On June 30, 2020, the Department of Justice (DOJ) and the Federal Trade Commission (FTC) issued Vertical Merger Guidelines (Guidelines), explaining how the FTC and the DOJ (jointly, “the Agencies”) intend to evaluate transactions among firms in vertical, as opposed to horizontal, relationships with each other. The Guidelines fill the place of the previous Non-Horizontal Merger Guidelines, which were issued in 1984 by the DOJ and were officially withdrawn by the Agencies on January 10, 2020. The final Guidelines reflect substantial modifications to the draft version released in January 2020, reflecting feedback from a March public workshop and more than 70 public comments.

Several important differences from the draft version the Agencies released in January 2020 are worth highlighting:

- The final Guidelines removed the quasi-safe harbor for vertical mergers in unconcentrated markets that was present in the draft Guidelines.
- The final Guidelines clarified that the elimination of double marginalization (or “EDM”) should factor into the initial determination of the merger’s competitive effects rather than merely be considered as an efficiency offsetting competitive harms.
- In addition to vertical mergers (those that combine firms or assets at different stages of the same supply chain), the final Guidelines also address diagonal mergers (those that combine firms or assets at different stages of competing supply chains) and mergers of complements.¹

Notably, the Guidelines also acknowledge that vertical mergers are frequently procompetitive and less likely to cause competitive concerns than horizontal mergers. Unlike the Horizontal Merger Guidelines², there is no presumption of anticompetitive effect—even in concentrated markets. Rather, the Agencies’ approach emphasizes a holistic view of the net effects of the merger, with a focus on the merged firm’s incentives and the different levers it can use to restrict competition in a relevant market.

**Identifying the Relevant Market and Related Products**
In “any merger enforcement action involving a vertical merger,” the Agencies will identify one or more relevant markets in which “the merger may substantially lessen competition.” Market definition tools used in horizontal merger analysis apply to vertical mergers as well. The Agencies may use market shares and concentration to aid in their assessment of competitive effects, but there is neither a presumption of legality for mergers in unconcentrated markets nor a presumption of anticompetitive effect for transactions occurring in highly concentrated markets.

Following identification of the relevant market, the Agencies will then specify one or more “related products” that are controlled by the merged firm and that may affect competition in the relevant market. A related product may be “an input, a means of distribution, access to a set of customers, or a complement.” Related products play a key role in the assessment of competitive effects; as outlined below, the Agencies analyze whether gaining control over a related product enables the merged firm to diminish competition in the relevant market, and whether the merged firm will have the incentives to do so.

**Unilateral Competitive Effects**

In assessing competitive effects, the Agencies focus on whether the merged firm will have the **ability** and **incentive** on its own to diminish competition. The Agencies focus on two key potential unilateral competitive effects:

1) **Foreclosure and Raising Rivals’ Costs.** The Agencies will assess whether the merged firm will have the ability and incentive to weaken its rivals in the relevant market by refusing to supply a related product or raising the costs by increasing its price or lowering its quality of the related product. In assessing the **ability** to engage in foreclosure, the Agencies focus on whether the merged firm is able to use control over a related product to deprive rivals of sales or to cause them to compete less aggressively, or whether rivals can easily find alternatives to the related product so the merged firm has little power to affect competition. In assessing the merged firm’s **incentive** to engage in foreclosure, the Agencies assess whether its gains from reducing competition in the relevant market would be greater than the losses it would suffer by reducing its sales of the related product. The Guidelines identify several non-exhaustive iterations (and examples) of foreclosure/raising rivals’ costs, including:

- **Classic input foreclosure and raising rivals’ costs:** A downstream company acquires an upstream firm that supplies an input for the downstream product, which is offered at a take-it-or-leave-it price that is constant across all units. The Agencies will assess whether the merged entity will be incentivized to forsake some revenue in the upstream market through reduced sales to its competitors in order to bolster its profits in the downstream market.

- **Raising the input costs of rivals with bargaining:** A downstream company acquires an upstream supplier that offers a product at terms set through bargaining. The Agencies will assess whether the vertical merger
improves the merged firm’s alternative to a supply agreement, giving it the leverage to raise its rivals’ costs by negotiating increased prices.

- **Creating the need for two-level entry**: A company facing potential competition from a new rival acquires a supplier of a critical input. The Agencies will assess whether the acquirer may now have the ability to prevent the new rival from successfully entering the market by refusing to supply the input and forcing the rival to bear the cost of making the input itself, thus making entry less likely. The Agencies will consider the net effects on the change in the likelihood of entry against the EDM. The net effect will depend, in part, on the change in the likelihood of new entry.

