

February 12, 2019

**Vertical Mergers, Guidelines,
and the FTC Hearings**

**American Bar Association
Section of Antitrust Law
67th Spring Meeting**

“FTC Hearings: Moving the Ball?”

March 27, 2019

Jonathan M. Jacobson^{*}

Wilson Sonsini Goodrich & Rosati
1301 Avenue of the Americas
New York, NY 10019
(212) 497-7700
jjacobson@wsgr.com

^{*} With many thanks to Steve Salop, Carl Shapiro, and Scott Sher for helpful comments. All mistakes are mine.

Vertical integration by merger has been commonplace since modern distribution systems developed at the end of the 19th Century. It was not until the late 1940s, however, that antitrust paid the issue any serious attention. And even then, the government's big *Columbia Steel* case went down to a stinging 5-4 defeat.² The loss led Congress, two years later, to pass the Celler-Kefauver Act,³ in part to ensure that section 7 of the Clayton Act would cover vertical mergers.

But after aggressive vertical merger enforcement throughout the 1960s and 1970s, very few cases were brought in the 1980s; and notwithstanding some consent orders in a variety of cases since, there was no litigated case until *AT&T* this past year.⁴ In the interim, the Department of Justice issued a set of vertical merger guidelines in 1984,⁵ but the developments in economics since have drained those *Guidelines* of much of any current value.⁶ Vertical mergers nevertheless remain common, and the uncertainty – barely tolerable when there was little enforcement – is increasingly harmful and will only get worse to the extent enforcement efforts increase.

The upshot is that there has been a widespread recognition of the need to clarify the applicable legal rules, which has led some to call for new vertical merger guidelines. But there is also recognition that consensus on what to say and what standards to apply will be difficult. While most agree that a burden shifting rule of reason approach under cases like *Baker Hughes*⁷ makes

² United States v. Columbia Steel Co., 334 U.S. 495 (1948).

³ Act of Dec. 29, 1950, 64 Stat. 1125, 15 U.S.C. § 18.

⁴ United States v. AT&T, 310 F. Supp. 3d 161 (D.D.C. 2018), *appeal pending*. The last prior vertical case tried was United States v. Hammerhill Paper, 429 F. Supp. 1271 (W.D. Pa. 1977); *see also Fruehauf Corp. v. FTC*, 603 F.2d 345 (2d Cir. 1979).

⁵ U.S. DEP'T OF JUSTICE, NON-HORIZONTAL MERGER GUIDELINES (1984), *available at* bit.ly/2HJ1qOI.

⁶ *See, e.g.,* Steven C. Salop, *Invigorating Vertical Merger Enforcement*, 127 YALE L.J 1962 (2018); Steven C. Salop & Daniel P. Culley, *Revising the U.S. Vertical Merger Guidelines: Policy Issues and an Interim Guide for Practitioners*, 4 J. ANTITRUST ENFORCEMENT 1 (2016).

⁷ United States v. Baker Hughes Inc., 908 F.2d 981 (D.C. Cir. 1990).

sense even in the vertical merger context, there is sharp disagreement on the handling of efficiencies and significant differences on extent to which the benefits of vertical mergers should be presumed to outweigh the harms. With a backdrop of populist calls for significantly increased merger enforcement, new attacks on antitrust’s consumer welfare standard, and the overhang of DOJ’s pending appeal in *AT&T*, the issues are current, noteworthy, and difficult.

The discussion here focuses on the modern approaches to vertical mergers, whether there is a place or a need for new guidelines, the treatment in recent cases, and the important topic of remedies. The FTC hearings have been quite thought-provoking in all of these respects.

