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Updated Vertical Merger Guidelines May Be on the Horizon

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The Federal Trade Commission (FTC) and Department of Justice's Antitrust Division (DOJ) promulgated the standing guidance relating to vertical and conglomerate mergers—the Non-Horizontal Merger Guidelines—in 1984. Relative to the Horizontal Merger Guidelines, which were updated in 2010, this guidance is long in the tooth.

That may soon change. On March 29, 2019, at the ABA Antitrust Spring Meeting, DOJ Antitrust Division Assistant Attorney General Makan Delrahim noted that the agency has been working to update its vertical merger guidance. The announcement comes in the wake of several notable enforcement actions involving the combination of businesses that do not compete, but instead operate at different levels of the supply chain, including *Comcast/NBCU*, *AT&T/Time Warner*, *CVS/Aetna*, and *Staples/Essendant*.

The analytical approach applied to these and other FTC and DOJ vertical merger matters has not been transparent or consistent, and AAG Delrahim acknowledged that the business community would benefit from "knowing where we stand from an enforcement standpoint." FTC Chairman Joe Simons generally agreed with this sentiment, but he also cited the challenges in finding a consensus on the appropriate framework for analyzing vertical mergers between the agencies and within the agencies themselves. The FTC commissioners have split 3-2 along party lines in two recent vertical mergers—*Staples/Essendant* and *Fresenius/NxStage*—highlighting the ongoing debate within the FTC.

A refresh to the agencies' guidance has the potential to bring much-needed transparency and consistency into the vertical transaction review standards. The content of updated vertical merger guidelines and whether the DOJ and the FTC can agree to a single set of guidelines remains to be seen, but we note below several potential topics that updated guidance may address.

The 1984 Non-Horizontal Merger Guidelines

The 1984 Non-Horizontal Merger Guidelines were a component of the Horizontal Merger Guidelines issued the same year. The Non-Horizontal Merger Guidelines outlined three methods of harm from a non-horizontal transaction:

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- **Elimination of Specific Potential Entrants** – An acquisition by an existing market participant of a potential market entrant could be anticompetitive, depending on the likelihood and effect of the target's entry. By keeping the potential new entrant out of the market, the buyer might be able to maintain higher prices and less competition going forward.

- **Enhanced Barriers to Entry** – A vertical combination could impose a new and more onerous condition on entrants by forcing them to enter both the upstream and downstream markets at the same time. For consumer harm to occur under this theory, among other things, the combination must result in such vertical integration that it becomes very difficult to successfully compete in the upstream or downstream market alone.

- **Increased Likelihood of Collusion** – Based on the theory that downstream prices are more easy to monitor than upstream prices for inputs, a vertical merger could make it easier for existing participants in the upstream market to coordinate on price. For consumer harm of this type to occur, the upstream market must itself be vulnerable to collusion, and the product(s) at issue must be primarily sold through vertically integrated downstream (*i.e.*, distribution or retail) outlets. Alternatively, the harm could occur because a transaction could eliminate a disruptive buyer whose existence prevented upstream firms from being able to settle on a collusive agreement.

Notably, each of these theories are closely related to more traditional theories of harm that apply to horizontal mergers.

Recent Agency Enforcement Involving Vertical Mergers Show Diminished Relevance of 1984 Non-Horizontal Guidelines

There have been several recent, high-profile investigations, settlements, and court challenges of vertical transactions. The theories of consumer harm asserted by the agencies in these matters are quite different than the theories outlined in the 1984 Guidelines.

- **DOJ's Settlement of *Comcast/NBCU*** – In 2009, Comcast announced its intent to acquire a majority stake in NBCUniversal. Comcast was one of the nation's largest cable TV distributors of TV content; NBCU was a major programmer that created content for distribution. Both the DOJ and the Federal Communications Commission intensely scrutinized the deal out of concern that Comcast might charge higher rates to rival distributors, including then-emerging online video distributors, such as Netflix and Hulu, for access to NBCU's programming and related content. The DOJ cleared the deal in 2011, subject to behavioral conditions designed to prevent Comcast from withholding NBCU content from its rivals.

- **DOJ's Challenge to *AT&T/TimeWarner*** – Like *Comcast/NBCU*, this transaction combined a pay-TV distributor (AT&T through DirecTV) with a programmer (TimeWarner). The DOJ challenged the deal in court, claiming that the vertical integration of Time Warner programming and DirecTV distribution would give the merged firm increased "bargaining leverage" to raise prices on rival distributors that wanted access to Time Warner programming. Following a lengthy and widely-publicized trial, the court ruled in AT&T's favor, holding that there was insufficient evidence in support of the government's "bargaining theory" of harm. The D.C. Circuit recently affirmed the district court's decision.

