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New US Antitrust Merger Guidelines Focus on 'Vertical' Acquisitions

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Reaction to recent trial losses; focus of enforcement will remain on mergers between competitors

On June 30, the US Department of Justice and the Federal Trade Commission published new Vertical Merger Guidelines clarifying the analytical framework the agencies use to evaluate transactions between companies that are not current or potential future competitors – so-called "vertical" transactions.

The guidelines replace 1984 guidance issued by the DOJ. They are touted by the agencies as providing predictability and clarity, while affirming the agencies' commitment to vigorous enforcement and willingness to challenge such transactions. Transparency is valuable as the agencies increasingly scrutinize vertical mergers, including those by online platforms that are not competitors, and review consummated deals in high-tech markets.

Understanding the agencies' playbook for assessing vertical transactions, and effectively advancing efficiency defenses, can make the difference between winning or losing before the agencies, or succeeding in court before a judge if a transaction is challenged.

Backdrop: DOJ's loss in *AT&T/Time Warner,* FTC Hearings on Competition and Consumer Protection in the 21st Century and public comments on draft guidelines

The guidelines are, at least in part, a reaction to DOJ's failed 2018 challenge to AT&T's $85 billion acquisition of Time Warner, the then-owner of CNN, HBO and Warner Brothers, which was the first litigated challenge to a vertical transaction in nearly 40 years. After a six-week trial, the US District Court for the District of Columbia found that DOJ failed to show the acquisition was likely to lessen competition, marking DOJ's first loss in a merger challenge since 2004. The DC Circuit Court affirmed the district court's decision, noting that the DOJ's vertical merger guidelines had not been updated since 1984, but declined to provide clarity on the proper legal standards for evaluating vertical mergers.

The recent FTC Hearings on Competition and Consumer Protection in the 21st Century also addressed, among other topics, a deep dive into vertical merger analysis. Those hearings addressed the question, "What guidance should they provide regarding the assessment of the competitive effects of vertical mergers, including the substantive theories of competitive harm and the treatment of transaction-related efficiencies?" The FTC cited these hearings as informing the guidelines.

The guidelines follow issuance of a draft in January and more than 70 public comments. The two Democrats on the commission abstained from the issuance of the draft guidelines and the final guidelines address their concerns in part, although they still dissented from the final product.

2020 vision on the newly issued guidelines

The 2020 guidelines update the DOJ's 1984 Vertical Merger Guidelines to reflect both agencies' current enforcement stance, including a more expansive review of "the principal concern in any vertical merger review: How may a vertical merger create a firm with the ability and incentive to foreclose, in whole or in part, a rival from a relevant market and cause net harm to consumers?"

Undoubtedly, the agencies aim to provide courts with an understanding of where they draw the line on allowable mergers between companies that are not competitors. Indeed, courts rely heavily on the Horizontal Merger Guidelines, often citing them in decisions involving challenges to mergers among competitors. The agencies clearly hope courts will find the vertical guidelines equally influential and citable, and avert outcomes like *AT&T/Time Warner*.

Key takeaways

Key takeaways from the guidelines include: (1) clarification on the relationship between market definition and "related products"; (2) the theories of harm that the agencies will pursue; (3) articulation of the "elimination of double marginalization" as a procompetitive efficiency; (4) no guidance on remedies; and (5) no quasi-safe harbor on market share.

Clarification on relationship between market definition + 'related products'

The guidelines lay out the agencies' approach to defining relevant markets in analyzing vertical mergers, borrowing from the methodology set out in the 2010 Horizontal Merger Guidelines, but also that the agencies may identify one or more "related products." A related product is a "product or service that is supplied or controlled by the merged firm and is positioned vertically or is complementary to the products and services in the relevant market." A related product may be "an input, a means of distribution, access to a set of customers, or a complement." An example offered in the guidelines is a retail chain buying the manufacturer of cleaning products. In the example, the merged firm could affect downstream competition between retailers, or conversely the merged firm could impact competition between manufacturers.

Theories of harm for vertical mergers

1. Foreclosure and raising rivals' costs

The guidelines focus on raising rivals' costs and foreclosure as competitive concerns, explaining that a vertical merger may "diminish competition by allowing the merged firm to profitably use its control of the related product to weaken or remove the competitive constraint from one or more of its actual or potential rivals in the relevant market" and "increase the vertically integrated firm's incentive or ability to raise its rivals' costs by increasing the price or lowering the quality of the related product."

