

COVID-19 Merger Moratorium Could Hamper Vital Innovation

By **Stephanie Demperio, Tanisha James, Gabriella Monahova and Emily Walden** (May 15, 2020)

Recently, Sen. Elizabeth Warren, D-Mass., and Rep. Alexandria Ocasio-Cortez, D-N.Y., introduced legislation titled the Pandemic Anti-Monopoly Act,[1] which would temporarily prohibit a significant number of mergers and acquisitions during the COVID-19 pandemic.[2]

The authors of the proposed act expressed concern that small business are "potential targets of large corporations seeking to increase their power through predatory mergers." [3] According to Warren, one aim of the legislation is "to protect workers, entrepreneurs, small businesses, and families from being squeezed even more by harmful mergers during this crisis and any future national emergency."

Ocasio-Cortez further explained that

if we don't stop predatory M&As now, the actions of big corporations will have decades-long economic consequences — for all of us. With less competition, the whole country will see job loss and higher costs for consumers.

Specifically, the proposed act would impose a moratorium on all mergers currently reportable under the Hart-Scott-Rodino Act, including and in addition to:

- Deals between companies with over \$100 million in revenue or financial institutions with market capitalization above \$100 million;
- Deals involving private equity firms, hedge funds or their majority-owned companies; and
- Deals involving companies "with an exclusive patent that impacts the crisis."

The proposal also directs the Federal Trade Commission to create rules establishing a legal presumption against "mergers and acquisition that pose a risk to the government's ability to respond to a national emergency" and would remain in place "until the Federal Trade Commission ... unanimously determines that small businesses, workers and consumers are no longer under severe financial distress."

While the proposed act may be well-intentioned, such a broad ban on M&A activity could



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stifle firms' ability to grow or merely stay afloat in these uncertain times. It may also have a chilling effect on innovations that could be crucial for our ability to navigate and eventually overcome this health and economic crisis, as well as adapt to the post-pandemic world, thereby harming the very businesses, workers, and consumers it aims to protect.

The agencies and existing merger review laws are sufficiently robust and flexible to handle required M&A analysis, even during a pandemic.

The goal of U.S. antitrust law is to protect competition and consumer welfare. Mergers and acquisitions are not prohibited or presumed unlawful under existing law because of a long-standing acknowledgment that mergers may offer substantial benefits to firms and consumers, including synergies that lead to cost savings and innovation. Antitrust law requires firms to report mergers and acquisitions that meet certain baseline criteria to the antitrust agencies^[4] for review.

Using the existing, well-established framework, the agencies weigh the costs and benefits of a proposed transaction and assess whether harm to competition (and, thus, consumers) is likely to occur.^[5] After that assessment, the antitrust agencies either approve the transaction or are specifically mandated to challenge it if they determine the transaction would substantially reduce competition in a way that has the potential to result in higher prices, reduced output, fewer choices or decreased innovation.

The authors of the proposed act claim that a ban is necessary because the "antitrust agencies have already admitted their capacity to review mergers is reduced by the crisis."^[6] This claim ignores the fact that even if their capacity was affected immediately after the stay-at-home orders were enacted, the agencies moved swiftly and efficiently to ensure minimal disruption to the merger review process.^[7]

More importantly, the agencies have reported a decrease in their merger review burden, suggesting that they have adequate resources to continue vetting transactions.^[8] In fact, the agencies have publicly stated that the pandemic will not lead to a relaxation of the current merger review process or antitrust enforcement in general.^[9] They have kept that promise by continuing to thoroughly review transactions and announcing increased COVID-related enforcement where needed.^[10]

The proposed act assumes that a broad moratorium is necessary to prevent small businesses from being acquired by larger firms, as such acquisitions would hurt small businesses, increase job losses and reduce competition. However, the proposal's authors appear to view every acquisition of a small firm by a larger one as a predatory merger without considering the benefits that such mergers may provide to firms and consumers.

