

The Federal Trade Commission and the Department of Justice Should Abandon the Proposed Vertical Merger Guidelines and Embrace the Framework of the 1968 Guidelines

Introduction

The Open Markets Institute, the American Economic Liberties Project, and Professors Frank Pasquale and Maurice Stucke* welcome the opportunity to offer our perspective on the Federal Trade Commission (FTC) and the Department of Justice’s (DOJ) proposed vertical merger guidelines. We submit this comment to underscore the need for new agency guidelines on vertical mergers, to describe the profound problems in the proposed guidelines, and to explain that the DOJ’s 1968 Merger Guidelines (“1968 Merger Guidelines”) are a template on which the agencies should build.

As examined in Part I, Congress, in enacting the Clayton Act, aimed to stop significant horizontal, vertical, and conglomerate mergers and maintain decentralized market structures. Congress viewed these mergers as threatening the economic and political interests of Americans. Critically, Congress intended the Clayton Act to stop mergers that *threaten* competitive market structures, not only mergers that are certain to reduce competition. Furthermore, otherwise illegal mergers cannot be permitted because they promise to create productive efficiencies. Congress sought to prevent increased concentration even if that theoretically prevents corporations from achieving efficiencies through mergers and acquisitions.

Part II presents some of the important competitive harms from vertical mergers. These mergers, which combine firms in an actual or potential buyer-seller relationship, can harm open and competitive markets in multiple ways. Three harms are highlighted here. First, they can empower newly integrated firms to cut off (or “foreclose”) upstream or downstream rivals that rely on the products or services provided by one of the merged businesses. Vertically integrated firms can raise the price of vital inputs, or deny them outright, to non-integrated downstream rivals. They can also limit or block market access to non-integrated upstream competitors. Second, vertical mergers can facilitate collusion: An upstream or downstream affiliate can serve

* See page 26 for a description of the commenters.

as a conduit for sharing competitively sensitive information among rivals and can help to coordinate prices. Third, vertical mergers can eliminate important potential competitors. For instance, a dominant upstream firm can buy out a downstream firm that is the most likely to expand backward and introduce competition in the upstream market.

As Part III shows, the need for vertical merger guidelines is clear. The current Non-Horizontal Merger Guidelines are generally ignored by enforcers. Due to the absence of a clear analytical framework, vertical mergers are governed by the nebulous rule of reason, which impairs enforcement, frustrates business planning, and precludes public accountability. Organizations across the political spectrum have called for new guidelines on how the agencies analyze non-horizontal mergers, including vertical mergers.

Part IV describes the fundamental deficiencies in the proposed vertical merger guidelines and explains why they should not be adopted. Most important, they flout the relevant law in two ways. First, they ignore the incipency standard in the Clayton Act and reflect agency revision—not faithful application—of the statute and controlling precedent. Second, they recognize an efficiencies defense to otherwise illegal mergers. The Supreme Court expressly rejected this defense. The DOJ, FTC, and lower courts are not at liberty to ignore statute and precedent in agency guidance documents, including those that do not carry the force of law.

Part V presents a superior model—the 1968 Merger Guidelines—and explains that they set forth a strong template for enforcers to follow as they develop new vertical merger guidelines. Three principles stand out:

1. The market shares of firms involved in a vertical merger are critical to analyzing the competitive significance of the merger.
2. A merger that threatens to reduce competition should *not* be allowed on efficiency grounds.
3. Reserving the right to examine mergers in their full context. For example, the agencies should consider, as appropriate, factors such as the recent consolidation history of an industry or the strategic importance of the firm involved in an acquisition.

Enforcers should recommit to and strengthen these three principles. These steps would help ensure that the analytical framework of any new vertical merger guidelines is consistent with and advances the legislative intent of the Clayton Act.

I. New Vertical Merger Guidelines Must Be Faithful to the Statutory Text and Congressional Intent of the Clayton Act

Merger guidelines issued by the antitrust agencies serve as agency interpretations of the Clayton Act. While agency guidelines do not carry the force of law, guidelines should still be faithful to the underlying statute, as they serve as a form of notice to the public as to how the agencies will challenge mergers. A clear understanding of the statutory text and congressional intent of the Clayton Act is therefore a key prerequisite to issuing new guidelines.

Congress enacted the Clayton Act to preserve decentralized market structures and stop mergers that threaten these structures. The Clayton Act, as amended by the 1950 Celler-Kefauver Antimerger Act (“1950 Amendments”), reflects this congressional commitment and is designed to compensate for the perceived shortcomings of the Sherman Act.¹ Both the statutory text and the legislative history of the Clayton Act reveal a congressional intent to stop mergers that pose a reasonable threat to competitive market structures, not only mergers that are *certain* to do so. Furthermore, Congress rejected the idea that mergers that threaten competition should still be permitted if they might generate economies of scale or other productive efficiencies. The intent was not to weigh the potential harms and benefits of any given merger, but to block harmful mergers outright.

In enacting the Clayton Act, Congress sought to promote the dispersion of private power and advance a range of economic and political interests. Corporate concentration was the principal evil that the drafters of the Clayton Act and the 1950 Amendments sought to prevent and combat.² Members of Congress treated corporate concentration as a threat to consumers,

¹ Eleanor M. Fox, *Economic Concentration, Efficiencies and Competition: Social Goals and Political Choices*, 46 ANTITRUST L.J. 882, 889–92 (1977).

² A Senate report stated that “[t]he purpose of the proposed bill . . . is to limit future increases in the level of economic concentration resulting from corporate mergers and acquisitions.” S. REP. NO. 1775, 81st Cong., 2d Sess. 3 (1950). A House report announced a similar purpose: “The bill is intended to permit intervention in such a cumulative process [of acquisitions] when the effect of an acquisition may be a significant reduction in the vigor of competition, even though this effect may not be so far-reaching as to amount to a combination in restraint of trade, create a monopoly or constitute an attempt to monopolize.” H.R. REP. NO. 1191, 81st Cong., 1st Sess. 8 (1949).

businesses, and citizens. They recognized that corporate concentration harms consumers by raising the price of goods and services and impairs the ability of small and medium-sized businesses to compete.³ Concentration also aggrandizes the political power of corporations—and their corporate executives and financiers—in ways that subvert democratic institutions.⁴ The framers of the 1950 Amendments generally recognized this threat to democracy, and the two named sponsors of the amendments drew a direct connection between the growth of cartels and monopolies and the rise of fascism in Germany in the 1930s.⁵

The Clayton Act is an incipency statute that stops corporate mergers (horizontal, vertical, and conglomerate) that threaten competitive market structures. Congress drafted and enacted a bill that imposes a lower legal burden on the government and other enforcers than the Sherman Act does.⁶ The language of Section 7 speaks to this orientation. It prohibits mergers whose effects “*may* be substantially to lessen competition, or to *tend* to create a monopoly.”⁷ This language is probabilistic and aims to catch and stop mergers that may harm competition.

Given the incipency standard of the Clayton Act, the Supreme Court and lower courts have held that antitrust enforcers need to establish only that a merger reasonably threatens competition. The Supreme Court has stated that the Clayton Act “can deal only with probabilities, not with certainties”⁸ and that a more onerous legal burden would contradict “the

³ Robert H. Lande, *Wealth Transfers as the Original and Primary Concern of Antitrust: The Efficiency Interpretation Challenged*, 34 HASTINGS L.J. 65, 135–36 (1982); Wesley A. Cann, Jr., *Section 7 of the Clayton Act and the Pursuit of Economic “Objectivity”: Is There Any Role for Social and Political Values in Merger Policy?*, 60 NOTRE DAME L. REV. 273, 278 (1985).

⁴ Lande, *supra* note 3, at 137–39.

⁵ The remarks of the two sponsors in congressional debate of the 1950 Amendments are illustrative. Representative Celler quoted a government report from the United Kingdom and stated corporate monopolies installed Hitler in power in Germany. 95 CONG. REC. 11,486 (1949). Senator Kefauver observed that “the history of what has taken place in other nations where mergers and concentrations have placed economic control in the hands of very few people is too clear to pass over easily. A point is eventually reached, and we are rapidly reaching that point in this country, where the public steps in to take over when concentration and monopoly gain too much power. . . . It either results in a Fascist state or the nationalization of industries and thereafter a Socialist or Communist state.” 96 CONG. REC. 16,452 (1950).

