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A Comparison of the US Draft Vertical Merger Guidelines with the EU Non-Horizontal and the UK Merger Assessment Guidelines

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I.Introduction

On January 10, 2020, the U.S. Department of Justice and the Federal Trade Commission (US agencies) published their long-awaited Draft Vertical Merger Guidelines (US-DVMG).[i]

In this article, we briefly compare and contrast the content of the US-DVMG to the analogous EU non-horizontal merger guidelines (EU-NHMG)[ii] and UK Merger Assessment Guidelines (UK-MAG).[iii] Understanding the relationship between guidelines in major jurisdictions is important for both day-to-day advisory and expert work.

We begin our discussion by noting that the US-DVMG document is undeniably short, at just nine pages. Such brevity inevitably affects the extent of the guidance provided. For example:

- In contrast to the US-DVMG, the EU-NHMG covers both conglomerate and vertical mergers, while the UK-MAG is a single document across all types of horizontal and non-horizontal mergers. The more limited coverage means that connections between the US agencies' approach to analyzing vertical, horizontal, and conglomerate mergers are not developed within the US-DVMG. The agencies and merging parties may not agree whether a particular transaction is appropriately characterized as a vertical or horizontal (or diagonal) merger. For example, European Commission economists explicitly described that they faced such challenges in Google/DoubleClick soon after the EU-NHMG was released.[iv]
- The EU-NHMG and UK-MAG provide a richer description of the factors they will consider in particular circumstances than does the US-DVMG. For instance, the EU-NHMG and UK-MAG discuss which factors suggest an ability and which suggest an incentive to suppress competition, how capacity constraints at one level affect the analysis, which types of contracts suggest a pre-existing ability to influence competition in the other market, and so forth.

There is much in common between the US-DVMG, EU-NHMG, and UK-MAG. However, there remain notable substantive differences in approach. We consider a number of such differences in the rest of

this article and note that they mean that coordinating the advice and analysis of transactions across jurisdictions will likely remain a necessary challenge for some time to come.

II.The Related Product

The US-DVMG introduces the concept of a "related product," describing it as one that (a) is supplied by the merged firm; (b) is vertically related to the products and services in the relevant market; and (c) to which access by the merged firm's rivals affects competition in the relevant market. The US-DVMG goes on to describe that "[a] related product could be, for example, an input, a means of distribution, or access to a set of customers."[v] Note that the last of these—"access to a set of customers"—is an unusual-sounding product. We presume this could be something like a media service offering content providers carriage and, therefore, access to the customers already subscribed to the service. However, we note that this example makes it particularly clear that inferring the chain of product flow and the limitations of strictly vertical transactions can become a linguistic challenge.

The US agencies' motivation for introducing the concept of a "related product" may be twofold. The first is to avoid having to define both upstream and downstream markets. The US-DVMG does not expressly describe whether the US agencies will always define both upstream and downstream markets, or that they will not. [vi] However, there may be an implication that the US agencies will not define a market for the related product. In contrast, in practice the EU and UK authorities do define both upstream and downstream markets where it is necessary for the analysis.[vii]

The second is to avoid economists' terms of art such as "input foreclosure" and "customer foreclosure," which provide much of the structure in the EU guidelines.[viii] Less economic terminology will be helpful for non-specialist judges. However, the US-DVMG is effectively adopting a framework with an additional level of abstraction—one that must simultaneously describe the framework for analysis for both theories of harm (and indeed any others that the US agencies may have in mind). Instead, the US-DVMG provides a number of examples that aim to bring out that both input- and customer-foreclosure can be considered through the lens of the "related product." The net result is a reduction in the length of the US-DVMG, but also its clarity compared to that provided by the EU-NHMG and UK-MAG.

