UNITED STATES COUNCIL FOR INTERNATIONAL BUSINESS

Re: USCIB Comments on the U.S. Department of Justice and the Federal Trade Commission Draft Vertical Merger Guidelines

The United States Council for International Business ("USCIB") is pleased to submit these comments on the U.S. Department of Justice ("DOJ") and the Federal Trade Commission ("FTC") (together the "Agencies") Draft Vertical Merger Guidelines ("Draft VMGs") issued on January 10, 2020.

USCIB promotes open markets, competitiveness and innovation, sustainable development, and corporate responsibility, supported by international engagement and regulatory coherence. Its members include U.S.-based global companies and professional services firms from every sector of the economy, with operations in every region of the world, generating $5 trillion in annual revenues and employing over 11 million people worldwide. As the U.S. affiliate of the International Chamber of Commerce (ICC), the International Organization of Employers, and Business at OECD (known as BIAC), USCIB helps to provide business views to policy makers and regulatory authorities worldwide, and works to facilitate international trade and investment.[1]

USCIB members understand the tremendous procompetitive benefits and efficiencies that can be associated with vertical mergers. Our members value transparency and predictability in vertical merger enforcement policy and welcome the Agencies' joint effort to clarify the analytic framework and methods they employ to review vertical mergers. We applaud the Agencies for proposing Draft VMGs based on the well-established economics of vertical relationships and grounded in the consumer welfare standard.

USCIB submits these comments to support the Agencies in their effort to issue final Vertical Merger Guidelines that foster transparency and eliminate unnecessary regulatory obstacles to efficient vertical transactions. We respectfully recommend that the Agencies clarify and amend certain sections of the Draft VMGs as described below.[2]

I. Affirm That The United States Does Not Recognize Conglomerate Theories of Harm in Merger Analysis.

The conglomerate theory of harm in merger review was introduced in two high profile European Commission cases. First, in 2001 the Commission acted to block a merger between General Electric and Honeywell,[3] a high-profile decision that drew much attention as an example of

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[1] USCIB at a Glance, https://www.uscib.org/uscib-at-a-glance-ud-2410/.

[2] Proposed additions to text are included in **<u>bold underline</u>**; proposed deletions are noted with ~~strikethrough~~.

[3] Case No. COMP/M.2220 General Electric/Honeywell (July 3, 2001) https://ec.europa.eu/competition/mergers/cases/decisions/m2220_en.pdf.

divergence between U.S. and European merger enforcement law and policy.[4] Then in 2002, the Commission made the decision to block the Tetra Laval/Sidel deal.[5] Although in both cases the European Court of Justice later rejected the vertical and conglomerate effects theories, parties facing a merger review in Europe today continue to face uncertainty and enforcement risk based on a conglomerate theory of harm.[6]

Since most antitrust regimes around the world follow the European competition law model, dozens of newer antitrust agencies are watching these cases with interest. While we do not believe it is the Agencies' intention, USCIB members are concerned that the discussion of "related products" in the Draft VMGs may be misunderstood or misread by newer antitrust agencies as an endorsement of the conglomerate merger theory of harm. We therefore encourage the Agencies to add a footnote to make clear that the guidelines are not an endorsement of the so-called conglomerate merger theory of harm.[7]

II. Emphasize That the Agencies Will Focus on Harm to Competition Not Harm to a Competitor.

USCIB is similarly concerned that international competition enforcers, particularly at newer agencies, may misunderstand the distinction we believe the Agencies intend to draw between a vertical merger that is likely to harm competition and one that may merely harm a rival. We are particularly uneasy with the discussion of the potential for unilateral harm through raising rivals' costs ("RRC") or foreclosure.

As the Agencies understand, a vertical merger raises competitive concerns only where it is likely to substantially lessen competition. While the Agencies do state that they will focus on "harm to competition" and harm to competitors that is likely to "reduc[e] the competitive constraint imposed by those rival firms"[8] we are concerned that less experienced agencies may misconstrue subtle language throughout the document. USCIB thus respectfully requests that the Agencies make the point more express by amending the text as follows.

