Comments on the DOJ/FTC Draft Vertical Merger Guidelines

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INTRODUCTION

1. We are Ph.D. economists who teach competition-related classes at our universities, conduct policy research, and lecture widely on competition issues. Several of us have served at either the Department of Justice or the Federal Trade Commission, or otherwise been involved in the antitrust practice. We read the Department of Justice’s and Federal Trade Commission’s Draft Vertical Merger Guidelines ("Draft Guidelines"),¹ and we applaud the fact that the agencies have put forward a proposal to replace those from 36 years ago. The intervening years have seen much learning about competition concerns stemming from vertical mergers as well as about the benefits from integration. This learning has been based on both economic research and experience. It also should form the foundation for any new vertical merger guidelines.

2. Unfortunately, this is not the case here. The Draft Guidelines do not capture the state of learning with respect to anticompetitive theories for vertical mergers. Moreover, they provide an excessively permissive standard for parties seeking to merge.² In these comments, we provide specific bases for this assessment: First, the Draft Guidelines are substantively incomplete, overlooking several well-accepted concerns with vertical mergers. Second, the Draft Guidelines are procedurally defective, giving several advantageous arguments to merging parties. Third, the Draft Guidelines should make clear that vertical mergers raising competitive concerns are more difficult to resolve through remedies, and thus face a higher probability of challenge than in the case of horizontal mergers. We conclude that the Guidelines should have a statement cautioning that vertical mergers are unlikely to be resolved through remedies or ex post antitrust enforcement under Section 2.

I. THE DRAFT GUIDELINES ARE SUBSTANTIALLY INCOMPLETE

¹ The authors’ affiliations are as follows: Nicholas Economides, Professor of Economics, NYU Stern School of Business; John Kwoka, Neal F. Finnegan Distinguished Professor of Economics, College of Social Sciences and Humanities, Northeastern University; Thomas Philippon, Max L. Heine Professor of Finance, NYU Stern School of Business; Hal Singer, Managing Director at Econ One, Adjunct Professor at Georgetown McDonough School of Business; and Lawrence J. White, Robert Kavesh Professor of Economics, NYU Stern School of Business.
3. To begin, we note that the legal landscape for challenging vertical mergers is hostile, and therefore the omission in the vertical merger guidelines of any recognized theory of harm will tend to create an even higher burden on the agency or party seeking to demonstrate the lack of validity of a merger. Accordingly, it is doubly important that any new guidelines provide a comprehensive outline of such theories. The last two major enforcement actions by the Department of Justice (DOJ) highlight the weakness of the current standards and the burden they create for enforcers. In its failed challenge of AT&T’s acquisition of Time Warner, the DOJ largely staked its claim on price effects arising from AT&T’s potentially withholding Time Warner’s Turner programming from cable distribution rivals. Because AT&T’s downstream distribution share was relatively small, and because the customer “departure rate” associated with losing Turner’s cable programming properties was hard to measure, the DOJ’s projected price effects were deemed speculative by the trial judge. The trial judge’s decision was sustained upon appeal in the D.C. Circuit. In its complaint in CVS-Aetna, the DOJ did not state any vertical theories of harm, permitting the formation of the only vertically integrated pharmacy/PBM/health plan in the United States—despite a serious concern among several states that the vertically integrated firm could deny a must-have input (CVS pharmacy services) to a rival health plan such as UnitedHealth. Instead, the DOJ sought and secured a modest requirement to spin off Aetna’s Medicare Part D prescription drug plan based on a horizontal theory of harm. These cases show that the legal landscape for prosecuting vertical mergers is challenging, potentially discouraging enforcement against anticompetitive vertical mergers.

