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ALERT MEMORANDUM

FTC Issues Commentary on Vertical Merger Enforcement

January 11, 2021

On December 22, 2020, the US Federal Trade Commission (the "FTC") issued a Commentary on Vertical Merger Enforcement. This follows the recent issuance of revised Vertical Merger Guidelines published jointly by the FTC and Department of Justice (the "Agencies") on June 30, 2020. While the Guidelines explain the Agencies' approach to assessing the competitive effects of vertical mergers, the Commentary builds on this base by using past cases to show how these principles are implemented by the Agencies in practice. The Commentary hews closely to the Guidelines and, like the Guidelines themselves, reflects a largely middle-of-the-road approach.

In connection with the DOJ's and FTC's enforcement of Section 7 of the Clayton Act, which prohibits mergers that may substantially lessen competition, the Agencies periodically publish official guidance explaining their approach to merger review. They also publish commentary elaborating on the official guidance, such as the 2006 Commentary published to elaborate on the Agencies' approach to the 1997 Horizontal Merger Guidelines. Consistent with this practice, the FTC has issued its Commentary on Vertical Merger Enforcement to expand on the principles in the recently revised Vertical Merger Guidelines. The Commentary does not alter the Vertical Merger Guidelines, but rather is intended to "provide greater transparency to the public" about Agency practice.

As explained below, the Commentary primarily consists of summaries of specific investigations from 1994 to 2019, including those where the Commission took enforcement action and those where the Commission did not take action, to elucidate the principles described in more general terms in the Guidelines. The Commentary was issued by a 3-2 vote of the Commission. Commissioners Rohit Chopra and Rebecca Slaughter issued a joint dissenting statement criticizing the Commentary as reflecting past under-enforcement and warning parties against relying on it in the future. Commissioners Noah Phillips and Christine Wilson issuing their own statement in rejoinder harshly criticizing Commissioners Chopra and Slaughter's dissent.

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Vertical Mergers: Theories of Harm and Efficiencies[1]

A vertical merger combines firms that do not compete with each other, but rather operate at different levels of a single supply chain. Conventionally, many in the bar and at the Agencies, as well as antitrust economists, have believed vertical mergers to be less likely to harm competition than mergers between competitors (horizontal mergers), and enforcement against vertical mergers has therefore been relatively uncommon. Nevertheless, in some circumstances, vertical mergers may lead to a number of competitive concerns.

The Commentary lays out common theories of harm and efficiencies that the Commission has assessed in investigating vertical mergers, in each instance describing the facts and analysis in specific investigations.

— **Elimination of current horizontal competition**: The Commentary explains that a merger may have both horizontal and vertical aspects if one of the merging parties is already vertically integrated. In such situations, merger analysis must account for the loss of horizontal competition as a result of the merger.

— **Elimination of future horizontal competition**: Even when neither party is already vertically integrated a merger may have effects on horizontal competition if it was likely one party would have organically expanded to become vertically integrated but for the merger. The merger could diminish the incentive for this new entry, thus leading to horizontal effects.

— **Input foreclosures and raising rivals' costs**: Unilateral anticompetitive effects from input foreclosure is the concern raised most frequently with vertical mergers. This concern arises when a firm that supplies inputs to multiple customers acquires a new incentive to raise prices or shut off supply entirely after acquiring one of these customers. This is because by cutting off access or raising costs for a necessary input, the merged firm renders its competitors in the downstream market less competitive and the downstream part of the merged firm captures some of the diverted sales.

— **Decreased incentive to facilitate future entry**: Pre-merger, a large input supplier may have an incentive to facilitate entry by a firm that would then become its new customer, or a large customer may have an incentive to facilitate entry by a firm that would then become a new option for supply. A vertical merger could decrease this incentive because the would-be sponsor will not want to facilitate entry by a firm that will now compete directly against the sponsor.

— **Increased access to competitor CSI**: Because a seller often has access to competitively sensitive information ("CSI") of its customer, or vice versa, a vertical merger may give a firm access to its competitors' CSI. This can have both unilateral and coordinated anticompetitive effects. Unilaterally, it can decrease incentives to attempt procompetitive initiatives, mute competitive responses, or lead firms to end trade relationships to the detriment of customers. It can also facilitate establishing or maintaining tacit coordination among competitors, or remove a disruptive buyer thus facilitating tacit coordination among those who remain.

