

FTC and DOJ Release Draft Vertical Merger Guidelines

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01 / 21 / 20

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As anticipated, on January 10, 2020, the Department of Justice (DOJ) and the Federal Trade Commission (FTC) (collectively, the Agencies) released Draft Vertical Merger Guidelines (Draft Guidelines),¹ marking the first update since the Non-Horizontal Merger Guidelines were published in 1984 (1984 Guidelines).² The newly minted Draft Guidelines aim to increase “the transparency of the analytical process underlying the Agencies’ enforcement decisions” for mergers between firms at different levels of a supply chain. Concurrent with publication of the Draft Guidelines, the Agencies formally withdrew the 1984 Guidelines, which were largely considered out-of-date and out-of-touch with current Agency practice. According to FTC Chairman Joseph Simons, “the agencies’ vertical merger policy has evolved substantially since the issuance of the 1984 Non-Horizontal Merger Guidelines, and our guidelines should reflect the current enforcement approach.”³ Assistant Attorney General Makan Delrahim of the DOJ’s Antitrust Division echoed Chairman Simons’ sentiments, stating that “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.”⁴

Theories of Harm and Efficiencies

The Draft Guidelines identify two types of potential harmful unilateral effects arising from vertical mergers. Unilateral effects of a merger are those which “diminish competition between one merging firm and rivals that trade with, or could trade with, the other merging firm,” typically by virtue of actions taken by the merged entity. First, the Draft Guidelines note that a vertical merger may lessen competition by enabling the combined entity to foreclose competitors by refusing to supply them with necessary inputs or denying them access to vital distribution channels. Along the same lines, a vertical merger can facilitate the strategic viability of raising rival entities’ costs or otherwise altering the terms of their access to necessary inputs or distribution channels. The Draft Guidelines explain that the Agencies will consider whether the combined entity’s strategy of foreclosure or raising its rivals’ costs would cause those rivals to lose sales and whether those sales would be diverted to the combined entity. If so, the Agencies will assess whether those diverted sales would render foreclosure or raising rivals’ costs profitable to the merged entity. The DOJ alleged such input foreclosure in its unsuccessful challenge to the AT&T/Time Warner deal, claiming that the merged company would have the ability and incentive to deny content to its cable/satellite TV competitors.⁵ The Draft Guidelines also note that the magnitude of this strategy must rise above a *de minimis* level such that it would substantially lessen competition.

The second type of unilateral effect identified in the Draft Guidelines is the ability of a combined firm to “gain access to and control of sensitive business information about its upstream or downstream rivals” that it did not previously have. Per the Draft Guidelines, access to competitively sensitive information is subject to potential abuse, as a combined entity could use the information to “preempt or react quickly to a rival’s

¹ U.S. Dept. of Just. and Fed. Trade Comm’n, *Draft Vertical Merger Guidelines* (Jan. 10, 2020).

² U.S. Dept. of Just., *1984 Merger Guidelines* (Jun. 14, 1984).

³ DOJ Office of Public Affairs, *DOJ and FTC Announce Draft Vertical Merger Guidelines for Public Comment* (Jan. 10, 2020).

⁴ *Id.*

⁵ See *Complaint, U.S. v. AT&T Inc., DirecTV Group Holdings, LLC, and Time Warner Inc.*, No. 1:17-cv-02511 (D.D.C. Nov. 20, 2017) (No. 98-2389).

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pro-competitive business actions.” The Draft Guidelines also state that such access could potentially dissuade the combined entity from undertaking pro-competitive initiatives such as investing in research and development, or cause rivals to be reluctant to do business with the combined entity over fears that the merged firm will abuse access to competitively sensitive information, dampening the intensity of competition as rivals are forced to turn to less preferred or more expensive suppliers. The FTC considered this type of vertical concern with the recent Staples/Essendant deal, alleging that Staples would gain access to competitively sensitive information about its rivals that relied on Essendant for wholesale office supplies.⁶

The Draft Guidelines also identify several harmful coordinated effects that could result from vertical mergers. Coordinated effects occur when a merger “diminish[es] competition by enabling or encouraging post-merger coordinated interaction among firms in the relevant market that harms customers.” First, the Draft Guidelines posit that vertical mergers can further a market’s susceptibility to unlawful coordination through the elimination or weakening of a “maverick firm.” Changes in market structure and the combined entity’s access to confidential information are among the other consequences of a vertical merger identified as potentially facilitating coordinated effects post-merger. The Agencies expressed particular concern in the Draft Guidelines with instances in which post-merger changes or access to information could facilitate tacit agreements between market participants and affect the detection and punishment of cheating on those tacit agreements.

On the other hand, the Draft Guidelines also recognize that vertical mergers have the potential to generate significant efficiencies by “combin[ing] complementary economic functions and eliminat[ing] contracting friction” at different levels of the supply chain. Because of this, the Agencies will assess efficiency claims as set forth in the Horizontal Merger Guidelines — namely, the merging parties will bear the burden of substantiating verifiable, merger-specific efficiencies to justify approval of a merger with likely adverse competitive effects.

