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FTC and DOJ Announce Draft Vertical Merger Guidelines for Public Comment

On Jan. 10, 2020, the Federal Trade Commission (FTC) and the Department of Justice's Antitrust Division (DOJ) (together, the Agencies) announced that they had released for public comment draft 2020 Vertical Merger Guidelines (Draft Guidelines). A merger is considered a vertical merger or non-horizontal merger when the transaction involves two (or more) companies that produce goods or services at distinct levels in a supply chain for the same final product.

Comments on the draft guidelines will be accepted until Feb. 11, 2020, and the Agencies will consider comments received when finalizing the guidelines. Once finalized, these will be the first formal updates in 36 years to the Agencies' 1984 Non-Horizontal Merger Guidelines. Primarily, the Draft Guidelines seek to formalize the way the Agencies have been operating rather than introduce new rules.

Background

The Draft Guidelines aim to consolidate now-familiar theories of harm and approaches to reviewing vertical mergers, which the Agencies have developed and refined since 1984, and provide additional guidance to attorneys and companies. Indeed, in the FTC press release, Assistant Attorney General Makan Delrahim of the DOJ stated: "The revised draft guidelines are based on new economic understandings and the Agencies' experience over the past several decades and better reflect the Agencies' actual practice in evaluating proposed vertical mergers. Once finalized, the Vertical Merger Guidelines will provide more clarity and transparency on how we review vertical transactions."[1]

The Draft Guidelines incorporate many of the Agencies' definitions and methodologies from their Horizontal Merger Guidelines from a decade ago and do not introduce new analytical approaches. Rather, the draft is significant with regard to which topics are covered and which are avoided.

Market Definition and Theories of Harm

When thinking about relevant markets, market participants, market shares, and market concentration, the Draft Guidelines reference the methodologies outlined in the Horizontal Merger Guidelines as relevant in vertical mergers. When the Agencies identify a concern in a relevant market, they will also specify one or more "related products." A related product is "a product or service that is supplied by the merged firm, is vertically related to the products and services in the relevant market, and to which access by the merged firm's rivals affects competition in the relevant market."[2]

The principal areas of harm the Agencies see arising from vertical mergers include unilateral effects, such as when the vertical merger could lead to foreclosure (i.e., it is profitable for the merged firm to refuse to sell a key input to one of its downstream rivals, thereby raising rivals' costs for that input or foreclosing access to it) and a corresponding price increase to consumers for the downstream product.

The Agencies will also assess possible coordinated effects from a vertical merger. Coordinated effects are considered a competitive problem if the merger would encourage coordination among remaining firms in the relevant market, by hampering an independent firm that acts as a price maverick in a downstream market and that sources from the now-vertically integrated competitor,[3] including "when changes in market structure or the merged firm's access to confidential information facilitate (a) reaching a tacit agreement among market participants, (b) detecting cheating on such an agreement, or (c) punishing cheating firms." A vertical merger could also allow access to competitively sensitive information about the firm's downstream rivals (such as the specific costs of key inputs of the rivals' products, production volume, and anticipated time to market).

In horizontal mergers, in which the parties compete at the same level of the supply chain of a product, the Agencies analyze competitive impact in part by measuring the change in concentration in the relevant market. When analyzing a vertical merger, the Agencies assess the market shares of the parties at their respective levels in the supply chain.

The Draft Guidelines note that the Agencies would be unlikely to challenge a proposed merger if the parties to the merger have a market share of less than 20%, and the related product is used in less than 20% of the relevant market.[4] However, the Draft Guidelines caution that even this "safe harbor" is not without exception, and the Agencies may still challenge a merger when one party has a share below 20% if, for example, that party is uniquely positioned to rapidly grow market share.

[1] FTC and DOJ Announce Draft Vertical Merger Guidelines for Public Comment, Jan. 10, 2020, https://www.ftc.gov/news-events/press-releases/2020/01/ftc-doj-announce-draft-vertical-merger-guidelines-public-comment.
[2] *Id.* at 2.
[3] As the Draft Guidelines elaborate, "the merged firm could use its power over a product or service in a related product to harm the ability of a non-merging maverick in the relevant market to compete, thereby increasing the likelihood of coordinated interaction among the merged firm and rivals participating in that market." U.S. Department of Justice and The Federal Trade Commission Draft Vertical Merger Guidelines, Released for Public Comment on Jan. 10, 2020, at 8.
[4] This market share threshold is generally lower than the 30% threshold considered by competition authorities in jurisdictions in Europe when reviewing vertical mergers.

The Agencies expect to rely on types of evidence similar to those mentioned in the Horizontal Merger Guidelines to assess the effects of vertical mergers, including “actual effects observed in consummated mergers, direct comparisons based on experience, and evidence about the disruptive role of a merging party.”[5]

Pro-Competitive Benefits

Importantly, the Draft Guidelines acknowledge that vertical mergers are often pro-competitive in that they result in substantial efficiencies that may result in lower prices to consumers as well as more robust and rapid innovation. Specifically, the Draft Guidelines confirm that the Agencies will consider the elimination of double marginalization (i.e., eliminating a scenario where both parties in the vertical chain each charge a margin of their product) as a key source of efficiencies. They also acknowledge that an integration of vertically-related business assets can “streamline production, inventory management, or distribution, or create innovative products in ways that would have been hard to achieve though arm’s length contracts.”[6]

Key Takeaways

The Draft Guidelines are a helpful step in the right direction by providing merging parties with a clearer understanding of the ways in which the Agencies will analyze vertical mergers for anticompetitive effects while at the same time acknowledging the pro-consumer benefits of such transactions.

However, the Draft Guidelines are sufficiently generic as to allow the Agencies considerable flexibility in enforcement, particularly with respect to the nature of remedies, which are not discussed in any detail. Merging firms may not find much clarity in the Draft Guidelines to assist them in determining whether their deal may face regulatory demands for structural or behavioral conditions to receive Agency clearance.

The two Democratic commissioners, Rebecca Kelly Slaughter and Rohit Chopra, abstained from voting on the Draft Guidelines for public comment on the grounds that they appear overly permissive of vertical combinations.

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[5] *Id.* at 4.
[6] *Id.* at 9.

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