S. HRG. 118–107

TRENDS IN VERTICAL MERGER ENFORCEMENT

HEARING

BEFORE THE

SUBCOMMITTEE ON COMPETITION POLICY, ANTITRUST, AND CONSUMER RIGHTS

OF THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

ONE HUNDRED EIGHTEENTH CONGRESS

FIRST SESSION

JULY 19, 2023

Serial No. J–118–26

Printed for the use of the Committee on the Judiciary

www.judiciary.senate.gov
www.govinfo.gov

U.S. GOVERNMENT PUBLISHING OFFICE

53–502 PDF WASHINGTON : 2024

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TRENDS IN VERTICAL MERGER ENFORCEMENT

WEDNESDAY, JULY 19, 2023

UNITED STATES SENATE,
SUBCOMMITTEE ON COMPETITION POLICY, ANTITRUST,
AND CONSUMER RIGHTS,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The Subcommittee met, pursuant to notice, at 2:48 p.m., in Room 226, Dirksen Senate Office Building, Hon. Amy Klobuchar, Chair of the Subcommittee, presiding.

Present: Senators Klobuchar [presiding], Blumenthal, Hirono, Lee, Hawley, Tillis, and Blackburn.

Also present: Chair Durbin.

OPENING STATEMENT OF HON. AMY KLOBUCHAR, A U.S. SENATOR FROM THE STATE OF MINNESOTA

Chair KLOBUCHAR. All right. Thank you. The hearing is called to order, the hearing of the Subcommittee on Competition Policy, Antitrust, and Consumer Rights, on "Trends in Vertical Merger Enforcement."

Senator Lee and I were noting that once again votes have been scheduled miraculously during our antitrust hearing. At some point, we'll begin to wonder. But we are going to work this out and make sure that any Senator that has a question is able to ask one.

I think we all know that for years, competition policy has focused on mergers of two companies that sell the same or similar products or services. Those so-called horizontal mergers clearly impact competition. When two companies that previously competed to offer consumers high-quality goods or services at a good price merge, it makes the market less competitive and gives consumers fewer choices. We saw this after, say, T-Mobile and Sprint merged, when consumers were left with one less option for phone service. It's important that we continue to police mergers between competitors, but those mergers cannot be our only focus.

For too long, I believe there's not been enough attention paid to another kind of merger that can greatly harm consumers: the vertical merger. Vertical mergers happen when a company buys a supplier, distributor, or retail locations above or below them in the supply or distribution chain. For years, companies have argued that this kind of vertical integration helps consumers by lowering their costs. But it's not really the story.

Vertical mergers can also allow companies to amass market power and clout that they can use to unfairly leverage power against their competitors. These mergers can also create potential conflicts of interest by incentivizing companies to preference their own products over the products of competitors. Sounds familiar for those of us that have been working on tech legislation.

There was a time when vertical mergers were a key part of antitrust enforcement. One of the most significant antitrust cases ever brought was the Department of Justice's suit against Standard Oil. DOJ argued way back then that Standard Oil used its power in the oil refining business to buy and expand its monopoly power from refining to other parts of the oil supply chain, including production, pipelines, and even gas stations. The DOJ won that case, and Standard Oil was broken up. Yet, in the last half century, we have forgotten that lesson.

Since the 1980s, antitrust enforcers have largely ignored the way vertical mergers can entrench monopoly power. Instead of considering a merger's anticompetitive impact in the long run, enforcers have too often taken businesses at face value when they say that buying a company up or down the supply chain will lower prices for consumers.

In January—and this is a good example of this—we held a full Committee hearing on how Ticketmaster's 2010 merger with Live Nation has allowed Ticketmaster to wield power over artists, venues, and consumers, which has resulted in high fees and botched ticket sales. It was a highly bipartisan hearing. Before the merger, Live Nation was primarily a concert promoter, but since acquiring ticketing provider, Ticketmaster, Live Nation has used its role as a concert promoter to force venues to sell tickets through its newly acquired platform. This has decimated competition in the ticketing industry and resulted in higher fees for consumers.

Unfortunately, this is not a surprising result. At the time of the merger, DOJ was so concerned that something like this might happen that it made Live Nation promise not to retaliate against concert venues for using another ticketing company. But guess what? That didn't work. Live Nation's conduct created such an issue that in 2019, DOJ reopened the consent decree and strengthened the limits on Live Nation. So, that's one example.

Another example, something Senator Lee knows well: Google advertising. In May, we held a hearing in this Subcommittee on Google's dominance in the digital advertising space. But Google's dominance in online advertising was no accident. Google was already a significant player in the online advertising industry when it acquired the largest online and publisher business, DoubleClick, in 2007. In hindsight, this merger effectively cemented Google's online advertising monopoly.

The FTC cleared the deal largely because it assumed, contrary to what we know now, that vertical mergers are almost always good. One former commissioner, Bill Kovacic, who voted to allow the acquisition, recently told The New York Times, "If I knew in 2007 what I know now, I would've voted to challenge the DoubleClick acquisition."

It's beyond time that we stop ignoring the problems that vertical mergers pose for competition. That's why I have introduced, along with Senator Grassley, the American Innovation and Choice Online Act, to put in place some rules of the road. It is why Senator Lee has worked on the advertising issue with regard to Google, the AMERICA Act, to resolve many of the problems that have resulted from Google's DoubleClick acquisition, and I have been proud to join him on that bill.

We are not the only ones who think that it's time to rethink how to approach vertical mergers. Just this morning, we got news that the DOJ and FTC have released new merger guidelines, including updated guidance on how enforcers should consider the harms posed by vertical mergers. These proposed guidelines take an important step toward ensuring that enforcers consider how markets, including digital markets, actually work before deciding to allow a merger to go forward. They acknowledge that it is not enough to assume that consumers will benefit when a company buys a supplier or a tech company acquires an up-and-coming technology.

Under the new guidelines, enforcers must focus on the facts of the market in front of them rather than on outdated assumptions. These new guidelines will move us closer to addressing the problems that vertical mergers can create.

I turn it over to Senator Lee for his opening remarks. Thank you.

OPENING STATEMENT OF HON. MICHAEL S. LEE, A U.S. SENATOR FROM THE STATE OF UTAH

Senator LEE. Thanks so much, Madam Chair, and I know what everyone is thinking. Whenever you hear the words "vertical integration," it immediately springs to mind, "That sounds like a wonderful, exciting topic for a Subcommittee hearing"—which it is. The question of how our antitrust enforcers and courts are to analyze, handle, and otherwise address mergers that involve partners who are combining business partners, is fundamental to the vitality of antitrust enforcement and the entire system of antitrust laws that we have.

Now, look, there's no doubt that vertical integration—that is, when firms at different levels of the supply chain combine, it often leads to substantial efficiencies that, in some cases, can make businesses a lot more competitive and lead to better outcomes for consumers. And at the same time, when what you have is a dominant firm that acquires a supplier or a distributor, it has the ability to create the potential that it'll use its market power at one level of the supply chain to foreclose competition with the firm that it's acquiring.

So this all sounds pretty technical, but in plain language, it becomes simpler, which is just, you can end up with a situation in which one or a few firms come to dominate or control entire industries within our economy by buying up their business partners within the supply chain. And when that happens, the efficiencies of vertical integration can become very unlikely to flow to consumers and instead are used to pad profits and further forestall competition to acquire or maintain dominance in the industry.

We've seen this when Ticketmaster merged with concert promoter and venue operator, Live Nation. And even a DOJ consent decree, specifically prohibiting retaliation against non-Live Nation venues post-merger—those non-Live Nation venues that don't use Ticketmaster—even that hasn't prevented these repeated complaints that Live Nation is doing just that, that it's engaging in the very conduct that's supposed to be covered and taken off the table by the consent decree.

This, of course, prompted the Department of Justice to extend the consent decree up to 15 years. Nor does it seem like Live Nation's vertical integration did anything to help the Swifties, who understandably still regard this merger, quite appropriately, as the proverbial "nightmare dressed like a daydream."

But perhaps the most notorious example today is something involving Google's serial acquisitions of various ad tech companies, especially DoubleClick, which led to its complete domination in the digital advertising market. That business is now rife with conflicts of interests, and it's invited antitrust enforcement entities from the U.S. Department of Justice, 33 States and territories through their Attorneys General, the European Commission, and scores of private parties.

In fact, former FTC Commissioner Bill Kovacic said, quote, "If I knew in 2007 what I know now, I would've voted to challenge the DoubleClick acquisition."

We hear those words sometimes years after the fact, and at this hearing, we'll be talking about ways that we can identify those sooner so that we don't have to rest assured simply with the "I'm sorry" explanation at the end of all of it.

These kinds of concerns should be particularly recognizable to conservatives and to students of federalism. As I've explained to many captive audiences, including my infant grandson—who I think is 6 months old as of today, most members of my staff have also heard this talk, and also random people who have the misfortune of sitting next to me on a long flight: Our Constitution secures both horizontal federalism, meaning the separation of powers among the three coordinate branches of Government, as well as vertical federalism, meaning the limitation of Federal power and the protection of the sovereignty of the States.

So in a way, Google buying DoubleClick would be like the Federal Government taking over State governments and dictating to their legislatures and their governors how they have to run their States. If you would be outraged by the latter, then the former ought to at least concern you.

Now, I get it. It's not a perfect analogy, but it's a fun one anyway. In one, you have competing claims of sovereignty and a Constitution that establishes a perpetuation of that sovereignty. Nonetheless, the point remains clear. Our antitrust laws do, within our economy, some of the same things that our Constitution is set up to do with our Government. That is, they prevent—they protect the people against the otherwise dangerous accumulation of power, in one case political and the other economic.

Unfortunately, in recent decades, far too little concern has been raised with these sorts of arrangements while there's still time to do anything about it in advance. In both the political and economic spheres, antitrust enforcers and judges have been too deferential, at times, to speculative economic claims of purported efficiencies from vertical integration, while also being too skeptical of the potential risks. They've also been, at times, too quick to settle for behavioral remedies that prove ineffective and leave the Federal Government managing, in effect, the affairs of private businesses.

Something that we're not really well equipped to handle from Washington, DC.

This was only magnified by the uncertainty created for litigants, enforcers, and judges, to say nothing of would-be merging parties, when the FTC in 2001 repealed the 2020 Vertical Merger Guidelines without any replacement for almost 2 years.

So this hearing provides an opportunity to critically examine vertical integration, the new proposed Merger Guidelines, and to discuss how best to move forward with these issues, and I look forward very much to our conversation. Thanks.

Chair KLOBUCHAR. Thank you very much, Senator Lee. I'm just sort of having a flashback in the Ticketmaster hearing when the Live Nation CEO mentioned Garth Brooks. And your response was—remember this?—You said, "With all due respect, we all love Garth Brooks up there but I'm just not sure he's an expert on vertical integration." That happened. All right, so——

Senator LEE. I'm sure he'll write a song about it one day.

Chair KLOBUCHAR. Yes, that's——

Senator LEE. It's going to be a real hit.

Chair KLOBUCHAR. That's for sure. Okay. So I get to introduce our witnesses.

Nancy Rose is the Charles P. Kindleberger Professor of Applied Economics at MIT, where her teaching and research focus on competition policy, the economics of regulation, and industrial organization. She served as Deputy Assistant Attorney General for Economic Analysis in the Antitrust Division of the DOJ from 2014 to 2016.

Makan Delrahim, making a repeat appearance back before this Subcommittee, is a partner at the law firm of Latham & Watkins, and he previously served as the Assistant Attorney General for Antitrust during the Trump administration. He oversaw matters related to vertical mergers, including the AT&T-Time Warner, CVS-Aetna, and the extension of the Live Nation-Ticketmaster consent decree.

Charlotte Slaiman is the competition policy director at Public Knowledge. She worked in the Anticompetitive Practices Division of the FTC and as a legislative aide to a former Member of this Committee, Senator Al Franken, focusing on Judiciary Committee issues, including competition, media, and consumer privacy.

I'll now swear in the witnesses. If you could please raise your right hand.

[Witnesses are sworn in.]

Chair KLOBUCHAR. Thank you. You can be seated. I will now introduce—allow for the testimony, for 5 minutes, of Dr. Rose. Thank you.

STATEMENT OF NANCY L. ROSE, CHARLES P. KINDLEBERGER PROFESSOR OF APPLIED ECONOMICS, AND FORMER DEPARTMENT HEAD OF THE ECONOMICS DEPARTMENT, MASSACHUSETTS INSTITUTE OF TECHNOLOGY, CAMBRIDGE, MASSACHUSETTS

Professor ROSE. Thank you, Chair Klobuchar, and Ranking Member Lee, and Members of the Subcommittee, for this opportunity to testify before you today. As has been alluded, it's a major day for antitrust enforcement, with the release of the proposed revised Merger Guidelines this morning, which I've done a quick skim of, but if you've looked at them and the appendices, there's a lot there, so it's just been a skim, but I'm sure those will come up.

Antitrust enforcement is a subject near and dear to my heart. I've taught antitrust and regulatory economics to MIT students for more than 35 years, devoted my academic research career to competition regulation and competition policy issues, and, as Chair Klobuchar mentioned, worked for 28 months with the incredible career staff who serve the public in the DOJ Antitrust Division.

I've been increasingly concerned about the rise of market power due in no small part to the erosion of antitrust enforcement capabilities, as I had the privilege of speaking with this Subcommittee about in 2021. There are many contributors to this erosion, including chronically under-resourced enforcement agencies, but the body of increasingly anti-enforcement caselaw is a substantial roadblock and explanation, I believe. This is especially apparent in the context of vertical merger and vertical conduct enforcement.

Vertical acquisitions in oligopoly markets, such as mergers of a dominant video content provider with a video cable/satellite distributor; the merger of a popular—perhaps the most popular video gaming franchise with the dominant—a dominant platform or console provider; the combination of a key provider of an innovative input by 1 of the 3 users of that input in semiconductor equipment manufacturing—all of these types of mergers create the incentive and ability for a firm to foreclose competition or raise rivals' costs, advantaging that firm against its competitors and harming consumers.

To be fair, as Senator Lee noted, vertical integration may also create efficiencies in production or pricing that benefit both competition and consumers. But, as in horizontal mergers, experience has shown that firms frequently overpromise and underdeliver on those efficiencies. The economic literature, the empirical literature on vertical mergers, more precisely, provides little comfort for the notion that vertical mergers are always or even almost always are on balance procompetitive. I think one need only look at the debacle over the years following AT&T's acquisition of DirecTV and Time Warner, Inc. to appreciate this failure.

In 2017, the DOJ's suit against AT&T's acquisition of Time Warner was heralded as the first litigated vertical merger challenge by DOJ in 40 years. Many commentators spoke of the need to update caselaw. Well, agencies have been pursuing that agenda and now have amassed a very deeply concerning library of opinions that continue to express skepticism of market power motives, excessive deference to claimed efficiencies, and naive credulity of assurances by executives not to act on the incentives and ability that the vertical merger creates to increase their shareholders' value at a cost to American consumers and to the value of market competition.

Enforcers increasingly face litigating too often inadequate remedies that are proposed by parties that further weakens deterrence and enforcement, even when, as in AT&T-Time Warner, there was no binding commitment to even adhere to the proposed fixes. While the new Merger Guidelines seem to provide an effort to increase the guidance to parties and to courts to facilitate better decision-making, I have to say that I'm skeptical that these alone will be sufficient to reverse the recent course on vertical mergers. Judges and Justices may need to hear from Congress that our Nation is committed to preserving competitive markets through vigorous application of antitrust law and that the costs of underenforcement are too high to continue, particularly in this area of vertical mergers and vertical conduct.

My experience as a regulatory economist highlights the urgency of this. When we fail to prevent the excessive accumulation of market power through mergers and exclusionary conduct, there is an inexorable push for intrusive regulation that frequently follows, with all of the costs and challenges that that poses. So I thank you for this Committee's interest in this topic, and I look forward to your questions.

[The prepared statement of Professor Rose appears as a submission for the record.]

Chair KLOBUCHAR. Very good. Thank you.

Mr. Delrahim, you know how much I appreciated your work when you were in your job, and both Senator Lee and I have a really good relationship with you. So, welcome back to the Committee.

STATEMENT OF MAKAN DELRAHIM, PARTNER, LATHAM & WATKINS LLP, AND FORMER ASSISTANT ATTORNEY GENERAL, ANTITRUST DIVISION, U.S. DEPARTMENT OF JUSTICE, WASHINGTON, DC

Mr. DELRAHIM. Thank you, Senator. Chairman Klobuchar, Ranking Member Lee, and distinguished Members of the Subcommittee, it's an honor to be back here before you today. My testimony is animated both by my practice over the last close to 30 years—I used to work with Ms. Slaiman's father, who was also a staff member here on the Antitrust Subcommittee, and I'm feeling much older today. But also by my experiences, as you mentioned, as an enforcer, as Assistant Attorney General for the Division.

I speak today solely in my personal capacity and, needless to say, not on behalf of any of my firm's clients or the Department of Justice, for some of the matters I was involved with personally.

I will dispense with a description of vertical mergers as you have well described them, but needless to say, many transactions have both horizontal and vertical elements. It's not a mere coincidence. Businesses of all shapes and sizes have long recognized that there are efficiencies and procompetitive profit opportunities to be realized through integration.

One way to think about so-called vertical transactions is, when we hire a pool cleaning service, we outsource that activity to the pool service. I could buy that pool service's business and incorporate it into my home business, or I could go and purchase the equipment and train one of my children to do it. Each will have the same objective—getting my pool clean—but each one comes with different economic costs and efficiencies for me and the parties involved.

The interplay between horizontal and vertical theories of harm to competition is not as simple as labeling them "vertical" or "horizontal." There are, however, different analytical methods and economic policies that guide antitrust merger enforcement practices, depending on whether a transaction presents horizontal or vertical theories of harm. The guiding principle for evaluating all the mergers is whether the proposed transaction will substantially lessen competition.

I want to share quickly just some of the legal framework, some of the experiences, as you've mentioned, at the DOJ, and what challenges, practically, folks like Professor Rose and I have faced as enforcers in the court system, and why, perhaps, there hasn't been as much success on the enforcement side.

Unlike the horizontal mergers, the Division and the FTC cannot rely on legal presumptions of anticompetitive effects by simply showing that a challenged vertical merger would increase market concentration above a certain threshold. Of course, the agencies rely on these presumptions, and these presumptions have been the outgrowth of ever-evolving antitrust common law. They're not in the text of the Clayton Act. I wondered, as an enforcer, I feared, what if the current Supreme Court was presented with that question? Would it still read any presumptions in Section 7 of the Clayton Act?

For vertical mergers, courts have agreed that there is no presumption of harm based on market shares or market concentration. Instead, the legal framework asks whether, despite a vertical merger's procompetitive effects, the Government has met its proof in demonstrating that the particular transaction, given the fact-specific evidence at issue, is likely to substantially lessen competition. And, of course, with the burden-shifting framework that we have, once the Government meets its burden of proof, the burden shifts to the defendant to prove if there's procompetitive benefits and then back to the Government.

Many scholars, including Professor Salop and others, have mapped out several efficiency benefits arising from vertical combinations, including costs, quality efficiencies, increased incentives, product design, and production improvements, and many others. Calibrating the enforcement of vertical mergers can create complex policy decisions. I had to face them. On the one hand, blocking vertical merger may deprive consumers of the procompetitive benefits of the very kind that the antitrust laws should support. On the other hand, competitors sometimes argue that the vertical merger forecloses a firm from having the necessary input or raises that competitor's costs.

Of course, 5 years ago, as you've mentioned, the Division was forced to bring the litigation in the AT&T-DirecTV-Time Warner merger. There were many attempts to try to reach a remedy, but sometimes you have to litigate. Nobody likes to lose a case, and nobody should resort to litigation if there are remedies available to resolve a dispute. In that case, we were not able to, and of course the Division did not prevail. That case and its history—it's in my submitted testimony—nevertheless present a learning opportunity for enforcers and for merging parties, and I think it's helpful for your oversight duties here and which you're engaging in with today's hearing.

And, you know, I have not had—it took the Division of the FTC a valiant effort for 2 years to come up with the Merger Guidelines that they issued this morning. I have not had the chance to fully digest them. I'm sure we'll see a lot of commentary over the coming weeks. I'm happy to discuss some of the challenges in the questions and answers as you have today for the benefit of the Committee. But one of the—I think one of the most important things—and I know I'm over my time—is that merger enforcement, in general, is a predictive exercise, and it is even more challenging when the enforcement is in the context of vertical mergers. Judges are not quite comfortable dealing with them.

That's just reality. The courts have said that. They want real-world examples of alleged harms. A theory alone will not win a case. And, of course, in that *AT&T* case, we had no guidelines to point the court to. The 1984 guidelines were woefully inadequate and not useful, which what—is what led us to work toward the 2020 Merger Guidelines with the FTC, which were issued and replaced today. Thank you.

[The prepared statement of Mr. Delrahim appears as a submission for the record.]

Chair KLOBUCHAR. Thank you very much. Ms. Slaiman?

STATEMENT OF CHARLOTTE SLAIMAN, COMPETITION POLICY DIRECTOR, PUBLIC KNOWLEDGE, WASHINGTON, DC

Ms. SLAIMAN. Thank you so much, Chairwoman Klobuchar, Ranking Member Lee, and Members of the Subcommittee. I'm Charlotte Slaiman, competition policy director at Public Knowledge, a nonprofit working in the public interest.

It is an honor to be testifying today at this historic moment. The new Merger Guidelines published this morning truly represent a watershed moment for antitrust enforcement and the American economy. These new Merger Guidelines will be incredibly valuable for courts, antitrust practitioners, business leaders, and advocates. The guidelines lay out clearly the types of mergers that risk substantially lessening competition in violation of the Clayton Act.

The Department of Justice and the Federal Trade Commission have completed the Herculean task of bringing together the relevant precedents, up-to-date economics research, and distilling it into clear explanations of the law. These new guidelines were written by experts in the field, interpreting the law clearly and fairly. Together with the increased enforcement that we've seen in recent years, these guidelines can be an inflection point.

It has been exciting to witness the revitalization of antitrust enforcement that is currently underway at the FTC and DOJ. In the past, courts narrowed antitrust law, and Congress cut antitrust budgets. In response, antitrust enforcers narrowed their view of what they can achieve. Though Congress charged them to protect competition and consumers, caution and formalism sometimes held our enforcers back from using the tools at their disposal to promote a competitive economy where corporations compete for customers and workers.

Today, Congress and antitrust enforcers recognize the importance of preserving competition and open markets through aggressive antitrust enforcement. In particular, we've seen a marked increase in our Federal enforcers suing to block vertical mergers. This is something that Public Knowledge has been calling for, for a long time. The FTC and DOJ are to be commended for this impressive and important shift.

Vertical integration leaves consumers with fewer choices, less innovation, worse products, and, yes, even higher prices. Unfortunately, it appears that the courts have not yet come around to this perspective. Antitrust law was written broadly, which has allowed courts the flexibility to incorporate new economic learning over time. This has given courts a lot more power in this area of the law than in many others. The consumer welfare standard wasn't built in a day, and fixing it purely through litigation will take some time, as well.

The new Merger Guidelines published today can help immensely. Courts should look to the new guidelines for the most up-to-date understanding of competition law and economics, but Congress can and must do its part, as well. Americans cannot wait decades for their antitrust laws to slowly catch up with the market needs of today. The Competition and Antitrust Law Enforcement Reform Act, CALERA, from Chairwoman Klobuchar and others, would update the standard for merger review to help our antitrust enforcers stop more mergers. Sector-specific tools, like the American Innovation and Choice Online Act, the Open App Markets Act, and the AMERICA Act, are critical to addressing the problems of vertical integration in digital platform markets.

Congress has already begun to support the increased antitrust enforcement effort by passing the Merger Filing Fee Modernization Act last year, giving more funding to our Federal enforcers. Thank you for passing this important legislation. However, I fear our Federal enforcers are still resource constrained, facing more anticompetitive mergers than they have the resources to stop. We call on Congress to authorize more funding for Federal antitrust enforcement at the DOJ and FTC.

Our antitrust enforcement agencies are doing their part to promote competition throughout the economy. They are bringing the cases we need to stop anticompetitive mergers. Consumer advocates have been sounding the alarm for years, saying that existing antitrust law is not where it needs to be to address the harms of consolidation. We need Congress to do its part in this fight. Thank you.

[The prepared statement of Ms. Slaiman appears as a submission for the record.]

Chair KLOBUCHAR. Very good. Thank you very much, Ms. Slaiman. Senator Lee has come back from another hearing of some kind. We also were joined by Senator Hirono and Senator Tillis, who I know went to vote.

But I thought I'd start with you, Mr. Delrahim. As Assistant Attorney General, you voted for the Department—you advocated, I'm thinking of votes, you advocated for the Department to stop waiving through harmful mergers based mostly on promises from the company.

Can you explain why, in your view, it's important to block anticompetitive mergers instead of just rely on promises?

Mr. DELRAHIM. Thanks for that question. I think a general view is, what is exactly the design of the agencies. My view of antitrust enforcement is, in its best form, it's really a law enforcement function and not a regulator with the central planning type of tools for ongoing interference with the market. I viewed if there was a problematic part of a merger, there should be a remedy—a structural remedy would be preferred—and the Government gets in, the Government gets out. But with that, it also means that you do not slap yourself on the back with some promise where there's not a problem in a merger just because merging parties are willing to pay that tax and get a merger through. So, it was a two-sided effort to create efficiency.

You know, I think there are times, but rare instances, where behavioral remedies, if there's no other—if there's not a structural remedy available that could preserve the procompetitive benefits of a merger, it should be accepted, but otherwise, you know, it should be litigated. *AT&T*, we had—I think this is a matter of public record, you know, either selling control of DirecTV or Tribune were on the table. Had those been accepted, and I'm sure the executives wish they had now, that transaction would not have posed the foreclosure concerns——

Chair KLOBUCHAR. Mm-hmm.

Mr. DELRAHIM [continuing]. And raising rivals' costs that we thought it had.

Chair KLOBUCHAR. Mm-hmm. While you were Assistant AG, you stated that the risks from vertical mergers are heightened in digital markets, especially if data plays a role in designing products or services for consumers.

Can you explain why some experts believe digital markets may be especially vulnerable to harm from vertical mergers?

Mr. DELRAHIM. As, you know, I think has been shown, one of the concerns is potentially the network effects that could be caused, but it's not present in every transaction. Every single one is fact specific, and we have to take a look to see is the transaction intended to block somebody who is going to disrupt the market power that the underlying digital platform may have. With that, you know, you would hope that preserve the competitive forces rather than them—and we had, I think, 2 days of hearings at Stanford Business School to look exactly at that, and there's a body of record about that. That was one of the reasons I had made that comment.

Chair KLOBUCHAR. Mm-hmm. Okay. Thank you. Dr. Rose, can you talk about why many economists now accept that vertical mergers in concentrated industries can be harmful?

Professor ROSE. Sure. So, I think, let's look at a kind of simple situation where you've got a firm that is participating in a concentrated market. And let's assume that it's got, you know, a reasonably sizable position in that market, and now it's thinking about buying someone else either upstream or downstream. And the concerns that economists have raised, first from a theoretical perspective—and this goes back to literature in the 1980s and 1990s and forward—and, increasingly, in empirical analyses, is that that type of merger may give the firm, the combined firm, the incentive and the ability to exercise its market power through something like raising its rivals' costs, so making its rivals less effective competitors and enabling that firm to increase its profits, and in the process of doing that, raise prices to consumers, or foreclosing rivals from competing altogether.