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[4] See then Deputy Assistant Attorney General, Deborah Platt Majoras, GE-Honeywell: The U.S. Decision (Nov. 29, 2001) https://www.justice.gov/atr/speech/ge-honeywell-us-decision.

[5] Case No. COMP/M.2416 Tetra Laval/Sidel (Jan. 30, 2002) https://ec.europa.eu/competition/mergers/cases/decisions/m2416_20020130_1240_en.pdf.

[6] Examples of EC approvals of mergers subject to behavioral commitments to remove conglomerate theory of harm concerns in recent years include M.7822 Dentsply/Sirona, M.7873 Worldline/Equens/Paysquare, M.8124 Microsoft/LinkedIn, and M.8314 Broadcom/Brocade, M.8084 Bayer/Monsanto, and M.8306 Qualcomm/NXP. In M.8394 Essilor/ Luxottica the Commission considered conglomerate theory but the deal was eventually cleared without conditions.

[7] For example, the Agencies could amend the language on page 2 stating that "These Guidelines are intended to assist the business community and antitrust practitioners by increasing the transparency of the analytical process underlying the Agencies' enforcement decisions **regarding vertical mergers**." The Agencies could consider then appending a footnote to that sentence stating that the guidelines apply to vertical mergers and should not be read as an endorsement of conglomerate theories of harm.

[8] Draft VMGs at 5.

> **5. UNILATERAL EFFECTS**
> A vertical merger **raises competitive concerns only where it is likely to harm competition. While harm to competitors alone does not raise competitive concerns, a vertical merger that harms a rival may also harm competition by diminishing an important competitive constraint on the merging firms' decisions on price, quality, or other dimensions of competition.** ~~may diminish competition between one firm and rivals that trade with, or could trade with, the other merging firm.~~ Whether the elimination of double marginalization…

III. No Presumption of Harm Applies in the Case of a Vertical Merger

In the discussion of unilateral effects in Section 5.a., the Agencies identify a set of four factors that they may consider in evaluating the potential for post-merger competitive harm through RRC or foreclosure.[9] Those factors include whether a post-merger decision to discontinue supply or raise price to a rival would cause customers to shift from the rival to the merged entity. The Agencies state that mergers where these conditions are met, and the effects are more than de minimis, "raise significant competitive concerns and often warrant scrutiny."[10]

USCIB is concerned that this section may be misunderstood by courts or foreign jurisdictions to suggest a presumption of harm based on thin conditions that do not, standing alone, suggest harm is likely, even under a Section 7 incipiency standard. The Agencies themselves recently recognized that even where good data is available, estimating the post-merger firm's incentive and ability to harm competition through foreclosure or RRC is an uncertain exercise, which must simultaneously account for the more likely benefits from the elimination of double marginalization and other efficiencies.[11] Even noted antitrust scholars who advocate for more vigorous vertical merger enforcement reject simple presumptions of harm for vertical merger analysis.[12]

Though we do not believe that the Agencies intend to create even a soft presumption of harm, USCIB respectfully requests that the Agencies make this important point express by amending the text as follows.

> **While the Agencies will not apply any presumption of harm in to a vertical merger,** [m]ergers for which each of these conditions

[9] Draft VMGs at 5.

[10] Draft VMGs at 5.

[11] DAF/COMP/WD(2019)59 Vertical mergers in the technology, media and telecom sector—Note by the United States (June 7, 2019) ("Where the upstream and downstream markets are both highly concentrated and firms engage in unit pricing, a vertical merger is more likely to generate benefits from EDM. Accordingly, assessing the impact of a vertical merger under [foreclosure or RRC] theories requires balancing any potential competitive harm against EDM and other efficiencies."), https://www.ftc.gov/system/files/attachments/us-submissions-oecd-2010-present-other-international-competition-fora/vertical_mergers_us-oecd.pdf

[12] Steven C. Salop, *Invigorating Vertical Merger Enforcement*, 127 Yale. L.J. 1962, 1974 (2018) ("Salop 2018").

