FREE STATE FSF FOUNDATION

Federal Trade Commission
600 Pennsylvania Avenue NW
Washington, DC 20580

U.S. Department of Justice
Antitrust Division
950 Pennsylvania Avenue NW
Washington, DC 20580

**Re: FTC and DOJ Announce Draft Vertical Merger Guidelines for Public Comment**

To the FTC Commissioners and Staff and the DOJ Antitrust Division:

**Introduction and Summary**

These comments express the views of Randolph May, President of the Free State Foundation, and Theodore Bolema, Director of the Institute for the Study of Economic Growth at Wichita State University and a member of the Board of Academic Advisors of the Free State Foundation.[1] The Free State Foundation is an independent, nonpartisan, non-profit free market-oriented think tank focusing heavily on communications and Internet law and policy. Within the realm of that communications and Internet law and policy work, the Free State Foundation has focused on, and devoted scholarly resources to, researching and writing about public policy-related issues. It is with this expertise and experience in mind that we offer these comments on the two agencies' proposed vertical merger guidelines.

[1] The views expressed do not necessarily represent the views of others associated with the Free State Foundation or Wichita State University.

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The Draft Vertical Merger Guidelines (Draft Guidelines) released on January 10, 2020, by the Department of Justice (DOJ) and the Federal Trade Commission (FTC) are the first updated vertical merger guidelines by the agencies since the 1984 Non-Horizontal Merger Guidelines (1984 Guidelines). As such, the 1984 Guidelines did not reflect current economic analysis, particularly regarding "unilateral effects" theories of harm. In that regard, the Draft Guidelines explain how the agencies will assess unilateral concerns, including foreclosure and raising rivals' costs. Incorporating these theories into enforcement guidelines is positive development and generally done well in the Draft Guidelines, but could be improved with some additional clarification.

Even more importantly, the authors of the Draft Guidelines wisely did not succumb to calls for more interventionist enforcement based on structural factors and, instead, generally retained case-by-case enforcement. Retaining case-by-case enforcement is appropriate because even though the 1984 Guidelines may not have reflected current economic analysis, there is little or no evidence that vertical merger enforcement has not been aggressive enough or has systematically allowed anticompetitive vertical mergers to occur.

Having vertical merger guidelines in place is important because there is much less legal precedent for vertical mergers than horizontal mergers. Antitrust concerns regarding vertical mergers in recent decades usually have been resolved with settlements with the agencies rather than litigated enforcement, with the decision regarding the A&T/Time Warner merger being one of the few recent court decisions providing guidance through legal precedent.[2]

**Vertical Merger Enforcement Should Proceed on a Case-by-Case Basis**

Some have called for more interventionist antitrust enforcement based on certain structural characteristics found in markets where the merging companies operate. In particular, some have claimed that certain structural factors should be presumed anticompetitive. For example, a group of prominent economists have asserted that a vertical merger involving a firm that is dominant on a particular platform should be presumed anticompetitive on the grounds that network effects and economies of scale would raise barriers to entry and increase market power of the dominant firm.[3] They do not argue for *per se* illegality based on these structural characteristics, but they do argue for a shifting of the burden of the proof to the merging parties to show that the vertical merger is not anticompetitive.

Dominance of a firm on a particular platform is an example of a structural characteristic that may well raise legitimate anticompetitive concerns, but this situation can nonetheless be addressed under a case-by-case review. Free State Foundation scholars have advocated for the employment of deregulatory presumptions in the context of assessing competitive effects in the increasingly competitive, technologically dynamic communications marketplace. But shifting the burdens to the parties to a vertical merger based on a structural characteristic would be more of a regulatory

[2] United States v. AT&T, 916 F.3d 1029 (D.C. Cir. 2019).
[3] Jonathan B. Baker, Nancy L. Rose, Steven C. Salop, and Fiona Scott Morton, "Five Principles for Vertical Merger Enforcement Policy," Georgetown Law Working Paper (Apr. 5, 2019), available at https://scholarship.law.georgetown.edu/facpub/2148.

presumption.[4] In effect, deregulatory rebuttable presumptions are a matter of procedure not requiring substantive law change, while it is less clear that a presumption of harm from a vertical merger is not a substantive change. Randolph May points out that similar deregulatory presumptions have been created by other agencies, including:

> FERC's presumption that sellers who "pass[] two indicative . . . screens" lack horizontal market power and the FCC's presumption that foreign carriers with less than 50% market share in relevant foreign markets "lack[] sufficient market power to effect competition in the United States." In both cases, the agency expressly provided for parties who wish to contest the application of the presumption in specific circumstances to make their case to the agency. Similar provisions for contesting the rebuttable presumption could be made by the FCC in implementing Sections 10 and 11 (internal citations omitted).[5]

While some burden-shifting presumptions already exist for horizontal mergers, it is not appropriate at this time to impose new presumptions against vertical mergers. With very little recent caselaw on vertical mergers, we have little or no legal precedent to draw upon for making such a significant presumption in enforcement policy. In contrast, deregulatory presumptions for vertical mergers may be appropriate. The "safe harbor" defined in the Draft Guidelines identifies a situation in which the agencies make a rebuttable assumption of no antitrust harm, so it is an example of a deregulatory rebuttable presumption that is not a substantive law change.

