Federal Trade Commission v. Meta Platforms, Inc.

___ F.Supp.3d ____ (N.D. Calif. December 13, 2023)

EDWARD J. DAVILA, United States District Judge: This action was brought by Plaintiff Federal Trade Commission ("FTC") to block the merger between a virtual reality ("VR") device provider and a VR software developer. Defendant Meta Platforms Inc. ("Meta") has agreed to acquire all shares of Within Unlimited, Inc. ("Within," collectively with Meta, "Defendants"). The FTC has come before the Court to seek preliminary injunctive relief pursuant to Section 13(b) of the Federal Trade Commission Act, 15 U.S.C. § 53(b), to enjoin Defendants from consummating their proposed merger (the "Acquisition") pending the outcome of ongoing administrative proceedings before the FTC. ECF Nos. 101, 164.

In addition to the FTC's motion for preliminary injunction, Defendants have filed a motion to dismiss the Amended Complaint ("FAC") ***. Over the course of a seven-day evidentiary hearing, the Court heard the parties' arguments and evidence. The Court has also received briefing on all pending motions, as well as pre-hearing and post-hearing submissions of the parties' proposed findings of fact. Having considered the parties' submissions and evidence, the Court DENIES Defendants' motion to dismiss *** and DENIES the FTC's motion for preliminary injunction.

I. FACTUAL FINDINGS

A. Defendant Meta Platforms, Inc.

1. Defendant Meta Platforms, Inc. is a publicly traded corporation organized under Delaware law and headquartered in Menlo Park, California. Meta operates a collection of social networking platforms referred to as its "Family of Apps," which includes Facebook, Instagram, Messenger, and WhatsApp. Meta also manufactures VR devices, such as the Quest 2 and the Quest Pro headsets, through its Reality Labs division.

2. VR technology enables users to experience and interact with a digitally generated three-dimensional environment by wearing a headset with stereoscopic displays in front of each eye. Users can download a wide variety of VR software applications ("apps") from digital marketplaces, or app stores, for use on their personal VR devices. Quest headsets are designed so that a user's geolocation determines what content is available and at what price.

3. In 2020, 2021, and 2022, Meta spent several billion dollars each year on its VR Reality Labs division.

4. Meta operates an app store called the Quest Store, previously known as the Oculus Store. Third-party app developers can request to have their app distributed in the Quest Store, and Meta also actively seeks out and invites developers to bring apps to the Quest StoreApps must meet several content, technical, and asset requirements before they may be considered for listing on the Quest Store; however, Meta may still reject an app that meets all the requirements pursuant to the Quest Store's curation policy. Apart from the Quest Store, Meta also operates App Lab, an app distribution service for VR applications that meet basic technical and content requirements but is otherwise free from any editorial curating by Meta. Quest users can also download VR apps from other app stores on VR platforms that Meta does not own, such as SideQuest and Steam VR Store.

5. The content and apps that are available for a particular VR system plays an important role in the widespread adoption of that system, and many users may purchase a VR system for specific content they want to experience. As a result, high quality and popular VR apps—

dubbed as "system sellers"—can drive adoption and sales of the specific headsets for which they are available. Broad adoption of a specific VR system, in turn, will attract third-party app developers to create more VR content for that system, a phenomenon referred to as a "flywheel" effect.

6. When a VR app is developed wholly by a developer unaffiliated with Meta, Meta refers to that as third-party ("3P") development. When Meta funds all or most of a VR app's development, Meta refers to that as second-party ("2P") development. When a VR app is developed in-house at Meta, either by acquired VR studios or Meta employees themselves, Meta refers to that as first-party ("1P") development.

7. Meta encourages third-party VR app developers to build apps for the Quest platform by providing funding and technical VR engineering assistance to those developers. Specifically, Meta provides grants that are designed to improve existing VR software or incentivize the development of software on Quest that may only exist on another platform. Meta also maintains a developer relations engineering team consisting of veteran engineers who work directly with developers to improve software quality, fix bugs, or polish the experience they are building. Meta's VR content organization spends approximately [redacted].

8. In addition to providing funding or engineering support to third-party VR app developers, Meta has also sought to increase the VR app content available on its platform by acquiring third-party app developers and developing its own apps internally.

9. Although decisions may be made on a case-by-case basis, Meta typically will seek to acquire or build its own VR app if: [redacted].

10. Similarly, Meta is more inclined to build its own VR app instead of acquiring an existing third-party developer [redacted].

11. In the past three years, Meta has acquired at least nine VR app studios: Beat Games, Sanzaru Games, Ready at Dawn Studios, Downpour Interactive, BigBox VR, Unit 2 Games, Twisted Pixel, Armature Studio, and Camouflaj.

12. The VR apps that Meta has independently developed and released include Horizon Worlds (world building), Horizon Workrooms (productivity), Horizon Venues (live events), and Horizon Home (social networking). Meta's background and emphasis has been on communication and social VR apps. That said, Meta has also developed and released Dead and Buried, a multiplayer shooter game.

B. Defendant Within Unlimited, Inc.

13. Defendant Within Unlimited, Inc. is a privately held corporation organized under the laws of Delaware with headquarters in Los Angeles, California. Within is a software development company founded by Chris Milk and Aaron Koblin, who were experienced visual artists.

14. Within's flagship product is Supernatural, a subscription VR fitness service launched in April 2020 on the Quest Store. Supernatural releases new workouts daily and continues to add new modalities (e.g., aerobic boxing, meditation) to its lineup of workouts. Users access Supernatural's workouts by paying a monthly subscription fee of $18.99 or an annual subscription fee of $179.99. Within has never changed Supernatural's prices.

C. The Alleged "VR Dedicated Fitness App" Market

15. The FTC alleges that the relevant market consists of VR dedicated fitness apps in the United States. The government defines "VR dedicated fitness apps" as VR apps that are "designed so users can exercise through a structured physical workout in a virtual setting anywhere they choose to use their highly portable VR headset."

16. Both Meta and Within have repeatedly referred to VR apps intended to provide immersive at-home structured physical exercise as "deliberate" or "dedicated" fitness apps. Meta now describes these apps as "trainer workout apps." VR dedicated fitness apps are sometimes called "VR deliberate fitness apps" or "trainer workout apps." The Court will use the phrase "VR dedicated fitness apps" throughout.

17. VR dedicated fitness apps are marketed to customers for the purpose of exercise. Some other VR apps, often called "incidental" or "accidental" fitness apps, may include mechanics that may allow users to exercise as a byproduct but have a primary focus other than fitness (such as gaming). Unlike VR incidental fitness apps, VR dedicated fitness apps often have features like trackable progress goals, heart rate tracking, and motion calibration. Additionally, VR dedicated fitness apps generally require the producing company to have expertise and assets that allow them to create exercise content, e.g., workout coaches, green screen studios, stereoscopic capture, post processing pipelines. And because VR dedicated fitness apps create content on an ongoing basis to avoid user boredom, they are better suited than most other VR apps to be priced using a subscription model (although not all VR dedicated fitness apps follow this model).

18. The user base for VR dedicated fitness apps differs from that of VR overall. VR users generally skew younger and male, but VR dedicated fitness app users tend to have an older and more female set of users. In addition to the diverse appeal of VR dedicated fitness apps, they have strong user retention and rapid growth. Within touted these features in a presentation to Meta in April 2021, estimating the "addressable market" for a Quest headset paired with a monthly Supernatural subscription to be 101 million people in North America, and suggesting that fitness could "expand [the] Quest market" to 28 million additional women over the age of 40. A year later, as of [redacted]. Some data suggests that users who [redacted].

19. Multiple companies that make VR dedicated fitness apps consider their products to compete with the extensive range of methods by which an individual can seek to exercise. According to Within, Supernatural "compete[s] with every product or service or offering that offers fitness or wellness," ranging from connected fitness devices like Peloton equipment to gyms to YouTube videos intended to be mimicked by a viewer. Within does not, however, consider a VR incidental fitness app to constitute a fitness offering. The founder of VirZoom, another VR company with a dedicated fitness app (VZfit), made similar claims, and added that VZfit even "compete[s] with somebody who wants to just jump on their bike and go for a bike ride." However, Odders Lab, another VR company that makes not only a dedicated fitness app but also a rhythm game app and a chess app, stated that its fitness app competed most directly with other fitness dedicated apps, such as Supernatural and FitXR, and that the launch of its fitness app had not diminished sales of its rhythm game app.

20. [redacted] Apple provides Fitness+, a paid subscription app, and [redacted], but it does not currently offer its own headset.

21. The customers for more established fitness offerings are perceived to be more likely to have long-term or well-developed fitness routines, while VR dedicated fitness app users are targeted more toward "fitness strugglers" who have less fitness experience. No record evidence

suggests that these firms possess VR engineering expertise. As such, these fitness offerings do not create the 360-degree embodiment in a virtual environment provided by VR dedicated fitness apps. Although some fitness offerings may display videos of various locations around the world, those videos are displayed on a flat screen.

22. Connected fitness devices are generally stationary and larger than the portable and relatively small VR headset equipment required to use a VR dedicated fitness app. The upfront device cost can be over $1,000, and users pay a monthly subscription fee to access fitness content; for example, Peloton and Tonal are connected fitness device companies, and cost, respectively $1,445 plus $44 per month and $3,495 plus $49 per month. There are also more affordable alternatives outside of VR, such as a Peloton mobile app-only subscription, which costs $12.99 per month. The subscription model is common in the overall fitness industry—in addition to the examples above, traditional gyms and Fitness+ charge monthly subscriptions.

23. Within's VR app Supernatural is a dedicated fitness app: it was designed specifically for fitness and offers "daily personalized full-body workouts and expert coaching from real-world trainers." Within began developing Supernatural in February 2019, and launched it in the Quest Store on April 23, 2020. Supernatural now offers over 800 fully immersive video workouts set to music in various photorealistic landscapes, such as the Galapagos Islands and the Great Wall of China. Through deals with major music studios, Supernatural sets each workout to songs from A-list artists like Katy Perry, Imagine Dragons, Lady Gaga, and Coldplay. Within optimized the exercise movements in Supernatural through consultations with experts holding PhDs in kinesiology and biomechanics; the workouts are led by personal trainers, calibrated to users' range of motion, mapped out in VR by dance choreographers, and filmed at Within's studio in Los Angeles. Within's founders are experienced directors of interactive music videos. Due to limitations on Within's music licensing rights, Supernatural is only available to Quest headset users in the United States and Canada.

24. Other VR dedicated fitness apps include FitXR, Les Mills Bodycombat, VZfit, VZfit Premium, PowerBeats VR, RealFit, Holofit, Liteboxer, Liteboxer Premium VR, and VRWorkout. Singer Report ¶ 39. Like Supernatural, Liteboxer Premium VR costs $18.99 per month. Les Mills Bodycombat, PowerBeatsVR, and RealFit have respective one-time costs of $29.99, $22.99, and $19.99; Liteboxer and VRWorkout are free; and the other VR dedicated fitness apps charge monthly subscription prices ranging from about $9 to $12. Companies producing VR dedicated fitness apps generally pursue business strategies optimized for growth and market penetration, often at the cost of operating at a loss. These companies expect that high growth and penetration metrics will render them attractive acquisition targets.

25. All of these apps, including Supernatural, were launched within the past five years. New VR dedicated fitness apps are expected to launch in the near future. Supernatural currently possesses an 82.4% share of market revenue among the existing VR dedicated fitness apps (or a 77.6% share of VR apps in the Quest Store's "Fitness and Wellness" category).

26. The FTC's economics expert, Dr. Singer, analyzed the concentration of the VR dedicated fitness app market using the Herfindahl-Hirschman Index ("HHI"). Dr. Singer performed the HHI calculation multiple times to account for different conceptions of the firms contained within the VR dedicated fitness app market. Using a set of firms based off a list of Supernatural competitors provided by Meta to the FTC, Dr. Singer calculated an HHI of 6,917 by measuring each firm's market share of revenue. Then, to capture broader potential set of firms within the VR dedicated fitness app market, Dr. Singer analyzed all apps listed in Meta's Quest Store under its "Fitness & Wellness" category and calculated an HHI of 6,148 (again, based on revenue).

Dr. Singer also calculated HHI using market share of total hours spent and identified outputs 6,307 for the set of firms based off Meta's list and 4,863 for the broader set of "Fitness & Wellness firms." Lastly, Dr. Singer calculated HHI using market share of monthly active users and identified outputs of 3,377 and 2,098 for the two respective sets of firms. Markets are generally considered "highly concentrated" when the HHI is above 2,500 and "moderately concentrated" when the HHI is between 1,500 and 2,500.

D. The Challenged Acquisition

27. Meta and Zuckerberg first expressed interest in acquiring Within as early as February 22, 2021.

28. After Zuckerberg showed some interest in [redacted], Michael Verdu (Vice President of VR Content) investigated and [redacted].

29. On March 11, 2021, Meta employees met to discuss potential VR fitness investments with Mark Rabkin, the head of VR technology at Meta and one of the final decision makers to approve any VR investment. In advance of this meeting, Ananda Dass (Meta's director of non-gaming VR content) and Jane Chiao (business-side employee) prepared a pre-read document analyzing five potential investment options. Shortly before this meeting, on March 4, 2021, Jane Chiao had also prepared a document titled, [redacted]. During the meeting, the attendees decided [redacted].

30. On March 17, 2021, Dass and Chiao summarized the advantages and disadvantages of acquiring Supernatural [redacted]. At this time, they proposed spending the next few months inquiring into [redacted].

31. On April 20, 2021, Melissa Brown (Head of Developer Relations) prepared an executive summary pre-read in advance of Meta's meeting with Within, which was circulated to Verdu and Dass. The executive summary contains analyses into Within's VR portfolio, Supernatural's business model and performance, past partnership with Oculus, long-term goals, and future opportunities with Meta.

32. On April 26, 2021, Brown circulated a [redacted].

33. On May 26, 2021, Anand Dass [redacted]. At that point, Meta's acquisition focus had been primarily on [redacted]. The news that Within may soon be acquired by Apple accelerated Meta's internal decision-making processes to acquire a VR fitness app developer.

34. Frank Casanova (Apple's senior director of augmented reality product marketing) testified that Apple [redacted] Casanova's personal recollection was that [redacted].

35. In mid-July 2021, Meta and Within entered into a non-binding term sheet regarding a potential acquisition. Meta and Within executed the Merger Agreement on October 22, 2021.

E. Beat Saber Expansion Proposal

36. Beat Saber is a VR rhythm game in which players use virtual swords to slash oncoming blocks timed to music. Beat Saber is the most popular and best-selling VR app of all time.

37. Meta acquired Beat Games, the studio that produces Beat Saber, in late 2019.

38. At the time it acquired Beat Games, Meta viewed Beat Saber as a potential "vector into fitness as a game-adjacent use case." There was a continuing internal dialogue at Meta regarding a potential fitness version of Beat Saber, which was referred to as the "perpetual white whale quest to get ... Beat Games to build a fitness version of Beat Saber." The founders of Beat

Games were "warm to the idea" and released a "FitBeat" song for Beat Saber, but the idea otherwise did not gain traction.

39. On February 16, 2021, Rade Stojsavljevic (director of Meta's first party studios) was riding his Peloton bike on a workout with a live DJ spinning music when he came up with the idea of a Peloton partnership with Beat Saber.

40. Shortly thereafter, Stojsavljevic collaborated on a presentation called "Operation Twinkie," in which he proposed repositioning Beat Saber as a fitness app in a partnership with Peloton. The same presentation recommended [redacted]."

41. On March 4, 2021, Chiao responded to comments regarding partnering with Peloton to create VR content, expressing doubts as to the feasibility of repositioning Beat Saber into a fitness app.

42. On March 11, 2021, Stojsavljevic attended the VR fitness investment meeting with Mark Rabkin. Alongside the acquisitions of [redacted] Supernatural, the March 11 meeting concluded that Stojsavljevic was to prepare a presentation to Rabkin to expand Beat Saber to dedicated fitness.

43. On March 15, 2021, Stojsavljevic queried a group chat and solicited feedback on his proposal for a Beat Saber–Peloton partnership. The group members discussed different forms the partnership could take.

44. On March 25, 2021, Stojsavljevic received a presentation from a consultant, [redacted], titled "Beat Saber x Peloton Opportunity Identification." The presentation provided a quote for [redacted] to investigate the Beat Saber and Peloton opportunity, which was to take about 8 weeks and cost $23,500. Id. at 8. [redacted]'s proposed research approach included nine action items, as follows: (1) analyze the home fitness market; (2) analyze the Peloton market; (3) assess the Peloton bike capabilities; (4) analyze the current XR[1] fitness market; (5) analyze Beat Saber's current strategy and its Fitbeat song; (6) identify Beat Saber x Peloton opportunities; (7) identify XR fitness opportunities; (8) define the go-to-market approach; and (9) define how to approach Peloton with the partnership. Stojsavljevic ultimately did not engage [redacted] to undertake this research project.

45. Based on the parties' representations and to the best of the Court's review of the evidence, the next reference to the Beat Saber–Peloton proposal was on June 11, 2021, after Meta began pursuing Within as an acquisition target. In a chat, Stojsavljevic briefly mentioned that Chiao and Dass had disagreed with his Beat Saber–Peloton proposal and had wanted to [redacted]. At the evidentiary hearing, Stojsavljevic testified that his enthusiasm for the Beat Saber–Peloton proposal had "slowed down" before Meta's decision to acquire Within. He also testified that he had not undertaken the research project that he had promised Rabkin because he had been busy working on another Meta acquisition.

46. On September 15, 2021, during a pause in Meta's merger negotiations with Within, Jason Rubin—who had just transitioned into his role as the vice president of Metaverse content on August 1, 2021—made comments about Beat Saber in response to the stalled negotiations. Rubin suggested that building "Beat Fitness" could be an alternative to the Within acquisition. He subsequently remarked that repositioning Beat Saber into fitness would be a difficult and delicate project.

[1] The Court understands "XR" to refer generally to virtual reality, augmented reality, and mixed reality.

II. PROCEDURAL HISTORY

Defendants signed an Agreement and Plan of Merger for a proposed acquisition of Within by Meta (the "Acquisition") on October 22, 2021. On July 27, 2022, the FTC filed a complaint for a temporary restraining order and preliminary injunction enjoining the Acquisition. At the time of the FTC's filing, Defendants would have been free to consummate the Acquisition after July 31, 2022. On July 29, 2022, the Court granted the parties' stipulated order preventing Defendants from consummating the Acquisition until after August 6, 2022. On August 5, 2022, the Court granted the parties' second stipulated order and entered a temporary restraining order enjoining the Acquisition until after December 31, 2022. The FTC filed its amended complaint on October 7, 2022 and Defendants moved to dismiss the amended complaint on October 13, 2022 ("MTD"). The Court took the MTD under submission without oral argument on December 2, 2022.

On October 31, 2022, pursuant to the parties' stipulated order, the FTC filed its memorandum in support of its motion for a preliminary injunction (the "Motion"). The evidentiary hearing on the Motion began on December 8, 2022. *** The evidentiary hearing concluded on December 20, 2022 and the Court granted the parties' stipulated order extending the temporary restraining order to enjoin the Acquisition until January 31, 2023.

On January 31, 2023, the FTC filed an emergency motion requesting an extension of the temporary restraining order if the Court either was not prepared to rule on the Motion until after that date or denied the Motion ("Emergency Motion"). The Court's ruling on the Emergency Motion will be filed in a separate order. ***

III. LEGAL CONCLUSIONS

A. Legal Standard

Section 13(b) of the FTC Act provides that "[u]pon a proper showing that, weighing the equities and considering the Commission's likelihood of ultimate success, such action would be in the public interest, and after notice to the defendant, a temporary restraining order or a preliminary injunction may be granted without bond." 15 U.S.C. § 53(b)(2). In evaluating a motion for preliminary injunction brought under Section 13(b), courts must "1) determine the likelihood that the Commission will ultimately succeed on the merits and 2) balance the equities." *F.T.C. v. Warner Commc'ns Inc.*, 742 F.2d 1156, 1160 (9th Cir. 1984) (emphasis added) (citing *F.T.C. v. Simeon Mgmt. Corp.*, 532 F.2d 708, 713–14 (9th Cir. 1976)).

The federal court is not tasked with "mak[ing] a final determination on whether the proposed merger violates Section 7, but rather [with making] only a preliminary assessment of the merger's impact on competition." Warner Commc'ns Inc., 742 F.2d at 1162. To obtain a preliminary injunction, the FTC must "raise questions going to the merits so serious, substantial, difficult and doubtful as to make them fair ground for thorough investigation, study, deliberation and determination by the FTC in the first instance and ultimately by the Court of Appeals." Id. (citations omitted) *** .

B. Relevant Market Definition

The first step in analyzing a merger challenge under Section 7 of the Clayton Act is to determine the relevant market. *U.S. v. Marine Bancorporation, Inc.*, 418 U.S. 602, 619 (1974) (citing *E.I. Du Pont*, 353 U.S. 586, 593 (1957)). The relevant market for antitrust purposes is determined by (1) the relevant product market and (2) the relevant geographic market. *Brown Shoe Co. v. U.S.*, 370 U.S. 294, 324 (1962).

1. Product Market

"The outer boundaries of a product market are determined by the reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it." *Brown Shoe*, 370 U.S. at 325. "Within a general product market, 'well-defined submarkets may exist which, in themselves, constitute product markets for antitrust purposes.'" *Hicks v. PGA Tour, Inc.*, 897 F.3d 1109, 1121 (9th Cir. 2018) (quoting *Brown Shoe*, 370 U.S. at 325). The definition of the relevant market is "basically a fact question dependent upon the special characteristics of the industry involved." *Twin City Sportservice, Inc. v. Charles O. Finley & Co., Inc.*, 676 F.2d 1291, 1299 (9th Cir. 1982). Products need not be fungible to be included in a relevant market, but a relevant market "cannot meaningfully encompass th[e] infinite range" of substitutes for a product. Id. at 1271 (quoting *Times Picayune Publishing Co. v. United States*, 345 U.S. 594, 611, 612 n. 31, (1953)). The overarching goal of market definition is to "recognize competition where, in fact, competition exists." *Brown Shoe*, 370 U.S. at 326.

Courts have used both qualitative and quantitative tools to aid their determinations of relevant markets. A qualitative analysis of the relevant antitrust market, including submarkets, involves "examining such practical indicia as industry or public recognition of the submarket as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors." *Brown Shoe*, 370 U.S. at 325). A common quantitative metric used by parties and courts to determine relevant markets is the Hypothetical Monopolist Test ("HMT"), as described in the U.S. Department of Justice and the FTC's 2010 Merger Guidelines. U.S. Dep't of Justice & FTC, Horizontal Merger Guidelines ("2010 Merger Guidelines") § 4 (2010).

There is "no requirement to use any specific methodology in defining the relevant market." *Optronic Techs., Inc. v. Ningbo Sunny Elec. Co., Ltd.*, 20 F.4th 466, 482 (9th Cir. 2021). As such, courts have determined relevant antitrust markets using, for example, only the *Brown Shoe* factors, or a combination of the *Brown Shoe* factors and the HMT. *** The FTC proposes a relevant product market consisting of VR dedicated fitness apps, meaning VR apps "designed so users can exercise through a structured physical workout in a virtual setting." Mot. 13. According to the FTC, VR dedicated fitness apps are distinct from (1) other VR apps and (2) other fitness offerings. To differentiate their proposed market from other VR app markets, the FTC claims that VR dedicated fitness apps have distinct customers and pricing strategies. The FTC further argues that VR dedicated fitness apps are in a separate market from other fitness offerings (e.g., gyms, at-home fitness equipment) because they provide users with "fully immersive, 360-degree environments," are fully portable, save space, cost less, and target a different type of consumer. The FTC claims that these qualitative product differences satisfy the *Brown Shoe* practical indicia of a relevant market, and that the Hypothetical Monopolist Test conducted by the FTC's economics expert further confirms the relevant product market definition.

Unsurprisingly, Defendants disagree. They claim that the FTC's proposed market is impermissibly narrow because it excludes "scores of products, services, and apps" that are "reasonably interchangeable" with VR dedicated fitness apps, including dozens of VR apps categorized as "fitness" apps on the Quest platform, fitness apps on gaming consoles and other VR platforms, and non-VR connected fitness products and services. Defendants argue that members of the FTC's proposed market subjectively consider other VR apps and other fitness offerings to be competing products, and that several such products also possess the very features—portability, immersion, and pricing models—that the FTC highlights as distinguishing or unique to its proposed market. ***

In this case, the Court finds the FTC has made a sufficient evidentiary showing that there exists a well-defined relevant product market consisting of VR dedicated fitness apps.

a. *Brown Shoe* Analysis

The Court first examines in turn each of the *Brown Shoe* factors, i.e., "practical indicia [such] as industry or public recognition of the submarket as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors." 370 U.S. at 325.

i. Industry or Public Recognition

The evidence indicates that Defendants and other VR dedicated fitness app makers viewed VR dedicated fitness apps as an economic submarket of VR apps. For example, in April 2021, Within represented that fitness could "expand [the] Quest market" to 28 million additional women over the age of 40. Within also estimated the "addressable market" for the purchase of a Quest headset paired with a monthly Supernatural subscription included 101 million people in North America. Within's contemporaneous view of untapped market segments indicates that a "fitness first" app paired with a VR headset—i.e., a VR dedicated fitness app—would be in a distinct segment of the overall VR market. Likewise, as explained in greater detail in the sections below, Meta repeatedly stated that VR dedicated fitness apps constituted a distinct market opportunity within the VR ecosystem due to their unique uses, distinct customers, and distinct prices. And a representative the VR app company Odders Lab testified that the launch of its VR dedicated fitness app did not diminish sales of its VR rhythm app, acknowledging that its VR fitness app "compete[d] more directly with fitness dedicated applications than gaming applications." Industry companies' internal communications showing frequent distinctions between various categories of applications is "strong[ ] support" of a distinct submarket. *Klein*, 580 F. Supp. 3d at 758.

Participants in the broader fitness industry also recognized VR fitness as a "separate economic entity." [redacted]. See *United States v. Microsoft Corp.*, 253 F.3d 34, 53 (D.C. Cir. 2001) (rejecting inclusion of middleware products in the relevant market where middleware was a potential, rather than current, competitor). *** Defendants' evidence shows that there is a broad fitness market that includes everything from VR apps to bicycles. This in no way precludes the existence of a submarket constituting a relevant product market for antitrust purposes. *Brown Shoe*, 370 U.S. at 325. *** The Court therefore acknowledges that VR dedicated fitness apps compete for consumers with every manner of exercise (including gyms, bike rides, and connected fitness), but finds that Defendants and the broader fitness industry recognized VR dedicated fitness apps as an economically distinct submarket.

ii. Peculiar Characteristics and Uses

The evidence indicates that VR dedicated fitness apps have several "peculiar characteristics and uses" in comparison to both other VR apps and non-VR fitness offerings. *Brown Shoe*, 370 U.S. at 325. Even assuming "[a]lmost all VR applications require body movement," VR dedicated fitness apps are "specifically marketed to customers for the purpose of exercise." To support that marketing, VR dedicated fitness apps (unlike other VR apps) are often characterized by their fitness-specific features, such as trainer-led workout regimens, calorie tracking, and the ability to set and track progress toward fitness goals. See, e.g., Paynter Dep. 24:2–12 ("what [Meta] used to call [dedicated] fitness apps now correspond to a category ... call[ed] ... trainer workout apps"); PX0487, at 4 (VR dedicated fitness apps are "[d]esigned to allow a player to deliberately set and attain fitness goals, with fitness-specific features i.e. coaching, trackable progress"); PX0001, at 5 n.10 ("Meta draws a distinction between apps designed to allow users to set and attain fitness goals, with features like coaching and trackable progress (called 'deliberate' or 'dedicated' fitness apps) and games whose primary focus is not fitness that allow users to get a workout as a byproduct (sometimes called 'incidental' or 'accidental' fitness apps).").

The most "peculiar characteristic" of VR dedicated fitness apps in comparison to non-VR fitness offerings is, of course, the VR technology itself. A VR user is "embodied" in a virtual environment. Zuckerberg Hr'g Tr. 1298:5–6. She is "teleported to a different place, feeling like when you move your head and look around, you're in a new space and seeing virtual things as if they are real, which is virtual reality." Rabkin Hr'g Tr. 835:24–836:3. Defendants' fitness industry expert, Dr. Vickey, submitted that non-VR fitness options could also be immersive, describing the non-VR Hydrow rowing machine as an "immersive exercise piece of equipment" because the Hydrow displayed video footage of various locations on a touchscreen the user viewed while rowing. The Court finds that no matter how crisp or accurate a video may be, a two-dimensional screen display is inherently far less immersive than a 360-degree environment. The evidence does not suggest—and the Court is not aware of—any other at-home fitness offering that can transport the user in this way. That a user of a VR dedicated fitness app can exercise in a VR setting is, therefore, a "distinct core functionality" indicative of a submarket. *Klein*, 580 F.Supp.3d at 767 (quoting *Datel Holdings, Ltd. v. Microsoft Corp.*, 712 F.Supp.2d 974, 997 (N.D. Cal. 2010)).

The FTC puts forth other hallmarks of VR dedicated fitness apps that generally differ from characteristics of non-VR fitness offerings. For example, the FTC argues that "VR headsets are fully portable and take up little space." Mot. 14. These appear to be distinguishing features in relation to bulky connected fitness devices, such as the Peloton Bike or Hydrow rowing machine, but Defendants persuasively argue that mobile fitness apps can offer these same functionalities. Nonetheless, the virtual reality fitness experience created by VR dedicated fitness apps appears to be vastly different from a workout conducted on a large and stationary device or based off a mobile phone screen.

With respect to "peculiar ... uses," Defendants have shown that consumers use non-VR fitness offerings for exercise. Defendants have additionally shown that consumers may use other VR apps for fitness. As explained above, the existence of a broader fitness market does not mean a relevant submarket does not exist. Defendants have themselves recognized the characteristics that distinguish VR dedicated fitness apps from other VR apps. E.g., PX0001, at 5 n.10 ("Meta draws a distinction between apps designed to allow users to set and attain fitness goals, with features like coaching and trackable progress (called 'deliberate' or 'dedicated' fitness apps) and games whose primary focus is not fitness that allow users to get a workout as a byproduct (sometimes called 'incidental' or 'accidental' fitness apps)."); Milk Hr'g Tr. 683:8–21 (Supernatural, unlike Beat Saber, "employed experts in movement and fitness[;] built companion apps for the phones and for heart rate tracking integration[; and] calibrate[d to a] range of motion so that [it would not] injury anybody."); see also Koblin Hr'g Tr. 606:5–8 ("VR games that require some incidental physical exertion" are not a fitness offering). The Court therefore finds that the "peculiar characteristics and uses" factor of the *Brown Shoe* analysis supports the finding that VR dedicated fitness apps constitute a relevant antitrust product market.

iii. Unique Production Facilities

The parties did not explicitly develop arguments regarding unique production facilities in support of their positions regarding the relevant product market. The Court notes, however, that VR dedicated fitness apps require a unique combination of production inputs. [redacted]. See Singer Report ¶ 82 ("[T]he talent needed to create true triple-A VR experiences is going to be scarce and really valuable in a few years."); Pruett Hr'g Tr. 286:6–8 ("I have an engineering team ... [who] are a group of veteran engineers who are particular experts in our VR technology and our hardware."). Similarly, most VR companies are unlikely to have the fitness expertise and equipment necessary to create content for VR dedicated fitness apps. See Koblin Hr'g Tr. 650:3–12 ("[I]t seemed highly unlikely to me that [Meta] would get into virtual reality fitness ... honestly at that level of depth, it just seemed extremely unlikely that they would hire coaches and build a green screen studio and dive deep into the psychology of what makes fitness fitness."); Garcia Hr'g Tr. 1079:16–24 ("[One of the things that we have done in Odders Lab whenever developing any of our apps has always been looking into – – been looking at the experts.... And for our fitness app, we also started reaching out to local experts.").

Although relevant markets are generally defined by demand-side substitutability, supply-side substitution also informs whether alternative products may be counted in the relevant market. *Twin City Sportservice, Inc.*, 512 F.2d at 1271 ("While the majority of the decided cases in which the rule of reasonable interchangeability is employed deal with the 'use' side of the market, the courts have not been unaware of the importance of substitutability on the 'production' side as well."); see also *Brown Shoe*, 370 U.S. at 325 n.42 ("The cross-elasticity of production facilities may also be an important factor in defining a product market.").

Supply-side substitution focuses on suppliers' "responsiveness to price increases and their ability to constrain anticompetitive pricing by readily shifting what they produce." *RAG-Stiftung*, 436 F.Supp.3d at 293 (citing *Rebel Oil Co. v. Atlantic Richfield Co.*, 51 F.3d 1421, 1436 (9th Cir. 1995) ("reasonable market definition must also be based on 'supply elasticity'")). Here, as explained above, the evidence indicates that neither general fitness firms nor general VR firms have the production facilities to readily produce a substitute VR dedicated fitness app product, even if VR dedicated fitness apps were to raise prices and make market entry more attractive. That existing companies are not easily able to alter their facilities to produce VR dedicated fitness apps is additional evidence that such apps constitute a distinct product market.5

iv. Distinct Customers

The FTC proffered evidence showing that users of VR dedicated fitness apps differ from those of other VR apps along multiple axes. Internal evaluations by Meta and Within found that although overall users of VR apps skewed younger and male, users of VR dedicated fitness apps tended to have an older and more female user base. For example, Meta claimed in its response to the FTC's Second Request regarding the Meta-Within transaction that the overall Quest user base was about [redacted]. VR fitness apps, on the other hand, drew far more women. Meta expected that VR dedicated fitness apps would expand the reach of virtual reality to new customer segments. To that end, Meta's Vice President of Metaverse Content informed the company's board of directors that "Supernatural, FitXR, and ... other fitness applications, ... unlike our gaming population ... had tended to be more successful with on average an older person, on average more women. It was a very different demographic, and ... we had always been in search of expanding VR beyond gaming into more of a general computing platform." PX0066 ("Rubin Dep.") 131:19–132:14; see also PX0127, at 6 ("[g]rowing [dedicated] fitness will broaden and diversify our user base, and bring on a disproportionate % of women).

Defendants acknowledge that VR fitness appeals to different user demographics than other VR apps. Defendants do, however, dispute that VR dedicated fitness apps have a customer base that is distinct from that of non-VR fitness offerings. The evidence indicates that VR dedicated fitness apps are targeted more toward "fitness strugglers" who have less fitness experience and more difficulty finding motivating fitness products (rather than to individuals who have long-term or well-developed fitness routines.) As stated by Within's executive vice president of business development and finance, it was "Within's understanding that Supernatural appeals to fitness strugglers in a way that other existing fitness products do not." PX0051 ("Cibula Dep.") 84:20–25. Within insiders also compared Supernatural to Peloton, Mirror, Tonal, Beachbody, and Obé Fitness, noting that "many ... shoppers are not comparing us necessarily to [these] leading fitness options." And in summer 2021—when Meta was in negotiations regarding the acquisition of Supernatural—a Meta employee described Within's business model as "encouraging users who don't think about fitness much as well as users with a light routine, not the fitness buff who is better served by the likes of Peloton cycling or Crossfit classes." PX0318, at 1, June 22, 2021; [redacted]. The Court finds the VR dedicated fitness apps have a customer base that is distinct from those of both other VR apps and several other fitness offerings—particularly connected device offerings from companies like Peloton.

v. Distinct Prices

The pricing of VR dedicated fitness apps likewise differs in at least one key respect from other VR apps and non-VR fitness offerings. The main difference in comparison to the former category is that VR dedicated fitness apps are more likely to have a subscription-based pricing model. As one of Within's founders testified, Within's daily release of new workout content requires ongoing revenue, which is supported by a subscription membership. Milk Hr'g Tr. 671:10–19. Likewise, Meta's Director of Content Ecosystem testified that "subscriptions are particularly good monetization strategies for [fitness] applications" because "fitness applications need to produce content on an ongoing basis ... in order to not get boring." Pruett Hr'g Tr. 269:9–23. However, subscription pricing does not provide a clear basis for delineating between VR dedicated fitness apps and other VR apps. Some VR dedicated fitness apps do not charge subscription fees and other VR apps may also be a good fit for subscription pricing. Nonetheless, the evidence indicates that "the majority of the video game applications on the Quest platform are not a good fit for subscriptions" including because "most of them don't have [an] ongoing content pipeline." Pruett Hr'g Tr. 270:12–17.

Many fitness offerings, whether virtual or physical, use subscription models. As Meta noted in its June 2022 white paper to the FTC, Supernatural's "monthly subscription model ... is similar in structure to other connected fitness solutions included specialized equipment solutions (e.g., Peloton, Mirror, Tonal), paid apps (e.g., Apple Fitness+), and other VR fitness apps (e.g., FitXR, Holofit, VZfit), as well as in-person gym memberships (e.g., Equinox, CrossFit, 24 Hour Fitness)." PX0001, at 2. The FTC argues that despite sharing a subscription pricing model, VR dedicated fitness apps tend to be "far less expensive" than "other at-home smart fitness devices." Mot. 14. The evidence supports this assertion with respect to several connected fitness devices—Supernatural, the most expensive VR dedicated fitness app,[6] costs $399 plus $18.99 per month. There are, however, digital fitness options—generally mobile phone apps—with subscriptions "in the sort of $8 to $12 range."

The Court finds that the VR app and non-VR pricing evidence tilts slightly in favor of the existence of a VR dedicated fitness app market. See, e.g., *FTC v. Tronox Ltd.*, 332 F.Supp.3d 187, 200–01 (D.D.C. 2018) ("The existence of distinct prices ... are 'not what one would expect if North American customers were willing and able to substitute one type of titanium dioxide for another in response to a change in their relative prices.'") (citations omitted). Testimony from both Within and Meta indicate a practical reason for VR fitness apps to be generally best served by a subscription pricing model, which is in line with broader non-VR fitness offerings. And VR dedicated fitness apps are much more affordable than the non-VR fitness products that come closest to offering the level of immersion available in VR. However, in light of the evidence that there exist both other VR apps that can strategically employ a subscription model and non-VR fitness offerings that are comparably priced to VR fitness apps, the overall weight of this factor is lessened.

vi. Sensitivity to Price Changes

The sixth *Brown Shoe* factor evaluates the change in sales of a possible substitute product given a change in the price of products within the relevant market. Because this is in essence the same question posed by the HMT, see *FTC v. Staples*, 970 F.Supp. 1066, 1075 (D.D.C. 1997), the Court will not duplicate its analysis here. Drawing from that analysis, the Court finds this factor to be neutral as to the existence of a VR dedicated fitness app market.

vii. Specialized Vendors

The final *Brown Shoe* factor considers whether a product's distribution requires vendors with specialized knowledge or practices. The FTC has not presented evidence that the VR dedicated fitness app market requires specialized vendors.

* * *

For the reasons explained above, the Court finds that the following *Brown Shoe* "practical indicia" support the FTC's assertion that VR dedicated fitness apps constitute the relevant product market: industry or public recognition; peculiar characteristics and uses; unique production facilities; distinct customers; and (to a lesser degree) distinct prices. These factors indicate that VR dedicated fitness apps present in-market firms with an economic opportunity that is distinct from both other VR apps and other fitness offerings. The Court therefore finds that the FTC has met its burden of showing that VR dedicated fitness apps constitute a relevant antitrust product market. *Brown Shoe*, 370 U.S. at 325–28.

b. Hypothetical Monopolist Test (HMT)

In the interests of thoroughness, the Court also addresses the parties' HMT arguments. The HMT is a quantitative tool used by courts to help define a relevant market by determining reasonably interchangeable products. *Optronic Techs., Inc.,* 20 F.4th at 482 n.1. The test asks whether a "hypothetical monopolist that owns a given set of products likely would impose at least a small but significant and nontransitory increase in price (SSNIP) on at least one product

[6] Some VR dedicated fitness apps charge a one-time price over $18.99, and another VR dedicated fitness app has a free version as well as a premium version priced equally to Supernatural at $18.99 per month. All other VR dedicated fitness apps charge subscriptions lower than $18.99 per month, and one is free.

in the market, including at least one product sold by one of the merging firms." See 2010 Merger Guidelines § 4.1.1. If enough consumers would respond to a SSNIP—often calculated as a five percent increase in price—by making purchases outside the proposed market definition so as to make the SSNIP not profitable, then the proposed market is defined too narrowly.

The FTC's economics expert, Dr. Singer, conducted a hypothetical monopolist test on the VR dedicated fitness app market. To inform his analysis of the response to a SSNIP in the VR dedicated fitness app market, Dr. Singer commissioned Qualtrics to conduct "a survey of Supernatural users to determine what fitness apps they perceive to be a reasonably close substitutes to Supernatural and to VR dedicated fitness products generally." Id. ¶ 60. Dr. Singer testified that although an economist's natural path would be to collect data about Supernatural customers' transactions and reactions to any price increases, such data was unavailable here because Supernatural has never changed its price from $18.99 per month. The survey was his "next best" option, and the approach is supported by the 2010 Merger Guidelines. Based on his analysis of the survey, Dr. Singer determined that VR dedicated fitness apps constituted a relevant market. *** These questions, among others, suggest that the survey data underlying Dr. Singer's HMT analysis may not be reliable, which in turn casts doubt on the conclusions to be drawn from the HMT. The Court's reservations about the survey do not change its finding that VR dedicated fitness apps constitute a relevant antitrust product market. Because the Court bases its determination of the relevant product market on its *Brown Shoe* analysis rather than the HMT, it need not determine the validity of Dr. Singer's survey methodology. ***

2. Geographic Market

*** The FTC asserts that the United States is the relevant geographic market, and Defendants do not argue to the contrary. *** Accordingly, the relevant antitrust market for the analysis of the competitive impacts of Meta's acquisition of Within is VR dedicated fitness apps in the United States.

C. Substantial Market Concentration

The FTC has challenged Meta's acquisition of Within on the basis that the merger would substantially lessen potential competition. The Supreme Court has taken note of two species of potential competition theories: actual potential competition and perceived potential competition. See *United States v. Falstaff Brewing Corp.*, 410 U.S. 526 (1973); *United States v. Marine Bancorporation, Inc.*, 418 U.S. 602 (1974). Although the two theories have different elements and are grounded in different presumptions about the market, they share a common requirement: they have "meaning only as applied to concentrated markets." *Marine Bancorporation*, 418 U.S. at 630–31. Because both doctrines posit that potential competitors can or will soon impact the market, there would be no need for concern if the market is already genuinely competitive.

In assessing whether the relevant market is "substantially concentrated," the Supreme Court sets forth a burden-shifting framework. First, the FTC may establish a prima facie case that the relevant market is substantially concentrated by introducing evidence of concentration ratios. Id. at 631. Once established, the burden shifts to the merging companies to "show that the concentration ratios, which can be unreliable indicators of actual market behavior, did not accurately depict the economic characteristics of the [relevant] market." Id. If the prima facie case is not rebutted, then the market is suitable for the potential competition doctrines.

1. Market Concentration Ratios

The Court finds that the FTC has sufficiently presented evidence using concentration ratios as permitted by *Marine Bancorporation*. Here, the FTC has provided the Herfindahl-Hirschman Index ("HHI")—a widely accepted measure of industry concentration frequently used by courts considering antitrust merger and acquisition actions—for the relevant market. The FTC's 2010 Merger Guidelines provide that a market is considered "moderately concentrated" when the HHI exceeds 1500 and "highly concentrated" when it exceeds 2500. 2010 Merger Guidelines § 5.3.

The FTC's expert, Dr. Singer, calculated the HHI multiple times, accounting for different market definitions and stipulations. Dr. Singer first calculated the HHI by measuring each firm's market share using revenue. This yielded an HHI of 6,917, with Supernatural possessing an 82.4% market share. Dr. Singer also calculated the market's HHI using "total hours spent" and "average monthly active users" as metrics and data collected from the Quest Store. The HHI for "total hours spent" was 6,307; and for "monthly active users" was 3,377.

The Court finds that—regardless of the metrics used—every one of these ratios reflect a market concentration well above what the Merger Guidelines have designated as "highly concentrated." Accordingly, the FTC have made their prima facie showing, and the burden shifts to Defendants to "show that the concentration ratios ... did not accurately depict the economic characteristics of the [relevant] market." *Marine Bancorporation*, 418 U.S. at 631.

2. Defendants' Pleading Challenges

Before continuing to Defendants' substantive arguments seeking to rebut the FTC's prima facie case, the Court first turns to the Defendants' legal attacks on the FTC's pleadings. Defendants argue that the FTC's case stumbles right out of the blocks because the complaint does not allege oligopolistic or "interdependent or parallel behavior." Mot. Dismiss FAC ("MTD") 10–13. Defendants' position arises from the following language in Marine Bancorporation:

> The potential-competition doctrine has meaning only as applied to concentrated markets. That is, the doctrine comes into play only where there are dominant participants in the target market engaging in interdependent or parallel behavior and with the capacity effectively to determine price and total output of goods or services.

418 U.S. at 631.

Defendants' argument is unpersuasive. Their fidelity to a stilted and strained reading of the Supreme Court's commentary conveniently dodges the actual burden-shifting framework that *Marine Bancorporation* set forth and applied. In fact, the Supreme Court held that the district court had erred by taking the precise course of action that Defendants urge the Court takes here, i.e., requiring the FTC to allege parallel behavior when it is Defendants' burden to present the absence. Id. ("In our view, *appellees did not carry this burden*, and the District Court erred in holding to the contrary. Appellees introduced no significant evidence of the absence of parallel behavior in the pricing or providing of commercial bank services in [the relevant market].") (emphasis added). *** Defendants also are unable to identify any authority that has adopted its proposed inversed framework, not even the one Fifth Circuit decision they cited. For all the reasons discussed, Defendants' theory that the FTC was required to plead oligopolistic, interdependent, or parallel behavior is without merit. To the extent Defendants' motion to dismiss the FAC is premised on this theory, the Court DENIES Defendants' motion.

3. Economic Characteristics of the "VR Dedicated Fitness App" Market

The FTC having established a prima facie case of "substantial concentration" using concentration ratios, the burden now shifts to Defendants to rebut that showing that "the concentration ratios ... did not accurately depict the economic characteristics of the [relevant] market." *Marine Bancorporation*, 418 U.S. at 631. The touchstone inquiry, however, appears to be whether the relevant market "is in fact genuinely competitive." *Marine Bancorporation*, 418 U.S. at 631The Court addresses each argument that Defendants have raised in rebuttal.

The Court first makes an opening observation that there appear to be at least some characteristics of the market that may be difficult to express with concentration ratios. If nothing else, both parties seem to agree that the VR dedicated fitness app market is a nascent and emerging market, which would be an economic characteristic of the market not fully captured by the concentration ratios. However, the Court must consider whether those characteristics indicate that the market is genuinely competitive.

Nascency. The Court has received conflicting expert evidence from both parties as to whether nascent markets are more or less vulnerable to coordinated oligopolistic behaviors. Dr. Carlton submits that a nascent market with rapidly evolving products is more difficult to coordinate behaviors, while Dr. Singer has asserted that there is no accepted economic theory to support the segmentation of nascent, adolescent, or mature markets.

The evidence presented suggests that companies in the VR dedicated fitness market do not exhibit revenue or profit-maximizing behaviors, such as price competition. Instead, their strategies appear to be optimized for growth and penetration—even if they end up operating at a loss—with the expectation that those qualities will render them an attractive acquisition target. See, e.g., Milk Hr'g Tr. 736:15–21 ("We haven't focused on profitability. We've focused on growth. And it also is important to potential acquirers ... because they're not buying you for the revenue, they're buying you for some larger strategic reason conceivably."); Zyda Hr'g Tr. 1227:18–22, 1228:15–18 ("[S]tartups that work in the VR space can get acquired, and that's pretty much the dream of almost every startup."). It is unclear to the Court how this departure from conventional profit-maximization strategies—an assumption often made in defining antitrust markets, see 2010 Merger Guidelines § 4.1.1 (noting that the HMT "requires [ ] a hypothetical profit-maximizing firm")—should affect the assessment of genuine competition in this market.[8]

Notwithstanding the experts' robust economics discussions, neither party has presented the Court with a working definition of "nascency," such that it can distinguish a nascent market from a more mature market. Rather, the parties appear to use the "nascency" label—however the lines are drawn—as a proxy for other more observable market descriptions, such as highly differentiated products, unstable market shares, and new entrants. Accordingly, the Court will give limited weight to the fact that the VR dedicated fitness market may be characterized as a nascent market and focus instead on the underlying market indicators.

Market Share Volatility. Dr. Carlton claims that the VR dedicated fitness market exhibits changing market shares, but he does not provide any historical data or evidence that the market shares have changed over time. Instead, Dr. Carlton relies on the fact that none of the apps were in existence five years ago, that new entries are occurring, and on Dr. Singer's data on changes in other But new entrants do not necessarily result in shifting or deconcentrating market shares,

[8] Indeed, the many novel questions of law presented by this case may signal an ill fit between these long-standing antitrust doctrines and the structures of modern technology markets.

and Defendants have not presented evidence of actual historical shifts in shares for the relevant market here. Moreover, [redacted].

New Entrants. Defendants and Dr. Carlton have made much ado about the incoming entrants and the fact that the FTC's relevant market has effectively doubled since the initiated this litigation. Although the "introduction of new firms and fluid condition of market entry and exit can indicate competitive behavior," the bottom line is that these new entrants have not significantly deconcentrated the market, nor do they suggest a trend towards such deconcentration. *Black & Decker*, 430 F.Supp. at 751.

Barriers to Entry. Defendants rely on the new entrants into the market as evidence that barriers to entry are low. However, the number of new entrants "does not belie the substantial entry barriers characteristic of the [relevant] market." *Black & Decker*, 430 F.Supp. at 751. The evidence presented suggest that barriers to entry are existent but are not insurmountable. As the Court discusses further in this order, there are several ingredients required for a potential entrant considering entry into the VR dedicated fitness app entrant, including financial resources, VR engineering resources, fitness experience and content creation, and studio production capabilities. On the other hand, for most potential entrants into any VR app market, Meta provides grants, software development kits, infrastructure code, and even engineering support to third-party VR app developers.

Having considered the VR dedicated fitness app market's nascency, volatility, new entrants, barriers to entry, and price competition, the Court is inclined to find that Defendants have not rebutted the FTC's prima facie case. The Court certainly appreciates that a nascent market with an emerging technology may have some features and market incentives that are not captured by concentration ratios. However, the evidence does not support a finding that the VR dedicated fitness app market exhibits the characteristics or desirable behaviors of a competitive market. And as the Supreme Court noted in *Falstaff Brewing*, the absence of "blatantly anti-competitive effects" may not necessarily preclude the propriety of potential competition theories, because the high degree of market concentration indicates that the "seeds of anti-competitive conduct are present." 410 U.S. 526, 550. That said, because the Court finds infra that the FTC has not satisfied the other elements of the potential competition theories they have brought, the Court need—and does not—decide whether the Defendants' showing here is sufficient to rebut the FTC's prima facie case on substantial concentration.

D. Actual Potential Competition

The FTC first argues that the Acquisition would substantially lessen competition because it deprives the VR dedicated fitness app market of the competition that would have arisen from Meta's independent entry into the market, a theory known as the "actual potential competition" or "actual potential entrant" doctrine. See, e.g., *United States v. Marine Bancorporation, Inc.*, 418 U.S. 602, 633 (1974). Although the Supreme Court has twice declined to resolve the doctrine's validity when presented, it has nonetheless identified two essential preconditions before the theory can be applied: (1) the alleged potential entrant must have "available feasible means for entering the [relevant] market other than by acquiring [the target company]"; and (2) those "means offer a substantial likelihood of ultimately producing deconcentration of that market or other significant procompetitive effects." Id. The doctrine has since been applied by Courts of Appeal and district courts alike, though the Ninth Circuit has not yet had an opportunity to provide guidance on the actual potential competition theory.

Although "available feasible means" for entry may be established either by de novo entry or a toehold acquisition, the FTC has not argued that Meta could have entered the relevant market through a toehold acquisition, nor does it identify any company in the relevant market that could have served as such a target. ***Accordingly, the Court will only consider whether Meta had "available feasible means" for entering the relevant market de novo.

1. Threshold Issues

Before discussing the evidence, the Court first turns to three threshold disputes of law between the parties, which are: (1) the continued vitality of the actual potential competition theory; (2) the standard of proof the FTC must meet; and (3) the roles and consideration of objective and subjective evidence.

a. Doctrinal Validity

Throughout this litigation, Defendants have sought to cast doubt as to the very existence of the actual potential competition theory because it has never been fully endorsed by the Supreme Court. Notwithstanding Defendants' doubts, this doctrine has been applied by multiple Circuit Courts of Appeal, e.g., *Yamaha Motor Co. v. FTC*, 657 F.2d 971 (8th Cir. 1981); *United States v. Siemens Corp.*, 621 F.2d 499 (2d Cir. 1980); *FTC v. Atl. Richfield Co.*, 549 F.2d 289 (4th Cir. 1977); the Federal Trade Commission itself, *Altria Group, Inc.*, 2022 WL 622476 (Feb. 23, 2022); *B.A.T. Industries*, 1984 WL 565384 (Dec. 17, 1984); and various district courts, including one that ordered divestiture upon a finding of actual potential competition and whose judgment was affirmed by the Supreme Court. *United States v. Phillips Petroleum Co.*, 367 F. Supp. 1226 (C.D. Cal. 1973), aff'd sub nom. *Tidewater Oil Co. v. United States*, 418 U.S. 906 (1974). Given 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. To the extent Defendants' motion to dismiss sought dismissal of the FTC's actual potential competition claim on the basis that it is a "dead-letter doctrine," Defendants' motion is DENIED.

b. Standard of Proof

There is less consistency among courts as to the proper standard of proof by which the FTC must prove its case on actual potential competition, and it is an issue of first impression within the Ninth Circuit. The Fourth Circuit has held that the FTC must establish its case with "strict proof." *Atl. Richfield*, 549 F.2d at 295. The Second Circuit has asked whether a defendant "would likely have entered the market in the near future." *Tenneco, Inc. v. FTC*, 689 F.2d 346, 352 (2d Cir. 1982) (emphasis added). The Fifth Circuit adopted the "reasonable probability" standard, which it remarked "signifies that an event has a better than fifty percent chance of occurring [with a] 'reasonable' probability represent[ing] an even greater likelihood of the event's occurrence." *Mercantile Texas Corp. v. Bd. of Governors*, 638 F.2d 1255, 1268–69 (5th Cir. 1981). The Eighth Circuit also appeared to adopt the "reasonable probability." *Yamaha Motor*, 657 F.2d at 977 (defining the inquiry as "would [defendant], absent the joint venture, *probably* have entered the [relevant] market independently") (emphasis added). Finally, the FTC itself has unambiguously adopted a "clear proof" standard. *B.A.T. Industries*, 1984 WL 565384, at *10.

In the absence of guiding Ninth Circuit law, the Court begins with *Brown Shoe's* teaching that Section 7 deals with neither certainties nor ephemeral possibilities but rather "probabilities." *Brown Shoe Co. v. U.S.*, 370 U.S. 294, 323 (1962). In the context of an actual potential competition claim, however, the Court must not only consider the effects of future scenarios where the Acquisition occurs and where it is blocked, but it must also gauge the likelihood—in the second scenario—that the blocked would-be acquirer would enter the relevant market independently. Furthermore, the harm to competition the doctrine aims to prevent is not the loss of present competition but rather the potential loss of a future competitor (the acquiring company). Given the many a priori inferences required by the doctrine, the Court is wary of any inquiry that strays too close to the specters of ephemeral possibilities, yet it must nonetheless ensure the standard does not require the FTC to operate on certainties. The Court accordingly holds that the "reasonable probability" standard—as clarified by the Fifth Circuit to suggest a likelihood noticeably greater than fifty percent—is the standard of proof that the FTC must present.

To the extent Defendants' motion to dismiss is based on the assertion that the correct standard of proof is "clear proof," the Court DENIES Defendants' motion.

c. Objective vs. Subjective Evidence

Finally, the Court reaches the parties' disagreement as to the roles of objective and subjective evidence. The FTC asserts that it may meet its burden using solely objective evidence regarding Meta's "overall size, resources, capability, and motivation." Mot. 18–19. Defendants, meanwhile, strenuously emphasize subjective evidence that Meta never had any plan to enter the Relevant Market de novo and would not do so if the Acquisition is blocked.

Courts have uniformly recognized the highly probative value of objective evidence in evaluating whether a potential entrant is reasonably probable to enter the market de novo; the disagreement only arises as to whether plaintiffs can satisfy their burden using only objective evidence and whether subjective evidence should warrant any consideration. *** Many courts have also consulted both objective and subjective evidence in reaching their conclusions. *** Here, the Court will first consider whether the objective evidence presented by the FTC supports the findings and conclusions necessary to satisfy the actual potential competition doctrine. If the objective evidence is weak, inconclusive, or conflicting, the Court will consult subjective evidence to illuminate the ambiguities left by the objective evidence, with the understanding that the subjective evidence cannot overcome any directly conflicting objective evidence.

2. Objective Evidence

Having disposed of the threshold questions, the Court now proceeds to apply the doctrine. The inquiry can be stated as follows: "Is it reasonably probable that Meta would have entered the VR dedicated fitness app market de novo if it was not able to acquire Within?"[9] "In exploring the feasible means of entry alternative to the challenged acquisition, the court must analyze the incentive and capability of the acquiring firm to enter the relevant market." *Black & Decker*, 430 F.Supp. at 755. The Court thus considers in turn the objective evidence on Meta's capabilities and incentives to enter the VR dedicated fitness app market.

a. Capabilities of Entry

There can be no serious dispute that Meta possesses the financial resources to undertake a de novo entry. Meta has spent over $12.4 billion in the most recent fiscal year on its VR business, and it anticipates investing more in the VR space. Unsurprisingly, Meta also enjoys a deep and talented pool of engineers in its Reality Labs Division, who could provide the technical VR expertise to develop a VR dedicated fitness app should Meta so choose. In fact, Meta maintains

[9] As noted above, because the FTC has not argued that Meta could have entered the relevant market through a toehold acquisition, the Court considers only the question of de novo entry.

a team of "veteran engineers who are particular experts in [Meta's] VR technology and hardware" and who work directly with third-party VR app developers to "improve the quality of their software or help them fix bugs or [ ] polish the experience that the developer is building." Pruett Hr'g Tr. 286:4–12. The Court finds that the objective evidence establishes that Meta has the financial resources and ready access to qualified VR engineers to enter the VR dedicated fitness app market de novo.

But financial and engineering capabilities alone are insufficient to conclude it was "reasonably probable" that Meta would enter the VR dedicated fitness app market. Indeed, Meta seems willing to concede—as is supported by the evidence—that it "does not take a large team or substantial resources to make a successful VR app." Defs.' Findings ¶ 53. Instead, courts often counterbalance undisputed financial capabilities with those capabilities unique to the relevant market, rarely relying solely on the potential entrant's substantial wherewithal. The Court here finds that Meta lacked certain capabilities that are unique and critical to the VR dedicated fitness app market. See PX0127, at 7 (noting that Meta "will need to build 4 new [fitness] functions that are not part of Facebook's pipelines; Content development, instructors, studio production ..., music rights & technology.").

