FTC-DOJ Vertical Merger Guide Aims To Boost Transparency

By **Maureen Ohlhausen and Christine Ryu-Naya** (January 23, 2020)

On Jan. 10, the Federal Trade Commission and the Antitrust Division of the U.S. Department of Justice released joint draft vertical merger guidelines. The draft guidelines, which will be open to public comment for 30 days, rescind the nonhorizontal merger guidelines issued by the DOJ in 1984. The 1984 guidelines were widely considered out-of-date and not representative of agency practice.


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Although vertical mergers were generally — though not categorically — viewed as competitively neutral or pro-competitive for the past several decades, the new draft guidelines come at a time when vertical mergers have been garnering significant headlines and debate. This is due to several factors, including the DOJ's high-profile challenge to the merger between AT&T Inc. and Time Warner Cable in 2017 and vigorous dissents by FTC Commissioners Rebecca Slaughter and Rohit Chopra in Staples Inc.'s 2018 acquisition of Essendant Inc.

The press release announcing the issuance of the draft guidelines included quotes from the heads of both agencies acknowledging the need for revised guidance to provide increased transparency and better reflect current agency practice. FTC Chairman Joseph Simons noted that "challenging anticompetitive vertical mergers is essential to vigorous enforcement" and that "greater transparency about the complex issues surrounding vertical mergers will benefit the business community, practitioners, and the courts."

Assistant Attorney General Makan Delrahim added that "the revised draft guidelines are based on new economic understandings and the agencies' experience over the past several decades."[1]

The draft guidelines outline the agencies' approach to market definition and shares, identify possible anti-competitive effects of vertical mergers and discuss the consideration of potential benefits from vertical mergers. The draft guidelines identify anti-competitive effects arising primarily from foreclosure, raising costs for rivals, permitting access to rivals' sensitive business information and enabling or encouraging coordination between the merged company and other firms.

The draft guidelines are intended to be read in conjunction with the principles and goals of the agencies' joint Horizontal Merger Guidelines issued in August 2010.

Market Definition and Market Share

As with a horizontal merger, the agencies' review of a vertical merger normally involves the identification of one or more relevant markets in which the merger may substantially lessen competition. The draft guidelines refer to the methodology set forth in the horizontal merger guidelines as the appropriate approach for vertical mergers as well.[2]

As part of the evaluation, the agencies may also consider market shares and market concentration. Although noting that the agencies will rely on the methodology set out in the horizontal merger guidelines to measure concentration, the draft guidelines state that they will not rely on changes in concentration (e.g., changes in the Herfindahl–Hirschman Index) as an indicator of competitive effects from vertical theories of harm.[3]

The draft guidelines state that the agencies are unlikely to challenge a vertical merger when the companies involved have less than a 20% share of the relevant market and the product related to that market is used less than 20% of the time.[4] However, this is not an absolute safe harbor, and lower shares can trigger antitrust concerns (for example, if the related product is new and its presence in the market is rapidly growing).

Conversely, a "share of 20% or more in the relevant market or a related products' share of use in the relevant market of 20% or more, or both, does not, on its own, support an inference that the vertical merger is likely to substantially lessen competition."[5] In other words, the 20% thresholds are not a "rigid screen," but are instead meant to help identify mergers that are unlikely to pose competitive harm, as well as mergers where other competitive factors should be considered.

Possible Anti-Competitive Effects

The draft guidelines also identify possible anti-competitive effects — both unilateral and coordinated — of vertical mergers. The first of these is foreclosure, which refers to a merged entity refusing to supply rivals with an input or resource (such as a distribution system) that one of the merging parties previously supplied.

