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COMMENTS OF AT&T SERVICES INC.

RESPONSE TO ISSUE 6

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RESPONSE TO ISSUE 6:

> ***"Evaluating the competitive effects of M&A", including "the economic and legal analysis of vertical … mergers" and "empirical validation of the analytical tools used to evaluate acquisitions and mergers."***

Although the antitrust agencies have regularly updated the *Horizontal Merger Guidelines*, the *Non-Horizontal Merger Guidelines* have not been updated since their initial publication by the Justice Department in 1984.[1] There is widespread consensus that those 34-year-old guidelines "do not provide useful guidance for vertical mergers today."[2] Senior DOJ officials have now broached the possibility of formally revising them.[3] If such plans gain momentum, AT&T urges this Commission to play an active role in the drafting process, as it has consistently done for the last several revisions of the horizontal guidelines.

Below, we explain that any new set of vertical guidelines should (1) harmonize the approach to vertical integration by *merger* with well-established doctrine governing vertical integration by *contract*, thereby ensuring greater consistency and predictability in enforcement

[1] DOJ, *Non-Horizontal Merger Guidelines* § 4 (1984). Those guidelines addressed conglomerate as well as vertical mergers.

[2] Remarks of D. Bruce Hoffman, *Vertical Merger Enforcement at the FTC*, Credit Suisse 2018 Washington Perspectives Conference, at 4 n.9 (Jan. 10, 2018) ("Hoffman Vertical Merger Remarks"); *see also* Stephen Salop & Daniel Culley, *Revising the US Vertical Merger Guidelines: Policy Issues and an Interim Guide for Practitioners*, 4 J. Antitrust Enforcement 1 (2016) ("[The 1984 Guidelines] are now woefully out of date. They do not reflect current economic thinking about vertical mergers. Nor do they reflect current agency practice.") (footnote omitted); ABA Antitrust Section, *Comments Regarding the Federal Trade Commission and Department of Justice Horizontal Merger Review Project* 4 (Nov. 9, 2009) ("practitioners and businesses do not have any current guidance on how the Agencies will analyze such mergers").

[3] David Hatch, *DOJ Eyes Overhaul of Vertical Merger Guidelines: Delrahim*, The Deal (June 1, 2018), https://pipeline.thedeal.com/article/14608361/index.dl. *But cf.* Antitrust Modern. Comm'n, Report & Recommendations, at 423 (2007) (Separate Statement of Donald Kempf) ("Updating the Merger Guidelines to cover . . . non-horizontal mergers . . . strikes me as a bad idea. . . . [T]hose are almost never challenged. For good reason. An effort to 'explain' this carries with it the temptation to fashion 'creative' new theories as to when such mergers can be anticompetitive and should be challenged. Again, it would be better to leave well enough alone and let 'guidance,' to the extent it is needed at all, develop in the context of actual proposed transactions and . . . with the assistance of the courts if need be.").

decisions, and (2) recognize the appropriately central role that behavioral remedies can play in vertical merger enforcement.

1. Updated Vertical Merger Guidelines Should Reflect the Consensus that Vertical Integration Is Procompetitive Except in Limited Circumstances.

a. There is broad economic consensus that vertical mergers are usually procompetitive.

Vertical merger analysis should start from a point of broad consensus: vertical integration is generally procompetitive and poses concerns only in limited circumstances.[4] As Bureau of Competition Director Bruce Hoffman observes, "there are plenty of theories of anticompetitive harm from vertical mergers. But the problem is that those theories don't generally predict harm from vertical mergers; they simply show that harm is possible under certain conditions."[5] Moreover, although "[t]hese theoretical issues are important," "empirical data is also very important[, and] empirical work has tended to show that vertical mergers (and vertical restraints) are typically procompetitive."[6]

Two empirical papers vividly illustrate this point. The first is a study published in 2005 by Luke Froeb, Michael Vita, and other Commission economists, who surveyed "multiple studies of vertical mergers and restraints" and "found only one example where vertical integration harmed consumers, and multiple examples where vertical integration unambiguously

