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DOJ and FTC Propose Highly Anticipated Vertical Merger Guidelines

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On January 10, 2020, the U.S. Department of Justice and the Federal Trade Commission released draft ***Vertical Merger Guidelines*** for public comment. The new guidelines, which will replace the outdated 1984 Non-Horizontal Merger Guidelines, are intended to assist the business community, antitrust practitioners, and courts by providing transparency about the agencies' current enforcement policy with respect to vertical mergers.

Vertical mergers combine two or more companies or businesses that operate at different levels in the same supply chain, such as a manufacturer of a product and a wholesale or retail distributor of that product. Unlike horizontal mergers of competitors, which reduce the number of players in a specific market, vertical mergers do not eliminate a competitor; hence, the overall competitive effects of vertical mergers are often more difficult to predict. As Assistant Attorney General Makan Delrahim noted, "[w]hile many vertical mergers are competitively beneficial or neutral, both [DOJ] and the Federal Trade Commission have recognized for over 25 years that some vertical transactions can raise serious concern."

Vertical mergers have entered the antitrust spotlight frequently in recent years, most visibly in the DOJ's ***unsuccessful court challenge*** to AT&T's $85 billion merger with Time Warner. Despite DOJ's defeat in that case, several other vertical mergers have undergone intense antitrust scrutiny lately, including CVS/Aetna, Cigna/Express Scripts, and Staples/Essendant.

The draft Vertical Merger Guidelines, which import certain principles from the agencies' 2010 Horizontal Merger Guidelines, describe analytical and enforcement considerations that are specific to vertical mergers. The Vertical Merger Guidelines discuss the importance of defining a relevant market and evaluating market shares and market concentration. Notably, the guidelines state that the agencies "are unlikely to challenge a vertical merger" where the merging parties have less than a 20% share of the relevant market and the vertically related product is used in less than 20% of the relevant market. However, the guidelines also emphasize that shares below those thresholds can trigger competitive concerns in some circumstances, for example, if the related product is relatively new (e.g., a new active ingredient for a pharmaceutical drug) and its share of use in the relevant market is rapidly growing. The 20% threshold thus serves as a guidepost, with DOJ and FTC retaining discretion to challenge vertical mergers falling below that threshold if the specific facts warrant.

The guidelines then describe potential anticompetitive effects of vertical mergers, identifying foreclosure and raising rivals' costs as possible elements of antitrust harm. This can involve, for example, the merged firm charging downstream competitors a higher price for a key input product, or simply refusing to supply its rivals with that product, in order to divert sales from those rivals to its own downstream operations. The guidelines also discuss the potential negative consequences of a company gaining access to sensitive business information about its upstream or downstream rivals, as well as ways in which a vertical merger may enable coordinated interaction among firms that could harm customers. While the draft guidelines describe modern theories of harm from vertical mergers, they do not explain how the antitrust agencies will apply those theories in practice.

Offsetting those concerns, vertical mergers can have procompetitive benefits. The draft Vertical Merger Guidelines discuss "elimination of double marginalization" (EDM), whereby vertical integration may create an incentive and ability for the merged firm to lower prices to customers and still remain profitable. The guidelines also recognize that vertical mergers can generate valuable efficiencies by combining complementary business operations, such as streamlining of production, inventory management, or distribution, or creation of new and innovative products. Both EDM and efficiencies should be considered as part of vertical merger analysis.

Significantly, the FTC's two Democratic commissioners, Rebecca Kelly Slaughter and Rohit Chopra, agreed with the need to replace the 1984 Non-Horizontal Merger Guidelines but abstained from the vote by their three Republican colleagues to publish the new Vertical Merger Guidelines. In a statement explaining her reasoning, Commissioner Slaughter first reiterated her general concerns about vertical mergers that she had ***previously expressed in a dissenting statement*** a year ago in the Staples/Essendant merger, i.e. that the current approach to vertical merger review has led to substantial under-enforcement. Slaughter then objected to what she views as an "effective safe harbor" for firms with less than 20% market share, taking issue with both the notion of a safe harbor in the vertical merger context and the 20% figure itself, which she says lacks evidentiary support. She also expressed concern that the guidelines set too high a bar for certainty of competitive harm when considering whether enforcement action is warranted.

In his own statement, Commissioner Chopra said that the draft guidelines "miss the mark," because they are not supported by an analysis of past enforcement decisions, they perpetuate an overdependence on theoretical models, and they do not reflect all of the ways that competition can be harmed by vertical mergers. Transaction reviews, according to Chopra, should encompass all the ways that vertical integration could allow the combined firm to deter market entry or reduce new firm formation, and it is not enough to solely look at overlapping product markets or markets that appear relevant to a specific supply chain. Instead, "[t]he nature of competition for capital, the new norms created by technological advancement, and the business incentives associated with data require a broader assessment of market power."

Comments on the draft 2020 Vertical Merger Guidelines can be submitted to the FTC and DOJ until February 11, 2020. (Commissioners Slaughter and Chopra both questioned whether the 30 day comment period provides sufficient time for all interested stakeholders to respond.)