7 of the Clayton Act are “less stringent than those used in applying the Sherman Act.”<sup>10</sup>

Nevertheless, officials offer two reasons why Section 2 may be better equipped to deal with killer acquisitions than its more commonly used counterpart.

The first reason has to do with proving, as a factual matter, that a merger would harm competition. Although the law is unsettled, an agency challenging an acquisition under Section 7 based on the theory that the parties may be future competitors must generally show that the acquired firm “probably would have entered” the market “within a reasonable period of time” absent the merger.<sup>11</sup> An agency may also need to show that the acquired firm’s entry would “probably have increased competition more than the [merger] did.”<sup>12</sup> Some officials say these requirements make it almost impossible to successfully block acquisitions of start-ups, given the difficulty of predicting how innovative products will develop and how they will fare competitively against established players.<sup>13</sup>

In contrast, officials have argued that Section 2’s standard for proving the causal relationship between anticompetitive conduct and the acquisition or maintenance of monopoly power is “somewhat relaxed.”<sup>14</sup> For this, they point to the D.C. Circuit’s opinion in *United States v. Microsoft*, where the court required only a showing that “as a general matter, the exclusion of nascent threats is the type of conduct that is reasonably capable of contributing significantly to a defendant’s continued monopoly power.”<sup>15</sup> As one former FTC official noted, this inquiry focuses on the “general tendency” of the anticompetitive conduct, not its specific effects in any case, and does not require “but-for causation of the monopoly.”<sup>16</sup> The standard therefore differs from the government’s burden under Section 7, which requires proof that a *specific* transaction (not a category of transactions in general) is *likely to substantially lessen* (not reasonably capable of lessening) competition in the relevant market.

A second reason given for analyzing tech mergers under Section 2 instead of Section 7 is that Section 2 would supposedly allow agencies to step in when an incumbent acquired (or threatens to acquire) market power through a series of small transactions. Such transactions may escape scrutiny under Section 7, some say, because they may not alone substantially lessen competition. Using Section 2 would allow agencies to put greater emphasis on a “pattern of conduct,” including the competitive impact of past transactions and a platform’s internal documents referencing start-ups. The Antitrust Division’s chief economist has suggested this analysis would be particularly appropriate in technology platform markets which, because of network effects, can easily “tip” into monopoly.<sup>17</sup>

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9 See, e.g. “FTC Tech Enforcer: Agencies Can’t Block Deals Based on Unknown Products,” *Global Competition Rev.* (November 20, 2019), <https://globalcompetitionreview.com/article/usa/1211096/ftc-tech-enforcer-agencies-can%E2%80%99t-block-deals-based-on-unknown-products>.

10 *Brown Shoe Co. v. United States*, 370 U.S. 294, 329 (1962).

11 *FTC v. Steris Corp.*, 133 F. Supp. 3d 962, 966 (N.D. Ohio 2015).

12 *Yamaha Motor Co. v. FTC*, 657 F.2d 971, 977-78 (8th Cir. 1981).

13 See “Courts Don’t Easily Block Buyouts of Potential Competitors, Says FTC Official,” *Global Competition Rev.* (February 27, 2020), <https://globalcompetitionreview.com/article/usa/1215548/courts-don%E2%80%99t-easily-block-buyouts-of-potential-competitors-says-ftc-official>.

14 See D. Bruce Hoffman, Dir. Bureau of Competition, U.S. Fed. Trade Comm’n, “Antitrust in the Digital Economy: A Snapshot of FTC Issues,” at 10 (May 22, 2019), [https://www.ftc.gov/system/files/documents/public\\_statements/1522327/hoffman\\_-\\_gcr\\_live\\_san\\_francisco\\_2019\\_speech\\_5-22-19.pdf](https://www.ftc.gov/system/files/documents/public_statements/1522327/hoffman_-_gcr_live_san_francisco_2019_speech_5-22-19.pdf).

15 *United States v. Microsoft*, 253 F.3d 34, 78-79 (D.C. Cir. 2001) (en banc).

