April 21, 2022

Federal Trade Commission
600 Pennsylvania Ave., N.W.
Washington, D.C. 20580

U.S. Department of Justice
Antitrust Division
950 Pennsylvania Ave., N.W.
Washington, D.C. 20530

VIA ONLINE SUBMISSION

Re: Comments of Engine Advocacy in response to *Request for Information on Merger Enforcement,* Docket no. FTC-2022-0003-0001

To Whom It May Concern:

Engine is a non-profit technology policy, research, and advocacy organization that bridges the gap between policymakers and startups. Engine works with government and a community of thousands of high-technology, growth-oriented startups across the nation to support the development of technology entrepreneurship through economic research, policy analysis, and advocacy on local and national issues. We encourage the consideration of startup perspectives as the FTC and DOJ weigh updates to the merger guidelines and accordingly appreciate the opportunity to share these comments in response to the agencies' request.

I. Startups are important stakeholders in competition policy.

Startups are major drivers of innovation, growth, dynamism, and competition in the U.S. economy.[1] They play a critical role in developing emerging technologies and routinely set out to improve the everyday lives and operations of people and businesses across the country. As relentless problem solvers, startups develop innovative products and services in industries ranging from agriculture to artificial intelligence to healthcare, education, transportation, and clean energy and so many others.

[1] As central to our mission, Engine regularly highlights the importance of startups, their role in the economy, and their rightful place as stakeholders in policy debates. Accordingly, this section draws heavily on previous commentary, including, e.g., *Startups & the U.S. Patent System: Prioritizing Quality and Balance to Promote Innovation*, Engine (July 2021), https://www.engine.is/news/category/prioritizing-quality-and-balance-to-promote-innovation.

Emerging tech companies are not only essential to advancing technology, but they make outsized contributions to economic progress and net job creation.[2] Across the U.S., firms in their first year of existence create an average of three million new jobs per year,[3] and that positive trend is especially true for high-tech, information, and communications tech companies.[4]

The U.S. continues to be a world leader when it comes to startup growth and success, and has seen tremendous growth across all sizes of startup funding rounds over the past decade.[5] While Silicon Valley is still the most developed startup ecosystem in the country (and world), startups operate in every state.[6] And the volume of venture capital funding has been growing and becoming less concentrated in the nation's largest startup ecosystems over the last fifteen years.[7]

Startups make impressive contributions to the economy but also operate on tight budgets as they seek to grow. Policies that increase compliance costs or litigation risks consume startups' limited resources and can distract from their core startup activities—like hiring, product development, or customer acquisition. That means for startups, all policy is competition policy.

But competition policy itself is rarely, if ever raised at all by startups in our network and never as a primary concern. In surveys of our network of startups (which are located in virtually every congressional district, across nearly every industry, with a variety of business models), access to capital and access to talent consistently rank as the top issues they encounter. These concerns were echoed in a recent congressional hearing and a recent survey of small businesses conducted by the National Federation of Independent Businesses.[8] In that survey, myriad issues—including labor/talent issues, regulation, and inflation—all rate high as the most important issue facing their business.[9] Competition from large businesses (zero percent) is at the bottom of the list.[10]

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[2] *The Economic Impact Of High-Growth Startups*, Kauffman Foundation (June 7, 2016), https://www.kauffman.org/wp-content/uploads/2019/12/PD_ HighGrowth060716.pdf.

[3] Tim Kane, *The Importance of Startups in Job Creationand Job Destruction*, Kauffman Foundation 2 (July 2010), https://www.kauffman.org/wp-content/uploads/2019/12/firm_formation_importance_of_ startups.pdf

[4] Ian Hathaway, *Tech Starts: High-Technology Business Foundation and Job Creation in the United States,* Kauffman Foundation 4-5 (2013), https://www.kauffman.org/wp-content/uploads/2019/12/bdstechstartsreport.pdf

[5] *The State of the Startup Ecosystem*, Engine 6-9 (2021), https://engineis.squarespace.com/s/The-State-of-the-Startup-Ecosystem.pdf.

[6] *See, e.g., #StartupsEverywhere*, Engine, https://www.engine. is/startupseverywhere (campaign celebrating entrepreneurial ecosystems in every state); *The United States of Startups:The Most Well-Funded Tech Startup in Every U.S. State*, CB Insights (Feb. 17, 2021), https://www.cbinsights.com/research/well-funded-startups-us-map/; *Silicon Valley - Bay Area,* Startup Genome, https://startupgenome.com/ecosystems/silicon-valley.

