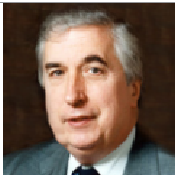
Activist Short Selling Today: The Two Sides of the Coin
By John C. Coffee, Jr.

The Fall of Wirecard
2 *By Todd H. Baker*

Stress Testing During a Pandemic
By Kathryn Judge

Editor-At-Large
Reynolds Holding

Editorial Board
John C. Coffee, Jr.
Edward F. Greene
Kathryn Judge

Skadden Discusses FTC and DOJ Vertical Merger Guidelines

By Karen M. Lent, Kenneth B. Schwartz, David P. Wales and Andrew D. Kabbes July 15, 2020

Comment

Following their January publication of Draft Vertical Merger Guidelines (draft guidelines) for public comment, the Federal Trade Commission (FTC) and the Department of Justice (DOJ) (collectively, the agencies) issued final Vertical Merger Guidelines (Guidelines) on June 30, 2020.1 This marks the first official guidance update on vertical mergers from either of the agencies since the Non-Horizontal Merger Guidelines were published by the DOJ in 1984 (1984 guidelines),2 and the first time that the agencies have jointly issued vertical merger guidance, albeit over the continued objection of two FTC commissioners.

The new guidance aims to provide merging parties and their counsel with increased "transparency of the analytical process underlying the agencies' enforcement decisions" with respect to mergers combining businesses at different levels of the supply chain. The heads of the agencies echoed this goal in public statements, and highlighted the continued importance of vertical merger enforcement. The FTC chairman, Joe Simons, called the Guidelines an "important step forward in maintaining vigorous antitrust enforcement" that "reaffirm [the FTC's] commitment to challenge vertical mergers that are anticompetitive and would harm American consumers."3 Assistant Attorney General Makan Delrahim of the DOJ's Antitrust Division agreed, and explained that the new guidance reflect the DOJ's "investigative practices as [it] appl[ies] them today and ha[s] applied them in recent years."4 Both Chairman Simons and AAG Delrahim also touted the collaboration of the agencies in crafting the new Guidelines and praised the public for its input through comment on the draft guidelines.

The Guidelines retain much of the same substance and focus of the draft version, although with some key changes stemming from the aforementioned public comment, as well as from criticisms by Commissioner Rebecca Slaughter and Commissioner Rohit Chopra of the FTC. The most notable such change was the removal of the "safe harbor" provision stating that the agencies would be unlikely to challenge vertical mergers where the combined firm's market share is under twenty percent. The other changes to the draft guidelines generally took the form of expanded discussion and explanation of the agencies' analysis of potential competitive effects in vertical mergers, as well as the use of illustrative examples of various vertical merger structures. And while Chairman Simons and AAG Delrahim commended the Guidelines' codification of recent agency practice, Commissioner Slaughter and Commissioner Chopra remained unsatisfied by the revised product, each dissenting and again criticizing the Guidelines for supporting the view that vertical mergers are often procompetitive.

Relationship With Horizontal Merger Guidelines

The Guidelines state that they should be "read in conjunction with the Horizontal Merger Guidelines"5 because many of the concepts are the same for horizontal mergers and vertical mergers, yet the agencies also explain that vertical mergers raise issues distinct from those present in horizontal mergers. For instance, the Guidelines state that vertical mergers often benefit consumers (which lessens the risk of competitive harm), but later clarify that the agencies will review any harm to competition as a result of a vertical merger — not just harm to consumers — due to potential enhancement of buyer power in addition to seller power. In addition, in discussing the potential evidence considered in reviewing a vertical merger, the Guidelines point to the standard evidence considered in the Horizontal Merger Guidelines (such as actual effects of already consummated mergers or the disruptive role of a merging party), as well as evidence about "the disruptive role of non-merging firms" (where the agencies may probe whether the merging party could "discipline" such a disrupter).

Theories of Harm and Procompetitive Effects

The Guidelines identify specific types of harm potentially present in vertical mergers, due to both traditional unilateral effects and coordinated effects. The Guidelines also present potential procompetitive effects, including the potential efficiencies present in many vertical mergers.

