

NON-HORIZONTAL MERGER GUIDELINES IN THE
UNITED STATES AND THE EUROPEAN COMMISSION:
TIME FOR THE UNITED STATES TO CATCH UP?

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INTRODUCTION

Although the vast majority of potentially anticompetitive mergers deal with direct competitors (“horizontal mergers”), mergers involving firms that do not currently compete with one another (“non-horizontal mergers”) can reduce competition under certain circumstances. Non-horizontal mergers are typically divided into three groups: vertical mergers (between firms in a customer-supplier relationship); conglomerate mergers (between firms producing complementary, neighboring, or unrelated products); and mergers of potential competitors (one firm in a market merging with a prospective or constraining competitor).¹ Although there have been relatively few non-horizontal merger challenges compared to the number of horizontal merger challenges, the competition agencies in the United States and Europe have challenged a number of mergers in recent years based at least in part on non-horizontal theories of anticompetitive effects. Moreover, over time economic analysis has progressed in identifying more clearly instances where non-horizontal mergers can result in a reduction in competition.

Given the enforcement history and current economic thinking, the European Commission (“E.C.”) recently issued detailed non-horizontal merger guidelines covering vertical and conglomerate mergers.² In contrast, the U.S. antitrust agencies have not updated their non-horizontal merger guidelines for almost twenty-five years. In the areas of vertical and conglomerate mergers, the U.S. 1984 Non-Horizontal Merger Guidelines

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¹ “Constraining” and “prospective” competitors are also called “perceived potential” and “actual potential” competitors, respectively.

² See generally EUROPEAN COMMISSION, GUIDELINES ON THE ASSESSMENT OF NON-HORIZONTAL MERGERS UNDER THE COUNCIL REGULATION ON THE CONTROL OF CONCENTRATIONS BETWEEN UNDERTAKINGS, 2008 O.J. (C 265) 6, available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2008:265:0006:0025:EN:PDF> (adopted on Nov. 28, 2007 and published on Oct. 18, 2008) [hereinafter E.C. GUIDELINES].

(“1984 Guidelines,” “U.S. 1984 Guidelines,” or “Guidelines”)³ simply do not reflect current economic thinking on merger enforcement, and a wide variety of government officials and the U.S. Antitrust Modernization Commission (“AMC”) have recognized this. Some argue that these Guidelines should not be updated because there is no consensus about how to analyze these mergers and the conditions for anticompetitive effects. Additionally, a public statement about merger enforcement in these areas would encourage much more active enforcement against these mergers than merited. However, the transparency in merger policy and enforcement that guidelines provide is extremely important in ensuring that businesses understand the ground rules. This transparency also provides self-discipline for the agencies to consistently and objectively determine what they will challenge and what they will not. Even if a revision in the 1984 Merger Guidelines is not perfect, the Guidelines could be further refined with experience just as other antitrust guidelines have been. Moreover, now is a particularly good time to start the process of revising the 1984 Guidelines.

Part I of this Article briefly discusses the history, purpose, and contents of the 1984 Guidelines. Part II summarizes the economics of non-horizontal mergers, and some of the recent U.S. and E.C. enforcement history relating to non-horizontal mergers. Part III compares the 1984 Guidelines to those issued by the E.C. (“E.C. Guidelines”). These E.C. Guidelines, issued in October 2008, clearly reflect more recent economic analysis and European Union (“E.U.”) enforcement efforts. Part IV discusses the benefits and costs of updating the 1984 Guidelines. Part V summarizes the lessons the United States can learn from the E.C.’s recent development of non-horizontal merger guidelines, and Part VI explains why now is a particularly good time to start the process of revising the Guidelines.

I. THE 1984 NON-HORIZONTAL MERGER GUIDELINES

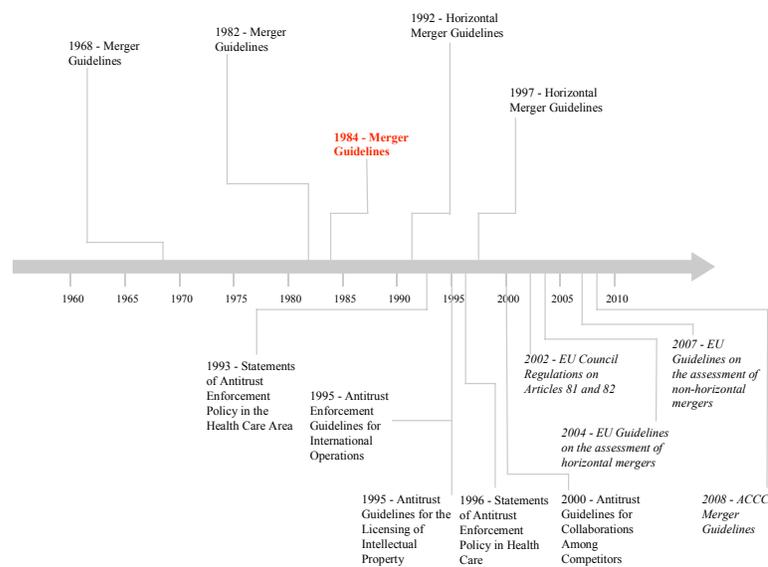
The stated purpose of antitrust guidelines is embodied in the current U.S. Horizontal Merger Guidelines. “The Guidelines are designed primarily to articulate the analytical framework the Agency applies in determining whether a merger is likely substantially to lessen competition”⁴ In attempting to accomplish these goals, the Department of Justice (“DOJ” or “the Department”) and the Federal Trade Commission (“FTC” or “the Commission”) issued or revised merger guidelines five times over the last forty years, as illustrated in Figure 1 above the horizontal timeline. In 1982,

³ U.S. DEP’T OF JUSTICE, MERGER GUIDELINES (1984), *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,103, available at <http://www.usdoj.gov/atr/hmerger/11249.pdf> [hereinafter 1984 GUIDELINES].

⁴ U.S. DEP’T OF JUSTICE & FED. TRADE COMM’N, HORIZONTAL MERGER GUIDELINES § 0.1 (rev. 1997), *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,104, available at <http://www.usdoj.gov/atr/public/guidelines/hmg.pdf> [hereinafter HORIZONTAL MERGER GUIDELINES].

the DOJ completely revised its 1968 Merger Guidelines.⁵ These 1982 Merger Guidelines addressed how the Department would analyze both horizontal and non-horizontal mergers.⁶ In 1984, the DOJ revised the 1982 Guidelines.⁷ In 1992, the DOJ and the FTC issued new Horizontal Merger Guidelines, which did not revise the parts of the 1984 Merger Guidelines that address non-horizontal mergers (1984 Guidelines). Again, the agencies revised the Horizontal Merger Guidelines in 1997, but the changes only relate to how the DOJ and the FTC will view claims of efficiencies from a horizontal merger.

Figure 1: Timeline of Guideline Releases: US, EU and Australia



As illustrated in Figure 1, below the timeline, the agencies issue anti-trust guidelines not just for mergers, but several other areas including the licensing of intellectual property,⁸ cooperation of competitors,⁹ and health

⁵ U.S. DEP'T OF JUSTICE, MERGER GUIDELINES (1968), *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,101, *available at* <http://www.usdoj.gov/atr/hmerger/11247.pdf> [hereinafter 1968 GUIDELINES]; U.S. DEP'T OF JUSTICE, MERGER GUIDELINES (1982), *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,102, *available at* <http://www.usdoj.gov/atr/hmerger/11248.htm> [hereinafter 1982 GUIDELINES].

⁶ 1982 GUIDELINES, *supra* note 5.

⁷ 1984 GUIDELINES, *supra* note 3.

⁸ U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, ANTITRUST GUIDELINES FOR THE LICENSING OF INTELLECTUAL PROPERTY (1995), *available at* <http://www.usdoj.gov/atr/public/guidelines/0558.pdf>.

⁹ FED. TRADE COMM'N & U.S. DEP'T OF JUSTICE, ANTITRUST GUIDELINES FOR COLLABORATIONS AMONG COMPETITORS (2000), *available at* <http://www.ftc.gov/os/2000/04/ftcdojguidelines.pdf>.

care over time.¹⁰ Although the agencies issued these other guidelines more recently than the Merger Guidelines, the agencies also revised some of these guidelines as they gained more experience. For example, the two agencies initially issued the Statements of Antitrust Enforcement Policy in Health Care in 1993, and then revised them in 1996.¹¹

In addition to the U.S. Guidelines, the E.C. issued its own competition and merger guidelines, as shown below the timeline in Figure 1. In particular, the E.C. issued horizontal merger guidelines in 2004 and non-horizontal merger guidelines in 2007. Other countries have also issued merger guidelines that explicitly address how the national agencies analyze vertical and conglomerate effects from mergers. Figure 1 also indicates that the Australian Competition & Consumer Commission (“A.C.C.C.”) issued merger guidelines in November of 2008, which includes sections that explicitly discuss both horizontal and non-horizontal mergers.¹² The A.C.C.C. Merger Guidelines are in substance and structure similar to the E.C. Merger Guidelines.¹³

The 1984 Guidelines focus mainly on anticompetitive concerns that can stem from the merger of potential competitors or from a vertical merger. Regarding the former, these Guidelines distinguish between perceived potential competition and actual potential competition in their discussion of the elimination of potential competitors. The Guidelines note that while non-horizontal mergers may be characterized either as vertical or conglomerate, such distinctions do not add anything substantial to the analysis. Apart from this statement, the Guidelines make no further reference to conglomerate mergers or their enforcement.¹⁴ As such, the 1984

¹⁰ U.S. DEP’T OF JUSTICE & FED. TRADE COMM’N, STATEMENTS OF ANTITRUST ENFORCEMENT POLICY IN HEALTH CARE (1996), available at <http://www.usdoj.gov/atr/public/guidelines/0000.pdf>.

¹¹ Press Release, U.S. Dep’t of Justice & Fed. Trade Comm’n, Justice Department and Federal Trade Commission Issue Revised Antitrust Guidelines for the Health Care Industry (Aug. 28, 1996), available at <http://www.usdoj.gov/opa/pr/1996/August96/412at.htm> (announcing that the two agencies revised the antitrust guidelines for the healthcare industry).

¹² See AUSTL. COMPETITION & CONSUMER COMM’N, MERGER GUIDELINES (2008), available at <http://www.accc.gov.au/content/item.php?itemId=809866&nodeId=7cfe08f3df2fe6090df7b6239c47d063&fn=Merger%20guidelines%202008.pdf> [hereinafter A.C.C.C. GUIDELINES].

¹³ See, e.g., *id.* §§ 1.15 (types of mergers covered), 5 (unilateral effects), 6 (coordinated effects). These Guidelines do not have an independent section on the coordinated effects of conglomerate and vertical merger (while the E.C. Guidelines do); however, the A.C.C.C. Guidelines recognize in section 6 that vertical and conglomerate mergers may give rise to coordinated effects and discuss generally how a merger (of any type) can facilitate coordinated conduct. *Id.* § 6. The A.C.C.C. Guidelines are in many ways similar to the E.C. Guidelines in that they recognize foreclosure and other anticompetitive theories that are absent from the 1984 Guidelines. *E.g., id.* § 5.21-22.

¹⁴ The section on conglomerate mergers from the 1968 Guidelines includes three theories: reciprocity, entrenchment, and potential competition. 1968 GUIDELINES, *supra* note 5, § III. For a discussion of why the theories on conglomerate mergers were dropped in the 1982 Guidelines, see Donald I. Baker & William Blumenthal, *The 1982 Guidelines and Preexisting Law*, 71 CAL. L. REV. 311, 339-42 (1983).

