**UNITED STATES OF AMERICA**
**BEFORE THE**
**U.S. DEPARTMENT OF JUSTICE AND FEDERAL TRADE COMMISSION**

**DRAFT VERTICAL MERGER GUIDELINES**

**COMMENTS OF THE AMERICAN ANTITRUST INSTITUTE**

## I. Introduction

The American Antitrust Institute (AAI) herein responds to the U.S. Department of Justice's (DOJ's) and Federal Trade Commission's (FTC's) ("agencies") request for comments on the Draft Vertical Merger Guidelines ("Draft Guidelines").[1] AAI commends the DOJ and FTC for engaging in a collaborative effort that produced the Draft Guidelines.[2] The opportunity for public comment is an essential part of the agencies' process for producing a final version of vertical guidelines. When the agencies revised the 2010 Horizontal Merger Guidelines (HMGs), they held five workshops in different parts of the country, and took public comments spanning a several-month period.[3] The amount of time afforded for public comment and input regarding the Draft Guidelines is far less and out of proportion with the importance of the guidelines for a critical area of merger enforcement.

Updated guidance on how the agencies approach the review of vertical mergers is long overdue. By combining economic resources in markets for complementary products or services, vertical mergers can enhance the merged firm's incentive to exercise market power, thus impairing competition at multiple levels and harming consumers, workers and businesses. At the same time, the agencies' accumulating experience with vertical enforcement, outstanding controversy over major theoretical and empirical issues, and growing evidence from consummated mergers demonstrate the need for extreme care in crafting vertical merger guidelines.

AAI's comments on the Draft Guidelines fall into three major areas. The first concerns the important broader goals that should motivate vertical merger guidelines. The second addresses parts of the Draft Guidelines that create uncertainty and confusion, thus limiting their usefulness. The third focuses on issues that are either omitted from or given undue emphasis in the Draft

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[1] AAI is an independent, non-profit organization devoted to promoting competition that protects consumers, businesses, and society. For more information, see www.antitrustinstitute.org.
[2] U.S. Department of Justice and Federal Trade Commission, *Draft Vertical Merger Guidelines* (Jan. 10, 2020), https://www.justice.gov/opa/press-release/file/1233741/download.
[3] Federal Trade Commission, Horizontal Merger Guidelines Review Project, https://www.ftc.gov/news-events/events-calendar/2010/01/horizontal-merger-guidelines-review-project.

Guidelines. AAI concludes that the Draft Guidelines should not be adopted without significantly more support, improvement, and revision.

## II. Broader Goals That Should Motivate Enforcement Guidelines

Merger guidelines serve a vital purpose. They provide the business and consumer communities and the courts with important transparency regarding how the agencies evaluate the competitive effects of mergers. This transparency, together with a balanced and informed approach based on learning and evidence, supports the predictability of enforcement decisions, particularly those mergers that are subject to challenge. The absence of these features risks uncertainty and confusion, which limits the usefulness of the guidelines and impairs enforcement. AAI suggests that the following basic principles promote transparency, balance, and predictability in any finalized vertical merger guidelines.

### A. The Draft Guidelines Should Be Clear and Align with Other Agency Guidance

The Draft Guidelines should be crafted in a way that provides the clearest possible elucidation of the analytical approach the agencies use to evaluate vertical mergers. The Guidelines' should be comprehensible to *all* that use them, not a narrow audience of technical antitrust experts. AAI is concerned that the Draft Guidelines do not speak to a more general audience that would benefit from a clear and complete articulation of antitrust concepts and examples. They are delivered in a short and spare format that is one-quarter the length of the HMGs.[4]

For example, the Draft Guidelines state: "These Guidelines should be read in conjunction with the HMGs. The principles and analytical frameworks used to assess horizontal mergers apply to vertical mergers."[5] This approach essentially incorporates the HMGs in the Draft Guidelines by reference, but with little additional direction. The statement could be read to apply to the full array of anticipated fact-finding and analysis, including direct evidence of anticompetitive effects, market definition, efficiencies, and entry. But the Draft Guidelines' numerous references to "relevant" concepts in the HMGs—without specifically articulating what those concepts are—gives users of the guidelines little comfort that the horizontal and vertical merger guidelines will align. Nor do they provide useful guidance for how the relevant concepts from the HMGs, whatever they are, will be applied in the vertical merger context.[6]