⁶ Derek C. Bok, *Section 7 of the Clayton Act and the Merging of Law and Economics*, 74 HARV. L. REV. 226, 255 (1960). For instance, a Senate report indicated that “[t]he intent here, as in other parts of the Clayton Act, is to cope with monopolistic tendencies in their incipency and well before they have attained such effects as would justify a Sherman Act proceeding.” S. REP. NO. 1775, 81st Cong., 2d Sess. 4–5 (1950).

⁷ 15 U.S.C. § 18 (emphasis added).

⁸ *FTC v. Procter & Gamble Co.*, 386 U.S. 568, 577 (1967).

congressional policy of thwarting [anticompetitive mergers] in their incipiency.”⁹ In implementing this probabilistic standard, the government and other challengers do *not* have to meet any “definite quantitative or qualitative tests.”¹⁰ The courts have consistently held that plaintiffs in merger cases must only establish a “reasonable probability” of harm to competition.¹¹

In seeking to control corporate concentration, Congress not only lowered the burden on plaintiffs, but it also rejected an efficiencies defense. Congress saw rising concentration as a threat to the economic and political interests of Americans. A leading antitrust scholar has written that “[w]e can be certain that Congress wanted to err on the side of losing productive efficiency rather than risk the formation of market power.”¹² Indeed, given the commitment to limiting the political power of corporations, productive efficiencies under the Clayton Act should be neutral at best, and may even generate undesirable outcomes. For example, through mergers and acquisitions, firms can grow and achieve “productive efficiencies” in lobbying and influencing government—a result antithetical to the purposes of the Clayton Act.¹³

At the same time, the Clayton Act does not impose a categorical prohibition on businesses seeking to achieve productive efficiencies. It restricts one channel by which firms can achieve efficiencies: mergers and acquisitions. But under the Clayton Act, even large firms can still realize efficiencies through internal expansion.¹⁴

In reading the intent of Congress, the Supreme Court has rejected an efficiencies defense in merger cases. In *Brown Shoe*, the Court wrote that “Congress appreciated that occasional higher costs and prices might result from the maintenance of fragmented industries and markets . . . [and] resolved these competing considerations in favor of decentralization.”¹⁵ The Court made a similar point in *Procter & Gamble*, stating that “[p]ossible economies cannot be used

⁹ *Id.*

¹⁰ *Brown Shoe Co. v. United States*, 370 U.S. 294, 321 (1962).

¹¹ *E.g.*, *United States v. Von’s Grocery Co.*, 384 U.S. 270, 285 (1966) (Stewart, J., dissenting); *FTC v. H.J. Heinz Co.*, 246 F.3d 708, 713 (D.C. Cir. 2011); *United States v. Dairy Farmers of Am., Inc.*, 426 F.3d 850, 858 (6th Cir. 2005).

¹² Lande, *supra* note 3, at 134.

¹³ Michael Pertschuk & Kenneth M. Davidson, *What’s Wrong with Conglomerate Mergers?*, 48 FORDHAM L. REV. 1, 6, 10 (1979).

¹⁴ RUDOLPH J. R. PERITZ, *COMPETITION POLICY IN AMERICA: HISTORY, RHETORIC, LAW* 198 (1996).

¹⁵ 370 U.S. at 344.

as a defense to illegality.”¹⁶ And in *United States v. Philadelphia National Bank*, the Court rejected judicial balancing of costs and benefits, once the government shows a merger violates the Clayton Act.¹⁷

II. Vertical Mergers Can Threaten Competitive Market Structures in Multiple Ways

Vertical mergers between upstream suppliers of goods, services, and intellectual property and downstream buyers can threaten competitive market structures in multiple ways. These harms are especially probable when one of the affected markets is highly concentrated. Like horizontal mergers, or mergers between competitors in the same market, vertical mergers can make firms with market power even stronger. Three major harms of vertical mergers are foreclosure, collusion, and loss of potential competition. In digital markets characterized by network effects, vertical mergers can help cement dominant positions and prevent the emergence of competition.¹⁸ Meanwhile, in markets characterized by decentralization and many participants, vertical integration, whether by merger or by internal expansion, poses few competitive risks and can enhance product quality and consumer choice.

For these and other reasons, law and policy in the United States have long favored vertical separation between distribution and production in markets in which one segment is under monopolistic or oligopolistic control.¹⁹ For instance, to address the threat to free expression from consolidated, vertical control over both the distribution and production of television content, the Federal Communication Commission’s (FCC) former Financial Interest and Syndication (Fin-

¹⁶ 386 U.S. at 580.

¹⁷ See 374 U.S. 321, 371 (1963) (“We are clear . . . that a merger the effect of which ‘may be substantially to lessen competition’ is not saved because, on some ultimate reckoning of social or economic debits and credits, it may be deemed beneficial.”). In recent decades, some lower courts have recognized an efficiencies defense but have conceded that such a defense is hard to reconcile with Supreme Court precedent. See, e.g., *United States v. Anthem, Inc.*, 855 F.3d 345, 353 (D.C. Cir. 2017) (“Despite, however, widespread acceptance of the potential benefit of efficiencies as an economic matter, . . . , it is not at all clear that they offer a viable legal defense to illegality under Section 7.”); *FTC v. Penn State Hershey Med. Ctr.*, 838 F.3d 327, 347 (3d Cir. 2016) (“We note at the outset that we have never formally adopted the efficiencies defense. Neither has the Supreme Court. Contrary to endorsing such a defense, the Supreme Court has instead, on three occasions, cast doubt on its availability.”).

¹⁸ See MAURICE E. STUCKE & ALLEN P. GRUNES, *BIG DATA AND COMPETITION POLICY* 82–83 (2016) (examining why Facebook paid nearly \$22 billion for WhatsApp and suggesting the acquisition may have been “a defensive mechanism aimed to deprive [Facebook’s] remaining competitors of the scale necessary to compete effectively”).

¹⁹ See, e.g., Paul L. Joskow & Roger G. Noll, *The Bell Doctrine, Applications in Telecommunications, Electricity, and Other Network Industries*, 51 STAN. L. REV. 1249 (1999); *United States v. Paramount Pictures, Inc.*, 334 U.S. 131 (1948) (holding that movie studios’ practice of block booking and vertical integration into theater ownership were anticompetitive and monopolistic practices.).

Syn) Rules established partial vertical separation between television networks and content ownership. The Fin-Syn Rules sought to limit “the excessive power of the three major broadcasting networks in the financing, development and syndication of television programming” and to “promote diversity of programming sources and distributors.”²⁰ To do so, the rules prohibited major television networks from owning prime-time programming and airing syndicated programming in which they had a financial stake.²¹

Foreclosure

A principal threat to competition from vertical mergers is that of foreclosure.²² A vertically integrated firm with market power in at least one market can deprive downstream rivals of important production inputs. It can also deprive upstream competitors of important buyers or distributors. Of the 48 DOJ and FTC challenges to vertical mergers from 1994 to 2015, 36 involved concerns that the merger likely would lead to foreclosure.²³ Foreclosure can occur at both the upstream or downstream levels of a supply chain, and a vertically integrated firm might engage in one or both types of foreclosure.²⁴ Either type of foreclosure hurts competition and consumers and risks entrenching a dominant firm’s market position.

In an input-foreclosure strategy, a vertically integrated firm seeks to hurt competition in the downstream market.²⁵ When an upstream firm with market power merges with a downstream firm, the threat of foreclosure is significant.²⁶ The vertically integrated firm can raise the price or withhold it entirely from downstream competitors. In other words, the vertically integrated firm can use its power in the supplying market to raise downstream competitors’ costs and weaken and even exclude them from the market.²⁷ Patents can be one such input for downstream

²⁰ *Report and Order in re Evaluation of the Syndication and Financial Interest Rules*, 56 Fed. Reg. 26, 242 (1991).

²¹ *Id.*

²² *Brown Shoe*, 370 U.S. at 323–24 (1962) (“The primary vice of a vertical merger or other arrangement tying a customer to a supplier is that, by a foreclosing [sic] the competitors of either party from a segment of the market otherwise open to them, the arrangement may act as a ‘clog on competition,’ ... which ‘deprive[s] ... rivals of a fair opportunity to compete.’”).

²³ 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, 17 (2015).

²⁴ Janusz A. Ordover, Garth Saloner & Steven C. Salop, *Equilibrium Vertical Foreclosure*, 127 AM. ECON. REV. 127 (1990); Patrick Rey & Jean Tirole, *A Primer on Foreclosure*, 3 HANDBOOK INDUS. ORG. 2145, 2148–50 (2007).