Guidelines do not specifically address any of the potential anticompetitive effects from conglomerate mergers relating to leveraging and other theories discussed in the E.C. or A.C.C.C. guidelines.

The 1984 Guidelines offer a mix of five subjective and objective criteria to determine whether mergers that affect potential competition are harmful. The first is market concentration. Mergers that take place where the concentration in the incumbent firm's market¹⁵ is below a Herfindahl-Hirschman Index ("HHI") of 1800 are unlikely to be challenged, with the likelihood of challenge increasing with increased concentration.¹⁶ Second, if firms without specific entry advantages can enter the incumbent's market relatively easily, then the merger is unlikely to be challenged. Third, if there are three or more firms that possess the entry advantages that are ascribed to the potential entrant, then the merger is also unlikely to be challenged because these firms would likely continue to restrain the merged firm from exercising market power. Fourth, if the incumbent firm involved in the merger has a market share of 5 percent or less, then a challenge to the merger is unlikely. Conversely, the merger is more likely to be challenged if that firm has a market share of 20 percent or more. Finally, the Guidelines state that efficiency criteria will be evaluated in conjunction with these other considerations to weigh the costs and benefits of the merger.¹⁷

For vertical mergers, the 1984 Guidelines identify three areas of concern: creation of barriers (because of the increased need to enter at two levels), facilitating collusion, and permitting the evasion of rate regulation. By and large, the Guidelines suggest that mergers are unlikely to be challenged if entry into either the upstream or downstream market can be accomplished with relative ease.¹⁸ In all matters of vertical integration, the Guidelines set an HHI of 1800 as the minimum level of market concentration above which a merger is likely to be challenged. The Guidelines recognize that challenges depend on a case-by-case evaluation of the competitive effects of a merger.

¹⁵ That is, the concentration of the market where the non-potential entrant that is part of the merger competes before the merger.

¹⁶ 1984 GUIDELINES, *supra* note 3, § 4.131.

¹⁷ Cognizable efficiencies include, but are not limited to, achieving economies of scale, better integration of production facilities, plant specialization, lower transportation costs, and similar efficiencies relating to specific manufacturing, servicing, or distribution operations of the merging firms. The Department may also consider claimed efficiencies resulting from reductions in general selling, administrative, and overhead expenses, or that otherwise do not relate to specific manufacturing, servicing, or distribution operations of the merging firms, although, as a practical matter, these types of efficiencies may be difficult to demonstrate. *Id.* § 3.5.

¹⁸ Ease of entry is determined by the likelihood and probable entry in response to a small but significant and non-transitory increase in price in the market. *See id.* § 4.211-212. The Guidelines also note that different capital requirements and differences in the minimum-efficient-scale of plants in the upstream and downstream markets are two factors that may further constrict the entry opportunities of a firm into a market. *Id.*

To create barriers to entry, a merger between firms in the upstream and downstream markets would have to link the two markets so extensively that future entrants must enter both markets simultaneously, and therefore, make future entry in one of those markets significantly more difficult.¹⁹ However, mergers are unlikely to be challenged if sufficient production capacity exists in either the upstream or downstream markets so that entrants to one market will not be forced to enter both.

The Guidelines also recognize the collusion-facilitating potential of vertical mergers in two areas. The first involves mergers in the retail sector where a merger may make it easier to monitor prices at that level rather than upstream.²⁰ The second stems from the elimination of a particularly aggressive competitor (a “maverick”).²¹ If this were to occur in a market that is generally conducive to collusion, there is potential for anticompetitive harm.

The third area of potential competitive concern for vertical mergers is the evasion of rate regulation.²² For example, a merger between a public utility company and a supplier would potentially allow the utility company to inflate the transfer price of inputs and pass on these increased prices to consumers as legitimate cost increases. While noting that such mergers may have positive efficiency effects, the Guidelines mention that mergers will be challenged where the scope for evading rate regulation is high.

These Guidelines in general recognize the importance of potential efficiencies, particularly vertical mergers. While the Guidelines state that the agencies should consider efficiencies similar to those discussed relating to horizontal mergers, they go on to say that “the Department will give relatively more weight to expected efficiencies in determining whether to challenge a vertical merger than in determining whether to challenge a horizontal merger.”²³ However, these Guidelines do not attempt to explain how the analyses of efficiencies of horizontal and vertical mergers should differ.

II. ECONOMICS OF NON-HORIZONTAL MERGERS AND RECENT ENFORCEMENT HISTORY

Since 1984, there has been a great deal of new economic thinking about the competitive implications of both vertical and conglomerate mergers. Two recent articles by Jeffrey Church discuss in detail the economics

¹⁹ *Id.* § 4.21.

²⁰ *Id.* § 4.221.

²¹ *Id.* § 4.222.

²² 1984 GUIDELINES, *supra* note 3, § 4.23.

²³ *Id.* § 4.24.

literature and the enforcement history in these areas.²⁴ John Kwoka has done the same for potential competition matters.²⁵ Accordingly, this Part provides only a general summary of the economics literature and examples of non-horizontal merger cases.

A. *Vertical Mergers*

The competitive effects of a vertical merger are often ambiguous because there is no elimination of direct competition and there are a number of efficiencies that may result from vertical integration. The Chicago School literature on vertical mergers argues against challenging vertical mergers, greatly influencing enforcement policy. Central to much of the Chicago School's argument supporting the procompetitive effects of vertical integration is the successive monopoly model. Under this model's assumptions, there is only one maximum monopoly profit. Additional monopolies in the manufacturing and distribution chain can only reduce that monopoly profit due to "double marginalization." Double marginalization occurs when an upstream monopolist increases price and restricts output compared to the competitive level, and the downstream monopolist raises prices further and restricts output because of higher input costs. The increase in prices at each level of distribution lead to higher prices to the ultimate consumer and reduce total profits because output is restricted to below the optimal monopoly level. Vertical integration allows the upstream firm to supply inputs to the downstream firm at marginal cost without adding a supracompetitive profit margin. Since output is not restricted at both the upstream and downstream levels, double marginalization does not occur. Other efficiencies from vertical mergers can include the realization of economies of scope, supply assurance, improved information flow and coordination compared to contracting, the elimination of free riding on promotional activities, and the internalization of research and development ("R&D") benefits.²⁶

The elimination of double marginalization provides a strong argument for the procompetitive effects of vertical integration that do not occur in a pure horizontal merger.²⁷ This result, however, depends on the assumptions

²⁴ See generally Jeffrey Church, *Vertical Mergers*, in 2 ISSUES IN COMPETITION LAW AND POLICY 1455 (Dale W. Collins ed., 6th ed. 2008) [hereinafter Church, *Vertical Mergers*]; Jeffrey Church, *Conglomerate Mergers*, in 2 ISSUES IN COMPETITION LAW AND POLICY, *supra*, at 1503.

²⁵ See generally John Kwoka, *Eliminating Potential Competition*, in 2 ISSUES IN COMPETITION LAW AND POLICY, *supra* note 24, at 1437 [hereinafter Kwoka, *Eliminating Potential Competition*].

²⁶ For a discussion of potential efficiencies from vertical and conglomerate mergers, see SIMON BISHOP ET AL., THE EFFICIENCY-ENHANCING EFFECTS OF NON-HORIZONTAL MERGERS (2005), available at http://ec.europa.eu/enterprise/library/lib-competition/doc/non_horizontal_mergers.pdf.

²⁷ The single profit result states that there is only one monopoly rent to be captured between two firms in a vertical relationship. See ROBERT H. BORK, THE ANTITRUST PARADOX 225-45 (1978);

of successive monopolies, linear pricing,²⁸ and the input being used in fixed proportion to other inputs. Absent these assumptions, there is the potential for anticompetitive effects from a vertical merger, although an anticompetitive effect is not guaranteed.

Modern or “post-Chicago” theories of vertical mergers allow for the possibility of foreclosure—or a firm’s capacity to avoid dealing with or otherwise substantially disadvantaging its competitors in a post-merger environment. By considering a broader spectrum of imperfectly competitive markets in the pre- and post-merger environment, the modern literature goes beyond the Chicago School to reveal that vertical integration may lead to anticompetitive outcomes and increased market power under certain circumstances.

The literature in general identifies two types of foreclosure: input foreclosure (where the integrated firm seeks to raise rivals’ costs) and customer foreclosure (where the integrated firm seeks to reduce rivals’ revenues). Michael A. Salinger provides a comprehensive model of input foreclosure assuming oligopoly in both the upstream and downstream markets along with Cournot competition downstream.²⁹ His paper shows that a merger between an upstream and downstream firm could lead to three possible outcomes.³⁰ First, there can be an increase in output of the final good.³¹ Second, there can be a reduction in the demand for the intermediate good.³² Third, the merged firm could withdraw from selling on the intermediate market.³³ Depending on the relative strength of each outcome and the overall market structure, vertical integration could result in an increase in the price of the intermediate good.³⁴ Input foreclosure follows from a vertical merger when the upstream division of an integrated firm either stops supplying inputs to competitors of its downstream division, or continues to sell at a substantially increased price.³⁵ These actions allow the downstream division (which receives inputs at marginal cost) to have a lower cost structure than its rivals.³⁶

Unlike Salinger,³⁷ Ordover et al. assume duopoly in the upstream and downstream markets along with Bertrand competition downstream.³⁸ Like

RICHARD A. POSNER, ANTITRUST LAW 196-201 (1976). As a consequence, integration will not add anything to the market power of the acquiring firm. BORK, *supra*; POSNER, *supra*.

²⁸ That is unit pricing, without non-linear discounting such as rebates.

²⁹ Michael A. Salinger, *Vertical Mergers and Market Foreclosure*, 103 Q.J. ECON. 345, 346 (1988).

³⁰ *Id.* at 345-46.

³¹ *Id.*

³² *Id.*

³³ *Id.*

³⁴ *Id.*

³⁵ See Salinger, *supra* note 29, at 354-55.

³⁶ *Id.*

³⁷ *Id.* at 345-46.

Salinger, their results indicate that vertical integration is capable of bringing about input foreclosure through an increase in the price of the intermediate good.³⁹ More importantly, Ordover et al. show that an acquiring downstream firm may actually have the incentive to foreclose its rivals—a result which the Chicago School has treated as implausible.⁴⁰ These authors also illustrate the conditions under which increased intermediate prices have the effect of increasing final goods prices, thereby harming consumers.⁴¹

These two papers gave rise to a series of additional articles that have produced qualitatively similar results on input foreclosure.⁴² While the 1984 Non-Horizontal Merger Guidelines do not acknowledge the possibility of input foreclosure being the basis for a merger challenge, this argument has been used successfully by both the FTC and the DOJ in challenging vertical merger cases since 1984. The following examples illustrate the agencies' use of input foreclosure arguments in cases since 1990, showing that the agencies often do not follow their Guidelines.⁴³

In 1995, the FTC challenged a merger between workstation manufacturer Silicon Graphics and graphics software firms Alias Research Inc. and Wavefront Technologies Inc.⁴⁴ Both Alias and Wavefront used workstation manufacturers as platforms on which to sell their software, thereby placing them upstream of Silicon Graphics.⁴⁵ The FTC argued that among other factors, the merger would foreclose access by other workstation producers to significant, independent sources of entertainment graphics software thereby giving Silicon Graphics access to sensitive information about other workstation producers.⁴⁶ Furthermore, foreclosure of this nature would increase costs to rivals of Alias and Wavefront, who sought to develop software for Silicon Graphics workstations.⁴⁷ The FTC obtained a consent agreement that a majority of the Commission believed would address the

³⁸ Janusz A. Ordover et al., *Equilibrium Vertical Foreclosure*, 80 AM. ECON. REV. 127, 129 (1990).

