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February 14, 2020

VIA ELECTRONIC FILING

Federal Trade Commission
Office of the Secretary
600 Pennsylvania Avenue NW
Suite CC-5610 (Annex C)
Washington, DC 20580

Re: ***Draft 2020 Vertical Merger Guidelines***

To Whom It May Concern:

The U.S. Chamber of Commerce ("the Chamber") welcomes the opportunity to comment on the Federal Trade Commission and Department of Justice (the Agencies") draft Vertical Merger Guidelines ("Guidelines") that were released for public comment on January 10, 2020.

The Chamber commends the Agencies for investing the time and effort to provide guidance on vertical merger enforcement policy to the business community, antitrust practitioners and the public. The draft Guidelines make a number of positive contributions toward that goal. We do, however, have some comments and concerns about the draft Guidelines, as discussed below. Vertical mergers are a central element of efficient business organization, and they have been – for good reason – an infrequent subject of antitrust enforcement. It is important that the Guidelines avoid articulating policies that could, even unintentionally, unduly impede efficient mergers.

A. General Principles

The choice of business activities in which to engage is a fundamental decision made by every firm. Increasing the scope of a firm's activities within the chain of supply and distribution is a form of vertical integration. Firms may change the scope of their activities based on the evolution of variables such as demand, cost, risk, technology, information, or other factors. They may choose to vertically integrate through internal expansion or through acquisitions, with acquisitions often being the more efficient method. Firms have powerful incentives to choose the degree and type of vertical integration that will maximize their productivity and their competitiveness with other integrated and non-integrated firms. These incentives promote an efficient and competitive market economy for the benefit of consumers.

Antitrust merger enforcement has long focused mainly on transactions that combine competitors, even though the vast majority of horizontal mergers are unlikely to harm competition. And it is widely understood that vertical mergers are even less likely than horizontal mergers to raise competitive concerns, in that: by definition they do not reduce competition between the merging firms, and they are even more likely to generate substantial efficiencies that result from – indeed, are intrinsic to – vertical integration. As a result, while horizontal merger analysis is relatively well-developed in theory and in practice, existing theories of competitive harm from vertical mergers do not predict such harm, but merely describe conditions in which harm is said to be possible.[1] The empirical literature on the effects of vertical integration clearly supports the conclusion that vertical mergers are overwhelmingly procompetitive and that competitive harm is unlikely.[2]

These fundamentals are not controversial among antitrust scholars. Not surprisingly, then, vertical merger enforcement has been a very small element of the Agencies' enforcement records. We know the Agencies are aware of this history, but it is important to bear it in mind in formulating policy guidance:

- Over roughly the past quarter century, the FTC and DOJ only conducted detailed investigations of at most 2-3 vertical mergers per year,[3] a tiny fraction of the thousands of transactions reported annually under the Hart-Scott-Rodino ("HSR") Act of 1976.
- Of those investigations, only one was litigated to a conclusion, and the result was that the merger was allowed to go forward.[4] DOJ had last sued to block a vertical merger more than 40 years earlier, in 1977 – a timeframe spanning the modern era of U.S. merger review since the HSR Act was enacted, during which tens of thousands of mergers were reported. The outcome of that case was the same: DOJ's 1977 vertical merger case was the same as in AT&T/Time Warner: the government lost.[5]
- Of the vertical investigations that resulted in remedies – only about one per year – nearly all were settled via consent decrees, with no judicial testing of the

[1] *See, e.g.,* D. Bruce Hoffman, Acting Director, Fed. Trade Comm'n, *remarks at Credit Suisse 2018 Washington Perspectives Conference: Vertical Merger Enforcement at the FTC* (Jan. 10, 2018) ("Hoffman speech"), at 3, https://www.ftc.gov/public-statements/2018/01/vertical-merger-enforcement-ftc.

[2] *See* Koren Wong-Ervin, *Antitrust Analysis of Vertical Mergers: Recent Developments and Economic Teachings,* Antitrust Source (February 2019) ("Wong-Ervin") at 3-5 (summarizing the empirical literature).

[3] Steven C. Salop & Daniel P. Culley, Vertical Merger Enforcement Actions: 1994-July 2018, Georgetown University Law School Working Paper (Aug. 23, 2018), *cited in* Wong-Ervin, n.2 *supra,* at 1.