Limiting mergers based on company size, ownership type and the product(s) involved rather than on the potential competitive effects ignores the existing merger review framework, which is designed to protect consumers from merger-related harms while allowing them to reap the benefits.

Indeed, it is easy to come up with food purchase and delivery examples — such as the acquisition of Whole Foods Market Inc. by Amazon.com Inc. or that of Shipt by Target Corp. — that involve very large companies, but have benefitted consumers, especially during this pandemic. If such deals do not involve any competitive overlaps and do not give rise to foreclosure or other vertical concerns, there would likely be no harm to competition and consumers, but there could be tangible benefits.

The proposed act also imposes a moratorium on mergers involving "companies with an exclusive patent that impacts the crisis, like personal protective equipment." To the extent that the authors of the proposed act are concerned about a reduction in supply, a decline in quality, a disincentive toward innovation or an increase in price as a result of a merger, the standard merger review framework addresses these concerns without requiring the antitrust agencies to determine which patents may or may not impact the crisis — an ambiguous criterion.

The agencies commonly assess patent portfolios as part of their review of life sciences and high-tech mergers, among others, to determine whether the merger would harm competition. If there are warranted concerns, the agencies can require remedies, including divestiture, licensing and more. Because the agencies are already well-equipped to handle such rigorous analyses, a broad moratorium is not necessary to protect consumers.

In addition, the proposed act extends the ban on M&A activity beyond the transactions that would otherwise be reported and reviewed by the agencies. As noted, reporting requirements under existing antitrust law are designed to screen out mergers for which the cost of merger review likely outweighs any potential harm to competition. While nonreportable transactions are not immune to antitrust challenges by the agencies, they are less likely to harm consumers and typically proceed without review.

A ban on these transactions (i.e., transactions that the existing framework has determined are unlikely to result in harm to competition) would delay and potentially deprive consumers of the benefits of these transactions while offering little countervailing protection.

A merger ban removes a source of funding and growth for firms, which may harm innovation during a time when innovation is critically important.

The proposed moratorium would temporarily halt mergers and acquisitions that are necessary sustenance for certain firms and an important funding mechanism for innovation. During a period when cooperation and creativity across sectors is especially important, to the proposed act may unintentionally hamper innovation.

Now more than ever, we are looking for breakthroughs in drug and vaccine development and technological innovations to help treat patients^[11] and increase the ability to test^[12] and trace infected people so that economies can reopen safely. We are also in need of innovations that will help employers and employees maintain or create jobs that have suddenly become relevant in a socially distanced world. That is, we need creative ideas and the investors willing to back them.

While the proposed act aims to protect small business and consumers, it fails to factor in the important benefits innovation provides to those very businesses and consumers, as well as the fact that access to capital is the lifeblood of growth and innovation — a relationship in which acquisition often plays a key role. The reality is that most startups and new technologies do not succeed. And most investors go many years without realizing any returns on investment, if they ever do.

Given these risks, investors are willing to part with their funds only if they can reasonably expect future returns on those investments. If acquisitions are removed as an exit option for some firms, investors may be less willing to back startups. This would make entrepreneurs less inclined and able to develop new ideas and launch new businesses.

Without entrepreneurs and the investors to back them, we would not have firms such

as Airbnb Inc., TOMS, Netflix Inc., Impossible Foods Co. and countless others. Looking forward, without acquisition as an exit option, ideas for new and unique products or services that have become relevant as a result of the pandemic may never see the light of day.

Eliminating M&A activity could also impede existing firms' ability to grow and innovate under uncertain and rapidly changing conditions. Even for firms that are able to secure initial funding and launch an innovative product, being acquired can greatly increase the speed of the product's development and distribution and provide funding and expertise to build on the initial innovation to the benefit of consumers.[13]

While they may be brimming with bold new ideas to increase output and broaden consumer reach, for many small- and medium-sized firms, acquisitions are the best way to get that immediate infusion of cash, resources, platform, expertise and access to consumers necessary to reach the next level. Removing this critical ability for firms to combine is short-sighted.