I. The FTC Hearing

The vertical mergers hearing, held November 1, 2018, was in three parts. The first was a presentation by Steve Salop,⁸ followed by an economist panel (Francine Lafontaine, Dan O’Brien, Carl Shapiro, and Margaret Slade, moderated by Bruce Kobayashi),⁹ and then a policy panel (Gene Kimmelman, Sharis Pozen, Jon Sallet, Laura Wilkinson, Paul Yde, moderated by Bruce Hoffman).¹⁰

There was little consensus among the panelists on some key issues. Francine Lafontaine, consistent with her 2007 empirical analysis,¹¹ was largely skeptical that vertical mergers present a serious competition problem. Dan O’Brien, similarly, made a point that, “[w]hile market power is necessary for harm, it does not appear to distinguish net harm from net benefit for vertical and complementary [product] mergers.”¹² Professor Salop, in contrast, countered that vertical mergers

⁸ Hearing, Nov. 1, 2018, Tr. 13-37, *available at* bit.ly/2SfDTZGa (“Hearing”).

⁹ *Id.* at 37-94.

¹⁰ *Id.* at 95-161.

¹¹ Francine Lafontaine & Margaret Slade, *Vertical Integration and Firm Boundaries: The Evidence*, 45 J. ECON. LITERATURE 629 (2007).

¹² Hearing at 42.

should be treated largely the same as horizontal mergers, as both can lead to harmful coordinated effects as well as unilateral effects, while the efficiencies offered in vertical cases are often neither cognizable nor sufficient from his perspective.¹³ Professor Shapiro took a middle ground.

The most vigorous disagreement was on the treatment of efficiencies. Although most agreed that the *Horizontal Merger Guidelines*' rigorous standard for efficiencies¹⁴ should apply to most types of efficiency claims, the majority was of the view that EDM, elimination of double marginalization, should be presumed and presumed to be merger-specific – in contrast to the general efficiencies standard which poses a high burden for the defense to prove the reality, magnitude, and merger-specific nature of the claim.¹⁵ Although this might appear to be a minor disagreement, it actually goes to the heart of the main issue. Those who view the elimination of one side's markup as pervasive and beneficial are far more likely to take a cautious view on vertical merger enforcement. Those who are skeptical of the benefits, such as Professor Salop, would intervene in vertical mergers far more frequently.

II. Vertical Merger Analysis

The general outline of how to analyze a vertical merger is broadly accepted. First, the plaintiff (usually the government) must demonstrate a probable anticompetitive effect from the acquisition. Second, if such a prima facie case has been made, the burden of going forward shifts to the defense either to offer evidence that the anticompetitive effects are unlikely to occur, or are outweighed by efficiency justifications. And, third, if the prima facie case has been rebutted, the

¹³ *Id.* at 14-15.

¹⁴ U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, HORIZONTAL MERGER GUIDELINES § 10 (2010), available at bit.ly/2D1CE6C.

¹⁵ *Id.* Even Carl Shapiro, who is much less skeptical of vertical merger enforcement than some of the other panelists, was of that view. *See* Hearing at 83.

burden of confirming the anticompetitive effect shifts back to the plaintiff “and merges with the ultimate burden of persuasion, which remains on the [plaintiff] at all times.”¹⁶

A. Potential Anticompetitive Effects

The hearings and the literature identify a number of potential effects of a vertical merger that could harm consumers significantly and thus violate section 7. These include:

Exclusionary effects

1. *Input foreclosure.* By acquiring the supplier of an important input, the merged firm can disadvantage rivals who rely on the input. This raising of rivals’ costs is anticompetitive to the extent it lessens the constraints on the merged firm’s market power, allowing it to raise price.

2. *“Frankenstein monster.”* If a merger between a manufacturer and input supplier leaves one independent input supplier left in the market for downstream customers, that unconstrained input supplier becomes a “Frankenstein monster” that is free to charge monopoly prices to the non-vertically integrated remaining players, raising rivals’ costs.¹⁷

3. *Bargaining leverage.* Another variant of input foreclosure, if an acquisition gives the merged firm sufficient control of “must have” properties, the firm can then disadvantage its downstream rivals by raising the prices of those properties.¹⁸

¹⁶ *Baker Hughes*, 908 F.2d at 982-83; *AT&T*, 310 F. Supp. 3d at 189-92; *see also* *St. Alphonsus Med. Center-Nampa, Inc. v. St. Luke’s Health Sys.*, 778 F.3d 775, 783 (9th Cir. 2015).