[4] *United States v. AT&T Inc.,* 916 F.3d 1029 (D.C. Cir. 2019) affirming *United States v. AT&T Inc.,* 310 F. Supp. 3d 161 (D.D.C. 2018).

[5] *U.S. v. Hammermill Paper Co.,* 429 F. Supp. 1271 (W.D. Pa. 1977).

government's alleged facts or theories of harm. Most of those remedies were behavioral in nature. [6]

Put simply, unlike horizontal mergers, vertical mergers have virtually no track record of proven cases and theories: relatively few detailed investigations, even fewer enforcement actions, hardly any litigation, and no litigated government victories in the modern antitrust era. What has been created, however, is a modest record of consent decrees involving vertical mergers. It is important to recognize what this record does, and does not, say about how to chart vertical merger enforcement policy.

A typical vertical merger scenario involves a transaction driven by significant efficiencies from vertical integration – whether by combining complementary technologies, streamlining information flow, eliminating contracting frictions, or eliminating double marginalization ("EDM"). In those rare vertical cases in which the antitrust Agencies identify competitive concerns, they typically involve fears that the deal will give the merged entity the incentive and ability to engage in some form of anticompetitive conduct, such as input foreclosure or sharing competitive information. Such concerns usually can be – and in practice, usually are – addressed by remedies that specify and prohibit the conduct of concern, while allowing the generally efficient merger to proceed. The merging parties may be willing to agree to such remedies for a number of reasons: they are allowed to consummate their overall, procompetitive transaction; and they may well have had no intention of engaging in the prohibited conduct in the first place. Under these quite common circumstances, the issuance of a consent decree indicates very little about the strength of the agency's alleged facts or theories, or whether they would have stood up in court.

What such decrees do indicate, however, is that the agency believed its competitive concerns warranted seeking a remedy. So it is useful for the business community and the public to understand what could lead the Agencies to have concerns. Vertical merger guidelines can provide this, and to some extent the draft Guidelines do. However, in sharp contrast with the Agencies' Horizontal Merger Guidelines ("HMGs"), the Guidelines cannot purport to be based upon theories of harm that have been tested in an extensive track record of enforcement and litigation.

These realities makes it important that the Guidelines:

- Clearly articulate – consistently with the Agencies' actual enforcement records, economic analysis, and empirical evidence – that vertical mergers are substantially less likely than horizontal mergers to raise competitive concerns, even when the merging firms have substantial market power.

- Clearly state the Guidelines do not specify *sufficient* conditions for competitive concerns to exist. At most, they can only describe conditions that are *necessary*, under certain theories of harm, for possible concerns to require further investigation.

[6] Wong-Ervin, n.2 *supra,* at 1.

- Make clear that even if all necessary preconditions to possible harm have been met, and even if some competitors may be harmed, evidence must demonstrate likely harm to competition and consumers – the ultimate question under any competitive effects theory.

- Clearly describe the well-recognized efficiency benefits that are likely to result from vertical integration, and either articulate a rebuttable presumption that such efficiencies exist, or at a minimum employ a burden-neutral analysis of efficiencies; and in particular, recognize that EDM is intrinsic to the economics of vertical integration, cannot be separated from analysis of the merger's overall potential price effects, and typically should be presumed to exist.

- Provide guidance on remedies, making it clear that – consistently with established agency practice and sound policy – vertical merger concerns usually can be remedied by provisions that identify and prohibit or require specified conduct, allowing the overall transaction to proceed.

Some of these principles are reflected to some degree in the draft Guidelines, but they should be stated clearly throughout.

We respectfully offer the following comments on specific sections.

B. Specific Guidelines Sections and Issues

Section 1 – Overview

This section should be revised to articulate the general principles of vertical mergers that are described above.

Section 2 – Market Definition and Related Products

The draft Guidelines dispense with the need to define product markets at both the upstream and downstream levels, and instead provide that at one level the Agencies may merely specify "related products," which are described as "a product or service that is supplied by the merging firm." This is one of the questions Commissioner Wilson identified in her statement concurring in the release of the draft Guidelines for public comment.