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[4] *See generally Comcast Cable Commc'ns, LLC v. FCC*, 717 F.3d 982, 990 (D.C. Cir. 2013) (Kavanaugh, J., concurring) (in general, "vertical integration and vertical contracts are *procompetitive*"); *Nat'l Fuel Gas Supply Corp. v. FERC*, 468 F.3d 831, 840 (D.C. Cir. 2006) ("[V]ertical integration creates efficiencies for consumers."); Salop & Culley, *supra*, at [5] (2014) ("Most vertical mergers do not raise competitive concerns and likely are procompetitive."); Hoffman Vertical Merger Remarks at 4 (noting the "broad consensus in competition policy and economic theory that the majority of vertical mergers are beneficial because they reduce costs and increase the intensity of interbrand competition").

[5] Hoffman Vertical Merger Remarks at 3 (footnote omitted).

[6] *Id.* at 4.

benefited consumers."[7] The second is a 2007 analysis coauthored by University of Michigan Professor Francine LaFontaine, who recently served as Director of the Commission's Bureau of Economics. She and coauthor Margaret Slade of the University of British Columbia "did not have a particular conclusion in mind when [they] began to collect the evidence," "tried to be fair in presenting the empirical regularities," and were "therefore somewhat surprised at what the weight of the evidence is telling us."[8] In particular, they found that, "under most circumstances, profit-maximizing vertical-integration decisions are efficient, not just from the firms' but also from the consumers' points of view. Although there are isolated studies that contradict this claim, the vast majority support it."[9]

Vertical mergers have this pro-competitive track record for two basic reasons, as Mr. Hoffman explained. First, "[w]here horizontal mergers reduce competition on their face—though that reduction could be minimal or more than offset by benefits—vertical mergers do not."[10] Second, "while efficiencies are often important in horizontal mergers, they are *much more intrinsic to a vertical transaction* …. Due to the elimination of double-marginalization and the resulting downward pressure on prices, vertical mergers come with a more built-in likelihood of improving competition than horizontal mergers."[11] These two features of vertical mergers have led the U.S. antitrust agencies to urge their foreign counterparts to adopt a strong presumption in favor of such mergers. In the words of a U.S. report to the OECD in 2007,

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[7] *Id.* (citing James C. Cooper, Luke M. Froeb, Dan O'Brien, & Michael G. Vita, *Vertical Antitrust Policy as Problem of Inference*, 23-7 Int. J. of Indus. Org. (2005), https://www.ftc.gov/public-statements/2005/02/vertical-antitrust-policy-problem-inference).

[8] Francine Lafontaine & Margaret Slade, *Vertical Integration and Firm Boundaries: The Evidence*, 45 *J. of Econ. Literature*, 629, 680 (2007).

[9] *Id.*

[10] Hoffman Vertical Merger Remarks at 3.

[11] *Id.* (emphasis added).

vertical mergers "generally raise fewer competitive concerns than do horizontal mergers," "merit a stronger presumption of being efficient than do horizontal mergers," and therefore "should be allowed to proceed except in those few cases where convincing, fact-based evidence relating to the specific circumstances of the vertical merger indicates likely competitive harm."[12]

b. Updated vertical merger guidelines should harmonize review of vertical integration by *merger* with precedent regarding vertical integration by *contract*.