AAI is also concerned that the Draft Guidelines do not clearly "map" concepts and methods from the HMGs to the Draft Guidelines. As discussed below, there are a number of instances where the Draft Guidelines both deviate from approaches set forth in the HMGs and the 1984 Merger Guidelines, and set forth new approaches, but without sufficient explanation to guide the user.[7] This lack of clarity and transparency risks confusion that could spark significant interpretational differences among users of the guidelines, thus impairing merger enforcement. In light of the complexity and controversy surrounding some areas of vertical merger enforcement, AAI believes

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[4] U.S. Department of Justice and Federal Trade Commission, *Horizontal Merger Guidelines* (2010), https://www.ftc.gov/sites/default/files/attachments/merger-review/100819hmg.pdf.; U.S. Department of Justice, *Policy Guide To Merger Remedies* (Oct. 2004), *available at* http://www.justice.gov/atr/public/guidelines/205108.pdf.
[5] *Draft Guidelines, supra* note 2, at 1.
[6] *Id.*
[7] U.S. Department of Justice and Federal Trade Commission, *Non-Horizontal Merger Guidelines* (1984), https://www.justice.gov/sites/default/files/atr/legacy/2007/07/11/11249.pdf.

that the Draft Guidelines, and how they interact with the HMGs, should be more fulsomely developed and explained.

### B. The Draft Guidelines Should Reflect Agency Experience, Evidence, and a Balanced Interpretation of Current Learning

AAI believes that the Draft Guidelines should reflect enforcement experience and evidence from consummated mergers. The agencies' own experience provides significant insight into whether application of merger guidelines has produced the desired result, i.e., to challenge mergers that are likely to lead to anticompetitive effects. This includes enforcement decisions where a merger was: (1) granted early termination under the Hart Scott Rodino Act filing requirements; (2) given more extensive review under a second request but not challenged; (3) challenged and simultaneously settled with competitive concerns resolved in a consent decree; and (4) challenged and litigated in federal court.

Moreover, it is vital that the Draft Guidelines incorporate learning from the growing body of retrospective analysis of consummated mergers.[8] This includes documented instances of post-merger prices increases, decreases in quality or innovation, and where remedies failed to fully restore competition in relevant markets.[9] As discussed in examples below, AAI is concerned that the draft Guidelines do not adequately incorporate agency experience and evidence.

The Draft Guidelines should also reflect a balanced and comprehensive state of learning regarding the legal, economic, business, and institutional factors that form the basis for vertical merger analysis. A burgeoning area of economic research highlights the effects of increasing market concentration and market power on higher prices, lower wages, diminished innovation, and lower rates of market entry.[10] The role of lax merger enforcement over the past four decades in explaining these outcomes is important. This is particularly true in light of the historical deference given by enforcers to claimed cost-savings and consumer benefits, without proof that they have materialized in consummated mergers.[11]

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[8] *See, e.g.,* Federal Trade Commission, *FTC's Merger Remedies 2006-2012, A Report of the Bureaus of Competition and Economics* (Jan. 2017), www.ftc.gov/system/files/documents/reports/ftcs-merger-remedies-2006-2012-reportbureaus-competition-economics/p143100_ftc_merger_remedies_2006-2012.pdf; Federal Trade Commission, *A Study of the Commission's Divestiture Process, Bureau of Competition* (Aug. 1999), www.ftc.gov/sites/default/files/attachments/merger-review/divestiture.pdf.