> are met potentially raise significant competitive concerns and often warrant scrutiny.[13]

IV. The Agencies Should Clarify the Concept of a "Related Product" and Provide a More Definitive Safe Harbor for Unconcentrated Markets.

USCIB strongly supports the idea of a safe harbor for vertical transactions that are unlikely to cause competitive harm. However, to provide effective guidance, a safe harbor must be clear and based on statistics or data that are both good predictors of likely competitive harm and easy to compile or calculate. USCIB is concerned that, as drafted, the safe harbor does not meet these goals. In particular, parties in some markets or sectors may find it difficult to identify the related product or understand how to determine if "the related product is used in less than 20 percent of the relevant market."[14] And in other cases, "use" may not be the most relevant measure of likely competitive harm.

The Agencies define a "related product" as "a product or service that is supplied by the merged firm, is 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."[15] The concept is central to the proposed guidance on both unilateral and coordinated effects theories of harm, including application of the proposed quasi-safe harbor.

USCIB recommends that the Agencies clarify their definition and explanation of the concept of a related product. For instance, in the hypothetical merger between a downstream retail chain and an upstream manufacturer of cleaning products in Example 1, the description of the related product is confusing and appears internally inconsistent. Where the relevant market is at the downstream retail level, the Agencies define the related product as the merging firm's supply of cleaning products to the downstream market ("the related product is the supply of the cleaning products by the manufacturer to retailers…"). But where the relevant market is the upstream manufacturing level, the related product is purchase or distribution of "that manufacturer's cleaning products," rather than the merging firm's purchase from, or supply of distribution services to, the upstream relevant market. We respectfully request that the Agencies clarify this example.

The Agencies' application of the concept of the related product to the proposed quasi-safe harbor is also confusing. In Section 3, the Agencies state that one "measure[] of competitive significance of the related product," is "the share of the output in a relevant market *that uses* the related products."[16] While "use" is relatively easy to understand in the example of merger between an orange grove and an orange juice supplier, it is not clear what "use" means in other scenarios. For instance, Example 1 describes a merger between a retail supplier and a

[13] Draft VMGs at 5.

[14] Draft VMGs at 3.

[15] Draft VMGs at 2.

[16] Draft VMGs at 3 (emphasis added).

manufacturer of cleaning products.[17] If the Agencies define the downstream retail supply of cleaning products as the relevant market, and the merging firm's supply of cleaning products to retailers as the related product, how should the merging parties calculate use in the relevant market? Assuming that the merging retailer represents less than 20 percent of the relevant market, does the safe harbor apply if retailers that represent more than 20 percent of the relevant market offer the manufacturer's product(s), but the product(s) account for less than 20 percent of revenue in the relevant market? The analysis gets even murkier in markets where goods, services, or content is supplied in bundles, such as, for example, video or music streaming services, or cloud or enterprise IT services. Where products are offered in bundles, sales of the bundle may not reflect the competitive significance of each element of the bundle. But if the downstream seller accounts for at least 20 percent of the relevant market, "use" appears to assign equal competitive significance to each element of the bundle, regardless of whether that particular product or service is widely used or drives demand for the bundle in the downstream market.

USCIB recognizes the challenge of creating a screen that captures the relevant competitive dynamics for all fact patterns, particularly for digital and platform markets. However, we encourage the Agencies to provide a more useful screen by expanding the test to apply, in the alternative, where the relevant product represents less than 20 percent of its relevant market. Providing such an alternative would not require parties or the Agencies to necessarily define a relevant market where unnecessary for the analysis, but would create additional certainty for parties analyzing transactions where "use" is not a relevant measure of likely competitive effects. In particular, USCIB recommends amending the text as follows.

> The Agencies are unlikely to challenge a vertical merger where the parties to the merger have a share in the relevant market of less than 20 percent, and the related product **sold by the merging parties** is **either** used in less than 20 percent of the relevant market **or represents less than 20 percent of the relevant market for the related product**.[18]

[17] Draft VMGs at 2.

