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Comments on the U.S. Department of Justice and the Federal Trade Commission Draft Vertical Merger Guidelines

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I am happy to offer these comments on the draft 2020 Vertical Merger Guidelines issued by the U.S. Department of Justice and the Federal Trade Commission (FTC). I submit these comments as a scholar with a longstanding interest in vertical merger policy[1] who has been invited to international fora to share my thoughts on vertical mergers.[2] These comments represent my personal views and do not represent the views of the University of Pennsylvania or the Center for Technology, Innovation and Competition. I would welcome an opportunity to participate in any upcoming workshops on the draft guidelines.

I join the antitrust community in congratulating the Agencies for revising guidelines that have long been obsolete. I offer these comments in the hopes that they may prove helpful in improving the draft still further.

Importance of Empirical Work

The draft guidelines take a more structural approach than the 2010 Horizontal Merger guidelines. Section 2 emphasizes market definition. Section 3 focuses on market shares and concentration. Section 4 shifts towards empiricism by following Section 2.1 of the Horizontal Merger Guidelines by acknowledging the importance of "Evidence of Anticompetitive Effects," including "effects observed in consummated mergers" and "direct comparisons based on experience." Section 5 returns to a structural emphasis by stating, "Where sufficient data are available, the Agencies may construct economic models designed to quantify the likely unilateral price effects resulting from the merger."

This approach stands in stark contrast with the 2010 Horizontal Merger Guidelines. Section 2 of the Horizontal Merger Guidelines begins not with a structural analysis, but rather with "Evidence of Anticompetitive Effects," with Sections 2.1.1 and 2.1.2 emphasizing empirical evidence before acknowledging market shares and concentration as a relevant source of evidence in Section 2.1.3. Market definition is not presented until Section 4, and even then, the Horizontal

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1 *See, e.g.*, Christopher S. Yoo, *Vertical Integration and Media Regulation in the New Economy*, 19 YALE J. ON REG. 171 (2002).

2 *See, e.g.*, *Enforcement Approach to Vertical Mergers*, Best Practice Roundtable on "Vertical Mergers in the Technology, Media and Telecom Sector," Organization for Economic Co-Operation and Development (OECD) Directorate for Financial Enterprise Affairs, Competition Committee, Paris, France (June 7, 2019), https://www.oecd.org/daf/competition/vertical-mergers-in-the-technology-media-and-telecom-sector.htm.

Merger Guidelines deemphasize it by stating, "The Agencies' analysis need not start with market definition." The clear spirit of those guidelines is to focus on empirical evidence over structural modeling whenever the empirical evidence is available.

The empirical literature on vertical integration underscores the consumer benefits that would result from adopting the same approach in the draft guidelines. A comprehensive survey of the empirical literature on vertical integration by Francine Lafontaine (who would later serve as Director of the Bureau of Economics during the Obama Administration) and Margaret Slade (who would testify on vertical mergers before the OECD[3]) concluded that aside from a few isolated studies, the weight of the evidence indicated that "under most circumstances, profit-maximizing vertical-integration decisions are efficient, not just from firms' but also from the consumers' points of view," a conclusion that the authors did not have in mind when they began their review of the evidence and which they found somewhat surprising.[4] The survey concluded that "faced with a vertical arrangement, the burden of evidence should be placed on competition authorities to demonstrate that that arrangement is harmful before the practice is attacked."[5] Moreover, the survey found "clear evidence that restrictions on vertical integration that are imposed . . . on owners of retail networks are usually detrimental to consumers."[6] They thus called on "government agencies to reconsider the validity of such restrictions."[7]

A recent survey of the empirical literature on vertical restraints conducted by four members of the Federal Trade Commission's senior staff during the Administration of George W. Bush found "a paucity of support for the proposition that vertical restraints/vertical integration are likely to harm consumers."[8] Only one study unambiguously found that vertical integration harmed consumers, and in that study the welfare losses were "miniscule."[9]

Leading vertical integration theorist and former FCC Chief Economist Michael Riordan similarly concludes, "A general presumption that vertical integration is pro-competitive is warranted by a substantial economics literature identifying efficiency benefits of vertical integration, including empirical studies demonstrating positive effects of vertical integration in various industries."[10] Subsequent studies have largely confirmed the same.[11]

The emphasis on structuralism is out of step with the large-scale movement away from the structure-conduct-performance paradigm in favor of more direct measures of competitive effects. The structural, post-Chicago literature provides little additional empirical support for opposing vertical mergers.[12] Absent empirical evidence of the overall impact of a practice on

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[3] *Id.*

[4] Francine Lafontaine & Margaret Slade, *Vertical Integration and Firm Boundaries: The Evidence*, 45 J. ECON. LIT. 629, 680 (2007).

[5] *Id.*

[6] *Id.*

[7] *Id.*

[8] James C. Cooper et al, *Vertical Antitrust Policy as a Problem of Inference*, 23 INT'L J. INDUS. ORG. 639, 648 (2005).

[9] *Id.*

[10] Michael H. Riordan, *Competitive Effects of Vertical Integration*, *in* HANDBOOK OF ANTITRUST ECONOMICS 145, 169 (Paolo Buccirossi ed., 2008).

[11] Global Antitrust Institute, Comment Letter on Federal Trade Commission's Hearings on Competition and Consumer Protection in the 21st Century, Vertical Mergers (George Mason Law & Economics Research Paper No. 18-27, Sept. 6, 2018), https://ssrn.com/abstract =3245940.

