UNITED STATES OF AMERICA
**Federal Trade Commission**
WASHINGTON, D.C. 20580

Office of Commissioner
Rebecca Kelly Slaughter

# DISSENTING STATEMENT OF COMMISSIONER REBECCA KELLY SLAUGHTER

*In re FTC-DOJ Vertical Merger Guidelines*
*Commission File No. P810034*
*June 30, 2020*

## Summary

I voted against the Commission's release of the Vertical Merger Guidelines ("Guidelines") because the process adopted by the Federal Trade Commission and the Department of Justice ("the Agencies") short-circuited the more thorough discussion that the public and this effort deserve and because I continue to have substantive concerns about the Guidelines. I very much appreciate the extensive and thoughtful commentary stakeholders provided on the first draft of the Guidelines released in January 2020 and the work staff has done since then. While I continue to appreciate the need to withdraw and update the old Guidelines, the final version the Commission releases today misses the mark on both process and substance. I expand on each of these concerns below.

## Process

The Guidelines make sweeping changes to the original draft first proposed in January. This fact alone supports a second public comment period, at a minimum, as well as another public workshop to replace the one that the FTC canceled due to COVID-19.[1] The utility of the detailed, thoughtful comments the Agencies received on the first draft of the Guidelines serves to underscore the value of having further public input on this substantially revised version. A second comment period would have not only demonstrated the FTC's commitment to transparency and good government but also provided the opportunity to continue the discussion of topics critical to vertical-merger enforcement and improve the final product. Finally, the benefits afforded by a rigorous second comment period far outweigh an immaterial delay in the final issuance of the Guidelines, and the decision not to engage in one leaves the Guidelines seriously lacking.

## Substance

[1] The FTC cancelled a public workshop in March 2020 due to COVID-19. Now, more than three months later, we have seen very successful public panels and workshops conducted virtually. Notably, the FTC plans to hold its annual Privacy Con virtually.

Turning to my substantive concerns, I must first acknowledge that I appreciate the staff's hard work and the ways in which the revisions to the Guidelines are responsive to my concerns and those of many commenters with whom I agree.[2] Among the positive changes are: the elimination of the quasi-safe harbor based on market share; the more thorough discussions and corresponding examples of potential competitive harm from vertical mergers, such as creating the need for two-level entry and raising rivals' distribution costs; and the discussion of some unique considerations regarding mergers of complements, diagonal mergers, and acquisitions of firms that are the most likely potential competitors.

However, this progress is compromised by provisions that undermine one of the key points of the Guidelines: to disavow the false assertion that vertical mergers are almost always procompetitive. I also fear that the Guidelines signal that the Agencies will view vertical mergers as likely to be procompetitive and will use the Guidelines to justify lack of enforcement against vertical mergers.[3] I come to this conclusion based on the following issues that I will address in turn: (1) the over-emphasis of the benefits of vertical mergers; (2) failure to identify merger characteristics that are most likely to be problematic; (3) the treatment of the elimination of double marginalization ("EDM"); and (4) the omission of important competition concerns including buy-side power, regulatory evasion, and remedies.

*Over-emphasis on the benefits of vertical mergers*

From the outset, the Guidelines appear to put a thumb on the scale in favor of vertical mergers. The Overview section notes that there are "distinct considerations" raised by vertical mergers that are not considered in the Horizontal Merger Guidelines.[4] However, the only "distinct consideration" recognized in the Overview is the potential procompetitive benefit of EDM.[5] The Vertical Merger Guidelines are inexplicably mute on the well-known and well-supported fact that the potential anticompetitive harms from raising rivals' cost and foreclosure are also "distinct considerations" in vertical-merger analysis.[6] This opening unbalanced treatment of the

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[2] *See* Comm'r Rebecca Kelly Slaughter, Fed. Trade Comm'n, Statement on the FTC-DOJ Draft Vertical Merger Guidelines, File No. P810034 (Jan. 10, 2020), https://www.ftc.gov/system/files/documents/public_statements/1561721/p810034slaughtervmgabstain.pdf.