And it's not just price. It can hurt consumers through innovation, as well. So I give an example of a merger—a vertical merger, that came to DOJ when I was there, between Lam, a semiconductor equipment manufacturer, and KLA-Tencor, a company that produces the metrology equipment that's needed to make sure that your equipment manufacturing—your manufacturing equipment is really capable of meeting the very precise tolerances that the chip manufacturers—the innovative chip manufacturers, like Intel, need.

You know, that was a merger where the companies came and said, well, this integration is going to create all these efficiencies and innovation and make it more effective. And what we realized as we looked at this is that it gave the combined company the ability to deny access to the KLA-Tencor metrology equipment, not necessarily permanently. Maybe all it had to do was deny access to the Lam competitors for a few months, but that would be enough to disadvantage those competitors, leaving them behind in the race to produce equipment that could manufacture the new generation of chips, and that there, to Mr. Delrahim's point, was really no way that you could write a conduct remedy that would prohibit the company or exclude the company from denying that access in something as simple as just—you know, maybe it was just a little slower to tell rivals about this new measurement equipment that was available.

I think that's the problem that we face, is that when the company has both the incentive and ability, through its acquisition of an upstream or downstream firm, to disadvantage rivals, it's compelled to use that market power. And I think that's the understanding that economists now have of many vertical mergers. Not all, but many——

Chair KLOBUCHAR. Not all.

Professor ROSE [continuing]. Especially in oligopoly——

Chair KLOBUCHAR. Yes.

Professor ROSE [continuing]. Markets.

Chair KLOBUCHAR. I think that's an important point. Okay. Live Nation, Ticketmaster, brought it up at the beginning. Ms. Slaiman, in 2010, the DOJ allowed Live Nation to acquire Ticketmaster after Live Nation promised not to use its music promotion business to force venues to use Ticketmaster for ticketing services. Nine years later, the DOJ had to step in and set new terms for Live Nation after the company repeatedly broke those promises. And earlier this year, The New York Times reported that the DOJ is investigating Live Nation for continuing its unlawful conduct. And we hope that our hearing and the information that we gathered at that hearing will be helpful for that reported investigation.

Ms. Slaiman, in instances like the Live Nation merger, where a company later reneges on an agreement that was key to the decision to approve the merger in the first place, even though many of us raised issues with it at the time, I'd just like to note for the record, but when the company later reneges on an agreement that was key to the decision to approve the merger in the first place, how are consumers generally harmed?

Ms. SLAIMAN. Well, it very much depends on the details of the situation. It became so clear in the *Ticketmaster* case that consumers were not well served by the lack of competition against Ticketmaster.

I think Taylor Swift felt the need to talk about why this terrible consumer experience happened to her fans, and one of the things that she mentioned was, she likes to take as much of this process in-house as she can. And with Ticketmaster, that wasn't an option. I think that's because of these exact agreements, because Live Nation has such strong control over the venues. As someone doing a nationwide tour—the Eras Tour is happening across the country—she needs a lot of different venues. She has to work with Live Nation, and, as a result, she had to work with Ticketmaster.

Chair KLOBUCHAR. Right. And as you know, during the hearing, it's not just her. It's everything——

Ms. SLAIMAN. Of course.

Chair KLOBUCHAR [continuing]. The examples from Bad Bunny to Bruce Springsteen to Clyde, who was our witness, of the Clyde Lawrence Band. So, I mean, the point is, even for the smaller bands, it's actually a lot harder because they aren't making that kind of money.

And we learned in the hearing that Ticketmaster is, like, 90 percent of the venues for the largest events, for things like the NFL, NHL, 80 percent when you break it down to the next large events, and 70 percent of events overall. This is just by memory, but I believe that's what it was.

So, do you agree that the Ticketmaster-Live Nation merger has ended up harming consumers, and if so, how? And then I'll turn it over—I'm going to go vote and turn it over to Senator Lee and return.

Ms. SLAIMAN. Yes. It has ended up harming consumers, and I believe that that was foreseeable at the time, as it sounds like you did, as well. So what's important here is that the result is that it's very difficult to compete in ticketing, so we don't have alternatives to Ticketmaster, and there isn't that competitive pressure on Ticketmaster to provide a better service to consumers.

Chair KLOBUCHAR. All right. Thank you very much.

Senator LEE [presiding]. Thank you, Madam Chair. Mr. Delrahim, I'd like to start with you, if possible. Back in 2020, you were the head of the Antitrust Division at the Department of Justice, and in 2020, you issued, along with the FTC, of course, the 2020 Vertical Merger Guidelines, while you were there. Tell me why you thought that was important.

Mr. DELRAHIM. Thank you, Senator. So, as we litigated the AT&T transaction, we saw that the courts were generally not comfortable. It was, as mentioned, it was the first case, not the first enforcement case. Professor Salop has got a great paper of the number of enforcement matters that have either ended in a consent decree or abandonment. But it was the first one litigated because we couldn't get to a resolution.

Then there were several other transactions that we were involved with, and when we looked at the guidelines, one of the benefits of the guidelines when you have them—and I think, you know, they've generally served, in a bipartisan way, well both agencies, and they have been updated periodically with the benefit of the expertise of experts like Professor Rose and Professors Shapiro, Carlton, and others who have come to the Division—is that it provides transparency to the public, to the enforcers, about how the law is, and that's really important—and to the judges.

When there is support, both in the law and the economic—accepted economic thinking, those guidelines have value. If they do not, they do not have any value because the courts will say this is aspirational. You want to change the law, go to Congress. This is the right place to do it. If there isn't support for them, what I fear is the courts will begin dismissing them, and they really don't have any value.

What we wanted to do was provide a guideline, a transparency document, at the Justice Department and the FTC—fortunately, we were able to do that—and, you know, synthesize the body of the law and economic thinking on vertical mergers to serve as a recipe book for both business community, enforcers, practitioners, and, most importantly, judges, so they can rely on that.

I thought, you know, it was unfortunate when the Federal Trade Commission unilaterally withdrew those without replacing one, and then they brought several cases. Frankly, I think, you know, had they had a guideline that they could have pointed to, it might've helped them in some of the litigations which they lost and have created, you know, a law on the other side of what their enforcement objectives were.

Senator LEE. I assume you were a little surprised when they did that, when they walked away from those, when they withdrew them.

Mr. DELRAHIM. To be honest with you, it was less surprised, but, you know, saddened. I was very glad that the Justice Department did not do that.

Senator LEE. Yes.

Mr. DELRAHIM. And, you know, Assistant Attorney General Kanter kept them in place until there's a replacement because——

Senator LEE. It was——

Mr. DELRAHIM [continuing]. Frankly, it was one that's widely recognized, and they should—they're acceptable, and—you know, those guidelines, the 2020 Guidelines. So it was—it was unfortunate, but such is life.

Senator LEE. Now, we've—as of this morning, we've got a new set of guidelines in place. I assume you've had at least a little bit of chance to take a look at them. To the extent that you have, are the new guidelines, in your view, sufficiently robust to cover the nuances presented by vertical mergers and the lessons learned from recent losses in enforcement actions in that area?

Mr. DELRAHIM. I really don't know. I haven't had the time to digest those guidelines. The one thing I do hope is that, you know, as we look and unpack those guidelines and look at them, is that they are supported by current economic thinking, recent—most importantly, recent cases, because without that, it is less useful. The one thing I can say about them is that I think they recognize the efficiencies of merging two guidelines into one, and that's a good thing for the Government.

Senator LEE. Right, because historically, it's not been done that way. Right?

Mr. DELRAHIM. Right. We've had the Horizontal Merger Guidelines, and then from 1984 until 2020, we had the Non-Horizontal Merger Guidelines. That was the DOJ. So, we now have one comprehensive guideline, which as an administrative matter, is good.

Senator LEE. Okay. So you——

Mr. DELRAHIM. But substantively, I really have no comment. It took, you know, the two agencies 2 years of a lot of work with dedicated folks. I don't think I would do them any service making any comments about them in the last few hours when I haven't had the chance to look at them.

Senator LEE. One thing I've noticed is that, generally speaking, these guidelines tend to cite older cases, mostly pre-1977 cases, generally, but that's especially true, glaringly so, with respect to the parts dealing with vertical mergers specifically. And so, as a result of that, the new guidelines don't cite, much less aggressively address, cases in which the U.S. Government lost, cases involving *AT&T-Time Warner*, *UnitedHealthcare-Change*, and *Microsoft-Activision*.

Can enforcers—first of all, what do you make of that? And I assume this is not something that should be taken as an indication that enforcers can just ignore these cases that are binding precedent, including precedent from the D.C. Circuit.

Mr. DELRAHIM. My understanding is these guidelines are up for comments. I'm hoping that they will be updated with newer caselaw. Just, you know, not citing them do not go away in future litigation. Litigants will cite them. They're precedent, and I think the courts—I mean, you've had courts that have ruled against the Division and the Federal Trade Commission.

By the way, these are not, you know, Judge Bork courts. These are appointed by President Obama, President Clinton, President Biden, very recently. And I'll add one more case to the list that you've mentioned, another vertical one, which was the *Meta-Within* litigation. That's another one that the agencies lost and has vertical components.

Senator LEE. Right. I mean, it seems pretty significant to cite those recent cases, especially recent cases in which the Government lost. I'm not quite sure what to make of that. Now, you mentioned Judge Bork a minute ago. Am I supposed to read anything into that, the fact that they didn't cite any pre-1977 cases—well, very few, generally, but definitely none in the part of the guidelines that deals with vertical mergers in particular. Is that a Bork thing?

Mr. DELRAHIM. You know, I don't have any insight into that. I doubt it. I think there's also just less—one of the reasons Congress wrote the Hart-Scott-Rodino Act was, before that, you had parties merge, then the Government came and enforced, and had to unscramble the egg. It was not a clean process, and because of that, you had a lot of cases published.

People think that you don't have a lot of published opinions because the Government has not been enforcing the law. That's not the case. It's because Congress put in this Hart-Scott-Rodino regime, where before you merged, you had this period of time not to get approval, but at least give the agencies a chance to take a look at it, and that's, I think, a large reason. Of course, we've had cases since because the parties have disagreed, but I think that's the large reason why we haven't had as many published opinions over the years as we did prior to the Hart-Scott-Rodino regime.

Senator LEE. Right. Now, I'm not someone who likes per se rules. I'm glad, for example, that *Dr. Miles* is no more. I agree with Judge Bork that per se rules generally are to be avoided, in part because they miss out on a number of things. Historically, merging parties in a vertical merger would point to efficiencies and procompetitive benefits presented by the would-be vertical merger.

For example, the elimination of double marginalization. It's known as EDM, not the EDM that's a genre of music. That's cool, too, but this kind of EDM is also very important. They don't talk about this kind of EDM at raves, as far as I'm aware, but that's a different thing.

[Laughter.]

Senator LEE. Do you—do you expect that the DOJ and the FTC are going to credit or not credit these arguments as they've previously credited them, even if we have recent caselaw that credits EDM?

Mr. DELRAHIM. You know, I would assume courts will demand that. So, again, I was on the losing side of the *AT&T* case. In that litigation, Professor Shapiro was our testifying expert. I made the decision, and I think everybody agreed, that, in court, we have to admit the efficiencies from the elimination of double marginalization that occurred in the *AT&T* case. Now, you know, the court took that into account to try to find it. We had a case despite the efficiencies, but I thought that was the right thing to do. That's the—you know, we're not just private litigants at the Justice Department. It was, I think, the honest thing to do there, and I hope that the future guidelines reflect the efficiencies that have been well accepted amongst economists as well as in courts.

Senator LEE. Thank you. Senator Blumenthal.

Senator BLUMENTHAL [presiding]. Thank you. Thank you, Senator Lee, and thank you all for being here on this very important topic. I'd like to ask the other two witnesses today, Professor Rose and Ms. Slaiman, whether you have a preliminary opinion on the Merger Guidelines that have just been issued.

Professor ROSE. So, like Mr. Delrahim, I have not had time to digest what is a quite lengthy document, especially if you go to the appendices. I do think this approach of trying to lay out, in terms that are easier to understand, the various theories of harm and concerns that mergers might raise should be of enormous support for courts that are struggling with some of these issues, often with judges who have never had an antitrust case before a merger case from the DOJ or FTC lands on their docket. So, I think that that's helpful.

In the context of—specifically of the vertical provisions, I've had a chance to look through, quickly, Sections 5 and 6, which are really the core areas that kind of articulate the potential problems with vertical mergers. I think they're quite clear with respect to this discussion about double marginalization and efficiencies. I think these guidelines take a balanced approach to them, which is to say, you know, just as parties will always assert in vertical—in horizontal mergers that the merger is going to create efficiencies—I've yet—at least when I was there, yet to hear one where that wasn't an argument—and the agencies are appropriately skeptical and ask the parties—to really push them hard to support that with evidence, I think these also take that view with some of the vertical efficiencies that are claimed, and I think that's appropriate.

You know, to go back to—we keep talking about AT&T-Time Warner, but, that was something where the Department of Justice credited the EDM. The court then said, well, the profit maximization that gives you, with this integrated entity, the elimination of double marginalization, we think that will happen, but we don't think the profit maximization—that's exactly the same process, that creates the raising rivals' costs and foreclosure concerns. I don't think that's going to happen, because the executives said, oh, I—we never maximize profits that way. That tension is fundamental in evaluating a vertical merger. I think it's important that the guidelines, I think, are trying to explain to courts some of that.

Senator BLUMENTHAL. Ms. Slaiman?

Ms. SLAIMAN. Thank you. I wanted to respond, in particular, to Mr. Delrahim's comments about referring to old caselaw. I think that that caselaw is still good caselaw. That's still good law. What we're trying—what the goal of guidelines, I think, always is, is to merge the law with the up-to-date economics. One of the problems that we face in antitrust law is that old economics is getting enshrined in caselaw, and I think that is not how antitrust law is supposed to function. We're supposed to be using the most up-to-date economics and merging that with prior judicial decisions. So that's what these guidelines are doing, and I think that's exactly right. That's what we need. So I was very glad to see that perspective in the guidelines.

Senator BLUMENTHAL. Good point. Mr. Delrahim, welcome back to the Committee.

Mr. DELRAHIM. Thank you, Senator.

Senator BLUMENTHAL. Thank you for your service. In 2019, I think, as you know, the Department of Justice said about the consent decree on Live Nation-Ticketmaster, and I'm quoting: "Live Nation repeatedly and over the course of several years engaged in conduct that, in the Department's view, violated the final judgment," end quote. I know Senator Klobuchar has asked you about Ticketmaster-Live Nation.

Coming right to the point, the Department of Justice reportedly has an investigation underway about the potential violations of the consent decree. Assuming that it finds there has been yet again—I think it's the third time—a violation of that consent decree, isn't it time to break up that merger, to roll it back, to admit it ain't working out for consumers, as I think most consumers will tell you in very graphic terms. Talking about remedies, wouldn't, in effect, breaking up the merger now be the right remedy?

Mr. DELRAHIM. As you noted, that enforcement action was during my tenure, and I was personally involved. I've been advised by the Department's ethics officials to not speak publicly about the matter while it's still pending. I can't even use it in my class at University of Pennsylvania, so——

Senator BLUMENTHAL. Even though we're 4 years later?

Mr. DELRAHIM. Until, you know, they tell me okay, I will. That's one area of the law that I don't want to violate.

Senator BLUMENTHAL. Okay. Professor Rose, Ms. Slaiman, maybe you can comment.

Professor ROSE. I'd be happy to weigh in on that. I think that what we have learned over 40 years of vertical merger enforcement through consent decrees that are almost always behavioral remedies is that they don't work. As has been alluded to, the courts are not regulators. The enforcement agencies are not regulators. And the companies understand, when they're negotiating those decrees, sort of what they can agree to that will still preserve their ability to exercise the market power that was often the target of that vertical merger, the goal of that merger. So I would have to say I think if you want to remedy this problem in this particular context, that probably divestiture is the only solution that will give you a lasting remedy to it.

Senator BLUMENTHAL. Ms. Slaiman?

Ms. SLAIMAN. Well, I'd like to speak more generally about the idea of behavioral remedies because I absolutely agree with many of the criticisms that we've heard today of behavioral remedies. They are frequently not enforced well. They are frequently time limited for too short a time limit. But I am hopeful that we can set to improving our system of behavioral remedies because I think there are times when behavioral remedies can be an important solution. We talked about the resource constraints that the agencies are facing today, so I think there may be times when settlement is necessary, and it would be great if we had a better system of behavioral conditions that could actually be enforced quickly and effectively. So, I think we should work to improve behavioral conditions.

Senator BLUMENTHAL. I'm not going to ask you the next question, which is, tell me a behavioral remedy that has worked. Tell me a consent decree that has been effective. I'm going to give you a little time to think about it, mainly because my time has expired. It certainly hasn't worked for Live Nation-Ticketmaster.

Ms. SLAIMAN. Absolutely.

Senator BLUMENTHAL. And it's made a mockery of the idea of consent remedies. It runs circles around the enforcers. They deluded the public, and I don't want to prejudge the result of the Department of Justice investigation, but if it does what it should do, then I think that some structural remedy here is absolutely appropriate.

Senator Blackburn.

Senator BLACKBURN. Thank you, and welcome to each of you. We are glad that you are here, and I have to tell you, I'm pleased to see conversation about the Ticketmaster issue. I'm from Tennessee, and needless to say, there was quite a bit of conversation around this, and it was not just the Taylor Swift concert. There were several last year.

And I think, Professor Rose, to your point, it just points out how widespread this is. It's not a single issue. It is something that, when you look at this, you have to say, is divestiture what is going to work, and to separate this.

And, of course, we do have some artists that are moving forward and are saying they will not sell through Ticketmaster and then negotiating separately with venues, and doing a good old-fashioned private-sector solution to this without the Government. They're opting to change the way that they do business because of Live Nation-Ticketmaster and the control that they have.

Mr. Delrahim, welcome back to Committee.

Mr. DELRAHIM. Thank you, Senator.

Senator BLACKBURN. Yes. I want to talk with you just a moment about some of the mergers and the trend we've seen out of the FTC blocking mergers. We've been through a situation in this administration with an entity out of Tennessee trying to buy another entity, and the process was laborious and did not serve the marketplace well because of the demands that were coming from the FTC. And, of course, the overreach that we're seeing there from the FTC really came to light just recently with the *Microsoft-Activision*. They failed to be able to block that merger. But there seems to be this attitude that any merger is bad, and I have found that so interesting because they're not all bad. They're not all good. But there should be proper wait and review that is given to this.

And one of the things that has interested me as we've talked to Tennessee companies is how they view some of these actions as having such a negative impact on the marketplace, and I'd love for you to speak to that for just a couple of minutes as to what you're seeing and how you're viewing that.

Mr. DELRAHIM. Sure. Thank you, Senator. You know, it's a good point. I have been critical of some of the procedures, and I think we need to look at Government design, and that's perfectly appropriate for this Committee. We have two Federal agencies, plus 50-plus other antitrust agencies with the State AGs, all who do great work. The Federal Trade Commission has incredible public servants, great folks, but the procedures—just as Justice Kagan noted in the *Axon* case, this past term——

Senator BLACKBURN. Mm-hmm.

Mr. DELRAHIM [continuing]. You know, which said agency—the Federal Trade Commission may know something about competition, but it certainly doesn't know anything about separation of powers where the parties were not allowed to sue until the end of the administrative process, but now they do have an ability to go to court and seek redress.

The due process is really important, and when you have an agency that brings—again, without commenting on any particular transaction, just procedurally, you have the review process. They have a different legal standard than the Justice Department without any statutory, you know, direction from Congress of what agency reviews what transaction, but arbitrarily, you know, some of them—I was involved in them because of the clearance process.

The legal standard to get an injunction in court is different for the two agencies, you know, arguably a lower standard for the FTC, one. Two, when they bring administrative litigation before an administrative law judge in their FTC Commission, when they lose, you appeal back to the Commission. Well, guess what? It's the same Commission who reported out a complaint. Again, procedurally, it makes no sense, because in 40 years, guess how many times they have lost an appeal of their own loss? [Vocalization sound.] Zero.

Senator BLACKBURN. Yes.

Mr. DELRAHIM. Then you go to court. So in the real world where parties are dealing with ticking fees, high interest rates of deals, you now have to factor in 2 years to now go to a circuit court to seek your legal redress. And I think when you have an overreach by the Government, the Supreme Court—I don't know, how many 9–nothing decisions, but Justice Kagan's decision just last year in the *Axon*—is just one, and I—you know, and there's more cases of those.

Senator BLACKBURN. Mm-hmm.

Mr. DELRAHIM. That's not good for the enforcement of the law.

Senator BLACKBURN. Yes. Let me ask you this, also. The 2020 Guidelines that we've already discussed here today, why do you think FTC and DOJ was moving so aggressively to remove those guidelines?

Mr. DELRAHIM. You know, I don't know. I don't want to guess. The DOJ did not. To their credit, they did not withdraw those guidelines because they, I think, recognized there was a lot of work that went into it. It was widely accepted. Many experts, including Professor Rose, Professor Shapiro, Salop, and others, provided comments, and it was well regarded. And I think the statement of the commissioners who withdrew the guidelines speaks for itself.

It was a fundamental misunderstanding of the law about the burden shifting, and the difference between procompetitive effects and efficiencies, I think, is one of the reasons. But they withdrew them without having another one in place to provide some guidance for the courts, and my question is, some of the litigations may have been more successful had those guidelines remained there.

Senator BLACKBURN. Well, and I think that the way Mr. Kanter and Ms. Khan moved forward aggressively to move away from those guidelines is something that was not lost on a lot of people. My time has expired, Madam Chairman. Thank you.

Chair KLOBUCHAR [presiding]. Well, thank you very, very much, Senator Blackburn, for all your work in this area, and thank you for being here. Next up, Senator Durbin, the Chair of our Committee—the real Chair.

Chair DURBIN. Thank you, Real Chair Klobuchar. Makan, it's good to see you back in this room where we've spent much time.

Mr. DELRAHIM. Great to see you, Chairman.

Chair DURBIN. Thank you, Professor Rose and Ms. Slaiman, for joining us today. Mr. Delrahim, in a speech you gave at Duke in 2021, you noted several court precedents that proved to be particularly challenging as an antitrust enforcer. One of those cases was the 2018 decision, *Ohio v. American Express*, which you said was a classic example of bad case leading to bad law. How did the decision in that case impact your ability to challenge proposed mergers?

Mr. DELRAHIM. That decision—thank you, Chairman Durbin, for that question. That decision was one that was cited in the—I think erroneously, at that time, cited in the *Sabre-Farelogix* challenge, where the Division brought, and an incredibly bright judge looked at that, and it's a complex case, looked at the market definition, and made it very difficult for the Division, as a matter of law, to go into court, say, you know, you should look at the definition on one side of the market rather than the two sides of the market.

It's a decision where, when I mentioned bad case bringing bad law, and when I came in, I tried to settle that because I saw the train wreck going to happen at the Supreme Court, the uncertainty of the bad law being made. Unfortunately, it was a case that was—even though it was the Justice Department's case, the State of Ohio was the one that ended up seeking cert, and I was not able to get all the parties involved. The challenge with it is that now you have a law on market definition with two-sided markets that's very difficult to administer, and, you know, it's a great precedent to litigate, but it's just very difficult for enforcers because it doesn't have clarity.

Chair DURBIN. Is the clarity lacking in terms of law and precedent or the complexity of the case?

Mr. DELRAHIM. The complexity of the case. I mean, how you address that, you're going to have to litigate. I believe the judge in Delaware with the *Sabre-Farelogix*—I believe he's been elevated now in a court of appeals. Incredibly bright judge. He just looked at it. He said, as a matter of law, I have difficulty. Here's how I have to interpret this market or define this market, and that was one of the challenges.

These are difficult for the Supreme Court to—you know, two-sided markets are difficult to understand. To really appreciate why two-sided markets are important, sometimes you have to engage in perhaps restricting some output on one side. For example, Uber is one where, if you don't have enough drivers, there's not going to be demand on the consumers who want it. If you have enough drivers, then—so, the two sides are really important. There's an interplay between the two, and you have to factor those both in, as the Court mentioned. You can't just say because you're limiting output on one side, you now have an antitrust violation.

And in that case, it was against American Express, who, for many years tried to enter into the market against Visa, Mastercard, it couldn't. It set up its own separate network, exactly the type of thing we would like somebody to invest. They got, I think, 24, 25 percent of the market, and there was enforcement actions against Visa and Mastercard. And then we sued for an antitrust against American Express by saying that, you know, if you're using my network that I invested in, you can't, you know, direct consumers over—that I brought to you to the other side. And I think that was just a mistake in enforcement.

Chair DURBIN. Professor Rose, in an interview with the Harvard Gazette, 2021—I missed that issue, I'm sure it was sent to my home—you said the caselaw relating to vertical mergers was too lenient and decisions have too frequently been based on misunderstanding the economics. Could you reflect on that comment based on the exchange Mr. Delrahim and I——

Professor ROSE. Sure. That's a—I'm interested that someone found that article. That was when I was at Radcliffe. Yes. So, here's, I think, what I was referring to. So first, with respect to the economics, there was this, I'll just call it, a very naive and formulaic view about vertical mergers that focused on the potential efficiencies of vertical integration and made the erroneous economics argument that in any vertical chain of production, there was, at most, one monopoly profit, and so it didn't really matter whether that profit was earned at one level or another level—by combining the two levels, you weren't going to increase the amount that a firm could earn.

And what we understand as we look at markets where there are relatively few competitors that interact, is that that model is just wrong, that, in particular—you know, I described earlier foreclosure effects. If I can combine, say, the upstream manufacturer and the distributor, and I can foreclose access to, say, the distributor network to my upstream rivals, and they've got to go through some more costly way—you have to go back to this discussion of Ticketmaster—they've got to go through some more costly way of selling tickets because they don't have a low-cost ticket option anymore—then I'm able to raise prices kind of at the expense of these rivals who have lost because their costs are higher.

And so we understand now that vertical mergers can create the ability for firms to exclude rivals or to raise their costs, advantage themselves in competition, and harm consumers in that way. And I think the problem is that—we talked a little bit about the caselaw in the Merger Guidelines. I think they're just citing to Supreme Court. I haven't gone through them with tooth and comb, but I think they're just citing to Supreme Court cases, and there just haven't been many merger cases that have hit the Supreme Court, in general, over the last few decades, and really nothing in the vertical context since this economic understanding has become better accepted and understood. And so I think the problem is that judges are still disproportionately inclined to say, as the decision in *Microsoft-Activision* was, to cite to, you know, quotation after quotation about vertical mergers are almost always procompetitive or vertical mergers create efficiencies, without recognizing their ability to harm competition and, therefore, our need to enforce against them.

Chair DURBIN. Thank you. Thank you, Madam Chair.

Chair KLOBUCHAR. Thank you very much, Mr. Chairman. I'm going to ask a few additional questions, then at some point, I think we'll all—and Senator Blumenthal does, and then hopefully Senator Lee will return for a bit, but then we have to go back so we don't hold up additional votes.

I'd start with—I know you, Ms. Slaiman, mentioned the bill that we passed, the Merger Filing Fee Modernization Act, which I appreciated Mr. Delrahim, when he was in his old position, was advocating within the administration to get this done, and we finally got it done with a little drama, I will say, the bill that Senator Grassley and I had for a long time, at the end of last year. We also passed a bill that Senator Lee had about the venues of cases, that they stay—supported by nearly every Attorney General in the country, from liberal to conservative—that the cases stay in the States where they are supposed to be—stay. That was a bill that Senator Lee and I did.

