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Antitrust Agencies Propose Updated Guidance on Vertical Transactions

The U.S. Department of Justice (DOJ) and the Federal Trade Commission (FTC) recently proposed new joint guidelines that describe the principal analytical techniques, practices, and enforcement policies concerning the federal government's antitrust review of vertical mergers and acquisitions. Vertical transactions combine two or more companies that operate at different levels in the same supply chain. The proposed guidelines supersede the "Non-Horizontal Merger Guidelines" issued by the DOJ more than 25 years ago. As DOJ Assistant Attorney General Makan Delrahim explained, "The revised draft guidelines are based on new economic understandings and the agencies' experience over the past several decades and better reflect the agencies' actual practice in evaluating proposed vertical mergers."

The joint effort by the DOJ and FTC reflects a renewed focus by the federal antitrust agencies on the potential anticompetitive effects of vertical transactions. As FTC Chairman Joseph J. Simons reiterated, "Challenging anticompetitive vertical mergers is essential to vigorous enforcement. The agencies' vertical merger policy has evolved substantially since the issuance of the 1984 Non-Horizontal Merger Guidelines, and our guidelines should reflect the current enforcement approach." The proposed guidelines signal the agencies' commitment to carefully scrutinize vertical transactions, particularly in the health care and technology sectors, which have seen rapid vertical consolidation in recent years.

The 1984 Guidelines and Vertical Merger Developments

Traditionally, vertical mergers have been perceived as presenting fewer antitrust risks than horizontal mergers because they do not reduce the number of competitors. And they often increase efficiency by, for example, allowing a finished-good manufacturer to own a key input supplier or distributor, or a service provider to acquire businesses in adjacent markets. The 1984 guidelines identified only a limited set of theories about how these transactions could harm competition, including eliminating potential entrants and creating barriers to entry.

The past decade has brought abundant vertical merger activity in a variety of sectors, spurred in part by economic growth, legal and regulatory shifts, and the expansion of the technology sector. One of the industries with a notable level of integration has been health care. In the years after the Affordable Care Act was enacted in 2010, there have been scores of mergers and affiliations between insurers and providers, insurers and pharmacies and pharmacy benefit managers, and providers and suppliers. The technology sector also has seen many acquisitions of small companies that provide complementary innovations or platforms by larger companies.

During this same period, a number of prominent academics and politicians – including both liberal Democrats and conservative Republicans – have warned that vertical deals may enable companies with market power to thwart rivals, harming competition and consumers. And, significantly, in recent years enforcers have challenged or carefully scrutinized vertical transactions:

- Most prominently, less than two months after Delrahim was confirmed to lead the DOJ Antitrust Division in 2017, the DOJ challenged AT&T's acquisition of Time Warner. The primary basis for the challenge was a vertical theory alleging that AT&T, as owner of DirecTV, could foreclose rivals from obtaining Time Warner's desirable programming. The D.C. Circuit ultimately upheld the trial court's rejection of the DOJ's proof, noting the absence of precedent or recent governmental guidelines in support of its theory of harm.
- In May 2018, the DOJ asserted vertical as well as horizontal theories in requiring Bayer to sell off $9 billion worth of assets as a condition of its acquisition of Monsanto, the largest divestiture in U.S. history.
- In early 2019, the FTC split 3–2 in approving two vertical mergers in the office products and dialysis sectors with modest remedies. The dissenting Democratic commissioners argued that both deals needed more robust fixes to prevent anticompetitive use of market power by the merged entities.

Thus it was no surprise when Simons, a Trump appointee who included vertical mergers as a topic in the agency's hearings on the future of competition law, stated in September 2019 that "anticompetitive vertical mergers are not unicorns, and there should not be a presumption that all vertical mergers are benign. There are well-known ways in which vertical mergers can be anticompetitive, and although such mergers may not arise every day, they are common enough that we need to pay careful attention to look for and challenge them."