³⁹ *Id.* at 129-301.

⁴⁰ *Id.*

⁴¹ *Id.*

⁴² See, e.g., Yongmin Chen, *On Vertical Mergers and Their Competitive Effects*, 32 RAND J. ECON. 667, 667-69 (2001); Gerard Gaudet & Ngo Van Long, *Vertical Integration, Foreclosure, and Profits in the Presence of Double Marginalization*, 5 J. ECON. & MGMT. STRATEGY 409, 409 (1996); Richard S. Higgins, *Competitive Vertical Foreclosure*, 20 MANAGERIAL & DECISION ECON. 229, 229 (1999).

⁴³ Church, *Vertical Mergers*, *supra* note 24, at 1460 & nn.26, 27 (providing a list of twenty-three merger consents or abandoned mergers that involve vertical anticompetitive theories during the 1990s). He lists three cases since 2000. *Id.* at 1460 n.28.

⁴⁴ See Press Release, FTC Consent Agreement with Silicon Graphics, Inc. (Nov. 16, 1995), available at <http://www.ftc.gov/opa/1995/11/sil2g.shtm>.

⁴⁵ See *id.*

⁴⁶ *Id.*

⁴⁷ *Id.*

issues of potential foreclosure raised by the merger.⁴⁸ In particular, the FTC required that Silicon Graphics: (1) offer open architecture and programming interfaces to competitor software developers; (2) offer independent entertainment graphics software companies participation in its software development programs on no less favorable terms than other software developers; and (3) have an FTC-approved “porting agreement” so that two major entertainment software programs could be run on the porting partner’s competing system.⁴⁹

In 1999, book retailer Barnes & Noble and book wholesaler Ingram abandoned a proposed merger after the FTC raised questions about input foreclosure.⁵⁰ Ingram was deemed to be the single largest supplier to independent book shops, so the FTC argued that Ingram’s acquisition by Barnes & Noble would lead to increased costs for other retail customers of Ingram, and, by extension, harm to final consumers.⁵¹ Richard Parker of the FTC stated that

raising rivals’ costs theory ha[d] been developed in the economic literature of the last decade or so, and focuse[d] on the actual impact on competition from foreclosure. The issue is whether the integrated firm after the vertical merger has both the incentive and the ability to increase its rivals’ costs by denying access to essential inputs upstream or to essential outlets for production downstream.⁵²

Not only did the FTC conclude that Barnes & Noble had both the ability and the incentive to foreclose its rivals, but also that it would use financial information acquired by Ingram against rivals.⁵³

The FTC was not alone in challenging mergers in the 1990s based on the potential for input foreclosure. The DOJ considered the acquisition by AT&T of McCaw, a dominant provider of cellular services, to be anticompetitive.⁵⁴ The DOJ reasoned that the merger would reduce other cellular operators’ access to essential infrastructure equipment supplied by AT&T, and thereby harm competition. Since the DOJ thought AT&T had significant market power in the upstream market, AT&T would be in a position to

⁴⁸ *Id.*

⁴⁹ *Id.*

⁵⁰ Richard G. Parker, Senior Deputy Dir., Bureau of Competition, Fed. Trade Comm’n, Address Before the International Bar Association (Sept. 28, 1999), available at <http://www.ftc.gov/speeches/other/barcelona.shtm> [hereinafter *Parker Address*].

⁵¹ Parker noted that possible cost increases could come from increased costs for non-Barnes & Noble bookstores, a reduction in the speed of shipments, restriction of access to certain titles, restriction of access to extended inventory, or generally higher prices and reduction of services. *Id.*

⁵² *Id.* (footnote omitted). Parker cited this theory back to Ordovery et al., *supra* note 38.

⁵³ *Parker Address, supra* note 50. For instance, credit information, titles and quantities of books ordered, promising store locations, and so on. *Id.*

⁵⁴ See Press Release, U.S. Dep’t of Justice, Justice Department Files Antitrust Suit and Consent Decree in AT&T-McCaw Merger (July 15, 1994), available at http://www.usdoj.gov/atr/public/press_releases/1994/211893.pdf.

benefit from the “lock-in” of its customers. The vertical integration between AT&T and McCaw was a potential exacerbation of the lock-in effect, since AT&T might use its market power to limit the supply and raise the price of its equipment. Furthermore, the DOJ reasoned that there “was little elimination of double marginalization, reduction of transaction costs, and opportunity for improved coordination since McCaw did not purchase AT&T equipment and [was] unlikely to do so in the future because it [was] also ‘locked in’ to its current equipment supplier.”⁵⁵ As a remedy, the DOJ required that other cellular operators be able to obtain equipment from AT&T and use alternative suppliers instead.⁵⁶

Although there have been fewer vertical mergers challenged since the 1990s, there still have been investigations and some challenges. For example, Cytoc Corp.’s acquisition of Digene Corp. was blocked in 2003 based in part on a foreclosure argument.⁵⁷ Cytoc’s product accounted for 93 percent of the U.S. market for FDA-approved liquid-based Pap tests, while Digene was the only company selling a DNA-based test for the human papillomavirus (“HPV”). Digene’s test was typically conducted using samples obtained from liquid Pap tests. The FTC stated that “it [was] important that a company manufacturing liquid Pap tests have FDA approval to run the Digene HPV test off its sample medium” as well as viable access to Digene’s HPV test.⁵⁸ The FTC argued that if the merger were to take place, Cytoc’s rivals would have difficulty accessing Digene’s HPV test and gaining much-needed FDA approval, thereby increasing costs to consumers.⁵⁹

Customer foreclosure follows from a vertical merger when the downstream division of a merger-created integrated firm ceases to purchase inputs from competitors of the upstream division. This allows the upstream division of the firm to constrict the revenues of its competitors and thereby increase their cost structure. However, for customer foreclosure to be credible, it must be profit-maximizing for the downstream division to forgo obtaining its inputs from an external supplier. Furthermore, the likelihood and the scope of customer foreclosure depend on whether or not the upstream and downstream firms maximize their joint profits.⁶⁰

⁵⁵ Steven C. Sunshine, Deputy Assistant Att’y Gen., Antitrust Div., U.S. Dep’t of Justice, Remarks Before the American Bar Association Section of Antitrust Law (Apr. 5, 1995), available at <http://www.usdoj.gov/atr/public/speeches/2215.pdf>.

⁵⁶ See *id.*

⁵⁷ See Press Release, Fed. Trade Comm’n, FTC Seeks to Block Cytoc Corp.’s Acquisition of Digene Corp. (June 24, 2002), available at http://www.ftc.gov/opa/2002/06/cytoc_digene.shtm.

⁵⁸ *Id.*

⁵⁹ *Id.*

⁶⁰ This requires that inputs be transferred from the upstream firm to the downstream firm at marginal cost.

The literature on customer foreclosure typically assumes a monopolist downstream and a duopoly upstream.⁶¹ The net impact on downstream prices is a complicated function of the price and cross elasticities of demand between input and downstream products, marginal costs, and the level of double marginalization in the pre-merger environment. Under certain conditions, both upstream and downstream prices may fall—thereby benefiting consumers. Under other circumstances, both prices may rise—thereby hurting consumers. There may also be conditions under which the price of one (inputs or downstream products) rises and the other falls. Under these conditions, consumer welfare may increase or decrease. If the two inputs are close substitutes, then the likelihood of downstream prices increasing is greater.

Despite customer foreclosure's absence from the 1984 Guidelines, the FTC has also invoked the potential for anticompetitive customer foreclosure as a reason for challenging mergers. Customer foreclosure arguments were used, among others, in the 1997 case of Cadence Design Systems (an operator of integrated circuit layout environments) and Cooper and Chyan Technology (a producer of integrated circuit routing tool software).⁶² In this case, routing tools were used as inputs in layout environments, making it a merger between an upstream and a downstream firm in the integrated circuit market. In its complaint, the FTC noted that "Cadence historically [had] been reluctant to provide . . . layout environments to suppliers of integrated circuit layout tools that compete with Cadence products."⁶³ Therefore, the FTC argued that the proposed merger would "make Cadence less likely to permit potential suppliers of . . . routing tools to obtain access to Cadence integrated circuit layout environments."⁶⁴ The FTC negotiated a consent order where developers of integrated circuit routing tools would be able to participate in the merged firm's independent software interface programs at rates no less favorable than the terms applicable to any other participant (i.e., other participants that do not compete with the merging firms' products).

In 2002, the FTC challenged on similar grounds the merger between Synopsys Inc., a producer of front-end tools for chip design, and Avant!

⁶¹ See B. Douglas Bernheim & Michael D. Whinston, *Exclusive Dealing*, 106 J. POL. ECON. 64, 65-67 (1998) (describing exclusive dealing); Michael A. Salinger, *Vertical Mergers in Multi-Product Industries and Edgeworth's Paradox of Taxation*, 39 J. INDUS. ECON. 545, 545-47 (1991) (describing vertical mergers).

⁶² See Complaint ¶¶ 15-20, Cadence Design Systems, Inc. (No. 971-0033), available at <http://www.ftc.gov/os/1997/05/cadence.pdf>; see also Statement of Chairman Robert Pitofsky & Commissioners Janet D. Steiger & Christine A. Varney, Cadence Design Systems, Inc./Cooper & Chyan Technology, Inc. (No. 971-0033), available at <http://www.ftc.gov/os/1997/05/state01.htm>. Consent was subsequently given on this merger. *In re* Cadence Design Sys., Inc., No. 971-0033, 1997 WL 233899 (F.T.C. 1997) (Agreement Containing Consent Order).

⁶³ Complaint, *supra* note 62, ¶ 16.

⁶⁴ *Id.* ¶ 17.

Corp., a producer of back-end tools for chip design. In his consent statement on the matter, FTC Commissioner Thomas B. Leary stated that the case was evaluated by determining whether the acquisition by Synopsis would give it “an incentive to enhance the back-end competitive position of the formerly independent Avant!, by making it harder for competing back-end products to communicate with Synopsis’ dominant front-end product.”⁶⁵ Essentially, the question was whether the merger amounted to customer foreclosure on the part of Synopsis. While the FTC decided to close its investigation on the merger, Commissioner Leary cited the use of customer foreclosure theories in understanding the anticompetitive effects of the merger in his discussion of the case.⁶⁶

Although the U.S. agencies clearly challenge vertical mergers from time to time based on foreclosure theories and there has been substantial economic modeling of the potential for foreclosure, there are many who believe that vertical mergers should seldom (if ever) be challenged. For example, Cooper et al. argue that the recent economic models only show the possibility of anticompetitive effects, and that procompetitive outcomes are much more likely to result from a vertical merger based on existing research.⁶⁷ Others disagree with their interpretation of the existing empirical work.⁶⁸

B. *Conglomerate Merger Cases*

It appears that neither of the U.S. antitrust agencies has pursued a purely conglomerate case (i.e., not horizontal, vertical, or potential competition) since 1984. In contrast, the E.C. has used conglomerate theories to challenge mergers, and these attempts have been controversial, as illustrated by the following five cases.⁶⁹ In general, the cases’ anticompetitive theories are consistent with the economics literature on the potential effects of tying, bundling, and exclusionary practices developed since 1984.

