The Long and Successful History of Nascent Acquisitions Suggests Caution in Rethinking Antitrust Enforcement

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Abstract

Policymakers and antitrust enforcers are debating whether to increase scrutiny of "nascent" acquisitions, in which an established company purchases a smaller firm in a related market, out of a concern that such acquisitions may stifle competition by nipping in the bud a potential rival. Despite such concerns, America's corporate history teaches that these types of acquisitions have served the interests of both competition and consumers. In their early years, many iconic companies in critical industries grew in part through acquisitions of smaller firms. In many cases, nascent purchases provided critical financing that allowed smaller firms to survive and innovate, and helped larger companies bring new products to more consumers, more cheaply, and more quickly via their existing distribution chains and marketing expertise. The empirical economic analysis confirms that vertical acquisitions usually lead to lower prices and greater innovation. Accordingly, policymakers should exercise restraint before they discourage such acquisitions, whether through rules changes or through lawsuits that seek to unwind such purchases years later.

I. Introduction

Everyone knows that America was built, in part, on acquisitions. From the Louisiana Purchase to the Gadsden Purchase to Alaska, territorial acquisitions helped the country and its inhabitants grow and prosper. Less acknowledged, however, is the role that acquisitions have played in America's corporate history. Since the inception of modern corporations more than a century ago, acquisitions helped fuel the early growth of many of our most iconic companies in our most critical industries. Boeing, General Motors, Caterpillar, and many others all purchased smaller companies, including potential rivals, in ways that ultimately helped the companies, their customers, and the interests of competition.

This history should inform the current debate over corporate acquisitions of potential, "nascent" competitors, and whether to subject such deals to more antitrust scrutiny in order to prevent anticompetitive harm in its "incipiency." The original "incipiency" doctrine focused on blocking horizontal mergers that marginally increased concentration in a particular industry; its goal was to forestall a wave of mergers.[2] Today, the general concern is that an established company might suppress competition by purchasing a smaller

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[2] *See* Robert H. Lande, *Resurrecting Incipiency: From Von's Grocery to Consumer Choice*, 68 ANTITRUST L.J. 875, 876 (2000).

company in a related market, thereby nipping in the bud a potential rival. Public reports suggest that the antitrust agencies are investigating some such purchases for anticompetitive effects, with a view toward possibly unwinding the transactions years after the fact.[3]

Despite such concerns, America's corporate history teaches that these types of acquisitions have served the interests of both competition and consumers. In many cases, "nascent" purchases provided small companies with critical financing that allowed them to survive and innovate. In other cases, acquisitions helped larger companies develop new products and bring those products to more consumers, more cheaply, and more quickly via their existing distribution chains and marketing expertise. The empirical economic analysis also supports this narrative. Most nascent acquisitions are "vertical" transactions: mergers of firms at different levels of the distribution chain, such as when an oil refiner purchases an oil exploration company, or when AT&T, a communications company, purchased Time Warner, a media and entertainment company, in part to benefit its subsidiary DirecTV. The evidence shows that such acquisitions usually lead to lower prices and greater innovation.

Accordingly, policymakers should exercise restraint before they discourage such acquisitions, whether through rules changes or through lawsuits that seek to unwind such purchases years later. Of course, this is not to say that such an acquisition can *never* harm competition, or should never receive scrutiny after the fact. History, however, shows that such acquisitions often lead to benefits that policymakers can scarcely imagine at the time. If yesterday's antitrust enforcers had adopted some of today's more aggressive proposals, America's economic history could have looked very different — and less robust.

II. For More than a Century, Companies Have Used Acquisitions to Develop New Products and Reach New Consumers

In preparing this paper, the authors looked for "nascent" purchase examples in industries that have existed for many years. In automobiles, agriculture, and aviation, leading companies can trace their lineage back a century or more and thus provide good fodder for review (plus, both authors' first names start with the letter "A", so there really was no need to look to, say, the boating or construction industries). No doubt there are other examples with different companies in different industries, in which one could argue that nascent purchases arguably harmed competition. Such examples would not, however, undermine this paper's central theses: (i) that nascent purchases can enhance competition and benefit

[3] For a discussion of some of these proposals and the history of the antitrust laws, *see* Richard Steuer, *Incipiency*, 31 LOYOLA CONSUMER L. REV. 155 (2019).

consumers, (ii) that there is no reason to adopt a presumption against such acquisitions, and (iii) that the inherent limits of counterfactual constructs prevent antitrust enforcers from having any meaningful ability to determine whether a particular acquisition in the distant past helped or harmed competition.

