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ANTITRUST TRADE AND PRACTICE

FTC Demonstrates Aggressive Focus On Vertical Merger Transactions

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On Jan. 21, 2021, President Biden designated Rebecca Kelly Slaughter, a Commissioner at the Federal Trade Commission since 2018, to serve as the Acting Chair of the FTC. The designation of Slaughter, who has advocated for more aggressive antitrust enforcement by the FTC since joining the Commission, signifies the Administration's increased focus on competition issues and concern with threats to competition. One area where Acting Chairwoman Slaughter seemingly intends to sharply increase the FTC's focus and efforts is in its treatment of vertical merger transactions, identifying the evaluation and enforcement of such transactions as an area where the Commission should break with historical approaches and adopt a more aggressive posture. Acting Chairwoman Slaughter dissented from, and calls for revisions to, the Commission's 2020 Vertical Merger Guidelines, criticizes the way in which the FTC has historically evaluated such transactions and expresses skepticism at the presumption that such transactions are generally procompetitive. In March, the Commission demonstrated its willingness to police such transactions more aggressively, voting 4-0 to challenge the acquisition of Grail, Inc. by Illumina, Inc. Merging parties should take heed and consider any vertical interlocks between them, as well as whether a proposed transaction may lead to any change of incentives that could foster competitive harms.

The Vertical Merger Guidelines

On June 30, 2020, the FTC and the Department of Justice (the agencies) jointly issued Vertical Merger Guidelines. These guidelines replaced the DOJ's Non-Horizontal Merger Guidelines which had been adopted in 1984, and remained unchanged since. The Vertical Merger Guidelines provide an overview of the analytical approaches that the agencies apply to their evaluation of vertical transactions. The Guidelines adopt the position that vertical mergers are often procompetitive and beneficial to consumers. Nonetheless, the Guidelines identify numerous potential harms to competition that vertical transactions may raise. Among these harms are the risk that a merged firm could foreclose rivals' access to, or raise costs for, necessary products (i.e., inputs). See U.S. DOJ and FTC, Vertical Merger Guidelines (June 30, 2020). The Guidelines indicate that the agencies will review both the ability as well as the incentive of a merged firm to foreclose rivals. The ability element will not be satisfied where competitors of the merged firm could easily switch to alternatives to, or alternative suppliers of, the related products without negative effects on their competitive strength. Id. The incentive element will not be satisfied if a merged firm would not benefit from reduced competition

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with the users of its related product in the relevant market. Id. Furthermore, the Guidelines indicate that, even in mergers where the incentive and ability elements are both satisfied, the agencies' review will consider the merger's net effect on competition and any efficiencies created by the deal. Id.

The Guidelines indicate that, despite the potential for competitive harms, vertical mergers may create significant procompetitive effects and opportunities for efficiencies. Among the potential procompetitive effects, the Guidelines explain that vertical mergers may result in a merged firm capable of "combin[ing] complementary economic functions and eliminat[ing] contracting friction" throughout the supply chain. Id. The Guidelines also explain that vertical mergers of complements can result in a merged firm with the incentive to set profit-maximizing prices for both complements, potentially resulting in lower prices for consumers. Id. Finally, the Guidelines acknowledge the importance of weighing procompetitive effects in vertical merger analyses, and note that the agencies will accept procompetitive evidence where presented with the same precision and reliability measures required for evidence of anticompetitive effects. Id.

Notably, the adoption of the Vertical Merger Guidelines was not unanimous, with Commissioners Slaughter and Rohit Chopra dissenting. In her dissenting statement, Commissioner Slaughter expressed concern "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." See "Dissenting Statement of Commissioner Rebecca Kelly Slaughter" (June 30, 2020). Specifically, Commissioner Slaughter criticized the Guidelines for overemphasizing the benefits of vertical mergers, failing to indicate when mergers would warrant scrutiny and enforcement action, being overly optimistic that most vertical transactions would lead to the elimination of double marginalization, and failing to include or account for the competitive concerns inherent in vertical transactions. Id.

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A New Approach?