- **Raising rivals’ costs of distribution**: When an upstream company merges with a distributor, the Agencies will assess whether the merged entity has the incentive to cut off key distribution channels or use the distribution channel to disadvantage rival upstream companies by increasing the retail prices of their products. Again, the Agencies will consider the net effect of the harm against the EDM.

- **Merger of complements raising vertical issues**: Two companies that sell complementary products (i.e., demand for both components increase when the price of either falls) merger. The Agencies may investigate whether the merged firm has the incentive and ability to disadvantage its rivals by offering increased prices to customers that buy only one of its components and decreased prices to customers that buy both. If both effects are likely to be present, the Agencies will balance the two to determine the net effect on prices.

- **Diagonal merger**: A company acquires a firm that has developed a component that: (1) will enable the acquirer’s rivals to compete more effectively with the acquirer’s products but (2) does not improve the acquiring firm’s product. The Agencies will assess whether the merged entity has the ability and incentive to increase the price, degrade the quality, or reduce the availability of the component.

2) **Access to Competitively Sensitive Information**. The Agencies will assess whether the merged firm will gain access to competitively sensitive business information of its downstream or upstream rivals that it could use to react quickly to a rival’s procompetitive business actions. Specifically, the Agencies are concerned that rivals may forego these competitive initiatives or stop doing business with the merged firm out of concern that the merged firm will use competitively sensitive information against them. As a result, the rivals may become less effective competitors because they have fewer, and less preferred choices for trading partners.

**Coordinated Competitive Effects**
In addition to assessing the new ability and incentives of the merged firm to engage unilaterally in anticompetitive conduct, the Guidelines also discuss the Agencies’ consideration of whether the vertical merger lessens competition by enabling **coordinated** interaction among firms in the relevant market. Two primary concerns dictate the Agencies’ analysis of potential coordinated effects.

1) **Eliminating or Hindering a Maverick Firm.** The Agencies worry that a vertical merger might eliminate or hinder a “maverick” firm, a firm that plays a disruptive role in the relevant market to the benefit of customers, such as through a new technology or business model. By foreclosing a maverick firm from a related product, for example, the merged firm could harm a maverick firm that “plays or would play an important role in preventing or limiting anticompetitive coordination” among the merged firm and its rivals.

2) **Changes to Market Structure/Access to Confidential Information.** The Agencies also express concern that vertical mergers might facilitate collusion amongst rivals by making it easier to use confidential information gained from the merger to reach tacit agreement among relevant market participants or detect and punish firms cheating on such an agreement. To illustrate this concern, the Guidelines cite a hypothetical merger between a manufacturer of components and a maker of final products. If the component manufacturer supplies rival makers of final products, the maker will now have information on the rivals’ volumes of final product and would be better able to detect any deviation from a tacit agreement to limit output. As a result, the merger “may make an agreement to limit supply more effective.”

**Procompetitive Effects**

The Agencies will evaluate efficiency claims using the same approach set forward in the Horizontal Merger Guidelines, i.e., the efficiencies must be cognizable, merger-specific, verified, and not arising from anticompetitive reductions in output or service. These efficiencies might include the ability to “streamline production, inventory management, or distribution” and the ability “to create innovative products in ways that would not likely be achieved through arm’s-length contracts.”

The Agencies spend several paragraphs elaborating on how they will evaluate EDM—the lowering of downstream prices because the firm no longer has to pay a mark-up on its own inputs—an effect that is particularly relevant to vertical mergers. The Agencies will include EDM and its accompanying procompetitive benefits as part of the evaluation of the net effect of the merger’s harms, rather than as an offsetting efficiency applied after harm is quantified. Additionally, the Agencies have taken the rare step of stating that they will not reject the merger specificity of EDM “solely because it could theoretically be achieved but for the merger, if such practices are not reflected in the documentary evidence.” In addition, the Agencies specify that they will “generally take the same approach” to evaluating the “likely contractual arrangements” as they use when evaluating raising rivals’ costs or foreclosure.

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The Agencies have described a wide swathe of combinations that may fall within the analysis described in the Vertical Merger Guidelines. O’Melveny has extensive experience shepherding such mergers through regulatory review and trial. Our experienced merger lawyers are available to answer questions about the Guidelines or analyze what they mean for your business.


3 Vertical Merger Guidelines, supra note 1, at 3.

4 Id. at 3.

5 Horizontal Merger Guidelines, supra note 2, at 3-4.

6 Vertical Merger Guidelines, supra note 1, at 10.

7 Id. at 11.

8 Id. at 11.

9 Id. at 11.

10 Not only is EDM relevant to unilateral effect analysis, it also presents procompetitive effects by making a market less vulnerable to coordinated conduct by increasing the merged firm’s incentive to cheat on a tacit agreement.

11 Id. at 12.

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