Given current economic conditions, the importance of growth, or simply survival, through M&A cannot be overstated. Under ordinary circumstances, firms have multiple avenues to obtain funding, and thereby growth, including loans, initial public offerings and acquisition by a larger company. In the current climate, debt financing may not be a viable source of capital, and IPOs have become less desirable given the recent market downturn and volatility.[14]

Many startups and other private companies are struggling: Away, a luggage startup, ClassPass Inc., a fitness company, and ezCater, a corporate catering startup, and many others have cut jobs due to pandemic-related restrictions and closures.[15] Eliminating the prospect for acquisition further limits firms' options to remain viable and may well lead some firms to exit the market, resulting in job losses and fewer options for consumers — the exact opposite of the proposed act's stated goal.

Conclusion

In short, the need for a broad ban on mergers should be carefully considered. The proposed act rightfully highlights the important roles that M&A and competition play, particularly during a global crisis, and laudably aims to protect small businesses, employees and consumers.

However, it insufficiently credits the analytical flexibility inherent in merger review analysis, its durability,[16] and the resiliency of the agencies tasked with its enforcement. It has the potential to do more harm than good by ignoring one of the key benefits that can result from mergers — innovation — and the financing needed to ensure that it occurs.

Furthermore, the vague terms and timing of the proposed ban exacerbate the potential harms as firms will face additional uncertainty.[17] In a time of widespread uncertainty, the proposal is misguided and may ultimately harm the small businesses, workers and consumers it aims to protect.

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[1] "Warren, Ocasio-Cortez to Introduce Pandemic Anti-Monopoly Act," Press Release, 28 April 2020, available at <https://www.warren.senate.gov/newsroom/press-releases/warren-ocasio-cortez-to-introduce-pandemic-anti-monopoly-actread-one-pager-here>.

[2] In addition, House Antitrust Subcommittee Chairman David Cicilline (D-RI) has also recently called for similar restrictions. See Lauren Feiner, "House antitrust chairman says most mergers should be banned during the pandemic," CNBC, 23 April 2020, available at <https://www.cnbc.com/2020/04/23/house-antitrust-chairman-wants-most-mergers-banned-during-the-pandemic.html>. And, last week, more than two dozen liberal and progressive groups urged Congress' top two Democratic leaders to pass the planned bill. See McCord Pagan, "Liberal Groups Support Bill Banning Most M&As During Crisis," Law360, 8 May 2020, available at <https://www.law360.com/mergersacquisitions/articles/1271759/liberal-groups-support-bill-banning-most-m-as-during-crisis?copied=1>.

[3] <https://www.warren.senate.gov/imo/media/doc/Merger%20Moratorium%20One%20Pager.pdf>.

[4] In the United States, the US Department of Justice and the Federal Trade Commission have concurrent federal jurisdiction to conduct merger review.

[5] Many of the deals covered by the proposed legislation would already be reviewed under the current merger review process. For example, the \$100 million revenue threshold proposed in the legislation is above the current \$94 million size of transaction threshold, which is adjusted annually. See "HRS threshold adjustments and reportability for 2020," FTC, 31 January 2020, available at <https://www.ftc.gov/news-events/blogs/competition-matters/2020/01/hsr-threshold-adjustments-reportability-2020>.

[6] "Warren, Ocasio-Cortez to Introduce Pandemic Anti-Monopoly Act," Press Release, 28 April 2020, available at <https://www.warren.senate.gov/newsroom/press-releases/warren-ocasio-cortez-to-introduce-pandemic-anti-monopoly-actread-one-pager-here>.

[7] "Will COVID-19 Impact Antitrust Review of M&A Deals + How Can Parties Minimize Disruption?" Cooley, 23 March 2020, available at <https://www.cooley.com/news/insight/2020/2020-03-23-will-covid19-impact-antitrust-review-of-ma-deals>.