²⁵ Jonathan B. Baker, *Exclusion as a Core Competition Concern*, 78 ANTITRUST L.J. 517, 540 (2013).

²⁶ *See id.*

²⁷ *See generally* Thomas G. Krattenmaker & Steven C. Salop, *Anticompetitive Exclusion: Raising Rivals’ Costs to Achieve Power Over Price*, 96 YALE L.J. 209 (1986). *See also* Johannes Boehm & Jan Sonntag, *Vertical Integration*

suppliers. For instance, a manufacturer that owns patented technology embodied in its main product may refuse to license the patents to rival manufacturers or only license them on unreasonable or discriminatory terms.²⁸

By raising rivals' costs, this type of foreclosure can weaken a downstream firm's ability to compete. For example, the FCC examined the vertical integration of content distributor DirecTV with content owner News Corp., whose offerings included Fox and other networks. The FCC found that "[a]verage monthly prices and the percentage price increase" in programming fees to other content distributors "were both higher during periods of vertical integration."²⁹

Input foreclosure has also been documented in, among other markets, gasoline retail, cable television, and railroads. Justine Hastings and Richard Gilbert studied wholesale gasoline prices in the 1990s on the West Coast after a streak of mergers in that decade, many of which were vertical, and found that "mergers in the gasoline industry that increase the extent of vertical integration may lead to an increase in wholesale prices as a consequence of the incentive to raise rivals' costs."³⁰

Similarly, in her study of the vertical integration of programming and distribution in the cable television industry, Tasneem Chipty found that "[v]ertical integration between cable operators and premium program services results in the exclusion of rival services."³¹ And in an examination of vertical integration in the railroad industry, Curtis Grimm, Clifford Winston, and Carol Evans concluded that "to the extent [non-integrated] interline competitors are eliminated

and Foreclosure: Evidence from Production Network Data 22 (2018), <https://jmboehm.github.io/foreclosure.pdf> ("This paper presents results that suggest that vertical foreclosure along the extensive margin is occurring among large firms – and across a range of sectors in the economy. Vertical relationships are much more likely to break when the supplier is integrating with a competitor of the buyer, than when the supplier is integrating with an unrelated party.").

²⁸ Marina Lao, *Unilateral Refusals to Sell or License Intellectual Property and the Antitrust Duty to Deal*, 9 CORNELL J.L. & PUB. POL'Y 193, 218 (1999). The antitrust agencies previously required dominant, vertically integrated firms that owned intellectual property to license their patents to competitors. See Barry Lynn, *Estates of Mind*, WASH. MONTHLY, July/Aug. 2013, <https://washingtonmonthly.com/magazine/julyaugust-2013/estates-of-mind/>. See, e.g., *In re Xerox Corp.*, 86 F.T.C. 364 (1975) (requiring Xerox to license photocopier patents on royalty-free basis to all interested parties).

²⁹ Jonathan B. Baker et al., *The Year in Economics at the FCC, 2010-11: Protecting Competition Online*, 37 REV. INDUS. ORG. 279, 305–06 (2010).

³⁰ Justine S. Hastings and Richard J. Gilbert, *Market Power, Vertical Integration and the Wholesale Price of Gasoline*, 53 J. INDUS. ECON. 469, 490 (2005).

³¹ Tasneem Chipty, *Vertical Integration, Market Foreclosure, and Consumer Welfare*, 91 AM. ECON. REV. 450.

by vertical integration ... a welfare loss to shippers will result; if interline competition is promoted, there will be a welfare gain.”³²

In a customer-foreclosure strategy, a vertically integrated firm tries to hurt competitors in the upstream market. Using buyer power in the downstream market, the vertically integrated firm can reduce demand for the inputs of non-integrated upstream firms.³³ Whereas input foreclosure can be thought of as raising rivals’ costs, customer foreclosure can be thought of as reducing rivals’ revenues. As a result, the vertically integrated firm marginalizes non-integrated upstream firms and fortifies its market power.

Foreclosure can have additional harmful effects on competitive market structures beyond the foreclosure of a non-integrated firm or segment by a vertically integrated firm. Salop and Culley note that a vertically integrated firm with downstream buyer power “might threaten to refuse to purchase [from other independent input suppliers] in order to induce the independent input suppliers to raise prices to or withhold inputs from the merged firm’s downstream rivals.”³⁴ The vertically integrated firm’s threat is different from a non-integrated firm’s threat to reduce demand for inputs, because the vertically integrated firm can obtain inputs internally. A vertically integrated company with upstream market power can follow an analogous strategy: It can threaten to raise prices or withhold supply to non-integrated buyers unless they reduce their purchases or refrain from purchasing from rival input suppliers. In the case of dominant online firms, they can, following a vertical acquisition, undertake practices to disadvantage and exclude their rivals in multiple markets.³⁵

³² Curtis M. Grimm, Clifford Winston, & Carol A. Evans, *Foreclosure of Railroad Markets: A Test of Chicago Leverage Theory*, 35 J.L. & ECON. 295, 305 (1992).

³³ Salop & Culley, *supra* note 23, at 17.

³⁴ *Id.* at 23.

³⁵ See, e.g., Claire Cain Miller, *U.S. Clears Google Acquisition of Travel Software*, N.Y. TIMES (Apr. 8, 2011), <https://www.nytimes.com/2011/04/09/technology/09google.html> (“Google announced its intention in July to buy [flight search software firm] ITA. Many airlines and online travel agents license the software, including Orbitz, American Airlines, United Airlines and Microsoft’s Bing Travel.”).

Collusion

Vertical mergers can also increase the ease and likelihood of horizontal collusion among direct competitors. This increased risk comes about in two ways: the sharing of sensitive cost and price information, and the elimination of aggressive, or “maverick,” rivals.³⁶

First, a vertical merger may allow sensitive information to be passed between firms and thereby facilitate price coordination. In their joint guidance on information sharing among competitors, the FTC and the DOJ stated, “[T]he sharing of information related to a market in which the collaboration operates or in which the participants are actual or potential competitors may increase the likelihood of collusion on matters such as price, output, or other competitively sensitive variables.”³⁷ A vertically integrated firm could obtain competitively sensitive information through its relationship selling inputs to downstream purchasers and then share it with its own downstream affiliate, ultimately helping to facilitate coordination on prices and other terms in the downstream market.³⁸

Second, vertical mergers can eliminate “maverick” firms. A “maverick” is a firm that tends to defy the explicit or tacit rules or conventions in a market, such as pricing practices or business models.³⁹ An acquisition of a maverick firm could effectively remove this threat to an otherwise stable collusive arrangement. If a maverick firm gets acquired by an upstream or downstream player, that maverick may be less inclined to disrupt collusive behavior. Salop

³⁶ Michael H. Riordan & Steven C. Salop, *Evaluating Vertical Mergers: A Post-Chicago Approach*, 63 ANTITRUST L.J. 513, 520, 542 (1995).

³⁷ FED. TRADE COMM’N & U.S. DEP’T OF JUSTICE, ANTITRUST GUIDELINES FOR COLLABORATIONS AMONG COMPETITORS § 3.31 (b) (April 2000), https://www.ftc.gov/sites/default/files/documents/public_events/joint-venture-hearings-antitrust-guidelines-collaboration-among-competitors/ftcdojguidelines-2.pdf; *see also* Michael Bloom, FTC Bureau of Competition, *Information Exchange: Be Reasonable* (December 11, 2014), <https://www.ftc.gov/news-events/blogs/competition-matters/2014/12/information-exchange-be-reasonable> (summarizing the DOJ and FTC’s guidelines as broadly saying, “The sharing of information relating to price, cost, output, customers, or strategic planning is more likely to be of competitive concern than the sharing of less competitively sensitive information.”). *See also* Baker, *supra* note 23, at 579 (noting that “an agreement among rivals to exchange information,” may “harm[] competition by facilitating collusion, as by helping them detect cheating rapidly.”).

³⁸ *See* Steven C. Salop, *Invigorating Vertical Merger Enforcement*, 127 YALE L.J. 1962, 1978 (2017) (“Coordination also can be facilitated by one of the merging firms transferring sensitive competitive information to its merger partner, information that can be used to facilitate parallel accommodating conduct, interdependent pricing, or even express collusion.”).