4. We note that the Draft Guidelines substantively offer only two unilateral theories of anticompetitive harm flowing from vertical mergers: (1) Foreclosure and Raising Rivals’ Costs; and (2) Access to Competitively Sensitive Information. It is well understood that vertical integration can shift the bargaining power towards the integrated firm, resulting in higher input costs for rivals. Although the Draft Guidelines allude to bargaining theory in one hypothetical...
example under raising rival’s costs,⁹ the treatment there is scant, and does not capture the theoretical complexity nor best practices for empirical application of bargaining models.¹⁰ Even within its Foreclosure and Raising Rivals’ Cost section, the Draft Guidelines focus exclusively on input foreclosure, or “denying [a rival] access to a related product,”¹¹ yet the section neglects customer foreclosure entirely—denying a rival input provider’s access to the vertically integrated firm’s customers.¹² Customer foreclosure can generate anticompetitive effects, by discouraging entry in input markets (such as content in media mergers) in future periods.

5. The Draft Guidelines also ignore or pay short shrift to a number of specific theories of possible harm from vertical mergers. These include the following:

* **Vertical mergers can create a two-market entry barrier.** Only in a single hypothetical example under Foreclosure and Raising Rivals’ Costs do the Draft Guidelines mention how a refusal to supply a key input post vertical integration could require “two-stage entry” in the pharmaceutical industry.¹³ Yet the issue is much more general.¹⁴ Entry barriers can insulate incumbents from competition, and a vertical merger can, even absent other effects, add to the barrier to entry at any one stage if an outside firm must also provide both products. This is especially relevant in cases where access to consumers’ data becomes a critical input as well as a potential barrier to entry. Vertical mergers can greatly increase the opportunity to monopolize access to data.


9. Draft Guidelines at 6 (Example 4) (“When the merged firm bargains with Company C over the price of the related product, it may be more willing to hold out for higher prices compared to an unintegrated Company A because losing (or delaying) sales of the related product to Company C may be more costly for standalone Company A than for the merged firm.”). The Guidelines also briefly acknowledge how a vertical merger might “chang[e] the terms of those rivals’ access to one or more related products.” Id. at 4.

10. One important version of the application of the bargaining theory approach would be as follows: When an upstream firm and a downstream firm merge, the upstream partner can become a tougher bargainer (e.g., insisting on a higher price) vis-à-vis the downstream partner’s rivals, because some of the otherwise lost profits (from the lost sales from the tougher bargaining) may be recaptured when the customers of the downstream rivals switch their purchases (in response to the rivals’ higher prices or reduced offerings) to the downstream partner.


12. Customer foreclosure of rival input or content is also referred to as content discrimination. See, e.g., Daniel Rubinfeld & Hal Singer, Vertical Foreclosure in Broadband Access, 49 JOURNAL OF INDUSTRIAL ECONOMICS (2003) (“We consider the economic incentives of such a firm to engage in two distinct vertical foreclosure strategies: (1) conduit discrimination—insulating its own conduit from competition by limiting rival platform distribution of its affiliated content and services, and (2) content discrimination—insulating its own affiliated content from competition by blocking or degrading the quality of outside content.”).

13. Id. at 6 (Example 5) (“If Company B buys Company A, the merged firm may find it profitable to refuse to supply the ingredient to any rivals or potential rivals if doing so would deter Company C from entering, or prevent it from financing entry, by requiring it to start producing both the active ingredient and the drug at the same time (two stage entry).”).

14. See, e.g., ALISTER LINDSAY & ALISON BERRIDGE, THE EU MERGER REGULATION: SUBSTANTIVE ISSUES 445 (4th ed. Thompson Reuters 2012) (“Simultaneous entry may be harder if the cost of capital for entering the secondary market is higher or there are substantial economies of scale in the secondary market.”). Slaughter & May, The EU Merger Regulation: An Overview of the European Merger Control Rules at 23 (2018) (“However, in circumstances where the products acquired are complementary to the acquirer’s own products, such a merger may give rise to concerns about ‘portfolio power.’ This may occur when the market power deriving from a portfolio of brands exceeds the sum of its parts, thereby enabling the merged group to exercise market power in individual markets more easily.”).
**Vertical mergers can be used to remove a potential competitor from the market.** Vertical mergers raise concerns that one or both of the firms may be the other’s most likely potential horizontal rival.\(^{15}\) After all, two vertically related companies know much about each other’s businesses and may well represent the most likely entrant into each other’s domain. While there is mention of potential rivals in the context of foreclosure, missing entirely is any treatment of how a vertical merger could remove a potential competitor from the playing field. Commonly cited examples concern WhatsApp and Instagram. Although these targets were not characterized as horizontal competitors to Facebook’s social media platform at the time of those acquisitions, WhatsApp and Instagram have each evolved into social media platforms of their own. The failure to prevent these acquisitions has eliminated the possibility that they might compete with Facebook.