Since assuming the role of Acting Chair, Commissioner Slaughter continues to advocate for increased enforcement activity with regards to vertical transactions and expresses an intent to have the Commission more aggressively scrutinize such deals. In a prepared statement to the House Subcommittee on Antitrust, Commercial and Administrative Law on March 18, 2021, Acting Chairwoman Slaughter reiterated her disagreement with the 2020 Vertical Merger Guidelines and noted that vertical merger analysis is, and has been, too reliant on the assumed procompetitive benefits of such transactions. See "Prepared Statement of Federal Trade Commission Acting Chairwoman Rebecca Kelly Slaughter" (March 18, 2021). Noting the current challenges to litigating vertical mergers, Acting Chairwoman Slaughter advocated for a reconsideration of the Guidelines. She explained that, where past enforcement of vertical mergers has been sought, it has resulted in behavioral consent decrees which have failed to "adequately captur[e] the competitive consequences of these transactions." Id. She expressed her view that the Commission should not "shy away from structural remedies in cases," noting that such remedies are less radical than typically characterized because they can "provide a clean separation and fresh start for a business" whereas "behavioral remedies require ongoing involvement and monitoring by government overseers." Id.

The Illumina Challenge

The FTC translated this new aggressive posture into action at the end of March, filing both an administrative challenge and a challenge in federal court to block Illumina's $7.1 billion proposed acquisition of Grail, Inc. See Complaint, *Fed. Trade Comm'n v. Illumina*, No. 1:21-cv-00873 (D.D.C. March 31, 2021). Grail is a producer of cancer-screening tests which utilize DNA sequencing to detect multiple types of cancer in asymptomatic patients at very early stages. Illumina formed

Grail in 2015 and held a majority ownership stake in the company until 2017; Illumina is currently the only provider of DNA sequencing available for use in Grail's tests. Id. In its challenge to the transaction, the FTC asserts that, if consummated, the transaction would significantly decrease competition in the U.S. multi-cancer early detection (MCED) test market by diminishing innovation, increasing prices, limiting consumer choice and reducing the quality of MCED tests. Id.

Notably, the MCED market identified by the FTC currently lacks any commercial products. Grail is expected to launch its first MCED tests within a year and other producers of MCED tests are expected to follow suit shortly thereafter. The FTC's challenge thus specifically focuses on the chilling effects that the transaction could have on the development of the nascent and emerging MCED market, with the FTC contending that the transaction would reduce innovation and product development. Id.

The FTC's challenge to the transaction specifically focuses on the potential harm stemming from Illumina's role as the only supplier of a critical input required for MCED tests. The FTC argues that the merged firm would have both the ability and the incentive either to restrict access to, or to increase the costs for, DNA sequencing for competitors because the developers of MCED tests have no choice but to use Illumina's gene sequencing technology. Id. Control of this vital input, the FTC asserts, would also permit the merged firm to monitor the development of competitors' products and, where it determines a threat to the merged firm exists, impede competitors' research and development efforts. Currently, all MCED test developers rely on Illumina to execute the license agreements necessary to distribute their tests to third-party laboratories. Id. Finally, the FTC notes that, even if a viable substitute to Illumina's gene-sequencing business entered the market, it could take years for MCED test developers to switch from Illumina to the new entrant due to the need to reconfigure their platform and, in some cases, to conduct new clinical trials. Id. The theories expressed and relied upon by the FTC are very much in line with the text of the Guidelines as drafted. Despite the rhetoric surrounding the challenge, the FTC's case does not appear to present a novel theory of vertical merger analysis or enforcement.

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Illumina and Grail have agreed not to close the deal until a decision is reached on the FTC's challenge to the transaction. Executives at both Illumina and Grail say that the companies intend to vigorously defend the acquisition against the challenge and note that the deal would significantly expand access to early detection tests, reduce healthcare costs, and allow Illumina to scale testing operations more rapidly than Grail could on its own, benefitting patients. *See* Press Release "Illumina Committed to Pursuing GRAIL Acquisition to Access to Breakthrough Multi-Cancer Early Detection Blood Test" (March 30, 2021).

The FTC's challenge will be an important test for the Commission's aggressive posture towards vertical transactions under Acting Chairwoman Slaughter. A victory for the FTC may indicate a substantial shift in the way that such transactions are understood to impact competition and the ways in which they are scrutinized and evaluated by the enforcement agencies. Such a shift could significantly alter the considerations and incentives for parties seeking to enter into merger transactions with either upstream or downstream counterparties. Preparation to address these theories, including through use of data and established econometrics, will become even more critical to agency advocacy.

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