¹⁷ Thomas Krattenmaker & Steven Salop, *Anticompetitive Exclusion: Raising Rivals’ Costs To Achieve Power over Price*, 96 *YALE L.J.* 209, 240-42 (1986). The ultimate “Frankenstein monster” concern is coordinated effects. It is precipitated, however, by foreclosure and thus is something of a hybrid in this respect.

¹⁸ The bargaining leverage approach was used unsuccessfully on the facts in *AT&T*, 310 F. Supp. 3d at 226, and its use has been controversial. It was used successfully to block the Comcast/Time Warner Cable merger, however. *See* notes 32-34 *infra* & accompanying text.

4. *Customer foreclosure.* By acquiring a downstream distributor and its customer base, a supplier can disadvantage its rivals (for example, by depriving them of scale). Again, if the reduced customer base lessens rivals' ability to constrain the merged firm's market power, consumers will be harmed.

5. *Raising entry barriers by requiring entry at both levels.* If the input or customer foreclosure is sufficiently substantial, a firm seeking expand in one market might have to enter the other to ensure sufficient access to the input or customer base in issue.

6. *Misuse of competitively sensitive information.* By purchasing a distributor that also sells other brands, the supplier can get and misuse confidential business strategies shared with the distributor.

Coordinated and other effects

7. *Collusive information exchange.* If as upstream firm acquires a distributor also handling competing products, the merged firm may have increased opportunities and incentives to collude, through the distributor, with the distributor's other customers by sharing promotional plans or the like.

8. *Removal of a maverick or disruptive buyer.* In especially highly concentrated markets, the removal of a key player responsible for disruptive competition can lessen competition both upstream and downstream.

9. *Eliminating potential competition.* Often, a vertical acquisition is an alternative to new entry, e.g., when a supplier buys a distributor instead of entering into distribution itself. Under narrow circumstances, consumers may be harmed by the elimination of the potential competition that new entry would have provided (or by the removal of the perception of such new entry).

10. *Evasion of regulation.* A vertical merger may be used by a firm subject to rate regulation to circumvent the regulation. As the DOJ’s 1984 Guidelines explain, “[t]he clearest example is the acquisition by a regulated utility of a supplier of its fixed or variable inputs. After the merger, the utility would be selling to itself and might be able arbitrarily to inflate the prices of internal transactions. Regulators may have great difficulty in policing these practices, particularly if there is no independent market for the product (or service) purchased from the affiliate. As a result, inflated prices could be passed along to consumers as ‘legitimate’ costs.”¹⁹

B. Importance of Concentration

Absent unusual circumstances, both the upstream and downstream markets must be concentrated for anticompetitive effects to be plausible from a vertical merger, and the market shares of the merging firms in their respective markets should be substantial.²⁰ If, for example, a supplier with a very high market share in a highly concentrated output market purchases the producer of an input in an unconcentrated upstream market, the supplier’s rivals will not be harmed unless the acquired firm’s product is in some way unique. Conversely, if a large market share input producer in a highly concentrated input market buys one of many OEM customers, competition in the input market would be harmed only in unusual circumstances. Professor Hovenkamp’s treatise would require high concentration in the primary market as a condition for illegality, together with high entry barriers and a lack of available capacity in the secondary market.²¹

¹⁹ NON-HORIZONTAL GUIDELINES, *supra* note 4, § 4.23.

²⁰ *See, e.g., id.* § 4.31; Jonathan Sallet, Deputy Asst. Attn’y Gen., Remarks Before the Fall Forum, ABA Section of Antitrust Law, Nov. 17, 2016, *available at* bit.ly/2CXp2sY.

