

Comments on the Draft Vertical Merger Guidelines

*Daniel P. Culley**

The draft Guidelines released on January 10, 2020 represent a marked improvement over the outdated and now affirmatively misleading 1984 Guidelines. That said,

consistent with a focus on the characteristics above.² The agencies might consider phrasing this as there being no reason to believe that the combined firm would have “market power” in a relevant market, as that is a term that is used broadly in antitrust and in the case law.

Aside from market shares’ lack of utility in predicting effects, there are a number of reasons that a safe harbor may cause problems:

- x The Guidelines do not provide any explanation for how the 20% thresholds were determined. Separate public comments by DAAG Barry Nigro indicate that the threshold was not the result of rigorous analysis, but were instead chosen by a consensus of “what people felt comfortable with.”³ But including specific thresholds in the Guidelines lends them an air of credibility that they do not deserve when viewed by those not practicing antitrust day to day, such as by the courts or foreign authorities.
- x The 20% thresholds do not provide any insight into actual enforcement practice. Recent enforcement history suggests that the agencies are “unlikely” to challenge transactions until shares are far higher than 20%, regardless of one’s views of the merits of those decisions. Adopting a threshold that is out of line with actual practice risks creating one impression for the public and another for members of the antitrust bar who know what the agencies “really do.”
- x Although the Guidelines specifically say that they do not create a presumption of illegality above the thresholds, they create exactly that danger among staff and in foreign jurisdictions that look to the agencies as examples. In particular, the 20% thresholds differ from the similar 30% guidance provided in the European Commission’s Guidelines on Non-Horizontal Mergers.⁴ While it is one thing to choose a different set of enforcement priorities than other authorities based on a considered judgment of the risks, or based on a perception that those thresholds have led to underenforcement, that is not what is happening here, and it makes y39 (c)-2 (o21 (m)-1 (pl

- x The vagueness of “is used in less than 20% of the relevant market” is likely to lead to argument around an issue that is not relevant to competitive effects. In particular, it is unclear what the agencies intend to measure in markets where distributors or retailers typically carry products from many upstream manufacturers. Do the agencies intend the threshold to mean that the upstream product accounts for 20% of the inputs used in the downstream market? That the input is carried by 20% of distributors or retailers? Distributors or retailers representing 20% of retail sales? Each of these measures can be radically different from one another.

Relatedly, a number of commenters may criticize the lack of a “presumption of legality” for vertical mergers, because vertical mergers are supposedly more likely to be procompetitive than horizontal ones. The agencies should stand their ground and not add such a presumption to the Guidelines. The vast majority of all mergers, whether horizontal or vertical, are procompetitive, as reflected by the fact that the agencies only rarely issue Second Requests.⁵ And all mergers, whether horizontal or vertical, have an initial presumption of legality because the government has the burden of proof. There is no vertical equivalent to the **Philadelphia National Bank** presumption, nor (rightly) have the Guidelines attempted to establish one. Thus, if the Guidelines were to adopt a presumption of legality, they would be effectively raising the burden of proof.

For the same reason, the agencies should alplw 17.365 0 Tdh1 (l)-1 (o)2 h onetherou4 and ne (f)J (the

relevant to different theories of harm.⁶ The Guidelines of course do not necessarily need to go into that same level of detail, although I do think it would be helpful. But there are several areas in particular where more detail appears critical:

- x The Guidelines do not expressly mention the concept of input substitution. The Guidelines should explain that raising the price of an input to a rival or withholding the input from a rival may cause the rival to lose some sales. The more difficult it is for the rival to switch its supply of the input to an alternative supplier (or the higher the costs it incurs by doing so), the more likely that this is to occur. The Guidelines should also explain that, the greater the proportion of the gross margin on a sale is captured by the upstream industry, the more likely it is that it is difficult to substitute inputs, and vice versa.

- x The Guidelines should mention that the greater the share of a downstream rival's costs an input represents, the more likely an increase in price or withholding of the input is to lead a rival to lose sales.

- x The Guidelines mention diversion, but do not link it directly to the same unilateral effects concepts in the horizontal context. The Guidelines should explain that foreclosure is an indirect way of causing rivals to raise their prices or otherwise restrict their output, and so the agencies can use similar tools to analyze the effects downstream. For example, stating that the greater the value of rivals' lost sales that will be recaptured by the combined firm, the greater will be the agencies' concern about unilateral effects.