[3] When I refer to "vertical mergers," I am using this as shorthand to refer also to mergers of complements and diagonal mergers that implicate similar potential for competitive harm.

[4] U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, VERTICAL MERGER GUIDELINES § 1 (2020) [hereinafter "GUIDELINES"].

[5] *Id*.

[6] Commissioner Chopra's statement notes particular harms that have come to fruition following vertical mergers, including AT&T/DirecTV and AT&T/Time Warner. *See also* Public Knowledge & Open Technology Institute, Public Comment on FTC-DOJ Draft Vertical Merger Guidelines 7–10 (Feb. 26, 2020), https://www.ftc.gov/system/files/attachments/798-draft-vertical-merger-guidelines/pk_oti_comments_on_draft_vertical_merger_guidelines_022620.pdf; Open Markets Institute & American Economic Liberties Project, Public Comment on FTC-DOJ Draft Vertical Merger Guidelines 13 (Feb. 2020), https://www.ftc.gov/system/files/attachments/798-draft-vertical-merger-guidelines/comment_to_ftc-doj_re_vertical_merger_guidelines.pdf. For the academic theory of the harms associated with vertical mergers, see Thomas G. Krattenmaker & Steven C. Salop, *Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power over Price*, 96 YALE L.J. 209 (1986). For a literature summary of the harms associated with vertical mergers see

potential harms and benefits of vertical mergers sets the tone for all that follows. It raises concerns regarding the Agencies' analysis and likely disposition in evaluating vertical mergers. The Overview should clearly articulate what we all know to be true based on the economic evidence and what motivated these Guidelines in the first place—that vertical mergers can and frequently do raise serious anticompetitive concerns. This asymmetry continues in the treatment of EDM that I discuss more fully below.

*Failure to identify merger characteristics that are most likely to be problematic*

The Guidelines set out considerations for identifying whether a vertical merger will increase the incentive and ability of the merged firm to engage in foreclosure or raising rivals' costs. In explaining the concepts of incentive and ability, they identify when mergers will "rarely warrant scrutiny."[7] However, they are considerably weaker in terms of indicating when mergers *will* warrant scrutiny and be more likely to warrant enforcement action.[8]

At all stages of merger review, the Agencies must determine whether there is reason to believe that the merger violates the law. For that reason, scrutiny by way of investigation is often needed to determine whether there is likely to be an increase in incentive and ability to engage in foreclosure or raising rivals' costs. Yet, the Guidelines appear to require a determination that incentive and ability are "likely" in order to warrant scrutiny.[9]

The Guidelines should make clear that scrutiny may be applied in the first instance and affirm that scrutiny is not dependent on meeting any set of conditions. I am worried that, with this omission, parties will use the Guidelines against the Agencies in the early stages of investigations to argue that the investigation itself is inappropriate. The Guidelines should instead make clear that a merger *will* warrant scrutiny when conditions indicate that the merged firm has the potential to gain the incentive and ability to engage in foreclosure or raising rivals' costs. Further investigation will then indicate whether an enforcement action is warranted. A failure to make clear that scrutiny is warranted to evaluate the potential for anticompetitive foreclosure or raising rivals' costs leads me to question how committed the Agencies are to examining vertical mergers seriously.

Beyond simply identifying when mergers likely warrant scrutiny, the Guidelines should also clearly indicate what conditions, if found during an investigation, would most likely present competitive concerns and merit enforcement. For example, the Guidelines should explicitly raise

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Marissa Beck & Fiona Scott Morton, Public Comment on FTC-DOJ Draft Vertical Merger Guidelines (Feb. 26, 2020), https://www.ftc.gov/system/files/attachments/798-draft-vertical-merger-guidelines/beck_scott_morton_comments_on_draft_vertical_merger_guidelines_022620.pdf.

[7] GUIDELINES, *supra* note 4, § 4(a)(1) (explaining conditions under which "[t]his element would not be satisfied, and in turn a merger would rarely warrant close scrutiny for its potential to lead to foreclosure or raising rivals' costs"); *id*. § 4(a)(2) (same).

