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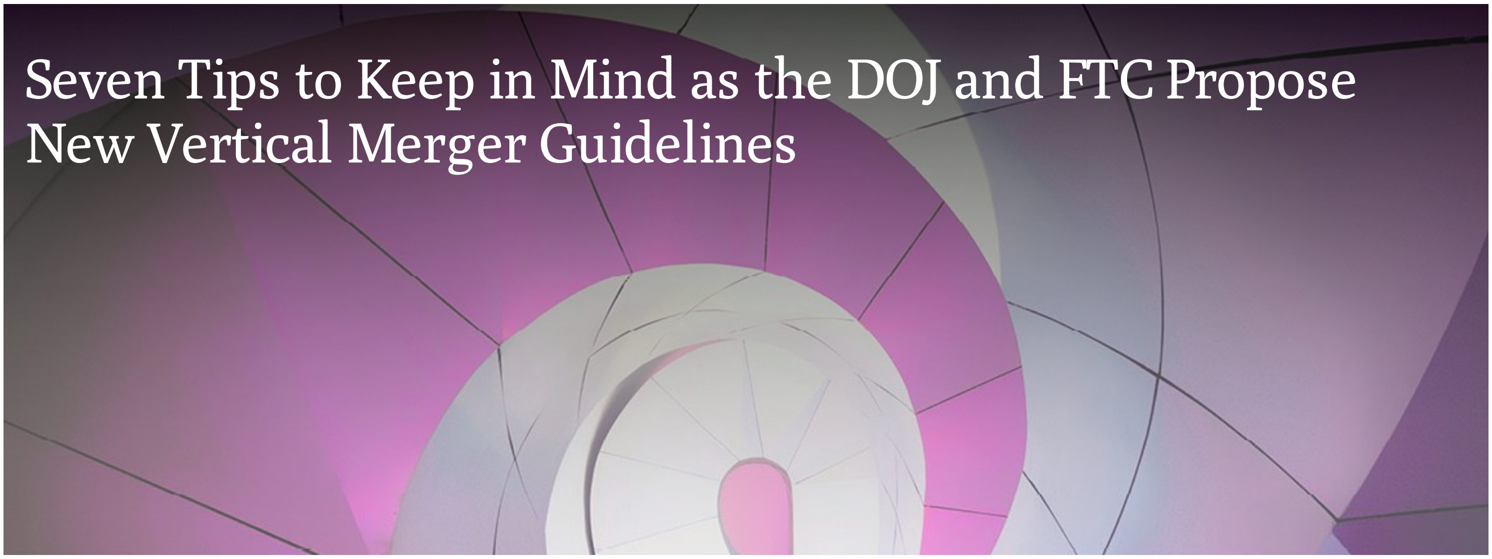
BLOG

Seven Tips to Keep in Mind as the DOJ and FTC Propose New Vertical Merger Guidelines



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For the first time in over three decades, the Department of Justice (DOJ) and Federal Trade Commission (FTC) have proposed updating the official guidance regarding vertical mergers. These proposed Vertical Merger Guidelines follow public criticism from the Agencies themselves that the existing Guidelines issued by the DOJ in 1984 "do not provide useful guidance for vertical mergers today"[1] and do not reflect the competitive effects theories now applied by the DOJ and FTC.[2] On January 10, 2020, the DOJ withdrew the 1984 Non-Horizontal Merger Guidelines and released draft Vertical Merger Guidelines. Assistant Attorney General Makan Delrahim of the DOJ's Antitrust Division explained that "[t]he 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."[3]

While the proposed guidelines are still subject to change during the notice and comment process, the final guidelines will likely be substantially similar to the draft. The comment period closes on February 26, 2020, and the Agencies will hold workshops to solicit public dialogue about the draft guidelines on March 11, 2020, and March 18, 2020.