Because vertical mergers by definition cause no increase in market concentration, they do not trigger the "structural presumption" of unlawfulness that applies to horizontal mergers between close competitors in concentrated markets. *See United States v. Baker Hughes, Inc.*, 908 F.2d 981, 982 (D.C. Cir. 1990). The antitrust agencies instead consider whether a vertical merger under review will have other types of "anticompetitive effects … , including the [merging parties'] ability to foreclose competitors' access to a critical input[.]"[13] Although the agencies have reviewed a number of vertical mergers in recent years, there is no recent judicial precedent on the legal framework for assessing such mergers: until the AT&T-Time Warner case, the federal government had not taken such a merger to trial for four decades. And the *AT&T/Time Warner* court itself avoided any big-picture doctrinal issues by deciding that case on narrow fact-based grounds.[14]

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[12] Note by the Delegation of the United States to the Organization for Economic Co-operation and Development, Competition Committee 2, 10 (Feb. 21-22, 2007), https://www.ftc.gov/sites/default/files/attachments/us-submissions-oecd-and-other-international-competition-fora/07RoundtableonVerticalMergers.pdf; *see also* Int'l Competition Network, *Vertical Mergers Survey Results* 11 (2018) ("ICN Report"), http://icn2018delhi.in/images/ICN-survey-report-on-vertical-mergers-17-03-18.pdf (noting view that "while efficiencies are often important in horizontal mergers, they are much more intrinsic to a vertical transaction due to the cost-reducing effects of most vertical mergers").

[13] *The FTC's Merger Remedies 2006-2012: A Report of the Bureaus of Competition and Economics*, at 11 n.20 (Jan. 2017) ("FTC Remedies Study").

[14] *See United States v. AT&T*, No. 17-2511, slip op. at 71 n.23 (D.D.C. June 12, 2018) (assuming *arguendo*, while expressing "serious doubts," that DOJ could establish a "substantial lessening of

It is nonetheless instructive to review *Brown Shoe*-era antitrust decisions concerning vertical transactions, when antitrust law generally was far more pro-plaintiff than it is today. Even during that era, vertical mergers were invalidated for harming rivals only if they caused the merging parties to stop dealing with those rivals to some extent *and* only if this exclusive dealing between the merging parties "foreclosed" the rivals from "a substantial share of [the] market."[15] For example, in *Ford/Autolite*, Ford's acquisition of a spark-plug manufacturer foreclosed third-party spark-plug makers from selling to Ford and thus reduced their potential scale.[16]

Today, modern antitrust law places even greater burdens on plaintiffs challenging vertical transactions because there is now a legal consensus matching the economic consensus that "vertical integration and vertical contracts are *procompetitive*."[17] In particular, courts require plaintiffs to show much larger foreclosure percentages than in the *Brown Shoe* era to satisfy the

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competition" under Section 7 simply by showing a 0.2% retail price increase, and concluding that this legal issue was unnecessary to reach because DOJ had failed "to show that there are likely to be *any* price increases" as a factual matter).

[15] *United States v. E.I. du Pont de Nemours & Co.*, 353 U.S. 586, 595 (1957) (ellipsis omitted) (quoting *Standard Oil Co. of Cal. v. United States*, 337 U.S. 293, 314 (1949)); *see, e.g.*, *Brown Shoe Co. v. United States*, 370 U.S. 294, 323-24 (1962); *Fruehauf Corp. v. FTC*, 603 F.2d 345, 352 & n.9 (2d Cir. 1979).

[16] *Ford Motor Co. v. United States*, 405 U.S. 562, 568 (1972). As these cases illustrate, foreclosure is a necessary element of claims that a vertical merger should be blocked because it disadvantages competitors. Foreclosure is obviously not a necessary element of unrelated theories for challenging vertical mergers, such as elimination of "potential competition" from one of the merged companies, *Non-Horizontal Merger Guidelines* § 4.1, or "facilitat[ing] collusion … by making it easier to monitor price," *id.* § 4.22. *See* Hoffman Vertical Merger Remarks at 6 (noting concern that "the integrated firm gains access that it didn't previously have to competitively sensitive business information of an upstream or downstream rival"). As discussed below, firewalls are often appropriate and effective remedies for such "collusion" concerns. *See id.*

[17] *Comcast*, 717 F.3d at 990 (Kavanaugh, J., concurring); *see id.* ("[b]eginning in the 1970s," the Supreme Court shifted to a favorable view of "vertical integration and vertical contracts").

