UNITED STATES OF AMERICA
BEFORE THE
FEDERAL TRADE COMMISSION

Hearing #5 On Competition and Consumer Protection in the 21st Century.

COMMENTS OF THE
AMERICAN ANTITRUST INSTITUTE

The American Antitrust Institute (AAI)[1] appreciates the opportunity to respond to the Commission's invitation for public comment on the topics identified for Hearing #5 On Competition and Consumer Protection in the 21st Century. Below is a response to a select question posed on the Commission's website. Certain questions associated with Hearing #5 relate to other questions associated with previous or subsequent hearings. To avoid duplication AAI may omit responses to certain questions for Hearing #5 that are addressed in comments for other hearings.

Should the U.S. antitrust agencies publish Vertical Merger Guidelines? What guidance should they provide regarding the assessment of the competitive effects of vertical mergers, including the substantive theories of competitive harm and the treatment of transaction-related efficiencies? Under what conditions, if any, should the guidelines recognize a presumption of anticompetitive harm? What showing should be required to overcome such a presumption? Under what circumstances, if any, should behavioral remedies be accepted to remedy the likely anticompetitive effects of vertical mergers?

Economic thinking has advanced far since the days when conservative Chicago School theorists argued that vertical mergers are always or almost always benign or procompetitive. Both the Federal Trade Commission and the Antitrust Division of the Department of Justice now have an established track record of vertical merger enforcement. The agencies recognize that vertical mergers can enhance the ability and incentive of merging firms to exclude their upstream or downstream rivals by raising their rivals' costs or cutting off their rivals' access to critical resources, thereby impairing horizontal competition and harming consumers. The magnitude of threatened unilateral exclusionary or coordinated effects from vertical mergers is increased when concentration is high in affected upstream and/or downstream markets.

AAI has long advocated in favor of updating the 1984 Non-Horizontal Merger Guidelines to reflect modern economic thinking and appropriate agency practice, along with a clear incipiency mandate, a strong structural presumption, and meaningful standards for crediting claimed efficiencies. On the appropriate burden of proof to assign the government in establishing anticompetitive effects, we ask the Commission to consider AAI's views as reflected in Brief of Amici Curiae American Antitrust Institute, Consumers Union and Public Knowledge, United States v. AT&T Inc., No. 18-5214 (filed Aug. 13, 2018). For an explanation of the conditions under which vertical mergers in highly concentrated upstream and/or downstream markets should be presumptively anticompetitive, we ask the Commission to consider AAI's views as reflected in

[1] AAI is an independent, nonprofit organization devoted to promoting competition that protects consumers, businesses, and society. It serves the public through research, education, and advocacy on the benefits of competition and the use of antitrust enforcement as a vital component of national and international competition policy. For more information about AAI, see http://www.antitrustinstitute.org.

Letter from Diana L. Moss, President, American Antitrust Institute, to Makan Delrahim, Assistant Attorney General, Antitrust Div., U.S. Dep't of Justice, re the Competitive and Consumer Concerns Raised by the CVS-Aetna Merger (March 26, 2018); Letter from Diana L. Moss, President, American Antitrust Institute, et al., to Andrew Finch, Acting Assistant Attorney General, Antitrust Div., U.S. Dept. of Justice, re Proposed Merger of Monsanto and Bayer (July 26, 2017); and Letter from Diana L. Moss, President, American Antitrust Institute, et al. to Renata Hesse, Principal Deputy Assistant Attorney General, Antitrust Div., U.S. Dept. of Justice, re the Proposed Dow-Dupont Merger (May 31, 2016).

Among other things, revised Non-Horizontal Merger Guidelines should recognize that claimed efficiencies from vertical mergers often fail to materialize. Historically, the antitrust agencies have given significant weight to the complex and often difficult-to-prove efficiencies claims arising from vertical integration. Merger-related efficiencies can include cost savings and/or consumer benefits. Claimed efficiencies from vertical mergers often include a reduction in post-merger transactions costs, elimination of double margins, and economies of coordination associated with integrating a supplier with a customer. Many of these claims rest on relatively restrictive economic models that too often go unchallenged by the government or private plaintiffs. And many more claims are speculative and/or poorly substantiated by the merging parties, and not merger-related or cognizable, per the requirements of the *Horizontal Merger Guidelines*.[2]

The reality is that post-merger vertical integration is fraught with problems and failures. For example, managers must integrate two (often large) business ecosystems post-merger. In cases where the agencies negotiate a remedy with the parties, managers must undo key businesses by spinning off assets or comply with conduct remedies that run contrary to their unchanged incentives to exercise market power, or do both simultaneously. For example, the merger of agricultural biotechnology giants Bayer and Monsanto is subject to what is purportedly the largest divestiture in history. Objectors cautioned that the agreed remedies pose considerable execution risk, which could threaten the post-merger realization of claimed efficiencies.[3]

With or without remedies, post-merger integrations often press on the bounds of managerial competency. Managers are burdened with making good on promises to deliver cost savings and consumer benefits at the same time they create significant changes that are likely to affect profit-incentives, relationships between affiliates, and other key operational factors. Collectively, these factors affect post-merger operations, conduct, and strategy, often in ways that reduce or entirely eliminate claimed efficiencies.