First and foremost, although Meta has an abundance of VR personnel on hand, it lacks the capability to create fitness and workout content, a necessity for any fitness product or market. See PX0111 ("The answer is content creation.... You need that content variety to serve different ability levels, musical tastes, instructor personalities, etc."), Feb. 23, 2021. As a comparison, Supernatural's VR workouts are led by personal trainers and are optimized for VR activity through consultations with experts holding PhDs in kinesiology and biomechanics. Certainly, this absence is not an insurmountable obstacle; Meta could conceivably circumvent it by partnering with an established fitness brand to provide the fitness content, as Odders Lab did with Les Mills.10 FTC's Findings ¶¶ 123, 148. Regardless of any potential workarounds, the objective fact that Meta presently lacks the capability to create fitness content is, at the very least, probative as to the reasonable probability that Meta would enter the VR dedicated fitness app market de novo.

In addition to fitness content, the evidence also indicates that Meta lacked the necessary studio production capabilities to create and film VR workouts. Once again comparing to Supernatural, Within records daily workout classes in its Los Angeles studio, and its founders have directed several interactive music videos. When Meta employees were strategizing VR fitness investments, they recognized that "studio production (e.g. green screen ops, stereoscopic capture, post processing pipelines)" was a new function that was "not part of Facebook's pipelines."11 PX0127, at 7, Mar. 10, 2021. Contrary to the FTC's suggestion, the Court finds that Meta's acquisition of Armature Studio—a third-party VR studio with expertise in co-developing VR apps—does not provide the necessary studio production capabilities to develop a VR dedicated fitness app. The evidence indicates that Armature is very much a game studio, not a production studio [redacted] PX0527, at 6 (listing Armature's [redacted] The FTC highlights an internal Meta presentation that presented Armature as an acquisition target who could "build a fitness-first product based on Beat Saber x their sports experience.") However, the basis for this suggestion comes not from any prior production studio experience but rather Armature's experience developing the rendered VR video game, Sports Scramble. As with Meta's fitness expertise, its lack of production studio capabilities to film a VR fitness workout is a relevant—though less compelling—factor for the Court's "reasonably probable" consideration.

b. Incentives to Enter

In addition to the objective evidence presented of Meta's capabilities of entering the VR dedicated fitness app market, the Court also considers the objective evidence of Meta's incentives and motivations for entering this market.

Users and Growth. The record is replete with evidence supporting Meta's interest in the VR fitness space. Defs.' Findings ¶ 280 ("[E]mployees at Reality Labs were interested in fitness as a promising VR use case"). First, fitness is a use for VR that appeals to a more diverse population, specifically consumers that are female and older. Id. ¶ 280 (citing testimony). This demographic is notably distinct from the typical VR demographic, which tends to skew younger and more male. Fitness is also "retentive," meaning that users will tend to regularly use the product or app. PX0386, at 12 (fitness apps had a "strong [redacted] retention"), Apr. 12, 2022. Meta's internal data also indicated that "deliberate fitness apps" were the "fastest growing segment" with [redacted] year-over-year growth. These promising demographic, use, and growth metrics are especially important to Meta, because it has "bet[ ] on VR technology as a general computing platform to join today's PCs, laptops, smartphones, and tablets." Defs.' Findings ¶ 44.

Although they undergird Meta's undisputed interest in VR fitness, the aforementioned factors provide limited probative value in assessing Meta's likelihood to enter the VR dedicated fitness app market itself. As the Court established earlier in this section, the relevant inquiry is whether it is "reasonably probable" that Meta would have entered the VR dedicated fitness app market de novo, not whether Meta was excited about or interested in more generally investing in VR fitness. Meta's interest in the promising VR fitness app metrics—diverse appeal, strong user retention, rapid growth—stems from the potential for broader VR adoption and market penetration. And Meta, as a competitor in the VR headset market, benefits from that growth so long as high-quality VR fitness apps exist in the VR ecosystem; Meta need not itself be a player in that ecosystem. This mutually beneficial relationship between the VR platform and third-party VR apps distinguishes this case from other potential competition cases where potential entrants are typically incentivized to enter the relevant market because they are not capturing any of the neighboring market's growth or profitability. The Court accordingly does not find that these specific features of the VR dedicated fitness app market increase the probability that Meta would enter the market de novo, because Meta would enjoy those incentives even if it remained outside the relevant market and provided funding or technical support for in-market VR fitness app developers, as it already does.

Hardware Integration. Apart from the incentives arising from the VR fitness market itself, the evidence also reflects one other incentive that arises from Meta's direct participation in the relevant market. Specifically, entering the VR dedicated fitness app market with its own app would facilitate Meta's subsequent development of fitness-related VR hardware. This is an incentive to "first-party" entry that is acknowledge across multiple instances of internal contemporaneous correspondence at Meta. That said, the evidence also suggests that de novo entry is not strictly necessary to develop fitness hardware, though independent entry into the market could streamline that development.

Profitability. Finally, there is some evidence of the relevant market's profitability and that it [redacted] PX0386, at 12. The profitability of the relevant market is unsurprisingly a relevant incentive that many courts consider. While this factor is often quite salient in other potential competition cases, it is somewhat muted here, [redacted]. PX0062 ("Milk Dep.") 19:8–12. Of course, a market's current profitability does not reflect its future profitability, especially if that market is exhibiting rapid growth as the VR dedicated fitness app market does here. Nonetheless, the fact that [redacted] would indicate that the profitability of the relevant market warrants less consideration than it otherwise would.

* * *

Having reviewed and considered the objective evidence of Meta's capabilities and incentives, the Court is not persuaded that this evidence establishes that it was "reasonably probable" Meta would enter the relevant market. Meta's undisputed financial resources and engineering manpower are counterbalanced by its necessary reliance on external fitness companies or experts to provide the actual workout content and a production studio for filming and post-production. Furthermore, the record is inconclusive as to Meta's incentives to enter the relevant market. There are certainly some incentives for Meta to enter the market de novo, such as a deeper integration between the VR fitness hardware and software. However, it is not clear that Meta's readily apparent excitement about fitness as a core VR use case would necessarily translate to an intent to build its own dedicated fitness app market if it could enter by acquisition.

On balance, the objective evidence does not so "strongly point to the feasibility of entry de novo" that the Court should decline to consider subjective evidence of intent. *Falstaff Brewing*, 410 U.S. at 570.

3. Subjective Evidence

The Court first notes that it will accord little weight to subjective evidence and statements provided by Meta employees during the course of this litigation. Although they are relevant, entitled to some weight, and no doubt offered by persons of character, the bias affiliated with such ex post facto testimony is widely recognized and unavoidable. In reviewing the subjective evidence in the record, the Court will refer primarily to contemporaneous statements made by Meta employees.

The record reveals certain documents created contemporaneously by Meta employees that appear to set forth Meta's overall third-party VR investment strategy, along with individualized analyses of various VR fitness investment options. PX0492 ("Quick Fitness/M&A Thoughts"), Mar. 9, 2021; PX0127 ("VR Fitness Content investment thesis v2"), Mar. 10, 2021; PX0146 ("FB Inc Fitness Strategy Working Draft"), June 18, 2021. The FTC has represented that these documents were sponsored by Meta employees: Rade Stojsavljevic, who oversaw all of Meta's first-party VR gaming studios (Stojsavljevic Hr'g Tr. 69:18–24); Anand Dass, Meta's director of non-gaming VR content (id. 138:11–18); and Jane Chiao, a business-side employee who reported directly to Mark Rabkin, the head of VR technology at Meta (id. 140:23–141:1, Rabkin Hr'g Tr. 800:7–11). Furthermore, exhibit PX0127 was a "pre-read" circulated in advance of a meeting with Mark Rabkin, see Stojsavljevic Hr'g Tr. 149:16–151:12, who would have been one of the decisionmakers needed to sign off on any significant VR fitness investment. These are not "memoranda of lower echelon [ ] employees." *Siemens*, 621 F.2d at 508. Accordingly, the Court finds that the statements in these documents reflect the thoughts and impressions of relatively significant stakeholders, as the authors were generally one or two people away from the final decisionmaker.

The evidence contained in these strategy documents is consistent—Meta's subjective motivations to enter the relevant market were primarily to (1) better develop VR fitness hardware or (2) ensure the continued existence of a high-quality VR fitness app in the market. The Court notes that these incentives would apply to both entry by acquisition and entry de novo, though perhaps not with equal force.

First, this subjective evidence corroborates the objective evidence that Meta primarily wanted to be a first-party firm in the VR dedicated fitness market so it could improve its VR fitness hardware (e.g., headsets, heart monitor, wrist straps). See PX0492, at 2 ("Deep integration with hardware and software to create best in class experience that other devs can follow"); PX0127, at 7 [redacted] PX0146 ("1P content is not a goal in itself – it is only in the service of broader platform objectives (e.g., help accelerate progress of market phases).") (emphasis added). The importance of this incentive is supported by internal Meta communications. See PX0179, at 2 (noting that "strategic rationale already exists" to pursue VR fitness, which was to "[c]reate option value for [Meta's device], software platform and hand tracking"), Mar. 11, 2021.

Second, the evidence also indicates that Meta would want to enter the VR dedicated fitness app market if the availability of VR fitness apps was at risk of becoming constrained and, therefore, Meta could ensure that at least one high-quality VR fitness app remained in the market. Specifically, as early as March 2021, Meta employees were expecting Apple to "lock in" VR fitness content to be exclusive with Apple's VR hardware. This incentive was also corroborated by contemporaneous communications. The evidence also suggests that this incentive was the primary animating factor that ultimately compelled Meta to pursue Within as an acquisition. See, e.g., PX0117 (noting that the news that Within was pursued by Apple "accelerated everything").

Meta's prior ventures into other VR app markets also do not support a subjective intention or proclivity to build its own apps as opposed to an acquisition. Courts have considered a potential entrant's history of acquisitions and expansions in determining its likelihood of de novo entry. The evidence indicates that Meta has tended to build its own VR app where the experience did not call for specialized or substantive content, e.g., Horizon Worlds (a world-building app where other users can create worlds in VR), Horizon Workrooms (a productivity app), Horizon Venues (a live-events app), Horizon Home (social networking app). Meta's Answer and Affirmative Defenses ¶ 35; see also PX0056 ("Carmack Dep.") 101:15–23 (indicating Meta does not have "anything internally developed that was a hit outside of our browser application"). Meanwhile, Meta has acquired other VR developers where the experience requires content creation from the developer, such as VR video games, as opposed to an app that hosts content created by others. With respect to fitness, the Court finds that VR dedicated fitness is more akin to a gaming app—where the emphasis is on the content created or provided by the developer—than a browser or world-building app, where the value is derived from the users' own creativity rather than the developers'. Accordingly, based on Meta's past entries into VR app markets, the evidence would suggest an interest in entry by acquisition instead of entry de novo.

But even more pertinent than the record of Meta's past entries into VR app markets is the evidence that Meta had consciously considered and appeared doubtful of the proposition to build its own independent VR fitness app. The pre-read strategy document prepared for Mark Rabkin's attention contains a separate section that "[i]t will be hard to build Fitness from scratch." Specifically, a VR fitness app would require Meta to [redacted] Id. The document also recognized that Meta would have to "build new kinds of expertise at the intersection of software, instructor-led fitness, music, media." Id. The decision not to build Meta's own VR fitness app is corroborated by the lack of any other contemporaneous discussion on the topic. The record does, however, indicate that Meta attempted to gauge whether it could expand Beat Saber together with a fitness partner, a prospect the Court delves into further below.

In sum, the subjective evidence indicates that Meta was subjectively interested in entering the VR dedicated fitness app market itself, either for hardware development or defensive market purposes. However, the Court again notes that these incentives would support both market entry by acquisition and de novo, but the Court's inquiry is only concerned with the feasibility of de novo entry. For instance, even though Meta's concern about [redacted] was an incentive to acquire Within, that incentive does not apply with equal force [redacted]. And, as the Court elaborates below, the evidence shows that all these factors—Meta's capabilities and incentives, both objective and subjective—did not result in Meta ever seriously contemplating a de novo entry, i.e., building its own VR fitness app.

4. Identified Means of Entry

Up to this point, the Court has only addressed Meta's capabilities, incentives, and intent to enter the VR dedicated fitness app market in the abstract. However, an assessment of the probability and feasibility of a hypothetical de novo entry would not be complete without addressing the actual means of entry that Meta considered. Nevertheless, the FTC has implied that the Court may infer that Meta would have entered the market de novo—irrespective of its actual plans for entry—using "available feasible means" unbeknownst to the parties or the Court. See FTC Closing Hr'g Tr. 1494:16–18 ("We don't have to show that Meta actually had a subjective intention to enter the market."). To the extent the FTC implies that—based solely on the objective evidence of Meta's resources and its excitement for VR fitness—it would have inevitably found and implemented some unspecified means to enter the market, the Court finds such a theory to be impermissibly speculative. *** [I]nsofar as the FTC implies Meta could overcome its lack of fitness experience and content creation by hiring experts or partnering with a fitness brand, the suggestion reflects "the kind of unsupported speculation" rejected in *Tenneco*. 689 F.2d at 354 (rejecting the FTC's "conclusion that [potential entrant] would have entered the market de novo with the aid of a license" for the necessary technology).

The Court here does not hold that every case of actual potential competition will require consideration of a potential entrant's actual and subjective plans for entry. See Falstaff Brewing, 410 U.S. at 565 ("We have certainly never suggested that subjective evidence of likely future entry is required to make out a § 7 case.") (Marshall, J., concurring). Nor does the Court suggest that a particular entry strategy can only be "reasonably probable" and "feasible" if it has reached a certain inflection point in the firm's decision-making process. Such a conclusion would incentivize corporate gamesmanship and reward decisionmakers for reaching merger decisions hastily without exploring non-merger alternatives. See generally id. at 563–71 (Marshall, J., concurring). However, where the objective evidence is "weak or inconclusive" and does not "strongly point[ ] to the feasibility of entry de novo," id. at 570, it is incumbent on the Court to consider the potential entrant's actual plans of entry for the purposes of ensuring that Section 7 enforcement does not veer into the realm of ephemeral possibilities. As applied here, the Court holds that the FTC may not rest solely on evidence of Meta's considerable resources and the company's clear zeal for the VR dedicated fitness app market as a whole; the evidence must show that Meta had some feasible and reasonably probable path to de novo entry.

Turning then to the evidence, the record indicates that Meta would only have entered by acquisition or a Beat Saber collaboration with a fitness content creator; the Court is unaware of any evidence that Meta considered building a VR fitness app on its own. In the strategy document that was prepared for the meeting with Mark Rabkin, Meta personnel had outlined and analyzed five options for investing in VR fitness: (1) acquire Within and Supernatural; (2) acquire [redacted]; (3) expand Beat Saber into deliberate fitness, likely by partnering with Peloton; (4) increase funding for development of third-party VR fitness apps; and (5) do nothing and maintain the status quo. PX0127, at 2–4. The record reflects that, although Meta initially pursued the first three options in parallel, the frontrunner was the [redacted] acquisition until approximately June 2021 when Meta pivoted to acquire Within. See, e.g., PX0179, at 1–2 (indicating that action items included pursuing due diligence for both Supernatural and [redacted] and having Stojsavljevic "present a proposal to Rabkin on expanding Beat Saber to deliberate fitness"), Mar. 11, 2021; PX0284, at 1 (drafting email to Michael Verdu summarizing the "pros/cons of [redacted] vs. Supernatural"), Mar. 18, 2021; DX1012, at 1, 3 ("[Zuckerberg] asked if we were engaged with [Within].... [Bosworth] responded that our focus has been on [redacted]"), May 26, 2021. Notably, even though Meta personnel had considered the option to increase third-party funding without entering the market and an option to do nothing as comparison, there was never an option for Meta to build its own VR dedicated fitness app to enter the market de novo.

Given the degree of analysis evident from these strategy documents, the Court finds that Meta had only considered the acquisition of Within, the acquisition of [redacted], and the partnership of Beat Saber with Peloton as feasible means to enter the relevant market. These three options, therefore, comprise the universe of "available feasible means" that the Court will consider for the purposes of the FTC's actual potential competition claim.

a. Entry by Acquisition

Meta's first two means of entry into the relevant market were both entries by acquisitions, either [redacted]. The evidentiary record indicates that these two options were both among the earliest proposals presented to Mark Zuckerberg, as well as the last two considered before Meta decided to acquire Within.

The evidence supports a finding that, but for its pursuit of Within as an acquisition, there was a reasonably probability [redacted]. However, the inquiry before the Court is not whether it was reasonably probable that Meta [redacted]. The FTC has argued almost exclusively that Meta's "available feasible means" of entering the relevant market is by de novo entry, not acquisition. The FTC also does not take the position [redacted] that could have also conceivably had procompetitive effects. See, e.g., Mot. 21 (noting that Meta's entry into the market would have "introduce[ed] a strong, well-established new rival to Supernatural and FitXR"); see also *Marine Bancorporation*, 418 U.S. at 625 (defining a toehold acquisition as a "small existing entrant").

Accordingly, the Court does not consider the "reasonable probability" that Meta could have entered the VR dedicated fitness market [redacted] as an "available feasible means" for the purposes of the actual potential competition analysis.

b. Entry by Beat Saber–Peloton Partnership

This brings us to the final means—and the FTC's main theory—by which Meta could have entered the VR dedicated fitness market: expanding its existing rhythm game app Beat Saber into dedicated fitness and partnering with a fitness brand. The FTC claims that Meta scrapped this Beat Saber proposal once it learned that Within was at risk of being acquired by Apple. However, this theory is neither supported by the contemporaneous remarks regarding the Beat Saber proposal nor the timing of the subsequent investigation into this proposal.

First, the evidentiary record is unclear as to what exactly the widely referenced Beat Saber–Peloton proposal would even look like. On some occasions, Stojsavljevic—the proposal's primary advocate—refers to it as a "brand licensing w/ Peloton" or a "co-branding ... Peloton mode inside Beat Saber." PX0144, at 1, Mar. 8, 2021; PX0407, at 1, Mar. 15, 2021. On other occasions, Stojsavljevic considers whether the proposal would be a separate Quest Store app. Michael Verdu—another proponent of expanding Beat Saber into fitness—also recalled that the proposal never reached a point of "understanding what that partnership would look like." Verdu Dep. 201:14–23 ("[I]s it a Peloton-branded headset? Is it Peloton-branded content inside of our headset? Like we didn't even get to the point where we were exploring at that level of detail."). This uncertainty is consistent with the March 2021 "Beat Saber x Peloton Opportunity Identification" presentation that [redacted] prepared at Stojsavljevic's request, which indicated that part of [redacted] task would be to define the partnership opportunity and determine how to present the proposal to Peloton. Ultimately, Stojsavljevic did not even engage [redacted] to proceed with her proposed research into the Beat Saber proposal.

Second, the Beat Saber–Peloton proposal did not enjoy uniform or even widespread support among the Meta personnel who were researching VR fitness opportunities. See PX341, at 2 ("Jane and Anand were arguing with me [Stojsavljevic] when I was proposing Beat Saber x Peloton and thought we should buy [redacted] or Supernatural instead."), June 11, 2021. Particularly, Jane Chiao had consistently and contemporaneously expressed doubts regarding the feasibility of repositioning Beat Saber to fitness. See PX0492, at 1, 7 ("Jane's quick thoughts" included a section titled "Why not Beat Saber?" setting forth reasons against pivoting Beat Saber to fitness), Mar. 9, 2021. In one exchange, Chiao commented that "1/ I think it's confusing for users on what the [proposed Beat Saber fitness] app is for.... 2/ I think it takes a lot longer and more expertise than we have (and can hire for given constraints) to build out a fitness version." PX0251, at 2, Mar. 4, 2021. Chiao's opinion was informed by the previous difficulties she had in attempting to reposition Meta's social functions for other uses. Id. at 2–3 [redacted]

Third, the timeline and dearth of contemporaneous internal discussions on the Beat Games–Peloton proposal is inconsistent with the FTC's narrative that the Within acquisition derailed an otherwise full-speed effort to explore the Beat Games proposal. See generally DDX07 (Defendants' timeline demonstrative), at 31. In short, the idea was raised and endorsed by Stojsavljevic on March 11, 2021; he solicited feedback from his peers a few days later; and on March 25, 2021, he received a quote for a contractor to look into the proposal, but did not proceed with it. After this initial scramble, the record reflects no further discussion about expanding Beat Saber into fitness before June 2021, when Meta began pursuing Within as an acquisition. Although the FTC argues that there is no direct evidence that Meta had deliberately dropped the Beat Saber proposal, the absence of active discussions could just as reasonably—and the Court finds that it does—support Meta's explanation that the Beat Saber proposal had lost momentum after March 2021. The proposal's main driver, Stojsavljevic, testified that he had already "slowed down before [Meta's decision to pursue Within]," because he was busy with another Meta acquisition. Stojsavljevic Hr'g Tr. 165:12–17. Although subjective corporate testimony is generally deemed self-serving and entitled to low weight, Stojsavljevic's lack of bandwidth is corroborated by his contemporaneous decision to outsource the research for the Beat Games proposal.

Moreover, when viewed alongside Meta's history with Beat Saber, these two months of inactivity between March and June 2021 appear to have been the norm rather than the exception. Although Meta employees like Verdu were excited about Beat Saber's potential as a vector into fitness, Meta has never been able to execute on that excitement in any of the years since they acquired Beat Saber. Verdu Dep. 178:12–20 ("[I]t was the perpetual white whale quest to get ... Beat Games to build a fitness version of Beat Saber, which was like pushing on a string. We tried and tried and tried, and they never picked it up."); see PX0123 ("[Beat Fitness] was on the goal list for the [beat] saber acquisition.... But that goal was never followed up on."), Sept. 15, 2021. *** For all these reasons, the Court finds that it was not "reasonably probable" that Meta would have repositioned their top-selling VR app, Beat Saber, into a dedicated fitness app, even assuming that it could have identified a partner willing to provide VR fitness content.

* * *

After reviewing the evidentiary record and the parties' arguments, the Court concludes that it is not "reasonably probable" that Meta would enter the market for VR dedicated fitness apps if it could not consummate the Acquisition. Though Meta boasts considerable financial and VR engineering resources, it did not possess the capabilities unique to VR dedicated fitness apps, specifically fitness content creation and studio production facilities. As a VR platform developer, Meta can enjoy many of the promising benefits of VR fitness growth without itself intervening in the VR fitness app market. Finally, the proposal for Meta to expand Beat Saber into fitness was not "reasonably probable" for a whole host of reasons, in addition to the aforementioned obstacles to Meta's de novo entry.

Accordingly, the Court finds that Meta did not have the "available feasible means" to enter the relevant market other than by acquisition. Because the FTC has not met its burden on this element, the Court does not proceed to the issue of whether Meta's de novo entry was substantially likely to deconcentrate or result in other procompetitive effects in the relevant market.

In so finding, the Court concludes that the FTC has failed to establish a likelihood that it would ultimately succeed on the merits as to its Section 7 claim based on the actual potential competition theory.

E. Perceived Potential Competition

In addition to its claim that the Acquisition would lessen competition pursuant to the actual potential competition theory, the FTC also claims that the Acquisition violates Section 7 under the perceived potential competition theory. FAC ¶¶ 97–102. Under this theory, the FTC argues that the Acquisition would eliminate the competitive influence that Meta exerts on firms within the relevant market by virtue of its presence on the fringes of the market. See, e.g., *United States v. Falstaff Brewing Corp.*, 410 U.S. 526, 559–60 (1973).

To prevail on a claim that the Acquisition would have eliminate perceived potential competition, the FTC must establish—in addition to showing a highly concentrated market, see Section III.C—the following: (1) Meta possessed the "characteristics, capabilities, and economic incentive to render it a perceived potential de novo entrant"; and (2) Meta's "premerger presence on the fringe of the target market in fact tempered oligopolistic behavior on the part of existing participants in that market." *United States v. Marine Bancorporation, Inc.*, 418 U.S. 602, 625 (1974). The same objective facts regarding Meta's capability of entering the market under an actual potential competition theory are also "probative of violation of § 7 through loss of a procompetitive on-the-fringe influence." *Falstaff Brewing*, 410 U.S. at 534 n.13. However, whereas a claim for actual potential competition may consider the potential entrant's intent to enter the market, a perceived potential competition claim ignores the potential entrant's subjective intent to enter the market and instead focuses on the subjective perceptions of the in-market firms.

1. Potential Entrant Characteristics

In evaluating the FTC's perceived potential competition claim, the Court considers the same objective evidence regarding Meta's capabilities and incentives to enter the relevant market. Unsurprisingly, and for the same reasons explained above, the objective evidence in the record is insufficient to support a finding that it was "reasonably probable" Meta would enter the relevant market for purposes of the perceived potential competition doctrine.

Nor does the subjective evidence of the in-market firms' perceptions move the needle on this point. Although the FTC produced some evidence that Within co-founders and employees had expressed concern that Beat Saber or its fans could create a fitness version to compete with Supernatural, these statements are mostly stale with some significantly preceding the relevant time period. The FTC's strongest evidence that Within had considered Beat Saber a potential entrant were statements made before Meta announced its acquisition of Beat Saber in November 2019 and before Supernatural even entered the VR market in April 2020. See, e.g., PX0627, at 2 (comparing pricing to Beat Saber's model), Feb. 27, 2019; PX0619 (Q: "Is there a competitor you're most concerned about?" A: "Most concerned about Beat Saber's high degree of polish on visual effects, sound effects, and haptics, as well as its growing name awareness"), June 10, 2019; PX0730, at 1 ("I continue to believe that we need to differentiate and drastically improve on [Beat Saber] more than we recognize."), Sept. 10, 2019. The FTC has only produced one document that post-dates Supernatural's launch, which is a June 2020 "Supernatural Product Strategy" presentation that noted Within was concerned about "Other VR games (Beatsaber decides to get into fitness)." PX0615, at 8. However, even this document's weight is undercut by the fact that it was created nearly a year before Meta began pursuing Within as an acquisition target.

Furthermore, subsequent but still contemporaneous evidence indicated that Within eventually came to perceive Beat Saber as a "video game and not a fitness service." DX1083, at 10, Sept. 22, 2020. In a September 2020 text conversation with a Within investor, Within's co-founder Chris Milk explained that the concern about Beat Games "came up when we were first launching and quickly went away once people started using us." Id. at 7. *** In summary, the evidentiary record indicates that [redacted] This finding, in addition to the overall absence of testimony from other in-market firms, would suggest that the FTC has failed to demonstrate that it was "reasonably probable" that Meta was perceived as a potential competitor into the relevant market. However, even if the FTC had prevailed on this element, the Court is convinced that it did not satisfy the second required showing for a perceived potential competition claim.

2. Tempering Effect

Under the second element of the perceived potential competition claim, the FTC must establish that Meta's "premerger presence on the fringe of the target market in fact tempered oligopolistic behavior on the part of existing participants in that market." *Marine Bancorporation*, 418 U.S. at 624–25 (emphasis added). In other words, the FTC must present evidence that it was "reasonably probable" that Meta's presence as a potential competitor had a direct effect on the firms in the VR Dedicated Fitness market.

In setting forth this standard, the Court rejects the FTC's suggestion that it need only provide "[p]robabilistic proof of 'likely influence' on existing competitors." Mot. 21. This interpretation arises from the language used by the Supreme Court in a footnote from *Falstaff Brewing*, specifically "[t]he Government did not produce *direct evidence* of how members of the [relevant] market reacted to potential competition from [the potential entrant], but circumstantial evidence is the lifeblood of antitrust law." 410 U.S. at 534 n.13 (emphasis added). The Court reads this language to mean the FTC need not provide direct evidence of Within adopting its conduct to account for Meta's presence (e.g., a hypothetical internal email at Within expressly communicating fear of Meta's imminent entry and taking actions in anticipation). Direct evidence, however, is distinguishable from evidence of a direct effect experienced within the relevant market (e.g., circumstantial evidence that Within reduced prices shortly after Meta's hypothetical public announcement that it was looking into the VR Dedicated Fitness market). This interpretation is supported by the Supreme Court's statement of the law in *Marine Bancorporation*, 418 U.S. at 624–25 (requiring "presence ... in fact tempered oligopolistic behavior") and the Second Circuit's interpretation in *Tenneco, Inc. v. FTC*, 689 F.2d 346, at 358 ("The Commission is correct that it need not produce direct evidence that [acquired company] altered its actions in response to a perception of [potential entrant] 'in the wings.' However, it must produce at least circumstantial evidence that [potential entrant's] presence probably *directly affected* competitive activity in the market.") (emphasis added). Accordingly, the FTC must produce some evidence—direct or circumstantial—that Meta's presence had a direct effect on the firms in the relevant market.

Under this standard, the FTC's evidence on this element is insufficient. The only evidence that suggests any kind of effect in the relevant market is that Within cited, as reasons not to reduce headcount at Within shortly before launching Supernatural, [redacted]. As noted above, Within and Supernatural had not even entered the relevant market at the time of this presentation. Consequently, this cannot be evidence of a direct effect within the VR dedicated fitness app market; rather, they are the preemptive considerations of a firm contemplating entry into the market. Moreover, the evidence indicates that Within had subsequently changed its perception of Beat Saber and Meta as potential entrants after it had entered the market. Other than this presentation, the FTC suggests that Meta had affected Within based on internal Within communications that they "expect [to] have more competition soon. We need to keep innovating from the foundation we've built." PX0621, at 2, Dec. 8, 2020. Although this is circumstantial evidence that Within was concerned about hypothetical potential entrants, absent further evidence, this email is no basis to infer the critical nexus, i.e., that Meta was one such potential entrant.

The Court recognizes that its interpretation of the "effect" requirement sides with Defendants' position set forth in their Motion to Dismiss. Although the Court ultimately determines that the FTC's evidence has not established that Meta's presence had a direct effect on Within's behavior, it finds that the FTC's pleadings are sufficient. The FTC had alleged that Within was "concerned about making any moves that would hurt its ability to compete against Meta as a potential entrant" and provided an example. At the pleadings stage, this satisfies their burden. Accordingly, the Court DENIES Defendants' motion to dismiss the perceived potential competition claim.

In summary, the Court finds that the objective evidence does not support a reasonable probability that firms in the relevant market perceived Meta as a potential entrant. Even if it did, the Court finds that there is no direct or circumstantial evidence to suggest that Meta's presence did in fact temper oligopolistic behavior or result in any other procompetitive benefits. Accordingly, the FTC has not demonstrated a likelihood of ultimate success as to its Section 7 claim arising from perceived potential competition.

F. Balancing of Equities

Because the FTC has not demonstrated a likelihood of ultimate success on the merits per the first § 13(b) element, the Court need not proceed to the balance the equities in the second portion of the § 13(b) inquiry.

IV. CONCLUSION

Based on the foregoing reasons, the Court ORDERS as follows:

1. Defendants' Motion to Dismiss is DENIED;
2. Defendants' Motion to Strike is DENIED AS MOOT; and
3. Plaintiff's Motion for Preliminary Injunction is DENIED.

IT IS SO ORDERED.

Illumina, Inc. v. Federal Trade Commission

___ F.4th ___ (5th Cir. December 15, 2023)

EDITH BROWN CLEMENT, Circuit Judge: The Federal Trade Commission determined that Illumina, Inc.'s acquisition of Grail, Inc. violated Section 7 of the Clayton Act, and therefore ordered that the merger be unwound. Because the Commission applied an erroneous legal standard at the rebuttal stage of its analysis, we VACATE the Commission's order and REMAND for further proceedings.

I.

A.

Founded in 1998, Illumina is a publicly traded, for-profit corporation that specializes in the manufacture and sale of next-generation sequencing ("NGS") platforms. NGS is a method of DNA sequencing that is used in a variety of medical applications. In September 2015, Illumina founded a wholly-owned subsidiary, Grail, which was so-named because its goal was to reach the "Holy Grail" of cancer research—the creation of a multi-cancer early detection ("MCED") test that could identify the presence of multiple types of cancer from a single blood sample.

Grail was incorporated as a separate entity in January 2016. Illumina maintained a controlling stake in the company until February 2017 when, to raise the capital needed to move Grail's MCED test from concept to clinical trials, Illumina decided to bring in outside investors. This spin-off reduced Illumina's equity stake in Grail to 12%. By September 2020, Grail had raised $1.9 billion through a combination of venture capital and strategic partners. Then, on September 20, 2020, Illumina entered into an agreement to re-acquire Grail for $8 billion, with the goal of bringing Grail's now-developed MCED test to market.

The MCED-test industry had changed dramatically between February 2017—when Illumina spun Grail off—and September 2020—when Illumina agreed to re-acquire Grail. Grail's MCED test—which it named Galleri—had acquired a breakthrough device designation from the U.S. Food and Drug Administration ("FDA"), and Grail had published promising results from a clinical study concerning the initial version of Galleri and was undergoing additional clinical studies to validate its updated version. Meanwhile, Thrive Earlier Detection Corporation had announced that the initial version of its own MCED test—CancerSEEK—had also been clinically validated. And other MCED tests—including Singlera Genomics, Inc.'s PanSeer—were in development. All of the MCED tests in development—including Galleri, CancerSEEK, and PanSeer—relied on Illumina's NGS platforms for sequencing, and there were no available alternatives.

Given their reliance on Illumina's NGS platforms, Illumina's customers—both within and without the MCED-test industry—expressed concern about whether they would be able to continue to purchase Illumina's NGS products post-merger on the same terms and conditions as pre-merger. So, Illumina developed a standardized supply contract (the "Open Offer") that it made available to all for-profit U.S. oncology customers on March 30, 2021. The Open Offer is irrevocable, may be accepted by a customer at any time until August 18, 2027, became effective as of the merger's closing, and will remain effective until August 18, 2033. Among other terms, the Open Offer requires Illumina to provide its NGS platforms at the same price and with the same access to services and products that is provided to Grail.

Grail first offered Galleri for commercial sale in April 2021 as a laboratory-developed test.[1] While Galleri is the only NGS-based MCED test currently available on the market, others expect to go to market soon and to directly compete with Galleri. Illumina's NGS platforms are still the only means of sequencing MCED tests and will remain so for the foreseeable future.

B.

On March 30, 2021—the same day Illumina released its Open Offer— the FTC's Complaint Counsel issued a complaint alleging that the Illumina-Grail merger agreement, if consummated, would violate Section 7 of the Clayton Act.[2] The merger was, in fact, consummated on August 18, 2021, but, due to ongoing regulatory review by the European Commission, Illumina held—and continues to hold—Grail as a separate company.

The FTC's Chief Administrative Law Judge ("ALJ") convened an evidentiary hearing on August 24, 2021. In the coming months, the parties developed an extensive evidentiary record consisting of over 4,500 exhibits and the live or deposition testimony of fifty-six fact witnesses and ten experts. Based on this record, the ALJ issued his initial decision on September 1, 2022. The ALJ found that Complaint Counsel failed to prove that the merger was likely to cause a substantial lessening of competition in the market for the research, development, and commercialization of MCED tests. Specifically, the ALJ concluded that Complaint Counsel had not shown a likelihood that Illumina would foreclose against Grail's rivals because Grail has no current competitors in the market to be foreclosed, the MCED tests in development would not be a good substitute for Grail's test, and any foreclosing activities would cause harm to Illumina's NGS-sales business. In any event, the ALJ determined, the Open Offer "effectively constrains Illumina from harming Grail's alleged rivals and rebuts the inference that future harm to Grail's alleged rivals, and thus future harm to competition, is likely."

Complaint Counsel appealed the ALJ's decision to the Commission, and, after oral argument, the Commission reversed. Upon its de novo review, the Commission concluded that the merger was likely to substantially lessen competition in the market for the research, development, and commercialization of MCED tests. The Commission found that the ALJ had factually erred in discussing the capabilities of Grail and other MCED tests in development, improperly focused on foreclosure harm to MCED tests on the market today as opposed to tests in development, and failed to recognize that any losses to Illumina's NGS sales would be more than offset by Illumina's expected gains in clinical testing. The Commission also held that the Open Offer was a remedy that should not be factored into the liability analysis. But the Commission evaluated the Open Offer as rebuttal evidence anyway, finding that the Open Offer failed to rebut Complaint Counsel's prima facie case because it would not "eliminate the effects" of the merger. Finally, the Commission rejected Illumina's constitutional defenses. The Commission therefore ordered Illumina to divest Grail. Illumina now appeals.

---

[1] The FDA does not review or validate safety or efficacy data of tests sold as laboratory-developed tests. Rather, independent labs self-certify the quality of their own product under the regulatory framework set forth under the Clinical Laboratory Improvement Amendments. For this reason, laboratory-developed tests have lower adoption rates than FDA-approved tests.

[2] For clarity, we use "FTC" when discussing the Federal Trade Commission generally, "Complaint Counsel" when describing the FTC's actions as a party to these adversary proceedings, and "Commission" when referring to the FTC's actions as an adjudicatory body.

II.

We review the Commission's decision, not that of the ALJ. *Impax Laboratories, Inc. v. FTC*, 994 F.3d 484, 491 (5th Cir. 2021). All legal questions pertaining to the Commission's order are reviewed de novo while the Commission's factual findings are reviewed for "substantial evidence." *Chicago Bridge & Iron Co. N.V. v. FTC*, 534 F.3d 410, 422 (5th Cir. 2008). Under this standard, we are bound by the Commission's factual determinations so long as they are supported by "such relevant evidence as a reasonable mind might accept as adequate." *FTC v. Ind. Fed'n of Dentists*, 476 U.S. 447, 454 (1986) (citation omitted). This is so "even if suggested alternative conclusions may be equally or even more reasonable and persuasive." *N. Tex. Specialty Physicians v. FTC*, 528 F.3d 346, 354 (5th Cir. 2008) (internal quotation marks and citation omitted).

III.

Because, as explained below, resolution of Illumina's statutory claims does not "obviate the need to consider" the constitutional issues raised, *United States v. Wells Fargo Bank*, 485 U.S. 351, 354 (1988), we begin with Illumina's four constitutional challenges. Each is foreclosed by Supreme Court authority.

A.

First, Illumina contends that the Commission proceedings were the result of an unconstitutional delegation of legislative power in violation of Article I. Specifically, Illumina claims that Congress delegated to the FTC the power to decide whether to bring antitrust enforcement actions in an administrative proceeding, pursuant to Section 5(b) of the FTC Act, 15 U.S.C. § 45(b), or to bring this same enforcement action in an Article III court pursuant to Section 13(b) of the FTC Act, 15 U.S.C. § 53(b), without providing "any guidance for purposes of deciding between administrative proceedings and federal court."

But as the Supreme Court recently clarified, federal-court actions under Section 13(b) are not the same as administrative proceedings under Section 5(b). Rather, when the FTC goes to federal court under Section 13(b), it is limited to pursuing injunctive relief; to obtain other forms of relief, such as monetary damages, the FTC must resort to administrative proceedings under Section 5(b). *AMG Cap. Mgmt., LLC v. FTC*, 141 S. Ct. 1341, 1348-49 (2021).

Moreover, to the extent that Illumina argues that Congress's directive for the FTC to commence an enforcement action when such a proceeding would be "in the interest of the public" does not provide an "intelligible principle," we disagree. To the contrary, the Supreme Court has repeatedly "found an 'intelligible principle' in various statutes authorizing regulation in the 'public interest.'" *Whitman v. Am. Trucking Ass'ns*, 531 U.S. 457, 474 (2001) (collecting cases).

B.

Second, Illumina claims that the FTC unconstitutionally exercised executive powers while insulated from presidential removal in violation of Article II. But *Humphrey's Executor v. United States* held that the FTC's enabling act did not run afoul of Article II because, essentially, the FTC was vested with quasi-legislative/quasi-judicial authority rather than purely executive authority. 295 U.S. 602, 626-32 (1935). While the Supreme Court has cabined the reach of *Humphrey's Executor* in recent years, it has expressly declined to overrule it. See *Seila Law LLC v. CFPB*, 140 S. Ct. 2183, 2206 (2020); accord *Collins v. Yellin*, 141 S. Ct. 1761, 1783 (2021). Thus, although the FTC's powers may have changed since *Humphrey's Executor* was decided, the question of whether the FTC's authority has changed so fundamentally as to render *Humphrey's Executor* no longer binding is for the Supreme Court, not us, to answer.

C.

Third, Illumina argues that the FTC violated Illumina's due process rights by serving as both prosecutor and judge. But the Supreme Court has held that administrative agencies can, and often do, investigate, prosecute, and adjudicate rights without violating due process. *Withrow v. Larkin*, 421 U.S. 35, 47, 56 (1975). Of course, if there is evidence that a decisionmaker has "actual bias" against a party, that raises due process concerns. Id. at 47. But courts cannot "presume bias" merely from the institutional structure of an agency. *United States v. Benitez-Villafuerte*, 186 F.3d 651, 660 (5th Cir. 1999). Moreover, this court has already rejected the argument that the FTC's structure, which combines prosecutorial and adjudicative functions, deprives parties of due process. *Gibson v. FTC*, 682 F.2d 554, 559-60 (5th Cir. 1982). Illumina points to no evidence of actual bias and instead takes issue with the FTC's structural design. Whatever merit this argument may have, it is barred by precedent.

D.

Fourth, Illumina claims an equal-protection violation because there is no rational basis for allocating certain antitrust enforcement actions to the FTC and others to the Department of Justice. But rational-basis review is a low bar that is satisfied so long as "there is any reasonably conceivable state of facts that could provide a rational basis for the classification." *FCC v. Beach Commc'ns, Inc.*, 508 U.S. 307, 313 (1993). Here, the FTC and the DOJ have an "interagency clearance process" which allocates antitrust investigations to one agency or the other based primarily on which agency has "expertise in [the] particular industry or market" of the transaction under review. U.S. Gov't Accountability Off., GAO-23-105790, DOJ and FTC Jurisdictions Overlap, But Conflicts Are Infrequent (2023). This is undoubtedly a rational basis for giving one agency the lead over the other.

IV.

We turn now to Illumina's Clayton Act challenge. Section 7 of the Clayton Act prohibits mergers and acquisitions "where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition." 15 U.S.C. § 18. To evaluate Section 7 claims, courts apply a burden-shifting framework. See, e.g., *Chicago Bridge*, 534 F.3d at 423; *United States v. AT&T Inc.*, 916 F.3d 1029, 1032 (D.C. Cir. 2019) (applying burden-shifting framework to Section 7 claim concerning vertical merger). Complaint Counsel bears the initial burden to "establish a prima facie case that the merger is likely to substantially lessen competition in the relevant market." *AT&T*, 916 F.3d at 1032. If a prima facie case is made, "the burden shifts to the defendant to present evidence that the prima facie case inaccurately predicts the relevant transaction's probable effect on future competition or to sufficiently discredit the evidence underlying the prima facie case." Id. (internal quotation marks and citations omitted). If such a rebuttal is provided, "the burden of producing additional evidence of anticompetitive effects shifts to the government, and merges with the ultimate burden of persuasion, which remains with the government at all times." Id. (citation omitted). This framework is applied flexibly—"in practice, evidence is often considered all at once and the burdens are often analyzed together." *Chicago Bridge*, 534 F.3d at 424.

A.

We start by reviewing Complaint Counsel's prima facie case. The Commission concluded that Complaint Counsel had carried its burden of (1) identifying the relevant product and geographic market as the market for the research, development, and commercialization of MCED tests in the United States, and (2) showing that the Illumina-Grail merger was likely to substantially lessen competition in this market. We find that these conclusions are supported by substantial evidence.

1.

The first step of the prima facie case requires defining the relevant market—that is, the "line of commerce" and the "section of the country" where the relevant competition occurs. 15 U.S.C. § 18; see also *United States v. Marine Bancorporation, Inc.*, 418 U.S. 602, 618 (1974) ("Determination of the relevant product and geographic markets is a necessary predicate to deciding whether a merger contravenes the Clayton Act." (internal quotation marks and citation omitted)). The parties agree with the Commission's finding that the relevant geographic market is the United States but disagree as to its determination that the relevant product market is "the research, development, and commercialization of MCED tests."

In antitrust law, the relevant product market is "the area of effective competition," which is typically the "arena within which significant substitution in consumption or production occurs." *Ohio v. Am. Express Co.*, 138 S. Ct. 2274, 2285 (2018) (internal quotation marks and citation omitted). However, the relevant product market must "correspond to the commercial realities of the industry." *Brown Shoe Co. v. United States*, 370 U.S. 294, 336 (1962) (internal quotation marks and citation omitted). So, "courts should combine different products or services into a single market" when necessary to reflect these realities. *Ohio*, 138 S.Ct. at 2285 (alteration adopted) (internal quotation marks and citation omitted).

To determine the boundaries of the relevant product market, the Commission relied on what is known as the "*Brown Shoe*" methodology, which looks to certain "practical indicia" of market demarcation, such as "industry or public recognition of the [market] as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors." *Brown Shoe*, 370 U.S. at 325.

First, the Commission found that MCED tests have "peculiar characteristics and uses" as compared to other current standard-of-care cancer-screening tests. As the Commission explained, cancer is traditionally detected through more invasive procedures, like a tissue biopsy, colonoscopy, or mammography, which often screen for only one type of cancer and only at a later stage of cancer development.

Second, the Commission found that MCED tests are designed for distinct customers—asymptomatic patients as opposed to those with symptoms or a history of cancer. And, as the Commission noted, MCED test developers expect to market their tests to primary care physicians and, in Illumina's case, directly to patients, as opposed to marketing plans for other oncology tests, which focus on sales to oncologists and other cancer specialists.

Third, the Commission found that MCED tests, which will be targeted toward a more general population than traditional cancer-screening tests, will likely have their own distinct pricing strategy. Specifically, MCED tests will need to have particularly low out-of-pocket costs to patients in order to achieve wide acceptance. Other MCED-test developers testified that they anticipated competing with Grail on price, and evidence in the record showed that Grail understood that lower-priced MCED tests would pose a competitive threat. Finally, the Commission found that "MCED developers, including Grail, see themselves as competing in a distinct market and view each other as key competitors."

Critically, because the Commission viewed the relevant product market as one for the research, development, and commercialization of MCED tests—not the existing commercial market for MCED tests—it based its market definition on what MCED-test developers reasonably sought to achieve, not what they currently had to offer. Each of Illumina's proposed bases for why the Commission's market definition fails springs from the presumption that the Commission should have defined the market based on the products that currently exist, not those that are anticipated or expected. We disagree.

First, Illumina argues that there is no evidence of reasonable interchangeability of use or cross-elasticity of demand between Galleri and other MCED tests in development because the other tests either will not match Galleri's "performance characteristics" or "are years from coming to market." But as the Commission noted, record evidence suggested otherwise—CancerSEEK has been shown to detect eight types of cancer in an asymptomatic screening population while Galleri has only been shown to detect seven. And even if Illumina was correct in its claim that the other MCED tests in development would only be able to detect a subset of the fifty cancer types that Galleri can detect, two products need not be identical to be in the same market; rather, the question is merely whether they are "similar in character or use." *United States v. Anthem, Inc.,* 236 F.Supp.3d 171, 194 (D.D.C) (quoting *FTC v. Staples, Inc.*, 970 F.Supp. 1066, 1074) (D.D.C. 1997), aff'd, 855 F.3d 345 (D.C. Cir. 2017). And the Commission correctly noted that these other tests could still take sales from Galleri (i.e., be substitutes, albeit not perfect substitutes) if they were priced lower.

Nor was the Commission required to mathematically demonstrate cross-elasticity of demand. Indeed, requiring such hard metrics to prove the bounds of a market where only one product has been commercialized but there is indisputably ongoing competition to bring additional products to market would, in effect, prevent research-and-development markets from ever being recognized for antitrust purposes. This, in turn, would directly contravene the purpose of Section 7—"to arrest anticompetitive tendencies in their incipiency." *United States v. Phila. Nat'l Bank*, 374 U.S. 321, 362 (1963) (internal quotation marks and citation omitted).[8]

To be sure, simply labeling a market as one for "research and development" does not relieve Complaint Counsel of its burden to delineate the bounds of a relevant product market. In some circumstances, there may be no firms which can fairly be said to be "competing" in a space. And the mere fact that some company, someday may innovate a competing product in a given market would be too speculative to support a Section 7 claim, lest every acquisition be presumptively unlawful. Cf. *FTC v. Elders Grain, Inc.*, 868 F.2d 901, 906 (7th Cir. 1989) ("Section 7 forbids mergers and other acquisitions the effect of which 'may' be to lessen competition substantially. . . . Of course the word 'may' should not be taken literally, for if it were, every acquisition would be unlawful."). But that is not the case here. While Grail may have the most advanced MCED test, competing tests—particularly CancerSEEK—have been clinically validated, and other developers have concrete plans to begin the trials necessary for FDA approval.

[8] For similar reasons, the Commission was not required to use the hypothetical monopolist test to define the relevant product market. In a research-and-development market where most products have yet to reach the consumer marketplace, there are no prices from which to build a data set, and thus no way to run a hypothetical monopolist test analysis.

Indeed, Grail's own internal documents show that the company viewed itself as being in active competition with these other MCED-test developers.

For similar reasons, Illumina's other arguments—that the Commission misapplied the *Brown Shoe* factors and "baseless[ly]" defined the market to include products in development—also fail. Specifically, Illumina contends that the Commission assessed the *Brown Shoe* "practical indicia" too broadly, examining whether MCED tests were different from other oncology tests rather than whether Galleri was different from other MCED tests in development. But Illumina's proposed approach assesses the indicia far too narrowly. Indeed, under the narrower application urged by Illumina, the relevant market would consist of only one product—Galleri. Antitrust law does not countenance such a cramped view of competition, particularly in a research-and-development market.

2.

With the relevant market established, we next turn to whether Complaint Counsel carried its initial burden of showing that "the proposed merger is likely to substantially lessen competition." *AT&T*, 916 F.3d at 1032 (emphasis omitted). As the Commission recognized, courts have used "two different but overlapping standards for evaluating the likely effect of a vertical transaction": (1) the Brown Shoe standard, which requires courts to look (again) at the factors first enunciated in Brown Shoe and carried on through its progeny, including *Fruehauf Corp. v. FTC*, 603 F.2d 345, 353 (2d Cir. 1979); and (2) the "ability-and-incentive" standard, which asks whether the merged firm will have both the ability and the incentive to foreclose its rivals, either from sources of supply or from distribution outlets. Commissioner Wilson, concurring in the Commission's decision, argued that there is no *Brown Shoe* standard—only the "ability-and-incentive" test—for vertical mergers in modern antitrust analysis. But we need not resolve this issue because we find that, under either standard, Complaint Counsel established a prima facie case supported by substantial evidence.

a.

We begin by addressing the test upon which all Commissioners agreed—the ability-and-incentive test. Under this framework, courts consider whether the merged firm will have the ability and incentive to foreclose rivals from sources of supply or distribution to determine whether the merger is likely to substantially lessen competition in the relevant market.

Illumina concedes that it would have the ability to foreclose Grail's rivals post-merger. But, in its reply brief, Illumina claims that merely having the ability to foreclose is not enough; rather, the merger must have "increased Illumina's ability to foreclose." But we do not consider arguments raised for the first time on reply. And, in any event, we disagree with Illumina's assertion. As the Commission astutely observed, Illumina was already established as the monopoly supplier of a key input—NGS platforms—to MCED-test developers pre-merger. So, it would have been impossible for Complaint Counsel to show that the merger would increase Illumina's ability to foreclose. Thus, as the Commission explained, requiring such a showing would effectively "per se exempt from the Clayton Act's purview any transaction that involves the acquisition of a monopoly provider of inputs to adjacent markets." We decline to adopt a rule that would have such perverse results.

That leaves incentive to foreclose as the determining factor in evaluating the Illumina-Grail merger under the ability-and-incentive test. As the Commission explained, the degree to which Illumina has an incentive to foreclose Grail's rivals depends upon the balance of two competing interests: Illumina's interest in maximizing its profits in the downstream market for MCED tests vis-à-vis its ownership interest in Grail versus Illumina's interest in maximizing its profits in the upstream market for NGS platforms vis-à-vis its sales to all MCED-test developers. Foreclosing Grail's rivals would increase the former (by diverting MCED-test sales from competitors to Grail) but decrease the latter (by reducing the total number of MCED tests in the marketplace). So, the Commission reasoned, the greater Illumina's ownership stake in Grail, the more its interest in maximizing downstream profits will outweigh its interest in preserving upstream profits, and thus the more incentive it will have to foreclose. And since the merger would increase Illumina's ownership stake in Grail from 12% to 100%, Illumina would "now earn much more from the sale of a [Grail] test than from the sale of a rival's test" and would therefore "have a significantly greater incentive to foreclose [Grail's] rivals rather than to keep them on a level playing field."

Illumina challenges this conclusion on two bases. First, Illumina argues that, even if the merger would result in Illumina earning larger profits from the sale of a Grail test than the sale of a rival MCED test, that profit differential means nothing without proof of diversion, i.e., Grail's capture of sales lost by rival MCED-test developers. Illumina is correct that diversion is necessary for a vertical merger to give rise to foreclosure incentives. If Illumina forecloses Grail's rivals, preventing them from entering the MCED-test market or lowering their sales, Illumina's NGS-sales revenue generated from those rivals will suffer. Therefore, a foreclosure strategy is only economically rational if Grail can pick up enough of its competitors' lost MCED-test sales to offset the losses to Illumina's NGS-sales revenue. But, Illumina argues, "[b]ecause Galleri is the only test on the market today, there are no sales to divert," so foreclosing Grail's rivals would only harm Illumina's NGS revenue without any concomitant benefit to Grail's MCED-test-sales revenue.

This contention suffers from the same fatal flaw as Illumina's arguments concerning the Commission's market definition—it insists that the Commission must consider only the MCED tests on the market right now, not those likely to be on the market in the future. But the relevant market is not "MCED tests commercialized today," it is the "research, development, and commercialization of MCED tests." And as explained earlier, there is substantial evidence in the record showing that other MCED-test developers are, right now, working on creating tests that will rival Grail's capabilities and that are expected to make it to the market in the near future. And when they do, they would divert sales from Grail—or vice versa, should a foreclosure strategy be pursued.

Illumina's second argument—that harm to Illumina's NGS business from foreclosure of Grail's rivals would outweigh any benefit to Grail's MCED-testing business—is more compelling. Pre-merger, the vast majority of Illumina's revenue—nearly 90% in 2020—was earned through its core business of selling NGS products. And Illumina is right that pursuing a foreclosure strategy threatens material harm to this business in two ways: first, by loss of NGS sales to the foreclosed MCED-test developers, and second, by loss of NGS business in areas outside of cancer detection as a result of reputational damage. But, as the Commission identified, there are two reasons why the risk of such harm is not as great as Illumina claims. First, there are myriad ways in which Illumina could engage in foreclosing behavior without triggering suspicion in other customers, such as by making late deliveries or subtly reducing the level of support services. And second, and more importantly, Illumina's monopoly power in the NGS-platform market means that, even if other customers did learn about Illumina's foreclosing behavior and therefore wanted to take their business elsewhere, they would have nowhere else to turn.

In any event, there is a more fundamental reason why any harm to Illumina's NGS business may not disincentivize Illumina from pursuing a foreclosure strategy against Grail's rivals—the Illumina-Grail merger was the cornerstone of a foundational change in Illumina's business model through which Illumina planned to "transform [itself] into a clinical testing and data driven healthcare company" as opposed to its current iteration as a "life sciences tools & diagnostics company focused on genomics." In other words, Illumina was willing to suffer losses to its NGS-platform sales in order to accelerate the growth of its MCED-test sales because it now viewed the latter, not the former, as its primary (and far more profitable) business. Illumina's own internal projections bear this out, predicting that, although Illumina would lose money in the short term as a result of the merger, by 2035, its "net margin profit pool" for clinical testing services would be nearly eight times the projected profit pool for its NGS-related sales.

In light of the foregoing, the Commission had substantial evidence to support its conclusion that Complaint Counsel made a prima facie showing that, post-merger, Illumina had a significantly increased incentive to crowd out Grail's competitors from the market. MCED testing is a nascent field in which, although only one firm—Grail—has begun to commercialize its product, numerous firms are researching and developing their own products with the end goal of commercialization. And all of the players expect the field to one day generate tens of billions of dollars in yearly revenue. To create and eventually sell this product, each developer will need access to one critical input—NGS platforms. Now, the sole supplier of that input—Illumina—has purchased the first mover in this nascent industry. Given Illumina's monopoly power and shifting business priorities, it was reasonable for the Commission to conclude that Illumina would likely foreclose against Grail's competitors—even at the expense of some short-term profits—to pursue its long-term goal of establishing itself (via Grail) as the market leader in clinical testing.

b.

The Commission also applied the factors first identified in *Brown Shoe*, and later reiterated in Fruehauf, to determine whether the Illumina-Grail merger was likely to substantially lessen competition. These factors include:

> [T]he nature and economic purpose of the [transaction], the likelihood and size of any market foreclosure, the extent of concentration of sellers and buyers in the industry, the capital cost required to enter the market, the market share needed by a buyer or seller to achieve a profitable level of production (sometimes referred to as "scale economy"), the existence of a trend toward vertical concentration or oligopoly in the industry, and whether the merger will eliminate potential competition by one of the merging parties. To these factors may be added the degree of market power that would be possessed by the merged enterprise and the number and strength of competing suppliers and purchasers, which might indicate whether the merger would increase the risk that prices or terms would cease to be competitive.

Fruehauf, 603 F.2d at 353. The Commission found that at least four of the factors—likely foreclosure, the nature and purpose of the transaction, the degree of market power possessed by the merged firm, and entry barriers— supported a finding of a probable Section 7 violation. We conclude that the Commission's *Brown Shoe* determination was supported by substantial evidence.

The first factor the Commission relied upon—likelihood of foreclosure—weighs in favor of Complaint Counsel for the reasons set forth in our ability-and-incentive analysis. The second factor—nature and purpose of the transaction—also overlaps significantly with our prior discussion and supports Complaint Counsel: The "nature" of the transaction is the acquisition of a downstream customer by a sole-source supplier, and the "purpose" is to fundamentally transform Illumina's business model such that it would be competing most intensely in the downstream market, i.e., the same market in which it has the ability to foreclose.

As for the third factor—degree of market power—the parties' arguments reflect a broader debate about how to view the potential anticompetitive impact of the merger, which we have now already addressed twice: whether the Commission was required to look at the immediate effect of the merger (in which case, Illumina would be correct to say that the acquisition does not change Grail's share of the MCED-test market because its Galleri test is the only product on the market) or could consider the merger's long-term impact. And as we have already explained, the Commission properly considered the longer-term impact of the merger and found that the merger was likely to lead to a concentration of market power in the merged firm. This factor thus favors Complaint Counsel as well.