16 Hoffman, *supra* note 14, at 10-11.

17 Jeffrey M. Wilder, Acting Deputy Assistant A.G., Antitrust Div. Dep’t of Justice, “Potential Competition in Platform Markets” (June 10, 2019), <https://www.justice.gov/opa/speech/acting-deputy-assistant-attorney-general-jeffrey-m-wilder-delivers-remarks-hal-white>.

But neither of these reasons justify ditching traditional merger enforcement tools in favor of a much less tested standard.

On the causation point first, it is unclear that *Microsoft's* “reasonably capable” standard would apply when assessing the competitive effects of a merger, rather than exclusionary conduct. That language has been quoted in only a handful of judicial opinions since *Microsoft* came down in 2001, and never in the context of a merger challenge. A court asked to condemn a merger between two potential competitors may well demand clearer evidence of causation than it would when assessing exclusionary conduct like *Microsoft's*. Mergers and acquisitions, as the agencies recognize, can provide tremendous benefit to consumers by reducing firms’ costs, combining complementary assets, and inspiring the creation of new products.<sup>18</sup> They are also a staple of economic activity — no less in the tech sector, where start-ups may innovate and compete with one another to attract attention from potential buyers. Given the potential costs of an erroneous merger challenge, it’s reasonable to demand proof of actual lost competition. Indeed, other commentators have suggested *Microsoft's* causation standard applies by its own terms only to exclusionary conduct, given the court’s reasoning that “to some degree, the defendant is made to suffer the uncertain consequences of its own *undesirable conduct*.”<sup>19</sup>

Section 7 is also sufficient to prevent an incumbent from monopolizing a market by acquiring multiple start-ups in adjacent markets. Put simply, a merger that threatens to tip a market into monopoly following a series of transactions would substantially lessen competition. Contrary to some suggestions, Section 7 doesn’t limit review to “each transaction in isolation.”<sup>20</sup> Instead, as the D.C. Circuit explained in *Baker Hughes*, the statute envisages a “totality-of-the-circumstances approach” that weighs “a variety of factors to determine the effects of particular transactions on competition.”<sup>21</sup> That approach is flexible enough to consider facts relevant to a serial acquisition scenario, such as the effects of past acquisitions on product development, unrealized efficiency gains, and internal discussions of potential rivals. Indeed, this sort of evidence often features in Section 7 cases.

## IV. INCREASED CHALLENGES IN SECTION 2 ENFORCEMENT

Contrary to some suggestions, then, it’s doubtful Section 2 would prevent anticompetitive deals that Section 7 wouldn’t. And in some ways, a Section 2 merger challenge could be harder for the government to win.

Most obviously, any monopolization case needs a monopolist. Direct proof of monopoly power, such as evidence of steep price increases, is “only rarely available,”<sup>22</sup> and will likely be even harder to come by in cases involving dynamic technology platforms and zero consumer prices.

In most instances, then, the government will need to prove monopoly power by showing that the acquiring firm has a dominant share of the relevant market (plus the existence of entry barriers). But, as others have observed, this requirement poses its own challenges in cases involving the acquisition of start-ups, which typically develop on the fringes of established markets.<sup>23</sup> Defining a narrow market may help establish the acquiring firm’s dominant market share, but it could also make it harder to prove that future head-to-head competition is likely between two firms with no historical overlap. A broad market definition, on the other hand, may help prove that the two firms will someday compete in the same market, but could frustrate claims that the acquirer is dominant. Battles over market definition will take on added complexity and importance under Section 2.

Section 2 may also leave defendants more room to justify mergers with potential anticompetitive effects. Under Section 7, efficiencies must “enhance the merged firm’s ability and incentive to compete,” offsetting increased market concentration through lower prices, increased quality, or new products.<sup>24</sup> And the burden of proving such efficiencies is high — parties must generally verify efficiencies with objective evidence and show that they can’t be achieved without a merger.

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18 See U.S. Dep’t of Justice & Fed Trade Comm’n, Horizontal Merger Guidelines § 10 (August 19, 2010), <https://www.justice.gov/atr/horizontal-merger-guidelines-08192010#10>.

