NATIONAL VENTURE CAPITAL ASSOCIATION'S COMMENTS TO THE U.S. DEPARTMENT OF JUSTICE AND THE FEDERAL TRADE COMMISSION'S DRAFT MERGER GUIDELINES

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I. INTRODUCTION.

The National Venture Capital Association shares the Antitrust Agencies' desire to promote innovation through robust competition. But the Draft Merger Guidelines, though well-intentioned, undermine that goal by taking a myopic and misguided view of how innovation markets work.

The antitrust laws encourage firms – large and small – to develop new technologies and products to better serve the populace. We all agree on that. The question is how best to do it. In today's world, there is no shortage of brilliant ideas for the betterment of society, but there is a shortage of funds to pursue them. Even the largest, most established firms do not have unlimited R&D budgets and infinite resources. Instead, established firms in effect outsource the incubation function to startups, particularly those backed by venture capital. This allows established firms to focus on what they do best: efficiently produce and distribute proven, high-quality, and reliable products to consumers. It also allows startups to focus on what they do best: pursue promising new ideas and develop them to the point of commercial viability. Of course, most new ideas will fail; it is a high-risk endeavor. And it is not for the faint of heart. Nor is it a risk that can usually be borne by the solo inventor tinkering in his or her garage. Except for the most simplistic of ideas, developing new technologies requires funding. The inventors, the academics, the employees of these start-ups must put food on their tables, just like everyone else. That is where venture capital comes in.

Venture Capital funds spread the risk by investing in hundreds or thousands of promising ideas. Some will blossom, and some will wilt. But each will have its chance, and on average, Venture Capital – itself a competitive market – will earn returns on investment commensurate with the risk-adjusted market rate. But this model only works if Venture Capital-backed startups can sell their inventions to established firms capable of taking the invention to the next level once the incubation stage is over. There is nothing anticompetitive about this model. It is considerably more efficient than a world in which each firm (large or small) must invent, develop, produce, distribute, market, and sell their own technologies from scratch with no help from anyone else and irrespective of their own abilities. In that world, innovation would grind to a halt to everyone's detriment.

Yet the Draft Merger Guidelines threaten the existence of this model by creating unrealistic presumptions against the sale of innovative technologies to established firms. If there is no exit strategy, there is no investment in the first place. The Draft Merger Guidelines should, therefore, be revised to recognize that venture-backed startups are essentially outsourced R&D departments of established firms, encouraging M&A activity, not condemning it.

Specifically, Guidelines 1, 4, 9, and 12 purport to condemn transactions that are the engine of innovation in today's economy and perfectly lawful under current law. Guideline 1 harms this innovation by creating structural presumptions against large, established firms investing in or acquiring relatively small startups.[1] Guideline 4 deviates from longstanding antitrust law by presuming that any acquisition of a "potential competitor" is anticompetitive, without due regard for that fact that investments in startups are made with the primary goal of delivering commercially viable technologies to established firms. Guideline 9 similarly prevents established firms from looking at the venture-capital-backed startup community as a source of R&D development, which not only chills startup innovation but deadens competition by established firms that can no longer look outside themselves to develop products to better serve consumers. Under this Guideline, an established firm can place a bet on one startup, but only one, lest the second investment be deemed a "series of multiple acquisitions." Finally, Guideline 12, which casts doubt on partial ownership

[1] Because the structural presumption would be triggered by any transaction that results in a market share above 30% and a change in HHI of more than 100, the presumption can apply even in unconcentrated markets. Draft Merger Guidelines at 6-7.

and minority interests, chills investments both by Venture Capital firms with expertise in specific industries who may focus their investments in multiple, potentially alternative solutions, and by established firms that may support promising technologies and their inventors through a minority investment.[2]

Collectively, the Draft Merger Guidelines threatens to crush innovation. NVCA, therefore, respectfully urges the FTC and the DOJ to revise the Draft Merger Guidelines to recognize that acquisitions of, and investments in, startups by established firms is a crucial part of an efficient market for innovation and should be celebrated rather than condemned.

II. THE NVCA MISSION IS TO PROTECT THIS NATION'S INNOVATION ECONOMY.

NVCA is the nonprofit trade association that supports the United States venture capital ("VC") community by promoting the formation and growth of emerging, innovative companies while protecting and advancing the United States' status as the best place in the world for entrepreneurs to launch high-growth companies. NVCA represents a diverse membership including VC partnerships, corporate venture groups, seed capital, growth equity firms, and university innovation funds.