Finally, the Commission found that the merger would increase barriers to entry in the relevant market. Specifically, based on testimony from other MCED-test developers and Complaint Counsel's expert witness, the Commission found that rival firms would be disincentivized from investing in MCED-test development post-merger. Illumina suggests that the Commission gave too much weight to this self-interested testimony and too little weight to other record evidence. But even if we would have found a different conclusion to be "more reasonable and persuasive" had we weighed the evidence ourselves, that would not be enough to set aside the Commission's finding on this factor under our deferential "substantial evidence" review.

Nor did the Commission commit legal error by omitting three of the *Brown Shoe* factors from its analysis. There is "no precise formula[]" when it comes to applying these factors. *Fruehauf*, 603 F.2d at 353. Indeed, the Supreme Court has found a vertical merger unlawful by examining only three of the *Brown Shoe* factors. *Ford Motor Co. v. United States*, 405 U.S. 562, 566 (1972) (considering the nature and purpose of the transaction, increased barriers to entry, and increased concentration).

At bottom, the record supports the Commission's findings that the merger will result in the potential foreclosure of a key input by the sole supplier, that it was intended to transform Illumina's business model by shifting its focus from NGS products to clinical testing, and that investment by other MCED-test developers may be chilled, especially given the deferential nature of our review. This was sufficient to support a determination that Complaint Counsel had made a prima facie showing that the merger was likely to substantially lessen competition under the Brown Shoe test.

B.

Next, we address the Open Offer—the long-term supply agreement that Illumina offered to rival MCED-test developers. First, we consider where in the Section 7 analysis the Open Offer should be evaluated, and second, we turn to how it should be evaluated.

1.

Based on the record, the parties' arguments, and applicable case law, we see three different options for the point in the Section 7 analysis at which the Open Offer could come into play.

The first option—pressed by Illumina—is to require Complaint Counsel to account for the Open Offer as part of its prima facie case. The second option—adhered to by the Commission's majority opinion—is to only consider the Open Offer at the remedy stage following a finding of liability. The third option—suggested by Commissioner Wilson in her concurring opinion—is to place the burden of showing the Open Offer's competitive effects on Illumina as part of its rebuttal to the prima facie case. As explained below, we agree with Commissioner Wilson.

a.

The parties' divergent views on this issue appear to stem from a disagreement over whether the Open Offer should be treated as a "market reality"—as Illumina contends—or a remedy—as the Commission found. But we do not think that the Open Offer fits neatly into either bucket, and we decline to force it into one.

On the one hand, it is evident that the Open Offer is not just a normal commercial supply agreement but instead a direct response to anticompetitive concerns over the Illumina-Grail merger. The opening sentence of the Open Offer makes this plain; it explains that the Open Offer was made "[i]n connection with Illumina's proposed acquisition of Grail . . . to allay any concerns relating to the [merger], including that Illumina would disadvantage Grail's potential competitors." So, to treat the Open Offer as just another fact of the marketplace seems to miss the forest for the trees.

But, on the other hand, the Open Offer is different in kind from a Commission- or court-ordered "remedy," which, as the Commission itself noted, can be imposed "only on the basis of a violation of the law," i.e., after a finding of liability. See *Gen. Bldg. Contractors Ass'n, Inc. v. Pennsylvania*, 458 U.S. 375, 399 (1982). Indeed, the Open Offer became effective before the evidentiary hearing in this case had even begun and nineteen months before the Commission's liability determination. Thus, the Commission majority's reliance on cases like *Ford Motor Co.*, 405 U.S. at 571.and *United States v. E. I. du Pont de Nemours & Co.*, 366 U.S. 316, 334 (1961)—which concerned court-ordered divestitures after a finding of Section 7 liability—to support its position that the Open Offer is a remedy is misplaced. So too is its reliance on *United States v. Aetna Inc.*, 240 F. Supp. 3d 1 (D.D.C. 2017), and *FTC v. Sysco Corp.*, 113 F. Supp. 3d 1 (D.D.C. 2015). To be sure, both *Aetna* and *Sysco*—like this case—involved proposals by the parties, not decrees by the Commission or court. But in both cases, the proposed divestitures were conditional upon the court's liability determination, coming into effect in *Aetna* only if the court found such divestiture "necessary to counteract the merger's anticompetitive effects," 240 F. Supp. 3d at 17, and in *Sysco* "if the merger received regulatory approval," 113 F. Supp. 3d at 15. No such conditions accompanied the Open Offer.

In this sense, the Open Offer is somewhere in between a fact and a remedy—a post-signing, pre-closing adjustment to the status quo implemented by the merging parties to stave off concerns about potential anticompetitive conduct. Take, for example, the arbitration agreement at issue in United States v. AT&T, Inc., 310 F. Supp. 3d 161 (D.D.C. 2018), aff'd, 916 F.3d 1029 (D.C. Cir. 2019). That case concerned a Section 7 challenge to the vertical merger between AT&T (which distributes television content via its cable platform DirecTV) and Time Warner (which packages television content via its networks such as TNT, TBS, CNN, and HBO and licenses such networks to distributors). Id. at 167. Shortly after the government filed suit, and in an effort to assuage concerns that it would price-discriminate against distributors other than

AT&T post-merger, Time Warner made an irrevocable offer to distributors to engage in "baseball style" arbitration when it came time to renew their licensing agreements. Id. at 184.[14] The government argued that the arbitration agreements should be "ignored" until the remedy stage, but the court disagreed, holding that the agreements would have "real-world effect[s]" that should be considered prior to any liability determination. Id. at 217 n.30.

The Northern District of California reached a similar determination in *FTC v. Microsoft Corp.*, where the court considered a "binding offer" by Microsoft (the details of which are redacted from the opinion) designed to assuage the government's concerns that Microsoft (the manufacturer of the popular Xbox gaming console) would pull certain videogames from competing consoles following its vertical merger with videogame publisher Activision. No. 23-cv-02880-JSC, 2023 WL 4443412, at *15 (N.D. Cal. July 10, 2023). The court rejected the government's argument that, under du Pont, Microsoft's offer was merely a "proposed remedy" to be considered after a finding of liability and explained that "offered and executed agreements made before any liability trial, let alone liability finding," should be considered at the liability phase. Id.

The Open Offer is akin to the remedial agreements at issue in *AT&T* and *Microsoft.* And we agree with those courts that such agreements should be addressed at the liability—not remedy—stage of the Section 7 proceedings.

b.

Having determined that the Open Offer should be considered at the liability stage, the question remains: where does it fit within the burden-shifting framework for determining liability? Illumina urges that Complaint Counsel was required to incorporate the Open Offer into its prima facie case. Commissioner Wilson says that the Open Offer only comes into play as part of Illumina's rebuttal to Complaint Counsel's prima facie case. We find the latter approach most compatible with the "flexible framework" at play. See *Chicago Bridge*, 534 F.3d at 424.

As we and our sister circuits have recognized, the burden-shifting framework is "somewhat artificial." *FTC v. Butterworth Health Corp.*, No. 96-2440, 1997 WL 420543, at *1 (6th Cir. July 8, 1997). "Conceptually, this shifting of the burdens of production, with the ultimate burden of persuasion remaining always with the government, conjures up images of a tennis match, where the government serves up its prima facie case, the defendant returns with evidence undermining the government's case, and then the government must respond to win the point." *FTC v. Univ. Health, Inc.*, 938 F.2d 1206, 1219 n.25 (11th Cir. 1991). "In practice, however, the government usually introduces all of its evidence at one time, and the defendant responds in kind." Id. Thus, the "evidence is often considered all at once and the burdens are often analyzed together." *Chicago Bridge*, 534 F.3d at 425. This is particularly true in vertical merger cases. In horizontal merger cases, the government can "use a short cut to establish [its prima facie case] through statistics about the change in market concentration." *AT&T*, 916 F.3d at 1032. No such "short cut" exists in vertical merger cases, and the government "must make a 'fact-specific' showing" even at the prima facie stage. Id.

That is precisely what happened in this case. As the government's brief explains, "[h]ere, Complaint Counsel produced evidence in its case-in-chief that the Open Offer was ineffective, and Illumina attempted to produce contrary evidence in the defense case." The Commission

[14] In "baseball style" arbitration, "each party puts forward a final offer before knowing about its counterparty's offer, and the arbitrator chooses between those two." *AT&T*, 310 F.Supp.3d at 217.

then siloed all of this Open-Offer-related evidence into the rebuttal stage of its analysis. Had the Commission applied the correct standard at the rebuttal stage, there would have been no error in this approach. Indeed, we approved such a methodology in *Chicago Bridge*.

As we explained there, in many Section 7 cases, the "[g]overnment's prima facie case anticipates and addresses the respondent's rebuttal evidence." *Chicago Bridge*, 534 F.3d at 426. In such a situation, the Commission need only "assess[] the rebuttal evidence in light of the prima facie case" rather than switch the burden of production back-and-forth. Id. at 424.

2.

At the rebuttal stage of the Section 7 analysis, Illumina bore the burden "to present evidence that the prima facie case inaccurately predicts the relevant transaction's probable effect on future competition." *AT&T*, 916 F.3d at 1032 (internal quotation marks and citation omitted). Because Complaint Counsel preemptively addressed the Open Offer as part of its case-in-chief, Illumina's burden on rebuttal was "heightened." *Chicago Bridge*, 534 F.3d at 426. To be sure, Illumina's burden was only one of production, not persuasion; the burden of persuasion remained with Complaint Counsel at all times. *AT&T*, 916 F.3d at 1032. But to satisfy its burden of production, Illumina was required to do more than simply put forward the terms of the Open Offer; it needed to "*affirmatively show*[]" why the Open Offer undermined Complaint Counsel's prima facie showing to such an extent that there was no longer a probability that the Illumina-Grail merger would "substantially lessen competition." See *United States v. Baker Hughes Inc.*, 908 F.2d 981, 991 (D.C. Cir. 1990) (emphasis added).

This is where the Commission erred. The Commission held Illumina to a rebuttal standard that was incompatible with the plain language of Section 7 of the Clayton Act, which only prohibits transactions that will "substantially" lessen competition. 15 U.S.C. § 18. And this error pervaded the Commission's analysis of the Open Offer, as the Commission invoked the wrong standard in five separate instances. Specifically, the Commission held that Illumina was required to "show that the Open Offer would restore the pre-[merger] level of competition," i.e., "eliminate Illumina's ability to favor Grail and harm Grail's rivals." In effect, Illumina could only rebut Complaint Counsel's showing of a likelihood of a substantial reduction in competition with a showing that, due to the Open Offer, the merger would not lessen competition at all. This was legal error.

The Commission's standard stems from its mistaken belief that the Open Offer is a remedy. Indeed, the source of this total-negation standard is the Supreme Court's holding in *Ford Motor* Co. that "[t]he relief in an antitrust case must be 'effective to redress the violations' and 'to restore competition.'" 405 U.S. at 573 (quoting *du Pont*, 366 U.S. at 326). The District of Columbia applied this remedy-stage standard in its liability-stage analysis in a string of cases, beginning with *Sysco*, 113 F.Supp.3d at 72, continuing in *Aetna*, 240 F.Supp.3d at 60, and then again in *FTC v. RAG-Stiftung*, 436 F.Supp.3d 278, 304 (D.D.C. 2020). But in its most recent case, the District of Columbia reversed course, recognizing that the total-negation standard "contradicts the text of Section 7." *United States v. UnitedHealth Grp. Inc.*, 630 F.Supp.3d 118, 132 (D.D.C. 2022). As that court explained, "the text of Section 7 is concerned only with mergers that 'substantially . . . lessen competition,'" and by requiring on rebuttal a showing that the merger will "preserve exactly the same level of competition that existed before the merger, the Government's proposed standard would effectively erase the word 'substantially' from Section 7." Id. at 133 (quoting 15 U.S.C. § 18).

*** To rebut Complaint Counsel's prima facie case, Illumina was only required to show that the Open Offer sufficiently mitigated the merger's effect such that it was no longer likely to substantially lessen competition. Illumina was not required to show that the Open Offer would negate the anticompetitive effects of the merger entirely.

C.

Finally, we turn to Illumina's other proffered rebuttal evidence— efficiencies. As it did before the Commission, Illumina contends on appeal that the Illumina-Grail merger would have "result[ed] in significant efficiencies" which would have "easily offset[] the supposed [anticompetitive] harm."[17] To be cognizable as rebuttal evidence, an efficiency must be (1) merger specific, (2) verifiable in its existence and magnitude, and (3) likely to be passed through, at least in part, to consumers. The Commission determined that none of Illumina's proposed efficiencies were cognizable. We find that this conclusion was supported by substantial evidence.

First, Illumina claimed that the merger would reduce (if not eliminate entirely) Grail's obligation to pay Illumina a royalty, which would have generated a significant consumer surplus. The Commission found that this claimed efficiency was neither merger specific nor likely to be passed through to consumers. We find that the former determination was not supported by substantial evidence, but the latter was. The Commission's finding that the royalty reduction was not merger specific was based on evidence demonstrating that Grail had considered other ways to reduce or eliminate the royalty without merging with Illumina, such as a buyout or longer-term supply agreement. But the Commission did not fairly consider evidence that Grail—in coordination with its bankers at Morgan Stanley—had determined that it lacked the leverage necessary to bring Illumina to the table on these alternative proposals, leaving merger as the only realistic option. We therefore cannot conclude that substantial evidence supported this finding.

With respect to pass-through, however, there was substantial evidence to support the Commission's finding that, while Grail could decrease the price of Galleri (i.e., pass some of the benefit through to consumers) following reduction of the royalty, Illumina had not shown a likelihood that Grail would do so. Indeed, as explained earlier, substantial evidence supported the Commission's finding that the merger would increase Illumina's incentive to foreclose against Grail's rivals such that competing MCED tests either never make it to market or the costs of bringing such tests to market increase. In other words, Grail had no reason to pass its royalty-reduction savings through to Galleri's customers because, if any of Grail's competitors actually made it to market, Grail could force those competitors to pass through extra costs to their customers.

Second, Illumina argued that the merger would eliminate double marginalization—i.e., Illumina would no longer charge Grail a margin, as it did before the merger—leading to additional consumer surplus. But Illumina never put forward a proposed model for calculating this benefit, only an "illustrative" one. Illumina does not contest this fact. Rather, Illumina contends that it was Complaint Counsel's burden to model these benefits. But when it comes to efficiencies,

[17] The Commission stated that, to rebut the prima facie case, any substantiated efficiencies needed "to offset and reverse the likely anticompetitive effects" of the merger. This standard gives us pause for the same reasons discussed with respect to the standard used to evaluate the Open Offer. But we need not decide whether such a standard is appropriate for evaluating efficiencies because the Commission did not rely on it. Instead, the Commission found that Illumina had failed to substantiate its claimed efficiencies in the first place. We also note that our court has never addressed the threshold question of whether it is proper for a court to take account of a merger's efficiencies as a defense in a Section 7 case.

"much of the information relating to efficiencies is uniquely in the possession of the merging firms." 4a Areeda & Hovenkamp, Antitrust Law ¶ 970f (citation omitted). It is therefore Illumina—not Complaint Counsel—that "must demonstrate that the intended acquisition would result in significant economies." *Univ. Health*, 938 F.2d at 1223. And because Illumina failed to demonstrate that this proposed efficiency was verifiable, the Commission had substantial evidence in support of its decision not to recognize it.

Third, Illumina contended that the merger would lead to "significant supply chain and operational efficiencies" of approximately $140 million over a ten-year period. But, again, it presented no model by which it calculated this number. And without an underlying model, including the assumptions upon which it was based, the Commission had a sound basis to conclude that Illumina had failed to carry its burden of showing this efficiency was verifiable. See *United States v. H & R Block, Inc.*, 833 F.Supp.2d 36, 91 (D.D.C. 2011) ("[T]he lack of a verifiable method of factual analysis resulting in the cost estimates renders [the proposed efficiency] not cognizable by the Court."). Plus, record evidence showed that Grail was in the process of improving its operations pre-merger, and Illumina had not shown any method of quantifying the incremental value, if any, the merger would provide with respect to these operational efficiencies. Thus, there was not only a verification issue, but a merger-specificity issue as well.

Fourth, Illumina claimed that the merger would result in significant research-and-development efficiencies. But Illumina made no attempt to quantify these claimed efficiencies, instead relying on testimony of its executives that such efficiencies would be achieved. But "[w]hile reliance on the estimation and judgment of experienced executives about costs [or innovation] may be perfectly sensible as a business matter, the lack of a verifiable method of factual analysis . . . renders [the efficiency] not cognizable." *H & R Block*, 833 F.Supp.2d at 91.

Fifth, Illumina argued that due to its "regulatory and market-access expertise," the merger would "accelerate" FDA approval and payer coverage for Galleri. But the Commission, again supported by substantial evidence, found that Illumina had not established that such acceleration would actually occur, much less shown how it would be achieved. For instance, Illumina's own financial modeling of the merger did not assume that Galleri's widespread commercialization would be accelerated. Nor did it account for the costs that would be associated with achieving any such acceleration, such as diverting Illumina personnel to work on Grail projects. And in any event, Illumina had failed to demonstrate that its claimed "regulatory expertise" was superior to that which Grail already possessed. Indeed, Grail had already obtained breakthrough device designation for Galleri on its own. Illumina, on the other hand, had only ever obtained pre-market approval for one Class III NGS-based diagnostic test, and in that instance, a third party sponsored the clinical study upon which approval was granted.

Sixth, Illumina pointed to "international efficiencies," i.e., that the merger would "accelerate the international expansion of Galleri." But as the Commission explained, Illumina "offered no concrete plans regarding countries in which international expansion would occur, how much more quickly the international expansion would occur, how much additional data the international expansion would generate, how much the international efforts would cost, or why such international expansion could only be achieved through a merger."[18]

[18] Because we find that substantial evidence supported the Commission's conclusion that Illumina had failed to substantiate its claimed international efficiencies, we do not address the question of whether it is proper to consider efficiencies outside of the relevant geographic market. But see *Phila. Nat'l Bank*, 374 U.S. at 370 (rejecting contention that "anticompetitive effects in one market could be justified by procompetitive consequences in another").

At bottom, an efficiency defense is very difficult to establish. And substantial evidence supported the Commission's determination that Illumina failed to establish cognizable efficiencies here.

V.

To sum up, Illumina's constitutional challenges to the FTC's authority are foreclosed by binding Supreme Court precedent, and substantial evidence supported the Commission's conclusions that (1) the relevant market is the market for the research, development, and commercialization of MCED tests in the United States; (2) Complaint Counsel carried its initial burden of showing that the Illumina-Grail merger is likely to substantially lessen competition in that market under either the ability-and-incentive test or looking to the Brown Shoe factors; and (3) Illumina had not identified cognizable efficiencies to rebut the anticompetitive effects of the merger. However, in considering the Open Offer, the Commission used a standard that was incompatible with the plain language of the Clayton Act. We therefore VACATE the Commission's order and REMAND the case for reconsideration of the effect of the Open Offer under the proper standard.

Merger Guidelines

U.S. Department of Justice and the Federal Trade Commission

Issued: December 18, 2023

1. Overview

These Merger Guidelines identify the procedures and enforcement practices the Department of Justice and the Federal Trade Commission (the "Agencies") most often use to investigate whether mergers violate the antitrust laws. The Agencies enforce the federal antitrust laws, specifically Sections 1 and 2 of the Sherman Act, 15 U.S.C. §§ 1, 2; Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45; and Sections 3, 7, and 8 of the Clayton Act,[1] 15 U.S.C. §§ 14, 18, 19.[2] Congress has charged the Agencies with administering these statutes as part of a national policy to promote open and fair competition, including by preventing mergers and acquisitions that would violate these laws. "Federal antitrust law is a central safeguard for the Nation's free market structures" that ensures "the preservation of economic freedom and our free-enterprise system."[3] It rests on the premise that "[t]he unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress, while at the same time providing an environment conducive to the preservation of our democratic political and social institutions."[4]

Section 7 of the Clayton Act ("Section 7") prohibits mergers and acquisitions where "in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly." Competition is a process of rivalry that incentivizes businesses to offer lower prices, improve wages and working conditions, enhance quality and resiliency, innovate, and expand choice, among many other benefits. Mergers that substantially lessen competition or tend to create a monopoly increase, extend, or entrench market power and deprive the public of these benefits. Mergers can lessen competition when they diminish competitive constraints, reduce the number or attractiveness of alternatives available to trading partners, or reduce the intensity with which market participants compete.

Section 7 was designed to arrest anticompetitive tendencies in their incipiency.[5] The Clayton Act therefore requires the Agencies to assess whether mergers present risk to competition. The Supreme Court has explained that "Section 7 itself creates a relatively expansive definition of antitrust liability: To show that a merger is unlawful, a plaintiff need only prove that its effect '*may be* substantially to lessen competition'" or to tend to create a monopoly.[6] Accordingly, the Agencies do not attempt to

---

[1] As amended under the Celler-Kefauver Antimerger Act of 1950, Pub. L. No. 81-899, 64 Stat. 1125 (1950), and the Hart-Scott-Rodino Antitrust Improvements Act of 1976, 15 U.S.C. § 18a.

[2] Although these Guidelines focus primarily on Section 7 of the Clayton Act, the Agencies consider whether any of these statutes may be violated by a merger. The various provisions of the Sherman, Clayton, and FTC Acts each have separate standards, and one may be violated when the others are not.

[3] *North Carolina State Bd. of Dental Examiners v. FTC*, 574 U.S. 494, 502 (2015).

[4] *NCAA v. Board of Regents*, 468 U.S. 85, 104 n.27 (1984) (quoting *Northern Pac. R. Co. v. United States*, 356 U.S. 1, 4-5 (1958)); *see also NCAA v. Alston*, 141 S. Ct. 2141, 2147 (2021) (quoting *Board of Regents*, 468 U.S. at 104 n.27).

[5] *See, e.g.*, *Brown Shoe Co. v. United States*, 370 U.S. 294, 318 nn.32-33 (1962); *see also United States v. AT&T, Inc.*, 916 F.3d 1029, 1032 (D.C. Cir. 2019) (Section 7 "halt[s] incipient monopolies and trade restraints outside the scope of the Sherman Act." (quoting *Brown Shoe*, 370 U.S. at 318 n.32)); *Saint Alphonsus Medical Center-Nampa v. St. Luke's*, 778 F.3d 775, 783 (9th Cir. 2015) (Section 7 "intended to arrest anticompetitive tendencies in their incipiency." (quoting *Brown Shoe*, 370 U.S. at 322)); *Polypore Intern., Inc. v. FTC*, 686 F.3d 1208, 1213-14 (11th Cir. 2012) (same). Some other aspects of *Brown Shoe* have been subsequently revisited.

[6] *California v. Am. Stores Co.*, 495 U.S. 271, 284 (1990) (quoting 15 U.S.C. § 18 with emphasis) (citing *Brown Shoe*, 370 U.S. at 323).

predict the future or calculate precise effects of a merger with certainty. Rather, the Agencies examine the totality of the evidence available to assess the risk the merger presents.

Competition presents itself in myriad ways. To assess the risk of harm to competition in a dynamic and complex economy, the Agencies begin the analysis of a proposed merger by asking: how do firms in this industry compete, and does the merger threaten to substantially lessen competition or to tend to create a monopoly?

The Merger Guidelines set forth several different analytical frameworks (referred to herein as "Guidelines") to assist the Agencies in assessing whether a merger presents sufficient risk to warrant an enforcement action. These frameworks account for industry-specific market realities and use a variety of indicators and tools, ranging from market structure to direct evidence of the effect on competition, to examine whether the proposed merger may harm competition.

How to Use These Guidelines: When companies propose a merger that raises concerns under one or more Guidelines, the Agencies closely examine the evidence to determine if the facts are sufficient to infer that the effect of the merger may be to substantially lessen competition or to tend to create a monopoly (sometimes referred to as a "prima facie case").[7] **Section 2** describes how the Agencies apply these Guidelines. Specifically, Guidelines 1-6 describe distinct frameworks the Agencies use to identify that a merger raises prima facie concerns, and Guidelines 7-11 explain how to apply those frameworks in several specific settings. In all of these situations, the Agencies will also examine relevant evidence to determine if it disproves or rebuts the prima facie case and shows that the merger does not in fact threaten to substantially lessen competition or tend to create a monopoly. **Section 3** identifies rebuttal evidence that the Agencies consider, and that merging parties can present, to rebut an inference of potential harm under these frameworks.[8] **Section 4** sets forth a non-exhaustive discussion of analytical, economic, and evidentiary tools the Agencies use to evaluate facts, understand the risk of harm to competition, and define relevant markets.

These Guidelines are not mutually exclusive, as a single transaction can have multiple effects or raise concerns in multiple ways. To promote efficient review, for any given transaction the Agencies may limit their analysis to any one Guideline or subset of Guidelines that most readily demonstrates the risks to competition from the transaction.

Guideline 1: Mergers Raise a Presumption of Illegality When They Significantly Increase Concentration in a Highly Concentrated Market. Market concentration is often a useful indicator of a merger's likely effects on competition. The Agencies therefore presume, unless sufficiently disproved or rebutted, that a merger between competitors that significantly increases concentration and creates or further consolidates a highly concentrated market may substantially lessen competition.

Guideline 2: Mergers Can Violate the Law When They Eliminate Substantial Competition Between Firms. The Agencies examine whether competition between the merging parties is substantial since their merger will necessarily eliminate any competition between them.

---

[7] *See, e.g.*, *United States v. AT&T, Inc.*, 916 F.3d at 1032 (explaining that a *prima facie* case can demonstrate a "reasonable probability" of harm to competition either through "statistics about the change in market concentration" or a "fact-specific" showing (quoting *Brown Shoe*, 370 U.S. at 323 n.39)); *United States v. Baker Hughes*, 908 F.2d 981, 982-83 (D.C. Cir. 1990).
[8] These Guidelines pertain only to the Agencies' consideration of whether a merger or acquisition may substantially lessen competition or tend to create a monopoly. The consideration of remedies appropriate for mergers that pose that risk is beyond the Merger Guidelines' scope. The Agencies review proposals to revise a merger in order to alleviate competitive concerns consistent with applicable law regarding remedies.

Guideline 3: Mergers Can Violate the Law When They Increase the Risk of Coordination. The Agencies examine whether a merger increases the risk of anticompetitive coordination. A market that is highly concentrated or has seen prior anticompetitive coordination is inherently vulnerable and the Agencies will infer, subject to rebuttal evidence, that the merger may substantially lessen competition. In a market that is not highly concentrated, the Agencies investigate whether facts suggest a greater risk of coordination than market structure alone would suggest.

Guideline 4: Mergers Can Violate the Law When They Eliminate a Potential Entrant in a Concentrated Market. The Agencies examine whether, in a concentrated market, a merger would (a) eliminate a potential entrant or (b) eliminate current competitive pressure from a perceived potential entrant.

Guideline 5: Mergers Can Violate the Law When They Create a Firm That May Limit Access to Products or Services That Its Rivals Use to Compete. When a merger creates a firm that can limit access to products or services that its rivals use to compete, the Agencies examine the extent to which the merger creates a risk that the merged firm will limit rivals' access, gain or increase access to competitively sensitive information, or deter rivals from investing in the market.

Guideline 6: Mergers Can Violate the Law When They Entrench or Extend a Dominant Position. The Agencies examine whether one of the merging firms already has a dominant position that the merger may reinforce, thereby tending to create a monopoly. They also examine whether the merger may extend that dominant position to substantially lessen competition or tend to create a monopoly in another market.

Guideline 7: When an Industry Undergoes a Trend Toward Consolidation, the Agencies Consider Whether It Increases the Risk a Merger May Substantially Lessen Competition or Tend to Create a Monopoly. A trend toward consolidation can be an important factor in understanding the risks to competition presented by a merger. The Agencies consider this evidence carefully when applying the frameworks in Guidelines 1-6.

Guideline 8: When a Merger is Part of a Series of Multiple Acquisitions, the Agencies May Examine the Whole Series. If an individual transaction is part of a firm's pattern or strategy of multiple acquisitions, the Agencies consider the cumulative effect of the pattern or strategy when applying the frameworks in Guidelines 1-6.

Guideline 9: When a Merger Involves a Multi-Sided Platform, the Agencies Examine Competition Between Platforms, on a Platform, or to Displace a Platform. Multi-sided platforms have characteristics that can exacerbate or accelerate competition problems. The Agencies consider the distinctive characteristics of multi-sided platforms when applying the frameworks in Guidelines 1-6.

Guideline 10: When a Merger Involves Competing Buyers, the Agencies Examine Whether It May Substantially Lessen Competition for Workers, Creators, Suppliers, or Other Providers. The Agencies apply the frameworks in Guidelines 1-6 to assess whether a merger between buyers, including employers, may substantially lessen competition or tend to create a monopoly.

Guideline 11: When an Acquisition Involves Partial Ownership or Minority Interests, the Agencies Examine Its Impact on Competition. The Agencies apply the frameworks in Guidelines 1-6 to assess if an acquisition of partial control or common ownership may substantially lessen competition.

* * *

This edition of the Merger Guidelines consolidates, revises, and replaces the various versions of Merger Guidelines previously issued by the Agencies. The revision builds on the learning and experience reflected in those prior Guidelines and successive revisions. These Guidelines reflect the collected experience of the Agencies over many years of merger review in a changing economy and have been refined through an extensive public consultation process.

As a statement of the Agencies' law enforcement procedures and practices, the Merger Guidelines create no independent rights or obligations, do not affect the rights or obligations of private parties, and do not limit the discretion of the Agencies, including their staff, in any way. Although the Merger Guidelines identify the factors and frameworks the Agencies consider when investigating mergers, the Agencies' enforcement decisions will necessarily continue to require prosecutorial discretion and judgment. Because the specific standards set forth in these Merger Guidelines will be applied to a broad range of factual circumstances, the Agencies will apply them reasonably and flexibly to the specific facts and circumstances of each merger.

Similarly, the factors contemplated in these Merger Guidelines neither dictate nor exhaust the range of theories or evidence that the Agencies may introduce in merger litigation. Instead, they set forth various methods of analysis that may be applicable depending on the availability and/or reliability of information related to a given market or transaction. Given the variety of industries, market participants, and acquisitions that the Agencies encounter, merger analysis does not consist of uniform application of a single methodology. The Agencies assess any relevant and meaningful evidence to evaluate whether the effect of a merger may be substantially to lessen competition or to tend to create a monopoly. Merger review is ultimately a fact-specific exercise. The Agencies follow the facts and the law in analyzing mergers as they do in other areas of law enforcement.

These Merger Guidelines include references to applicable legal precedent. References to court decisions do not necessarily suggest that the Agencies would analyze the facts in those cases identically today. While the Agencies adapt their analytical tools as they evolve and advance, legal holdings reflecting the Supreme Court's interpretation of a statute apply unless subsequently modified. These Merger Guidelines therefore reference applicable propositions of law to explain core principles that the Agencies apply in a manner consistent with modern analytical tools and market realities. References herein do not constrain the Agencies' interpretation of the law in particular cases, as the Agencies will apply their discretion with respect to the applicable law in each case in light of the full range of precedent pertinent to the issues raised by each enforcement action.

2. Applying the Merger Guidelines

This section discusses the frameworks the Agencies use to assess whether a merger may substantially lessen competition or tend to create a monopoly.

2.1. Guideline 1: Mergers Raise a Presumption of Illegality When They Significantly Increase Concentration in a Highly Concentrated Market.

Market concentration and the change in concentration due to the merger are often useful indicators of a merger's risk of substantially lessening competition. In highly concentrated markets, a merger that eliminates a significant competitor creates significant risk that the merger may substantially lessen competition or tend to create a monopoly. As a result, a significant increase in concentration in a highly concentrated market can indicate that a merger may substantially lessen competition, depriving the public of the benefits of competition.

The Supreme Court has endorsed this view and held that "a merger which produces a firm controlling an undue percentage share of the relevant market, and results in a significant increase in the concentration of firms in that market[,] is so inherently likely to lessen competition substantially that it must be enjoined in the absence of [rebuttal] evidence."[9] In the Agencies' experience, this legal presumption provides a highly administrable and useful tool for identifying mergers that may substantially lessen competition.

An analysis of concentration involves calculating pre-merger market shares of products[10] within a relevant market (see Section 4.3 for a discussion of market definition and Section 4.4 for more details on computing market shares). The Agencies assess whether the merger creates or further consolidates a highly concentrated market and whether the increase in concentration is sufficient to indicate that the merger may substantially lessen competition or tend to create a monopoly.[11]

The Agencies generally measure concentration levels using the Herfindahl-Hirschman Index ("HHI").[12] The HHI is defined as the sum of the squares of the market shares; it is small when there are many small firms and grows larger as the market becomes more concentrated, reaching 10,000 in a market with a single firm. Markets with an HHI greater than 1,800 are highly concentrated, and a change of more than 100 points is a significant increase.[13] A merger that creates or further consolidates a highly

---

9 *United States v. Phila. Nat'l Bank*, 374 U.S. 321, 363 (1963); *see, e.g.*, *FTC v. v. Hackensack Meridian Health, Inc.*, 30 F.4th 160, 172-73 (3d Cir. 2022); *United States v. AT&T, Inc.*, 916 F.3d at 1032.

10 These Guidelines use the term "products" to encompass anything that is traded between firms and their suppliers, customers, or business partners, including physical goods, services, or access to assets. Products can be as narrow as an individual brand, a specific version of a product, or a product that includes specific ancillary services such as the right to return it without cause or delivery to the customer's location.

11 Typically, a merger eliminates a competitor by bringing two market participants under common control. Similar concerns arise if the merger threatens to cause the exit of a current market participant, such as a leveraged buyout that puts the target firm at significant risk of failure.

12 The Agencies may instead measure market concentration using the number of significant competitors in the market. This measure is most useful when there is a gap in market share between significant competitors and smaller rivals or when it is difficult to measure shares in the relevant market.

13 For illustration, the HHI for a market of five equal firms is 2,000 ($5 \times 20^2 = 2{,}000$) and for six equal firms is 1,667 ($6 \times 16.67^2 = 1667$).

concentrated market that involves an increase in the HHI of more than 100 points[14] is presumed to substantially lessen competition or tend to create a monopoly.[15] The Agencies also may examine the market share of the merged firm: a merger that creates a firm with a share over thirty percent is also presumed to substantially lessen competition or tend to create a monopoly if it also involves an increase in HHI of more than 100 points.[16]

Indicator	Threshold for Structural Presumption
Post-merger HHI	Market HHI greater than 1,800 AND Change in HHI greater than 100
Merged Firm's Market Share	Share greater than 30% AND Change in HHI greater than 100

When exceeded, these concentration metrics indicate that a merger's effect may be to eliminate substantial competition between the merging parties and may be to increase coordination among the remaining competitors after the merger. This presumption of illegality can be rebutted or disproved. The higher the concentration metrics over these thresholds, the greater the risk to competition suggested by this market structure analysis and the stronger the evidence needed to rebut or disprove it.

2.2. Guideline 2: Mergers Can Violate the Law When They Eliminate Substantial Competition Between Firms.

A merger eliminates competition between the merging firms by bringing them under joint control.[17] If evidence demonstrates substantial competition between the merging parties prior to the

[14] The change in HHI from a merger of firms with shares *a* and *b* is equal to 2*ab*. For example, in a merger between a firm with 20% market share and a firm with 5% market share, the change in HHI is 2 x 20 x 5 = 200.

[15] The first merger guidelines to reference an HHI threshold were the merger guidelines issued in 1982. These guidelines referred to mergers with HHI above 1,000 as concentrated markets, with HHI between 1,000 and 1,800 as "moderately concentrated" and above 1,800 as "highly concentrated," while they referred to an increase in HHI of 100 as a "significant increase." Each subsequent iteration until 2010 maintained those thresholds. *See* Fed. Trade Comm'n & U.S. Dep't of Justice, Horizontal Merger Guidelines § 1.51 (1997); Fed. Trade Comm'n & U.S. Dep't of Justice, Horizontal Merger Guidelines § 1.51 (1992); U.S. Dep't of Justice, Merger Guidelines § 3(A) (1982). During this time, courts routinely cited to the guidelines and these HHI thresholds in decisions. *See, e.g.*, *Chicago Bridge & Iron Co. N.V. v. FTC*, 534 F.3d 410, 431 (5th Cir. 2008); *FTC v. H.J. Heinz Co.*, 246 F.3d 708, 716 (D.C. Cir. 2001); *FTC v. Univ. Health, Inc.*, 938 F.2d 1206, 1211 (11th Cir. 1991). Although the Agencies raised the thresholds for the 2010 guidelines, based on experience and evidence developed since, the Agencies consider the original HHI thresholds to better reflect both the law and the risks of competitive harm suggested by market structure and have therefore returned to those thresholds.

[16] *Phila. Nat'l Bank*, 374 U.S. at 364-65 ("Without attempting to specify the smallest market share which would still be considered to threaten undue concentration, we are clear that 30% presents that threat.").

[17] The competitive harm from the elimination of competition between the merging firms, without considering the risk of coordination, is sometimes referred to as unilateral effects. The elimination of competition between the merging firms can also lessen competition with and among other competitors. When the elimination of competition between the merging firms

merger, that ordinarily suggests that the merger may substantially lessen competition.[18]Although a change in market structure can also indicate risk of competitive harm (see Guideline 1), an analysis of the existing competition between the merging firms can demonstrate that a merger threatens competitive harm independent from an analysis of market shares.

Competition often involves firms trying to win business by offering lower prices, new or better products and services, more attractive features, higher wages, improved benefits, or better terms relating to various additional dimensions of competition. This can include competition to research and develop products or services, and the elimination of such competition may result in harm even if such products or services are not yet commercially available. The more the merging parties have shaped one another's behavior, or have affected one another's sales, profits, valuation, or other drivers of behavior, the more significant the competition between them.

The Agencies examine a variety of indicators to identify substantial competition. For example:

***Strategic Deliberations or Decisions*.** The Agencies may analyze the extent of competition between the merging firms by examining evidence relating to strategic deliberations or decisions in the regular course of business. For example, in some markets, the firms may monitor each other's pricing, marketing campaigns, facility locations, improvements, products, capacity, output, input costs, and/or innovation plans. This can provide evidence of competition between the merging firms, especially when they react by taking steps to preserve or enhance the competitiveness or profitability of their own products or services.

***Prior Merger, Entry, and Exit Events*.** The Agencies may look to historical events to assess the presence and substantiality of direct competition between the merging firms. For example, the Agencies may examine the competitive impact of recent relevant mergers, entry, expansion, or exit events.

***Customer Substitution*.** Customers' willingness to switch between different firms' products is an important part of the competitive process. Firms are closer competitors the more that customers are willing to switch between their products. The Agencies use a variety of tools, detailed in Section 4.2, to assess customer substitution.

Impact of Competitive Actions on Rivals. When one firm takes competitive actions to attract customers, this can benefit the firm at the expense of its rivals. The Agencies may gauge the extent of competition between the merging firms by considering the impact that competitive actions by one of the merging firms has on the other merging firm. The impact of a firm's competitive actions on a rival is generally greater when customers consider the firm's products and the rival's products to be closer substitutes, so that a firm's competitive action results in greater lost sales for the rival, and when the profitability of the rival's lost sales is greater.

Impact of Eliminating Competition Between the Firms. In some instances, evidence may be available to assess the impact of competition from one firm on the other's actions, such as firm choices

---

leads them to compete less aggressively with one another, other firms in the market can in turn compete less aggressively, decreasing the overall intensity of competition.

[18] *See also United States v. First Nat'l Bank & Trust Co. of Lexington*, 376 U.S. 665, 669-70 (1964) (per curiam) ("[I]t [is] clear that the elimination of significant competition between [merging parties] constitutes an unreasonable restraint of trade in violation of § 1 of the Sherman Act. . . . It [can be] enough that the two . . . compete[], that their competition [is] not insubstantial and that the combination [would] put an end to it."); *ProMedica Health Sys., Inc. v. FTC*, 749 F.3d 559, 568-70 (6th Cir. 2014), *cert. denied*, 575 U.S. 996 (2015).

about price, quality, wages, or another dimension of competition. Section 4.2 describes a variety of approaches to measuring such impacts.

***Additional Evidence, Tools, and Metrics*.** The Agencies may use additional evidence, tools, and metrics to assess the loss of competition between the firms. Depending on the realities of the market, different evidence, tools, or metrics may be appropriate.

Section 4.2 provides additional detail about the approaches that the Agencies use to assess competition between or among firms.

2.3. Guideline 3: Mergers Can Violate the Law When They Increase the Risk of Coordination.

The Agencies determine that a merger may substantially lessen competition when it meaningfully increases the risk of coordination among the remaining firms in a relevant market or makes existing coordination more stable or effective.[19] Firms can coordinate across any or all dimensions of competition, such as price, product features, customers, wages, benefits, or geography. Coordination among rivals lessens competition whether it occurs explicitly—through collusive agreements between competitors not to compete or to compete less—or tacitly, through observation and response to rivals. Because tacit coordination often cannot be addressed under Section 1 of the Sherman Act, the Agencies vigorously enforce Section 7 of the Clayton Act to prevent market structures conducive to such coordination.

Tacit coordination can lessen competition even when it does not rise to the level of an agreement and would not itself violate the law. For example, in a concentrated market a firm may forego or soften an aggressive competitive action because it anticipates rivals responding in kind. This harmful behavior is more common the more concentrated markets become, as it is easier to predict the reactions of rivals when there are fewer of them.

To assess the extent to which a merger may increase the likelihood, stability, or effectiveness of coordination, the Agencies often consider three primary factors and several secondary factors. The Agencies may consider additional factors depending on the market.

2.3.A. Primary Factors

The Agencies may conclude that post-merger market conditions are susceptible to coordinated interaction and that the merger materially increases the risk of coordination if any of the three primary factors are present.

Highly Concentrated Market. By reducing the number of firms in a market, a merger increases the risk of coordination. The fewer the number of competitively meaningful rivals prior to the merger, the greater the likelihood that merging two competitors will facilitate coordination. Markets that are highly concentrated after a merger that significantly increases concentration (see Guideline 1) are presumptively susceptible to coordination. If merging parties assert that a highly concentrated market is not susceptible to coordination, the Agencies will assess this rebuttal evidence using the framework

[19] *See Brooke Grp. Ltd. v. Brown & Williamson Tobacco Corp.,* 509 U.S. 209, 229-30 (1993) ("In the § 7 context, it has long been settled that excessive concentration, and the oligopolistic price coordination it portends, may be the injury to competition the Act prohibits.").

described below. Where a market is not highly concentrated, the Agencies may still consider other risk factors.

Prior Actual or Attempted Attempts to Coordinate. Evidence that firms representing a substantial share in the relevant market appear to have previously engaged in express or tacit coordination to lessen competition is highly informative as to the market's susceptibility to coordination. Evidence of failed attempts at coordination in the relevant market suggest that successful coordination was not so difficult as to deter attempts, and a merger reducing the number of rivals may tend to make success more likely.

Elimination of a Maverick. A maverick is a firm with a disruptive presence in a market. The presence of a maverick, however, only reduces the risk of coordination so long as the maverick retains the disruptive incentives that drive its behavior. A merger that eliminates a maverick or significantly changes its incentives increases the susceptibility to coordination.

2.3.B. Secondary Factors

The Agencies also examine whether secondary factors demonstrate that a merger may meaningfully increase the risk of coordination, even absent the primary risk factors. Not all secondary factors must be present for a market to be susceptible to coordination.

Market Concentration. Even in markets that are not highly concentrated, coordination becomes more likely as concentration increases. The more concentrated a market, the more likely the Agencies are to conclude that the market structure suggests susceptibility to coordination.

Market Observability. A market is more susceptible to coordination if a firm's behavior can be promptly and easily observed by its rivals. Rivals' behavior is more easily observed when the terms offered to customers are readily discernible and relatively observable (that is, known to rivals). Observability can refer to the ability to observe prices, terms, the identities of the firms serving particular customers, or any other competitive actions of other firms. Information exchange arrangements among market participants, such as public exchange of information through announcements or private exchanges through trade associations or publications, increase market observability. Regular monitoring of one another's prices or customers can indicate that the terms offered to customers are relatively observable. Pricing algorithms, programmatic pricing software or services, and other analytical or surveillance tools that track or predict competitor prices or actions likewise can increase the observability of the market.

Competitive Responses. A market is more susceptible to coordination if a firm's prospective competitive reward from attracting customers away from its rivals will be significantly diminished by its rivals' likely responses. This is more likely to be the case the stronger and faster the responses from its rivals because such responses reduce the benefits of competing more aggressively. Some factors that increase the likelihood of strong or rapid responses by rivals include: (1) the market has few significant competitors, (2) products in the relevant market are relatively homogeneous, (3) customers find it relatively easy to switch between suppliers, (4) suppliers use algorithmic pricing, or (5) suppliers use meeting-competition clauses. The more predictable are rivals' responses to strategic actions or changing competitive conditions, and the more interactions firms have across multiple markets, the greater the susceptibility to coordination.

Aligned Incentives. Removing a firm that has different incentives from most other firms in a market can increase the risk of coordination. For example, a firm with a small market share may have less incentive to coordinate because it has more to gain from winning new business than other firms. The same issue can arise when a merger more closely aligns one or both merging firms' incentives with the other firms in the market. In some cases, incentives might be aligned or strengthened when firms compete with one another in multiple markets ("multi-market contact"). For example, firms might compete less aggressively in some markets in anticipation of reciprocity by rivals in other markets. The Agencies examine these and any other market realities that suggest aligned incentives increase susceptibility to coordination.

Profitability or Other Advantages of Coordination for Rivals. The Agencies regard coordinated interaction as more likely to occur when participants in the market stand to gain more from successful coordination. Coordination generally is more profitable or otherwise advantageous for the coordinating firms the less often customers substitute outside the market when firms offer worse terms.

Rebuttal Based on Structural Barriers to Coordination Unique to the Industry. When market structure evidence suggests that a merger may substantially lessen competition through coordination, the merging parties sometimes argue that anticompetitive coordination is nonetheless impossible due to structural market barriers to coordinating. The Agencies consider this rebuttal evidence using the framework in Section 3. In so doing, the Agencies consider whether structural market barriers to coordination are "so much greater in the [relevant] industry than in other industries that they rebut the normal presumption" of coordinated effects.[20] In the Agencies' experience, structural conditions that prevent coordination are exceedingly rare in the modern economy. For example, coordination is more difficult when firms are unable to observe rivals' competitive offerings, but technological change has made this situation less common than in the past and reduced many traditional barriers or obstacles to observing the behavior of rivals in a market. The greater the level of concentration in the relevant market, the greater must be the structural barriers to coordination in order to show that no substantial lessening of competition is threatened.

2.4. Guideline 4: Mergers Can Violate the Law When They Eliminate a Potential Entrant in a Concentrated Market.

Mergers can substantially lessen competition by eliminating a potential entrant. For instance, a merger can eliminate the possibility that entry or expansion by one or both firms would have resulted in new or increased competition in the market in the future. A merger can also eliminate current competitive pressure exerted on other market participants by the mere perception that one of the firms might enter. Both of these risks can be present simultaneously.

A merger that eliminates a potential entrant into a concentrated market can substantially lessen competition or tend to create a monopoly.[21] The more concentrated the market, the greater the magnitude of harm to competition from any lost potential entry and the greater the tendency to create a monopoly. Accordingly, for mergers involving one or more potential entrants, the higher the market concentration, the lower the probability of entry that gives rise to concern.

[20] *See H.J. Heinz Co.*, 246 F.3d at 724.
[21] *United States v. Marine Bancorp.*, 418 U.S. 602, 630 (1974). A concentrated market is one with an HHI greater than 1,000 (See Guideline 1, n.15).

2.4.A. Actual Potential Competition: Eliminating Reasonably Probable Future Entry

In general, expansion into a concentrated market via internal growth rather than via acquisition benefits competition.[22] Merging a current and a potential market participant eliminates the possibility that the potential entrant would have entered on its own—entry that, had it occurred, would have provided a new source of competition in a concentrated market.

To determine whether an acquisition that eliminates a potential entrant into a concentrated market may substantially lessen competition,[23] the Agencies examine (1) whether one or both[24] of the merging firms had a reasonable probability of entering the relevant market other than through an anticompetitive merger, and (2) whether such entry offered a substantial likelihood of ultimately producing deconcentration of the market or other significant procompetitive effects.[25]

Reasonable Probability of Entry. The Agencies' starting point for assessment of a reasonable probability of entry is objective evidence regarding the firm's available feasible means of entry, including its capabilities and incentives. Relevant objective evidence can include, for example, evidence that the firm has sufficient size and resources to enter; evidence of any advantages that would make the firm well-situated to enter; evidence that the firm has successfully expanded into similarly situated markets in the past or already participates in adjacent or related markets; evidence that the firm has an incentive to enter; or evidence that industry participants recognize the company as a potential entrant. This analysis is not limited to whether the company could enter with its pre-merger production facilities, but also considers overall capability, which can include the ability to expand or add to its capabilities on its own or in collaboration with someone other than the acquisition target.

Subjective evidence that the company considered entering absent the merger can also indicate a reasonable probability that the company would have entered without the merger. Subjective evidence that the company considered organic entry as an alternative to merging generally suggests that, absent the merger, entry would be reasonably probable.

Likelihood of Deconcentration or Other Significant Procompetitive Effects. New entry can yield a variety of procompetitive effects, including increased output or investment, higher wages or improved working conditions, greater innovation, higher quality, and lower prices. If the merging firm had a reasonable probability of entering a highly concentrated relevant market, this suggests benefits that would have resulted from its entry would be competitively significant, unless there is substantial direct evidence that the competitive effect would be *de minimis*. To supplement the suggestion that new entry yields procompetitive effects, the Agencies will consider projections of the potential entrant's

---

[22] *See Ford Motor Co. v. United States*, 405 U.S. 562, 587 (1972) (referring to the "typical[]" competitive concern when "a potential entrant enters an oligopolistic market by acquisition rather than internal expansion" as being "that such a move has deprived the market of the pro-competitive effect of an increase in the number of competitors").

[23] Harm from the elimination of a potential entrant can occur in markets that do not yet consist of commercial products, even if the market concentration of the future market cannot be measured using traditional means. Where there are few equivalent potential entrants, including one or both of the merging firms, that indicates that the future market, once commercialized, will be concentrated. The Agencies will consider other potential entrants' capabilities and incentives in comparison to the merging potential entrant to assess equivalence.

[24] *United States v. Penn-Olin Chemical Co.*, 378 U.S. 158 (1964) (holding that a merger between two firms, each or both of which might have entered the relevant market, could violate Section 7).

[25] *See id.* at 175-76; *Marine Bancorp.*, 418 U.S. at 622, 633 ("[T]he proscription expressed in § 7 against mergers 'when a "tendency" toward monopoly or [a] "reasonable likelihood" of a substantial lessening of competition in the relevant market is shown' applies alike to actual- and potential-competition cases." (quoting *Penn-Olin*, 378 U.S. at 171)); *see also Yamaha Motor Co. v. FTC*, 657 F.2d 971, 980-981 (8th Cir. 1981) (acquisition of potential entrant violated Section 7).

competitive significance, such as market share, its business strategy, the anticipated response of competitors, or customer preferences or interest.

A merger of two potential entrants can also result in a substantial lessening of competition. The merger need not involve a firm that has a commercialized product in the market or an existing presence in the same geographic market. The Agencies analyze similarly mergers between two potential entrants and those involving a current market participant and a potential entrant.

2.4.B. Perceived Potential Competition: Lessening of Current Competitive Pressure

A perceived potential entrant can stimulate competition among incumbents. That pressure can prompt current market participants to make investments, expand output, raise wages, increase product quality, lower product prices, or take other procompetitive actions. The acquisition of a firm that is perceived by market participants as a potential entrant can substantially lessen competition by eliminating or relieving competitive pressure.

To assess whether the acquisition of a perceived potential entrant may substantially lessen competition, the Agencies consider whether a current market participant could reasonably consider one of the merging companies to be a potential entrant and whether that potential entrant has a likely influence on existing competition.[26]

Market Participant Could Reasonably Consider a Firm to Be a Potential Entrant. The starting point for this analysis is evidence regarding the company's capability of entering or applying competitive pressure. Objective evidence is highly probative and includes evidence of feasible means of entry or communications by the company indicating plans to expand or reallocate resources in a way that could increase competition in the relevant market. Objective evidence can be sufficient to find that the firm is a potential entrant; it need not be accompanied by any subjective evidence of current market participants' internal perceptions or direct evidence of strategic reactions to the potential entrant. If such evidence is available, it can weigh in favor of finding that a current market participant could reasonably consider the firm to be a potential entrant.

Likely Influence on Existing Rivals. Direct evidence that the firm's presence or behavior has affected or is affecting current market participants' strategic decisions is not necessary but can establish a showing of a likely influence. Even without such direct evidence, circumstantial evidence that the firm's presence or behavior had an effect on the competitive reactions of firms in the market may also show likely influence. Objective evidence establishing that a current market participant could reasonably consider one of the merging firms to be a potential entrant can also establish that the firm has a likely influence on existing market participants. Subjective evidence indicating that current market participants—including, for example, customers, suppliers, or distributors—internally perceive the merging firm to be a potential entrant can also establish a likely influence.

2.4.C. Distinguishing Potential Entry from Entry as Rebuttal

When evaluating a potentially unlawful merger of current competitors, the Agencies will assess whether entry by other firms would be timely, likely, and sufficient to replace the lost competition using the standards discussed in Section 3.2. The existence of a perceived or actual potential entrant may not meet that standard when considering a merger between firms that already participate in the relevant market. The competitive impact of perceived and actual potential entrants is typically attenuated

[26] *See United States v. Falstaff Brewing Corp.*, 410 U.S. 526, 533-36 (1973); *Marine Bancorp.*, 418 U.S. at 624-25.

compared to competition between two current market participants. However, because concentrated markets often lack robust competition, the loss of even an attenuated source of competition such as a potential entrant may substantially lessen competition in such markets. Moreover, because the Agencies seek to prevent threats to competition in their incipiency, the likelihood of potential entry that could establish that a merger's effect "may be" to substantially lessen competition will generally not equal the likelihood of entry that would rebut a demonstrated risk that competition may be substantially lessened.

2.5. Guideline 5: Mergers Can Violate the Law When They Create a Firm that May Limit Access to Products or Services That Its Rivals Use to Compete.

The Agencies evaluate whether a merger may substantially lessen competition when the merged firm can limit access to a product, service, or route to market[27] that its rivals may use to compete. Mergers involving products or services rivals may use to compete can threaten competition in several ways, for example: (A) the merged firm could limit rivals' access to the products or services, thereby weakening or excluding them, lessening competition; (B) the merged firm may gain or increase access to rivals' competitively sensitive information, thereby facilitating coordination or undermining their incentives to compete; or (C) the threat of limited access can deter rivals and potential rivals from investing.

These problems can arise from mergers involving access to any products, services, or routes to market that rivals use to compete, and that are competitively significant to those rivals, whether or not they involve a traditional vertical relationship such as a supplier and distributor relationship. Many types of related products can implicate these concerns, including products rivals currently or may in the future use as inputs, products that provide distribution services for rivals or otherwise influence customers' purchase decisions, products that provide or increase the merged firm's access to competitively sensitive information about its rivals, or complements that increase the value of rivals' products. Even if the related product is not currently being used by rivals, it might be competitively significant because, for example, its availability enables rivals to obtain better terms from other providers in negotiations. The Agencies refer to any product, service, or route to market that rivals use to compete in that market as a "related product."

The Agencies analyze competitive effects in the relevant market in which the merged firm competes with rivals that use the related product. The Agencies do not always define a market around the related product, although they may do so (see Section 2.5.A.2).

2.5.A. The Risk that the Merged Firm May Limit Access

A merger involving products, services, or routes to market that rivals use to compete may substantially lessen competition when the merged firm has both the ability and incentive to limit access to the related product so as to weaken or exclude some of its rivals (the "dependent" rivals) in the relevant market.

The merged firm could limit access to the related product in different ways. It could deny rivals access altogether, deny access to some features, degrade its quality, worsen the terms on which rivals

[27] A "route to market" refers to any way a firm accesses its trading partners, such as distribution channels, marketplaces, or customers.

can access the related product, limit interoperability, degrade the quality of complements, provide less reliable access, tie up or obstruct routes to market, or delay access to product features, improvements, or information relevant to making efficient use of the product. All these ways of limiting access are sometimes referred to as "foreclosure."[28]

Dependent rivals can be weakened if limiting their access to the related product would make it harder or more costly for them to compete; for example, if it would lead them to charge higher prices or offer worse terms in the relevant market, reduce the quality of their products so that they were less attractive to trading partners, or interfere with distribution so that those products were less readily available. Competition can also be weakened if the merger facilitates coordination among the merged firm and its rivals, for example by giving the merged firm the ability to threaten to limit access to uncooperative rivals.

Rivals or potential rivals may be excluded from the relevant market if limiting their access to the related product could lead them to exit the market or could deter them from entering. For example, potential rivals may not enter if the merged firm ties up or obstructs so many routes to market that the remaining addressable market is too small. Exclusion can arise when a new entrant would need to invest not only in entering the relevant market, but also in supplying its own substitute for the related product, sometimes referred to as two-stage entry or multi-level entry.

Because the merged firm could use its ability to limit access to the related product in a range of ways, the Agencies focus on the overall risk that the merged firm will do so, and do not necessarily identify which precise actions the merged firm would take to lessen competition.

2.5.A.1. Ability and Incentive to Foreclose Rivals

The Agencies assess the merged firm's ability and incentive to substantially lessen competition by limiting access to the related product for a group of dependent rivals in the relevant market by examining four factors.

1. Availability of Substitutes. The Agencies assess the availability of substitutes for the related product. The merged firm is more able to limit access when there are few alternative options to the merged firm's related product, if these alternatives are differentiated in quality, price, or other characteristics, or if competition to supply them is limited.

2. Competitive Significance of the Related Product. The Agencies consider how important the related product is for the dependent firms and the extent to which they would be weakened or excluded from the relevant market if their access was limited.

3. Effect on Competition in the Relevant Market. The Agencies assess the importance of the dependent firms for competition in the relevant market. Competition can be particularly affected when the dependent firms would be excluded from the market altogether.

4. Competition Between the Merged Firm and the Dependent Firms. The merged firm's incentive to limit the dependent firms' access depends on how strongly it competes with them. If the dependent firms are close competitors, the merged firm may benefit from higher sales or prices in the relevant market when it limits their access. The Agencies may also assess the potential for the merged

[28] *See Illumina, Inc. v. FTC*, No. 23-60167, slip op. at 17 (5th Cir. Dec. 15, 2023) ("[T]here are myriad ways in which [the merged firm] could engage in foreclosing behavior . . . such as by making late deliveries or subtly reducing the level of support services.").

firm to benefit from facilitating coordination by threatening to limit dependent rivals' access to the related product. These benefits can make it profitable to limit access to the related product and thereby substantially lessen competition, even though it would not have been profitable for the firm that controlled the related product prior to the merger.

