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FTC Rescinds Vertical Guidelines, Introducing Opacity Into Merger Review

- The FTC has rescinded its 2020 Vertical Merger Guidelines, which were issued jointly with the DOJ to provide transparency about the agencies' approach to vertical merger analysis. No new guidelines have been issued.
- The current FTC may be more willing to challenge vertical integrations using expanded theories of harm, though any change in the law must come from Congress and the courts.
- Companies contemplating M&A transactions should continue to be mindful of the potential consequences of the evolving antitrust enforcement landscape when evaluating and structuring deals and drafting deal documents.

At its public meeting today, the Federal Trade Commission (FTC) rescinded its Vertical Merger Guidelines. These guidelines were issued jointly by the Department of Justice (DOJ) and FTC in June 2020, and served to "outline the principal analytical techniques, practices, and enforcement policies of the" DOJ and FTC "with respect to a range of transactions often described as vertical mergers and acquisitions." The FTC also rescinded its related Commentary on Vertical Merger Enforcement issued in December 2020. The FTC did not issue replacement guidelines. Instead, the majority statement said that sometime in the future the FTC "will issue updated guidelines or rules to ensure our merger analysis aligns with market realities."

This development follows President Biden's July 9 Executive Order on Promoting Competition in the American Economy, which called on the FTC and DOJ to "review" and "consider whether to revise" the agencies' extant horizontal and vertical merger guidelines. At that time, the agencies said that they would "jointly launch a review of our merger guidelines with the goal of updating them to reflect a rigorous analytical approach consistent with applicable law." Shortly after the FTC's vote today, the DOJ issued a statement saying that the Vertical Merger Guidelines "remain in place at" the DOJ, but that it has "identified several aspects of the guidelines that deserve close scrutiny" and that it "will work closely with the FTC to update" the Vertical and Horizontal Merger Guidelines "as appropriate."

The FTC's vote to rescind was 3-to-2 along party lines. The vote to adopt the guidelines last summer was also 3-to-2 along party lines, with current commissioners Rohit Chopra and Rebecca Kelly Slaughter voting no at the time. Today, they joined Chair Lina Khan in voting to rescind the guidelines. Today's vote follows a series of recent party-line Commission votes to rescind existing policy statements.

Background on the Vertical Merger Guidelines

As we wrote when they were issued last summer, the Vertical Merger Guidelines describe ways in which a vertical merger might, in the agencies' view, have both harmful unilateral effects and harmful coordinated effects, while also setting forth certain pro-competitive benefits vertical mergers might have.

With respect to unilateral effects, the guidelines focus on potential harms arising from an integrated firm's potential ability 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 foreclose a competitor's access to a necessary input by refusing to supply it. The guidelines also describe potential harms that could arise when a newly integrated firm becomes a supplier to a rival and gains access to that rival's competitively sensitive information. With respect to coordinated effects, the guidelines, among other things, recognize that access to rivals' information by a vertically integrated firm may be used to facilitate tacit agreements among competitors.

The guidelines also recognize that vertical mergers are often pro-competitive and can lead to lower prices by eliminating double marginalization (EDM): "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. 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."

While the guidelines may not have been be a comprehensive catalog of all of the ways the FTC might analyze a vertical merger, they provided transparency to courts and the antitrust bar.

Criticism of the Vertical Merger Guidelines

When Commissioner Slaughter voted against issuing the guidelines last year, she wrote that they "appear to put a thumb on the scale in favor of vertical mergers" by over-emphasizing their benefits, and she expressed her view that "vertical mergers can and frequently do raise serious anticompetitive concerns."

In particular, she wrote that the guidelines were "overly optimistic that EDM will be achieved and translate into benefits" and did not go far enough in describing situations in which EDM might *not* be achieved. "For example," she wrote, "the downstream firm may not be able to use inputs from the upstream firm when it is locked into a long-term contract with another supplier, when it faces switching costs, or when there is geographic incompatibility that makes it irrational to source from the vertically integrated upstream firm." She went on to write that "the upstream firm also may have limited capacity that can be switched over to the newly acquired downstream firm. Or the downstream firm might already be vertically integrated and therefore not obtain any new benefit of EDM." She also questioned the degree to which vertically integrated firms "self-supply" and thus could benefit from EDM.

She went on to write that the guidelines did not go far enough in discussing situations where the benefit of EDM may not outweigh the potential harms from a vertical merger. For example, she wrote that because a vertical merger may raise rivals' costs, there may be a "reduction in profits for the rivals" which "may adversely affect their ability to finance innovation or expansion activities" and that this could lead to harm to competition and consumers. In line with this, today's majority statement said that the guidelines' "reliance on EDM is theoretically and factually misplaced" and that "[u]ntil new guidance is issued, the FTC will analyze mergers in accordance with its statutory mandate, which does not presume efficiencies for any category of mergers."

In addition, Commissioner Slaughter wrote in her earlier statement that vertical guidelines should include discussion of potential buy-side consequences of vertical mergers, which, she wrote "may harm suppliers, particularly workers, by increasing the likelihood of coordination." She also called for a consideration of whether "regulatory evasion" should be included as a potential theory of harm. (This is the theory that "a firm can evade rate regulations by acquiring an upstream input and raising the cost of that input, which can lead . . . a regulator to authorize a higher downstream regulated rate based on that higher input cost.") Finally, Commissioner Slaughter wrote that the guidelines should include a discussion of merger remedies.