A. Automobiles

In 1908, Fred, Charles, and Albert Fisher started the Fisher Body Company in Detroit.[4] From the beginning, Fisher Body was a family company.[5] In order to appeal to women and families, the brothers designed an auto body that was entirely enclosed, protecting passengers from the world outside (perhaps men in the early twentieth century were relatively less concerned about having their children thrown from a moving car?).[6] This insight helped the company prosper, and, by 1913, Fisher Body produced nearly 100,000 auto bodies per year.[7] By 1918, Fisher Body sold to most major automobile manufacturers as well as to the U.S. military, which purchased more than 2,000 airplanes during World War I.[8]

Although Fisher Body sold to all the major auto companies, it developed a particularly close relationship with General Motors. In 1917, General Motors contracted with Fisher Body "to purchase substantially all their output at cost, plus 17.6 per cent."[9] As General Motors continued to grow, it became concerned about its future supply of auto bodies.[10] In 1919, General Motors purchased sixty percent of Fisher Body, given "the absolute necessity of having an assured control over General Motors' largest and most critical supplier . . . [which] [t]hey simply could not afford to have . . . fail to renew their contract . . . ."[11] By 1926, General Motors had grown "anxious to acquire the 40 percent of the stock of Fisher Body that it did not own." The firm's anxiety flowed from a "desire to bring the Fisher brothers even more closely into the General Motors organization" and "concern[] that the minority holding . . . might fall into other hands with whom it might be difficult to deal."[12] General Motors

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[4] *Fisher Body Company*, OHIO HISTORY CENTRAL (last visited Nov. 5, 2020), http://ohiohistorycentral.org/w/Fisher_Body_Company.

[5] John K. Teahen Jr., *'Body by Fisher': A family affair*, AUTOMOTIVE NEWS (Sept. 14, 2008), https://www.autonews.com/article/20080914/OEM02/309149960/body-by-fisher-a-family-affair.

[6] *See* Fisher Body Company, *supra* note 4.

[7] *See id*.

[8] *See id*.

[9] R. H. Coase, *The Acquisition of Fisher Body By General Motors*, 43 J. L. & ECON. 15, 20 (2000).

[10] *Id.* at 21.

[11] *Id*.

[12] *Id.* at 25.

acquired the remaining two-fifths of Fisher,[13] but even after the purchase, until the 1990s, General Motor's auto bodies continued to feature an insignia that read: "Body by Fisher."[14]

This acquisition is one of the most famous vertical integrations in American history. Ronald Coase, who won the Nobel Prize for his work on how transactions costs shape industrial organization,[15] named a paper after Fisher.[16] Coase based his analysis on his 1932 tour of General Motors's factory to study "'lateral and vertical integration' in industry."[17] Coase's insights presage today's debates around mergers and competition.

Coase concluded that an "asset specificity problem" led General Motors to purchase Fisher Body.[18] In general, such problems arise when a firm's manufacturing process becomes so specialized that changing or redeploying that process would be extremely risky or costly. Coase recalled that "the reason for the acquisition of Fisher Body was to make sure that the body plants were located near the General Motors assembly plants."[19]

Although asset specificity problems are "normally best handled by a long-term contract rather than by vertical integration[,]" long-term contracts open the door to "opportunistic behavior" by a party seeking to take advantage of changed circumstances during the contract term.[20] Fortunately, "'the propensity for opportunistic behavior is usually effectively checked by the need to take account of the effect of the firm's actions on future business.'"[21] Thus, long-term contracts are not always a sustainable option for specialized businesses, and vertical integration provides an effective and efficient means to resolve an asset specificity problem.

In *The Nature of the Firm*, Coase observed that the size and shape of a firm are determined by a series of decisions in which managers compare the costs and benefits of internal versus external provision.[22] If the manager of an automobile maker predicts a better payoff from

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[13] Fisher Body Company, *supra* note 4.

[14] Teahen, *supra* note 5.

[15] Press Release, The Nobel Prize, The Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel 1991 (Oct. 15, 1991), available at https://www.nobelprize.org/prizes/economic-sciences/1991/press-release/.

[16] Coase, *supra* note 9.

[17] *Id.* at 16.

[18] *See id.* at 30.

[19] *Id.* at 18.

[20] *See id.* at 30.

[21] *Id* (quoting R. H. Coase, *The Nature of the Firm: Origin, Meaning, Influence*, 4 J. L. ECON. & ORG. 3 (1988)).

[22] *See generally* R. H. Coase, *The Nature of the Firm: Origin, Meaning, Influence*, 4 J. L. ECON. & ORG. 3 (1988).

self-production of windshield wiper blades, it will produce them. By contrast, if independent manufacturers of blades provide advantages sufficient to offset the costs of using the market, the automaker will purchase them.[23]

For smaller companies, the possibility of being acquired and integrated into a larger business provides incentive and downside protection for specializing their manufacturing process to meet the specific needs of buyers. Rather than focusing on the costs and risks of specializing their assets, small companies can look forward to the possibility of large rewards in the future. Further, suppliers must out-compete and out-specialize each other to attract the business and attention of larger manufactures, thus fostering competition. On the other hand, vertical integration allows large companies to streamline their business model and reduce costs, generating value for customers and shareholders. For companies large and small, and for both buyers and suppliers, vertical integration is a logical solution to the problem of asset specificity — and solves problems that cannot be solved entirely through contracts. Thus, market participants can and should determine whether to meet their needs through contracts or acquisitions.

B. Aviation

The early days of aviation also reveal numerous "nascent" purchases. Boeing is now the nation's largest airplane manufacturer and, current travails notwithstanding, a global leader in the aerospace industry. Its early days were fueled by acquisitions. For example, in 1926, a bus operator founded Pacific Air Transport to carry mail, as well as passengers, between Seattle and Los Angeles.[24] The airline struggled for two years, with thin profits and the loss of several aircraft.[25] In 1928, Boeing Air Transport acquired seventy-three percent of Pacific Air Transport's stock.[26] Boeing immediately upgraded Pacific Air's operations by supplying it with six more reliable airplanes.[27]

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[23] *See* Herbert Hovenkamp, *Antitrust and the Design of Production*, 103 CORNELL L. REV. 1155 (2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3013122.

