Clients&FriendsMemo

FTC and DOJ Jointly Issue Vertical Merger Antitrust Guidelines

July 2, 2020

The Federal Trade Commission and the U.S. Department of Justice this week announced the final version of their first jointly-issued Vertical Mergers Guidelines (the "Guidelines"). The Guidelines were issued along a party-line vote, with the three Republican FTC Commissioners and the Republican-led DOJ supporting the Guidelines and the two Democratic FTC Commissioners vehemently opposing them. U.S. Senator Amy Klobuchar (D-MN), Ranking Member of the Subcommittee on Antitrust, expressed deep disappointment that the agencies did not continue the public process of updating the Guidelines to better bridge the partisan gap in merger enforcement.

Last February, when the Guidelines were published in draft form for public comment, we wrote that they provided an appearance of analytic clarity but actually reserved wide latitude for the government to justify a range of outcomes for any given vertical merger investigation. In the final version, the government tightened the analysis but left plenty of room for discretion.

The Basic Outline

The Guidelines are intended to explain how the enforcement agencies go about analyzing the possible anticompetitive effects of a proposed vertical merger. The analysis is expressly distinguished from the government's Horizontal Merger Guidelines, which apply to proposed combinations of head-to-head competitors. Although termed "Vertical Merger Guidelines," the analytical framework and policies embedded in the new Guidelines "apply to strictly vertical mergers (those that combine firms or assets at different stages of the same supply chain), 'diagonal' mergers (those that combine firms or assets at different stages of competing supply chains), and vertical issues that can arise in mergers of complements."

The Guidelines largely codify the economic analytic framework that has less formally characterized the agencies' review of most proposed vertical mergers over the past several decades. The primary theories of harm that may flow from a vertical merger are that the combination of firms may lead to competitive foreclosure, raising rivals' costs and/or providing access to nonpublic competitively sensitive information. The Guidelines are chock-full of hypothetical examples explicating these theories of harm. For example, one hypothetical explains how a vertical merger may force potential

This memorandum has been prepared by Cadwalader, Wickersham & Taft LLP (Cadwalader) for informational purposes only and does not constitute advertising or solicitation and should not be used or taken as legal advice. Those seeking legal advice should contact a member of the Firm or legal counsel licensed in their jurisdiction. Transmission of this information is not intended to create, and receipt does not constitute, an attorney-client relationship. Confidential information should not be sent to Cadwalader without first communicating directly with a member of the Firm about establishing an attorney-client relationship. ©2020 Cadwalader, Wickersham & Taft LLP. All rights reserved.

entrants to enter a market at two levels (the market and a "related" market) in order to compete at either level. Another example focuses on how a vertical merger may raise rivals' distribution costs. Yet another example shines a light on how the agencies view a "diagonal" merger as potentially anticompetitive. Many of these examples were added to the initial draft Guidelines as a way to address concerns of the two dissenting FTC Commissioners that the Guidelines as initially drafted were too permissive to vertical mergers. Under a Guidelines analysis, as before, the inquiry into possible harms will be heavily fact-based but illuminated through a prism of intense economic analysis.

The EDM Controversy

The enforcement agencies, in administrations of both political parties, have long treated vertical mergers informally as presumptively procompetitive. Indeed, there has been a remarkable consensus among policymakers, economists, and practicing lawyers that vertical mergers are less threatening to competition generally than horizontal mergers. The agencies have brought very few challenges to vertical mergers in recent decades, and most mergers that were challenged ended in a conduct – rather than structural – consent decree, such as an agreement to impose information firewalls to address potential anticompetitive sharing of competitive information.

The basis of the permissive attitude toward vertical mergers is the expectation that a vertical merger eliminates double marginalization ("EDM"). The basic EDM theory is that by combining two adjacent firms in a supply chain that previously both added some amount of margin to the price it charged a customer, the combined firm could avoid adding a margin in its internal transfer, leading to an overall lower cost product that would allow the combined firm to compete more vigorously. The theory assumes that the EDM savings would be passed on to consumers in the form of lower prices.

The two self-styled progressive FTC Commissioners have pushed back hard against the EDM economic orthodoxy. Their challenge seems less based on economic data suggesting that the theory is wrong than it is based on oppositional political and economic theory. Although the Guidelines were airbrushed from the draft to its final version in order for the majority to present a picture that does not presume that procompetitive EDM is inherent in a vertical merger, the Guidelines nevertheless do appear to embed this concept. In its introductory section, the Guidelines observe that "vertical mergers often benefit consumers through the elimination of double marginalization." And in the EDM section, the Guidelines merely note that vertical mergers are not "invariably innocuous." Despite what appears to be a wink toward presumptive acceptance of proposed vertical mergers, the Guidelines do provide that it will be incumbent on the merging firms to "substantiate" claims that the transaction will produce EDM and, presumably, that the cost savings would be passed on to consumers in the form of lower prices. But in the very next breath, the Guidelines also provide that the agencies "may independently" undertake their own EDM

analysis to quantify the EDM effects of a given merger, suggesting that even if the parties fail to substantiate the EDM benefits, the agencies may do so on their own.

Remedies Ignored

A major question left unaddressed in both the draft and final versions of the Guidelines has to do with potential remedies for a vertical merger that the agencies decide to challenge. In horizontal merger cases, both agencies have traditionally required structural (*i.e.*, divestiture) remedies in any consent decree intended to eliminate competitive harms from a merger. Traditionally, in vertical merger cases, the agencies have permitted conduct remedies, such as informational or decisional firewalls or affirmative injunctions to treat all rival customers/suppliers equally with the owned upstream or downstream firm. However, both the current Antitrust Division and FTC have indicated through public statements that they believe structural remedies should be preferred in vertical merger cases as well.

Despite the stated preference of the current DOJ/FTC, the agencies are not necessarily putting the preference into action. For example, the currently constituted FTC recently accepted a consent decree that permitted the Staples/Essendant vertical merger to proceed upon the imposition of an information firewall separating Staples' business-to-business end customer-selling functions from Essendant's wholesale-selling function. The concern was that access to this commercially sensitive information may substantially lessen competition in the market for the sale and distribution of office products to midmarket business-to-business customers by eliminating direct and substantial competition between Staples' and Essendant's resellers, which could result in higher prices to midmarket end customers.

Things are more confusing at the DOJ, which launched and badly lost a vertical merger challenge to ATT's proposed acquisition of Time Warner. While the DOJ did adhere to its stated view that a vertical merger challenge should not be resolved through a conduct decree, its substantive analysis in challenging the proposed merger did not appear to conform in any way to the analysis now enshrined in the Guidelines, and the Guidelines do not address that analysis. Moreover, by challenging the merger but losing the case, the DOJ lost the opportunity to ameliorate any perceived anticompetitive effects through a traditional conduct decree.

Conclusion

The Guidelines generally reflect how the agencies currently review vertical mergers, which, in turn, reflects the current composition of the agencies. With the upcoming election, it remains to be seen just how "final" these Guideline are. Should a Democrat win the White House in November, the dissenting Commissioners may find themselves in the majority and with the ability to update these Guidelines before the ink even has fully dried.

* * *

If you have any questions, please feel free to contact any of the following Cadwalader attorneys.

Joel Mitnick	+1 212 504 6555	joel.mitnick@cwt.com
Ngoc Hulbig	+1 704 348 5282	ngoc.hulbig@cwt.com
Eden Sung	+1 202 862 2338	eden.sung@cwt.com