Here are some key considerations and tips to keep in mind as the new guidelines are finalized and take effect:

1. Keep your copy of the Horizontal Merger Guidelines handy.

The draft Vertical Merger Guidelines should be read in conjunction with the 2010 Horizontal Merger Guidelines. Many of the same principles and analyses applied to horizontal mergers also apply to vertical mergers, and the draft Vertical Merger Guidelines do not repeat all of them. For example, the proposed guidelines reference Sections 4.1 and 4.2 of the Horizontal Merger Guidelines for guidance on how the DOJ and FTC define the relevant market in a vertical merger, and refer to Sections 5.1 through 5.3 of the Horizontal Merger Guidelines to explain the methodology for measuring market shares and concentration.

2. Focus on the facts, not presumptions.

One of the most impactful provisions of the Horizontal Merger Guidelines has been to define when a merger results in a firm controlling an undue percentage of the relevant market and thus creates a rebuttable presumption that the merger is illegal. Courts routinely adopt the Horizontal Merger Guidelines' approach, which relies on market shares and concentration metrics to determine when the presumption of illegality applies. The draft Vertical Merger Guidelines, however, include no similar attempt to create a presumption of illegality in vertical mergers based on market shares or measures of concentration. As a result, vertical merger challenges will continue to be extremely fact-intensive.[4]

3. Avoid raising eyebrows where the vertically merged firm has less than 20 percent market share in each of the relevant markets.

Indeed, rather than create a presumption of when a transaction is likely anticompetitive, the draft Vertical Merger Guidelines identify when a transaction is unlikely to be anticompetitive. The proposed guidelines state that the FTC and DOJ are "unlikely to challenge a vertical merger where the parties to the merger 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." This is not meant to be a hard-and-fast rule or "rigid screen," but is a tool for determining how important it will be for the parties to think through the likely competitive effects of a proposed vertical merger.

Notably, the inclusion of this 20 percent threshold in the draft Vertical Merger Guidelines has spurred concern and disagreements among some antitrust authorities, including the FTC's two Democratic commissioners, Rebecca Slaughter and Rohit Chopra—both of whom abstained from voting to publish the draft Vertical Merger Guidelines. Commissioner Slaughter opposed what she considers an "effective safe harbor for firms with less than 20 percent market share" because: (1) such a threshold "may be an imperfect proxy for assessing whether a vertical merger poses competitive concerns," (2) the 20 percent figure appears to be unjustified and arbitrary, and (3) the draft Vertical Merger Guidelines do not include with the threshold "stronger language about when the merger is likely to warrant scrutiny or enforcement."[5] Similarly, Commissioner Chopra warned that it is "unclear whether there is any empirical basis for the market-share cutoff that the draft guidelines suggest would indicate that a vertical merger is benign."[6]

4. Keep an eye out for possible anticompetitive effects on "related products."

The draft Vertical Merger Guidelines also appear to give the DOJ and FTC wide latitude with respect to market definition by emphasizing the importance of effects on "*related* products," which are defined as products or services (which could include "for example, an input, a means of distribution, or access to a set of customers") that are "supplied by the merged firm, [] 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." The DOJ and FTC may, in effect, have the ability to challenge a deal that only impacts related products—even if there are no issues in the relevant market.

5. Be prepared to rebut arguments that the proposed vertical merger will result in anticompetitive unilateral effects.

A key consideration for the DOJ and FTC when reviewing a vertical merger is whether a merging party's competitors will be prevented from fully competing as a result of its rival's vertical integration. For example, if a retailer of Product X merges with the manufacturer of Product X, will other retailers that ordinarily sell, or could sell, Product X be less able to compete in the sale of Product X?

The guidelines provide two examples of how this might happen: (1) the manufacturer changes the terms of sale for the competing retailers (*i.e.*, raises the price), causing their costs to increase, or altogether stops selling Product X to them; or (2) the manufacturer and/or the retailer gain access to (or even control over) its competitors' sensitive business information to which it would not have had access before the merger, allowing it to moderate its competitive responses to rival competitors.

Parties to a vertical merger should be prepared to show that these unilateral effects are unlikely, not in the best interest of the merging parties, or that any potential unilateral effects that may result would be, at most, *de minimis*, and thus would not substantially lessen competition.