The Proposed Revisions

With all of these developments, the DOJ and FTC proposed revisions to the 1984 guidelines based on "new economic understandings and the agencies' experience … in evaluating proposed vertical mergers." Among the key elements of the proposed changes are:

- *Related products*. The agencies' Horizontal Merger Guidelines, which were revised in 2010, set forth current criteria for defining the relevant product and geographic markets in which competitive effects typically are analyzed. The proposed vertical guidelines add the concept of a "related product," which is defined as "a product or service that is supplied by the merged firm, is vertically related to the products and services in the relevant market, and to which access by the merged firm's rivals affects competition in the relevant market."
- *Elimination of double marginalization recognized as potential benefit*. The proposed guidelines recognize that vertical integration within the supply chain can reduce the cost of goods and services. But the guidelines warn that this elimination of double marginalization (EDM) must be demonstrable.
- *Updated theories of harm*. The proposed guidelines are updated to reflect modern economic doctrines about foreclosure and raising rivals' costs as potential sources of competitive harm in addition to other traditional merger theories of harm.
- *New focus on access to competitively sensitive information*. The proposed guidelines also observe that a vertical transaction may expand access to competitively sensitive information, which may have a negative impact on competition. For example, a company that acquires a distributor or supplier may have a legitimate reason to know the cost structures or prices of a rival. The guidelines do not speak explicitly about creating safeguards to prevent misuse of that information, but simply observe that rivals might not work with or compete as vigorously against a merged firm that has access to such sensitive information, potentially reducing competition and raising prices.

- *Creation of a new presumptive "safe harbor."* The proposed guidelines would create a presumptive safe harbor for transactions when the new entity has no more than 20 percent share of the relevant market and the related product is used in less than 20 percent of the relevant market. The guidelines say the check about the related product's use in the relevant market is "one indicator of [its] competitive significance," but few details are provided about how it may be applied. And all transactions – both inside and outside the safe harbor – will be analyzed on their facts for competitive impact.

It is noteworthy that the two Democratic FTC commissioners, Rebecca Kelly Slaughter and Rohit Chopra, abstained from voting on the proposed guidelines because they did not believe they were sufficiently robust. In particular, Chopra issued a statement that the draft guidelines "are not supported by an analysis of past enforcement decisions, perpetuate an overdependence on theoretical models, and do not reflect all of the ways that competition can be harmed."

Observations and Next Steps

The debate over whether these draft guidelines will be helpful to the business community and antitrust practitioners is far from over. Even before they were issued, commentators questioned whether, given the fact-specific nature of vertical mergers, any guidelines could provide meaningful guideposts. The agencies received 72 public comments – from businesses, trade associations, academics, practitioners, and 26 state attorneys general – during a comment period that was extended two weeks into late February 2020. And the agencies are holding two public workshops in March 2020 to receive additional feedback.

Issues that were raised in the comments and are likely to be discussed at the hearings include:

- How the agencies approach balancing procompetitive benefits and anticompetitive harms. At a recent American Bar Association Antitrust Law Section event on the proposed guidelines, FTC Commissioner Christine Wilson invited discussion on this subject, asking whether EDM should be equal to the harm from the potential to raise rivals' costs and whether either or both of them are always attributable only to the proposed merger. In her statement abstaining from approving the draft guidelines, Slaughter also said she would be interested in comments on when harm from vertical mergers might be presumed, the role of EDM, and how to analyze differentiated products, non-linear pricing, and bargaining leverage.

- Whether more guidance is needed on specific industries with high degrees of vertical integration and remedies that may be appropriate to address competitive concerns. Commentators have noted that, even with all the vertical integration in the health care sector, not a single fact pattern discussed in the guidelines arises from that industry. Nor is there much discussion about the technology sector, which the FTC indicated a continued interest in last month by ordering five large companies to provide information about small acquisitions, including vertical deals, closed over the past decade.

- Whether the new definitions and safe harbor are useful. It remains to be seen if more detail is needed to identify and apply the "related product" concept, which remains vague and might be hard to apply in rapidly innovating industries. And, as Deputy Assistant Attorney General Barry Nigro noted at a recent ABA program, the 20 percent safe harbor was not based on conclusive economic study but rather made the agencies feel "comfortable." Wilson has added that she welcomed input about how to identify which vertical transactions are likely to only have a minor competitive impact.

Regardless of the number, content, and impact of the comments on the guidelines, the bipartisan interest in analyzing vertical mergers as a potential source of competitive harm is likely to continue. And, unlike the *AT&T* case, the agencies will be in a better position to bring enforcement actions having enumerated their concerns outside a pending case. Companies considering mergers that raise vertical issues, which can occur on a standalone basis or as part of a transaction with a rival, would be well served to monitor the final guidelines, future commentary on them, and enforcement actions by the agencies and anticipate continued scrutiny of these types of transactions.

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