[12] Bruce H. Kobayashi & Timothy J. Muris, *Chicago, Post-Chicago, and Beyond: Time to Let Go of the 20th Century*, 78 ANTITRUST L.J. 147, 148 (2012) (noting how "lack of empirical verification of these theories likely has

competition, structural theories (such as bargaining theories) that take the status quo ante as the relevant baseline that must be maintained run the risk of protecting competitors instead of consumers.

The lack of empirical support is particularly problematic with respect to the 20% safe harbor suggested by the draft guidelines. This represents a change from the 1984 Non-Horizontal Merger Guidelines, which effectively required 33% market share in the upstream market in order to show foreclosure.[13] It also deviates from the 30% safe harbor reflected in the European vertical merger guidelines[14] and conflicts with court decisions.[15] Adoption of a position that deviates from prior guidelines, the practices of other leading enforcement agencies, and judicial precedent begs for some empirical justification.

I would recommend bringing the draft guidelines more in line with the 2010 Horizontal Merger Guidelines by moving Section 4 up and renumbering it Section 2 and adopting the language. In addition, the language from the Horizontal Merger Guidelines noting market definition may not be necessary could be added to the draft guidelines. In addition, the empirical record favors restoring the language from the 1984 Non-Horizontal Merger Guidelines noting that "non-horizontal mergers are less likely than horizontal mergers to create competitive problems."[16]

The safe harbor would benefit from being based on empirical evidence, judicial precedent, or past enforcement practice. It would also be helpful to explain why the draft guidelines how the statement the agency is "unlikely" to challenge mergers falling below the threshold differs from the language in other guidelines providing that challenges within the safe will not be brought "absent extraordinary circumstances"[17] or should explain the reasons and empirical basis for the deviation.

Eliminating Double Marginalization

Section 6 of the draft guidelines appropriately acknowledge that vertical mergers can benefit consumers by eliminating double marginalization (EDM). The benefits of EDM are well established in the economic literature.[18] The location of the Section on EDM between Section 5

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limited the impact of Post-Chicago School economics on U.S. antitrust law"); Daniel A. Crane, *Chicago, Post-Chicago, and Neo-Chicago*, 76 U. CHI. L. REV. 1911, 1924, 1925 (2009) (noting that "post-Chicago's empiricism is thin" and that "post-Chicago offers little empiricism").

[13] Non-Horizontal Merger Guidelines § 4.212, 49 Fed. Reg. 26,823 (1984) (referring to then Section 3.3).

[14] Guidelines on the Assessment of Non-Horizontal Mergers Under the Council Regulation on the Control of Concentrations Between Undertakings, art. 25, 2008 O.J. (C 365) 7, 9 ("The Commission is unlikely to find concern in non-horizontal mergers . . . where the market share post-merger of the new entity in each of the markets concerned is below 30 % and the post-merger HHI is below 2,000").

[15] *See, e.g.*, *Sterling Merchandising, Inc. v. Nestle, S.A.*, 656 F.3d 112, 123-24 (1st Cir. 2011) ("foreclosure levels are unlikely to be of concern where they are less than 30 or 40 percent…"); *Valley Prods. Co. v. Landmark*, 128 F.3d 398, 402 n.3 (6th Cir. 1997) ("30 percent market share is insufficient to confer . . . market power"); *United States v. Microsoft Corp.*, 87 F. Supp. 2d 30, 52-53 (D.D.C. 2000) (foreclosure rate closer to 40 percent is required), *cited in* Michael B. Bernstein et al., *DOJ/FTC Publish Draft Vertical Merger Guidelines*, ARNOLD & PORTER (Jan. 24, 2020), https://www.arnoldporter.com/en/perspectives/publications/2020/01/doj-ftc-publish-draft-vertical.

[16] Non-Horizontal Merger Guidelines, *supra* note 13, § 4.

[17] U.S. Dep't of Justice & Fed. Trade Comm'n, Statements of Antitrust Enforcement Policy in Health Care 5 (Aug. 1996).

[18] *See* Yoo, *supra* note 1, at 177-78 (surveying the literature).

on unilateral effect and Section 7 on coordinate effects appears to treat EDM as a consideration in evaluating the prima facie case of a harm to competition on which the Agencies bear the burden of proof. The separate discussion of efficiencies on which the defendant bears the burden of proof in Section 8 appears to confirm this. This is to be applauded, although the fact that some of the commentary read the draft guidelines as treating EDM as an efficeicy suggests that this consideration could use some clarification.

Raising Rivals' Costs

Section 5(a) presents raising rivals' costs (RRC) as a potential unliteral anticompetitive effect that may result from vertical mergers. Any application of this theory would benefit from a close reading of the excellent working paper authored by two FTC economists exploring the limits of RRC as a theory of foreclosure and the disequilibrium that results when other parties become aware the attempt to corner the market on an input.[19]

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I appreciate the opportunity to submit these comments and hope that they prove useful to the Agencies' consideration of the draft guidelines. I stand ready to assist the Agencies during the upcoming workshops on the draft guidelines or in any way that would be helpful.

[19] Malcolm B. Coate & Andrew N. Kleit, Exclusion, Collusion, and Confusion: The Limits of Raising Rivals' Costs (FTC Working Paper No. 179, Oct. 1990), https://www.ftc.gov/sites/default/files/documents/reports/exclusion-collusion-and-confusion-limits-raising-rivals-cost/wp179.pdf.