**Vertical mergers can generate non-price harms.** Non-price merger harms are especially important in vertical relationships.\(^{16}\) Relative to price effects, innovation harms are hard to measure, yet contribute greatly to consumer welfare over the long term. As noted above, customer foreclosure resulting from vertical tie-ups in media can lead to exit by independent content providers, generating innovation harms. Yet innovation harms and quality harms receive little attention in the Draft Guidelines, despite their importance to vertical theories of harm.\(^{17}\)

**Vertical mergers can be used to evade regulation in one sphere of a firm’s orbit.** Artificial transfer prices within the integrated firm allow it to avoid rate regulation.\(^{18}\) For example, in its review of the British Telecom/MCI merger, the DOJ concluded that this integration gave the merged entity the ability and incentive to evade an FCC policy to send calls to U.S. carriers in the same proportion it receives from those carriers, and as a result, to raise the international settlement rate.\(^{19}\) The Draft Guidelines make no mention of this anticompetitive motivation for vertical mergers.

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\(^{15}\) Salop & Culley, supra, at 11-13; Competitive Impact Statement, United States v. Ticketmaster Entertainment, Inc., No. 1:10-cv-00139 (D.D.C. Jan. 25, 2010), available at www.justice.gov/atr/cases/f254500/254544.pdf; John E. Kwoka, Jr, Rockonomics: The Ticketmaster-Live Nation Merger and the Rock Concert Business, in JOHN E. KWOKA, JR. & LAWRENCE J. WHITE, THE ANTITRUST REVOLUTION (Oxford Press 7th Ed. 2019); Federal Trade Commission, Competitive Effects 2020 (“For another, it would eliminate the procompetitive effect that an outside firm can have on a market simply by being recognized as a possible entrant. What accounts for that effect? The firms already in the market may avoid raising prices to levels that would make the outside firm’s entry more likely. Eliminating the potential entrant through a merger would remove the threat of entry and possibly lead to higher prices.”).

\(^{16}\) See, among others, Salop & Culley, supra, at 15 (noting that degrading a rival’s quality may be less detectable than price increases). Id. n. 26 (“Threatening non-price foreclosure may be used to increase bargaining power, but end up being implemented temporarily when the bargaining process breaks down.”). Non-price issues are likely to be especially relevant in the context of online platforms, where the platform offers “free” services (which are supported by the sale of advertising) to consumers but those services have non-price quality dimensions that are important to those consumers.

\(^{17}\) Draft Guidelines at 4 (“For example, the merged firm may be able to raise its rivals’ costs by charging a higher price for the related products or by lowering service or product quality.”); id. at 4-5 (“Alternatively, the merger may increase the incentive or ability of the merged firm to raise its rivals’ costs or decrease the quality of their rivals’ products or services, thereby reducing the competitive constraints imposed by those rival firms.”).

\(^{18}\) Salop & Culley, supra (citing United States v. AT&T, 524 F. Supp. 1336, 1370–75 (D.D.C. 1981)).

\(^{19}\) Steven Sunshine, Deputy Assistant Attorney General Antitrust Division U.S. Department of Justice, Vertical Merger Enforcement Policy, Before the ABA Section of Antitrust Law Spring Meeting (May 1995).
*Vertical mergers can eliminate a maverick firm.* It may be in the interests of the vertically situated acquirer to acquire a maverick firm in the vertically related market and thereby dampen competition among that acquired firm’s rivals. Yet there is no mention of regulatory evasion as a reason to merge with a vertical rival in the Draft Guidelines.

