Office of Commissioner
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UNITED STATES OF AMERICA
Federal Trade Commission
WASHINGTON, D.C. 20580

STATEMENT OF COMMISSIONER ROHIT CHOPRA

Regarding the Request for Comment on Vertical Merger Guidelines
Commission File No. P810034
January 10, 2020

Summary

- The 1984 Non-Horizontal Merger Guidelines should be rescinded, as they represent an antiquated, narrow, and overly permissive mode of thinking that is not reflective of today's economy or the current approach to enforcement.
- The U.S. economy is far different than it was forty years ago. Increasing concentration, declining new firm formation, and other market trends necessitate a modernization of vertical merger review.
- The draft guidelines released for public comment miss the mark. They are not supported by an analysis of past enforcement decisions, perpetuate an overdependence on theoretical models, and do not reflect all of the ways that competition can be harmed.
- Any new guidelines must establish a comprehensive framework for assessing the modern threats to competition posed by prospective vertical mergers.

I agree with rescinding the outdated and permissive 1984 Non-Horizontal Merger Guidelines[1] and engaging the public in the process of putting into place a new framework. I share the objective of my colleague Chairman Simons that we must "…make clear that anticompetitive vertical mergers are not unicorns, and there should not be a presumption that all vertical mergers are benign."[2] However, I disagree with proposing the draft guidelines published today because they are not comprehensive or reflective of modern economic realities.[3]

Merger Review in the Modern Economy

The U.S. economy has dramatically evolved since the publication of the 1984 Guidelines. Firm behavior and market structure have shifted. Most sectors of the economy are far more concentrated. Capital is more mobile. Supply chain management has evolved and is less linear. Multi-sided platforms facilitate an ever-increasing array of direct exchanges between users, sellers, service providers, creators, and other commercial and private actors. Within these digital

[1] U.S. DEP'T OF JUST., NON-HORIZONTAL MERGER GUIDELINES (June 14, 1984) [hereinafter "1984 Guidelines"], https://www.justice.gov/sites/default/files/atr/legacy/2006/05/18/2614.pdf.
[2] Chairman Joseph Simons, Fed. Trade Comm'n, Prepared Remarks at Fordham University's 46th Conference on Int'l Antitrust Law and Pol'y, at 8 (Sept. 13, 2019), https://www.ftc.gov/system/files/documents/public_statements/1544082/simons_-_fordham_speech_on_hearings_output_9-13-19.pdf.
[3] Because my position is split along the lines outlined in this statement, I have registered my vote as an abstention.

markets, data has become a currency, a price that must be paid to participate in economic or social activity.[4] Big data and artificial intelligence are driving network effects and creating new first-mover advantages.[5]

Today's economy is also more financialized, leading managers of both small and large enterprises to be more responsive to incentives driven by Wall Street and the capital markets. This has significant implications, since large firms are increasingly optimizing for return on invested capital, rather than overall profits. Indeed, companies often shut down profitable business segments for this reason.

Economic activity and wealth are more closely concentrated in a smaller set of firms across and within sectors and geographic areas.[6] Corporate profits as a percent of our nation's economic output have risen, since new entry has not competed these profits away. Despite our perception of the U.S. as an entrepreneurial nation, new business starts have been on the decline for decades, with firm deaths actually eclipsing new businesses a decade ago.[7] Outsourcing and reduction of employee bargaining power has reshaped the competitive landscape of our labor markets.

All of these changes raise questions about whether our existing approach to competition policy and antitrust law have kept up with the times. As our economy has evolved, so too has the business rationale for mergers, acquisitions, and other transactions. Today, many mergers are motivated by a thirst for data.[8] But deals animated by the acquisition and combination of different data streams are often difficult to characterize within the traditional boundaries of "horizontal" or "vertical" integration.

Outside of data, the methods for corporate control are now murkier, given the spread of new ownership structures and financial instruments that allow a firm to exert power over another. In particular, private pools of capital, including private equity, hedge funds, and venture capital firms have created new vehicles for control and reshaped the incentives for how managers operate assets they acquire.[9]

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[4] Maurice E. Stucke & Allen P. Grunes, *Big Data and Competition Policy* 215–16 (2016).

