CENTER FOR DEMOCRACY & TECHNOLOGY

Comments on the Draft Vertical Merger Guidelines

A few years ago, a satirical ad ran as part of a *Parks and Recreation* episode. It announced the fictional merger of Verizon, Exxon, and Chipotle, three companies that, according to the ad, all give people energy in different ways. The fake ad ended with the tagline "Proud to be one of America's 8 companies."[1]

It is against this backdrop of increasing consolidation and market power across many sectors of the American economy that we provide these comments on the Agencies' draft vertical merger guidelines. The Center for Democracy & Technology is a non-profit advocacy organization working to promote democratic values online and in new, existing, and emerging technologies. We believe in the power of the internet, and we seek policy outcomes that keep the internet open and innovative.

We appreciate the Agencies' efforts to update their guidance about vertical mergers. We submit, however, that the draft guidelines omit many important points. We urge the Agencies to consider adding additional commentary especially in the areas of (1) evidence of adverse competitive effects, (2) unilateral effects, and (3) efficiencies. In addition to those specific areas, we encourage the Agencies to add more illustrative examples and discussion of how they assess vertical mergers in data-intensive and tech-oriented industries.

In addition, these draft guidelines are styled as applying to vertical mergers. The earlier guidelines from the 1980s addressed "non-horizontal" mergers. The Agencies should explain in the final guidelines whether they apply only to vertical mergers or also to other forms of non-horizontal mergers. If these guidelines are not intended to apply to mergers that are not strictly vertical, the Agencies should publish additional guidelines that explain their approaches to non-horizontal, non-vertical mergers. This is of particular importance in the high tech space, where the lines separating horizontal, vertical, and conglomerate mergers can be difficult to draw.

1. *Evidence of adverse competitive effects.*

In merger analysis, any relevant evidence should be considered by the reviewing Agency. The draft guidelines embrace this principle. But they devote only five sentences to describing what those kinds of evidence can be. The draft guidelines would be more useful if they offered more detail. For example, the Agencies could describe what kinds of evidence were most probative during recent vertical mergers that resulted in challenges, including Comcast/NBCU, AT&T/Time Warner, and CVS/Aetna. It would also be helpful to discuss the types of econometric analysis that are most relevant to the Agencies, as well as how the Agencies balance econometric studies with other forms of evidence. We also note that the draft guidelines do not mention a history of

[1] Available at https://www.youtube.com/watch?v=XFKoGtgg6Mo.

collusion in either the upstream or downstream markets as a relevant point of evidence and suggest that the draft be updated to include that explicitly as a factor.

2. *Unilateral effects.*

The draft guidelines discuss a few categories of anticompetitive unilateral effects: foreclosure, raising rivals' costs, and access to competitively sensitive information. We agree that those are all areas of potential concern and appreciate the Agencies' efforts to explain them in clear, simple terms.

The Agencies state in the draft that those three categories of competitive harm "do not exhaust the types of possible unilateral effects." We agree. We are concerned that the failure to enumerate additional types of unilateral effects may be confusing to courts and practitioners alike. We encourage the Agencies to add descriptions of more categories of unilateral effects to the draft guidelines to provide greater clarity to lawyers, companies, and other advocates.

Specifically, we note that there are several categories of unilateral effects that were included in the 1984 Guidelines but are missing from the current draft, including but not limited to:

a. **Harm to potential competition**. A vertical merger can have a horizontal effect if either one of the merging parties was a potential entrant into the other's market. The current draft guidelines do not address this possibility. It is, however, potentially a very significant merger effect, and one that has been part of the Agencies' merger analysis for years. For example, potential entry was one of the reasons that the Department of Justice sought relief in the Ticketmaster/LiveNation merger. As it stated in that 2010 Competitive Impact Statement: "By 2008, Ticketmaster's longstanding dominance faced a major threat. Live Nation was better positioned to overcome the entry barriers ...than any other existing or potential competitor because it could achieve sufficient scale to compete effectively with Ticketmaster simply by ticketing its own venues."[2]

   Potential competition issues can be assessed in vertical merger cases by examining whether either party was likely to enter the other's markets, including whether any actual plans to do so had been developed by the merging parties prior to their deal announcement. Of course, the fact of potential entry itself is not dispositive; the Agencies should investigate whether the potential entry is competitively significant, whether there are other likely entrants, and any other relevant factors to the competitive analysis. For example, if the target of the acquisition was particularly well-situated to enter the acquirer's market, the potential for anticompetitive unilateral effects is greater. In addition, markets with high levels of

[2] https://www.justice.gov/atr/case-document/competitive-impact-statement-209

concentration may be more significantly affected in anticompetitive ways if potential competitors are purchased and eliminated as a competitive threat in either the upstream or downstream market.

b. **Two level entry issues**. Standard competitive effects analysis includes assessing whether markets are characterized by barriers to entry. Where barriers to entry are high, it is more difficult for potential new entrants to provide a strong competitive effect on anticompetitive conduct. While this may be primarily viewed as a horizontal merger concern, it also arises in the vertical merger context if the acquisition makes entry harder by requiring a new firm to enter both the upstream and downstream markets simultaneously.