NVCA serves hundreds of VC members as they take on significant risk "betting on" emerging companies, many of which do not succeed, and supporting the nation's entrepreneurial talent in turning ideas and basic research into products and services that have transformed the world. NVCA members invest across various capital stages (i.e., from seed to growth equity) and in critical areas of our economy, such as life sciences and cutting-edge high-tech industries like information technology, blockchain, and cybersecurity.

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[2] *See* Gary Dushnitsky & Daniel Sokol, *Mergers, Antitrust, and the Interplay of Entrepreneurial Activity and the Investments That Fund It*, 24 VAND. J. ENT. & TECH. L. 255, 257 (2022).

At their own risk of loss, VCs build companies that would not otherwise have access to capital, from the simplest form—perhaps just the entrepreneur and an idea expressed as a business plan—to freestanding, mature organizations. In 2022 alone, 16,464 U.S.-based VC-backed companies received $240.9 billion in funding. These investments are essentially illiquid, do not bear any financial return unless the companies can successfully exit through an IPO or an M&A event, and many never provide any return if the company fails. More information about NVCA and its members can be found on NVCA's website here.

Venture Capital is a critical aspect of the U.S. economy.[3] Startups, many of which are VC backed, are responsible for almost all of the net new U.S. jobs created since 1977.[4] An academic study found that of the 1,677 U.S. companies that went public between 1978 and 2020, 834 (or 50%) were venture backed and that these 834 companies represented 77% of the market capitalization and 92% of total research and development of those 1,677 companies.[5] In 2020, VC-backed companies accounted for 41% of market capitalization and 46% of the total R&D spending in the United States.[6]

VCs support companies that would not otherwise have access to capital through traditional financing (e.g., a bank loan). In addition to funds, VCs add value by providing strategic guidance,

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[3] *See* Will Gornall & Ilya A. Strebulaev, *The Economic Impact of Venture Capital: Evidence from Public Companies*, Stanford University Graduate School of Business Research Paper, 5 (June 2021) (available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2681841) (88 out of the 300 largest US public companies are VC-backed while only 11 out of 300 largest companies in other G7 countries are VC-backed.).

[4] Tim Kane, *The Importance of Startups in Job Creation and Job Destruction*, Kauffman Foundation Research Series: Firm Formation and Economic Growth, 2 (June 2010) (available at https://www.kauffman.org/wp-content/uploads/2019/12/firm_formation_importance_of_startups.pdf); *see also* 2020 Global Startup Outlook, Silicon Valley Bank, 3 (2020) available at https://www.svb.com/globalassets/library/uploadedfiles/content/trends_and_insights/reports/startup_outlook_report/suo_global_report_2020-final.pdf) (79% of startups planned to hire in 2020, a continued increase from 2018 and 2019).

[5] Gornall & Strebulaev, *supra* note 3, at 17. The study also found that the six largest U.S. companies by market capitalization received most of their early external financing from venture capitalists. *Id.* at 2.

[6] *Id.* at 16-17.

sourcing key employees, and attracting additional investors.[7] The investments are high risk, as investment in early-stage companies are often illiquid, and do not bear financial return unless the companies can successfully exit through an IPO or an M&A event.[8] Estimates suggest that the failure rate for VC startups is approximately 75%.[9] IPOs are a viable exit option only for the most successful and highest value companies, making acquisition the only feasible exit opportunity for many successful startups.[10] As a result, maintaining a robust M&A market for startups is the main driver of VC activity.[11]

NVCA is deeply concerned that aspects of the Draft Merger Guidelines threaten M&A opportunities for venture-backed startups. In some specific instances, the Guidelines exceed the jurisprudence of existing antitrust law and doctrine. This creates, at minimum, risk of added scrutiny to transactions posing no risk of competitive harm, and risk of chilling M&A activity involving startups. The Guidelines' overreach is contrary to the Antitrust Agencies' stated purpose that the guidelines "reflect the law as written by Congress and interpreted by … courts."[12]

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[7] *Id.* at 18-19.

[8] *See* David Emanuelson & Danielle Drory, *The Potential Chilling Effects of Lowering Standards for Tech M&A Enforcement*, 34 ANTITRUST ABA 14, 18 (2020).

[9] *Id.*

[10] *See* Dushnitsky & Sokol, *supra* note 2, at 268 ("In any given year, there are at least five times more M&A events than there are IPOs."); Emanuelson & Drory, *supra* note 8, at 19 ("In 2019, 71 percent of venture capital exits were through acquisitions, while only 9 percent were through IPOs (and the remaining 20 percent of exits were through buyouts)."); *see also* 2020 Global Startup Outlook, Silicon Valley Bank, 7 (2020) available at https://www.svb.com/globalassets/library/uploadedfiles/content/trends_and_insights/reports/startup_outlook_report/suo_global_report_2020-final.pdf) (58% of successful startups' stated goal is acquisition, compared to only 17% wishing to go public via IPO).