[8] *See id*. § 4(a) ("Mergers for which these conditions are met potentially raise significant competitive concerns and often warrant scrutiny.").

[9] "[T]he Agencies generally consider whether the following conditions are satisfied." *Id*. They then go on to describe conditions that "would likely" occur. *Id*. § 4.

the alarm that the most dangerous mergers are those that likely result in the exit of rival firms or increased barriers to entry.[10] To illustrate by using an example from the Guidelines, if the merging orange supplier has the ability and incentive to raise the cost of oranges to rival orange-juice producers, or completely foreclose rival orange-juice producers, and the effect of this act is to cause the exit of one or more rival orange-juice suppliers because continued operation is unprofitable, the merger may be particularly problematic. Clearly articulating conditions under which the most problematic mergers are likely to be found would provide needed guidance for the courts and could deter problematic mergers from being proposed in the first place.

Indeed, explicit presumptions of harm might be appropriate to help clarify competitively problematic mergers; at a minimum, the Agencies would have benefited from additional comments and consideration of this concept of presumptions of harm (as opposed to presumptions that a merger is competitively benign, which the first version of the Guidelines proposed).[11]

*Treatment of EDM*

The Guidelines' treatment of EDM continues to cause me concern. This topic alone merits another round of public comment. Specifically, I will discuss concerns and questions about how the Guidelines treat: (1) the cognizability and likely achievement of EDM; (2) the short-term benefits of EDM versus the potential for long-term harm to competition; and (3) other theories of harm that may offset the benefits of EDM to consumers.

As we know, when firms can eliminate double marginalization—the mark-up at both levels in a supply chain—through vertical integration, there may be benefits for competition and consumers on top of the benefits for the merged firm. However, achieving EDM is not guaranteed. Nor are the benefits of EDM always passed along to consumers.[12] I worry that, even though the Guidelines indicate some skepticism of EDM, in total they are overly optimistic that EDM will be achieved and translate into benefits.

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[10] Commissioner Chopra's statement details concerns about entry suppression, particularly in digital markets, which I share.

[11] An additional public comment period and workshop could have examined in more depth the potential for more explicit presumptions of harm that could be helpful to guide courts. As Baker, Rose, Salop, and Scott Morton suggest, "If the upstream merging firm in a concentrated market is a substantial supplier of a critical input to the competitors of the other merging firm and a hypothetical decision to stop dealing with those downstream competitors would lead to substantial diversion of business to the downstream market firm," then there should be a rebuttable presumption of harm to competition. Jonathan B. Baker, Nancy L. Rose, Steven C. Salop, & Fiona Scott Morton, *Five Principles for Vertical Merger Enforcement*, 33 ANTITRUST 12, 16 (Summer 2019).

[12] *See, e.g.*, Martin Gaynor, Public Comment on FTC-DOJ Draft Vertical Merger Guidelines 2 (Feb. 26, 2020), https://www.ftc.gov/system/files/attachments/798-draft-vertical-merger-guidelines/gaynor_comment_vmg_feb_26_2020.pdf ("It's worth noting that EDM is not, in general, a necessary consequence of vertical (non-horizontal) integration.").

It is notable that the Guidelines explicitly import the principles of Section 10 of the Horizontal Merger Guidelines, which indicate that efficiencies must be merger-specific and cognizable.[13] This is a critical point that could go a long way to ensuring that the burden will be placed squarely on the merging parties to demonstrate that EDM is achievable. However, in elaborating on the concept of EDM, the Guidelines appear to limit the rigor imposed by Section 10.[14] In addition, the discussion of EDM in the section on foreclosure fails to adopt the provisions of Section 10, which place the burden on the parties to prove that an offsetting efficiency, or in this case benefit from EDM, is timely, likely, and merger-specific.[15]