[9] *See, e.g.,* John E. Kwoka Jr., *Does Merger Control Work? A Retrospective on Enforcement Policy, Remedies, and Outcomes* 78 ANTITRUST L J 619, 636 (2013). *See also,* United States v. Comcast Corp., 808 F. Supp. 2d 145 (D. D.C. 2011), Makan Delrahim, Asst. Att'y Gen., Dep't of Justice, Antitrust Div., Keynote Address at American Bar Association's Antitrust Fall Forum (Nov. 16, 2017), https://www.justice.gov/opa/speech/assistant-attorney-general-makan-delrahim-delivers-keynote-address-american-bar; Ted Johnson, *Senator Asks DOJ to Take Another Look at Comcast-NBCUniversal Merger*, VARIETY (Dec. 13, 2017), www.heritage.org/technology/commentary/time- repeal-the-ftcs-common-carrier-jurisdictional-exemption-among-other.

[10] *See, e.g.,* Council of Economic Advisers, *Benefits of Competition and Indicators of Market Power*, THE WHITE HOUSE at 4 (Apr. 2016), https://www.whitehouse.gov/sites/default/files/page/files/20160414_cea_competition_issue_brief.pdf; Bruce A. Blonigen & Justin R. Pierce, *Evidence for the Effects of Mergers on Market Power and Efficiency*, 24 (Fed. Reserve Bd., Working Paper No. 2016-082 (2016); José Azar et al., *Labor Market Concentration*, NBER, Working Paper No. 24147 (Dec. 2017), http://www.nber.org/papers/w24147.

[11] *See, e.g.*, Michael Christofi, Erasmia Leonidou, and Demetris Vrontis, *Marketing research on mergers and acquisitions: a systematic review and future directions*, 34 INT'L. MARKETING REV. 629 (2017), https://doi.org/10.1108/IMR-03-2015-0100.

Deference to efficiency claims has tilted the enforcement balance and led enforcers to unevenly compare the cost of mistakenly challenging benign or pro-competitive mergers to the cost of mistakenly not challenging anticompetitive transactions. AAI is concerned that the Draft Guidelines continue to reflect this "error cost" bias.[12] This is particularly clear in the inclusion of a safe harbor without a corresponding positive presumption. Bias is also evident in the Draft Guidelines' discussion of the elimination of double margins (EDM), an efficiency that is often touted by proponents of more permissive merger enforcement but is also enmeshed in significant controversy.[13]

### C. Draft Guidelines Should Recognize the Relationship Between Antitrust Enforcement and Competition Policy

Merger guidelines are intended primarily as a guide to how enforcers will evaluate the likely competitive effects of transactions. AAI believes that to accomplish this goal, the Draft Guidelines should implicitly recognize the important relationship between law enforcement and competition policy. For example, agency enforcement decisions directly affect markets, including price and non-price dimensions of competition, entry, and innovation. These outcomes have implications for the role of other policy tools (e.g., regulation and intellectual property) and legislative proposals designed to support competition.[14] Market conditions and outcomes that are shaped by those public policies, in turn, affect merger enforcement.

AAI is concerned that the Draft Guidelines do not recognize the important feedback loop between enforcement and competition policy. For example, we note that the average annual number of vertical merger cases subject to enforcement action increased by over 200% between the mid-1960s to mid-1990s and the mid-1990s to the present.[15] This activity has and continues to shape key markets through the emergence of multi-level, integrated systems in sectors such as healthcare, agricultural biotechnology, and communications. The effects of this change are wide-ranging. They include, among others: higher barriers to entry for standalone firms competing at any single level of a supply chain and stronger incentives for vertically integrated firms to pursue proprietary, exclusive systems. The Draft Guidelines do not, but should, recognize the issues raised by high and growing levels of extant vertical integration.