But if we could go back to the funding that we had then take effect immediately after some debate, and we actually had a floor vote and got nearly, I think, 90 of the Senators to vote for that.

How do you anticipate that the agencies, what they will—they got their support. Why is it helpful with regard to vertical mergers, and what steps do you recommend Congress—additional steps that

Congress should take to support vertical merger enforcement? So it's kind of like, how can this be helpful with vertical mergers, the additional funding which, as you know, is done by charging more on the large mergers and less on smaller mergers? How can that Congress—that funding be helpful, and then what else do you think Congress should be doing?

Ms. SLAIMAN. Great. Thank you very much, Madam Chairwoman, for the question. So the agencies may be able to bring more cases as a result of receiving additional funding. There are many more mergers that need to be examined today than we have had historically, and so I think that is really testing the capacity of our antitrust enforcement agencies. The funding has not been keeping up with the increase in mergers that need to be examined, so making that change in the Merger Filing Fee Modernization Act is hugely helpful for that. I do think, as a next step, that they actually need even more funding, even more resources. I fear that they will still be resource constrained even after——

Chair KLOBUCHAR. And is it true that these—from what I recall, they bring in funding. They bring in money from bringing these cases because of either remedies, payments, filing fees, and the like.

Ms. SLAIMAN. Right. So on mergers, I think that comes from the filing fees, but certainly other cases that the agency in particular I think about, the FTC is always returning a lot of money to the Treasury from prosecuting fraud and things like that.

Chair KLOBUCHAR. Mm-hmm.

Ms. SLAIMAN. So they absolutely are bringing in money, as well.

Chair KLOBUCHAR. All right. Thank you. Dr. Rose, one thing that we've seen is that vertically integrated online platforms will often use their dominant position in a market, as we've discussed today, to preference their own products or content. That's why we've reintroduced the bipartisan—Senator Grassley and I—American Innovation and Choice Online Act. We thank Senator Blumenthal for being one of the many co-sponsors.

Dr. Rose, how could more vigilant review of vertical mergers help to prevent companies from unfairly preferencing their own products and services over those of competitors? And we're talking here—as you know, the bill's been endorsed by the National Federation of Independent Businesses because of the fact that small businesses feel very strongly about this, that they are getting pushed down the platform in preference for things like Amazon Basics products on the Amazon platform. Professor Rose?

Professor ROSE. So, I think there are two parts of your question, and the first I want to really highlight is, again, I keep coming back to, as you've heard also, I think, from others on this panel, the benefit of congressional action. And, if we take something like self-preferencing, I think that's a behavior that is currently extremely difficult for U.S. antitrust enforcers to reach. Even if it is reflective of the anticompetitive action that would fall under Section 2, it's just extraordinarily difficult to bring an enforcement action and succeed in court. So I think Congress making it clear that that's a violation will help both in deterrence and in——

Chair KLOBUCHAR. Which they've done in other countries.

Professor ROSE. Yes. Yes. Well, in other countries, what's the equivalent of our Section 2 standard is also a bit easier. You've got this abuse of a dominant position that we don't have here that allows them to enforce it.

Chair KLOBUCHAR. Mm-hmm.

Professor ROSE. So I would just say, if we've got a problem, and self-preferencing may not—may arise in many contexts that have nothing to do with vertical acquisitions——

Chair KLOBUCHAR. Mm-hmm.

Professor ROSE [continuing]. It may just arise organically, that having this kind of congressional action to make clear what types of behavior and conduct they feel violate the law would be very helpful.

In terms of vertical mergers, I guess I think—and this is something that we've seen the agencies I think begin to consider, that the acknowledgment that the more you're acquiring companies that are related to you, either in a vertical chain or with these platforms, it may not even be vertical. They're depending on you for some things, but they're complementary, part of this kind of two-sided market. I think recognizing that there's a potential harm that can arise from increasing your activity off the platform, that then is in conflict with providing service to your downstream or small business competitors, Amazon Basics competitors, you have an incentive to preference your product over theirs. I think recognizing that potential in mergers could be an important thing for agencies to do.

Chair KLOBUCHAR. Mm-hmm.

Professor ROSE. I think it's going to be extremely difficult to successfully bring challenges based on that theory of harm, but I think if Congress demonstrates——

Chair KLOBUCHAR. Without additional——

Professor ROSE. Yes.

Chair KLOBUCHAR [continuing]. Legal authority? So, we're just——

Professor ROSE. Yes, and——

Chair KLOBUCHAR. I mean, my problem is we're just, and I'm going to turn it over to Senator Blumenthal, who has done some incredible work on app stores and the like. It feels like, to me, that we're just static. We're pretending the world is as it was, not quite back to the Standard Oil days with the old cartoons, but 30, 40 years ago. And we have this whole new market, and we haven't really passed, with the exception of the resources and the venue bill, one piece of competition legislation in the tech area, and we're just pretending like it's not there. And the rest of the world isn't. They're moving around.

Professor ROSE. Right.

Chair KLOBUCHAR. They're looking at it. And so I just think, in the end, it's going to be at our great folly for competition and for the economy as a whole because the power is so immense with 90 percent market share for Google of search engines. And then not putting any guardrails in place is just going to lead to much more limited choice and much—all kinds of little companies going under because they're just not going to be able to compete if that is their gateway.

Professor ROSE. Or we outsource our enforcement to Europe and the U.K.

Chair KLOBUCHAR. Well, that is exactly right. We don't have our American brand of enforcement. We are—of course, these companies, we're proud of the innovations they've brought in, but that doesn't mean you just step back. We were also proud that they built the railroad. That really was a great thing. But we didn't just step back and say this is just going so well for everybody. We said, okay, we have to put some rules in place. This just isn't happening here, and that's what I'm trying to convince my colleagues of, that, as you say, we're letting—we are outsourcing how this is regulated to other nations as we speak, if we don't do something ourselves. What a great segue to Senator Blumenthal. Thank you.

Senator BLUMENTHAL. Definitely outsourcing enforcement to other countries, to Europe, primarily. And how ironic and, in a sense, shameful that the United States, which really originated the idea of antitrust enforcement, trust busting, and so forth, should be behind Europe.

And just to sort of add a footnote to what Senator Klobuchar just said, the way I view your testimony, Professor Rose, is that you're saying not so much that economics have changed or that the economy has changed, but the old assumptions, which were not based on facts, they were theoretical. Bork being—Professor Bork, I should say, with all due respect, I took his course at Yale Law School in antitrust—simply kind of erected this construct of theory that really bore very little relationship to the facts of how vertical mergers don't have those efficiencies that were presumed and do have the anticompetitive effects that were presumed not to exist, and maybe now we're just becoming more realistic about it.

But let me ask you, coming back to remedies because for many years I was an enforcer, so I'm more interested in the practical results of enforcement, should we—and this is really a question for all of you. Should we be engaging in consent decrees anymore? Shouldn't we just say, no, this is not going forward? This merger has too many problems. We're not going to try to set conditions or divestiture requirements. Just—it's too big.

Professor ROSE. So, I do think we need to have the resources to bring more enforcement challenges, just outright challenges. I don't, unfortunately, think that the option of taking settlement entirely off the table is likely to succeed in the way that we want.

I've been increasingly thinking what congressional intervention could help, and one of the things we're seeing, I think, in the last few years is an increasing tendency of parties to come in, having proposed a remedy. I think that Makan had to deal with this when he was at the DOJ as well, but I just see it even coming in more frequently, particularly in the vertical space, but not just vertical. And the agencies are having to litigate the fix, and it's extraordinarily difficult.

And so I'm wondering if something like, and I think this would have to be congressional action, a presumption—or a burden shifting or a presumption that says the agencies litigate the mergers presented and the harm, and if the parties have a fix for it, then it's their burden to demonstrate that that will alleviate all of the competitive harm. And, they've got the information and data to be able to present that case. It's very hard for the agencies to prove the negative of that because they don't have as much access to information and understanding of markets.

And I don't know if that would help and, also, at the same time, make it a little bit less attractive for companies to come in and say, yes, we know there's a problem, but let's just settle. But I do think in the vertical context, these conduct remedies just—I'm going to go take your assignment to go back and look, but I'm sure there are some that have worked okay because probably the incentive to foreclose rivals wasn't so strong.

But if the companies can make more money by doing A prime, B prime, and C prime, they will say, I agree not to do A, B, or C. That's in the contractual terms of the consent decree, and the Department of Justice is not going to be able to go and convince a judge that they're doing A prime, B prime, C prime—you should stop them. The judge will say, well, if you didn't want them to do that, you should've written it in the consent decree. And I just think that's the problem we're facing in so many of these situations.

Mr. DELRAHIM. I think, Senator, it depends on—when you say, "to disallow the consent decree," it depends on what do we mean. Is it behavioral or structural? A lot of times, a consent decree is a settlement to a merger where the parties agree to sell something or do something, where it removes the disincentive to act in a profit-maximizing way. And that becomes the problem with some of the behavioral remedies that I think the agencies were too quick to enter into. So I think it's—we shouldn't remove them. We should look at what are ways to have them enforceable, to have them—that actually solve the problem.

The other thing is, we did this for the first time, but Attorney General Reno put in place—Congress, 1995, passed a law to arbitrate administrative cases. Attorney General Reno issued regulations. We did that in one merger case for the first time in history. It created efficiencies of resources. It created predictability. The Division actually prevailed in that case against my current law firm now.

It was a good result, and I think the agencies and if Congress supported that, is to encourage more of that. Now you have an expert arbitrator that the two sides would agree, who has an economics background, who has an actual incentive to be there rather than a judge with 400, 500 cases, who has no interest to hear this case or want to be educated by Professor Rose on one side but maybe Professor Carlton on the other side, who are both incredibly qualified, but say the exact opposite thing. And that's one of the challenges of administrability.

The other thing that I think would be helpful is that we really don't have a lot of judicial guidance on remedies. That's something that I've been thinking a lot about researching. The Supreme Court's decision in the *NCAA* last year, Justice Gorsuch's decision, gave some guidance, to say, here's the discretion that the judge has and wide discretion at the district court level to construct remedies. The previous judicial guidance on this was really the *Microsoft* case in the D.C. Circuit, 20 years ago, about—this was a structural remedy that the judge had imposed, and the D.C. Circuit said, uh-uh, no, not really.

Senator BLUMENTHAL. I'm very familiar with——

Mr. DELRAHIM. I know you are.

Senator BLUMENTHAL [continuing]. The case, having actually been a plaintiff——

Mr. DELRAHIM. In that matter.

Senator BLUMENTHAL [continuing]. Said to the judge, this structural remedy ain't going to fly with the D.C. Circuit, and we were right, but the district court judge——

Mr. DELRAHIM. Judge Jackson, at the time.

Senator BLUMENTHAL. Yes.

Mr. DELRAHIM. Yes. That's the challenge, is that, what is the guidance that judges have to craft a remedy, and deducing from that, what do the enforcers have, because ultimately, that's—how do you craft these? It's an administrative issue, and these have nothing to do with, I don't think, Bork judges or Trump judges and all that. The recent case, the *ASSA ABLOY* case, was a Biden-appointed judge, the *UnitedHealth-Change*, those both remedies that were readily available, the Department had rejected, but the judges had rejected.

Chair KLOBUCHAR. All right.

Senator BLUMENTHAL. My time has expired, so I'm going to ask——

Mr. DELRAHIM. Thank you.

Senator BLUMENTHAL [continuing]. Ms. Slaiman to respond in writing, if you don't mind. I would be very eager to have your response.

And again, to all of you, if you have suggestions for consent decrees that have worked, I'd be very interested in getting into them and seeing why they've worked as opposed to the many that have not. Thank you.

Chair KLOBUCHAR. Good point. Thank you very much, Senator Blumenthal. And then to close things out, so we both don't hold up the Senate, Senator Lee.

Senator LEE. Thank you very much. Mr. Delrahim, getting back to you, covering some of the themes that we talked about earlier about instances in which the Department of Justice and the Federal Trade Commission sometimes take divergent views, sometimes take different paths, one deciding to withdraw Merger Guidelines, the other not. That's just the tip of the tip of the iceberg. No one would ever envision the Catholic Church being successful if it had two Popes serving simultaneously in the exact same position. We would never dream of having two Presidents of the United States serving simultaneously. This sort of two-headed monster phenomenon is a recipe for disaster, and that's why I've long advocated for choosing one or the other. Pick a horse and ride it, as my former boss, Paul Warner, used to say.

As I look to which horse we ought to ride, all things being equal, I think it ought to go to the Department of Justice. There are a couple of reasons for this. Number one, it's set up in such a way that it is more politically accountable. It's run by people who are appointed by the President and, after Senate confirmation, serve at the pleasure of the President. And its overall structure is also just generally better suited for decisive enforcement of the sort that's necessary to protect American consumers. Moreover, given the criminal ramifications of some of the—some of our antitrust laws, it's important to put it in an entity that has criminal law enforcement authority. The Department of Justice has that. The Federal Trade Commission, not so much. So the One Agency Act would do this. It would consolidate antitrust authority in one agency, in the Department of Justice.

Mr. Delrahim, what do you think of the—first of all, the wisdom, or lack thereof, of having two separate entities, and second, the idea that if you're going to pick a horse, it ought to be the Department of Justice?

Mr. DELRAHIM. Thank you, Senator, for the question. I'm no longer in an administration where I need OMB approval. I may cause other problems by my comments here. I think that even other countries—China recently combined its three agencies into one—one and a half. There's great efficiencies in the administration of justice, especially when we're talking about law enforcement.

Here you have, for a number of reasons—you mentioned it—why I think the DOJ is better. You have one decision-maker. You know, we've had issues in the past—*Microsoft* case at the FTC was one, *Google* was another—where you have a tie or you have litigation where one commissioner writes an amicus to a judge, who is really not comfortable with this stuff anyways and is like, wait a minute—your commission is bringing a lawsuit and one of your commissioners is writing a perfectly legible argument why it's bad? How am I supposed to decide this? You have a decision-maker. If there's—if Mr. Kanter, for example, is recused, then the Attorney General steps in or the Deputy Attorney General, and you can make a decision and enforce the law in a predictable way.

I think bringing the Federal Trade Commission—wonderful entity—taking the Bureau of Competition only, putting it in the Antitrust Division, and I actually think you might have this opportunity because the Supreme Court's going to review the constitutionality of the CFPB next year, and who knows where that goes? If I were a betting man, I would vote against the constitutionality of its current structure.

So, if you want to sort of keep the CFPB and let it survive, it enforces the same exact law as Section 5. Why not take the CFPB, put it in the FTC? While you're at it, let's create some more taxpayer savings. Take the CPSC—so you have one consumer protection agency, one antitrust agency that actually administers the law, and a much more—I mean, nobody loses a job, maybe a couple of politically appointed commissioners. That would make a lot of sense as a government design, and I think it would create efficiencies in the Government that would benefit everybody involved.

So, that's one suggestion, and for a number of reasons, I think the Justice Department is the better place, as I mentioned. Most important is the fact that you have one decision-maker. It's a law enforcement. You have the chief law enforcer making that decision.

Senator LEE. So not just efficiency but also increased certainty and enhanced accountability. Hardly——

Mr. DELRAHIM. Due process.

Senator LEE. Hardly sounds radical to me, coupled with due process. Ms. Slaiman, we often expect vertical integration in most markets to have at least some potential to create efficiencies, increased efficiencies of the sort that could benefit consumers in the right set of circumstances. And that often is the case, but it's certainly not always the case. Where there are substantial barriers to entry and where there are switching costs, for instance, it can also lead to foreclosure that keeps competition at bay, that keeps competition out. And to that extent, it can have the ability to either entrench, or expand, or, in some cases, even confer monopoly power. How has this worked out in ad tech?

Ms. SLAIMAN. Thank you very much, Ranking Member Lee. I just want to very briefly respond about the importance of having both the FTC and the Department of Justice enforcing antitrust law. One of—I could spend a lot of time on this, and I won't since you didn't ask me, but one of the reasons is, it's very useful to have competition and consumer protection working together under one roof because there are important synergies between the two, but I'll focus on your question.

The DoubleClick merger in 2007, as you have mentioned and Senator Klobuchar mentioned, along with many other mergers helped Google to amass an incredibly powerful position in ad tech. Right now, I think there's a serious conflict of interest. They are representing publishers and advertisers, and have a significant control of the exchange where publishers and advertisers are meeting in the middle to do their auctions. I think that conflict of interest is very pernicious, and I think we have now reached a point where divestiture is going to be the best solution to promote competition in that very important space.

Senator LEE. Yes. No, you're exactly right. We do have a problem here. We've got companies like—well, we've got Google cutting off publishers who don't consent to Google collecting data on web visitors. That's why we need to pass the AMERICA Act. The AMERICA Act would solve this problem, and, among other things, it would create a duty for digital ad companies to act in the best interest of their customers and provide transparencies. I assume we agree on that one, even though we respectfully disagree——

Ms. SLAIMAN. Absolutely.

Senator LEE [continuing]. On the other.

Ms. SLAIMAN. Thank you.

Senator LEE. Thank you, Madam Chair.

Chair KLOBUCHAR. Well, thank you very much, Senator Lee. This has been a very informative hearing on a really important and timely topic, given the announcement of the new guidelines today.

And we all know that vertical mergers are not the first thing that people may be thinking of on the tip of their tongue, but they are starting to see the effects, whether they are forced to pay higher prices to see their favorite band, or that they are charged too much on a bill, or they don't have the choice they should when it comes to an online platform. Those are the harms that certain vertical mergers cause.

So as we work to continue to modernize our antitrust laws, we have to keep our eye on the prize. That is, the people of this country and the competition in our economy, which has been a cherished method for improvement of the lives of so many people, and we can't let that fall behind, which is why I am singularly focused on getting these bills through one at a time, and I have a lot of patience. Not really, I don't, but I've learned it over time working with Senator Lee.

So, with that, do you want to say anything in closing, Senator Lee?

Senator LEE. Go, fight, win.

[Laughter.]

Chair KLOBUCHAR. Okay. All right, excellent. With that, the hearing is adjourned, and we're going to allow the record to be open for 1 week, until July 26th, 2023. Thank you very much to our witnesses.

[Whereupon, at 4:26 p.m., the hearing was adjourned.]

[Additional material submitted for the record follows.]

A P P E N D I X

Additional Material Submitted for the Record

Witness List
Hearing before the
Senate Committee on the Judiciary
Subcommittee on Competition Policy, Antitrust, and Consumer Rights

"Trends in Vertical Merger Enforcement"

Wednesday, July 19, 2023
Dirksen Senate Office Building, Room 226
2:45 p.m.

Makan Delrahim
Partner, Latham & Watkins LLP
Former Assistant Attorney General, DOJ Antitrust Division
Washington, D.C.

Nancy Rose
Charles P. Kindleberger Professor of Applied Economics
Massachusetts Institute of Technology
Cambridge, MA

Charlotte Slaiman
Competition Policy Director
Public Knowledge
Washington, D.C.

Prepared Testimony of

Makan Delrahim
Former Assistant Attorney General, Antitrust Division (2017-2021),
U.S. Department of Justice

Before the Subcommittee on Competition Policy, Antitrust and Consumer Rights

U.S. Senate Committee on the Judiciary

Hearing on "Trends in Vertical Merger Enforcement"

July 19, 2023

Chairman Klobuchar, Ranking Member Lee, and distinguished members of the Senate Judiciary Subcommittee on Competition Policy, Antitrust and Consumer Rights, it is an honor to be back before you today. My testimony today will discuss vertical mergers and their enforcement under U.S. antitrust laws. My views are animated both by my perspectives today as a practitioner, and by my experiences during my time as Assistant Attorney General for the Antitrust Division. I speak today solely in my personal capacity, and needless to say, not on behalf of my law firm, any of the firm's clients or the Department of Justice.

To provide some background, vertical mergers describe transactions that combine firms or assets at different levels of the same supply chain. To preview some of the terminology for vertical mergers, "downstream" players describe the stages closer to final consumers (such as distributors, retailers, or finished goods manufacturers), and "upstream" describes the stages further away from the end consumers (such as suppliers, wholesalers, or input manufacturers). In contrast, horizontal transactions combine firms or assets at the same level of the supply chain.

Many transactions, however, could have both horizontal and vertical elements. That is not mere coincidence. Businesses of all shapes and sizes have long recognized that there are efficiencies and procompetitive profit opportunities to be realized through vertical integration. A classic example is the drilling, refining, and retail of fossil fuels. We may not know it, but we all encounter that example directly when we fill up at a local gas station.

Another way to think about a so-called vertical transaction is when we hire a pool cleaning service. We outsource that activity to the pool service. I could buy that pool service's business and incorporate it into my home business. Or I could go and purchase the equipment and train my child to do it. Each will achieve the same objective, getting my pool cleaned; but each comes with different economic costs and efficiencies for me.

Using the retail gasoline example, as many of you likely know: Exxon, which until 1973 was Standard Oil of New Jersey, is the legacy descendant of the Standard Oil corporation of John D. Rockefeller. That company in many ways spurned the legislative reform that led to the enactment of federal antitrust laws at the turn of the twentieth century. Indeed, one of the primary complaints leveled against Standard Oil at the turn of the century was that it had vertically integrated across the oil refining supply chain and used its market power across the supply chain to eliminate competition at different levels. This complex interplay between vertical integration and horizontal competition has led some antitrust scholars, including my esteemed colleague on the panel, Professor Rose, to observe that "all theories of harm from vertical mergers posit a horizontal interaction that is the ultimate source of harm."

The interplay between horizontal and vertical theories of harm to competition is not as simple as labeling a transaction "vertical" or "horizontal." The complex transactions that are the focus of the Division and the Federal Trade Commission enforcement priorities can raise intersecting vertical and horizontal competition concerns. There are, however, certain analytical methods and economic policies that guide antitrust merger enforcement practices depending on whether a transaction presents horizontal or vertical theories of antitrust harm—the guiding principle for evaluating all types of mergers is whether the proposed transaction is likely to substantially lessen competition in one or more product and geographic markets.

In my comments today, I will share the legal framework for assessing vertical mergers, some potential procompetitive benefits of vertical integration, and finally enforcement considerations for vertical mergers, including remedies.

Legal Framework

As you know, Section 7 of the Clayton Act prohibits any merger or acquisition if, "in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly." This provision applies to vertical mergers, as Congress made plain in the 1950 amendments to the Clayton Act. In fact, the House Committee Report accompanying that amendment specifically states that Section 7 "applies to all types of mergers and acquisitions, vertical and conglomerate, as well as horizontal."

Unlike with horizontal mergers, the Division and FTC cannot rely on a legal presumption of anticompetitive effects by simply showing that a challenged vertical merger would increase market concentration above a certain threshold. Of course, these presumptions are the outgrowth of ever evolving antitrust common law and are not in the text of the Clayton Act. One must wonder if the current Supreme Court were presented with the question, would it still read any presumption into Section 7?

For vertical mergers, courts have agreed that there is no presumption of harm based on market shares or market concentration. Instead, the framework asks whether, despite a vertical merger's conceded procompetitive effects, the government has met its burden of proof in demonstrating that a particular transaction—given the fact-specific evidence at issue—is likely to substantially lessen competition. Once the government meets its burden of proof, the burden shifts to the defendant to prove that the government's case fails to accurately predict the likely effect on competition, including presenting evidence of procompetitive efficiencies. The burden then shifts back to the government to produce evidence sufficient to sustain its burden, i.e., a showing that a merger is likely to substantially lessen competition in a relevant antitrust market.

Vertical Mergers Provide Procompetitive Benefits

While horizontal mergers among direct competitors can raise competition concerns, vertical combinations are different. The reason is that vertical mergers, by their nature, have the potential to generate substantial efficiencies and synergies that benefit consumers, suppliers, and distributors. Antitrust practitioners, economists, and scholars across the political spectrum have acknowledged that vertically-integrated firms can provide significant procompetitive benefits.

Judge Robert Bork, of course, going back to his book, the "Antitrust Paradox," described vertical mergers as a "means of creating efficiency."

More recently, scholars such as Professor Steve Salop, who teaches at Georgetown, has mapped out several efficiency benefits arising from vertical combinations, including cost and quality efficiencies, increased investment incentives, reduced potential for coordination, design and production improvements, and the elimination of double marginalization—which is the technical economic term for eliminating double mark-up of costs. When independent firms operate at different levels of the supply chain, upstream suppliers have the incentive to charge a profit-maximizing price that only accounts for the sale of a single product. Downstream suppliers are similarly incentivized to charge a second, additional markup, which is passed on to consumers. But when firms vertically integrate, the incentive to charge two mark-ups is eliminated because the combined firm would prefer to sell more widgets at a presumably reduced mark-up. Both the merged firm and consumers often are better off by collaborating to sell more products at a single, profit-maximizing margin—and a lower cost to consumers than when the firms operated separately.

Enforcement of Anti-Competitive Vertical Mergers

Calibrating enforcement of vertical mergers can create complex policy decisions. On the one hand, blocking vertical mergers may deprive consumers of procompetitive benefits of the very kind that the antitrust laws should support. On the other hand, competitors sometimes argue that a vertical merger forecloses a firm from having a necessary input or raises that competitor's costs.

Historically, the Antitrust Division has sought to prevent transactions where it believes that post-merger the combined firm would have been both a major producer of a product and the only supplier of critical components to one of its top competitors. This would have provided the merged firm with the opportunity and incentive to withhold or delay delivery of critical inputs to a close competitor. This type of potential foreclosure on certain facts can potentially leave competitors without access to necessary inputs and makes it less likely that competition will discipline commercial interactions in the marketplace. The Division, in the past has in some cases sought what it terms a "structural" remedy through divestitures to mitigate the potential harm from such transactions.

Of course, as you know, around five years ago, many television pundits all of a sudden became vertical merger antitrust experts. That was when the Division was forced to litigate the proposed transaction between AT&T/DirecTV and Time Warner. In the decade prior to my leadership of the Division, the Antitrust Division reviewed the vertical mergers of Google / ITA and Comcast / NBC Universal—to name a few. In these vertical cases, the investigation ended with a remedy allowing the merger to proceed, or abandonment of the transaction, so there was no litigation.

United States v. AT&T was the first merger case litigated to judgment in 40 years. Nobody likes to lose a case and nobody should resort to litigation if there are remedies available to solve a dispute. The Division and the parties were unable to reach an agreement on remedies, the case was litigated and, of course, the Division did not prevail.

But that case and its history, nevertheless present a learning opportunity for enforcers and for merging parties, which I think is helpful as you perform your oversight here. First, the theory. The Division challenged the merger on the theory that it would substantially lessen competition among traditional video distributors and empower AT&T to raise the prices for Time Warner's popular television networks, a cost that would be passed on to American consumers. The Division believed that the merger would disrupt competition from online video distributors, which—at that time—charged low prices for more video content. During the trial and appeal, AT&T/DirecTV and Time Warner repeatedly emphasized that the merged firm would arbitrate renewal disputes with rival distributors if they disagreed with the value of content, and that distributors would retain the right to carry Time Warner networks pending the arbitration process. The court took this remedy into account as it evaluated the alleged competitive harms. The Division, of course, for the first time, I believe, conceded significant efficiencies from the elimination of double marginalization. Although the Division was not required to do so, it nevertheless did, believing it to be the honest course of conduct. That efficiency also factored into the court's decision.