6. Finally, we note the complete absence from the Draft Guidelines of concern or method to challenge a series of (apparently) individually inconsequential vertical mergers that collectively represents a threat to competition. This scenario has arisen in the case of dominant platforms, whose acquisitive behavior under these guidelines will largely continue unabated. To borrow a single example of under-enforcement under the current policy regime, the UK Competition & Markets Authority (CMA) recently noted that Google acquired nine independent ad tech companies to achieve dominance in the open-display advertising market. CMA identified four vertical foreclosure strategies made possible through these vertical mergers: (1) using its market power in inventory and data (including exclusive access to YouTube’s inventory) to advantage its own demand-side platform services (Google Ads and DV360); (2) channeling Google Ads demand through Google’s supply-side platform (AdX) and limiting the integration of AdX with rival publisher ad servers; (3) self-preferencing between Google’s publisher ad server and AdX; and (4) self-preferencing between Google’s demand-side and supply-side platform.

Under the current merger-enforcement regime, Google has been able to leverage its power in publisher ad server supply (90 percent market share) to gain a substantial and growing foothold in demand- and supply-side platforms for open-display advertisements. According to CMA, in the United Kingdom, Google now accounts for between 50 and 70 percent of the value of ads purchased through demand-side platforms and between 40 and 60 percent of the value of ads sold through supply-side platforms. As the Draft Guidelines are currently written, nothing could prevent this “vertical stack” from reforming afresh in 2020 or beyond. By not offering a pathway through which an agency could challenge a series of such vertical mergers, the Draft Guidelines are substantively incomplete.

II. THE DRAFT GUIDELINES ARE PROCEDURALLY DEFECTIVE

7. The second major drawback to the Draft Guidelines is that they are procedurally defective, and as a result they provide several advantageous arguments to merging parties. To begin, there is no presumption against mergers involving dominant firms (as proxied with very high shares and entry barriers in a relevant market), even though there is a safe harbor of 20 percent market share at the other extreme. This safe harbor stands in sharp contrast with the Horizontal

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21. UK Competition & Markets Authority, *Online platforms and digital advertising: Market study interim report* (December 2019), at 200. These acquisitions include DoubleClick (April 2007), AdMob (November 2009), Invite Media (June 2010), AdMeld (June 2011), Adometry (May 2014), mDialog June 2014), Directr (August 2014), Toro February 2015), and Famebit (October 2016).

22. Id. at 204.

23. Id. at 197.

24. Id. at 3 (“The 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, and the related product is used in less than 20 percent of the relevant market. … Moreover, a share of 20 percent or more in the relevant market or a related products’ share of use in the relevant market of 20 percent or more, or both, does not, on its own, support an inference that the vertical merger is likely to substantially less competition.”).
Merger Guidelines (HMGs), which pairs its share-based presumptive safe harbor with a presumption against high share mergers in high concentration markets. It makes little sense to offer a safe harbor without also providing any fact pattern where a vertical merger would be presumptively anticompetitive.\(^{25}\) Moreover, there is no support offered in the Draft Guidelines for its arbitrary safe harbor threshold.\(^{26}\) As a caution, one of us has found numerous anticompetitive horizontal mergers within its 20 percent safe harbor.\(^{27}\)

8. This omission is especially startling since several leading antitrust academics have identified many such fact patterns where an anticompetitive presumption is warranted. Professors Jonathan Baker, Nancy Rose, Steven Salop and Fiona Scott Morton (2019) suggest that the agencies should adopt anticompetitive presumptions when certain conditions are met, including, among others, an input- and customer-foreclosure presumption—based on the same foreclosure theories discussed above—as well as a dominant-platform presumption.\(^{28}\) The dominant-platform presumption would arise whenever a dominant platform “acquires a firm with a substantial probability of entering in competition with it absent the merger, or if that dominant platform company acquires a competitor in an adjacent market.”\(^{29}\) For example, because Google could be characterized as a dominant platform in both search and open-display advertising markets, this presumption could have been invoked to prevent Google from developing a dominant position across the open-display ad tech stack. A number of large firms, such as Amazon, Apple and Facebook, besides Google, are obvious candidates for dominant platforms. Additionally, in certain local markets, a cable operator or Internet service provider such as Comcast could be characterized as a dominant platform as well.