Furthermore, the Guidelines do little to identify the well-recognized reasons why EDM may not be achieved in a vertical merger.[16] The lone reference is found in Example 7, which notes technological incompatibility between the upstream and downstream firms. However, the Guidelines fail to identify several other reasons, supported by economic literature, that EDM may not be achieved. For example, the downstream firm may not be able to use inputs from the upstream firm when it is locked into a long-term contract with another supplier, when it faces switching costs, or when there is geographic incompatibility that makes it irrational to source from the vertically integrated upstream firm. In addition, the upstream firm also may have limited capacity that can be switched over to the newly acquired downstream firm. Or the downstream firm might already be vertically integrated and therefore not obtain any new benefit of EDM.[17] Finally, a growing body of literature indicates that vertically integrated firms do not often self-supply and therefore do not benefit from EDM.[18] A more complete discussion of the

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[13] GUIDELINES, *supra* note 4, § 6 ("The Agencies evaluate efficiency claims by the parties using the approach set forth in Section 10 of the Horizontal Merger Guidelines, as elaborated here."). Section 10 of the Horizontal Merger Guidelines states, "The Agencies credit only those efficiencies likely to be accomplished with the proposed merger and unlikely to be accomplished in the absence of either the proposed merger or another means having comparable anticompetitive effects. These are termed merger-specific efficiencies." U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, HORIZONTAL MERGER GUIDELINES § 10 (2010).

[14] GUIDELINES, *supra* note 4, § 6 ("Due to the elimination of double marginalization, mergers of vertically related firms will often result in the merged firm's incurring lower costs for the upstream input than the downstream firm would have paid absent the merger.").

[15] *Id*. § 4. In a speech last February, Assistant Attorney General Delrahim explained that the merging parties bear the burden of demonstrating EDM. *See* Makan Delrahim, Assistant Attorney General, Antitrust Div., Dep't. of Justice, Remarks at the George Mason Law Review 22nd Annual Antitrust Symposium: "Harder Better Faster Stronger": Evaluating EDM as a Defense in Vertical Mergers (Feb. 15, 2019) (explaining that "the burden is on the parties in a vertical merger to put forward evidence to support and quantify EDM as a defense"). The DOJ made the same argument in the recent AT&T-Time Warner case. *See* Proposed Conclusions of Law 44, United States v. AT&T Inc., No. 1:17-cv-02511-RJL (D.D.C. filed May 8, 2018), ECF No. 127 ("Defendants bear the burden of their efficiencies defense."). *See also* State Attorneys General, Public Comment on FTC-DOJ Draft Vertical Merger Guidelines 20–21 (Feb. 26, 2020), https://www.justice.gov/atr/page/file/1258786/download (arguing that the merging parties bear the burden of proving EDM).

[16] *See, e.g.*, Steven C. Salop, *Invigorating Vertical Merger Enforcement*, 127 YALE L.J. 1962, 1970–71 (2018) (discussing why EDM may not occur in a vertical merger).

[17] *See id*.

[18] *See* Enghin Atalay, Ali Hortaçsu, & Chad Syverson, *Vertical Integration and Input Flows*, 104 AM. ECON. REV. 1120, 1120 ("We find that most vertical ownership does not appear to be primarily concerned with facilitating physical goods movements along a production chain within the firm, as is commonly presumed. Upstream units ship surprisingly small shares of their output to their firms' downstream establishments. Almost one-half of upstream

circumstances under which EDM will not be achieved in a vertical merger would provide better guidance for the courts and the marketplace.

Merger specificity is required for efficiencies to be deemed cognizable in the Horizontal Merger Guidelines.[19] How to apply such merger specificity in the context of vertical mergers is an issue that would also benefit from additional public comment. Some commenters say that, if we are truly importing Section 10 of the Horizontal Merger Guidelines and truly committed to scrutinizing EDM, the evaluation of EDM requires addressing the same questions and evidence of cognizability and pass-through.[20] Others say that EDM should be presumed merger-specific and cognizable if the merging parties failed to achieve EDM through contracting before the merger.[21] That is, if the merging firms have not achieved EDM prior to the merger, that should be sufficient to prove that EDM is unlikely to occur absent the merger.

