Antitrust

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DOJ and FTC Release New Vertical Merger Review Guidelines for Public Comment

On Friday, January 10, the Department of Justice's Antitrust Division and the Federal Trade Commission issued new guidelines for the agencies' review of vertical mergers. Vertical mergers involve the combination of firms operating at different levels of the same supply chain, such as a manufacturer acquiring its supplier or its distributor. The proposed Vertical Merger Guidelines (the "Guidelines") are intended to provide businesses with guidance regarding the circumstances in which the agencies might decide to challenge a vertical merger. The Guidelines are currently open for public comment.

KEY POINTS

Although they do not set out strict criteria for an agency investigation, the Guidelines do outline several key factors likely to play a role in the agencies' merger analysis, specifically:

- **20% Market Share Threshold:** In vertical mergers, the agencies not only examine the relevant market but also the related product. A related product is a good or service that is "supplied by the merged firm, is vertically related to the products or services in the relevant market, and to which access by the combined entity's rivals will affect competition in the relevant market."[1] The proposed Guidelines establish that the agencies are unlikely to challenge a vertical merger where the parties to the transaction have less than a 20% share of the relevant market and the related product is used in less than 20% of the relevant market. The threshold recognizes that firms with low market shares are unlikely to have the ability to harm competition. However, if the related product is new or its use in the relevant market is growing, the agencies may choose to challenge a merger even if these thresholds are not met. [2] This is consistent with the agencies forward looking approach to assessing the legality of a proposed transaction.

- **Foreclosure & Raising Rivals' Costs:** The agencies are more likely to challenge a transaction if, as a result of the merger, the combined firm will have both the ability and incentive to foreclose competition in the relevant market by denying/impeding access to or raising their rivals' cost to access to an input (the related product) that they need to compete. The agencies analyze the likelihood of foreclosure and other negative effects on rivals by examining the benefit of such actions to the merged firm and the magnitude of the impact on its competitors.[3] This view is consistent with the approach taken recently by DOJ in its unsuccessful challenge of AT&T's acquisition of Time Warner (there the district court, which was upheld by the D.C. Circuit, rejected the notion that AT&T ownership of related products (Time Warner's programming content, such as HBO) gave it sufficient "bargaining leverage" to foreclose competitors of AT&T/DirectTV's multichannel video distribution business (e.g., cable/satellite TV).

- **Access to Competitively Sensitive Information:** Vertical mergers may also raise concerns with the agencies where there is the potential for the merged firm to gain access to competitively sensitive information about its competitors. Such access may allow the merged firm to preempt rivals' procompetitive business decisions. The merged firm's competitors could also refrain from doing business with the merged firm due to concerns over information access, potentially rendering these rivals less effective as competitors.[4] This view is consistent with the approach taken in the FTC's recent settlement with Staples over its acquisition of Essendant where the FTC alleged that Staples, the largest reseller of office products, would have access to commercially sensitive business information on Essendant's reseller customers of office products which would allow Staples to offer higher prices than it would otherwise when bidding against its reseller competitors.
- **Coordinated Effects:** Vertical mergers may also create agency concern where there is a credible risk that the merger will enable or encourage coordinated interaction among firms in the relevant market. This can occur as the result of the market structure (e.g., a vertical merger giving a firm the ability to foreclose competition from a price maverick by raising their cost to access a related product) or by facilitating coordination through the access to competitively sensitive information and the interaction with competitors that occurs from supplying them the related product. Where the relevant market shows signs of vulnerability to coordinated conduct, the agencies are more likely to be concerned about the possibility of tacit collusion.[5]

Recognizing that vertical mergers may also result in procompetitive benefits, the Guidelines also lay out several factors the agencies consider in determining whether to clear a proposed merger, including:

- **Elimination of Double Marginalization:** The agencies are unlikely to challenge a vertical merger where the merger would eliminate double marginalization of a product. Where two merging firms are vertically related and each charge a profitable margin on their products, the merged firm will benefit from both margins on any additional sales and the merged company can reduce prices to downstream buyers while still maximizing its profit margins. However, the elimination of double marginalization cannot always be relied upon as evidence of the procompetitive effects of a merger.[6]
- **Efficiencies:** The agencies are unlikely to challenge a vertical merger where there is evidence of cognizable efficiencies resulting from the proposed merger.[7]

THE DISSENTING VIEWS

Although issued by both the DOJ and FTC, two FTC Commissioners opted to abstain from the Commission vote on opening the proposed guidelines for public comment. Rebecca Slaughter and Rohit Chopra, the two Democratic Commissioners, have issued separate dissenting statements contending the revised Guidelines do not fully address the concerns raised by vertical mergers.

Commissioner Slaughter, while agreeing with the need to update the Guidelines, raised concerns that the 20% market share threshold would create an effective safe harbor for vertical mergers. She also contends the proposed Guidelines require a degree of certainty regarding a vertical merger's anticompetitive effects, noting that this high standard may make it difficult to stop anticompetitive mergers in their incipiency.[8]

Commissioner Chopra has also expressed support for revising the Guidelines but argues that the proposed Guidelines rely too heavily on theoretical models as evidence of a merger's harm to competition. Commissioner Chopra further objected to the Guidelines' failure to address the role of "big data" in motivating vertical mergers and the possible anticompetitive results.[9]

TAKEAWAYS

- Unsurprisingly, the Guidelines are relatively general and reflect conventional and well-accepted economic principles in vertical merger analysis that are reflected in existing legal precedent. The Guidelines also do not address remedies and their absence creates questions whether the agencies chose to avoid the legal debate around vertical merger remedies (e.g., the agencies under the current administration's reluctance to accept behavioral remedies even though most vertical merger concerns have historically been remedied through behavior commitments such as firewalls and nondiscrimination obligations).
- Although the Guidelines provide valuable insight into how the antitrust agencies will evaluate a vertical merger, the Guidelines are not law and the agencies are not required to strictly adhere to them. Ultimately, the facts of each transaction will dictate the outcome of a merger analysis.
- With horizontal mergers, case law has established rebuttable presumptions that certain merger outcomes are anticompetitive. No such presumption exists for vertical mergers, meaning that the agencies face an enormous challenge to demonstrate a merger's anticompetitive effects as can be seen in DOJ's unsuccessful challenge of AT&T/Time Warner.
- Vertical mergers are generally acknowledged to be procompetitive except in limited circumstances. Importantly, however, the proposed Guidelines do not establish any presumption that a vertical merger will benefit competition.

[1] DOJ & FTC, DRAFT VERTICAL MERGER GUIDELINES 2 (Jan. 10, 2020), *available at* https://www.justice.gov/opa/press-release/file/1233741/download.
[2] *Id.* at 3.
[3] *Id.* at 4-5.
[4] *Id.* at 6-7.
[5] *Id.* at 8.
[6] *Id.* at 7.
[7] *Id.* at 9.
[8] REBECCA SLAUGHTER, STATEMENT OF COMMISSIONER REBECCA KELLY SLAUGHTER 2-3 (Jan. 20, 2020), *available at* https://www.ftc.gov/system/files/documents/public_statements/1561721/p810034slaughtervmgabstain.pdf.
[9] ROHIT CHOPRA, STATEMENT OF COMMISSIONER ROHIT CHOPRA 2, 4 (Jan. 20, 2020), *available at* https://www.ftc.gov/system/files/documents/public_statements/1561727/p810034chopravmgabstain.pdf.