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Kirkland Alert

FTC and DOJ Issue New Vertical Merger Guidelines

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On June 30, 2020, the Federal Trade Commission and the Department of Justice (the "Agencies") issued new Vertical Merger Guidelines (the "Guidelines") explaining how they regulate mergers of companies that are not current or potential competitors. The Guidelines replace guidance dating to 1984 that had fallen by the wayside in several important respects, and are intended as a companion to the Horizontal Merger Guidelines (regarding competitor transactions) issued by the Agencies in 2010. While such guidelines are not legally binding and claim only to describe current Agency practices, they provide a *de facto* framework that Agency lawyers and merging parties use to analyze deals, and are often relied upon by courts interpreting the antitrust laws.

The new Guidelines are consistent with the existing approach of the Agencies, and in that sense they contain no major surprises. That said, however, three points stand out:

- First, vertical mergers have attracted significant scrutiny from the Agencies and commentators in recent years, and the issuance of revised Guidelines (long after the 1984 guidelines became stale) underscores the fact that vertical deals continue to be an area of focus.
- Second, the finalized Guidelines differ in several notable respects from the draft guidelines (described in a previous Kirkland *Alert*) that were released for public comment in January 2020. These changes were explicitly made in response to concerns raised via the public comment process, including concerns raised by state attorneys general and one of the dissenting FTC commissioners (as described below).
- Third, in a departure from past Agency practice in which broad statements of policy are typically issued unanimously, the two Democratic commissioners comprising a minority of the FTC dissented from the issuance of the Guidelines, which they critiqued, on a variety of grounds, as being too permissive of problematic mergers.

> These dissents are consistent with a recent trend toward political polarization at the FTC, and drive home how a Democratic victory in the 2020 presidential election could have a significant impact on the enforcement of the antitrust laws.

While transactions between competitors will continue to be the primary concern of Agency enforcement efforts, the issuance of the Guidelines (and Democratic reactions to them) show that the renewed focus on vertical mergers will continue to persist for the foreseeable future. Parties considering vertical mergers should consult with antitrust counsel early in the deal process to identify potential regulatory risks, which are often less intuitive than those arising in competitor transactions. Counsel can help quantify those risks, and, if needed, prepare to mitigate them (possibly in partnership with expert economists) by developing evidence that the merger will not substantially lessen competition.

Antitrust Issues in Vertical Mergers

The Agencies are charged with investigating whether proposed mergers may substantially lessen competition. When a merger combines firms that do or could compete with each other, it is self-evident how competition could be lessened. Vertical mergers (a term which most often refers to mergers of companies at different levels in a supply chain, but may encompass all non-competitor transactions) do not remove a competitor from the market, though they may lessen competition nonetheless. The Guidelines describe three primary ways in which this may occur:

- **Foreclosure and Raising Rivals' Costs.** For example, when one of the merging parties produces or controls access to an input needed by competitors to the other party, the merged firm may be able to increase the price of the input or prevent competitors from obtaining it. The Guidelines describe several other ways in which foreclosure and raising rivals' costs may occur, but input foreclosure of the type described here is the most significant.
- **Access to Competitively Sensitive Information.** The merger may give the combined firm access to and control of sensitive business information about its rivals, such as customers of one merging party that compete with the other merging party.
- **Facilitation of Collusion.** The merger may facilitate anticompetitive coordination between one or both of the merging parties and firms that compete with it.

The theory of harm related to foreclosure and raising rivals' costs is the principal concern addressed by the Guidelines. It has been the basis of most significant Agency investigations of vertical mergers and presents more challenging conceptual and policy questions than the other theories of harm described above. It is highly fact-specific, focusing on whether the merged firm would have the ability and incentive to foreclose its rivals, followed by an analysis of the likely net effect on competition (i.e., including procompetitive effects) of all changes to the merged firm's incentives. The Agencies have also conducted many investigations related to access to competitively sensitive information, but these issues tend to be relatively straightforward and any concerns arising from them relatively easy to fix with a settlement prohibiting problematic information-sharing within the merged firm.

Clarifications of Agency Enforcement Policy

The Guidelines state that vertical mergers often benefit consumers due to the elimination of double-marginalization ("EDM") (simply put, the markup at both levels of a supply chain), which tends to lessen the risk that the merger will result in competitive harm. The Guidelines clarify that claims of EDM must be substantiated through rigorous analysis— EDM cannot be presumed from the nature of the deal — and should be evaluated, to the extent possible, using the same framework of facts and assumptions used to evaluate potential harms arising from the deal. This position that EDM is likely but must be proven like other procompetitive synergies strikes something of a middle ground between proponents and skeptics of the notion that EDM is a typical feature of vertical mergers that tends to benefit consumers.

Also notable are two points that were changed from the January 2020 draft guidelines due to public feedback and critiques from state attorneys general and one of the dissenting FTC commissioners.

First, the draft guidelines had proposed a near-safe harbor for deals in which the merged firm would have shares below 20% in both the upstream and downstream markets. The final Guidelines eliminated the safe harbor concept. However, practically speaking, relevant case law and agency practice indicate that shares significantly higher than 20% are unlikely to raise concerns. The absence of a formal safe harbor will not change this dynamic.

Second, while the 1984 guidelines discussed harm from the elimination of potential competition, the draft guidelines were silent on this concept. The final Guidelines clarify that concerns about potential competition (including between parties that are currently in a vertical relationship) should be evaluated using the principles set forth in the Horizontal Merger Guidelines.

Democratic Dissents and the Road Ahead

If President Trump wins the 2020 election, antitrust regulation of horizontal and vertical mergers will likely continue to reflect the current approach, including as set forth in the Guidelines, which has been moderately enforcement-minded and broadly consistent with bipartisan historical norms.

A Democratic victory, however, could present two paths forward, which are exemplified by the dissents of the two Democratic FTC commissioners to the issuance of the Guidelines. One such commissioner made measured critiques of the substance of the Guidelines and the absence of an additional public comment period to receive feedback on the changes implemented since the January 2020 draft. The other dissenting commissioner, consistent with his prior statements about merger enforcement generally, called the Guidelines fundamentally flawed and would prefer a framework that is much more unfriendly to mergers. These approaches, reflecting the moderate-liberal divide in the Democratic Party, could lead to incremental changes to antitrust policy that impact marginal cases, or to a wholesale reevaluation of antitrust enforcement and its guiding principles. Given the moderate outlook of presumptive Democratic nominee Joe Biden and the strong institutional bent at the Agencies to adhere to established practices, the more measured approach is likely to hold sway, but more sweeping changes, and their attendant turbulence, cannot be ruled out.

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