Unilateral Effects

Of the two theories of harm, the Guidelines place considerably more focus on unilateral effects — those which "diminish competition between one merging firm and rivals that trade with, or could trade with, the other merging firm." In particular, the Guidelines examine in significant detail the potential for a merged firm to either foreclose rivals from access to related products (like inputs) offered by the merged firm, or raise the costs of rivals by increasing the price or lowering the quality of those related products. The Guidelines provide more detail on these types of effects than did the draft version and add that the agencies will generally review both (i) the ability and (ii) the incentive of a merged firm to foreclose a rival or raise rivals' costs. The Guidelines explain that where the merging parties' competitors can easily (and without negative effect on the competitive strength of rivals) switch to alternatives to the related products, the "ability element" will not be satisfied. Next, the "incentive element" will not be satisfied if a merged firm would not benefit from reduced competition with the users of its related product in the relevant market. The Guidelines make clear, however, that even in mergers where the ability and incentive elements are met, the agencies will assess the merger's net effect on competition, including any efficiencies such as elimination of double marginalization.6 This emphasis on foreclosure and raising rivals' costs aligns with recent enforcement in vertical mergers, including, for example, the DOJ's claim of input foreclosure in its unsuccessful challenge to the AT&T/Time Warner deal, where it alleged that the merged company would have the ability and incentive to deny content to cable/satellite TV competitors.7

The Guidelines also identify a second type of potential unilateral effect whereby vertical mergers may give one or both of the merging parties access to competitively sensitive business information of their upstream or downstream rivals. For example, if a downstream target previously had relationships with numerous upstream suppliers, an upstream acquirer may have access to pricing or other sensitive information of its rivals in the upstream market after consummating a vertical merger. Per the Guidelines, merging parties could use that information to "preempt or react quickly to a rival's procompetitive business actions," which may deter industry participants from taking such actions. In addition, the Guidelines express concern that rivals may be reluctant to do business with the combined entity out of fear that the merged firm will abuse their information, potentially reducing competition as rivals turn to less effective or more costly alternative partners.

Coordinated Effects

Secondly, the Guidelines explain that vertical mergers can cause harmful coordinated effects, which refer to the potential for a merger to allow or encourage "post-merger coordinated interaction among firms in the relevant market that harms customers." Eliminating or weakening a third-party "maverick" is one potential form by which a vertical merger may have coordinated effects, according to the Guidelines, especially where the maverick would be playing a role in limiting coordination among other competing firms. In addition, a shake-up to market structure or increased access by the merged firm to sensitive business information can cause coordinated effects, with the Guidelines specifically identifying increased concerns around tacit agreements. As with theories of harm related to unilateral effects, however, the Guidelines explicitly note that some procompetitive effects of vertical mergers may counteract potential coordinated effects (e.g., where elimination of double marginalization may increase incentives for a merged firm to break a tacit agreement).

Procompetitive Effects

As noted above, throughout the discussion of potential theories of harm, the Guidelines recognize that vertical mergers afford the opportunity for unique and significant efficiencies. Furthermore, the Guidelines dedicate a section to analysis of procompetitive effects, explaining that these effects can result in vertical mergers where a merged firm can "combine complementary economic functions and eliminate contracting friction" at different levels of the supply chain. This "Procompetitive Effects" section in the Guidelines is expanded from January's draft, perhaps reflecting a more explicit recognition of these efficiencies as the counterweight to potential anticompetitive effects.

As the draft version did, the Guidelines point to the Horizontal Merger Guidelines in identifying the approach that the agencies will use to review efficiency claims. The Guidelines provide expanded examples of efficiency claims as well as explanations of how such claims can be substantiated and shown to be merger-specific. For example, in addition to analyzing elimination of double marginalization for standard vertical combinations, the Guidelines emphasize that mergers of complements can have similar synergies because such a merger may give the combined firm the incentive to set prices that maximize the profits of both complements, potentially leading to lower prices for consumers of each. The Guidelines also further highlight the importance of weighing procompetitive effects of vertical mergers against potential anticompetitive effects, stating that the agencies "may independently attempt to quantify [elimination of double marginalization's] effect based on all available evidence, including the evidence they develop to assess the potential for foreclosure or raising rivals' costs," and that efficiency claims will generally be credited if quantified with similar precision and reliability measures as evidence of anticompetitive effects. The Guidelines reflect that the agencies will review the merger specificity of efficiency claims in a similar manner, stating that in evaluating likely contractual arrangements absent the merger (i.e., whether self-supply post-merger would be less costly than existing alternatives), the agencies will "take the same approach … as the one they use when evaluating raising rivals' costs or foreclosure."