III.The Safe Harbor Threshold

The US-DVMG proposes a two-pronged test to determine whether a merger will benefit from a safe harbor. Namely, the US agencies are unlikely to challenge a vertical merger where (a) the parties to the merger "have a share in the relevant market of less than 20 percent" and (b) "the related product is used in less than 20 percent of the relevant market."[ix]

The EU-NHMG describes instead that "[t]he Commission is unlikely to find concern in non-horizontal mergers, be it of a coordinated or of a non-coordinated nature, where the market share post-merger of the new entity in each of the markets concerned is below 30% and the post-merger HHI is below 2000."[x]

As a result, the US and EU guidelines[xi] will allow different sets of mergers to benefit from the safe harbor. Significantly, the draft US guidelines may allow a narrower set of mergers to benefit from the safe harbor than under the EU and UK regimes, in terms of market shares. There is then a contrast between the US-DVMG, which requires use of the related product in less than 20% of the relevant market, and the EU and UK regimes, which only extend the safe harbor to mergers in, at most,

moderately concentrated markets. A post-merger HHI of 2000 would imply, after all, a post-merger market less concentrated than the position with five equal-sized firms each with 20% market shares.

The harbor may be safe but, to continue the nautical analogy, the boats in the harbor are still subject to some risk of particularly stormy conditions. Specifically, both the US-DVMG and EU-NHMG provide caveats allowing mergers that satisfy the safe harbor threshold to nonetheless give rise to competitive concerns in, to quote the EU-NHMG, "special circumstances."[xii] The EU-NHMG provides a wider set of examples of special circumstances. However, it is unclear whether the authors of the US-DVMG and the UK-MAG have considered the relevance of all those examples and have decided that they are either unnecessary or, alternatively, that they disagree with them.

IV.Foreclosure and Raising Rivals' Costs

The US-DVMG describes that the US agencies may consider whether:

(1) The merged firm's foreclosure of, or raising costs of, one or more rivals would cause those rivals to lose sales (for example, if they are forced out of the market, if they are deterred from innovating, entering or expanding, or cannot finance these activities, or if they have incentives to pass on higher costs through higher prices), or to otherwise compete less aggressively for customers' business;
(2) The merged firm's business in the relevant market would benefit (for example if some portion of those lost sales would be diverted to the merged firm);
(3) Capturing this benefit through merger may make foreclosure, or raising rivals' costs, profitable even though it would not have been profitable prior to the merger; and,
(4) The magnitude of likely foreclosure or raising rivals' costs is not de minimis such that it would substantially lessen competition.[xiii]

This basic structure appears largely to mirror the approach taken in the EU-NHMG, while using less economic terminology. In the EU-NHMG, condition 1 corresponds to "Ability to foreclose," conditions 2 and 3 relate to "Incentive to foreclose," and condition 4 corresponds to "Overall likely impact on effective competition." Specifically, these quotations are headings in the EU-NHMG within both the sub-sections on input foreclosure (IV.A.1) and customer foreclosure (IV.A.2). This approach also closely mirrors that laid out in paragraph 5.6.6 of the UK-MAG.

The most significant difference may be the use of the *de minimis* test for effects in the US-DVMG, which implicitly appears to categorize the magnitude of any effect that is not *de minimis* as substantial.

The section in the US-DVMG on Foreclosure and Raising Rivals' Costs lays out a number of helpful examples. Here we describe those examples, adopting the economic terminology from the EU-NHMG:

- Example 3 describes the "vertical arithmetic" for a total input foreclosure theory of harm; that is, the merged firm may entirely stop supplying an input to competitors downstream.
- Example 4 describes a partial input foreclosure wherein the merged firm continues to offer to supply downstream competitors from its upstream division, but increases the price it charges to independent downstream competitors post-merger.
- Example 5 describes total input foreclosure of a potential new entrant into a relevant downstream market.
- Example 6 describes a form of partial customer foreclosure wherein the distributor division of the merged firm finds it profitable to raise the price of wholesale distribution after the merger

even if the price rise were not profitable pre-merger.

