The Potential for Potential Competition after FTC v. Meta

Michael R Moiseyev, Rachel Williams, and Geneva Hardesty

Aug 30, 2023   13 min read

Antitrust | Antitrust Litigation & Enforcement | Media & Technology | Mergers

Summary

- Section 7 plaintiffs are required to prove that anticompetitive effects from a transaction are probable, which imposes strict evidentiary requirements in potential competition cases.
- To satisfy Section 7, courts have required the government to prove that entry is at least "reasonably probable" for actual potential competition, and that the prospect of entry had a direct effect on existing competition for perceived potential competition.
- The high evidentiary bar in potential competition cases has resulted in losses in almost all actual potential competition cases.
- The FTC's loss in *Meta* confirmed that the evidentiary standards in potential competition cases are high, and did not materially improve the government's prospects in cases brought under the theory.

Jump to:

Potential Competition Background →

Elements of the Potential Competition Theories →

The Decision in FTC v. Meta →

Potential Competition under the Draft 2023 Merger Guidelines →

Takeaways →

When the Federal Trade Commission filed its request for a preliminary injunction to prevent Meta Platforms, Inc. ("Meta") from acquiring Within Unlimited, Inc. ("Within"), the company behind the virtual reality ("VR") fitness app Supernatural, it touted the request as an effort to preserve competition in the "dynamic, rapidly growing U.S. markets for fitness and dedicated-fitness VR ap…

[1] By the time it got to trial, the sole question before the court was whether the transaction eliminated "potential competition," as Meta, which owns the Quest VR platform, did not have a "dedicated fitness VR app" similar to Supernatural prior to the acquisition. [2] After a seven-day bench trial, Judge Edward Davila of the Northern District of California denied the FTC's request for an injunction.

Despite the loss, the FTC has publicly characterized the decision as an important victory. The Director of the Bureau of Competition claimed that it had "beneficial interpretations of the law that can help us in future cases down the road, and really chart out a new course." [3] A month later, her deputy told a conference that the potential competition theories of harm were a tool that had gotten "rusty" over time but with this decision they were now "sharp" and "ready to use"—calling that a "very significant win." [4] So, what, if anything, did the FTC "win" with this loss?

Potential Competition Background

The notion that Section 7 of the Clayton Act applies to mergers between firms that are not current competitors, but could be in the future, is said to have begun in *United States v. El Paso Natural Gas Co.*, where the Supreme Court first recognized that a firm with no current share of the relevant market could nonetheless be an important competitive force. [5] From there, the concept expanded through a number of Supreme Court cases in the 1960s and early 1970s to cover transactions where one of the parties was not participating in the market at issue at all, but was nonetheless viewed as influencing competition. [6] The theory was then expanded to transactions in which there was no current effect on the market, but where there was a potential threat to the competitiveness of the market in the future. [7]

Having established it as a viable theory of harm in Section 7 cases in the 1960s and early 1970s, the FTC and DOJ (the "Agencies") set about bringing potential competition cases and almost immediately found themselves colliding with another tenet of Section 7: that the Act applies only to "[m]ergers with a *probable* anticompetitive effect," not those whose effect is an "ephemeral possibility." [8] The rule that emerged—that it must be shown that the potential entrant was likely to enter the market or be perceived as likely to enter by market incumbents—proved over the next decade to be an essentially insurmountable hurdle to successful invocation of the potential competition doctrine. Tl
government's string of losses culminated in the FTC's rejection of a challenge to the acquisition of Appleton by B.A.T. Industries in 1984, in which concurring Commissioner Bailey observed, "The clear trend among the courts which this Commission today joins, is reluctant to undo business transactions on the basis of speculation." [9]

After the mid-1980s, the government did not litigate another potential competition merger case until 2015, when the FTC sought to enjoin an acquisition of a potential competitor in *FTC v. Steris Corp*.

It turned out that little had changed, as the court concluded that Steris would not "probably" enter the target duopoly market. [11] Most recently, the FTC tried again to press a potential competition claim against Meta's planned acquisition of Within, in line with the Biden administration's broader effort to enforce the antitrust laws "vigorously," particularly when it comes to "dominant Internet platforms." [12] The effort was not rewarded, at least in the outcome, as the resulting loss extended the government's losing streak in potential competition cases to over forty years.

Elements of the Potential Competition Theories

In standard horizontal merger cases, courts are presented with information about the current competitive structure and dynamics of the affected market to draw conclusions (aided by structural presumptions) about the competition that would be lost with the merger. In potential competition cases, the competitive effect is the elimination of the prospect of new competition. This can take one of two forms. The first has become known as "perceived potential competition," that firms in a concentrated market maintain their competitive behavior because they perceive that one of the parties may enter if they do not, and removing that constraint would lessen competition. The second is "actual potential competition," a somewhat contradictory label for the idea that, but-for the merger, one of the firms would enter and improve competition. Although they have slightly different elements, both potential competition theories depend on predictions about the likelihood and impact of entry by the non-incumbent firm.