[7] *Startup Ecosystem, supra* note 5, at 8.

[8] *See Competition and the Small Business Landscape: Fair Competition and a Level Playing Field: Hearing before the Committee on Small Business,* 117th Congress (2022) (Testimony of Douglas Holtz-Eakin), https://smallbusiness.house.gov/uploadedfiles/03-01-22_dr._holtz-eakin_testimony.pdf; *and see also, e.g., Competition and the Small Business Landscape: Fair Competition and a Level Playing Field: Hearing before the Committee on Small Business,* 117th Congress (2022) (Remarks of Rep. Young Kim), https://docs.house.gov/Committee/Calendar/ByEvent.aspx?EventID=114436.

[9] William C. Dunkelberg and Holly Wade*, Small Business Economic Trends Monthly Report,* NFIB, (Jan. 2022) at 18, https://assets.nfib.com/nfibcom/SBET-Jan-2022-Final.pdf

[10] *Id.*

Each of those issues highlighted by startups are underscored by the need for robust capital access to overcome them and ensure they are able to continue to innovate. And startup funding is inextricably linked to a robust M&A market.[11]

As the Commission and the Department consider potential updates to the merger guidelines, they must recognize the critical role that mergers and acquisitions play in the startup ecosystem. Unfortunately, the RFI and accompanying press release take a skeptical tone toward acquisitions and suppose the startup ecosystem is struggling when it is experiencing impressive growth.[12] Both of these incorrect presumptions could lead to harmful conclusions for startups. Instead, any new merger guidelines must be objective, consensus-based, and promote a vibrant, competitive merger and acquisition market.

II. Successful startup exits promote investment and a vibrant, competitive startup ecosystem.

Startup exits are an important moment in the lifecycle of a startup—after an exit, startups are generally no longer considered startups. In successful exits, investors earn a return on their investment, and founders are rewarded for the blood, sweat, and tears they have put into building the company. Often, these resources are reinvested in the startup ecosystem and new startups. And even unprofitable exits (for example, where a startup is acquired for less than a previous valuation) can provide a soft landing for investors and founders. Investors are able to recoup some of the original investment, and founders and employees might be given a job at the acquiring firm, allowing them to build their resumes ahead of their next venture.

Broadly, there are three types of startup exits: going public via an initial public offering (IPO), being acquired by another company, or failure and shutdown. An analysis of the approximately 12,000 startup exits from Aug 2002 to March 2020 revealed that 35 percent of startups failed and shutdown, 61 percent were acquired, and four percent underwent an IPO.[13] Startup founders recognize these dynamics when they consider goals for their company. In a 2020 survey, 58 percent

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[11] *Infra* at II.

[12] *See, Request for Information on Merger Enforcement,* US Department of Justice and US Federal Trade Commission (Jan.18, 2022), https://www.regulations.gov/document/FTC-2022-0003-0001, *see also, Federal Trade Commission and Justice Department Seek to Strengthen Enforcement Against Illegal Mergers,* Federal Trade Commission (Jan.18, 2022), https://www.ftc.gov/news-events/news/press-releases/2022/01/federal-trade-commission-justice-department-seek-strengthen-enforcement-against-illegal-mergers, *see also, Economic Report of the President*199-226 (Feb. 2020), whitehouse.gov/wp-content/uploads/2021/07/2020-ERP.pdf (explaining that assertions about concentration or a decline in competition are unfounded, weakly supported, or based upon research too narrow to be broadly applied), *and see generally, Startup Ecosystem, supra* note 5.

[13] Susan Woodward, *Irreplaceable Acquisitions,* Sand Hill Econometrics 5 (Nov. 2021), http://www.sandhillecon.com/pdf/Woodward_Irreplaceable_Acquisitions.pdf, (of those that were acquired, Woodward notes that 42% of acquisitions were unprofitable, comprising 26% of all exits).

of startup founders said acquisition was "the realistic long goal" for their company.[14] The ability to be acquired, then, is a critical part of the startup ecosystem.