— **EDM and other efficiencies**: Vertical mergers can result in a particular kind of efficiency called "eliminating double marginalization" or "EDM," where a vertically integrated company can effectively acquire inputs at cost and pass these savings along to customers downstream. There are good reasons to think that eliminating double marginalization is less speculative than other kinds of efficiencies—including those that may result from horizontal mergers. Vertical mergers can also

[1] For a more complete analysis of the Vertical Merger Guidelines, including potential theories of harm and efficiencies arising from vertical mergers, see Cleary Gottlieb's July 2, 2020, alert memorandum *US Agencies Publish Final Revised Vertical Merger Guidelines*.

lead to other types of efficiencies like enhanced design integration between products.

Statements of FTC Commissioners

Commission Chair Joseph Simons and fellow Republican Commissioners Noah Phillips and Christine Wilson of the Federal Trade Commission voted to issue the Guidelines. Commissioners Rohit Chopra and Rebecca Slaughter voted against issuing the Guidelines and issued a statement in dissent. Commissioners Phillips and Wilson issued their own statement in rebuttal. The exchange between the two was unusually acrimonious.

— **Dissent**: The Democrat Commissioners Chopra and Slaughter explain that they voted against issuing the Commentary because it reflects "the same status quo thinking that has allowed decades of vertical consolidation to go uninvestigated and unchallenged." In particular, they object to the Commentary highlighting investigations in which the Agencies did not take enforcement action and those where Agency concerns were resolved with behavioral remedies, which they view as ineffectual.

  Commissioners Chopra and Slaughter disclaim the Commentary entirely: "We strongly caution the market against relying on the Vertical Merger Guidelines and the Vertical Merger Commentary as an indication of how the FTC will act upon past, present, and future transactions. Moving forward, we need to aggressively enforce against the harms of vertical mergers. We look forward to turning the page on the era of lax oversight and to beginning to investigate, analyze, and enforce the antitrust laws against vertical mergers with vigor."

— **Concurrence**: Commissioners Phillips and Wilson write to explain that the Commentary faithfully recounts past Agency practice—thus promoting transparency, predictability, and credibility—and point out that the dissent's objection is to that history itself and not the faithfulness of the recounting.

  They fault the dissent for lacking substance: "Any proposals for a new approach to vertical merger enforcement, which our colleagues have yet to articulate, would need to take into account and grapple with the law, economics, and the evidence in each case. Until then, vague promises of a dramatic and undefined change in enforcement ring hollow."

Analysis

The Commentary hews closely to the Guidelines. For theories of harms or efficiencies that are addressed by the Guidelines, the Commentary's discussion is similar, expanding somewhat but not breaking new ground. The Commentary, however, does elaborate on theories of harm that are not discussed in detail by the Guidelines. In particular, while the Guidelines reference only briefly that vertical mergers can have horizontal aspects as well or that they can decrease incentives to facilitate entry, the Commentary explains these theories and how they work.

The Commentary reflects a continuation of past Agency practice. As might be expected for a document that summarizes past actions, the Commentary does not announce a radical departure from past enforcement practices and priorities. Rather, it continues the Guidelines' middle-of-the-road approach to vertical merger enforcement.

The Commentary is relatively short. At 35 pages, the Commentary is about half the length of the Commentary on the Horizontal Merger Guidelines. This is not entirely surprising, as vertical merger enforcement has been less frequent than for horizontal theories of harm.

The Commentary was issued surprisingly quickly. The FTC issued the Commentary less than half a year after publishing the Guidelines. As compared to the Horizontal Merger Commentary, which was released in 2006 nearly a decade after the then-effective 1997 Guidelines, a delay this brief is surprising.

The Democrat Commissioners' dissent foreshadows increased future aggressiveness in enforcement, though the courts are likely to forestall any major

changes. The dissenting and concurring Commissioners issued strongly worded statements, reflecting continued division at the Commission. With a Democrat administration now in the White House, control of the Commission will be shifting in favor of the Democrats, either in 2023 when Commissioner Phillips' term expires, or earlier with a Republican resignation. Biden appointments at the Department of Justice will likely result in a Democrat-appointed head of the Antitrust Division much sooner. The Agencies in the new administration will likely be looking hard for vertical cases to bring to demonstrate aggressive antitrust enforcement along the lines of that sought by Commissioners Chopra and Slaughter in their dissent.

Any aggressive vertical enforcement action will not have an easy road, however. Unlike horizontal mergers, where enforcement can benefit from a share-based presumption of illegality under certain circumstances, no such presumption exists for vertical mergers. The Government's most recent vertical enforcement effort, the DOJ's challenge to *AT&T/Time Warner*, provides a reminder that more aggressive vertical enforcement may be more easily promised than accomplished.

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