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better explain the mechanics outside of advocacy for a specific case and thus better garner judicial support.⁷ The Guidelines should explain that the combined firm's leverage may increase because its best alternative to a negotiated agreement becomes more attractive: if bargaining between the upstream division and a rival breaks down, the combined firm may recapture some portion of the rival's sales. This can lead to a higher price. The Guidelines should also confront the policy decision when this higher price occurs even if the number of units purchased stays the same. This is unlikely to result in immediate harm to downstream customers, but it may, for example, reduce rivals' incentives to innovate. The agencies should say whether they would challenge such as a case. (And I would say they should if the potential for long-term harm is sufficiently concrete or there is a lack of any benefit to downstream customers from, for example, elimination of double marginalization.)

- x It appears that the Guidelines intend to cover both input and customer foreclosure in a single section. They should say explicitly that is what they are doing. The Guidelines could then explain that, where the concern is customer foreclosure, the agencies are not concerned with lack of access to a customer in and of itself, but rather how the loss of access to a customer impacts an upstream rival's ability to compete for other customers. Thus, the agencies will be more concerned when there is a potential that the loss of a customer could lead to a loss of minimum viable scale, or where marginal costs are declining with scale.
- x Although the draft Guidelines address deterring potential entry in Example 5 in the foreclosure section, the Guidelines should also address the loss of potential sponsors of entry as a separate unilateral theory of harm. Including this only in the foreclosure section suggests that the only way harm can occur is by denying a potential entrant an input. But a firm upstream or downstream of a potential entrant may have incentives to sponsor entry that go beyond simply supplying inputs or purchasing outputs. For example, such a firm might have the incentive to commit to purchasing a particular volume or to supply a particular volume at a favorable rate, or be more willing to finance the potential entrant than would public markets, because that firm will capture some of the benefits of entry through more competition. For example, a dominant software platform may have an incentive to finance rivals to a dominant application that runs on that platform (and vice versa), and that incentive would be eliminated if the two firms merged.

⁷ See *United States v. AT&T, Inc.*, 916 F.3d 1029, 1039–43 (D.C. Cir. 2019).

The draft Guidelines would be clearer if they were more transparent about significant policy decisions.

The draft Guidelines contain at least three significant policy decisions that end up being mostly implicit: (1) asserting that the agencies will define only a single relevant market; (2) focusing on the change in welfare of the closest to final consumers impacted by a transaction; and (3) declining to identify regulatory evasion as a valid theory of harm. I do not generally disagree with these decisions, but failing to confront them squarely makes the text difficult to follow. It would be better to simply acknowledge these decisions and explain the basis for them.

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the upstream input), there will still often be some residual incentive to increase upstream prices. I do not see choosing this as a policy rule to be meaningfully different from the general rule in evaluating exclusion under Section 1 or Section 2, which is that harm to rivals is irrelevant unless it leads to harm to competition between the firm and its rivals for their downstream customers. Because the situation is likely to arise often, the Guidelines should be clear about how to handle it. That would also allow the Guidelines to clarify that it does not mean there is a requirement to show harm to downstream customers if the agencies can demonstrate that a combined firm would raise prices to rivals, but there would be no offsetting benefits to downstream customers, for example because the input is not compatible with the combined firm's production process.

The Guidelines should state that evasion of regulation is not a theory of harm that the agencies will rely on to challenge transactions. If the agencies were writing on a blank slate, mere omission might be sufficient, but the 1984 Guidelines specifically identified evasion of regulation as a theory of harm. Given the Supreme Court's decisions in, among others, *Verizon Communications Inc. v. Trinko*, the judicial response to such a theory is likely to be that it is for the regulatory agency (or for Congress) to address potential evasion of regulation.⁹ The Guidelines should say so. Alternatively, if the

would not be appropriate, because there are not parallel pre-merger incentives to accomplish each.

If foreclosure could be achieved through vertical contracts, then most often the reason why the merging parties will not have attempted them is because they would violate Section 1 of the Sherman Act. Indeed, almost by definition, a contract that raises rivals' costs and leads to harm to downstream customers would violate Section 1. Perhaps the Commissioner is envisioning certain exclusionary non-linear price schedules that might be considered unilateral and reachable only through Section 2, in cases where the merging party does not have monopoly power or does not meet more stringent below-cost pricing tests. But if that outcome can be achieved unilaterally, then it is unclear why the firm would not have already done it pre-merger.

By contrast, firms may not have undertaken steps to eliminate double marginalization by contract because of the