³⁹ *See* U.S. DEP’T OF JUSTICE & FED. TRADE COMM’N, HORIZONTAL MERGER GUIDELINES § 2.1.5 (2010) (defining a maverick as “a firm that plays a disruptive role in the market to the benefit of customers.”).

explains, “In a market where the upstream merging firm has been a maverick seller, whose behavior deterred input market coordination, a vertical merger similarly might eliminate this incentive and facilitate coordination in selling to rivals of its downstream division.”⁴⁰ The maverick can threaten more than collusive arrangements and may be poised to challenge an incumbent’s dominance and its existing business model.⁴¹

Collusion and Foreclosure in Tandem

Additional harms from vertical integration come from a combination of foreclosure and collusive behavior.⁴² First, foreclosure can act as a potent tool for maintaining a collusive arrangement.⁴³ A vertically integrated firm may foreclose on competitors to keep them in line and make sure they continue to collude.⁴⁴ The firm may also use foreclosure as a barrier to entry and disadvantage new competitors from participating in a market and undermining a collusive agreement.⁴⁵

Foreclosure and collusion in tandem can also hurt non-integrated rivals and compel prospective competitors to enter both upstream and downstream markets at the same time, a requirement that serves as a strong deterrent to any entry at all. Parallel exclusionary conduct is one mechanism by which such “two-level entry” becomes necessary. When multiple firms in an industry integrate vertically, parallel exclusionary conduct against non-integrated competitors by vertically integrated competitors becomes more likely. In a parallel exclusionary conduct

⁴⁰ Salop, *supra* note 38, at 1978. For an analogous explanation with a maverick downstream firm, see Riordan & Salop, *supra* note 36, at 542. For an analysis of how vertical integration can increase the payoffs of collusion, see Sara Biancini & David Ettinger, *Vertical Integration and Downstream Collusion*, 52 INT’L J. INDUS. ORG. 99, 110 (2017) (“[A] vertical merger could help firms to facilitate collusion in contexts in which previous attempts revealed ineffective ... Our analysis shows that a vertical merger can indeed be a way for firms to increase the feasibility of collusion and make it successful in these markets.”).

⁴¹ See Sharon Terlep & Brent Kendall, *Schick Owner Abandons Takeover of Harry’s Following FTC Suit to Block It*, WALL ST. J. (Feb. 10, 2020), <https://www.wsj.com/articles/schick-owner-abandons-takeover-of-harrys-11581345469> (“Both Schick, which is a distant No. 2 in terms of sales to Procter & Gamble Co.’s Gillette razor brand, and Gillette have lost customers in recent years to online upstarts like Harry’s and Dollar Shave Club, which is owned by Unilever PLC.”).

⁴² See Baker, *supra* note 25, at 558 (“Exclusion and collusion are closely related in a second way: they are often and naturally combined by firms exercising market power. Colluding firms may need to exclude in order for their collusive arrangement to succeed.”).

⁴³ *Id.*

⁴⁴ *Id.*

⁴⁵ *Id.*

strategy, “conduct, engaged in by multiple firms, . . . blocks or slows would be market entrants.”⁴⁶

In 2011, the FCC opposed the proposed merger between wireless providers AT&T and T-Mobile, in part, on parallel exclusion grounds. It observed that AT&T and Verizon participated in exclusionary conduct against smaller non-integrated competitors.⁴⁷ These smaller companies both competed with, and purchased network capacity from, the major wireless companies in order to serve their own customers. The leading wireless companies’ exclusionary conduct “included the carriers’ refusal, in parallel, to offer roaming or wholesale services to smaller carriers or providers that might need such services to compete effectively.”⁴⁸ The ultimate effect of parallel exclusion is to make entry or survival in a market feasible only if an entrant or competitor enters and competes at two levels of the supply chain.

Loss of Potential Competition

Vertical integration also can maintain concentrated market structures by eliminating potential competitors.⁴⁹ A non-integrated upstream firm may be the best positioned to enter into a downstream market in the near term (likewise, a non-integrated downstream firm may be best positioned to enter into an upstream market).⁵⁰ By acquiring the upstream firm, a downstream firm can eliminate this potential competitive threat. Potential competition is not a substitute for actual competition and should not be counted on to constrain the power of incumbents.⁵¹

⁴⁶ C. Scott Hemphill & Tim Wu, *Parallel Exclusion*, 122 YALE L.J. 1182, 1229 (2013).

⁴⁷ *Id.* at 1249.

⁴⁸ *Id.*

⁴⁹ See Salop, *supra* note 38, at 1976.

⁵⁰ Vertical integration through internal expansion can create its own threats to competition. A vertically integrated firm can leverage its market or monopoly power into an adjacent market. At least in the past, this type of monopoly extension has been policed under the non-merger provisions of the Clayton Act, as well as the Sherman and FTC Acts. See, e.g., *MCI Communs. Corp. v. Am. Tel. & Tel. Co.*, 708 F.2d 1081, 1132 (7th Cir. 1983) (“The jury found that AT&T unlawfully refused to interconnect MCI with the local distribution facilities of Bell operating companies—an act which prevented MCI from offering FX and CCSA services to its customers. A monopolist’s refusal to deal under these circumstances is governed by the so-called essential facilities doctrine. Such a refusal may be unlawful because a monopolist’s control of an essential facility (sometimes called a ‘bottleneck’) can extend monopoly power from one stage of production to another, and from one market into another.”).

⁵¹ See, e.g., Paul Stephen Dempsey, *The Financial Performance of the Airline Industry Post-Deregulation*, 45 HOU. L. REV. 421, 474–75 (2008) (“Most empirical studies have demonstrated that deregulated airline markets are not perfectly contestable and that there is a positive relationship between concentration and fares. While ticket prices in city-pair markets with two competitors were about 8% lower than in monopoly markets, and markets with three competitors were another 8% less still, a potential competitor has one-tenth to one-third the competitive impact of an actual competitor.”).

However, the threat of a potential competitor becoming an actual competitor can provide *one* important check on the power of a monopolist or a tight oligopoly.⁵²

The case of the 2010 merger in the live music industry of Live Nation and Ticketmaster is a high-profile illustration of how vertical integration can eliminate a potential competitor. Live Nation and Ticketmaster were leaders in concert promotion and ticketing, respectively. Before the merger, *The New York Times* reported, “Live Nation, which had long stayed in its lane as a promoter and venue operator, had just begun to sell tickets and was taking on that role at some 110 venues.”⁵³

In an unsuccessful attempt to preserve an important potential competitor in the ticketing industry, the DOJ required Ticketmaster “to license its ticketing software – the proprietary system that allowed it to service swarms of customers when a popular concert went on sale – to its competitor AEG. It was also required to divest a ticketing subsidiary, Paciolan, to another competitor.”⁵⁴ But AEG has not used Ticketmaster’s software, and Paciolan has not grown into a major competitor to Ticketmaster.⁵⁵ Live Nation represented a distinct threat to Ticketmaster because its leadership in event promotion would have allowed it to ticket its own events and “achieve minimum viable scale.”⁵⁶ The ultimate result of the Live Nation and Ticketmaster merger is that “the ticketing market lost its most powerful future competitor.”⁵⁷ The DOJ remedy failed to preserve competition and allowed Live Nation to cement its dominance.⁵⁸

Network Effects and Nascent Competitors

Products or services exhibiting network effects become more valuable to users as more people use the product or service.⁵⁹ Communications markets and products are a common

⁵² John E. Kwoka, *Non-Incumbent Competition: Mergers Involving Constraining and Prospective Competitors*, 25 CASE W. RES. L. REV. 173, 192–96 (2001).

⁵³ Ben Sisario & Graham Bowley, *Live Nation Rules Music Ticketing, Some Say With Threats*, N.Y. TIMES (Apr. 1, 2018), <https://www.nytimes.com/2018/04/01/arts/music/live-nation-ticketmaster.html>.

⁵⁴ *Id.*

⁵⁵ *Id.* AEG told the *Times* that it never licensed Ticketmaster’s proprietary ticketing software “because, it said, it did not view the technology as cutting edge.”

⁵⁶ Salop, *supra* note 38, at 1976.

⁵⁷ *Id.*

⁵⁸ Ben Sisario & Graham Bowley, *Live Nation Rules Music Ticketing, Some Say with Threats*, N.Y. TIMES (Apr. 1, 2018), <https://www.nytimes.com/2018/04/01/arts/music/live-nation-ticketmaster.html>

⁵⁹ See Michael L. Katz & Carl Shapiro, *Systems Competition and Network Effects*, 8 J. ECON. PERSP. 93 (1994); see also Jeffrey Rohlfs, *A Theory of Interdependent Demand for a Communications Service*, 5 BELL J. ECON. 16 (1974).

example of industries exhibiting network effects; as Michael Katz and Carl Shapiro have pointed out, “Owners of fax machines, for example, found those machines more valuable as others bought (compatible) fax machines.”⁶⁰ Network effects in digital markets means that vertical mergers can neutralize emerging rivals and preserve concentrated market structures.