[5] *See e.g*., Ariel Ezrachi & Maurice E. Stucke, *Virtual Competition: The Promise and Perils of the Algorithm-Driven Economy* 203 (2016).

[6] Andre Tartar & Reade Pickert, *A Third of America's Economy Is Concentrated in Just 31 Counties*, BLOOMBERG (Dec. 16, 2019, 5:00 AM), https://www.bloomberg.com/graphics/2019-us-gdp-concentration-counties/; *see also* BUREAU OF ECON. ANALYSIS, GROSS DOMESTIC PRODUCT BY COUNTY, 2001-2018 (Dec. 12, 2019), https://www.bea.gov/system/files/2019-12/lagdp1219.pdf.

[7] *See* Ian Hathaway & Robert E. Litan, THE BROOKINGS INSTITUTION, *Declining Business Dynamism in the United States: A Look at States and Metros*, at 1 (May 2014) https://www.brookings.edu/wp-content/uploads/2016/06/declining_business_dynamism_hathaway_litan.pdf; *see also* Stacy Mitchell, INST. FOR LOCAL SELF-RELIANCE, MONOPOLY POWER AND THE DECLINE OF SMALL BUSINESS: THE CASE FOR RESTORING AMERICA'S ONCE ROBUST ANTITRUST POLICIES (Aug. 2016), https://ilsr.org/wp-content/uploads/2018/03/MonopolyPower-SmallBusiness.pdf.

[8] In terms of non-horizontal transactions, more mergers are motivated by a firm's desire to expand its data estate. According to the OECD, 'big data related' mergers and acquisitions rose from 55 in 2008 to 134 in 2012. This desire for analytic capabilities and new data, particularly when used to feed and train artificial intelligence, can impact the competitive landscape in ways that limit new entry. This is not limited to internet platforms or consumer-facing businesses; *see also* EUROPEAN DATA PROTECTION SUPERVISOR, REPORT OF WORKSHOP ON PRIVACY, CONSUMERS, COMPETITION AND BIG DATA, at 1-2 (June 2014), https://edps.europa.eu/sites/edp/files/publication/14-07-11_edps_report_workshop_big_data_en.pdf.

[9] *American Tech Giants Are Making Life Tough for Startups*, THE ECONOMIST (June 2, 2018), https://www.economist.com/business/2018/06/02/american-tech-giants-are-making-life-tough-for-startups; *see also* Asher Schechter, *Google and Facebook's "Kill Zone": "We've Taken the Focus Off of Rewarding Genius and Innovation to Rewarding*

Current Guidelines Should Be Rescinded

The 1984 Guidelines developed and published by the U.S. Department of Justice ("DOJ") should be rescinded. By outlining a narrow set of potential harms that may result from vertical mergers, they represent a permissive approach to reviewing these transactions. They are also clearly outdated, and have not reflected the full range of theories underpinning enforcement settlements and challenges by the DOJ or the Federal Trade Commission ("FTC") for quite some time.

The narrow set of harms described by the 1984 Guidelines includes the likelihood that (1) a transaction could substantially increase barriers to entry to potential rivals; (2) that a transaction could facilitate collusion or other horizontal effects; and (3) that a transaction could have an effect on rate regulation.[10] The 1984 Guidelines largely ignore how a market player could foreclose a competitor through a transaction or how a merger could lead to the abuse of a competitor's sensitive information.