[11] Gordon M. Phillips & Alexei Zhdanov, *Venture Capital Investments, Mergers and Competition Laws around the World*, Tuck School of Business Working Paper No. 3072665 (June 16, 2018) (Finding "evidence of a strong positive association between VC investment and lagged M&A activity, consistent with the hypothesis that an active M&A market provides viable exit opportunities for VC companies and therefore incentivizes them to engage in more deals.").

[12] Press Release, FTC and DOJ Seek Comment on Draft Merger Guidelines (July 19, 2023) (available at https://www.ftc.gov/news-events/news/press-releases/2023/07/ftc-doj-seek-comment-draft-merger-guidelines).

While the Guidelines would not change the state of antitrust laws, deviation from established precedent risks chilling M&A activity, specifically harming a subset of transactions that serve as the main driver of startup activity in the U.S. economy. The harm threatened by the Draft Merger Guidelines is unnecessary, as the overwhelming majority of startup acquisitions do not lead to a substantial lessening of competition and are driven by incentives that benefit the economy at large and create the high-growth ecosystem that has set the U.S. economy apart.[13]

III. THE DRAFT MERGER GUIDELINES DO NOT CREDIT THE PROCOMPETITIVE EFFECTS OF STARTUP ACQUISITIONS.

The Draft Merger Guidelines take a pessimistic view of the ability of the economy and of markets to serve consumers' interests. However, research shows that acquisitions serve a critical role as an exit strategy for successful innovators and the positive impact VC backed innovation has on consumers and the economy as a whole.[14] These benefits are driven by economic incentives, which, in the case of VC firms, typically comes in the form of an acquisition of the VC-backed startup.[15] A robust M&A market for startups is necessary to maximize incentives and allow for sustainable returns on VC investment, providing risk-based economic reward for successful entrepreneurs, thus motivating future innovation. VC-backed innovation brings numerous benefits to the economy. We highlight three:

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[13] *See* Dushnitsky & Sokol, *supra* note 2, at 257 ("For certain industries and business models built upon acquisitions, such as hardware, software, biotechnology, finance, and various industrial applications, change would fundamentally alter the ability to innovate. Altering this entrepreneurial ecosystem creates significant barriers to innovation and reduces the incentives for firms to exit the market via acquisition."); The Global Startup Ecosystem Index Report 2023, StartupBlink, (available at https://www.startupblink.com/startup-ecosystem/united-states) ("When it comes to its startup environment, the US is still the land of opportunity, representing the world's most vibrant source of free and disruptive technological creativity.").

[14] *See e.g.*, *id.*; Dushnitsky & Sokol, *supra* note 2, at 272-282.

[15] *See* n.8.

The R&D Department of the Modern Economy. VC-backed startups serve as idea incubators and the modern R&D department for much of the U.S. economy.[16] Startups are full of energy and innovation, and lack the bureaucracy accompanying many larger companies. This allows for greater risk-taking and innovation. But startups frequently lack capacity and experience to bring technologies to market at scale. And it is often more efficient for incumbent companies to acquire a startup to gain a complementary asset rather than develop it from scratch in-house. These efficiencies have created an ecosystem where it is common for larger firms to acquire innovative startups and either incorporate their technologies into existing products or scale entirely new products.[17]

The Venture Capital Multiplier Effect. The acquisitions of VC-backed startups by larger firms creates a multiplier, or recycling, effect that is a key driver of dynamism in our economy.[18] Entrepreneurs who realize liquidity through the sale of their company regularly go on to found more new, innovative companies, and often invest in other startups as angel investors or VCs. Acquisitions also help power the returns of VC funds, thereby supporting the pensions, endowments, and foundations that invest capital in venture funds. These acquisitions also fuel future VC investment funds, creating investment for the next generation of entrepreneurs. Consumers benefit from this investment cycle through improved products, and they experience the societal benefits of job creation, increased standard of living, and overall economic growth.[19]

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[16] *See* Dushnitsky & Sokol, *supra* note 2, at 281 ("Acquisitions of nascent firms may allow the larger firm to replenish its basic R&D with new approaches. This R&D replenishment may be more difficult if a large firm tries to innovate itself.").

[17] *Id.* ("[B]ecause it is likely easier to acquire a complementary asset rather than develop it, it can become easier for an acquiring firm to be more competitive vis-a-vis its competition.").