The Agencies assess the extent of competition with rivals and the risk of coordination using analogous methods to the ones described in Guidelines 2 and 3, and Section 4.2.

* * *

In addition to the evidentiary, analytical, and economic tools in Section 4, the following additional considerations and evidence may be important to this assessment:

Barriers to Entry and Exclusion of Rivals. The merged firm may benefit more from limiting access to dependent rivals or potential rivals when doing so excludes them from the market, for example by creating a need for the firm to enter at multiple levels and to do so with sufficient scale and scope (multi-level entry).

Prior Transactions or Prior Actions. If firms used prior acquisitions or engaged in prior actions to limit rivals' access to the related product, or other products its rivals use to compete, that suggests that the merged firm has the ability and incentive to do so. However, lack of past action does not necessarily indicate a lack of incentive in the present transaction because the merger can increase the incentive to foreclose.

Internal Documents. Information from business planning and merger analysis documents prepared by the merging firms might identify instances where the firms believe they have the ability and incentive to limit rivals' access. Such documents, where available, are highly probative. The lack of such documents, however, is less informative.

Market Structure. Evidence of market structure can be informative about the availability of substitutes for the related product and the competition in the market for the related product or the relevant market. (See Section 2.5.A.2)

2.5.A.2. Analysis of Industry Factors and Market Structure

The Agencies also sometimes determine, based on an analysis of factors related to market structure, that a merger may substantially lessen competition by allowing the merged firm to limit access to a related product.[29] The Agencies' assessment can include evidence about the structure, history, and probable future of the market.

Structure of the Related Market. In some cases, the market structure of the related product market can give an indication of the merged firm's ability to limit access to the related product. In these cases, the Agencies define a market (termed the "related market") around the related product (see Section 4.3). The Agencies then define the "foreclosure share" as the share of the related market to which the merged firm could limit access. If the share or other evidence show that the merged firm is

[29] *See Brown Shoe*, 370 U.S. at 328-34; *Illumina*, slip op. at 20-22 ("There is no precise formula when it comes to applying these factors. Indeed, the Supreme Court has found a vertical merger unlawful by examining only three of the *Brown Shoe* factors." (cleaned up)); *Fruehauf Corp. v. FTC*, 603 F.2d 345, 353 (2d Cir. 1979); *U.S. Steel Corp. v. FTC*, 426 F.2d 592, 599 (6th Cir. 1970).

approaching or has monopoly power over the related product, and the related product is competitively significant, those factors alone are a sufficient basis to demonstrate that the dependent firms do not have adequate substitutes and the merged firm has the ability to weaken or exclude them by limiting their access to the related product. (See Considerations 1 and 2 in Section 2.5.A.1).[30]

Structure of the Relevant Market. Limiting rivals' access to the related product will generally have a greater effect on competition in the relevant market if the merged firm and the dependent rivals face less competition from other firms. In addition, the merged firm has a greater incentive to limit access to the dependent firms when it competes more closely with them. Market share and concentration measures for the merged firm, the dependent rivals, and the other firms, can sometimes provide evidence about both issues.

Nature and Purpose of the Merger. When the nature and purpose of the merger is to foreclose rivals, including by raising their costs, that suggests the merged firm is likely to foreclose rivals.

Trend Toward Vertical Integration. The Agencies will generally consider evidence about the degree of integration between firms in the relevant and related markets, as well as whether there is a trend toward further vertical integration and how that trend or the factors driving it may affect competition. A trend toward vertical integration may be shown through, for example: a pattern of vertical integration following mergers by one or both of the merging companies; or evidence that a merger was motivated by a desire to avoid having its access limited due to similar transactions among other companies that occurred or may occur in the future.

*　　*　　*

If the parties offer rebuttal evidence, the Agencies will assess it under the approach laid out in Section 3.[31] When assessing rebuttal evidence focused on the reduced profits of the merged firm from limiting access from rivals, the Agencies examine whether the reduction in profits would prevent the full range of reasonably probable strategies to limit access. When evaluating whether this rebuttal evidence is sufficient to conclude that no substantial lessening of competition is threatened by the merger, the Agencies will give little weight to claims that are not supported by an objective analysis, including, for example, speculative claims about reputational harms. Moreover, the Agencies are unlikely to credit claims or commitments to protect or otherwise avoid weakening the merged firm's rivals that do not align with the firm's incentives. The Agencies' assessment will be consistent with the principle that firms act to maximize their overall profits and valuation rather than the profits of any particular business

[30] *See Brown Shoe*, 370 U.S. at 328 ("If the share of the market foreclosed is so large that it approaches monopoly proportions, the Clayton Act will, of course, have been violated . . . ."). The Agencies will generally infer, in the absence of countervailing evidence, that the merging firm has or is approaching monopoly power in the related product if it has a share greater than 50% of the related product market. A merger involving a related product with share of less than 50% may still substantially lessen competition, particularly when that related product is important to its trading partners.

[31] A common rebuttal argument is that the merger would lead to vertical integration of complementary products and as a result, "eliminate double marginalization," since in specific circumstances such a merger can confer on the merged firm an incentive to decrease prices to purchasers. The Agencies examine whether elimination of double marginalization satisfies the approach to evaluating procompetitive efficiencies in Section 3.3, including examining: (a) whether the merged firm will be more vertically integrated as a result of the merger, for example because it increases the extent to which it uses internal production of an input when producing output for the relevant market; (b) whether contracts short of a merger have eliminated or could eliminate double marginalization such that it would not be merger-specific, and (c) whether the merged firm has the incentive to reduce price in the relevant market given that such a reduction would reduce sales by the merged firm's rivals in the relevant market, which would in turn lead to reduced revenue and margin on sales of the related product to the dependent rivals.

unit. A merger may substantially lessen competition or tend to create a monopoly regardless of the claimed intent of the merging companies or their executives. (See Section 4.1)

If the merged firm has the ability and incentive to limit access to the related product and lessen competition in the relevant market, there are many ways it could act on those incentives. The merging parties may put forward evidence that there are no reasonably probable ways in which they could profitably limit access to the related product and thereby make it harder for rivals to compete, or that the merged firm will be more competitive because of the merger.

2.5.B. Mergers Involving Visibility into Rivals' Competitively Sensitive Information

If rivals would continue to access or purchase a related product controlled by the merged firm post-merger, the merger can substantially lessen competition if the merged firm would gain or increase visibility into rivals' competitively sensitive information. This situation could arise in many settings, including, for example, if the merged firm learns about rivals' sales volumes or projections from supplying an input or a complementary product; if it learns about promotion plans and anticipated product improvements or innovations from its role as a distributor; or if it learns about entry plans from discussions with potential rivals about compatibility or interoperability with a complementary product it controls. A merger that gives the merged firm increased visibility into competitively sensitive information could undermine rivals' ability or incentive to compete aggressively or could facilitate coordination.

Undermining Competition. The merged firm might use visibility into a rival's competitively sensitive information to undermine competition from the rival. For example, the merged firm's ability to preempt, appropriate, or otherwise undermine the rival's procompetitive actions can discourage the rival from fully pursuing competitive opportunities. Relatedly, rivals might refrain from doing business with the merged firm rather than risk that the merged firm would use their competitively sensitive business information to undercut them. Those rivals might become less-effective competitors if they must rely on less-preferred trading partners or accept less favorable trading terms because their outside options have worsened or are more limited.

Facilitating Coordination. A merger that provides access to rivals' competitively sensitive information might facilitate coordinated interaction among firms in the relevant market by allowing the merged firm to observe its rivals' competitive strategies faster and more confidently. (See Guideline 3.)

2.5.C. Mergers that Threaten to Limit Rivals' Access and Thereby Create Barriers to Entry and Competition

When a merger gives a firm the ability and incentive to limit rivals' access, or where it gives the merged firm increased visibility into its rivals' competitively sensitive information, the merger may create entry barriers as described above. In addition, the merged firm's rivals might change their behavior because of the risk that the merged firm could limit their access. That is, the risk that the merger will give a firm the ability and incentive to limit rivals' access or will give the merged firm increased visibility into sensitive information can dissuade rivals from entering the market or expanding their operations.

Rivals or potential rivals that face the threat of foreclosure, or the risk of sharing sensitive information with rivals, may reduce investment or adjust their business strategies in ways that lessen competition. Firms may be reluctant to invest in a market if their success is dependent on continued supply from a rival, particularly because the merged firm may become more likely to foreclose its competitor as that competitor becomes more successful. Firms may use expensive strategies to try to reduce their dependence on the merged firm, weakening the competitiveness of their products and services. Even if the merged firm does not deliberately seek to weaken rivals, rivals or potential rivals may fear that their access will be limited if the merged firm decides to use its own products exclusively. These effects may occur irrespective of the merged firm's incentive to limit access and are greater as the merged firm gains greater control over more important inputs that those rivals use to compete.

2.6. Guideline 6: Mergers Can Violate the Law When They Entrench or Extend a Dominant Position.

The Agencies consider whether a merger may entrench or extend an already dominant position. The effect of such mergers "may be substantially to lessen competition" or "may be . . . to tend to create a monopoly" in violation of Section 7 of the Clayton Act. Indeed, the Supreme Court has explained that a merger involving an "already dominant[] firm may substantially reduce the competitive structure of the industry by raising entry barriers."[32] The Agencies also evaluate whether the merger may extend that dominant position into new markets.[33] Mergers that entrench or extend a dominant position can also violate Section 2 of the Sherman Act.[34] At the same time, the Agencies distinguish anticompetitive entrenchment from growth or development as a consequence of increased competitive capabilities or incentives.[35] The Agencies therefore seek to prevent those mergers that would entrench or extend a dominant position through exclusionary conduct, weakening competitive constraints, or otherwise harming the competitive process.

To undertake this analysis, the Agencies first assess whether one of the merging firms has a dominant position based on direct evidence or market shares showing durable market power. For example, the persistence of market power can indicate that entry barriers exist, that further entrenchment may tend to create a monopoly, and that there would be substantial benefits from the emergence of new competitive constraints or disruptions. The Agencies consider mergers involving dominant firms in the context of evidence about the sources of that dominance, focusing on the extent to which the merger relates to, reinforces, or supplements these sources.

Creating or preserving dominance and the profits it brings can be an important motivation for a firm to undertake an acquisition as well as a driver of the merged firm's behavior after the acquisition. In particular, a firm may be willing to undertake costly short-term strategies in order to increase the chance that it can enjoy the longer-term benefits of dominance. A merger that creates or preserves dominance may also reduce the merged firm's longer-term incentives to improve its products and services.

A merger can result in durable market power and long-term harm to competition even when it initially provides short-term benefits to some market participants. Thus, the Agencies will consider not just the impact of the merger holding fixed factors like product quality and the behavior of other industry participants, but they may also consider the (often longer term) impact of the merger on market

---

[32] *FTC v. Procter & Gamble Co.*, 386 U.S. 568, 577-578 (1967); *see, e.g.*, *Fruehauf*, 603 F.2d at 353 (the "entrenchment of a large supplier or purchaser" can be an "essential" showing of a Section 7 violation).
[33] *Ford*, 405 U.S. at 571 (condemning acquisition by dominant firm to obtain a foothold in another market when coupled with incentive to create and maintain barriers to entry into that market).
[34] *See, e.g.*, *United States v. Grinnell Corp.*, 384 U.S. 563 (1966) (acquisitions are among the types of conduct that may violate the Sherman Act).
[35] *See*, *e.g.*, *id.* at 570-71.

power and industry dynamics. Important dynamic competitive effects can arise through the entry, investment, innovation, and terms offered by the merged firm and other industry participants, even when the Agencies cannot predict specific reactions and responses with precision. If the ultimate result of the merger is to protect or preserve dominance by limiting opportunities for rivals, reducing competitive constraints, or preventing competitive disruption, then the Agencies will approach the merger with a heightened degree of scrutiny. The degree of scrutiny and concern will increase in proportion to the strength and durability of the dominant firm's market power.

2.6.A. Entrenching a Dominant Position

***Raising Barriers to Entry or Competition*.** A merger may create or enhance barriers to entry or expansion by rivals that limit the capabilities or competitive incentives of other firms. Barriers to entry can entrench a dominant position even if the nature of future entry is uncertain, if the identities of future entrants are unknown, or if there is more than one mechanism through which the merged firm might create entry barriers. Some examples of ways in which a merger may raise barriers to entry or competition include:

- *Increasing Switching Costs.* The costs associated with changing suppliers (often referred to as switching costs) can be an important barrier to competition. A merger may increase switching costs if it makes it more difficult for customers to switch away from the dominant firm's product or service, or when it gives the dominant firm control of something customers use to switch providers or of something that lowers the overall cost to customers of switching providers. For example, if a dominant firm merges with a complementary product that interoperates with the dominant firm's competitors, it could reduce interoperability, harming competition for customers who value the complement.

- *Interfering With the Use of Competitive Alternatives.* A dominant position may be threatened by a service that customers use to work with multiple providers of similar or overlapping bundles of products and services. If a dominant firm acquires a service that supports the use of multiple providers, it could degrade its utility or availability or could modify the service to steer customers to its own products, entrenching its dominant position. For example, a closed messaging communication service might acquire a product that allowed users to send and receive messages over several competing services through a single user interface, which facilitates competition. The Agencies would examine whether the acquisition would entrench the messaging service's market power by leading the merged firm to degrade the product or otherwise reduce its effectiveness as a cross-service tool, thus reducing competition.

- *Depriving Rivals of Scale Economies or Network Effects.* Scale economies and network effects can serve as a barrier to entry and competition. Depriving rivals of access to scale economies and network effects can therefore entrench a dominant position. If a merger enables a dominant firm to reduce would-be rivals' access to additional scale or customers by acquiring a product that affects access such as a customer acquisition channel, the merged firm can limit the ability of rivals to improve their own products and compete more effectively.[36] Limiting access by rivals to customers in the short run can lead to long run entrenchment of a dominant position and tend to create monopoly power.

[36] The Agencies' focus here is on the artificial acquisition of network participants that occurs directly as a result of the merger, as opposed to future network growth that may occur through competition on the merits.

> For example, if two firms operate in a market in which network effects are significant but in which rivals voluntarily interconnect, their merger can create an entity with a large enough user base that it may have the incentive to end voluntary interconnection. Such a strategy can lessen competition and harm trading partners by creating or entrenching dominance in this market. This can be the case even if the merging firms did not appear to have a dominant position prior to the merger because their interoperability practices strengthened rivals.

Eliminating a Nascent Competitive Threat. A merger may involve a dominant firm acquiring a nascent competitive threat—namely, a firm that could grow into a significant rival, facilitate other rivals' growth, or otherwise lead to a reduction in its power.[37] In some cases, the nascent threat may be a firm that provides a product or service similar to the acquiring firm that does not substantially constrain the acquiring firm at the time of the merger but has the potential to grow into a more significant rival in the future. In other cases, factors such as network effects, scale economies, or switching costs may make it extremely difficult for a new entrant to offer all of the product features or services at comparable quality and terms that an incumbent offers. The most likely successful threats in these situations can be firms that initially avoid directly entering the dominant firm's market, instead specializing in (a) serving a narrow customer segment, (b) offering services that only partially overlap with those of the incumbent, or (c) serving an overlapping customer segment with distinct products or services.

Firms with niche or only partially overlapping products or customers can grow into longer-term threats to a dominant firm. Once established in its niche, a nascent threat may be able to add features or serve additional customer segments, growing into greater overlap of customer segments or features over time, thereby intensifying competition with the dominant firm. A nascent threat may also facilitate customers aggregating additional products and services from multiple providers that serve as a partial alternative to the incumbent's offering. Thus, the success and independence of the nascent threat may both provide for a direct threat of competition by the niche or nascent firm and may facilitate competition or encourage entry by other, potentially complementary providers that may provide a partial competitive constraint. In this way, the nascent threat supports what may be referred to as "ecosystem" competition. In this context, ecosystem competition refers to a situation where an incumbent firm that offers a wide array of products and services may be partially constrained by other combinations of products and services from one or more providers, even if the business model of those competing services is different.

Nascent threats may be particularly likely to emerge during technological transitions. Technological transitions can render existing entry barriers less relevant, temporarily making incumbents susceptible to competitive threats. For example, technological transitions can create temporary opportunities for entrants to differentiate or expand their offerings based on their alignment with new technologies, enabling them to capture network effects that otherwise insulate incumbents from competition. A merger in this context may lessen competition by preventing or delaying any such beneficial shift or by shaping it so that the incumbent retains its dominant position. For example, a dominant firm might seek to acquire firms to help it reinforce or recreate entry barriers so that its dominance endures past the technological transition. Or it might seek to acquire nascent threats that might otherwise gain sufficient customers to overcome entry barriers. In evaluating the potential for entrenching dominance, the Agencies take particular care to preserve opportunities for more competitive markets to emerge during such technological shifts.

[37] The Agencies assess acquisitions of nascent competitive threats by non-dominant firms under the other Guidelines.

Separate from and in addition to its Section 7 analysis, the Agencies will consider whether the merger violates Section 2 of the Sherman Act. For example, under Section 2 of the Sherman Act, a firm that may challenge a monopolist may be characterized as a "nascent threat" even if the impending threat is uncertain and may take several years to materialize.[38] The Agencies assess whether the merger is reasonably capable of contributing significantly to the preservation of monopoly power in violation of Section 2, which turns on whether the acquired firm is a nascent competitive threat.[39]

2.6.B. Extending a Dominant Position into Another Market

The Agencies also examine the risk that a merger could enable the merged firm to extend a dominant position from one market into a related market, thereby substantially lessening competition or tending to create a monopoly in the related market. For example, the merger might lead the merged firm to leverage its position by tying, bundling, conditioning, or otherwise linking sales of two products. A merger may also raise barriers to entry or competition in the related market, or eliminate a nascent competitive threat, as described above. For example, prior to a merger, a related market may be characterized by scale economies but still experience moderate levels of competition. If the merged firm takes actions to induce customers of the dominant firm's product to also buy the related product from the merged firm, the merged firm may be able to gain dominance in the related market, which may be supported by increased barriers to entry or competition that result from the merger.

These concerns can arise notwithstanding that the acquiring firm already enjoys the benefits associated with its dominant position. The prospect of market power in the related market may strongly affect the merged firm's incentives in a way that does not align with the interests of its trading partners, both in terms of strategies that create dominance for the related product and in the form of reduced incentives to invest in its products or provide attractive terms for them after dominance is attained. In some cases, the merger may also further entrench the firm's original dominant position, for example if future competition requires the provision of both products.

* * *

If the merger raises concerns that its effect may be to entrench or extend a dominant position, then any claim that the merger also provides competitive benefits will be evaluated under the rebuttal framework in Section 3. For example, the framework of Section 3 would be used to evaluate claims that a merger would generate cost savings or quality improvements that would be passed through to make their products more competitive or would otherwise create incentives for the merged firm to offer better terms. The Agencies' analysis will consider the fact that the incentives to pass through benefits to customers or offer attractive terms are affected by competition and the extent to which entry barriers insulate the merged firm from effective competition. It will also consider whether any claimed benefits are specific to the merger, or whether they could be instead achieved through contracting or other means.

---

[38] *United States v. Microsoft Corp.*, 253 F.3d 34 (D.C. Cir. 2001) (en banc) (per curiam).

[39] *See id*. at 79 ("[I]t would be inimical to the purpose of the Sherman Act to allow monopolists free reign to squash nascent, albeit unproven, competitors at will. . . .").

2.7. Guideline 7: When an Industry Undergoes a Trend Toward Consolidation, the Agencies Consider Whether It Increases the Risk a Merger May Substantially Lessen Competition or Tend to Create a Monopoly.

The recent history and likely trajectory of an industry can be an important consideration when assessing whether a merger presents a threat to competition. The Supreme Court has explained that "a trend toward concentration in an industry, whatever its causes, is a highly relevant factor in deciding how substantial the anticompetitive effect of a merger may be."[40] It has also underscored that "Congress intended Section 7 to arrest anticompetitive tendencies in their incipiency.[41] The Agencies therefore examine whether a trend toward consolidation in an industry would heighten the competition concerns identified in Guidelines 1-6.

The Agencies therefore closely examine industry consolidation trends in applying the frameworks above. For example:

Trend Toward Concentration. If an industry has gone from having many competitors to becoming concentrated, it may suggest greater risk of harm, for example, because new entry may be less likely to replace or offset the lessening of competition the merger may cause. Among other implications, in the context of a trend toward concentration, the Agencies identify a stronger presumption of harm from undue concentration (see Guideline 1), and a greater risk of substantially lessening competition when a merger eliminates competition between the merging parties (see Guideline 2) or increases the risk of coordination (see Guideline 3).

Trend Toward Vertical Integration. The Agencies will generally consider evidence about the degree of integration between firms in the relevant and related markets and whether there is a trend toward further vertical integration. If a merger occurs amidst or furthers a trend toward vertical integration, the Agencies consider the implications for the competitive dynamics of the industry moving forward. For example, a trend toward vertical integration could magnify the concerns discussed in Guideline 5 by making entry at a single level more difficult and thereby preventing the emergence of new competitive threats over time.

Arms Race for Bargaining Leverage. The Agencies sometimes encounter mergers through which the merging parties would, by consolidating, gain bargaining leverage over other firms that they transact with. This can encourage those other firms to consolidate to obtain countervailing leverage, encouraging a cascade of further consolidation. This can ultimately lead to an industry where a few powerful firms have leverage against one another and market power over would-be entrants or over trading partners in various parts of the value chain. For example, distributors might merge to gain leverage against suppliers, who then merge to gain leverage against distributors, spurring a wave of mergers that lessen competition by increasing the market power of both. This can exacerbate the problems discussed in Guidelines 1-6, including by increasing barriers to single-level entry, encouraging coordination, and discouraging disruptive innovation.

[40] *United States v. Pabst Brewing*, 384 U.S. 546, 552-53 (1966).
[41] *Phila. Nat'l Bank*, 374 U.S. at 362 (quoting *Brown Shoe*, 370 U.S. at 317).

***Multiple Mergers*.** The Agencies sometimes see multiple mergers at once or in succession by different players in the same industry. In such cases, the Agencies may examine multiple deals in light of the combined trend toward concentration.

2.8. Guideline 8: When a Merger is Part of a Series of Multiple Acquisitions, the Agencies May Examine the Whole Series.

A firm that engages in an anticompetitive pattern or strategy of multiple acquisitions in the same or related business lines may violate Section 7.[42] In these situations, the Agencies may evaluate the series of acquisitions as part of an industry trend (see Guideline 7) or evaluate the overall pattern or strategy of serial acquisitions by the acquiring firm collectively under Guidelines 1-6.

In expanding antitrust law beyond the Sherman Act through passage of the Clayton Act, Congress intended "to permit intervention in a cumulative process when the effect of an acquisition may be a significant reduction in the vigor of competition, even though this effect may not be so far-reaching as to amount to a combination in restraint of trade, create a monopoly, or constitute an attempt to monopolize."[43] As the Supreme Court has recognized, a cumulative series of mergers can "convert an industry from one of intense competition among many enterprises to one in which three or four large [companies] produce the entire supply."[44] Accordingly, the Agencies will consider individual acquisitions in light of the cumulative effect of related patterns or business strategies.

The Agencies may examine a pattern or strategy of growth through acquisition by examining both the firm's history and current or future strategic incentives. Historical evidence focuses on the strategic approach taken by the firm to acquisitions (consummated or not), both in the markets at issue and in other markets, to reveal any overall strategic approach to serial acquisitions. Evidence of the firm's current incentives includes documents and testimony reflecting its plans and strategic incentives both for the individual acquisition and for its position in the industry more broadly. Where one or both of the merging parties has engaged in a pattern or strategy of pursuing consolidation through acquisition, the Agencies will examine the impact of the cumulative strategy under any of the other Guidelines to determine if that strategy may substantially lessen competition or tend to create a monopoly.

2.9. Guideline 9: When a Merger Involves a Multi-Sided Platform, the Agencies Examine Competition Between Platforms, on a Platform, or to Displace a Platform.

Platforms provide different products or services to two or more different groups or "sides" who may benefit from each other's participation. Mergers involving platforms can threaten competition, even when a platform merges with a firm that is neither a direct competitor nor in a traditional vertical relationship with the platform. When evaluating a merger involving a platform, the Agencies apply Guidelines 1-6 while accounting for market realities associated with platform competition. Specifically,

---

[42] Such strategies may also violate Section 2 of the Sherman Act and Section 5 of the FTC Act. Fed. Trade Comm'n, *Policy Statement Regarding the Scope of Unfair Methods of Competition Under Section 5 of the Federal Trade Commission Act*, at 12-14 & nn.73 & 82 (Nov. 10, 2022) (noting that "a series of . . . acquisitions . . . that tend to bring about the harms that the antitrust laws were designed to prevent" has been subject to liability under Section 5).
[43] H.R. Rep. No. 81-1191, at 8 (1949).
[44] *See Brown Shoe*, 370 U.S. at 334 (citing S. Rep. No. 81-1775, at 5 (1950); H.R. Rep. No. 81-1191, at 8 (1949)).

the Agencies consider competition *between* platforms, competition *on* a platform, and competition to *displace* the platform.

Multi-sided platforms generally have several attributes in common, though they can also vary in important ways. Some of these attributes include:

- Platforms have multiple sides. On each side of a platform, platform participants provide or use distinct products and services.[45] Participants can provide or use different types of products or services on each side.

- A platform operator provides the core services that enable the platform to connect participant groups across multiple sides. The platform operator controls other participants' access to the platform and can influence how interactions among platform participants play out.

- Each side of a platform includes platform participants. Their participation might be as simple as using the platform to find other participants, or as involved as building platform services that enable other participants to connect in new ways and allow new participants to join the platform.

- Network effects occur when platform participants contribute to the value of the platform for other participants and the operator. The value for groups of participants on one side may depend on the number of participants either on the same side (direct network effects) or on the other side(s) (indirect network effects).[46] Network effects can create a tendency toward concentration in platform industries. Indirect network effects can be asymmetric and heterogeneous; for example, one side of the market or segment of participants may place relatively greater value on the other side(s).

- A conflict of interest can arise when a platform operator is also a platform participant. The Agencies refer to a "conflict of interest" as the divergence that can arise between the operator's incentives to operate the platform as a forum for competition and its incentive to operate as a competitor on the platform itself. As discussed below, a conflict of interest sometimes exacerbates competitive concerns from mergers.

Consistent with the Clayton Act's protection of competition "in any line of commerce," the Agencies will seek to prohibit a merger that harms competition within a relevant market for any product or service offered on a platform to any group of participants—i.e., around one side of the platform (see Section 4.3).[47]

---

[45] For example, on 1990s operating-system platforms for personal computer (PC) software, software developers were on one side, PC manufacturers on another, and software purchasers on another.

[46] For example, 1990s PC manufacturers, software developers, and consumers all contributed to the value of the operating system platform for one another.

[47] In the limited scenario of a "special type of two-sided platform known as a 'transaction' platform," under Section 1 of the Sherman Act, a relevant market encompassing both sides of a two-sided platform may be warranted. *Ohio v. American Express Co.*, 138 S. Ct. 2274, 2280 (2018). This approach to Section 1 of the Sherman Act is limited to platforms with the "key feature . . . that they cannot make a sale to one side of the platform without simultaneously making a sale to the other." *Id.* Because "they cannot sell transaction services to [either user group] individually . . . transaction platforms are better understood as supplying only one product—transactions." *Id.* at 2286. This characteristic is not present for many types of two-sided or multi-sided platforms; in addition, many platforms offer simultaneous transactions as well as other products and services, and further they may bundle these products with access to transact on the platform or offer quantity discounts.

The Agencies protect competition *between* platforms by preventing the acquisition or exclusion of other platform operators that may substantially lessen competition or tend to create a monopoly. This scenario can arise from various types of mergers:

A. Mergers involving two platform operators eliminate the competition between them. In a market with a platform, entry or growth by smaller competing platforms can be particularly challenging because of network effects. A common strategy for smaller platforms is to specialize, providing distinctive features. Thus, dominant platforms can lessen competition and entrench their position by systematically acquiring firms competing with one or more sides of a multi-sided platform while they are in their infancy. The Agencies seek to stop these trends in their incipiency.

B. A platform operator may acquire a platform participant, which can entrench the operator's position by depriving rivals of participants and, in turn, depriving them of network effects. For example, acquiring a major seller on a platform may make it harder for rival platforms to recruit buyers. The long-run benefits to a platform operator of denying network effects to rival platforms create a powerful incentive to withhold or degrade those rivals' access to platform participants that the operator acquires. The more powerful the platform operator, the greater the threat to competition presented by mergers that may weaken rival operators or increase barriers to entry and expansion.

C. Acquisitions of firms that provide services that facilitate participation on multiple platforms can deprive rivals of platform participants. Many services can facilitate such participation, such as tools that help shoppers compare prices across platforms, applications that help sellers manage listings on multiple platforms, or software that helps users switch among platforms.

D. Mergers that involve firms that provide other important inputs to platform services can enable the platform operator to deny rivals the benefits of those inputs. For example, acquiring data that helps facilitate matching, sorting, or prediction services may enable the platform to weaken rival platforms by denying them that data.

The Agencies protect competition *on* a platform in any markets that interact with the platform. When a merger involves a platform operator and platform participants, the Agencies carefully examine whether the merger would create conflicts of interest that would harm competition. A platform operator that is also a platform participant may have a conflict of interest whereby it has an incentive to give its own products and services an advantage over other participants competing on the platform. Platform operators must often choose between making it easy for users to access their preferred products and directing those users to products that instead provide greater benefit to the platform operator. Merging with a firm that makes a product offered on the platform may change how the platform operator balances these competing interests. For example, the platform operator may find it is more profitable to give its own product greater prominence even if that product is inferior or is offered on worse terms after the merger—and even if some participants leave the platform as a result.[48] This can harm competition in

[48] However, few participants will leave if, for example, the switching costs are relatively high or if the advantaged product is a small component of the overall set of services those participants access on the platform. Moreover, in the long run few participants will leave if scale economies, network effects, or entry barriers enable the advantaged product to eventually gain market power of its own, with rivals of the advantaged product exiting or becoming less attractive. After these dynamics play

the product market for the advantaged product, where the harm to competition may be experienced both on the platform and in other channels.

The Agencies protect competition to *displace* the platform or any of its services. For example, new technologies or services may create an important opportunity for firms to replace one or more services the incumbent platform operator provides, shifting some participants to partially or fully meet their needs in different ways or through different channels. Similarly, a non-platform service can lessen dependence on the platform by providing an alternative to one or more functions provided by the platform operators. When platform owners are dominant, the Agencies seek to prevent even relatively small accretions of power from inhibiting the prospects for displacing the platform or for decreasing dependency on the platform.

In addition, a platform operator that advantages its own products that compete *on* the platform can lessen competition *between* platforms and to *displace* the platform, as the operator may both advantage its own product or service, and also deprive rival platforms of access to it, limiting those rivals' network effects.

2.10. Guideline 10: When a Merger Involves Competing Buyers, the Agencies Examine Whether It May Substantially Lessen Competition for Workers, Creators, Suppliers, or Other Providers.

A merger between competing buyers may harm sellers just as a merger between competing sellers may harm buyers.[49] The same—or analogous—tools used to assess the effects of a merger of sellers can be used to analyze the effects of a merger of buyers, including employers as buyers of labor. Firms can compete to attract contributions from a wide variety of workers, creators, suppliers, and service providers. The Agencies protect this competition in all its forms.

A merger of competing buyers can substantially lessen competition by eliminating the competition between the merging buyers or by increasing coordination among the remaining buyers. It can likewise lead to undue concentration among buyers or entrench or extend the position of a dominant buyer. Competition among buyers can have a variety of beneficial effects analogous to competition among sellers. For example, buyers may compete by raising the payments offered to suppliers, by expanding supply networks, through transparent and predictable contracting, procurement, and payment practices, or by investing in technology that reduces frictions for suppliers. In contrast, a reduction in competition among buyers can lead to artificially suppressed input prices or purchase volume, which in turn reduces incentives for suppliers to invest in capacity or innovation. Labor markets are important buyer markets. The same general concerns as in other markets apply to labor markets where employers are the buyers of labor and workers are the sellers. The Agencies will consider whether workers face a risk that the merger may substantially lessen competition for their labor.[50] Where a merger between

---

out, the platform operator could advantage its own products without losing as many participants, as there would be fewer alternative products available through other channels.

[49] *See, e.g.*, *Mandeville Island Farms, Inc. v. Am. Crystal Sugar Co.*, 334 U.S. 219, 235-36 (1948) ("The [Sherman Act] does not confine its protection to consumers, or to purchasers, or to competitors, or to sellers. . . . The Act is comprehensive in its terms and coverage, protecting all who are made victims of the forbidden practices by whomever they may be perpetrated.").

[50] *See, e.g.*, *Alston*, 141 S. Ct. 2141 (applying the Sherman Act to protect workers from an employer-side agreement to limit compensation).

employers may substantially lessen competition for workers, that reduction in labor market competition may lower wages or slow wage growth, worsen benefits or working conditions, or result in other degradations of workplace quality.[51] When assessing the degree to which the merging firms compete for labor, evidence that a merger may have any one or more of these effects can demonstrate that substantial competition exists between the merging firms.

Labor markets frequently have characteristics that can exacerbate the competitive effects of a merger between competing employers. For example, labor markets often exhibit high switching costs and search frictions due to the process of finding, applying, interviewing for, and acclimating to a new job. Switching costs can also arise from investments specific to a type of job or a particular geographic location. Moreover, the individual needs of workers may limit the geographical and work scope of the jobs that are competitive substitutes.

In addition, finding a job requires the worker and the employer to agree to the match. Even within a given salary and skill range, employers often have specific demands for the experience, skills, availability, and other attributes they desire in their employees. At the same time, workers may seek not only a paycheck but also work that they value in a workplace that matches their own preferences, as different workers may value the same aspects of a job differently. This matching process often narrows the range of rivals competing for any given employee. The level of concentration at which competition concerns arise may be lower in labor markets than in product markets, given the unique features of certain labor markets. In light of their characteristics, labor markets can be relatively narrow.

The features of labor markets may in some cases put firms in dominant positions. To assess this dominance in labor markets (see Guideline 6), the Agencies often examine the merging firms' power to cut or freeze wages, slow wage growth, exercise increased leverage in negotiations with workers, or generally degrade benefits and working conditions without prompting workers to quit.

If the merger may substantially lessen competition or tend to create a monopoly in upstream markets, that loss of competition is not offset by purported benefits in a separate downstream product market. Because the Clayton Act prohibits mergers that may substantially lessen competition or tend to create a monopoly in *any* line of commerce and in *any* section of the country, a merger's harm to competition among buyers is not saved by benefits to competition among sellers. That is, a merger can substantially lessen competition in one or more buyer markets, seller markets, or both, and the Clayton Act protects competition in any one of them.[52] If the parties claim any benefits to competition in a relevant buyer market, the Agencies will assess those claims using the frameworks in Section 3.

Just as they do when analyzing competition in the markets for products and services, the Agencies will analyze labor market competition on a case-by-case basis.

---

[51] A decrease in wages is understood as relative to what would have occurred in the absence of the transaction; in many cases, a transaction will not reduce wage levels, but rather slow wage growth. Wages encompass all aspects of pecuniary compensation, including benefits. Job quality encompasses non-pecuniary aspects that workers value, such as working conditions and terms of employment.

[52] Often, mergers that harm competition among buyers also harm competition among sellers as a result. For example, when a monopsonist lowers purchase prices by decreasing input purchases, they will generally decrease sales in downstream markets as well. (See Section 4.2.D)

2.11. Guideline 11: When an Acquisition Involves Partial Ownership or Minority Interests, the Agencies Examine Its Impact on Competition.

In many acquisitions, two companies come under common control. In some situations, however, the acquisition of less-than-full control may still influence decision-making at the target firm or another firm in ways that may substantially lessen competition. Acquisitions of partial ownership or other minority interests may give the investor rights in the target firm, such as rights to appoint board members, observe board meetings, influence the firm's ability to raise capital, impact operational decisions, or access competitively sensitive information. The Agencies have concerns with both cross-ownership, which refers to holding a non-controlling interest in a competitor, as well as common ownership, which occurs when individual investors hold non-controlling interests in firms that have a competitive relationship that could be affected by those joint holdings.

Partial acquisitions that do not result in control may nevertheless present significant competitive concerns. The acquisition of a minority position may permit influence of the target firm, implicate strategic decisions of the acquirer with respect to its investment in other firms, or change incentives so as to otherwise dampen competition. The post-acquisition relationship between the parties and the independent incentives of the parties outside the acquisition may be important in determining whether the partial acquisition may substantially lessen competition. Such partial acquisitions are subject to the same legal standard as any other acquisition.[53]

The Agencies recognize that cross-ownership and common ownership can reduce competition by softening firms' incentives to compete, even absent any specific anticompetitive act or intent. While the Agencies will consider any way in which a partial acquisition may affect competition, they generally focus on three principal effects:

First, a partial acquisition can lessen competition by giving the partial owner the ability to influence the competitive conduct of the target firm.[54] For example, a voting interest in the target firm or specific governance rights, such as the right to appoint members to the board of directors, influence capital budgets, determine investment return thresholds, or select particular managers, can create such influence. Additionally, a nonvoting interest may, in some instances, provide opportunities to prevent, delay, or discourage important competitive initiatives, or otherwise impact competitive decision making. Such influence can lessen competition because the partial owner could use its influence to induce the target firm to compete less aggressively or to coordinate its conduct with that of the acquiring firm.

Second, a partial acquisition can lessen competition by reducing the incentive of the acquiring firm to compete.[55] Acquiring a minority position in a rival might blunt the incentive of the partial owner to compete aggressively because it may profit through dividend or other revenue share even when it loses business to the rival. For example, the partial owner may decide not to develop a new product feature to win market share from the firm in which it has acquired an interest, because doing so will

[53] *See United States v. E. I. du Pont de Nemours & Co.*, 353 U.S. 586, 592 (1957) ("[A]ny acquisition by one corporation of all or any part of the stock of another corporation, competitor or not, is within the reach of [Section 7 of the Clayton Act] whenever the reasonable likelihood appears that the acquisition will result in a restraint of commerce or in the creation of a monopoly of any line of commerce.").
[54] *See United States v. Dairy Farmers of Am., Inc.*, 426 F.3d 850, 860-61 (6th Cir. 2005).
[55] *See Denver & Rio Grande v. United States*, 387 U.S. 485, 504 (1967) (identifying Section 7 concerns with a 20% investment).

reduce the value of its investment in its rival. This reduction in the incentive of the acquiring firm to compete arises even when it cannot directly influence the conduct or decision making of the target firm.

Third, a partial acquisition can lessen competition by giving the acquiring firm access to non-public, competitively sensitive information from the target firm. Even absent any ability to influence the conduct of the target firm, access to competitively sensitive information can substantially lessen competition through other mechanisms. For example, it can enhance the ability of the target and the partial owner to coordinate their behavior and make other accommodating responses faster and more targeted. The risk of coordinated effects is greater if the transaction also facilitates the flow of competitively sensitive information from the investor to the target firm. Even if coordination does not occur, the partial owner may use that information to preempt or appropriate a rival's competitive business strategies for its own benefit. If rivals know their efforts to win trading partners can be immediately appropriated, they may see less value in taking competitive actions in the first place, resulting in a lessening of competition.

* * *

The analyses above address common scenarios that the Agencies use to assess the risk that a merger may substantially lessen competition or tend to create a monopoly. However, they are not exhaustive. The Agencies have in the past encountered mergers that lessen competition through mechanisms not covered above. For example:

A. A merger that would enable firms to avoid a regulatory constraint because that constraint was applicable to only one of the merging firms;

B. A merger that would enable firms to exploit a unique procurement process that favors the bids of a particular competitor who would be acquired in the merger; or

C. In a concentrated market, a merger that would dampen the acquired firm's incentive or ability to compete due to the structure of the acquisition or the acquirer.

As these scenarios and these Guidelines indicate, a wide range of evidence can show that a merger may lessen competition or tend to create a monopoly. Whatever the sources of evidence, the Agencies look to the facts and the law in each case.

Whatever frameworks the Agencies use to identify that a merger may substantially lessen competition or tend to create a monopoly, they also examine rebuttal evidence under the framework in Section 3.

3. Rebuttal Evidence Showing that No Substantial Lessening of Competition is Threatened by the Merger

The Agencies may assess whether a merger may substantially lessen competition or tend to create a monopoly based on a fact-specific analysis under any one or more of the Guidelines discussed above.[56] The Supreme Court has determined that analysis should consider "other pertinent factors" that may "mandate[] a conclusion that no substantial lessening of competition [is] threatened by the acquisition."[57] The factors pertinent to rebuttal depend on the nature of the threat to competition or tendency to create a monopoly resulting from the merger.

Several common types of rebuttal and defense evidence are subject to legal tests established by the courts. The Agencies apply those tests consistent with prevailing law, as described below.

3.1. Failing Firms

When merging parties suggest the weak or weakening financial position of one of the merging parties will prevent a lessening of competition, the Agencies examine that evidence under the "failing firm" defense established by the Supreme Court. This defense applies when the assets to be acquired would imminently cease playing a competitive role in the market even absent the merger.

As set forth by the Supreme Court, the failing firm defense has three requirements:

A. "[T]he evidence show[s] that the [failing firm] face[s] the grave probability of a business failure."[58] The Agencies typically look for evidence in support of this element that the allegedly failing firm would be unable to meet its financial obligations in the near future. Declining sales and/or net losses, standing alone, are insufficient to show this requirement.

B. "The prospects of reorganization of [the failing firm are] dim or nonexistent."[59] The Agencies typically look for evidence suggesting that the failing firm would be unable to reorganize successfully under Chapter 11 of the Bankruptcy Act, taking into account that "companies reorganized through receivership, or through [the Bankruptcy Act] often emerge[] as strong competitive companies."[60] Evidence of the firm's actual attempts to resolve its debt with creditors is important.

C. "[T]he company that acquires the failing [firm] or brings it under dominion is the only available purchaser."[61] The Agencies typically look for evidence that a company has made unsuccessful good-faith efforts to elicit reasonable alternative offers that pose a less severe danger to competition than does the proposed merger.[62]

---

[56] *See United States v. AT&T, Inc.*, 916 F.3d at 1032.
[57] *See United States v. Gen. Dynamics Corp.*, 415 U.S. 486, 498 (1974); *Baker Hughes*, 908 F.2d at 990 (quoting *General Dynamics* and describing its holding as permitting rebuttal based on a "finding that 'no substantial lessening of competition occurred or was threatened by the acquisition'").
[58] *Citizen Publ'g Co. v. United States*, 394 U.S. 131, 138 (1969).
[59] *Id*.
[60] *Id*.
[61] *Id.* at 136-39 (quoting *Int'l Shoe Co. v. FTC*, 280 U.S. 291, 302 (1930)).
[62] Any offer to purchase the assets of the failing firm for a price above the liquidation value of those assets will be regarded as a reasonable alternative offer. Parties must solicit reasonable alternative offers before claiming that the business is failing.

Although merging parties sometimes argue that a poor or weakening position should serve as a defense even when it does not meet these elements, the Supreme Court has "confine[d] the failing company doctrine to its present narrow scope."[63] The Agencies evaluate evidence of a failing firm consistent with this prevailing law.[64]

3.2. Entry and Repositioning

Merging parties sometimes raise a rebuttal argument that a reduction in competition resulting from the merger would induce entry or repositioning[65] into the relevant market, preventing the merger from substantially lessening competition or tending to create a monopoly in the first place. This argument posits that a merger may, by substantially lessening competition, make the market more profitable for the merged firm and any remaining competitors, and that this increased profitability may induce new entry. To evaluate this rebuttal evidence, the Agencies assess whether entry induced by the merger would be "timely, likely, and sufficient in its magnitude, character, and scope to deter or counteract the competitive effects of concern."[66]

Timeliness. To show that no substantial lessening of competition is threatened by a merger, entry must be rapid enough to replace lost competition before any effect from the loss of competition due to the merger may occur. Entry in most industries takes a significant amount of time and is therefore insufficient to counteract any substantial lessening of competition that is threatened by a merger. Moreover, the entry must be durable: an entrant that does not plan to sustain its investment or that may exit the market would not ensure long-term preservation of competition.

Likelihood. Entry induced by lost competition must be so likely that no substantial lessening of competition is threatened by the merger. Firms make entry decisions based on the market conditions they expect once they participate in the market. If the new entry is sufficient to counteract the merger's effect on competition, the Agencies analyze why the merger would induce entry that was not planned in pre-merger competitive conditions.

The Agencies also assess whether the merger may increase entry barriers. For example, the merging firms may have a greater ability to discourage or block new entry when combined than they would have as separate firms. Mergers may enable or incentivize unilateral or coordinated exclusionary

---

Liquidation value is the highest value the assets could command outside the market. If a reasonable alternative offer was rejected, the parties cannot claim that the business is failing.

[63] *Citizen Publ'g*, 394 U.S. at 139.

[64] The Agencies do not normally credit claims that the assets of a division would exit the relevant market in the near future unless: (1) applying cost allocation rules that reflect true economic costs, the division has a persistently negative cash flow on an operating basis, and such negative cash flow is not economically justified for the firm by benefits such as added sales in complementary markets or enhanced customer goodwill; and (2) the owner of the failing division has made unsuccessful good-faith efforts to elicit reasonable alternative offers that would keep its assets in the relevant market and pose a less severe danger to competition than does the proposed acquisition. Because firms can allocate costs, revenues, and intra-company transactions among their subsidiaries and divisions, the Agencies require evidence that is not solely based on management plans that could have been prepared for the purpose of demonstrating negative cash flow or the prospect of exit from the relevant market.

[65] Repositioning is a supply-side response that is evaluated like entry. If repositioning requires movement of assets from other markets, the Agencies will consider the costs and competitive effects of doing so. Repositioning that would reduce competition in the markets from which products or services are moved is not a cognizable rebuttal for a lessening of competition in the relevant market.

[66] *FTC v. Sanford Health*, 926 F.3d 959, 965 (8th Cir. 2019).

strategies that make entry more difficult. Entry can be particularly challenging when a firm must enter at multiple levels of the market at sufficient scale to compete effectively.

Sufficiency. Even where timely and likely, the prospect of entry may not effectively prevent a merger from threatening a substantial lessening of competition. Entry may be insufficient due to a wide variety of constraints that limit an entrant's effectiveness as a competitor. Entry must at least replicate the scale, strength, and durability of one of the merging parties to be considered sufficient. The Agencies typically do not credit entry that depends on lessening competition in other markets.

As part of their analysis, the Agencies will consider the economic realities at play. For example, lack of successful entry in the past will likely suggest that entry may be slow or difficult. Recent examples of entry, whether successful or unsuccessful, provide the starting point for identifying the elements of practical entry barriers and the features of the industry that facilitate or interfere with entry. The Agencies will also consider whether the parties' entry arguments are consistent with the rationale for the merger or imply that the merger itself would be unprofitable.

3.3. Procompetitive Efficiencies

The Supreme Court has held that "possible economies [from a merger] cannot be used as a defense to illegality."[67] Competition usually spurs firms to achieve efficiencies internally, and firms also often work together using contracts short of a merger to combine complementary assets without the full anticompetitive consequences of a merger.

Merging parties sometimes raise a rebuttal argument that, notwithstanding other evidence that competition may be lessened, evidence of procompetitive efficiencies shows that no substantial lessening of competition is in fact threatened by the merger. This argument asserts that the merger would not substantially lessen competition in any relevant market in the first place.[68] When assessing this argument, the Agencies will not credit vague or speculative claims, nor will they credit benefits outside the relevant market that would not prevent a lessening of competition in the relevant market. Rather, the Agencies examine whether the evidence[69] presented by the merging parties shows each of the following:

Merger Specificity. The merger will produce substantial competitive benefits that could not be achieved without the merger under review.[70] Alternative ways of achieving the claimed benefits are considered in making this determination. Alternative arrangements could include organic growth of one of the merging firms, contracts between them, mergers with others, or a partial merger involving only those assets that give rise to the procompetitive efficiencies.

[67] *Phila. Nat'l Bank*, 374 U.S. at 371; *Procter & Gamble Co.*, 386 U.S. at 580 ("Congress was aware that some mergers which lessen competition may also result in economies but it struck the balance in favor of protecting competition.").
[68] *United States v. Anthem*, 855 F.3d 345, 353-55 (D.C. Cir. 2017) (although efficiencies not a "defense" to antitrust liability, evidence sometimes used "to rebut a prima facie case"); *Saint Alphonsus Medical Center-Nampa*, 778 F.3d at 791 ("The Clayton Act focuses on competition, and the claimed efficiencies therefore must show that the prediction of anticompetitive effects from the prima facie case is inaccurate.").
[69] In general, evidence related to efficiencies developed prior to the merger challenge is much more probative than evidence developed during the Agencies' investigation or litigation.
[70] If inter-firm collaborations are achievable by contract, they are not merger specific. The Agencies will credit the merger specificity of efficiencies only in the presence of evidence that a contract to achieve the asserted efficiencies would not be practical. *See Anthem*, 855 F.3d at 357.

Verifiability. These benefits are verifiable, and have been verified, using reliable methodology and evidence not dependent on the subjective predictions of the merging parties or their agents. Procompetitive efficiencies are often speculative and difficult to verify and quantify, and efficiencies projected by the merging firms often are not realized. If reliable methodology for verifying efficiencies does not exist or is otherwise not presented by the merging parties, the Agencies are unable to credit those efficiencies.

Prevents a Reduction in Competition. To the extent efficiencies merely benefit the merging firms, they are not cognizable. The merging parties must demonstrate through credible evidence that, within a short period of time, the benefits will prevent the risk of a substantial lessening of competition in the relevant market.

Not Anticompetitive. Any benefits claimed by the merging parties are cognizable only if they do not result from the anticompetitive worsening of terms for the merged firm's trading partners.[71]

Procompetitive efficiencies that satisfy each of these criteria are called cognizable efficiencies. To successfully rebut evidence that a merger may substantially lessen competition, cognizable efficiencies must be of a nature, magnitude, and likelihood that no substantial lessening of competition is threatened by the merger in any relevant market. Cognizable efficiencies that would not prevent the creation of a monopoly cannot justify a merger that may tend to create a monopoly.

[71] The Agencies will not credit efficiencies if they reflect or require a decrease in competition in a separate market. For example, if input costs are expected to decrease, the cost savings will not be treated as an efficiency if they reflect an increase in monopsony power.

4. Analytical, Economic, and Evidentiary Tools

The analytical, economic, and evidentiary tools that follow can be applicable to many parts of the Agencies' evaluation of a merger as they apply the factors and frameworks discussed in Sections 2 and 3.

4.1. Sources of Evidence

This subsection describes the most common sources of evidence the Agencies draw on in a merger investigation. The evidence the Agencies rely upon to evaluate whether a merger *may* substantially lessen competition or tend to create a monopoly is weighed based on its probative value. In assessing the available evidence, the Agencies consider documents, testimony, available data, and analysis of those data, including credible econometric analysis and economic modeling.

Merging Parties**.** The Agencies often obtain substantial information from the merging parties, including documents, testimony, and data. Across all of these categories, evidence created in the normal course of business is more probative than evidence created after the company began anticipating a merger review. Similarly, the Agencies give less weight to predictions by the parties or their employees, whether in the ordinary course of business or in anticipation of litigation, offered to allay competition concerns. Where the testimony of outcome-interested merging party employees contradicts ordinary course business records, the Agencies typically give greater weight to the business records.

Evidence that the merging parties intend or expect the merger to lessen competition, such as plans to coordinate with other firms, raise prices, reduce output or capacity, reduce product quality or variety, lower wages, cut benefits, exit a market, cancel plans to enter a market without a merger, withdraw products or delay their introduction, or curtail research and development efforts after the merger, can be highly informative in evaluating the effects of a merger on competition. The Agencies give little weight, however, to the lack of such evidence or the expressed contrary intent of the merging parties.

Customers, Workers, Industry Participants, and Observers**.** Customers can provide a variety of information to the Agencies, ranging from information about their own purchasing behavior and choices to their views about the effects of the merger itself. The Agencies consider the relationship between customers and the merging parties in weighing customer evidence. The ongoing business relationship between a customer and a merging party may discourage the customer from providing evidence inconsistent with the interests of the merging parties.

Workers and representatives from labor organizations can provide information regarding, among other things, wages, non-wage compensation, working conditions, the individualized needs of workers in the market in question, the frictions involved in changing jobs, and the industry in which they work.

Similarly, other suppliers, indirect customers, distributors, consultants, and industry analysts can also provide information helpful to a merger inquiry. As with other interested parties, the Agencies give less weight to evidence created in anticipation of a merger investigation and more weight to evidence developed in the ordinary course of business.

Market Effects in Consummated Mergers**.** Evidence of observed post-merger price increases or worsened terms is given substantial weight. A consummated merger, however, may substantially lessen competition even if such effects have not yet been observed, perhaps because the merged firm may be aware of the possibility of post-merger antitrust review and is therefore moderating its conduct.

Consequently, in evaluating consummated mergers, the Agencies also consider the same types of evidence when evaluating proposed mergers.

***Econometric Analysis and Economic Modeling*.** Econometric analysis of data and other types of economic modeling can be informative in evaluating the potential effects of a merger on competition. The Agencies give more weight to analysis using high quality data and adhering to rigorous standards. But the Agencies also take into account that in some cases, the availability or quality of data or reliable modeling techniques might limit the availability and relevance of econometric modeling. When data is available, the Agencies recognize that the goal of economic modeling is not to create a perfect representation of reality, but rather to inform an assessment of the likely change in firm incentives resulting from a merger.

Transaction Terms. The financial terms of the transaction may also be informative regarding a merger's impact on competition. For example, a purchase price that exceeds the acquired firm's stand-alone market value can sometimes indicate that the acquiring firm is paying a premium because it expects to be able to benefit from reduced competition.

4.2. Evaluating Competition Among Firms

This subsection discusses evidence and tools the Agencies look to when assessing competition among firms. The evidence and tools in this section can be relevant to a variety of settings, for example: to assess competition between rival firms (Guideline 2); the ability and incentive to limit access to a product rivals use to compete (Guideline 5); or for market definition (Section 4.3), for example when carrying out the Hypothetical Monopolist Test (Section 4.3.A).

For clarity, the discussion in this subsection often focuses on competition between two suppliers of substitute products that set prices. Analogous analytic tools may also be relevant in more general settings, for example when considering: competition among more than two suppliers; competition among buyers or employers to procure inputs and labor; competition that derives from customer willingness to buy in different locations; and competition that takes place in dimensions other than price or when terms are determined through, for example, negotiations or auctions.

Guideline 2 describes how different types of evidence can be used in assessing the potential harm to competition from a merger; some portions of Guideline 2 that are relevant in other settings are repeated below.

4.2.A. Generally Applicable Considerations

The Agencies may consider one or more of the following types of evidence, tools, and metrics when assessing the degree of competition among firms:

***Strategic Deliberations or Decisions*.** The Agencies may analyze the extent of competition among firms, for example between the merging firms, by examining evidence of their strategic deliberations or decisions in the regular course of business. For example, in some markets, the firms may monitor each other's pricing, marketing campaigns, facility locations, improvements, products, capacity, output, input costs, and/or innovation plans. This can provide evidence of competition between the merging firms, especially when they react by taking steps to preserve or enhance the competitiveness or profitability of their own products or services.

Prior Merger, Entry, and Exit Events. The Agencies may look to historical events to assess the presence and substantiality of direct competition between the merging firms. For example, the Agencies may examine the impact of recent relevant mergers, entry, expansion, or exit events on the merging parties or their competitive behavior.

Customer Substitution. Customers' willingness to switch between different firms' products is an important part of the competitive process. Firms are closer competitors the more that customers are willing to switch between their products, for example because they are more similar in quality, price, or other characteristics.

Evidence commonly analyzed to show the extent of substitution among firms' products includes: how customers have shifted purchases in the past in response to relative changes in price or other terms and conditions; documentary and testimonial evidence such as win/loss reports, evidence from discount approval processes, switching data, customer surveys, as well as information from suppliers of complementary products and distributors; objective information about product characteristics; and market realities affecting the ability of customers to switch.

Impact of Competitive Actions on Rivals. When one firm takes competitive actions to attract customers, this can benefit the firm at the expense of its rivals. The Agencies may gauge the extent of competition among firms by considering the impact that competitive actions by one firm have on the others. The impact of a firm's competitive actions on a rival generally depends on how many sales a rival would lose as a result of the competitive actions, as well as the profitability of those lost sales. The Agencies may use margins to measure the profitability of the sale a rival would have made.[72]

Impact of Eliminating Competition Between the Firms. In some instances, evidence may be available to assess the impact of competition from one or more firms on the other firms' actions, such as firm choices about price, quality, wages, or another dimension of competition. This can be gauged by comparing the two firms' actions when they compete and make strategic choices independently against the actions the firms might choose if they acted jointly. Actual or predicted changes in these results of competition, when available, can indicate the degree of competition between the firms.

To make this type of comparison, the Agencies sometimes rely on economic models. Often, such models consider the firms' incentives to change their actions in one or more selected dimensions, such as price, in a somewhat simplified scenario. For example, a model might focus on the firms' short-run incentives to change price, while abstracting from a variety of additional competitive forces and dimensions of competition, such as the potential for firms to reposition their products or for the merging firms to coordinate with other firms. Such a model may incorporate data and evidence in order to produce quantitative estimates of the impact of the merger on firm incentives and corresponding choices. This type of exercise is sometimes referred to by economists as "merger simulation" despite the fact that the hypothetical setting considers only selected aspects of the loss of competition from a merger. The Agencies use such models to give an indication of the scale and importance of competition, not to precisely predict outcomes.

[72] The margin on incremental units is the difference between incremental revenue (often equal to price) and incremental cost on those units. The Agencies may use accounting data to measure incremental costs, but they do not necessarily rely on accounting margins recorded by firms in the ordinary course of business because such margins often do not align with the concept of incremental cost that is relevant in economic analysis of a merger.

4.2.B. Considerations When Terms Are Set by Firms

The Agencies may use various types of evidence and metrics to assess the strength of competition among firms that set terms to their customers. Firms might offer the same terms to different customers or different terms to different groups of customers.

Competition in this setting can lead firms to set lower prices or offer more attractive terms when they act independently than they would in a setting where that competition was eliminated by a merger. When considering the impact of competition on the incentives to set price, to the extent price increases on one firm's products would lead customers to switch to products from another firm, their merger will enable the merged firm to profit by unilaterally raising the price of one or both products above the pre-merger level. Some of the sales lost because of the price increase will be diverted to the products of the other firm, and capturing the value of these diverted sales can make the price increase profitable even though it would not have been profitable prior to the merger.

A measure of customer substitution between firms in this setting is the diversion ratio. The diversion ratio from one product to another is a metric of how customers likely would substitute between them. The diversion ratio is the fraction of unit sales lost by the first product due to a change in terms, such as an increase in its price, that would be diverted to the second product. The higher the diversion ratio between two products made by different firms, the stronger the competition between them.

