Consumer Reports Comments on
Proposed New FTC-DOJ
Draft Vertical Merger Guidelines
February 26, 2020

Consumer Reports[1] submits these comments on the undertaking by the Department of Justice and the Federal Trade Commission (DOJ, FTC, the agencies) to update the remnants of the 1984 Merger Guidelines as they apply to vertical mergers.[2] These are mergers that combine two companies that operate at different levels in a supply and marketing chain, and therefore do, or could, do business with each other.[3] The purpose of updating the Guidelines, as described by the agencies, is to incorporate advances in understanding of, and to better reflect, the ways in which vertical mergers can result in harm to competition.

This undertaking, long overdue, is particularly timely given the dramatic changes since 1984 that have rocked the marketplace, especially with the emergence and growth of online commerce and communications. The online marketplace is being dominated by a handful of giant platforms. Their formidable market power enables them to exercise inordinate gatekeeping control over the ability of suppliers, sellers, and information content providers to reach consumers, and thus to exercise inordinate control over the choices available to consumers. Age-old competition concerns are being magnified and transformed by an entirely new dimension of high-tech market power, fueled by massive troves of data and awesome technological capabilities to gather, sort, and manipulate it, reaching into all corners of our commercial and personal interactions and preferences. In profound and unprecedented ways, this is

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[1] Consumer Reports is an expert, independent, non-profit organization, founded in 1936, that works side by side with consumers for a fairer, safer, and healthier world, fueled by our trusted research, journalism, advocacy, and insights. We reach nearly 20 million people each month across our print and digital media properties, and we use our labs, auto test center, and survey research center to rate thousands of products and services annually. We have been active for decades on a wide range of policy issues affecting consumers, including promoting competition and supporting sound antitrust enforcement.

[2] The Horizontal Merger Guidelines have been updated from 1984 three times -- in 1992, 1997 and, most recently, in 2010.

[3] There is widespread recognition that the 1984 Guidelines are outmoded. *E.g.*, Federal Trade Comm'n Hearings, Competition and Consumer Protection in the 21st Century, Hearing No. 5, Vertical Mergers Session 1, Tr. beginning at 14:55 (Nov. 1, 2018)(Stephen Salop), https://www.ftc.gov/news-events/audio-video/video/ftc-hearing-5-nov-1-welcome-remarks-vertical-mergers-session-1; *Id.*, Tr. beginning at 1:15:25 (Carl Shapiro); Jonathan Sallet, The Interesting Case of the Vertical Merger, remarks at American 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.

fundamentally jeopardizing any ability of the online marketplace to work effectively for consumers and for those who seek to reach them.

In light of this, we highlight two shortcomings in the draft Guidelines: First, they do not adequately reflect competition concerns as they exist in the new online marketplace. And second, they are not written so as to be sufficiently illuminating to those who need to understand them. We also discuss two specific examples where these shortcomings are particularly evident: the treatment of potential competition, and the treatment of efficiencies.

Updated Guidelines Should Reflect Current Marketplace and Concerns

A principal goal of revising the 1984 Guidelines is, and should be, to update them to make them more reflective of the current marketplace and the dramatic changes that have taken place in recent years. To accomplish that goal, the new Guidelines need to speak to the challenges posed by those dramatic changes. Yet the draft Guidelines are conspicuously silent on those matters. The descriptions, and the illustrative examples – for example, orange orchards and orange juice suppliers – could have been written for a marketplace as it existed decades ago, or even further back, to the marketplace Adam Smith lived in and wrote about 250 years ago. Illustrative examples are needed from the online marketplace, where dominant platforms have made dozens or hundreds of acquisitions in the past two decades – most of which are vertical in nature or have significant vertical aspects, in that they either supply a component for the platform or feed into its distribution system. (Or they are acquisitions that combine products and services that are complements for each other, which create similar kinds of potential for harm to competition, and so should also be addressed in any new Guidelines.)

The way the draft Guidelines describe the danger that a vertical merger could give the newly-merged company access to a competitor's sensitive business information is similarly grounded in a bygone era. While still applicable, the description fails to illuminate the magnitude of the risk posed when a powerful online platform acquires such access. It needs to be explained that a vertical merger could hand over to the platform the ability to access and exploit sensitive business information not only from suppliers and retailers who use the platform, but also from competing or potentially competing online platforms. This would enable the platform to further entrench its dominance, further denying consumers the benefits of choice. And these risks stand to be further magnified by the possibility that the merger could combine marketplace data collected at two separate levels in the supply and marketing chain, including vast troves of consumer data.

New Guidelines would by no means need to be *solely* preoccupied with cutting-edge competition concerns. But they must be comprehensive enough to *include* those concerns, to speak to what businesses and consumers are contending with in the current marketplace.