⁶⁵ See Statement of Commissioner Thomas B. Leary, Synopsis Inc./Avant! Corp. (No. 021-0049), available at <http://www.ftc.gov/os/2002/07/avantlearystmmt.htm>.

⁶⁶ *Id.*

⁶⁷ James C. Cooper et al., *Vertical Antitrust Policy as a Problem of Inference*, 23 INT’L J. INDUS. ORG. 639, 639-664 (2005).

⁶⁸ See Frederic M. Scherer et al., *Vertical Antitrust Policy as a Problem of Inference: The Response of the American Antitrust Institute 2* (AAI Working Paper No. 05-04, 2005), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1103589.

⁶⁹ For further discussion of these cases, see U.S. DEP’T OF JUSTICE, RANGE EFFECTS: THE UNITED STATES PERSPECTIVE 12-14 (2001), available at <http://www.usdoj.gov/atr/public/international/9550.pdf>; see also William J. Kolasky, Deputy Assistant Att’y Gen., Antitrust Div., U.S. Dep’t of Justice, Remarks Before the George Mason University Symposium 12-13 (Nov. 9, 2001), available at <http://www.usdoj.gov/atr/public/speeches/9536.pdf>; Paul Yde, *Non-Horizontal Merger Guidelines: A Solution in Search of a Problem?* 22 ANTITRUST 74, 79 (2007).

General Electric and Honeywell (2001).⁷⁰ The U.S. DOJ found that the merger between General Electric (“GE”) and Honeywell would eliminate actual competition in certain aviation markets, and approved the merger on the condition that the merged entity “divest Honeywell’s helicopter engine business and . . . authorize a new third-party [maintenance, repair and overhaul] service provider for certain models of Honeywell aircraft engines and [auxiliary power units].”⁷¹ The E.C., on the other hand, moved to block the merger citing horizontal, vertical, and conglomerate effects.⁷² The horizontal part involved elimination of competition in the market for large regional jet engines, while the vertical part involved input foreclosure (refusal to supply GE’s competitor in the engine market with Honeywell’s engine starters). The conglomerate part involved GE’s potential bundling of aircraft engines with Honeywell’s avionic and non-avionic components, resulting in foreclosure of competitors. The E.C.’s theory is consistent with the strain of models classified as foreclosure by bundling of system’s components, which has been explored by Nalebuff,⁷³ Denicolo,⁷⁴ and Choi.⁷⁵ In these models, the markets of each component are initially oligopolistic and cost advantages due to the “Cournot effect” allows the producer of the system (of components) to price lower than specialist firms initially, eventually driving them out of the market so prices could then be raised.⁷⁶ Nalebuff (the economic expert for GE-Honeywell in the case) specifically applied his model to the GE-Honeywell case, and found no anticompetitive effect.⁷⁷ The case went to court, which upheld the ban on the merger.⁷⁸ However, the

⁷⁰ Commission Decision 2004/134, Gen. Elec./Honeywell, 2004 O.J. (L 48) 1 [hereinafter *GE/Honeywell Comm’n Decision*].

⁷¹ Press Release, U.S. Dep’t of Justice, Justice Department Requires Divestitures in Merger Between General Electric and Honeywell (May 2, 2001), available at http://www.usdoj.gov/atr/public/press_releases/2001/8140.pdf.

⁷² *GE/Honeywell Comm’n Decision*, *supra* note 70, at 5.

⁷³ Barry J. Nalebuff, *Competing Against Bundles* 10 (Yale School of Mgmt., Working Paper No. ES-02, 2000), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=239684.

⁷⁴ Vincenzo Denicolo, *Compatibility and Bundling with Generalist and Specialist Firms*, 48 J. INDUS. ECON. 177, 186-87 (2000).

⁷⁵ Jay Pil Choi, *Antitrust Analysis of Mergers with Bundling in Complementary Markets: Implications for Pricing, Innovation, and Compatibility Choice* 23-24 (NET Inst., Working Paper No. 03-02, 2003), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=617624.

⁷⁶ The “Cournot effect” occurs when there are two complementary products that are valuable only when used together (perfect complements). See Barry J. Nalebuff, *Bundling: GE-Honeywell*, in *THE ANTITRUST REVOLUTION: ECONOMICS, COMPETITION, AND POLICY* 388, 392 (John E. Kwoka & Lawrence J. White eds., Oxford Univ. Press 2004). If there are two independent producers of each product with some degree of market power, then they would set inefficiently-high prices. *Id.* at 392-93. Each producer fails to internalize (does not take into account) the profit increase of the other producer resulting from a reduction in the price of its product. *Id.* This outcome is similar to the “vertical” double mark-up.

⁷⁷ *Id.* at 398.

⁷⁸ Case T-210/01, Gen. Elec. v. Comm’n, 2005 E.C.R. II-5575.

court based its decision on horizontal effect.⁷⁹ The court found a lack of evidence on the conglomerate and vertical effect, although it did not dismiss the theories.⁸⁰

Tetra Laval and Sidel (2001).⁸¹ The E.C. found the merger between Tetra Laval (“Tetra”) and Sidel to have both horizontal and conglomerate anticompetitive effect. According to the E.C., Tetra dominated carton liquid food packaging while Sidel led the industry in producing plastic liquid food packaging. These two are “closely related neighbouring markets,” and thus, their merger would lead to a reduction in actual competition in the overall liquid food packaging market.⁸² Furthermore, the E.C. expressed concern that Tetra would use its dominant position in carton packaging to enhance Sidel’s position in liquid packaging through tying/bundling the two companies’ products. The E.C.’s theories are consistent with the economic model where a monopoly of one market (that of Tetra) is able to leverage its market power into a market with imperfect competition (that of Sidel). The most relevant economics papers on this issue are Whinston⁸³ for tying, and Martin⁸⁴ and Carbajo et al.⁸⁵ for bundling. The case went to court, which annulled the E.C. decision and ordered the E.C. to conduct a second investigation with a broader market definition.⁸⁶ In this second directed investigation, the E.C. approved the merger, subject to compulsory licensing of an upcoming technology Tetra developed.

Boeing and McDonnell-Douglas (1997).⁸⁷ The FTC investigated the merger between Boeing and McDonnell-Douglas, but did not challenge it. The E.C., however, sought to block the merger on grounds of both horizon-

⁷⁹ *Id.* ¶ 65.

⁸⁰ *Id.*

⁸¹ Commission Decision 2004/103, 2004 O.J. (L 38) 1; *see also* Commission Decision, 2004/124, 2004 O.J. (L 43) 13.

⁸² *See* Press Release, European Comm’n, Commission Prohibits Acquisition of Sidel by Tetra Laval Group (Oct. 30, 2001), *available at* <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/01/1516&format=HTML&aged=0&language=EN&guiLanguage=en>.

⁸³ Michael D. Whinston, *Tying, Foreclosure, and Exclusion*, 80 AM. ECON. REV. 837, 855 (1990) (showing that a monopolist can extend its monopoly power to a complementary market, which has imperfect competition, by tying and enjoying a profit that is higher than the one-monopoly profit).

⁸⁴ Stephen Martin, *Strategic and Welfare Implications of Bundling*, 62 ECON. LETTERS 371, 371 (1999) (“Bundling in appropriate proportions is privately profitable, reduces rivals’ profits and overall welfare, and may drive rivals from the market.”).

⁸⁵ Jose Carbajo et al., *A Strategic Motivation for Commodity Bundling*, 38 J. INDUS. ECON. 283, 296-97 (1990) (showing that imperfect competition creates a strategic incentive to bundle).

⁸⁶ *See* Press Release, Court of First Instance, No. 87/02: The Court of First Instance Annuls a Commission Decision Prohibiting the Merger of Tetra Laval and Sidel and the Related Divestiture Decision (Oct. 25, 2002), *available at* <http://curia.europa.eu/en/actu/communiqués/cp02/aff/cp0287en.htm>.

⁸⁷ Commission Decision 97/816, *Boeing/McDonnell Douglas*, 1997 O.J. (L 336) 16.

tal and conglomerate effects.⁸⁸ The horizontal part involved the elimination of an actual competitor in the market for commercial aircraft. Regarding conglomerate effects, the E.C. expressed concern about Boeing's large expansion in the defense and space businesses. The U.S. government funds both Boeing and McDonnell-Douglas, and the E.C. was concerned that the revenue from the government contracts could be used to subsidize the commercial aircraft market.⁸⁹ The E.C. also had concerns that Boeing would abuse its increased bargaining power through exclusive contracting with its suppliers. The E.C. approved the merger with conditions designed to make Boeing's use of R&D funding (on defense and space) transparent, and to limit Boeing's newly-gained bargaining power.

Coca-Cola and Carlsberg (1997).⁹⁰ The E.C. found that the merger between Coca-Cola and Carlsberg would have anticompetitive conglomerate effects, particularly from tying and enhanced efficiency. For tying, the E.C. reasoned that a strong brand such as Carlsberg could enhance market power of other beverages in the proposed merger's portfolio. The E.C. also found that the newly gained economies of scale and economies of scope would ultimately be detrimental to competitors. The E.C. allowed the merger on the condition that the merged entity divest its interest in a bottling company and a cola brand in Denmark.

Guinness and Grand Metropolitan (1998).⁹¹ The E.C. concluded that the merger between Guinness and Grand Metropolitan gave the merged firm "the possibility of bundling sales or increasing the sales volume of one category by tying it to the sale of another category."⁹² However, the E.C. allowed the merger on condition that the merged entity end its distribution of Bacardi rum in Greece.

It seems clear that the E.C. has been challenging mergers and obtaining remedies based on conglomerate anticompetitive theories that are similar to those developed in the recent economic literature. Where these challenges have been appealed, the courts have, in general, not challenged the anticompetitive theories, but instead required that the E.C. provide more evidence of anticompetitive effects. The U.S. antitrust agencies have chosen not to bring conglomerate cases. Moreover, researchers and representatives of the U.S. antitrust agencies frequently criticize the E.C.'s actions.⁹³ In the GE-Honeywell case, for instance, then deputy assistant attorney general William J. Kolasky criticized the E.C. for attempting to protect competitors rather than competition. In the same matter, then deputy assistant attorney

⁸⁸ *Id.* ¶ 20.

⁸⁹ In effect, these concerns were in the spirit of the U.S. 1984 Guidelines' discussion of the avoidance of rate regulation.

⁹⁰ Commission Decision 98/327, *Coca Cola Co./Carlsberg A/S*, 1998 O.J. (L 145) 41.

⁹¹ Commission Decision 96/602, *Guinness/Grand Metropolitan*, 1998 O.J. (L 288) 24.

⁹² *Id.* ¶ 100.