[18] Gornall & Strebulaev, *supra* note 3, at 18-20 (summarizing academic analysis of micro-level evidence showing "that VCs add value to their investments" and recognizing that VC financing creates positive spillover effects).

[19] *See* Devin Reilly, Daniel Sokol, & David Toniatti, *The Importance of Exit via Acquisition to Venture Capital, Entrepreneurship, and Innovation*, 46 Minn. J. Int'l L. 159, 168 (2022) ("Exit through acquisition can create

Modern Venture Capital Drives Startup Diversity. VC has become a driver of diversity in the entrepreneurial community. Startups have historically suffered from a lack of diversity, and minority innovators often struggled to secure financing.[20] Many new venture funds aim to reverse this trend by making diversity a stated priority and seeking out minority entrepreneurs.[21] Beyond societal benefit, research shows that opening the startup environment to a larger pool of entrepreneurs and investors creates better financial performance and promotes growth across the economy.[22]

IV. THE DRAFT MERGER GUIDELINES UNNECESSARILY BURDEN M&A ACTIVITY.

The VC economy is driven by exit opportunities for successful firms.[23] As IPOs become increasingly difficult and costly, they are a viable option for only the most successful startups.[24]

'multiplier' effects by stimulating further entrepreneurship and associated innovation. This creates further benefits for consumers within the same dynamic ecosystem, which, in turn, leads to societal benefits such as job creation, increased standard of living and overall economic growth.").

[20] Darian M. Ibrahim, *Corporate Venture Capital*, 24 U. Pa. J. Bus. L. 209, 227-28 (2021) ("In 2016, male entrepreneurs raised $58.2 billion from venture capitalists, while female entrepreneurs raised only $1.46 billion. Additionally, startups founded by black females raised an average paltry sum of $36,000.").

[21] Dushnitsky & Sokol, *supra* note 2, at 283 ("[M]any of the first-time funds launched in the last couple of years focus on inclusion and diversity. Many of these funds are raised by investors of more diverse backgrounds. Moreover, the new cadre of investors makes it their mission to support founders of diverse backgrounds."); *see also* Ibrahim, *supra* note 20, at 230 ("Diverse boards are becoming more common for public corporations, and it follows that corporate venture capitalists used to that culture would be more willing to implement gender and/or racial diversity on startup boards they fund, too.").

[22] Benjamin P. Edwards & Ann C. McGinley, *Venture Bearding*, 52 U.C. DAVIS L. REV. 1873, 1922-23 (2019); *see also* Siri Chilazi, *Advancing Gender Equality in Venture Capital*, HARV. KENNEDY SCH. 1, 2-4 (2019) (available at https://perma.cc/KA2S-SVSS) (finding that gender diversity among investors boosts financial performance for VC firms, gender-diverse portfolio companies appear to be better investments, lack of gender diversity is associated with decreased financial performance in VC, and gender inequality hits the bottom line directly).

[23] *See* Emanuelson & Drory, *supra* note 8, at 15 ("There is also a quantitative case to be made through data. These data show a vibrant start-up ecosystem, funded by venture capital, and dependent on acquisitions, or "exits," by established technology firms…. [T]hese exits generate significant efficiencies for the acquiring firm. But they also generate returns to the investing venture capital firms, which are then reinvested back into the start-up ecosystem, driving more innovation and consumer benefit.").

[24] *See* Dushnitsky & Sokol, *supra* note 2, at 268 ("In any given year, there are at least five times more M&A events than there are IPOs. While less frequent, IPOs tend to take place at higher valuations, with the average IPO valuation hovering around $500 million and peaking at above $2 billion more recently. Conversely, average M&A activity involves much lower valuations.").

For the vast majority of VC-backed ventures, acquisitions are the only realistic opportunity to earn a return on success and for investors to diversify their investment. That means that startup valuations in M&A markets are the driver of future startup investment. Additional risk, costs, or a reduction in potential acquirers in startup M&A markets would lead to lower valuations and real harm to the future of the VC economy.

Startups typically have small market shares and rarely have the capacity to meaningfully scale and expand into new markets. In some cases, a startup may be considered a "potential competitor" or "nascent competitor," but more often, an acquiring firm is an established player in a separate but related business. Thus, as research on the impact of changes in antitrust law on the VC activity shows, the Draft Guidelines' expansion of antitrust enforcement beyond established precedent and bringing added scrutiny to everyday startup acquisitions would meaningfully disrupt the entrepreneurial ecosystem.[25]

With these considerations in mind, four of the Draft Guidelines would impose unnecessary costs, lead to lower valuations, and disrupt the startup ecosystem, without improving the ability of the Antitrust Agencies to identify transactions that potentially violate antitrust laws.