A high diversion ratio between the products owned by two firms can indicate strong competition between them even if the diversion ratio to another firm is higher. The diversion ratio from one of the products of one firm to a group of products made by other firms, defined analogously, is sometimes referred to as the aggregate diversion ratio or the recapture rate.

A measure of the impact on rivals of competitive actions is the value of diverted sales from a price increase. The value of sales diverted from one firm to a second firm, when the first firm raises its price on one of its products, is equal to the number of units that would be diverted from the first firm to the second, multiplied by the difference between the second firm's price and the incremental cost of the diverted sales. To interpret the magnitude of the value of diverted sales, the Agencies may use as a basis of comparison either the incremental cost to the second firm of making the diverted sales, or the revenues lost by the first firm as a result of the price increase. The ratio of the value of diverted sales to the revenues lost by the first firm can be an indicator of the upward pricing pressure that would result from the loss of competition between the two firms. Analogous concepts can be applied to analyze the impact on rivals of worsening terms other than price.

4.2.C. Considerations When Terms Are Set Through Bargaining or Auctions

In some industries, buyers and sellers negotiate prices and other terms of trade. In bargaining, buyers commonly negotiate with more than one seller and may play competing sellers off against one another. In other industries, sellers might sell their products, or buyers might procure inputs, using an auction. Negotiations may involve aspects of an auction as well as aspects of one-on-one negotiation. Competition among sellers can significantly enhance the ability of a buyer to obtain a result more favorable to it, and less favorable to the sellers, compared to a situation where the elimination of competition through a merger prevents buyers from playing those sellers off against each other in negotiations.

Sellers may compete even when a customer does not directly play their offers against each other. The attractiveness of alternative options influences the importance of reaching an agreement to the negotiating parties and thus the terms of the agreement. A party that has many attractive alternative trading partners places less importance on reaching an agreement with any one particular trading partner than a party with few attractive alternatives. As alternatives for one party are eliminated (such as through a merger), the trading partner gains additional bargaining leverage reflecting that loss of competition. A merger between sellers may lessen competition even if the merged firm handles negotiations for the merging firms' products separately.

Thus, qualitative or quantitative evidence about the leverage provided to buyers by competing suppliers may be used to assess the extent of competition among firms in this setting. Analogous evidence may be used when analyzing a setting where terms are set using auctions, for example, procurement auctions where suppliers bid to serve a buyer. If, for some categories of procurements, certain suppliers are often among the most attractive to the buyer, competition among that group of suppliers is likely to be strong.

Firms sometimes keep records of the progress and outcome of individual sales efforts, and the Agencies may use these data to generate measures of the extent to which customers would likely substitute between the two firms. Examples of such measures might include a diversion ratio based on the rate at which customers would buy from one firm if the other one was not available, or the frequency with which the two firms bid on contracts with the same customer.

4.2.D. Considerations When Firms Determine Capacity and Output

In some markets, the choice of how much to produce (output decisions) or how much productive capacity to maintain (capacity decisions) are key strategic variables. When a firm decreases output, it may lose sales to rivals, but also drive up prices. Because a merged firm will account for the impact of higher prices across all of the merged firms' sales, it may have an incentive to decrease output as a result of the merger. The loss of competition through a merger of two firms may lead the merged firm to leave capacity idle, refrain from building or obtaining capacity that would have been obtained absent the merger, lay off or stop hiring workers, or eliminate pre-existing production capabilities. A firm may also divert the use of capacity away from one relevant market and into another market so as to raise the price in the former market. The analysis of the extent to which firms compete may differ depending on how a merger between them might create incentives to suppress output.

Competition between merging firms is greater when (1) the merging firms' market shares are relatively high; (2) the merging firms' products are relatively undifferentiated from each other; (3) the market elasticity of demand is relatively low; (4) the margin on the suppressed output is relatively low; and (5) the supply responses of non-merging rivals are relatively small. Qualitative or quantitative evidence may be used to evaluate and weigh each of these factors.

In some cases, competition between firms—including one firm with a substantial share of the sales in the market and another with significant excess capacity to serve that market—can prevent an output suppression strategy from being profitable. This can occur even if the firm with the excess capacity has a relatively small share of sales, as long as that firm's ability to expand, and thus keep prices from rising, makes an output suppression strategy unprofitable for the firm with the larger market share.

4.2.E. Considerations for Innovation and Product Variety Competition

Firms can compete for customers by offering varied and innovative products and features, which could range from minor improvements to the introduction of a new product category. Features can include new or different product attributes, services offered along with a product, or higher-quality services standing alone. Customers value the variety of products or services that competition generates, including having a variety of locations at which they can shop.

Offering the best mix of products and features is an important dimension of competition that may be harmed as a result of the elimination of competition between the merging parties.

When a firm introduces a new product or improves a product's features, some of the sales it gains may be at the expense of its rivals, including rivals that are competing to develop similar products and features. As a result, competition between firms may lead them to make greater efforts to offer a variety of products and features than would be the case if the firms were jointly owned, for example, if they merged. The merged firm may have a reduced incentive to continue or initiate development of new products that would have competed with the other merging party, but post-merger would "cannibalize" what would be its own sales.[73] A service provider may have a reduced incentive to continue valuable upgrades offered by the acquired firm. The merged firm may have a reduced incentive to engage in disruptive innovation that would threaten the business of one of the merging firms. Or it may have the incentive to change its product mix, such as by ceasing to offer one of the merging firms' products, leaving worse off the customers who previously chose the product that was eliminated. For example, competition may be harmed when customers with a preference for a low-price option lose access to it, even if remaining products have higher quality.

The incentives to compete aggressively on innovation and product variety depend on the capabilities of the firms and on customer reactions to the new offerings. Development of new features depends on having the appropriate expertise and resources. Where firms are two of a small number of companies with specialized employees, development facilities, intellectual property, or research projects in a particular area, competition between them will have a greater impact on their incentives to innovate.

Innovation may be directed at outcomes beyond product features; for example, innovation may be directed at reducing costs or adopting new technology for the distribution of products.

4.3. Market Definition

The Clayton Act protects competition "in any line of commerce in any section of the country."[74] The Agencies engage in a market definition inquiry in order to identify whether there is any line of commerce or section of the country in which the merger may substantially lessen competition or tend to create a monopoly. The Agencies identify the "area of effective competition" in which competition may be lessened "with reference to a product market (the 'line of commerce') and a geographic market (the 'section of the country.')."[75] The Agencies refer to the process of identifying market(s) protected by the Clayton Act as a "market definition" exercise and the markets so defined as "relevant antitrust markets,"

[73] Sales "cannibalization" refers to a situation where customers of a firm substitute away from one of the firm's products to another product offered by the same firm.
[74] 15 U.S.C. § 18.
[75] *Brown Shoe*, 370 U.S. at 324.

or simply "relevant markets." Market definition can also allow the Agencies to identify market participants and measure market shares and market concentration.

A relevant antitrust market is an area of effective competition, comprising both product (or service) and geographic elements. The outer boundaries of a relevant product market are determined by the "reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it."[76] Within a broad relevant market, however, effective competition often occurs in numerous narrower relevant markets.[77] Market definition ensures that relevant antitrust markets are sufficiently broad, but it does not always lead to a single relevant market. Section 7 of the Clayton Act prohibits any merger that may substantially lessen competition "in any line of commerce" and in "any section of the country," and the Agencies protect competition by challenging a merger that may lessen competition in any one or more relevant markets.

Market participants often encounter a range of possible substitutes for the products of the merging firms. However, a relevant market cannot meaningfully encompass that infinite range of substitutes.[78] There may be effective competition among a narrow group of products, and the loss of that competition may be harmful, making the narrow group a relevant market, even if competitive constraints from significant substitutes are outside the group. The loss of both the competition between the narrow group of products and the significant substitutes outside that group may be even more harmful, but that does not prevent the narrow group from being a market in its own right.

Relevant markets need not have precise metes and bounds. Some substitutes may be closer, and others more distant, and defining a market necessarily requires including some substitutes and excluding others. Defining a relevant market sometimes requires a line-drawing exercise around product features, such as size, quality, distances, customer segment, or prices. There can be many places to draw that line and properly define a relevant market. The Agencies recognize that such scenarios are common, and indeed "fuzziness would seem inherent in any attempt to delineate the relevant . . . market."[79] Market participants may use the term "market" colloquially to refer to a broader or different set of products than those that would be needed to constitute a valid relevant antitrust market.

The Agencies rely on several tools to demonstrate that a market is a relevant antitrust market. For example, the Agencies may rely on any one or more of the following to identify a relevant antitrust market.

A. Direct evidence of substantial competition between the merging parties can demonstrate that a relevant market exists in which the merger may substantially lessen competition and can be sufficient to identify the line of commerce and section of the country affected by a merger, even if the metes and bounds of the market are only broadly characterized.

---

[76] *Id.* at 325.
[77] *Id.* ("[W]ithin [a] broad market, well-defined submarkets may exist which, in themselves, constitute product markets for antitrust purposes."). Multiple overlapping markets can be appropriately defined relevant markets. For example, a merger to monopoly for food worldwide would lessen competition in well-defined relevant markets for, among others, food, baked goods, cookies, low-fat cookies, and premium low-fat chocolate chip cookies. Illegality in any of these in any city or town comprising a relevant geographic market would suffice to prohibit the merger, and the fact that one area comprises a relevant market does not mean a larger, smaller, or overlapping area could not as well.
[78] *United States v. Cont'l Can Co.*, 378 U.S. 441, 449 (1964); *see also FTC v. Advoc. Health Care Network*, 841 F.3d 460, 469 (7th Cir. 2016) ("A geographic market does not need to include all of the firm's competitors; it needs to include the competitors that would substantially constrain the firm's price-increasing ability." (cleaned up)).
[79] *Phila. Nat'l Bank*, 374 U.S. at 360 n.37.

B. Direct evidence of the exercise of market power can demonstrate the existence of a relevant market in which that power exists. This evidence can be valuable when assessing the risk that a dominant position may be entrenched, maintained, or extended, since the same evidence identifies market power and can be sufficient to identify the line of commerce and section of the country affected by a merger, even if the metes and bounds of the market are only broadly characterized.

C. A relevant market can be identified from evidence on observed market characteristics ("practical indicia"), such as industry or public recognition of the submarket as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors.[80] Various practical indicia may identify a relevant market in different settings.

D. Another common method employed by courts and the Agencies is the hypothetical monopolist test.[81] This test examines whether a proposed market is too narrow by asking whether a hypothetical monopolist over this market could profitably worsen terms significantly, for example, by raising price. An analogous hypothetical monopsonist test applies when considering the impact of a merger on competition among buyers.

The Agencies use these tools to define relevant markets because they each leverage market realities to identify an area of effective competition.

Section 4.3.A below describes the Hypothetical Monopolist Test in greater detail. Section 4.3.B addresses issues that may arise when defining relevant markets in several specific scenarios.

4.3.A. The Hypothetical Monopolist Test

This Section describes the Hypothetical Monopolist Test, which is a method by which the Agencies often define relevant antitrust markets. As outlined above, a relevant antitrust market is an area of effective competition. The Hypothetical Monopolist/Monopsonist Test ("HMT") evaluates whether a group of products is sufficiently broad to constitute a relevant antitrust market. To do so, the HMT asks whether eliminating the competition among the group of products by combining them under the control of a hypothetical monopolist likely would lead to a worsening of terms for customers. The Agencies generally focus their assessment on the constraints from competition, rather than on constraints from regulation, entry, or other market changes. The Agencies are concerned with the impact on economic incentives and assume the hypothetical monopolist would seek to maximize profits.

When evaluating a merger of sellers, the HMT asks whether a hypothetical profit-maximizing firm, not prevented by regulation from worsening terms, that was the only present and future seller of a group of products ("hypothetical monopolist") likely would undertake at least a small but significant and non-transitory increase in price ("SSNIP") or other worsening of terms ("SSNIPT") for at least one

---

[80] *Brown Shoe*, 370 U.S. at 325, *quoted in United States v. U.S. Sugar Corp.*, 73 F.4th 197, 204-07 (3d Cir. 2023) (affirming district court's application of *Brown Shoe* practical indicia to evaluate relevant product market that included, based on the unique facts of the industry, those distributors who "could counteract monopolistic restrictions by releasing their own supplies").

[81] *See FTC v. Penn State Hershey Med. Center*, 838 F.3d 327, 338 (3d Cir. 2016). While these guidelines focus on applying the hypothetical monopolist test in analyzing mergers, the test can be adapted for similar purposes in cases involving alleged monopolization or other conduct. *See, e.g.*, *McWane, Inc. v. FTC*, 783 F.3d 814, 829-30 (11th Cir. 2015).

product in the group.[82] For the purpose of analyzing this issue, the terms of sale of products outside the candidate market are held constant. Analogously, when considering a merger of buyers, the Agencies ask the equivalent question for a hypothetical monopsonist. This Section often focuses on merging sellers to simplify exposition.

4.3.B. Implementing the Hypothetical Monopolist Test

The SSNIPT. A SSNIPT may entail worsening terms along any dimension of competition, including price (SSNIP), but also other terms (broadly defined) such as quality, service, capacity investment, choice of product variety or features, or innovative effort.

Input and Labor Markets. When the competition at issue involves firms buying inputs or employing labor, the HMT considers whether the hypothetical monopsonist would undertake at least a SSNIPT, such as a decrease in the offered price or a worsening of the terms of trade offered to suppliers, or a decrease in the wage offered to workers or a worsening of their working conditions or benefits.

The Geographic Dimension of the Market. The hypothetical monopolist test is generally applied to a group of products together with a geographic region to determine a relevant market, though for ease of exposition the two dimensions are discussed separately, with geographic market definition discussed in Section 4.3.D.2.

Negotiations or Auctions. The HMT is stated in terms of a hypothetical monopolist *undertaking* a SSNIPT. This covers settings where the hypothetical monopolist sets terms and makes them worse. It also covers settings where firms bargain, and the hypothetical monopolist would have a stronger bargaining position that would likely lead it to extract a SSNIPT during negotiations, or where firms sell their products in an auction, and the bids submitted by the hypothetical monopolist would result in the purchasers of its products experiencing a SSNIPT.

Benchmark for the SSNIPT. The HMT asks whether the hypothetical monopolist likely would worsen terms relative to those that likely would prevail absent the proposed merger. In some cases, the Agencies will use as a benchmark different outcomes than those prevailing prior to the merger. For example, if outcomes are likely to change absent the merger, e.g., because of innovation, entry, exit, or exogenous trends, the Agencies may use anticipated future outcomes as the benchmark. Or, if suppliers in the market are coordinating prior to the merger, the Agencies may use a benchmark that reflects conditions that would arise if coordination were to break down. When evaluating whether a merging firm is dominant (Guideline 6), the Agencies may use terms that likely would prevail in a more competitive market as a benchmark.[83]

---

[82] If the pricing incentives of the firms supplying the products in the group differ substantially from those of the hypothetical monopolist, for reasons other than the latter's control over a larger group of substitutes, the Agencies may instead employ the concept of a hypothetical profit-maximizing cartel comprised of the firms (with all their products) that sell the products in the candidate market. This approach is most likely to be appropriate if the merging firms sell products outside the candidate market that significantly affect their pricing incentives for products in the candidate market. This could occur, for example, if the candidate market is one for durable equipment and the firms selling that equipment derive substantial net revenues from selling spare parts and service for that equipment. Analogous considerations apply when considering a SSNIPT for terms other than price.

[83] In the entrenchment context, if the inquiry is being conducted after market or monopoly power has already been exercised, using prevailing prices can lead to defining markets too broadly and thus inferring that dominance does not exist when, in

Magnitude of the SSNIPT. What constitutes a "small but significant" worsening of terms depends upon the nature of the industry and the merging firms' positions in it, the ways that firms compete, and the dimension of competition at issue. When considering price, the Agencies will often use a SSNIP of five percent of the price charged by firms for the products or services to which the merging firms contribute value. The Agencies, however, may consider a different term or a price increase that is larger or smaller than five percent.[84]

The Agencies may base a SSNIP on explicit or implicit prices for the firms' specific contribution to the value of the product sold, or an upper bound on the firms' specific contribution, where these can be identified with reasonable clarity. For example, the Agencies may derive an implicit price for the service of transporting oil over a pipeline as the difference between the price the pipeline firm paid for oil at one end and the price it sold the oil for at the other and base the SSNIP on this implicit price.

4.3.C. Evidence and Tools for Carrying Out the Hypothetical Monopolist Test

Section 4.2 describes some of the qualitative and quantitative evidence and tools the Agencies can use to assess the extent of competition among firms. The Agencies can use similar evidence and analogous tools to apply the HMT, in particular to assess whether competition among a set of firms likely leads to better terms than a hypothetical monopolist would undertake.

To assess whether the hypothetical monopolist likely would undertake at least a SSNIP on one or more products in the candidate market, the Agencies sometimes interpret the qualitative and quantitative evidence using an economic model of the profitability to the hypothetical monopolist of undertaking price increases; the Agencies may adapt these tools to apply to other forms of SSNIPTs.

One approach utilizes the concept of a "recapture rate" (the percentage of sales lost by one product in the candidate market, when its price alone rises, that is recaptured by other products in the candidate market). A price increase is profitable when the recapture rate is high enough that the incremental profits from the increased price plus the incremental profits from the recaptured sales going to other products in the candidate market exceed the profits lost when sales are diverted outside the candidate market. It is possible that a price increase is profitable even if a majority of sales are diverted outside the candidate market, for example if the profits on the lost sales are relatively low or the profits on the recaptured sales are relatively high.

Sometimes evidence is presented in the form of "critical loss analysis," which can be used to assess whether undertaking at least a SSNIPT on one or more products in a candidate market would raise or lower the hypothetical monopolist's profits. Critical loss analysis compares the magnitude of the two offsetting effects resulting from the worsening of terms. The "critical loss" is defined as the number of lost unit sales that would leave profits unchanged. The "predicted loss" is defined as the number of unit sales that the hypothetical monopolist is predicted to lose due to the worsening of terms. The worsening of terms raises the hypothetical monopolist's profits if the predicted loss is less than the

---

fact, it does. The problem with using prevailing prices to define the market when a firm is already dominant is known as the "Cellophane Fallacy."

[84] The five percent price increase is not a threshold of competitive harm from the merger. Because the five percent SSNIP is a minimum expected effect of a hypothetical monopolist of an *entire* market, the actual predicted effect of a merger within that market may be significantly lower than five percent. A merger within a well-defined market that causes undue concentration can be illegal even if the predicted price increase is well below the SSNIP of five percent.

critical loss. While this "breakeven" analysis differs somewhat from the profit-maximizing analysis called for by the HMT, it can sometimes be informative.

The Agencies require that estimates of the predicted loss be consistent with other evidence, including the pre-merger margins of products in the candidate market used to calculate the critical loss. Unless the firms are engaging in coordinated interaction, high pre-merger margins normally indicate that each firm's product individually faces demand that is not highly sensitive to price. Higher pre-merger margins thus indicate a smaller predicted loss as well as a smaller critical loss. The higher the pre-merger margin, the smaller the recapture rate[85] necessary for the candidate market to satisfy the hypothetical monopolist test. Similar considerations inform other analyses of the profitability of a price increase.

4.3.D. Market Definition in Certain Specific Settings

This Section provides details on market definition in several specific common settings. In much of this section, concepts are presented for the scenario where the merger involves sellers. In some cases, clarifications are provided as to how the concepts apply to merging buyers; in general, the concepts apply in an analogous way.

4.3.D.1. Targeted Trading Partners

If the merged firm could profitably target a subset of customers for changes in prices or other terms, the Agencies may identify relevant markets defined around those targeted customers. The Agencies may do so even if firms are not currently targeting specific customer groups but could do so after the merger.

For targeting to be feasible, two conditions typically must be met. First, the suppliers engaging in targeting must be able to set different terms for targeted customers than other customers. This may involve identification of individual customers to which different terms are offered or offering different terms to different types of customers based on observable characteristics.[86] Markets for targeted customers need not have precise metes and bounds. In particular, defining a relevant market for targeted customers sometimes requires a line-drawing exercise on observable characteristics. There can be many places to draw that line and properly define a relevant market. Second, the targeted customers must not be likely to defeat a targeted worsening of terms by arbitrage (e.g., by purchasing indirectly from or through other customers). Arbitrage may be difficult if it would void warranties or make service more difficult or costly for customers, and it is inherently impossible for many services. Arbitrage on a modest scale may be possible but sufficiently costly or limited, for example due to transaction costs or search costs, that it would not deter or defeat a discriminatory pricing strategy.

If prices are negotiated or otherwise set individually, for example through a procurement auction, there may be relevant markets that are as narrow as an individual customer. Nonetheless, for analytic convenience, the Agencies may define cluster markets for groups of targeted customers for whom the

---

[85] The recapture rate is sometimes referred to as the aggregate diversion ratio, defined in Section 4.2.B.

[86] In some cases, firms offer one or more versions of products or services defined by their characteristics (where brand might be a characteristic). When customers can select among these products and terms do not vary by customer, the Agencies will typically define markets based on products rather than the targeted customers. In such cases, relevant antitrust markets may include only some of the differentiated products, for example products with only "basic" features, or products with "premium features." The tools described in Section 4.2 can be used to assess competition among differentiated products.

conditions of competition are reasonably similar. (See Section 4.3.D.4 for further discussion of cluster markets.)

Analogous considerations arise for a merger involving one or more buyers or employers. In this case, the analysis considers whether buyers target suppliers, for example by paying targeted suppliers or workers less, or by degrading the terms of supply contracts for targeted suppliers. Arbitrage would involve a targeted supplier selling to the buyer indirectly, through a different supplier who could obtain more favorable terms from the buyer.

If the HMT is applied in a setting where targeting of customers is feasible, it requires that a hypothetical profit-maximizing firm that was the only present or future seller of the relevant product(s) to customers in the targeted group would undertake at least a SSNIPT on some, though not necessarily all, customers in that group. The products sold to those customers form a relevant market if the hypothetical monopolist likely would undertake at least a SSNIPT despite the potential for customers to substitute away from the product or to take advantage of arbitrage. In this exercise, the terms of sale for products sold to all customers outside the region are held constant.

4.3.D.2. Geographic Markets

A relevant antitrust market is an area of effective competition, comprising both product (or service) and geographic elements. A market's geography depends on the limits that distance puts on some customers' willingness or ability to substitute to some products, or some suppliers' willingness or ability to serve some customers. Factors that may limit the geographic scope of the market include transportation costs, language, regulation, tariff and non-tariff trade barriers, custom and familiarity, reputation, and local service availability.

4.3.D.2.a. Geographic Markets Based on the Locations of Suppliers

The Agencies sometimes define geographic markets as regions encompassing a group of supplier locations. When they do, the geographic market's scope is determined by customers' willingness to switch between suppliers. Geographic markets of this type often apply when customers receive goods or services at suppliers' facilities, for example when customers buy in-person from retail stores. A single firm may offer the same product in a number of locations, both within a single geographic market or across geographic markets; customers' willingness to substitute between products may depend on the location of the supplier. When calculating market shares, sales made from supplier locations in the geographic market are included, regardless of whether the customer making the purchase travelled from outside the boundaries of the geographic market (see Section 4.4 for more detail about calculating market shares).

If the HMT is used to evaluate the geographic scope of the market, it requires that a hypothetical profit-maximizing firm that was the only present or future supplier of the relevant product(s) at supplier locations in the region likely would undertake at least a SSNIPT in at least one location. In this exercise, the terms of sale for products sold to all customers at facilities outside the region are typically held constant.[87]

[87] In some circumstances, as when the merging parties operate in multiple geographies, if applying the HMT, the Agencies may apply a "Hypothetical Cartel" framework for market definition, following the approach outlined in Section 4.3.A, n.81.

4.3.D.2.b. Geographic Markets Based on Targeting of Customers by Location

When targeting based on customer location is feasible (see Section 4.3.D.1), the Agencies may define geographic markets as a region encompassing a group of customers.[88] For example, geographic markets may sometimes be defined this way when suppliers deliver their products or services to customers' locations, or tailor terms of trade based on customers' locations. Competitors in the market are firms that sell to customers that are located in the specified region. Some suppliers may be located outside the boundaries of the geographic market, but their sales to customers located within the market are included when calculating market shares (see Section 4.4 for more detail about calculating market shares).

If prices are negotiated individually with customers that may be targeted, geographic markets may be as narrow as individual customers. Nonetheless, the Agencies often define a market for a cluster of customers located within a region if the conditions of competition are reasonably similar for these customers. (See Section 4.3.D.4 for further discussion of cluster markets.)

A firm's attempt to target customers in a particular area with worsened terms can sometimes be undermined if some customers in the region substitute by travelling outside it to purchase the product. Arbitrage by customers on a modest scale may be possible but sufficiently costly or limited that it would not deter or defeat a targeting strategy.[89]

If the HMT is used to evaluate market definition when customers may be targeted by location, it requires that a hypothetical profit-maximizing firm that was the only present or future seller of the relevant product(s) to customers in the region likely would undertake at least a SSNIPT on some, though not necessarily all, customers in that region. The products sold in that region form a relevant market if the hypothetical monopolist would undertake at least a SSNIPT despite the potential for customers to substitute away from the product or to locations outside the region. In this exercise, the terms of sale for products sold to all customers outside the region are held constant.[90]

4.3.D.3. Supplier Responses

Market definition focuses solely on demand substitution factors, that is, on customers' ability and willingness to substitute away from one product or location to another in response to a price increase or other worsening of terms. Supplier responses may be considered in the analysis of competition between firms (Guideline 2 and Section 4.2), entry and repositioning (Section 3.2), and in calculating market shares and concentration (Section 4.4).

4.3.D.4. Cluster Markets

A relevant antitrust market is generally a group of products that are substitutes for each other. However, when the competitive conditions for multiple relevant markets are reasonably similar, it may be appropriate to aggregate the products in these markets into a "cluster market" for analytic convenience, even though not all products in the cluster are substitutes for each other. For example, competing hospitals may each provide a wide range of acute health care services. Acute care for one health issue is not a substitute for acute care for a different health issue. Nevertheless, the Agencies may

---

[88] For customers operating in multiple locations, only those customer locations within the targeted region are included in the market.
[89] Arbitrage by suppliers is a type of supplier response and is thus not considered in market definition. (See Section 4.3.D.3)
[90] In some circumstances, as when the merging parties operate in multiple geographies, the Agencies may apply a "Hypothetical Cartel" framework for market definition, as described in Section 4.3.A, n.81.

aggregate them into a cluster market for acute care services if the conditions of competition are reasonably similar across the services in the cluster.

The Agencies need not separately analyze market definition for each product included in the cluster market, and market shares will typically be calculated for the cluster market as a whole.

Analogously, the Agencies sometimes define a market as a cluster of targeted customers (see Section 4.3.D.1) or a cluster of customers located in a region (see Section 4.3.D.2.b).

4.3.D.5. Bundled Product Markets

Firms may sell a combination of products as a bundle or a "package deal," rather than offering products "*a la carte*," that is, separately as standalone products. Different bundles offered by the same or different firms might package together different combinations of component products and therefore be differentiated according to the composition of the bundle. If the components of a bundled product are also available separately, the bundle may be offered at a price that represents a discount relative to the sum of the *a la carte* product prices.

The Agencies take a flexible approach based on the specific circumstances to determine whether a candidate market that includes one or more bundled products, standalone products, or both is a relevant antitrust market. In some cases, a relevant market may consist of only bundled products. A market composed of only bundled products might be a relevant antitrust market even if there is significant competition from the unbundled products. In other cases, a relevant market may include both bundled products and some unbundled component products.

Even in cases where firms commonly sell combinations of products or services as a bundle or a "package deal," relevant antitrust markets do not necessarily include product bundles. In some cases, a relevant market may be analyzed as a cluster market, as discussed in Section 4.3.D.4.

4.3.D.6. One-Stop Shop Markets

In some settings, the Agencies may consider a candidate market that includes one or more "one-stop shops," where customers can select a combination of products to purchase from a single seller, either in a single purchase instance or in a sequence of purchases. Products are commonly sold at a one-stop shop when customers value the convenience, which might arise because of transaction costs or search costs, savings of time, transportation costs, or familiarity with the store or web site.

A multi-product retailer such as a grocery store or online retailer is an example of a one-stop shop. Customers can select a particular basket of groceries from a range of available goods and different customers may select different baskets. Some customers may make multiple stops at specialty shops (e.g., butcher, baker, greengrocer), or they may do the bulk of their shopping at a one-stop shop (the grocery store) but also shop at specialty shops for particular product categories.

There are several ways in which markets may be defined in one-stop shop settings, depending on market realities, and the Agencies may further define more than one relevant antitrust market for a particular merger. For example, a relevant market may consist of only one-stop shops, even if there is significant competition from specialty shops; or it may include both one-stop shops and specialty shops. When a product category is sold by both one-stop shops and specialty suppliers (such as a type of produce sold in grocery stores and produce stands), the Agencies may define relevant antitrust markets for the product category sold by a particular type of supplier, or it may include multiple types of suppliers.

4.3.D.7. Market Definition When There is Harm to Innovation

When considering harm to competition in innovation, market definition may follow the same approaches that are used to analyze other dimensions of competition. In the case where a merger may substantially lessen competition by decreasing incentives to innovate, the Agencies may define relevant antitrust markets around the products that would result from that innovation if successful, even if those products do not yet exist.[91] In some cases, the Agencies may analyze different relevant markets when considering innovation than when considering other dimensions of competition.

4.3.D.8. Market Definition for Input Markets and Labor Markets

The same market definition tools and principles discussed above can be used for input markets and labor markets, where labor is a particular type of input. In input markets, firms compete with each other to attract suppliers, including workers. Therefore, input suppliers are analogous to customers in the discussions above about market definition. In defining relevant markets, the Agencies focus on the alternatives available to input suppliers. An antitrust input market consists of a group of products and a geographic area defined by the location of the buyers or input suppliers. Just as buyers of a product may consider products to be differentiated according to the brand or the identity of the seller, suppliers of a product or service may consider different buyers to be differentiated. For example, if the suppliers are contractors, they may have distinct preferences about who they provide services to, due to different working conditions, location, reliability of buyers in terms of paying invoices on time, or the propensity of the buyer to make unexpected changes to specifications.

The HMT considers whether a hypothetical monopsonist likely would undertake a SSNIPT, such as a reduction in price paid for inputs, or imposing less favorable terms on suppliers. (See Section 4.2.C for more discussion about competition in settings where terms are set through auctions and negotiations, as is common for input markets.)

When defining a market for labor the Agencies will consider the job opportunities available to workers who supply a relevant type of labor service, where worker choice among jobs or between geographic areas is the analog of consumer choices among products and regions when defining a product market. The Agencies may consider workers' willingness to switch in response to changes to wages or other aspects of working conditions, such as changes to benefits or other non-wage compensation, or adoption of less flexible scheduling. Depending on the occupation, alternative job opportunities might include the same occupation with alternative employers, or alternative occupations. Geographic market definition may involve considering workers' willingness or ability to commute, including the availability of public transportation. The product and geographic market definition may involve assessing whether workers may be targeted for less favorable wages or other terms of employment according to factors such as education, experience, certifications, or work locations. The Agencies may define cluster markets for different jobs when firms employ workers in a variety of jobs characterized by similar competitive conditions (see Section 4.3.D.4).

4.4. Calculating Market Shares and Concentration

This subsection further describes how the Agencies calculate market shares and concentration metrics.

---

[91] *See Illumina*, slip op. at 12 (affirming a relevant market defined around "what . . . developers reasonably sought to achieve, not what they currently had to offer").

As discussed above, the Agencies may use evidence about market shares and market concentration as part of their analysis. These structural measures can provide insight into the market power of firms as well as into the extent to which they compete. Although any market that is properly identified using the methods in Section 4.3 is valid, the extent to which structural measures calculated in that market are probative in any given context depends on a number of considerations. The following market considerations affect the extent to which structural measures are probative in any given context.[92]

First, structural measures may be probative if the market used to estimate them includes the products that are the focus of the competitive concern that the structural inquiry intends to address. For example, the concentration measures discussed in Guideline 1 will be most probative about whether the merger eliminates substantial competition between the merging parties when calculated on a market that includes at least one competing product from each merging firm.

Second, the market used to estimate shares should be broad enough that it contains sufficient additional products so that a loss of competition among all the suppliers of the products in the market would lead to significantly worse terms for at least some customers of at least one product. Markets identified using the various tools in Section 4.3 can satisfy this condition—for example, all markets that satisfy the HMT do so.

Third, the competitive significance of the parties may be understated by their share when calculated on a market that is broader than needed to satisfy the considerations above, particularly when the market includes products that are more distant substitutes, either in the product or geographic dimension, for those produced by the parties.

4.4.A. Market Participants

All firms that currently supply products (or consume products, when buyers merge) in a relevant market are considered participants in that market. Vertically integrated firms are also included to the extent that their inclusion accurately reflects their competitive significance. Firms not currently supplying products in the relevant market, but that have committed to entering the market in the near future, are also considered market participants.

Firms that are not currently active in a relevant market, but that very likely would rapidly enter with direct competitive impact in the event of a small but significant change in competitive conditions, without incurring significant sunk costs, are also considered market participants. These firms are termed "rapid entrants." Sunk costs are entry or exit costs that cannot be recovered outside a relevant market. Entry that would take place more slowly in response to a change in competitive conditions, or that requires firms to incur significant sunk costs, is considered in Section 3.2.

Firms that are active in the relevant product market but not in the relevant geographic market may be rapid entrants. Other things equal, such firms are most likely to be rapid entrants if they are already active in geographies that are close to the geographic market. Factors such as transportation

[92] For simplicity, the discussion in the text focuses on the case where concerns arise that involve competition among the suppliers of products; analogous considerations may also arise for suppliers of services, or when concerns arise about competition among buyers of a product or service, or when analyzing market shares in certain specific settings (see Section 4.3.D).

costs are important; or for services or digital goods, other factors may be important, such as language or regulation.

In markets for relatively homogeneous goods where a supplier's ability to compete depends predominantly on its costs and its capacity, and not on other factors such as experience or reputation in the relevant market, a supplier with efficient idle capacity, or readily available "swing" capacity currently used in adjacent markets that can easily and profitably be shifted to serve the relevant market, may be a rapid entrant. However, idle capacity may be inefficient, and capacity used in adjacent markets may not be available, so a firm's possession of idle or swing capacity alone does not make that firm a rapid entrant.

4.4.B. Market Shares

The Agencies normally calculate product market shares for all firms that currently supply products (or consume products, when buyers merge) in a relevant market, subject to the availability of data. The Agencies measure each firm's market share using metrics that are informative about the market realities of competition in the particular market and firms' future competitive significance. When interpreting shares based on historical data, the Agencies may consider whether significant recent or reasonably foreseeable changes to market conditions suggest that a firm's shares overstate or understate its future competitive significance.

How market shares are calculated may further depend on the characteristics of a particular market, and on the availability of data. Moreover, multiple metrics may be informative in any particular case. For example:

- Revenues in a relevant market often provide a readily available basis on which to compute shares and are often a good measure of attractiveness to customers.
- Unit sales may provide a useful measure of competitive significance in cases where one unit of a low-priced product can serve as a close substitute for one unit of a higher-priced product. For example, a new, much less expensive product may have great competitive significance if it substantially erodes the revenues earned by older, higher-priced products, even if it earns relatively low revenues.
- Revenues earned from recently acquired customers (or paid to recently acquired buyers, in the case of merging buyers) may provide a useful measure of competitive significance of firms in cases where trading partners sign long-term contracts, face switching costs, or tend to re-evaluate their relationships only occasionally.
- Measures based on capacities or reserves may be used to calculate market shares in markets for homogeneous products where a firm's competitive significance may derive principally from its ability and incentive to rapidly expand production in a relevant market in response to a price increase or output reduction by others in that market (or to rapidly expand its purchasing in the case of merging buyers).
- Non-price indicators, such as number of users or frequency of use, may be useful indicators in markets where price forms a relatively small or no part of the exchange of value.

Apple Inc. v. Pepper

139 S.Ct. 1514 (U.S. 2019)

JUSTICE KAVANAUGH delivered the opinion of the Court: In 2007, Apple started selling iPhones. The next year, Apple launched the retail App Store, an electronic store where iPhone owners can purchase iPhone applications from Apple. Those "apps" enable iPhone owners to send messages, take photos, watch videos, buy clothes, order food, arrange transportation, purchase concert tickets, donate to charities, and the list goes on. "There's an app for that" has become part of the 21st-century American lexicon.

In this case, however, several consumers contend that Apple charges too much for apps. The consumers argue, in particular, that Apple has monopolized the retail market for the sale of apps and has unlawfully used its monopolistic power to charge consumers higher-than-competitive prices.

A claim that a monopolistic retailer (here, Apple) has used its monopoly to overcharge consumers is a classic antitrust claim. But Apple asserts that the consumer-plaintiffs in this case may not sue Apple because they supposedly were not "direct purchasers" from Apple under our decision in *Illinois Brick Co. v. Illinois,*431 U.S. 720, 745-746 (1977). We disagree. The plaintiffs purchased apps directly from Apple and therefore are direct purchasers under *Illinois Brick*. At this early pleadings stage of the litigation, we do not assess the merits of the plaintiffs' antitrust claims against Apple, nor do we consider any other defenses Apple might have. We merely hold that the *Illinois Brick* direct-purchaser rule does not bar these plaintiffs from suing Apple under the antitrust laws. We affirm the judgment of the U.S. Court of Appeals for the Ninth Circuit.

I

In 2007, Apple began selling iPhones. In July 2008, Apple started the App Store. The App Store now contains about 2 million apps that iPhone owners can download. By contract and through technological limitations, the App Store is the only place where iPhone owners may lawfully buy apps.

For the most part, Apple does not itself create apps. Rather, independent app developers create apps. Those independent app developers then contract with Apple to make the apps available to iPhone owners in the App Store.

Through the App Store, Apple sells the apps directly to iPhone owners. To sell an app in the App Store, app developers must pay Apple a $ 99 annual membership fee. Apple requires that the retail sales price end in $ 0.99, but otherwise allows the app developers to set the retail price. Apple keeps 30 percent of the sales price, no matter what the sales price might be. In other words, Apple pockets a 30 percent commission on every app sale.

In 2011, four iPhone owners sued Apple. They allege that Apple has unlawfully monopolized "the iPhone apps aftermarket." App. to Pet. for Cert. 53a. The plaintiffs allege that, via the App Store, Apple locks iPhone owners "into buying apps only from Apple and paying Apple's 30% fee, even if" the iPhone owners wish "to buy apps elsewhere or pay less." *Id.,* at 45a. According to the complaint, that 30 percent commission is "pure profit" for Apple and, in a competitive environment with other retailers, "Apple would be under considerable pressure to substantially lower its 30% profit margin." *Id.,* at 54a-55a. The plaintiffs allege that in a competitive market, they would be able to "choose between Apple's high-priced App Store and less costly alternatives." *Id.,* at 55a. And they allege that they have "paid more for their iPhone apps than they would have paid in a competitive market." *Id.,* at 53a.

Apple moved to dismiss the complaint, arguing that the iPhone owners were not direct purchasers from Apple and therefore may not sue. In *Illinois Brick,* this Court held that direct purchasers may sue antitrust violators, but also ruled that indirect purchasers may not sue. The District Court agreed with Apple and dismissed the complaint. According to the District Court, the iPhone owners were not direct purchasers from Apple because the app developers, not Apple, set the consumers' purchase price.

The Ninth Circuit reversed. The Ninth Circuit concluded that the iPhone owners were direct purchasers under *Illinois Brick* because the iPhone owners purchased apps directly from Apple. According to the Ninth Circuit, *Illinois Brick* means that a consumer may not sue an alleged monopolist who is two or more steps removed from the consumer in a vertical distribution chain. See *In re Apple iPhone Antitrust Litig.,* 846 F. 3d 313, 323 (2017). Here, however, the consumers purchased directly from Apple, the alleged monopolist. Therefore, the Ninth Circuit held that the iPhone owners could sue Apple for allegedly monopolizing the sale of iPhone apps and charging higher-than-competitive prices. *Id.,* at 324. We granted certiorari. 585 U.S. ___ (2018).

II

A

The plaintiffs' allegations boil down to one straightforward claim: that Apple exercises monopoly power in the retail market for the sale of apps and has unlawfully used its monopoly power to force iPhone owners to pay Apple higher-than-competitive prices for apps. According to the plaintiffs, when iPhone owners want to purchase an app, they have only two options: (1) buy the app from Apple's App Store at a higher-than-competitive price or (2) do not buy the app at all. Any iPhone owners who are dissatisfied with the selection of apps available in the App Store or with the price of the apps available in the App Store are out of luck, or so the plaintiffs allege.

The sole question presented at this early stage of the case is whether these consumers are proper plaintiffs for this kind of antitrust suit—in particular, our precedents ask, whether the consumers were "direct purchasers" from Apple. *Illinois Brick,* 431 U.S. at 745-746. It is undisputed that the iPhone owners bought the apps directly from Apple. Therefore, under *Illinois Brick,* the iPhone owners were direct purchasers who may sue Apple for alleged monopolization.

That straightforward conclusion follows from the text of the antitrust laws and from our precedents.

First is text: Section 2 of the Sherman Act makes it unlawful for any person to "monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations." 26 Stat. 209, 15 U.S.C. § 2. Section 4 of the Clayton Act in turn provides that "*any person* who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue ... the defendant ... and shall recover threefold the damages by him sustained, and the cost of suit, including a reasonable attorney's fee." 38 Stat. 731, 15 U.S.C. § 15(a) (emphasis added). The broad text of § 4—"any person" who has been "injured" by an antitrust violator may sue—readily covers consumers who purchase goods or services at higher-than-competitive prices from an allegedly monopolistic retailer.

Second is precedent: Applying § 4, we have consistently stated that "the immediate buyers from the alleged antitrust violators" may maintain a suit against the antitrust violators. *Kansas v.*

UtiliCorp United Inc., 497 U.S. 199, 207 (1990); see also *Illinois Brick,* 431 U.S. at 745-746. At the same time, incorporating principles of proximate cause into § 4, we have ruled that *indirect* purchasers who are two or more steps removed from the violator in a distribution chain may not sue. Our decision in *Illinois Brick* established a bright-line rule that authorizes suits by *direct* purchasers but bars suits by *indirect* purchasers. *Id.,* at 746.

The facts of *Illinois Brick* illustrate the rule. Illinois Brick Company manufactured and distributed concrete blocks. Illinois Brick sold the blocks primarily to masonry contractors, and those contractors in turn sold masonry structures to general contractors. Those general contractors in turn sold their services for larger construction projects to the State of Illinois, the ultimate consumer of the blocks.

The consumer State of Illinois sued the manufacturer Illinois Brick. The State alleged that Illinois Brick had engaged in a conspiracy to fix the price of concrete blocks. According to the complaint, the State paid more for the concrete blocks than it would have paid absent the pricefixing conspiracy. The monopoly overcharge allegedly flowed all the way down the distribution chain to the ultimate consumer, who was the State of Illinois.

This Court ruled that the State could not bring an antitrust action against Illinois Brick, the alleged violator, because the State had not purchased concrete blocks directly from Illinois Brick. The proper plaintiff to bring that claim against Illinois Brick, the Court stated, would be an entity that had purchased directly from Illinois Brick. *Ibid.*

The bright-line rule of *Illinois Brick,* as articulated in that case and as we reiterated in *UtiliCorp,* means that indirect purchasers who are two or more steps removed from the antitrust violator in a distribution chain may not sue. By contrast, direct purchasers—that is, those who are "the immediate buyers from the alleged antitrust violators"—may sue. *UtiliCorp,* 497 U.S. at 207.

For example, if manufacturer A sells to retailer B, and retailer B sells to consumer C, then C may not sue A. But B may sue A if A is an antitrust violator. And C may sue B if B is an antitrust violator. That is the straightforward rule of *Illinois Brick.* See *Loeb Industries, Inc. v. Sumitomo Corp.,* 306 F.3d 469, 481-482 (C.A.7 2002) (Wood, J.).

In this case, unlike in *Illinois Brick,* the iPhone owners are not consumers at the bottom of a vertical distribution chain who are attempting to sue manufacturers at the top of the chain. There is no intermediary in the distribution chain between Apple and the consumer. The iPhone owners purchase apps directly from the retailer Apple, who is the alleged antitrust violator. The iPhone owners pay the alleged overcharge directly to Apple. The absence of an intermediary is dispositive. Under *Illinois Brick,* the iPhone owners are direct purchasers from Apple and are proper plaintiffs to maintain this antitrust suit.

B

All of that seems simple enough. But Apple argues strenuously against that seemingly simple conclusion, and we address its arguments carefully. For this kind of retailer case, Apple's theory is that *Illinois Brick* allows consumers to sue only the party who sets the retail price, whether or not that party sells the good or service directly to the complaining party. Apple says that its theory accords with the economics of the transaction. Here, Apple argues that the app developers, not Apple, set the retail price charged to consumers, which according to Apple means that the consumers may not sue Apple.

We see three main problems with Apple's "who sets the price" theory.

First, Apple's theory contradicts statutory text and precedent. As we explained above, the text of § 4 broadly affords injured parties a right to sue under the antitrust laws. And our precedent in *Illinois Brick* established a bright-line rule where direct purchasers such as the consumers here may sue antitrust violators from whom they purchased a good or service. *Illinois Brick,* as we read the opinion, was not based on an economic theory about who set the price. Rather, *Illinois Brick* sought to ensure an effective and efficient litigation scheme in antitrust cases. To do so, the Court drew a bright line that allowed direct purchasers to sue but barred indirect purchasers from suing. When there is no intermediary between the purchaser and the antitrust violator, the purchaser may sue. *** Apple's theory would require us to rewrite the rationale of *Illinois Brick* and to gut the longstanding bright-line rule.

To the extent that *Illinois Brick* leaves any ambiguity about whether a direct purchaser may sue an antitrust violator, we should resolve that ambiguity in the direction of the statutory text. And under the text, direct purchasers from monopolistic retailers are proper plaintiffs to sue those retailers.

Second, in addition to deviating from statutory text and precedent, Apple's proposed rule is not persuasive economically or legally. Apple's effort to transform *Illinois Brick* from a direct-purchaser rule to a "who sets the price" rule would draw an arbitrary and unprincipled line among retailers based on retailers' financial arrangements with their manufacturers or suppliers.

In the retail context, the price charged by a retailer to a consumer is often a result (at least in part) of the price charged by the manufacturer or supplier to the retailer, or of negotiations between the manufacturer or supplier and the retailer. Those agreements between manufacturer or supplier and retailer may take myriad forms, including for example a markup pricing model or a commission pricing model. In a traditional markup pricing model, a hypothetical monopolistic retailer might pay $ 6 to the manufacturer and then sell the product for $ 10, keeping $ 4 for itself. In a commission pricing model, the retailer might pay nothing to the manufacturer; agree with the manufacturer that the retailer will sell the product for $ 10 and keep 40 percent of the sales price; and then sell the product for $ 10, send $ 6 back to the manufacturer, and keep $ 4. In those two different pricing scenarios, everything turns out to be economically the same for the manufacturer, retailer, and consumer.

Yet Apple's proposed rule would allow a consumer to sue the monopolistic retailer in the former situation but not the latter. In other words, under Apple's rule a consumer could sue a monopolistic retailer when the retailer set the retail price by marking up the price it had paid the manufacturer or supplier for the good or service. But a consumer could not sue a monopolistic retailer when the manufacturer or supplier set the retail price and the retailer took a commission on each sale.

Apple's line-drawing does not make a lot of sense, other than as a way to gerrymander Apple out of this and similar lawsuits. In particular, we fail to see why the form of the upstream arrangement between the manufacturer or supplier and the retailer should determine whether a monopolistic retailer can be sued by a downstream consumer who has purchased a good or service directly from the retailer and has paid a higher-than-competitive price because of the retailer's unlawful monopolistic conduct. As the Court of Appeals aptly stated, "the distinction between a markup and a commission is immaterial." 846 F.3d at 324. *** If a retailer has engaged in unlawful monopolistic conduct that has caused consumers to pay higher-than-competitive prices, it does not matter how the retailer structured its relationship with an upstream manufacturer or supplier—whether, for example, the retailer employed a markup or kept a commission.

To be sure, if the monopolistic retailer's conduct has not caused the consumer to pay a higher-than-competitive price, then the plaintiff's damages will be zero. Here, for example, if the competitive commission rate were 10 percent rather than 30 percent but Apple could prove that app developers in a 10 percent commission system would always set a higher price such that consumers would pay the same retail price regardless of whether Apple's commission was 10 percent or 30 percent, then the consumers' damages would presumably be zero. But we cannot assume in all cases—as Apple would necessarily have us do—that a monopolistic retailer who keeps a commission does not ever cause the consumer to pay a higher-than-competitive price. We find no persuasive legal or economic basis for such a blanket assertion.

In short, we do not understand the relevance of the upstream market structure in deciding whether a downstream consumer may sue a monopolistic retailer. Apple's rule would elevate form (what is the precise arrangement between manufacturers or suppliers and retailers?) over substance (is the consumer paying a higher price because of the monopolistic retailer's actions?). If the retailer's unlawful monopolistic conduct caused a consumer to pay the retailer a higher-than-competitive price, the consumer is entitled to sue the retailer under the antitrust laws.

Third, if accepted, Apple's theory would provide a roadmap for monopolistic retailers to structure transactions with manufacturers or suppliers so as to evade antitrust claims by consumers and thereby thwart effective antitrust enforcement.

Consider a traditional supplier-retailer relationship, in which the retailer purchases a product from the supplier and sells the product with a markup to consumers. Under Apple's proposed rule, a retailer, instead of buying the product from the supplier, could arrange to sell the product for the supplier without purchasing it from the supplier. In other words, rather than paying the supplier a certain price for the product and then marking up the price to sell the product to consumers, the retailer could collect the price of the product from consumers and remit only a fraction of that price to the supplier.

That restructuring would allow a monopolistic retailer to insulate itself from antitrust suits by consumers, even in situations where a monopolistic retailer is using its monopoly to charge higher-than-competitive prices to consumers. We decline to green-light monopolistic retailers to exploit their market position in that way. We refuse to rubber-stamp such a blatant evasion of statutory text and judicial precedent.

In sum, Apple's theory would disregard statutory text and precedent, create an unprincipled and economically senseless distinction among monopolistic retailers, and furnish monopolistic retailers with a how-to guide for evasion of the antitrust laws.

C

In arguing that the Court should transform the direct-purchaser rule into a "who sets the price" rule, Apple insists that the three reasons that the Court identified in *Illinois Brick* for adopting the direct-purchaser rule apply to this case—even though the consumers here (unlike in *Illinois Brick*) were direct purchasers from the alleged monopolist. The *Illinois Brick* Court listed three reasons for barring indirect-purchaser suits: (1) facilitating more effective enforcement of antitrust laws; (2) avoiding complicated damages calculations; and (3) eliminating duplicative damages against antitrust defendants.

As we said in *UtiliCorp,* however, the bright-line rule of *Illinois Brick* means that there is no reason to ask whether the rationales of *Illinois Brick* "apply with equal force" in every individual case. 497 U.S. at 216. We should not engage in "an unwarranted and counterproductive exercise to litigate a series of exceptions." *Id.,* at 217.

But even if we engage with this argument, we conclude that the three *Illinois Brick* rationales—whether considered individually or together—cut strongly in the plaintiffs' favor here, not Apple's.

First, Apple argues that barring the iPhone owners from suing Apple will better promote effective enforcement of the antitrust laws. Apple posits that allowing only the upstream app developers—and not the downstream consumers—to sue Apple would mean more effective enforcement of the antitrust laws. We do not agree. Leaving consumers at the mercy of monopolistic retailers simply because upstream suppliers could *also* sue the retailers makes little sense and would directly contradict the longstanding goal of effective private enforcement and consumer protection in antitrust cases.

Second, Apple warns that calculating the damages in successful consumer antitrust suits against monopolistic retailers might be complicated. It is true that it may be hard to determine what the retailer would have charged in a competitive market. Expert testimony will often be necessary. But that is hardly unusual in antitrust cases. *Illinois Brick* is not a get-out-of-court-free card for monopolistic retailers to play any time that a damages calculation might be complicated. *Illinois Brick* surely did not wipe out consumer antitrust suits against monopolistic retailers from whom the consumers purchased goods or services at higher-than-competitive prices. Moreover, the damages calculation may be just as complicated in a retailer markup case as it is in a retailer commission case. Yet Apple apparently accepts consumers suing monopolistic retailers in a retailer markup case. If Apple accepts that kind of suit, then Apple should also accept consumers suing monopolistic retailers in a retailer commission case.

Third, Apple claims that allowing consumers to sue will result in "conflicting claims to a common fund—the amount of the alleged overcharge." *Illinois Brick,* 431 U.S. at 737. Apple is incorrect. This is not a case where multiple parties at different levels of a distribution chain are trying to all recover the same passed-through overcharge initially levied by the manufacturer at the top of the chain. If the iPhone owners prevail, they will be entitled to the *full amount* of the unlawful overcharge that they paid to Apple. The overcharge has not been passed on by anyone to anyone. Unlike in *Illinois Brick,* there will be no need to "trace the effect of the overcharge through each step in the distribution chain." 431 U.S. at 741.

It is true that Apple's alleged anticompetitive conduct may leave Apple subject to multiple suits by different plaintiffs. But *Illinois Brick* did not purport to bar multiple liability that is unrelated to passing an overcharge down a chain of distribution. *** Multiple suits are not atypical when the intermediary in a distribution chain is a bottleneck monopolist or monopsonist (or both) between the manufacturer on the one end and the consumer on the other end. A retailer who is both a monopolist and a monopsonist may be liable to different classes of plaintiffs—both to downstream consumers and to upstream suppliers—when the retailer's unlawful conduct affects both the downstream and upstream markets.

Here, some downstream iPhone consumers have sued Apple on a monopoly theory. And it could be that some upstream app developers will also sue Apple on a monopsony theory. In this instance, the two suits would rely on fundamentally different theories of harm and would not assert dueling claims to a "common fund," as that term was used in *Illinois Brick.* The consumers seek damages based on the difference between the price they paid and the competitive price. The app developers would seek lost profits that they could have earned in a competitive retail market. *Illinois Brick* does not bar either category of suit.

In short, the three *Illinois Brick* rationales do not persuade us to remake *Illinois Brick* and to bar direct-purchaser suits against monopolistic retailers who employ commissions rather than markups. The plaintiffs seek to hold retailers to account if the retailers engage in unlawful anticompetitive conduct that harms consumers who purchase from those retailers. That is why we have antitrust law.

* * *

*** The consumers here purchased apps directly from Apple, and they allege that Apple used its monopoly power over the retail apps market to charge higher-than-competitive prices. Our decision in *Illinois Brick* does not bar the consumers from suing Apple for Apple's allegedly monopolistic conduct. We affirm the judgment of the U.S. Court of Appeals for the Ninth Circuit.

It is so ordered.

Justice GORSUCH, with whom THE CHIEF JUSTICE, Justice THOMAS, and Justice ALITO join, dissenting: More than 40 years ago, in *Illinois Brick Co. v. Illinois,* 431 U.S. 720 (1977), this Court held that an antitrust plaintiff can't sue a defendant for overcharging *someone else* who might (or might not) have passed on all (or some) of the overcharge to him. *Illinois Brick* held that these convoluted "pass on" theories of damages violate traditional principles of proximate causation and that the right plaintiff to bring suit is the one on whom the overcharge immediately and surely fell. Yet today the Court lets a pass-on case proceed. It does so by recasting *Illinois Brick* as a rule forbidding only suits where the plaintiff does not contract directly with the defendant. This replaces a rule of proximate cause and economic reality with an easily manipulated and formalistic rule of contractual privity. That's not how antitrust law is supposed to work, and it's an uncharitable way of treating a precedent which—whatever its flaws—is far more sensible than the rule the Court installs in its place.

II

*** The lawsuit before us depends on just the sort of pass-on theory that *Illinois Brick* forbids. The plaintiffs bought apps from third-party app developers (or manufacturers) in Apple's retail Internet App Store, at prices set by the developers. The lawsuit alleges that Apple is a monopolist retailer and that the 30% commission it charges developers for the right to sell through its platform represents an anticompetitive price. The problem is that the 30% commission falls initially on the developers. So if the commission is in fact a monopolistic overcharge, the *developers* are the parties who are directly injured by it. Plaintiffs can be injured *only* if the developers are able and choose to pass on the overcharge to them in the form of higher app prices that the developers alone control. Plaintiffs admitted as much in the district court, where they described their theory of injury this way: "[I]f Apple tells the developer ... we're going to take this 30 percent commission ... what's the developer going to do? The developer is going to increase its price to cover Apple's... demanded profit." App. 143.

Because this is *exactly* the kind of "pass-on theory" *Illinois Brick* rejected, it should come as no surprise that the concerns animating that decision are also implicated. Like other pass-on theories, plaintiffs' theory will necessitate a complex inquiry into how Apple's conduct affected third-party pricing decisions. And it will raise difficult questions about apportionment of damages between app developers and their customers, along with the risk of duplicative damages awards. If anything, plaintiffs' claims present these difficulties even more starkly than did the claims at issue in *Illinois Brick*.

Consider first the question of causation. To determine if Apple's conduct damaged plaintiffs at all (and if so, the magnitude of their damages), a court will first have to explore whether and to what extent each individual app developer was able—and then opted—to pass on the 30%

commission to its consumers in the form of higher app prices. Sorting this out, if it can be done at all, will entail wrestling with "'complicated theories'" about "how the relevant market variables would have behaved had there been no overcharge." *Illinois Brick,* 431 U.S. at 741-743. Will the court hear testimony to determine the market power of each app developer, how each set its prices, and what it might have charged consumers for apps if Apple's commission had been lower? Will the court also consider expert testimony analyzing how market factors might have influenced developers' capacity and willingness to pass on Apple's alleged monopoly overcharge? And will the court then somehow extrapolate its findings to all of the tens of thousands of developers who sold apps through the App Store at different prices and times over the course of years?

This causation inquiry will be complicated further by Apple's requirement that all app prices end in $ 0.99. As plaintiffs acknowledge, this rule has caused prices for the "vast majority" of apps to "cluster" at exactly $ 0.99. Brief for Respondents 44. And a developer charging $ 0.99 for its app can't raise its price by just enough to recover the 30-cent commission. Instead, if the developer wants to pass on the commission to consumers, it has to more than double its price to $ 1.99 (doubling the commission in the process), which could significantly affect its sales. In short, because Apple's 99-cent rule creates a strong disincentive for developers to raise their prices, it makes plaintiffs' pass-on theory of injury even harder to prove. Yet the court will have to consider all of this when determining what damages, if any, plaintiffs suffered as a result of Apple's allegedly excessive 30% commission.