Concerns over the failure of mergers to deliver cost savings and consumer benefits have grown in tandem with mounting evidence of failed merger-related efficiencies claims. The failure to deliver post-merger efficiencies results from any number of factors, many of which are highly relevant to antitrust analysis and should be considered by enforcers. These include post-merger integration costs that are higher than forecast at the time the parties justified their deals to antitrust enforcers, incompatibility and conflicts between the business models and corporate cultures of

[2] U.S. Dep't of Justice & Federal Trade Comm'n, Horizontal Merger Guidelines (2010).
[3] *See* Attorneys General of California, Iowa, Massachusetts, Mississippi, & Oregon, Comments on the Proposed Final Judgment in United States v. Bayer AG, No. 1:18-cv-01241 (D.C. Cir. filed Aug. 10, 2018), *available at* https://oag.ca.gov/system/files/attachments/press_releases/180810%20States%27%20Tunney%20Act%20Comments%20Letter_0.pdf.

merging firms, and other factors. One particularly critical question is whether the post-merger entity operates vertically-related affiliates separately, or actually integrates them in a way that allows for the potential realization of claimed efficiencies.[4] Without such integration, *most* of the typical claims for why a vertical merger will reduce costs or otherwise benefit consumers become invalid.

Academic research buttresses these concerns. Studies by strategic management experts show that "study after study puts the failure rate of mergers and acquisitions somewhere between 70% and 90%."[5] Other empirical research of consummated mergers concludes that "most buyers routinely overvalue the synergies to be had from acquisitions," finding that almost 70% of the mergers in the database studied failed to achieve expected synergies related to obtaining access to a target's customers, channels, and geographies.[6]

Analysis of some of the large airline mergers in the U.S. reveals grossly underestimated post-merger integration costs, which eat into claimed costs savings and the ability to deliver consumer benefits post-merger.[7] Another study shows that "evidence of systematically lower costs among merged hospitals has been tough to find. Despite the pace of takeovers, hospital costs have never been higher."[8] Strategic management and marketing experts keep a running list of mergers that have failed to produce claimed benefits. Among the failed deals are Daimler-Chrysler, Bank of America-Merrill Lynch, eBay-Skype, AOL-Time Warner, MySpace-News Corporation, and Sprint-Nextel.[9]

AAI strongly encourages the antitrust agencies, in their process of crafting updated guidelines, to consider mounting evidence of failed mergers and failed merger efficiencies that have real and significant consequences for merger policy and enforcement. In vertical mergers that involve highly concentrated upstream and/or downstream markets and few substitution possibilities by rivals that are threatened by higher costs or foreclosure, countervailing efficiencies claims should be subject to intense scrutiny and a high bar. Moreover, the current failure of the agencies to hold merging companies' "feet to the fire" in demonstrating the post-merger realization of claimed efficiencies creates perverse incentives for the parties to exaggerate their pre-merger estimates. Accordingly, the agencies should consider updating the guidelines to to include reporting requirements, perhaps through consent orders, regarding the realization of post-merger efficiencies and forecast-to-actual integration costs.

Revised Non-Horizontal Merger Guidelines should also adhere to the principal that behavioral remedies should be disfavored relative to structural remedies, absent unusual

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[4] Clayton M. Christensen et al., *The Big Idea: The New M&A Playbook,* HARVARD BUSINESS REVIEW (Mar. 2011). ("[I]f you buy a company for its business model, it's important to keep the model intact, most commonly by operating it separately. That's what Best Buy did with Geek Squad, running its high-touch, higher-cost service model as a separate business alongside its low-margin, low-touch retail operation.").

[5] *Id.*

[6] Scott A. Christofferson, Robert S. McNish & Diane L. Sias, *Where Mergers Go Wrong*, MCKINSEY QUARTERLY (May 2004), https://www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/where-mergers-go-wrong.

[7] *See e.g.*, Diana L. Moss, *Delivering the Benefits? Efficiencies and Airline Mergers* AM. ANTITRUST INST. (Nov. 21, 2013), https://www.antitrustinstitute.org/wp-content/uploads/2013/12/AAI_USAir-AA_Efficiencies-1.pdf.

[8] Matt Schmitt, *Do Hospital Mergers Really Cut Healthcare Costs?*, UCLA ANDERSON REV. (Jan. 31, 2018), https://www.anderson.ucla.edu/faculty-and-research/anderson-review/hospital-mergers-cost (discussing Matt Schmitt, *Do Hospital Mergers Really Cut Healthcare Costs?* 52 J HEALTH ECON. 74 (2017)).