Next, I am concerned that, in balancing EDM against the harms from a vertical merger as described in the Guidelines, the Agencies may be trading short-term EDM benefits for long-term harm to competition.[22] Specifically, even for a vertical merger in which our analysis indicates that the procompetitive benefits such as EDM just offset the harm due to raising rivals' cost for foreclosure, there may still be a significant shift in profits from the rivals to the merged firm. In this case, consumers may be unharmed (on balance) in the short run, but there still may be a significant shift in profits among suppliers. This reduction in profits for the rivals may adversely affect their ability to finance innovation or expansion activities. So competition and consumers may still be harmed in the end. The Guidelines are silent on this possibility.

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establishments do not report making shipments inside their firms."). *See also* Beck & Scott Morton, *supra* note 6 (reviewing the academic literature on vertical mergers).

[19] U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, HORIZONTAL MERGER GUIDELINES, *supra* note 13, § 10 ("The Agencies credit only those efficiencies likely to be accomplished with the proposed merger and unlikely to be accomplished in the absence of either the proposed merger or another means having comparable anticompetitive effects. These are termed merger-specific efficiencies. Only alternatives that are practical in the business situation faced by the merging firms are considered in making this determination.").

[20] *See, e.g.*, State Attorneys General, *supra* note 15, at 20–21 (arguing that the merging parties' burden to demonstrate EDM "applies as much to vertical as to horizontal mergers"); Steven C. Salop, Public Comment on FTC-DOJ Draft Vertical Merger Guidelines 18 (Mar. 26, 2020), https://www.ftc.gov/system/files/attachments/798-draft-vertical-merger-guidelines/salop_suggested_vertical_merger_guidelines.pdf ("The Agencies will not presume merger-specificity simply because it was not achieved in the pre-merger market, but will expect the parties to provide credible evidence of pre-merger impediments and how the merger will eliminate the impediments.").

[21] *See, e.g.*, Comm'r Christine S. Wilson, Fed. Trade Comm'n, Remarks at the DOJ Workshop on Draft Vertical Merger Guidelines: "Reflections on the 2020 Draft Vertical Merger Guidelines and Comments from Stakeholders" (Mar. 11, 2020), https://www.ftc.gov/system/files/documents/public_statements/1568909/wilson_-_vertical_merger_workshop_speech_3-11-20.pdf ("For me, the relevant question is whether the firms *did* achieve efficient contracting before merging, not whether they *could*."); Geoffrey A. Manne & Kristian Stout, Public Comment on FTC-DOJ Draft Vertical Merger Guidelines 1 (Feb. 2020), https://www.ftc.gov/system/files/attachments/798-draft-vertical-merger-guidelines/icle_vmg_draft_comments_0.pdf ("[The agencies should clearly disavow . . . the implications of the presumed functional equivalence of vertical integration by contract and by merger.").

[22] *See* Delrahim, *supra* note 15 ("Longer term harms to competition may support challenging a merger even if the effect of EDM is greater than the price effect from foreclosure or raising rivals' costs in the short term.").

In addition to questions regarding whether EDM can be achieved and is merger specific, the Guidelines do not discuss theories of harm that may at least partially offset the effect of EDM on the downstream price of the merged firm. Specifically, if the merged firm raises its price in the downstream market, downstream rivals may increase their sales, which could increase their demand for inputs from the merged firm's upstream business. Capturing this benefit through merger may make a downstream price increase more profitable, thereby offsetting the effect of EDM on the prices consumers pay at least to some degree. The extensive nature of these questions and concerns regarding the treatment of EDM alone merit another comment period. I would have liked to also receive reactions from commenters about the placement of the EDM discussion in both the Unilateral Effects section (Section 4) and the new "Procompetitive Benefits" section (Section 6).