²¹ 4A PHILLIP AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 1032b (4th ed. 2016). Vertical mergers would not be subject to a structural presumption of illegality unless “both markets are highly concentrated.” *Id.* ¶ 1032a.

C. Magnitude of foreclosure

Foreclosure is not a problem in itself. It causes consumer harm only when rivals are hampered to such an extent that they can no longer constrain effectively the defendants' market power.²² Using exclusive dealing law as an analogy, one would expect to see at least 40 percent of the secondary market foreclosed before inferring competitive harm, with potentially lower shares if the acquiring primary market firm is a monopolist; and, even then, consumers would not be harmed absent barriers to entry into, and limited choices available in, the secondary market.²³ In vertical merger cases, unlike exclusive dealing, however, foreclosure cannot be assumed. So, for example, if a truck manufacturer acquires a transmission producer, it cannot be assumed that all of the producer's transmissions will be foreclosed to rival truck manufacturers. It may well be more profitable for the merged firm to continue or even expand existing non-party customer supply without raising prices. Or the transmission producer may have contractual obligations to continue supply at current price levels. A closer look at the claim of input or customer foreclosure is required before condemning a vertical merger on foreclosure grounds. Often, the only profitable strategy will be to continue rival supply without a price increase.

D. Efficiencies

It is a rare vertical merger that does not result in some cost-saving efficiency. As in the context of horizontal mergers, there often will be strategic alignment, production savings, overhead savings, plant specialization savings, and the like. These efficiencies are cognizable to the extent the

²² See, e.g., *McWane, Inc. v. FTC*, 783 F.3d 814, 840 (11th Cir. 2015); Jonathan M. Jacobson, *Exclusive Dealing, "Foreclosure," and Consumer Harm*, 70 ANTITRUST L.J. 311 (2002).

²³ E.g., *McWane*, 783 F.3d at 837.

defendant can prove both that they will be realized in fact and that they are “merger-specific,” i.e., that they could not be achieved without the merger.²⁴

The significantly greater potential for consumer benefits arising out of cost-saving efficiencies, together with the fact that a purely vertical merger eliminates no direct competition, separates the analysis of vertical mergers from their horizontal counterparts.²⁵ Vertical mergers typically, although not invariably, eliminate double marginalization, reduce transaction costs, align incentives, and facilitate product design enhancements. Consumers may benefit from any of these effects.

One of the key debates in the vertical merger context is how much weight to give these efficiencies generally and, in particular, how to evaluate the elimination of double marginalization. Professor Salop and some others express the view that EDM is “not inevitable and is not always merger-specific.”²⁶ In contrast, others believe that EDM savings are largely inevitable, and are skeptical that they can be achieved through means other than merger.²⁷

Professor Shapiro’s view is that efficiencies other than EDM should be treated “the same as we do in horizontal mergers,”²⁸ while EDM can be at least rebuttably presumed. That seems right. EDM inherently reduces costs. Getting an input at cost (because you are now its producer) saves money versus paying the input supplier’s profit margins. It is true that DM can be reduced (and

²⁴ HORIZONTAL MERGER GUIDELINES, *supra* note 13, § 10 (“cognizable efficiencies are merger-specific efficiencies that have been verified and do not arise from anticompetitive reductions in output or service.”).

²⁵ *E.g.*, Global Antitrust Institute, Comment on Vertical Mergers 2-3, 5, available at bit.ly/2UFUZgN; D. Bruce Hoffman, *Vertical Merger Enforcement at the FTC* 3 (Jan. 10, 2018), available at bit.ly/2SxQFCZ.

²⁶ Hearing at 28.

²⁷ *E.g.*, *id.* at 40-41 (O’Brien); *id.* at 71-72 (Lafontaine).