Provisions Indicating More Aggressive Enforcement

In some respects, the Draft Guidelines indicate a more aggressive approach to enforcement of vertical mergers than expressed in the 1984 Guidelines. For example, no explicit presumption of

legality or *de minimis* effects is included, even in cases where the acquired entity’s market share is less than the 5-percent threshold that the 1984 Guidelines stated was unlikely to require a merger challenge. Further, the same stringent efficiencies analysis outlined in the Horizontal Merger Guidelines will be applied to vertical deals, without the countervailing acknowledgement stated in the 1984 Guidelines that “non-horizontal mergers are less likely than horizontal mergers to create competitive problems.” Additionally, instead of the 1984 Guidelines’ approach of defining separate product markets at different levels of the supply chain to determine competitive effects, the Draft Guidelines state that the Agencies can simply consider the competitive significance of related products to identify mergers warranting further scrutiny. A related product or service is one 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.”

Provisions Indicating Less Aggressive Enforcement

In contrast to the provisions above, a number of sections of the Draft Guidelines indicate less aggressive enforcement than what was contemplated in the 1984 Guidelines. For instance, the Draft Guidelines indicate that the “Agencies 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.” Whereas the 1984 Guidelines, which contained the lower 5-percent “safe harbor” described above based on the size of the *acquired* firm, also included a presumption of competitive concerns where an acquired firm holds over a 20-percent market share, the Draft Guidelines do not contain a similar presumption.

In addition, the Draft Guidelines provide insight into the pro-competitive benefits of vertical mergers and how the Agencies will evaluate such benefits. One key benefit addressed in the Draft Guidelines (which was not acknowledged in the 1984 Guidelines) is the elimination of double marginalization, which occurs when two successive firms in a distribution chain (each charging a profit-maximizing price) choose to merge. As a result of such a merger, the combined entity is incentivized to reduce prices because of its direct and cheaper access to necessary inputs. This price reduction is more likely to be profitable as the combined entity benefits from the margins on both upstream and downstream sales. The task of proving the pro-competitive benefits of eliminating double marginalization, as with other pro-competitive efficiencies, will fall on the merging parties.

⁶ See *Complaint, In the matter of Sycamore Partners II, L.P., Staples, Inc. and Essendant Inc.*, Docket No. C04667.

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Several other features of the Draft Guidelines indicate that the Agencies are inclined to take a less aggressive approach to vertical merger enforcement. For example, the Draft Guidelines use tentative language in stating that certain mergers which “potentially raise significant competition concerns” “may warrant scrutiny.” As explained by Commissioner Rebecca Slaughter, a Democratic commissioner who abstained from publishing the Draft Guidelines, more forceful guidance would state that such mergers “do warrant scrutiny and may warrant enforcement.”⁷ Finally, the omission of more exotic vertical theories of harm in the Draft Guidelines, such as regulatory evasion, also indicate a less aggressive approach to vertical merger enforcement than contemplated in recent years.

Next Steps and Practical Implications

Despite near unanimous agreement that the agencies needed to update the 1984 Guidelines, the release of the Draft Guidelines was approved along a party-line vote with both Democratic FTC Commissioners Rebecca Slaughter and Rohit Chopra abstaining and issuing statements criticizing the Draft Guidelines for not being aggressive enough. The Draft Guidelines are subject to a 30-day comment period, which expires on February 11, 2020. This process is similar to the process used to develop the most recent Horizontal Merger Guidelines, which were released in draft form in April 2010 and ultimately approved in August 2010, after a comment period and series of public workshops hosted by the Agencies.

⁷ [Statement of Commissioner Rebecca Kelly Slaughter on the FTC-DOJ Draft Merger Guidelines \(Jan. 10, 2020\)](#).

The final version of the guidelines could emerge more or less aggressive depending on whether it is the product of bipartisan consensus. The guidelines would undoubtedly be more aggressive if revised to secure the support of the two Democrat Commissioners. Those Commissioners’ statements detail the more pro-enforcement provisions they desire. Conversely, if the final guidelines are the product of a 3-2 approval split along party lines, they would likely reflect the less aggressive approach to merger enforcement aligned with the current Draft Guidelines. As Chairman Simons has noted, the Agencies have an incentive to make the guidelines as bipartisan as possible to avoid reversal by a subsequent administration.⁸ The level of bipartisan support of the final guidelines may also weigh on whether courts will recognize the final vertical merger guidelines as controlling in litigated cases. There is much less legal precedent regarding non-horizontal mergers, which have largely been subject to settlements with the agencies rather than litigated enforcement, and courts have faced more difficulty analyzing vertical deals than they have horizontal ones. In the event that the vote to approve the final version of the vertical merger guidelines is not unanimous, the guidelines will likely have less precedential force and may be withdrawn by the next administration. Substantively, however, the Draft Guidelines fairly closely reflect vertical merger analysis as currently performed by the Agencies, with the divergence between the Republican and Democratic Commissioners at the FTC also evident in the split votes and dissents seen in recent vertical deals.⁹ We expect the final guidelines, which will include consideration of comments received during the comment period, to be published in the second quarter.

⁸ Pallavi Guniganti, *US Agencies Issue Draft Vertical Merger Guidelines*, Global Competition Review (Jan. 13, 2020).

⁹ See, e.g., *In the matter of Sycamore Partners II, L.P., Staples, Inc. and Essendant Inc.*