There are good economic reasons for being skeptical about imposing presumptions against allowing vertical mergers to proceed while allowing other presumptions in favor of vertical mergers.[6] Vertical mergers do not involve the loss of a direct competitor, so, if anything, antitrust policy should presume that vertical mergers are less likely to harm consumers or competition than horizontal mergers. We don't necessarily advocate making such a statement in the Draft Guidelines, but rather make this point to stress that the agencies should be reluctant to create any burden-shifting presumption for vertical mergers. Current legal precedent and economic theory are not sufficient to identify the potentially anticompetitive vertical mergers a priori with any confidence. So the Draft Guidelines case-by-case approach continues to be the appropriate policy for identifying vertical mergers that could be anticompetitive.

## "Related" Products

The Draft Guidelines for the first time contains a definition of "related products." This is a useful addition that would benefit from some additional clarification. An upstream input or downstream

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[4] *See, e.g.,* Randolph J. May and Seth L. Cooper, "A Proposal for Improving the FCC's Forbearance Process," Perspectives from FSF Scholars, Vol. 12, No. 4 (Jan. 17, 2017), available at https://freestatefoundation.org/wp-content/uploads/2019/10/A-Proposal-for-Improving-the-FCC%E2%80%99s-Forbearance-Process-011717.pdf.

[5] Randolph J. May, "The FCC Should Employ Rebuttable Presumptions to Reduce Unnecessary Regulation," Perspectives from FSF Scholars, Vol. 14, No. 1 (Jan. 8, 2019), at 11, available at: https://freestatefoundation.org//wp-content/uploads/2019/05/The-FCC-Should-Employ-Rebuttable-Presumptions-in-Forbearance-and-Regulatory-Review-Proceedings-010719.pdf.

[6] Two studies surveying vertical mergers and generally finding a lack of evidence of systematic harm are James C. Cooper, Luke M. Froeb, Daniel P. O'Brien, and Michael Vita, "Vertical Antitrust Policy as a Problem of Inference," 23 International Journal of Industrial Organization 639 (2005), and Francine Lafontaine and Margaret Slade, "Vertical Integration and Firm Boundaries: The Evidence," 45 Journal of Economic Literature 629 (2007).

distribution channel is considered related if access to "an input, a means of distribution, or . . . set of customers" would affect competition in the relevant market. For example, in the challenge to the AT&T/Time Warner merger, DOJ claimed that the combined company could deny access to key Warner programming such as HBO to video programming distributors that compete with AT&T's U-Verse and DirecTV services.

The foreclosure theory raised by DOJ in its AT&T/Time Warner challenge is a plausible economic theory that failed to persuade the court based on the harm not being supported by the DOJ's evidence. The foreclosure and raising rivals' costs theories, which are included in the new Draft Guidelines, were not discussed in the 1984 Guidelines. If including a definition for related products is intended to provide a foundational concept for these vertical theories of harm, then including the definition is a useful addition to the Draft Guidelines. If, however, the concept of "related product" is included to support a separate theory of harm, the agencies should clarify that this is their intent.

We propose that the agencies add some clarifying language to this section of the Draft Guidelines. We do not believe that the agencies intend to create a separate theory of harm by adding this definition of related products, nor should they, but this language appears to be somewhat unclear about what the agencies intended. Moreover, the agencies could add some language on how the agencies plan to determine whether access to a related product affects competition in the relevant market.

**Efficiencies**

The Draft Guidelines recognize that evidence of efficiencies can be used to offset anticompetitive concerns from a vertical merger. This discussion is presented in a rather negative way, however. Section 6 of the Draft Guidelines presents the agencies' discussion of eliminating "double marginalization," or having only one company profiting from marking up prices instead of two. The Draft Guidelines acknowledge that eliminating double marginalization often benefits both the merging companies and their customers. Elsewhere the Draft Guidelines only briefly acknowledge that other efficiencies are possible and refers to efficiency analysis in the Horizontal Merger Guidelines.

AT&T's demonstration of efficiency benefits were a key part of the District Court's analysis when rejecting DOJ's challenge to AT&T's Time Warner acquisition, and the Draft Guidelines suggest that the agencies remain overly skeptical in how they evaluate efficiency benefits.[7] Efficiency benefits from vertical mergers go well beyond the elimination of double marginalization, and include being able to combine complementary assets, streamline production processes, reduce supply chain risk, and spread overhead costs over a larger production base. Antitrust policy that is overly skeptical of efficiency benefits can be particularly harmful if unsuccessful challenges, like the AT&T/Time Warner challenge, have a chilling effect on other vertical mergers where the efficiency benefits outweigh the potential for anticompetitive harm.

[7] *United States v. AT&T Inc*., 310 F. Supp. 3d 161 (DDC 2018).

## Conclusion

Thank you for the opportunity to comment on these issues. For the foregoing reasons, the agencies should act in accordance with the views expressed herein.

Sincerely,

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