[18] The Agencies adopted a similar standard for evaluating restraints in IP licensing transactions. Dep't of Justice and Fed. Trade Comm'n, Antitrust Guidelines for the Licensing of Intellectual Property (Jan. 12, 2017) p.24, (https://www.justice.gov/atr/IPguidelines/download). (The Agencies will apply a safety zone for restraings in licensing transactions where "the licensor and its licensees collectively account for no more than twenty percent of each relevant market signficantly affected by the restraint.").

V. The Agencies Should Evaluate the Predictions From Economic Models Together With Other Forms of Evidence.

USCIB agrees with the Agencies that it is appropriate to consider a range of evidence in evaluating the effects of vertical mergers, including actual observed effects in consummated mergers and other real-world economic data.[19] However, we are concerned that in the discussion of foreclosure and RRC theories of harm, the Agencies overemphasize the value of economic models, in isolation from other forms of evidence, in evaluating the competitive effects of a vertical merger.[20] Although the Agencies state that they "do not treat merger simulation evidence as conclusive in itself," they suggest that simulation evidence will carry more weight where different specifications of a model predict a price increase without stressing the need to also pressure test simulation results against historical data from past mergers, or the other forms of real-world economic data discussed just a few paragraphs earlier in the draft.

While USCIB recognizes that economic models and merger simulation can play an important role in merger analysis, antitrust economists understand that merger simulation and other predictive economic models are as much art as science. Even the most thoughtful models are based on highly stylized assumptions that often abstract from the messy details of real-world markets and transactions to predict, at best, tendencies that must be evaluated together with other quantitative and non-quantitative evidence.[21]

USCIB respectfully recommends that the Agencies confirm the need to test even multiple specifications of a model against other forms of evidence by modifying the text as follows.

> The Agencies do not treat merger simulation evidence as conclusive in itself, and they place more weight on whether their merger simulations consistently predict substantial price increases than on the precise prediction of any single simulation, **<u>and where those predictions are consistent with other forms of quantitative and qualitative evidence (Section 4)</u>**.[22]

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[19] Draft VMGs at 4 ("The types of evidence described in Section 2.1 of the HMG can also be informative about the effects of vertical mergers, including: actual effects observed in consummated mergers, direct comparisons based on experience…")

[20] Draft VMGs at 4 ("Where sufficient data are available, the Agencies may construct economic models designed to quantify the likely unilateral price effects resulting from the merger.")

[21] Statement of Commissioner Christine S. Wilson, In the Matter of Staples, Inc./Essendant, Inc., File No. 181-0180 at 6-7 (Jan. 28, 2019), *citing* Michael A. Salinger, *Vertical Mergers*, OXFORD HANDBOOK OF INTERNATIONAL ANTITRUST ECONOMICS 551, 574 (Roger D. Blair & D. Daniel Sokol eds. 2015) ("Wilson Staples/Essendant Statement"), *see also* Salop 2018 at 1979-80 ("These quantitative methodologies can be useful. But, while they are framed as if they are precise predicted price changes, they are more imprecise indicators of the direction and strength of incentives…These quantitative methodologies can be combined with documentary and other evidence to make a more reliable prediction of the likelihood of anticompetitive effects from the proposed merger").

[22] Draft VMGs at 4.

VI. Evidence of a Prior Contractual Relationship Should Not Weigh Against Credit for the Elimination of Double Marginalization.

Vertical mergers often generate efficiencies through the elimination of double marginalization. USCIB commends the Agencies for providing separate guidance on how they will account for the elimination of double marginalization in their analysis. However, USCIB does not believe that a prior contractual relationship between the merging parties that could, in theory, have aligned their pricing incentives, should signal to the Agencies that the later merger is less likely to generate efficiencies through the elimination of double marginalization.