[24] *See Pacific Air Transport (PAT): United States (1926-1928)*, WORLD HISTORY (Nov. 7, 2017), https://www.worldhistory.biz/contemporary-history/78597-pacific-air-transport-pat-united-states-1926-1928.html; *Pacific Air Transport*, AIRLINE TIMETABLE IMAGES (Feb. 6, 2016), https://www.timetableimages.com/ttimages/pat.htm.

[25] *See* Pacific Air Transport (PAT), *supra* note 24.

[26] *Boeing History Chronology*, Boeing (2020), https://www.boeing.com/resources/boeingdotcom/history/pdf/Boeing_Chronology.pdf ("Jan. 1 Boeing Air Transport acquires 73 percent of Pacific Air Transport's stock and runs an airline up and down the West Coast.").

[27] *See* Ed Betts, *Maddux Air Lines 1927-1929*, 42 Am. Aviation Hist. Soc'y J. 82 (1997).

The purchase kept Pacific Air in business — and expanded output for airplanes, mail delivery, and passengers. Within two years of the acquisition, the company had roughly tripled its number of passengers and volume of mail, from 1,252 passengers and 76,237 pounds of mail in 1927, to 3,279 passengers and 254,457 pounds in 1929.[28] Moreover, the acquisition ensured Pacific Air's survival. As part of the sale, "all of the employees of his financially strapped airline will keep their jobs and the stockholders will be protected."[29] Had Boeing not purchased Pacific Air, or had contemporary antitrust officials blocked the sale, it is entirely possible that another company would have purchased it. Pacific Air was later acquired by United Air Lines.[30] We do not know (and cannot know), however, if some other purchaser would have been able to expand output in the same manner as Boeing. We do know that Boeing's purchase of Pacific Air, arguably a "nascent" competitor, helped consumers and expanded output.

Other airline acquisitions improved innovation. In 1930, for instance, North American Aviation purchased another airplane manufacturer, Berliner-Joyce Aircraft, and saved its assets and intellectual property from extinction.[31] A few years later, the combined company produced key fighters for the military during World War II, including the Mustang and the plane that completed the successful Doolittle Raid over Japan.[32] North American Aviation itself was later acquired by General Motors and Rockwell.[33]

C. Agriculture

Mergers and acquisitions also benefited consumers in the agricultural industry. Today, Deere & Company is the world's largest manufacturer of agricultural equipment. In the early twentieth century, Deere was just a farm equipment company, one that sold planters, buggies, wagons, grain drills, and hay and harvesting equipment.[34] Deere did not, however,

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[28] Pacific Air Transport (PAT), *supra* note 24.

[29] *Id*.

[30] *Id*.

[31] *See Berliner-Joyce Board Accepts Offer Here; Baltimore Aircraft Company to Be Taken Over By North American Aviation*, EVENING SUN, June 11, 1930, at 42, available at https://www.nytimes.com/1930/06/12/archives/berlinerjoyce-board-accepts-offer-here-baltimore-aircraft-company.html.

[32] *See* Mike Lombardi & Erik Simonsen, *The high and the mighty*, BOEING FRONTIERS (Dec. 2009–Jan. 2010), https://www.boeing.com/news/frontiers/archive/2009/december/ts_sf02.pdf.

[33] *North American Aviation*, AIRCRAFT IN FOCUS (2020), http://aircraft-in-focus.com/north-american-aviation/; *ROCKWELL*, GLOBALSECURITY.ORG (last visited Nov. 5, 2020), https://www.globalsecurity.org/military/industry/rockwell.htm.

[34] *See John Deere History: A Timeline of How we Got Here*, MACHINEFINDER (Feb. 18, 2019), https://blog.machinefinder.com/29921/john-deere-history.

sell tractors. Deere failed repeatedly to design a competitive model. The company had developed one, two, and four-cylinder concept tractors. Some ran on gas, some on kerosene. Some had all-wheel drive and auto steer, some had front wheel drive. All flopped in the marketplace.[35]

To satisfy its customer base, Deere needed to sell tractors. In 1918, Deere purchased the Waterloo Gasoline Engine Company, whose predecessor has developed the first successful gasoline tractor and whose "Waterloo Boy" tractor performed well in field tests.[36] The company committed to the new tractor: "It is our intention … to sell the Waterloo Boy Tractor through our established John Deere dealers and thereby strengthen the prestige of the John Deere line with our dealers and thus increase our trade on the John Deere line, and the power machinery in particular."[37] Over the next year, Deere devoted more than one-third of its advertising budget to touting the tractor.[38]

The bet paid off — to the benefit of Deere and its customers. In its first year, Deere's existing distribution network allowed it to increase its sales from zero to 5,634 tractors[39]. Although exact data is not readily available, in the previous four years (from 1914-1918), Waterloo Gasoline sold about 8,000 tractors total.[40] Deere sold these tractors for five years, until 1923, when the combined company developed a new model. The rest, as they say, is history, and over time Deere's green tractors and leaping deer became icons around the globe.[41]

Caterpillar, another global agricultural leader, illustrates how acquisitions can advance innovation and provide companies with critical financing. During World War I, Holt Caterpillar Company sold tractors to the government.[42] Those sales helped Holt Caterpillar's bottom line during the war, but at the cost of reducing the company's investment in new technologies. Competitors, like C.L. Best, captured the domestic tractor market with new and

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[35] *See generally* Bill Cawthon, *From Waterloo to the world*, PROMOTEX (Feb. 1, 2006), http://www.promotex.ca/articles/cawthon/2006/2006-02-01_article.html.