²⁸ *Id.* at 83.

conceivably eliminated) by contract. But as a matter of practical reality, contracts truly eliminating EDM are rarely profitable for both sides. Proponents of a harsh approach to EDM have provided no evidence that contractual elimination of EDM is anything but extremely rare.²⁹

It is fair to say that EDM, and especially its merger-specificity, is not truly inevitable. As one example, there may be cases where the buyer elects not to use the input acquired. The burden of going forward is appropriately on the merging parties to present evidence that an effect of the merger will be to eliminate DM. But it is not realistic or appropriate to require the merging parties to demonstrate that the savings could not be achieved by one of the myriad hypothetical contracts that could have been signed. Were eliminating EDM so easy, the buyer in most cases would have at least tried to do so prior to seeking a merger. Because EDM is fairly ubiquitous – cases where the buyer will not use the assets being acquired are hardly the norm – it is appropriate for the burden of persuasion on the issue to be on the plaintiff. The information should be available in response to a second request or discovery.

III. The Recent Cases

Over the past few years, there have been a number of non-horizontal merger enforcement proceedings.³⁰ Three are worth discussion in this context, *Comcast/Time Warner*, *AT&T/Time Warner*, and *Staples/Essendant*.³¹

²⁹ Often in a make-or-buy decision, “buy” is the more cost-effective outcome. But vertical mergers are improbable if the effect is to increase cost.

³⁰ See Steven C. Salop & Daniel P. Culley, *Vertical Merger Enforcement Actions: 1994-2016* (Georgetown Univ. Law Ctr., June 30, 2017).

³¹ My firm, Wilson Sonsini, was one of many representing AT&T, and represented Netflix (a complainant) in *Comcast/Time Warner*.

A. Comcast

Comcast's proposed 2015 acquisition of Time Warner's cable television business was, for the most part, not perceived as either horizontal or vertical, and was expected in many quarters to sail through unopposed. That did not happen. Instead, the deal was abandoned in the face of opposition from both DOJ and the FCC.³²

Comcast is and Time Warner Cable was an operator of cable TV systems. Their systems were in different geographic areas as a result of cable regulation, so they did not compete against each other in serving local customers. But that was not the end of the matter. The agencies proceeded on a bargaining theory approach. They concluded, first, that even though there was no competition between the companies for local subscribers, "the relationship between size and fees [charged to Internet content suppliers such as Netflix or Amazon] was found to be positive, statistically significant, and economically meaningful."³³ Put simply, if the merger were consummated, content access fees would rise. The agencies engaged in the same analysis, and reached the same conclusion, with respect to the fees paid by Comcast and Time Warner to programmers (such as Disney, Fox, NBC, CBS). Based on econometric analyses demonstrating that larger cable systems (and other video distributors) pay lower fees and have more bargaining leverage, the Division concluded that "the merged firm would have gained additional bargaining leverage over programmers by removing the programmers' ability to substitute the stand-alone

³² There is no publicly-available decision in this case. There is, however, an insider's analysis of the issues in Nicholas Hill, *et al.*, *Economics at the Antitrust Division 2014-2015*, 47 REV. INDUS. ORG. 425 (2015).

³³ *Id.* at 428.

[Comcast and Time Warner] for each other.”³⁴ Given these agency concerns, and the threat of lengthy FCC administrative proceedings, the parties abandoned the merger.

B. *AT&T*

The *AT&T* case involves the acquisition by AT&T of a different Time Warner entity – one providing video entertainment on a large scale, with assets such as HBO and the CNN, TBS, and TNT cable networks. The Justice Department’s challenge was again based on bargaining theory – the idea that the merged firm would raise carriage fees to cable operators by threatening to deny “must have” programming such as TBS or CNN. This would also have the effect of raising the costs of (AT&T-owned) DirectTV’s rivals, a foreclosure concern.

The district court rejected the challenge largely on the facts, noting in passing that the government had not cited any “trials” in which the bargaining leverage argument was used successfully to block a vertical merger.³⁵ Although the court agreed that Time Warner’s content gave it bargaining leverage, it concluded that the evidence that the merger would increase that leverage was lacking, and that Professor Shapiro’s testimony supporting the government’s theory was flawed in several respects.³⁶ The Justice Department has appealed, arguing that the Court’s assessment of the facts was clearly erroneous and was tainted by the court’s failure to apply “the established principle of corporate-wide profit maximization.”³⁷ A decision from the D.C. Circuit is expected soon.