Plaintiffs' claims will also necessitate "massive efforts to apportion the recovery among all potential plaintiffs that could have absorbed part of the overcharge," including both consumers and app developers. *Illinois Brick,* 431 U.S. at 737. If, as plaintiffs contend, Apple's 30% commission is a monopolistic overcharge, then the app developers have a claim against Apple to recover whatever portion of the commission they did not pass on to consumers. *** So courts will have to divvy up the commissions Apple collected between the developers and the consumers. To do that, they'll have to figure out which party bore what portion of the overcharge in every purchase. And if the developers bring suit separately from the consumers, Apple might be at risk of duplicative damages awards totaling more than the full amount it collected in commissions. To avoid that possibility, it may turn out that the developers are necessary parties who will have to be joined in the plaintiffs' lawsuit. See Fed. Rule Civ. Proc. 19(a)(1)(B).

III

The United States and its antitrust regulators agree with all of this, so how does the Court reach such a different conclusion? Seizing on *Illinois Brick*'s use of the shorthand phrase "direct purchasers" to describe the parties immediately injured by the monopoly overcharge in that case, the Court (re)characterizes *Illinois Brick* as a rule that anyone who purchases goods directly from an alleged antitrust violator can sue, while anyone who doesn't, can't. Under this revisionist version of *Illinois Brick,* the dispositive question becomes whether an "intermediary in the distribution chain" stands between the plaintiff and the defendant. And because the plaintiff app purchasers in this case happen to have purchased apps directly from Apple, the Court reasons, they may sue.

This exalts form over substance. Instead of focusing on the traditional proximate cause question where the alleged overcharge is first (and thus surely) felt, the Court's test turns on who happens to be in privity of contract with whom. *** To evade the Court's test, all Apple must do is amend its contracts. Instead of collecting payments for apps sold in the App Store and remitting the balance (less its commission) to developers, Apple can simply specify that consumers' payments will flow the other way: directly to the developers, who will then remit commissions to Apple. No antitrust reason exists to treat these contractual arrangements differently, and doing so will only induce firms to abandon their preferred—and presumably more efficient—distribution arrangements in favor of less efficient ones, all so they might avoid an arbitrary legal rule.

Nor does *Illinois Brick* come close to endorsing such a blind formalism. Yes, as the Court notes, the plaintiff in *Illinois Brick* did contract directly with an intermediary rather than with the putative antitrust violator. But *Illinois Brick*'s rejection of pass-on claims, and its explanation of the difficulties those claims present, had nothing to do with privity of contract. Instead and as we have seen, its rule and reasoning grew from the "general tendency of the law ... not to go beyond" the party that first felt the sting of the alleged overcharge, and from the complications that can arise when courts attempt to discern whether and to what degree damages were passed on to others. The Court today risks replacing a cogent rule about proximate cause with a pointless and easily evaded imposter. We do not usually read our own precedents so uncharitably.

Maybe the Court proceeds as it does today because it just disagrees with *Illinois Brick*. After all, the Court not only displaces a sensible rule in favor of a senseless one; it also proceeds to question each of *Illinois Brick*'s rationales—doubting that those directly injured are always the best plaintiffs to bring suit, that calculating damages for pass-on plaintiffs will often be unduly complicated, and that conflicting claims to a common fund justify limiting who may sue. Court even tells us that any "ambiguity" about the permissibility of pass-on damages should be resolved "in the direction of the statutory text," ignoring that *Illinois Brick* followed the well-trodden path of construing the statutory text in light of background common law principles of proximate cause. Last but not least, the Court suggests that the traditional understanding of *Illinois Brick* leads to "arbitrary and unprincipled" results. It asks us to consider two hypothetical scenarios that, it says, prove the point. The first is a "markup" scenario in which a monopolistic retailer buys a product from a manufacturer for $ 6 and then decides to sell the product to a consumer for $ 10, applying a supracompetitive $ 4 markup. The second is a "commission" scenario in which a manufacturer directs a monopolistic retailer to sell the manufacturer's product to a consumer for $ 10 and the retailer keeps a supracompetitive 40% commission, sending $ 6 back to the manufacturer. The two scenarios are economically the same, the Court asserts, and forbidding recovery in the second for lack of proximate cause makes no sense.

But there is nothing arbitrary or unprincipled about *Illinois Brick*'s rule or results. The notion that the causal chain must stop somewhere is an ancient and venerable one. As with most any rule of proximate cause, reasonable people can debate whether *Illinois Brick* drew exactly the right line in cutting off claims where it did. But the line it drew is intelligible, principled, administrable, and far more reasonable than the Court's artificial rule of contractual privity. Nor do the Court's hypotheticals come close to proving otherwise. In the first scenario, the markup falls initially on the consumer, so there's no doubt that the retailer's anticompetitive conduct proximately caused the consumer's injury. Meanwhile, in the second scenario the commission falls initially on the manufacturer, and the consumer won't feel the pain unless the manufacturer can and does recoup some or all of the elevated commission by raising its own prices. In *that* situation, the manufacturer is the directly injured party, and the difficulty of disaggregating damages between those directly and indirectly harmed means that the consumer can't establish proximate cause under traditional principles.

*** Without any invitation or reason to revisit our precedent, and with so many grounds for caution, I would have thought the proper course today would have been to afford *Illinois Brick* full effect, not to begin whittling it away to a bare formalism. I respectfully dissent.

United States v. New York Great Atlantic & Pacific Tea Co.

173 F.2d 79 (7th Cir. 1949)

MINTON, CIRCUIT JUDGE: This case comes to us on appeal from the Eastern District of Illinois. The defendant The New York Great Atlantic & Pacific Tea Company, Inc., herein called A&P, several of its subsidiary and affiliated companies, and certain officers of the A&P chain were found guilty by the District Court of a conspiracy to restrain and to monopolize trade, in violation of Sections 1 and 2 of the Sherman Act, 15 U.S.C.A. §§ 1, 2. The defendants Carl Byoir, the public relations counsel of A&P, and Business Organization, Inc., a corporation through which Byoir conducted such public relations, were also found guilty.

*** This is a charge of a conspiracy to restrain trade and to monopolize. Some of the things done by the defendants, when examined and considered separately may be perfectly legal, but when used to promote or further a conspiracy to do an unlawful thing, that which when considered alone is lawful, when used to further the conspiracy becomes unlawful.

The issue is whether there is substantial evidence to show a conspiracy by the defendants to restrain and monopolize trade in commerce in food and food products by controlling the terms and conditions upon which the defendants and their competitors might do business and by oppressing competitors through the abuse of the defendants' mass buying and selling power. The Government insists that this case is not an attack upon A&P because of its size or integration and the power that may rightly go with such size and integration, but it is an attack upon the abuse of that power.

There is substantial evidence in this voluminous record to show the following. The A&P system is comprised of fourteen corporations, twelve of which were named defendants and three of which defendants were ultimately acquitted. The system is completely integrated, both horizontally and vertically. A&P is engaged in the food industry as buyer, manufacturer, processor, broker, and retailer. It operates 5,800 retail stores in forty states and the District of Columbia, and thirty-seven warehouses serve these stores.

The top holding company is the defendant A&P, a New York corporation. The George H. Hartford Trust, of which John A. and George L. Hartford are trustees, owns approximately ninety-nine per cent of A&P. This top holding company owns and controls the whole hierarchy, with very tight control in the hands of the Hartfords. The wholesale warehouses and retail operation of the A&P system are divided up into divisions, units, and stores. The division presidents control the policy of the system, but the Hartfords control the appointment of the division presidents. The Hartfords sit with them in the quarterly division policy making meetings and are a dominating influence at these meetings. On the whole, it is a well disciplined organization, from top to bottom. Ultimate control of buying, with unimportant exceptions, is centralized in headquarters of A&P. In this way, A&P controls the buying policy for the entire system and hence the purchase price of its merchandise. This centralized control also gives A&P control of such things as advertising allowances and label and bag allowances, which are related to the buying.

The buying policy of A&P was to so use its power as to get a lower price on its merchandise than that obtained by its competitors. This policy, as implemented by "direct buying," was referred to by the top officers of A&P as a two-price level, the lower for A&P and the higher for its competitors. It used its large buying power to coerce suppliers to sell to it at a lower price than to its competitors on the threat that it would place such suppliers on its private blacklist if they did not conform, or that A&P would go into the manufacturing business in competition with the recalcitrant suppliers.

The following are some of the techniques used by A&P to get a lower price than its competitors. As early as about 1925, A&P sent its buyers into the field to buy merchandise for it under strict control of headquarters. These buyers were on A&P's payroll and were operating out of its establishments, in offices mostly under their individual names. Their primary object was to get the merchandise for A&P as cheaply as they could, and for this the supplier was compelled, if he obtained the business, to pay A&P a seller's brokerage of from one to five per cent. These so-called brokerage fees went into the coffers of A&P as a further reduction in price. Except on brokerage received from meat packers, which was outlawed in 1934, this system continued until 1936, when it was made illegal by the Robinson-Patman Act, 15 U.S.C.A. §§ 13, 13a, 13b, 21a. In 1935, gross revenues from this source amounted to $2,500,000.

After 1936, the buyers, instead of getting credit for alleged brokerage, induced their suppliers to reduce their price further to A&P by the amount of the brokerage fee. Thus the allowance became a markdown of the price on the invoice. This was called net buying. When this was outlawed by a decision of the Third Circuit upholding a cease and desist order of the Federal Trade Commission directed at this practice, A&P adopted a policy of direct buying. It thereafter would buy from no one who sold through a broker. Not only would it not buy from suppliers who offered to sell to it through brokers; it would not buy from a supplier who sold to anyone else through brokers. This clearly affected the business of brokers, who resisted as best they could, and as one of the defendant officers said, "these brokers are dieing (sic) hard." This policy also affected the trade that was unable to buy directly. Suppliers were in effect told that if they did not sell direct to all customers, A&P would withdraw its patronage. This policy of direct buying was broadcast to all the trade in a national press release by A&P, and A&P continued to get its usual lower price, which was supposed to be justified by cost savings in such direct buying and because A&P bought in large quantities. This system continued until the trial.

A substantial amount of the discounts A&P received rarely bore a relationship to cost savings. A&P got the largest discount on the basis of "large quantities" purchased, but as pointed out by A&P's attorney, the use of the expression "large quantities" was "definitely misleading." The large discounts A&P got were not for taking large quantities at one time but were based on a large volume purchased over a period of time and delivered in many small shipments. The defendants' attorneys pointed out to them that, "A large volume ordered out in many small shipments rarely involves any savings in and of itself * * *." Whatever the system used or by whatever name designated, A&P always wound up with a buying price advantage. This price advantage given A&P by the suppliers was, it is fairly inferable, not "twice blessed" like the quality of mercy that "droppeth as the gentle rain from heaven." It did not bless "him that gives and him that takes." Only A&P was blessed, and the supplier had to make his profit out of his other customers at higher prices, which were passed on to the competition A&P met in the retail field.

One cannot escape the conclusion on the very substantial evidence here, as one follows the devious manipulations of A&P to get price advantages, that it succeeded in obtaining preferential discounts not by force of its large purchasing power and the buying advantage which goes therewith, but through its abuse of that power by the threats to boycott suppliers and place them on its individual blacklist, and by threats to go into the manufacturing and processing business itself, since it already possessed a considerable establishment and experience that would enable it to get quickly and successfully into such business if a recalcitrant supplier, processor, or manufacturer did not yield. The A&P organization was urged to keep secret whatever preferences it received. These predatory discounts and other preferences amounted to 22.15% of A&P's total profits in 1939; 22.47% in 1940; and 24.59% in 1941.

The influence of this ruthless force in the food buying field was also used to compel suppliers to discontinue practices in their business which might be detrimental to A&P. For instance, some A&P suppliers were making store door deliveries to A&P competitors. Since A&P had to deliver to its own store doors from the warehouses it maintained, it was unable to get the full benefit of its warehousing policy if the suppliers continued the store door deliveries. A&P forced some manufacturers to "widen the spread" between store door deliveries and warehouse deliveries and thus perpetuated its purchasing advantage. Also, it forced other suppliers to discontinue merchandising by aid of premiums given the customers. A&P did not want to be bothered with the premium details, and it did not want its competitors to have the advantage thereof, so it forced many suppliers to give up the premium aid to merchandising.

To do their buying of fruits, vegetables, and produce, A&P set up a wholly-owned subsidiary, the Atlantic Commission Company, herein referred to as ACCO. It acted as buyer for A&P and selling and buying broker for the rest of the trade, and for this latter service, ACCO received the usual broker's fees which went into the pocket of A&P since the latter was the sole owner of ACCO. ACCO was the largest single operator in its field. For a time it took brokerage from the seller for the merchandise it sold to A&P. These funds went, of course, to A&P. That system was abandoned. But the technique used by A&P in the purchase of merchandise other than fresh fruits, vegetables, and produce, in order to receive preferential treatment as to price, was used by ACCO in its field and with like success.

*** ACCO's aggressiveness and insistence upon its prerogative to fix prices unilaterally are evidenced by a statement of the defendant Baum, an executive officer and director of ACCO:

> "* * * it will be necessary for your shippers to accept the price we place on this merchandise at the time of arrival and discontinue this bartering over 5¢ differential and if the shippers find that this procedure is not in accordance with their ideas or they are not given a fair deal on the average over a period of time then of course it is their privilege to discontinue these arrival sales or price arrivals."

*** From this evidence, we see that ACCO collected brokerage from the trade, which increased the price to A&P's competitors, and the brokerage went into A&P's coffers to increase its competitive advantage. Secondly, ACCO got the best quality for A&P and passed on the inferior to A&P's competitors and, of course, ACCO got preferential treatment as to prices under one scheme or another. ACCO's profits constituted 5.08% of A&P's total profit in 1939; 5.62% in 1940; and 7.16% in 1941.

Closely related to the policy and the purpose to establish a two-price level by the abuse of its power and position, A&P by the same methods forced its suppliers to give it advertising and space allowances that bore no relation to the cost of the service rendered in the matter of advertising or display of merchandise in A&P's stores. *** The profits from these allowances were substantial and amounted in 1939 to 5.93% of A&P's total profit; in 1940 to 6.23%; and in 1941 to 5.46%.

Another but smaller item was the bag and label allowances. A&P furnished bags and labels to processors and manufacturers, for which it received an allowance. For instance, in the canning industry, the standard allowance for labels was $1.50 per thousand, but A&P insisted upon and received $2 per thousand. It was claimed that A&P's labels were more attractive and expensive. However that may be, the fact remains that A&P was not in the label business any more than it was in the advertising business, but it managed in both to realize a substantial difference between the cost to it and what it realized out of the transaction from other suppliers. Everything was grist to the mill that was grinding down prices to A&P to enable it to maintain the two-price level to its advantage. The bag and label allowances amounted in 1939 to .83% of the total profit of A&P; in 1940 to .75%; and in 1941 to .38%.

As we have indicated, A&P owned and controlled, through the vertical integration of its system, certain corporations that were engaged in the manufacturing and processing of merchandise for sale by A&P in its stores. For instance, the defendant The Quaker Maid Company, Inc., made many items sold in A&P retail stores. The defendant White House Milk Company, Inc., manufactured canned milk. The defendant Nakat Packing Corporation canned fish. These companies were satellites of the A&P system. Their products were sold only to A&P stores and were invoiced at a markup above the cost of production. These corporations were tools in the hands of A&P, used and useful in maintaining the two-price level to enable it to maintain its position of dominance in the retail food business. Whatever the spread between cost to these defendants in processing and manufacturing and what they invoiced the goods to A&P for, was credited on the books to A&P. This, of course, was a bookkeeping transaction between A&P and its satellites and was a paper profit which eventually went to reduce the cost of the products to the retail stores when allocated to their credit on a fair method of allocation based upon use employed by the retail stores. In fact, all the paper profits of these manufacturing and processing satellites, together with the real profits of ACCO, the preferential discounts and buying allowances, the advertising allowances, the bag and label allowances, and certain other profits and gains throughout the system, were all kept track of by a system of what the defendants designate statistical accounting, for their own guidance to enable them to determine what the satellites, departments within the system as well as the retail stores, were doing. These accumulated profits and allowances at headquarters amounted in 1939 to 93.69% of A&P's total profits; in 1940 to 90.63%; and in 1941 to 89.02%. The difference between these accumulated profits and allowances and the total profits left the profits shown by the retail stores to be 6.31% in 1939; 9.37% in 1940; and 10.98% in 1941.

No question is raised about the fairness of the method of allocation of the accumulated profits and allowances. When made, they have the effect of reducing to the retail stores the cost of merchandise sold. It is the predatory method through which this accumulation of profits and allowances is obtained and not the method of allocation or statistical handling of them that is challenged by the Government. With this large fund accumulated at the buying and supplying level and allocated to the advantage of low cost of merchandise to the retail or selling level, A&P's enormous power or advantage over competitors emerges more clearly when we consider the evidence on the retail level. Here the price advantage A&P has enjoyed through the coercive use of its power enables it to undersell its competitors and to pick and choose the locations in which the price advantage shall be used. For instance, if a division, unit, or store is selected for attention, whether on the basis of its experience historically in that community or some other basis sufficient to the policy makers of A&P, these policy makers have only to give their attention to gross profit percentages. If Area X is having a tough experience competitionwise, or the area looks prospective in which to increase the volume of business, the gross profit percentage in this area is lowered. This lowers the price at which goods may be sold and the volume increases at the expense of somebody. Sometimes the gross profit rate is fixed so low that the store runs below the cost of operation, even with all the advantage derived by the store in reduction of the cost of its merchandise occasioned by the headquarters' allocation of its predatory profits and accumulations. When the gross profit rate is reduced in Area X, it is an almost irresistible conclusion that A&P had the power to compensate for any possible decline in net profits by raising the gross profit rate and retail prices in Area Y, where it was in a competitive position to do so. The record is replete with instances of deliberate reductions of gross profit rates in selected areas. Thus Area Y, at the desire of the policy makers of A&P, can be brought to aid in the struggle in Area X, which in numerous instances, as the record shows, sustained heavy net losses for periods extending over a substantial number of consecutive years. There must inevitably be a compensation somewhere in the system for a loss somewhere else, as the overall policy of the company is to earn $7 per share per annum on its stock.

On this record it seems apparent that the goal of the conspiracy to establish a two-price level at the buying level, which enables A&P to meet its competitors with an enormous advantage at the retail level, has been realized.

When Congress enacted the Sherman Act it did not undertake to regulate business in commerce, which so often leads to price or rate fixing. Just a few years before the Sherman Act was enacted, Congress passed the Interstate Commerce Act, 49 U.S.C.A. § 1 et seq., whereby it did fix rates through an instrumentality of its own creation and within limits which Congress prescribed. The Sherman Act sought to avoid, not only for reasons of policy but for considerations of power, any regulation of business not in the category with railroads, which were supposed to be affected with the public interest, and to establish a punitive or corrective system for other business in commerce. Congress evidently believed that if competition were preserved in this field, free enterprise would regulate itself. The purpose of Congress was to see to it that competition was not destroyed. To this end, in the most comprehensive and sensitive terms, Congress provided among other things that a conspiracy to restrain trade in commerce and to monopolize it in part should be a criminal offense. That is the offense of which these defendants stand convicted.

No court has yet said that the accumulation and use of great power is unlawful per se. Bigness is no crime, although "size is itself an earmark of monopoly power. For size carries with it an opportunity for abuse." *United States v. Paramount Pictures*, 334 U.S. 131, 174. That there was an accumulation of great power by A&P cannot be denied. How it used that power is the question. When A&P did not get the preferential discount or allowance it demanded, it did not simply exercise its right to refuse to contract with the supplier. It went further and served notice on the supplier that if that supplier did not meet the price dictated by A&P, not only would the supplier lose the business at the moment under negotiation, but it would be put upon the unsatisfactory list or private blacklist of A&P and could expect no more business from the latter. This was a boycott and in and of itself is a violation of the Sherman Act. *Fashion Originators Guild v. Federal Trade Comm.*, 312 U.S. 457.

While it is not necessary to constitute a violation of Sections 1 and 2 of the Sherman Act that a showing be made that competitors were excluded by the use of monopoly power, there is evidence in this record of how some local grocers were quickly eliminated under the lethal competition put upon them by A&P when armed with its monopoly power. As the evidence showed in this case, A&P received quantity discounts that bore no relation to any cost savings to the supplier. While A&P tried to rig up various contracts with its suppliers that would give the suppliers a semblance of compliance with the Robinson-Patman Act, by colorably relating the discriminatory preferences allowed to cost savings, the primary consideration with A&P seemed to be to get the discounts, lawfully, if possible, but to get them at all events. The conclusion is inescapable on this record that A&P was encouraging its suppliers to violate the Robinson-Patman Act. The unlawful discounts were to be received by A&P as its due, regardless.

Whether or not A&P in inducing and knowingly receiving these price discriminations was in violation of the Robinson-Patman Act, as its suppliers certainly were, the advantage which A&P thereby obtained from its competitors is an unlawful restraint in itself. The purpose of these unlawful preferences and advantages was to carry out the avowed policy of A&P to maintain this two-price level which could not help but restrain trade and tend toward monopoly. Furthermore, to obtain these preferences, pressure was put on suppliers not by the use but by the abuse of A&P's tremendous buying power. The means as well as the end were unlawful. With the concessions on the buying level acquired by the predatory application of its massed purchasing power, A&P was enabled to pressure its competitors on the selling level even to the extent of selling below cost and making up the loss in areas where competitive conditions were more favorable. The inevitable consequence of this whole business pattern is to create a chain reaction of ever-increasing selling volume and ever-increasing requirements and hence purchasing power for A&P, and for its competitors hardships not produced by competitive forces, and, conceivably, ultimate extinction. Under all the cases, this is a result which Sections 1 and 2 of the Sherman Act were designed to circumvent.

*** On the whole record, we think that there is substantial evidence to support the finding as to the guilt of all the defendants. The other errors complained of have all been considered and found unsubstantial, and the judgment is affirmed.

U.S. Wholesale Outlet & Distribution, Inc. v. Innovation Ventures, LLC

___ F.4th ___ (9th Cir. December 22, 2023)

MILLER, Circuit Judge, as to Parts I and II: This appeal arises out of an action under the Robinson- Patman Price Discrimination Act, 15 U.S.C. §§ 13–13b, 21a. The jury returned a verdict for the defendants, and the district court denied the plaintiffs' requested injunctive relief. The plaintiffs challenge various jury instructions as well as the denial of injunctive relief. We affirm in part and vacate, reverse, and remand in part.

I

Living Essentials, LLC, produces 5-hour Energy, a caffeinated drink sold in 1.93-ounce bottles. Living Essentials sells 5-hour Energy to various purchasers, including wholesalers, retailers, and individual consumers.

This case concerns Living Essentials' sales of 5-hour Energy to two sets of purchasers. One purchaser is the Costco Wholesale Corporation, which purchases 5-hour Energy for resale at its Costco Business Centers—stores geared toward "Costco business members," such as restaurants, small businesses, and other retailers, but open to any person with a Costco membership. The other purchasers, whom we will refer to as "the Wholesalers," are seven California wholesale businesses that buy 5-hour Energy for resale to convenience stores and grocery stores, among other retailers. The Wholesalers allege that Living Essentials has offered them less favorable pricing, discounts, and reimbursements than it has offered Costco.

During the time period at issue here, Living Essentials charged the Wholesalers a list price of $1.45 per bottle of "regular" and $1.60 per bottle of "extra-strength" 5-hour Energy, while Costco paid a list price of ten cents per bottle less: $1.35 and $1.50, respectively. Living Essentials also provided the Wholesalers and Costco with varying rebates, allowances, and discounts affecting the net price of each bottle. For example, the Wholesalers received a 7-cent per bottle "everyday discount," a 2 percent discount for prompt payment, and discounts for bottles sold from 5-hour Energy display racks. Meanwhile, Costco received a 1 percent prompt-pay discount; a spoilage discount to cover returned, damaged, and stolen goods; a 2 percent rebate on total sales for each year from 2015 to 2018; payments for displaying 5- hour Energy at the highly visible endcaps of aisles and fences of the store; and various advertising payments.

Living Essentials also participated in Costco's Instant Rebate Coupon (IRC) program. Under that program, Costco sent monthly mailers to its members with redeemable coupons for various products. About every other month, Costco would offer its members an IRC worth $3.60 to $7.20 per 24-pack of 5-hour Energy—a price reduction of 15 to 30 cents per bottle. The customer would redeem the IRC from Costco at the register when buying the 24-pack, and Living Essentials would reimburse Costco for the face value of the 5-hour Energy IRCs redeemed that month. Over the course of the seven-year period at issue here, Living Essentials reimbursed Costco for about $3 million in redeemed IRCs.

In February 2018, the Wholesalers brought this action against Living Essentials and its parent company, Innovation Ventures, LLC, in the Central District of California, alleging that by offering more favorable prices, discounts, and reimbursements to Costco, Living Essentials had violated the Robinson-Patman Act, which prohibits sellers of goods from discriminating among competing buyers in certain circumstances. The Wholesalers sought damages under section 2(a) of the Act and an injunction under section 2(d).

Section 2(a)—referred to as such because of its original place in the Clayton Act, see *Volvo Trucks N. Am., Inc. v. Reeder-Simco GMC, Inc.*, 546 U.S. 164, 175 (2006)—bars a seller from discriminating in price between competing purchasers of commodities of like grade and quality. 15 U.S.C. § 13(a). One form of prohibited discrimination under section 2(a) is secondary-line price discrimination, "which means a seller gives one purchaser a more favorable price than another." *Aerotec Int'l, Inc. v. Honeywell Int'l, Inc.*, 836 F.3d 1171, 1187 (9th Cir. 2016). To establish secondary-line discrimination, a plaintiff must show that (1) the challenged sales were made in interstate commerce; (2) the items sold were of like grade and quality; (3) the seller discriminated in price between the disfavored and the favored buyer; and (4) "'the effect of such discrimination may be . . . to injure, destroy, or prevent competition' to the advantage of a favored purchaser." *Volvo*, 546 U.S. at 176–77 (quoting 15 U.S.C. § 13(a)). The fourth component of that test, the element at issue in this case, ensures that section 2(a) "does not ban all price differences," but rather "proscribes 'price discrimination only to the extent that it threatens to injure competition.'" Id. at 176 (quoting *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 220 (1993)).

Section 2(d) makes it unlawful for a manufacturer to discriminate in favor of one purchaser by making "payment[s]" to that purchaser "in connection with the . . . sale, or offering for sale of any products . . . unless such payment or consideration is available on proportionally equal terms to all other customers competing in the distribution of such products." 15 U.S.C. § 13(d). To prevail on a claim for injunctive relief under section 2(d), the plaintiff must establish that it is in competition with the favored buyer, and "must show a threat of antitrust injury," *Cargill, Inc. v. Monfort of Colo., Inc.*, 479 U.S. 104, 122 (1986), but it need not make "a showing that the illicit practice has had an injurious or destructive effect on competition." *FTC v. Simplicity Pattern Co.*, 360 U.S. 55, 65 (1959).

On summary judgment, the district court found that the Wholesalers had proved the first three elements of their section 2(a) claim—that the products were distributed in interstate commerce, of like grade and quality, and sold at different prices to Costco and to the Wholesalers.

The parties proceeded to try to a jury the fourth element of section 2(a), whether there was a competitive injury, and to try to the court the section 2(d) claim for injunctive relief.

At trial, the parties focused on whether the Wholesalers and Costco were in competition. The Wholesalers introduced numerous emails from Living Essentials employees discussing the impact of Costco's pricing on the Wholesalers' sales. Additionally, they presented the testimony of a marketing expert who opined that the Wholesalers and the Costco Business Centers were in competition. The expert based that opinion on the companies' geographic proximity and on interviews he conducted in which the Wholesalers' proprietors stated that they lost sales due to Costco's lower prices. Living Essentials primarily relied on the testimony of an expert who reviewed sales data and opined that buyers of 5-hour Energy are not price sensitive and do not treat the Wholesalers and Costco Business Centers as substitutes; for that reason, he concluded that the Wholesalers and Costco Business Centers were not competitors.

The district court instructed the jury that section 2(a) required the Wholesalers to show that Living Essentials made "reasonably contemporaneous" sales to them and to Costco at different prices. The Wholesalers objected. They agreed that the instruction correctly stated the law but argued that "[t]here is literally no evidence to suggest that Living Essentials' sales of 5-Hour Energy to Costco and Plaintiffs occurred at anything other than the same time over the entire 7-year period." The court nevertheless gave the proposed instruction, telling the jury that "[e]ach Plaintiff must prove that the sales being compared were reasonably contemporaneous." The instruction directed the jury to find for Living Essentials if it determined "that the sales compared are sufficiently isolated in time or circumstances that they cannot be said to have occurred at approximately the same time for a Plaintiff." The instruction also listed a number of factors for the jury to consider in its evaluation, such as "[w]hether market conditions changed during the time between the sales."

The district court further instructed the jury that the Wholesalers had to prove that any difference in prices could not be justified as "functional discounts" to compensate Costco for marketing or promotional functions that it performed. The Wholesalers again objected. As with the instruction on reasonably contemporaneous sales, the Wholesalers agreed that the instruction was a correct statement of the law, but they argued that there was "a complete absence of evidence" of any savings for Living Essentials or costs for Costco in performing the alleged functions justifying the discount. Rejecting that argument, the court instructed the jury that Living Essentials claimed that "its lower prices to Costco are justified as functional discounts," which the court defined as discounts "given by a seller to a buyer based on the buyer's performance of certain functions for the seller's product." The instructions explained that while the Wholesalers had "the ultimate burden to prove that defendant's lower prices were not justified as a functional discount," Living Essentials had the burden of production and so "must present proof" that "(1) Costco actually performed the promotional, marketing, and advertising services" it claimed to perform and "(2) the amount of the discount was a reasonable reimbursement for the actual functions performed by Costco." The instructions told the jury to find for Living Essentials if it found that the price discrimination was "justified as a functional discount."

The jury returned a verdict for Living Essentials on the section 2(a) claim. The court then denied the Wholesalers' request for injunctive relief under section 2(d). The court reasoned that "the jury implicitly found no competition existed between [the Wholesalers] and Costco, and the Court is bound by that finding." In addition, the court concluded, based on its own independent review of the evidence, that the Wholesalers had "failed to prove by a preponderance of the evidence that they competed with Costco for resale" of 5-hour Energy.

II

We begin by considering the jury instructions on reasonably contemporaneous sales and functional discounts. *** The question before us is whether the district court abused its wide discretion in finding that there was any foundation for giving the instructions. We conclude that it did not.

A

The Wholesalers argue that the district court abused its discretion in instructing the jury on reasonably contemporaneous sales because "there was no legitimate dispute" that the Wholesalers carried their burden on that requirement.

To establish a prima facie case under section 2(a), a plaintiff must show that the discriminating seller made one sale to the disfavored purchaser and one sale to the favored purchaser "within approximately the same period of time." *Texas Gulf Sulphur Co. v. J.R. Simplot Co.*, 418 F.2d 793, 807 (9th Cir. 1969) (quoting *Tri-Valley Packing Ass'n v. FTC*, 329 F.2d 694, 709 (9th Cir. 1964)). In other words, it must establish "[t]wo or more contemporaneous sales by the same seller." *Rutledge v. Electric Hose & Rubber Co.*, 511 F.2d 668, 677 (9th Cir. 1975). That requirement ensures that the challenged price discrimination is not the result of a seller's lawful response to a change in economic conditions between the sales to the favored and disfavored purchasers. *Texas Gulf Sulphur Co.*, 418 F.2d at 806.

As we have explained, the Wholesalers do not argue that the district court's instructions on reasonably contemporaneous sales misstated the law. Instead, they contend that they so clearly carried their burden on this element that the district court should have found the element satisfied rather than asking the jury to decide it. In the Wholesalers' view, "there was no dispute . . . that [Living Essentials] had made thousands of contemporaneous sales to Costco and to all seven Plaintiffs."

The Wholesalers' position appears to be that when the plaintiff has the burden of proving an element of its case, a district court should decline to instruct the jury on that element if the court determines the plaintiff has proved it too convincingly. We are unaware of any authority for that proposition. To the contrary, our cases that have rejected proposed jury instructions have done so because the party bearing the burden presented too little evidence to justify the instruction, not too much. *** But although the Wholesalers did move for judgment as a matter of law, they have not challenged the denial of that motion on appeal. The Wholesalers may not bypass that procedure by challenging a jury instruction on an element of their prima facie case.

Even if it could be error to instruct the jury on an element that a plaintiff obviously proved, the proof here was far from obvious. The Wholesalers might be right that the evidence established reasonably contemporaneous sales, but during the trial, they did not explain how it did so. In their written objection to the instructions, the Wholesalers stated that "[t]here is literally no evidence to suggest" that the compared sales were not contemporaneous, and in their oral objection, they similarly declared that there was "no dispute" on the issue. The first and last time the Wholesalers mentioned the requirement to the jury was during closing argument, when they said that the "[t]he sales were made continuously to Costco and to plaintiffs over the entire seven years." Despite those confident assertions, the Wholesalers did not direct the district court to any evidence to substantiate their claim.

The Wholesalers did not point to any evidence of reasonably contemporaneous sales until their post-trial motion for judgment as a matter of law. Because that motion was not available to the district court when the court instructed the jury, it cannot be a basis for concluding that the court abused its discretion. In any event, the motion did not clearly identify any reasonably contemporaneous sales. Instead, the Wholesalers merely referred to Exhibit 847, a series of spreadsheets introduced by Living Essentials that spans more than 100,000 cells cataloguing seven years' worth of Living Essentials' sales to all purchasers, including Costco and the Wholesalers. The motion presented a modified version of that exhibit that included only Living Essentials' sales to Costco and the Wholesalers, omitting sales to other purchasers. But that (relatively) pared-down version—itself more than 200 pages long—was never presented to the jury. Even that version is hardly self- explanatory, and the Wholesalers made little effort to explain it: They did not point to any specific pair of sales that were reasonably contemporaneous.

Indeed, even on appeal, the Wholesalers have not identified any pair of sales that would satisfy their burden. The most they have argued is that the column entitled "Document Date" reflects the date of the invoice, so in their view the spreadsheets speak for themselves in showing "thousands of spot sales to Costco and Plaintiffs." At no time have the Wholesalers shown that there were two or more sales between Living Essentials and both Costco and each plaintiff that were reasonably contemporaneous such that changing market conditions or other factors did not affect the pricing.

The Wholesalers complain that they are being unfairly faulted for not more thoroughly arguing "the incorrectly instructed point to the jury." That complaint reflects a misunderstanding of their burden. To take the issue away from the jury, it was the Wholesalers' burden to make—and support—the argument that the sales were reasonably contemporaneous. Perhaps, when it developed the jury instructions, the district court could have reviewed all of the evidence, located Exhibit 847 (the full version, not the more focused one the Wholesalers submitted later), and then identified paired transactions for each Wholesaler from the thousands upon thousands of cells it contained. *** There may have been a needle—or even many needles—in the haystack of sales data. It was not the district court's job to hunt for them.

Significantly, the district court identified factors that might have influenced the pricing between sales, including that "the overall sales of 5-hour Energy in California were declining." That trend could potentially explain why two differently priced sales resulted from "diverse market conditions rather than from an intent to discriminate." *Texas Gulf Sulphur Co.*, 418 F.2d at 806. The timing of the disputed sales is unclear, so it could be that the Wholesalers bought the product during periods of higher market pricing that Costco avoided. The possibility that sales were not reasonably contemporaneous has "some foundation in the evidence," and that is enough. With only the Wholesalers' conclusory assertions, an unexplained mass of spreadsheets, and Living Essentials' evidence of changing market conditions before it, the district court did not abuse its discretion in instructing the jury on this disputed element of the Wholesalers' prima facie case.

B

The Wholesalers next argue that the district court abused its discretion in giving the functional-discount instruction.

The Supreme Court has held that when a purchaser performs a service for a supplier, the supplier may lawfully provide that purchaser with a "reasonable" reimbursement, or a "functional discount," to compensate the purchaser for "its role in the supplier's distributive system, reflecting, at least in a generalized sense, the services performed by the purchaser for the supplier." *Texaco Inc. v. Hasbrouck*, 496 U.S. 543, 562, 571 n.11 (1990). For example, the Court has held that a "discount that constitutes a reasonable reimbursement for the purchasers' actual marketing functions will not violate the Act." Id. at 571.

Separately, the Robinson-Patman Act contains a statutory affirmative defense for cost-justified price differences, or "differentials which make only due allowance for differences in the cost of manufacture, sale, or delivery." 15 U.S.C. § 13(a). The functional-discount doctrine is different because it requires only a "reasonable," not an exact, relationship between the services performed and the discounts given. *Hasbrouck*, 496 U.S. at 561 & n.18. Also, in contrast to the cost-justification defense, it is the plaintiff's burden to prove that the price discrimination was not the result of a lawful functional discount. Id. at 561 n.18. But the doctrine applies "[o]nly to the extent that a buyer *actually* performs certain functions, assuming all the risk, investment, and costs involved." Id. at 560–61. And it does not "countenance a functional discount completely untethered to either the supplier's savings or the wholesaler's costs" Id. at 563.

The Wholesalers do not dispute that the jury instructions accurately stated the law governing functional discounts. Instead, they argue that the district court should not have given a functional-discount instruction because the doctrine does not apply "as *between* favored and disfavored wholesalers" and because the discounts given to Costco bore no relationship to Living Essentials' savings or Costco's costs in performing the alleged functions. We find neither argument persuasive.

The Wholesalers are correct that selective reimbursements may create liability for the supplier under section 2(d) if the supplier fails to offer them "on proportionally equal terms to all other" competing purchasers. 15 U.S.C. § 13(d). Nevertheless, purchasers at the same level of trade may receive different functional discounts if they perform different functions. A functional discount may compensate a purchaser for "assuming all the risk, investment, and costs involved" with "perform[ing] certain functions," *Hasbrouck*, 496 U.S. at 560–61, and "*[e]ither* because of this additional cost or because competing buyers do not function at the same level," James F. Rill, *Availability and Functional Discounts Justifying Discriminatory Pricing*, 53 Antitrust L.J. 929, 934 (1985) (emphasis added), a functional discount "negates the probability of competitive injury, an element of a prima facie case of violation," *Hasbrouck*, 496 U.S. at 561 n.18 (quoting Rill, supra, at 935). Conversely, even where customers do operate at different levels of trade, a discount may violate the Robinson-Patman Act if it does not reflect the cost of performing an actual function.

In all section 2(a) cases, a plaintiff "ha[s] the burden of proving . . . that the discrimination had a prohibited effect on competition." *Hasbrouck*, 496 U.S. at 556. To the extent that a "legitimate functional discount," id. at 561 n.18, compensates a buyer for "*actually* perform[ing] certain functions, assuming all the risk, investment, and costs involved," id. at 560 (citation omitted), no such effect can be shown.

Here, the competitive-injury element was the subject of dispute at trial. Because Living Essentials offered evidence that it compensated Costco for performing certain functions and assuming certain risks (which would eliminate a competitive injury), the Wholesalers had the burden of showing that those functions and risks did not justify the discounted price that Costco received—whether or not Costco and the Wholesalers were at the same level of trade.

The Wholesalers also argue that even if the functional- discount instruction was legally available to Living Essentials, the district court still abused its discretion in giving the instruction because there was no foundation in the evidence to support it. In fact, Living Essentials presented evidence that Costco performed several marketing and other functions that could have been compensated for by a functional discount. For example, Costco promoted 5-hour Energy by giving the product prime placement in aisle endcaps and along the fence by the stores' entrances; it created and circulated advertisements and mailers; it provided delivery and online sales for 5-hour Energy; and it contracted for a flat "spoilage allowance" rather than requiring Living Essentials to deal with spoilage issues as they arose. In addition to providing those services, Costco allowed Living Essentials to participate in its IRC program, in which Costco sent out bi-monthly mailers with coupons for 5-hour Energy, among other products, to its members. The member would redeem the coupon at the register, and Costco would advance the discount to the buyer on behalf of Living Essentials, record the transaction, and then collect the total discount from Living Essentials at the end of each period.

Living Essentials testified that Costco received "allowance[s]" in relation to its placement services because Costco was "performing a service for us." As to Costco's advertising and IRC services, Living Essentials testified that they allowed it to reach some 40 million Costco members, whom it could not otherwise reach "with one payment." Finally, in the case of the spoilage discount, Living Essentials explained that by providing a flat, upfront discount in exchange for Costco's assumption of the risk of loss and spoilage, Living Essentials avoided having to negotiate case-by-case with Costco over product loss.

The Wholesalers argue that the functional discount defense is unavailable because Living Essentials separately compensated Costco for promotional, marketing, and advertising services, so "the entirety of the price-gap cannot be chalked up to a unitary 'functional discount.'" They cite spreadsheets showing that Costco was paid for endcap promotions, advertising, and IRCs. But those spreadsheets do not show that Living Essentials' separate payments to Costco fully compensated it for those services. They therefore do not foreclose the possibility that some additional discount might have reflected reasonable compensation for the services.

More generally, the Wholesalers argue that even if Costco's services were valuable, "Living Essentials introduced zero evidence that its lower prices to Costco bore any relationship to either" Living Essentials' savings or Costco's costs. In fact, there is evidence in the record from which it is possible to infer such a relationship. For instance, Living Essentials presented testimony that Costco's performance of advertising functions—especially the 40- million-member mailers as well as endcap and fence placement programs—gave it "a tremendous amount of reach and awareness," which Living Essentials would otherwise have had to purchase separately. The record thus supported the conclusion that Living Essentials provided Costco "a functional discount that constitutes a reasonable reimbursement for [its] actual marketing functions." *Hasbrouck*, 496 U.S. at 571.

To be sure, the evidence did not establish a particularly precise relationship between the discounts and Costco's services, and it was open to the Wholesalers to argue that the discounts were so "untethered to either the supplier's savings or the wholesaler's costs" as not to qualify as functional discounts. Hasbrouck, 496 U.S. at 563. But it was the jury's role, not ours, to decide which party had the better interpretation of the evidence. The only question before us is whether the district court abused its discretion in determining that there was enough evidence to justify giving an instruction on functional discounts. Because at least some evidence supported the instruction, we conclude that there was no abuse of discretion.

The Wholesalers separately argue that the district court erred in denying their pre-verdict motion for judgment as a matter of law to exclude the functional-discount defense. Because the Wholesalers did not renew that argument in their post-verdict motion under Federal Rule of Civil Procedure 50(b), they failed to preserve the issue for appeal.

III

Finally, the Wholesalers challenge the district court's denial of injunctive relief under section 2(d). ***

A

Under section 2(d), it is unlawful for a seller to pay "anything of value to or for the benefit of a customer" for "any services or facilities furnished by or through such customer in connection with the . . . sale" of the products unless the payment "is available on proportionally equal terms to all other customers competing in the distribution of such products." 15 U.S.C. § 13(d); *Tri-Valley Packing Ass'n*, 329 F.2d at 707–08. In enacting the Robinson- Patman Act, "Congress sought to target the perceived harm to competition occasioned by powerful buyers, rather than sellers; specifically, Congress responded to the advent of large chainstores, enterprises with the clout to obtain lower prices for goods than smaller buyers could demand." *Volvo*, 546 U.S. at 175 (citing 14 Herbert Hovenkamp, Antitrust Law ¶ 2302 (2d ed. 2006)). In other words, Congress meant to prevent an economically powerful customer like a chain store from extracting a better deal from a seller at the expense of smaller businesses.[1]

The key issue in this case is whether Costco and the Wholesalers (both customers of Living Essentials) are "customers competing" with each other as to resales of 5- hour Energy for purposes of section 2(d). The FTC has interpreted the statutory language in section 2(d) to mean that customers are in competition with each other when they "compete in the resale of the seller's products of like grade and quality at the same functional level of distribution." 16 C.F.R. § 240.5.[2]

Our interpretation of "customers competing," as used in 15 U.S.C. § 13(d), is consistent with the FTC's. We have held that, to establish that "two customers are in general competition," it is "sufficient" to prove that: (1) one customer has outlets in "geographical proximity" to those of the other; (2) the two customers "purchased goods of the same grade and quality from the seller within approximately the same period of time"; and (3) the two customers are operating "on a particular functional level such as wholesaling or retailing." *Tri-Valley Packing Ass'n*, 329 F.2d at 708. Under these circumstances, "[a]ctual competition in the sale of the seller's goods may then be inferred." Id. We reasoned that this interpretation was consistent with "the underlying purpose of section 2(d)," which is to "require sellers to deal fairly with their customers who are in competition with each other, by refraining from making allowances to one such customer unless making it available on proportionally equal terms to the others." *Tri-Valley Packing Ass'n*, 329 F.2d at 708. Because sellers, in order to avoid violating section 2(d), must "assume that all of their direct customers who are in functional competition in the same geographical area, and who buy the seller's products of like grade and quality within approximately the same period of time, are in actual competition with each other in the distribution of these products," courts must make the same assumption of competition "in determining whether there has been a violation." Id. at 709. Applying this rule, *Tri-Valley* held that two wholesalers that received canned goods from the same supplier and sold them in the same geographical area

[1] To avoid confusion, we refer to the seller or supplier of a product as the "seller," the seller's customers as "customers," and those who buy from the seller's customers as "buyers."

[2] Although the FTC Guides that "provide assistance to businesses seeking to comply with sections 2(d) and 2(e)," 16 C.F.R. § 240.1, do not have the force of law, "we approach the [Guides] with the deference due the agency charged with day-to-day administration of the Act," *FTC v. Fred Meyer, Inc.*, 390 U.S. 341, 355 (1968).

would be in "actual competition" if the wholesalers had purchased the canned goods at approximately the same time. If this final criterion were met, then "a section 2(d) violation would be established" because the canned-good supplier gave one wholesaler a promotional allowance, but did not offer the same allowance to the other wholesaler. Id.

In considering the third prong of the *Tri-Valley* test— whether the two customers are operating "on a particular functional level such as wholesaling or retailing," id. at 708—we ask whether customers are actually functioning as wholesalers or retailers with respect to resales of a particular product to buyers, regardless of how they describe themselves or their activities. See *Feesers, Inc. v. Michael Foods, Inc.*, 498 F.3d 206, 214 (3d Cir. 2007) ("[T]he relevant question is whether two companies are in 'economic reality acting on the same distribution level,' rather than whether they are both labeled as 'wholesalers' or 'retailers.'") (citation omitted).

In listing the factors to consider in determining whether customers are competing, Tri-Valley did not include the manner in which customers operate. It makes sense that operational differences are not significant in making this determination, given that the Robinson-Patman Act was enacted to protect small businesses from the harm to competition caused by the large chain stores, notwithstanding the well-understood operational differences between the two. See, e.g., *Innomed Labs, LLC v. ALZA Corp.*, 368 F.3d 148, 160 (2d Cir. 2004) (explaining that chain stores have a more integrated distribution apparatus than smaller businesses and are able to "undersell their more traditional competitors"). Thus, courts have indicated that potential operational differences are not relevant to determining whether two customers compete for resales to the same group of buyers. In *Simplicity Pattern Co.*, the Supreme Court held that competition in the sale of dress patterns existed between variety stores that "handle and sell a multitude of relatively low-priced articles," and the more specialized fabric stores, which "are primarily interested in selling yard goods" and handled "patterns at no profit or even at a loss as an accommodation to their fabric customers and for the purpose of stimulating fabric sales." 360 U.S. at 59–60. The Court noted that the manner in which these businesses offered the merchandise to buyers was different, because the variety stores "devote the minimum amount of display space consistent with adequate merchandising— consisting usually of nothing more than a place on the counter for the catalogues, with the patterns themselves stored underneath the counter," while "the fabric stores usually provide tables and chairs where the customers may peruse the catalogues in comfort and at their leisure." Id. at 60. Nevertheless, the Court held there was no question that there was "actual competition between the variety stores and fabric stores," given that they were selling an "identical product [patterns] to substantially the same segment of the public." Id. at 62.

Similarly, in *Feesers*, the "different character" of two businesses that bought egg and potato products from a food supplier did not affect the analysis of whether they were in actual competition. 498 F.3d at 214 n.9. Although the businesses operated and interacted with their clients in different ways—one was a "full line distributor of food and food related products" while the other was a "food service management company"—the court held that "[t]he threshold question is whether a reasonable factfinder could conclude [the two customers] directly compete for resales [of the food supplier's] products among the same group of [buyers]." Id.

An assumption underlying the *Tri-Valley* framework is that two customers in the same geographic area are competing for resales to the same buyer or group of buyers. However, the Supreme Court has identified an unusual circumstance when that assumption does not hold true and customers who resell the same product at the same functional level in the same geographic area are not in competition because they are not reselling to the same buyer. See *Volvo*, 546 U.S. at 175.

In *Volvo*, Volvo dealers (customers of Volvo, the car manufacturer and seller) resold trucks through a competitive bidding process, where retail buyers described their specific product requirements and invited bids from selected dealers of different manufacturers. 546 U.S. at 170. Only after a Volvo dealer was invited to bid did it request discounts or concessions from Volvo as part of preparing the bid. Id. Volvo dealers typically did not compete with each other in this situation.4 Because the plaintiff in Volvo (a Volvo dealer) could not show that it and another Volvo dealer were invited by the same buyer to submit bids, there was no competition between Volvo dealers, and therefore no section 2(a) violation (which requires competition and potential competitive injury). Id. Moreover, because the plaintiff did not ask for price concessions from Volvo until after the buyer invited it to bid, id., (and no other Volvo dealer had been invited to bid, id. at 172) there could be no section 2(a) violation, id. at 177. Recognizing that the fact pattern in *Volvo* was different from a traditional Robinson-Patman Act "chainstore paradigm" case, where large chain stores were competing with small businesses for buyers, id. at 178, the Court "declin[ed] to extend Robinson-Patman's governance" to cases with facts like those in *Volvo*, id. at 181; see also *Feesers*, 498 F.3d at 214 (suggesting that there may be no actual competition where customers are selling to "two separate and discrete groups" of buyers).

B

We now turn to the question whether Costco and the Wholesalers were in actual competition.

It is undisputed that Costco and the Wholesalers were customers of Living Essentials and purchased goods of the same grade and quality. Further, the district court found that the Wholesalers' businesses were in geographic proximity to the Costco Business Centers, the only outlets that sold 5- hour Energy. It held that there "was at least one Costco Business Center in close proximity to each of the [Wholesalers] or their customers." Living Essentials and Judge Miller's dissent seemingly argue that this finding is clearly erroneous, because the maps in the record are ambiguous and the Wholesalers' expert, Dr. Frazier, is unreliable, because he "did not calculate the distance or drive time[s] between the stores" and did not conduct customer surveys. We disagree. "Where there are two permissible views of the evidence, the factfinder's choice between them cannot be clearly erroneous." *Anderson v. City of Bessemer City, N.C.*, 470 U.S. 564, 574 (1985). Therefore, we defer to the district court's fact-finding notwithstanding the alleged ambiguity in the evidence. Further, the district court could reasonably reject Living Essentials' critique of Dr. Frazier's methodology.

We next consider whether Costco and the Wholesalers operated at different functional levels with respect to resales of 5-hour Energy. The district court found that they did operate at different functional levels, and therefore competed for different customers of 5-hour Energy. In so holding, the district court abused its discretion because its ruling was based on both legal and factual errors.

First, the district court erred as a matter of law in concluding that, because the jury found in favor of Living Essentials on the section 2(a) claim, the jury made an implicit factual finding that there was no competition between Costco and the Wholesalers. As we have explained, to prevail on a section 2(a) claim, the Wholesalers had to show that the Wholesalers and Costco were in competition with each other, and that discriminatory price concessions or discounts caused a potential injury to competition. Therefore, in rejecting the Wholesalers' claim, the jury could have determined that the Wholesalers and Costco were competing, but there was no potential harm to competition. Because the jury did not necessarily find that the Wholesalers and Costco were not competing, the district court erred by holding that the jury had made an implicit finding of no competition.

Second, the district court erred in holding that Costco and the Wholesalers did not operate at the same functional level. The district court stated that Costco was a retailer and made the vast majority of its sales to the ultimate consumer. This finding is unsupported by the record, which contains no evidence that Costco sold 5-hour Energy to consumers. Rather, the evidence supports the conclusion that Costco sold 5-hour Energy to retailers. First, Living Essentials' Vice President of Sales, Scott Allen, testified that from 2013 to 2016, only Costco Business Centers, which target retailers, and not regular Costco stores, which target consumers, carried 5-hour Energy. Another Living Essentials employee, Larry Fell, testified that 90 percent of all Costco Business Center clients were businesses, and that Costco Business Centers targeted mom-and-pop convenience stores and small grocery stores. Allen also testified that Costco Business Centers sold 5-hour Energy in 24-packs, which Living Essentials packages for sale to businesses rather than to consumers. This evidence supports the conclusion that Costco sold 24-packs of 5-hour Energy to retailers, and there is no evidence supporting the district court's conclusion that Costco sold 5-hour Energy to consumers. Therefore, as a matter of "economic reality," both Costco and the Wholesalers were wholesalers of 5-hour Energy. The district court clearly erred by holding otherwise.

Because the evidence shows that Costco and the Wholesalers operated at the same functional level in the same geographic area, if the Wholesalers and Costco purchased 5-hour Energy within approximately the same period of time, this confluence of facts is sufficient to establish that Costco and the Wholesalers are in actual competition with each other in the distribution of 5-hour Energy.

C

Judge Miller's dissent argues that Costco and the Wholesalers are not in actual competition because they did not compete in the resales of 5-hour Energy to the same buyers. The dissent bases this argument on evidence in the record that Costco and the Wholesalers had "substantial differences in operations" and that buyers did not treat Costco and the Wholesalers as substitute supply sources of 5-hour Energy. We disagree with both arguments.

First, the differences in operations that Judge Miller's dissent cites, such as differences in the availability of in- store credit, negotiated prices, or different retail-oriented accessories such as 5-hour Energy display racks, are not relevant to determining whether Costco and the Wholesalers are "customers competing" under 15 U.S.C. § 13(d). As explained above, customers may compete for purposes of section 2(d) even if they operate in different manners.

In addition to precedent, FTC guidance indicates that customers are in competition with each other when they "compete in the resale of the seller's products of like grade and quality at the same functional level of distribution," regardless of the manner of operation. 16 C.F.R. § 240.5. For example, a discount department store may be competing with a grocery store for distribution of laundry detergent. See id. (Example 3).

Second, Judge Miller's dissent argues that Costco and the Wholesalers may not be in actual competition because it is not clear they sold to the same buyers. In making this argument, the dissent and Living Essentials primarily rely on Living Essentials' economic expert, Dr. Darrel Williams, who testified that Costco and the Wholesalers were not in competition because their buyers did not treat Costco and the Wholesalers as substitute supply sources. Dr. Williams based this conclusion on evidence that the Wholesalers' buyers continued to purchase 5-hour Energy from the Wholesalers regardless of changes in relative prices between the Wholesalers and Costco. This argument fails, however, because the question whether one business lost buyers to another does not shed light on whether the businesses are in competition, but only on whether there has been an injury to competition. Therefore, Dr. Williams's testimony about a lack of switching between Costco and the Wholesalers does not undermine the Wholesalers' claim that they are in competition with Costco for resales of 5-hour Energy.

Finally, Judge Miller's dissent relies on *Volvo* for the argument that even when the criteria in *Tri-Valley* are met for actual competition, a seller can show that the two customers are not in actual competition because "markets can be segmented by more than simply functional level, geography, and grade and quality of goods." But *Volvo* is inapposite. In *Volvo*, the customers (Volvo dealers) did not offer the same product to buyers in the same geographical area (i.e., the *Tri-Valley* scenario). Rather, it was the buyer who chose the customers from whom it solicited bids for a possible purchase. Since the buyer at issue in *Volvo* did not solicit bids from competing Volvo dealers, they were not in competition, and so a section 2(a) violation was not possible. In short, *Volvo* tells us that there may be circumstances where the evidence shows that each customer is selling to a "separate and discrete" buyer, as in *Volvo*, or to a separate and discrete group of buyers, eliminating the possibility of competition between customers. But there is no evidence supporting such a conclusion here. Instead, this case is a typical chainstore-paradigm case where the Wholesalers and Costco carried and resold an inventory of 5-hour Energy to all comers.

Because the district court erred by finding that Costco and the Wholesalers operated at different functional levels and competed for different customers with respect to 5-hour Energy, it abused its discretion in denying injunctive relief to the Wholesalers on that basis. We therefore vacate the district court's holding as to section 2(d) and reverse and remand for the district court to consider whether Costco and the Wholesalers purchased 5-hour Energy from Living Essentials "within approximately the same period of time" in light of the record (the only remaining Tri-Valley requirement), Tri-Valley Packing Ass'n, 329 F.2d at 709, or whether the Wholesalers have otherwise proved their section 2(d) claim.

AFFIRMED IN PART; VACATED, REVERSED, AND REMANDED IN PART.

GILMAN, Circuit Judge, concurring in part and dissenting in part: Contrary to the majority's decision, I am of the opinion that the district court abused its discretion in giving the "reasonably contemporaneous" instruction to the jury. I would therefore reverse the judgment of the court and remand for a new trial on the Wholesalers' Section 2(a) claim with a properly instructed jury. On the other hand, I agree with the majority that the court did not abuse its discretion in giving the "functional discount" jury instruction. Finally, I agree with the majority that the court abused its discretion in finding that Costco and the Wholesalers operated at different functional levels. In sum, I concur in vacating the court's denial of the Wholesalers' Section 2(d) claim for injunctive relief and would go further in granting a new trial on the Wholesalers' Section 2(a) claim.

The Wholesalers' secondary-line price-discrimination claim under Section 2(a) requires them to show that: (1) the challenged sales were made in interstate commerce; (2) the items sold were of like grade and quality; (3) the defendant- seller discriminated in price between favored and disfavored purchasers; and (4) "'the effect of such discrimination may be . . . to injure, destroy, or prevent competition' to the advantage of a favored purchaser." *Volvo Trucks N. Am, Inc. v. Reeder-Simco GMC, Inc.*, 546 U.S. 164, 176–77 (2006) (quoting 15 U.S.C. § 13(a)).

Secondary-line price discrimination is unlawful "only to the extent that the differentially priced product or commodity is sold in a 'reasonably comparable' transaction." *Aerotec Int'l, Inc. v. Honeywell Int'l, Inc.*, 836 F.3d 1171, 1188 (9th Cir. 2016) (citing *Tex. Gulf Sulphur Co. v. J.R. Simplot Co.*, 418 F.2d 793, 807 (9th Cir. 1969)).

To be reasonably comparable, the transactions in question must, among other things, occur "within approximately the same period of time," such that the challenged price discrimination is not a lawful response to changing economic conditions. *Tex. Gulf Sulphur*, 418 F.2d at 807 (quoting *Tri-Valley Packing Ass'n v. FTC*, 329 F.2d 694, 709 (9th Cir. 1964)). A plaintiff must show at least two contemporaneous sales by the same seller to a favored purchaser and a disfavored purchaser to make a Section 2(a) claim.

