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DOJ and FTC Announce New Draft Vertical Merger Guidelines

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On January 10, 2020, the Department of Justice's Antitrust Division ("DOJ") and the Federal Trade Commission ("FTC") (together, the "Agencies") released Draft Vertical Merger Guidelines (the "Draft Guidelines") that are intended to outline the Agencies' "principal analytical techniques, practices and enforcement policy . . . with respect to vertical mergers and acquisitions."[1] Vertical mergers are defined as those mergers "combin[ing] firms or assets that operate at different stages of the same supply chain" such as a product manufacturer acquiring one of its input suppliers, or a retail chain acquiring a company that manufactures products sold in the retailer's stores.[2]

Background and Process

For years, commentators and practitioners have sought updated vertical merger guidelines from the Agencies, as the previous guidance has long been viewed as too outdated and divorced from current practice to be useful. Although these new Draft Guidelines will undoubtedly spur fresh, Goldilocks-like debate over whether their guidance is too lax, too aggressive, or "just right," the mere fact of updated input from the Agencies on this important topic is noteworthy and useful. Notably, the Draft Guidelines are not binding on any court, and indeed not binding on the Agencies themselves. However, over time, portions of the Draft Guidelines, once finalized, will almost certainly make their way into litigation pleadings and court opinions.

The Draft Guidelines should be read alongside the Agencies' joint 2010 Horizontal Merger Guidelines, as the new Draft Guidelines draw heavily from and incorporate many of the analytical concepts and principles outlined in the Horizontal Merger Guidelines. In terms of prior vertical merger guidance from the Agencies, the Draft Guidelines are explicitly intended to supersede prior guidance from the relevant portions of the Department of Justice's 1984 Merger Guidelines.[3]

The Draft Guidelines are open to public comment for thirty (30) days, until February 11, 2020. The Agencies will consider the comments received during the public comment period before issuing final guidelines.

Theories of Competitive Harm

The Draft Guidelines describe several theories of anticompetitive harm that may result from vertical mergers, addressing both so-called unilateral effects as well as coordinated effects.

- Unilateral Effects

  The Agencies describe two "common types" of unilateral anticompetitive effects that may arise from vertical mergers: **(1) foreclosure and raising rivals' costs**, and **(2) access to competitively sensitive information**. Notably, the Draft Guidelines make clear that "[t]hese [examples of possible anticompetitive] effects do not exhaust the types of possible unilateral effects."[4]

  - **Foreclosure and raising rivals' costs:** Following a vertical merger, a merged firm may find it profitable to restrict or withhold access to one or more related products (*e.g.*, by raising price, lowering service or quality, or outright refusal to supply) to its actual or potential rivals in the relevant market. The Draft Guidelines explain that the effect of such conduct may be to weaken actual or potential rivals and thereby diminish competition.
  - **Access to competitively sensitive information:** Vertical mergers also may result in firms having access to sensitive business information about upstream or downstream rivals that they did not have access to pre-merger. Such knowledge may reduce competition by leading the combined firm to act or react in a less competitive way to rivals' conduct, or by impairing the competitive strength or behavior of rivals, who, for example, may choose not to do business with the combined entity in order to prevent the merged firm's access to sensitive information, and may instead do business with higher-cost or less-preferred business partners.

- Coordinated Effects

  The Draft Guidelines also describe how vertical mergers may reduce competition through so-called coordinated effects, *i.e.*, by facilitating post-merger coordination among rivals.[5] The specific coordinated effects concerns described in the Draft Guidelines are:

  - **Eliminating or hobbling a "maverick" firm:** A combined firm resulting from a vertical merger could act anticompetitively by restricting a so-called maverick firm's access to a related product, thereby weakening a "maverick" firm that may have previously played an important competitive role in destabilizing the ability of firms in the market to profitably coordinate their competitive activities.[6] The concept of a "maverick" firm is another concept drawn from the Agencies' Horizontal Merger Guidelines.[7]
  - **Additional coordinated effects:** Coordinated effects are possible in other ways, including that a merged firm created by a vertical merger may have access to confidential information that could facilitate: "(a) reaching a tacit agreement among market participants, (b) detecting cheating on such an agreement, or (c) punishing cheating firms."[8]

Potential Procompetitive Effects From Vertical Mergers

In addition to describing the principal ways in which vertical mergers may harm competition, the Draft Guidelines also address the other side of the ledger, by outlining at least two ways in which vertical mergers have the potential to benefit competition and consumers, namely through:

- **Elimination of double marginalization:** The Draft Guidelines explain "[e]limination of double marginalization can occur when two vertically related firms that individually charge a profit-maximizing margin on their products choose to merge."[9] By eliminating so-called double marginalization, the merged entity could potentially decrease prices below the levels that existed before the vertical integration. Parties asserting this vertical merger benefit will need to identify and illustrate how the proposed combination will result in elimination of double marginalization.
- **Efficiencies:** The Agencies recognize that vertical mergers may generate efficiencies that benefit competition and consumers by combining complementary functions and assets at various points in a

supply chain.[10] The Draft Guidelines indicate that such efficiency claims will be analyzed under the same approach included in the Horizontal Merger Guidelines.