[8] FTC Commissioner Noah Phillips stated that "the [premerger notification office] estimates nearly 60% reduction in HSR reported transactions [in April], compared to the historical average." See Noah Phillips, "Let's (NOT) Stop All the Mergers: The Case for Letting the Agencies Do Their Jobs," Truth on the Market, 5 May 2020, available at <https://truthonthemarket.com/2020/05/05/lets-not-stop-all-the-mergers-the-case-for-letting-the-agencies-do-their-jobs/>. Commissioner Phillips also noted that such a decline in merger activity is consistent with prior economic downturns, stating, "During fiscal year 2009, the height of the crisis, HSR reported transactions were down nearly 70% compared to just two years earlier, in fiscal year 2007." See McCord Pagan, "Liberal Groups Support

Bill Banning Most M&As During Crisis," Law360, 8 May 2020.

[9] Bryan Koenig, "'No Relaxation' Under COVID-19, FTC Antitrust Chief Says," Law360, 20 April 2020, available at <https://www.law360.com/articles/1265571?scroll=1&related=1>; <https://www.justice.gov/opa/pr/justice-department-cautions-business-community-against-violating-antitrust-laws-manufacturing>; "COVID-19: Antitrust Implications of Dynamic Pricing, Online Third-Party Seller Platforms and Price Gouging," Cooley, 30 March 2020, available at <https://www.cooley.com/news/insight/2020/2020-03-30-covid-19-antitrust-implications-of-dynamic-pricing-online-third-party-seller-platforms>.

[10] "Cengage and McGraw-Hill Terminate Merger Agreement in Response to Antitrust Concerns," DOJ, Press Release, 4 May 2020, available at <https://www.justice.gov/opa/pr/cengage-and-mcgraw-hill-terminate-merger-agreement-response-antitrust-concerns>.

[11] Steve Lohr, "New York Needs Ventilators. So They Developed One in a Month," The New York Times, 20 April 2020, available at <https://www.nytimes.com/2020/04/20/technology/new-york-ventilators-coronavirus.html?searchResultPosition=8>.

[12] "Mesa Biotech Receives Emergency Use Authorization from FDA for a 30 Minute Point of Care Molecular COVID-19 Test," Mesa Biotech, Press Release, 24 March 2020, available at <https://www.mesabiotech.com/news/euacoronavirus>.

[13] "Competition in Digital Technology Markets: Examining Acquisitions of Nascent or Potential Competitors by Digital Platforms," Prepared Statement, 24 September 2019, available at <https://www.judiciary.senate.gov/download/yun-testimony>.

[14] See, for example, Airbnb's decision to seek funding from private equity firms rather than issue an IPO as planned: Ariel Shapiro, "With IPO Plans Looking Shaky, Airbnb Raises \$1 Billion In Funding," Forbes, 6 April 2020, available at <https://www.forbes.com/sites/arielshapiro/2020/04/06/with-ipo-plans-looking-shaky-airbnb-raises-1-billion-in-funding/#661a43c44c0e>.

[15] Kevin Dowd, "9 big things: Lost jobs litter the startup landscape," Pitchbook, 12 April, 2020, <https://pitchbook.com/news/articles/9-big-things-lost-jobs-litter-the-startup-landscape>).

[16] Ian Conner, "Antitrust review at the FTC: staying the course during uncertain times," FTC, 6 April 2020, available at <https://www.ftc.gov/news-events/blogs/competition-matters/2020/04/antitrust-review-ftc-staying-course-during-uncertain>.

[17] The moratorium in the proposed Act would be in place "until the Federal Trade Commission (FTC) unanimously determines that small businesses, workers, and consumers are no longer under severe financial distress," which is vague and not further defined in the Act. Uncertainty regarding the duration of the policy would also likely harm businesses and chill innovation as firms and investors would not be able to effectively plan under such an indefinite term.