We recognize that the agencies are still learning, and adapting to, the ramifications of online commerce, communications, and technology. But that is no reason to ignore those new realities. Any new Guidelines should address them to the extent of the agencies' current developing understanding. And the Guidelines should also make clear that those ramifications are still being explored, which can be expected to lead to further illumination and guidance. In other words, that the new Guidelines themselves remain a work in progress, and are not exhaustive or the last word regarding the risks to competition that need to be assessed and addressed.

If the agencies are not confident that they have sufficient understanding yet of these new realities to be comfortable even beginning to describe them, that is a reason to wait to publish new Guidelines until they do. The FTC has recently announced that it is undertaking a retrospective examination of acquisitions by large online platforms that were too small at the time to trigger required pre-merger notification under Hart-Scott-Rodino, but that could nonetheless have preempted the emergence of a competitor.[4] This examination could yield important new insights.

The agencies could nonetheless take the interim step now of formally withdrawing the 1984 Guidelines – with a statement that they are outmoded and that a revision is being pursued – without the need to immediately replace them. That in itself would be an important constructive step forward.

Updated Guidelines Should Be More Illuminating to a Wider Audience

The goal of Enforcement Guidelines is to provide guidance not only internally, to inform the agencies' own economists and attorneys, but also externally, to inform courts, and also businesses, journalists, and the wider public. To accomplish that, they need to be more illuminating – to begin with, written in language that is more accessible to a wider audience. The current draft is excessively reliant on specialized terminology familiar primarily to experienced antitrust economists and practitioners.

The final product needs to be more than a tutorial among antitrust experts talking to each other. The agencies should put forth the extra effort to translate descriptions and explanations into language that, while remaining faithful to sound economic thinking, can be more easily understood. The agencies should try to keep the use of specialized terms to a minimum, and to explain them so that those concerned about these threats to competition can understand how the agencies intend to protect them.

Instead, specialized terms are used under the apparent assumption that everyone reading the draft Guidelines already understands those terms and how they apply. Indeed, the very term "vertical merger" is not explained up front in the text – the definition is buried in the second footnote.

[4] FTC to Examine Past Acquisitions by Large Technology Companies (Feb. 11, 2020), https://www.ftc.gov/news-events/press-releases/2020/02/ftc-examine-past-acquisitions-large-technology-companies.

A prominent example of this tendency is where the draft Guidelines introduce an entirely new specialized term, “related product.” This term refers to a product (or service) created at one level in a supply and marketing chain, and sold to another level for use there – such as a component part, or an ingredient, or a distribution outlet. After an all-too-cursory and abstract description of this new term, the draft Guidelines go on to use it repeatedly, with little further explanation. And the term does not even seem to be used consistently. At times, the “related product” seems to be describing only the particular units of some product that are actually provided by one or the other of the merging companies. At other times, it seems to be describing the entire product market, no matter who is providing the product.

New Guidelines would also be easier to understand if they are self-contained. For example, incorporation by reference of principles from the Horizontal Merger Guidelines should not be used as a shorthand substitute for explaining how the principles apply in the vertical merger context – which may differ in important respects. For one thing, supposed efficiencies in the horizontal context often have to do with economies of scale, while in the vertical context they often have to do with streamlining a supply and marketing chain. To the extent that the reference to the Horizontal Merger Guidelines’ treatment of efficiencies is intended only to mean that efficiencies in the vertical context, as in the horizontal, need to be demonstrable, merger-specific, and shown to benefit the marketplace, that can and should be explained clearly, fully, and in context.

Furthermore, some of the descriptions in the draft Guidelines are too tentative and irresolute to be useful for understanding and predicting enforcement decisions. In particular, in several places there is some variation of a statement that “if the likely effect [of a merger] were to substantially lessen competition, the merger potentially raises significant competitive concerns and may warrant scrutiny.” But it is a cornerstone of antitrust law that if the likely effect of a merger is to substantially lessen competition, that is a *prima facie* violation of section 7 of the Clayton Act, and ordinarily warrants not only scrutiny, but legal challenge.

Example: Updated Guidelines Should Address Potential Competition

Aside from a couple of offhand references to “potential rivals,” there is no discussion of potential competition. This omission is particularly glaring when it comes to assessing the online marketplace.

One major shortcoming in present-day merger enforcement is a focus that is too static, too tied to a snapshot of current conditions and immediate effects. Congress intended for merger enforcement to take a longer view. Specifically, one of Congress’s principal purposes in enacting Section 7 of the Clayton Act more than a century ago, and then strengthening it further almost 70 years ago, was to prevent market concentration from ever reaching levels of concern – by “provid[ing] authority for arresting mergers at a time when the trend to lessening of competition in a line of commerce is still in its incipiency ... to brake this force at its outset and before it gathered momentum."[5] This purpose is embodied in the text of Section 7, which prohibits acquisitions where "the effect of such acquisition *may be* substantially to lessen competition or to tend to create a monopoly."[6]

Unfortunately, in recent decades courts and antitrust enforcers have become too reluctant to apply this "incipiency standard" as vigorously as it was intended. They have effectively read the "may" out of Section 7. The standard has instead devolved to essentially require antitrust enforcers to prove demonstrable, concrete, imminent, quantifiable harm. This has resulted in piecemeal consideration of each merger, including a series of acquisitions by the same corporation, in isolation, disregarding discernable trends until it is often too late. It also fails to account for potential competition that is foreseeable to the acquiring corporation and may be its principal motivation for the merger – that is, to eliminate it.