[36] *See* John Deere History, *supra* note 34; *Waterloo Boy Tractor Proves to Be Right Fit for Deere*, JOHN DEERE (Nov. 15, 2017), https://johndeerejournal.com/2017/11/waterloo-boy-tractor-proves-to-be-right-fit-for-deere/.

[37] Waterloo Boy Tractor, *supra* note 36.

[38] *Id*.

[39] *See* John Deere History, *supra* note 34.

[40] *See* Cawthon, *supra* note 35.

[41] *See id*.

[42] *#6 World War I Changed the California Tractor Industry*, CALIFORNIA AGRICULTURE MUSEUM (last visited Nov. 6, 2020), https://www.californiaagmuseum.org/impacts-of-wwi-on-the-tractor-industry; *The Merger of Holt & Best*, CATERPILLAR (last visited Nov. 6, 2020), https://www.caterpillar.com/en/company/history/history-timeline/merger.html.

innovative designs.[43] After the war, both companies struggled, in part because a surplus of machines depressed the market for new tractors.[44]

In 1925, the two companies merged to form the Caterpillar Tractor Company. Best had the domestic market, an advanced dealer network, and an expanded product line, while Holt had a worldwide reputation, the "Caterpillar" name, and modern manufacturing facilities. The merger provided the combined company with the funds to survive and the technological resources to develop new products.[45]

As a result of the combination, Caterpillar invested heavily in diesel tractors, which promised to provide customers with more economical horsepower.[46] Diesel engines generated massive low-end torque and consumed roughly half the fuel of gas tractors. In 1931, Caterpillar began producing its first diesel tractor model, and by the mid-1930s, Caterpillar had become the largest producer of diesel engines in the world.[47] The new company also developed other "groundbreaking" technologies. In 1928, Caterpillar acquired the Russell Grader Manufacturing Company to develop new motor graders, which are used to level surfaces for roads, buildings, and mines.[48] Russell blade graders were frequently paired with Caterpillar tractors, so Russell and Caterpillar explored opportunities to partner and expand their product lines. In 1931, Caterpillar released the world's first true motor grader.[49]

D. Other Examples

Across the economy, nascent acquisitions have helped smaller companies expand output. For instance, the Coca Cola Company's distribution network helped Honest Tea's specialty drinks reach thousands of new customers and gave its investors a "profitable exit."[50]

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[43] The Merger of Holt & Best, *supra* note 42.

[44] *Id*.

[45] *Id*.

[46] *1931: The Year of Innovation*, CATERPILLAR (last visited Nov. 6, 2020), https://www.caterpillar.com/en/company/history/archive/1931-the-year-of-innovation.html.

[47] *Id*.

[48] *Id*.

[49] *Id*.

[50] Information Technology & Innovation Foundation, Comments in Response to Initial Topics for Comment, FTC Hearings on Competition and Consumer Protection in the 21st Century (Aug. 20, 2018) at 3, https://www.ftc.gov/system/files/documents/public_comments/2018/08/ftc-2018-0053-d-0020-154977.pdf.

McDonald's helped Chipotle grow from fourteen locations to nearly five hundred within seven years, allowing Chipotle's output to expand to tens of thousands of new customers.[51]

Nascent purchases can also spur innovation. After drug manufacturer Roche purchased Spark Therapeutics, the FTC concluded that the acquisition would help Roche "accelerate, rather than decelerate the development of Spark's gene therapy."[52] Similarly, the Federal Trade Commission approved the merger of Genzyme and Novazyme in part because the "merger made possible synergies" and allowed for "comparative experiments and provided information that enabled the Novazyme program to avoid drilling dry holes."[53]

Finally, in the tech sector, certain acquisitions almost indisputably enhanced consumer welfare. In 1987, for example, Microsoft purchased Forethought, which allowed it to improve and expand PowerPoint, which has become the world's most used and sought after presentation suite.[54] Microsoft also purchased Hotmail and transformed it into a global platform; at the time, Microsoft noted that the acquisition "completes its lineup" by adding free email to its product offerings.[55] In this sense, Microsoft's purchase of Hotmail perfectly parallels John Deere's acquisition of Waterloo Gasoline — both wanted to offer customers a full set of products.

The history of YouTube follows a similar arc to that of PowerPoint and Hotmail. YouTube started as a video-based dating website.[56] Cofounders Chad Hurley, Steve Chen, and Jawed

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[51] Hayley Peterson, *The ridiculous reason McDonald's sold Chipotle and missed out on billions of dollars*, BUSINESS INSIDER (May 22, 2015), https://www.businessinsider.com/the-ridiculous-reason-mcdonalds-sold-chipotle-2015-5.