## III. Numerous Provisions in the Draft Guidelines Will Create Confusion and Weaken Vertical Merger Enforcement

The Draft Guidelines establish a "safe harbor," or a condition under which the agencies are likely to find that mergers are benign and therefore unlikely to be challenged. The Draft Guidelines state:

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[12] *See, e.g.,* Jonathan B. Baker, *Taking the Error Out of 'Error Cost' Analysis: What's Wrong with Antitrust's Right*, 80 Antitrust L. J. 1 (2015), https://ssrn.com/abstract=2333736.
[13] *See, e.g.,* Robert Pitofsky, *Introduction: Setting the Stage*, in HOW THE CHICAGO SCHOOL OVERSHOT THE MARK: THE EFFECT OF CONSERVATIVE ECONOMIC ANALYSIS ON U.S. ANTITRUST(Robert Pitofsky ed., 2008), at 5-6.
[14] *See, e.g.,* William E. Kovacic, *Institutional Foundations for Economic Legal Reform in Transition Economies: The Case of Competition Policy and Antitrust Enforcement*, 77 CHI.-KENT L. REV. 265 (2001).
[15] U.S. Department of Justice Antitrust Division, Antitrust Case Filings, filtered for vertical mergers, https://www.justice.gov/atr/antitrust-case-filings; and Federal Trade Commission, Cases and Proceedings: Advanced Search, filtered for vertical mergers, https://www.ftc.gov/enforcement/cases-proceedings/advanced-search.

*"The Agencies are unlikely to challenge a vertical merger where the parties to the merger have a share in the relevant market (supply of orange juice) of less than 20 percent, and the related product (oranges) is used in less than 20 percent of the relevant market."* [16]

AAI is concerned that the proposed used of a safe harbor raises a number of critical issues that will directly affect the clarity, predictability, and vigor of enforcement. These include the Draft Guidelines' inclusion of a safe harbor without an accompanying positive presumption; and a safe harbor based on market share, as opposed to superior measures of competitive significance, such as market concentration.

### A. A Safe Harbor Without an Accompanying Positive Presumption Is Inconsistent with Other Guidance and Will Misallocate Burdens Between the Government and the Merging Parties

Under the Draft Guidelines' safe harbor, a merging firm with market shares above the specified level (i.e., 20%) presents a scenario where the agency *might* challenge a merger. AAI is concerned that the safe harbor will increase the agencies' burden in making a *prima facie* case for a vertical merger's anticompetitive effects. That higher burden derives from proving the likelihood of adverse outcomes under a potentially vast number of scenarios where the merging firm has a market share between 20% and 100%. This concern is exacerbated by the absence of a corresponding positive presumption in the Draft Guidelines, or a specified level *above* which a merger is presumed to harm competition and consumers. Under a positive presumption, the merging parties bear the burden of rebutting the presumption that their merger will result in anticompetitive effects.

Because of the asymmetry created by inclusion of a safe harbor and exclusion of a positive presumption, the Draft Guidelines create an inefficient and inequitable allocation of burdens between the government and the merging parties.[17] It is presumably for this reason that the HMGs and 1984 Merger Guidelines include both a safe harbor and a positive presumption. For example, the HMG's explain:

*"Mergers resulting in unconcentrated markets are unlikely to have adverse competitive effects and ordinarily require no further analysis," and that "Mergers resulting in highly concentrated markets … that involve an increase in the HHI of more than 200 points will be presumed to be likely to enhance market power. The presumption may be rebutted by persuasive evidence showing that the merger is unlikely to enhance market power."*[18]

Likewise, the 1984 Merger Guidelines state:

*"The Department is unlikely to challenge a merger on this ground unless overall concentration of the primary market is above 1800 HHI …," and that "The Department is unlikely to challenge a merger on this ground unless 1) overall concentration of the upstream market is above 1800 HHI*

[16] *Draft Guidelines*, *supra* note 2, at § 3.
[17] *See*, United States v. Phila. Nat'l Bank, 374 U.S. 321, 338 (1963); Brown Shoe Co. v. United States, 370 U.S. 294, 317 (1962).
[18] *HMGs, supra* note 4, at § 5.3.