Relatedly, a merged entity could also raise its rivals' costs by charging a higher price for related products or by lowering service or product quality. In analyzing theories of foreclosure and raising rivals' costs, the agencies may examine whether such tactics would actually reduce rivals' sales, if it would benefit the merged entity and whether there is more than a de minimis competitive impact.[6]

Another potential unilateral effect involves access to competitively sensitive information. Specifically, a vertical merger may allow a merged entity to gain access to sensitive business information about upstream or downstream rivals, which it could use to shape its response to a rival's competitive actions.[7]

In some cases, a vertical merger may enable or encourage post-merger coordinated interaction among firms that harms customers. Section 7.1 of the horizontal merger guidelines notes that the agencies "are more likely to challenge a merger on the basis of coordinated effects when the relevant market shows signs of vulnerability to coordinated conduct, and the agencies have a credible basis on which to conclude that the merger may enhance that vulnerability."

The draft guidelines also refer to the horizontal merger guidelines' list of evidence relevant to evaluating a market's vulnerability to coordination.

A vertical merger may enhance vulnerability to coordination by eliminating a maverick firm or impacting its ability to compete. A merged firm's access to confidential information could also give rise to coordinated effects, including by facilitating tacit agreements between market participants. However, the draft guidelines acknowledge that some effects of a vertical merger may make the market less vulnerable to coordination, which could reduce these risks.[8]

Potential Benefits of Vertical Mergers

Finally, the draft guidelines state that the agencies will weigh the potential benefits that vertical mergers can create. A particularly important benefit is the elimination of double marginalization, which may otherwise lead to reduced output in a market because of successive markups in a chain of distribution.

Notably, Delrahim gave a speech on eliminating double marginalization last year in which he noted that "double marginalization is present only in some vertical relationships, and therefore eliminated by only some vertical mergers."[9] Delrahim's speech further detailed that "the burden is on the parties in a vertical merger to put forward evidence to support and quantify [eliminating double marginalization] as a defense."[10]

This view is reflected in the draft guidelines, which specify that the agencies will generally be reliant on the parties to identify incentives to eliminate double marginalization, which will be judged on how realistic they are, whether the parties already had a contractual relationship potentially duplicating the effect and other pressures on pricing.

Ultimately, the draft guidelines state that "the Agencies will not challenge a merger if the net effect of elimination of double marginalization means that the merger is unlikely to be anticompetitive in any relevant market."[11]

The draft guidelines also state that efficiencies gained from a merger will also be considered as potential offsets to anticompetitive harms if cost savings are passed on to customers. Such efficiencies can include streamlined production, inventory management, distribution or the creation of innovative products.[12]

Again, the draft guidelines refer to their horizontal counterparts, stating that the agencies will evaluate efficiency claims using the approach set forth in Section 10 of the horizontal merger guidelines. Interestingly, the 1984 nonhorizontal merger guidelines stated that efficiencies in vertical mergers would receive "relatively more weight" than in the horizontal merger analysis.

The draft guidelines state that the agencies will not challenge a merger if the cognizable efficiencies are "of a character and magnitude such that the merger is unlikely to be anticompetitive in any relevant market."[13]

Commissioner Statements on the Draft Guidelines

The FTC's announcement of the draft guidelines notes that the vote to publish was 3-0-2, with Slaughter and Chopra abstaining. Both abstaining commissioners issued statements about the draft guidelines, as did Commissioner Christine Wilson, who voted in support of issuance.

Wilson's statement suggests that vertical mergers are likely to be pro-competitive and encourages comment on a set of issues, including the treatment of the elimination of double marginalization, whether pro-competitive and anti-competitive effects should be evaluated symmetrically and whether the guidelines should establish a definitive safe harbor.[14]

Slaughter's statement generally supports much of the draft guidelines and praises their focus on requiring evidence of benefits but raises concerns about the effective safe harbor for firms with less than 20% market share. She also writes that the draft guidelines set too high a bar for enforcement and expresses concern about "the departure from Section 7 of the Clayton Act's mandate to stop anti-competitive mergers in their incipiency."[15]

In his statement, Chopra asserts that "the draft guidelines do not account for all of the ways the existing dominance can be used to choke off market entry or distort competition," and he calls for consideration of a broader set of harms. His statement also encourages the FTC to stake out broader prohibitions even if the DOJ does not agree.[16]

Conclusion

Although the draft guidelines do not meaningfully change the current theories of analysis for or types of cognizable anti-competitive harms arising from vertical mergers, they do signal that the agencies will carefully scrutinize such transactions and that merging parties will be held to a searching evidentiary obligation to prove efficiencies and pro-competitive benefits.