"substantial share" requirement, and that foreclosure showing is no longer a sufficient basis for establishing liability.[18]

This precedential shift is evident in cases involving the type of vertical integration by contract most analogous to a vertical merger: an exclusive dealing arrangement, under which one company agrees to buy from (or sell to) another company exclusively.[19] Under modern precedent, exclusive dealing arrangements are lawful even if they do foreclose rivals from a substantial portion of the market unless they also leave the rivals "stunted" as competitors (*e.g.*, by keeping them below efficient scale), prevent them from "provid[ing] meaningful price competition," and thereby enable the defendant to charge more for its own products than it otherwise could.[20] This narrow theory of exclusive dealing liability underlay the Commission's *McWane* decision in 2014 and the Eleventh Circuit's affirmation of that decision in 2015.[21]

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[18] *See*, *e.g.*, 7 Areeda, *Antitrust Law* ¶ 1511e2, at 517-18 (4th ed. 2017) (older Supreme Court precedent addressed vertical mergers "under an aggressive standard that struck down many mergers that would never be challenged today" because "our theory and most of our law of vertical integration have changed very considerably since that time"); *see also Baker Hughes*, 908 F.2d at 990 n.12 ("The most important developments that cast doubt on the continued vitality of such [merger] cases as *Brown Shoe* . . . are found in [non-merger] cases, where the Supreme Court . . . has said repeatedly that the economic concept of competition, rather than any desire to preserve rivals as such, is the lodestar that shall guide the contemporary application of the antitrust laws, not excluding the Clayton Act.") (internal quotation marks omitted).

[19] *See*, *e.g.*, *McWane, Inc. v. FTC*, 783 F.3d 814, 838-39 (11th Cir. 2015); *United States v. Microsoft Corp.*, 253 F.3d 34, 71 (D.C. Cir. 2001) (en banc) (per curiam).

[20] *McWane*, 783 F.3d at 838-39; *see also Microsoft*, 253 F.3d at 71 (issue is whether exclusive dealing keeps competitors "below the critical level necessary . . . to pose a real threat" to defendant's market power); *Roland Mach. Co. v. Dresser Indus., Inc.*, 749 F.2d 380, 394 (7th Cir. 1984) ("The exclusion of competitors is cause for antitrust concern only if it impairs the health of the competitive process itself.").

[21] *See McWane, Inc.*, 2014-1 Trade Cas. (CCH) ¶ 78670 (FTC Jan. 30, 2014), *aff'd*, *McWane*, 783 F.3d at 838-39. *McWane* was analyzed under Section 2 the Sherman Act, whereas any merger is addressed under Section 7 of the Clayton Act. But that is a distinction without a difference. Historically, many exclusive dealing agreements were assessed under Section 3 of the Clayton Act, which contains the same operative language as Section 7 ("may substantially lessen competition"). The statutory scheme thus requires courts to align analysis of vertical mergers with analysis of exclusive dealing arrangements. *See Fruehauf Corp. v. FTC*, 603 F.2d 345, 352 & n.9 (2d Cir. 1979). If anything, the distinction between Section 2 and Section 7 cuts in favor of subjecting Section 7 plaintiffs to the same elements as required in

An example drives home the need to harmonize vertical merger review with this modern exclusive dealing precedent. Suppose that Supply Firm and Distribution Firm are choosing between (1) a long-term exclusive dealing arrangement and (2) a vertical merger that might involve some preferential treatment between the upstream and downstream components of the merged firm but *not* exclusive dealing. The exclusive dealing arrangement would disadvantage Distribution Firm's rivals more than the vertical merger would because, by definition, it would foreclose them from distributing Supply Firm's goods at all. *Even so*, a plaintiff could not challenge that exclusive dealing arrangement simply by introducing an abstract model predicting price increases for the distribution rivals (*e.g.*, because they must turn to more expensive suppliers), even if some percentage of those wholesale increases would be passed through to retail consumers. Instead, the plaintiff would have to prove *structural* harm to competition by showing that the transaction would foreclose a "substantial portion" of the input market from the distribution rivals, stunt them as competitors, and substantially increase Distribution Firm's market power, such that *it* could then charge higher prices than in the absence of the agreement.[22] Because those showings would be required for an exclusive dealing agreement, which by definition involves *some* foreclosure, it would be illogical to excuse a plaintiff from making those same showings as a basis for invalidating a vertical merger that involves *no* foreclosure.