Commissioner Chopra – who will leave the FTC if he is confirmed to be Director of the Consumer Financial Protection Board – also voted against the issuance of the Vertical Merger Guidelines last summer. In his dissenting statement, he pointed to concerns about "entry suppression." According to his statement, this includes, among other things, the idea that elimination of potential customers could deter investment in potential new entrants and the idea that a vertically integrated firm might act as a gatekeeper and "condition access to the market on any number of one-sided, onerous contract terms." Commissioner Slaughter wrote that she shared these entry-suppression concerns.

While Chair Khan was not a member of the FTC when it voted to adopt the merger guidelines, her earlier writing, in which she raised the prospect of "strictly policing forms of vertical integration that firms can use for anticompetitive ends," provides some insights into how she might analyze a vertical merger. For example, she has argued that the "current approach to antitrust does not sufficiently account for how vertical integration may give rise to anticompetitive conflicts of interest, nor does it adequately address the way a dominant firm may use its dominance in one sector to advance another line of business." One particular concern she has raised is the ability of a vertically integrated firm to "cross-leverage data" – i.e., "use insights generated through data acquired in one sector to undermine rivals in another" – and suggested that this theory be part of merger investigations. She has also suggested that "dominant platforms" should be "ban[ned] from vertical integration."

For its part, in its statement today, the DOJ listed several areas of the Vertical Merger Guidelines that "warrant consideration," including whether the guidelines: "create confusion as to the merging parties' burden to establish that" EDM "is verifiable, merger specific and will likely be passed through to consumers;" "unduly emphasize the quantification of price effects, which is not the only means to determine that a vertical merger is unlawful;" "appropriately account for the traditional burden shifting framework applied by U.S. courts in their review of mergers;" "should more fully explain . . . the range of circumstances that can lead to a concern that a merger may have anticompetitive effects;" and "would benefit from further elaboration of the circumstances in which mergers raise concerns of harm related to the evasion of regulation."

Significance of the FTC's Action

The Vertical Merger Guidelines were issued "to assist the business community and antitrust practitioners by increasing the transparency of the analytical process underlying the Agencies' enforcement." The rescinding of the guidelines introduces a degree of opacity and uncertainty to reviews of vertical mergers, at least by the FTC.

Indeed, the FTC has not yet issued any superseding guidelines and, at today's meeting, Commissioner Slaughter noted some "anxiety" in rescinding the guidelines without replacing them. She did say that she was not advocating a return to the "dead letter" of the prior vertical merger guidance issued by the DOJ in 1984. She also said, in line with the Commission's statement, that the potential vertical harms outlined in the rescinded Vertical Merger Guidelines were still valid, but that, in her view, there are additional potential harms that should be taken into account. While she did not enumerate these additional potential harms at the meeting, her earlier statement on the Vertical Merger Guidelines, discussed above, outlines at least some of these theories – e.g., "regulatory evasion" and buy-side coordination. Chair Khan's earlier writings may also be instructive about how she will view a proposed vertical merger. Alvaro Bedoya – the Georgetown law professor who has been nominated to replace Commissioner Chopra – has focused his work on privacy issues, and less is known about his views on vertical mergers at this time.

In addition to looking for guidance in the Commissioners' prior statements, today's majority statement may also be instructive. In particular, it appears to take a dim view of efficiencies and characterizes the now-rescinded vertical guidelines' discussion of EDM as "a non-statutory efficiency defense." According to the statement, "the FTC's [current] view [is] that it is inappropriate for the Commission's analysis of whether a transaction may lead to a substantial lessening of competition to assume that EDM is likely to exist." The statement also says that the Clayton Act (relating to acquisitions) does not "contain exceptions for mergers that lessen competition but also create some form of efficiency" and "does not provide for a balancing test where an 'efficient' merger is allowed even if it may lessen competition." Rather, the statement says, "efficiencies are only relevant insofar as they shed light on the level of post-merger competition, which must be considered across many dimensions—price, quality, innovation, variety, service, and more."

It remains to be seen whether the FTC – alone or in cooperation with the DOJ – will issue updated vertical merger guidelines. And the DOJ made clear that the 2020 Vertical Merger Guidelines are still "in place" at that agency. As Commissioner Philips noted in his dissenting statement at today's meeting, businesses are now faced with the prospect of two federal antitrust enforcement agencies who will conduct investigations using different analytical frameworks for vertical mergers. Companies with deals being investigated by the FTC may find an agency more willing to challenge a deal based on an expanded set of theories of harm. This could have implications in the investigatory phase, as Staff pursue more leads, and of course could lengthen deal timelines should the FTC decide to sue to block a deal.

It bears emphasizing, however, that courts are the ultimate arbiters of the legality of mergers and agency merger guidelines are not themselves law. As such, it is unclear what practical effect, if any, the FTC's rescindment will have on courts called on to adjudicate merger challenges. No court has ruled on the substance of a vertical merger since the vertical guidelines were issued last summer and vertical merger challenges have historically been rare. (The most recent example is the DOJ's challenge to the AT&T-Time Warner deal in the prior Administration, in which courts found for the merging parties.)

Nevertheless, as we have written before, in this environment, companies contemplating M&A transactions should be mindful of the potential consequences of the evolving antitrust enforcement landscape when evaluating and structuring deals and when drafting deal documents. The FTC's rescinding of the Vertical Merger Guidelines is another example of this evolving terrain.

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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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