Focusing on a specific input supplied by a particular firm may be a reasonable shorthand way of beginning a vertical merger analysis, but we have concerns with ending the definitional phase in this way, without going through the rigor of defining relevant product markets at both levels. Any ultimate assessment of anticompetitive effects must consider whether there are substitute products, or substitute suppliers, for the "related products" produced by the merging party. And even if such substitutes are not offered or purchased today, they could well be substitutable readily enough to fall within the same relevant market under the HMG's market definition rubric. Presumably the Agencies would take such actual or potential substitution into account at some point in the analysis, but the draft Guidelines do not appear to specify how or when this would happen. Later in the draft Guidelines, Section 4 states that "the Agencies also consider market shares and concentration in relevant markets and related products," but does not explain how market shares and concentration could be calculated for "related products" if no relevant market has been defined for those products.

The appropriate juncture to assess substitution issues, at both levels of the vertical chain, is at the market definition phase. In some cases the facts may demonstrate that the "related product" produced by one merging firm is sufficiently distinct that it makes sense to limit the vertical analysis to that product, but in other instances this may not be true at all. This is precisely why market definition is typically an initial step in merger analysis, which can often avoid the need for further investigation.

Section 3 – Market Participants, Market Shares, and Market Concentration

The draft Guidelines state that the Agencies are "unlikely to challenge" a vertical merger if the parties to the merger have share of less than 20 percent of the relevant market and the related product is used in less than 20 percent of that market. This is another issue on which Commissioner Wilson encouraged comments in her concurring statement.

We have several concerns with the relatively weak market share screen in the draft Guidelines. First, the 20 percent figure is simply too low to provide an adequate screen. We do not believe it is consistent with sound economics or actual agency practice. It is also significantly lower than other comparable screens, including the European Commission's 30 percent vertical merger share threshold, and market share screens of 30-35 percent used for vertical analysis in other guidelines and Supreme Court cases. Given the very low likelihood of concerns from vertical mergers, it is especially important that the Guidelines provide a more realistic screen of at least 30 or 35 percent.

Second, the proposed market share screen is unduly weakened by Section 3's "unlikely to challenge" language, which is less definitive than the "absent extraordinary circumstances" language used in other guidelines, including the HMGs.

Third, the draft Guidelines weaken the market share screen further by stating that "[i]n some circumstances, mergers with shares below the thresholds can give rise to competitive concerns," and providing as an example a merger where "the related product is relatively new, and its share of use in the relevant market is rapidly growing." This simplistic language provides a seemingly open-ended offramp from the share screens for new and growing products, and it should be deleted. If it is necessary for the Agencies to depart from the (already relatively weak) share screen, they could do so under an appropriately worded "extraordinary circumstances" provision.

Fourth, it is generally accepted that vertical merger concerns are unlikely to arise unless there are oligopoly markets at both levels. Consistently with this, the EC guidelines establish both a 30 percent market share screen and a 2000 HHI market concentration screen. The draft Guidelines should incorporate a market concentration screen requiring that both the upstream and downstream markets are highly concentrated under the HMGs' definition (HHIs above 2500). The importance of market structure at both levels is an additional reason why the market definition exercise is needed at both levels (see discussion of "related products" in Section 2, above).

Section 5 – Unilateral Effects

We have several comments on this key section of the draft Guidelines, which describes some common theories of possible harm from vertical mergers.

First, the Guidelines should make clear that the Agencies' application of this analysis is always subject to the general principles set out earlier in these comments. Enforcement guidelines are generally susceptible to being interpreted and applied as restrictive, regulatory templates rather than as analytical guideposts. This risk is especially great for vertical merger guidelines, since the risks of actual competitive harm are slight, and the theories of possible harm can at most set out conditions that are necessary but not sufficient for harm to occur.

Second, Section 5(a), describing foreclosure and raising rivals' costs ("RRC") theories, should clarify several important points:

- That the relevant inquiry for foreclosure and RRC is the effect on downstream competition and that raising the cost of, or even foreclosing, an upstream input with no demonstrated downstream effects does not "substantially lessen competition."
- That it is necessary to demonstrate harm to competition and consumers under all competitive effects theories.
- That the Agencies will analyze whether the merger will give the parties both the incentive and ability to engage in anticompetitive conduct – incentive alone is not sufficient.
- That the analysis of all necessary conditions for competitive harm is not static, but rather that at all stages of the analysis, dynamic factors such as shifting supply and demand decisions, competitor and customer expansion and repositioning, and other market responses need to be taken into account, and may often counteract or eliminate any potential for harm.
- That the sequence of conditions set out Section 5(a)(1)-(4) do not create any presumptions, shift any burdens, or suggest a *prima facie* case of competitive harm. The statement that "[m]ergers for which each of these conditions are met potentially raise significant competitive concerns and often warrant scrutiny" appears, unhelpfully, to suggest otherwise. If so, this would be of great concern to the

business community. We urge the Agencies to clarify that the conditions in 5(a)(1)-(4) are necessary, but not sufficient, to establish that a vertical merger ultimately harms competition and consumers.

- The *de minimis* provision in Section 5(a)(4) provides little guidance, but appears to set too low a bar. It is not clear what "magnitude" of foreclosure or RRC is being discussed, nor how a *de minimis* magnitude would be identified. Given the strong likelihood of efficiencies from vertical mergers – particularly EDM, which is an integral element of the assessment of any price effects from RRC – this provision would be more accurate and helpful if it stated that any nominal downstream price effect resulting from Section 5's "vertical math" must be sufficiently large to exceed the efficiencies that are likely to result.

Third, Section 5(b) describes theories that the Agencies have used in obtaining several consent decrees in cases in which vertical mergers gave the combined firm access to competitive information about an upstream or downstream rival. These cases are notable because, even more clearly than with other vertical cases, (1) the Agencies' theories and facts have not been evaluated in litigation, and (2) when the Agencies have identified concerns, they have invariably been addressed with consent decrees. This suggests two changes to the draft Guidelines:

- Section 5(b) should be revised to make clearer the need for evidence of likely harm not just to competitors, but to competition and consumers. For example, it is not enough that access to competitive information allows a merged firm to "preempt or react quickly to a rival's procompetitive business actions," which could in some circumstances be a procompetitive reaction; nor that it may cause rivals to "see less competitive value in taking procompetitive actions." These possible effects on competitors are necessary but not sufficient conditions for the creation or enhancement of market power through access to information about a competitor.
- The Guidelines should address remedies in such cases (see remedies discussion below), and in particular should make clear that if competitive harm is shown to be likely under an information-access theory, agency practice has demonstrated that conduct remedies are sufficient and appropriate.

Section 6 – Elimination of Double Marginalization

The inclusion of a separate discussion of EDM in the draft Guidelines is helpful given that EDM is distinct from other efficiencies. It could be improved, however, in several respects that would align the Guidelines more clearly with the economic analysis of EDM and vertical integration. The Guidelines should:

- Explicitly state that EDM is intrinsic to the analysis of RRC, not a post-hoc calculation or mitigation of RRC; effects on downstream prices cannot be predicted without also calculating the benefits from EDM. In addition, by stating that "[t]he Agencies generally rely on the parties to identify and demonstrate whether and how the merger eliminates double marginalization," Section 6 appears to place the EDM burden of proof on the parties. This is an unjustified departure from the seemingly burden-neutral list of factors in Section 4 that the Agencies will consider in attempting to measure competitive harm from foreclosure or RRC, and it should be deleted.

- More clearly recognize the difficulties that arise in attempting to achieve efficiencies through contracting and the costly processes of forming, administering, and enforcing contracts with independent suppliers.
- Explicitly state that a preexisting contract will not be treated as conclusive evidence that EDM is less likely or that vertical integration is unnecessary, and may in fact be evidence to the contrary.

Section 7 – Coordinated Effects

This section exemplifies the need for the Guidelines to more clearly recognize the inherent limitations in theories of harm from vertical mergers, especially in comparison to horizontal merger theories. Section 7 of the draft Guidelines describes ways that vertical mergers might lead to horizontal coordination, and cross-references the coordinated effects theories in the HMGs in a way that appears to unduly equate the potential for such effects from vertical and horizontal mergers. While it might be reasonable to draw upon the HMGs in order to identify markets that are vulnerable to coordinated effects, the theories of how vertical mergers may lead to such effects are fundamentally different from – and inherently weaker than – coordinated effects theories from horizontal mergers. The Guidelines should make this clear.