19 Timothy Muris & Jonathan Nuechterlein, *First Principles for Antitrust Review of Long-Consummated Mergers*, 5 Criterion J. on Innovation 29, 39-40 (2019) (quoting *Microsoft*, 253 F.3d at 79) (their emphasis).

20 Wilder, *supra* note 17.

21 *United States v. Baker Hughes, Inc.*, 908 F.2d 981, 984 (D.C. Cir. 1990).

22 *Microsoft*, 253 F.3d at 51.

23 Mats Holmström, Jorge Padilla, Robin Stitzing & Pekka Sääskilähti, *Killer Acquisitions? The Debate on Merger Control for Digital Markets*, 2018 Y.B. of the Fin. Competition L. Assoc., at 16-17 (2019).

24 See *FTC v. H.J. Heinz Co.*, 246 F.3d 708, 720 (D.C. Cir. 2001) (citing and quoting Horizontal Merger Guidelines § 10). CPI Antitrust Chronicle May 2020

Under Section 2, on the other hand, a defendant's conduct "is redeemed by a legitimate business purpose,"<sup>25</sup> whether or not it promotes competition. Any conduct that is "profitable without regard to the destruction of rivals" survives Section 2 scrutiny.<sup>26</sup> The burden of proof is also low: if a court finds a monopolist's business justification "valid" — i.e. not a pretext for excluding competition, or trivial compared with the competitive harm — there is no antitrust liability.<sup>27</sup> One can reasonably argue that Section 2's business-justification defense shouldn't be available in cases involving a merger between potential rivals. Many of the cases involve a monopolist's exclusionary conduct; and antitrust law is rightly more skeptical of agreements between competitors (however nascent) than unilateral action. But by invoking Section 2, the agencies nevertheless give defendants the opportunity to use this case law — and its more lenient standards of proof — to their advantage.

## V. CONCLUSION

Section 2 is therefore probably no silver bullet for killer acquisitions. In a litigated merger challenge, relaxed causation standards may be unavailable, and the additional need to prove monopoly power (plus potentially greater deference to business justifications) may frustrate the agencies' chances of success. Section 7 is sufficient to police anticompetitive acquisitions of nascent competitors, just as it is anticompetitive acquisitions in general.

But in many ways, these discussions put the cart before the horse. It's hard (and somewhat futile) to say whether existing tools are fit to meet a problem without knowing whether that problem exists. As already discussed, potential evidence of killer acquisitions in the pharmaceutical industry does not mean that other industries are similarly afflicted — least of all tech, where competition and innovation are unpredictable and tie-ups between potential competitors may actually increase consumer welfare.

In February 2020, the FTC announced that it had ordered five large technology firms — Alphabet, Amazon, Apple, Facebook, and Microsoft — to turn over documents about acquisitions made in the last decade, including information about the reasons for the deals and what happened to acquired assets after consummation.<sup>28</sup> FTC leadership has said the investigation will look at whether platforms have used mergers to squash nascent competitors or monopolize adjacent markets. Conducted properly, this study could shed light on whether Big Tech has a killer acquisitions problem — and whether traditional antitrust tools are sufficient to solve it.

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<sup>25</sup> *Universal Analytics, Inc. v. MacNeal-Schwendler Corp.*, 914 F.2d 1256, 1258 (9th Cir. 1990).

<sup>26</sup> Areeda & Hovenkamp, *Antitrust Law: An Analysis of Antitrust Principles and their Application* ¶ 658f (4th ed. 2013-2018); see also *Morris Commc'ns Corp. v. PGA Tour, Inc.*, 364 F.3d 1288, 1295 (11th Cir. 2004) (Section 2 proscribes "conduct without a legitimate business purpose that makes sense only because it eliminates competition").

<sup>27</sup> See *High Tech. Careers v. San Jose Mercury News*, 996 F.2d 987, 990-91 (9th Cir. 1993).

<sup>28</sup> Press Release, U.S. Fed. Trade Comm'n, "FTC to Examine Past Acquisitions by Large Technology Companies" (February 11, 2020), <https://www.ftc.gov/news-events/press-releases/2020/02/ftc-examine-past-acquisitions-large-technology-companies>.

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