All successful exits—by either IPO or acquisition—provide incentives to innovate, create a return on investment, and promote investment in new startups as capital and talent tend to remain in the ecosystem.[15] However, acquisitions are more accessible for startups at all stages of development, and startup acquisitions share a stronger, more positive relationship with startup investment.[16]

Furthermore, startup acquisitions are important to the growth of the startup ecosystem in places outside of the major U.S. technology hubs like Silicon Valley, Seattle, New York, Los Angeles, or Boston where large exits via IPO are typically out of reach.[17] Successful exits, almost always via acquisition, inject momentum and help attract more investment capital and talent into these smaller ecosystems.[18] And startup founders often remain in the ecosystem, becoming startup investors, mentors, or beginning new companies there.[19]

Acquisitions promote the investment necessary to grow startups and broaden the startup ecosystem. Successful exits via acquisitions create incentives to innovate, disrupt and compete, and even acquisitions of failing startups can provide a soft landing so that the founders can remain in the ecosystem and take the next shot at building a competitive startup. As the agencies evaluate the merger guidelines and necessarily seek to minimize harmful anticompetitive conduct, they must not unduly burden the ability for startups to exit via acquisition.

III. Initial Public Offering (IPO) is not an interchangeable alternative to exit via acquisition and a robust M&A market.

Going public through the IPO process is another form of exit, but it is not an interchangeable alternative or replacement to exit via acquisition. Critics of startup acquisitions have suggested that acquisitions of startups should be reduced by changes in the law or merger enforcement, and that startups will just be able to IPO instead.[20] This is a false and dangerous assertion. There are myriad relevant differences in size, frequency, accessibility, and company type that distinguish startup exits via IPO versus acquisition.

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[14] *2020 Startup Outlook Report,* Silicon Valley Bank 5 (2020), https://www.svb.com/globalassets/library/uploadedfiles/content/trends_and_insights/reports/startup_outlook_report/suo_global_report_2020-final.pdf, (meanwhile, 17% said IPO, and the remaining ¼ gave other responses).
[15] *Startup Ecosystem, supra* note 5, at 11-12.
[16] *Id.*
[17] *Id.*
[18] *Id., see also, Global Startup Ecosystem Report,* Startup Genome (2021), https://startupgenome.com/report/gser2021.
[19] *See Startup Ecosystem, supra* note 5, at 11-12, *see also, Global Report supra* note 18.
[20] *See, e.g., The Impact of Consolidation and Monopoly Power on American Innovation: Hearing before the Subcommittee on Competition Policy, Antitrust, and Consumer Rights of the Committee on the Judiciary,* 117th Congress (2021) (Especially remarks of Sens. Durbin and Klobuchar).

The characteristics of IPOs make them unique and not interchangeable with acquisitions. IPOs are rare—just four percent of all exits.[21] Companies that IPO tend to be much older, located in a large, preeminent tech hub, more profitable, and more sophisticated.[22] Exits via IPO tend to be much (25 times) larger than exits via acquisition.[23] This means IPOs are not right for every company, and going public too soon can spell failure. Most startup acquisitions are for values of less than $50 million, but a company cannot reasonably succeed as a public company at this stage.[24] Indeed, companies that have gone public at such valuations are likely to fail because they are too young and not profitable enough to be public companies—40 percent of companies that went public at a valuation of $50 million or less have since failed.[25]

IPOs are accordingly out of reach of many startups and are only weakly associated with investment in new startups.[26] Limiting exit opportunities to the public markets will drastically reduce the number of successful startups, restrict the ability of investors to earn a return on their investment, and increase the risk for startup founders of walking away with nothing. The consequences would spell a less vibrant startup ecosystem, where a few large companies dominate and are rarely challenged by competitive startups.

The regulatory framework around being a public company, the Sarbanes-Oxley Act (SOX), creates burdens that push an IPO out of reach for many startups. But the law and its consequences for the startup ecosystem forewarn against undue restrictions on legal startup acquisitions.