*… and 2) a large percentage of the upstream product would be sold through vertically-integrated retail outlets after the merger."*[19]

Much as evidence of adverse effects in consummated horizontal mergers support the importance of a presumption, so does such evidence in vertical merger analysis.[20] The agencies' own enforcement actions speak volumes. For example, in February 2020, the DOJ amended the 10-year-old consent decree in the 2010 merger of Live Nation and Ticketmaster. The government cited evidence that the merged company persistently violated the conduct remedies contained in the decree.[21] Moreover, the government recognized Ticketmaster's dominant position in ticketing at the time of the merger, a fact that should have established the merger's presumptive illegality.[22] The failure of the government's remedies confirms that the merger was illegal in 2010, and remains illegal today. The enforcement error of Live Nation-Ticketmaster should not be repeated. A positive presumption in vertical merger guidelines is needed to underscore the importance of flagging mergers such as Live Nation-Ticketmaster that are likely to lead to anticompetitive effects.

In sum, the Draft Guidelines' inclusion of a safe harbor without a corresponding presumption creates an unprecedented and troubling break with past policy and represents a significant weakening of agency review. AAI therefore strongly urges the agencies to revise the Draft Guidelines accordingly.

### B. The Safe Harbor's Reliance on Market Shares Misses Important Competitive Dynamics That Are Relevant to Vertical Theories of Harm

The safe harbors and positive presumptions included in the HMGs and 1984 Merger Guidelines are based on market concentration. The Draft Guidelines' construction of a safe harbor based on market share marks a significant departure from this approach, without any justification, with significant implications for enforcement. As the agencies well know, a complete assessment of a merger's effect on competitive incentives is critical for merger review. The Draft Guidelines' unprecedented shift to a singular focus on the market share of the merged company in the relevant market, and its share of related product sales into the downstream market, fails to account for the important role of market structure in competitive dynamics.

For example, the use of market shares in a safe harbor unduly limits the agencies' analysis to a restricted set of circumstances, namely what the merged company *currently* sells into the downstream relevant market to its own affiliate and/or rivals. But the merged company's changed competitive incentives are as important for existing sales as they are for *potential* sales to downstream rivals. It is notable that Section 3 of the Draft Guidelines' discussion of the structure of the relevant market and

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[19] *1984 Merger Guidelines, supra* note 7, at § 4.213 and § 4.221.

[20] For example, analysis of merger retrospectives confirms that highly concentrative mergers have produced post-merger price increases in a number of cases. Data on past FTC merger enforcement actions shows a relatively strong correlation (~80 percent) between enforcement action and level of post-merger concentration in cases where mergers produced adverse effects. *See,* John Kwoka, *The Structural Presumption and the Safe Harbor in Merger Review: False Positives or Unwarranted Concerns?*, 81 ANTITRUST L.J. 837, 860–61 (2017).

[21] United States v. Ticketmaster Entertainment, Inc. and Live Nation Entertainment Inc., Motion To Modify Final Judgment and Enter Amended Final Judgment, Case No. 1:10-cv-00139-RMC (D.D.C. Jan. 8, 2020).

[22] Letter from the American Antitrust Institute to Assistant Attorney General, Makan Derahim, Re: Amended Final Judgment: U.S v. Ticketmaster Entertainment, Inc., and Live Nation Entertainment, Inc. (Feb. 4, 2020), https://www.antitrustinstitute.org/wp-content/uploads/2020/02/AAI_Ltr-to-DOJ_LN-TM_F.pdf.

related product market does not refer anywhere to "potential competition" or "potential rivals."[23] Rather, the Draft Guidelines consider the role of potential competition later, in Section 4's discussion of competitive effects such as foreclosure. AAI is concerned that this comes too late in the proposed methodological approach.[24] The significance of potential competition should be implicit in any safe harbor and positive presumption by using market concentration.

AAI is further concerned that a market share-based safe harbor ignores other important competitive dynamics in the related product and relevant product markets. A scenario in which the upstream affiliate of a merged company attempted to cut off downstream rivals' access to, or raise the prices of, a critical input illustrates this concern. For example, the criteria that the related product sold by the merging firm be used in less than 20% of the relevant market ignores critical competitive dynamics in the related product market. This measure fails to consider both the number and size distribution of alternative input sellers that are available to downstream rivals at risk of foreclosure. The structure of the related product market factors importantly in whether an input foreclosure strategy would impair downstream rivals' ability to compete. Whether a downstream rival can choose from three equal size suppliers of an input, versus one dominant and four smaller suppliers, has material implications for avoiding foreclosure.