For either type of potential competition case, there are familiar prerequisites. As with all merger challenges, definition of the relevant product and geographic markets that would be affected is a "necessary predicate." [13] And that market must be concentrated. As the Supreme Court explained:

> The potential competition doctrine has meaning only as applied to concentrated markets. . . . If the target market performs as a competitive market in traditional antitrust terms, the participants in the market will have no occasion to fashion their behavior to take into account the presence of a potential entrant. The present procompetitive effects that a perceived potential entrant may produce in an oligopolistic market will already have been accomplished if the target market is performing competitively. [14]

Beyond these, the firm must be one of few potential competitors, since if there are many, independent entry, or the threat of it, could not have significant procompetitive effects. As the Court noted in *United States v. Procter & Gamble Co.*, "[T]he number of potential entrants was not so large that the elimination of one would be insignificant, [and] . . . Procter was . . . *the most likely entrant*." [15]

Perceived Potential Competition

Of the two potential competition theories, only perceived potential competition has been formally accepted by the Supreme Court, [16] which set forth the elements required to prove that a transa n

violates Section 7 under this theory:

1. The potential entrant "has the characteristics, capabilities, and economic incentive to render it a perceived potential *de novo* entrant;" and
2. The firm's "presence on the fringe of the target market in fact tempered oligopolistic behavior on the part of existing participants in that market." [17]

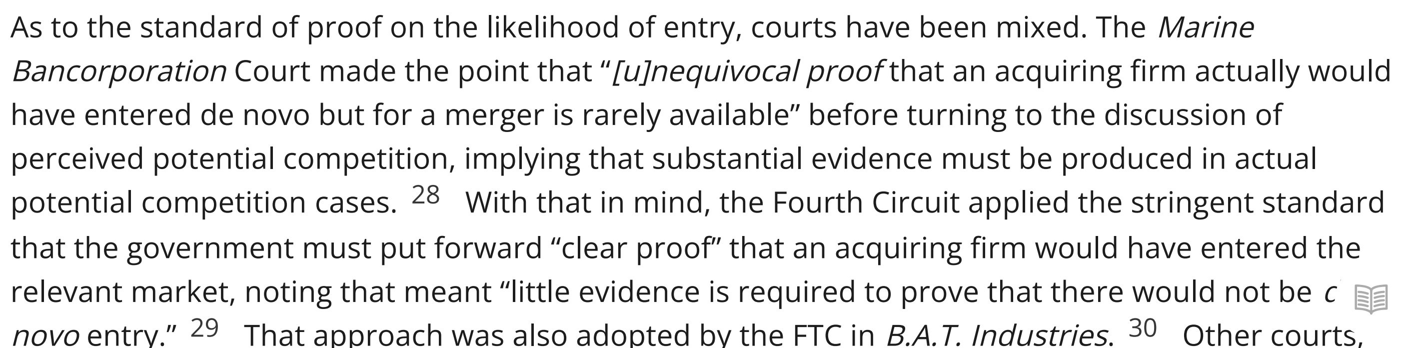
Thus, in order to prevail in a perceived potential competition case, the government must not only make a threshold showing that the potential entrant is objectively well positioned to enter the target market, but also that its presence "in the wings" has, *in fact*, exerted a substantial procompetitive effect. [18]

Actual Potential Competition

Without clear guidance from the Supreme Court on its viability, the law of the actual potential competition has been largely created by lower courts, resulting in a mixed bag of acceptance and requirements. At the appellate level, only the Eighth Circuit has fully endorsed the theory, [19] while the First, Second, [20] Fourth [21] and Fifth [22] Circuits have formally reserved judgment. [23] Nevertheless, the Supreme Court and a number of lower courts have discussed what the requirements of the theory would be.

In *United States v. Marine Bancorporation, Inc.*, the Supreme Court identified two "preconditions" for an actual potential competition case: (1) the non-incumbent must have the "available feasible means" of independent entry; and (2) "that those means offer a substantial likelihood of ultimately producing deconcentration of that market or other significant procompetitive effects." [24] It is the second requirement—that the entry must offer a *substantial likelihood* of procompetitive effects—that has ultimately proven insurmountable for the government in these cases.

