CLIFFORD

CHANCE

DOJ AND FTC RELEASE DRAFT VERTICAL MERGER GUIDELINES: A GLOBAL PERSPECTIVE

Last week, the U.S. Federal Trade Commission ("FTC") and the Antitrust Division of the U.S. Department of Justice ("DOJ") (together the "U.S. Agencies") jointly released draft 2020 Vertical Merger Guidelines ("Guidelines") for public comment. This much anticipated update to the 1984 Non-Horizontal Merger Guidelines ("1984 Guidelines"), provides an analytical framework into how the FTC and DOJ evaluate the competitive effects of vertical mergers. While Assistant Attorney General Makan Delrahim asserts the draft Guidelines reflect "new economic understandings" and FTC Chairman Joseph Simons states they provide "greater transparency," the analytical framework outlined is not groundbreaking. Perhaps more noteworthy is the fact that the two Democratic FTC Commissioners abstained from voting on the Guidelines, which they did not think were aggressive enough. It is clear, however, the release of these Guidelines confirm that vertical mergers will continue to be an enforcement priority for both the FTC and DOJ.

Today, in our ever-increasing global economy it is important to understand the impact of these proposed Guidelines in conjunction with guidance from other jurisdictions, most notably in Europe. As a threshold matter, one notable difference between the new Guidelines, the old 1984 Guidelines and the European Commission's Guidelines on the Assessment of Non-Horizontal Mergers Under the Council Regulation on the Control of Concentrations Between Undertakings ("EC Guidelines") is that the new proposed Guidelines have no general statement that vertical mergers are less likely to generate competitive harm than horizontal mergers. Both the EC Guidelines and the former 1984 Guidelines explicitly recognize that "non-horizontal mergers are generally less likely to significantly impede effective competition than horizontal mergers."

Attorney Advertising: Prior results do not guarantee a similar outcome

The Guidelines are intended to provide antitrust practitioners and the business community with greater transparency regarding the analytical framework the U.S. Agencies employ when assessing vertical mergers. Summarized below are key take-aways from the Guidelines:

RELATIONSHIP WITH THE HORIZONTAL MERGER GUIDELINES

The Guidelines adopt the well-established principles in the Horizontal Merger Guidelines[1] regarding market definition, including how to define product markets and measure concentration levels, and evaluating evidence of adverse competitive effects of a vertical merger. The Guidelines also introduce the concept of "related products," which are defined as products or services that are "supplied by the merged firm, [are] vertically related to the products and services in the relevant market, and to which access by the merged firm's rivals affects competition in the relevant market," such as an input, means of distribution, or access to certain customers.[2]

THRESHOLDS

The Guidelines establish a "soft" 20 percent threshold, where the U.S. Agencies are "unlikely to challenge a vertical merger" if the merging parties have less than a 20 percent share of the relevant market and the related product is used in less than 20 percent of the relevant market. However, the Guidelines do not set a presumption of anticompetitive harm if market shares are higher than the threshold and the Guidelines note that "[i]n some circumstances, mergers with shares below the thresholds can give rise to competitive concerns."[3] The Guidelines focus more on the competitive effects analysis, rather than rigid formulaic assessments of market shares.

UNILATERAL AND COORDINATED EFFECTS

The unilateral effects theories of harm discussed in the Guidelines include: (a) foreclosure and raising rivals' costs, and (b) access to competitively sensitive information. The foreclosure and raising rivals' costs theories suggest that "[a] vertical merger may diminish competition by allowing the merged firm to profitably weaken . . . one or more of its actual or potential rivals in the relevant market by changing the terms of those rivals' access to one or more related products."[4] Alternatively, the merged firm could refuse to supply competitors altogether, which would foreclose their access to a necessary product or service, or access to a necessary group of customers. Vertical mergers may also enable the combined firm to obtain competitively sensitive business information regarding its upstream or downstream rivals. Simply having access to information is not sufficient to cause competitive concern, but an anticompetitive effect can occur when the merged company uses this information to change its business practices in response to a rival competitor's actions. Competitors may also refuse to deal with

---

1 U.S. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines (2010), https://www.justice.gov/atr/horizontal-merger-guidelines-08192010.

2 U.S. Dep't of Justice & Fed. Trade Comm'n, Draft Vertical Merger Guidelines, Jan. 10, 2020, https://www.ftc.gov/system/files/documents/public_statements/1561715/p810034verticalmergerguidelinesdraft.pdf.

3 *Id.*

4 *Id.*

the merged company and become less competitive by having to rely upon weaker trade partners or purchasing inputs at higher prices or that are lower quality.

The Guidelines also explain how vertical mergers may lead to coordinated effects. Under a coordinated effects theory, a vertical transaction may "eliminate or hobble" a "maverick" firm that would otherwise prevent or limit anticompetitive coordination in the relevant market. The Guidelines note that in a vertical merger the merged firm's access to sensitive information could also lead to coordinated effects theories of harm by facilitating a tacit agreement, detecting cheating, or punishing cheaters.