6. Identify and document deal efficiencies, including whether and how the merger eliminates double marginalization.

According to the proposed guidelines, the FTC and DOJ "will not challenge a merger if the net effect of elimination of double marginalization means that the merger is unlikely to be anticompetitive in any relevant market." Double marginalization occurs when two independent entities in a vertical relationship are pricing a product at a mark-up.

For example, a manufacturer of Product X will sell to the retailer at a markup, who in turn will sell Product X to consumers at a markup over and above the manufacturer's already marked-up price. In this case, the retailer's price for Product X is based on double marginalization. Suppose the manufacturer and retailer seek to merge. If they can demonstrate that by merging, they will be able to eliminate the double marginalization on Product X, thus reducing the price customers pay for Product X, then they may be able to show that this incentive to lower prices will mitigate or eliminate any potential anticompetitive effects of the merger.

The draft guidelines do not, however, explicitly require that the merging parties prove the benefits of eliminating double marginalization using the same approach used to evaluate efficiencies in the Horizontal Merger Guidelines.

More broadly, though, the proposed guidelines make clear that the DOJ and FTC recognize that a vertical merger can result in "cognizable efficiencies that benefit competition and consumers." Parties should highlight how the merger will combine complementary economic functions, bring together assets at different levels of a supply chain to streamline production, allow for more efficient inventory management or distribution, or incentivize and foster creating better, more innovative products. Indeed, under the proposed guidelines, a merger will not be challenged "if cognizable efficiencies are of a character and magnitude such that the merger is unlikely to be anticompetitive in any relevant market." A vertical transaction's efficiencies, however, will be evaluated using the same high standards as in the Horizontal Merger Guidelines.

7. Consider engaging antitrust counsel and economic experts early.

The proposed guidelines confirm the DOJ and FTC's longstanding position that whether a vertical merger is likely to substantially lessen competition hinges on complex economic factors and facts unique to each transaction. Engaging antitrust counsel early in the deal process will enable the parties to identify potential relevant markets, related products, and the likelihood of a challenge by the antitrust authorities. Depending on the likely antitrust risk, counsel may work with an economist to develop the overall procompetitive story, and to prepare responses to anticipated questions about the merger's effects on competition. Such work ultimately can help minimize the overall length and scope of—or even outright avoid—an investigation.

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[1] D. Bruce Hoffman (Former Director, FTC Bureau of Competition), *Vertical Merger Enforcement at the FTC*, Credit Suisse 2018 Washington Perspectives Conference, at 4 n.9 (Jan. 10, 2018), *available at* https://www.ftc.gov/system/files/documents/public_statements/1304213/hoffman_vertical_merger_speech_final.pdf.

[2] John Sallet, former Deputy Assistant Attorney General for Litigation, Antitrust Division, ABA 2016 Fall Forum, *available at* https://www.justice.gov/opa/speech/deputy-assistant-attorney-general-jon-sallet-antitrust-division-delivers-remarks-american.

[3] Press Release, DOJ and FTC Announce Draft Vertical Merger Guidelines for Public Comment, *available at* https://www.justice.gov/opa/pr/doj-and-ftc-announce-draft-vertical-merger-guidelines-public-comment.

[4] *See United States v. AT&T, Inc.*, 916 F.3d 1029, 1032 (D.C. Cir. 2019) ("[T]he government must make a 'fact-specific' showing that the proposed merger is 'likely to be anticompetitive.'" (citing Joint Statement on the Burden of Proof at Trial at 3–4)).

[5] Statement of Commissioner Rebecca Kelly Slaughter on the FTC-DOJ Draft Vertical Merger Guidelines, File No. P810034, at 3 (Jan. 10, 2020), *available at* https://www.ftc.gov/system/files/documents/public_statements/1561721/p810034slaughtervmgabstain.pdf.

[6] Statement of Commissioner Rohit Chopra Regarding the Request for Comment on Vertical Merger Guidelines, File No. P810034, at 6-7 (Jan. 10, 2020), *available at* https://www.ftc.gov/system/files/documents/public_statements/1561727/p810034chopravmgabstain.pdf.

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