Merger enforcement in general is a predictive exercise, and it is even more challenging where the enforcement is in the context of a vertical merger where there have been no precedents for more than forty years. That is just reality, and the courts today want real world examples of alleged harms. Theory alone won't win cases. And, of course, the Division could not point to Guidelines as support: the 1984 DOJ Non-Horizontal Merger Guidelines were woefully out of date and of no help to the courts, the Division or any merging party.

Vertical Merger Guidelines

After the experience with the AT&T case, and a few transactions immediately after that, including the CVS/Aetna transaction, I initiated a major initiative to update the old 1984 DOJ vertical merger guidelines. For some time leading up to the revision of the vertical guidelines, many antitrust practitioners believed that the antitrust agencies' approach to vertical enforcement over the prior decades had been vague and unclear. The only published guidance, up to the time of my tenure at Division, included the 1984 Non-Horizontal Merger Guidelines. To add more transparency to the business community, bar, and enforcers on vertical merger enforcement, the Division worked with the FTC, experts in academia and the bar, and the business community to craft and publish the 2020 Vertical Merger Guidelines. Rather than creating new methods of evaluating vertical mergers, the 2020 Guidelines explained the agencies' investigative practices toward vertical combinations as they have been applied, based on the past four decades of experience, and informed by modern economics and enforcement experiences. The goal was to provide greater clarity and predictability to market participants.

Transparency in antitrust enforcement is a goal that benefits all stakeholders. The great Robert H. Jackson, who served both in the role of Assistant Attorney General for the Antitrust Division and as a well-known Supreme Court jurist, characterized prior antitrust enforcement as alternating between being "aggressively vague and passively vague." He stated that "[e]very antitrust problem is economic as well as legal," and aimed to articulate a standard for antitrust enforcement "intelligible both to those expected to comply with it and to those expected to enforce it." Our mandate in crafting the guidelines was to provide a similar solution of transparency for vertical merger enforcement.

When then-Assistant Attorney General William Baxter faced criticism that the 1982 Merger Guidelines were too clear and provided too much guidance, he rejected criticisms that expressed an inherent hostility to mergers themselves and emphasized that mergers are "an important and extremely valuable capital market phenomenon" and that "it is socially desirable that uncertainty and risk be removed wherever possible to do so, subject of course, to the very important limitation that where a merger threatens significantly to lessen competition, it should be halted."

Further, in contrast to the 1984 Non-Horizontal Merger Guidelines that were issued unilaterally by the Division, the 2020 Vertical Merger Guidelines followed workshops and public comments that brought together diverse views from the antitrust bar and academics on vertical mergers. Some comments advocated for what would amount to changing the law to favor vertical mergers as *per se* legal. Other commentators advocated for changing the law to disfavor vertical mergers. What was clear, though, was that the end result should reflect the lodestar of antitrust, which is an appreciation of competitive market realities.

Importantly, the 2020 Vertical Guidelines encouraged the Division and FTC to evaluate the positive, potential procompetitive effects of vertical transactions. Under the Guidelines, the agencies considered economic efficiencies resulting from the merged firm's enhanced ability to streamline production and distribution. And the agencies also considered whether the merger could lead to the creation of innovative products that would otherwise not be achieved. Finally, the Guidelines affirmatively stressed that the Division and FTC would consider the benefits created by the elimination of double marginalization resulting from the merged firms incurring lower costs for upstream inputs. Resulting procompetitive effects were to be weighed against anticompetitive effects in determining whether to challenge the merger.

In 2021, the FTC unilaterally withdrew the 2020 Vertical Merger Guidelines, but the Division kept them in place, pending an overall review of both the horizontal and vertical merger guidelines and while seeking public comment. I thought the decision to withdraw those guidelines and not have another set in place was ill-advised and associate myself with the views of the dissenting FTC Commissioners Wilson and Phillips, who opposed withdrawal.

While I do not know when the Division and FTC will issue new finalized guidance on vertical mergers, I urge them to propose a route forward that will provide all stakeholders, including enforcers, lawmakers, judges, practitioners, and the business community, with clarity on how the agencies will continue to carry out vertical merger enforcement. Effective and accurate guidance depends on the agencies contending with current case law from their recent vertical merger challenges—as well as accepted economic principles. I urge them to resist any urge to use guidelines as a prescriptive document to represent what they wish the laws to be rather than what the laws actually are. If the laws need to be changed, the appropriate branch of government to do so is this body, Congress. If the guidelines are not supported by the case law and economic evidence, I fear the courts will simply disregard them, resulting in the loss of the positive effects they have had, as a consensus recipe book for both the business community and the courts, for the past 40 years.

Although some see antitrust law as a means to address broader concerns about the economy, I do not believe the antitrust laws are bent towards values other than competition. As Justice Black explained in *Northern Pacific Railway v. United States*, the Sherman Act, our first U.S. antitrust law, is "aimed at preserving free and unfettered competition as the rule of trade" and "the policy unequivocally laid down by the Act is competition."

Thank you again for this opportunity to provide these views. I look forward to your questions.

Written Testimony of Professor Nancy L. Rose

Senate Judiciary Committee

Subcommittee on Antitrust, Consumer Protection and Consumer Rights

July 19, 2023

Chairwoman Klobuchar, Ranking Member Lee, and Members of the Subcommittee, thank you for the opportunity to testify in front of you today on the antitrust treatment of vertical mergers. Merger enforcement policy is a subject near and dear to my heart. I have been encouraged by the attention many of you have directed to this topic during recent years, and by passage of the Merger Filing Fee Modernization Act of 2022, which better matches the HSR filing fee structure to the costs imposed by mergers of different size, and which facilitates additional resources for the enforcement agencies.

My Background

I am the Charles P. Kindleberger Professor of Applied Economics and former Department Head of the MIT Department of Economics. I have been engaged in research and teaching on industrial organization, with a particular focus on competition and regulatory policy, as an academic economist for 38 years. I was the founding director of the National Bureau of Economic Research program in Industrial Organization, and led that program for more than twenty years. I am a member of the

Academy of Arts and Sciences, Research Associate of the National Bureau of Economic Research, President of the Industrial Organization Society, and President-elect of the Western Economics Association International. And I had the immense privilege of serving the people of the United States as the Deputy Assistant Attorney General for Economics in the Antitrust Division of the Department of Justice from 2014 through the end of 2016, working with Division leadership and its outstanding career staff to protect and promote competition and the benefits of competitive markets for all Americans.

While I am proud of the work we accomplished during my service in the Antitrust Division, that experience provided first-hand confirmation of a conclusion suggested by an increasing body of empirical economic research and a concern I know that many of you also share: we have a market power problem. Many factors contribute to that outcome. But I believe that one of the most significant is the increasing difficulty that the Department of Justice Antitrust Division and the Federal Trade Commission face in enforcing our antitrust statutes to deter, prevent, halt, or remedy anticompetitive conduct that threatens free and fair markets. That concerns me, as I think it should all Americans, since competitive markets are the cornerstone of our economy and our prosperity. I welcome the opportunity to discuss this with you, focusing today on vertical merger enforcement.

What is a "vertical merger" and why does "vertical" matter?

Roughly speaking, "vertical" relationships are those between firms positioned at different levels of a supply or production chain. This allows us to distinguish vertical mergers, such as a manufacturer's acquisition of a supplier ("upstream") or of a distributor or customer ("downstream"), from horizontal mergers that occur between competitors. Horizontal mergers by definition reduce the number of competing firms, so the bulk of antitrust enforcement attention in a horizontal merger investigation is devoted to determining whether such a reduction is likely to constitute a substantial lessening of competition. The analysis of vertical mergers is more complex. Vertical mergers typically leave the number of entities at each stage of a supply chain unchanged, so there is not the immediate elimination of a competitor. Moreover, vertical integration by the merging firm may lead to otherwise unattainable efficiencies in production, distribution, or pricing, possibly increasing the intensity of competition—a result antitrust law generally applauds. But this is neither inevitable nor the only possible result of a vertical merger. Reductions in competition may nonetheless arise; for example, from changes in the incentives or ability of the merged firm to disadvantage horizontal rivals at one or more levels of their supply chain, or from eliminating a likely entrant into competition with the acquiring firm. These concerns may be particularly relevant in more concentrated markets, and especially where one of the merging firms has a dominant market position in its stage of the supply chain.

I focus here on vertical mergers, but note that many of the concerns they raise, and tools developed to analyze them, also may apply to other non-horizontal mergers such as "mergers of complements" in production or "diagonal" mergers that combine firms at different stages of competing supply chains.[1]

Examples of relatively recent vertical mergers challenged on antitrust grounds include Microsoft's announced acquisition of Activision (combining Microsoft's gaming console/platform operations with Activision's games); the acquisition by health insurer UnitedHealth of Change Healthcare's data platform and claims processing technology; Illumina 's (producer of next-generation genetic sequencing platforms) proposed acquisition of GRAIL (developer of a multi-cancer early detection test that uses next-generation sequencing platforms to process their tests); AT&T/DirecTV's acquisition of content provider Time Warner, Inc. Vertical mergers challenged but settled with

[1] See the explanation in the U.S. Department of Justice and Federal Trade Commission, "Vertical Merger Guidelines," June 30, 2020 https://www.justice.gov/media/1090651/dl?inline , which the FTC voted to withdraw from on September 15, 2021. The FTC and DOJ have signaled their intention to replace both the 2010 Horizontal Merger guidelines and prior vertical merger guidelines with unified guidelines this year.

behavioral remedies include Ticketmaster's 2010 acquisition of the events promotion and venue management company Live Nation, and Comcast's 2011 acquisition of NBC-Universal, and Staples' 2019 acquisition of Essendant, a wholesale distributor of office products.

What does economic theory tell us about potential benefits or harms from vertical mergers?

There is a long-standing theoretical literature on the potential motivation for and benefits of vertical integration that focuses on which activities are most efficiently brought inside the firm and which remain mediated through market transactions between independent firms. Foundational work in this space has been recognized by Nobel Prizes awarded to Ronald Coase (1991), Oliver Williamson (2009), Oliver Hart and Bengt Holmstrom (2016). Much of this work focused on the relative importance of transactions costs (both within and between firms), the role of incomplete contracts and relationship-specific investments, and allocation of property rights. This literature describes the factors that may influence where firm boundaries are most efficiently drawn, acknowledging that the answer to that question depends on the particulars of any given situation.

In addition, application of simple price theory models illustrate the potential benefit of integrating two independent firms in a vertical chain, each of which otherwise exercises market power by charging a single uniform price that reflect a mark-up over its marginal cost. Combining these into a single firm could eliminate successively compounded mark-ups over marginal cost by each firm, and under certain assumptions, reduce the final product price, expand output, and increase profits relative to the unintegrated chain, in a benefit conventionally termed "elimination of double marginalization."[2]

The Chicago School of Antitrust, championed by Robert Bork,[3] made much of the efficiency theories of vertical integration and the presumption that there was but a "single monopoly profit" to be earned in any vertical chain to assert that vertical mergers (and contracts) provide no opportunities to reduce competition or increase profits that did not exist in their absence. Like many of Bork's other conclusions about antitrust economics, this seems to be based largely on choosing a preferred theoretical

[2] In addition to the assumption of market power at each stage of the supply chain, and that the product price of the upstream firm is a marginal cost of production for the downstream firm, other conditions include the inability of non-integrated firms to reach contractual agreements to eliminate EDM despite their benefit to both firms and the inability of the upstream firm to use either nonlinear price or quantity forcing mechanisms. The model also assumes that post-integration, decisions are made to maximize the profits of the combined entity, without frictions between the previously independent firms (now divisions) that would impede that outcome.

[3] See, e.g., Robert H. Bork, *The Antitrust Paradox: A Policy At War With Itself* (1978).

possibility from economic models, asserting forcefully its empirical relevance regardless of whether there is much evidence on that point, and then applying that to suggest that since vertical integration was (presumed) beneficial, vertical mergers and vertical contractual restraints also must be competitively beneficial or at worst neutral.[4]

By the time the courts were embracing Bork's position and adopting a more neutral or even favorable view of vertical mergers and contracting, advances in game theory were being introduced into models of oligopoly and calling those positions into question.[5] Beginning in the 1980s and continuing through the present, industrial organization theorists have demonstrated the fragility of the "single monopoly profit" claim and elucidated the conditions under which vertical acquisitions or exclusionary contracts can harm competition by creating the incentive and ability to raise rivals' costs,

[4] See, e.g., the discussion of Bork on horizontal mergers in Nancy L. Rose & Jonathan Sallet, "The Dichotomous Treatment of Efficiencies in Horizontal Mergers: Too Much? Too Little? Getting it Right," 168 *University of Pennsylvania Law Review* (2020) https://scholarship.law.upenn.edu/penn_law_review/vol168/iss7/3; and Herbert Hovenkamp, "Robert Bork and Vertical Integration: Leverage, Foreclosure, and Efficiency," 79 *Antitrust Law Journal* (2014) https://scholarship.law.upenn.edu/faculty_scholarship/1848/.

[5] See the discussion in Steven C. Salop, " Invigorating Vertical Merger Enforcement," 127 *Yale Law Journal* (2018), and Michael D. Whinston, *Lectures on Antitrust Economics* (2006).

foreclose even more efficient competitors from the market, heighten barriers to entry into the market, or facilitate coordinated behavior.[6]

To be quite clear, this literature does not invalidate the existence of possible pro-competitive rationales for either vertical mergers or vertical restraints. Rather, it highlights the conditions under which vertical mergers and restraints may, on net, harm competition—conditions that may be readily met in many oligopoly markets. This suggests that vertical antitrust enforcement, like horizontal merger enforcement, should rest on a fact-specific determination of whether a particular merger or practice is likely to be anticompetitive, *without an implicit or explicit presumption in favor of a procompetitive rationale for such behavior*. That is an especially important conclusion given the state of the existing empirical literature, to which I turn next.

What is the empirical evidence on the actual effects of vertical mergers in oligopoly markets?

[6] See the literature in *ibid.* and in Steven C. Salop and Daniel P. Culley, "Revising the U.S. Vertical Merger Guidelines: Policy Issues and an Interim Guide for Practitioners," 4 *Journal of Antitrust Enforcement* (2015). https://scholarship.law.georgetown.edu/facpub/1530

It has become quite common to read claims of the form "most vertical mergers are procompetitive."[7] Whether or not this claim is true for the universe of vertical mergers is empirically unknown, and whether it is true for the highly selected set of vertical mergers that involve concentrated markets or dominant firms has been rarely assessed. Instead, the claim seems to be based on some combination of the rarity of challenges to vertical mergers (a statement about enforcement activity and policy) and empirical evidence on vertical integration in general (not mergers, and not restricted to oligopoly markets likely to be most susceptible to anticompetitive motivations for vertical mergers and restraints).[8] The author of an often cited review of that literature cautions against applying it to antitrust policy: "many of the industries studied are workably competitive (e.g., fast food, apparel, and hotels) not the industries where vertical

[7]E.g., Christine Varney, Public Statement, "Vertical Merger Enforcement Challenges at the FTC" (July 17 1995) https://www.ftc.gov/news-events/news/speeches/vertical-merger-enforcement-challenges-ftc ("most vertical arrangements raise few competitive concerns," but noting exceptions to this statement). Judicial opinions generally are careful to qualify this with "many" rather than "most," but citations often tilt toward the competitive benefits view. See, for example, Judge Corley's opinion in FTC v. Microsoft et al., N. District of California (2023) at 30: "For a vertical merger, such as the Microsoft/Activision merger, 'there is no short-cut way to establish anticompetitive effects, as there is with horizontal mergers' [United States v. UnitedHealth Grp. Inc., 630 F. Supp. 3d 118, 130 (D.D.C. 2022)] at 192 (cleaned up). This is in part because 'many vertical mergers create vertical integration efficiencies between purchasers and sellers.' Id. at 193; see also Nat'l Fuel Gas Supply Corp. v. FERC, 468 F.3d 831, 840 (D.C. Cir. 2006) ('vertical integration creates efficiencies for consumers'); Phillip E. Areeda & Herbert Hovenkamp, Antitrust Law: An Analysis of Antitrust Principles and Their Application, ¶ 755c (online ed. May 2023) ('Vertical integration is ubiquitous in our economy and virtually never poses a threat to competition when undertaken unilaterally and in competitive markets.')…"

[8] See, e.g., the survey by Francine Lafontaine and Margaret Slade, "Vertical integration and firm boundaries: The evidence." *Journal of Economic Literature*, 45(2007).

mergers are typically challenged. In addition, some of the benefits that integrated firms enjoy — such as those that are due to geographic proximity — cannot usually be achieved through merger. Finally, much of the empirical work examines one side of the problem — costs or benefits — whereas mergers typically involve tradeoffs between the two."[9] Just as my work with Jonathan Sallet focusing on horizontal merger efficiencies argues,[10] there is little relevant empirical foundation for this claim as applied to the vertical mergers that come under agency review, which tend to involve markets characterized by some combination of high concentration, dominant firms, and substantial economies of scale, scope, and network density (see Salop and Culley, 2018).

More recent work has focused directly on empirically measuring the impact of vertical mergers and on assessing the lessons from the literature that are most directly relevant to vertical mergers in oligopoly settings. This work is far less sanguine about the ubiquity of procompetitive impacts. Lafontaine and Slade (2021) evaluate vertical merger retrospectives that they believe are best suited to guiding the development of antitrust policy, and conclude that of the ten such studies they can identify, four

[9] Margaret E. Slade, "Vertical Mergers: A Survey of Ex Post Evidence and Ex Ante Evaluation Methods," 58 *Review of Industrial Organization (2021)* at 496.

[10] Nancy L. Rose and Jonathan Sallet, "The Dichotomous Treatment of Efficiencies in Horizontal Mergers: Too Much? Too Little? Getting it Right," 168 *University of Pennsylvania Law Review* (2020). https://scholarship.law.upenn.edu/penn_law_review/vol168/iss7/3

demonstrate an overall positive effect on consumer welfare, and six show either neutral or ambiguous effects.[11] Beck and Scott Morton do a deeper dive into each of 29 studies of vertical integration published in the past decade. They conclude that "overall, 14 articles find evidence of harm, and 14 articles find evidence of benefits. The removal of articles based on methodological limitations—such as those that rely solely on cross-sectional variation or stock market event studies—would not significantly alter the conclusion. This balance of results constitutes a significant finding in an environment where the literature has been presented as supporting the proposition that almost all vertical mergers are benign."[12]

Given that these studies generally select vertical mergers that were either unchallenged by antitrust authorities or were investigated and allowed to proceed with some type of settlement intended to remedy potential competitive harm, the mixed nature of the

[11] Francine Lafontaine and Margaret E. Slade, "Presumptions in Vertical Mergers: The Role of Evidence," 59 *Review of Industrial Organization* (2021) at 268.

[12] Marissa Beck & Fiona M. Scott Morton, "Evaluating the Evidence on Vertical Mergers," 59 *Review of Industrial Organization* (2021) at 279. https://ssrn.com/abstract=3554073. The authors note that while their sample includes the studies surveyed in Lipsky et al. (2020), their analysis of the studies reaches quite different conclusions. See Tad Lipsky et al., DOJ/FTC draft 2020 Vertical Merger Guidelines comment of the Global Antitrust Institute, Antonin Scalia Law School, George Mason University. George Mason Law and Economics research paper no. 20–03 (2020).
https://www.law.gmu.edu/pubs/papers/doj_ftc_draft_2020_vertical_merger_guidelines_comment_of_the_global_antitrust_institute

results should give considerable pause to those evaluating the current skepticism of antitrust enforcement against vertical mergers. I briefly discuss that next.

What do recent enforcement actions reveal about our ability to deter or block anticompetitive vertical mergers?

Salop and Culley (2018) describe their accounting of U.S. antitrust enforcement actions against mergers that included a vertical component of alleged harm, comprising 48 merger challenges between 1994 and 2015, including a categorization according to theories of harm alleged in the complaints. An online appendix updates this analysis to 66 enforcement actions through 2020.[13] Though this includes a very few transactions that were abandoned during the investigation, I believe the only successful litigated challenge was the private action against a consummated merger by JELD-WYN (which produces doors and a product called door skins, which cover interior doors) of door skin manufacturer CMI. Steve's, which purchases door skins to complete the interior molded doors they produce, alleged foreclosure by JELD-WYN after its acquisition, and was successful in its pursuit of damages and a divestiture order.

[13] Steven C. Salop and Daniel P. Culley (2020) https://papers.ssrn.com/sol3/Delivery.cfm/SSRN_ID3583588_code238438.pdf?abstractid=2684107&mirid=1

Against that backdrop of successes are a litany of unsuccessful litigated challenges, beginning with DOJ's loss in its effort to block AT&T's acquisition of Time Warner, Inc in 2018 (and its 2019 loss in its appeal of the district court's ruling). As noted in my introduction, more recent adverse decisions in litigation include the FTC's challenges to the Microsoft/Activision and Illumina/GRAIL mergers and DOJ's challenge of UnitedHealth/Change Healthcare. The decisions in these cases, while opining that the government did not provide adequate evidence on competitive harm, raise concerns about the standard applied to vertical challenges. For example, in AT&T/Time Warner, Judge Leon accepted without question merger benefits attributable to the elimination of double marginalization (EDM) for Time Warner content on AT&T/DirecTV's systems—an effect that requires the integrated firm to maximize the firm-level, not division-level profits—but rejected the government's argument that the merger gave AT&T/DirectTV the incentive and ability to raise rivals' costs of accessing that content—which proceeds economically from the same forces that underpin an argument about EDM. Instead, the judge accepted statements from self-interested executives that they would—for that purpose—consider siloed division profits, not the overall company's bottom line. From an economic and legal perspective, this makes no sense.

Current agency leadership has emphasized the importance of bringing more litigated challenges, including of vertical mergers, even if those do not always (ever?) result in court decisions supporting the agency. While this strategy does indeed bring more attention to this area of antitrust law, and may well serve the purpose of highlighting where case law may be deviating from the intent of antitrust statutes, the compounding losses in this space risk creating even worse case law, as judges in one case cite to district court decisions in previous vertical cases (see Judge Corley's extensive citations to the Unitedhealth/Change Healthcare decision, for example).

It is possible that clearer guidance in the merger guidelines could help—something colleagues and I argued in 2019, prior to the 2020 Vertical Merger Guidelines (since withdrawn by the FTC and likely to be replaced by the upcoming merger guidelines revision). [14] We are likely to see how the most recent guideline revisions propose to deal with vertical harm this week. But I am skeptical of the ability of guideline revisions alone to make a substantial difference to vertical merger enforcement, let alone vertical conduct enforcement, particularly in the near term. As I testified to this subcommittee in 2021, exclusionary conduct, including vertical merger, "has been

[14] Jonathan B. Baker, Nancy L. Rose, Steven C. Salop, Fiona Scott Morton, "Five Principles for Vertical Merger Enforcement Policy," 33 *Antitrust* (Summer 2019).

granted excessive deference, or in some cases, pushed almost beyond the reach of antitrust enforcement. Correcting misperception about the inevitability of competition and overcoming decades of case law founded on incorrect principles through efforts to educate courts and build up new precedents to reverse course is likely to take time that we do not have, particularly in the realm of exclusionary conduct and particular types of merger harms. This is a major factor in why I and other colleagues have urged legislative action to restore competition."[15]

I am greatly encouraged by this Committee's ongoing interest in assessing antitrust enforcement in this space, and hope that Congress might consider weighing in on this issue for the benefit of the courts, the economy, competitive markets, and consumers. I appreciate the chance to talk about these important issues with you here today.

[15] Nancy L. Rose, written testimony submitted to the Senate Judiciary Committee Subcommittee on Antitrust, Consumer Protection and Consumer Rights "Competition Policy for the Twenty-First Century: The Case for Antitrust Reform, 11 March 2021, citing Jonathan B. Baker et al., "Joint Response to the House Judiciary Committee on the State of Antitrust Law and Implications for Protecting Competition in Digital Markets," April 2020, https://digitalcommons.wcl.american.edu/pub_disc_cong/18/

Five Principles for Vertical Merger Enforcement Policy

BY JONATHAN B. BAKER, NANCY L. ROSE, STEVEN C. SALOP, AND FIONA SCOTT MORTON

VERTICAL MERGERS HAVE BECOME increasingly prominent and controversial in antitrust policy-making. There seems to be consensus that the Department of Justice's 1984 Vertical Merger Guidelines,[1] now 35 years old, reflect neither modern theoretical and empirical economic analysis nor current agency enforcement policy.[2] There is little dispute that antitrust enforcement should be based on rigorous economic analysis.[3] However, widely divergent views of preferred enforcement policies were expressed by the Federal Trade Commission Commissioners when resolving Staples's acquisition of Essendant[4] and Fresenius's acquisition of NxStage,[5] by Commissioner Wilson in a recent speech,[6] by the various amicus briefs filed in connection with the appeal of the Justice Department's unsuccessful challenge to AT&T's acquisition of Time Warner,[7] by Assistant Attorney General Makan Delrahim,[8] and by the participants at the FTC's competition policy hearing on vertical mergers.[9] This broad range of views suggests the difficulty that the FTC Commissioners will face in reaching consensus on vertical mergers in any potential FTC hearings report and the problem that the two enforcement agencies will face in formulating new vertical merger guidelines. It also creates difficulties for practitioners when counseling clients or advocating in favor of, or in opposition to, proposed vertical transactions.

The D.C. Circuit's decision in *United States v. AT&T* offered some guidance but did not suggest that courts should apply different legal standards to vertical mergers than to horizontal mergers.[10] It observed that under Section 7 of the Clayton Act, "the government must show that the proposed merger is likely to *substantially* lessen competition, which encompasses a concept of 'reasonable probability'" and accepted that the modern burden-shifting approach to evaluating merger challenges, developed in horizontal merger cases, applied to all cases brought under Section 7.[11] As a result, the court left substantial gaps that the agencies and the courts will need to fill.

To assist the enforcement agencies in navigating these choppy waters, we have briefly set forth our views on critical economic analysis and process issues regarding vertical merger enforcement policy. In doing so, we assume that the agencies will base their enforcement on the burden-shifting analysis of mergers set forth by the D.C. Circuit in *AT&T*, *Baker Hughes*, and *Heinz* (without invoking the *Philadelphia National Bank*[12] horizontal merger structural presumption). A similar burden-shifting framework is applied to analyze claims brought under both Section 1 and Section 2 of the Sherman Act.

Based on our review of the economic literature on vertical integration and our experience in analyzing vertical mergers, we recommend that the agencies adopt the following five principles to guide vertical merger enforcement:

- Consider and investigate the full range of potential anticompetitive harms.
- Decline to presume that vertical mergers benefit competition in the oligopoly markets that typically prompt agency review, nor set a higher evidentiary standard based on such a presumption.
- Evaluate claimed efficiencies as carefully and critically as they evaluate those resulting from horizontal mergers, including requiring the merging parties to show that the efficiencies are verifiable, merger-specific, and sufficient to reverse the potential anticompetitive effects.
- Decline to adopt a safe harbor for vertical mergers, even if rebuttable, except perhaps when both firms compete in unconcentrated markets.
- Consider adopting rebuttable presumptions that a vertical merger harms competition when certain factual predicates (as indicated below) are satisfied.