[9] *See* CB Insights, *Fools Rush In: 37 of the Worst Corporate M&A Flops* (Oct. 30, 2018), CB INSIGHTS RESEARCH BRIEFS, https://www.cbinsights.com/research/merger-acquisition-corporate-fails/.

circumstances. On the propriety of behavioral remedies generally, we ask the Commission to consider AAI's views as reflected in John E. Kwoka & Diana L. Moss, Behavioral Merger Remedies: Evaluation and Implications for Antitrust Enforcement, Am. Antitrust Inst. (2011). On the question of how to evaluate behavioral remedies relative to horizontal remedies in the context of vertical mergers in particular, we ask the Commission to consider AAI's views as reflected in Diana Moss, AAI Applauds Move to Block AT&T-Time-Warner Merger, Sets Record Straight on Vertical Merger Enforcement, Am. Antitrust Inst. (Dec. 6, 2017). The following is a relevant excerpt from this commentary:

> [B]oth the DOJ and FTC have a long history of enforcement against vertical mergers. The DOJ Antitrust Division website, which has accessible data on past enforcement actions, shows a first record of a vertical merger challenge in the early 1960s.[10] The data reveal that the agencies have challenged dozens of vertical mergers over the last several decades. In many of those cases, the government resolved competitive concerns through settlements, with remedies embodied in consent decrees. In a number of instances, vertical mergers have been abandoned.
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> The fact that few of these cases were actually litigated and resolved by a judge does not suggest the cases brought were weak. Most merger challenges, horizontal and vertical, are resolved without litigation. The relevant focus therefore should be on the government's *entire* record of challenging vertical mergers. There is no reason to think that had the government gone to court in such cases, it would not have prevailed in blocking the mergers. Indeed, the fact that companies in dozens of vertical merger cases either abandoned the deal in the face of government opposition, or chose to settle, may signal that they perceived significant litigation risk if they had gone to court.
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> The data also show that the government has used a mix of structural and conduct (or behavioral) remedies in vertical merger cases. This debunks any narrative that the agencies have always employed the same approach to vertical mergers. From 1994 to 2016, for example, about 27% of the total remedies taken by the DOJ and FTC in vertical merger cases were structural and about 73% were conduct-related.[11]
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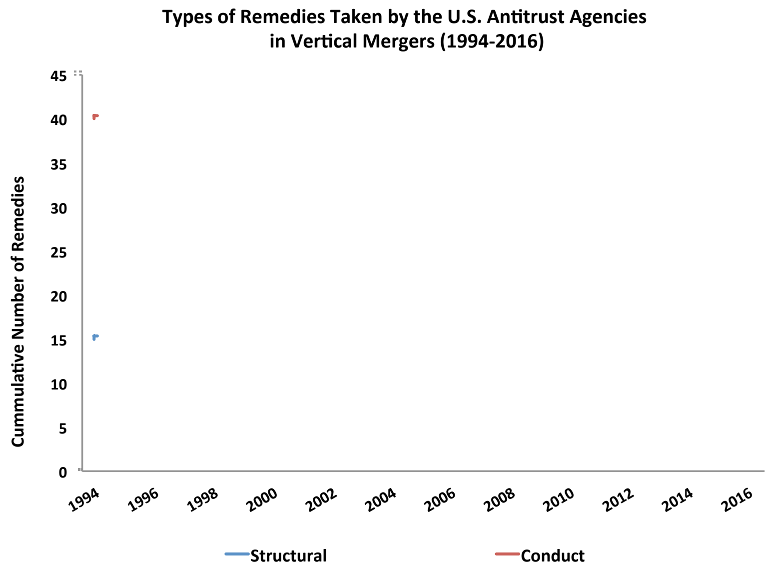
> The graph below shows cumulative remedies (by type) over this period. We note a bump up in conduct remedies in 2010-2011 following a relatively inactive period during the first half of the 2000s. This is likely the basis of claims that behavioral remedies are a historical fixture in vertical merger enforcement. But it cannot be reconciled with a period of activism during the last half of the 1990s where *both* conduct and structural remedies were actively employed. These data support the

[10] *See Antitrust Case Filings*, U.S. DEP'T OF JUST., https://www.justice.gov/atr/antitrust-case-filings (last visited Dec. 5, 2017). The FTC's website lists merger data going back to 1996. *See Cases and Proceedings: Advanced Search*, FED. TRADE COMM'N, https://www.ftc.gov/enforcement/cases-proceedings/advanced-search (last visited Dec. 5, 2017).

[11] Steven C. Salop & Daniel P. Culley, *Vertical Merger Enforcement Actions: 1994–2016,* h3p://scholarship.law.georgetown.edu/facpub/1529; *see* U.S. DEP'T OF JUST., *Antitrust Case Filings*, https://www.justice.gov/atr/antitrust-case-filings (last visited Dec. 5, 2017); FED. TRADE COMM'N, *Cases and Proceedings: Advanced Search*, FED. TRADE COMMISSION, https://www.ftc.gov/enforcement/cases-proceedings/advanced-search (last visited Dec. 5, 2017).

notion that the DOJ's move to block the AT&T-Time Warner case is not unprecedented, nor a radical departure from decades of previous enforcement.



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Thank you for considering the views of AAI. Questions or reactions to any of these comments may be addressed to:

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