These narrow parameters have tended to make merger reviews overly permissive. For those using the guidelines to evaluate a transaction, there is an implicit assumption that bad vertical mergers are rare. That assumption, combined with the limited set of harms to consider, has set the bar for serious scrutiny too low. So it is unsurprising that the FTC and the DOJ have seldom litigated non-horizontal merger challenges since the guidelines were published.[11] The recent challenge of the proposed merger between AT&T and Time Warner was the first one of significance in decades. Instead, the agencies have largely addressed vertical merger harms through settlements.[12]

These settlements and the limited number of merger challenges make it clear that these guidelines no longer reflect the agencies' thinking on vertical mergers.[13] In practice, the theories of harm pursued in many settlements have gone beyond those that are outlined in the 1984 Guidelines.[14] Notably, former FTC Chairman Robert Pitofsky confirmed that none of the three

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Capital and Scale" PROMARKET (May 25, 2018), https://promarket.org/google-facebooks-kill-zone-weve-taken-focus-off-rewarding-genius-innovation-rewarding-capital-scale/.

[10] 1984 Guidelines, 24 – 27.

[11] The United States has also promoted a permissive approach to vertical merger enforcement. For example, a 2007 submission to the OECD by the United States noted that "an overly aggressive enforcement posture toward vertical mergers would run the risk of hindering the ongoing realignment of firm boundaries that is necessary to maintaining an efficient allocation of resources in a dynamic economy." *See* SUBMISSION BY THE DELEGATION OF THE U.S. TO THE COMPETITION COMMITTEE, ROUNDTABLE ON VERTICAL MERGERS – NOTE BY THE UNITED STATES, at 10 (Feb. 2007), https://www.ftc.gov/sites/default/files/attachments/us-submissions-oecd-and-other-international-competition-fora/07RoundtableonVerticalMergers.pdf.

[12] Steven C. Salop & Daniel P. Culley, *Vertical Merger Enforcement Actions: 1994– July 2018* (2018), https://scholarship.law.georgetown.edu/cgi/viewcontent.cgi?article=2541&context=facpub; *see* U.S. DEP'T OF JUST., *Antitrust Case Filings,* https://www.justice.gov/atr/antitrust-case-filings (last visited Jan. 9, 2020); FED TRADE COMM'N, *Cases and Proceedings: Advanced Search*, https://www.ftc.gov/enforcement/cases-proceedings/advanced-search (last visited Jan. 9, 2020).

[13] Steven C. Salop, *Reinvigorating Vertical Merger Enforcement*, 127 YALE L.J. 1962, 1964 (2018) (noting that the last vertical merger case litigated to completion by the FTC occurred in 1979).

[14] Steven Salop, Revising the Vertical Merger Guidelines at the FTC-Georgetown University Event: Hearings on Competition and Consumer Protection in the 21st Century, at 14 (Nov. 1, 2018), https://www.ftc.gov/system/files/documents/public_events/1415284/ftc_hearings_5_georgetown_slides.pdf. *See also* Laura Blum-Smith & Garrett Andrew Schneider, Comment of the Writers Guild of Am. West, Hearing #5 on Competition and Consumer Protection, #FTC-2018-0091-D-0015 (Dec. 28, 2018) (arguing that "recent vertical mergers in the telecommunications and entertainment industries illustrate the deficiencies of the current regulatory regime…"), https://www.ftc.gov/system/files/documents/public_comments/2018/12/ftc-2018-0091-d-0015-163436.pdf.

vertical merger challenges the FTC brought during his tenure were related to theories in the 1984 Guidelines.[15]

Despite the antiquated mode of thinking they espouse and the fact that they do not accurately reflect the theories of harm that the agencies pursue, the 1984 Guidelines continue to be influential on the courts.[16]

While many of our peer agencies, including the European Commission and the Australian Competition & Consumer Commission, replaced their non-horizontal guidelines over a decade ago, the United States has not yet rescinded the 1984 Guidelines.[17] The rescission of the 1984 Guidelines is appropriate and overdue.

Draft Guidelines Miss the Mark

But in rescinding the guidelines, we are also faced with the question of whether the FTC should put new guidelines into place with the DOJ. While new guidelines would not be binding upon courts, they will be influential if they are substantiated by economic realities. Unfortunately, the draft guidelines fall short in providing an analytical framework that adequately reflects today's real-world business environment.

