September 18, 2023

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 regarding *Draft Merger Guidelines,* Docket no. FTC-2023-0043-0001

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. Capital access and the ability to successfully exit—most frequently through a merger or acquisition by a larger firm, are critical to the promotion of technology entrepreneurship and the success of the U.S. startup ecosystem. We appreciate the opportunity to share these comments on the draft merger guidelines[1] and encourage the FTC and DOJ (the agencies) to revise the draft merger guidelines to reflect economic benefits associated with mergers and acquisitions, their essential role in the startup ecosystem, and the reality that most acquisitions present few competitive concerns.

I. Startups are important stakeholders in competition policy.

Startups are major drivers of innovation, growth, dynamism, and competition in the U.S. economy. 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.

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[1] *Merger Guidelines (DRAFT – FOR PUBLIC COMMENT PURPOSES – NOT FINAL)*, DOJ & FTC (July 2023), https://www.regulations.gov/document/FTC-2023-0043-0001.

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.[8] That means for startups, all policy is competition policy.

But competition policy itself is rarely 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 have been echoed by startups and small businesses before Congress and in non-Engine surveys of small businesses.[9] Businesses rank myriad issues—including labor/talent issues, regulation, and inflation—as the most

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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 Creation and 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 e.g.*, *Privacy Patchwork Problem: Costs, Burdens, and Barriers Encountered by Startups*, Engine (Mar. 2023), https://static1.squarespace.com/static/571681753c44d835a440c8b5/t/6414a45f5001941e519492ff/1679074400513/Privacy+Patchwork+Problem+Report.pdf; *Startups, Content Moderation & Section 230*, Engine, (Dec. 2021), https://static1.squarespace.com/static/571681753c44d835a440c8b5/t/61b26e51cdb21375a31d312f/1639083602320/Startups%2C+Content+Moderation%2C+and+Section+230+2021.pdf.

[9] *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.

important issue facing their business.[10] Competition from large businesses (zero percent) is at the bottom of the list.[11]

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, because exits, most often facilitated by an acquisition, provide liquidity and enable capital flows through the startup ecosystem.[12]

As the agencies further refine the draft merger guidelines, they must recognize the critical role that mergers and acquisitions play in the startup ecosystem. Unfortunately, the draft guidelines fail to account for pro-competitive, pro-innovation benefits that can arise from acquisitions, and build on suppositions that the startup ecosystem is struggling when it is experiencing impressive growth.[13] Both of these incorrect presumptions could lead to harmful conclusions for startups. Instead, the new merger guidelines should facilitate a vibrant, competitive merger and acquisition market that produces the best outcomes for startups.

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 and early employees 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, founders, and employees. 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.[14] Startup founders recognize these dynamics when they consider goals for their company. In a 2020 survey, 58 percent

[10] *See, e.g.*, 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
[11] *Id.*
[12] *Infra* at II.
[13] *See, e.g.*, *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); *see generally, Startup Ecosystem, supra* note 5.
[14] 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.[15] 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.[16] However, acquisitions are more accessible for startups at all stages of development, and startup acquisitions share a stronger, more positive relationship with startup investment.[17]

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.[18] Successful exits, almost always via acquisition, inject momentum and help attract more investment capital and talent into these smaller ecosystems.[19] And startup founders often remain in the ecosystem, becoming startup investors and mentors, or beginning new companies there.[20]

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. The agencies' merger guidelines necessarily seek to minimize harmful anticompetitive conduct, but they must not unduly burden the ability for startups to exit via acquisition. Unfortunately, the draft guidelines are imbalanced toward the former, and threaten to proscribe the latter.

III. Startup founders say acquisitions are a good thing, and policymakers shouldn't make it harder to be acquired.

Acquisitions are the most common form of successful startup exit, and it's important to understand their role in the ecosystem and the acquisition experience from those who've lived it. We've attached a pair of Engine reports as appendices to these comments that include both important empirics on startups and acquisitions and a compendium of startup founders, serial entrepreneurs, startup investors, and startup accelerators discussing the critical role of acquisitions in the startup ecosystem.[21] These stakeholders emphasize that acquisitions are a good thing which fund