These examples are clearly helpful additions to the US-DVMG, but they also rely on implicit assumptions. In practice, the economic analysis of vertical mergers can involve developing an understanding of:

- *The nature of vertical contracts that could be used in each of the factual and the counterfactual scenarios*. For example, the EU-NHMG states that the efficiencies associated with the elimination of double marginalization (EDM) "may … not always be merger specific because vertical cooperation or vertical agreements may, short of a merger, achieve similar benefits with less anti-competitive effects." The US-DVMG makes a similar point in relation to EDM. [xiv]
- *Whether the incentive to engage in a foreclosure strategy is greater than the incentive to engage in other, procompetitive, strategies available to the merging parties*. The US-DVMG and EU-NHMG focus on whether foreclosure is a feasible and profitable strategy, without placing particular emphasis on whether foreclosure would be the most profitable strategy available to the merging parties. Similarly, the UK-MAG formulates the "incentive" question explicitly as whether the merged firm would "find it profitable" to foreclose.[xv]
- *The potential counterstrategies available*. For example, citing Boeing/Hughes the EU-NHMG describes that in the context of customer foreclosure considerations it will consider "whether there are effective and timely counter-strategies, sustainable over time, that the rival firms would be likely to deploy." There is no explicit discussion of counterstrategies to foreclosure in the US-DVMG. [xvi]

V.Coordinated Effects

The US-DVMG deals with coordinated effects analysis specific to vertical cases in less than a page, while referring the reader to the discussion in Section 7 of the US Horizontal Merger Guidelines.

Overall, the US-DVMG shares a great deal with the approach outlined in the EU-NHMG and UK-MAG, although the text in relation to coordinated effects in both is markedly more expansive than that in the US-DVMG.

The US-DVMG highlights that coordinated effects can arise:

- In a situation when a vertical merger "by eliminating or hobbling a maverick firm"[xvii] would, in the counterfactual, play an important role in preventing or limiting anticompetitive coordination in the relevant market.
- When the merger or merged firm's access to confidential information facilitates "(a) reaching a tacit agreement among market participants, (b) detecting cheating on such an agreement, or (c) punishing cheating firms."[xviii]

All three guidance documents adopt a similar overall framework. However, the EU and UK guidelines place a greater, or at least an explicit, emphasis on the ability and incentives for cooperation. Moreover, the US-DVMG does not attempt to draw lessons from the economic literature about the role of specific industry characteristics (e.g., post-merger industry symmetry) that may be associated with an increased risk of coordination resulting from the merger.

VI.Efficiencies – Except Elimination of Double Marginalization (EDM)

The efficiencies section of the US-DVMG describes that vertical mergers combine complementary economic functions and eliminate contracting frictions and so may create efficiencies. However, overall, the US-DVMG is remarkably quiet on efficiencies, containing no statement akin to those in the EU-NHMG and UK-MAG that non-horizontal mergers are generally less likely to lead to competitive effects than would horizontal mergers. [xix]

The potential for a vertical merger to EDM appears to benefit from a special status, having its own section (US-DVMG Section 6). The US agencies propose to consider EDM as part of the analysis of whether there is a problem rather than as a part of their efficiencies analysis, and identify a number of potential limitations to the application of the EDM argument.[xx] In contrast, the EU-NHMG considers EDM as a potential efficiency,[xxi] following the principles set out in the Commission's horizontal guidelines.[xxii] Namely, for efficiency claims to be taken into account when assessing a merger, the efficiencies have to benefit consumers, be merger-specific, and be verifiable.

VII.Conclusion

The publication of the US-DVMG, replacing outdated fragments of guidelines with a description of current practice, however abbreviated, has potential to be a significant milestone on the sometimes elusive path toward international convergence, almost a decade after the publication of the EU-NHMG.

The US-DVMG will be a useful document for practitioners, even if this first draft is rather abstract. While the level of abstraction may give the US agencies more room for maneuver in future cases, it does take away from the extent that the document provides guidance to practitioners. The EU and UK guidelines describe the factors they will consider in much richer detail (e.g., margins, capacity constraints, types of contracts, the possibility of sponsoring entry, and so forth). In this sense, they provide more guidance than the US-DVMG and may remain go-to documents.

