COMMENTS OF THE AMERICAN BAR ASSOCIATION

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| FTC and DOJ Antitrust Guidelines for Collaborations Among Competitors | "Absent extraordinary circumstances, the Agencies do not challenge a competitor collaboration on the basis of effects o competition in an innovation market where three or more independently controlled research efforts in addition to those |

Like the DOJ and FTC, competition authorities around the world have also adopted screens for merger or other antitrust analysis, be it at the case submission phase or for deepening the analysis of notified matters. Table 2 below reports major jurisdictions that have share

all circumstances known to the Agencies in which they have or will deviate from the screen, understanding that new factual circumstances may arise.

In sum, given the Agencies' prior enforcement history, foreign jurisdiction screens, and the Section's past comments,[22] the Section recommends that the DOJ and FTC adopt a market screen that is in the range of 20-30 percent, consistent with the variety of precedents that are outlined herein,[23] below which the Agencies are unlikely to challenge a transaction absent extraordinary enumerated circumstances.[24]

The Section recommends that the VMGs identify why mergers below the proposed 20-30 percent screen are not likely to lead to anticompetitive effects and proposes the following examples:

Example 3:[25] Company A is a wholesale supplier of orange juice. It seeks to

in the supply of oranges to wholesalers is 30%. Because of its low market share in the supply of oranges, it is unlikely that the combined entity could foreclose or other

Example 4: Company A is a wholesale supplier of orange juice. It seeks to

in the purchase of oranges from orchards is 30%. Because of its market

[22] Joint Comments of the American Bar Association Section of Antitrust Law and Section of International Law on the Proposal of the European Commission for a Revised Block Exemption Regulation and Guidelines on Supply and Distribution Agreements at 7 (Sept. 1, 2009), https://www.americanbar.org/content/dam/aba/administrative/antitrust_law/comments_proposec.pdf (advocating for a 40% screen for vertical agreements).

[23] See Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2, 45-47 (1984) ("[T]he arrangement forecloses only a small fraction [30%] of the markets in which anesthesiologists may sell their services, and a still smaller fraction of the market in which hospitals may secure anesthesiological services."); ABA SECTION OF ANTITRUST LAW, ANTITRUST LAW DEVELOPMENTS § 1.D.2.b, 213-14 (8th ed. 2017) ("Since the early 1970s, judicial decisions have established a virtual safe harbor for market foreclosure of 20 percent or less. Although foreclosure of 20 to 30 percent was a gray area before *Jefferson Parish*, the concurring opinion in *Jefferson Parish*, which found exclusive dealing lawful without detailed analysis when 30 percent of the market was foreclosed, has led many courts to hold that higher market share thresholds are a prerequisite to finding exclusive dealing unlawful. Even then, a finding that the arrangement is anticompetitive is not a foregone conclusion.").

[24] The Section previously submitted comments to the European Commission on its draft guidelines that established 30% and 2,000 HHI thresholds below which horizontal mergers were unlikely to be anticompetitive were "too conservative, both qualitatively and quantitatively." Joint Comments of the American Bar Association's Section of Antitrust Law and Section of International Law on the European Commission's Draft Guidelines on the Assessment of Non-Horizontal Mergers Under the Council Regulation on the Control of Concentrations Between Undertakings (May 1, 2007), available at http://www.americanbar.org/content/dam/aba/administrative/antitrust_law/comments_assess-mergers.authcheckdam.pdf. The Section encourages economists and Agencies to study whether this threshold should be adjusted upward or downward over time.

[25] We would recommend inserting these additional examples at the end of § 3.

consistency with the Agencies' Horizontal Merger Guidelines, which also recognize that both the ability and incentive is what matters.[12]

Third, the draft VMGs discuss the types of evidence the Agencies will consider in Section 4, and this is to be commended. The draft VMGs also list several conditions that are necessary for anticompetitive unilateral effects, such as that "[t]he magnitude of likely foreclosure or raising rivals' costs is not de minimis such that it would substantially lessen co{ ori " umA J 'w ' "

Example 11[37]: Building off of Example 3, after the merged firm foreclosed its rivals, the rivals seek to import oranges from Mexico at a reasonably comparable cost (and/or suppliers in Mexico are attracted to a profit opportunity that previously did not exist in the U.S.). Prior to the merger, orange juice suppliers had not tried to import oranges from Mexico, but during its investigation, the Agency learns that orange juice suppliers can do so. With a new source of supply, rivals recapture lost sales from the merged firm, and prices in the orange juice market would likely return to premerger levels.

Example 12: Building off of Example 3, if the merged firm were to foreclose its rivals (Companies C, D, & E), Company C is likely to purchase its own orange grove, Company D is likely to purchase a defunct orange grove, and Company E is likely to establish its own orange grove, which helps the rivals recapture lost sales from the merged firm. Within a short period following the merger, prices in the orange juice would likely market return to premerger levels.

