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Illuminating Vertical Merger Challenges: FTC Challenges Illumina's Reacquisition of a Nascent Company it Founded

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After a bit of hiatus on aggressively challenging vertical mergers, regulators both here in the United States and abroad have resumed initiated actions to challenge vertical mergers. Traditionally a difficult lift for the FTC, vertical vergers involve companies above and below each other in the supply chain. Instead of directly competing, an upstream company acquires the company it supplies with critical inputs. Recent announcements of high-profile vertical mergers signal increased FTC and European regulatory scrutiny in the area.

Originally founded by Illumina in 2015, Grail has been a stand-alone entity since 2016 when Illumina reduced its ownership share to 14.5%. Illumina now seeks to re-acquire Grail to expand access to the cancer detection tests. The acquisition constitutes a vertical merger at two points in the supply chain. Illumina supplies DNA sequencing platforms for Grail and others companies developing multi-cancer early detection tests. Grail and its potential competitors rely on Illumina's sequencing platform for their products. To conduct a multi-cancer early detection test, a patient's blood sample is sent to Grail, where the DNA is extracted and sequenced—using Illumina's platform. The resulting readout is used to determine whether the patient has any of the markers for various cancers.

Such mergers pique the FTC's interest because, in its view, Illumina could monitor and disrupt potential competitors, potentially chilling innovative research and development. Further, the FTC's initial complaint alleges that should the deal be consummated, Illumina could raise prices to Grail's competitors.

The FTC has identified only three providers of viable sequencing platforms. According to the FTC's complaint, Illumina is the primary US based provider, as the other companies are based outside the US, including one in China. The FTC also alleged that potential market entrants face several difficulties. The start-up costs for DNA sequencing platforms can run in to the hundreds of millions of dollars. New companies additionally face patent obstacles as Illumina owns several critical patents in the DNA sequencing research arena. Illumina's potential competitors would either need to develop alternatives or obtaining use licenses from Illumina. And even should a viable competitor to Illumina

emerge, downstream users, such as Grail's competitors, would face significant switching costs. According to the complaint, migrating to a different supplier of DNA sequencing would be costly and could require overhauling the product to ensure compatibility.

Grail's competitors would face limited options for obtaining the necessary inputs for cancer detection tests. If Illumina were to engage in business with them on an equal basis with Grail, the downstream rivals must reveal critical business information to its rival's owners. According to the FTC's Vertical Merger Guidelines, it will consider how an upstream company like, Illumina, could use marketing, sales, or margins data it acquires in the course of dealing with downstream rivals to disadvantage competitors.

The parties' proposed remedies to ameliorate the FTC's concerns include amending Illumina's standard contracts to guarantee sequencing access and a commitment to lower prices by 40% over four years. Such standard contracts would include a 12 year term, guaranteed pricing for the contract term, and a promise not to discontinue sales to cancer test developers.

For now, however, the FTC has declined to resolve the case and is moving forward with its administrative complaint within the confines of the normal administrative review process. Trial is set to begin in late August 2021.

In addition to scrutiny from US enforcers, the European Commission's new acquisitions review policy has expanded the Commission's review over firms which otherwise don't have high enough sales to trigger the traditional review process. This transaction would mark the first test of these new rules, assuming the Commission can first overcome Illumina's jurisdictional challenge.

As the Illumina case moves forward both overseas and here in the US, companies considering vertical mergers should examine the various considerations at play in this case when assessing potential risks.

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