The role of incomplete contracts and transaction costs in shaping efficient vertical relationships is well established.[23] While parties can, in theory, design contracts that align incentives, uncertainty and complexity make it difficult to write complete contract and such efforts can easily fail, particularly in rapidly changing market environments. Parties may turn to vertical integration in response. USCIB recommends that the Agencies recognize that a prior contractual relationship should not necessarily weigh either for or against credit for merger-specific efficiencies resulting from the elimination of double marginalization and should instead evaluate each matter based on the facts, on a case-by-case basis. We accordingly recommend amending the language in Section 6 as follows.

> The effects of the elimination of double marginalization may be lower if, prior to the merger, the parties already engaged in contracting that aligned their incentives, for example by using a two-part tariff with a fixed fee and low unit prices that incorporate no, or a small, margin. **<u>The Agencies will not presume that any such prior contractual relationship weighs against claims that the merger will create efficiencies through the elimination of double marginalization and will evaluate such claims based on the range of available evidence</u>.** The effects of the elimination…[24]

VII. Information Exchanges

The second unilateral effects theory is rooted in the concern that a vertically integrated firm may gain access to competitively sensitive information about an upstream or downstream competitor, and use that information to change how it competes with that upstream or downstream rival. The guidelines further suggest that the competitive concerns are not limited to the risk that a vertically integrated firm may access or improperly use information from a competitor. Rival firms may be reluctant to share information with the vertically integrated competitor, which may effectively eliminate the rival's access to an important input or distributor.

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[23] *See e.g.* Oliver E. Williamson, MARKETS AND HIERARCHIES, ANALYSIS AND ANTITRUST IMPLICATIONS: A STUDY IN THE ECONOMICS OF INTERNAL ORGANIZATIONS (Free Press 1975), Oliver E. Williamson, *The Theory of the Firm as Governance Structure: From Choice to Contract*, 16 J. ECON. PERSP. 171 (2002), Benjamin Klein, Robert G. Crawford & Armen A. Alchian, *Vertical Integration, Appropriable Rents, and the Competitive Contracting Process*, 21 J.L. & ECON. 297 (1978).

[24] Draft VMGs at 7.

While access to a competitor's information can impact the competitive process, the guidelines leave merging parties with little guidance on how the Agencies will evaluate concerns about information exchange. And if the parties are able to show that there is no evidence of foreclosure and that alternate sources of supply exist, concerns about providing confidential information to a competitor or supplier should be mitigated by the lack of foreclosure risk. Respectfully, USCIB submits that this theory is subjective and open to manipulation by third parties. Should the Agencies include this section in the final version of the Guidelines, USCIB requests that the Agencies include further guidance as to precisely how the agencies will evaluate information sharing concerns, as well as how the merging parties may be able to assuage these concerns, through firewalls or other mechanisms. For example, the Agencies should consider if the newly merged businesses will be run separately, in different divisions, or with different profit centers, which would tend to minimize the risk of the anticompetitive exchange of information. We also recommend that the Agencies endorse the use of firewalls when sufficient to protect competition, and provide guidance to the business community on best practices for constructing and implementing a firewall that will allow an otherwise procompetitive deal to proceed.[25]

VIII. Conclusion

USCIB appreciates for the opportunity to provide these comments. Our members would be pleased to further engage with the Agencies about these important issues. USCIB would also welcome the opportunity for Lisa Kimmel, Crowell & Moring LLP, to speak on our behalf during the workshop on either March 11, 2020 or March 18, 2020.

[25] For example, the FTC recently allowed Staples to acquire office supply wholesaler Essendant under a consent order that limits Staples access to the competitively sensitive information of Essendant's customers. In the Matter of Sycamore Partners II, L.P., a limited partnership; Staples, Inc., a corporation; and Essendant Inc., a corporation, File No. 181-0180, Decision and Order, Docket No. C-4667 (Jan. 25, 2019), https://www.ftc.gov/system/files/documents/cases/1810180_staples_essendant_do_and_apps_a-g-redacted_public_version.pdf.