The Wholesalers challenge as discriminatory thousands of sales of 5-Hour Energy that Living Essentials made to Costco over the course of seven years. Living Essentials also made thousands of sales to the Wholesalers over the same time period, many of which occurred on the very same day as sales to Costco. Trial Exhibit 847, a spreadsheet of all of Living Essentials' sales during the relevant time period, documents each of these transactions (approximately 95,000 transactions in total).

Although the spreadsheet is extensive, it is fairly self- explanatory, not an "unexplained mass" as it is characterized by the majority. Each transaction appears on a separate line, with the date, the name of the buyer, the type of buyer ("wholesaler" or "Costco," for example), the number of bottles purchased, and the price all clearly indicated. This evidence establishes that thousands of sales to Costco and to the Wholesalers occurred in close proximity over the course of the entire seven-year period, which more than satisfies the Robinson-Patman Act's requirement that the challenged sales be reasonably contemporaneous.

Yet the majority concludes that the Wholesalers failed to meet their burden to establish contemporaneous sales because they "did not direct the district court to any evidence to substantiate their claim" until their post-trial motion for judgment as a matter of law, and even then the Wholesalers failed to "clearly identify any reasonably contemporaneous sales." The majority concedes that "[t]here may have been a needle—or even many needles—in the haystack of sales data." But the majority concludes that "[i]t was not the district court's job to hunt for them." In fact, however, there were many thousands of needles (contemporaneous sales data) in the evidentiary haystack of Trial Exhibit 847, so the court did not have to "hunt for them"—the data was staring the court in the face for all to see.

Moreover, by focusing only on whether the Wholesalers "identified any pair of sales that would satisfy their burden," the majority fails to account for the full record in the trial court. The comprehensive sales data was referenced frequently at trial—indeed it was the centerpiece of much of the proceedings. To offer just one example, Living Essentials' expert witness, Dr. Williams, engaged in an extensive analysis of the "sales data" by "look[ing] at every single day between 2012 and 2018."

In light of this evidence, I see no justification to characterize the transactions in this case as anything other than reasonably contemporaneous. And I am not aware of any authority supporting the proposition that the sufficiency of the evidence for a jury instruction turns on how thoroughly counsel discussed certain evidence at trial, so long as it is properly admitted (which is the case here). Nor did Living Essentials offer any contrary evidence to place the issue back in dispute. In other words, giving the contemporaneous-sales instruction was unwarranted because the Wholesalers introduced unrefuted evidence that the sales were in fact contemporaneous. As the Wholesalers rightly pointed out, "[t]here is literally no evidence to suggest that Living Essentials' sales of 5-Hour Energy to Costco and Plaintiffs occurred at anything other than the same time."

The majority disagrees, holding that the district court properly ruled that the price differential could be explained (and therefore rendered lawful) by the fact that sales of 5- Hour Energy were declining overall. They further speculate that the Wholesalers might have "bought the product during periods of higher market pricing that Costco avoided." But declining overall sales is a market condition that would have affected all purchasers for resale and, more importantly, the price differential remained consistent throughout the seven- year period over which the Wholesalers and Costco bought 5-Hour Energy from Living Essentials. The record provides no basis to support the proposition that fluctuations in demand could account for price differentials between transactions that occurred on the same day.

*** Faced with the evidence outlined above, no reasonable juror could conclude that the transactions in this case were other than contemporaneous. No separation in time between transactions can account for the difference between the higher price offered to the Wholesalers and the lower price offered to Costco. That is what matters for the purposes of the Robinson-Patman Act, which targets price discrimination between "competing customers," *England v. Chrysler Corp.*, 493 F.2d 269, 272 (9th Cir. 1974), in "*comparable transactions*," *Tex. Gulf Sulphur Co. v. J.R. Simplot Co.*, 418 F.2d 793, 806 (9th Cir. 1969) (emphasis in original) (quoting *FTC v. Borden Co.*, 383 U.S. 637, 643 (1966)), in order to combat "the perceived harm to competition occasioned by powerful buyers," *Volvo Trucks N. Am., Inc. v. Reeder-Simco GMC, Inc.*, 546 U.S. 164, 175 (2006).

The Wholesalers clearly objected to the "reasonably contemporaneous" instruction, and I find no evidence to support giving that instruction. I am therefore of the opinion that so instructing the jury was an abuse of the district court's discretion. And the Wholesalers need not have challenged the district court's denial of their entire post-trial renewed motion for judgment as a matter of law in order for us to remand for a new trial on the basis of this instructional error; the very fact that they "objected at the time of trial on grounds that were sufficiently precise to alert the district court to the specific nature of the defect" is sufficient. See *Merrick v. Paul Revere Life Ins. Co.*, 500 F.3d 1007, 1015 (9th Cir. 2007) (internal quotation marks omitted); see also Fed. R. Civ. P. 51.

Nor was the district court's error harmless. In the event of instructional error, prejudice is presumed, and "the burden shifts to [the prevailing party] to demonstrate that it is more probable than not that the jury would have reached the same verdict had it been properly instructed." *BladeRoom Grp. Ltd. v. Emerson Elec. Co.*, 20 F.4th 1231, 1243 (9th Cir. 2021) (quoting *Clem*, 566 F.3d at 1182). In this case, the jury was told to "find for the Defendants" if it determined that Living Essentials' sales to the Wholesalers and to Costco were not reasonably contemporaneous. And Living Essentials highlighted these instructions in their closing argument, calling the Wholesalers' failure to present evidence of contemporaneous sales "fatal to their claim." There is "no way to know whether the jury would [have] return[ed] the same [verdict] if the district court" had not given the "reasonably contemporaneous" instruction. See id. at 1244–45. I would therefore reverse the judgment of the court and remand for a new trial on the Wholesalers' Section 2(a) claim with a properly instructed jury.

MILLER, Circuit Judge, dissenting in part: I agree that the district court did not abuse its discretion in instructing the jury on the section 2(a) claims, but I do not agree that the district court erred in rejecting the section 2(d) claims. I would affirm the judgment in its entirety.

Under section 2(d), if two or more customers of a seller compete with each other to distribute that seller's products, the seller may not pay either customer "for any services or facilities furnished by or through such customer in connection with the . . . sale" of the products unless the payment "is available on proportionally equal terms to all other customers competing in the distribution of such products." 15 U.S.C. § 13(d); see *Tri-Valley Packing Ass'n v. FTC*, 329 F.2d 694, 707–08 (9th Cir. 1964). Unlike section 2(a), section 2(d) does not require "a showing that the illicit practice has had an injurious or destructive effect on competition." *FTC v. Simplicity Pattern Co.*, 360 U.S. 55, 65 (1959). But it does demand that the favored and the disfavored customer be "competing" with each other. 15 U.S.C. § 13(d).

The district court did not clearly err in finding that the Wholesalers failed to establish by a preponderance of the evidence that they were competing with Costco. (The district court was wrong to suggest that the jury's verdict compelled this conclusion, but the court expressly stated that its finding also rested on an "independent review of the evidence," and we may uphold it on that basis.) We have previously held that "customers who are in functional competition in the same geographical area, and who buy the seller's products of like grade and quality within approximately the same period of time, are in actual competition with each other in the distribution of these products." *Texas Gulf Sulphur Co. v. J.R. Simplot Co.*, 418 F.2d 793, 807 (9th Cir. 1969) (quoting *Tri-Valley Packing Ass'n*, 329 F.2d at 709). We have not set out a definitive definition of "functional competition," and the Wholesalers argue that they need only show a "'competitive nexus,' whereby 'as of the time the price differential was imposed, the favored and disfavored purchasers competed at the same functional level, i.e., all wholesalers or all retailers, and within the same geographic market.'" (quoting *Best Brands Beverage, Inc. v. Falstaff Brewing Corp.*, 842 F.2d 578, 585 (2d Cir. 1987)).

Such a capacious understanding of competition is foreclosed by the Supreme Court's decision in *Volvo Trucks North America, Inc. v. Reeder-Simco GMC, Inc.*, 546 U.S. 164 (2006). There, the Court clarified that a common position in the supply chain in a shared geographical market is not sufficient, by itself, to establish actual competition. Id. at 179 ("That Volvo dealers may bid for sales in the same geographic area does not import that they in fact competed for the same customer-tailored sales."). Thus, it is not enough to point to evidence of "sales in the same geographic area." Id. Instead, the evidence must show that the disfavored buyer "compete[d] with beneficiaries of the alleged discrimination for the same customer." Id. at 178. Consistent with *Volvo*, other circuits have held that "two parties are in competition only where, after a 'careful analysis of each party's customers,' we determine that the parties are 'each directly after the same dollar.'" *Feesers, Inc. v. Michael Foods, Inc.*, 591 F.3d 191, 197 (3d Cir. 2010) (quoting *Feesers, Inc. v. Michael Foods, Inc.*, 498 F.3d 206, 214 (3d Cir. 2007)).

In this case, Living Essentials presented evidence of substantial differences in operations that suggests that the Wholesalers and Costco were not competing "for the same customer." *Volvo*, 546 U.S. at 178. For example, unlike Costco, most of the Wholesalers sold 5-hour Energy only in store, negotiated pricing with their customers—offering in- house credit and different prices for 5-hour Energy—and sold only to retailers, not to end-consumers. Meanwhile, Costco Business Centers sold both in store and online at set prices to any consumer with a Costco membership, some of whom were end-consumers; in addition, they carried fewer than half of the 5-hour Energy flavors carried by the Wholesalers, and they did not sell 5-hour Energy display racks or other retailer-oriented accessories for Living Essentials. It is true that Costco Business Centers sold most of their 5-hour Energy to retailers. But it is far from clear that Costco sold to the same retailers as the Wholesalers. The Wholesalers' distinct features, such as their credit and wider inventory, may well have appealed to different customers.

Expert testimony corroborated that evidence. The parties offered dueling experts on the issue of competition. For the Wholesalers, Dr. Gary Frazier, a marketing expert, opined that the purchasers did compete based on his review of emails sent by Living Essentials' employees discussing sales, the testimony of six of the seven Wholesalers, and maps showing the locations of the Wholesalers, their customers, and the seven Costco Business Centers. But on cross-examination, Dr. Frazier acknowledged that he did not speak with any of the Wholesalers' customers, and that the maps on which he relied included all of the Wholesalers' customers in a cluster of unlabeled dots without regard to whether the customer ever purchased 5-hour Energy or the actual travel time for the customer to get to a Wholesaler versus one of the seven Costco Business Centers. The district court found that the Costco Business Centers and the Wholesalers were in close proximity to each other, and I do not question that finding. But the court was not required to accept Dr. Frazier's inference that their 5-hour Energy customers were the same.

For Living Essentials, Dr. Darrel Williams, an expert in industrial organization and economics, testified that a "necessary condition for competition is that the buyers consider the two sellers substitute[s]," and he opined that this "necessary condition" was absent. After analyzing Living Essentials' sales records, the sales data provided by four of the Wholesalers, and the Wholesalers' customer data, Dr. Williams concluded that the Wholesalers did not compete with Costco for sales of 5-hour Energy. His analysis showed that even though some Wholesalers priced 5-hour Energy above the prices of other Wholesalers and Costco, the Wholesalers' customers did not switch to the seller with the cheapest product; from the lack of any economically significant customer loss, he inferred that the Wholesalers' customers did not treat Costco as a substitute supplier of 5- hour Energy. He determined that the maximum level of customer switching across the Wholesalers and Costco was ten times lower than the switching attributable to ordinary customer "churn," and that even the opening of three new Costco Business Centers had no statistically significant effect on the Wholesalers' 5-hour Energy sales. Dr. Williams posited that operating differences between the Wholesalers and Costco might explain why their customers differed. He reasoned that the Wholesalers might draw customers interested in buying on credit or in the unique products the Wholesalers offer. In its ruling on the Wholesalers' motion for judgment as a matter of law, the district court summarized this testimony by explaining that "[b]ecause customers are presumed to purchase a product at the lowest available price, the jury could reasonably conclude this evidence tended to show Costco and Plaintiffs did not compete for the same customers."

The Wholesalers respond that Dr. Williams's testimony goes only to whether there was competitive injury, not whether there was competition in the first place. But that is a misreading of the testimony. Based on his conclusion that the Wholesalers' customers were not sensitive to the price of 5-hour Energy, Dr. Williams opined that the Wholesalers and Costco did not compete "for the same customer." *Volvo*, 546 U.S. at 178. To be sure, the district court was not required to credit Living Essentials' evidence and Dr. Williams's economic analysis of the sales data over the Wholesalers' evidence and Dr. Frazier's examination of emails and maps. But it did not clearly err in doing so and in finding that the Wholesalers failed to carry their burden.

In reversing the denial of an injunction, the court deems all of the evidence of lack of actual competition—and the district court's findings based on that evidence—to be irrelevant. It relies on our decision in *Tri-Valley Packing*, in which we said that where two direct customers of a seller both "operat[e] solely on the same functional level," if "one has outlets in such geographical proximity to those of the other as to establish that the two customers are in general competition, and . . . the two customers purchased goods of the same grade and quality from the seller within approximately the same period of time," then it is not necessary to trace the seller's goods "to the shelves of competing outlets of the two in order to establish competition." 329 F.2d at 708. Instead, "[a]ctual competition in the sale of the seller's goods may then be inferred." Id.

As the court reads *Tri-Valley Packing*, the "confluence of facts" of operating on the same functional level, being in geographic proximity, and reselling goods of like grade and quality is sufficient to conclusively establish competition, making any other evidence irrelevant. But what we said in *Tri-Valley Packing* is that actual competition "may . . . be inferred," 329 F.2d at 708, not that it "shall be irrebuttably presumed."

Nowhere in *Tri-Valley Packing* did we say that a defendant is barred from rebutting the inference of competition by presenting evidence that two resellers at the same functional level and in the same geographic area are not, in fact, in actual competition with each other. If we had, our insistence in *Tri-Valley Packing* on a showing of "functional competition," which I have already discussed, would have been superfluous. 329 F.2d at 709. Reading *Tri- Valley Packing* in that way is contrary to the economic reality that markets can be segmented by more than simply functional level, geography, and grade and quality of goods. Some differences in operations may not matter to customers, but others are undoubtedly significant. (In the New York geographic market, you can order a Coke both at Le Bernardin and at McDonald's, but no one thinks they are engaged in actual competition.)

The court's approach is also contrary to *Volvo*, which says that section 2(d) requires competition "for the same customer." 546 U.S. at 178. It is contrary to the decisions of other circuits that have recognized that finding competition requires "a careful analysis of each party's customers," not the application of a categorical rule. *Feesers, Inc.*, 591 F.3d at 197 (internal quotation marks omitted). And it is unsupported by the Federal Trade Commission's interpretation of section 2(d). In regulations defining "competing customers," the FTC gives the following illustrative example: "B manufactures and sells a brand of laundry detergent for home use. In one metropolitan area, B's detergent is sold by a grocery store and a discount department store." 16 C.F.R. § 240.5. Under the court's reading of *Tri-Valley Packing*, the grocery store and the discount department store would necessarily be in competition with each other. But that is not how the FTC sees it. Instead, the agency says, "*If* these stores compete with each other, any allowance, service or facility that B makes available to the grocery store should also be made available on proportionally equal terms to the discount department store." Id. (emphasis added). The presence or absence of competition must be assessed based on the facts.

The district court appropriately reviewed all of the evidence in making a finding that Living Essentials had not established competition. Because that finding was not clearly erroneous, I would affirm the judgment in its entirety.

Meyer v. Kalanick

174 F.Supp.3d 817 (S.D.N.Y. 2016)

JED S. RAKOFF, DISTRICT JUDGE: On December 16, 2015, plaintiff Spencer Meyer, on behalf of himself and those similarly situated, filed this putative antitrust class action lawsuit against defendant Travis Kalanick, CEO and co-founder of Uber Technologies, Inc. ("Uber"). Mr. Meyer's First Amended Complaint, filed on January 29, 2016, alleged that Mr. Kalanick had orchestrated and facilitated an illegal price-fixing conspiracy in violation of Section 1 of the federal Sherman Antitrust Act, 15 U.S.C. § 1, and the New York State Donnelly Act, New York General Business Law § 340. See First Amended Complaint ("Am. Compl."), Dkt. 26, ¶¶ 120-140. Plaintiff claimed, in essence, that Mr. Kalanick, while disclaiming that he was running a transportation company, had conspired with Uber drivers to use Uber's pricing algorithm to set the prices charged to Uber riders, thereby restricting price competition among drivers to the detriment of Uber riders, such as plaintiff Meyer.

On February 8, 2016, defendant Kalanick moved to dismiss the Amended Complaint. See Notice of Motion, Dkt. 27. Plaintiff opposed on February 18, 2016; defendant replied on February 25, 2016; and oral argument was held on March 9, 2016. Having considered all of the parties' submissions and arguments, the Court hereby denies defendant's motion to dismiss.

In ruling on a motion to dismiss, the Court accepts as true the factual allegations in the complaint and draws all reasonable inferences in favor of the plaintiff. *** In the antitrust context, stating a claim under Section 1 of the Sherman Act "requires a complaint with enough factual matter (taken as true) to suggest that an agreement was made. Asking for plausible grounds to infer an agreement does not impose a probability requirement at the pleading stage; it simply calls for enough fact to raise a reasonable expectation that discovery will reveal evidence of illegal agreement." *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 556 (2007).

The relevant allegations of the Amended Complaint are as follows. Uber, founded in 2009, is a technology company that produces an application for smartphone devices ("the Uber App") that matches riders with drivers (called "driver-partners"). See Am. Compl. ¶¶ 2, 21, 24, 27. Uber states that it is not a transportation company and does not employ drivers. See id. ¶¶ 2, 23. Defendant Kalanick, in addition to being the co-founder and CEO of Uber, is a driver who has used the Uber app. See id. ¶ 3. Plaintiff Meyer is a resident of Connecticut, who has used Uber car services in New York. See id. ¶ 7.

Through the Uber App, users can request private drivers to pick them up and drive them to their desired location. See id. ¶ 24. Uber facilitates payment of the fare by charging the user's credit card or other payment information on file. See id. ¶ 32. Uber collects a percentage of the fare as a software licensing fee and remits the remainder to the driver. See Am. Compl. ¶ 27. Drivers using the Uber app do not compete on price, see id. ¶ 2, and cannot negotiate fares with drivers for rides, see id. ¶ 34. Instead, drivers charge the fares set by the Uber algorithm. See id. ¶ 2. Though Uber claims to allow drivers to depart downward from the fare set by the algorithm, there is no practical mechanism by which drivers can do so. See id. ¶ 69. Uber's "surge pricing" model, designed by Mr. Kalanick, permits fares to rise up to ten times the standard fare during times of high demand. See id. ¶ 26, 48, 50. Plaintiff alleges that the drivers have a "common motive to conspire" because adhering to Uber's pricing algorithm can yield supra-competitive prices, Am. Compl. ¶ 90, and that if the drivers were acting independently instead of in concert, "some significant portion" would not agree to follow the Uber pricing algorithm. See id. ¶ 93.

Plaintiff further claims that the drivers "have had many opportunities to meet and enforce their commitment to the unlawful agreement." Am. Compl. ¶ 92. Plaintiff alleges that Uber holds meetings with potential drivers when Mr. Kalanick and his subordinates decide to offer Uber App services in a new geographic location. See id. ¶ 40. Uber also organizes events for its drivers to get together, such as a picnic in September 2015 in Oregon with over 150 drivers and their families in attendance, and other "partner appreciation" events in places including New York City. See id. ¶ 41. Uber provides drivers with information regarding upcoming events likely to create high demand for transportation and informs the drivers what their increased earnings might have been if they had logged on to the Uber App during busy periods. See id. ¶ 58. Moreover, plaintiff alleges, in September 2014 drivers using the Uber App in New York City colluded with one another to negotiate the reinstitution of higher fares for riders using Uber-BLACK and UberSUV services (certain Uber car service "experiences"). See id. ¶¶ 25, 87. Mr. Kalanick, as Uber's CEO, directed or ratified negotiations between Uber and these drivers, and Uber ultimately agreed to raise fares. See id. ¶ 87.

As to market definition, plaintiff alleges that Uber competes in the "relatively new mobile app-generated ride-share service market," of which Uber has an approximately 80% market share. Amended Complaint ¶¶ 94-95. Uber's chief competitor in this market, Lyft, has only a 20% market share, and a third competitor, Sidecar, left the market at the end of 2015. See id. ¶¶ 95-96. Although, plaintiff contends, neither taxis nor traditional cars for hire are reasonable substitutes for mobile app-generated ride-share service, Uber's own experts have suggested that in certain cities in the U.S., Uber captures 50% to 70% of business customers in the combined market of taxis, cars for hire, and mobile-app generated ride-share services. See id. ¶ 107.

Plaintiff claims to sue on behalf of the following class: "all persons in the United States who, on one or more occasions, have used the Uber App to obtain rides from uber driver-partners and paid fares for their rides set by the Uber pricing algorithm," with certain exclusions, such as Mr. Kalanick. See id. ¶ 13. Plaintiff also identifies a "subclass" of riders who have paid fares based on surge pricing. See id. ¶ 114. Plaintiff alleges that he and the putative class have suffered antitrust injury because, were it not for Mr. Kalanick's conspiracy to fix the fares charged by Uber drivers, drivers would have competed on price and Uber's fares would have been "substantially lower." See id. ¶ 109. Plaintiff also contends that Mr. Kalanick's design has reduced output and that, as "independent studies have shown," the effect of surge pricing is to lower demand so that prices remain artificially high. Am. Compl. ¶ 110. Based on these allegations, plaintiff claims that Mr. Kalanick has violated the Sherman Act, 15 U.S.C. § 1, and the Donnelly Act, New York General Business Law § 340. See id. ¶¶ 120-140. ***

In the instant case, the Court finds that plaintiff has adequately pled both a horizontal and a vertical conspiracy. As to the horizontal conspiracy, plaintiff alleges that Uber drivers agree to participate in a conspiracy among themselves when they assent to the terms of Uber's written agreement (the "Driver Terms") and accept riders using the Uber App. See Am. Compl. ¶¶ 70-71. In doing so, plaintiff indicates, drivers agree to collect fares through the Uber App, which sets fares for all Uber drivers according to the Uber pricing algorithm. In plaintiff's view, Uber drivers forgo competition in which they would otherwise have engaged because they "are guaranteed that other Uber drivers will not undercut them on price." See id. ¶ 72; Memorandum of Law in Opposition to Defendant Travis Kalanick's Motion to Dismiss ("Pl. Opp.Br."), Dkt. 33, at 11. Without the assurance that all drivers will charge the price set by Uber, plaintiff contends, adopting Uber's pricing algorithm would often not be in an individual driver's best interest, since not competing with other Uber drivers on price may result in lost business opportunities.

See Am. Compl. ¶ 72. The capacity to generate "supra-competitive prices" through agreement to the Uber pricing algorithm thus provides, according to plaintiff, a "common motive to conspire" on the part of Uber drivers. See Amended Complaint ¶ 90. Plaintiff also draws on its allegations about meetings among Uber drivers and the "September 2014 conspiracy," in which Uber agreed to reinstitute higher fares after negotiations with drivers, to bolster its claim of a horizontal conspiracy. See Pl. Opp. Br. at 14-15; Am. Compl. ¶¶ 41, 87, 92. In plaintiff's view, defendant Kalanick is liable as the organizer of the price-fixing conspiracy, Am. Compl. ¶¶ 76, 88; Pl. Opp. Br. at 9, and as an Uber driver himself, see id. ¶¶ 80-85.

Defendant Kalanick argues, however, that the drivers' agreement to Uber's Driver Terms evinces no horizontal agreement among drivers themselves, as distinct from vertical agreements between each driver and Uber. See Memorandum of Law in Support of Defendant Travis Kalanick's Motion to Dismiss ("Def.Br."), Dkt. 28, at 9, 12-13; Transcript of Oral Argument dated March 9, 2016 ("Tr.") 3:19-22. According to Mr. Kalanick, drivers' individual decisions to enter into contractual arrangements with Uber constitute mere independent action that is insufficient to support plaintiff's claim of a conspiracy. See Def. Br. at 9. Defendant asserts that the most "natural" explanation for drivers' conduct is that each driver "independently decided it was in his or her best interest to enter a vertical agreement with Uber," and doing so could be in a driver's best interest because, for example, Uber matches riders with drivers and processes payment. See Def. Br. at 12-13. In defendant's view, the fact that "a condition of [the agreement with Uber] was that the driver-partner agree to use Uber's pricing algorithm" does not diminish the independence of drivers' decisions. See id. at 13. It follows, defendant contends, that such vertical arrangements do not support a horizontal conspiracy claim.

The Court, however, is not persuaded to dismiss plaintiff's horizontal conspiracy claim. In *Interstate Circuit v. United States*, 306 U.S. 208 (1939), the Supreme Court held that competing movie distributors had unlawfully restrained trade when they each agreed to a theater operator's terms, including price restrictions, as indicated in a letter addressed to all the distributors. For an illegal conspiracy to exist, the Supreme Court stated:

> It was enough that, knowing that concerted action was contemplated and invited, the distributors gave their adherence to the scheme and participated in it.... Acceptance by competitors, without previous agreement, of an invitation to participate in a plan, the necessary consequence of which, if carried out, is restraint of interstate commerce, is sufficient to establish an unlawful conspiracy under the Sherman Act.

Interstate Circuit, 306 U.S. at 226-27. Much more recently, the Second Circuit stated:

> [C]ourts have long recognized the existence of "hub-and-spoke" conspiracies in which an entity at one level of the market structure, the "hub," coordinates an agreement among competitors at a different level, the "spokes." These arrangements consist of both vertical agreements between the hub and each spoke and a horizontal agreement among the spokes to adhere to the [hub's] terms, often because the spokes would not have gone along with [the vertical agreements] except on the understanding that the other [spokes] were agreeing to the same thing.

United States v. Apple, Inc., 791 F.3d 290, 314 (2d Cir.2015), (internal citation and quotation marks omitted);.

In this case, plaintiff has alleged that drivers agree with Uber to charge certain fares with the clear understanding that all other Uber drivers are agreeing to charge the same fares. See Amended Complaint ¶¶ 70-71. These agreements are organized and facilitated by defendant

Kalanick, who as at least an occasional Uber driver, is also a member of the horizontal conspiracy. See id. ¶ 76, 84.

On a motion to dismiss, the Court is required to draw all reasonable inferences in plaintiff's favor. Given this standard, the Court finds that plaintiffs have plausibly alleged a conspiracy in which drivers sign up for Uber precisely "on the understanding that the other [drivers] were agreeing to the same" pricing algorithm, and in which drivers' agreements with Uber would "be against their own interests were they acting independently." *Apple*, 791 F.3d at 314, 320. Further, drivers' ability to benefit from reduced price competition with other drivers by agreeing to Uber's Driver Terms plausibly constitutes "a common motive to conspire." *Apex Oil Co. v. DiMauro*, 822 F.2d 246, 254 (2d Cir. 1987). The fact that drivers may also, in signing up for Uber, seek to benefit from other services that Uber provides, such as connecting riders to drivers and processing payment, is not to the contrary. Of course, whether plaintiff's allegations are in fact accurate is a different matter, to be left to the fact-finding process.

The Court's conclusion that plaintiff has alleged a plausible horizontal conspiracy is bolstered by plaintiff's other allegations concerning agreement among drivers. Plaintiff, as noted supra, contends that Uber organizes events for drivers to get together, see Am. Compl. ¶ 41, and, more importantly, that Mr. Kalanick agreed to raise fares following drivers' efforts to negotiate higher rates in September 2014. See id. ¶ 87. While it is true that these allegations about agreements among drivers reaching even beyond acceptance of Uber's Driver Terms are not extensive, see Def. Reply Br. at 7 n.8, nonetheless, they provide additional support for a horizontal conspiracy, and plaintiff need not present a direct, "smoking gun" evidence of a conspiracy, particularly at the pleading stage. *Mayor & City Council of Baltimore, Md. v. Citigroup, Inc.*, 709 F.3d 129, 136 (2d Cir. 2013).

More basically, it is well to remember that a Sherman Act conspiracy is but one form of conspiracy, a concept that is as ancient as it is broad. It is fundamental to the law of conspiracy that the agreements that form the essence of the misconduct are not to be judged by technical niceties but by practical realities. Sophisticated conspirators often reach their agreements as much by the wink and the nod as by explicit agreement, and the implicit agreement may be far more potent, and sinister, just by virtue of being implicit. *** In the instant case, Uber's digitally decentralized nature does not prevent the App from constituting a "marketplace" through which Mr. Kalanick organized a horizontal conspiracy among drivers.

Defendant argues, however, that plaintiff's alleged conspiracy is "wildly implausible" and "physically impossible," since it involves agreement "among hundreds of thousands of independent transportation providers all across the United States." Def. Br. at 1. Yet as plaintiff's counsel pointed out at oral argument, the capacity to orchestrate such an agreement is the "genius" of Mr. Kalanick and his company, which, through the magic of smartphone technology, can invite hundreds of thousands of drivers in far-flung locations to agree to Uber's terms. See Tr. 12:15-16. The advancement of technological means for the orchestration of large-scale price-fixing conspiracies need not leave antitrust law behind. The fact that Uber goes to such lengths to portray itself—one might even say disguise itself—as the mere purveyor of an "app" cannot shield it from the consequences of its operating as much more.

Recent jurisprudence on vertical resale price maintenance agreements does not, as defendant would have it, undermine plaintiff's claim of an illegal horizontal agreement. In *Leegin*, the Supreme Court held that resale price maintenance agreements—e.g., a retailer's agreement with a manufacturer not to discount the manufacturer's goods beneath a certain price—are to be judged by the rule of reason, unlike horizontal agreements to fix prices, which are per se illegal.

See *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877, 886 (2007). The Court cited various "procompetitive justifications for a manufacturer's use of resale price maintenance," id. at 889, and concluded that although this practice may also have anticompetitive effects, the rule of reason is the best approach to distinguishing resale price maintenance agreements that violate the antitrust laws from those that do not. See id. at 897-900.

Here, unlike in *Leegin*, Uber is not selling anything to drivers that is then resold to riders. Moreover, the justifications for rule of reason treatment of resale price maintenance agreements offered in *Leegin* are not directly applicable to the instant case. In particular, the Court's attention has not been drawn to concerns about free-riding Uber drivers, or to efforts that Uber drivers could make to promote the App that will be under-provided if Uber does not set a pricing algorithm. See *Leegin*, 551 U.S. at 890-91. While Mr. Kalanick asserts that Uber's pricing algorithm facilitates its market entry as a new brand, this observation—which is fairly conclusory—does not rule out a horizontal conspiracy among Uber drivers, facilitated by Mr. Kalanick both as Uber's CEO and as a driver himself. The Court therefore finds that plaintiff has adequately pleaded a horizontal antitrust conspiracy under Section 1 of the Sherman Act.

As to plaintiff's claim of a vertical conspiracy, a threshold question is whether plaintiff has alleged a vertical conspiracy in the Amended Complaint, which defendant denies. Although plaintiff's allegations of a vertical conspiracy are much more sparse than his contentions about a horizontal conspiracy, the Court finds that the Amended Complaint adequately pleads a vertical conspiracy between each driver and Mr. Kalanick. In particular, plaintiff alleges that "[a]ll of the independent driver-partners have agreed to charge the fares set by Uber's pricing algorithm," Am. Compl. ¶ 68, and that Mr. Kalanick designed this business model, see id. ¶¶ 76, 78. The Amended Complaint also includes several allegations that would be pertinent to a rule of reason, vertical price-fixing theory. See id. ¶¶ 94-108. Under the Sherman Act count, plaintiff states that the "unlawful arrangement consists of a series of agreements between Kalanick and each of the Uber driver-partners, as well as a conscious commitment among the Uber driver-partners to the common scheme of adopting the Uber pricing algorithm..." Am. Compl. ¶ 124. Plaintiff claims that Mr. Kalanick is per se liable as organizer of the conspiracy and as an occasional Uber driver, ¶¶ 128-29, and then states that "[i]n the alternative, Kalanick is also liable under Section 1 of the Sherman Act under a 'quick look' or 'rule of reason' analysis." Id. ¶ 130. In the Court's view, these allegations of legal theory, when coupled with the allegations of pertinent facts, are sufficient to plead a vertical conspiracy theory.

The question, then, is whether this theory is plausible under a "rule of reason" analysis. Under this analysis, "plaintiff bears the initial burden of showing that the challenged action has had an actual adverse effect on competition as a whole in the relevant market." *Capital Imaging Associates, P.C. v. Mohawk Valley Med. Associates, Inc.*, 996 F.2d 537, 543 (2d Cir. 1993). "To survive a Rule 12(b)(6) motion to dismiss, an alleged product market must bear a rational relation to the methodology courts prescribe to define a market for antitrust purposes—analysis of the interchangeability of use or the cross-elasticity of demand, and it must be plausible." *Todd v. Exxon Corp.*, 275 F.3d 191, 200 (2d Cir. 2001) (internal citation and quotation marks omitted).

As to market definition, plaintiff defines the relevant market as the "mobile app-generated ride-share service market." Am. Compl. ¶ 94. Plaintiff alleges that Uber has an approximately 80% market share in the United States in this market; Uber's chief competitor Lyft has nearly a 20% market share; and a third competitor, Sidecar, left the market at the end of 2015. Id. ¶¶ 95-97. Plaintiff then explains that traditional taxi service is not a reasonable substitute for Uber, since, for example, rides generated by a mobile app can be arranged at the push of a button and tracked on riders' mobile phones; riders need not carry cash or a credit card, or, upon arrival, spend time paying for the ride; and riders can rate drivers and see some information on them before entering the vehicle. Id. ¶ 104. Indeed, plaintiff claims, Uber has itself stated that it does not view taxis as ride-sharing competition. Id. ¶ 105.

Plaintiff also alleges that traditional cars for hire are not reasonable substitutes, since they generally need to be scheduled in advance for prearranged locations. Id. ¶ 106. However, plaintiff nevertheless contends that "Uber has obtained a significant share of business in the combined markets of taxis, cars for hire, and mobile-app generated ride-share services," and that Uber's own experts have suggested that in some U.S. cities, Uber has 50% to 70% of business customers "among all types of rides," which seems to refer to these combined markets. Id. ¶ 107.

Defendant contests plaintiff's proposed market definition, arguing that plaintiff provides inadequate justification for the exclusion not just of taxis and car services, but also of public transit such as subways and buses, personal vehicle use, and walking. See Def. Br. at 18; Def. Reply Br. at 8. In defendant's view, "[e]ach of these alternatives is a clear substitute for the services provided by driver-partners." Def. Br. at 18.

One could argue this either way (and defendant's attorneys are encouraged to hereinafter walk from their offices to the courthouse to put their theory to the test). But for present purposes, plaintiff has provided plausible explanations for its proposed market definition, and the accuracy of these explanations may be tested through discovery and, if necessary, trial. "Market definition is a deeply fact-intensive inquiry [and] courts [therefore] hesitate to grant motions to dismiss for failure to plead a relevant product market." Chapman v. New York State Div. for Youth, 546 F.3d 230, 238 (2d Cir. 2008). Plaintiff's allegation that Uber—an industry member—recognizes that it does not compete with taxis, see Am. Compl. ¶ 105, also deserves consideration. The Court finds that plaintiff has pleaded a plausible relevant product market.

The Court further finds that plaintiff has adequately pleaded adverse effects in the relevant market. Specifically, plaintiff pleads that "Kalanick's actions have further restrained competition by decreasing output," Am. Compl. ¶ 110 (citing "independent studies"); "Uber's market position has already helped force Sidecar out of the marketplace," id. ¶ 102; "Uber's dominant position and considerable name recognition has also made it difficult for potential competitors to enter the marketplace," id. ¶ 103.

Defendant counters that Uber provides many pro-competitive benefits, see Def. Reply Br. at 9, and also disputes the conclusions that plaintiff purports to draw from the cited studies. See Def. Letter. Defendant's counter-assertions, while certainly well worth a fact-finder's consideration, do not persuade the Court to grant a motion to dismiss. The Court hence determines that plaintiff has plausibly pleaded adverse effects in the relevant market. Consequently, the Court finds that plaintiff has presented a plausible claim of a vertical conspiracy under Section 1 of the Sherman Act. ***[8] For these reasons, the Court denies defendant Kalanick's motion to dismiss. ***

[8] Defendant argues that plaintiff is equitably estopped from avoiding the class action waiver in the user agreement that plaintiff made with Uber. The relevant provision of the User Agreement reads:

> Dispute Resolution: You and Company agree that any dispute, claim or controversy arising out of or relating to this Agreement... will be settled by binding arbitration... *You acknowledge and agree that you and Company are each waiving the right to a trial by jury or to participate as a plaintiff or class User in any purported class action or representative proceeding.*

User Agreement at 8-9. Although plaintiff has sued Mr. Kalanick personally and not Uber, defendant claims that plaintiff's

Philadelphia Taxi Ass'n, Inc. v. Uber Technologies, Inc.

886 F.3d 332 (3rd Cir. 2018)

RENDELL, CIRCUIT JUDGE: Philadelphia taxicab drivers, aggrieved by the influx of taxis hailed at the touch of an app on one's phone, brought this antitrust action to protest the entry of Appellee Uber Technologies, Inc. ("Uber") into the Philadelphia taxicab market. The Philadelphia Taxi Association ("PTA"), along with 80 individual taxicab companies (collectively, "Appellants"), appeal the District Court's dismissal of their Second Amended Complaint ("SAC") alleging one count of attempted monopolization under Section 2 of the Sherman Act, 15 U.S.C. § 2, and seeking injunctive relief and treble damages under Section 4 of the Clayton Act, 15 U.S.C. § 15.

Appellants urge us to reverse the District Court's Order, contending that Uber violated the antitrust laws because its entry into the Philadelphia taxicab market was illegal, predatory, and led to a sharp drop in the value of taxicab medallions as well as a loss of profits. They contend that this is evidence that Uber's operation in Philadelphia was anticompetitive and caused them to suffer an antitrust injury. However, the conduct they allege falls short of the conduct that would constitute an attempted monopoly in contravention of the antitrust laws. Thus, we will affirm the District Court's dismissal of the SAC for failure to state a claim for attempted monopolization and failure to state an antitrust injury.

I. Background & Procedural History

From March of 2005 to October of 2014, taxicabs operating in Philadelphia were required to have a medallion and a certificate of public convenience, issued by the Philadelphia Parking Authority ("PPA"). Medallions are property and are often pledged as collateral to borrow funds to finance the purchase of the cab or to "upgrade and improve the operations of taxicabs." 53 Pa. C.S.A. § 5712(a). Once medallion-holders comply with the obligatory standards for taxicabs, they may obtain a certificate of public convenience. Those standards, which provide for safety and uniformity among taxicabs, require vehicles to be insured and in proper condition, and mandate that drivers are paid the prevailing minimum wage, are proficient in English, and have the appropriate drivers' licenses.

As alleged in the SAC, when the medallion system was mandated in Philadelphia in 2005, a medallion was worth only $65,000. In October of 2014, there were approximately 500 taxicab companies in Philadelphia. Together, 7,000 drivers held 1610 medallions, each valued at an average of $545,000. Appellants are 80 of those 500 companies, which collectively hold 240 of the 1610 medallions, as well as PTA, which was incorporated to advance the legal interests of its members—the 80 individual medallion taxicab companies.

Uber began operating in Philadelphia in October of 2014 without securing medallions or certificates of public convenience for its vehicles. While a potential rider can avail himself of a medallion taxicab by calling a dispatcher or hailing an available cab, to use Uber, he can download the Uber application onto his mobile phone and request that the vehicle come to his location, wherever he is. Passengers enter payment information, which is retained by Uber and

claims against Mr. Kalanick are "intimately founded in and intertwined with" the underlying agreement with Uber. The Court finds, however, that since defendant is not seeking to compel arbitration, and plaintiff is not seeking to enforce the User Agreement against defendant, plaintiff is not equitably estopped from pursuing a class action suit against Mr. Kalanick, nor has plaintiff waived the right to proceed through this mechanism.

automatically processed at the end of each ride. Uber does not own or assume legal responsibility for the vehicles or their operation, nor does it hire the drivers as its employees. Uber did not pay fines to the PPA or comply with its regulations when it first entered the Philadelphia taxi market, as is otherwise required for medallion taxicabs. Appellants maintain that this rendered Uber's operation illegal, and enabled the company to cut operating costs considerably.

In October of 2016, the Pennsylvania state legislature passed a law approving Uber's operation in Philadelphia, under the authority of the PPA. The law, which went into effect in November of 2016, allows the PPA to regulate both medallion taxicab companies and Transportation Network Companies ("TNCs")—a classification that includes Uber and other vehicle-for-hire companies that operate through digital apps—in Philadelphia. TNCs must now obtain licenses to operate and comply with certain requirements, including insurance obligations and safety standards for drivers and vehicles. The law also exempts TNCs from disclosing the number of drivers or vehicles operating in the city, and allows TNCs to set their own fares, unlike medallion taxicab companies, which comply with established rates, minimum wages, and have a limited number of vehicles and medallions operating at once in Philadelphia.

Before this law passed, in Uber's first two years in Philadelphia, nearly 1200 medallion taxicab drivers left their respective companies and began to drive for Uber. In those two years, there were 1700 Uber drivers and vehicles operating in Philadelphia, serving over 700,000 riders, for more than one million trips. Simultaneously, medallion taxi rides reduced by about 30 percent, and thus Appellants experienced a 30 percent decrease in earnings. The value of each medallion dropped significantly, to approximately $80,000 in November of 2016. Fifteen percent of medallions have been confiscated by the lenders due to default by drivers.

The PTA and 75 individual taxicab companies filed a Complaint, alleging three counts: attempted monopolization under Section 2 of the Sherman Act, tortious interference with contract under Pennsylvania law, and unfair competition under Pennsylvania law. Uber moved to dismiss the Complaint.

Appellants, the PTA and now 80 individual taxicab companies, then filed an Amended Complaint, alleging the same three counts. Uber moved to dismiss the Amended Complaint. The District Court granted the dismissal, without prejudice. The District Court noted that Plaintiffs alleged merely harm to their business after Uber entered the Philadelphia taxicab market, and that Plaintiffs pointed to Uber's supposed illegal participation in the taxicab market as evidence of attempted monopolization. However, the District Court concluded that these harms are "not the type of injuries that antitrust laws were intended to prevent, and thus do not establish antitrust standing." Phila. Taxi Ass'n, Inc. v. Uber Techs., Inc., 218 F.Supp.3d 389, 392 (E.D. Pa. 2016). The Court also dismissed the state law claims, for failure to plead the proper elements of an unfair competition or a tortious interference claim.

Appellants then filed the SAC, alleging one count of attempted monopolization under Section 2 of the Sherman Act and seeking treble damages under Section 4 of the Clayton Act. Uber responded with a Motion to Dismiss, which the District Court granted, with prejudice. The District Court held that Appellants, in spite of multiple opportunities for amendment, had pled no antitrust injury sufficient for antitrust standing, and were unlikely to cure the lack of standing with any amendments to the SAC. The Court also held that the PTA could not satisfy the requirements for associational standing because the association's members lacked standing to sue on their own. ***

III. Discussion

*** If the challenged conduct has an effect on "prices, quantity or quality of goods or services," *Mathews v. Lancaster Gen. Hosp.*, 87 F.3d 624, 641 (3d Cir. 1996), we will find a violation of antitrust laws only when that effect harms the market, and thereby harms the consumer.

Anticompetitive conduct is the hallmark of an antitrust claim. An allegation of anticompetitive conduct is necessary both to: (1) state a claim for attempted monopolization; and (2) aver that a private plaintiff has suffered an antitrust injury. Appellants' SAC, however, is deficient in averring conduct that is, in fact, anticompetitive.

While our caselaw is unresolved regarding which to address first—an antitrust violation or an antitrust injury—we need not resolve that here, because Appellants' claim fails on both counts. We begin by discussing how Appellants' allegations in the SAC fall short of demonstrating anticompetitive conduct, and thus fail to state a claim for attempted monopolization, and then discuss how in the alternative, Appellants fail to allege antitrust injury to have antitrust standing. For both reasons, we affirm the judgment of the District Court dismissing the SAC with prejudice.

A. Attempted Monopolization

To prevail on a claim under Sherman Act Section 2 for attempted monopolization, a plaintiff must prove: "(1) that the defendant has engaged in predatory or anticompetitive conduct with (2) a specific intent to monopolize and (3) a dangerous probability of achieving monopoly power." *Mylan Pharm. Inc. v. Warner Chilcott Pub. Ltd. Co.*, 838 F.3d 421, 433 (3d Cir. 2016) (quoting *Broadcom Corp. v. Qualcomm Inc.*, 501 F.3d 297, 317 (3d Cir. 2007). *** Liability hinges on whether valid business reasons, as part of the ordinary competitive process, can explain the defendant's actions that resulted in a dangerous probability of achieving monopoly power. See *Avaya Inc., RP v. Telecom Labs, Inc.*, 838 F.3d 354, 393 (3d Cir. 2016).

In the SAC, Appellants allege that Uber: (1) flooded the market with non-medallion taxicabs, entered the market illegally without purchasing medallions, operated at a lower cost by failing to comply with statutory requirements and regulations, and lured away drivers from Individual Plaintiffs, which allegedly impaired the competitive market for medallion taxicabs; (2) knew of PPA's regulatory jurisdiction over vehicles for hire, purposefully ignored or avoided the regulations and rulings of the Court of Common Pleas, and thereby excluded rivals from competing in the taxicab market; and (3) is dangerously close to achieving monopoly power with its market share and by operating in an unfair playing field with the "financial ability" to be the only market player and to destroy competitors' business. SAC ¶ 83. Appellants also complain that the new legislation authorizing the TNCs' operation would facilitate the creation of an illegal monopoly.

We find that the SAC fails to plausibly allege any of the three elements of an attempted monopolization claim.

1. Anticompetitive Conduct

Allegations of purportedly anticompetitive conduct are meritless if those acts would cause no deleterious effect on competition. This is where the SAC falters: Appellants set forth a litany of ways in which Uber's entry into the market has harmed Appellants' business and their investment in medallions; yet none of the allegations demonstrate a harmful effect on competition.

To determine whether conduct is anticompetitive, "courts must look to the monopolist's conduct taken as a whole rather than considering each aspect in isolation." *LePage's Inc. v. 3M*, 324 F.3d 141, 162 (3d Cir. 2003) (en banc).

Here, Appellants claim that Uber inundated the Philadelphia taxicab market illegally with their non-medallion vehicles. They contend that Uber's entry into the market was predatory because it failed to comply with statutory and regulatory requirements, failed to purchase medallions, failed to pay drivers a minimum wage, and failed to obtain the proper insurance, among other actions. All of these actions, Appellants assert, enabled Uber to operate at a significantly lower cost than the medallion companies, and thereby acquire a stronghold in the Philadelphia taxicab market.

Appellants also maintain that Uber "flooded" the Philadelphia taxicab market by improperly luring drivers away from medallion companies, including Individual Plaintiffs. Appellants cite Uber's practice of sending representatives to 30th Street Station and the Philadelphia International Airport, where medallion taxicab drivers often congregate, to disseminate information about its services and to recruit potential drivers. They argue that Uber promised new drivers financial inducements, such as reimbursements for the cost of gasoline, as an incentive to leave their medallion companies and instead drive for Uber.

Considering the averments regarding Uber's conduct in their totality, Uber's elimination of medallion taxicab competition did not constitute anticompetitive conduct violative of the antitrust laws.

First, inundating the Philadelphia taxicab market with Uber vehicles, even if it served to eliminate competitors, was not anticompetitive. Rather, this bolstered competition by offering customers lower prices, more available taxicabs, and a high-tech alternative to the customary method of hailing taxicabs and paying for rides. It is well established that lower prices, as long as they are not predatory, benefit consumers—"regardless of how those prices are set." *Atl. Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328, 340 (1990). "Cutting prices in order to increase business often is the very essence of competition." *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 592 (1986). Thus, lost business alone cannot be deemed a consequence of "anticompetitive" acts by the defendant. See *Atl. Richfield*, 495 U.S. at 337.

Second, Uber's ability to operate at a lower cost is not anticompetitive. Running a business with greater economic efficiency is to be encouraged, because that often translates to enhanced competition among market players, better products, and lower prices for consumers. Even if Uber were able to cut costs by allegedly violating PPA regulations, Appellants cannot use the antitrust laws to hold Uber liable for these violations absent proof of anticompetitive conduct. Even unlawful conduct is "of no concern to the antitrust laws" unless it produces an anticompetitive effect. *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 487 (1977).

Finally, hiring rivals may be anticompetitive, but only in certain cases. For example, if rival employees were hired in an attempt to exclude competitors from the market for some basis other than efficiency or merit, such as to acquire monopoly power or to merely deny the employees to the rival, this could violate the antitrust laws if injurious to the rival and to competition at large.

However, Appellants acknowledge that the nearly 1200 medallion taxicab drivers that Uber recruited did not remain idle, but rather they drove for Uber. In sum, what Appellants allege does not give rise to an inference of anticompetitive or exclusionary conduct and suggests, if anything, that Uber's ability to attract these drivers was due to its cost efficiency and competitive advantage.

Thus, the SAC is devoid of allegations of truly anticompetitive conduct.

2. Specific Intent to Monopolize

Appellants allege specific intent to monopolize from Uber's knowledge that the PPA maintained regulatory authority over vehicles-for-hire, and its choice to avoid regulation by being a TNC that neither owned vehicles nor employed drivers. They also point to Uber's alleged willful disregard of the rulings of the Court of Common Pleas. Appellants' claim, in essence, is that Uber's knowledge that their operation was illegal reveals a specific intent to monopolize.

"[I]n a traditional § 2 claim, a plaintiff would have to point to specific, egregious conduct that evinced a predatory motivation and a specific intent to monopolize." *Avaya*, 838 F.3d at 406 (citing *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447, 456 (1993)). ***

While Uber's alleged conduct might have formed the basis of a regulatory violation, its knowledge of existing regulations alone cannot reasonably be said to demonstrate specific intent to monopolize. Further, Uber's choice to distinguish itself from other vehicles-for-hire, eschewing medallions in favor of independent drivers who operate their own cars at will, can instead be reasonably viewed as "predominantly motivated by legitimate business aims." *Times Picayune Publ'g Co. v. United States*, 345 U.S. 594, 627 (1953). Appellants have not averred any other motive. The allegations suggest that these business choices allowed Uber to operate more efficiently, and to offer a service that consumers find attractive, thus enabling it to acquire a share of the Philadelphia taxicab market.

Thus, Uber's alleged competitive strategy of creating a vehicle-for-hire business model, presumably to acquire customers, does not reflect specific intent to monopolize. Accordingly, Appellants have failed to allege specific intent on Uber's part.

3. Dangerous Probability of Achieving Monopoly Power

We held in *Broadcom Corp. v. Qualcomm Inc.* that because the dangerous probability standard is a complex and "fact-intensive" inquiry, courts "typically should not resolve this question at the pleading stage 'unless it is clear on the face of the complaint that the "dangerous probability" standard cannot be met as a matter of law.'" 501 F.3d at 318-19 (quoting *Brader v. Allegheny Gen. Hosp.*, 64 F.3d 869, 877 (3d Cir. 1995)).

We may consider factors such as "significant market share coupled with anticompetitive practices, barriers to entry, the strength of competition, the probable development of the industry, and the elasticity of consumer demand" to determine whether dangerous probability was alleged in the pleadings. Id. Entry barriers include "regulatory requirements, high capital costs, or technological obstacles[] that prevent new competition from entering a market." Id. at 307 (citations omitted). "No single factor is dispositive." Id. at 318.

Appellants argue that Uber has a dangerous probability of achieving monopoly power because it has pushed numerous competitors out of the market. As discussed, however, the SAC fails to allege anticompetitive practices by Uber. Nor does the SAC mention Uber's market share; it merely suggests that Uber and medallion taxicabs had similar numbers of vehicles operating in Philadelphia as of October 2016. This allegation falls short of indicating Uber's market share in the context of all the competitors in the Philadelphia taxicab market, such as other TNCs.

Similarly, the SAC makes no allegation of current barriers to entry or weak competition from other market participants. Appellants make the bold allegation that Uber holds the power to raise barriers to entry in the market, without any factual support. In fact, the SAC alleges that Uber was readily able to enter the Philadelphia market. *** Surely other competitors, such as Lyft, are able to enter without difficulty, as well.

Nor does the SAC describe any potentially harmful industry developments. It only vaguely claims that Uber may be able to drive out competition and raise entry barriers. Appellants assert in the SAC that once Uber becomes the dominant competitor, it would be able to charge higher prices, and consumers who do not own smartphones would be deprived of the ability to hail taxis on the street. Absent any allegations of a dangerous probability of achieving monopoly power, this argument fails. And, as counsel for Uber stated at oral argument, if Uber raised its prices, this would encourage other rivals to enter the market and charge lower prices, battling Uber through price competition.

Because the elements of attempted monopolization are often interdependent, proof of one element may provide "permissible inferences" of other elements. *Broadcom*, 501 F.3d at 318 (quoting *Barr Labs., Inc. v. Abbott Labs.*, 978 F.2d 98, 112 (3d Cir. 1992)). Even so, none of the other elements of attempted monopolization allow us to infer a dangerous probability that Uber will achieve monopoly power. Acknowledging *Broadcom's* reticence to resolve the dangerous probability question at the pleadings stage, we nevertheless find that the SAC does not allege any of the relevant factors to prove that Uber had a dangerous probability of achieving monopoly power.

In sum, Appellants have failed to set forth a plausible claim of attempted monopolization under Section 2 of the Sherman Act, as a matter of law. ***

V. Conclusion

Appellants may have been better off, financially, if Uber had not entered the Philadelphia taxicab market. However, Appellants have no right to exclude competitors from the taxicab market, even if those new entrants failed to obtain medallions or certificates of public convenience. See *Ill. Transp. Trade Ass'n v. City of Chicago*, 839 F.3d 594, 597 (7th Cir. 2016) (Posner, J.).

If medallion taxicabs could prevent TNCs from entering the Philadelphia market, and if incumbents could prevent new entrants or new technologies from competing because they fear loss of profits, then "economic progress might grind to a halt." Id. at 596-97. "Instead of taxis we might have horse and buggies; instead of the telephone, the telegraph; instead of computers, slide rules." Id. at 597.

Absent any allegations of anticompetitive conduct, Appellants fail to allege any of the elements for a claim for attempted monopolization under Section 2 of the Sherman Act and fail to allege antitrust standing.

For the foregoing reasons, the judgment of the District Court is AFFIRMED.

Chamber of Commerce of the United States of America v. City of Seattle

890 F.3d 769 (9th Cir. 2018)

M. SMITH, CIRCUIT JUDGE: On December 14, 2015, the Seattle City Council enacted into law Ordinance 124968, an Ordinance Relating to Taxicab, Transportation Network Company, and For-Hire Vehicle Drivers (Ordinance). The Ordinance was the first municipal ordinance of its kind in the United States, and authorizes a collective-bargaining process between "driver coordinators"—like Uber Technologies (Uber), Lyft, Inc. (Lyft), and Eastside for Hire, Inc. (Eastside)—and independent contractors who work as for-hire drivers. The Ordinance permits independent-contractor drivers, represented by an entity denominated an "exclusive driver representative," and driver coordinators to agree on the "nature and amount of payments to be made by, or withheld from, the driver coordinator to or by the drivers." Seattle, Wash., Municipal Code § 6.310.735(H)(1). This provision of the Ordinance is the crux of this case.

Acting on behalf of its members Uber, Lyft, and Eastside, Plaintiff-Appellant the Chamber of Commerce of the United States of America, together with Plaintiff-Appellant Rasier, LLC, a subsidiary of Uber (collectively, the Chamber), sued Defendants-Appellees the City of Seattle, the Seattle Department of Finance and Administrative Services (the Department), and the Department's Director, Fred Podesta (collectively, the City), challenging the Ordinance on federal antitrust and labor law grounds. First, the Chamber asserts that the Ordinance violates, and is preempted by, section 1 of the Sherman Antitrust Act, 15 U.S.C. § 1, because the Ordinance sanctions price-fixing of ride-referral service fees by private cartels of independent-contractor drivers. Second, the Chamber claims that the Ordinance is preempted by the National Labor Relations Act (NLRA), 29 U.S.C. §§ 151-169, under *Machinists* and *Garmon* preemption.

The district court dismissed the case, holding that the state-action immunity doctrine exempts the Ordinance from preemption by the Sherman Act, and that the NLRA does not preempt the Ordinance. The Chamber appealed both holdings.

We have jurisdiction over this appeal pursuant to 28 U.S.C. § 1291. We reverse the district court's dismissal of the Chamber's federal antitrust claims, and remand the federal antitrust claims to the district court for further proceedings. We also affirm the district court's dismissal of the Chamber's NLRA preemption claims.

FACTUAL AND PROCEDURAL BACKGROUND

A. Ride-Referral Companies

Eastside is the largest dispatcher of taxicab and for-hire vehicles in the Pacific Northwest. Eastside provides licensed taxicab and for-hire vehicle drivers with dispatch, advertising, payment processing, and other administrative services, in exchange for a weekly fee, payable by drivers to Eastside. Relying on advertising and a preexisting client base, Eastside generates transportation requests from passengers, who call, text-message, or email Eastside to request a ride. Eastside then refers ride requests to drivers through a mobile data terminal. If a passenger uses a credit card to pay a driver, Eastside processes the transaction and remits the payment to the driver. The drivers who pay for Eastside's services are independent contractors—Eastside does not dictate how the drivers operate their transportation businesses. For example, some drivers own licensed vehicles, whereas others lease them.

Uber and Lyft, founded in 2009 and 2012, respectively, have ushered ride-referral services into the digital age. Uber and Lyft have developed proprietary smartphone applications (apps) that enable an online platform, or digital marketplace, for ride-referral services, often referred to as "ridesharing" services. After downloading the Uber or Lyft app onto their smartphones, riders request rides through the app, which transmits ride requests to available drivers nearby. Drivers are free to accept or ignore a ride request. If a driver accepts a ride request, he or she is matched electronically with the rider, and then proceeds to the rider's location and fulfills the ride request. If a driver ignores a ride request, the digital platform transmits the request to another nearby driver. Drivers may cancel a ride request, even after initially accepting it, at any point prior to the commencement of the ride. Riders, too, may decide whether or not to accept a ride from any of the drivers contacted through the app. After a ride is completed, riders pay drivers via the Uber or Lyft app, using a payment method, such as a credit card, placed on file with Uber or Lyft.

Uber and Lyft's business models have facilitated the rise of the so-called "gig economy." In order to receive ride requests through the apps, drivers contract with, and pay a technology licensing fee to, Uber or Lyft. These licensing fees are a percentage of riders' paid fares: Uber and Lyft subtract their technology licensing fees from riders' payments, and remit the remainder to drivers. Drivers' contractual agreements with either Uber or Lyft are not exclusive—in fact, many drivers use several ridesharing apps and even operate multiple apps simultaneously. Drivers may use the Uber and Lyft apps for however long and whenever they wish, if they wish to use them at all.