Sarbanes-Oxley was legislated in response to a series of high-profile accounting scandals. Similar to today, where no policymaker or member of the startup ecosystem is in favor of illegal anticompetitive conduct, no member of Congress or the public is or was in favor of corporate fraud in their consideration of Sarbanes-Oxley. Also like today, where many are warning of consequences of burdening startups through poorly crafted competition policies,[27] several members of Congress did warn of the consequences of burdening capital formation for small companies like startups through SOX. Then-Rep. Jeff Flake (R-Ariz.) cautioned against proceeding without knowing "what cost we're going to impose, particularly on small businesses."[28] Sens. Phil Gramm (R-Texas) and Kit Bond (R-Miss.) respectively voiced concern that the law would "use up the resources" of small companies, and "damag[e] the economic framework for small companies to reach our capital

[21] *Irreplaceable Acquisitions, supra* note 13.
[22] *Id., See also Startup Ecosystem, supra* note 5, at 9-12.
[23] *Irreplaceable Acquisitions, supra* note 13, at 7-8.
[24] *Id.*
[25] *Id.*
[26] *Startup Ecosystem, supra* note 5, at 11-12.
[27] The volume of voices expressing these concerns would be difficult to capture in one footnote, and the agencies have received several RFI responses to the same. Also, s*ee generally, e.g., Startup Ecosystem, supra* note 5, *see also, e.g., Evaluating Competition Proposals with the Startup Perspective,* Engine (Jun. 17, 2021), https://www.engine.is/news/category/evaluating-competition-proposals-through-the-startup-perspective.
[28] *Partial Transcript: Your World with Neil Cavuto*, Fox News (Jul. 30, 2002), https://www.foxnews.com/story/sen-paul-sarbanes-d-md-rep-jeff-flake-r-ariz.

markets."[29] These concerns have borne out. The burdens of being a public company now easily exceed $1 million annually, resulting in fewer companies deciding to go public, and, as previously discussed, those that do are larger and older.[30]

Startup founders have warned policymakers to avoid the same mistakes by enacting competition policy that burdens startups' ability to exit and "risks similar unintended consequences."[31] In considering updates to the merger guidelines, the FTC and DOJ must endeavor to not unduly burden the ability of startups to undergo exit via acquisition, and must not presume burdens on acquisitions to be immaterial by reasoning an IPO to be an interchangeable form of startup exit.

IV. Merger guidelines must promote and enable a robust, vibrant, and competitive M&A market.

Merger enforcement is critical to creating a fair, competitive playing field where startups can thrive and consumers benefit from the latest innovations at the best prices. At the same time, the FTC and DOJ must conduct enforcement against illegal anticompetitive behavior without burdening the ability of startups to undergo legal acquisitions and diminishing the benefits of a robust, vibrant, and competitive M&A market where many acquisitive firms might bid on any one startup. The current guidelines have done this well, as evinced by a flourishing startup ecosystem.[32]

The mission of the FTC has long recognized the importance of balancing enforcement with the promotion of legitimate business practices: "Protecting consumers and competition by preventing anticompetitive, deceptive, and unfair business practices through law enforcement, advocacy, and education *without unduly burdening legitimate business activity* (emphasis added)."[33] While a draft of the Commission's 2022-2026 strategic plan did not include the emphasized phrase,[34] this principle of balance and avoiding undue burdens should guide the DOJ and FTC as they consider updates to the merger guidelines.

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[29] *See* 148 Cong. Rec. S7353 (2002) (Remarks of Sen. Gramm) https://www.congress.gov/crec/2002/07/25/CREC-2002-07-25-pt1-PgS7350-4.pdf, *and id.* at S7361 (remarks of Sen. Bond).

[30] *See, e.g, Startup Ecosystem, supra* at note 5, at 9-12, *and, The Cost of Being a Public Company in Lightof Sarbanes-Oxley and the Federalization of Corporate Governance: Hearing before the Subcommittee on Investor Protection, Entrepreneurship and Capital Markets* 115th Congress (2017) (Remarks of Chairman Huizenga), https://www.govinfo.gov/content/pkg/CHRG-115hhrg28750/html/CHRG-115hhrg28750.htm

[31] *The Impact of Consolidation and Monopoly Power onAmerican Innovation: Hearing before the Subcommittee on Competition Policy, Antitrust, and Consumer Rights of the Committee on the Judiciary,*117th Congress (2021) (Testimony of Bettina Hein).

[32] *See, e.g.,* discussion of the startup ecosystem, *supra* at I.

[33] *See "About the FTC,"* FTC, https://www.ftc.gov/about-ftc, *see also,* Andy Jung, *FTC Proposes Astounding Change to the Agency's Mission Statement,* Washington Legal Foundation (Dec. 7, 2021) wlf.org/2021/12/07/wlf-legal-pulse/ftc-proposes-astounding-change-to-the-agencys-mission-statement/, (Detailing the history of the FTC's mission).