Vertical mergers raise a number of other important policy questions that we do not discuss here, though one of us has addressed those issues extensively elsewhere.[13]

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Approaches to Vertical Merger Enforcement

We next explain the rationale for these principles in more detail. Our overall concern is to reduce false negatives (including under-deterrence), while keeping false positives (including over-deterrence) low. Our analysis focuses on oligopoly markets where vertical mergers are most likely to raise concerns. We note that these may include digital markets—markets for services produced and consumed online—which are increasing in significance in the economy with the growth of information technology. In such markets, production economies of scale and network effects can create oligopoly structures and entry barriers, leading to the exercise of market power. That possibility raises the competitive concerns from vertical mergers.

Consider and Investigate the Full Range of Potential Competitive Harms. Enforcers should evaluate the full range of potential competitive harms when investigating vertical mergers. These harms can lead to higher prices, as well as reduced quality and innovation.[14] We encourage the agencies to commit themselves to investigating all such harms. The agencies should also evaluate the full range of potential competitive benefits too, but this proposition is widely accepted.

Economic analysis—both economic theory[15] and empirical studies[16]—and merger enforcement[17] have identified a number of ways by which vertical mergers can harm competition. Such harms include input foreclosure or customer foreclosure, and the creation of two-level entry barriers. "Foreclosure" is broadly defined. For example, input foreclosure includes price increases, cost increases, and other disadvantages placed on downstream rivals, not just total denial of the relevant input.[18] We also note that "input foreclosure" would describe foreclosure after a manufacturer acquires a distributor, because the distribution services provided by a distributor are an input into the sale of the product.[19] Competitive harms from foreclosure can occur from the merged firm exercising its increased bargaining leverage to raise rivals' costs or reduce rivals' access to the market.[20] Vertical mergers also can facilitate coordination by eliminating a disruptive or "maverick" competitor at one vertical level, or through information exchange.[21] Vertical mergers also can eliminate potential competition between the merging parties. In addition, regulated firms can use vertical integration to evade rate regulation. These competitive harms normally occur when at least one of the markets has an oligopoly structure. They can lead to higher prices, lower output, quality reductions, and reduced investment and innovation.[22]

Economic analysis and merger enforcement also have identified a number of ways by which vertical mergers can lead to efficiency benefits that can increase competition.[23] These benefits can include lower costs or higher quality products resulting from better integration in design or production, which can be achieved by economies of scope or better communication between the parties. By aligning incentives and preventing ex post holdup, investment and innovation incentives also might increase. Efficiency benefits also can include elimination of double marginalization (EDM) when the merged company sets the internal transfer price and the downstream price with a focus on joint profits instead of simply the profits of the separate businesses.[24] These competitive benefits can mitigate or prevent competitive harms if they are sufficient in magnitude.

Do Not Presume that Mergers in Oligopoly Markets Benefit Competition. Some commentators have proposed that antitrust enforcement treat vertical mergers more permissively than horizontal mergers, even in concentrated markets.[25] Doing so would be tantamount to presuming that vertical mergers benefit competition regardless of market structure. However, such a presumption is not warranted for vertical mergers in the oligopoly markets that typically prompt enforcement agency review. Neither economic theory nor empirical evidence supports it. Moreover, the adoption of such a presumption would permit anticompetitive vertical mergers, which then would empirically invalidate the presumption. At best, one might say that vertical mergers are unlikely to harm competition if both markets are unconcentrated. However, anticompetitive effects are possible when one market is unconcentrated, or even when both are, for reasons discussed later.

1. Economic Theory. The argument that vertical merger enforcement should be very light-handed has two parts. The first is the view that vertical mergers are somehow inherently less likely to harm competition than horizontal mergers because the latter result in the loss of a horizontal rival, which tends to lead to price increases.[26] For example, Robert Bork argued that vertical mergers merely rearrange buyer/seller relationships, and he criticized an FTC case with his famous remark that the FTC should have hosted an "industry social mixer" instead of challenging the merger.[27] But the claim that vertical mergers are inherently unlikely to raise horizontal concerns fails to recognize that all theories of harm from vertical mergers posit a horizontal interaction that is the ultimate source of harm. Vertical mergers create an inherent exclusionary incentive as well as the potential for coordinated effects similar to those that occur in horizontal mergers.[28]

The inherent exclusionary incentive can be explained with an example involving input foreclosure.[29] Suppose that only two upstream suppliers compete to supply a critical input to several modestly-sized downstream firms. Suppose that these downstream firms compete with a larger downstream firm that also acquires inputs from these suppliers. The low input prices resulting from the upstream competition leads to greater downstream competition.

However, suppose next that one of the two upstream suppliers merges with the leading downstream firm. This merger inherently will reduce competition upstream and downstream. In the upstream market, the merged upstream supplier would gain the incentive to raise the price it charges for its input to the smaller buyers that it does not own.[30] As a result of these input price increases, the smaller downstream firms

There is no fundamental difference in incentives to harm competition between horizontal and vertical mergers that would justify a presumption that vertical mergers in oligopoly markets are unlikely to harm competition, but not a similar presumption for horizontal ones.

would suffer higher costs. These higher costs in turn would induce the smaller downstream firms to compete less aggressively, reducing downstream competition overall. In particular, the smaller downstream firms would have an incentive to pass on their higher costs by raising their prices, which would permit the downstream merging firm to raise its price. In effect, the vertical merger would lead to involuntary pricing cooperation between the disadvantaged downstream firms and the downstream merging firm, leading to higher downstream prices.[31]

It might be argued that this input foreclosure strategy would be unprofitable because the upstream merging firm would lose too many customers among the downstream rivals to the competing upstream supplier. It is the case that if the merged firm's upstream affiliate raises its prices, the downstream rivals it sells to would have an incentive to look for another supplier. However, as the only alternative input supplier, the competing input supplier normally would have an incentive to raise its own price in response, that is, to accommodate the price increase by the merged firm's upstream affiliate.[32] It might not fully match the price increase, but it would be expected to accommodate it, at least partially. In conventional unilateral effects analysis, for example, a price increase by one differentiated products competitor typically leads the producers of differentiated substitutes also to raise their prices. Thus, the competing supplier would not be expected to prevent upstream prices from rising altogether. In addition, the incentive of the competing supplier to raise its prices would be exacerbated if some of the downstream firms are unwilling to purchase from the merged firm after the merger out of a fear that their confidential information will be shared with its downstream affiliate.[33] These input price increases in turn make harm to the customers of the downstream firms more likely. If rivals' costs increase, downstream prices may increase from the downstream merging firm gaining power to raise prices.

The lesson of this example is that vertical mergers give the merged firm an inherent incentive to foreclose rivals at one vertical level (downstream in the example), at least when the market at the other vertical level (upstream in the example) has a structure that would give the competing input suppliers the incentive to at least partially accommodate the price increase by the merged firm. There is no fundamental difference in incentives to harm competition between horizontal and vertical mergers that would justify a presumption that vertical mergers in oligopoly markets are unlikely to harm competition, but not a similar presumption for horizontal ones. A horizontal merger among differentiated product firms in an oligopoly market has a normal tendency to raise prices. The same is true after a vertical merger in an oligopoly input market for a critical input, where the upstream merging firm is a substantial competitor. But, just as the inherent incentive after a vertical merger to increase the input price charged by the merged firm's upstream affiliate turns on market structure, so does the inherent incentive to raise price after a horizontal merger.[34]

Vertical mergers also raise coordinated effects concerns similar to those that can occur in horizontal mergers. Vertical mergers can eliminate sell-side mavericks or disruptive buyers. In addition, unlike strictly horizontal mergers, vertical mergers also can lead to anticompetitive information transfers from rivals to the merging firm. These information transfers can facilitate collusive information exchanges.[35]

The inherent exclusionary incentive created by vertical mergers combined with their ability to generate adverse coordinated effects means that enforcers should not presume that vertical mergers in oligopoly markets cannot harm competition.[36] For the same reason, enforcers also should not set a higher evidentiary standard for finding anticompetitive harms from a vertical merger than it applies when reviewing horizontal deals.

2. Empirical Evidence. As with economic theory, the empirical evidence does not justify presuming that vertical mergers in oligopoly markets benefit competition. Surveys of earlier economic studies, relied upon by commenters who propose a procompetitive presumption, reference studies of vertical mergers in which the researchers sometimes identified competitive harm and sometimes did not.[37] However, recent empirical work using the most advanced empirical toolkit often finds evidence of anticompetitive effects.[38] While vertical restraints, as distinct from vertical mergers, also can lead to efficiencies, they too can harm competition.[39]

It is inappropriate to base a presumption that vertical mergers are unlikely to harm competition on the examples collected in these earlier surveys. Some of the cited studies involve vertical integration (whether by explicit merger or contract) in competitive markets where a challenge would have been unlikely. Yet it is not possible to draw conclusions about the interbrand competitive effects of vertical mergers in oligopoly markets from studies of the consequences of a variety of vertical restraints and integration in competitive markets. Similarly, some studies involved the impact of divestitures required by state action for non-antitrust concerns, so they were less likely to show any impact of eliminating anticompetitive conduct. Other studies analyzed the impact of intrabrand restraints that might not have raised interbrand competition concerns.

Moreover, some studies were not constructed to distinguish between cost-raising and elimination of double marginalization effects. For example, studies that compare the relative prices or shares of the downstream merging firm and its rivals, and stock market event studies that examine the impact of a merger on the stock price of a competitor of the merging firm, cannot distinguish between the effects of EDM and foreclosure.[40] The cited studies also disproportionately focus on a narrow set of industries (e.g., cable, beer), which may not be representative.

The surveyed studies also suffer from another selection bias. Studies of the competitive effects of vertical integration will be systematically biased in favor of finding procompetitive benefits when firms behave in the shadow of antitrust law.[41] To isolate the overall competitive consequences of conduct, it is necessary to compare how that conduct affects competition with and without antitrust restraints, which the surveyed studies do not do. For example, in their study of resale price maintenance, MacKay and Smith avoid this selection bias by comparing outcomes in states with and without *Leegin*-repealer statutes.[42]

A concern about selection bias also can arise in studying the competitive impact of specific vertical mergers that were cleared by the agencies. Thus, the fraction of mergers that are found to be anticompetitive understates the rate of false negatives that would occur if enforcement were relaxed. Studies of the competitive effects of vertical integration are also systematically biased in favor of procompetitive benefits to the extent researchers depend on cooperation from the merging firms to obtain data.

Carefully Evaluate Merging Firms' Efficiency Claims. The other part of the argument that vertical merger enforcement should be very light-handed is a claim that vertical mergers are inherently efficient, even if markets are highly concentrated.[43] Vertical mergers certainly can create efficiency benefits, just as horizontal mergers can. But such efficiencies are not necessarily merger-specific. Nor are they always sufficient to reverse the competitive harm. Moreover, a careful merger review should analyze whether these criteria are satisfied.

Claimed efficiencies must be substantiated so they can be verified, merger-specific, and not the product of an anticompetitive reduction in output or service. These cognizability criteria are just as important when analyzing claimed efficiencies from a vertical merger as they are for evaluating the claimed efficiencies from a horizontal merger—and they should be applied to evaluate those claims with equally close scrutiny.[44] Efficiencies must also be sufficient to reverse any competitive harms. That is, pass-through of claimed efficiencies should be required in the analysis of vertical mergers to the same extent it is required in the analysis of horizontal mergers.

A careful analysis, rather than a presumption, also should be applied to efficiency claims involving the elimination of double marginalization. EDM often may occur from a vertical merger, but it is not an inevitable result. EDM already might have been achieved before the merger through bargaining that leads to multi-part tariffs, take-or-pay contracts, or other contractual provisions. A merger also will not generate EDM efficiencies if the downstream merging partner does not use the input produced by the upstream merging firm, for example because of incompatible technology. A recent study found that there are no inter-firm input transfers in almost half of the vertically integrated firms.[45] In addition, EDM benefits may be limited because the integrated firm will take into account the fact that diversion of inputs from the merging firm's upstream affiliate to its downstream affiliate will sacrifice some profitable input sales by the upstream firm to downstream third parties that compete with the merged firm's downstream affiliate.[46] This recognition limits the degree to which EDM leads the merging firm to lower its inter-firm input transfer prices or downstream prices. These possibilities make it essential that the magnitude of likely EDM be substantiated and verified.

Because EDM might be eliminated through negotiation of vertical contracts between independent firms, EDM should also be tested for merger-specificity;[47] merger specificity should not simply be assumed without analysis. Even if the upstream firm sells its input to the downstream merging firm at a pre-merger price that exceeds marginal cost, that fact by itself does not prove that the efficiency is merger-specific. Even in the absence of formal two-part pricing schedules, contracts with quantity steps or minimums, or negotiations that explicitly or implicitly reward volume expansion, may substantially limit or completely eliminate double marginalization. For example, consider a patent license that sets a positive running royalty, but with a contractual purchase minimum that exceeds the likely purchases. In that situation, the effective marginal price is zero.

If in advance of the merger the parties never considered contracting to eliminate double marginalization, that fact may suggest that EDM would not achieve substantial benefits. If the parties tried and failed to negotiate a contract, it would be important to understand why the negotiation failed in order to determine whether the explanation is credible, as well as to determine whether double marginalization likely would be eliminated through a vertical merger.[48] A general claim that there were "bargaining frictions" is an inadequate explanation, just as it would not be considered sufficient evidence of merger-specificity in horizontal merger cases.[49] After all, the parties apparently were able to overcome bargaining frictions in successfully negotiating the merger agreement, and input prices are commonly negotiated between large firms. To mirror Robert Bork's famous remark about vertical restraints,[50] if the parties' only reason for failing to achieve EDM is bargaining frictions, the Commission would do better by introducing the parties to a top-notch mediator or arbitrator rather than permitting an otherwise potentially anticompetitive merger.[51]

Do Not Adopt a Safe Harbor Except Perhaps When Both Firms Compete in Unconcentrated Markets. The agencies should decline to adopt a safe harbor for vertical mergers, except perhaps when both firms compete in unconcentrated markets.[52] Vertical mergers involving firms in at least one oligopoly market raise the greatest competitive concerns. If both markets are unconcentrated, it is less likely that a vertical merger would be anticompetitive.

If even one of the markets is unconcentrated, however, a safe harbor would not be appropriate. For example, if the input market is concentrated, profitable input foreclosure does not require that the downstream market also be concentrated. Input foreclosure that raises the cost of all or most of the competitors in an unconcentrated downstream market could cause substantial diversion to the merged firm's downstream affiliate, making the input foreclosure profitable and leading to higher downstream prices.[53] In addition, the coordinated effects from eliminating an upstream maverick would not require the downstream market to be concentrated, and concentration upstream would make it more likely that a maverick would constrain coordination in that market. Similarly, a disruptive buyer in an unconcentrated downstream market might constrain coordination in a concentrated upstream market—in which case its acquisition by an upstream firm could make coordination more effective.

Consider Adopting Anticompetitive Presumptions When Certain Conditions Are Met. The agencies should consider adopting rebuttable presumptions that a vertical merger harms competition when certain factual predicates are satisfied. We set out several possible presumptions here that could be invoked when at least one of the markets is concentrated, and thus, when competitive harm is more likely.[54] In each case, the factual predicates aim to identify vertical mergers that are more likely to harm competition, so we would expect adoption of the presumption to enhance deterrence of anticompetitive conduct while reducing the costs of investigating and litigating vertical mergers and the costs associated with uncertainty about regulatory outcomes. By invoking a presumption, the plaintiff would satisfy its prima facie case, thereby shifting the burden of production to the merging firms.

We also emphasize that we do not intend these presumptions to describe all the ways by which vertical mergers can harm competition. These presumptions set out conditions where concerns are greatest. They identify narrow factual settings where competitive harm is particularly likely, and thus, where it is appropriate to presume anticompetitive harm. The agencies should continue to investigate vertical mergers that raise competitive concerns—including concerns about input and customer foreclosure, loss of a disruptive or maverick firm, or evasion of rate regulation—even if the specific factual predicates set forth in the following presumptions are not satisfied.

- *Input foreclosure presumption:*[55] If the upstream merging firm in a concentrated market is a substantial supplier of a critical input to the competitors of the other merging firm and a hypothetical[56] decision to stop dealing with those downstream competitors would lead to substantial diversion of business to the downstream merging firm. In this situation, a vertical merger can raise the costs of the unintegrated rivals and permit the merged firm to exercise market power in the downstream market. In this regard, it is important to emphasize that distributors provide an input (i.e., distribution services) to manufacturers, (as well as that manufacturers provide an input (i.e., the manufactured good) to distributors).[57]
- *Customer foreclosure presumption:*[58] If the downstream merging firm is a substantial purchaser of the input produced in a concentrated upstream market, and a decision to stop dealing with the competitors of the upstream merging firms would lead to the exit, marginalization, or significantly higher variable costs of one or more of those competitors by diverting a substantial amount of business away from them. In this situation, a vertical merger can reduce competition in the upstream market and permit the merged firm to exercise market power.[59]
- *Elimination of potential entry presumption:* If either (or both) of the merging firms has a substantial probability of entering into the other firm's concentrated market absent the merger. In this situation, the merger would eliminate the possibility that entry (or the fear of that entry if the incumbent firm charges excessive prices) would make the market more competitive.
- *Disruptive or maverick seller presumption:* If the upstream merging firm in a concentrated input market supplies the product purchased by competitors of the other merging firm, and by its conduct has prevented or substantially constrained coordination in the upstream market. In this situation, the constraining influence of the disruptive or maverick firm could be eliminated, leading to higher market prices.
- *Disruptive or maverick buyer presumption:* If the downstream merging firm purchases the product sold by the other merging firm or its competitors, and by its conduct has prevented or substantially constrained coordination in the sale of that product by the other merging firm and its competitors in a concentrated input market. In this situation, the constraining influence of the disruptive or maverick firm could be eliminated, leading to higher market prices.
- *Evasion of regulation presumption:* If the downstream firm's maximum price is regulated, competition nonetheless may be harmed from a vertical merger. This can occur, for example, if the regulation permits the downstream firm to raise its price in response to cost increases. The regulated downstream firm could raise the price of the input supplied to it by its upstream merger partner, increasing upstream profits and downstream prices. Evasion of regulation could also occur if the merger involves firms that sell complementary products. The newly merged firm

could raise the price of the bundle and attribute the price increase to the unregulated product.

- *Dominant platform presumption:* If a dominant platform acquires a firm with a substantial probability of entering in competition with it absent the merger, or if that dominant platform company acquires a competitor in an adjacent market. Rivals in vertically adjacent or complementary markets are often potential entrants, so this presumption reaches nascent threats to competition created by eliminating the potential entrants through the merger. The presumption also recognizes that a dominant platform's market power would give it the ability to substantially disadvantage firms in adjacent markets by choosing not to interoperate, which can raise foreclosure concerns. This presumption can be understood as an application of the elimination of potential entry presumption and an input or customer foreclosure presumption in a setting where network effects and economies of scale would be expected to raise barriers to entry, and thus endow a dominant platform with substantial market power.

None of these presumptions is purely structural in the sense of being based solely on market shares and concentration. The *dominant platform presumption* that would apply to a vertical merger if at least one of the merging firms is a dominant platform would be the closest.

All of these anticompetitive presumptions would be rebuttable, so they would not create per se prohibitions of vertical mergers. If the agencies adopt any or all of the presumptions, they should allow them to be rebutted by evidence showing that anticompetitive effects are unlikely. In the case of the input foreclosure presumption, for example, this could include evidence that the input was not critical, that substantial input market competition (including entry competition) would protect the targeted downstream rivals from cost increases, that sufficient downstream competition by non-targeted firms would prevent downstream price increases and consumer harm, that the expected margin and diversion ratio to the downstream merging firm would be very low, that sufficient countervailing buyer power would prevent upstream price increases, and so on. As should be evident, the type of evidence that could rebut the inference of anticompetitive effect would depend on the competitive effects theory that underlies the presumption.

Conclusion

The widely divergent views about enforcement policy that we noted in our introduction may make it hard for practitioners to counsel clients about vertical mergers or advocate before the agencies, whether they are supporting or questioning the transaction. Our analysis can be particularly useful for those advocates who may have wrongly supposed that vertical mergers should or will be presumed to benefit competition. As we have explained, modern economic analysis does not support a relaxed approach to vertical merger review and enforcement. For that reason, advocates should address the full range of potential competitive harms, with reference to the specific facts of their transaction, and apply the rigorous mainstream modern economic thinking that we have relied upon. For the same reason, advocates should analyze carefully the magnitude of claimed efficiencies, their merger-specificity, and the likelihood that they would reverse the potential anticompetitive effect.

We are also writing for the enforcement agencies, by setting forth our views on critical issues regarding vertical merger enforcement policy that the Commission must address in any hearings report and the agencies must resolve in formulating revised vertical merger guidelines. We have recommended these five principles to anchor effective vertical merger enforcement by reducing false negatives while keeping false positives low. We hope that the agencies will agree and follow our recommendations even before they release new vertical merger guidelines. These recommendations also could be useful if the Congress decides to amend Section 7 of the Clayton Act. ■

[1] U.S. Dep't of Justice, Non-Horizontal Merger Guidelines (1984), https://www.justice.gov/sites/default/files/atr/legacy/2006/05/18/2614.pdf.

[2] *See, e.g.*, D. Bruce Hoffman, Acting Director, Bureau of Competition, Fed. Trade Comm'n, Vertical Merger Enforcement at the FTC 4 n.9 (Jan. 10, 2018), http://www.ftc.gov/system/files/documents/public_statements/1304213/hoffman_vertical_merger_speech_final.pdf.

[3] The importance of rigorous economic analysis is a different question from whether antitrust should recognize non-economic goals, such as preventing threats to the political process from corporate giants or protecting access to the market by small business, along with economic ones, such as the familiar concern to protect consumer (trading partner) welfare.

[4] Staples, Inc., FTC No. 181-0180 (Jan. 28, 2019) (Statement of Chairman Joseph J. Simons, Comm'r Noah Joshua Phillips, and Comm'r Christine S. Wilson) [hereinafter *Staples* Majority Statement]; Staples, Inc., FTC No. 181-0180 (Jan. 28, 2019) (Statement of Comm'r Christine S. Wilson) [hereinafter Commissioner Wilson *Staples* Statement]; Staples, Inc., FTC No. 181-0180 (Jan. 28, 2019) (Dissenting Statement of Comm'r Rebecca Kelly Slaughter) [hereinafter Commissioner Slaughter *Staples* Statement]; Staples, Inc., FTC No. 181-0180 (Jan. 28, 2019) (Dissenting Statement of Comm'r Rohit Chopra) [hereinafter Commissioner Chopra *Staples* Statement].

[5] Fresenius Medical Care AG, FTC No. 171-0227 (Feb. 19, 2019) (Decision and Order). Fresenius Medical Care AG, FTC No. 171-0227 (Feb. 19, 2019) (Statement of Chairman Joseph J. Simons, Comm'r Noah Joshua Phillips, and Comm'r Christine S. Wilson) [hereinafter *Fresenius* Majority Statement]; Fresenius Medical Care AG, FTC No. 171-0227 (Feb. 19, 2019) (Dissenting Statement of Comm'r Slaughter) [hereinafter *Fresenius* Slaughter Statement]; Fresenius Medical Care AG, FTC No. 171-0227 (Feb. 19, 2019) (Dissenting Statement of Comm'r Chopra) [hereinafter *Fresenius* Chopra Statement].

[6] Christine S. Wilson, Comm'r, Fed. Trade Comm'n, Vertical Merger Policy: What Do We Know and Where Do We Go? Keynote Address at the GCR Live 8th Annual Antitrust Law Leaders Forum (Feb. 1, 2019), https://www.

ftc.gov/system/files/documents/public_statements/1455670/wilson_-_vertical_merger_speech_at_gcr_2-1-19.pdf.

7 Two of the authors (Baker and Scott Morton) joined Brief for 27 Antitrust Scholars as Amici Curiae in Support of Neither Party, United States v. AT&T, No. 18-5214 (D.C. Cir. filed Aug. 13, 2018) (No. 18-5214) [hereinafter 27 Scholars]; Corrected Proof Brief of Amici Professor William P. Rogerson and American Cable Association in Support of Appellant, United States v. AT&T, No. 18-5214 (D.C. Cir. filed Aug. 21, 2018); Brief Amici Curiae of 37 Economists, Antitrust Scholars, and Former Government Antitrust Officials in Support of Appellees and Supporting Affirmance, United States v. AT&T, No. 18-5214 (D.C. Cir. filed Sept. 26, 2018).

8 Makan Delrahim, Assistant Att'y Gen., Antitrust Div., U.S. Dep't of Justice, Harder Better Faster Stronger: Evaluating EDM as a Defense in Vertical Mergers, Remarks at George Mason Law Review 22nd Annual Antitrust Symposium (Feb. 15, 2019), https://www.justice.gov/opa/speech/assistant-attorney-general-makan-delrahim-delivers-remarks-george-mason-law-review-22nd.

9 One of the authors (Salop) made the lead presentation at the FTC Vertical Merger Hearing (Nov. 1, 2019). See Steven C. Salop, *Revising Vertical Merger Guidelines, Hearing #5 on Competition and Consumer Protection in the 21st Century* (Nov. 1, 2018), https://www.ftc.gov/system/files/documents/public_events/1415284/ftc_hearings_5_georgetown_slides.pdf. Presentations with differing views were made by other participants. *Id.* Diverse opinions also were expressed by the participants at two panels. For the unedited transcript, see Fed. Trade Comm'n, Competition and Consumer Protection in the 21st Century (Nov. 1, 2018) [hereinafter FTC Hearing Transcript], https://www.ftc.gov/system/files/documents/public_events/1415284/ftc_hearings_session_5_transcript_11-1-18.pdf.

10 United States v. AT&T, Inc., No. 18-5214, 2019 WL 921544 (D.C. Cir. Feb. 26, 2019).

11 *Id.* at *1. The court declined to opine further on the proper legal standards for evaluating vertical mergers on the ground that doing so was unnecessary to decide the case. *Id.* at *5. With respect to merger law generally, the court "[did] not hold that quantitative evidence of price increase is required in order to prevail on a Section 7 challenge." *Id.* at *13.

12 *Id.* at *1–2; United States v. Baker Hughes Inc., 908 F.2d 981, 982–83 (D.C. Cir. 1990); FTC v. H.J. Heinz Co., 246 F.3d 708, 715 (D.C. Cir. 2001); United States v. Phila. Nat'l Bank, 374 U.S. 321, 363 (1963).

13 Steven C. Salop, *Invigorating Vertical Merger Enforcement*, 127 Yale L.J. 1962 (2018); Steven C. Salop & Daniel P. Culley, *Revising the U.S. Vertical Merger Guidelines: Policy Issues and an Interim Guide for Practitioners*, 4 J. Antitrust Enforcement 1 (2016).

14 For example, the DOJ concerns regarding the Google/ITA and LAM/KLA mergers focused on innovation harms. See Jon Sallet, Deputy Assistant Att'y Gen., Antitrust Div., U.S. Dep't of Justice, The Interesting Case of Vertical Merger, Remarks at the Am. Bar Ass'n Fall Forum (Nov. 17, 2016), https://www.justice.gov/opa/speech/deputy-assistant-attorney-general-jon-sallet-antitrust-division-delivers-remarks-american.