Similarly, the safe harbor's 20% share threshold for the merged company's share of the relevant market ignores competitive dynamics in the relevant market. Customers of rivals in the relevant market that are at risk of foreclosure would look elsewhere in the relevant market to avoid a post-merger price increase. But both the number and size distribution of alternatives available to them bears directly on the likelihood of input foreclosure. As is clear in the 1984 Guidelines' treatment of vertical mergers, the only metric that accurately reflects competitive dynamics in the downstream relevant market and the upstream related product market is market concentration.[25]

For example, in the CVS-Aetna merger, the Tunney Act court explored *amici curiae* concerns over input foreclosure that were not introduced by the government in its complaint.[26] The concern centered on CVS's control of critical pharmacy benefit management services and an increase in the merged firm's bargaining power vis-à-vis rival insurers. The relevant market for health insurance was highly concentrated, leaving few alternatives for subscribers of foreclosed insurers to avoid higher prescription drug plan costs. High switching costs for subscribers further limited their ability to switch to competing insurers. Likewise, high concentration in the related PBM market left health insurers with few alternatives to CVS and Express Scripts for prescription drug plan services.

Application of the safe harbor outlined in the Draft Guidelines to CVS-Aetna would have involved a simple look at Aetna's market share in the relevant market for health insurance and CVS's share of total related product sales into that market. It is clear that such a test would have provided incomplete information about the competitive dynamics in both markets that are relevant to an input foreclosure theory of harm. AAI therefore strongly urges the agencies to specify that market

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[23] *Draft Guidelines, supra* note 2, at § 3.
[24] The Draft Guidelines' discussion of unilateral effects recognizes scenarios in which potential entry by a downstream rival might be deterred by the threat of input foreclosure. *Id.,* ex. 5.
[25] *Id.,* at §§ 4.213 and 4.221.
[26] *See, e.g.,* In Re: *United States v. CVS Health Corp.,* No. 1:18-cv-02340, Comments of the American Antitrust Institute (Dec. 17, 2018), https://www.justice.gov/atr/page/file/1132431/download.

concentration, not market share, will be used in the Draft Guidelines' safe harbors and presumptions.

## IV. Provisions That Are Either Missing From or Given Too Much Emphasis in the Draft Guidelines

The 1984 Merger Guidelines were comprehensive in their assessment of various components of vertical merger analysis. This approach reflected agency experience and advances in scholarship on the potential competitive effects of vertical combinations. AAI is concerned that the Draft Guidelines omit important components of, or give too much emphasis to, certain theories relating to vertical mergers. These errors of "omission and commission" are startling not only because the Draft Guidelines do not support them with more recent developments in law and economics but because enforcement experience and evidence from past transactions strongly support the case for why the missing components should be included.

For example, the Draft Guidelines exclude key theories of harm such as regulatory evasion and customer foreclosure. They also fail to consider the effects of vertical mergers on barriers to entry. But errors also include giving undue deference to a particular type of efficiency—elimination of double margins (EDM)—which has gained in favor among conservative economists over the last twenty years, but which remains controversial and unproven.[27] AAI believes that these and other errors and omissions will create significant uncertainty and confusion for users of the guidelines, reducing the transparency and predictability that guidelines are intended to promote. Such errors will weaken enforcement at a time when vertical integration is reshaping competition in key markets and the lack of vigorous enforcement has raised significant concerns.

### A. The Draft Guidelines' Omit Discussion of the Importance of Multi-Level Entry

The Draft Guidelines do not include any discussion of the implications of a vertical merger for entry. The 1984 Merger Guidelines note importantly that "In certain circumstances, the vertical integration resulting from vertical mergers could create competitively objectionable barriers to entry."[28] They articulate the conditions under which a vertical merger would enhance the likelihood that entry would have to occur simultaneously at two levels in order to effectively discipline the exercise of market power by a vertically integrated firm. In light of significant vertical integration over the past two decades, AAI believes it is critical that the Draft Guidelines consider multi-level entry.