[34] *Federal Trade Commission Strategic Plan for Fiscal Years 2022-2026,* U.S. Federal Trade Commission 4 (Oct. 2021), https://www.regulations.gov/document/FTC-2021-0061-0001.

Much as Customs and Border Protection (whose mission has similarly acknowledged the dual role of protecting Americans while promoting legitimate business activity)[35] could prevent illegal materials from entering the country by disallowing all imports, the agencies could (in theory) prevent illegal, anticompetitive acquisitions by forbidding all acquisitions. These are, of course, impractical, extreme, and unworkable solutions. They do, however, highlight the implicit and explicit powers of the agencies to steer the economy and the need for the FTC and DOJ to pursue a balanced approach that enables a robust M&A market while conducting merger enforcement.

Previous versions of the merger guidelines recognized this balance. The overviews of both the 2010 Horizontal Merger Guidelines and 2020 Vertical Merger Guidelines highlighted the desire "to identify and challenge competitively harmful mergers while avoiding unnecessary interference with mergers that are either competitively beneficial or neutral,"[36] and sought to "use a consistent set of facts and assumptions to evaluate both the potential competitive harm from a vertical merger and the potential benefits to competition."[37] To be successful, any future iteration of the merger guidelines must seek balance as well.

V. <u>Merger guidelines must be objective, clear, consistent, and inspire certainty.</u>

To enable legal acquisition activity without undue burden, the merger guidelines must be objective, understandable, and inspire certainty. Consensus-based guidelines, grounded in sound economic theory and legal precedent are needed to accomplish these goals and give them broad utility for all stakeholders in merger enforcement. Past guidelines that have followed these principles, like the 2010 Merger Guidelines, have been widely accepted and adopted by courts, agencies and merging parties. Review of cases shows that both the agencies and merging parties argue that they should prevail if the court properly follows the guidelines.[38] Any new iteration of the merger guidelines must follow these principles to be successful.

Companies observe and learn from past enforcement and respond to the implicit or explicit threat of enforcement.[39] The uncertainty created by unobjective enforcement that is not predictable or ground in precedent will chill acquisition activity, or cause companies to abandon planned acquisitions.[40]

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[35] *See, e.g., U.S. Customs and Border Protection Strategic Plan*, U.S. Customs and Border Protection 7 (2020). https://www.cbp.gov/sites/default/files/documents/CBP-Vision-Strategy-2020.pdf.
[36] *Horizontal Merger Guidelines,* U.S. Department of Justice & the Federal Trade Commission 1 (Aug. 19, 2010), https://www.justice.gov/atr/horizontal-merger-guidelines-08192010#1.
[37] *Vertical Merger Guidelines*, U.S. Department of Justice & the Federal Trade Commission 2 (Jun. 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.
[38] Carl Shapiro and Howard Shelanski, *Judicial Response to the 2010 Horizontal Merger Guidelines*. Review of Industrial Organization 58, 51–79 (2021), https://doi.org/10.1007/s11151-020-09802-x.
[39] Eric de Bolt, et al., *The (Un)intended Consequences of M&A Regulatory Enforcements*(Feb. 3, 2022). Proceedings of Paris December 2021 Finance Meeting EUROFIDAI - ESSEC, https://ssrn.com/abstract=4025495.
[40] *Id.*

An announced but abandoned acquisition is bad for startups. Large, acquiring companies will not experience drastic harms, but for startups, a failed acquisition sends a signal that disincents other potential buyers and costs the startup time, focus, and what are likely limited or the last of its funds.[41] For a startup, the result of an abandoned acquisition is likely to be failing worthless. This is a strictly worse outcome for all parties involved—the technological innovations do not live on, the founders and employees are more likely to leave the ecosystem for certain, salaried income, investors are not made whole, and capital does not flow to new startups. Merger enforcement should not increase the frequency of these outcomes by chilling acquisitions through unclear guidelines and uncertain enforcement based on novel theories of competition.

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Engine appreciates the opportunity to submit these comments on the important role acquisitions have in the startup ecosystem and hope that the agencies appreciate their importance as they consider new guidelines for enforcement. We are available to be a resource and look forward to engaging with the agencies on these issues in the future.

Respectfully,

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[41] *See, e.g., Irreplaceable Acquisitions*, supra note 13, at 6, (One of the reasons startups look to be acquired is when it is time to raise another funding round, or when they have tried, but failed to raise more funds).