Due to network effects, one or a small number of firms can quickly gain control of a market, as the growing number of users becomes a *de facto* barrier to entry for potential new firms. Online platforms, in particular, find that business success increasingly means dominating a market first, then reaping profits second.⁶¹ One of the concerns about online platform markets and network effects centers around market “tipping,” or the “tendency of one system to pull away from its rivals in popularity once it has gained an initial edge.”⁶²

In markets defined by network effects and vulnerable to monopolistic control, dominant and near-dominant firms’ acquisition of small—even nascent—competitors can stifle important sources of emerging competition and cement and perpetuate monopoly. A new firm can quickly attract users in one market (for example, photo sharing) and, on the strength of this user base, enter an adjacent market (for instance, general social media).⁶³ Under these circumstances, vertical mergers can combine the traditional risks of vertical mergers with the added concern about tipping and nascent competitors. In the presence of network effects, dominant firms have

⁶⁰ Katz & Shapiro, *supra* note 56, at 96.

⁶¹ See Lina M. Khan, *Amazon’s Antitrust Paradox*, 126 YALE L.J. 710, 785 (“For the purpose of competition policy, one of the most relevant factors of online platform markets is that they are winner-take-all. This is due largely to network effects and control over data, both of which mean that early advantages become self-reinforcing. The result is that technology platform markets will yield to dominance by a small number of firms.”); see also *id.* at 786 (“Given that online platforms operate in markets where network effects and control over data solidify early dominance, a company looking to compete in these markets must seek to capture them. The most effective way is to chase market share and drive out one’s rivals—even if doing so comes at the expense of short-term profits, since the best guarantee of long-term profits is immediate growth. Due to this dynamic, striving to maximize market share at the expense of one’s rivals makes predation highly rational; indeed, it would be irrational for a business not to frontload losses in order to capture the market.”).

⁶² Katz & Shapiro, *supra* note 59, at 105–06.

⁶³ See Alexei Oreskovic & Gerry Shih, *Facebook to Buy Instagram for \$1 Billion*, REUTERS (Apr. 9, 2012), <https://www.reuters.com/article/us-facebook/facebook-to-buy-instagram-for-1-billion-idUSBRE8380M820120410> (“As Instagram’s popularity has shot up in recent months, the company’s leadership has mulled possible strategies to expand the service into a fully featured social network - much like a photo-driven, stripped-down version of Facebook, Twitter, or even Path, a company insider said.”). For an earlier example, consider Netscape’s rapid growth in the internet browser market in the mid-1990s and how its large user base could have been the foundation for challenging Microsoft’s dominant operating system. Harry First & Andrew I. Gavil, *Re-framing Windows: The Durable Meaning of the Microsoft Antitrust Litigation*, 2006 UTAH L. REV. 679, 695–96.

powerful motivations to buy out and neutralize emerging competitors, which could grow and seize one market quickly and soon after challenge the dominant firm’s position directly.

At the FTC’s first “Competition and Consumer Protection in the 21st Century” hearing, Fiona Scott Morton explained that market shares alone may be inadequate to gauge competitive risks in markets where competition tends to be “winner-take-all” and that enforcers “would care an awful lot about entry. We would care an awful lot about potential competition. We would care an awful lot about acquisitions by the 99 percent of a teeny little epsilon percent.”⁶⁴ The reason for this shift in focus is that the small competitors might “not have a lot of share, but that is where the competition is coming from. That 99 percent guy is afraid the [little] epsilon is going to become one and attract all the teenagers and there is going to be a flip.”⁶⁵

III. The Federal Trade Commission and Department of Justice Should Publish New Vertical Merger Guidelines

The legal standards governing vertical mergers are amorphous. Due to the lack of current guidelines,⁶⁶ vertical mergers are evaluated under a rule of reason framework. Enforcers have to define relevant markets, compute market shares and concentrations, and show probable harmful effects to establish a prima facie case.⁶⁷ Defendants can challenge this prima facie case, including through the showing of merger-specific efficiencies,⁶⁸ despite the Supreme Court’s rejection of this defense in the 1960s.⁶⁹ The rule of reason frustrates enforcement, introduces subjectivity, impedes business planning, and prevents public accountability.⁷⁰ It also forces generalist judges to make the type of decisions ordinarily reserved for legislators and regulators. The district court’s decision in *United States v. AT&T Inc.* illustrates the deficiencies of the current standard for determining the legality of vertical mergers.⁷¹

⁶⁴ Fed. Trade Comm’n, *Competition and Consumer Protection in the 21st Century* 149–50, (September 13, 2018) https://www.ftc.gov/system/files/documents/public_events/1415284/ftc_hearings_session_5_transcript_11-1-18.pdf.

⁶⁵ *Id.* at 150.

⁶⁶ Salop, *supra* note 38, at 1983.

⁶⁷ *United States v. AT&T Inc.*, 310 F.Supp.3d 161, 189 (D.D.C. 2018).

⁶⁸ *Id.* at 191.

⁶⁹ *See supra* part I. For a detailed description of the status of the efficiencies defense in merger law today, *see United States v. Anthem, Inc.*, 855 F.3d 345, 353–55 (D.C. Cir. 2017).

⁷⁰ For a comprehensive critique of the rule of reason and similar open-ended frameworks in antitrust, see Maurice E. Stucke, *Does the Rule of Reason Violate the Rule of Law?*, 42 U.C. DAVIS L. REV. 1375 (2009).

⁷¹ *See* Chris Sagers, *No Fair Hearing for the DoJ in the AT&T-Time Warner Decision*, PROMARKET (June 18, 2018), <https://promarket.org/no-fair-hearing-doj-att-time-warner-decision/> (“[T]he [AT&T-Time Warner] case is an

The current “totality of the economic circumstances” standard for vertical mergers hurts enforcers and businesses. When reviewing a vertical merger, antitrust enforcers have no clear criteria or markers for screening harmful mergers from benign ones. Indeed, for all types of mergers, enforcers and courts must engage every time in an exhaustive factual investigation to determine whether a proposed consolidation is likely to have a probable harm on competition.⁷² This type of analytical framework has “subvert[ed] congressional intent by permitting a too-broad economic investigation”⁷³ and is inconsistent with the Clayton Act.⁷⁴ For businesses, the lack of guidelines impairs planning. Without guidelines, businesses cannot know with any certainty whether their vertical merger will pass muster or run afoul of the Clayton Act.

For members of the public, the lack of rules or even presumptions on vertical mergers compounds the existing opacity of the merger review process.⁷⁵ Under the current merger review process, whether a certain vertical merger is legal or illegal is unknown and indeed often unknowable for even an informed observer. When the government does challenge a merger, the public cannot easily know whether a suit was filed because the merger posed a reasonable threat to competition or because the merging parties had earned the wrath of the president and executive branch officials.⁷⁶ Vertical mergers that appear to have striking similarities on the

object lesson in the extremely unsatisfactory state of our substantive merger law, which I don’t imagine will change in our lifetimes. Virtually the entirety of the law boils down to the nearly unreviewable fact-finding of one person in each case (the trial judge), subject to the extravagant burden of proof created from more or less whole cloth by then-Judge Clarence Thomas in the 1990 DC Circuit decision *United States v. Baker Hughes*.”)

⁷² See, e.g., *United States v. Baker Hughes Inc.*, 908 F.2d 981, 988 (D.C. Cir. 1990) (“Predicting future competitive conditions in a given market, as the statute and precedents require, calls for a comprehensive inquiry.”).

⁷³ *Philadelphia National Bank*, 374 U.S. at 362.

⁷⁴ Louis B. Schwartz, *The New Merger Guidelines: Guide to Governmental Discretion and Private Counseling or Propaganda for Revision of the Antitrust Laws*, 71 CALIF. L. REV. 575, 595, 601 (1983).

⁷⁵ See Jesse Eisinger & Justin Elliott, *These Professors Make More Than a Thousand Bucks an Hour Peddling Mega-Mergers*, PROPUBLICA (Nov. 16, 2016), <https://www.propublica.org/article/these-professors-make-more-than-thousand-bucks-hour-peddling-mega-mergers> (“‘There are few government functions outside the CIA that are so secretive as the merger review process,’ said Seth Bloom, the former general counsel of the Senate Antitrust Subcommittee.”).