- **FTC's Settlement of *Staples/Essendant*** – Staples, one of the world's largest suppliers of office products and services, sells office products directly to mid-sized businesses. Essendant is a wholesale distributor of office supplies, including selling to independent dealers that compete with Staples for sales to mid-sized business customers. The FTC resolved its investigation through a 3-to-2 vote approving behavioral/conduct remedies requiring the merged company to impose a firewall that would prevent Staples from learning competitively sensitive information about its rivals. The dissents of Commissioners Slaughter and Chopra argued for a wholesale reevaluation of the Commission's analysis of vertical transactions, suggesting that there is a much greater potential for consumer harm than acknowledged by the current approach.

- **DOJ's Settlement of *CVS/Aetna*** – CVS's acquisition of Aetna presented both horizontal and vertical aspects, as CVS's pharmacy benefit management ("PBM") services were an upstream input in Aetna's provision of health insurance, while CVS and Aetna competed in Medicare Part D prescription drug plans. The DOJ's proposed settlement of its investigation, however, addressed only the horizontal aspect. The DOJ's proposed settlement required divestiture of Aetna's Medicare Part D business. Judge Richard Leon, the presiding judge in the *AT&T/TimeWarner* merger trial, has scheduled hearings in part to evaluate whether DOJ properly evaluated the risk of vertical effects from the merger. In response to public comments on the proposed settlement, the DOJ has stated that it believed that vertical harms—input foreclosure by denying Aetna's insurer competitors access to CVS's pharmacies and PBM services, and customer foreclosure through denying independent pharmacies access to Aetna members—were unlikely to result from the merger.

These matters and others reflect acceptance and rejection of a variety of theories of harm and a range of remedies to address any such harm and, notably, all involve theories that are not included in the 1984 Guidelines.

Possible Areas of Focus of Updated Vertical Merger Guidelines

The diversity of approaches reflected in the agency's recent vertical merger enforcement actions suggests that the content of updated vertical merger guidelines will be the subject of vigorous debate and consideration within the agencies. While observers can only speculate regarding the agency positions that might emerge from this process, the agency's recent cases suggest several topics that may be addressed:

- **Input Foreclosure and/or Changed Downstream Bargaining Incentives** – Updated vertical merger guidelines could address the circumstances in which consumer harm resulting from input foreclosure or altered bargaining incentives could occur. Theories of these types were at issue in *AT&T/Time Warner* and *Staples/Essendant*. As noted above, the dissents from Commissioners Chopra and Slaughter demonstrate they are clearly concerned that a vertically integrated firm could withhold or increase the price of key inputs vis-à-vis downstream competitors, thereby raising their rivals' costs.

- **Customer Foreclosure** – The revisions could also address customer foreclosure; namely, the circumstances in which a vertical transaction could cause the merging firm to refuse to buy inputs from non-merging input suppliers. The DOJ raised customer foreclosure as a potential concern in *Comcast/NBCU*, fearing that Comcast would refuse to carry networks competing with NBC.

- **Elimination of Double Marginalization** – The revisions could articulate standards for analyzing the efficiencies associated with the elimination of double marginalization, an efficiency generally associated with vertical transactions. The revised guidelines could discuss the situations under which this efficiency is expected to occur and the extent to which it is weighed against a potential for consumer harm. The revisions could also import the 2010 Horizontal Merger Guidelines' approach when assessing efficiencies generally, including the standards associated with merger-specificity, cognizability, and verifiability. In practice, the agencies are already analyzing efficiencies in vertical transactions in this manner.

- **Exchanges of Competitively Sensitive Information** – The revisions could present updated guidance on whether and under what circumstances vertical mergers facilitate anticompetitive disclosures of competitively sensitive information, such as prices. Any new guidance could also address remedies such as firewalls, which have been imposed in recent deals. As noted above, in *Staples/Essendant*, the FTC expressed concerns that Staples would gain access to sensitive information belonging to Essendant's customers, which would allow it to charge higher prices than it otherwise would when bidding against those customers for an end-user's business. These concerns were reflected in the consent decree, which limited Staples' access to such data.

- **Updates to the Theories of Harm Set Forth in the 1984 Guidelines** – We would expect the agencies to review the content of the 1984 Guidelines and consider whether it remains consistent with current agency practice and antitrust law more generally.

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Joint updates to merger enforcement guidelines require an immense amount of effort and cooperation between the DOJ and the FTC. Reaching consensus on issues as complex and controversial as vertical merger enforcement will be challenging, to say the least.