[52] *Statement of the Federal Trade Commission in re Roche Holding/Spark Therapeutics*, FTC (Dec. 16, 2019), https://www.ftc.gov/system/files/documents/public_statements/1558049/1910086_roche-spark_commission_statement_12-16-19.pdf.

[53] Jacqueline Grise et al., The No Kill Zone: The Other Side of Pharma Acquisitions, CPI Antitrust Chronicle (May 2020) at 3, https://www.cooley.com/-/media/cooley/pdf/reprints/2020/cpi--grise-burns--giordano.ashx.

[54] *Forethought acquired by Microsoft*, CRUNCHBASE (last visited Nov. 6, 2020), https://www.crunchbase.com/acquisition/microsoft-acquires-forethought--52fd1b34. See also https://en.wikipedia.org/wiki/Forethought,_Inc.

[55] *Hotmail acquired by Microsoft*, CRUNCHBASE (last visited Nov. 6, 2020), https://www.crunchbase.com/acquisition/microsoft-acquires-hotmail-2--1834850e. See also https://www.cnet.com/news/microsoft-buys-hotmail/.

[56] Paige Leskin, *YouTube is 15 years old. Here's a timeline of how YouTube was founded, its rise to video behemoth, and its biggest controversies along way*, Business Insider (May 30, 2020), https://www.businessinsider.com/history-of-youtube-in-photos-2015-10#october-2009-youtube-reveals-that-it-has-surpassed-the-milestone-of-1-billion-views-a-day-by-this-point-more-than-20-hours-of-video-are-being-uploaded-to-youtube-every-minute-23.

Karim started building the website in 2004 in Hurley's garage in Menlo Park, California.[57] On February 14, 2005, Hurley, the company's first CEO, registered the trademark, logo, and domain for YouTube. Hurley registered the domain to the company's new headquarters – located above a pizzeria.[58] YouTube struggled under its original business model as a dating site, driving the cofounders to take out ads offering women $20 to upload videos.[59]

In April 2005, YouTube pivoted to a free video hosting platform.[60] Chen, one of the cofounders, admits to hiring a public relations firm to overcome YouTube's tainted reputation.[61] In May of that year, YouTube launched its video-hosting beta version to the public.[62] Four months later, Sequoia Capital invested $3.5 million in YouTube's Series A round.[63] A partner at Sequoia learned about YouTube after using the service to upload old wedding and honeymoon videos. By the end of 2005, YouTube was clocking 8 million views a day.[64]

One year after launching its free video-hosting platform, YouTube raised $8 million in Series B funding from Sequoia Capital and Artis Capital Management, bringing total investment to almost $12 million.[65] Around the same time, however, YouTube started to face pushback from traditional media companies. In February 2006, NBC demanded that YouTube take down a viral clip from Saturday Night Live.[66] As a scrappy start-up, YouTube lacked the resources and focus to moderate user uploaded videos and police copyrighted material – let alone compensate media giants for violations.

In October 2006, Google acquired YouTube for $1.65 billion, netting each of the cofounders a profit of nearly $400 million.[67] Google viewed the purchase as investment in user-

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[57] *Id*.

[58] *See* Ace Exford, *The History of Youtube*, ENGADGET (Nov. 10, 2016), https://www.engadget.com/2016-11-10-the-history-of-youtube.html.

[59] Leskin, *supra* note 56.

[60] *Id*.

[61] *Id*.

[62] *Id*.

[63] *Id*.

[64] *Id*.

[65] *Id*.

[66] *Id*.

[67] *Id*.

generated content.[68] The acquisition infused YouTube with fresh capital, allowing the firm to grow its platform and increase its legitimacy as a media source.

In the year following the acquisition, YouTube greatly expanded and improved its platform. In June 2007, the site launched in the UK and eight other countries,[69] and YouTube launched its mobile site – the same month that Apple launched its first iPhone.[70] In August 2007, YouTube began running ads, utilizing Google's in-video format.[71] YouTube capped off 2007 by rolling out its Partner Program, allowing content creators to earn money based on ad revenue.[72] Through the program, Google transformed 'YouTuber' from a hobby into a career. A year later, successful YouTubers earned six-figure incomes.[73]

Google's investment also added much-needed legitimacy to the YouTube name. One year after the acquisition, YouTube established its Content Verification Program to help media companies easily identify and remove videos that violate copyright, redeeming the company's reputation following its early spat with NBC.[74] In July 2007, YouTube partnered with CNN to host a presidential debate featuring video questions submitted by the public. In 2008, seven out of the 16 presidential candidates announced their campaigns on YouTube.[75] In response to concerns over piracy, YouTube teamed up with a media company in April 2009 to launch Vevo, a licensed music video service which distributes copyrighted content on the platform.[76]

By 2009, users started using YouTube for a wide variety of purposes, including gaming and vlogging channels.[77] Halfway through 2011, the site hit three billion daily views. One year later, YouTube announced four billion daily video views, and Psy's 'Gangnam Style' hit one billion.[78] YouTube as we know it had officially arrived – thanks, in part, to its vertical integration with Google.

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[68] *Id*.

[69] Exford, *supra* note 58.

[70] Leskin, *supra* note 59.

[71] *Id.*

[72] *Id.*

[73] *Id.*

[74] *See id*.

[75] *Id*.

[76] *Id*.

[77] Exford, *supra* note 58.

[78] *Id*.