A. *Guideline 1's Structure Presumptions of Anticompetitive Concentration Unreasonably Restrict The Ability of Established Firms to Outsource Their R&D Functions to VC-Backed Startups.*

Guideline 1 utilizes the Herfindahl-Hirschman Index ("HHI") to measure market concentration as part of merger analysis.[26] As drafted, Guideline 1 significantly lowers the standard for when the agencies would presume market concentration and when a transaction would

[25] Phillips & Zhdanov, *supra* note 11. *See id.* at 30-33 for an analysis of how the passage of a state level antitakeover laws had "a significant negative relation to subsequent VC activity."

[26] By contrast, the 2010 Horizonal Merger Guidelines merely referred to market concentration thresholds as a "useful indicator of likely competitive effects of a merger" and "not … a rigid screen."

substantially lessen competition.[27] Guideline 1 would scrutinize transactions in which a larger firm acquires a smaller competitor, even if the merger results in only a marginal increase in market share.[28] The Guideline goes on to provide that if a merger would result in a combined firm with a market share over 30% and an HHI increase of more than 100 points, the merger would be presumed to substantially lessen competition without regard to overall market concentration. This means that firms with significant preexisting market shares or that operate in markets with limited number of players are more likely to face a presumption that even very small transactions violate antitrust laws.

The Draft Guidelines describe the concentration thresholds as "impermissible" but do not explain if that presumption is conclusive or rebuttable. If conclusive, Guideline 1 would eliminate the most viable potential startup acquirers from the pool of bidders. Even if rebuttable, the lower presumption would increase the number of potential acquirers *likely* to face regulatory scrutiny, forcing many to self-select themselves *out* of the bidding process and thereby pushing valuations down.

Lowering the bar for when a transaction presumptively lessens competition would have a dramatic, cascading, and wide-ranging effect on the startup acquisition and related markets: fewer potential acquirers, leading to reduce sale prices, leading to less profitability for entrepreneurs and

[27] The agencies now propose that markets with a post-merger HHI greater than 1,800 are "highly concentrated," the 2010 Horizontal Merger Guidelines defined highly concentrated markets as those with an HHI above 2,500. Similarly, the agencies suggest that markets with an HHI between 1,000 and 1,800 are "concentrated markets," while the 2010 Guidelines asserted that markets with an HHI below 1,500 were "unconcentrated."

[28] Draft Merger Guidelines at 6 ("[A] merger that eliminates even a relatively small competitor creates undue risk that the merger may substantially lessen competition.").

lower returns for investors.[29] If the presumptions contemplated under Guideline 1 are irrebuttable, the effects would be even more dramatic.

The policy behind Guideline 1 overlooks the benefits to the economy from larger firms acquiring emerging startups. Integration of innovations from startups into a broader portfolio or platform tends to reduce costs, drive new features, and enable a more seamless customer experience by offering a fully integrated product or service offering.[30] Such transactions allow new ideas to scale rapidly and quickly bring innovations to wider audiences.[31]

By eliminating or reducing the number of larger firms from the pool of potential acquirers, Guideline 1 threatens to eliminate the very type of transaction that has made the U.S. startup ecosystem the most successful and desirable in the world, obliterate one of the major incentives for entrepreneurial risk in the first place, and drive the benefits of innovation and startup activity elsewhere.[32]

B. *Guideline 4's Condemnation of Acquisitions of "Potential Competitors" Ignores the Fact that Startups Must be Able to Sell Their Innovations to Established Firms After Establishing Commercial Viability.*

Guideline 4 suggests lowering the standard set by longstanding judicial precedent for considering the ability of the acquired firm to potentially enter a market.[33] Deviation from

[29] Daniel Sokol, *Vertical Mergers and Entrepreneurial Exit*, 70 Fla. L. Rev. 1357, 1362 (2018) ("Increased difficulty in the exit for founders and ventures capitalists makes investment in such ventures less likely, since the purpose of such investment is to reap the rewards of scaling a venture to exit.").

[30] *See* Emanuelson & Drory, *supra* note 8, at 15.

[31] *Id.*

[32] *See* The Global Startup Ecosystem Index Report 2023, StartupBlink, (available at https://www.startupblink.com/startup-ecosystem/united-states) ("Amidst constant change and periodic ups and downs in the economic and geo-political situation worldwide, one thing remains constant: the substantial global influence and dominance of the US startup ecosystem. When it comes to its startup environment, the US is still the land of opportunity, representing the world's most vibrant source of free and disruptive technological creativity.").