*Failure to discuss buy-side concerns, remedies, regulatory evasion*

Finally, three additional important topics are omitted from the Guidelines. First, the Guidelines make only a passing reference in the Overview to the relevance of monopsony, or buy-side, concerns. The Guidelines should explicitly explain, for example, that vertical merges may harm suppliers, particularly workers, by increasing the likelihood of coordination.[23]

Second, as I noted in my January statement, the Guidelines should include regulatory evasion as a potential theory of harm. While some commenters have noted that recent vertical mergers have not involved such a theory of harm, I do not see any reason for excluding it in order to put firms on notice that this is a theory the Agencies may investigate and on which an enforcement action may be based.[24]

Third, as noted by several commenters, the Guidelines do not address how the Agencies will address remedies in vertical mergers. Discussion of Agency considerations regarding remedies, whether behavioral or structural, would have been helpful, and additional comment specifically on this topic could have been solicited. Given that this was not included, the Agencies should consider doing a formal review of past vertical-merger action or inaction by the Agencies. How effective have behavioral remedies been? Were the remedies easily enforceable, and what has the burden been on the Agencies to enforce them? Have fixes such as supply agreements, negotiated privately between the merging parties and downstream customers or upstream suppliers, been effective?

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[23] Salop, *supra* note 20, at 5.

[24] *See, e.g.*, American Antitrust Institute, Public Comment on FTC-DOJ Draft Vertical Merger Guidelines 9–10 (Feb. 2020), https://www.ftc.gov/system/files/attachments/798-draft-vertical-merger-guidelines/aai_comments_draft_vm_guidelines_f.pdf (explaining the need to include regulatory evasion in the Guidelines); Gaynor, *supra* note 12, at 2 (recommending the inclusion of regulatory evasion). In 2008, the FTC brought a vertical merger action based on this theory—that a firm can evade rate regulations by acquiring an upstream input and raising the cost of that input, which can lead to a regulator to authorize a higher downstream regulated rate based on that higher input cost. *See* Press Release, Fed. Trade Comm'n, FTC Challenges Vertical Agreement Between Fresenius and Daiichi Sankyo (Sept. 15, 2008), https://www.ftc.gov/news-events/press-releases/2008/09/ftc-challenges-vertical-agreement-between-fresenius-and-daiichi.

## Conclusion

To close, I want to share some forward-looking views on vertical mergers and the implementation of the Guidelines issued today. Even those who disagree on the substance of the Guidelines must share the view that how they are implemented will be critically important. This is not merely an academic or theoretical exercise. Vertical-merger enforcement will be relevant across the economy, especially in health care, agriculture, digital, and telecommunications markets, and it will affect every American.[25]

To that end, the FTC must aggressively investigate and apply the theories of harm that are identified in the Guidelines and be open to additional theories of harm as economic learning and investigatory experience evolves. This includes carefully considering whether a vertical merger will substantially increase the barriers to entry; it also includes appropriate skepticism about unsupported efficiency claims, such as EDM. While EDM may be beneficial in some cases, the Commission must not take that as a given, and parties must demonstrate that it is likely to be achieved. It is also incumbent on the FTC to strengthen its commitment to retrospective reviews of mergers, including mergers against which the Commission opted not to take action.

Effective implementation means deploying adequate resources to rigorous investigations when the evidence indicates a reasonable possibility for an anticompetitive outcome. This means not settling for inaction when the body of evidence is complicated or messy. Finally, this means accepting more litigation risk and refusing the call to avoid the false positives of over-enforcement at the expense of allowing the false negatives of under-enforcement. To some antitrust enforcers and observers, uncertainty points clearly in the direction of less enforcement. To me, high uncertainty means only that we have a challenging job in front of us, which will require greater effort in the name of protecting competition and consumers.

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[25] This is particularly true given the breadth of industries and consumers that will be affected by the Guidelines. *See, e.g.*, AIDS Healthcare Foundation, Public Comment on FTC-DOJ Draft Vertical Merger Guidelines (Feb. 26, 2020), https://www.ftc.gov/system/files/attachments/798-draft-vertical-merger-guidelines/ftc_doj_vergical_merger_guidelines_comments_ahf_2-26-20.pdf (commenting with respect to the healthcare industry); Organization for Competitive Markets, Public Comment on FTC-DOJ Draft Vertical Merger Guidelines (Feb. 26, 2020), https://www.ftc.gov/system/files/attachments/798-draft-vertical-merger-guidelines/ocm_public_comments_on_doj_and_ftc_draft_vertical_merger_guidelines.pdf (commenting with respect to agricultural and food industries).