15 *See, e.g.*, Steven C. Salop, *Invigorating Vertical Merger Enforcement*, 127 Yale L.J. 1962 (2018); Thomas G. Krattenmaker & Steven C. Salop, *Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power over Price*, 96 Yale L.J. 209 (1986); Michael H. Riordan & Steven C. Salop, *Evaluating Vertical Mergers: A Post-Chicago Approach*, 63 Antitrust L.J. 513 (1995); Jonathan Baker, *Exclusion as a Core Competition Concern*, 78 Antitrust L.J. 527, 538–43 (2013); Eric B. Rasmusen et al., *Naked Exclusion*, 81 Am. Econ. Rev. 1137, 1140–43 (1991) (explaining how competition can be harmed through exclusionary vertical agreements); Patrick Rey & Jean Tirole, *A Primer on Foreclosure*, *in* 3 Handbook of Industrial Organization 2145 (Mark Armstrong & Robert H. Porter eds., 2007) (surveying theories); Oliver Hart & Jean Tirole, *Vertical Integration and Market Foreclosure*, 21 Brookings Papers on Economic Activity (Microeconomics) 205 (1990).

16 *See, e.g.*, studies cited *infra* note 38.

17 *See, e.g.*, the list of agency consents in Steven C. Salop & Daniel P. Culley, *Vertical Merger Enforcement Actions: 1994–July 2018*, Geo. U.L. Ctr. (Aug. 23, 2018), https://scholarship.law.georgetown.edu/cgi/viewcontent.cgi?article=2541&context=facpub. These figures update the earlier enforcement statistics cited in Salop & Culley, *supra* note 13.

18 For further discussion of this modern concept of foreclosure, see, e.g., Steven C. Salop, *The Raising Rivals' Cost Foreclosure Paradigm, Conditional Pricing Practices, and the Flawed Incremental Price-Cost Test*, 81 Antitrust L.J. 371, 382–95 (2017).

19 *Id.*; Continental T.V., Inc. v. Sylvania Inc., 433 U.S. 36, 57 n.24 (1977) (stating that distributors charge a "cost of distribution").

20 Anticompetitive conduct in markets where buyers and sellers determine terms of trade through negotiation does not necessarily require a short-run reduction in output. C. Scott Hemphill & Nancy L. Rose, *Monopsony, Bargaining Leverage, and Buy-Side Benefits in Mergers*, 127 Yale L.J. 2078 (2018).

21 For some formal economic models of the impact of vertical mergers on coordination, *see, e.g.*, Volker Nocke & Lucy White, *Do Vertical Mergers Facilitate Upstream Collusion?*, 97 Am. Econ. Rev. 1321 (2007); Volker Nocke & Lucy White, *Vertical Merger, Collusion, and Disruptive Buyers*, 28 Int'l J. Indus. Org. 350 (2010); Hans-Theo Normann, *Vertical Integration, Raising Rivals' Costs and Upstream Collusion*, 53 Eur. Econ. Rev. 461 (2009).

22 *See* United States v. AT&T, Inc., No. 18-5214, 2019 WL 921544, at *13 (D.C. Cir. Feb. 26, 2019).

23 *See, e.g.*, Oliver E. Williamson, *The Vertical Integration of Production: Market Failure Considerations*, 61 Am. Econ. Rev. 112 (1971); Paul L. Joskow, *Vertical Integration*, *in* Handbook of New Institutional Economics 319 (Claude Menard & Mary M. Shirley eds., 2005); Martin K. Perry, *Vertical Integration: Determinants and Effects*, *in* 1 Handbook of Industrial Organization 183 (Richard Schmalensee & Robert Willig eds., 1989); Francine Lafontaine & Margaret Slade, *Vertical Integration and Firm Boundaries: The Evidence*, 45 J. Econ. Literature 629 (2007); Michael H. Riordan, *Competitive Effects of Vertical Integration*, *in* Handbook of Antitrust Economics 145 (Paolo Buccirossi ed., 2008).

24 For the seminal analysis of EDM, see Joseph J. Spengler, *Vertical Integration and Antitrust Policy*, 58 J. Pol. Econ. 347 (1950).

25 Daniel O'Brien, FTC Hearing, *supra* note 9, at 40 (logic calls for rebuttable presumption of benefits in concentrated markets); LaFontaine & Slade, *supra* note 23, at 71 (more positive view of vertical mergers as a starting point). Similar arguments are made with respect to vertical restraints. *See, e.g.*, James C. Cooper et. al, *Vertical Antitrust Policy as a Problem of Inference*, 23 Int'l J. Indus. Org. 639 (2005). Yet the Supreme Court has not mandated per se legality or adopted an overarching procompetitive presumption in reviewing vertical restraints under the Sherman Act, but instead has applied the conventional rule of reason. Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877, 894–99 (2007). Competitive effects analysis under Section 7 should be no more hospitable to defendants, as the Clayton Act authorizes the prevention of competitive harms in their incipiency. Consistent with this analysis, the D.C. Circuit in *AT&T* declined to presume that vertical mergers benefit competition. *AT&T*, WL 921544, at *1.

26 *E.g.*, Hoffman, *supra* note 2, at 2–3; Carl Shapiro, FTC Hearing, *supra* note 9, at 58 (horizontal mergers have a direct loss of competition unlike vertical mergers). The other part of the argument involves the claim that the vertical mergers inherently create efficiency benefits, as discussed *infra*.

27 Robert H. Bork, The Antitrust Paradox: A Policy at War with Itself 232 (1978). See Fruehauf Corp. v. FTC, 603 F.2d 345, 352 n.9 (2d Cir. 1979) ("[A] vertical merger may simply realign sales patterns.").

28 27 Scholars, *supra* note 7, at 7–8.

29 This incentive also could be illustrated for customer foreclosure by the downstream affiliate of the merged firm. In this comment, we use the terms upstream and downstream for expositional convenience; as a matter of economics, the merger of firms selling demand complements should be considered a vertical merger regardless of whether it is intuitive to view one as downstream of another in a supply chain. All of the theories and presumptions we discuss would apply in such cases as well.

30 Before the merger, the upstream merging firm would have raised its wholesale price to the point where the gains from charging more were just offset by the lost contribution to profit from the reduction in downstream sales. But that calculus would change as a result of the merger. Now, a higher input price causes diversion of some downstream sales to the merged firm's

downstream affiliate from the rival downstream firms when the cost increases lead the latter firms to raise their prices.

[31] *See* Jonathan B. Baker, *Exclusion as a Core Competition Concern*, 78 Antitrust L.J. 527, 556–58 (2013) (explaining that exclusionary conduct can harm competition by creating an involuntary or coerced cartel).

[32] This is what Krattenmaker & Salop term the "Frankenstein monster" scenario. Krattenmaker & Salop, *supra* note 15, at 241–42.

[33] In her statement on the Staples/Essendant merger, Commissioner Slaughter made a similar point. Commissioner Slaughter *Staples* Statement, *supra* note 4, at 8.

[34] For example, price would not normally rise after a horizontal merger when non-merging rivals have constant marginal costs and act as price-takers in an unconcentrated market. In that case, the rivals would not be expected to accommodate a post-merger price increase by the merged firm.

[35] Information exchanges also can have exclusionary effects by allowing the merging firm to preempt or more quickly match rivals' innovations. That conduct could deter innovation.

[36] *See* Jonathan B. Baker, The Antitrust Paradigm 141–42 (2019).

[37] James C. Cooper et al., *Vertical Antitrust Policy as a Problem of Inference*, 23 Int'l J. Indus. Org. 639 (2005); Francine Lafontaine & Margaret Slade, *Exclusive Contracts and Vertical Restraints: Empirical Evidence and Public Policy*, *in* Handbook of Antirust Economics 391 (Paolo Buccirossi ed., 2008). At the FTC Hearing, Margaret Slade observed that the results of the studies of vertical mergers were mixed and the set of industries studied was narrow. *See* FTC Hearing Transcript, *supra* note 9, at 51 (The transcript records the word "fixed" when the speaker actually said "mixed.").

[38] Examples in the last decade include Fernando Luco & Guillermo Marshall, Vertical Integration with Multiproduct Firms: When Eliminating Double Marginalization May Hurt Consumers (Working Paper, Jan. 15, 2018), https://ssrn.com/abstract=3110038; Laurence C. Baker et al., *Does Multispecialty Practice Enhance Physician Market Power?* (Nat'l Bureau of Econ. Research. Working Paper No. 23871, 2017), http://www.nber.org/papers/w23871; Leemore Dafny et al., *The Price Effects of Cross-Market Hospital Mergers* (Nat'l Bureau of Econ. Research. Working Paper No. 22106, 2018) (addressing mergers involving demand complements); Jean-François Houde, *Spatial Differentiation and Vertical Mergers in Retail Markets for Gasoline*, 102 Am. Econ. Rev. 47 (2012); Gregory S. Crawford et al., *The Welfare Effects of Vertical Integration in Multichannel Television Markets* 86 Econometrica 891 (2018) (evidence that vertical integration of cable TV distributors with regional sports networks sometimes raised prices, even using lower bound estimates of harm); Johannes Boehm & Jan Sonntag, *Vertical Integration and Foreclosure: Evidence from Production Network Data* (Sciences Po Econ. Discussion Paper No. 2018-12, 2018), https://jmboehm.github.io/foreclosure.pdf (suppliers more likely to break relationships with buyers when they integrate with competitor of buyers, relative to integration with non-competitor).

[39] *See* Margaret C. Levenstein & Valerie Y. Suslow, *How Do Cartels Use Vertical Restraints? Reflections on Bork's* The Antitrust Paradox, 57 J.L. & Econ. S33, S42 (2014) (concluding that at least one-quarter of cartels used vertical restraints to support their exercise of market power); *see generally* Jonathan B. Baker, *Taking the Error out of "Error Cost" Analysis: What's Wrong with Antitrust's Right*, 80 Antitrust L.J. 1, 17–23 (2015).

[40] Stock market event studies also are unable to control for the impact on stock prices of investors' expectations that competitors will be acquired in subsequent mergers, among other problems. Studies that assume that the contracts between the upstream and downstream firms take simple forms may build in double marginalization, and then identify an EDM benefit from merger by virtue of that assumption, without evaluating whether it actually occurred.

[41] Baker, *supra* note 39, at 19–22.

[42] Alexander MacKay & David Smith, The Empirical Effects of Minimum Resale Price Maintenance on Prices and Output (Working Paper, Aug. 28, 2016) (finding that resale price maintenance typically harmed competition for the products studied), https://ssrn.com/abstract=2513533.

[43] Daniel O'Brien, FTC Hearing Transcript, *supra* note 9, at 40 (mergers among complements in concentrated markets create downward pricing pressure, implying presumptive benefits); Francine Lafontaine, FTC Hearing Transcript, *supra* note 9, at 71 (interests of sellers of complements aligned with consumers); Hoffman, *supra* note 2 at 143 (EDM is an inherent effect).

[44] A verifiability requirement is necessary to prevent overreaching claims not supported by sufficient evidence. A merger-specificity requirement is necessary because, as explained by Ronald Coase in his seminal article, vertical contracts can substitute for vertical mergers in some circumstances. Ronald H. Coase, *The Nature of the Firm*, 16 Economica 386 (1937); Sanford J. Grossman & Oliver Hart, *The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration*, 94 J. Pol. Econ. 691 (1986).

[45] Enghin Atalay, Ali Hortaçsu & Chad Syverson, *Vertical Integration and Input Flows*, 104 Am. Econ. Rev. 1120, 1127 (2014) (finding that almost half of establishments report no internal shipments). This point was noted at the FTC Hearing by Margaret Slade. FTC Hearing Transcript, *supra* note 9, at 49.

[46] Serge Moresi & Steven C. Salop, *vGUPPI: Scoring Unilateral Pricing Incentives in Vertical Mergers*, 79 Antitrust L.J. 185 (2013).

[47] 27 Scholars, *supra* note 7, at 15. *See also* Coase, *supra* note 44.

[48] Improved allocation of downstream demand risk might be claimed as a reason why it would be difficult to negotiate a two-part tariff. However, in the case of two large firms, a two-part tariff that places the demand risk on the downstream firm is unlikely to be sufficiently inefficient to justify an otherwise problematic vertical merger.

[49] In reviewing a horizontal merger, for example, we doubt that the agencies would consider merger-specific a claim that the merger would eliminate a patent royalty or would allow the firms to settle their ongoing patent infringement litigation by eliminating bargaining frictions.

[50] Bork, *supra* note 27.

[51] In an analogous bargaining setting, most lawsuits settle. It is very rare for large firms involved in a lawsuit to settle the suit by merging.

[52] Safe harbors normally are rebuttable in extreme circumstances, for example, where documents indicate significant anticompetitive concern.

[53] To illustrate, suppose that the upstream input market is a duopoly and the downstream output market is unconcentrated and comprised of ten firms, each with a market share of 10%. If the vertical merger leads both upstream firms to raise prices significantly to the nine unintegrated competitors, their resulting cost increases could cause them to raise downstream prices, creating substantial customer diversion to the downstream affiliate of the merged firm and providing that affiliate with the power and incentive to raise its price (rather than simply increase its market share). This is also an example of the involuntary cooperation discussed in Baker, *supra* note 31, at 556–58.

[54] We do not propose a particular level of concentration at which to apply these presumptions. However, we would discourage the agencies from relying on the threshold for a "highly concentrated" market employed in the 2010 Horizontal Merger Guidelines, as we are concerned that this threshold was set at an overly permissive level. U.S. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines 19 (2010) (HHI of 2500 as threshold for a highly concentrated market).

[55] Although the factual predicate for application of this presumption incorporates a conceptual experiment involving complete foreclosure of the critical input, the competitive harm could instead arise from higher input prices or other exclusionary conduct short of full foreclosure.

[56] There are numerous other (and generally more profitable) foreclosure strategies. However, for purposes of the presumption, we are using this more extreme strategy. A stronger presumption would contemplate a small but significant input price increase.

[57] After the merger, the distributor may foreclose rival manufacturers by raising the price of its services or refusing to provide its services. *See* Salop, *supra* note 18, at 384.

[58] Although the factual predicate for application of this presumption incorporates a conceptual experiment involving complete foreclosure of the upstream firm access to the market, the competitive harm could instead arise from exclusionary conduct short of full foreclosure.

[59] If the upstream merging firm sells to the competitors of the downstream firm, customer foreclosure can lead to input foreclosure. For further details, *see* Salop, *supra* note 18, at 389.

Testimony of Charlotte Slaiman
Competition Policy Director
Public Knowledge

Before the
Senate Committee on the Judiciary
Subcommittee on Competition Policy, Antitrust,
and Consumer Rights

"Trends in Vertical Merger Enforcement"

July 19, 2023

I. Our antitrust enforcers are fighting anti-competitive vertical mergers

It has been exciting to witness the revitalization of antitrust enforcement that is currently underway at the FTC and Department of Justice. In the past, courts narrowed antitrust law and Congress cut antitrust budgets. In response, antitrust enforcers narrowed their view of what was possible for them to achieve. Though Congress charged them to protect competition and consumers, there were a number of instances of caution and formalism holding our enforcers back from using the tools at their disposal to promote a competitive economy where corporations compete for customers and workers. Today, it is clear that both Congress and our federal and state antitrust enforcers recognize the importance of preserving competitive and open markets through aggressive antitrust enforcement.

In particular we've seen a marked increase in our federal enforcers suing to block vertical mergers. This is something that Public Knowledge has been calling for for a long time. The FTC and DOJ are to be commended for this impressive and important shift.

Unfortunately, it appears that the courts have not yet come around to this perspective. Antitrust law was written broadly, which has allowed courts the flexibility to incorporate new economic learning over time. This has given courts a lot more power in this area of the law than in many others. The consumer welfare standard wasn't built in a day, and similarly I anticipate that implementing the economic learning of the last ten years purely through litigation would take some time as well. New merger guidelines will help immensely. Courts should look to new guidelines for the most up-to-date understanding of competition law and economics. Congress can and must do its part as well. Americans cannot wait another 20 years for their antitrust laws to slowly catch up with the market needs of today.

Congress has already begun to support the increased enforcement effort by passing the Merger Filing Fee Modernization Act last year giving more funding to our federal enforcers. Thank you for passing that important legislation. However I fear our federal enforcers are still resource constrained, facing more anti-competitive mergers than they have the resources to stop. We call on Congress to authorize more funding for federal antitrust enforcement. At the same time, a deterrence strategy is needed. By showing that the agencies are not afraid to sue to block anti-competitive mergers, they can make other potential merging parties think twice before attempting an anti-competitive merger. This strategy is particularly important for vertical mergers right now, where courts have been even more reluctant to recognize the impacts on competition. Showing that the enforcers are paying attention to anti-competitive vertical mergers can be especially effective at deterring them from being agreed to in the first place.

The effectiveness of a deterrence strategy can be hard to measure. Former Assistant Attorney General for Antitrust, Bill Baer, spoke about mergers that should not have left the boardroom. Today, Assistant Attorney General Kanter says: it's already happening, many of those mergers are no longer leaving the boardroom.[1]

II. Vertical mergers can have a pernicious effect on competition

Mergers can be horizontal, vertical, or conglomerate. A horizontal merger is between direct competitors, such as when two organic grocery chains merge. A vertical merger is a merger in which a company buys their input supplier, distributor, or a company at another layer of the technology stack, such as an e-commerce marketplace purchasing an organic grocery chain, or an app store purchasing an app developer. A conglomerate merger is one where a company buys another and their relationship isn't clear or they may have no relationship. Of course there are also mergers that exhibit some characteristics of each of these three categories.

When a platform buys a company that competes on the platform, we worry that the platform will have an incentive to self-preference its own products on the platform. This means that other companies competing on that platform may not have fair access to consumers. By making things more difficult for a competitor, the vertically integrated platform can also deter competition. As we have seen, a reputation for self-preferencing can deter investment, pushing the "smart money" to invest elsewhere.

When a company purchases an important input supplier or important distribution channel, enforcers should be on guard. The merged entity may now have the incentive and ability to withhold or degrade access to that input or distribution channel from competitors. This creates a risk that competition may be substantially lessened. Withholding access could take the form of refusing to sell the product or service, offering it on less advantageous terms, or denying or degrading interoperability. This concern also applies to platforms.

Platform annexation, identified in the work of Fiona Scott Morton and Susan Athey, is a merger where a dominant platform acquires a company in an adjacent market that makes multi-homing, using multiple service providers at once, more difficult.[2] Platform annexation deals give rise to a conflict of interest whereby a dominant provider has the incentive to degrade or withdraw the

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[1] Assistant Attorney Gen. Jonathan Kanter, Opening Remarks at the Second Annual Spring Enforcers Summit (Mar. 27, 2023), https://www.justice.gov/opa/speech/assistant-attorney-general-jonathan-kanter-delivers-opening-remarks-second-annual-spring.

[2] Fiona M. Scott Morton & Susan Athey, *Platform Annexation*, SSRN (Feb. 16, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3786434.

multi-homing experience for its competitors. If market participants are forced to choose just a single provider, it will most likely be the dominant player.

Multi-homing can be the competitive Achilles heel for dominant platforms. Their gatekeeper power makes it incredibly difficult for individuals and business users to quickly and completely leave. A seller might stick with Amazon even when they face mistreatment if the alternative is to completely sever their relationship with Amazon and thus lose their main conduit to customers and profits. In a "take it or leave it" world, dominant platforms win at the expense of those relying on the gatekeeper. Multi-homing allows companies to move between platforms gradually. Incurring smaller switching costs spread out over time instead of all at once. Smaller competitors that might not have the capacity to provide service to a huge customer all at once can grow over time.

A market with a high-degree of multi-homing is much more likely to be a competitively vibrant one. Multi-homing creates competitive pressure on dominant platforms. If they mistreat their platform business users through high fees or onerous terms, those business users have options to gradually disassociate themselves from the dominant platform. We should thus encourage making multihoming as seamless as possible and enforcers should be especially wary of potential mergers to make multi-homing more difficult.

I'm particularly concerned about the risk of a platform annexation merger in cloud computing. Multihoming for Cloud Computing Services is particularly important, since migrating a customer's entire cloud at once may be prohibitively costly. In the cloud industry, well capitalized hyperscalers Google, Amazon and Microsoft currently interoperate and coexist with other platforms like Snowflake that run on top of their services and facilitate multi-homing. A competitive environment in cloud computing is critical since so many businesses rely on it to do their work. The ability to multi-home by using independent platforms not owned by a downstream competitor hyperscaler (like Snowflake) is key to that competitive environment.

III. Agency guidelines for vertical mergers should include anti-competitive presumptions

Our antitrust enforcement agencies have been working hard on new merger guidelines for the past year. Public Knowledge and others have advocated that the new guidelines should include anti-competitive presumptions for certain types of vertical mergers that pose a risk to competition.[3] Of course presumptions are rebuttable if the merging parties can show in fact there is not a threat to substantially lessen competition.

Presumptions are an important part of merger guidelines. Presumptions can help the agencies and merging parties save valuable resources at every stage of a transaction's review. When experience shows that certain market structure puts competition at risk, it isn't cost effective to make enforcers prove the obvious and waste resources on unnecessary litigation. Presumptions also provide a certain level of business certainty to merging parties so that they can make informed decisions about their legal risks, and can help them to conserve their litigation resources as well.

Perhaps most importantly, anti-competitive presumptions in the merger guidelines can support generalist judges in quickly getting up to speed on the latest in antitrust law and economics. In too many recent antitrust cases, court decisions seemed to rely heavily on crediting the testimony of the merging parties' executives that they would behave differently from how the structure of the market would indicate. Judges should not credit a CEO's self-serving storytelling when past experience with this market structure--which should be reflected in new merger guidelines--shows incentives to harm competition. When corporate executives make unenforceable promises to judges to sway them to approve their deals, clear and well-supported anti-competitive presumptions can support judges to not credit that testimony.

Of course, structural presumptions are more complicated for non-horizontal mergers, but there are some non-horizontal structures that still deserve a presumption. In our comments on the vertical merger guidelines from 2020 and merger guidelines in 2022, both appended at the end of this testimony, Public Knowledge has called for a dominant platform presumption, an input foreclosure & customer foreclosure presumption, as well as presumptions against mergers that would eliminate a potential entrant or a maverick firm.[4]

IV. Remedies

Since so many vertical mergers have been allowed to go through, we find ourselves in the unenviable position of trying to remedy anti-competitive mergers through legislation. The subcommittee has already identified some particularly anti-competitive vertical holdings to target with legislation, some achieved through merger and others through organic growth. The

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[3] Comments on Draft Merger Guidelines, Public Knowledge, April 21, 2022, https://publicknowledge.org/policy/comments-on-doj-and-ftc-merger-guidelines; *Recommendation and Comments on the Draft Vertical Merger Guidelines*, Jonathan B. Baker, Nancy L. Rose, Steven C. Salop, and Fiona Scott Morton (filed Feb. 24, 2020), at 18-20.

[4] Comments on the Draft Vertical Merger Guidelines, Public Knowledge and Open Technology Institute, Feb. 26, 2020, https://publicknowledge.org/policy/comments-to-doj-and-ftc-on-vertical-merger-guidelines.

American Innovation and Choice Online Act focuses on self-preferencing and anti-competitive discrimination that gatekeeper platforms use to promote their own products on their own platforms at the expense of fair competition. The Open App Markets Act addresses the power that the operating system and app store companies have to control competition between apps and to put a thumb on the scale for their own apps. The AMERICA Act is also about vertical power: it takes on the conflict of interest that arises when the same company has a powerful market position in the ad exchange and both sides of the ad placement process, representing advertisers and publishers.

Once these huge vertical mergers are allowed to go through, it's much more difficult to restore competition. It would be much more efficient and effective to identify and stop anti-competitive vertical mergers, "in their incipiency" as the Clayton Act intended.

With the renewed interest in stopping vertical mergers, it will also be useful to review the types of remedies that can be effective for enforcers to impose at the time of a merger. While many vertical mergers will need to be outright blocked, there may also be situations where a consent decree can be an efficient resolution that protects competition and keeps the agency's powder dry for other priorities. Like any litigant, the FTC and DOJ are resource constrained and can do more with less if they can achieve beneficial settlements in some cases that would be expensive to litigate.

If the concern is withholding a critical input or distribution channel, imposing duties to deal can be really valuable for allowing fair competition to continue. This could include a compulsory license--as the EU has required of Microsoft as a condition of allowing its merger with Activision, interoperability requirements, or other obligations to deal fairly with competitors.

Non-discrimination requirements or prohibitions on self-preferencing can protect independent competitors' ability to compete fairly in the market. It may be difficult to identify *ex ante* all of the ways that a vertically integrated firm post-merger can preference their own products and discriminate against strategic competitors. It will be important to use broad definitions to capture new products and services and new mechanisms of self-preferencing or anti-competitive discrimination that arise.

The practicalities of enforcement are important to take into account when considering a consent decree. Consent decrees that are weak, difficult to enforce or not enforced well, or time limited for too short a time can do a real disservice to consumers and to competition. It can be difficult for our enforcement agencies as currently structured to police compliance on these internal decisions. Consent decrees should include details of how enforcement will be managed, and should err on the side of caution with those enforcement procedures by providing speedy resolution of alleged violations, auditing authority, and more. And Congress should authorize more funding so that the compliance division of each enforcement agency can operate effectively.

Another limitation of consent decrees has been keeping up with changing circumstances. Predicted pro-competitive outcomes may not materialize. To address this, agencies can leave open the possibility of modifying the consent decree if certain expected metrics are not met, as the DOJ did in the *Assa Abloy* settlement.[5]

V. Microsoft

A recent example can be found in the FTC's challenge of the Microsoft/Activision merger. Although Microsoft has some games, it is primarily a provider of consoles, gaming subscriptions, and cloud gaming. Activision is primarily a game studio. Enforcers at the FTC--and consumer groups like Public Knowledge-- were concerned about this primarily vertical merger. Microsoft competes primarily with Sony, another provider of consoles. Once they own a game studio would they have the incentive and ability to foreclose competition by withholding key games from Sony? The FTC determined that they would, and sued to block the merger. The UK competition and Markets Authority (CMA) also determined that the merger violated their competition laws.

At the preliminary injunction stage, the district court found last week for Microsoft, denying the preliminary injunction and clearing Microsoft to begin moving forward with their merger. Of particular note in Judge Corley's decision was her discussion of vertical mergers in general. She was able to justify her skepticism of an FTC challenge to a vertical merger by pointing out how rarely vertical mergers have been challenged in the past.[6] She particularly noted that there is no structural presumption against any category of vertical mergers.[7]

In an anti-competitive vertical merger it's common that the distributor would have an incentive to withhold a critical input from competing distributors. In this case before the merger Microsoft had an incentive to withhold Call of Duty from Sony and valve. Before the merger of course the distributor does not have the ability to withhold that input from competing distributors. The input supplier, on the other hand, has the ability but not the incentive to withhold that input. In this

[5] "Justice Department Reaches Settlement in Suit to Block ASSA ABLOY's Proposed Acquisition of Spectrum Brands' Hardware and Home Improvement Division" May 5, 2023, https://www.justice.gov/opa/pr/justice-department-reaches-settlement-suit-block-assa-abloy-s-proposed-acquisition-spectrum.
[6] *FTC v. Microsoft Corp.*, No. 23-cv-02880-JSC, 2023 U.S. Dist. LEXIS 119001, at *21 (N.D. Cal. July 10, 2023).
[7] *Id.* at *31.

case, Activision could have made Call of Duty exclusive to one platform, but that didn't benefit Activision when it was an independent company. When the distributor buys the supplier, the distributor's incentive is now matched up with the supplier's ability, and the merged firm may have the incentive and ability to foreclose competition by withholding--or degrading--access to a critical input from competitors. What's important for the merger analysis is that the merged firm has the incentive and ability to foreclose and that some component of that is increased or created by the merger. One need not increase both components. In fact it's very common that the incentive would already be in place and therefore not be increased by the merger. Or, in the case of a supplier buying a distributor, that the ability would already be in place but not the incentive. I believe the court's analysis would have been aided by merger guidelines that clearly stated a structural presumption for vertical mergers.