Example 13: Building off of Example 3, foreclosed rivals are unable to adequately source a sufficient supply of oranges to return prices to premerger levels in the orange juice market. However, during its investigation the Agency learns that rivals are capable of substituting a special mix of grapefruit and

The key structural change that can occur with a vertical merger is a combination of up and downstream profit margins, i.e., the merged firm is maximizing a single "pie" post-transaction. Joint profit maximization can induce the merged firm to lower its downstream prices through EDM, shifting consumer demand from rivals to the merged firm due to newly reduced prices. But the shift in rivals' consumer demand caused by EDM potentially affects the merged firm's incentive over whether to engage in RRC or not. For many vertical mergers, there can be both downward pricing pressure from EDM and upward pricing pressure from RRC.[39]

Moreover, beyond merely the fact that EDM and RRC are linked, present economic models show that EDM and RRC incentives can move together.[40] The ability to move together

is not to guarantee that EDM and RRC exactly cancel one another—the two incentives will often tend to move together, but which of the two is larger will be case-specific.

And as a more practical matter, the Agencies will tend to collect information that is probative of both EDM and RRC (and complete foreclosure) in the process of a typical investigation of a vertical merger. This reality is a close corollary of the relationship described above. Identifying and quantifying RRC depends on many of the same inputs that are used to identify and quantify EDM.[42] Thus, there is a practical consideration to quantifying EDM that is not necessarily present for other merger-related efficiencies.

Second, the Section observes that current economic literature explains that firms may generally find it difficult to achieve EDM (or other efficiencies for that matter) with contracts absent full vertical integration by merger. Simple facts, such as the existence of contracts, are not in themselves sufficient evidence that firms have realized EDM under the pre-transaction status quo. Even with contracts in place pre-merger, various frictions may limit full realization of EDM, and vertical mergers may facilitate significantly greater efficiency.

Given the apparent difficulty firms face in realizing EDM by contract and EDM's uniqueness relative to other efficiencies, the Section urges the Agencies to acknowledge that the ultimate proof of EDM may be somewhat different from other efficiencies. This is not to say that the merging firms have zero role in proving EDM. To the contrary, the merging firms are the best equipped to provide the inputs for quantifying EDM and are the best equipped in identifying conditions in which EDM is more likely (e.g., simple pricing pre-merger).

But unlike other efficiencies, the Agencies should give some leeway to instances in which the incentive and the ability to achieve EDM can reasonably be proven. The Section

marginalization or other practices that are inefficient. One must therefore balance the two. Two of the papers in the table attempt to assess that tradeoff (i.e., Mullin and Mullin (1997) and Chipty (2001)), and both conclude that efficiency gains outweigh foreclosure costs. The evidence in favor of anticompetitive foreclosure is therefore, at best weak, particularly when one considers that the industries studied were chosen because their vertical practices have been the subject of antitrust investigations.").

[42] Presentation, *supra* n. 2, at 79 (Slade); Moresi & Salop, *supra* n.

urges the Agencies to acknowledge that the process by which EDM is proven should more closely follow that of RRC than that of other efficiencies. That is, where the incentive and ability to realize EDM can be demonstrated, it should be assumed that EDM will be realized at least to some degree, just as it is generally assumed with RRC where the incentive and ability to do so can be demonstrated. This treatment is different from other efficiencies, where the Agencies generally require detailed proofs of post-merger implementation to demonstrate the efficiencies will be achieved.[45]

Thus, the Section suggests the Agencies more explicitly acknowledge (1) EDM is unique among merger benefits in its connection to vertical mergers and RRC, likelihood of, at least in part, coinciding with RRC, (2) firms may struggle to achieve EDM through contract absent a merger and the mere presence of a contract may not prove EDM has already been achieved, and (3) the means by which EDM is proven should more closely follow that of RRC as compared to other efficiencies. The Section recommends that more concrete discussion of these observations be incorporated into the VMGs to provide clearer guidance as to how and why EDM is considered separate and apart from other merger-related efficiencies.

§ 8. Efficiencies

In addition to EDM, vertical mergers can achieve efficiencies such as quality improvements and faster and/or better innovation from coordination in product, design, and innovation efforts, and elimination of free-riding from harmonization of incentives. The Section recommends that the efficiencies section be expanded to include a robust discussion of these potential efficiencies. We also urge the Agencies to begin the efficiencies section with more detailed discussion of the coordination problems raised by vertical dealing, and how they may be solved through vertical integration. In doing so, the Agencies could draw from their 2007 OECD paper on vertical mergers.[46]

As Ronald Coase explained in his classic 1937 study of the nature of the firm, there are transaction costs to market transactions; organizing economic activity within a firm can lower these costs and increase joint profits as compared to market transactions. Oliver Williamson emphasized the costs of "haggling" over "appropriable quasi-rents."[47] In addition to negotiation

[45] To this end, former Deputy Assistant Attorney General for Economics, Professor Carl Shapiro, explained that the manner by which EDM is proven ought to be more similar to RRC. Transcript, supra n. 28, at 61-63 (Shapiro) ("[W]e have to assume that the merged entity operates as a single entity to maximize overall profits and that means elimination of double marginalization. I do not think we have any alternative, as antitrust economists, to continue to assume that in all merger analysis that the merged entity operates as a unified entity that maximizes overall profits. . . . So that gives this elimination and that does create this efficiency. So, the key question then is, is it merger-specific? It is not about verifiability.").

[46] OECD, Competition Policy Roundtables, Vertical Mergers, (February 15, 2007), available at https://www.ftc.gov/sites/default/files/attachments/us-submissions-oecd-and-other-international-competition-fora/07Roundt

and “ink” costs, as Benjamin Klein[48] and Kevin Murphy[49] explain, with specific investments and insufficient reputational capital, vertical contractual relationships also present “rigidity costs,”