III. The Economic Literature Confirms the Benefits of Vertical Integration

There has long been a general consensus that "vertical integration is generally procompetitive and poses concerns only in limited circumstances."[79] Empirical studies confirm this view,[80] and in June 2020, the FTC and Department of Justice's Antitrust Division released updated Vertical Merger Guidelines that affirm their belief in the benefits of vertical integration.[81] The Guidelines "outline the principal analytical techniques, practices, and enforcement policies" of the agencies "with respect to a range of transactions often described as vertical mergers and acquisitions."[82] The Guidelines assert that vertical mergers "often benefit consumers[,]" recognizing that vertical integration "eliminat[es] . . . double marginalization, which tends to lessen the risks of competitive harm."[83] Consequently, "agencies more often encounter problematic horizontal mergers than problematic vertical mergers . . . ."[84] Most "nascent" purchases fall into the category of vertical mergers, when a larger company acquires a smaller company in a related market.

The FTC and DOJ echo Coase's earlier observations about vertical integration. Vertical integration leads to "cognizable efficiencies" by "combin[ing] complementary assets, including those used at different levels in the supply chain."[85] Restated using Coase's

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[79] AT&T, Comments on Competition and Consumer Protection in the 21st Century (Aug. 20, 2018), https://www.ftc.gov/system/files/documents/public_comments/2018/08/ftc-2018-0053-d-0017-154974.pdf (citing Comcast Cable Commc'ns, LLC v. FCC, 717 F.3d 982, 990 (D.C. Cir. 2013) (Kavanaugh, J., concurring) (in general, "vertical integration and vertical contracts are procompetitive"); Nat'l Fuel Gas Supply Corp. v. FERC, 468 F.3d 831, 840 (D.C. Cir. 2006) ("[V]ertical integration creates efficiencies for consumers."); Stephen Salop & Daniel Culley, *Potential Competitive Effects of Vertical Mergers: A How-To Guide for Practitioners* at 5, Georgetown University Law Center (Dec. 8, 2014), https://scholarship.law.georgetown.edu/facpub/1392/ ("Most vertical mergers do not raise competitive concerns and likely are procompetitive."); Remarks of D. Bruce Hoffman, Vertical Merger Enforcement at the FTC, Credit Suisse 2018 Washington Perspectives Conference, at 4 (Jan. 10, 2018) (noting the "broad consensus in competition policy and economic theory that the majority of vertical mergers are beneficial because they reduce costs and increase the intensity of interbrand competition")).

[80] *See generally* James C. Cooper, Luke M. Froeb, Dan O'Brien, & Michael G. Vita, *Vertical Antitrust Policy as Problem of Inference*, FTC (Feb. 18, 2005), https://www.ftc.gov/publicstatements/2005/02/vertical-antitrust-policy-problem-inference); Francine Lafontaine & Margaret Slade, *Vertical Integration and Firm Boundaries: The Evidence*, 45 J. OF ECON. LITERATURE 629 (2007).

[81] *Vertical Merger Guidelines*, DOJ & FTC (June 30, 2020), https://www.ftc.gov/system/files/documents/reports/us-department-justice-federal-trade-commission-vertical-merger-guidelines/vertical_merger_guidelines_6-30-20.pdf.

[82] *Id.* at 1.

[83] *Id.* at 2.

[84] *Id*.

[85] *Id.* at 11.

language, vertical integration solves the "asset specificity problem."[86] When a firm attempts to enter a new market or to innovate on a product, it is often more efficient for the firm to vertically acquire a firm from a different level of the supply chain rather than spending large amounts of capital on research and development. Furthermore, as the Guidelines explain, "[a] single firm able to coordinate how these assets are used may be able to streamline production, inventory management, or distribution. It may also be able to create innovative products in ways that would not likely be achieved through arm's-length contracts."[87]

The historical examples illustrate this phenomenon. Deere's acquisition of Waterloo Gasoline Engine Company allowed it to overcome its asset specificity problems in the 1920's. The combined company went on to develop the iconic line of green Deere tractors — and, once again, consumers benefitted.[88] Almost a century later, in 2008, John Deere ranked Highest in Customer Satisfaction according to the J.D. Power and Associates Report.[89]

Vertical integration also "eliminate[s] contracting friction" by bringing together two firms previously working at arm's-length and allowing companies "to create innovative products."[90] For instance, Caterpillar's acquisition of Russell allowed it to pair its tractors with Russell's blade graders, leading to the development of the world's first true motor grader.[91] North American Aviation's purchase of Berliner-Joyce Aircraft preserved Berliner's assets and intellectual property and eventually enabled it to produce advanced military equipment during World War II.[92] In short, vertical mergers have resulted in key technologies used in all sorts of iconic products, ranging from tractors to jet planes. As noted previously, we do not know and cannot know what would have happened had these acquisitions not occurred, but we certainly know that, as a historical matter, these "nascent" purchases benefited consumers and innovation.

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[86] *See* Coase, *supra* note 9, at 30.

[87] Vertical Merger Guidelines, *supra* note 8181, at 11.

[88] *See generally* Cawthon, *supra* note 35.

[89] *John Deere Ranks Highest in Customer Satisfaction According to J.D. Power and Associates Report*, LAWN & LANDSCAPE (Sept. 18, 2008), https://www.lawnandlandscape.com/article/john-deere-ranks-highest-in-customer-satisfaction-according-to-j-d--power-and-associates-report/.