It's worth noting that Microsoft offered to make Call of Duty and other existing games available to competing consoles and game stores. In the EU, they agreed to make all Activision games available for cloud streaming on any cloud service for the next 10 years. I think these commitments are good for consumers and for competition. From a consumer perspective, it is very important to me that any remedy focused exclusively on Call of Duty and existing games will be insufficient to protect consumers from anti-competitive harm. In a competitive marketplace I would expect consumers would care about more than just the most popular game, and that the most popular game will not always be Call of Duty. The market structure will remain after any commitments run out, and I fear that market structure will still push the merged firm to raise rivals' costs and degrade their quality, at the expense of consumers.

V. Conclusion

Today, the world of tech startups is built around the monumental gravitational pull of the largest tech platforms. Knowing that these firms provide a more reliable "exit" where founders and venture capital investors can obtain the exponential gains they need to fund their business model, has a huge impact on the types of businesses that get funded. Too many of our innovation resources--not just funding, but also brain power--now are focused on creating features that a big tech firm will want to buy. With greater scrutiny on these mergers, I'm hopeful that we can change this system. We want tomorrow's innovators to challenge the status quo. To build a competitor to the dominant platform, not a feature for it. Or to focus on a different interesting challenge.

Competitive markets function better. They function better for consumers, workers, competitors, and adjacent markets. They are easier to regulate because each individual business has less power. Businesses that face competition work hard to identify what their customers want and invest in innovation to provide that.

Our antitrust enforcement agencies are doing their part to promote competition throughout the economy. They are bringing the cases we need to stop anti-competitive mergers. Consumer advocates have been sounding the alarm for years saying that existing antitrust law is not where it needs to be to address the harms of consolidation. We need Congress to do its part in this fight.

The Competition and Antitrust Law Enforcement Reform Act (CALERA) from Senator Klobuchar and others would update the standard for merger review to help our antitrust enforcers to stop more mergers. Other efforts at antitrust reform also deserve attention. Sector specific tools like AICOA, OAMA, and the AMERICA Act are critical to opening up digital platform markets for fair competition.

Of course, it's important to keep in mind that antitrust cannot solve every problem. In digital markets, Public Knowledge is very aware of problems that are unlikely to be solved by competition alone. Consumer protections, particularly privacy protections, will still be needed in the law, and researcher access will be an important tool for understanding the problems of disinformation online.

Public Knowledge

April 21, 2022

Federal Trade Commission
Office of the Secretary
600 Pennsylvania Avenue NW
Washington, DC 20580

Submitted via Regulations.gov

Re: Request for Information on Merger Enforcement, FTC-2022-0003-0001

Public Knowledge appreciates the opportunity to comment on the Department of Justice (DOJ) and Federal Trade Commission's (FTC) merger guidelines. This is a great opportunity for our antitrust enforcement agencies to clarify this important area of the law where so much excellent research is available to improve our courts' understanding and decision-making. As experienced experts in this field, the views of the FTC and DOJ should be invaluable to courts in interpreting the law, just as past merger guidelines have been. Great progress has been made in our collective understanding of antitrust economics and the impacts of consolidation since the publication of the 2010 Horizontal Merger Guidelines, so it's important that the new guidelines make substantive changes in order to reflect new understanding.

In addition to stronger guidelines that more accurately interpret existing law, Public Knowledge believes that it's imperative for Congress to step in with statutory changes. To truly achieve competitive markets in key industries and across the economy, we need more than what existing law can accomplish. Public Knowledge supports legislation like Senator Klobuchar's *Competition and Antitrust Law Enforcement Reform Act of 2021* (CALERA) for its commonsense proposals to reform and strengthen the antitrust laws.[1] Congress can further empower antitrust enforcement through infusions of funding to ensure that agencies have the proper resources to combat the growing threat of consolidation and anticompetitive behavior throughout the economy. Sector-specific competition laws are also appropriate in key sectors such as dominant digital platforms. And other antitrust law reforms may be needed as well.

Digital Platforms

Public Knowledge believes that digital platform markets present unique risks to competition and are deserving of special analysis. Three major facets of these markets merit discussion: network effects, economies of scope and scale, and the limits of user choice. These markets tend towards tipping to one or a few powerful firms.[2] In such situations, competition occurs largely "for" the market rather than ongoing dynamic competition. Both enforcers and courts must take account of these unique features to make accurate enforcement decisions and achieve optimal market and consumer outcomes. Market participants, including the dominant platforms themselves,

[1] S. 225, 117th Cong. (2021).
[2] Nicolas Petit & Natalia Moreno Belloso, *A Simple Way to Measure Tipping in Digital Markets*, PROMARKET (Apr. 6, 2021), https://www.promarket.org/2021/04/06/measure-test-tipping-point-digital-markets/#:~:text=The%20conventional%20definition%20of%20tipping,not%20all%E2%80%94of%20the%20market.

understand these market realities and thus focus on aggressive growth to survive.[3] Digital platform markets, such as online search, e-commerce, and social networking, have grown to incredible economic importance since the last update to the merger guidelines. Public Knowledge believes this increasing importance, coupled with the unique market characteristics explained below, merits special attention in the merger guidelines.

Network Effects

A market exhibits network effects where the utility of a good goes up the more people that use said good.[4] As a network gains users, the number of potential connections goes up exponentially. This makes a larger network increasingly more attractive for both its current and potential future users. On the one hand, this is a major incumbency advantage that makes it very difficult for a second mover to have success. On the other hand, the potential for the market to tip and shift quickly to another network means that potential and nascent competitors may pose a more serious competitive threat than in other markets. Although uncertainty is high, incumbents in these markets face so little competition that enforcers and courts must err on the side of protecting the independence of these competitors. These dynamics deserve a special place in discussions about digital platform mergers. In markets characterized by network effects, companies that are small in size may still be important to protect from acquisition.[5] Agencies should look long and hard before allowing these firms to be acquired by the dominant platform purveyors (discussed in detail more below).

Economies of Scope and Scale

Today's platform markets run on data. Platforms collect data on our transactions, online searches, browser history, social media use, and so much more. This data is then aggregated and used to power targeted advertisements that make digital platforms some of the most profitable companies the world has ever seen. Data as a good has several unique properties. In many situations, data is non-rivalrous (one platform's exploitation of your data doesn't really affect the ability of another to do the same), and non-fungible (data is specific to an individual user so data from other users isn't helpful in filling in the blanks). Most importantly, however, data exhibits massive increasing returns both in scope and scale. More data, from more sources, is exponentially as valuable as less data. That means there will be a market gravitational pull keeping the companies with the most data on top.

Digital platforms also have a strong incentive to expand into as many verticals as possible, as each vertical can result in a new data stream about the user. This has a synergistic effect with network effects—bigger firms benefit both from stronger network effects and data scale

[3] *See* Tim Sullivan, *Blitzscaling*, HARVARD BUS. REV. (Apr. 2016), https://hbr.org/2016/04/blitzscaling.
[4] *See, e.g.*, Feng Zhu & Marco Iansiti, Why Some Platforms Thrive and Others Don't, HARVARD BUS. REV. (Jan. 2019), https://hbr.org/2019/01/why-some-platforms-thrive-and-others-dont.
[5] *See* Michael Kades & Fiona Scott Morton, *Interoperability as a competition remedy for digital networks*, Wash. Ctr. for Equitable Growth (Sept. 23, 2020), https://equitablegrowth.org/working-papers/interoperability-as-a-competition-remedy-for-digital-networks/.

advantages. This has advantages beyond just lowering the cost of production, but other advantages (such as attracting capital at favorable rates). This also must be taken into account as a potential motivator for and an impact of mergers. A merger that may appear not to have a horizontal impact can confer important data advantages.[6]

Natural and Unnatural Limits of User Choice

Digital platforms have unprecedented control over what their users experience on their platforms. The user interface for a website or app can be designed in ways to nudge or even aggressively push the user towards certain choices, including particular products and services.[7] Disfavored and competitor services may be more difficult for a user to access, especially when they don't know that they need to be looking extra hard to find alternatives.

This phenomenon is exacerbated by basic tenets of consumer behavior. Consumers may exhibit an "if it ain't broke, don't fix it" mentality when it comes to digital platform services. If a product has worked well enough, a user can be "sticky" and unlikely to switch and experiment with other products that may be superior.[8] Nobel Prize-winning economists Daniel Kahneman and Richard Thaler discuss how people exhibit "bounded rationality" in which they use shorthand rules of thumb to make decisions in a complex world.[9] Platforms can take advantage of this to manipulate consumer choices and stay on top. In digital platform markets dominated by online gatekeepers, just being the "best" sometimes isn't enough if consumers aren't willing to at least try your offerings.

The Importance of Protecting Potential and Nascent Competition

As a result of these market characteristics, enforcers and courts need to pay particular attention to potential and nascent competition in digital platform markets. They create markets prone to tipping, where a small, new, or potential competitor may play an outsized role. To protect competition in these markets, it's especially important to recognize the harms of acquisitions of potential or nascent competitors and block mergers that might be allowed in other types of markets.

Digital markets today are led by gatekeepers that can effectively control their competitors'

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[6] *See, e.g.*, Public Knowledge & Consumer Federation of America, *DOJ Letter on Google - Fitbit* (Apr. 29, 2020), https://publicknowledge.org/policy/public-knowledge-and-consumer-federation-of-america-doj-letter-on-google-fitbit-merger/.

[7] *See, e.g.*, The Consumer Council of Norway, *You Can Log Out, But You Can Never Leave* (Jan. 14, 2021), https://fil.forbrukerradet.no/wp-content/uploads/2021/01/2021-01-14-you-can-log-out-but-you-can-never-leave-final.pdf.

[8] Public Knowledge, *Letter to Antitrust Subcommittee for Innovation Hearing*, (July 19, 2019), https://docs.house.gov/meetings/JU/JU05/20190716/109793/HHRG-116-JU05-20190716-SD010.pdf.

[9] Richard H. Thaler, From Cashews to Nudges: The Evolution of Behavioral Economics, 108 AMER. ECON. REV. 1265 (2018)

access to the market.[10] While these markets today are characterized by a distinct lack of direct, ongoing, head-to-head competition, fear of being unseated as the market champion may have some competitive impact on dominant firms.[11] Even nascent or potential competitors can have positive effects for consumers in the market and influence the dominant players to innovate and respond. This competition might not look like much, but any sort of competitive pressure is vastly preferable to none at all.

This leads to a discussion of what is known as Type I and Type II errors. Since predicting the future is difficult, it's likely that "errors" may sometimes occur in antitrust enforcement. Type I errors are where the agencies block a benign merger ("false positive") while Type II errors represent the inverse, the agencies failing to block an anticompetitive merger ("false negative"). The concept was originally introduced by Frank Easterbrook in a seminal article in which he argued antitrust should be far more concerned with Type I, which might be termed "over-enforcement" than Type II, "under-enforcement" errors.[12]

The result of Easterbrook and his intellectual progeny has been systematic underenforcement of our antitrust laws and rising concentration throughout the entire economy. Today's experts have convincingly argued that antitrust has become unbalanced with deleterious effects on the economy as a whole.[13] However, the Easterbrook Type I error bias deserves special condemnation in markets prone to tipping such as digital markets.

Easterbrook dramatically overestimates market contestability and focuses too much on unquantified potential benefits, especially in the digital market context. The maxim that a firm cannot enjoy monopoly profits for long before competitors will swoop in for their own slice of the pie doesn't hold true in markets with massive entry barriers like digital platform markets. Meanwhile, increasing consolidation stifles innovation (especially the market-changing type that could threaten the dominant status quo) making the potential benefits even more illusory in platform markets.[14]

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[10] *See* Jonathan B. Baker, Joseph Farrell, Andrew I. Gavil, Martin S. Gaynor, Michael Kades, Michael L. Katz, Gene Kimmelman, A. Douglas Melamed, Nancy L. Rose, Steven C. Salop, Fiona M. Scott Morton & Carl Shapiro, *Joint Response to the House Judiciary Committee on the State of Antitrust Law and Implications for Protecting Competition in Digital Markets*, WASH CTR. FOR EQUITABLE GROWTH (2020), https://equitablegrowth.org/wp-content/uploads/2020/04/Joint-Response-to-the-House-Judiciary-Committee-on-the-State-of-Antitrust-Law-and-Implications-for-Protecting-Competition-in-Digital-Markets.pdf.

[11] George J. Stigler Ctr. for the Study of the Econ. and the State, Comm. for the Study of Dig. Platforms Mkt. Structure and Antitrust Subcomm. Report ["Stigler Report"] 50 (Jul. 1, 2019), https://research.chicagobooth.edu/-/media/research/stigler/pdfs/market-structure-report.pdf?la=en&hash=E08C7C9AA7367F2D612DE24F814074BA43CAED8C.

[12] Frank H. Easterbrook, *The Limits of Antitrust*, 63 TEX. L. REV. 1 (1984).

[13] *See e.g.*, Steven C. Salop, *Dominant Digital Platforms: Is Antitrust Up to The Task?*, 130 YALE L.J.F. 563 (2021); Lina Khan, *The New Brandeis Movement: America's Antimonopoly Debate*, 9 J. OF EUROPEAN COMP. L & PRACTICE 131 (2018); and TIM WU, THE CURSE OF BIGNESS: ANTITRUST IN THE NEW GILDED AGE (2018).

[14] *See, e.g.*, Asher Schechter, *Mergers Are Bad for Innovation*, PROMARKET (Sept. 29, 2017), https://www.promarket.org/2017/09/29/mergers-bad-innovation/.

Fundamentally, competition in these markets is *hard*. The theory that an agency mistakenly approving an ultimately anticompetitive merger would lead to new entry that would quickly alleviate any competitive concerns has not proven true in platform markets. For example, Facebook's acquisitions of Instagram and WhatsApp simply extended its dominance of social networking and no direct competitors have yet meaningfully entered. Given the high costs of Type I errors in these markets, it makes far more sense to worry more about Type II errors.

As an example, when Facebook sought to purchase Instagram, it faced a rare inflection point in its growth where it may have been at risk of being unseated.[15] A new technology, mobile phones, was taking off, and Facebook was slow to adapt. They might or might not have weathered that transition as the largest network. Facebook recognized the importance of retaining their position as the dominant incumbent, a "bet the firm" imperative in a market prone to tipping like social networking. Instagram was thriving with its focus on mobile, and despite its small size it had a dedicated and growing user base. Of course, the FTC's internal deliberations on that merger are non-public. But neither the agency nor the courts seemed to recognize at the time the general principle that a small competitor in what might at the time have been considered an adjacent industry could have a significant competitive impact on an incumbent in a market prone to tipping. It's crucially important that they incorporate this economic learning to be able to block a similar merger in the future.

Making Merger Enforcement More Efficient

The Federal Trade Commission and the Department of Justice are overworked and understaffed. The FTC has fewer staff than it did during the Jimmy Carter administration.[16] Meanwhile, mergers are at an all-time high. What was once a yearly estimate for the number of mergers that the agencies would need to evaluate (~200) is now happening about every two weeks.[17]

Strict statutory merger review timelines remain static despite the smaller staff and higher caseload. The current system is not working well for anyone. Agency staff is swamped with a backlog of requests and are thus unable to give every deal the scrutiny it deserves. This could lead to a situation where a deal that harms consumers and should be blocked might be able to sneak through. Honest businesses are also negatively affected by the inefficiencies of the current system. They face uncertainty for deals that should be quickly approved and have to face the specter of litigation to unwind their mergers for years. More funding and extending the statutory timelines for review would both be important statutory changes. Merger guidelines also have an important role to play in creating a more efficient system. Efficient merger enforcement would give businesses the clarity they need to properly pursue their economic goals.

[15] Amended Complaint, FTC v. Facebook, Inc., No. 1:20-cv-03590-JEB (D.D.C. Aug. 19, 2021).
[16] Federal Trade Commission, *FTC Appropriation and Full-Time Equivalent (FTE) History*, https://www.ftc.gov/about-ftc/bureaus-offices/office-executive-director/financial-management-office/ftc-appropriation (showing 1,746 employees in 1979 compared to just 1,123 in 2021).
[17] Federal Trade Commission, *Premerger Notification Program*, https://www.ftc.gov/enforcement/premerger-notification-program (showing ~400 HSR filings per month).

More Clarity Through Clear Presumptions

Properly constructed, the merger guidelines should provide clarity to both enforcers and businesses. Antitrust enforcement agencies are incredibly resource-constrained and need to operate efficiently. The merger guidelines should be structured in such a way that obviously anticompetitive mergers never make it out of the boardroom.[18] Presumptions can provide needed clarity and predictability. If incorporated into the guidelines, they can put the evidentiary burden on the merging parties rather than overworked and underfunded enforcers. This saves businesses from wasting time and effort on long-shot legal challenges, and enforcers can focus their efforts on mergers that are a closer call.

Presumptions make sense for several reasons. First, it is the merging parties themselves who have the most relevant information in their possession and are thus best equipped to prove their merger would be competitively benign.

Second, presumptions can halt competitively dangerous mergers in their infancy, saving agencies precious time and resources. When companies know that they'll have to offer proof alongside their merger applications, they should be far more wary of meritless mergers. This in turn allows the agencies to focus on the edge cases, creating further clarity in merger law which benefits all players.

Third, basic tenets of justice and fairness lean towards putting initial evidentiary burdens on the merging parties themselves in a wider range of circumstances. Antitrust enforcement agencies work for the public, not the merging parties. The pre-merger notification process confers a benefit on would-be merging parties seeking an advance indication from the agencies if their proposed deal would result in litigation.

One possible presumption that we think is appropriate would be a "dominant platform" presumption. This would state a dominant platform's attempts to acquire either: 1) a firm with a substantial probability of entering into competition with it absent the merger, or 2) a firm competing in an adjacent market would be presumptively anticompetitive. A dominant platform would be defined as one with gatekeeper or "bottleneck" power.[19] This could function as a proper way to recognize and account for the power that dominant platforms can exert in an already competitively precarious market. For more on this presumption as well as other potential presumptions, please see the joint comments of Public Knowledge and the Open Technology Institute on the Vertical Merger Guidelines.[20]

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[18] *Oversight of the Enf't of the Antitrust Laws Before the Subcomm. on Antitrust, Competition Pol'y and Consumer Rights of the S. Comm of the Judiciary* 114th Cong. (2016) (statement of Bill Baer, Asst. Att'y Gen., Antitrust Division), https://www.justice.gov/opa/speech/assistant-attorney-general-bill-baer-antitrust-division-testifies-senate-judiciary.

[19] Stigler Report, *supra* note 11, at 32; Digital Competition Expert Panel, *Unlocking digital competition* 59 (Mar. 13, 2019), https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/785547/unlocking_digital_competition_furman_review_web.pdf.

Clear presumptions can also cut down on the resources devoted to expensive competing economic analyses. Those same competing economic experts also spend time quantifying proposed efficiencies that may never materialize. Limiting these burdensome and sometimes unnecessary costs can allow the agencies to take on more mergers, as well as needed conduct enforcement.

Giving Less Credence to Merger Efficiency Claims

A recurring problem in merger enforcement is that merging companies are able to claim broad, consumer-centric efficiencies that will come about as a result of their merger. These claims receive little pushback from the agencies when they are made, despite sometimes questionable evidence in their favor. This problem is compounded by little to no follow-up from the agencies asking if the promised efficiencies ever materialized. If merging parties want to claim that their merger will be good for consumers, not just their shareholders, they should be forced to actually follow through on their claims.[21]

Absent competition, there is no reason to expect businesses to pass on earned efficiencies to consumers. Businesses are profit-maximizing enterprises and if consumers have nowhere else to go, businesses can comfortably raise and maintain prices at monopoly levels, no matter how "efficient" their operation becomes. Therefore, even if the agency analyzes efficiencies, they should be discounted or dismissed if insufficient competition exists post-merger. Consumers lose if they are made to give up competition in exchange for efficiencies. Heavy skepticism is also warranted for claims that concentration in an existing market will allow entry into a new one.

An excellent example of this phenomena is the AT&T/Time Warner merger. AT&T was able to complete the transaction in large part due to big claims about consumer-centric, merger-specific efficiencies. We now know those claims never materialized.[22] There was no continuing oversight of the AT&T/Time Warner combination and thus no real need for the company to follow through on its lofty promises. So, they didn't.

True efficiencies can result from a merger and in some cases consumers might be better off. Companies are free to claim this, but the merger guidelines should specify some level of proof needed. Just as wild claims devoid of factual basis are thrown out early in the litigation process, so should claims of merger efficiencies without a factual proof background.

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[20] Public Knowledge & Open Technology Institute, *Comments on the Draft Vertical Merger Guidelines* (Feb. 26, 2020), https://publicknowledge.org/policy/comments-to-doj-and-ftc-on-vertical-merger-guidelines/.
[21] *See* American Antitrust Institute & Public Knowledge, *DOJ Letter on Discovery/WarnerMedia Merger* (Sept. 2, 2021), https://publicknowledge.org/policy/public-knowledge-and-american-antitrust-institute-doj-letter-on-discovery-warnermedia-merger/.
[22] *See* John Bergmayer, *AT&T is Reminding Us Why the Video Marketplace Was Traditionally Highly Regulated*, PUBLIC KNOWLEDGE (June 3, 2020), https://publicknowledge.org/att-is-reminding-us-why-the-video-marketplace-was-traditionally-highly-regulated/.

Enforcement agencies should also have some sort of enforcement mechanism to ensure claimed efficiencies actually come to pass. This could be through unwinding mergers or by putting efficiency claims into consent decrees so the agency can enforce them. Notably, previous iterations of the guidelines expressed deep skepticism of merger efficiency claims, and we would advocate a return to this kind of thinking.[23]

Platform Annexation Deserves Special Scrutiny

Public Knowledge would like to highlight academic work by Susan Athey and Professor Fiona Scott Morton on "platform annexation."[24] This is a phenomenon where a dominant platform acquires a company in an adjacent market that makes multi-homing more difficult for the user. Although not strictly vertical or horizontal, platform annexation deals give rise to a conflict of interest whereby a dominant provider has the incentive to degrade or withdraw the multi-homing experience for its competitors. If market participants are forced to choose just a single provider, it will most likely be the dominant player.

Multi-homing can be the competitive Achilles heel for dominant platforms. Their gatekeeper power makes it incredibly difficult for individuals and business users to quickly and completely leave. A seller might stick with Amazon even when they face mistreatment if the alternative is to completely sever their relationship with Amazon and thus lose their main conduit to customers and profits. In a "take it or leave it" world, dominant platforms win at the expense of those relying on the gatekeeper. Multi-homing allows companies to wean themselves off the dominant platform gradually. The company can experiment with other platforms, while maintaining a relationship with the dominant platform, and then completely migrate over time.

A market with a high-degree of multi-homing is much more likely to be a competitively vibrant one. Multi-homing creates competitive pressure on dominant platforms. If they mistreat their platform business users through high fees or onerous terms, those business users have options to gradually disassociate themselves from the dominant platform. We should thus encourage making multihoming as seamless as possible and the merger guidelines should be especially wary of potential mergers to make multi-homing more difficult.

An example of this phenomenon can be found in the recent Amazon purchase of start-up Veeqo.[25] At first blush, there might appear to be little competitive concern in the acquisition. Veeqo is a small start-up with around 60 employees that didn't even directly compete with Amazon. Veeqo's core product was a tool that allowed online sellers to manage their sales and inventory across multiple e-commerce platforms, from Amazon to eBay to Shopify. In other words, Veeqo was a tool that made multihoming in e-commerce easier. Now that it is under

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[23] U.S. Dep't of Justice, Merger Guidelines ¶ 10 (1968), https://www.justice.gov/archives/atr/1968-merger-guidelines.
[24] Fiona M. Scott Morton & Susan Athey, *Platform Annexation*, SSRN (Feb. 16, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3786434.
[25] Annie Palmer, *Amazon acquires Veeqo, a start-up that helps sellers manage their online businesses*, CNBC (Mar. 7, 2022), https://www.cnbc.com/2022/03/07/amazon-acquires-e-commerce-software-start-up-veeqo.html.

Amazon's control, there are clear incentives to degrade interoperability with other platforms which in turn will force sellers to pick the one dominant player in the space—Amazon.

American Express and Two-Sided Markets

In *Ohio v. American Express Co.* (*AmEx*), the Supreme Court in effect created special rules for two-sided markets.[26] Special rules for two-sided markets don't make sense: separating a two-sided market from other types of markets is inexact, and harms to one "side" of the market should not be justified by benefits to another "side" of the market. While a statutory fix would be most effective at addressing this bad decision, it is appropriate and necessary for enforcers and courts to take a narrow interpretation of the *AmEx* case.

Of particular relevance for merger enforcement would be the proposition that companies competing on only one side of a market are not in the same market as companies competing on both sides of the market.[27] If not explicitly rejected by the guidelines, it could lead to a disastrous loophole allowing dominant digital platforms free reign to acquire and kill their one-sided competitors. Digital platform markets are notoriously two-sided. The Amazon Marketplace connects buyers and sellers and Google Search connects advertisers on one side with users and their search results on the other. These companies are so large and powerful, it can be too much to ask for a competitor to simultaneously enter every vertical a digital platform has a presence in. A strong competitor active on only one side of the market can exert meaningful competitive pressure on the dominant platform provider and thus an acquisition of such a company by the two-sided incumbent may cause harm to competition.[28]

Conclusion

With bold leadership in place, Public Knowledge is pleased to see the FTC and DOJ move forward on a rethinking and a revitalization of the merger guidelines. We hope these ideas will aid the enforcement agencies during their process. We welcome the opportunity to expound further on these ideas.

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[26] 138 S. Ct. 2274 (2018).

[27] Charlotte Slaiman, *U.S. v. Sabre Decision Is Wrong About Platform Markets*, PUBLIC KNOWLEDGE (Apr. 9, 2020), https://publicknowledge.org/u-s-v-sabre-decision-is-wrong-about-platform-markets/.

[28] *See* Aaron M. Panner, *Market Definition and Anticompetitive Effects in* Ohio v. American Express, 130 YALE L.J.F. 608 (2020).

Comments on the Draft Vertical Merger Guidelines

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Public Knowledge and New America's Open Technology Institute submit these comments in response to the request for public comment regarding the Federal Trade Commission's and Department of Justice's Draft Vertical Merger Guidelines.[1] We support the decision to revisit the non-horizontal merger guidelines that were last published in 1984. Since then, there has been much more antitrust scholarship on mergers generally and vertical mergers specifically, as well as real-world examples that should inform the new guidelines.

While the FTC and DOJ have made the right decision to revise the guidelines, the current draft has important shortcomings that should be addressed. In particular, we recommend revising the guidelines to include: (1) rebuttable anticompetitive presumptions; (2) application to all non-horizontal mergers; (3) an evaluation of previous vertical mergers and their enforcement impact; and (4) an extended deadline for first-round public comments and a second round of reply comments.

In addition to these written comments, Charlotte Slaiman of Public Knowledge and Joshua Stager of the Open Technology Institute would welcome the opportunity to participate as speakers at the workshops scheduled for March 11 and March 18, 2020.

