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Legal Sidebar

# Antitrust Regulators Release New Vertical Merger Guidelines

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On June 30, the Department of Justice (DOJ) and Federal Trade Commission (FTC) finalized new Vertical Merger Guidelines (VMG) outlining their approach to mergers and acquisitions between firms at different stages of a supply chain. The revised guidelines are timely: vertical integration is growing increasingly economically significant and politically fraught. As large firms in major industries—including health care, telecommunications, agriculture, and information technology—make prominent vertical deals, some lawmakers and economists have cast a critical eye toward a phenomenon that was once viewed as largely benign. This Legal Sidebar provides a general overview of vertical merger enforcement and discusses the implications of the new VMG. A companion CRS Insight analyzes competition issues raised by vertical integration in digital markets—a topic that the revised guidelines do not explicitly address.

## Vertical Merger Enforcement

Section 7 of the Clayton Antitrust Act prohibits mergers and acquisitions that may "substantially lessen" competition. The statute applies to both horizontal mergers between competitors (i.e., rival widget manufacturers) and vertical deals between firms at different stages of a supply chain (i.e., a widget manufacturer and a widget retailer).

While horizontal mergers can harm competition by allowing firms to directly absorb rivals, the potential harms of vertical transactions are more indirect. Vertical mergers most often raise antitrust concerns when an integrated firm would have the ability and incentive to "foreclose" rivals from supplies or customers. For example, if a large widget manufacturer acquires a widget retailer, the vertically integrated firm may charge higher prices to competing retailers or withhold widgets from those rivals altogether. And these tactics can harm competition by diminishing the ability of other retailers to challenge the vertically integrated firm. Similarly, if a large widget retailer acquires a widget manufacturer, the vertically integrated firm may refuse to purchase widgets from rival manufacturers, harming their competitive prospects.

But vertical mergers can also generate efficiencies. Because vertically integrated firms acquire inputs at cost while unintegrated companies typically pay a markup, integrated firms can theoretically pass cost

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savings along to their customers. This phenomenon—which antitrust practitioners have dubbed the "elimination of double marginalization" (EDM)—often plays a key role in evaluations of vertical transactions.

Traditionally, the DOJ and FTC—which share authority to enforce federal antitrust law—have policed vertical mergers less aggressively than horizontal deals. This deferential posture toward vertical transactions was driven in part by academic theories from the Chicago School of antitrust analysis, which heavily influenced antitrust doctrine in the 1970s and 1980s. Chicago School theorists viewed vertical integration as unobjectionable and mostly procompetitive, arguing that foreclosure is unlikely and that EDM generally benefits consumers.

But the tide may be turning. Post-Chicago scholarship has challenged the claim that vertical foreclosure is largely nonexistent. Economists have also argued that firms do not always pass the benefits of EDM to consumers. And some lawmakers have grown increasingly critical of vertical consolidation as major industries have become more integrated.

These trends may have already influenced the antitrust regulators. In 2017, the DOJ sued to block AT&T's merger with Time Warner in what became the first vertical transaction litigated to judgment in nearly 40 years. While the DOJ was unsuccessful, commentators have speculated that its lawsuit may signal a more skeptical approach toward future vertical deals.

# The New Vertical Merger Guidelines

The revised VMG—which replace the DOJ's increasingly outdated 1984 Non-Horizontal Merger Guidelines—reflect the analytical framework that now guides the antitrust regulators' review of vertical transactions. While the new guidelines are not legally binding, courts will likely treat them as persuasive authority in evaluating merger challenges, especially in light of the thin case law on vertical deals.

The revised VMG begin with a recitation of familiar antitrust principles. The DOJ and FTC explain that they scrutinize proposed mergers for possible harms to *competition* but do not seek to protect *competitors*. Although the agencies note that problematic horizontal mergers are more common than objectionable vertical deals, they acknowledge that vertical integration is "not invariably innocuous." The guidelines then discuss the harms and benefits that the regulators weigh in assessing vertical mergers. Consistent with post-Chicago scholarship and recent enforcement actions, the VMG identify a range of possible harms from vertical transactions, including the following:

- **Foreclosure and Raising Rivals' Costs.** The new VMG explain that the DOJ and FTC will analyze whether vertical mergers are likely to give integrated firms the ability and incentive to (1) refuse to supply rivals with a product or service, or (2) raise rivals' costs by increasing the price or degrading the quality of a product or service.
- **Access to Competitively Sensitive Information.** The VMG note that some vertical deals may give integrated firms access to rivals' sensitive business information, which may deter those rivals from taking certain procompetitive actions. While the guidelines do not offer an example here, commentators have theorized that integrated firms that sell inputs to competitors may have a window into those competitors' new product offerings. If an integrated firm uses this information to quickly imitate those products, the firm's downstream rivals may lose the incentive to innovate.
- **Coordinated Effects.** Finally, the regulators explain that some vertical mergers may facilitate post-merger coordination among competitors. For example, a vertical deal might eliminate or hinder a "maverick" firm that disciplined market pricing. A vertical merger might also allow an integrated firm to more easily detect "cheating" on tacit

- agreements—for example, implicit agreements to restrict output—by rivals that purchase the firm's products.

On the "benefit" side of the ledger, the VMG identify the standard efficiencies that firms proffer in defense of vertical integration. Specifically, the DOJ and FTC acknowledge that vertical mergers can generate procompetitive benefits from EDM and the combination of complementary economic functions. Although the guidelines explain that it is "incumbent" upon merging firms to substantiate claimed efficiencies, the agencies note that they may also "independently" assess such claims "based on all available evidence."

# Issues for Congress

While the new VMG expand upon the 1984 guidelines, they have also generated criticism from commentators who contend they do not go far enough. Both Democratic FTC Commissioners dissented from the revised guidelines, arguing that they overemphasize the benefits of vertical integration, neglect the unique issues posed by digital markets, and fail to address important topics like labor market competition, nonprice harms, and remedies. Some Members of Congress have also echoed similar concerns.

To address these issues, Congress could instruct the agencies to revisit the VMG, directly amend the antitrust laws, or enact sector-specific competition regulation. For example, S. 307 in the 116th Congress would broaden the legal standard under which the agencies can block mergers and shift the burden of proof to defendants in merger challenges involving large companies. Some commentators have also urged Congress to pass legislation adopting presumptions of illegality and even outright bans on vertical integration by dominant technology platforms. Finally, Congress can use its investigative powers to further examine the effects of vertical integration—a subject that is likely to be of interest when the CEOs of four large technology companies testify before the House Judiciary Committee later this month.

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