For example, vertical mergers have proliferated in a number of sectors, including: cable distribution and content, agricultural biotechnology, banking, aviation and defense, electricity and natural gas, and healthcare. Such mergers have in some cases produced multi-level "systems." These include, among others: (1) agricultural biotechnology mergers such as Bayer-Monsanto and Dow-Dupont (combining assets in crop traits, transgenic crop seed, agrochemicals, and digital farming); (2) healthcare mergers such as CVS-Aetna and Express Scripts-Cigna (combining PBM services/retail

[27] *See, e.g.,* Koren Wong-Ervin, *U.S. Vertical Merger Guidelines: Recommendations and Thoughts on EDM and Merger Specificity*, COMPETITION POLICY INT'L (Jan. 22, 2020), https://www.competitionpolicyinternational.com/u-s-vertical-merger-guidelines-recommendations-andthoughts-on-edm-and-merger-specificity/.
[28] *1984 Merger Guidelines*, *supra* note 7, at § 4.211.

pharmacy and health insurance); (3) content and distribution mergers such as AT&T-Time Warner and Comcast-NBCU (combining programming content and cable/broadband ISP distribution).

The effect of the foregoing vertical mergers on raising entry barriers is highly relevant to how the agencies will evaluate vertical mergers. For example, agricultural biotechnology mergers have increased barriers to entry by standalone firms competing at individual levels (e.g., crop traits or crop seed).[29] Higher levels of integration can enhance incentives to create proprietary systems that do not interoperate with rival technologies thus locking in customers and raising barriers to entry. And it can also enhance risks of coordination in markets dominated by only a few vertically integrated systems. AAI believes that the Draft Guidelines should include a discussion, similar to the 1984 Guidelines, regarding the evidence the agencies will consider in evaluating the effect of a vertical merger on raising the bar for multi-level entry.

### B. The Draft Guidelines Omit Regulatory Evasion as an Important Vertical Theory of Harm

The Draft Guidelines offer an incomplete discussion of potential vertical theories of harm. Namely, they fail to consider the risk that a vertical merger may enhance the ability and incentive to evade regulation. For example, a regulated supplier of inputs, when merged with a downstream output supplier, would sell to itself post-merger.[30] The merger could create incentives to inflate internal transfer prices, resulting in a pass through of artificially higher costs to final consumers. Regulators may not be able to police such practices under traditional rate regulation methods.

The agencies have challenged a number of mergers where evasion of regulation was the major competitive concern. For example, the FTC challenged a transaction between Fresenius Medical Care AG & Co. KGaA and Daiichi Sankyo Company, Ltd. involving kidney dialysis and an IV iron medication.[31] The FTC concluded that "the proposed agreement would give Fresenius, the largest provider of ESRD dialysis services in the nation, the ability and incentive to increase Medicare reimbursement payments for Venofer."[32] Similarly, in the merger of electric utility and gas pipeline Entergy Corporation and Entergy-Koch, the FTC challenged the transactions, alleging that "[p]rices of retail electricity are likely to rise as a result of Entergy passing on inflated costs for natural gas transportation to consumers."[33] The FTC explained that regulators would have difficulty in reviewing and challenging Entergy's purchases of natural gas transportation.[34]

The foregoing mergers raise real concerns regarding the evasion of regulation. AAI is concerned that the Draft Guidelines' omission of regulatory evasion as an important theory of harm will create uncertainty over how the agencies anticipate addressing it when it does arise. We therefore urge the

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29 *See, e.g.,* Diana L. Moss, *Consolidation And Concentration In Agricultural Biotechnology: Next Generation Competition Issues*, CPI ANTITRUST CHRONICAL (Jan. 2020)

30 Michael H. Riordan and Steven C. Salop, *Evaluating Vertical Mergers: A Post-Chicago Approach*, 63 ANTITRUST L.J. 513 (1994-1995).