[15] *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).
[16] *Startup Ecosystem, supra* note 5, at 11-12.
[17] *Id.*
[18] *Id.*
[19] *Id., see also, Global Startup Ecosystem Report,* Startup Genome (2021), https://startupgenome.com/report/gser2021.
[20] *See Startup Ecosystem, supra* note 5, at 11-12, *see also, Global Report supra* note 18.
[21] *Exits, Investment, and the Startup Experience: the Startup Voice on Acquisitions*, Engine (Sept. 2023), https://www.engine.is/s/2023-Startup-Voice-on-Acquisitions.pdf, (Attached as Appendix A);
Exits, Investment, and the Startup Experience: the role of acquisitions in the startup ecosystem, Engine (Oct. 2022), https://static1.squarespace.com/static/571681753c44d835a440c8b5/t/6356f5ccf33a6d5962bc7fd8/1666643406527/Ex

innovation, build ecosystems, democratize wealth, disperse knowledge, cut against discrimination, and are necessary for startups.

Jean Anne Booth, a serial entrepreneur and the current founder and CEO of UnaliWear who has had previous companies acquired by Apple and Texas Instruments, stresses that acquisitions are critical for startups and help to fund what comes next, saying that they shouldn't be limited because that will limit capital flowing to startups and slow innovation. She adds that having a competitive acquisition process is necessary to facilitate fair, positive outcomes for startups, and merger policy should avoid limiting competition for companies:

> "Most startup exits are through acquisitions and they are absolutely necessary because exits are the way that we fund what comes next. The normal lifecycle of companies and entrepreneurs is to start something, hope you at least hit a single, get some money, and plow that capital and knowledge into your next business or into someone else's business as an angel investor. That's my story. If I hadn't sold the earlier companies, UnaliWear wouldn't exist, and the thousands of Americans we give dignity, independence, and safety to would be without our technology. Limiting acquisitions without understanding their role could inadvertently hinder the flow of capital and stunt the progress of groundbreaking technologies.
>
> In the acquisition process it's critical to have competition for companies. A competitive process is what enables founders to negotiate deal terms and close at reasonable valuations. For example, with my semiconductor companies there were only so many potential corporate buyers. If you take any of them away, then you have a less competitive process or you're left with private equity buyers that have other motivations besides innovation. So, if policymakers or enforcement agencies limit who can acquire or what they can acquire, then you'll see worse outcomes for startups, less capital going to funding innovation, and fewer entrepreneurs able to plow money from their exit into the next thing."

Elizabeth Yin, a startup founder turned venture capital firm cofounder and general partner (following the acquisition of her startup) underscores that startup acquisitions build ecosystems through enabling flow of capital and dissemination of knowledge. Limiting acquisitions through bad policy could threaten these positive impacts and opportunities for everyday Americans to build wealth through entrepreneurship:

> "Acquisitions help the startup ecosystem on multiple levels. It helps entrepreneurs build generational wealth and become angel investors to pour back into startup ecosystems. These founders and early employees go on to angel invest in the next generation of founders. VCs

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its_Investment_Startup_Experience_role_of_acquisitions_Report_Engine_Startup_Genome.pdf, (Attached as Appendix B).

> generate wealth for their LPs who can reinvest into more funds and thereby more startups. I believe in democratization of wealth through entrepreneurship, and this is really only possible through acquisitions. Many of these founders whose companies are acquired typically don't come from loads of money, so this really is the American dream. If you start limiting who can acquire or what they can acquire, you're actually limiting opportunities for generational wealth for everyday people.
>
> Acquisitions are not just about the money. They are also an integral part of the knowledge transfer that makes a successful startup ecosystem. Founders that have been through a full cycle from launch to exit know what good looks like and also what mistakes they've made that they won't make again. Having experienced people on your team or experienced people coaching you, is the crux of what makes Silicon Valley successful, and perhaps why in other cities throughout the country, founders have a higher hill to climb without the institutional knowledge that is passed around as often in the San Francisco Bay Area. Acquisitions are good for startup ecosystems everywhere and reducing them would be a real detriment to the U.S."