Key Takeaways

- The Draft Guidelines reflect continued interest by the Agencies in pursuing antitrust enforcement with respect to vertical mergers. Notwithstanding the DOJ's loss in court challenging AT&T's proposed acquisition of Time Warner,[11] the risks of vertical merger enforcement by the Agencies cannot be ignored when considering possible transactions.
- The Agencies found some common ground. The joint Draft Guidelines reflect cooperation between the Agencies at a time when the Agencies have been at odds over a number of other policy- and case-related issues, as seen in the recent public debate between the Agencies regarding standard-essential patents, including the recent move by the DOJ Antitrust Division to seek to present oral argument opposing the FTC's position in the pending *Qualcomm* appeal.[12]
- Some divides remain. Specifically, disagreement still looms within the FTC regarding the proper approach to vertical mergers, as evidenced by the two Democratic Commissioners, who each abstained from the vote and issued their own, separate statements commenting on the shortcomings they perceive in the Draft Guidelines.
  - Commissioner Rebecca Kelley Slaughter's statement outlines her support for replacing the previous vertical merger guidelines, but takes issue with the specific language of the Draft Guidelines on two primary issues: (1) that the Draft Guidelines include "what amounts to a safe harbor" for vertical mergers involving firms with market shares of less than 20 percent; and (2) that the Draft Guidelines wrongly "suggest that a high degree of certainty is required for enforcement" of vertical mergers, which Commissioner Slaughter argues is inconsistent with the incipiency standard of Section 7 of the Clayton Act.[13]
  - Commissioner Rohit Chopra similarly abstained from the vote and released a statement criticizing the Draft Guidelines as "not comprehensive or reflective of modern economic realities" and "not refect[ing] all of the ways that competition can be harmed [by vertical mergers]."[14]
  - Separately, Republican Commissioner Christine S. Wilson issued a concurring statement in favor of issuing the Draft Guidelines and urging public comment on various topics, such as elimination of double marginalization, the possibility of adding a clear safe harbor limiting vertical merger enforcement to oligopoly markets, and whether some magnitude of anticompetitive effects from vertical mergers should be viewed as *de minimis*.[15]

[1] U.S. Dep't of Justice & Fed. Trade Comm'n, *Draft Vertical Merger Guidelines* (Jan. 10, 2020), available at https://www.ftc.gov/system/files/documents/public_statements/1561715/p810034verticalmergerguidelinesdraft.pdf.
[2] *Id.* at 1.
[3] *Id.* at n.1.
[4] *Id.* at 4-7.
[5] *Id.* at 8.
[6] *Id*.
[7] The Agencies define a "maverick" firm as "a firm that plays a disruptive role in the market to the benefit of customers" (U.S. Dep't of Justice & Fed. Trade Comm'n, *Horizontal Merger Guidelines* (Aug. 19, 2010), available at https://www.justice.gov/sites/default/files/atr/legacy/2010/08/19/hmg-2010.pdf).
[8] *Draft Guidelines*, *supra* note 1, at 8.
[9] *Id.* at 7.
[10] *Id.* at 9.
[11] *U.S. v. AT&T, Inc.*, 916 F.3d 1029 (D.C. Cir. 2019).
[12] Motion of the United States for Leave to Participate in Oral Argument as Amici Curiae, *FTC v. Qualcomm Inc.*, No. 19-16122 (9th Cir. Jan. 9, 2020).
[13] Statement of Commissioner Rebecca Slaughter, *FTC-DOJ Draft Vertical Merger Guidelines* (Jan. 10, 2020), available at https://www.ftc.gov/system/files/documents/public_statements/1561721/p810034slaughtervmgabstain.pdf.
[14] Statement of Commissioner Rohit Chopra, *Regarding the Request for Comment on Vertical Merger Guidelines* (Jan. 10, 2020), available at https://www.ftc.gov/system/files/documents/public_statements/1561727/p810034chopravmgabstain.pdf.
[15] Concurring Statement of Christine S. Wilson, *Publication of FTC-DOJ Draft Vertical Merger Guidelines for Public Comment* (Jan. 10, 2020), available at https://www.ftc.gov/system/files/documents/public_statements/1561709/p810034wilsonvmgconcur.pdf.

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