For practitioners, the guidelines offer some welcome clarity about how the agencies will approach inquiries into vertical mergers. For example, while still a far cry from Canada's established "efficiencies defense" (itself the subject of much debate), the draft guidelines acknowledge the potential for cognizable efficiencies that benefit competition and state that the agencies will evaluate efficiency claims using the approach set forth in Section 10 of the horizontal merger Guidelines.

The horizontal merger guidelines define "cognizable efficiencies" and give examples of when efficiencies arguments are most likely to be successful, offering practitioners a sense of the threshold to meet. Similarly, the draft guidelines' statement that challenges are unlikely where parties have a share of less than 20% offers concrete guidance that practitioners can use to advise clients.

Ultimately, both the draft guidelines and the announcement of their release express an intent to assist businesses and antitrust practitioners by providing transparency about current enforcement practices. The agencies will be accepting public comments until Feb. 11.

Businesses and practitioners may soon have additional guidance from across the pond as well: The European Commission is currently reviewing the Vertical Block Exemption Regulation (the regulation applying to vertical agreements) and is expected to publish proposals to revise the regulations sometime in the second quarter of 2020.

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[1] Press Release, "FTC and DOJ Announce Draft Vertical Merger Guidelines for Public

Comment," https://www.ftc.gov/news-events/press-releases/2020/01/ftc-doj-announce-draft-vertical-merger-guidelines-public-comment (January 10, 2020).

[2] U.S. Dep't of Justice and Fed. Trade Comm'n,Horizontal Merger Guidelines at Sections 4.1 and 4.2, https://www.justice.gov/atr/horizontal-merger-guidelines-08192010 (2010).

[3] See Sections 5.1, 5.2, and 5.3 of the Horizontal Merger Guidelines.

[4] U.S. Dep't of Justice and Fed. Trade Comm'n,Draft Vertical Merger Guidelines at Section 3 (2020).

[5] Id.

[6] Draft Vertical Merger Guidelinesat Section 5(a).

[7] Id.at Section 5(b).

[8] Draft Vertical Merger Guidelines at Section 7.

[9] Assistant Attorney General Makan Delrahim, "'Harder Better Faster Stronger': Evaluating EDM as a Defense in Vertical Mergers," Remarks at George Mason Law Review 22nd Annual Antitrust Symposium (Feb. 15, 2019), https://www.justice.gov/opa/speech/assistant-attorney-general-makan-delrahim-delivers-remarks-george-mason-law-review-22nd.

[10] Id.

[11] Draft Vertical Merger Guidelinesat Section 6.

[12] Id.at Section 8.

[13] Id.

[14] Christine S. Wilson, Concurring Statement of Commissioner Christine S. Wilson Concerning the Publication of FTC-DOJ Draft Vertical Merger Guidelines for Public Comment (Jan. 10, 2020), https://www.ftc.gov/public-statements/2020/01/concurring-statement-commissioner-christine-s-wilson-concerning.

[15] Rebecca Kelly Slaughter, Statement of Commissioner Rebecca Kelly Slaughter on the FTC-DOJ Draft Vertical Merger Guidelines (Jan. 10, 2010), https://www.ftc.gov/public-statements/2020/01/statement-rebecca-kelly-slaughter-ftc-doj-draft-vertical-merger-guidelines.

[16] Rohit Chopra, Statement of Commissioner Rohit Chopra Regarding the Request for Comment on Vertical Merger Guidelines (Jan. 10, 2020), https://www.ftc.gov/public-statements/2020/01/statement-commissioner-rohit-chopra-regarding-request-comment-vertical.