Tyler Griffin, another startup founder turned investor following the acquisition of his startup, emphasizes acquisitions are a necessary part of the investment model that powers innovation because IPOs are very rare. He additionally emphasizes that acquisitions are good outcomes for startup employees:

> "[W]e've had several portfolio companies exit, almost entirely through acquisitions. We approach every investment believing that the company could one day IPO, but understand that a successful exit probably is going to be an acquisition. IPOs are very hard, don't happen that often, and take many years. If the options for companies or for investors were IPO or total loss you wouldn't be able to sustain startups or an innovation-focused investment model.
>
> Acquisitions are a good thing and they're good for employees, too. Rarely do startup acquisitions involve people losing their jobs. Instead, they result in employees getting higher salaries. If you're an early stage company, you're almost always paying below-market salaries and you're making the difference up with equity. In an acquisition, employees will usually get equity in the acquiring firm and a raise to a market-based salary."

Parag Shah, a serial entrepreneur currently the founder of Vēmos, highlights how he used capital from previous exits to build his company and the important role of acquisitions in helping him attract the investment needed to grow it. He points out that limiting acquisitions will work against these benefits, instead halting innovation and company formation:

> "The initial capital to start Vēmos came from personal funds from the Foodsby exit, but we need investment to grow. The reality of any sort of investment is that investors need a return, or the likelihood of a return—and in the startup ecosystem, that's usually through an acquisition. Exits are such an important part of how innovation is enabled. Taking that away and not allowing people to be acquired would just halt innovation and new companies from forming.
>
> I know policymakers are concerned about a few large tech companies' acquisitions, but those are a small number of overall transactions, and that focus really clouds the overall importance of acquisitions to startups. The reality is that we're open to being acquired by anyone, and policymakers shouldn't make that harder for founders and everyone else that benefits from an exit. Most startups' compensation includes stock options and so an acquisition means liquidity for our employees and their families. An eventual successful exit is sort of their retirement plan because as a startup we aren't able to provide the same benefits as other corporations. At the end of the day, it's not about me, or even our investors, it's about everyone else that believes in what we're building."

Preston L. James II, the CEO and cofounder of DivInc., a startup accelerator focused on removing barriers to entrepreneurship for underrepresented founders, says that policymakers should actually be working to facilitate, rather than restrict M&A in order to help more communities realize the benefits of mergers and acquisitions:

> "Ultimately, anything policymakers can do to help facilitate successful exits for founders—especially underrepresented founders—is really important to the ecosystem. These exits, which lean heavily on M&A, are a critical step in the path of building wealth and creating new opportunities in diverse communities. With the capital from selling their company, as an example, a Black founder can become an investor that then invests in more Black founders. They can share their expertise to help those founders build to their own exit and the cycle repeats. Over time, this ripple effect builds generational wealth and fosters an ecosystem that helps diverse communities to prosper."

Steven Cox, the Founder and CEO of TakeLessons—acquired by Microsoft in 2021—spotlights the risks of limiting acquisitions in response to perceived policy issues in the technology sector:

> "I've been asked recently about big tech acquisitions that are made just to kill off new technologies. Personally, I haven't seen these 'killer acquisitions' where a large company tries to stamp out a small one. It's possible, I suppose, but I find that larger companies are more interested in playing offense than defense. …[P]olicymakers should be thoughtful about limiting mergers and acquisitions by big tech as a way of reigning in the major players. Being acquired is a desirable startup exit path, and restricting it will lead to less capital and less startup competition."

And in an oped following the release of the draft merger guidelines in July, Steven highlighted the broad benefits of acquisitions, writing that "[t]hey promote the building of knowledge, recycling of talent, and flowing of capital through the startup ecosystem, creating jobs and economic growth. They fuel investment in startups that are solving problems and helping people lead better lives."[22]

Shani Shoham, the CEO of software testing startup 21Labs summed it up well, saying "the acquisition of 21 by Perforce was a success and the right move for us, and I hope policymakers don't make these sorts of transactions more difficult." The agencies should heed his advice and that of others in the startup ecosystem. The draft merger guidelines threaten to make startup success more difficult by limiting sought-after startup exit opportunities.

IV. 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.[23] 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.

The characteristics of IPOs make them unique and not interchangeable with acquisitions. IPOs are rare—just four percent of all exits.[24] Companies that IPO tend to be much older, located in a large, preeminent tech hub, more profitable, and more sophisticated.[25] Exits via IPO tend to be much (25 times) larger than exits via acquisition.[26] 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.[27] 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.[28] And early IPO regimes set up in other countries suffer from similar issues with performance in addition to not being true exits for startup founders

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[22] Steven Cox, *Policymakers Are Threatening Startup Success Stories*, Inside Sources (Aug. 6, 2023), https://dcjournal.com/policymakers-are-threatening-startup-success-stories/.