⁹³ See, e.g., *supra* text accompanying note 66.

general Deborah Platt Majoras explained that the evaluation of conglomerate mergers for competitive concerns is a process fraught with error, and that “U.S. antitrust agencies [have] concluded that antitrust should rarely, if ever, interfere with any conglomerate merger.”⁹⁴

C. *Potential Competition Cases*

In two papers, Kwoka discusses potential competition cases, their theory, and some empirical evidence of the effects of potential competition.⁹⁵ Kwoka distinguishes potential competitors into two types: prospective competitors and constraining competitors. According to Kwoka, a prospective competitor “denotes a firm that has the incentive and capability actually to initiate production.”⁹⁶ The elimination of a prospective competitor would thus negate its entry and the associated reduction in market concentration.⁹⁷ A constraining competitor “is a non-incumbent firm that is viewed by incumbents as a threat to enter and thus imposes a very real constraint on their current pricing and other decisions.”⁹⁸ The elimination of a constraining competitor would thus relax the incumbents of such restraints.⁹⁹

Kwoka argues that although there are substantial similarities between a potential competition merger and a merger between incumbents, potential competition mergers are rarely challenged in the United States and are kept “alive by flying under the judicial radar.”¹⁰⁰ Despite this conclusion, Kwoka identifies post-1984 cases in his two papers, although most of the examples are from the 1990s.¹⁰¹ I briefly describe three of these cases from the E.C., and nine cases from the United States (four FTC, three DOJ, and two Federal Communications Commission (“FCC”). Most, but not all of these cases considered the elimination of potential competition as one of several concerns about the proposed merger. The E.C. has also based merger challenges on potential entry theories, and I discuss three recent cases below. It appears that the E.C. may have been more active since 2000 than the U.S.

⁹⁴ Deborah Platt Majoras, Deputy Assistant Att’y Gen., Antitrust Div., U.S. Dep’t of Justice, Remarks Before Antitrust Law Section of the State Bar of Georgia 13-14 (Nov. 29, 2001), available at <http://www.justice.gov/atr/public/speeches/9893.pdf>. DOJ commentators also expressed criticism of the E.C.’s use of range effects in their analysis of GE-Honeywell. See, e.g., Kolasky, *supra* note 69; Yde, *supra* note 69.

⁹⁵ See generally Kwoka, *Eliminating Potential Competition*, *supra* note 25; John E. Kwoka, *Non-Incumbent Competition: Mergers Involving Constraining and Prospective Competitors*, 52 CASE W. RES. L. REV. 173, 174-75 (2001) [hereinafter Kwoka, *Non-Incumbent Competition*].

⁹⁶ Kwoka, *Non-Incumbent Competition*, *supra* note 95, at 174.

⁹⁷ *Id.*

⁹⁸ *Id.*

⁹⁹ *Id.*

¹⁰⁰ *Id.* at 186.

¹⁰¹ *Id.* at 182-86.

agencies in pursuing potential competition cases. Unlike the vertical merger portion of the 1984 Guidelines, these potential competition cases in both the United States and European Union generally follow the tests described in the 1984 Guidelines.

*Hoechst's Acquisition of Marion Merrell Dow (1995).*¹⁰² The FTC found that Hoechst's acquisition of Marion Merrell Dow ("Marion") would eliminate prospective competition in four drug markets, which are characterized by high barriers of entry. In three of the markets, either Hoechst or Marion had a dominant position in the market and the other firm was in the process of developing a competitive product. In the fourth market, Marion was incumbent and Hoechst was jointly developing (with Biovail) a product that would have competed. Although Hoechst gave up its right to this product, the FTC deemed the action insufficient. The parties later agreed to a consent decree with the FTC. In the first three markets, the merging firms had to divest either the incumbent product or the product in development. In the fourth market, Hoechst had to grant Biovail the right of reference to certain research data. The consent decree did not mention explicitly how the elimination of a prospective competitor would harm consumers. This is probably because the consequences of an entry-negating merger are well-accepted.¹⁰³

*Zeneca Group PLC and Astra AB (1999).*¹⁰⁴ The FTC found that the merger between Zeneca Group PLC ("Zeneca") and Astra AB ("Astra") would weaken prospective competition in the market for local anesthetic. Astra was an incumbent in the market and Zeneca was jointly developing a product which would have entered the market. The merging parties entered into a consent decree with the FTC whereby Zeneca surrendered all of its rights towards the prospective product to the partner with which it was developing the product.

*Staples and Office Depot (withdrawn 1997).*¹⁰⁵ The FTC's main concern with the proposed merger between Staples and Office Depot was in actual competition, but it also mentioned elimination of prospective competition. FTC staff initially negotiated with the merging parties, but the Commission ultimately rejected the proposed agreement. The case went to court, and the FTC won a preliminary injunction, in effect stopping the merger.

*Boston Scientific Corp.'s Acquisition of Cardiovascular Imaging Systems and SCIMED Life Systems (1995).*¹⁰⁶ Boston Scientific and Cardiovas-

¹⁰² See Christine A. Varney, Comm'r, Fed. Trade Comm'n, Remarks Before the Fordham Corporate Law Institute Twenty-third Annual Conference on Antitrust Law & Policy (Oct. 17, 1996), available at http://www.ftc.gov/speeches/varney/fcli_96.shtm.

¹⁰³ Kwoka, *Non-Incumbent Competition*, *supra* note 95, at 190.

¹⁰⁴ See *Zeneca Group PLC*, 127 F.T.C. 874 (1999) (consent order).

¹⁰⁵ See *Complaint, FTC v. Staples, Inc.*, 970 F. Supp. 1066 (D.D.C. 1997) (No. 97-701), available at <http://www.ftc.gov/os/1997/04/staples2.pdf>.

¹⁰⁶ See *Boston Scientific Corp.*, 119 F.T.C. 549 (1995) (consent order).

cular Imaging Systems (“CVIS”) both manufactured intravascular ultrasound (“IVUS”) catheters, and the FTC believed that Boston Scientific’s acquisition of CVIS reduced actual competition. At the time, SCIMED Life Systems (“SCIMED”) was a prospective competitor (would have entered within two to three years), so the FTC argued that Boston Scientific’s acquisition of SCMED eliminated the strongest prospective competitor. In addition, the FTC argued that the combined patent pool between Boston Scientific and CVIS made entry more difficult, thus reducing pressure on price by constraining competitors. The merged entity later agreed to the compulsory licensing of IVUS catheter patents to Hewlett Packard in order to create a competitor in the market.

United Airlines and U.S. Airways (withdrawn 2001).¹⁰⁷ The DOJ determined that the merger would have eliminated actual competition in eleven routes and prospective competition in seven routes where U.S. Airways had a monopoly. The DOJ threatened to file a lawsuit, causing United Airlines to abandon its acquisition plan.

Signature and AMR Combs (1999).¹⁰⁸ The DOJ found that the proposed merger between Signature and AMR Combs would have reduced both actual competition at two airports and prospective competition at one airport on the market for fixed-base flight support.¹⁰⁹ The DOJ approved the merger subject to the condition that Signature divest its business at all three airports of concern.

Northwest’s Acquisition of a Controlling Stake in Continental (1998).¹¹⁰ The DOJ’s primary concern in this case was that of actual competition, but it also had concerns about the elimination of potential competition. “Northwest’s acquisition of a controlling interest in Continental . . . will reduce the likelihood that Continental will initiate nonstop service from its hub in Cleveland to cities already served by its controlling shareholder, Northwest, over its hub in Detroit.”¹¹¹ Northwest entered into a consent decree whereby it had to “divest all but seven percent of the voting interest in Continental and would be subject to significant restrictions upon its abil-

¹⁰⁷ See Press Release, U.S. Dep’t of Justice, Department of Justice and Several States Will Sue to Stop United Airlines from Acquiring U.S. Airways (July 27, 2001), available at http://www.usdoj.gov/atr/public/press_releases/2001/8701.pdf.

¹⁰⁸ See *United States v. Signature Flight Support Corp.*, No. Civ.A. 99 CV 0537RCL, 1999 WL 816730 (D.D.C. Mar. 26, 1999).

¹⁰⁹ See Press Release, U.S. Dep’t of Justice, Justice Department Approves Signature’s Acquisition of AMR Combs (Mar. 1, 1999), available at http://www.usdoj.gov/atr/public/press_releases/1999/2265.pdf (“At Denver Centennial Airport, Signature’s entry would have resulted in increased price and quality competition. That potential competition would have been lost without the proposed settlement.”).

¹¹⁰ See *Complaint, United States v. Nw. Airlines Corp.* (E.D. Mich. Oct. 23, 1998) (No. 98-74611), available at <http://www.usdoj.gov/atr/cases/f2000/2023.pdf>.

¹¹¹ *Id.* at 10.

ity to vote any stock it retains.”¹¹² There is no detailed discussion of any theory in the decree.

Primestar’s Acquisition of Satellite Assets from News Corporation and MCI (1989).¹¹³ News Corporation and MCI formed a joint venture, ASkyB, which planned to provide satellite television service. At the time, this would have competed with the cable operators that controlled Primestar. The DOJ believed that the acquisition would have weakened the prospective competitors in the multichannel video programming distribution market. The DOJ filed a civil antitrust suit to block the acquisition, and Primestar subsequently abandoned the planned acquisition.

Ameritech and Southern Bell (1999).¹¹⁴ The FCC found that the merger between Ameritech and Southern Bell would deny “benefits of future probable competition between the merging firms” and increase “the merged entity’s incentives and ability to raise entry barriers to, and otherwise discriminate against, entrants into the local markets in its region.”¹¹⁵ Clearly, the FCC was concerned with the elimination of potential competition between the companies, as well as the possibility of increasing barriers against anyone entering the relevant markets. The FCC approved the merger with conditions designed to open market competition, increase broadband service, and strengthen incentives for the merged entity to expand into new geographical markets.

Bell Atlantic and Nynex (1997).¹¹⁶ The FCC found that the merger would eliminate Bell as a prospective entrant into the New York metropolitan market for telephone services.¹¹⁷ The FCC also found evidence that Bell had conducted studies regarding the possibility of entering the market, and that NYNEX was aware of Bell’s entry plans into New York. Apart from Bell, there were three other prospective entrants (which is enough as specified in the 1984 Guidelines). The FCC eventually approved the merger under conditions designed to facilitate the entry or expansion of competitors in the market. Brenner analyzed this case, focusing on assessing Bell’s sunk assets in the New York market (as it applies to cost advantages for Bell

¹¹² Press Release, U.S. Dep’t of Justice, Department Announces Tentative Settlement in Northwest-Continental Lawsuit (Nov. 6, 2000), available at http://www.usdoj.gov/atr/public/press_releases/2000/6905.pdf.

¹¹³ See Complaint, *United States v. Primestar, Inc.* (D.D.C. May 12, 1998) (No. 98-1193), available at <http://www.usdoj.gov/atr/cases/f1700/1757.pdf>.

¹¹⁴ See Press Release, Fed. Commc’ns Comm’n, FCC Approves SBC-Ameritech Merger Subject to Competition-Enhancing Conditions (Oct. 6, 1999), available at http://www.fcc.gov/Bureaus/Common_Carrier/News_Releases/1999/nrcc9077.html.

¹¹⁵ *Id.*

¹¹⁶ Press Release, Fed. Commc’ns Comm’n, FCC Approves Bell Atlantic/NYNEX Merger Subject to Market-Opening Conditions (Aug. 14, 1997), available at http://www.fcc.gov/Bureaus/Common_Carrier/News_Releases/1997/nrcc7059.html.

¹¹⁷ The services refer to local exchange and exchange access service to residential and small businesses.

compared to other prospective entrants) and the strength and number of other prospective entrants.¹¹⁸

EDP and GDP (2004).¹¹⁹ GDP was the incumbent in Portugal's gas market, while EDP was the incumbent in Portugal's electricity market. EDP, together with an Italian company, planned to acquire joint control over GDP. The E.C. found that this would eliminate GDP as a potential competitor in the electricity market. Additionally, the E.C. was concerned about vertical foreclosure in the electricity market because gas is an essential input to the production of electricity in Portugal. As a result, the E.C. blocked the merger.

