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U.S. DEPARTMENT OF JUSTICE AND FEDERAL TRADE COMMISSION ISSUE DRAFT VERTICAL MERGER GUIDELINES

To Our Clients and Friends:

On January 10, 2020, the Federal Trade Commission and the Antitrust Division of the U.S. Department of Justice released for public comment draft Vertical Merger Guidelines, which would replace the Non-Horizontal Merger Guidelines originally published by the agencies in 1984.

Vertical mergers combine two or more companies that operate at different levels of the same supply chain. According to the draft Vertical Merger Guidelines, the principles and analytical framework used to assess horizontal mergers also apply to vertical mergers, and thus, the new guidelines are intended to be read in conjunction with the agencies' 2010 Horizontal Merger Guidelines. Common issues such as defining relevant product and geographic markets, evaluating entry considerations, treatment of a failing firm, and partial ownership acquisitions are addressed in the Horizontal Merger Guidelines, while the draft Vertical Merger Guidelines address distinct considerations raised by vertical mergers.

The draft Vertical Merger Guidelines do not appear to signal an intent to increase scrutiny of vertical mergers or a change in enforcement priorities. Rather, FTC Chairman Joseph Simons and Assistant Attorney General Makan Delrahim emphasized that the new guidelines are intended to more accurately describe current agency practice and provide greater transparency on how the agencies approach vertical mergers.

The Commission vote to publish the draft Vertical Merger Guidelines was 3-0-2, with Commissioners Rebecca Kelly Slaughter and Rohit Chopra abstaining. Public comments on the draft can be submitted to the agency by February 11, 2020. Although the guidelines may be modified after public comments are received, major changes are unlikely. If they are finalized without major changes, these guidelines are likely to govern the agencies' analysis, practice, and enforcement decisions with respect to vertical mergers for years to come.

Highlights

- **Related Products and Relevant Markets:** The draft guidelines describe how for analytical purposes the agencies normally will identify one or more relevant markets in which a vertical merger may substantially lessen competition. The agencies also will identify one or more "related products" – that is, products or services that are "vertically related to the products or services in the relevant market and to which access by the merged firm's rivals affects competition in the relevant market." A "related product" could be an input, a means of distribution, or access to customers.

- **Safe Harbor:** The draft guidelines state that the agencies are unlikely to challenge a vertical merger where the parties to the merger have less than 20 percent share in the relevant market and the related product is used in less than 20 percent of the relevant market. The agencies stress that these thresholds are not bright line rules. Mergers involving shares above these thresholds do not necessarily raise competitive concerns, and shares below these thresholds might raise competitive concerns, depending on the circumstances.

- **Unilateral Effects:** The draft guidelines outline two ways in which vertical mergers could have unilateral anticompetitive effects – that is, ways in which the merger could increase the ability or incentive of the merged firm to increase prices or reduce output on its own. First, a vertical merger could allow the merged firm to weaken a competitor by *foreclosing* that rival from or *raising the rival's costs* to access a related product, such as a necessary input or distribution channel. Second, a vertical merger could diminish competition by giving the merged firm access to *competitively sensitive information* of its upstream or downstream rivals, causing the merged firm to moderate its competitive response.

- **Coordinated Effects:** The draft guidelines also explain how a vertical merger could make a market more vulnerable to coordination by weakening or eliminating a maverick firm that would otherwise thwart anticompetitive coordination. Alternatively, according to the draft guidelines, a vertical merger might facilitate anticompetitive coordination by giving the merged firm access to competitively sensitive information.

- **Elimination of Double Marginalization:** When two vertically related firms merge, the merged firm is often able to profitably reduce its downstream prices. The draft guidelines acknowledge that this reduction, called the elimination of double marginalization ("EDM"), benefits both the merged firm and buyers of the downstream product or service. The draft guidelines put the burden on the merging parties to demonstrate whether and how the merger eliminates double marginalization, but states that the agencies will not challenge a merger if the net effect of the EDM means the merger is not likely to be anticompetitive.

- **Efficiencies:** The draft guidelines acknowledge that to the extent a vertical merger combines complementary assets, it has the potential to create other efficiencies that may benefit consumers. The agencies will evaluate those claimed efficiencies using the approach outlined in the Horizontal Merger Guidelines.

Potential Implications

As noted above, the release of draft Vertical Merger Guidelines does not signal increased enforcement of the antitrust laws with respect to vertical mergers. The 1984 Non-Horizontal Merger Guidelines were widely considered to be woefully out of date and did not reflect modern antitrust analysis. The draft guidelines reflect the agencies' effort to provide merging parties and their representatives with greater transparency as to the analytical framework they use today.

For example, much of the agencies' recent enforcement regarding vertical mergers focused on allegations that the vertical merger would foreclose rivals, although that theory is not discussed in the

1984 Guidelines. The draft guidelines include for the first time a description of how vertical mergers can harm competition by enabling the merged firm to foreclose rivals from necessary supply or distribution channels or raise its rivals costs for those products or services. This reflects DOJ's theory of harm in its unsuccessful challenge of AT&T's merger with Time Warner, where it alleged that the acquisition would provide AT&T with the ability and incentive to raise the cost of Time Warner programming to its competitors (other video programming distributors).

In discussing the theories regarding foreclosure and raising rivals costs, the draft guidelines introduce the term "related product." According to the draft guidelines, for example, an input or distribution channel is "related" if a rival's access to that product or service affects competition in the relevant market. It does not appear that the agencies intend the "related product" concept to support a separate theory of harm. Rather, it is discussed solely in the context of the foreclosure and raising rivals costs theories It remains to be seen how the agencies will identify related products in practice, and in particular how they will determine whether access to a potentially related product affects competition in the relevant market.

The draft guidelines also eliminate some theories outlined in the 1984 Non-Horizontal Merger Guidelines, including the theory that a vertical merger could raise barriers to entry by effectively requiring new rivals to simultaneously enter the upstream and downstream markets. The draft guidelines also eliminate reference to vertical mergers harming competition by enabling the merged firm to evade rate regulation.

As noted above, the draft guidelines provide a potentially useful "safe harbor" for cases in which the merged firm has less than 20 percent share of the relevant market and the related product is used in less than 20 percent of the relevant market. This threshold, however, is substantially lower than the safe harbor applied by the European Commission, which is unlikely to challenge a vertical merger if the merged firm has less than 30 percent share in the relevant and related markets.

The draft Vertical Merger Guidelines do not reference remedies and it is not clear whether or how these new guidelines will impact the agencies' consideration of remedies. Even when vertical mergers have the potential to harm competition, they also often yield substantial efficiencies. Historically, the agencies have sought to resolve concerns with vertical mergers while preserving those efficiencies. In its 2011 Policy Guide to Remedies, the DOJ stated that it would consider tailored conduct remedies to prevent potential harms of vertical mergers while still allowing efficiencies to be realized. In 2018, however, the DOJ withdrew the 2011 Guide, leaving in place the 2004 Policy Guide, which strongly disfavors conduct remedies in favor of structural remedies like divestiture.

Gibson, Dunn & Crutcher lawyers are available to assist in addressing any questions you may have regarding these issues. Please contact the Gibson Dunn attorney with whom you work in the Antitrust and Competition Practice Group, or the following authors:

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