[33] The guideline only considers potential entrants in markets that are concentrated, defined as having an HHI over 1,000. Draft Merger Guidelines at 11 n.33.

established law in this area threatens to interject new uncertainty for merging parties under a theory of liability that, by definition, already requires a forward looking and often speculative assessment of the potential future impact on competition.

The draft guideline introduces a "reasonable probability" standard for consideration of potential future market entry of the acquired firm.[34] The probability of entry, according to the guideline, should be informed by objective evidence, such as a firm's "capabilities and incentives" for entry and that "subjective evidence that the company considered organic entry [to the market] … suggests that … entry would be reasonably probable."[35]

This standard would significantly low the existing one articulated by appellate courts, under which "clear proof that entry would occur" is "preferabl[e] … since the loss threatened by the acquisition is not of existing, but only of potential, competition" and that organic entry must "appear to have been certain." *United States v. Siemens Corp.*, 621 F.2d 499, 506-07 (2d Cir. 1980); *F.T.C. v. Atl. Richfield Co.*, 549 F.2d 289, 294 (4th Cir. 1977) (endorsing view that "when the sole alleged anticompetitive consequence of a merger is the loss of what would have been a new entrant, prohibition is appropriate only when the market is a tight oligopoly and *when entry by internal expansion would appear to have been certain*") (emphasis added).[36] Unilaterally lowering the bar for when firms could be considered potential future entrants threatens to swallow numerous companies in related but distinct markets, that, despite success in their current market,

[34] *Id.* at 11.

[35] *Id.* at 11-12.

[36] Two conditions must be met before a merger between potential competitors may be found to violate section 7: the potential competitors must have an "available feasible means" for entering the market; and (2) those means must "offer a substantial likelihood of ultimately producing deconcentration … or other significant procompetitive effects." *United States v. Marine Bancorp.*, 418 U.S. 602, 633 (1974).

lack the capability to enter. Further, the proposed standard ignores any considerations regarding the nature of the target market other than the market having an HHI greater than 1,000.

The standard also ignores the temporal limitation on potential entrance. *BOC Int'l, Ltd. v. F.T.C.*, 557 F.2d 24, 29 (2d Cir. 1977) ("[I]t seems necessary under Section 7 that the finding of probable entry at least contain some reasonable temporal estimate related to the near future, with 'near' defined in terms of the entry barriers and lead time necessary for entry in the particular industry, and that the finding be supported by substantial evidence in the record."); *see also United States v. Cont'l Can Co.*, 378 U.S. 441, 458, (1964) ("[T]he competition with which § 7 deals includes not only existing competition but that which is sufficiently probable and imminent."). Not only is the requirement that the contemplated entry occur in the near future logical, eliminating it poses a particularly harsh burden on startup acquisitions because, by their nature, startups are young, high-growth companies. It is not hard to imagine how a regulator could speculate, based on a small period of high growth, that a successful startup could potentially enter any number of markets if given unlimited time. That amounts to a standardless standard.

The Guideline similarly purports to lower the bar regarding perceived potential competition. To assess whether the acquisition may substantially lessen competition, the Antitrust Agencies would consider only "whether a current market participant could reasonably consider one of the merging companies to be a potential entrant."[37] The Supreme Court, however, has held that to meet the burden of substantially lessening competition by a future entrant, the potential entrant must have "in fact tempered oligopolistic behavior on the part of existing participants in the market." *United States v. Marine Bancorp.*, 418 U.S. 602, 625 (1974) ("[T]he Court has interpreted § 7 as encompassing … the probability that the [potential entrant] prompted premerger

[37] Draft Merger Guidelines at 14.

procompetitive effects within the target market by being perceived by the existing firms in that market as likely to enter de novo.”). In contrast, the new standard would only require that a hypothetical “reasonable” incumbent might conceive of a firm as a potential entrant rather than requiring actual market facts showing affirmative altered behavior in response to potential entry.

Rewriting the potential market entry theory of harm through the Draft Merger Guidelines not only undermines the legal authority of the Guidelines but is harmful to the VC economy. VC-backed companies experience a high failure rate and rarely experience linear growth. Experts in the field often struggle to pick winners and losers themselves, and loosening the standards with which the Agencies would consider future market entry is likely to lead to greater speculation and guesswork, resulting in fruitless and expensive investigations.[38] Because of the vast scope of evidence needed to credibly establish that future entry is possible or was considered (emails, board minutes, expert economic analysis, etc.), lowering the criteria for when the theory applies would create unnecessary uncertainty and burden a range of transacting firms, particularly high-growth startups.