In every litigated actual potential competition case, the principal point of disagreement has been whether, but-for the merger, one of the firms would enter the market in question. The issue has two dimensions. First, what level of probability would suffice to qualify a firm as an actual potential entrant? And relatedly, how strong must the proof be that the firm has the interest, ability, and incentive to enter? For the first, seizing on the "substantial likelihood" language of *Marine Bancorporation*, most courts have aligned on "probable," [25] "would likely," [26] "reasonable probability," [27] or some other variant suggesting that entry must be at least more likely than not.



As to the standard of proof on the likelihood of entry, courts have been mixed. The *Marine Bancorporation* Court made the point that "*[u]nequivocal proof* that an acquiring firm actually would have entered de novo but for a merger is rarely available" before turning to the discussion of perceived potential competition, implying that substantial evidence must be produced in actual potential competition cases. [28] With that in mind, the Fourth Circuit applied the stringent standard that the government must put forward "clear proof" that an acquiring firm would have entered the relevant market, noting that meant "little evidence is required to prove that there would not be *c novo* entry." [29] That approach was also adopted by the FTC in *B.A.T. Industries*. [30] Other courts,

however, have been less strict, requiring only a "persuasive rationale" for independent entry compared to other investment options. [31]

When the FTC sued to enjoin Steris Corporation's proposed acquisition of Synergy Health in 2015 on the grounds that Synergy was an actual potential entrant into the two-firm U.S. radiation sterilization market prior to the acquisition, it alleged that Synergy was "on the verge of entering." [32] The complaint alleged that Synergy, the only other global supplier but with no U.S. presence, had significant entry advantages and had been executing a multi-year plan to bring its technology to the United States prior to the merger. [33] That evidence, the FTC contended, was sufficient to make Synergy a "probable" entrant, the standard that had been adopted by the Eighth Circuit in *Yamaha*.

In its decision, the *Steris* court sidestepped deciding the validity of the actual potential entrant doctrine and framed the relevant question as "whether, absent the acquisition, the evidence shows that Synergy probably would have entered" since that was the standard the FTC would apply in the merits trial. [34] The court agreed that Synergy had undertaken significant efforts and had secured approvals at high levels of the company, but ultimately credited Synergy's trial testimony that the project would not have been approved due to too-low prospective returns on investment. [35] Thus, the court concluded that the FTC had not shown that Synergy's entry was probable.

The Decision in *FTC v. Meta*

On July 27, 2022, the FTC filed for a preliminary injunction to prevent Meta from closing its proposed acquisition of Within. The complaint alleged that eliminating Meta as a potential independent competitor in its "dedicated fitness VR apps" market raised both actual and perceived potential competition concerns. [36] According to the FTC, absent the acquisition of Within, "there is a reasonable probability that Meta would have exercised one of its other available options to enter the VR Dedicated Fitness App market," so the acquisition would have the effect of "potentially dampening future innovation and leading to a market with less beneficial rivalry and competitive pressure." [37] In addition to its actual potential competition claim, the FTC also alleged that Meta's presence as a perceived potential entrant likely influenced competition in the dedicated fitness VR apps market. [38]

Judge Davila followed the traditional approach to assessing whether the required market conditions of market definition and concentration were present and concluded that the FTC had established a presumption. Beyond that, he left open whether the presumption was overcome by Meta's rebuttal evidence about nascency, volatility of shares, new entry, entry barriers, and the absence of price competition, concluding that it was unnecessary because the FTC did not satisfy the elements of the potential competition theories, and therefore was not entitled to an injunction. [39]

Much of the opinion is dedicated to evaluating the elements of the potential competition theories, the standard of proof, and the sufficiency of the FTC's evidence, and Judge Davila's discussion of those issues is, if nothing else, more extensive than in any decision in decades. But as he evaluated those aspects of the potential competition case before him, it is not clear that any of his views moved the ball on the key aspects of potential competition that have prevented the government from successfully blocking a deal under this theory.

A threshold question that was teed up directly in the case was whether the loss of actual potential competition is a cognizable harm under Section 7. Like almost every other court that has considered the question, Judge Davila was unwilling to conclude that the doctrine does not exist at all. Unlike Judge Polster in *Steris*—who explicitly assumed the validity of the theory [40] —Judge Davila went a bit further: "[g]iven the actual potential competition doctrine's consistent, albeit distant, history of judicial recognition, the Court declines to reject the theory outright and will apply the doctrine as developed." [41] But this is well short of a full-throated endorsement of actual potential competition, especially when coupled with the ultimate conclusion that the requirements had not been met.

