Comments on Proposed Vertical Merger Guidelines

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In this submission we comment on certain elements of the Proposed Vertical Merger Guidelines promulgated by the Department of Justice and the Federal Trade Commission. In these comments, we make three points. First, we argue that the vGUPPI approach to unilateral effects analysis, although creative, has severe shortcomings. Second, we show that a vertical merger can lead to both higher and lower upstream input prices for the unintegrated firms remaining after a vertical merger. Third, we show that to equate vertical foreclosure with an increase in the post-merger upstream price leaves out important effects that can threaten the viability of an unintegrated downstream competitor. We propose that the best metric to describe foreclosure is that of a vertical price squeeze. odology

[1] examine the incentives of the merged firm to either raise or lower its prices, assuming that other firms hold their prices at their pre-merger levels. Strictly speaking, this approach only looks at the effect of a small increase in the prices of a merged firm starting with the pre-merger levels of those prices.[2]

the post-merger upstream price of a firm about to engage in a vertical merger and for the post-merger downstream price of the merged firm. MS refer to the equivalent of the GUPPI applied to the upstream price in a vertical merger as the vGUPPIu. The corresponding calculation for the downstream price is called the vGPUUId.

Each of these formulas holds all prices but one fixed, and examines the effects of changing that one price a small amount. For example, the vGUPPd holds constant all prices but the downstream price of the merged firm. The vGUPPIu holds constant all prices except the upstream price of the merged firm. Yet, both of these prices will change once the merger takes place.[4] Further, they can change in ways that affect the signs of the various vGUPPI indices. This calls the accuracy of these expressions into question, even for directional effects of the merger.

In a recent paper, we have analyzed these issues in the context of a very simple model with an upstream monopoly supplying an industry with two downstream firms with a critical input.[5] Denoting the two downstream firms by D1 and D2, they both produce differentiated products and compete on price.

Even though the model is simple, it does not lend itself to closed form solutions. Therefore, we use the approach of Monte Carlo simulation. Our simulations are based on both linear and logit demands.

Without loss of generality, assume that the upstream monopolist and D1 merge and

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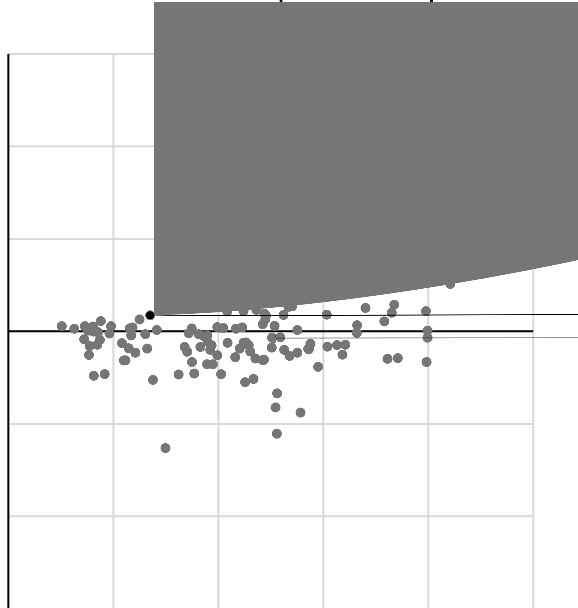
loses business to Firm 1 after the merger, the upstream demand curve faced by Firm 1 post-merger shifts in. This can cause the upstream price to be lower after the merger than before the merger.[8]

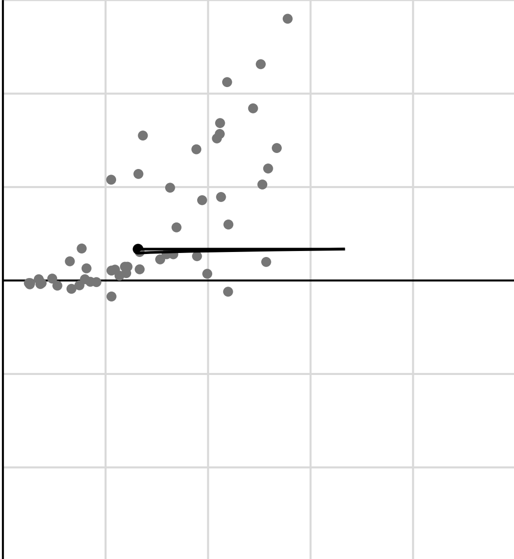
For the technical details in each of these simulations, we refer to DS (2019) and DS (2020).[9] DS do Monte Carlo simulations assuming both linear demand curves and logit demand curves.

Figure 1. Linear Demand. Upstream Input Price Change



downstream market, it tends to pay a lower price for the input after the merger. If Firm 1 was large before the merger, then Firm 2 tends to pay more after the merger.

Figure 2. Logit Demand. Upstream Input Price Change



firms. Figure 3 shows our simulation results for Firm 1’s price post-merger compared to pre-merger in the logit case.

Figure 3

reduction in the downstream price of Firm 1 can overwhelm Firm 2 even when Firm 2 pays a lower upstream price.

References