C. *Guideline 9’s Condemnation of a “Series of Acquisitions” Chills Investments in Multiple Promising but Unproven Technologies.*

Guideline 9 likewise would create artificial barriers to startup acquisitions, elongating the timeline for liquidity, and increasing the regulatory and legal costs of an acquisition. The guideline supposes that a series of acquisitions can violate § 7 although no one transaction is a violation. While this theory was suggested as a cause for the rise of “dominant Internet platforms” in

[38] *See* Emanuelson & Drory, *supra* note 8, at 15 (“Given the inherently uncertain trajectory of nascent technologies, the challenge of proving [that the nascent competitor ‘probably’ would have emerged to substantially impact competition] may explain the lack of cases, despite the increased volume of calls to step up enforcement.”).

President Biden's 2021 executive order on competition,[39] it is not grounded in legal precedent. The only case cited for Guideline 9 is *Brown Shoe*, which noted the fact that concentration is often the result of "successive small acquisitions", not that the series of mergers itself would independently violate antitrust laws. *Brown Shoe Co. v. United States*, 370 U.S. 294, 334 (1962). Without a footing in antitrust law, Guideline 9 is at best an articulation of a policy position.

Further, the position reflected in Guideline 9 assumes that acquiring a series of smaller firms is inherently anticompetitive. As discussed in Section III, there are numerous benefits to the economy and to competition by allowing larger companies to rely on acquisitions for innovation.[40] Further, research indicates that the effect of startup acquisitions by large tech companies *increased* the VC resources available to startups, meaning that the pattern of acquisitions drove additional future innovation, not diminished it.[41] The Draft Merger Guidelines should not be used to expand antitrust laws beyond Congress's directive and judicial precedent, and by doing so raise the costs of lawful and beneficial transactions.

[39] Exec. Order on Promoting Competition in the American Economy (July 9, 2021) (available at https://www.whitehouse.gov/briefing-room/presidential-actions/2021/07/09/executive-order-on-promoting-competition-in-the-american-economy/).

[40] *See e.g.*, Dushnitsky & Sokol, *supra* note 2, at 281 ("[B]ecause it is likely easier to acquire a complementary asset rather than develop it, it can become easier for an acquiring firm to be more competitive vis-a-vis its competition."); Reilly, Sokol, & Toniatti, *supra* note 19, at 168 (2022) ("Exit through acquisition can create "multiplier" effects by stimulating further entrepreneurship and associated innovation. This creates further benefits for consumers within the same dynamic ecosystem, which, in turn, leads to societal benefits such as job creation, increased standard of living and overall economic growth.").

[41] Tiago Prado & Johannes Bauer, *Big Tech platform acquisitions of Start-Ups and Venture Capital Funding for Innovation*, 59 Information Economics and Policy, 15 (2022) ("Overall, we detected evidence of a positive, statistically significant increase in venture investment in the industry segments in which the acquired start-ups operate. During the ten-year period covered in our data, there are no, detectable, systematic negative effects on start-up funding. Thus, the empirical evidence suggests that, in a given industry segment, venture capital resources available to start-ups for innovation purposes increase after big-tech acquisitions.")

D. *Guideline 12's Condemnation of Partial Investments and Minority Interests Unduly Constrains the Transfer of Technology From the Inventor who Incubated It to the Established Firm Best Able to Commercialize it.*

While Guideline 12's discussion of how acquiring a partial or minority interest can violate antitrust laws is not new, its inclusion in the Draft Guidelines suggests a more aggressive approach to partial ownership transactions. Additionally, the guideline expands upon previous merger guidelines by suggesting that acquiring non-voting interests may "provide opportunities to prevent, delay, or discourage important competitive initiatives, or otherwise impact competitive decision making" and theorizing that partial ownership can facilitate communication of confidential competitively sensitive information between rivals.[42]

These additions go beyond the cited partial acquisition cases. For example, in *United States v. Dairy Farmers of America*, the Sixth Circuit found that minority interest acquirers would hold "at the very least, an indirect role" in influencing the target company before finding the transaction violated the Clayton Act. *United States v. Dairy Farmers of Am., Inc.*, 426 F.3d 850, 861 (6th Cir. 2005) (The minority acquisition "included a mechanism by which [the acquirer] exercised ***some control*** over the business activities of [the target], and resulted in its controlling an undue percentage of the relevant market as well as a significant increase in the concentration of firms in that market."). As the decision recognizes, without a mechanism or means to influence the company, scrutiny of minority interests would be unbounded. The language of Guideline 12 appears to suggest that simply the identity of the minority interest holder could create a violation. Under established law, however, much more is required.