The guidelines also make clear that a merged firm could "refuse to supply rivals with the related products altogether." Examples highlight potential competitive harm from creating the need for two-level entry, raising rivals' distribution costs, mergers of complements, diagonal mergers and the acquisition of firms that are most likely potential competitors.

2. Access to competitively sensitive information

The guidelines also advise that vertical mergers can facilitate anticompetitive conduct by allowing the post-merger firm "to gain access to competitively sensitive business information about rivals in either upstream or downstream markets," which could restrict competition by allowing the merged firm to anticipate or react quickly to a rival's business strategy. This stance aligns with recent agency enforcement actions in the broadcast and other industries.

3. Coordinated effects

The guidelines also discuss potential harm to competition from coordinated effects. They suggest, for example, that a merged firm could "use its control over a related product or service to harm the ability of a non-merging maverick to compete in the relevant market" increasing the likelihood of collusion or coordinated interaction.

Elimination of double marginalization as a procompetitive effect

The guidelines acknowledge that vertical mergers can result in the elimination of double marginalization, now commonly referred to by its acronym, EDM. EDM occurs following the merger of vertically integrated firms operating at different levels in the supply chain which before the merger applied their own markups on prices at both the downstream and upstream levels. In the context of a vertical merger, incurring lower costs for the upstream input due to EDM can incentivize the merged firm to set lower downstream prices to the benefit of consumers. The guidelines advise that it is "incumbent upon the merging firms to provide substantiation for claims that they will benefit from the elimination of double marginalization."

No guidance on appropriate remedies for vertical transactions

Despite criticism regarding the lack of discussion of remedies, whether behavior or structural, in the draft guidelines, the final version also remains silent on this point. Such discussion would have been welcomed, given DOJ skepticism of so-called "behavioral" or non-structural remedies which have been more often accepted by the FTC. The Trump DOJ's refusal to accept behavioral remedies in AT&T/Time Warner, similar to those accepted by the Obama DOJ to resolve concerns with the Comcast-NBC Universal merger, is one reason that matter was litigated and explains DOJ's loss, in part.

No market share quasi-safe harbor

The draft vertical merger guidelines included a quasi-safe harbor based on market shares. The draft guidelines stated that the agencies would be unlikely to challenge vertical mergers in which the parties "have a share in the relevant market of less than 20 percent, and the related product is used in less than 20 percent of the relevant market." That proposal drew significant criticism and was left out of the final guidelines in favor of a broad reference to the methodology used in the 2010 Horizontal Merger Guidelines for measuring shares and concentration in a relevant market.

Democratic commissioners dissented from issuance of guidelines citing continued concerns with process and substance

Both Democratic FTC commissioners, Rohit Chopra and Rebecca Slaughter, dissented to the issuance of the guidelines. Chopra took issue with what he said was the guidelines' "support for the status-quo ideological belief that vertical mergers are presumptively benign, and even beneficial." He attacked the guidelines as relying on "contested economic theories and ideology." Slaughter focused her dissent on both process and substance, though did acknowledge positive changes between the draft and the final version. Slaughter expressed four concerns: "(1) the over-emphasis of the benefits of vertical mergers; (2) failure to identify merger characteristics that are most likely to be problematic; (3) the treatment of the elimination of double marginalization ("EDM"); and (4) the omission of important competition concerns including buy-side power, regulatory evasion, and remedies."

Looking ahead

Though the guidelines arrive on the heels of high-profile investigations, court battles and spirited debates regarding the appropriate analytical framework for evaluating vertical mergers, they do not mark a significant diversion from practitioners' understanding of the agencies' approach to evaluating vertical mergers today. Their issuance, and the changes from the draft to final, do underscore that the agencies are increasingly focused on vertical mergers and will be looking for test cases to apply the newly-issued guidance. Acquisitions by platforms, for example, are likely to be a ripe area for agency scrutiny.

Parties considering vertical mergers – particularly those where firms have high shares upstream and downstream and competitors may complain about higher costs or foreclosure – should analyze the risks that a particular transaction might raise in light of the issuance of the guidelines.

Key Contacts

Megan Browdie Washington, DC	mbrowdie@cooley.com +1 202 728 7104
Howard Morse Washington, DC	hmorse@cooley.com +1 202 842 7852