FTC and DOJ Antitrust Announce New Vertical Merger Guidelines

July 8, 2020

On June 30, 2020, the Federal Trade Commission ("FTC") and the Antitrust Division of the U.S. Department of Justice ("DOJ") issued new Vertical Merger Guidelines that outline how the federal antitrust agencies (the "Agencies") evaluate the potential competitive impact of vertical mergers. The Guidelines outline the Agencies' analytical techniques, practices, and enforcement policy when examining "strictly vertical" mergers (mergers involving firms or assets operating at different levels of the distribution chain), "diagonal" mergers (mergers that combine firms or assets at different stages of competing supply chains), and vertical issues that can arise in mergers of companies that produce complementary products.

While the final Guidelines reflect modifications to draft guidelines that the Agencies published earlier this year, much of the guidance is not new, but instead reflects the principles, tools, and frameworks that the Agencies have historically used to assess mergers. These tools include the Agencies' prior guidance in their Horizontal Merger Guidelines, many sections of which are explicitly incorporated into the Vertical Merger Guidelines. However, unlike the Horizontal Merger Guidelines, the Vertical Merger Guidelines do not presume that a vertical merger will have anticompetitive effects. Instead, the Agencies recognize that vertical mergers often benefit consumers, primarily through cost savings to a merged firm from self-supplying inputs that would have been purchased from independent suppliers absent the merger (a concept known as elimination of "double marginalization"). Nonetheless, the Guidelines caution that vertical mergers are "not invariably innocuous" and could injure competition in relevant markets.

THE NEW GUIDELINES

The Guidelines address the following elements of the Agencies' analysis:

Market Definition and Market Share

When analyzing a vertical merger, the Agencies identify the relevant market(s) in which "the merger may substantially lessen competition" and specify one or more products related to that market. A related product is a product that is supplied or controlled by the merged firm and is positioned vertically or is complementary to the products in the relevant market. Unlike in the horizontal merger context, market shares are not dispositive in the vertical merger context, though they may provide evidence about the likelihood, durability, or scope of anticompetitive effects in a relevant market. Perhaps the most notable change from the draft Guidelines is that the final Guidelines eliminated the draft's presumptive "safe harbor" for a vertically combined firm with a market share below 20%. While some might view this omission as indicating that vertical mergers with low combined market shares may be challenged, it could suggest that vertical mergers resulting in slightly above 20% market share may also be safe. Notably, a recent study of the Agencies' vertical merger settlements over the past 20 years indicated that neither the DOJ nor FTC has challenged a vertical merger resulting in combined market shares below 40%.[1]

Anticompetitive Effects of Vertical Mergers

In analyzing the effect that a transaction will have on competition, the Agencies focus on the combined firm's ***ability*** and ***incentive*** to diminish competition. That is, will the merged firm be capable of foreclosing rivals or offering inferior terms for the related product, and will it find it profitable to do so? Analysis of this key question includes a focus on potential unilateral competitive effects and coordinated competitive effects.

Unilateral Effects

The key unilateral effects that the Agencies focus on include:

- Foreclosure and raising rivals' costs: The critical question here is whether the merged firm could profitably use its supply of an input (the related product) to weaken competitors in the relevant market. The merger will be less likely to cause concern if rivals can switch suppliers or use alternatives to the related product without affecting product price, quality, or availability in the relevant market.

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[1] American Bar Association Antitrust Law Section Comments on the Draft Vertical Merger Guidelines Issued by the Department of Justice and the Federal Trade Commission Comments (Feb. 22, 2020).

- Access to competitively sensitive information: The Agencies will determine whether the merged firm will gain access to its competitors' competitively sensitive information. This access may create an unfair advantage for the combined firm or cause rivals to refrain from doing business with the combined firm. The Agencies will examine whether such behavior will weaken the merged firm's competitors.

Coordinated Effects

The Agencies separately examine whether a vertical merger may lead to coordination by (1) eliminating or hindering a "maverick" firm that otherwise restrains anticompetitive coordination in the relevant market, or by (2) changing the market structure or the merged firm's access to confidential information, thus allowing market participants to (a) reach a tacit agreement among market participants, (b) detect cheating on such an agreement, or (c) punish cheating firms.

Evidence of Adverse Competitive Effects

The sources of evidence the Agencies use to assess vertical mergers include those set forth in the Horizontal Merger Guidelines: documents and statements of the merging parties, their customers, and other industry participants and observers. The Agencies may also consider the actual effects of consummated mergers in the relevant markets and evidence about the disruptive role of competitors in the relevant market. While market shares and concentration in relevant markets will be considered, as noted above, market shares may not be dispositive.

Procompetitive Efficiencies

The Guidelines highlight the elimination of double marginalization as the principal efficiency likely to result from vertical mergers, including from streamlined production, inventory management, and distribution. The Guidelines also recognize that vertical mergers may allow a combined firm to create innovative products in ways that might not be achieved through arm's-length contracts. Nonetheless, the Guidelines emphasize that the Agencies will credit such procompetitive benefits only where they are "merger-specific," *i.e.*, could not have been achieved independent of the merger.

HOW DEBEVOISE CAN HELP

The new Guidelines do not legally bind courts, but they provide detailed insight into how the Agencies evaluate vertical mergers and serve as persuasive authority for courts analyzing challenged vertical mergers. Although the Guidelines recognize the potential procompetitive effects of vertical mergers, removal of the draft Guidelines' presumptive "safe harbor" and articulation of concerns over diagonal mergers and mergers of complements indicate the potential for increased enforcement covering a wide array of

transactions. The Guidelines also leave several questions unanswered, including how the Agencies approach remedies for vertical mergers.

Debevoise has extensive experience guiding clients through the HSR process and obtaining FTC and DOJ approval for vertical and horizontal mergers. Our team is available to answer questions about the Guidelines or analyze how they might apply to particular proposed transactions.

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Please do not hesitate to contact us with any questions.

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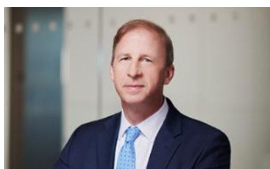

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