[23] *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).

[24] *Irreplaceable Acquisitions, supra* note 13.

[25] *Id., See also Startup Ecosystem, supra* note 5, at 9-12.

[26] *Irreplaceable Acquisitions, supra* note 13, at 7-8.

[27] *Id.*

[28] *Id.*

or investors—the kind that provide returns and deliver dynamic benefits to their local startup ecosystems.[29]

IPOs are accordingly out of reach of many startups and are only weakly associated with investment in new startups.[30] 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 that are presented by the draft guidelines.

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,[31] 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."[32] 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 markets."[33] 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.[34]

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[29] Appendix B at (24-27)

[30] *Startup Ecosystem, supra* note 5, at 11-12.

[31] *See, e.g.*, *Supra* §III. The volume of voices expressing these concerns would be difficult to capture in one footnote, and the agencies have received several comments and earlier RFI responses to the same. Also, *see 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.

[32] *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.

[33] *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).

[34] *See, e.g, Startup Ecosystem, supra* at note 5, at 9-12; Appendix B; *and, e.g.*, *The Cost of Being a Public Company in Light of 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

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."[35] The FTC and DOJ must further refine these draft merger guidelines 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.

V. <u>The draft merger guidelines diminish the availability of acquisitions as an exit path for startups and fail to adequately incorporate positive effects of mergers and acquisitions.</u>

In their zeal to mitigate anticompetitive conduct, the agencies' have drafted merger guidelines likely to proscribe procompetitive or innocuous acquisitions useful for the startup ecosystem, thereby actually accidentally mitigating innovation. The guidelines discourage acquisitions—even potentially beneficial ones—misunderstand how innovation happens in the technology sector, and take would-be acquirers off the table. And though the guidelines include a subsection on procompetitive efficiencies, this section appears largely self-defeating, detailing ways efficiencies may not be considered rather than how they can be realized.[36]

Several guidelines strike at the availability of exit by acquisition for startups. Through its 30 percent market share threshold,[37] Guideline 1 takes potential acquirers off the table, reducing competition for companies, worsening outcomes for startups, their employees, and other shareholders. Running a competitive acquisition process, for which many potential buyers are necessary, is key for a startup to secure the best possible terms. Less competition for companies reduces deal values, diminishing the benefits of an exit for key stakeholders, like investors (who invest in new companies),[38] founders (who start new companies),[39] and their employees (who become founders).[40] Other things equal, this is a strictly worse outcome for innovation.

Likewise, Guideline 4 discourages acquiring startups with its "preference for internal growth over acquisition."[41] This assertion relies on old case law that does not comport with the advent of new investment models or current economic understanding of how innovation happens. Guideline 4 cites cases from 1974 and earlier—before the true advent of venture capital.[42] Today, very few companies get very large without venture capital investment, and venture capital is the primary way

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[35] *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) (Testimony of Bettina Hein).
[36] *Merger Guidelines*, *supra* note 1 at § IV.(3)(C).
[37] *Merger Guidelines*, *supra* note 1 at Guideline 1.
[38] *See generally* appendices A&B.
[39] *Id.*
[40] *Id.*; (of course, not all employees go on to start their own companies, but it happens with enough frequency—using resources from an exit experienced as an employee—that stanching acquisitions will reduce beneficial economic outcomes).
[41] *Merger Guidelines*, *supra* note 1 at Guideline 4.
[42] *Id.*

that innovation is financed.[43] Though venture capital is traced to nascency following the Second World War, capital committed to venture capital firms only became meaningful following rules changes in 1979 that freed pension funds to invest in venture capital.[44] And venture capital deployed at that time was more than three orders of magnitude less than recent years.[45] Guideline 4 is likely to proscribe acquisitions of startups that comprise a critical part of this investment model that finances innovation in the U.S.

Guideline 7 embraces the flawed 'killer acquisition' theory,[46] which by and large doesn't match with the lived experience of startups,[47] and in so doing, only harms startups by limiting exit opportunities. Guideline 7 forecloses the acquisition of "nascent competitor" (read: startup). Acquiring a firm just to shelve it—in this scenario, likely by overpaying—is a poor allocation of capital and defies economic sense. And even if this were to occur, the winners from the transaction—founders and other shareholders use resources from the transaction to start new companies, usually in the same sector.[48]

Guideline 8—because it is dependent on trends rather than the individual merits of a transaction—could lead to challenges of transactions that don't otherwise present competitive concerns and thereby limit acquisitions of startups.