31 In the Matter of Fresenius Medical Care AG & Co. KGaA and Daiichi Sankyo Company, Ltd, No. 081-0146 (F.T.C. Sept. 15, 2008), https://www.ftc.gov/sites/default/files/documents/cases/2008/09/080915freseniuscmpt.pdf.

32 Federal Trade Commission, *FTC Challenges Vertical Agreement Between Fresenius and Daiichi Sankyo: Commission Order Prevents Fresenius From Inflating Medicare Reimbursement Rates for Dialysis Drug*, https://www.ftc.gov/news-events/press-releases/2008/09/ftc-challenges-vertical-agreement-between-fresenius-and-daiichi.

33 In the Matter of Entergy Corp. and Entergy-Koch, LP, No. C-3998 (F.T.C. Jan. 31, 20011), https://www.ftc.gov/enforcement/cases-proceedings/0010172/entergy-corporation-entergy-koch-lp.

34 *Id.*

agencies to restore a discussion of regulatory evasion in any final version of vertical merger guidelines.

### C. The Draft Guidelines Give Undue Emphasis to the Elimination of Double Margins

AAI is concerned that the Draft Guidelines give significant and unwarranted attention to EDM as a potential benefit of a vertical merger. For example, rather than discuss EDM in the section on vertical merger efficiencies, the Draft Guidelines elevate and assign it a separate section. The Draft Guidelines also refer in three separate instances to the role of EDM in moderating competitive concerns over both unilateral effects and anticompetitive coordination.[35] Moreover, the Draft Guidelines specifically consider EDM for "out of market" treatment. The HMGs state "In some cases … the Agencies in their prosecutorial discretion will consider efficiencies not strictly in the relevant market, but so inextricably linked with it that a partial divestiture or other remedy could not feasibly eliminate the anticompetitive effect in the relevant market without sacrificing the efficiencies in the other market(s)."[36] This further emphasizes that the agencies anticipate giving special consideration to EDM, but without any explanation or support for why "out of market EDM" is particularly important or how it would work in a vertical context. Moreover, given the proven ineffectiveness of conduct remedies in numerous vertical merger cases, the AAI is alarmed that the Draft Guidelines would place this type of emphasis on "out of market EDM."

Finally, the provision that the agencies will "generally rely on the parties" to prove EDM further tilts the tables toward favorable treatment of EDM in vertical merger analysis.[37] This stands in stark contrast to the specific requirement that, as with all efficiencies, the burden of proof should fall squarely on the shoulders of the defendants. In sum, AAI is concerned that the foregoing provisions place disproportionate emphasis on the role of EDM, highlighting it as almost a "super-efficiency." The agencies' treatment of EDM signals a deference to it but without the support that would justify it. There is a well-established case for caution regarding EDM, which is rooted in the restrictive assumptions that underly the theory.[38] But the Draft Guidelines do not appear to reflect in any comprehensive way such controversy. AAI urges the agencies to move any discussion of EDM to the appropriate section on efficiencies and revise the Draft Guidelines to give it more neutral treatment.

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[35] *Draft Guidelines, supra* note 2, at § 5(a) and § 7.
[36] *HMGs, supra* note 4, at footnote 14. The Draft Guidelines also err in failing to include the essential caveat that "[i]nextricably linked efficiencies are most likely to make a difference when they are great and the likely anticompetitive effect in the relevant market(s) is small so the merger is likely to benefit customers overall." *Id.*
[37] *Draft Guidelines, supra* note 2, at § 6.
[38] *See, e.g.,* John Kwoka & Margaret Slade, *Second Thoughts on Double Marginalization*, ANTITRUST (forthcoming 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3452207 and Fernando Luco Guillermo Marshall, *Vertical Integration With Multiproduct Firms: When Eliminating Double Marginalization May Hurt Consumers* (Jan. 15, 2018), https://ssrn.com/abstract=3110038.

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