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a Section 2 case. Section 2 applies only where, as in *McWane*, one of the parties has full-blown monopoly power, a fact that presents unusual competitive concerns. Those concerns are absent in Section 7 cases involving parties that *lack* monopoly power. It would be highly anomalous to subject non-monopolist Section 7 defendants, but not Section 2 monopolists, to special pro-plaintiff rules in otherwise analogous circumstances.

[22] *See McWane*, 783 F.3d at 838-39; *Microsoft Corp.*, 253 F.3d at 71.

2. Conduct Remedies Are Often Appropriate in Vertical Merger Cases.

In the unusual circumstance where a vertical merger does present genuine competitive concerns, the antitrust agencies should always carefully consider conduct (or "behavioral") remedies that negate those concerns without undermining the procompetitive efficiencies of the transaction itself. Structural remedies such as divestitures are often more appropriate in horizontal cases, where concerns typically arise from the prospect of undue concentration in particular markets and divestitures offer the only real solution. But such structural remedies are irrationally overbroad as vertical merger remedies when, as is often the case, they would undermine a merger's procompetitive rationale and conduct remedies are available as alternatives.

In future enforcement decisions, the Commission should reaffirm this basic point, which was not even seriously disputed until recently.[23] As BC Director Bruce Hoffman has noted, "we can, and we do, and we have fashioned conduct remedies in vertical mergers" because they are often the best enforcement outcome: "firewalls can prevent information sharing, and nondiscrimination clauses can eliminate incentives to disfavor rivals."[24] The Commission is particularly well-positioned to make such judgments because it has done the retrospective analysis needed to confirm the efficacy of vertical conduct remedies. As the 2017 *Remedy Study* found, "[a]ll the vertical mergers [in the 2006-2012 data set] were remedied with non-structural

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[23] *Cf.* Keynote Address of Ass't Atty. Gen. Makan Delrahim, ABA Antitrust Fall Forum (Nov. 16, 2017) ("That is not to say we would never accept behavioral remedies. In certain instances where an unlawful vertical transaction generates significant efficiencies that cannot be achieved without the merger or through a structural remedy, then there's a place for considering a behavioral remedy if it will completely cure the anticompetitive harms. It's a high standard to meet.").

[24] Hoffman Vertical Merger Remarks at 7 & n.17, 8 (citing, *inter alia*, *In re PepsiCo, Inc*., Dkt. C-4301 (complaint filed Feb. 26, 2010); *In re The Coca-Cola Company*, Dkt. C-4305 (complaint filed Sept. 27, 2010)); *In re Broadcom Limited*, Dkt. C-4622 (complaint filed Jul. 3, 2017)).

relief," and "[a]ll vertical merger orders were judged successful."[25] Those conclusions also comport with the nearly universal practice of foreign antitrust authorities. As the ICN recently noted, "[w]hen a merger is not unconditionally cleared as a result of vertical concerns, [national competition authorities] often impose behavioural remedies …. Structural remedies are rarely required[.]"[26]

[25] FTC Remedies Study at 13, 17 n.34; *see also id.* at 2 ("[r]emedies addressing vertical mergers also succeeded"); *id.* at 20 n.37 ("[v]ertical merger remedies raised no reported process concerns"); *id.* at 20 n.37; Hoffman Vertical Merger Remarks at 8 ("The Commission's recent Remedy Study included four orders related to vertical mergers, and each one succeeded in maintaining competition at premerger levels.").

[26] ICN Report at 23.