Alert

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COZEN O'CONNOR

Updated Government Guidance on Vertical Mergers

For the first time since the 1980s, the U.S. Department of Justice (DOJ) and the Federal Trade Commission (FTC), collectively the agencies, issued new Vertical Merger Guidelines (Guidelines) setting forth how they intend to analyze mergers between companies at different levels in a distribution chain (referred to as “vertical mergers”).[1] The Guidelines make clear the agencies’ position that vertical mergers may substantially lessen competition and be therefore prohibited depending on the circumstances and alleged harms to the competitive process and consumers.

Under the Sherman and Clayton Acts, mergers are subject to review and prohibited if “the effect of such [an] acquisition may be substantially to lessen competition, or to tend to create a monopoly.”[2] As a part of reviewing mergers, the agencies conduct a highly fact-specific inquiry into the relevant market and market concentration. The new Guidelines are intended to assist the business community and antitrust practitioners by increasing the transparency of the agencies’ review of vertical mergers. The Guidelines thus detail the analytical techniques, practices, and enforcement policy as applied to vertical mergers. While newly updated, the Guidelines largely memorialize the principles, tools, and frameworks that the agencies have historically used to assess these mergers.

The agencies acknowledge that vertical mergers often benefit customers in a number of ways, including through the elimination of two firms each making a profit at different stages in the supply chain (referred to as “double marginalization”). Nevertheless, the agencies identified two areas of particular concern in vertical mergers: (1) where a post-merger firm has ability to engage in foreclosure or raise a rival’s costs; and (2) where a post-merger firm gains access to and control of sensitive business information about its upstream or downstream rivals. In reviewing vertical mergers, agencies identify a “related product,” which is a product or service supplied or controlled by the merged firm and that is positioned vertically or is complementary to the products and services in the relevant market at issue. Examples of related products include inputs, means of distribution, access to a set of customers, or complements.

In the first area of concern, post-merger firms may have the ability and incentive to refuse to supply rivals with related products, known as foreclosure, increase the price of the related product, or lower the quality of the related product. Each of these potentially harm competition and raise significant competitive concerns which, according to the Guidelines, warrant scrutiny.

In the second, post-merger firms may have access to rivals sensitive business information. This may result in post-merger firm either moderating its competitive response or preempt or react quickly to a rival. In doing so, rivals may see less value in taking pro-competitive actions, thereby harming competition. Similarly, rivals may refrain from doing business with the post-merger firm resulting in them relying on less preferred trading partners or paying higher prices, thereby harming end consumers.

Additionally, the Guidelines recognize that a vertical merger may diminish competition by enabling or encouraging coordinated interaction among non-merger firms in a relevant market in an manner that harms customers. One way this may occur is by eliminating an upstream or downstream maverick firm that otherwise plays an important role in preventing or limiting anticompetitive coordination. Vertical mergers may also allow post-merging firms to coordinate because they may facilitate reaching a tacit agreement with market participants, detecting cheating on such an agreement, or punishing cheating firms.

The Guidelines recognize that vertical mergers do have procompetitive effects. For example, a post-merger firm may combine complementary assets to more competitively make a final product or create innovative products. Additionally, due to the elimination of double marginalization,

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mergers of vertically related firms will often result in lower costs to the producer and may also result in lower prices.

One notable change from the earlier draft version was the elimination of the presumption that agencies are unlikely to challenge a vertical merger where the parties to the merger have a share in the relevant market of less than 20 percent. Such challenges, however, are very rare, and we do not expect enforcement practices to change.

Notably, the FTC's decision to endorse the Guidelines was split along party lines, with the three Republican appointees endorsing the Guidelines and the two Democratic appointees dissenting. Both dissents argue that the Guidelines are too lax and may result in under-enforcement. This indicates that, under a future Democratic administration, DOJ and FTC may more closely scrutinize vertical mergers and may even withdraw or modify these Guidelines.

While no case has yet applied these Guidelines, they represent an ongoing commitment on the part of the agencies to review vertical mergers for potential competitive harm.

If you have any questions about this alert or any related antitrust matters, please feel free to reach out to David Reichenberg, Jonathan Grossman, Mark Jacobson, Thomas Ingalls, or any other member of our antitrust team.

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[1] U.S. Dept. of Justice & Fed. Trade Comm'n, Vertical Merger Guidelines (2020)

[2] Clayton Act, § 7, 15 U.S.C. § 18.