9. With respect to the 20 percent safe harbor, we further note that the issue of defining the “relevant market” to which the 20 percent would apply is not well addressed. Although reference is made to the market definition paradigm that is offered by the HMGs, what is neglected is the following: Under the “unilateral effects” theory of competitive harm of the HMGs, the horizontal merger of two firms that sell differentiated products that are imperfect substitutes could lead to significant price increases if the second-choice product for a significant fraction of each of the merging firms’ customers is sold by the partner firm. In such instances, the “relevant market” is simply the products that are sold by the two firms, and the merger is effectively a “2-to-1” merger. Under these circumstances, any apparently broader market (perhaps based on physical or functional similarities of products) is misleading, and the “market” shares of the merging parties that are based on that broader market under-represent the potential for their post-merger exercise of market power. Such unilateral-effects instances are revealed by examining detailed sales and

\(^{25}\) *See, e.g.*, Statement of Commissioner Rebecca Kelly Slaughter, FTC-DOJ Draft Vertical Merger Guidelines, Commission File No. P810034 January 10, 2020 at 3 (“I also find it difficult to consider a safe harbor that is not coupled with stronger language about when a merger is likely to warrant scrutiny or enforcement. If there is a threshold below which the Agencies are not likely to enforce, should not there be a presumption of harm when the market share is high or very high and there are barriers to entry?”).

\(^{26}\) There is also an important market definition issue that we discuss below.

\(^{27}\) *See John Kwoka, Mergers, Merger Control, and Remedies: A Retrospective Analysis of U.S. Policy* (MIT Press 2014). Again, that an estimated 20 percent share could lead to post-merger prices effects implies that the relevant market likely was defined too broadly and that the merged firm collectively had considerable pricing power.

\(^{28}\) *Five Principles, supra*, at 16-17.

\(^{29}\) *Id.* at 17.
substitution data with respect to the customers of the two merging firms. With a vertical merger, however, the potential for unilateral effects would have to be captured by examining the detailed sales and substitution patterns of each of the merging firms with all of their significant horizontal competitors. This will require a substantial, data-intensive effort. Of course, if this effort is not undertaken and an erroneously broader market is designated, the 20 percent “market” share threshold will understate the potential for competitive harm from a proposed vertical merger.

10. Relatedly, we are concerned with the emphasis in the Draft Guidelines on quantitative assessments as the primary mode of analysis. The DOJ’s failed challenge of AT&T-Time Warner revealed the inevitable disputes about data, modeling, and assumptions associated with such analysis. Sound competition analysis requires a blending of both quantitative and qualitative analyses. Yet there is no mention of qualitative analysis in the Draft Guidelines. If, for example, contemporaneous record evidence reveals an anticompetitive rationale to a vertical merger, such evidence should be afforded the same weight in merger review as that afforded any econometric model.

11. Another procedural defect is the Draft Guideline’s misplaced emphasis on the elimination of double marginalization (“EDM”) as an efficiency justification for vertical mergers. The Draft Guidelines devote an entire section to EDM (section 6), separate and apart from a standalone section on merger efficiencies (section 8). This position is too charitable to EDM and will predictably be seized on by merging parties. It bears noting that the FCC largely rejected the EDM efficiencies offered by Comcast-NBCU, finding that the analysis of the EDM “must account for revenues NBCU loses when subscribers who already receive NBCU programming from another MVPD switch to Comcast,” and that “the Applicants have failed to substantiate some of the likely benefits to consumers of eliminating double marginalization and have overstated others.” Although the Draft Guidelines note some obvious cases where EDM will be suspect (for example, “if the downstream firm cannot use the inputs from the upstream one”), they overlook many more critical assumptions. With Margaret Slade, one of us has outlined the strong assumptions of the basic EDM model, including how EDM depends crucially on the assumptions of a fixed proportion production process at the downstream stage, and on the assumption that the actual cost savings require vertical integration for their realization. Instead of presuming EDM generally applies, the agencies should recognize the results obtain only under specific fact patterns, and should adopt a presumption that EDM can be solved by nonlinear pricing.