We close by noting that, as the guidance documents and the case law they inspire continue to evolve, advisors and analysts will need to remain vigilant to the differences across jurisdictions. The apparent similarity of the guidelines can sometimes mask significant gaps in their practical applications.

The views expressed herein are solely those of the authors, who are responsible for the content, and do not necessarily represent the views of Cornerstone Research. This article was first published by Law360.

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i] *U.S. Department of Justice and Federal Trade Commission Draft Vertical Merger Guidelines*, Released for Public Comment on January 10, 2020, https://www.justice.gov/opa/press-release/file/1233741/download.

[ii] *Guidelines on the Assessment of Non-Horizontal Mergers under the Council Regulation on the Control of Concentrations between Undertakings*, Official Journal of the European Union, 2008/C 265/07, https://eur-lex.europa.eu/legal-

content/EN/TXT/PDF/?uri=CELEX:52008XC1018(03)&qid=1579197948739&from=EN.

[iii] *Merger Assessment Guidelines*, UK Competition Commission and Office of Fair Trading, September 2010, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/284449/OF[T1254.pdf. The UK-MAG was

subsequently adopted by the board of the UK's Competition and Markets Authority (CMA) when these former UK competition agencies merged in 2014.

[iv] Penelope Papandropoulos, European Commission, DG Competition, Chief Economist Team, "Non-horizontal Mergers: Recent EC Cases," Presentation at IMEDIPA, 3rd International Conference on Competition Law and Policy, Athens, May 29, 2009, p. 21,

https://ec.europa.eu/dgs/competition/economist/non_horizontal_mergers.pdf.

[v] US-DVMG at 2.

[vi] US-DVMG at 2

[vii] The only occurrence of the words "market definition" in the EU-NHMG is in EU-NHMG, n. 2, ¶ 24. Market definition is instead considered in the "Commission Notice on the definition of relevant market for the purposes of Community competition law" (97/C 372/03), https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:31997Y1209(01)&from=EN. (EU-MDEF).

[viii] EU-NHMG ¶¶ 31-77.

[ix] US-DVMG at 3.

[x] EU-NHMG ¶ 25.

[xi] The UK follows the approach in the EU guidelines on this point.

[xii] EU-NHMG ¶ 26.

[xiii] US-DVMG at 5.

[xiv] US-DVMG at 4; EU-NHMG ¶ 36; EU-NHMG, n. 2, ¶ 38; EU-NHMG, n. 7, ¶ 55; US-DVMG at 7.

[xv] UK-MAG ¶ 5.6.6.

[xvi] CaseCOMP/M.1879 — Boeing/Hughes (2000); EU-NHMG ¶ 67.

[xvii] US-DVMG at 8.

[xviii] US-DVMG at 8.

[xix] US-DVMG at 9; EU-NHMG ¶ 11; UK-MAG ¶ 5.6.1

[xx] US-DVMG at 7.

[xxi] The European Commission has sometimes blurred this distinction by considering EDM as an efficiency within its analysis of competitive effects. *See, e.g.*, Case COMP/M.4854 — TOMTOM/TELE ATLAS (2008). Under the heading "Effects in the downstream market," the decision includes a subsection with the heading "Efficiencies" (at 52) and goes on to describe the balancing test undertaken: "In order to estimate the overall effect of the proposed transaction taking into account the elimination of double marginalization, the Commission estimated pre- and post-merger equilibrium prices using a simple model with linear demand. The model indicates that the overall impact of the vertical integration of TomTom and Tele Atlas, taking into account the elimination of the double marginalization by the integrated company, is a small decline in the average PND prices." (¶ 243)

[xxii] *See* EU-NHMG ¶ 53 citing *Guidelines on the Assessment of Horizontal Mergers under the Council Regulation on the Control of Concentrations between Undertaking*, Official Journal of the European Union, C 31, 5.2.2004 s.

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