[90] Vertical Merger Guidelines, *supra* note 81, at 11.

[91] 1931: The Year of Innovation, *supra* note 46.

[92] Lombardi & Simonsen, *supra* note 32.

A. Today's Antitrust Proposals Likely Would Have Stifled Yesterday's Innovation

Many observers and policymakers are proposing changes to the nation's antitrust enforcement regime, both to the laws themselves and to the approach that courts should take to those laws. Some proposals would effectively rewrite the antitrust laws to focus on factors other than consumer welfare, while other, narrower proposals would subject nascent acquisitions to more scrutiny.

Had these concepts been in place a century ago, they likely would have stifled the growth of some of our country's most successful companies to the detriment of consumers and competition. Admittedly, there may be somewhat limited probative value in analyzing business transactions a century later under standards that did not exist at the time and with incomplete data about contemporary market conditions. The FTC has itself noted "the promise and problems associated with direct measurement of market outcomes after FTC action in the context of merger retrospectives."[93] It is hard to devise controls for the counterfactual ('but-for') world.[94] Nevertheless, a backwards glance can shed light on how a more aggressive antitrust regime may have played out over time. If adopted, that new regime may well hamper competition and innovation going forward.

B. Current Antitrust Proposals

The House Judiciary Committee's Subcommittee on Antitrust recently released a Report that proposed substantial changes to the nation's antitrust laws.[95] In its most far-reaching recommendation, the Report criticizes the consumer welfare standard as a "narrow construction" that should not represent the "sole goal of the antitrust laws."[96] Instead, the Report proposes that antitrust law also should protect "workers, entrepreneurs, independent businesses, open markets, a fair economy, and democratic ideals."[97]

The Report recommends other changes that focus on the technology sector, but that easily could extend to other sectors that garner heightened scrutiny from Washington, or even to

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[93] The Federal Trade Commission at 100: Into Our Second Century 149 (2009), at https://www.ftc.gov/sites/default/files/documents/public_statements/federal-trade-commission-100-our-second-century/ftc100rpt.pdf.

[94] *Id.* at 150.

[95] SUBCOMMITTEE ON ANTITRUST, COMMERCIAL AND ADMINISTRATIVE LAW OF THE COMMITTEE ON THE JUDICIARY, 116TH CONG., INVESTIGATION ON COMPETITION IN DIGITAL MARKETS, available at https://judiciary.house.gov/uploadedfiles/competition_in_digital_markets.pdf.

[96] *Id.* at 391.

[97] *Id.* at 392.

the entire economy. As set forth in the House Report, some other key ideas include the following:

- Structural separations and prohibitions of certain dominant platforms from operating in adjacent lines of business;[98]
- Nondiscrimination requirements, prohibiting dominant platforms from engaging in self preferencing, and requiring them to offer equal terms for equal products and services;[99]
- Presumptive prohibition against future mergers and acquisitions by the dominant platforms (*i.e.*, flipping the burden of proof so that companies would have to justify their merger);[100]
- Prohibitions on abuses of superior bargaining power, proscribing dominant platforms from engaging in contracting practices that derive from their dominant market position, and requiring due process protections for individuals and businesses dependent on the dominant platforms;[101]
- Strengthening Section 7 of the Clayton Act, including through restoring presumptions and bright-line rules, restoring the incipiency standard and protecting nascent competitors, and strengthening the law on vertical mergers;[102] and
- Strengthening Section 2 of the Sherman Act, including by introducing a prohibition on abuse of dominance and clarifying prohibitions on monopoly leveraging, predatory pricing, denial of essential facilities, refusals to deal, tying, and anticompetitive self-preferencing and product design.[103]

All these proposals could discourage large companies, including technology companies, from investing in smaller firms.

C. How These Proposals Could Have Affected Past Transactions

As applied to nascent acquisitions, many of these proposals suffer from "hindsight bias," the understandable tendency of human beings to evaluate past possibilities and decisions through the prism of what we know actually occurred.[104] For instance, sitting from the perspective of today, it is easy to conclude that John Deere eventually would have successfully entered the tractor market, that Boeing would have developed a presence on the West Coast, and that General Motors would have produced auto bodies as well as engines,

[98] *Id.* at 20.

[99] *Id.*

[100] *Id*.

[101] *Id*.

[102] *Id*.

[103] *Id*. at 20-21.

[104] *See generally* Christopher Leslie, *Hindsight Bias in Antitrust Law*, 71 Vanderbilt L.R. 1527 (2018).

all with the attendant benefits for consumers. In reality though, none of these events were inevitable.

At a minimum, had some of the Report's proposals been in place early in the last century, they would have created substantial uncertainty for both the acquirers and the acquired companies. They would have added transaction costs and time to the process, and given both regulators and competitors opportunities to challenge the acquisitions for reasons unrelated to consumer welfare. At worst, these proposals could have placed at risk every one of the acquisitions discussed in this paper.