⁷⁶ See David McLaughlin et al., *AT&T Cleared to Buy Time Warner in Blow to Trump Administration*, BLOOMBERG (June 12, 2018), <https://www.bloomberg.com/news/articles/2018-06-12/at-t-cleared-by-judge-to-buy-time-warner-create-media-giant> (“The government’s November lawsuit was also the first major merger challenge under President Donald Trump, who railed against the tie-up when it was announced during the 2016 campaign. He vowed that his administration would oppose it, and as president, he has relentlessly attacked CNN for its news coverage. . . . Trump’s criticism prompted speculation that the lawsuit was politically motivated. Still, the Justice Department’s case laid out a traditional antitrust theory: that combining two companies in different parts of a supply chain can give the merged company the ability to harm rivals.”).

surface may receive very different treatment from antitrust enforcers, for reasons unknown to the public.⁷⁷

The rule of reason approach also makes extraordinary demands on the judiciary. Federal judges are generalists who typically do not have experience or specialized knowledge in antitrust. Under the standards governing vertical mergers, however, the judiciary must set “sail on a sea of doubt”⁷⁸ and “ramble through wilds of economic theory.”⁷⁹ Both the government and defendants devote significant resources—assigning or hiring large teams of lawyers and economists—to review all relevant facts and build cases on why a merger likely will, or will not, hurt competition. This type of “cost-benefit analysis” is more akin to legislative or regulatory deliberation than litigation in court.⁸⁰ Ultimately, a judge, or a panel of judges, must decide whether the government or the merging parties’ story of the future is more credible. As a result, vertical merger litigation is unwieldy, costly, and unpredictable.⁸¹

Judge Richard Leon’s June 2018 decision in *United States v. AT&T Inc.*⁸² illustrates the deficiencies of the current approach to vertical mergers. Judge Leon reviewed all the relevant facts, applied what he asserted is the appropriate legal standard, and ruled against the government. While ruling against the government alone is not an adequate basis for indicting the

⁷⁷ Consider the Department of Justice’s very different responses to two recent mergers that appeared to have significant vertical effects. *Compare* Press Release, U.S. Dep’t of Justice, Justice Department Challenges AT&T/DirecTV’s Acquisition of Time Warner (Nov. 20, 2017), <https://www.justice.gov/opa/pr/justice-department-challenges-atdirectv-s-acquisition-time-warner> with Press Release, U.S. Dep’t of Justice, Justice Department Requires CVS and Aetna to Divest Aetna’s Medicare Individual Part D Prescription Drug Plan Business to Proceed with Merger (Oct. 10, 2018), <https://www.justice.gov/opa/pr/justice-department-requires-cvs-and-aetna-divest-aetna-s-medicare-individual-part-d>.

⁷⁸ *United States v. Addyston Pipe & Steel Co.*, 85 F. 271, 283 (6th Cir.1898) (Taft, J.), *aff’d*, 175 U.S. 211 (1899).

⁷⁹ *United States v. Topco Assocs., Inc.*, 405 U.S. 596, 609 (1972).

⁸⁰ *See id.* at 611–12 (“If a decision is to be made to sacrifice competition in one portion of the economy for greater competition in another portion, this too is a decision that must be made by Congress and not by private forces or by the courts. Private forces are too keenly aware of their own interests in making such decisions and courts are ill-equipped and ill-situated for such decisionmaking. To analyze, interpret, and evaluate the myriad of competing interests and the endless data that would surely be brought to bear on such decisions, and to make the delicate judgment on the relative values to society of competitive areas of the economy, the judgment of the elected representatives of the people is required.”).

⁸¹ The Supreme Court has lamented the costliness and protracted nature of antitrust litigation (and, on these grounds, restricted enforcement of the antitrust laws). *E.g.*, *Credit Suisse Securities (USA) LLC v. Billing*, 551 U.S. 264, 281–82 (2007); *Verizon Communs. Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 414 (2004). The Court, however, created this problem in the first place by adopting the rule of reason as the primary analytical framework in antitrust cases. *E.g.*, *State Oil Co. v. Khan*, 522 U.S. 3 (1997); *Continental TV, Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977).

⁸² 310 F.Supp.3d at 161. *aff’d*, 916 F.3d 1029 (D.C. Cir. 2019).

judge’s decision, his opinion features multiple inconsistencies and reflects the subjectivity of contemporary vertical merger enforcement—and antitrust decision-making in general—under the rule of reason. Judge Leon systematically accepted the merging parties’ evidence and disparaged the government’s, even when it meant being inconsistent. For instance, Judge Leon credited the testimony of industry executives who supported AT&T’s account of the merger but dismissed the testimony of critical executives from rivals as self-serving.⁸³ The judge failed to explain why the executives supporting the merger were proxies for the public whereas other executives were not.⁸⁴ He further implied that, post-merger, the new AT&T-Time Warner would seek to maximize the profits of *individual* business divisions and not the entire company.⁸⁵

For these reasons, organizations from across the ideological spectrum have lamented the status quo and called for vertical merger guidelines. While new guidelines would not carry the force of law nor bind the courts, they would likely be influential and granted significant deference by judges reviewing vertical mergers.⁸⁶ The bipartisan Antitrust Modernization Commission (“AMC”) in its 2007 report recommended that the antitrust agencies publish new guidelines for non-horizontal, including vertical, mergers.⁸⁷ In this recommendation, which was joined by the current head of the Antitrust Division, the AMC stated that “providing an explanation of how the agencies undertake analysis in non-horizontal mergers would supply beneficial transparency.”⁸⁸

⁸³ *Id.* at 178, 211.

⁸⁴ See Sagers, *supra* note 71 (“Judge Leon effectively threw out a big proportion of the government’s evidence in this case largely on small bits of the defendants’ own self-serving testimony. The things business executives say apparently never matter, nosiree, except when they cause the government to lose.”).

⁸⁵ *AT&T*, 310 F.Supp.3d at 250-51 (“[T]he Government has failed to show that the merged entity would have any incentive to foreclose rivals’ access to HBO-based promotions. This is because the Government’s promotion-withholding theory conflicts with HBO’s business model, which remains “heavily dependent” on promotion by distributors. HBO does not run ads, leaving subscription fees as its overwhelming source of revenue. This makes HBO a volume-based business, in which more subscribers means more revenue.”).

⁸⁶ See, e.g., *Saint Alphonsus Med. Ctr.-Nampa Inc. v. St. Luke’s Health Sys., Ltd.*, 778 F.3d 775, 784 n.9 (9th Cir. 2015) (internal citations omitted) (“Although the Merger Guidelines are not binding on the courts, they are often used as persuasive authority.”); *FTC v. H.J. Heinz Co.*, 246 F.3d 708 (D.C. Cir. 2001) (applying the Horizontal Merger Guidelines in a merger challenge). Hillary Greene has analyzed and shown the influence of the Merger Guidelines on judicial decision-making. Hillary Greene, *Guideline Institutionalization: The Role of Merger Guidelines in Antitrust Discourse*, 48 WM. & MARY L. REV. 771 (2006).

⁸⁷ ANTITRUST MODERNIZATION COMM’N, REPORT AND RECOMMENDATIONS 68 (2007).

⁸⁸ *Id.*

The American Bar Association, in presidential transition reports in 2013 and 2017 on the state of antitrust, called for new vertical merger guidelines.⁸⁹ The center-left American Antitrust Institute has urged the antitrust agencies to “update and expand the Non-Horizontal Merger Guidelines and bring them in line with modern treatment of mergers involving the elimination of a potential competitor or an independent producer of a complementary product.”⁹⁰

IV. The Proposed Vertical Merger Guidelines Are Inconsistent With the Clayton Act and Provide Little Guidance to the Public and Businesses

While the need for vertical merger guidelines is clear, the proposed guidelines have fundamental problems and should not be adopted. They represent an attempt by the federal antitrust agencies to subvert the Clayton Act, as opposed to faithfully applying and enforcing it. First, the guidelines ignore the incipency standard of the Clayton Act and instead use the higher standard of the Sherman Act. Second, they include an efficiencies defense, even though the Supreme Court expressly rejected this defense in three influential decisions in the 1960s. The agencies are bound to follow the text, purpose, and judicial interpretations of the Clayton Act and are not at liberty to rewrite it.