The FTC also did not gain much, if any, ground reducing the probability of successful entry or the time frame in which it must be accomplished. As noted, the battle ground in actual potential competition cases is almost always whether the non-incumbent will enter the market in the near future. Regarding the time frame in which the potential entry is considered, consistent with the view of the Second Circuit, [42] the Court made clear that the FTC's suggestion that Meta would have "inevitably found and implemented" an entry strategy veers into "uncabined speculation" that is impermissible in Section 7 cases. [43] As to the likelihood of entry, although the court rejected Meta's attempt to set the bar at "clear proof," it clarified that the FTC's proposed "reasonable probability" standard means "noticeably greater than fifty percent," which is arguably higher than the "probable" standard applied in *Steris.* [44]

An interesting aspect of the *Meta* decision is the discussion of the role of "objective" and "subjective" evidence in assessing the likelihood of entry under the actual potential competition theory. Evidence that a firm has the economic incentive to enter a market (considering its capabilities and the costs and benefits of entry) is considered objective evidence, while subjective evidence is proof of an actual intent to enter independently. The FTC had put forward extensive significant evidence in *Steris* [45] because actual intent to enter is considered the "best evidence" in potential competition cases. [46] In *Meta*, the subjective evidence was much thinner so the FTC attempted to augment it with objective evidence—Meta's interest in VR generally and VR fitness in particular and its significant financial and technical resources—in an effort to show that Meta would enter on its own. [47] The court conceded the "high probative value" of objective evidence generally, but found that unless it is conclusive, subjective evidence of actual intent to enter should be considered. [48] Note that when it came time to evaluate perceived potential competition, the *Meta* court explicitly rejected the FTC's suggestion that objective evidence ("[p]robabilistic proof of 'likely influence' on existing competitors") was sufficient, holding instead that the FTC must prove that the threat of entry by Meta actually affected competition. [49]

Potential Competition under the Draft 2023 Merger Guidelines

Before 2010, the Agencies evaluated mergers among potential competitors under the framework set out in the non-horizontal section of the 1984 Guidelines. [50] That changed with the issuance of the 2010 Horizontal Merger Guidelines, which explicitly brought mergers of current and potential competitors within the same framework, [51] with two accommodations for evaluating competitive effects: first, projected market shares for the non-incumbent could be used to measure changes in concentration, and second, anticompetitive effects would be evaluated on a sliding scale based on the

"market share of the incumbent, the competitive significance of the potential entrant, and the competitive threat posed by the potential entrant relative to others." [52]

The Draft Merger Guidelines, issued on July 19, 2023, [53] fully integrate potential competition within their unified assessment of the harms of mergers. Like the FTC's challenge of the Meta/Within merger, the Draft Merger Guidelines serve notice that the Agencies may take issue with any mergers they believe eliminate potential competition, without acknowledging all of the cases that narrow the situations in which the theory may apply. For actual potential competition, the Draft Merger Guidelines articulate a "reasonable probability" standard for potential entry, informed as a "starting point" by objective evidence, broadly defined, and if "the company considered organic entry" at all, that "generally suggests that, absent the merger, entry would be reasonably probable." [54] Not only is the "reasonable probability" bar lower than the holdings in a number of appellate court decisions and the importance of subjective evidence downplayed, the Draft Merger Guidelines omit entirely *Marine Bancorporation*'s admonition that "the loss of competition 'which is sufficiently probable *and imminent*' is the concern of § 7." [55] A similarly broad approach is found in the discussion of perceived potential competition, where the only question is whether, based on objective evidence, a current market participant could reasonably consider one of the merging firms to be a potential entrant," [56] a standard well short of the *Marine Bancorporation* requirement that the potential entrant "*in fact* tempered oligopolistic behavior on the part of existing participants in the market." [57] These sweeping rules, at odds with most of case law, may not prove to be materially useful in reversing the Agencies' extended losing streak in potential competition cases.

Takeaways

With almost sixty years of potential competition litigation to build on, it is not clear that the *Meta* decision did much (if anything) to move the needle in the FTC's favor. To be sure, for practitioners the decision is one of the more comprehensive discussions of potential competition, including perceived potential competition, which was not addressed in *Steris*. The Agencies may also take some solace in the mere fact that the court was willing to acknowledge that actual potential competition is a cognizable theory of harm, and in its extensive evaluation of both objective and subjective evidence after the rejection of the strong evidence of actual entry efforts in *Steris.* At the same time, the *Meta* court set the probabilistic and evidentiary bar sufficiently high that the government will likely continue to have difficulty advancing the theory, with either subjective or objective evidence, or a combination of the two, particularly in speculative cases like *Meta*. With the two modern litigation failures and the large number of unsuccessful potential competition challenges of the 1970s and 1980s, courts' acceptance of the theory seems to be a mirage that inevitably proves to be sand on the facts of each case.

Endnotes