Air Liquide and BOC (2000).¹²⁰ The E.C. found that the two companies were the strongest prospective entrants into each other's market. However, the E.C. allowed the merger after the parties agreed to divest certain assets.

Telia AB and Telenor AS (withdrawn 1999).¹²¹ The E.C.'s main concern with the merger between Telia AB and Telenor AS was that of potential competition. There were also concerns regarding actual competition, bundling, and traffic relationship. Regarding potential competition, the E.C. found that Telenor of the Norwegian market and Telia of the Swedish market represented the strongest potential entrant in each other's market. The E.C. gave a detailed explanation on the consequences of elimination of potential competition. In short, to enter a new market, a telecommunication firm would need access to the local network. Telenor and Telia were in a unique position to trade access to each other's network. Other operators in nearby countries (Sweden, Norway, Denmark, and Finland) were either not big enough or barred by regulation from trading network access. Apart from eliminating the strongest potential entrant in both markets, the merger was found to also increase the ability and incentive of the merged entity to eliminate potential (and actual) competition from third parties. Before the merger, if Telia tried to foreclose a potential entrant, this would have led to retaliation by Telenor (and vice versa). The merger would have eliminated this constraint on the incentive to foreclose. Furthermore, the large size of the merged entity would have allowed it to enter Denmark and Finland with less difficulty. This would have deterred Danish and Finnish operators from entering Sweden and Norway for fear of retaliation. The E.C. cleared the merger with conditions covering access to the local networks for telephony as well as requirements that both parties divest their respective cable TV and other overlapping businesses (including the sale of either party's interest in the two existing Irish mobile operators). After all of this, the parties

¹¹⁸ Steven R. Brenner, *Potential Competition and Local Telephone Service*, in THE ANTITRUST REVOLUTION, *supra* note 76, at 73, 74.

¹¹⁹ See Final Report 19/11, EDP/ENI/GDP, 2006 O.J. (C 288) 2.

¹²⁰ Commission Decision 2004/269, *Air Liquide/BOC*, 2004 O.J. (L 92) 1.

¹²¹ Commission Decision 2001/98, *Telia/Telenor*, O.J. (L 40) 1.

withdrew the merger due to the failure to agree on the issue of where the headquarters of the combined group's mobile unit would be.

These cases illustrate that U.S. agencies and the E.C. have pursued potential competition cases since 1984 based on theories similar to those outlined in 1984 Guidelines, although there have been fewer such challenges in the United States in recent years. The economics of potential competition has not changed much, although, as Kwoka argues, new thinking about barriers to entry should make potential competition cases more likely. Given that potential entry into a market is seldom certain and that it can be difficult to show a potential competitor is currently constraining competition in a market, perhaps it is not surprising that there were only a limited number of cases even in the 1990s. In some industries, potential competition cases can be easier to document. For example, the FTC pursued potential competition theories in forcing divestitures in some pharmaceutical mergers. In part, this is because the Food and Drug Administration ("FDA") identifies potential competitors as a drug works its way through the drug approval process. Sometimes, the FTC requires divestitures where two firms are both competing to develop products to treat a disease, and there are no other drugs that currently effectively treat a disease.¹²² In other words, the FTC expressed concern about potential competition in potential markets.

III. U.S. AND E.C. NON-HORIZONTAL MERGER GUIDELINES

A comparison of the E.C.'s 2007 Non-Horizontal Merger Guidelines with the 1984 Guidelines illustrates several areas of difference, at least some of which can be ascribed to the fact that the U.S. Guidelines predate the E.C. Guidelines by some twenty-three years. While there are baseline differences on quantitative measures, such as the use of specific variables in assessing anticompetitive effects, there are also important qualitative differences. The E.C. Guidelines, for instance, take a broader approach that incorporates more potential anticompetitive economic effects than do the U.S. Guidelines. This is particularly true for the potential foreclosure effects of vertical and conglomerate mergers. In fact, the complete absence of a discussion of conglomerate mergers in the 1984 Guidelines stands in contrast to the E.C. Guidelines, which devote substantial attention to conglomerate cases.

There are some differences between the U.S. and E.C. Guidelines with regard to the degree to which each uses market shares and HHI indices as

¹²² For example, the FTC ordered Baxter to license its rights to Fibrin Sealant in its acquisition of Immuno International AG. *In re Baxter Int'l, Inc.*, 123 F.T.C. 904, 910-13 (1997). Baxter and Immuno were two of only a small number of companies seeking FDA approval to market Fibrin Sealant in the United States. *See id.* at 906.

measures of potential anticompetitive behavior. The 1984 Guidelines establish an HHI of 1800 as the lower bound of markets concentrated enough to raise concerns of potential anticompetitive effects.¹²³ The U.S. 1984 Guidelines, as currently drafted, base their structural analysis and objective factors largely on the degree of concentration and market share in the acquiring and acquiree markets.¹²⁴ The E.C. Guidelines, on the other hand, set the lower bound on concentration at an HHI of 2000,¹²⁵ and state that “the existence of a significant degree of market power in at least one of the markets concerned is a necessary condition for competitive harm, but is not a sufficient condition.”¹²⁶ Given that the E.C. has, in general, challenged more non-horizontal mergers in the last twenty years than have the U.S. antitrust agencies, one must believe the U.S. agencies are not following the 1984 Guidelines’ apparently stricter enforcement criteria. If anything, the actual U.S. non-horizontal merger policy for vertical and potential competition mergers is more akin to the E.C. Guidelines than the U.S. Guidelines.

The U.S. 1984 Guidelines obviously do not reflect the additional economic literature in the field of non-horizontal mergers, which becomes more apparent when one compares the 1984 Guidelines to the E.C. Guidelines. Probably the most apparent area of a deficiency in the 1984 Guidelines is their limited discussion of non-coordinated effects, a topic given ample attention in the E.C. Guidelines. The E.C. Guidelines’ primary focus of non-coordinated effects is on the effects of foreclosure that are a product of “Modern Theories” in the vertical merger literature appearing after 1984. The E.C. Guidelines spell out the economics of both input and customer foreclosure, noting how each type of foreclosure affects competition.¹²⁷ Furthermore, the E.C. Guidelines also highlight the differences between the ability and the incentives to foreclose competition, while also examining the likelihood of foreclosure under different scenarios.¹²⁸

In contrast, the U.S. 1984 Guidelines’ presentation of non-coordinated competitive problems from vertical mergers is centered on barriers to entry. These Guidelines state the three conditions necessary (but not sufficient) for such barriers to exist.

First, the degree of vertical integration between the two markets must be so extensive that entrants to one market (the “primary market”) also would have to enter the other market (the

¹²³ 1984 GUIDELINES, *supra* note 3, § 3.1.

¹²⁴ *Id.* § 4.13.

¹²⁵ E.C. GUIDELINES, *supra* note 2, at 9. The E.C. Guidelines establish a post-merger market share of 30 percent as large enough to raise competitive concerns, *see id.*, whereas 20 percent is the analogous figure for the U.S. Guidelines. *See* 1984 GUIDELINES, *supra* note 3, § 4.134.

¹²⁶ E.C. GUIDELINES, *supra* note 2, at 9. Subsequent analysis in the E.C. Guidelines is based on (among other factors) the viability and incentives for foreclosure of competition, price, margins, sales, profits, and other quantitative measures. *See id.* at 9-19.

¹²⁷ *Id.* at 10-19.

¹²⁸ *See id.*

“secondary market”) simultaneously. Second, the requirement of entry at the secondary level must make entry at the primary level significantly more difficult and less likely to occur. Finally, the structure and other characteristics of the primary market must be otherwise so conducive to noncompetitive performance that the increased difficulty of entry is likely to affect its performance.¹²⁹

In this regard, the criteria used to analyze whether or not such conditions exist are identified as the amount of unintegrated capacity, cost of capital for entry into the primary and secondary markets, and the size of minimum-efficient-scale plants.¹³⁰

The E.C. Guidelines’ analysis of foreclosure effects is more consistent with much of the relatively recent literature on vertical integration, in contrast to the analysis of barriers to entry adopted by the U.S. Guidelines. Moreover, the E.C. Guidelines’ foreclosure analysis appears to be more comprehensive because it incorporates all of the anticompetitive concerns related to increasing barriers to entry in addition to several other factors.

The U.S. 1984 Guidelines explicitly discuss the evasion of rate regulation as a reason for potential concern.¹³¹ When monopolistic public utilities, whose price is regulated, merge with an input supplier they may be able to inflate the internal transfer price of the input and pass on increased costs to consumers. This effect is not explicitly discussed in the E.C. Guidelines; it is, however, a unique case of vertical integration that may result in harm to competition.

The U.S. 1984 Guidelines identify two areas in which vertical mergers may facilitate collusion. The first is when integration occurs between wholesalers and retailers. Since retail prices are more visible than wholesale prices, integrated wholesalers (upstream) may be able to collude on downstream prices because of their ability to monitor the market.¹³² The second occurs when a disruptive downstream buyer (one who competed aggressively) is eliminated through vertical integration. This allows upstream firms to collude on price more effectively.¹³³

The E.C. Guidelines outline the same two circumstances under which collusion may take place, while highlighting several other market conditions that may foster collusion in a post-merger environment. For instance, vertical mergers may increase symmetry between firms, thereby increasing the likelihood of coordination.¹³⁴ Similarly, vertical mergers may increase transparency between the upstream and downstream markets not only in prices, but also in information such as production technology.¹³⁵ Further-

¹²⁹ 1984 GUIDELINES, *supra* note 3, § 4.21 (footnote omitted).

¹³⁰ *Id.*

¹³¹ *Id.* § 4.23.

¹³² *Id.* § 4.221.

¹³³ *Id.* § 4.222.

¹³⁴ E.C. GUIDELINES, *supra* note 2, at 20.

¹³⁵ *Id.* at 21.

more, integrated firms may also find it easier to punish rivals that deviate from the terms of coordination because of the market power acquired through foreclosure or other means.¹³⁶

The U.S. 1984 Guidelines recognize conglomerate mergers as one of two types of non-horizontal mergers, but only state that distinctions between vertical and conglomerate mergers do not add anything qualitatively different to the analysis.¹³⁷ In contrast, the E.C. Guidelines recognize the anticompetitive effects of conglomerate mergers and devote an entire section to them.¹³⁸ While outlining potential anticompetitive effects, the E.C. Guidelines explicitly recognize that conglomerate mergers are rarely anticompetitive.¹³⁹

Additionally, the E.C. Guidelines indicate that the main concern regarding unilateral effects resulting from conglomerate mergers is foreclosure,¹⁴⁰ which they define as “any instance where actual or potential rivals’ access to supplies or markets is hampered or eliminated as a result of the merger, thereby reducing these companies’ ability and/or incentive to compete.”¹⁴¹ They discuss qualitatively the ability and incentive of a conglomerate firm to foreclose (by bundling/tying) and point out the potential for anticompetitive effects.¹⁴² The E.C. Guidelines state that a conglomerate merger will be challenged only if the conglomerate has both the ability and incentive to foreclose, and consumers are subsequently harmed as a result.¹⁴³

Section 5B of the E.C. Guidelines discusses coordinated effects resulting from conglomerate merger, and, in general, reflects the current literature. First, the E.C. Guidelines state that coordination is more likely to happen in markets where it is easy to identify terms of coordination.¹⁴⁴ Second, they explain that if foreclosed competitors exit the market, there will be a reduction in the number of firms in the market thereby making tacit collusion easier.¹⁴⁵ Third, the threat of foreclosure itself may induce competitors to coordinate because cheating may result in getting foreclosed by the con-

¹³⁶ *Id.*

¹³⁷ 1984 GUIDELINES, *supra* note 3, § 4.11 & n.25.