Changes Signaling More Aggressive Agency Enforcement

As noted above, the Guidelines took into account, in part, criticisms that the draft version was too lenient on vertical mergers. In particular, the final version removed the draft's suggested "safe harbor" for mergers where the combined firm would have less than a twenty-percent share in the relevant market, and where the related product is used in less than twenty percent of the relevant market. Also, the Guidelines' expanded discussion of the substantiation required to support efficiency claims could signal potential resistance to the agencies' acceptance of such claims.

Changes Signaling Less Aggressive Agency Enforcement

Despite certain changes in response to criticism from a faction of the commissioners and the public that the January draft was too lenient, some aspects of the Guidelines do suggest less aggressive enforcement. For example, while removal of the safe harbor for mergers with a pro forma market share of twenty percent may suggest scrutiny of mergers below that threshold, its removal may also cut the other way, avoiding any specific suggestion that mergers tripping that threshold are presumed to present anticompetitive concerns. Considering that the 1984 guidelines contained a much lower safe harbor of only five percent, and in fact included a presumption of competitive concerns for combined market shares of twenty percent, the agencies' decision to steer away from safe harbors entirely potentially signals a desire to avoid unnecessary scrutiny of mergers solely for tripping a market share threshold.

In addition, the more detailed discussion of procompetitive benefits of vertical mergers and how the agencies will evaluate such benefits could signal increased willingness to consider these arguments. Although the Guidelines expound on the substantiation required for claimed efficiencies to be credited, they also (i) discuss in further detail the potential procompetitive effects of elimination of double marginalization, (ii) add that mergers of complements may produce similar benefits and (iii) suggest that a common framework will be used to assess the effects of full or partial foreclosure and elimination of double marginalization. Considering these factors together with repeated references to weighing efficiencies against potential anticompetitive effects and language expressly stating that "vertical mergers often benefit consumers," the agencies appear to be more willing to contemplate procompetitive aspects of vertical mergers, even if the onus remains on merging parties to demonstrate these benefits.

Practical Implications

Because the new guidance is meant to provide a transparent account of the agencies' current views on vertical merger review and enforcement, the publication of the Guidelines is unlikely to result in significant changes to agency practice and should not be seen as a major change in agency policy. The influence of the Guidelines will likely depend on when and whether they are recognized by courts in litigated merger cases. The Horizontal Merger Guidelines are considered valuable precedent, but they have been in place for decades and have been consistently accepted by courts in numerous cases. By contrast, few vertical deals are litigated, and even in those cases, courts may choose not to adopt the Guidelines and instead continue to rely on existing precedent. In any case, the Guidelines could help to bring more discipline to the agencies' review of vertical mergers where the agencies' staff often struggles with how to determine whether a deal will raise concern.

Finally, despite an agreed-upon need to update the 1984 Guidelines, the new Guidelines were approved along a party-line vote at the FTC with dissenting statements from two commissioners.8 From a practical standpoint, merging parties could find that these dissents may speak louder than new Guidelines, which, in the words of the agencies themselves, simply codify existing agency practice over the past several decades. The dissenting statements suggest a minority interest to push for more aggressive review of vertical mergers, likely including enhanced scrutiny of claimed procompetitive benefits, support for novel theories of harm and closer looks at mergers involving less common vertical relationships. The dissenting viewpoints could also render the Guidelines as weak precedent in the eyes of courts reviewing challenges of vertical mergers, particularly until use of the Guidelines becomes more widespread. In addition, the Guidelines could be withdrawn following any change in the makeup of the next administration. Merging parties and their counsel should be prepared to monitor any such changes, as well as the agencies' review of vertical mergers in the near future.

This post comes to us from Skadden, Arps, Slate, Meagher & Flom LLP. It is based on the firm's memorandum, "FTC and DOJ Issue Vertical Merger Guidelines," dated July 10, 2020.

Leave a Reply

Your email address will not be published. Required fields are marked *

Comment

Name *

Email *

Post Comment

© Copyright 2020, The Trustees of Columbia University in the City of New York.