By definition, Guideline 9 will lead to challenging transactions beyond their own merits. And like Guideline 4, could prevent otherwise beneficial acquisitions of startups. Several startups innovate in the margins—solving niche problems that larger firms have failed to address. These companies are ultimately features but don't constitute a product and are likely to struggle to scale as a viable standalone company. Private equity and strategic buyers alike may acquire several such companies to bring those innovations to scale and better compete with rival firms.[49]

Guideline 13 is a catchall, inspires uncertainty, and—if the agencies desire to convey this information—it might be better accomplished as part of the overview, rather than as a separate guideline.

Taken together, the draft merger guidelines are far too impermissive of M&A, and thereby threaten a pillar of the startup ecosystem—exits by acquisition. The agencies should revise the guidelines to

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[43] Appendix B.
[44] *See* Paul Gompers & Josh Lerner, *What Drives Venture Capital Fundraising*, NBER Working Paper (Jan. 1999), https://www.nber.org/system/files/working_papers/w6906/w6906.pdf; *and see* appendix B at 13.
[45] *See generally* Appendix B.
[46] Papers like Cunningham et al., *Killer Acquisitions*, J. Pol. Econ. (2021), https://doi.org/10.1086/712506, find what they call 'killer acquisitions' in the pharmaceutical industry. There are relevant differences that mean this and related work should have little bearing on the technology sector where there isn't intellectual property, like a drug patent, to shelve).
[47] *Supra* § III; Appendices A&B
[48] *Id.*
[49] *Id.* (especially appendix B at 22-23).

include the potential benefits of some transactions and acknowledge that the overwhelming majority of transactions pose few competitive concerns and do not command attention from the agencies.

VI. **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. Startup founders and investors that have sold their companies or portfolio companies are emphatic about the importance of a competitive process to arrive at the best outcomes for themselves, their employees, shareholders, and the broader economy.[50] The draft merger guidelines are likely to limit demand for acquisitions, thereby diminishing the competition for companies critical to drive positive outcomes.

The mission of the FTC 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)."[51] While the Commission's mission regrettably no longer includes the emphasized phrase,[52] this principle of balance and avoiding undue burdens should guide the agencies to further refine the draft merger guidelines.

Much as Customs and Border Protection (whose mission has similarly acknowledged the dual role of protecting Americans while promoting legitimate business activity)[53] 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

[50] Appendix A at 3-15.
[51] *See* 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).
[52] *See "About the FTC,"* FTC, https://www.ftc.gov/about-ftc.
[53] *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.

mergers that are either competitively beneficial or neutral,"[54] 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."[55] The agencies' new draft merger guidelines fail to acknowledge accounting for benefits and avoiding interference with transactions that are beneficial or present few issues as the agencies conduct merger enforcement.[56] These phrases should be restored to the draft guidelines and the broader guidelines should be reworked to follow this notion of balance.

VII. <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.[57] Unfortunately, the draft merger guidelines instead are rooted in old and controversial cases, like *Brown Shoe* (decided in 1962), which undermines the efficacy of the new guidance.[58]

Companies observe and learn from past enforcement and respond to the implicit or explicit threat of enforcement.[59] The uncertainty created by unobjective enforcement that is not predictable or ground in precedent may chill acquisition activity, cause merging parties to engage in costly, drawn out litigation, or cause companies to abandon planned acquisitions.[60]

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

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[54] *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.

[55] *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.

[56] *Merger Guidelines*, *supra* note 1

[57] 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.

[58] *Merger Guidelines*, *supra* note 1 (the draft guidelines cite *Brown Shoe* (1962) more than two dozen times and the weighted average age of cited cases is nearly 50 years); *see also* Jason Furman & Carl Shapiro, *How Biden Can Get Antitrust Right*, Wall St. J. (July 27, 2023), https://www.wsj.com/articles/how-biden-can-get-antitrust-right-khan-ftc-justice-department-guidelines-11364639.

[59] 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.

[60] *Id.*

funds.[61] 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 theories of competition unsupported by economic analysis or recent case law.

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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 further refine guidelines for merger 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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[61] *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).