EFFICIENCIES AND DOUBLE MARGINALIZATION

Finally, the Guidelines discuss the elimination of double marginalization, which can occur with vertical integration. According to the Guidelines, the U.S. Agencies "will not challenge a merger if the net effect of eliminat[ing] double marginalization means that the merger is unlikely to be anticompetitive in any relevant market."[5] However, the U.S. Agencies only recognize the elimination of double marginalization as a pro-competitive efficiency if it is cognizable and merger specific, which are the same requirements set forth in the Horizontal Merger Guidelines and generally applicable to all alleged efficiencies.

COMPARISON TO OTHER JURISDICTIONS

Soft Thresholds

The draft Guidelines are not unique in providing a minimum market share threshold, however, the Guidelines miss the opportunity to create cross-border consistency, particularly with the European Commission.

The European Commission's vertical merger guidelines state the Commission is "unlikely to find concern" with a vertical merger affecting less than 30 percent of the relevant markets and the post-merger HHIs fall below 2000.[6] Most European authorities have adopted a similar approach. The proposal of a 20 percent threshold in the draft U.S. Guidelines creates a discrepancy between the U.S. and the European Commission's guidelines causing unnecessary uncertainty within the business and legal communities and, could, lead to inconsistent enforcement outcomes.

Europe is not alone. Both Japan and Chile have adopted thresholds similar to the European Commission. The Japanese competition authority ("JFTC") uses two thresholds. In Japan, a vertical merger is unlikely to restrain competition if either: 1) the combined entity's market share is below 10 percent in all relevant markets, or 2) the post-merger HHI is below 2,500 and the combined entity's market share is below 35 percent.[7] Chile's FNE has explained that for vertical mergers in the

---

5 *Id.*

6 European Commission, *Guidelines on the Assessment of Non-Horizontal Mergers Under the council Regulation on the Control of Concentrations between Undertakings* (2008), https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2008:265:0006:0025:en:PDF [hereinafter EC Guidelines].

7 Japan Fair Trade Commission, *Guidelines to the Application of the Antimonopoly Act Concerning Review of Business Combination*, part V (2004), https://www.jftc.go.jp/en/legislation_gls/imonopoly_guidelines_files/191217GL.pdf [hereinafter Japan Guidelines].

technology, media and telecom sectors a 30 percent market share is necessary to trigger heightened scrutiny.[8]

On the other hand, jurisdictions such as the United Kingdom and Canada do not establish safe harbor thresholds. Guidelines issued by the UK's Competition and Markets Authority ("CMA") and Canada's Competition Bureau each address the analytical approach used to review vertical mergers, while noting particular theories of harm that are unique to or especially applicable in the context of vertical mergers.[9]

Information Sharing Guidance

The Guideline's focus on concerns stemming from information exchanges is also noteworthy, particularly when compared to other jurisdictions. The European Commission's Vertical Merger Guidelines explain that access to competitively sensitive information can give rise to both unilateral and coordinated effects. Unilaterally, "by becoming the supplier of a downstream competitor, a company may obtain critical information, which allows it to price less aggressively in the downstream market."[10] On the other hand, "vertical integration may facilitate coordination by increasing the level of market transparency between firms through access to sensitive information on rivals or by making it easier to monitor pricing."[11] However, much less focus is placed on information exchange theories of harm in the European Commission's guidelines than in the Guidelines.

The JFTC and the UK's CMA likewise explain that access to competitively sensitive information can give rise to both unilateral and coordinated effects. The CMA's treatment of the topic is brief but aligns with the explanation provided by the EC.[12] The JFTC, by contrast, discusses the subject in some depth.[13] Again, though, access to competitively sensitive information is not given the same focus in these other jurisdictions as it is in the Guidelines.

Other jurisdictions have not fully elaborated the theory of harm arising from exchange of competitively sensitive information but have at least indicated that it is a relevant consideration. For example, in its analysis of the ATT/Time Warner merger, Chile noted the ability and incentive for the merging parties to exchange information strategically and sought remedies to restrict sharing between DirectTV and Time Warner.[14]

The special attention paid to access to competitively sensitive information in the Guidelines is not surprising given recent FTC precedent. For example, in January 2019, the FTC reached a consent decree pertaining to Staples Inc.'s ("Staples"), owned by Sycamore Partners II LP, acquisition of Essendant Inc. ("Essendant")

---

8 *Vertical Mergers in the Technology, Media and Telecom Sector – Note by Chile*, OECD (May 20, 2019), https://one.oecd.org/document/DAF/COMP/WD(2019)71/en/pdf.

9 UK Competition Commission & Office of Fair Trading, *Merger Assessment Guidelines*, section 5.6 (2010), https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/284449/OFT1254.pdf [hereinafter UK Guidelines]; Canada Competition Bureau, *Merger Enforcement Guidelines*, part 11 (2011), https://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/03420.html [hereinafter Canada Guidelines].

10 EC Guidelines, para. 78.

11 *Id*. at para. 86.