³⁴ *Id.* at 428-29.

³⁵ 310 F. Supp. 3d at 199.

³⁶ *Id.* at 199-240.

³⁷ Brief for the United States at 49, *United States v. AT&T*, available at bit.ly/2DUoi9Z. The district court had concluded it was unlikely for the merged firm in carriage negotiations to take into account the possible positive effects on DirectTV from an impasse-generated blackout. 310 F. Supp. 3d at 211-15.

C. Staples/Essendant

The most recent case is *Sycamore Partners II*, the merger of Staples with Essendant.³⁸ A 3-2 FTC majority, dividing on party lines, allowed the merger subject to a firewall remedy.

The case involved local relevant markets for “the sale and distribution of office products to midmarket business-to-business customers.”³⁹ Staples was a major seller in that market. On the distribution side, there was an effective duopoly with just two major players, Essendant and SPR. The majority saw one competitive problem from the deal – that Staples could gain access to rivals’ commercially sensitive information (CSI) from Essendant (who distributed rivals’ products) and use that information to disadvantage rivals or collude with them. The concern that SPR would be the only non-integrated distributor and that this might enable SPR to raise prices was found not supported by the evidence. With CSI access as the only concern borne out by the facts, the majority was satisfied that a firewall remedy – barring Staples access to rival CSI – would cure the problem. The Consent Order, therefore, was limited to that relief.⁴⁰

The two Democratic commissioners, Rohit Chopra and Rebecca Slaughter, dissented. Commissioner Chopra agreed with the majority on access to CSI as indicating a violation, and did not disagree with the remedy, but expressed concerns about partial foreclosure of Staples’ rivals – that the option of switching to SPR would not eliminate the problem – and that the merger would give the merged firm “buyer power” to negotiate better terms with suppliers.⁴¹ He further expressed

³⁸ FTC File No. 181-0180 (Jan. 29, 2019), *available at* bit.ly/2WicAGJ.

³⁹ *Id.*, Complaint ¶¶ 7-9.

⁴⁰ *See id.*, Analysis of Agreement Containing Consent Order to Aid Public Comment (Jan. 25, 2019).

⁴¹ Commissioner Chopra took issue with the belief that paying lower prices from bargaining power is an efficiency. Respectfully, it is. Getting better prices by buying *more* benefits consumers. Only if price is lowered by restricting purchases – monopsony – are consumers harmed. *See* Jonathan Jacobson, *Monopsony 2013: Still Not Truly Symmetric*, ANTITRUST SOURCE, Dec. 2013.

the view that, because Sycamore is a private equity firm, a desire for short-run profits would exacerbate the competitive concerns. And he was skeptical of the parties' efficiencies claims.

Commissioner Slaughter's dissent emphasized the foreclosure concern and disagreed with the majority's conclusion that the staff's analysis showed no price effects from the claimed foreclosure. She concluded that SPR would have the incentive to raise prices – along the lines of the “Frankenstein monster” effect addressed above. SPR was Essendant's most important competitor and Commissioner Slaughter believed that some dealers would no longer want to deal with Essendant out of fear that the firewall might be penetrated. She was also skeptical of the efficiency claims, although the majority said that their decision did not rest on efficiency benefits. Much of her dissent, however, was focused on broader policy issues – expressing a desire for significantly increased merger enforcement. Notably, she also laid out a strong case for conducting retrospective analyses of close cases where the acquisition was allowed, with a view to launching post-consummation challenges when warranted.