¹³⁸ See E.C. GUIDELINES, *supra* note 2, at 21-25.

¹³⁹ *Id.* at 21.

¹⁴⁰ *Id.* at 22.

¹⁴¹ *Id.* at 8.

¹⁴² *Id.* at 22-25.

¹⁴³ *Id.* at 22.

¹⁴⁴ E.C. GUIDELINES, *supra* note 2, at 25. This reflects the argument that multimarket contact reduces difficulty in identifying coordinate outcome. See JOHN T. SCOTT, PURPOSIVE DIVERSIFICATION AND ECONOMIC PERFORMANCE 22 (1993); see also John T. Scott, *Designing Multimarket Contact Hypothesis Tests: Patent Citations and Multimarket Contact in the Chemicals Industry*, in MULTIUNIT ORGANIZATION AND MULTIMARKET STRATEGY 175 (Joel A.C. Baum & Henrich R. Greve eds., 2001).

¹⁴⁵ E.C. GUIDELINES, *supra* note 2, at 25.

glomerate.¹⁴⁶ Last, the E.C. Guidelines note that multimarket competition increases the scope and effectiveness of disciplining.¹⁴⁷

The U.S. 1984 Non-Horizontal Merger Guidelines discuss the potential competition theory and set enforcement standards by which the agencies will likely challenge a merger. The E.C. Guidelines do not discuss potential competition in the non-horizontal section, but do so instead in the horizontal section.¹⁴⁸ Paragraphs fifty-eight to sixty of the E.C. Horizontal Guidelines in effect discuss perceived and actual potential competition bases for challenging a merger,¹⁴⁹ and are roughly consistent with the U.S. 1984 Guidelines.

The E.C. and U.S. Guidelines both point out that non-horizontal integration can result in important efficiency effects. In this regard, there are more similarities than differences between the E.C. and the U.S. Guidelines. For instance, both discuss the possibility of better integration of production facilities.¹⁵⁰ Furthermore, the E.C. Guidelines highlight specific efficiencies that should be taken into consideration when evaluating conglomerate mergers, such as the “Cournot effect”¹⁵¹ and economies of scope.¹⁵² Although the E.C. Guidelines discuss tying and bundling in the context that these actions may be anticompetitive, they also recognize that tying and bundling may lead to increased economic efficiency.¹⁵³ These considerations are consistent with the consensus in the economic literature

¹⁴⁶ *Id.* This is consistent with Professor Church’s report to the European Commission. See JEFFREY CHURCH, THE IMPACT OF VERTICAL AND CONGLOMERATE MERGERS ON COMPETITION 241-59 (2004), available at http://ec.europa.eu/competition/mergers/studies_reports/merger_impact.pdf.

¹⁴⁷ E.C. GUIDELINES, *supra* note 2, at 25; see F.M. SCHERER, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 340 (Houghton Mifflin Co. 2d ed. 1980) (“When one conglomerate enterprise competes with another, the two are likely to encounter each other in a considerable number of markets. The multiplicity of their contacts may blunt the edge of their competition. A prospect of advantage from vigorous competition in one market may be weighed against the danger of retaliatory forays by the competitor in other markets.” (quoting *Subcommittee on Antitrust and Monopoly Hearings*, 89th Cong. 45 (1965) (testimony by Corwin Edwards))). *But see* B. Douglas Bernheim & Michael D. Whinston, *Multimarket Contact and Collusive Behavior*, 21 RAND J. OF ECON. 1, 3 (1990) (“The problem with [Edwards’s] argument is that once a firm knows that it will be punished in every market, if it decides to cheat, it will do so in every market.”).

¹⁴⁸ EUROPEAN UNION, GUIDELINES ON THE ASSESSMENT OF HORIZONTAL MERGERS UNDER THE COUNCIL REGULATION ON THE CONTROL OF CONCENTRATIONS BETWEEN UNDERTAKINGS, 2004 O.J. (C 31) 5, available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2004:031:0005:0018:EN:PDF> (“[W]hen the undertakings concerned are actual or potential competitors on the same relevant market . . . [.] such mergers will be denoted ‘horizontal mergers.’”).

¹⁴⁹ *Id.* at 11.

¹⁵⁰ 1984 GUIDELINES, *supra* note 3, § 3.5; E.C. GUIDELINES, *supra* note 2, at 15. Note though that only the E.C. Guidelines mention the elimination of markups as a potential efficiency gain from vertical integration. *Id.* at 7, 15.

¹⁵¹ E.C. GUIDELINES, *supra* note 2, at 25.

¹⁵² *Id.*

¹⁵³ *Id.*

on non-horizontal mergers that efficiency considerations should be regarded with particularly high importance. However, neither set of guidelines provides a clear methodology for balancing efficiency benefits with potential anticompetitive concerns.

IV. COSTS AND BENEFITS TO REVISING THE U.S. NON-HORIZONTAL MERGER GUIDELINES

Past FTC commissioners have highlighted the limitations of the U.S. 1984 Non-Horizontal Merger Guidelines in varying degrees. In 2005, former chairman Robert Pitofsky stated that the 1984 Guidelines describe “very narrow circumstances in which a vertical merger could successfully be challenged.”¹⁵⁴ Moreover, he argued that under the 1984 Guidelines, none of five recent vertical challenges at that time would have been regarded as violations, and thus, none “could have been brought if the vertical merger guidelines were controlling.”¹⁵⁵ It appears, therefore, that in contrast to the Horizontal Merger Guidelines that are so influential, the “vertical merger guidelines have been widely ignored.”¹⁵⁶ Then commissioner Leary similarly expressed concern that “vertical relationships may give rise to strategic behavior that can affect competition in ways not contemplated by the 1984 Guidelines.”¹⁵⁷ However, Leary stated that recent agency action on vertical mergers was “a manifestation of the expansion of economic understanding” in the area.¹⁵⁸ Later, then chairman Timothy J. Muris described the 1984 Guidelines as “outmoded,” but argued that “current government enforcement against vertical mergers [was] sensible.”¹⁵⁹

With the exception of potential competition theories that have not changed much since 1984, there is a virtual consensus that the U.S. 1984 Guidelines do not accurately reflect current economic thinking or recent vertical merger cases, and do not reflect the vertical and conglomerate theories that the E.C. has investigated and pursued. As such, the Guidelines should be revised to “articulate the analytical framework the Agency applies in determining whether a merger is likely substantially to lessen competition”¹⁶⁰ for at least vertical mergers.

¹⁵⁴ Robert Pitofsky, *Past, Present, and Future of Antitrust Enforcement at the Federal Trade Commission*, 72 U. CHI. L. REV. 209, 219 (2005).

¹⁵⁵ *Id.* at 221.

¹⁵⁶ *Id.* at 220.

¹⁵⁷ Thomas B. Leary, *The Essential Stability of Merger Policy in the United States*, 70 ANTITRUST L.J. 105, 120 (2002).

¹⁵⁸ *Id.*

¹⁵⁹ Timothy J. Muris, *Principles for a Successful Competition Agency*, 72 U. CHI. L. REV. 165, 184 (2005). Muris illustrated his point by citing the FTC’s recent actions regarding the Cytoc/Digene and Synopsys/Avant! mergers. *Id.* at 184-85.

¹⁶⁰ HORIZONTAL MERGER GUIDELINES, *supra* note 4, §0.1.

As mentioned above, the AMC recommended updating the 1984 Guidelines to incorporate the new thinking about vertical mergers and to provide transparency in how the agencies analyze non-horizontal mergers.¹⁶¹ As recently as December 4, 2008, then FTC chairman Kovacic stated that he believed guidelines should be updated over time to take into account new thinking and policy, and he supported updating the Guidelines for these reasons.¹⁶²

However, there are costs and benefits associated with revising any policy statement. Yde¹⁶³ and Werden¹⁶⁴ present several arguments against updating the 1984 Guidelines at the present time, which should be considered before undertaking a revision.

Yde's article addresses the desirability of adopting the then-pending E.C. Guidelines and the U.S. 1984 Guidelines.¹⁶⁵ Yde devotes a substantial portion of his article to criticizing the anticompetitive theories of vertical and conglomerate mergers that have questioned the general conclusions of the Chicago School.¹⁶⁶ He argues that minimizing the costs of enforcement should include unintended consequences, which "requires the development of standards established on sound theoretical and empirical foundation."¹⁶⁷ However, Yde believes that the new economic theories and analyses do not provide such a foundation.¹⁶⁸ He then separately discusses justifications for U.S. and European guidelines.¹⁶⁹ In conclusion, Yde argues that there is no basis for changing the U.S. 1984 Guidelines because there is little enforcement in the United States based purely on vertical and conglomerate theories.¹⁷⁰ Even in Europe, where there has been substantial enforcement based at least in part on these theories,¹⁷¹ Yde stresses caution against any over-regulation of non-horizontal mergers that might result from issuing guidelines.¹⁷²

Yde raises several legitimate concerns about recent economic thinking on vertical and conglomerate mergers. It is true, for example, that there are clear differences in the nature of the horizontal and many non-horizontal

¹⁶¹ ANTITRUST MODERNIZATION COMM'N, REPORT AND RECOMMENDATIONS 68 (2007), available at http://govinfo.library.unt.edu/amc/report_recommendation/amc_final_report.pdf.

¹⁶² William E. Kovacic, Former Chairman, Fed. Trade Comm'n, Remarks at the George Mason Law Review Annual Symposium (Dec. 4, 2008), 16 GEO. MASON L. REV. 903, 906 (2009)

¹⁶³ Yde, *supra* note 69.

¹⁶⁴ Gregory J. Werden, *Should the Agencies Issue New Guidelines?: Learning from Experience*, 16 GEO. MASON L. REV. 839 (2009).

¹⁶⁵ Yde, *supra* note 69.

¹⁶⁶ *Id.* at 75-77.

¹⁶⁷ *Id.* at 74.

¹⁶⁸ *Id.* at 75-77.

¹⁶⁹ *Id.* at 77-79.

¹⁷⁰ *Id.* at 77.

¹⁷¹ Yde, *supra* note 69, at 78-79.

¹⁷² *Id.* at 80-81.

anticompetitive theories. Horizontal mergers can lead to an immediate reduction in output and increased prices. In contrast, anticompetitive theories relating to vertical mergers and conglomerate mergers between complementary products involve the merged firm expanding its output at the expense of its competitors, raising these rivals' costs, and in the long run reducing its competitors' sales by more than any expansion of the merged firm's output. This difference by itself does argue for caution in challenging non-horizontal mergers, but it does not support leaving clearly outdated guidelines on the books.

Yde makes four points that apply to both vertical and conglomerate merger theory that are potentially more relevant when considering improvements to the existing Guidelines. First, he points out that the current economic models describe possible anticompetitive effects, but they lack generality.¹⁷³ Second, Yde notes that the models often ignore procompetitive rationales.¹⁷⁴ Third, he argues that the risks to competition occur under very similar conditions where there are the largest potential efficiencies.¹⁷⁵ Fourth, the theories lack a systematic empirical basis.¹⁷⁶ However, upon consideration, these concerns do not persuasively argue for leaving the outdated Guidelines unrevised.

