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# DOJ and FTC Issue Final Vertical Merger Guidelines

Today, the Department of Justice (DOJ) and Federal Trade Commission (FTC) issued final Vertical Merger Guidelines. The release of the final guidelines follows a period of public comment on draft guidelines issued in January, and the guidelines issued today comport with the economic theories of potential competitive effects of vertical mergers underlying the earlier draft guidelines.

These guidelines describe potential anticompetitive harms that the agencies believe may arise with vertical mergers, while continuing to recognize that such transactions can be procompetitive or at least competitively neutral. New to the final version of the guidelines are expanded examples of how the guidelines might be applied to certain situations; and absent from the final version is the concept of a potential "safe harbor" based on parties' market shares.

In issuing the guidelines, the agencies seek to provide transparency about their approach to vertical merger analysis and the document provides important insight for business people and their advisors into how the agencies are likely to analyze mergers involving firms in "non-horizontal" combinations, which according to the guidelines, can include vertical mergers of firms at different levels of a supply chain, "diagonal" mergers of firms at different levels of competing supply chains, and vertical aspects of "mergers of complements."

The guidelines supersede the vertical merger guidance issued by the DOJ in 1984. FTC Commissioners Chopra and Slaughter dissented from the Commission's vote to issue the guidelines.

## Theories of Potential Harm from Vertical Mergers

The guidelines describe ways in which a vertical merger might, in the agencies' view, have both harmful unilateral effects and harmful coordinated effects.

### *Unilateral Effects*

**Foreclosure and Raising Rivals' Costs**. With respect to unilateral effects, the guidelines state that a vertical merger may harm competition if it leads the newly integrated firm to raise its rivals' costs by, for example, charging them more for a required input for a product manufactured by the firms or, more severely, entirely forecloses a competitor's access to a necessary input by refusing to supply it. In these scenarios, the rival may be hindered in its ability to compete with the vertically integrated firm and therefore may be less of a competitive constraint, which may cause prices for the end product to rise. The vertically-integrated firm may even gain sales that are diverted from its weakened rival, and this may offset any profits lost from decreased (or eliminated) sales of the input to its rival.

The final guidelines expand on the discussion in the draft guidelines of the foreclosure and raising rivals' costs theories of potential competitive harm. Specifically, the final guidelines explicitly describe circumstances in which a "merger would rarely warrant close scrutiny for its potential to lead to foreclosure or raising rivals' costs." These are when "rivals could readily switch purchases to alternatives to the" necessary input "including self-supply, without any meaningful effect on the price, quality, or availability of products or services in the relevant market;" or "if the merged firm would not benefit from a reduction in actual or potential competition with users of the related product in the relevant market." (A "related product," is "a product or service that is supplied or controlled by the merged firm and is positioned vertically or is complementary to the products and services in the relevant market" and could include "an input, a means of distribution, access to a set of customers, or a complement.")

**Access to Competitively Sensitive Information**. In addition to the raising rivals' costs and foreclosure theories, the new guidelines also recognize two ways in which potentially harmful unilateral effects may arise when a newly integrated firm becomes a supplier to a rival and gains access to that rival's competitively sensitive information. First, "the merged firm [could] use access to a rival's competitively sensitive information to moderate its competitive response to its rival's competitive actions. For example it may preempt or react quickly to a rival's procompetitive business actions. Under such conditions, rivals may see less competitive value in taking procompetitive actions." Second, "rivals may refrain from doing business with the merged firm rather than risk that the merged firm would use their competitively sensitive business information as described above," and therefore "[t]hey may become less effective competitors if they are forced to rely on less preferred trading partners, or if they pay higher prices because they have fewer competing options."

The final guidelines' discussion of the potential competitive effects of access to competitively sensitive information largely tracks the discussion in the draft.

*Coordinated Effects*

The guidelines state that a vertical merger may harm competition by "enabling or encouraging postmerger coordinated interaction among firms" that harms consumers when, for example, a newly vertically-integrated firm gets access to rivals' competitively sensitive information and this "facilitate[s] (a) reaching a tacit agreement among market participants, (b) detecting cheating on such an agreement, or (c) punishing cheating firms."

Apart from the potential harms arising from access to a rival's competitively sensitive information, the new guidelines also outline a coordinated-effects theory of harm based on the potential for a vertically-integrated firm to thwart a "maverick firm that otherwise plays or would play an important role in preventing or limiting anticompetitive coordination in the relevant market."

The final guidelines' discussion of coordinated effects largely tracks the discussion in the draft.

**Potential Procompetitive Effects**

Importantly, the guidelines recognize that a vertical merger might lead to lower prices by eliminating double marginalization. As the agencies describe it: "Due to the elimination of double marginalization, mergers of vertically related firms will often result in the merged firm's incurring lower costs for the upstream input than the downstream firm would have paid absent the merger. This is because the merged firm will have access to the upstream input at cost, whereas often the downstream firm would have paid a price that included a markup." The benefit of this lower cost may then result in lower downstream prices. Additions to the final guidelines discuss with specificity how the agencies will evaluate and potentially credit the elimination of double marginalization.

In addition, the guidelines recognize that vertical mergers may introduce efficiencies because they may "streamline production, inventory management, or distribution" and may also lead to the creation of "innovative products in ways that would not likely be achieved through arm's-length contracts."

**No Potential Safe Harbor**

The draft guidelines stated that if "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," then the merger is not likely to face a challenge by the agencies based on a vertical theory of harm. This was not carried forward to the final guidelines. According to the FTC's majority statement, this is the "most significant change" from the draft and was a "major concern" of several state Attorneys General, "a broad set of commenters" and a dissenting Commissioner.

**Significance**

The issuance of final vertical merger guidelines is an important development. They provide executives, dealmakers and their advisors with insight into how the federal agencies are likely to evaluate a deal with vertical elements, whether a deal is likely to be challenged and how a court might analyze an agency challenge seeking to block a deal. Thus, they are a key tool to help assess the antitrust risk of a proposed transaction.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:


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