The proposed guidelines ignore the incipency standard of the Clayton Act. Congress aimed to correct weaknesses in the Sherman Act and enacted the Clayton Act to reach consolidation before it can inflict harm on the public. As discussed earlier, the Clayton Act is intended to stop mergers that threaten to undermine competition or create a monopoly. Yet, the guidelines are drafted with no consideration nor acknowledgement of this anti-merger standard. They do not use the word “incipency” or “incipient” even once. As Commissioner Slaughter noted in her statement abstaining from the vote to publish the guidelines,⁹¹ the guidelines appear to apply the higher standard embodied in the Sherman Act.

On top of not acknowledging the incipency standard in text, the proposed guidelines conflict with it in two specific ways. First, the one concrete guidance in the proposed

⁸⁹ AM BAR ASSN., PRESIDENTIAL TRANSITION REPORT: THE STATE OF ANTITRUST ENFORCEMENT 2012, at 7–8 (2013); AM BAR ASSN., PRESIDENTIAL TRANSITION REPORT: THE STATE OF ANTITRUST ENFORCEMENT 7–8 (2017).

⁹⁰ AM. ANTITRUST INST., MERGERS, MARKET POWER, AND THE NEED FOR MORE VIGOROUS ENFORCEMENT 15 (2018), <https://www.antitrustinstitute.org/wp-content/uploads/2018/08/mergerfinal.pdf>.

⁹¹ Statement of Commissioner Rebecca Kelly Slaughter, FTC-DOJ Draft Vertical Merger Guidelines 3–4 (2020), https://www.ftc.gov/system/files/documents/public_statements/1561721/p810034slaughtervmgabstain.pdf.

guidelines—the safe harbor for vertical mergers that combine two firms each with less than 20 percent in their relevant markets—is contrary to the incipency standard. The Supreme Court made clear that the agencies should block consolidation well before it created a highly concentrated market, due to foreclosure or otherwise. In the landmark *Brown Shoe* decision, the Court wrote:

[I]t is apparent that a keystone in the erection of a barrier to what Congress saw was the rising tide of economic concentration, was its provision of authority for arresting mergers at a time when the trend to a lessening of competition in a line of commerce was still in its incipency. Congress saw the process of concentration in American business as a dynamic force; it sought to assure the Federal Trade Commission and the courts the power to brake this force at its outset and before it gathered momentum.⁹²

Permitting vertical consolidation, with little or no scrutiny, until the 20 percent market share threshold is reached contravenes this clear directive from Congress and the Supreme Court. Second, the guidelines articulate an open-ended rule of reason framework, presenting a list of factors that the agencies will consider when evaluating vertical mergers. This rule of reason is inconsistent with the incipency standard and fails to provide guidance to businesses and the public. By requiring a broad investigation and implicitly a showing of significant economic effects, this framework “subvert[s] congressional intent by permitting a too-broad economic investigation”⁹³ By disregarding the incipency standard, the proposed guidelines conflict with the text, purpose, and Supreme Court interpretations of the Clayton Act.

The proposed guidelines also recognize an efficiencies defense, in contravention of Supreme Court precedent. As discussed in Section I, the Supreme Court rejected an efficiencies defense for illegal mergers. The Court could not have been clearer on this point, stating in one decision that “[p]ossible economies cannot be used as a defense to illegality.”⁹⁴ The Court recognized the underlying purpose of the Clayton Act: Congress did not intend to categorically bar corporations, even large corporations, from achieving economies of scale and other efficiencies. Congress sought to promote growth through internal expansion—investment in new

⁹² *Brown Shoe*, 370 U.S. at 317–18.

⁹³ *Philadelphia National Bank*, 374 U.S. at 362.

⁹⁴ *Procter & Gamble*, 386 U.S. at 580.

plants and facilities that expand the nation’s productive capacity—instead of mergers and acquisitions, which represent the purchase, sale, and combination of existing business assets.⁹⁵ Accordingly, a large firm seeking to enter an adjacent market can do this by hiring the personnel and investing in the facilities necessary to participate in this market in lieu of buying out an existing firm in this market. The DOJ and FTC must follow the Supreme Court’s rejection of an efficiencies defense, not ignore it based on some theoretical arguments supporting corporate consolidation.

V. In Developing New Vertical Merger Guidelines, the FTC and the DOJ Should Build on the 1968 Merger Guidelines

In embracing the bipartisan call for new vertical merger guidelines, the FTC and the DOJ should look to the DOJ’s 1968 Merger Guidelines as a model on which to build. It is worth remembering that the Clayton Act is broader than the Sherman Act and intended to reach conduct that may not necessarily violate the Sherman Act. The 1968 Merger Guidelines are consistent with the statutory text and legislative intent of the Clayton Act.

Like its approach to horizontal mergers, the 1968 Merger Guidelines’ approach to vertical mergers protects decentralized market structures.⁹⁶ In its section on vertical mergers, the 1968 Merger Guidelines explain, “the Department [of Justice]’s enforcement activity ... is intended to prevent changes in market structure that are likely to lead over the course of time to significant anticompetitive consequences.”⁹⁷ Those consequences are more likely to occur when

⁹⁵ See *Philadelphia National Bank*, 374 U.S. at 370 (“[S]urely one premise of an antimerger statute such as § 7 is that corporate growth by internal expansion is socially preferable to growth by acquisition.”); Sandeep Vaheesan, *American Prosperity Depends on Stopping Mega-Mergers*, FT ALPHAVILLE (Apr. 25, 2019), <https://ftalphaville.ft.com/2019/04/25/1556192949000/American-prosperity-depends-on-stopping-mega-mergers/> (“Encouraging businesses to grow through product improvement and innovation and new investment instead of mergers would make customers, workers, and society much better off. Instead of the fewer choices and higher prices that often follow a merger, customers would have more options, lower prices, and better service. Instead of losing their jobs or receiving lower wages, workers would have more job opportunities and higher wages.”)

⁹⁶ U.S. DEP’T OF JUSTICE, 1968 MERGER GUIDELINES § 2 (1968) [hereinafter 1968 MERGER GUIDELINES] (“Within the over-all scheme of the Department’s antitrust enforcement activity, the primary role of Section 7 enforcement is to preserve and promote market structures conducive to competition. Market structure is the focus of the Department’s merger policy chiefly because the conduct of the individual firms in a market tends to be controlled by the structure of that market, i.e., by those market conditions which are fairly permanent or subject only to slow change (such as, principally, the number of substantial firms selling in the market, the relative sizes of their respective market share, and the substantiality of barriers to the entry of new firms into the market.”).

⁹⁷ *Id.* at § 11.

a vertical merger “tends significantly to raise barriers to entry ... or to disadvantage existing non-integrated or partly integrated firms in either market in ways unrelated to economic efficiency.”⁹⁸

The 1968 Merger Guidelines establish market share thresholds that would trigger a challenge from enforcers. By relying on market shares, the 1968 Merger Guidelines reflect the Clayton Act’s purpose “to preserve and promote market structures conducive to competition.”⁹⁹ These guidelines recognize that “emphasizing a limited number of structural factors also facilitates both enforcement decision-making and business planning.”¹⁰⁰ The DOJ announced that it would “ordinarily challenge” a merger between an upstream firm with 10 or more percent of its market and a downstream firm or firms with 6 percent or more of their respective markets.¹⁰¹

While the 1968 Merger Guidelines recognize the possibility of productive efficiencies from mergers, they, in accordance with congressional intent and controlling Supreme Court precedents,¹⁰² do not permit otherwise illegal mergers on efficiency grounds.¹⁰³ In theory, some vertical integration can allow companies to make a product more efficiently.¹⁰⁴ Nonetheless, the guidelines say, “integration accomplished by a large vertical merger will usually raise entry barriers or disadvantage competitors to an extent not accounted for by, and wholly disproportionate to, such economies as may result from the merger.”¹⁰⁵

The 1968 Merger Guidelines provide two additional justifications for rejecting an efficiencies defense. First, if a company can become more efficient through vertical integration, those efficiencies “can normally be realized through internal expansion into the supplying or

⁹⁸ *Id.*

⁹⁹ *Id.* at § 2.

¹⁰⁰ *Id.*

¹⁰¹ *Id.* at § 12.

¹⁰² *See supra* Part I.

¹⁰³ Today, merging companies today routinely invoke efficiencies as a shibboleth to get past antitrust enforcers. *See, generally* JOHN KWOKA, *MERGERS, MERGER CONTROL, AND REMEDIES: A RETROSPECTIVE ANALYSIS OF U.S. POLICY* (2014). But the presumption that vertical mergers produce efficiencies is supported by neither economic theory nor empirical evidence. Salop, *supra* note 38, at 1987.