This shortcoming is even more evident and pronounced in the online marketplace. Indeed, the FTC has essentially recognized this in its recently announced retrospective examination of past acquisitions by the giant online platforms that flew under the radar because they were too small to require pre-merger notification.[7]

In this regard, we are concerned that the draft Guidelines introduce, without explanation, a new presumptive safe harbor, which kicks in when either of the merging firms has less than 20 percent market share in its level of the supply and marketing chain. Accepting that concerns about harm to competition are greater in a concentrated marketplace, nonetheless, setting a 20-percent threshold for *both* levels ignores the critical importance of potential competition. This is particularly clear in the case of an acquisition by a dominant online platform of a small company, which the platform may have identified on the horizon as a potential threat to its dominance, and is seeking to co-opt that threat or nip it in the bud.

Example: Updated Guidelines Should More Clearly Explain Efficiencies

The draft Guidelines' summary treatment of efficiencies is too brief and general to be of much use to someone who is not already experienced in antitrust analysis. But more fundamentally, there needs to be a clearer and fuller explanation not only of what kinds of efficiencies there could potentially be, but of how – and why – taking them into account should justifiably be able to redeem a vertical merger that is otherwise determined to substantially lessen competition.

For example, the ability of two companies to cut costs by merging can no doubt help them increase their own profits. But that will not benefit the marketplace and consumers, if the merger also eases pressure on the merged company to keep the prices it charges in check. So projected cost savings cannot simply be "netted out" against price increases that would otherwise

[5] Brown Shoe Co. v. United States, 370 U.S. 294, 317-18 (1962).
[6] 15 U.S.C. § 18 (emphasis added).
[7] Note 2, *supra*.

be the predicted result. Moreover, even if these projected cost savings and price increases *could* somehow be offset, focusing on short-range price effects fails to encompass the full range of harms that result from loss of competition, and loss of the innovation and other benefits that competition spurs over time. Predicted efficiency benefits are speculative and fleeting; the change in business incentives that flows from the increase in market concentration is real and enduring.

Simply declaring that expected efficiencies will "outweigh" harm to competition should never be enough to justify approving a vertical merger, without further and clearer explanation of what that means. Efficiencies must not merely "outweigh" the harm to competition; they must be shown to *overcome* any such harm – to actually neutralize it. The most relevant efficiencies are those that make a meaningful *qualitative* change, one that truly creates new capabilities and incentives to improve and innovate that would not be possible absent the merger – not just a possibility that the merged company might reduce its prices.

Explaining clearly what efficiencies are, how they work, and why and how they should be taken into account – in language accessible to the wider public – will help ensure that they are given no more weight in a particular merger than is called for.

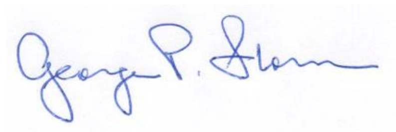
This is illustrated by the one kind of efficiency that the draft Guidelines describe specifically – a vertical merger's "elimination of double marginalization." The description is far too technical and overly concise for a reader not trained in antitrust economics to understand. There needs to be a clearer explanation of what double marginalization is, how it works, and when and how it affects pricing in the marketplace. And there needs to be a clearer and more thoughtful explanation regarding when and why a possible resulting reduction in price is enough to overcome the other harmful effects on competition resulting from the merger. Like all efficiencies, the benefit to the wider marketplace will be determined by how – or if – the merger alters the healthy pressures on the merged company, from competition or potential for it, to give those it deals with, including consumers, a good deal in every respect, not just price.

Conclusion

The task to update the Vertical Merger Guidelines should be done right. It should not be rushed. We urge the agencies to not issue new Guidelines unless and until they speak to present-day marketplace conditions and concerns. Any new Guidelines issued should emphasize that they remain a work in progress, that the descriptions are the best current effort but are not meant to be exhaustive, that new learning is continually being developed through investigations and enforcement actions, and through economic and market research, particularly in the new conditions of the online marketplace.

We also urge the agencies to ensure that updated Guidelines are written in accessible language. They need to be understood not just by antitrust enforcers who will follow them, courts that will refer to them, and antitrust attorneys and economists who will use them to advise clients. They also need to be understood by the wider public who are the intended beneficiaries of a marketplace where competition prevails. Updated Guidelines should promote sound antitrust enforcement that appropriately protects an open marketplace and consumers who shop in it. And they should give an increasingly aware and concerned public the assurance they deserve that their government is committed to that objective.

Respectfully,



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