Extending regulatory scrutiny into minority, non-voting shares not only threatens to significantly increase the burden on transacting parties but may eliminate the benefits of the

[42] Draft Merger Guidelines at 27.

"investment only" exception in the Clayton Act. 15 U.S.C. § 18. The investment-only exception provides a safe harbor for many transactions, reducing the risk and costs associated with minority transactions by saying that § 7 does not apply to minority investments that do not allow the acquiring party to use the acquisition to influence the firm. If even minority, nonvoting interest transactions could raise investigation concerns, transacting parties would lose the protection provided by the investment-only exception.

This would harm the growing practice of Corporate Venture Capital ("CVC"). Since CVC investments involve minority investments from established companies, they naturally target companies in at least tangentially related fields. It is easy to foresee a scenario where simply the identity of the corporate minority interest holder alone could be used as a justification to trigger an investigation under the guideline, when clearly more is required under established legal doctrine and precedent.

V. THE DRAFT MERGER GUIDELINES WOULD HARM THE U.S. ECONOMY.

If finalized, the expanded scope of scrutiny described in the Draft Merger Guidelines that extends beyond established antitrust laws would damage the US economy. The harm would not be limited to VC or to startups, and likely would affect many aspects of the economy. With such high stakes, we strongly caution the Antitrust Agencies from unilaterally expanding their mandate and imposing significant costs on lawful transactions.

The first area where we would expect to see harm from the Draft Merger Guidelines' overreach is in the VC economy itself.[43] Because the guidelines would make liquidation through acquisition more risky and costly, investors would turn to alternative investments. While the

[43] Phillips & Zhdanov, *supra* note 11, at 34 (showing that "stricter competition laws are associated with less VC activity while the passage of a pro-takeover law in a country is associated with more subsequent VC deals in that country").

Guidelines themselves do not change established antitrust law, their expansion beyond establish precedent would, at a minimum, have a general chilling effect on M&A activity which, as discussed above, would reduce incentives for both entrepreneurs and VCs alike.

Limitations on M&A exit opportunities would disproportionally impact startups in emerging geographical startup centers. In recent years, startup and venture capital activity has seen impressive growth outside of traditional startup centers, spreading entrepreneurial activity into new pockets of the economy and the country.[44] But because companies in some regions tend not to grow large enough to enter public markets, they are likely to disproportionately feel the effects of a reduction in M&A activity. What would be left are the established startup hubs where funding is more plentiful and supporting resources are common, while emerging tech and startup communities are left behind.

And if startup acquisition becomes more costly and impractical for larger incumbents, they are likely to return to less effective and less efficient in-house R&D. Instead of allowing open M&A markets to drive winners and losers in the innovation economy, incumbents would create "walled innovation gardens" where the incumbent has control over the emerging innovations as they mature.[45] Eliminating the efficiencies of the venture-backed startup ecosystem would harm

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[44] Ian Hathaway, *America's Rising Startup Communities*, Center for American Entrepreneurship (2018) (available at http://www.startupsusa.org/americas-rising-startup-communities/#author) (Finding that cities including Boulder, Dever, Durham-Chapel Hill, Madison, Pittsburgh, Columbus, Ann Arbor, and Indianapolis, among others are experiencing an increase in VC financing and that "of the 347 metros analyzed, 133 metros (or 38 percent) had more [venture capital] activity in 2016-17 than in 2009-10.").

[45] Dushnitsky & Sokol, *supra* note 2, at 286 ("One concern is that such an approach effectively creates these walled gardens where only pre-selected startups can reach and win incumbents' attention. This runs the risk of stifling innovation (for incumbents) and can also impact scale-up opportunities (for startups) and compensation and longevity of the VC funds that backed them. For incumbents, the risk is that they draw from a limited pool of innovators and, therefore, may miss out on other or better innovations beyond the focal pool. For entrepreneurs, it implies that many would be unable to scale or sell their companies, especially if the trade-sale route is blocked.").

customers as incumbents would inherently be less inclined to innovate and may kill new technologies or features rather than introduce them to markets.

VI. CONCLUSION.

The Draft Merger Guidelines risk destroying the symbiotic relationship between the startup community and more established firms. This will necessarily chill investment in venture capital-backed startups that have been a main driver of innovation in the U.S. economy over the last several decades. The NVCA, therefore, respectfully requests that the Draft Merger Guidelines be revised to mitigate the dangers they pose to this nation's economy.

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Respectfully submitted,

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