¹⁰⁴ *See, e.g.*, NAOMI LAMOREAUX, *THE GREAT MERGER MOVEMENT IN AMERICAN BUSINESS, 1895-1904* 32–33 (1988) (“The iron and steel industry provides an even clearer example of the workings of economies of speed. By the 1890s, large crude-steel manufacturers had so integrated successive stages of production that molten pig iron could be converted into steel and then into rails or billets without reheating.”).

¹⁰⁵ 1968 MERGER GUIDELINES, at § 11.

purchasing market.”¹⁰⁶ Through internal expansion, companies can integrate forward or backward along their supply chain without merging with another company. Second, even if there are obstacles to a firm’s vertical integration through internal expansion, the 1968 Merger Guidelines state that companies could still achieve efficiencies by acquiring smaller firms that would not exceed the thresholds laid out in the guidelines.¹⁰⁷

In using the 1968 Merger Guidelines as a template, the agencies should update and refine them. For instance, markets with network effects have clear consequences for merger enforcement. Enforcers need to be sensitive to dominant players buying up potential competitors that could threaten their market control in the future. As some commentators have argued, dominant firms may engage in predatory or otherwise apparently “irrational” behavior “because the economics and business dynamics of online platforms create incentives for companies to pursue growth at the expense of profits.”¹⁰⁸

Enforcers should be vigilant toward dominant platforms’ acquisitions of seemingly small or marginal firms and be ready to block acquisitions that may be part of a monopoly protection strategy. Dominant firms should not be permitted to expand through vertical acquisitions and cut off budding threats before these have a chance to bloom. Just as it is “inimical to the purpose of the Sherman Act to allow monopolists free reign to squash nascent, albeit unproven, competitors at will,”¹⁰⁹ it should be illegal under the Clayton Act’s incipency standard for firms with market power to buy out nascent competitors.

Adopting key principles from the 1968 Merger Guidelines would not create perfect transparency or predictability but would greatly increase both relative to the status quo. The agencies would still have to define relevant product and geographic markets. And as with any guidelines, the standard and approach set forth would not be completely determinative in deciding whether to challenge a merger. The 1968 Merger Guidelines were not, either. But they

¹⁰⁶ *Id.* at § 16.

¹⁰⁷ *See id.* (“(ii) where barriers prevent entry into the supplying or purchasing market by internal expansion, the Department’s adherence to the vertical merger standards will in any event usually result in no challenge being made to the acquisition of a firm or firms of sufficient size to overcome or adequately minimize the barriers to entry.”).

¹⁰⁸ Khan, *supra* note 61, at 784. *See id.* at 790 (“Because scale is both vital to platforms’ business model and helps entrench their dominant position, antitrust should reckon with the fact that pursuing growth at the expense of returns is—contra to current doctrine—highly rational.”).

¹⁰⁹ *United States v. Microsoft Corp.*, 253 F.3d 34, 79 (D.C. Cir. 2001) (*per curiam*).

represented a postwar recognition of the dangers of unchecked consolidation and calibrated law enforcement to aid in business planning while remaining flexible enough to handle individual cases. “In certain exceptional circumstances,” the guidelines indicated, “the structural factors used in these guidelines will not alone be conclusive,” and the guidelines cited “basic technological changes . . . creating new industries” as an example that might lead the DOJ to try to block a merger, even though the guidelines would seem to allow it, or might lead the DOJ to decline to block it, even though the guidelines might call for otherwise.¹¹⁰ Whereas subsequent guidelines indicated that the government would consider some mergers “practically unassailable,” the agencies under the 1968 Merger Guidelines reserved the right to challenge any merger.¹¹¹

VI. Conclusion

The need for vertical merger guidelines is clear. Vertical mergers can threaten competitive market structures in multiple ways. First, they can allow newly integrated firms to foreclose non-integrated upstream or downstream rivals. Vertically integrated firms can raise the price of vital inputs or deny them outright to non-integrated downstream rivals. They can also reduce or block market access to non-integrated upstream competitors. Second, vertical mergers can facilitate collusion: An upstream or downstream affiliate can share information among rivals and serve to coordinate prices. Third, vertical mergers can eliminate downstream or upstream firms that are the most likely to expand backward or forward and compete in the future.

The Open Markets Institute joins a range of organizations that have called for new guidelines. The current Non-Horizontal Merger Guidelines are generally ignored by enforcers. Because of the lack of a clear analytical framework, the federal antitrust enforcers and courts evaluate vertical mergers under the nebulous rule of reason, which impairs enforcement, frustrates business planning, and hurts public accountability. The lack of guidance introduces uncertainty and subjectivity into the law, as powerfully illustrated by Judge Leon’s June 2018 ruling against the government in *United States v. AT&T Inc.*

¹¹⁰ 1968 MERGER GUIDELINES, at § 2.

¹¹¹ Robert D. Hershey, Jr., *U.S. is Easing '68 Antitrust Guidelines on Mergers*, N.Y. TIMES (June 15, 1982), <https://www.nytimes.com/1982/06/15/business/us-is-easing-68-antitrust-guidelines-on-mergers.html>.

The proposed vertical guidelines, however, have fundamental deficiencies and should not be adopted. They flout the Clayton Act in two ways. First, they ignore the incipiency standard in the Clayton Act and reflect agency revision—not faithful application—of the statute and controlling precedent. Second, they recognize an efficiencies defense to otherwise illegal mergers. The Supreme Court expressly rejected this defense. The FTC and the DOJ are not at liberty to ignore statute and precedent in agency guidance documents, including those that do not carry the force of law, and must honor the text and purpose of federal statutory law.

The FTC and the DOJ should abandon the proposed vertical merger guidelines and draft guidelines that advance the purpose of the Clayton Act. Two essential principles for vertical merger guidelines today should be the 1968 Merger Guidelines’ emphasis on market share thresholds and the rejection of an efficiency justification for a merger, based on the Clayton Act’s aim of stopping mergers that threaten competitive market structures. In accordance with the Clayton Act, once firms reach a certain size, they should not be allowed to engage in vertical mergers and acquisitions that could protect or enhance their market power.

Commenters

The **Open Markets Institute** is a nonprofit organization dedicated to promoting fair and competitive markets. It does not accept any funding or donations from for-profit corporations. Its mission is to safeguard our political economy from concentrations of private power that undermine competition and threaten liberty, democracy, and prosperity. The vigorous enforcement of the antitrust laws against corporate mergers is essential to protecting the U.S. economy and democracy from monopoly and oligopoly. The Open Markets Institute regularly provides expertise on antitrust law and competition policy to Congress, federal agencies, courts, journalists, and other members of the public.

The **American Economic Liberties Project** is a new, independent organization fighting against concentrated corporate power to realize economic liberty for all, in support of a secure, inclusive democratic society. Our independent team and growing network include policymakers, lawyers, economists, working people, business owners, artists, and activists allied against excessive consolidations of economic and political power.

Frank Pasquale is the Piper & Marbury Professor of Law at the University of Maryland. He is an expert on the law of artificial intelligence, algorithms, and machine learning. His widely cited book, *The Black Box Society* (Harvard University Press, 2015), develops a social theory of reputation, search, and finance, and promotes pragmatic reforms to improve the information economy. He is on the academic advisory board of the Open Markets Institute. He is also an Affiliate Fellow at Yale University's Information Society Project, a member of the National Committee on Vital and Health Statistics and of the American Law Institute.

Maurice E. Stucke is the Douglas A. Blaze Distinguished Professor of Law at the University of Tennessee. He has worked for more than 25 years in private practice and as a prosecutor at the Department of Justice. He has testified before and provided expert reports for multiple governments and intergovernmental agencies, including the European Commission, OECD,



**AMERICAN
ECONOMIC
LIBERTIES
PROJECT**

United Nations, and World Bank. He co-authored three books: *Competition Overdose: How Free Market Mythology Transformed Us From Citizen Kings to Market Servants* (HarperCollins, forthcoming in 2020); *Virtual Competition: The Promise and Perils of the Algorithm-Driven Economy* (Harvard University Press 2016); and *Big Data and Competition Policy* (Oxford University Press 2016). He is on the academic advisory board of the Open Markets Institute. He also serves as a nongovernmental advisor to the International Competition Network and on the boards of the Institute for Consumer Antitrust Studies, the American Antitrust Institute, and the Academic Society for Competition Law.