I. The Guidelines Should Include Anticompetitive Presumptions

Vertical mergers in concentrated markets are often anticompetitive. As a result, certain anticompetitive presumptions are warranted in some types of cases. Presumptions can help the agencies and merging parties save valuable resources at every stage of a transaction's review. Presumptions also provide a certain level of business certainty to merging parties so that they can make informed decisions about their legal risks.

The agencies should adopt *rebuttable* presumptions that can be invoked when at least one of the markets is concentrated and therefore competitive harm is more likely, and when certain other key criteria are met.[2] None of the presumptions are based solely on market shares and concentration.[3] All of the presumptions would be rebuttable by evidence showing that anticompetitive effects are unlikely.[4]

[1] *Draft Vertical Merger Guidelines*, DOJ and FTC (rel. Jan. 10, 2020).
[2] Jonathan B. Baker, Nancy L. Rose, Steven C. Salop, and Fiona Scott Morton, *Five Principles for Vertical Merger Enforcement Policy*, Georgetown Law Faculty Publications and Other Works (hereafter "*Five Principles*") (Summer 2019), at 16, available at: https://scholarship.law.georgetown.edu/cgi/viewcontent.cgi?article=3166&context=facpub; see also *Recommendation and Comments on the Draft Vertical Merger Guidelines*, Jonathan B. Baker, Nancy L. Rose, Steven C. Salop, and Fiona Scott Morton (hereafter "*Comments of Baker, Rose, Salop, Morton*") (filed Feb. 24, 2020), at 18-20.
[3] *Five Principles*, at 17.
[4] *Id.*

The Commission should adopt a **dominant platform presumption**. This would be a presumption that a merger is anticompetitive if a dominant platform acquires a firm with a substantial probability of entering into competition with it absent the merger, or if that dominant platform company acquires a competitor in an adjacent market.[5] Competition against platforms occurs differently than in other types of markets and is often harder. Entering from an adjacent market is one of the few viable ways to compete against a dominant platform.[6] As a result, it is important that mergers between dominant platforms and adjacent markets receive extra scrutiny.

For purposes of this presumption, a dominant platform could be defined as a firm with bottleneck power, as discussed in the Stigler Digital Platforms and Market Power Report and the UK Digital Markets Competition Report (also known as "The Furman Report"). According to the Stigler Report, "'bottleneck power' describes a situation where consumers primarily single-home and rely upon a single service provider (a 'bottleneck'), which makes obtaining access to those consumers for the relevant activity by other service providers prohibitively costly."[7] The Furman Report describes gatekeepers as companies that "have a high degree of control and influence over the relationship between buyers and sellers, or over access by advertisers to potential buyers."[8] These platforms are often important routes to market for other firms. Bottlenecks also benefit from market characteristics that tend to impede entry and lead to foreclosure, such as high switching costs for users, bundled services (either by contract or technology), and the inertia of defaults. Digital businesses that have this incentive and ability to develop and preserve a single-homing environment should be considered dominant platforms and therefore subject to the presumption.

Platforms often face "competition for the market" rather than dynamic and ongoing competition.[9] This type of competition is especially hard for new entrants and can be easily thwarted. Dominant platforms will often be in a better position to identify potential competitors that have a chance of unseating the incumbent than regulators. The threat to the dominant incumbent is existential, but the chances of success for the new entrant may be low. This makes proving the likely anticompetitive effect of the merger especially difficult at the same time that protecting the potential competition is especially important. This is a situation where a presumption can provide a real competitive benefit to the market, as it incentivizes the dominant platform to compete rather than purchase the potential competitor. This presumption is similar to the elimination of potential entry presumption, but due to the network effects and economies of

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[5] *Id.*; see also *Comments of Baker, Rose, Salop, Morton*, at 18-19.
[6] Stiger Committee on Digital Platforms, Final Report, Stigler Center for the Study of the Economy and the State (Sept. 2019) (hereafter "Stigler Report"), available at: https://research.chicagobooth.edu/-/media/research/stigler/pdfs/digital-platforms---committee-report---stigler-center.pdf.
[7] *Stigler Report*, at 84.
[8] *Unlocking digital competition: Report of the Digital Competition Expert Panel* (Mar. 2019) (hereafter "Furman Report"), at 41, available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/785547/unlocking_digital_competition_furman_review_web.pdf.
[9] *Stigler Report*, at 88.

scale that protect dominant platforms from competition,[10] the need to prove that an adjacent market is a potential competitor is lifted.

Dominant platforms also have particular foreclosure capabilities for adjacent markets, which create incentives similar to vertical mergers in non-platform markets. A platform with market power could substantially disadvantage firms in an adjacent market by refusing to interoperate with them. If a platform purchased one adjacent market firm, it would then benefit from preferencing the owned firm over competing adjacent market firms, either by denying interoperability or making interoperability difficult, thereby diverting substantial business to the owned firm.

We can use the acquisition of Instagram by Facebook as an example. Though Instagram and Facebook may already have been horizontal competitors at the time of the merger, some have indicated that the two companies, one focused on mobile devices and photo sharing, the other focused on desktop devices and general social networking, may in fact have been in different markets.[11] If the FTC determined that in fact the two were not horizontal competitors, it could have been a useful time for a dominant platform presumption.

An **input foreclosure** presumption is another important anti-competitive presumption to include in the guidelines. When a company buys its input supplier, the merger may or may not be substantially likely to reduce competition.[12] But if the supplier produces a *critical* input, and if the market they're selling in (the input market) is *concentrated*, and if the merged company could divert substantial business to itself through a refusal to deal with competing customers, then a presumption that the merger would be substantially likely to reduce competition is warranted.[13]

This is because this situation allows the new merged firm to exercise market power. The new merged firm likely has the incentive and ability to fully withhold, or offer to sell only on unfavorable terms, the critical input from buyers that have now become competitors in the post-merger world.

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[10] *Five Principles*, at 17.

[11] There is no discussion of this question in the public closing documents, so we have no reliable indications of how the agency analyzed this merger. See *FTC Closes Its Investigation Into Facebook's Proposed Acquisition of Instagram Photo Sharing Program*, Press Release, Federal Trade Commission (Aug. 22, 2012), available at: https://www.ftc.gov/news-events/press-releases/2012/08/ftc-closes-its-investigation-facebooks-proposed-acquisition.

[12] *Five Principles*, at 16.

[13] This should also apply facing the other direction, as distribution can be considered a critical input for a manufacturer, such that what we typically think of as a downstream firm could also be considered an upstream firm, and vice versa. *Id.*

An illustrative example is the purchase of NBCUniversal, primarily a television content company, by Comcast, primarily a multi-channel video programming distributor (MVPD), in 2011. In that case, the FCC, applying its public interest standard, analyzed the merger much as an antitrust enforcer would, looking at possible input foreclosure.[14] The FCC found that a post-merger Comcast/NBCU would have the power to disadvantage downstream rivals—competing MVPDs—by permanently cutting off a rival from access to NBCU video programming, or even temporarily withholding that access.[15] It also found that the merged company could raise its rivals' costs by increasing the price of video programming to MVPD competitors.[16] The FCC then asked whether the exclusion of rivals would result in harm to competition and concluded that successful exclusion using one of these strategies would likely permit a merged Comcast/NBCU to obtain or maintain market power in the downstream MVPD market.[17] The FCC found that the merged firm would have the ability to "exclude all Comcast's rivals" from its programming.[18] In the end, the FCC approved a consent decree that it argued would remedy these problems, but as advocates argued at the time, it did not prove sufficient to remedy the complete competitive harm created by the merger.[19]

A presumption of anticompetitiveness in cases of input foreclosure would work in a similar way. Enforcers would have to show that the video programming market was concentrated, and that video programming was a critical input for MVPDs. They would have to show that a merged NBC/Comcast could divert substantial business—in this case subscribers to cable television—from competitors to itself by refusing to offer its programming to rival MVPDs. If enforcers could prove those three things, the burden would shift to Comcast to rebut the presumption that the merger is anti-competitive. Having such a presumption in place would not necessarily mean that a merger like Comcast/NBCU would not be settled with a consent decree. However, shifting the burden would make it possible to more easily block some anti-competitive mergers and to achieve stronger and more effective remedies if a consent decree was ordered. For example, the DOJ may have been able to require Comcast to commit to better arbitration requirements and/or stronger limits on most favored nation clauses (MFNs).

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[14] Jonathan Baker, *Comcast/NBCU: The FCC Provides a Roadmap for Vertical Merger Analysis* (2011), at 37, available at: https://transition.fcc.gov/osp/projects/baker_vertical_mergers.pdf.
[15] *Id.* at 37.
[16] *Id.*
[17] *Id.*
[18] *Id.* at 38.
[19] Commissioner Michael Copps correctly identified the problem with the consent decree, "I believe loopholes remain that will allow Comcast-NBCU to unduly pressure both distributors, especially small cable companies, and content producers who sit across the table from the newly-consolidated company during high-stakes business negotiations for programming and carriage." (Dissenting Statement of Commissioner Michael J. Copps, *In the Matter of Applications of Comcast Corporation, General Electric Company and NBC Universal, Inc. For Consent to Assign Licenses and Transfer Control of Licensees*, MB Docket 10-56, FCC 11-4 (rel. Jan. 18, 2011) (hereafter "*Comcast/NBCU Order*", available at: https://www.fcc.gov/proceedings-actions/mergers-transactions/comcast-corporation-and-nbc-universal-mb-docket-10-56).

A similar anti-competitive presumption should apply in the case of **customer foreclosure**. Like input foreclosure, this deals with customers and suppliers, but in this case, rather than selling a critical input, the merging firm need only be a *substantial* purchaser of an input produced in a *concentrated* market.[20] Similar to input foreclosure, the merged firm must also be able to divert a substantial amount of business through refusing to deal.[21] Again, in this type of case we expect the new merged firm can exercise market power. The new merged firm likely has the incentive and ability to refuse to buy, or offer to buy only on unfavorable terms, from input suppliers that have now become competitors in the post-merger world, and the merged firm represents a substantial part of their business.

This also came up in the context of the Comcast/NBCU merger. Though the FCC has a different legal standard, their economic analysis appears similar to the concept of customer foreclosure in antitrust law. The FCC considered a range of exclusionary strategies that Comcast might employ, including refusing to carry a rival programming network on Comcast's distribution system; placing a rival network in a less advantageous service tier where fewer users would pay for access to it, or making it difficult for subscribers to find the rival network by giving it a less advantageous channel number.[22] These exclusionary strategies could harm the rival programming networks by reducing their viewership thereby making them less attractive to advertisers. The FCC concluded, "As a result, these unaffiliated networks may compete less aggressively with NBCU networks, allowing the latter to obtain . . . or maintain market power with respect to advertisers seeking access to their viewers."[23] In a similar analysis at the DOJ or FTC, we might expect similar results under the antitrust laws.

Non-horizontal mergers should also be presumed anti-competitive if the merger **eliminates a potential entrant** to a concentrated market. This can be defined as one merging firm having a substantial probability of entering into the other firm's market in the absence of merger, when the market losing the potential entrant due to the merger is concentrated.[24] This would be a two component test, the first component is substantial probability of entry in the absence of the merger, and the second component is concentration in the potential entry market. Even the threat of entry can put competitive pressure on a concentrated market.

The **elimination of a maverick** firm should also lead to a presumption that a merger is anti-competitive. A maverick is defined as a firm that has prevented or substantially constrained coordination by its competitors in a concentrated market.[25] If a firm with a vertical relationship to the maverick, either a customer of the maverick's products or an input supplier to the

[20] *Five Principles*, at 16.
[21] *Id.*
[22] Baker, *Comcast/NBCU: The FCC Provides a Roadmap for Vertical Merger Analysis*, at 39.
[23] *Comcast/NBCU Order*, at ¶ 116.
[24] *Five Principles*, at 16.
[25] *Id.*

maverick, purchases the maverick, the constraining influence of the maverick could be eliminated, which would lead to higher prices.[26] This is because it would likely be in the interest of the new merged firm to cease the maverick firm's maverick behavior since it would now benefit from coordination in that market. The mechanism by which this change takes place may not be obvious, so an example is helpful. Perhaps the maverick firm is an input supplier being purchased by a customer. Ordinarily the customer would benefit from having a maverick in the upstream market. However, once the customer owns the maverick, it now benefits from a lack of competition in the upstream market, as it can absorb the increased revenues in the upstream market.

II. The Guidelines Should Apply to All Non-Horizontal Mergers

The previous guidelines were named Non-Horizontal Merger Guidelines rather than Vertical Merger Guidelines. This is an important and valuable distinction. Not all non-horizontal mergers are vertical, yet other types of non-horizontal mergers may also have anti-competitive effects. The Commission should explicitly clarify that the guidelines apply broadly to non-horizontal mergers and not only to vertical mergers.

Mergers of complementary products in particular share economic similarities to vertical mergers. It will not be a good use of resources for agencies to have to prove that the merger they are concerned about is actually vertical rather than complementary in order to benefit from these new guidelines. One key component of a vertical merger is that a company engaged in a vertical line of business often has an easier time entering a market than other companies. This is similar for complementary products, as products that are complementary today can quickly become competitors.

Limiting the application of these guidelines to cases where the agency can prove a vertical relationship would leave out many merging firms in non-horizontal markets, where a similar analysis should nonetheless apply. Especially in communications and internet-related markets, where products and services change often, it can be difficult to identify whether the two merging parties are "at different stages of the same supply chain," as the draft guidelines require in footnote 2. However, the merger still shares important characteristics with vertical mergers and should be subject to the same guidelines.

In today's economy, it is common to have mergers that would not necessarily be characterized as vertical yet where a vertical merger analysis should still apply.[27] For example, we can imagine a situation where an Internet service provider ("ISP") buys a programming company that offers a video streaming channel directly to consumers. If the consumer then buys Internet service from

[26] *Id.*
[27] *Comments of Baker, Rose, Salop, Morton*, at 5.

the ISP and contracts directly with the programming company for the video channel, is this a vertical relationship? It may not be so clear. Yet the economic analysis should apply in the same way. As such, the guidelines should include vertical as well as non-horizontal mergers to address mergers, such as the aforementioned example, that involve complementary products.

III. The Guidelines Should Include An Evaluation Of Past Enforcement Impact

The guidelines would benefit from an evaluation of how markets have fared after the approval of vertical mergers. At a minimum, past enforcement impact should inform the future direction of the Commission's work. Commenters have participated in several vertical transaction reviews, each of which can contribute to the Commission's record and understanding of the impacts of vertical mergers.

AT&T's 2015 acquisition of DirecTV demonstrates how promised efficiencies can fail to materialize in vertical mergers. AT&T claimed that the merger would produce efficiencies that would incentivize the deployment of new broadband service to millions of new customers. Specifically, AT&T committed to deploy fiber-to-the-home broadband to 12.5 million new locations and Fixed Wireless Local Loop services to 13 million rural households, all by the end of 2019.[28] This efficiency claim played a significant role in the transaction's approval, as it was viewed as a public interest benefit that could help close America's digital divide.[29]

However, AT&T appears to have wildly overestimated the merger's efficiencies. According to latest estimates, AT&T has only deployed Fixed Wireless Local Loop to 2.7 million households—a far cry from the 13 million household commitment.[30] When asked in 2017 if AT&T would honor this commitment, a spokesman merely replied that the commitment was not binding.[31] AT&T is even more opaque in its fulfillment of the fiber-to-the-home pledge. The company recently claimed it now "markets" fiber to 14 million locations.[32] However, *marketing* and *deployment to the home* are not synonymous, and AT&T is reportedly deeming any location within 1,000 feet of its fiber network as being served.[33] The Federal Communications Commission does not recognize this 1,000-foot threshold, and it is unclear how many locations

[28] *FCC releases order approving AT&T-DIRECTV Transaction*, Federal Communications Commission, (July 28, 2015), https://www.fcc.gov/document/fcc-releases-order-approving-att-directv-transaction.
[29] *Id.*
[30] *Fixed Wireless Internet Providers*, BroadbandNow, https://broadbandnow.com/Fixed-Wireless-Providers.
[31] Jon Brodkin, *AT&T's wireless home Internet, with 160GB cap, is now in 18 states*, Ars Technica, (Sept. 28, 2017), https://arstechnica.com/information-technology/2017/09/atts-10mbps-wireless-replacement-for-slow-dsl-comes-to-nine-more-states/.
[32] AT&T, *Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934*, (Nov. 5, 2019), https://otp.tools.investis.com/clients/us/atnt2/sec/sec-show.aspx?Type=html&FilingId=13718698&CIK=0000732717&Index=10000.
[33] Bruce Kushnik, *AT&T's 1000 Foot Violation of AT&T-DirecTV Merger Conditions?*, HuffPost, (June 14, 2016), https://www.huffpost.com/entry/atts-1000-foot-violation_b_10449612.

are merely close to AT&T's fiber network rather than directly connected as the commitment entailed.

It is clear that, since the transaction closed, AT&T has given DirecTV preferential treatment over third-party content providers. At the time, experts voiced concerns that if the merger was allowed, AT&T would give anticompetitive preference to DirecTV content on its network.[34] In 2017, the FCC concluded that AT&T's free data or "zero rating" plan for DirecTV content likely violated the agency's net neutrality rules.[35] Pointedly, this plan runs afoul of the pledge that AT&T made, just two years prior, to adhere to net neutrality rules as a condition of the DirecTV merger.[36]

Throughout the past four years of broken promises and unrealized efficiencies, the video service that AT&T acquired through the merger has suffered greatly. By the end of 2019, AT&T had 20.4 million video subscribers—down from 25.4 million when the merger closed in 2015.[37] According to industry press, DirecTV "keeps tanking" as it hemorrhages subscribers and faces investor calls to divest from AT&T.[38] Much of this was foreseeable from the get-go due to the inherent incentives of the market. Clearer, more specific guidelines could have helped the Department of Justice to either block this merger or obtain more effective conditions.

AT&T offers yet another instructive example with its **2018 acquisition of Time Warner**. This transaction closed less than two years ago, yet it has already provided ample evidence that relying on AT&T's price reduction claims in lieu of clear market structure-based guidelines was a failed approach. In 2018, AT&T told a federal judge that "the evidence overwhelmingly showed that this merger is likely to enhance competition substantially, because it will enable the merged company to reduce prices … There is no sound evidence from which the Court could fairly conclude that retail pay-TV prices are likely to increase."[39] Moreover, AT&T specifically argued that "certain merger efficiencies will begin exerting downward pressure on consumer prices almost immediately." Instead, AT&T raised the price of its video streaming service within

[34] Tom Wheeler to Sens. Edward J. Markey, Al Franken, Ron Wyden, Bernard Sanders, Elizabeth Warren, Tammy Baldwin, Richard Blumenthal, (Jan. 11, 2017), https://ecfsapi.fcc.gov/file/60001076101.pdf.
[35] FCC, Letter to Senator Markey (Jan. 11, 2017), https://transition.fcc.gov/Daily_Releases/Daily_Business/2017/db0111/DOC-342982A1.pdf.
[36] *FCC releases order approving AT&T-DIRECTV Transaction*, Federal Communications Commission, (July 28, 2015), https://www.fcc.gov/document/fcc-releases-order-approving-att-directv-transaction.
[37] Jon Brodkin, *AT&T loses another 1.2 million TV subscribers as DirecTV keeps tanking*, Ars Technica, (Jan. 29, 2020), https://arstechnica.com/information-technology/2020/01/att-loses-another-1-2-million-tv-subscribers-as-directv-keeps-tanking/.
[38] *Id.*
[39] *United States of America v. AT&T et al.*, Case 1:17-cv-02511-RJL, (D.C. 2018), https://www.courtlistener.com/recap/gov.uscourts.dcd.191339/gov.uscourts.dcd.191339.121.0_1.pdf.

weeks of the transaction closing.[40] Eight months later, AT&T imposed a second price increase.[41] Six months after that, the company increased prices yet again.[42] Also within months of the transaction closing, AT&T engaged in a dispute with Dish Network that ultimately led to AT&T withholding HBO content from Dish for the first time in 40 years.[43] The loss of HBO could drive consumers to leave Dish's rival streaming service in favor of AT&T's—precisely what AT&T told the federal judge it would not do. Clearer vertical merger guidelines should specify the economic expectations in a situation like this so that agencies and courts are not relying on promises of companies to defy economic expectations. These price hikes and distribution disputes have created, in short order, a compelling record of the dangers of vertical mergers, particularly in oligopoly markets such as broadband service.

Comcast's purchase of NBCUniversal in 2011 is another transaction that the FTC and DOJ should take into account while developing new guidelines. This merger offers clear lessons in why new, specific and clear non-horizontal merger guidelines would be useful and effective. The Justice Department and the FCC approved Comcast/NBCU in 2011 with a relatively complex set of conditions, obtained under both the antitrust laws and the FCC's public interest authority, addressing the company's video and broadband services. For years, Comcast evaded and outright violated the conditions as enforcers struggled to monitor the company's conduct. For example, Comcast failed to "visibly offer and adequately market" a standalone broadband plan, as the 2011 consent decree required, resulting in an unprecedented $800,000 fine and FCC investigation.[44] Comcast also violated a condition to carry all unaffiliated news networks in the same "neighborhood" of channels by discriminating against Bloomberg, a news network that competed with Comcast-owned CNBC.[45] Both violations were uncovered by complaints from consumer groups and a well-resourced company; they do not necessarily constitute the full extent of Comcast's violations. They do, however, offer instructive examples of why enforcers should be skeptical of promises that companies will behave differently than the market structure suggests they will.

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[40] Jon Brodkin, *AT&T promised lower prices after Time Warner merger—it's raising them instead*, Ars Technica, (July 2, 2018), https://arstechnica.com/information-technology/2018/07/att-promised-lower-prices-after-time-warner-merger-its-raising-them-instead/.

[41] Todd Spangler, *DirecTV Now Prices Going Up by $10 per Month for All Customers, AT&T Rolling Out Two New Reformatted Packages*, Variety, (Mar. 11, 2019), https://variety.com/2019/digital/news/directv-Now-price-Increases-
10-dollars-new-packages-1203160152/.

[42] Jon Brodkin, *AT&T hits online TV customers with second big price increase this year*, Ars Technica, (Oct. 18, 2019), https://arstechnica.com/information-technology/2019/10/att-hits-online-tv-customers-with-second-big-price-increase-this-year/.

[43] Chaim Gartenberg, *AT&T and Dish's HBO battle is the bleak future of cable and streaming*, The Verge, (Nov. 2, 2018), https://www.theverge.com/2018/11/2/18055780/att-dish-hbo-battle-warnermedia-cable-streaming-battle-future.

[44] *FCC Resolves Comcast NBCU Investigation*, Federal Communications Commission, (June 27, 2012), https://www.fcc.gov/document/fcc-resolves-comcast-nbcu-investigation.

[45] *FCC Affirms Bloomberg v. Comcast News Neighborhooding Decisions*, Federal Communications Commission, Sept. 26, 2013, https://www.fcc.gov/document/fcc-affirms-bloomberg-v-comcast-news-neighborhooding-decisions.

The Comcast/NBCU conditions have since expired, but Comcast's potential for market abuse has not. Within months of the conditions' expiration, Comcast faced complaints that it was using its content ownership to harm competitors. The American Cable Association, a lobbying group for smaller video and broadband providers, argued that Comcast now poses "an even bigger threat to competition than in 2011" and a bigger threat than the AT&T/Time Warner merger.[46] "When it was subject to the 2011 conditions, Comcast/NBCU at least thought twice about engaging in anticompetitive acts," the group wrote.[47] "Without a leash, it can engage in a much wider range of bad behavior and, if it gets caught, merely use its deep pockets to play out the clock or, at worst, ask for forgiveness."[48] The letter echoed concerns raised by Senator Richard Blumenthal, D-Conn., who in 2017 urged the Justice Department to investigate the expiring Comcast/NBC conditions and to consider unwinding the merger.[49] The agencies should consider whether stronger guidelines would have helped DOJ to devise a more effective way to prevent the harms identified in the DOJ Complaint.

Just as these examples are useful in these comments for explaining the presumptions, it will be useful for the final guidelines to have an accompanying commentary document explaining how the guidelines relate to recent precedents. The FTC endeavored to do this in 2006 with the Commentary on the Horizontal Merger Guidelines.[50] The FTC and DOJ should consider providing a similar commentary to accompany the new Non-Horizontal Merger Guidelines.

IV. The FTC and DOJ Should Extend The Comment Deadline And Solicit Reply Comments

The FTC and DOJ should extend the deadline for public comments and create a second round of reply comments. The FTC and DOJ publicly announced the draft guidelines on Jan. 10 along with a 30-day comment period. Reflecting the concerns of many, including Commissioner Chopra[51], the FTC and DOJ extended this deadline by two weeks. While we welcome this extension, we must acknowledge that six weeks is simply not sufficient time for individuals,

[46] Matthew W. Polka to Assistant Attorney General Makan Delrahim, (Nov. 6, 2018), https://www.americancable.org/wp-content/uploads/2018/11/181106-DOJ-Letter-re-Comcast-NBCU-w-Appendix-FINAL.pdf.
[47] *Id.*
[48] *Id.*
[49] Sen. Richard Blumenthal to Assistant Attorney General Makan Delrahim, (Dec. 13, 2017), https://www.blumenthal.senate.gov/imo/media/doc/12.13.17%20Letter%20to%20DOJ%20Antitrust%20re%20Comcast-NBCU.pdf.
[50] *Commentary on the Horizontal Merger Guidelines*, Department of Justice and Federal Trade Commission (March 2006), available at https://www.ftc.gov/sites/default/files/attachments/merger-review/commentaryonthehorizontalmergerguidelinesmarch2006.pdf.
[51] Statement of FTC Commissioner Rohit Chopra (Jan. 10, 2020), https://www.ftc.gov/system/files/documents/public_statements/1561727/p810034chopravmgabstain.pdf.

organizations, and scholars to adequately rethink 36 years of new antitrust scholarship, court decisions, case studies, and the future of vertical merger enforcement.

The FTC and DOJ announced they will be holding two joint public workshops on the Draft Vertical Merger Guidelines in March. While we support these workshops, we believe it would have been more productive and valuable for the agencies and commenters alike if the comment deadline occurs *after* these workshops. If the goal is to have guidelines that are rigorously developed and robustly vetted, it would make sense to allow potential commenters to attend the workshops, participate in an exchange of ideas, and then file their comments. Accordingly, the FTC and DOJ should extend the current deadline beyond these two workshops.

In addition, the FTC and DOJ should create a second round of comments to allow commenters to reply to issues raised in the first round. Revising the guidelines is a significant endeavor that will significantly impact the public interest. The public should be given ample opportunity to weigh in on such an important matter, to read arguments presented in the record, and to express support or offer criticism. This additional level of engagement promotes transparency and gives the agencies important additional context. A reply-comment round is also consistent with decades of public comment precedent, such as the process established by the Administrative Procedure Act. The FTC and DOJ do not need to speed through this process.

V. Conclusion

For the reasons described above, the FTC and DOJ should move forward with new guidelines in a manner that best reflects the reality of vertical and non-horizontal mergers today. This includes acknowledging the failed enforcement of previous vertical mergers; incorporating anticompetitive presumptions in addition to the competitive presumptions; ensuring the revised guidelines apply to all non-horizontal mergers; and allowing for an adequate public comment period. If adopted, these recommendations will create stronger guidelines that benefit the agencies and the public interest alike.