For instance, many of today's concepts would have jeopardized General Motors' purchase of Fisher Body. That acquisition might not have comported with the concepts of helping "workers, entrepreneurs, independent businesses, open markets, a fair economy, and democratic ideals." From one perspective, the purchase eliminated an independent business and arguably reduced an "open market" by making all of Fisher Body's output unavailable to competitors. Plus, as there is no evidence that either Fisher Body or General Motors surveyed their employees for their views, one could argue that this purchase was not "fair" or "democratic." Moreover, by foreclosing Fisher Body's output from its competitors, General Motors' purchase may have violated the "essential facilities" doctrine. By 1914, Fisher Body had become the world's largest manufacturer of auto bodies and supplied auto bodies to Ford, Chrysler, and many other manufacturers.[105] After the acquisition, those companies could not purchase bodies from Fisher Body, and at best had to negotiate with General Motors. Although a complete discussion of the essential facilities doctrine exceeds the scope of this paper, under today's proposals, or a more aggressive review of nascent acquisitions, how could General Motors have demonstrated that its purchase benefited competition and consumers? What could it have shown?

Furthermore, and going to the heart of the "nascent" competitor concept, the purchase removed Fisher Body as a potential competitor. There is no historical evidence that Fisher Body planned to manufacture automobiles or to compete directly with General Motors, but consistent with the nascent competitor theory, perhaps Fisher Body eventually would have developed into one of the Big Four auto manufacturers? Left to its own devices, there is no reason to think that Fisher Body wouldn't have looked to expand its product offerings at some point in time. It would have been impossible, both in a practical sense and in an epistemological sense, for General Motors to demonstrate conclusively that Fisher Body never would have grown into a competitor. This inescapable but-for evidentiary limitation

[105] *See* Fisher Body Company, *supra* note 4.

argues in favor of caution. Had the purchase been blocked under today's standards, perhaps Fisher Body eventually would have folded, General Motors could have failed to develop as high quality or as inexpensive a body, and consumers may have suffered.

Almost assuredly, both Deere and Caterpillar would have improperly breached today's concept of "structural separation" of business lines. Today, each company is one of the world's largest manufacturers of heavy equipment, and at the time, Deere already produced numerous other types of farm equipment, such as planters, buggies, wagons, grain drills, and hay and harvesting equipment. Deere's entry into the tractor market necessarily deprived competitors of market share, and but for Deere's purchase, perhaps Waterloo Gasoline Engine Company would have become a global rival (at a minimum, they would have had a famous ABBA song around which to build a marketing campaign). Similarly, the merger of Holt Caterpillar and Best deprived other farm equipment companies of access to Caterpillar's brand reputation and C.L. Best's dealer network. There is no evidence that anyone consulted each company's employees, or the voters, as to whether the combination comported with anyone's concept of "democratic ideals."

Finally, given the malleability of the term "abuse," one could have argued that Boeing "abused" its superior bargaining power in purchasing Pacific Air Transport. At the time, Pacific Air was a struggling nascent airline that had lost several aircraft in preceding years. Although Boeing, which had a dominant market position as compared to Pacific Air, continued to employ Pacific Air's workforce, there is no evidence that Boeing provided those employees with "due process protections." Had Boeing never bought Pacific Air Transport, perhaps Pacific Air would have survived on its own and eventually started manufacturing airplanes itself. Or it may have gone bankrupt, and, for many years afterwards, customers would have received their mail via bus.

IV. Conclusion

These past transactions have ongoing relevance to today's antitrust discussions. One can imagine a but-for world in which Instagram remained independent and grew to rival or surpass Facebook and Google, or in which Instagram merged with a different technology company and helped that combined company grow into a global juggernaut. One can also imagine another but-for world in which, without a purchaser, Instagram never developed a successful business model and its technology eventually disappeared from the marketplace. Which world is more likely? That's the province of science fiction, not science, and a question that cannot be answered with meaningful certainty by all of the economists and econometricians in the world.

In his 1974 speech accepting the Nobel Prize in Economics, Friedrich von Hayek urged economists, and regulators generally, to exercise caution in the face of limits of human knowledge.[106] As Hayek put it, "[i]f man is not to do more harm than good in his efforts to improve the social order, he will have to learn that in [economics] . . . he cannot acquire the full knowledge which would make mastery of the events possible." In the face of such uncertainty, the government should exercise significant caution before it revisits years-old transactions, or changes the existing antitrust regime to disfavor vertical mergers, out of a speculative belief that small acquired companies would have grown into giants, as both theory and empirical data strongly suggest that vertical mergers tend to enhance welfare.

Another Nobel laureate, Ronald Coase, also urged caution in the face of limited knowledge: "One important result of this preoccupation with the monopoly problem is that if an economist finds something—a business practice of one sort or other—that he does not understand, he looks for a monopoly explanation. And as in this field we are very ignorant, the number of ununderstandable practices tends to be rather large, and the reliance on a monopoly explanation, frequent."[107]

In short, an overly aggressive approach to nascent acquisitions ultimately could harm consumers and hamstring our growing and innovative economy. To paraphrase Hayek, the recognition of the insuperable limits of knowledge ought indeed to "teach the student of society a lesson of humility."

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[106] Friedrich von Hayek, *Prize Lecture*, THE NOBEL PRIZE (Dec. 11, 1974), https://www.nobelprize.org/prizes/economic-sciences/1974/hayek/lecture/.

[107] R.H. Coase, Industrial Organization: A Proposal for Research (1972), at https://www.nber.org/system/files/chapters/c7618/c7618.pdf.