Staples/Essendant is a difficult case because both the primary (office product sales) and secondary (distribution) markets are concentrated, with distribution as a duopoly. That kind of market structure can be conducive to consumer harm because the limited distribution alternatives – just SPR – render it easier for the merged firm to raise Staples' rivals' distribution costs. So the dissenters' concerns were not crazy. But the majority analyzed the issues carefully and applied mainstream antitrust principles to limit the remedy to a firewall. That outcome can be criticized, but in light of how close a call this was, Commissioner Slaughter's recommendation for a post-consummation retrospective of this transaction makes good sense.⁴²

⁴² The majority did not disagree, but expressed doubt whether the Commission has the resources to conduct retrospectives in *every* close call matter that was not challenged.

The question of the appropriate remedies in vertical mergers emerged as a subject of hot debate following Assistant Attorney General Makan Delrahim's 2017 Speech at the Section of Antitrust Law's Fall Forum,⁴³ in which he made clear the Division's policy is against behavioral remedies, criticizing in the process the prior administration's consents in *Comcast/NBCU*, *Google/ITA*, and *Live Nation/Ticketmaster*.⁴⁴

He added:

Like any regulatory scheme, behavioral remedies require centralized decisions instead of a free market process. They also set static rules devoid of the dynamic realities of the market. . . . Behavioral remedies often require companies to make daily decisions contrary to their profit-maximizing incentives, and they demand ongoing monitoring and enforcement to do that effectively. It is the wolf of regulation dressed in the sheep's clothing of a behavioral decree. And like most regulation, it can be overly intrusive and unduly burdensome for both businesses and government.⁴⁵

At the FTC hearing, however, no support was expressed for eliminating behavioral remedies altogether. There was instead a broad consensus that, although structural remedies are usually preferable, often a behavioral remedy can allow the parties and consumers to gain the benefits of a vertical merger while addressing a limited competition concern.⁴⁶ The *Staples/Essendant* firewall consent was entered on that basis.⁴⁷

Although debate on this subject is to be encouraged, we have today a situation where the outcome of a vertical merger investigation may well depend on which agency is cleared to review the deal – with behavioral remedies a reasonable prospect at the FTC but much less so at the

⁴³ Available at bit.ly/2DW1MNX.

⁴⁴ *Id.*

⁴⁵ *Id.*

⁴⁶ Hearing at 90-92, 103, 117.

⁴⁷ FTC File No. 181-0180, *supra* note 36, Analysis of Agreement Containing Consent Order, at 3-4.

Antitrust Division.⁴⁸ From a policy standpoint, that is precisely the type of conflict that the agencies should avoid – even where, as here, there are sound reasons for disagreeing on one approach rather than the other.

In light of the huge benefits vertical mergers can provide, the absence of empirical evidence that they are generally harmful, and the limited circumstances in which they threaten consumer harm, the agencies should not rule out behavioral remedies. The agencies should also continue to recognize that not all behavioral remedies are the same. Some are more intrusive and regulatory than others. Nondiscrimination provisions and continuing supply obligations are examples. Others are fairly self-executing, like a simple royalty-free licensing requirement. Firewalls stand somewhere in between. But every transaction is different and flexibility is crucial to accommodate the differences. We should continue the presumption favoring structural relief, but not rule out behavioral remedies where necessary and appropriate.

IV. Guidelines

Although there is widespread disagreement on whether a document labeled “Vertical Merger Guidelines” should be issued, there is actually consensus on some important issues. Still, we are a long way from being able to draft any consensus guidance document.

First, there is universal agreement that the 1984 *Guidelines* “are outdated and do not reflect current agency practice.”⁴⁹ Assistant Attorney General Delrahim has made clear that the Antitrust Division does not follow them,⁵⁰ and the view that they could simply be ignored was put in doubt by

⁴⁸ Eleanor Tyler, *Will Antitrust Regulators Demand Divestitures? Depends on the Agency*, Bloomberg Law, Feb. 4, 2019, available at bit.ly/2I8Urij.

⁴⁹ *E.g.*, Hearing at 7 (Commissioner Phillips), 56 (Shapiro).