12 UK Guidelines, section 5.6.13 and 5.6.15.

13 Japan Guidelines, part V.

14 *Vertical Mergers in the Technology, Media and Telecom Sector*, *supra* note 8.

based solely on concerns pertaining to access to information.[15] As a national wholesale distributor of office products to commercial resellers, including Staple's competitors, Essendant maintained competitively sensitive information about Essendant's reseller's end customers. The FTC alleged that, by gaining access to this competitively sensitive information, Staples could substantially lessen competition by changing its pricing behavior when bidding for end-customer business. The FTC ultimately allowed the deal to proceed, but required strict information firewalls and the implementation of a compliance monitor.[16]

TAKE AWAYS

While the long-awaited Guidelines give some insight into the U.S. Agency's analytical framework for analyzing vertical transactions, they fail to offer any groundbreaking revelations. The Guidelines confirm long-established theories of potential harm and cite heavily to the existing Horizontal Merger Guidelines.

Perhaps the most notable aspect of the Guidelines is the "soft" 20 percent threshold. The draft Guidelines miss the opportunity to harmonize their approach with those of the European Commission, Chile and Japan. A threshold discrepancy between international competition authorities creates unnecessary uncertainty in the business community, among the legal community trying to advise clients, and potentially inconsistent enforcement outcomes. Additionally, soft thresholds have a tendency to harden over time. While the soft 20 percent threshold is explicitly not a safe harbor for parties with market shares of less than 20 percent, it may turn out to be the case that, in practice, that same provision creates an antitrust danger zone for companies with shares above that level.

Beyond the dangers created by lack of international harmonization, setting the threshold at 20 percent has the potential to capture many vertical transactions that would be considered only "moderately concentrated," even potentially at the low end of the 1500 to 2500 HHI range. Setting the threshold so low fails to recognize the inherently procompetitive nature of the majority of vertical combinations. A more rational and transparent approach would be to adopt a method of analysis similar to the Statements of Antitrust Enforcement Policy in Health Care and provide a true safety zone "absent extraordinary circumstances."

The lack of unanimity among the U.S. antitrust enforcers in issuing the draft Guidelines is also notable. The abstentions and criticisms from the two Democratic FTC Commissioners provide far less certainty than should be expected from enforcement guidelines. The 2010 Horizontal Merger Guidelines were unanimously supported, with only one thorough concurring statement from Commissioner Rausch. Here, conversely, Commissioner Slaughter argued the Guidelines fail to fulfill the Clayton Act's mandate to stop anticompetitive mergers in their incipiency by setting too high a bar for certainty about anticompetitive harms. Commissioner Chopra called for greater emphasis on the ways that vertical mergers can create barriers to entry and deter new firm formation. He specifically highlighted the ever increasing importance of data pointing to the fact that "many mergers are motivated by a thirst for data. But deals animated by the

---

[15] Consent Order, *In re Sycamore Partners II, Staples, Inc. and Essendant Inc.*, Federal Trade Commission (Jan. 28, 2019), https://www.ftc.gov/system/files/documents/cases/1810180_staples_essendant_agreement_1-28-19.pdf.

[16] It is worth noting that FTC Commissioners Chopra and Slaughter voted in dissent to the consent decree, arguing that the consent decree would not sufficiently protect competition. These are the same two Commissioners that voted against the release of the Guidelines.

acquisition and combination of different data streams are often difficult to characterize within the traditional boundaries of 'horizontal' or 'vertical' integration." As we head into the next election cycle, businesses and legal practitioners should be mindful an administration change could alter the relevance of these Guidelines more significantly than prior iterations.

CLIFFORD CHANCE

CONTACTS

Timothy Cornell
Partner

T +1 202 912 5220
E timothy.cornell@cliffordchance.com

Robert Houck
Partner

T +1 212 878 3224
E robert.houck@cliffordchance.com

Sharis Pozen
Partner

T +1 202 912 5226
E sharis.pozen@cliffordchance.com

Brian Concklin
Counsel

T +1 202 912 5060
E brian.concklin@cliffordchance.com

Michael Van Arsdall
Counsel

T +1 202 912 5072
E michael.vanarsdall@cliffordchance.com

Eva Kurban
Associate

T +1 202 912 5074
E eva.kurban@cliffordchance.com

Lauren Sillman
Law Clerk

T +1 202 912 5089
E lauren.sillman@cliffordchance.com

This publication does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

www.cliffordchance.com

Clifford Chance, 2001 K Street NW, Washington, DC 20006-1001, USA

© Clifford Chance 2020

Clifford Chance US LLP

Abu Dhabi • Amsterdam • Barcelona • Beijing • Brussels • Bucharest • Casablanca • Dubai • Düsseldorf • Frankfurt • Hong Kong • Istanbul • London • Luxembourg • Madrid • Milan • Moscow • Munich • Newcastle • New York • Paris • Perth • Prague • Rome • São Paulo • Seoul • Shanghai • Singapore • Sydney • Tokyo • Warsaw • Washington, D.C.

Clifford Chance has a co-operation agreement with Abuhimed Alsheikh Alhagbani Law Firm in Riyadh.

Clifford Chance has a best friends relationship with Redcliffe Partners in Ukraine.