Section 8 – Efficiencies

Efficiencies are likely to arise from most mergers, and while the HMGs have over time evolved toward greater acceptance of efficiencies in horizontal mergers, they continue to indicate an unfounded skepticism. And, as noted above, it is uncontroversial that vertical mergers are even more likely to result in significant efficiencies. These realities need to be more clearly recognized in the draft Guidelines' discussion of vertical merger efficiencies.

First, Section 8 contains only a cursory discussion of the many varieties of efficiencies from vertical mergers, and merely state that vertical mergers "have the potential to create" efficiencies that are cognizable and beneficial. Even the HMGs appear to go farther than this, noting that "a primary benefit of mergers to the economy is their potential to generate significant efficiencies and thus enhance the merged firm's ability and incentive to compete, which may result in lower prices, improved quality, enhanced service, or new products." As described above in the discussion of general principles, the draft Guidelines' discussion of efficiencies should clearly recognize the ways in which vertical mergers are highly likely to create substantial efficiencies, which in the vast majority of cases results in the merger being procompetitive.

Second, Section 8 of the draft Guidelines explicitly – and unhelpfully – adopt the efficiencies analysis in Section 10 of the HMGs. As noted above, the HMGs' efficiency methodology is unduly restrictive even for horizontal mergers, creating unjustified hurdles and burdens of proof on issues such as merger-specificity, verification and quantification. It is wholly inappropriate for vertical mergers. The Guidelines should discuss efficiencies in a context that recognizes the general principles for vertical mergers discussed above, including the fact that efficiencies are highly likely from, and often intrinsic to, vertical integration.

Missing Section – Remedies

As discussed throughout these comments, there are significant differences between vertical and horizontal mergers – in the theories of potential competitive harm, the likelihood of such harm occurring, and the nature and likelihood of efficiencies. In no respect are vertical and horizontal mergers more different for antitrust purposes, however, than in the area of remedies. This is perhaps where sound policy guidance in vertical merger enforcement is the most needed, but the draft Guidelines fail to provide it.

As discussed above, U.S. vertical merger enforcement is implemented predominantly through conduct remedies, and for good reason. The Agencies' actual enforcement practices are consistent with the facts that:

- Vertical mergers are highly likely to generate substantial efficiencies that benefit competition and consumers. This is the case even with mergers that also raise vertical concerns. There is a strong public interest in allowing such mergers to go forward whenever possible, consistent with agencies' obligation to protect consumers.

- Most theories of harm from vertical mergers posit conduct that can readily be identified and prohibited or required, and that do not require that the overall transaction be blocked. This may not be the case for all theories of harm, but the exceptions can be defined. Useful policy guidance in this area would acknowledge the prevalence and efficacy of conduct remedies for most vertical theories of harm, and explain the conditions that may create exceptions.

- Remedies will not be imposed based on theories of harm that posit the facilitation of post-merger conduct such as bundled discounts or tying, both because the theories themselves are widely recognized to be deficient, and because any such conduct, which is highly likely to be efficient, can be identified and prohibited post-merger if it is found to be anticompetitive.

- Vertical merger enforcement policy has mainly been implemented through conduct remedies, and the available evidence confirms that these remedies are effective.[7]

Some confusion has been injected into the merger remedies discussion over the years, in part due to some public statements that failed to distinguish between horizontal mergers (where competitive harm results directly from structural consolidation and for which conduct remedies would generally be ineffective) and vertical mergers (where theories of competitive harm typically require specific conduct, such as information sharing or foreclosure, which can be identified and prohibited, or other remedial conduct can be required). Generalizations about the need for structural remedies and the inefficacy of conduct remedies in horizontal merger cases have at times been incorrectly applied to vertical mergers. If the Guidelines are going to do the job of accurately describing how the Agencies conduct vertical merger enforcement, they should confirm agency policy and practice in the important area of remedies.

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Once again, the Chamber thanks the Agencies for the opportunity to submit these comments.

Sincerely,

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U.S. Chamber of Commerce

[7] *See, e.g.,* Hoffman speech, n.1 *supra,* at 8, *citing* FTC Staff Report, *The FTCs's Merger Remedies 2006-2012: A Report of the Bureaus of Competition and Economics ˆ(2017),* https://www.ftc.gov/system/files/documents/reports/ftcs-merger-remedies-2006-2012-report-bureaus-competition-economics/p143100_ftc_merger_remedies_2006-2012.pdf