⁵⁰ *See* Tyler, *supra* note 48.

Judge Leon's repeated citation of them in the *AT&T* ruling.⁵¹ So pretty much everyone wants them withdrawn. The only issue raised at the Hearing was that the 1984 *Guidelines* were a Justice Department solo project, so there is nothing the FTC can do to get rid of them.

Second, everyone agrees that the sort of numeric specifics in the 1968, 1982, 1984, and 1992 horizontal merger guidelines documents is almost impossible and unrealistic.⁵² Beyond the possibility of safe harbors – say for unconcentrated markets or small market shares – there is no consensus on what level of market share or concentration level will give rise to competitive concerns. Quite the opposite; some believe that vertical mergers can offer net benefits even at the highest levels of share and concentration.⁵³ Developing non-numeric presumptions of harm from a vertical merger is correspondingly difficult.⁵⁴

Third, there is universal or near-universal agreement that the burden-shifting framework of *Baker Hughes* should apply.⁵⁵ There is large agreement, moreover, on the competitive harms that might be identified in step 1, and that the plaintiff bears the ultimate burden of persuasion in step 3. There are steep differences, however, in step 2. *Philadelphia National Bank*⁵⁶ has long been understood as saying that the defendant's burden under step 2 – i.e., after an anticompetitive effect has been established – is one of proof. *Baker Hughes*, however, states that the burden is one of

⁵¹ *AT&T*, 340 F. Supp. 3d at 191 n.17, 192 & n.18 & *passim*.

⁵² *E.g.*, Hearing at 127 (Sallet), 128 (Yde).

⁵³ *E.g.*, Global Antitrust Institute, Comment on Vertical Mergers, *supra* note 25.

⁵⁴ *But see* Salop, *supra* note 6, at 1989 (suggesting presumptions).

⁵⁵ *E.g.*, Hearing at 30-31 (Salop), 127 (Sallet).

⁵⁶ *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321 (1963).

production, not proof,⁵⁷ which is consistent with the Supreme Court’s recent decision in *Ohio v. American Express*⁵⁸ in the context of the rule of reason under section 1 of the Sherman Act.

Fourth, there is general agreement, even by those who oppose new “guidelines,” that some form of agency “guidance” would be welcome.⁵⁹ In light of the wide variance in perspectives, the desirability of meaningful guidance is obvious. Of course, getting agency consensus when they seem so far apart, particularly on remedies, may be difficult. Nevertheless, business and the bar would welcome greater coherence and a meaningful statement of enforcement policy. One possible model would be the agencies’ joint 2006 *Commentary on the Horizontal Merger Guidelines*,⁶⁰ which did not repeal the then-current 1992 *Guidelines* but provided helpful direction on what the agencies were doing in actual practice.

Notwithstanding the desire for some additional clarity in how vertical mergers will be reviewed, reaching a consensus document that both agencies will sign will be a challenge. The principal areas of disagreement include:

- Should vertical mergers be presumed to be beneficial?
- What structural conditions are necessary for consumers to be harmed?
- What degree of competitive harm should be required to satisfy step 1?
- Should merger-specificity of EDM be presumed?
- What degree of burden should be on the defense in step 2?
- What if any safe harbors or anticompetitive presumptions would be appropriate?
- When will a behavioral remedy be appropriate?

⁵⁷ 908 F.2d at 983.

⁵⁸ 138 S. Ct. 2274, 2284 (2018).

⁵⁹ Hearing at 55 (Slade), 127 (Sallet), 128 (Yde), 129 (Wilkinson); *but see* Pallari Guniganti, *Wilson Sees Little Need for Vertical Merger Guidelines*, Global Competition Review, Feb. 1, 2009, available at bit.ly/2RMsexg.

⁶⁰ Available at bit.ly/2Wz3I6e.

Given the differences on these critical issues, we should not expect consensus on the form or content of any vertical merger guidance any time soon. But we can hope.