   Two level entry can be harder in industries that require high upfront investment costs, or where inputs are difficult to access, where there is high minimum viable scale, or other industry-specific factors make it difficult to enter the upstream market without entering the downstream market, or vice versa.

   Two level entry issues have played a relatively limited role in merger cases in the last decade, based on publicly-available materials. We note however that commentators in the recent CVS-Aetna merger raised this concern: if entry into the pharmacy-benefit management industry functionally requires entry into the retail pharmacy market as well, new firms will likely be discouraged from entering the market.

   We also believe that the increasing value and power of data makes two level entry issues an important consideration in modern vertical merger cases. If, for example, a firm must have large quantities of consumer data to succeed in an industry, and it must also have specific hardware and/or software assets, entry may be less likely. Strategic vertical purchases of firms with data by firms with, for example, key hardware or software assets could make future entry significantly more difficult. Given the nascent economics of the antitrust implications of the power of data, it would be helpful to offer guidance to lawyers, companies, and other advocates about the Agencies' current thinking about two level entry issues specifically with regard to the accumulation of data.

In general, we appreciate the guidance provided in the unilateral effects section of the revised guidelines but strongly encourage the Agencies to add more examples of unilateral effects and a lengthier discussion about emerging data issues in vertical merger cases. We also encourage adding a note that the omission of certain categories of unilateral effects should not be understood as a repudiation of them as potential areas of anticompetitive harm that can flow from vertical mergers.

3. *Efficiencies*.

As the draft guidelines say, vertical mergers "have the potential to create cognizable efficiencies that benefit competition and consumers." We believe that there are two additional points that should be added to the discussion of efficiencies in the guidelines. First, efficiencies, even when cognizable, quantifiable, and merger-specific, do not necessarily benefit consumers and competition. They may, for example, be retained by the merged firm and squandered. The draft guidelines would be strengthened by noting that efficiencies should be credited by the Agencies when they are very likely to benefit competition and consumers. Extolling the values of efficiencies without tying them to consumer benefits could mislead lawyers, companies, and other advocates about the ability of efficiencies to offset concerns about consumer harm. Furthermore, the draft guidelines could note which types of efficiency benefits flow to customers most often and what industry characteristics facilitate the sharing of efficiencies with consumers.

Second, the guidelines should make it clear that the Agencies can and will study whether claimed efficiencies in past transactions were achieved and passed on to consumers. Such studies would be valuable to scholars of antitrust as a general matter. In addition, as industry consolidation continues, it seems likely that parties to future vertical mergers will often be repeat players. Assessing whether they achieved claimed efficiencies in past transactions and passed those benefits on to consumers can be used as a factor in deciding how much to credit efficiencies claims in future deals. The Agencies should use this as a factor in assessing efficiencies claims, and it should make that clear in the guidelines.

4. *Data/tech industry issues.*

Given the current level of scholarly, political, and public debate about "Big Tech" in the US and around the world, it would be valuable for the Agencies to clarify how they analyze vertical mergers of companies in the digital economy. The draft guidelines do not do so. For instance, the draft guidelines include seven examples of how vertical mergers can raise concerns, but all of those examples are of manufacturing and retail companies that could well have existed back in 1984 when the previous vertical merger guidelines were issued. We also encourage you to add examples that involve the digital economy.

We also recommend that the Agencies add more discussion of the particular challenges associated with vertical mergers in the digital economy, such as:

- When is data an input that can raise foreclosure concerns?
- How do the Agencies define upstream and downstream markets in data-driven markets?
- Do the Agencies consider data privacy and data protection issues as antitrust-relevant in vertical merger analysis?
- What do the Agencies think are the best measures for market power in emerging tech markets, where nascent firms may have few users or revenues?

- Do the Agencies have special concerns about vertical mergers involving large tech companies and nascent potential competitors?
- Does the elimination of double marginalization apply differently in vertical tech mergers where marginal costs are low?
- Do “winner-take-all” issues in digital platforms raise particular vertical merger concerns?
- Can remedies about disclosure and transparency help guard against potential anticompetitive harm in high tech vertical mergers?

Conclusion

While the content of the current draft guidelines reflects some of what is true about vertical mergers, there is much more that might be added. The antitrust community would benefit in particular from specific guidance about some of the emerging issues related to technology.

In short, the draft guidelines are too short.