First, the draft guidelines are not supported by an analysis of how competition has fared under the approach of the last several decades. Constant evaluation helps to maintain regulatory humility by assessing the efficacy of enforcement action and the impact of inaction. The FTC has previously conducted reviews of its own work to determine how it should proceed in future cases. For example, the agency published a study of remedies obtained in merger enforcement matters to assess their effectiveness.[18] In the context of vertical mergers, it will be important that any new guidelines are similarly guided by an assessment of past enforcement impact. In particular, since the agencies have challenged and litigated relatively few vertical mergers, it is critical to closely examine the potential harms of transactions that went unchallenged.[19]

Second, the draft guidelines continue to perpetuate an overdependence on theoretical models. The agencies often make use of predictive models derived from economic theory to help shed light on potential effects of a merger, especially price-related effects. It is tempting to rely heavily on quantitative models, since it gives the veneer of an objective, scientific approach. However, enforcers should be wary about limiting analysis to a set of variables and outcomes that can obscure the larger anticompetitive impact of a deal. These models need to be pressure-

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[15] Robert Pitofsky, *Antitrust: Past, Present, and Future of Antitrust Enforcement at the Federal Trade Commission*, 72 U. CHI. L. REV. 209, 220 (2005), https://chicagounbound.uchicago.edu/cgi/viewcontent.cgi?article=5322&context=uclrev.

[16] The district court's decision in AT&T/Time Warner referenced the non-binding nature of the 1984 Guidelines, but cited previous decisions that favorably discussed its analytical approach. *See United States v. AT&T Co.*, 552 F. Supp. 131, 170 (D.D.C. 1982).

[17] EUROPEAN COMM'N, GUIDELINES ON VERTICAL RESTRAINTS (2010), https://ec.europa.eu/competition/antitrust/legislation/guidelines_vertical_en.pdf; *see also* AUSTRALIAN COMPETITION & CONSUMER COMM'N, MERGER GUIDELINES, at 47 (2008), https://www.accc.gov.au/publications/merger-guidelines.

[18] FED. TRADE COMM'N, THE FTC'S MERGER REMEDIES 2006-2012: A REPORT OF THE BUREAUS OF COMPETITION AND ECONOMICS (Jan. 2017), https://www.ftc.gov/system/files/documents/reports/ftcs-merger-remedies-2006-2012-report-bureaus-competition-economics/p143100_ftc_merger_remedies_2006-2012.pdf.

[19] Salop & Culley, *supra* note 12.

tested with real-world business intelligence and their predictions checked against the actual outcomes.

Third, the draft guidelines do not account for all of the ways that existing dominance can be used to choke off market entry or distort competition. In today's economy, it is not enough to solely look at overlapping product markets or markets that appear relevant to a specific supply chain. The nature of competition for capital, the new norms created by technological advancement, and the business incentives associated with data require a broader assessment of market power. Capital markets don't just reward the creators of great ideas; they also reward managers who can build moats around these discoveries. The digital environment has opened up new ways for dominant firms to introduce new products and services that can quickly go to market and increase a firm's reach. Technology has also provided new tools to assess and execute business decisions. Sophisticated algorithmic machine learning allows firms in any sector to mine their proprietary data for market trends and insights that might not be obvious or intuitive to enforcers or even the business leaders of the past.

New Guidelines Should Reflect Economic Realities

Merger review must evolve to reflect these present-day economic realities. New guidelines should not simply reaffirm the existing methodology in practice. It is critical that they establish a comprehensive framework for assessing the modern threats to competition posed by prospective vertical mergers. One of the biggest threats to a competitive economy is increasing barriers to entry and reducing new firm formation. Throughout history, nascent firms have been a key source of innovation and dynamism in the economy. Transaction reviews should encompass all the ways that the merger will allow the combined firm to deter entry into any market in which it participates.

First, enforcers need to be more thorough about assessing each firm's existing dominance. A rigorous investigation must rely on a full inventory of the means by which each company has achieved, maintains, or exercises market power in all its respective lines of business. This means broadening and deepening the review of each firm's operations to identify all of the elements that would allow the combined entity to increase profitability by unfairly exploiting any advantages from a merger to lessen or eliminate competition.