First, it is true that new economic models depend on a variety of conditions, many of which are not easily observed. However, even horizontal mergers of firms in an oligopoly may lead to a variety of changes in the market, depending on assumptions about the competitors' behavior, which may be difficult to observe. In part, this is why the U.S. Horizontal Merger Guidelines devote a great deal of analysis to competitive effects. Given the greater complexity of the economics of vertical and conglomerate mergers, Yde is certainly correct that caution should be exercised in challenging these types of mergers, but he does not really argue against updating at least the vertical portions of the outdated 1984 Guidelines.

Second, Yde argues that many of the models do not address all of the procompetitive rationales, and he highlights the benefits of eliminating double marginalization in vertical cases.¹⁷⁷ However, as mentioned above, whether the elimination of double marginalization will be a clear benefit depends on the assumptions of successive monopolies, linear pricing, and the input being used in fixed proportion to other inputs. Although these conditions can occur, they are not assured and should not be assumed to be substantial in all non-horizontal mergers.

¹⁷³ *Id.* at 75.

¹⁷⁴ *Id.* at 76.

¹⁷⁵ *Id.*

¹⁷⁶ *Id.*

¹⁷⁷ Yde, *supra* note 69, at 75. The argument is similar for conglomerate mergers between firms that make complementary products, often referred to as the "Cournot effect." *See supra* note 76.

Third, the risks to competition can occur under conditions similar to those situations where there are large potential efficiencies. For example, anticompetitive effects can occur in a vertical merger when the merging firms have market power in the upstream and downstream markets, and this is a situation where the double marginalization could be eliminated under the assumptions listed in the last paragraph. Here, an inquiry into the likelihood of the elimination of double marginalization or other efficiencies can be done to reduce any potential error. Again, this argument is not persuasive support for not updating the outdated 1984 Guidelines.

Fourth, Yde's argument that vertical and conglomerate theories lack a systematic empirical basis needs to be taken into account when determining how aggressively these types of merger should be challenged. The economic research on vertical restraints has yielded some mixed results, and there is relatively little recent research specifically devoted to the impact of non-horizontal mergers. However, it should be kept in mind that there is also empirical research questioning whether horizontal merger enforcement has demonstrably improved welfare. The empirical research on the impact of vertical integration cautions against too-vigorous regulation of vertical and conglomerate mergers, but these results do not argue against modifying the existing guidelines to reflect past and prospective enforcement policy.

These criticisms of the new thinking on non-horizontal mergers lead Yde to reject the new thinking as a reason for revising the U.S. 1984 Guidelines.¹⁷⁸ Yde believes that trying to formalize these theories to challenge mergers would be akin to consenting to unguided economic theory.¹⁷⁹ However, in this argument, Yde does not give weight to the consensus that the 1984 Guidelines do not address the current economic thought that underlies the most recent U.S. or E.C. enforcement actions against non-horizontal mergers. Yde correctly argues for caution in too-actively regulating vertical and conglomerate mergers based on the state of the economics literature, but it is not an argument over whether the Guidelines should be revised to reflect current thinking and agency policy.

Yde also argues that revised Non-Horizontal Merger Guidelines would not provide more transparency to U.S. enforcement policy or explain past challenges in this area.¹⁸⁰ In particular, he argues that the past U.S. enforcement actions cannot be a basis for issuing enforcement guidelines because there are not enough formal decisions to provide guidance.¹⁸¹ As discussed above, Yde is correct that there have been few vertical mergers challenged over the last eight years under the Bush administration, but there were several notable vertical mergers challenged under the Clinton admini-

¹⁷⁸ *Yde, supra* note 69, at 75-77.

¹⁷⁹ *Id.* at 76.

¹⁸⁰ *Id.* at 77.

¹⁸¹ *Id.*

stration.¹⁸² Moreover, the DOJ's Assistant Attorney General for Antitrust Christine Varney and FTC Chairman Jon Leibowitz have announced more aggressive antitrust enforcement efforts.¹⁸³ To the extent that the Obama administration's non-horizontal merger policy is more like Clinton's than what was seen in the last eight years, there are enough cases that follow the new economic literature to provide guidance for revising the vertical portions of the 1984 Guidelines. Yde's point is, however, quite accurate with regard to conglomerate mergers. The only cases based on conglomerate theories have been in the E.C., but the results of those cases were mixed and have raised questions about the evidence necessary to support such theories.¹⁸⁴

Yde expresses concerns that revising the 1984 Non-Horizontal Merger Guidelines will lead to too much enforcement.¹⁸⁵ It is true that agency staffs would likely investigate the type of vertical theories in any revised guidelines. However, it is presumably beneficial for staff to follow new Non-Horizontal Merger Guidelines when they are not following the 1984 Guidelines, since revised guidelines should make clear what are considered potential anticompetitive theories and what are not. Moreover, senior management at both agencies are willing to encourage or check staff efforts and thus are in a position to prevent staff from deviating from the policies outlined in revised guidelines.

Yde also argues that the U.S. vertical merger cases typically involve negotiated consents, whereby the merging parties have incentives to agree to close the merger promptly.¹⁸⁶ Since the Guidelines' stated purpose is to make more transparent the agencies' analyses and concerns, the fact that some merging parties may have been willing to sign consents that support the agencies' theories in no way undercuts the usefulness of new guidelines to fulfill their goal.

In addition, Yde argues that vertical merger cases can be complex and therefore costly to investigate.¹⁸⁷ It is likely that vertical cases can be more costly to investigate, particularly if outdated guidelines do not identify the types of theories that may be pursued. If anything, this also argues for revising the 1984 Guidelines.

Finally, one of the basic concerns expressed by Yde about revising the 1984 Guidelines revolves around his interpretation of the agencies' attempts to explain their non-horizontal merger enforcement policy, and how that relates to the 1984 Guidelines. In particular, Yde argues the following:

¹⁸² See *supra* Part II.A.

¹⁸³ Stephen Labaton, *Obama Takes Tougher Antitrust Line*, N.Y. TIMES, May 11, 2009.

¹⁸⁴ See *supra* Part II.B.

¹⁸⁵ Yde, *supra* note 69, at 78.

¹⁸⁶ *Id.* at 78.

¹⁸⁷ *Id.* at 77.

Despite occasional attempts by the antitrust agencies to explain their vertical merger enforcement decisions, these decisions have been decidedly ad hoc and cannot be interpreted to express any coherent or predictable policy. Arguably this ad hoc approach demonstrates that the current vertical merger guidelines are sufficiently flexible that . . . the existing guidelines' framework is competent to accommodate the particular matter under review.¹⁸⁸

Although I do not necessarily agree with Yde's initial sentence, if existing policy statements "cannot be interpreted to express any coherent or predictable policy,"¹⁸⁹ then this strongly argues in favor of creating a clearer statement through a revision of the 1984 Guidelines. With regard to the latter sentence, the recent U.S. vertical merger cases have, in general, not been brought based on the theories articulated in the 1984 Guidelines. As such, these cases do not suggest that these Guidelines are "flexible," but instead that they are outdated.

V. LESSONS FROM THE EUROPEAN COMMISSION

Interestingly, Yde believes that the E.C. Guidelines may be justified because the E.C. has brought far more vertical and conglomerate cases than the United States.¹⁹⁰ Although it appears that the E.C. has challenged more mergers based on vertical and conglomerate theories, Yde's criticisms of the current state of economic theory and the complex nature of the cases exist on both sides of the Atlantic. If producing useful non-horizontal merger guidelines is possible in the E.C., presumably it is possible in the United States.

The economics of vertical and conglomerate mergers should not differ substantially between the E.C. and United States. The E.C. Guidelines include most new economic thinking about vertical and conglomerate mergers, as well as efficiencies being measured against any perceived harm to competition. The E.C. has provided guidelines that track what it would consider potentially anticompetitive behavior. Even if there are likely to be few mergers challenged in the United States based on non-horizontal theories, that is not a persuasive reason to leave admittedly inaccurate guidelines on the books.

Yde is correct that the approach taken by the United States in 1984 and the E.C. in 2007 in drafting their guidelines is appropriate,¹⁹¹ and the U.S. 1984 Guidelines can and should be revised along these lines. That is, the revision should describe a set of theories of anticompetitive actions and the factual circumstances in which those theories apply. The E.C. Guidelines follow this approach in a structured analysis that applies market power,

¹⁸⁸ *Id.*

¹⁸⁹ *Id.*

¹⁹⁰ *Id.* at 78.

¹⁹¹ Yde, *supra* note 69, at 80.

screens, identifies a coherent theory of anticompetitive harm that has factual relevance, and assesses the nature and magnitude of merger-related efficiencies.¹⁹² In effect, the E.C. has already done much of the difficult work here.

CONCLUSION

As the previous sections illustrate, updating the vertical portions of the 1984 Guidelines would not only inform businesses when a merger could be investigated, but also why. Updated non-horizontal guidelines would also give the agencies' staffs clearer guidance on what to investigate, and what not to investigate. The 1984 Guidelines should be updated, even considering the costs of a revision and the reasons to be very careful when challenging non-horizontal mergers.

Clearly the new leaders of U.S. antitrust agencies will have to create a list of priorities for the changes they will consider making. Assuming that they believe there is a need to revise the 1984 Guidelines, the question becomes when to begin the process. This decision obviously involves a weighing of priorities, and considering the costs and opportunity costs associated with revising the Guidelines. The most immediate of these costs is devoting the agencies' scarce resources to the revision. It took about two years to create the 1992 Horizontal Merger Guidelines, where there was more of a consensus on many of the important issues.¹⁹³ New non-horizontal merger guidelines would require agreement between the FTC and the DOJ—two agencies that do not always agree—on exactly how the 1984 Guidelines should be changed. Given the controversy among researchers and between the E.C. and the United States on what might constitute a good vertical case or whether any conglomerate cases should be brought at all, the task of working out new non-horizontal guidelines will be formidable.

However, merger activity is down due to the economic slowdown in most industries; this is likely to remain the case through much of 2009. The reduction in the number of mergers should lead to a relatively lower workload for the agencies, so the opportunity cost of revising the Guidelines this year should be relatively low. The Obama administration also presents an opportunity for the agencies to work together to develop a common understanding of antitrust enforcement in this area. Given that the vertical portions of the 1984 Guidelines are clearly the most out-of-date and that they

¹⁹² See E.C. GUIDELINES, *supra* note 2. I also agree with Yde that any revised guidelines should not be written in a way that gives the agencies too much room to discard efficiency claims. Yde, *supra* note 69, at 81.

¹⁹³ The author was involved in that process, and it was a major undertaking.

represent an area where there has been and will likely be enforcement actions, it makes sense to begin by revising these sections.

Werden argues that such a revision may be useful, but that the new administration should wait until it has sufficient experience to formulate policy.¹⁹⁴ I disagree. Calls for revisions of the 1984 Guidelines have existed at least since 2000, and it is not clear that further delay will yield any benefits. As discussed above, there were more vertical merger challenges under the last Democratic administration than during the last eight years. Unless there is a substantial foreseeable change in policy from the 1990s or in economic thinking, we can expect more non-horizontal merger challenges to take place under the new administration that follow the reasoning of past vertical cases and recent economic analysis. Moreover, to the extent that revised guidelines have problems, they can be revised relatively quickly as U.S. antitrust guidelines have been in the past. Accordingly, the time is ripe to start the overdue process of revising the 1984 Non-Horizontal Merger Guidelines.

¹⁹⁴ Werden, *supra* note 164, at 848-49.