30. With a vertical merger, such “unilateral effects” could arise post-merger in at least two ways: (a) The downstream partner could maintain a higher price, since some of the lost profits from some of the lost sales could be recaptured by the upstream partner’s profits on the sales of components to the downstream rivals (which gain some of the lost sales); and (b) the upstream partner could maintain a higher price to the downstream rivals, since some of the latter firms’ customers (and the concomitant profits) would be captured by the downstream partner.

31. Draft Guidelines at 4 (“Where sufficient data are available, the Agencies may construct economic models designed to quantify the likely unilateral price effects resulting from the merger.”).

32. Draft Guidelines at 7 (“The Agencies will not challenge a merger if the net effect of elimination of double marginalization means that the merger is unlikely to be anticompetitive in any relevant market.”).


34. Draft Guidelines at 7.

12. We further note that the Draft Guidelines inappropriately accept out-of-market efficiencies flowing from EDM as an offset to merger-related harms in the relevant market. This not only contravenes well-established U.S. merger policy from Philadelphia National Bank, but it also is an open invitation to merging parties to claim far-reaching benefits, ever harder for the agencies to measure and weigh against in-market harms.

III. THE DRAFT GUIDELINES SHOULD CAUTION THAT VERTICAL MergERS ARE UNLIKELY TO BE RESOLVED THROUGH REMEDIES OR EX POST ANTITRUST ENFORCEMENT

12. Finally, the final version of the Guidelines should have a statement cautioning that vertical mergers are unlikely to be resolved through remedies, and thus a finding of competitive harms is more likely to result in an outright challenge than in the case of a horizontal merger. The reason is straightforward: divestitures are usually infeasible without compromising efficiencies, and conduct remedies are often not effective. Indeed, the Assistant Attorney General for Antitrust himself has stated the Department’s intention of minimizing use of conduct remedies except where absolutely necessary. The clear implication is that vertical mergers that are competitively problematic cannot easily be remedied; this should be recognized in the final version of the Guidelines as a “competitive fact of life”.

13. In addition to the lack of feasible remedies, vertical merger enforcement is particularly important to preserve competition given the current state of antitrust law; monopoly leveraging is said to be a dead letter in antitrust, and few pathways remain to challenge ex post vertical foreclosure by a vertically integrated firm. Once a dominant firm has been permitted to extend its power throughout the supply chain, it is difficult to police discriminatory behavior via the antitrust laws. The inability to police discriminatory conduct by a vertically integrated firm is yet another reason why vertical merger guidelines need to be drawn stringently, so that such discriminatory post-merger conduct is unlikely to be profitable and thus unlikely to occur.

CONCLUSION

14. In the current economic landscape, as dominant platforms and other dominant firms acquire relatively small vertical complementors that extend their market power, the Draft Guidelines fail to offer any pathways by which a future series of such vertical mergers by a dominant platform could be challenged. The Draft Guidelines also fail to offer any pathways by which private or public enforcers could challenge vertical foreclosure strategies before or after a vertical merger is consummated. This absence of viable pathways implies that, if these guidelines are adopted, the United States will continue along our current course of excessive tolerance of vertical mergers. For example, few economists believe that in hindsight the FTC’s approval of

36. Id. n. 5 (“The Agencies may also consider elimination of double marginalization that is not strictly in the relevant market, using the principles set out in footnote 14 of the Horizontal Merger Guidelines for efficiencies that are inextricably linked.”) (emphasis added).

37. Discriminatory refusals to deal, exclusive dealing, and tie-ins are three such pathways.

Facebook’s acquisitions of Instagram and WhatsApp were procompetitive; yet the Draft Guidelines would do nothing to slow these types of acquisitions. Indeed, the Draft Guidelines would cement the status quo of excessive tolerance. For these and the foregoing reasons, we conclude that the Draft Guidelines are inadequate and require significant revisions along the lines of our comments above.