Corporate executives and board directors conduct these kinds of state-of-play assessments and enforcers should be doing the same. Knowing what unique capabilities, advantages, and market power each firm brings to the merger will help explain the rationale behind the deal and will make it easier to predict anticompetitive incentives and potential harm.

There are many indicators of existing dominance that merger reviews should scope. For example, each firm's current *reach,* such as its size, scale, structure, or contractual arrangements, may create considerable market power by affecting everything from ease of adjacent market entry to its cost of capital to its costs of production. The *structure of the markets* that the firms compete in may confer dominance, particularly with industries that tend to have high entry barriers such as significant investment costs, network effects, or government-granted exclusivity rights. The merging parties' *non-replicable assets*, including control of essential intellectual

property, infrastructure, and even data, may provide dominance, especially if they offer unique advantages or key leverage over competitors and new entrants. The acquirer's *track record*, including how it has operated acquired assets, its business strategy, and its past history of any anticompetitive or problematic behavior may indicate a root source or exercise of market power.

Second, enforcers need to be realistic about predicting the likely ways that the merger will incentivize or allow firms to distort competition by extending or enhancing their existing dominance. Understanding the deal rationale is key here, as it is likely to be linked to new ways to leverage market power. This requires a careful inquiry into all the incentives and opportunities that can lead to harm. Will the vertically integrated firm create a fundamental conflict of interest that allows the new entity to exploit other market participants? Will the merged firm have an incentive to gain an upper hand using government-granted benefits such as intellectual property rights or legal immunity? Will the merger give the combined firm the ability to access to competitors' sensitive business information? Will the new firm be able to package products or link technologies in ways that deter entrants from launching or gaining scale? Does the new firm's structure allow it to evade regulatory requirements that their competitors must follow? If any of these or other market distortions are possible, then the deal warrants significant scrutiny.

Finally, enforcers must be mindful of the expansive universe of harms that can result from a vertical merger that lessens competition. These harms go beyond the few currently considered by enforcers such as higher prices, reduced innovation, or a decrease in outputs or quality. The loss of competition can fundamentally alter business models and incentives to the extent that the private sector is no longer willing or able to deliver on market demands. And absent robust entry by new market participants, the public will lose the power to reap the benefits that competitive markets once produced.

Conclusion

The consequences of losing the benefits of competition can be severe for both consumers and the country. We may face heightened risks to national security when competition no longer exists to make our key infrastructure resilient. We may experience an erosion of our democratic values and rights to free speech by permitting mergers that centralize control of communications channels. We may face reduced opportunities for the American labor force to reach its full potential if consolidation robs workers of a competitive market for their hard work, skills, and talent. We may see a rise in threats to public safety, health, privacy, or quality of life when companies know that we can't vote with our feet because there are no competitors to offer better options.[20]

We need to turn the page on the outdated vertical merger enforcement framework currently in place. But the draft guidelines released for public comment clearly fall short. Some current theories of harm are not even included, such as how vertical mergers can contribute to regulatory evasion. This is not a transparent approach. There is also no indication of how the agencies have learned from past experience, including errors made through under-enforcement. It is also

[20] K. Sabeel Rahman, *Democracy Against Domination* 2–3 (2017).

unclear whether there is any empirical basis for the market-share cutoff that the draft guidelines suggest would indicate that a vertical merger is benign.[21]

Public comment on these and other deficiencies will help inform any next steps the FTC might take.[22] In theory, both the FTC and DOJ will be able to align on a new set of guidelines that are robust and transparent. However, the FTC must be mindful of its role as an independent agency. Any guidelines published by the FTC must clearly reflect today's economic realities and a sober-eyed assessment of the harms from a permissive approach.

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[21] I agree that oligopoly markets in particular merit special scrutiny when it comes to vertical merger enforcement. *See* Salop *supra*, note 14 at 13.

[22] Given the breadth of issues raised by the draft, the current duration of the comment period is likely too short.