B. The Ordinance

On December 14, 2015, the Seattle City Council adopted Ordinance 124968. The stated purpose of the Ordinance is to "allow[] taxicab, transportation network company, and for-hire vehicle drivers ('for-hire drivers') to modify specific agreements collectively with the entities that hire, direct, arrange, or manage their work," in order to "better ensure that [for-hire drivers] can perform their services in a safe, reliable, stable, cost-effective, and economically viable manner." Seattle, Wash., Ordinance 124968, pmbl.

The Ordinance requires "driver coordinators" to bargain collectively with for-hire drivers. Id. § 1(I). A "driver coordinator" is defined as "an entity that hires, contracts with, or partners with for-hire drivers for the purpose of assisting them with, or facilitating them in, providing for-hire services to the public." Seattle, Wash., Municipal Code § 6.310.110. The Ordinance applies only to drivers who contract with a driver coordinator "other than in the context of an employer-employee relationship"—in other words, the Ordinance applies only to independent contractors. Id. § 6.310.735(D).

The collective-bargaining process begins with the election of a "qualified driver representative," or QDR. Id. §§ 6.310.110, 6.310.735(C). An entity seeking to represent for-hire drivers operating within Seattle first submits a request to the Director of Finance and Administrative Services (the Director) for approval to be a QDR. Id. § 6.310.735(C). Once approved by the City, the QDR must notify the driver coordinator of its intent to represent the driver coordinator's for-hire drivers. Id. § 6.310.735(C)(2).

Upon receiving proper notice from the QDR, the driver coordinator must provide the QDR with the names, addresses, email addresses, and phone numbers of all "qualifying drivers." Id. § 6.310.735(D). This disclosure requirement applies only to driver coordinators that have "hired, contracted with, partnered with, or maintained a contractual relationship or partnership with, 50 or more for-hire drivers in the 30 days prior to the commencement date" set by the Director. Id.

The QDR then contacts the qualifying drivers to solicit their interest in being represented by the QDR. Id. § 6.310.735(E). Within 120 days of receiving the qualifying drivers' contact information, the QDR submits to the Director statements of interest from qualifying drivers indicating that they wish to be represented by the QDR in collective-bargaining negotiations with the driver coordinator. Id. § 6.310.735(F)(1). If a majority of qualifying drivers consent to representation by the QDR, the Director certifies the QDR as the "exclusive driver representative" (EDR) for all for-hire drivers for that particular driver coordinator. Id. § 6.310.735(F)(2).

Once the Director certifies the EDR,

> the driver coordinator and the EDR shall meet and negotiate in good faith certain subjects to be specified in rules or regulations promulgated by the Director including, but

> not limited to, best practices regarding vehicle equipment standards; safe driving practices; the manner in which the driver coordinator will conduct criminal background checks of all prospective drivers; *the nature and amount of payments to be made by, or withheld from, the driver coordinator to or by the drivers*; minimum hours of work, conditions of work, and applicable rules.

Id. § 6.310.735(H)(1) (emphasis added).

If an agreement is reached, the driver coordinator and the EDR submit the written agreement to the Director. Id. § 6.310.735(H)(2). The Director reviews the agreement for compliance with the Ordinance and Chapter 6.310 of the Seattle Municipal Code, which governs taxicabs and for-hire vehicles. Id. In conducting this review, the Director is to "ensure that the substance of the agreement promotes the provision of safe, reliable, and economical for-hire transportation services and otherwise advance[s] the public policy goals set forth in Chapter 6.310 and in the [Ordinance]." Id.

The Director's review is not limited to the parties' submissions or the terms of the proposed agreement. Id. Rather, the Director may gather and consider additional evidence, conduct public hearings, and request information from the EDR and the driver coordinator. Id.

The agreement becomes final and binding on all parties if the Director finds the agreement compliant. Id. § 6.310.735(H)(2)(a). The agreement does not take effect until the Director makes such an affirmative determination. Id. § 6.310.735(H)(2)(c). If the Director finds the agreement noncompliant, the Director remands it to the parties with a written explanation of the agreement's failures, and may offer recommendations for remedying the agreement's inadequacies. Id. § 6.310.735(H)(2)(b).

If the driver coordinator and the EDR do not reach an agreement, "either party must submit to interest arbitration upon the request of the other," in accordance with the procedures and criteria specified in the Ordinance. Id. § 6.310.735(I). The interest arbitrator must propose an agreement compliant with Chapter 6.310 and in line with the City's public policy goals. Id. § 6.310.735(I)(2). The term of an agreement proposed by the interest arbitrator may not exceed two years. Id.

The interest arbitrator submits the proposed agreement to the Director, who reviews the agreement for compliance with the Ordinance and Chapter 6.310, in the same manner the Director reviews an agreement proposed by the parties. Id. § 6.310.735(I)(3).

The parties may discuss additional terms and propose amendments to an approved agreement. Id. § 6.310.735(J). The parties must submit any proposed amendments to the Director for approval. Id. The Director has the authority to withdraw approval of an agreement during its term, if the Director finds that the agreement no longer complies with the Ordinance or furthers the City's public policy goals. Id. § 6.310.735(J)(1). ***

ANALYSIS

I. State-Action Immunity Does Not Protect the Ordinance from Preemption by Section 1 of the Sherman Act.

We turn first to the Chamber's federal antitrust claims, and hold that the Ordinance does not meet the requirements for state-action immunity.

A. Preemption

In determining whether the Sherman Act preempts a state or local law pursuant to the Supremacy Clause, we apply the principles of conflict preemption. "As in the typical pre-emption case, the inquiry is whether there exists an irreconcilable conflict between the federal and state [or local] regulatory schemes." *Rice v. Norman Williams Co.*, 458 U.S. 654, 659 (1982).

A state or local law, "when considered in the abstract, may be condemned under the antitrust laws," and thus preempted, "only if it mandates or authorizes conduct that necessarily constitutes a violation of the antitrust laws in all cases, or if it places irresistible pressure on a private party to violate the antitrust laws in order to comply with the statute." Id. at 661. "Such condemnation will follow under [section] 1 of the Sherman Act when the conduct contemplated by the statute is in all cases a per se violation." Id. However, "[i]f the activity addressed by the statute does not fall into that category, and therefore must be analyzed under the rule of reason, the statute cannot be condemned in the abstract." Id. Unlike the categorical analysis under the per se rule of illegality, "[a]nalysis under the rule of reason requires an examination of the circumstances underlying a particular economic practice, and therefore does not lend itself to a conclusion that a statute is facially inconsistent with federal antitrust laws." Id. In short, the Ordinance may be preempted facially by federal antitrust law if it authorizes a per se violation of section 1 of the Sherman Act, but not if it must be analyzed under the rule of reason. ***

Here, the district court assumed, without deciding, "that collusion between independent economic actors to set the prices they will accept for their services in the market is a per se antitrust violation." On appeal, the City acknowledges that it "did not challenge the Chamber's contention that collective negotiations regarding topics such as payments to drivers could, absent *Parker* immunity, constitute per se antitrust violations." Because the district court dismissed the Chamber's federal antitrust claims solely on the basis of state-action immunity, we limit our analysis to that issue. We accept, without reaching the merits of the question, that the Ordinance authorizes a per se antitrust violation. The parties may address on remand which mode of antitrust analysis—the per se rule of illegality or the rule of reason—applies.

B. The Requirements for State-Action Immunity

The state-action immunity doctrine derives from *Parker v. Brown*, 317 U.S. 341 (1943). In *Parker*, the Supreme Court held that "because 'nothing in the language of the Sherman Act ... or in its history' suggested that Congress intended to restrict the sovereign capacity of the States to regulate their economies, the Act should not be read to bar States from imposing market restraints 'as an act of government.'" *FTC v. Phoebe Putney Health Sys., Inc.*, 568 U.S. 216, 224 (2013) (quoting *Parker*, 317 U.S. at 350, 352). Following *Parker*, the Supreme Court has, "under certain circumstances," extended immunity from federal antitrust laws to "nonstate actors carrying out the State's regulatory program." Id. at 224-25.

State-action immunity is the exception rather than the rule. *** The Supreme Court uses a two-part test, sometimes referred to as the *Midcal* test, to "determin[e] whether the anticompetitive acts of private parties are entitled to immunity." Id. First, "the challenged restraint [must] be one clearly articulated and affirmatively expressed as state policy," and second, "the policy [must] be actively supervised by the State." Id. (quoting *Cal. Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, 445 U.S. 97, 105 (1980)).

"Because municipalities and other political subdivisions are not themselves sovereign, state-action immunity under *Parker* does not apply to them directly." Id. As such, "immunity will only attach to the activities of local governmental entities if they are undertaken pursuant to a 'clearly articulated and affirmatively expressed' state policy to displace competition." Id. at 226, (quoting *Cmty. Commc'ns Co. v. Boulder*, 455 U.S. 40, 52 (1982)). Local governmental entities, "unlike private parties, . . . are not subject to the 'active state supervision requirement' because they have less of an incentive to pursue their own self-interest under the guise of implementing state policies." Id. (quoting *Town of Hallie v. City of Eau Claire*, 471 U.S. 34, 46-47 (1985)). "Where state or municipal regulation by a private party is involved, however, active state supervision must be shown, even where a clearly articulated state policy exists." *Hallie*, 471 U.S. at 46 n.10.

i. The Clear-Articulation Test

We conclude that the anticompetitive restraint challenged in this case fails the first prong of the *Midcal* test. The State of Washington has not "clearly articulated and affirmatively expressed" a state policy authorizing private parties to price-fix the fees for-hire drivers pay to companies like Uber or Lyft in exchange for ride-referral services.

The clear-articulation test is met "if the anticompetitive effect was the 'foreseeable result' of what the State authorized." *Phoebe Putney*, 568 U.S. at 226-27 (quoting *Hallie*, 471 U.S. at 42). "'[T]o pass the "clear articulation" test,' a state legislature need not 'expressly state in a statute or its legislative history that the legislature intends for the delegated action to have anticompetitive effects.'" Id. at 226 (alteration in original) (quoting *Hallie*, 471 U.S. at 43). ***

Our inquiry with respect to the clear-articulation test is a precise one. "[T]he relevant question is whether the regulatory structure which has been adopted by the state has *specifically authorized the conduct* alleged to violate the Sherman Act." *Cost Mgmt. Servs., Inc. v. Wash. Nat. Gas Co.*, 99 F.3d 937, 942 (9th Cir. 1996) (emphasis added). The state's authorization must be plain and clear: The relevant statutory provisions must "'plainly show' that the [state] legislature *contemplated* the sort of activity that is challenged," which occurs where they "confer 'express authority to take action that *foreseeably* will result in anticompetitive effects.'" *Hass v. Or. State Bar*, 883 F.2d 1453, 1457 (9th Cir. 1989) (first emphasis added) (quoting *Hallie*, 471 U.S. at 43-44). The state, in its sovereign capacity, must "clearly intend[] to displace competition in a particular field with a regulatory structure ... in the relevant market." *S. Motor Carriers Rate Conference, Inc. v. United States*, 471 U.S. 48, 64 (1985).

Once we determine that there is express state authorization, we then turn to the concept of foreseeability, which "is to be used in deciding the *reach* of antitrust immunity that stems from an *already authorized* monopoly, price regulation, or other disruption in economic competition." *Shames*, 626 F.3d at 1084 (second emphasis added). A foreseeable result cannot circumvent the requirement that there be express authorization in the first place: "[A] foreseeable result cannot create state authorization itself," but must itself stem from express authorization, which is "the necessary predicate for the Supreme Court's foreseeability test." Id. (quoting *Columbia Steel Casting Co. v. Portland Gen. Elec. Co.*, 111 F.3d 1427, 1444 (9th Cir. 1996)). We must be careful not to "appl[y] the concept of 'foreseeability' from [the] clear-articulation test too loosely." *Phoebe Putney*, 568 U.S. at 229.

Applying these principles to the Ordinance, we conclude that the clear-articulation requirement has not been satisfied. The state statutes relied upon by the City Council in enacting the Ordinance—Revised Code of Washington sections 46.72.001, 46.72.160, 81.72.200, and 81.72.210—do not "plainly show" that the Washington legislature "contemplated" allowing for-hire drivers to price-fix their compensation. Nor is such an anticompetitive result foreseeable.

We examine the state statutes in turn. First, Revised Code of Washington section 46.72.001 provides:

> The legislature finds and declares that privately operated for hire transportation service is a vital part of the transportation system within the state. Consequently, the safety, reliability, and stability of privately operated for hire transportation services are matters of statewide importance. The regulation of privately operated for hire transportation services is thus an essential governmental function. Therefore, it is the intent of the legislature to permit political subdivisions of the state to regulate for hire transportation services without liability under federal antitrust laws.

Id.

That the Washington state legislature "inten[ded] ... to permit political subdivisions of the state to regulate for hire transportation services without liability under federal antitrust laws," id., is insufficient to bring the Ordinance within the protective ambit of state-action immunity. We are mindful of the Supreme Court's instruction that "a State may not confer antitrust immunity on private persons by fiat," *Ticor Title*, 504 U.S. at 633, and that a "State may not validate a municipality's anticompetitive conduct simply by declaring it to be lawful," *Hallie*, 471 U.S. at 39. Rather, it must first meet the *Midcal* requirements: A state "may displace competition with active state supervision [only] if the displacement is both intended by the State and implemented in its specific details." *Ticor Title*, 504 U.S. at 633. We may not "defer[] to private pricefixing arrangements under the general auspices of state law," but instead must ensure that the "precondition[s] for immunity from federal law," such as "[a]ctual state involvement," are met. Id. After all, "[i]mmunity is conferred out of respect for ongoing regulation by the State, not out of respect for the economics of price restraint." Id.

The plain language of the statute centers on the provision of "privately operated for hire transportation services," Wash. Rev. Code § 46.72.001, not the contractual payment arrangements between for-hire drivers and driver coordinators for use of the latter's smartphone apps or ride-referral services. Although driver coordinators like Uber and Lyft contract with providers of transportation services, they do not fulfill the requests for transportation services—the drivers do. Nothing in the statute evinces a clearly articulated state policy to displace competition in the market for ride-referral service fees charged by companies like Uber, Lyft, and Eastside. In other words, although the statute addresses the provision of transportation services, it is silent on the issue of compensation contracts between for-hire drivers and driver coordinators. To read into the plain text of the statute implicit state authorization and intent to displace competition with respect to for-hire drivers' compensation would be to apply the clear-articulation test "too loosely." *Phoebe Putney*, 568 U.S. at 229. ***

The regulation of rates in one area—i.e., the regulation of rates charged to passengers for transportation services—does not confer the shield of state-action immunity onto anticompetitive conduct in a related market—i.e., price-fixing the fees for-hire drivers pay to Uber and Lyft in order to use their digital platforms.

In cases in which the Supreme Court found the clear-articulation test to be satisfied, the initial state authorization clearly contemplated and plainly encompassed the challenged anticompetitive conduct. *** Tellingly, Uber and Lyft did not exist when the Washington statutes were enacted. The very concept of digital ridesharing services was probably well beyond the imaginations of lawmakers two to three decades ago, much less foreseeable. But the fact that technology has advanced leaps and bounds beyond the contemplation of the state legislature is not, on its own, the dispositive factor in our holding today. Digital platforms like Uber and Lyft have become "highly interconnected with modern economic and social life," *Fields v. Twitter, Inc.*, 881 F.3d 739, 749 (9th Cir. 2018), and present novel challenges and contexts for regulation.

Nevertheless, it is not our role to make policy judgments properly left to the Washington state legislature. Instead, we must tread carefully in the area of state-action immunity, lest "a broad interpretation of the doctrine ... inadvertently extend immunity to anticompetitive activity which the states did not intend to sanction," or "a broad application of the doctrine ... impede states' freedom by threatening to hold them accountable for private activity they do not condone 'whenever they enter the realm of economic regulation.'" *Cost Mgmt. Servs.*, 99 F.3d at 941 (quoting *Ticor Title*, 504 U.S. at 635-36).

Applying governing law, we hold that the clear-articulation requirement for state-action immunity is not satisfied in this case.

ii. The Active-Supervision Requirement

We next hold that the Ordinance does not meet the active-supervision requirement for *Parker* immunity.

"The active supervision requirement demands ... 'that state officials have and exercise power to review particular anticompetitive acts of private parties and disapprove those that fail to accord with state policy.'" *N.C. State Bd. of Dental Examiners v. FTC*, ____ U.S. ____ (2015) (quoting *Patrick v. Burget*, 486 U.S. 94, 101 (1988)). Because "[e]ntities purporting to act under state authority might diverge from the State's considered definition of the public good" and "[t]he resulting asymmetry between a state policy and its implementation can invite private self-dealing," the active-supervision requirement "seeks to avoid this harm by requiring the State to review and approve interstitial policies made by the entity claiming immunity." Id.

As a threshold matter, we first clarify that the active-supervision requirement applies to this case. It is settled law that "active state supervision is not a prerequisite to exemption from the antitrust laws where the actor is a municipality rather than a private party." *Hallie*, 471 U.S. at 47. However, where, as here, "state or municipal regulation by a private party is involved, . . . active state supervision must be shown, even where a clearly articulated state policy exists." Id. at 46n.10 (citing *S. Motor Carriers*, 471 U.S. at 62).

Southern Motor Carriers is illustrative. *** Likewise here, private parties—for-hire drivers and driver coordinators—are permitted to set rates collectively and submit them to the Director for approval. Accordingly, the active-supervision requirement applies.

The involvement of private parties in municipal regulation renders this case ineligible for the municipality exception outlined in *Hallie*: "*Hallie* explained that '[w]here the actor is a municipality, there is little or no danger that it is involved in a private price-fixing arrangement. The only real danger is that it will seek to further purely parochial public interests at the expense of more overriding state goals.'" *Dental Examiners*, 135 S.Ct. at 1112 (alteration in original) (quoting *Hallie*, 471 U.S. at 47). In contrast, this case presents a scenario in which the City authorizes collective price-fixing by private parties, which the Director evaluates and ratifies. The amount of discretion the Ordinance confers upon private actors is far from trivial.

Having decided that the active-supervision requirement applies to this case, we turn to examine whether it is met. Clearly, it is not. It is undisputed that the State of Washington plays no role in supervising or enforcing the terms of the City's Ordinance.

The City cites no controlling authority to support its argument that the Supreme Court uses the word "State" simply "as shorthand for the State and all its agents, including municipalities." The Supreme Court has stated repeatedly that active supervision must be "by the State itself." *Midcal*, 445 U.S. at 105.

We take it as a given that the Supreme Court means what it states. In *Hallie*, the Supreme Court stated that "[w]here state or municipal regulation by a private party is involved, however, active state supervision must be shown." 471 U.S. at 46 n.10. In the first clause, the Supreme Court used "state or municipal," thus drawing a disjunctive difference between the two words. In the second clause, it used only "state." It is highly improbable that the Supreme Court chose to distinguish between states and municipalities in the beginning of the sentence, only to conflate the two in the latter part of the sentence.

Moreover, the City's interpretation of the Supreme Court's use of "State" collapses the specific distinction the Supreme Court has drawn between cities, which are not sovereign entities, and states, which are. Sovereign capacity matters. Indeed, the very origins of *Parker* immunity stem from respect for the states' sovereign capacity to regulate their economies. *Phoebe Putney*, 568 U.S. at 224. A "substate governmental entity" is simply not equivalent to a state: "Because municipalities and other political subdivisions are not themselves sovereign, state-action immunity under *Parker* does not apply to them directly." *Phoebe Putney*, 568 U.S. at 225. Unlike a state, a municipality may invoke the protective cloak of *Parker* immunity under "the narrow exception *Hallie* identified" not because it is sovereign, but because there is "little or no danger that it is involved in a private price-fixing arrangement"; the fact that "municipalities are electorally accountable and lack the kind of private incentives characteristic of active participants in the market"; and the "substantially reduc[ed] ... risk that [a municipality] would pursue private interests while regulating any single field." *Dental Examiners*, 135 S.Ct. at 1112-13 (quoting *Hallie*, 471 U.S. at 47). All of the reasons justifying the *Hallie* exception are eviscerated by the involvement of private parties in this case.

In concluding that the active-supervision requirement is not satisfied in this case, we do not disturb *Hallie's* well-settled rule that municipal actors need not meet the active-supervision requirement. See *Hallie*, 471 U.S. at 47. Rather, following *Hallie*, we hold that in this case, in which private actors exercise substantial discretion in setting the terms of municipal regulation, "active state supervision must be shown." Id. at 46 n.10. Because the distinction between states and municipalities is of crucial importance for purposes of state-action immunity, we reject the City's invitation to treat the two entities interchangeably.

II. The Ordinance Is Not Preempted by the National Labor Relations Act.

We next hold that the Ordinance is not preempted by the NLRA under either *Machinists* or *Garmon* preemption. ***

CONCLUSION

For the foregoing reasons, we reverse the district court's dismissal of the Chamber's federal antitrust claims, and remand the federal antitrust claims to the district court for further proceedings. We also affirm the district court's dismissal of the Chamber's NLRA preemption claims. ***

Deslandes v. McDonald's USA LLC

81 F.4th 699 (7th Cir. 2023)

EASTERBROOK, Circuit Judge: Until recently, every McDonald's franchise agreement contained an anti-poach clause. Each franchise operator promised not to hire any person employed by a different franchise, or by McDonald's itself, until six months after the last date that person had worked for McDonald's or another franchise. A related clause barred one franchise from soliciting another's employee. We use "anti-poach clause" or "no-poach clause" to refer to these collectively.

Plaintiffs in this suit under § 1 of the Sherman Act, 15 U.S.C. § 1, worked for McDonald's franchises while these clauses were in force and were unable to take higher-paying offers at other franchises. They contend that the no-poach clause violates the antitrust laws. If this clause holds down the price of labor by reducing competition for fast-food workers, that could benefit owners—and conceivably consumers too. But the antitrust laws prohibit monopsonies, just as they prohibit monopolies. See *NCAA v. Alston*, ___ U.S. ___ (2021).

Claims under § 1 fall into two principal categories: naked restraints, akin to cartels, are unlawful per se, while other restraints are evaluated under the Rule of Reason. (The quick-look approach, see *NCAA v. University of Oklahoma*, 468 U.S. 85 (1984), is a subset of analysis under the Rule of Reason.) The district court rejected plaintiffs' per se theory after stating that the anti-poach clause is not a naked restraint but is ancillary to each franchise agreement—and, as every new restaurant expands output, the restraint is justified..

The court deemed the complaint deficient under the Rule of Reason because it does not allege that McDonald's and its franchises collectively have power in the market for restaurant workers' labor, Market power is essential to any claim under the Rule of Reason. See *Ohio v. American Express Co.*, ___ U.S. ___ (2018); *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877, 885-86 (2007). The absence of such an allegation rendered the claim implausible, the court held. See *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007) (establishing the plausibility requirement for antitrust complaints). The judge invited plaintiffs to file an amended complaint alleging market power. After they declined to do so, the judge dismissed the complaint with prejudice, ending the suit.

On appeal plaintiffs assert that they didn't "really" waive or forfeit their opportunity to allege market power, but the district court's contrary conclusion is not an abuse of discretion. Plaintiffs also contend that the existence of market power is too obvious to need allegations and proof, but that line of argument depends on treating "workers at McDonald's" as an economic market. That's not sound. People who work at McDonald's one week can work at Wendy's the next, and the reverse. People entering the labor market can choose where to go—and fast-food restaurants are only one of many options. If wages are too low at one chain, people can choose other employers. The mobility of workers—both from one employer to another and from one neighborhood to another —makes it impossible to treat employees at a single chain as a market.

The district judge found it undisputed that within three miles of Deslandes's home there are between 42 and 50 quick-service restaurants as well as two McDonald's franchises, and that within ten miles of her home there are 517 quick-service restaurants. This is not a situation in which a court can treat employment for a single enterprise as a market all its own. So the Rule of Reason is out of this suit, and, as quick-look analysis is part of the Rule of Reason, it is out too.

But the district judge jettisoned the per se rule too early. The complaint alleges a horizontal restraint, and market power is not essential to antitrust claims involving naked agreements among competitors. See, e.g., *Palmer v. BRG of Georgia, Inc.*, 498 U.S. 46 (1990).

An agreement among competitors is not naked if it is ancillary to the success of a cooperative venture. Consider a partnership to practice law. The partners devote their time to the law firm and pool their revenues; that's a horizontal agreement. The partners also promise not to compete with the law firm by taking their own clients. That agreement is lawful because the promise to devote all legal time to the firm's business helps each law firm compete against its rivals; in antitrust jargon, the no-compete pledge is ancillary to the venture in the sense that it makes the partnership more effective when competing in the market for legal services. See *Broadcast Music, Inc. v. Columbia Broadcasting System, Inc.*, 441 U.S. 1, 9 (1979).

The complaint alleges that McDonald's operates many restaurants itself or through a subsidiary, and that it enforced the no-poach clause at those restaurants. This made the arrangement horizontal: workers at franchised outlets could not move to corporate outlets, or the reverse. See *Interstate Circuit, Inc. v. United States*, 306 U.S. 208 (1939).

Still, the district court thought that the anti-poach clause is justified as an ancillary restraint. The court deemed the restraint ancillary because it appeared in franchise agreements—and each agreement expands the output of burgers and fries. (We need not consider the possibility that new franchises replace old ones, so that "new franchise" need not imply "more output," though this may need attention later.)

One problem with this approach is that it treats benefits to consumers (increased output) as justifying detriments to workers (monopsony pricing). That's not right; it is equivalent to saying that antitrust law is unconcerned with competition in the markets for inputs, and Alston establishes otherwise.

Another problem with using the appearance of a clause in a contract that, on the whole, increases output, is that the clause may have nothing to do with the output. A "restraint does not qualify as 'ancillary' merely because it accompanies some other agreement that is itself lawful." Phillip E. Areeda & Herbert Hovenkamp, Antitrust Law ¶ 1908b (4th ed. 2022). Is there some reason to think that a no-poach clause promotes the production of restaurant food? Maybe it just takes advantage of workers' sunk costs and helps each business's bottom line, without adding to output.

What we mean is this: People who choose to work at McDonald's or one of its franchises acquire business-specific (or location-specific) skills. Employees may choose to work for less than their marginal product in order to compensate the employer for the training. In a competitive market, workers recover these investments as their wages rise over time, in response to their greater productivity. But if McDonald's specifies a limited number of classifications of workers (something the complaint also alleges), that may delay promotion and frustrate workers' ability to recoup their investments in training. One way to obtain a higher salary, after paying for one's own training through lower wages, is to seek employment at another similar business where the skills can be put to use at the market wage. Deslandes alleges that this is what she tried to do, only to be blocked by the no-poach clause. And if this is what the no-poach agreement does—if it prevents workers from reaping the gains from skills they learned by agreeing to work at lower wages at the outset of their employment—then it does not promote output. It promotes profits, to be sure, as franchises capitalize on workers' sunk costs. But it does not promote output and so cannot be called "ancillary" in the sense antitrust law uses that term.

Common training and job classifications could in principle justify restraints on poaching. Suppose Franchise A hires workers and pays for necessary training, rather than requiring the workers to cover their own training costs through lower wages. During training in this approach, the wage exceeds the worker's productivity, but after training the worker produces enough value to pay back the costs of training and allow A to recoup the "excess" wage during training time. A needs to keep the worker for this to pay off. If Franchise B offers no training but a higher wage, this will be attractive to the worker who was trained at A, and B can make a profit from free riding on A's investment. B can do this because the restaurants have the same layout, tasks, and so on. In these circumstances a ban on poaching could allow A to recover its training costs and thus make training worthwhile to both franchise and worker. It would not imply monopsony. But eventually the cost of training will have been amortized, and a ban on transfer to another restaurant after that threshold could be understood as an antitrust problem.

So what was the no-poach clause doing? Was it protecting franchises' investments in training, or was it allowing them to appropriate the value of workers' own investments? That question can't be answered by observing that any given franchise contract, viewed by itself, expands the output of food. Why did the clause have a national scope, preventing a restaurant in North Dakota from hiring a worker in North Carolina, when the market for restaurant jobs is local? Why did the restriction last as long as the employment (plus six months), rather than be linked to any estimate of the time a franchise would need to recover its investments in training? If the answer to some of these questions depends (as McDonald's asserts) on the fact that the system as a whole advertises for workers and wants to prevent some outlets from free riding on the contributions of others, how do the terms of the no-poach clause reflect this objective?

These are all potentially complex questions, which cannot be answered by looking at the language of the complaint. They require careful economic analysis. More than that: the classification of a restraint as ancillary is a defense, and complaints need not anticipate and plead around defenses. Some language in the district court's opinions suggests that a complaint must contain enough to win, but that is not so. It suffices, *Twombly* holds, to make out a plausible claim, and this complaint does so. Nor need a complaint plead law or match facts to elements of legal theories. Once a complaint has identified a plausible antitrust claim, further development requires discovery, economic analysis, and potentially a trial.

Plaintiffs sought class certification, and the district court said no. The court may think it wise to reconsider in light of the need for a remand and the analysis in this opinion.

The judgment is vacated and the case is remanded for further proceedings.

RIPPLE, Circuit Judge, concurring: I join the opinion and the judgment of the court. The issue presented by this case is an important and timely one. I therefore write separately to make clear my understanding of what we decide, and do not decide, today.

Our opinion sends the ancillary restraint defense back to the district court for further analysis. It makes clear that, in further proceedings before the district court, the defendants bear the burden of establishing that the no-poaching clause in the franchise agreement qualifies as an ancillary restraint. It further suggests the sort of inquiry that the district court should undertake in considering this question. Our opinion's discussion of these perspectives hopefully will be helpful to the district court and to the parties. However, I do not understand the court's opinion to assess in any definitive way the merits of any of these suggested avenues of further economic analysis, nor do I understand the court to preclude other approaches that the parties believe pertinent and that the district court believes relevant.

Nor do I read the court's discussion as addressing the relative usefulness of the various considerations that it discusses. As I understand the court's opinion, it leaves the district court, with the assistance of the parties, to determine the relative importance of these considerations and to identify those issues worthy of its prime attention. For instance, the district court might determine that the scope and duration of the restriction in question reduces substantially the need for extended economic analysis of other "potentially complex questions." Op. 705. If the restriction cannot be justified because of its scope and duration, it is difficult to see how it can be reasonably necessary to the achievement of the procompetitive objectives of the franchise agreement. If we are to retain the benefits of applying a per se analysis to horizontal agreements, we need to ensure that our adjudication of possible defenses is a focused one.

Perhaps most importantly, I do not understand the court to question the continued vitality of the rule that the ancillary restraint defense requires that the defendants establish both that the restriction in question be "subordinate and collateral," *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210, 224 (D.C. Cir. 1986), to a "legitimate business collaboration" among the defendants, and be reasonably necessary to achieve a procompetitive objective of the franchise agreement. This rule is well-established, and I do not understand this opinion to weaken surreptitiously a principle upon which the bench and bar rely.

Federal Trade Commission v. Qualcomm Incorporated

969 F.3d 974 (9th Cir. 2020)

CALLAHAN, CIRCUIT JUDGE. This case asks us to draw the line between *anti*competitive behavior, which is illegal under federal antitrust law, and *hyper*competitive behavior, which is not. The Federal Trade Commission ("FTC") contends that Qualcomm Incorporated ("Qualcomm") violated the Sherman Act, 15 U.S.C. §§ 1, 2, by unreasonably restraining trade in, and unlawfully monopolizing, the code division multiple access ("CDMA") and premium long-term evolution ("LTE") cellular modem chip markets. After a ten-day bench trial, the district court agreed and ordered a permanent, worldwide injunction prohibiting several of Qualcomm's core business practices. We granted Qualcomm's request for a stay of the district court's injunction pending appeal. *FTC v. Qualcomm Inc.*, 935 F.3d 752 (9th Cir. 2019). At that time, we characterized the district court's order and injunction as either "a trailblazing application of the antitrust laws" or "an improper excursion beyond the outer limits of the Sherman Act." *Id.* at 757. We now hold that the district court went beyond the scope of the Sherman Act, and we reverse.

I

A

Founded in 1985, Qualcomm dubs itself "the world's leading cellular technology company." Over the past several decades, the company has made significant contributions to the technological innovations underlying modern cellular systems, including third-generation ("3G") CDMA and fourth-generation ("4G") LTE cellular standards—the standards practiced in most modern cellphones and "smartphones." Qualcomm protects and profits from its technological innovations through its patents, which it licenses to original equipment manufacturers ("OEMs") whose products (usually cellphones, but also smart cars and other products with cellular applications) practice one or more of Qualcomm's patented technologies.

Qualcomm's patents include cellular standard essential patents ("SEPs"), non-cellular SEPs, and non-SEPs. Cellular SEPs are patents on technologies that international standard-setting organizations ("SSOs") choose to include in technical standards practiced by each new generation of cellular technology. . . . Cellular SEPs are necessary to practice a particular cellular standard. Because SEP holders could prevent industry participants from implementing a standard by selectively refusing to license, SSOs require patent holders to commit to license their SEPs on fair, reasonable, and nondiscriminatory ("FRAND") terms before their patents are incorporated into standards.

. . . . Rather than license its patents individually, Qualcomm generally offers its customers various "patent portfolio" options, whereby the customer/licensee pays for and receives the right to practice all three types of Qualcomm patents (SEPs, non-cellular SEPs, and non-SEPs).

Qualcomm's patent licensing business is very profitable, representing around two-thirds of the company's value. But Qualcomm is no one-trick pony. The company also manufactures and sells cellular modem chips, the hardware that enables cellular devices to practice CDMA and premium LTE technologies and thereby communicate with each other across cellular networks. This makes Qualcomm somewhat unique in the broader cellular services industry. Companies such as Nokia, Ericsson, and Interdigital have comparable SEP portfolios but do not compete with Qualcomm in the modem chip markets. On the other hand, Qualcomm's main competitors in the modem chip markets—companies such as MediaTek, HiSilicon, Samsung LSI, ST-Ericsson, and VIA Telecom (purchased by Intel in 2015)—do not hold or have not held comparable SEP portfolios.

Like its licensing business, Qualcomm's modem chip business has been very successful. From 2006 to 2016, Qualcomm possessed monopoly power in the CDMA modem chip market, including over 90% of market share. From 2011 to 2016, Qualcomm possessed monopoly power in the premium LTE modem chip market, including at least 70% of market share. During these timeframes, Qualcomm leveraged its monopoly power to "charge monopoly prices on [its] modem chips." *Qualcomm*, 411 F.Supp.3d at 800. Around 2015, however, Qualcomm's dominant position in the modem chip markets began to recede, as competitors like Intel and MediaTek found ways to successfully compete. Based on projections from 2017 to 2018, Qualcomm maintains approximately a 79% share of the CDMA modem chip market and a 64% share of the premium LTE modem chip market.

B

Qualcomm licenses its patent portfolios exclusively at the OEM level, setting the royalty rates on its CDMA and LTE patent portfolios as a percentage of the end-product sales price. This practice is not unique to Qualcomm. As the district court found, "[f]ollowing Qualcomm's lead, other SEP licensors like Nokia and Ericsson have concluded that licensing only OEMs is more lucrative, and structured their practices accordingly." OEM-level licensing allows these companies to obtain the maximum value for their patented technologies while avoiding the problem of patent exhaustion, whereby "the initial authorized [or licensed] sale of a patented item terminates all patent rights to that item." *Quanta Comput., Inc. v. LG Elecs., Inc.*, 553 U.S. 617, 625 (2008). Due to patent exhaustion, if Qualcomm licensed its SEPs further "upstream" in the manufacturing process to competing chip suppliers, then its patent rights would be exhausted when these rivals sold their products to OEMs. OEMs would then have little incentive to pay Qualcomm for patent licenses, as they could instead become "downstream" recipients of the already exhausted patents embodied in these rivals' products.

Because rival chip manufacturers practice many of Qualcomm's SEPs by necessity, Qualcomm offers these companies what it terms "CDMA ASIC Agreements," wherein Qualcomm promises not to assert its patents in exchange for the company promising not to sell its chips to unlicensed OEMs. . . .

Qualcomm reinforces these practices with its so-called "no license, no chips" policy, under which Qualcomm refuses to sell modem chips to OEMs that do not take licenses to practice Qualcomm's SEPs. Otherwise, because of patent exhaustion, OEMs could decline to take licenses, arguing instead that their purchase of chips from Qualcomm extinguished Qualcomm's patent rights with respect to any CDMA or premium LTE technologies embodied in the chips. This would not only prevent Qualcomm from obtaining the maximum value for its patents, it would result in OEMs having to pay more money (in licensing royalties) to purchase and use a competitor's chips, which are unlicensed. Instead, Qualcomm's practices, taken together, are "chip supplier neutral"—that is, OEMs are required to pay a per-unit licensing royalty to Qualcomm for its patent portfolios regardless of which company they choose to source their chips from.

Although Qualcomm's licensing and modem chip businesses have made it a major player in the broader cellular technology market, the company is not an OEM. That is, Qualcomm does not manufacture and sell cellphones and other end-use products (like smart cars) that consumers purchase and use. Thus, it does not "compete"—in the antitrust sense—against OEMs like Apple and Samsung in these product markets. Instead, these OEMs are Qualcomm's *customers*.

C

* * *

Qualcomm's competitors in the modem chip markets contend that Qualcomm's business practices, in particular its refusal to license them, have hampered or slowed their ability to develop and retain OEM customer bases, limited their growth, delayed or prevented their entry into the market, and in some cases forced them out of the market entirely. These competitors contend that this result is not just anticompetitive, but a violation of Qualcomm's contractual commitments to two cellular SSOs . . . to license its SEPs "to all applicants" on FRAND terms. . . .

In 2011 and 2013, Qualcomm signed agreements with Apple under which Qualcomm offered Apple billions of dollars in incentive payments contingent on Apple sourcing its iPhone modem chips exclusively from Qualcomm and committing to purchase certain quantities of chips each year. Again, rivals such as Intel—as well as Apple itself, which was interested in using Intel as an alternative chip supplier—complained that Qualcomm was engaging in anticompetitive business practices designed to maintain its monopolies in the CDMA and premium LTE modem chip markets while making it impossible for rivals to compete. In 2014, Apple decided to terminate these agreements and source its modem chips from Intel for its 2016 model iPhone.

D

In January 2017, the FTC sued Qualcomm for equitable relief, alleging that Qualcomm's interrelated policies and practices excluded competitors and harmed competition in the modem chip markets, in violation § 5(a) of the FTC Act, 15 U.S.C. § 45(a), and §§ 1 and 2 of the Sherman Act, 15 U.S.C. §§ 1, 2. After a ten-day bench trial, the district court concluded that "Qualcomm's licensing practices are an unreasonable restraint of trade under § 1 of the Sherman Act and exclusionary conduct under § 2 of the Sherman Act." The district court ordered a permanent, worldwide injunction prohibiting Qualcomm's core business practices.

* * *

II

* * *

A

. . . [N]ovel business practices—*especially* in technology markets—should not be "conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use." *Microsoft*, 253 F.3d at 91. . . ; *see also* Rachel S. Tennis & Alexander Baier Schwab, *Business Model Innovation and Antitrust Law*, 29 Yale J. on Reg. 307, 319 (2012) (explaining how "antitrust economists, and in turn lawyers and judges, tend to treat novel products or business practices as anticompetitive" and "are likely to decide cases wrongly in rapidly changing dynamic markets," which can have long-lasting effects particularly in technological markets, where innovation "is essential to economic growth and social welfare" and "an erroneous decision will deny large consumer benefits").

Regardless of whether the alleged antitrust violation involves concerted anticompetitive conduct under § 1 or independent anticompetitive conduct under § 2, the three-part burden-shifting test under the rule of reason is essentially the same. . . . Under § 1, "the plaintiff has the initial burden to prove that the challenged restraint has a substantial anticompetitive effect that harms consumers in the relevant market". . . . "If the plaintiff carries its burden, then the burden shifts to the defendant to show a procompetitive rationale for the restraint". . . . "If the defendant makes this showing, then the burden shifts back to the plaintiff to demonstrate that the procompetitive efficiencies could be reasonably achieved through less anticompetitive means."

Likewise, "if a plaintiff successfully establishes a *prima facie* case under § 2 by demonstrating anticompetitive effect, then the monopolist may proffer a 'procompetitive justification' for its conduct." *Microsoft*, 253 F.3d at 59. "If the monopolist asserts a procompetitive justification—a nonpretextual claim that its conduct is indeed a form of competition on the merits because it involves, for example, greater efficiency or enhanced consumer appeal—then the burden shifts back to the plaintiff to rebut that claim." *Id.* If the plaintiff cannot rebut the monopolist's procompetitive justification, "then the plaintiff must demonstrate that the anticompetitive harm of the conduct outweighs the procompetitive benefit." *Id.*

The similarity of the burden-shifting tests under §§ 1 and 2 means that courts often review claims under each section simultaneously. . . . However, although the tests are largely similar, a plaintiff may not use *indirect* evidence to prove unlawful monopoly maintenance via anticompetitive conduct under § 2. . . .

B

A threshold step in any antitrust case is to accurately define the relevant market, which refers to "the area of effective competition." *Am. Express*, 138 S.Ct. at 2285 (citation omitted). . . .

Here, the district court correctly defined the relevant markets as "the market for CDMA modem chips and the market for premium LTE modem chips." Nevertheless, its analysis of Qualcomm's business practices and their anticompetitive impact looked beyond these markets to the much larger market of cellular services generally. Thus, a substantial portion of the district court's ruling considered alleged economic harms to OEMs—who are Qualcomm's *customers*, not its competitors—resulting in higher prices to consumers. These harms, even if real, are not "anticompetitive" in the antitrust sense—at least not *directly*—because they do not involve restraints on trade or exclusionary conduct in "the area of effective competition." *Am. Express*, 138 S.Ct. at 2285.

* * *

III

Accordingly, we reframe the issues to focus on the impact, if any, of Qualcomm's practices in the area of effective competition: the markets for CDMA and premium LTE modem chips. Thus, we begin by examining the district court's conclusion that Qualcomm has an antitrust duty to license its SEPs to its direct competitors in the modem chip markets.

* * *

A

"As the Supreme Court has repeatedly emphasized, there is 'no duty to deal under the terms and conditions preferred by [a competitor's] rivals[.]" Likewise, "the Sherman Act 'does not restrict the long recognized right of [a] trader or manufacturer engaged in an entirely private business, freely to exercise his own independent discretion as to parties with whom he will deal.'" *Trinko*, 540 U.S. at 408 (alteration in original). . . .

The one, limited exception to this general rule that there is no antitrust duty to deal comes under the Supreme Court's decision in *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585 (1985). There, the Court held that a company engages in prohibited, anticompetitive conduct when (1) it "unilateral[ly] terminat[es] . . . a voluntary and profitable course of dealing"; (2) "the only conceivable rationale or purpose is 'to sacrifice short-term benefits in order to obtain higher profits in the long run from the exclusion of competition'"; and (3) the refusal to deal involves products that the defendant already sells in the existing market to other similarly situated customers. The Supreme Court later characterized the *Aspen Skiing* exception as "at or near the outer boundary of § 2 liability." *Trinko*, 540 U.S. at 409.

The district court's conclusion that Qualcomm's refusal to provide exhaustive SEP licenses to rival chip suppliers meets the *Aspen Skiing* exception ignores critical differences between Qualcomm's business practices and the conduct at issue in *Aspen Skiing*, and it ignores the Supreme Court's subsequent warning in *Trinko* that the *Aspen Skiing* exception should be applied only in rare circumstances. . . .

First, the district court was incorrect that "Qualcomm terminated a 'voluntary and profitable course of dealing'" with respect to its previous practice of licensing at the chip-manufacturer level. In support of this finding, the district court cited a single piece of record evidence: an email from a Qualcomm lawyer regarding 3%-royalty-bearing licenses for modem chip suppliers. But this email was sent in 1999, seven years before Qualcomm gained monopoly power in the CDMA modem chip market. Furthermore, Qualcomm claims that it never granted exhaustive licenses to rival chip suppliers. Instead, as the 1999 email suggests, it entered into "non-exhaustive, royalty-bearing agreements with chipmakers that explicitly did not grant rights to the chipmaker's customers."

According to Qualcomm, it ceased this practice in response to developments in patent law's exhaustion doctrine, which made it harder for Qualcomm to argue that it could provide "non-exhaustive" licenses in the form of royalty agreements. Nothing in the record or in the district court's factual findings rebuts these claims. The FTC offered no evidence that, from the time Qualcomm first gained monopoly power in the modem chip market in 2006 until now, it ever had a practice of providing exhaustive licenses at the modem chip level rather than the OEM level.

Second, Qualcomm's rationale for "switching" to OEM-level licensing was not "to sacrifice short-term benefits in order to obtain higher profits in the long run from the exclusion of competition," the second element of the *Aspen Skiing* exception. Instead, Qualcomm responded to the change in patent-exhaustion law by choosing the path that was "far more lucrative," both in the short term *and* the long term, regardless of any impacts on competition. The district court itself acknowledged that this was Qualcomm's purpose, observing: "Following Qualcomm's lead, other SEP licensors like Nokia and Ericsson have concluded that licensing only OEMs is more lucrative, and structured their practices accordingly."

Finally, unlike in *Aspen Skiing*, the district court found no evidence that Qualcomm singles out any specific chip supplier for anticompetitive treatment in its SEP-licensing. In *Aspen*

Skiing, the defendant refused to sell its lift tickets to a smaller, rival ski resort even as it sold the same lift tickets to any other willing buyer (including any *other* ski resort); moreover, this refusal was designed specifically to put the smaller, nearby rival out of business. Qualcomm applies its OEM-level licensing policy equally with respect to all competitors in the modem chip markets and declines to enforce its patents against these rivals even though they practice Qualcomm's patents (royalty-free). . . .

As none of the required elements for the *Aspen Skiing* exception are present, let alone all of them, the district court erred in holding that Qualcomm is under an antitrust duty to license rival chip manufacturers. We hold that Qualcomm's OEM-level licensing policy, however novel, is not an anticompetitive violation of the Sherman Act.

B

Conceding error in the district court's conclusion that Qualcomm is subject to an antitrust duty to deal under *Aspen Skiing*, the FTC contends that this court may nevertheless hold that Qualcomm engaged in anticompetitive conduct in violation of § 2. This is so, the FTC urges, because

> "Qualcomm entered into a voluntary contractual commitment to deal with its rivals as part of the SSO process, which is itself a derogation from normal market competition," and (2) Qualcomm's breach of this contractual commitment "satisfies traditional Section 2 standards [in that] it 'tends to impair the opportunities of rivals and . . . does not further competition on the merits.'"

We disagree.

Even if the district court is correct that Qualcomm is contractually obligated via its SSO commitments to license rival chip suppliers—a conclusion we need not and do not reach—the FTC still does not satisfactorily explain how Qualcomm's alleged breach of this contractual commitment *itself* impairs the opportunities of rivals. It argues the breach "facilitat[es] Qualcomm's collection of a surcharge from rivals' customers." Appellee's Br. at 77. But this refers to a distinct business practice, licensing royalties, and alleged harm to OEMs, not rival chipmakers. In any case, Qualcomm's royalties are "chip-supplier neutral" because Qualcomm collects them from *all* OEMs that license its patents, not just "rivals' customers." The FTC argues that Qualcomm's breach directly impacts rivals by "otherwise deterring [their] entry and investment." But this ignores that Qualcomm's "CDMA ASIC Agreements" functionally act as de facto licenses ("no license, no problem") by allowing competitors to practice Qualcomm's SEPs (royalty-free) before selling their chips to downstream OEMs. Furthermore, in order to make out a § 2 violation, the anticompetitive harm identified must be to *competition itself*, not merely to competitors. The FTC identifies no such harm to competition.

The FTC's conclusion that OEM-level licensing does not further competition on the merits is not only belied by MediaTek and Intel's entries into the modem chip markets in the 2015–2016 timeframe, it also gives inadequate weight to Qualcomm's reasonable, procompetitive justification that licensing at the OEM and chip-supplier levels simultaneously would require the company to engage in "multi-level licensing," leading to inefficiencies and less profit. Qualcomm's procompetitive justification is supported by at least two other companies—Nokia and Dolby—with similar SEP portfolios to Qualcomm's.[1] More critically, this part of

[1] *See* Br. of Amicus Curiae Nokia Technologies Oy at 18–19 (noting that "[t]here are good reasons for SEP owners

the FTC's argument skips ahead to an examination of Qualcomm's procompetitive justifications, failing to recognize that the burden does not shift to Qualcomm to provide such justifications unless and until the FTC meets its initial burden of proving anticompetitive harm. Because the FTC has not met its initial burden under the rule of reason framework, we are less critical of Qualcomm's procompetitive justifications for its OEM-level licensing policy—which, in any case, appear to be reasonable and consistent with current industry practice.

* * *

Finally, we note the persuasive policy arguments of several academics and practitioners with significant experience in SSOs, FRAND, and antitrust enforcement, who have expressed caution about using the antitrust laws to remedy what are essentially contractual disputes between private parties engaged in the pursuit of technological innovation.

* * *

C

We next address the district court's primary theory of anticompetitive harm: Qualcomm's imposition of an "anticompetitive surcharge" on rival chip suppliers via its licensing royalty rates. According to the district court, Qualcomm's unreasonably high royalty rates enable Qualcomm to control rivals' prices because Qualcomm receives the royalty even when an OEM uses one of Qualcomm's rival's chips. Thus, the "all-in" price of any modem chip sold by one of Qualcomm's rivals effectively includes two components: (1) the nominal chip price; and (2) Qualcomm's royalty surcharge.

This central component of the district court's ruling is premised on the district court's findings that Qualcomm's royalty rates are (1) "unreasonably high" because they are improperly based on Qualcomm's monopoly chip market share and handset price instead of the "fair value of Qualcomm's patents," and (2) anticompetitive because they raise costs to OEMs, who pass the extra costs along to consumers and are forced to invest less in other handset features. . . .

We hold that the district court's "anticompetitive surcharge" theory fails to state a cogent theory of anticompetitive harm. . . .

1

First, the district court's determination that Qualcomm's royalty rates are "unreasonable" because they are based on handset prices misinterprets Federal Circuit law regarding "the patent rule of apportionment" and the smallest salable patent-practicing unit ("SSPPU"). The district court observed "that 'it is generally required that royalties be based not on the entire product, but instead on the [SSPPU].'" *Qualcomm*, 411 F.Supp.3d at 783.

Even if we accept that the modem chip in a cellphone is the cellphone's SSPPU, the district court's analysis is still fundamentally flawed. No court has held that the SSPPU concept is

to structure their licensing programs to license end-user products," including the reduction of "transaction costs and complexities associated with negotiating and executing licenses at multiple points in the supply chain," the avoidance of "overlapping and duplicative licensing," "expedite[d] access to SEPs for the entire supply chain," and "greater visibility to what products are actually licensed, for example, for auditing purposes"); Br. of Amicus Curiae Dolby Laboratories, Inc. at 28 ("Forcing SEP holders to license component suppliers would interfere with historical precedents and established practices, and produce significant inefficiencies and lack of transparency regarding whether products in the stream of commerce are in fact licensed.").

a per se rule for "reasonable royalty" calculations; instead, the concept is used as a tool in jury cases to minimize potential jury confusion when the jury is weighing complex expert testimony about patent damages. . . .

* * *

A second problem with the district court's "unreasonable royalty rate" conclusion is that it erroneously assumes that royalties are "anticompetitive"—in the antitrust sense—unless they precisely reflect a patent's current, intrinsic value and are in line with the rates other companies charge for their own patent portfolios. Neither the district court nor the FTC provides any case law to support this proposition, which sounds in patent law, not antitrust law. . . . We decline to adopt a theory of antitrust liability that would presume anticompetitive conduct any time a company could not prove that the "fair value" of its SEP portfolios corresponds to the prices the market appears willing to pay for those SEPs in the form of licensing royalty rates.

Finally, even assuming that a deviation between licensing royalty rates and a patent portfolio's "fair value" could amount to "anticompetitive harm" in the antitrust sense, the primary harms the district court identified here were to the OEMs who agreed to pay Qualcomm's royalty rates—that is, Qualcomm's *customers*, not its *competitors*. These harms were thus located outside the "areas of effective competition"—the markets for CDMA and premium LTE modem chips—and had no direct impact on competition in those markets. *See Rambus*, 522 F.3d at 464 (noting that if a practice "raises the price secured by a seller" or otherwise harms customers, "but does so without harming competition, it is beyond the antitrust laws' reach").

2

Regardless of the "reasonableness" of Qualcomm's royalty rates, the district court erred in finding that these royalties constitute an "artificial surcharge" on rivals' chip sales. In *Caldera, Inc. v. Microsoft Corp.*, 87 F. Supp. 2d 1244 (D. Utah 1999), the primary case relied upon by the district court for its surcharging theory, Microsoft required OEMs "to pay [it] a royalty on every machine the OEM shipped regardless of whether the machine contained MS DOS or another operating system." This resulted in OEMs having to pay two royalties instead of one for a portion of their product base unless they chose to exclusively install Microsoft's operating system in their products. Microsoft's policy thus had "the practical effect of exclusivity," as it imposed a naked tax on rivals' software even when the end-product—an individual computer installed with a non-Microsoft operating system—contained no added value from Microsoft. . . .

Qualcomm's licensing royalties are qualitatively different from the per-unit operating-system royalties at issue in *Caldera*. When Qualcomm licenses its SEPs to an OEM, those patent licenses have value—indeed, they are necessary to the OEM's ability to market and sell its cellular products to consumers—regardless of whether the OEM uses Qualcomm's modem chips or chips manufactured and sold by one of Qualcomm's rivals. And unlike *Caldera*, where OEMs who installed non-Microsoft operating systems in some of their products were required to pay royalties for both the actual operating system *and* MS DOS (which was not installed), here OEMs do not pay twice for SEP licenses when they use non-Qualcomm modem chips. Thus, unlike Microsoft's practice, Qualcomm's practice does not have the "practical effect of exclusivity". . . .

In its complaint and in its briefing, the FTC suggests that Qualcomm's royalty rates impose an anticompetitive surcharge on its rivals' sales not for the reasons at play in *Caldera*, but rather because Qualcomm uses its licensing royalties to charge anticompetitive, ultralow prices on its own modem chips—pushing out rivals by squeezing their profit margins and preventing them from making necessary investments in research and development. But this type of "margin squeeze" was rejected as a basis for antitrust liability in *linkLine*. 555 U.S. at 451–52, 457. There, multiple digital subscriber line ("DSL") high-speed internet service providers complained that AT&T was selling them access to AT&T's must-have telephone lines and facilities at inflated wholesale rates and then shifting those increased profits to charge ultra-low rates for DSL services at retail, effectively squeezing these DSL competitors out of the market. The Court rejected the plaintiffs' assertion of anticompetitive harm, holding that AT&T was under no antitrust duty to deal with its competitors on the wholesale level, and that the plaintiffs failed to introduce evidence of predatory pricing (that is, charging below cost) at the retail level.

Here, not only did the FTC offer no evidence that Qualcomm engaged in predatory pricing, the district court's entire antitrust analysis is premised on the opposite proposition: that Qualcomm "charge[s] monopoly prices on modem chips." Indeed, the district court faulted Qualcomm for lowering its prices only when other companies introduced CDMA modem chips to the market to effectively compete. We agree with Qualcomm that this is exactly the type of "garden-variety price competition that the law encourages," and are aware of no authority holding that a monopolist may not lower its rates in response to a competitor's entry into the market with a lower-priced product.

D

As with its critique of Qualcomm's royalty rates, the district court's analysis of Qualcomm's "no license, no chips" policy focuses almost exclusively on alleged "anticompetitive harms" to OEMs—that is, impacts outside the relevant antitrust market. The district court labeled Qualcomm's policy "anticompetitive conduct against OEMs" and an "anticompetitive practice[] in patent license negotiations." But the district court failed to identify how the policy directly impacted Qualcomm's competitors or distorted "the area of effective competition." *Am. Express*, 138 S.Ct. at 2285.

* * *

According to the FTC, the problem with "no license, no chips" is that, under the policy, "Qualcomm will not sell chips to a cellphone [OEM] like Apple or Samsung unless the OEM agrees to a license that requires it to pay a substantial per-phone surcharge *even on phones that use rivals' chips*." But this argument is self-defeating: if the condition imposed on gaining access to Qualcomm's chip supply applies regardless of whether the OEM chooses Qualcomm or a competitor (in fact, this appears to be the essence of Qualcomm's policy), then the condition by definition does not distort the "area of effective competition" or impact competitors. At worst, the policy raises the "all-in" price that an OEM must pay for modem chips (chipset + licensing royalties) regardless of which chip supplier the OEM chooses to source its chips from. As we have already discussed, whether that all-in price is reasonable or unreasonable is an issue that sounds in patent law, not antitrust law. Additionally, it involves potential harms to Qualcomm's *customers*, not its competitors, and thus falls outside the relevant antitrust markets.

* * *

E

Having addressed the primary components of the district court's antitrust ruling with respect to Qualcomm's general business practices, we now address the district court's more specific finding that from 2011 to 2015, Qualcomm violated both sections of the Sherman Act by signing "exclusive deals" with Apple that "foreclosed a 'substantial share' of the [CDMA] modem chip market."

* * *

Qualcomm argues that its agreements with Apple were "volume discount contracts, not exclusive dealings contracts." Unlike exclusive dealing arrangements, "volume discount contracts are legal under antitrust law . . . [b]ecause the contracts do not preclude consumers from using other . . . services." Likewise, conditional agreements that provide "substantial discounts to customers that actually purchase[] a high percentage of their . . . requirements from" a firm are not exclusive dealing arrangements, de facto or actual, unless they "prevent[] the buyer from purchasing a given good from any other vendor."

* * *

There is some merit in the district court's conclusion that the Apple agreements were structured more like exclusive dealing contracts than volume discount contracts. However, we do not agree that these agreements had the actual or practical effect of substantially foreclosing competition in the CDMA modem chip market, or that injunctive relief is warranted.

During the relevant time period (2011–2015), the record suggests that the only serious competition Qualcomm faced with respect to the Apple contracts was from Intel, a company from whom Apple had considered purchasing modem chips prior to signing the 2013 agreement with Qualcomm. The district court made no finding that any other specific competitor or potential competitor was affected by either of Qualcomm's agreements with Apple, and it is undisputed that Intel won Apple's business *the very next year*, in 2014, when Apple's engineering team unanimously recommended that the company select Intel as an alternative supplier of modem chips. The district court found that "Qualcomm's exclusive deals . . . delayed Intel's ability to sell modem chips to Apple until September 2016." There is no indication in the record, however, that Intel was a viable competitor to Qualcomm prior to 2014–2015, or that the 2013 agreement delayed Apple's transition to Intel by any more than one year. Given these undisputed facts, we conclude that the 2011 and 2013 agreements did not have the actual or practical effect of substantially foreclosing competition in the CDMA modem chip market.

* * *

We therefore **REVERSE** the district court's judgment and **VACATE** its injunction as well as its partial grant of summary judgment.