MERGER ANTITRUST LAW

LAW 1469 — Tuesdays and Thursdays, 3:30 pm – 5:30 pm
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Class 20 (November 4): Introduction to Vertical Mergers (Unit 11)

We will spend the next three classes on vertical mergers. Vertical mergers occur within the chain of manufacture and distribution, such as the merger between an input manufacturer and a final goods producer or between a wholesaler and a retailer. More generally, however, the theories of anticompetitive harm that apply to vertical mergers equally apply to any merger between companies producing complementary products.

Theories of anticompetitive harm for vertical mergers can be categorized into two general types: exclusionary effects and coordinated effects.

Exclusionary effects. The canonical vertical exclusionary effect is *foreclosure*. For example, a lithium battery manufacturer acquires a lithium mine that premerger supplied several battery manufacturers. After the acquisition, the combined company refuses to sell lithium to competitor battery manufacturers. The idea is that by foreclosing on its downstream competitors by refusing to sell them a critical input, the combined company will disadvantage its competitors—in the extreme, drive them out of business—and reap anticompetitive gains as the customers of the foreclosed competitors shift to the combined firm.

As this example reveals, whether this foreclosure is anticompetitive depends on several factors:

1. Is the foreclosed product "essential" to competitors of the merged firm?
2. Can the foreclosed competitors purchase the input in adequate quantities and at premerger prices from third-party suppliers?
3. Does the combined firm have the profit-maximizing incentive to foreclose its competitors?

If the product is not "essential" to the manufacturing process, manufacturers can substitute other inputs, and there will be no harm to competition. Likewise, if competitor manufacturers can obtain inputs from third-party suppliers without suffering a competitive disadvantage, there will be no harm to competition. Finally, even if the combined firm can foreclose its competitors, it may not have the incentive to do so: foreclosing competitors means lost profits from the sales that otherwise would have been made, and it may be that the anticompetitive gains from foreclosure from higher prices (due to less competition) do not outweigh the losses from the foreclosed sales that the company otherwise would have made.

Short of complete foreclosure, the combined firm could increase the prices of the input it sells to its downstream competitors. This theory, developed primarily by Professor Steven Salop and known as *raising rivals' costs* (RRC), has become the primary theory of vertical anticompetitive harm. Raising rivals' costs is not as extreme as complete foreclosure, but it may still be in the combined firm's profit-maximizing interest to increase its prices to rivals, even if it is not in the firm's interest to completely foreclose its competitors. An acquisition that provides the combined firm the incentive and ability to raise its rivals' costs, with the likely effect of increasing market prices or otherwise harming competition, violates Section 7.

In both complete foreclosure and raising costs to rivals, the combined firm's conduct will be governed by whether its incremental profit gains from the higher prices outweigh its incremental profit losses from the lost foreclosed sales.

While the example above deals with *input foreclosure*, the same theories of anticompetitive harm apply to *output foreclosure*. For example, suppose that a particular distribution channel is critical for manufacturers to reach a specific group of customers. An incumbent manufacturer acquires the distribution channel and either forecloses its manufacturer rivals from the channel or increases their costs to access it. If, as a result, the competitor-manufacturers are disadvantaged in their ability to compete against the combined firm, with the likely result that consumer prices will increase, the acquisition violates Section 7.

Coordinated effects. Coordinated effects are the second type of anticompetitive harm that may result from a vertical merger. Four common varieties of coordinated effects can arise from a vertical merger:

1. *Elimination of a disruptive buyer*: The acquisition by an incumbent supplier of a disruptive buyer that premerger was destabilizing efforts by suppliers to increase prices could increase the postmerger likelihood or effectiveness of coordinated interaction.
2. *Elimination/disciplining of new disruptive competition*. When the merged firm can price discriminate in the prices it charges its rivals, it can target new entrants that threaten to disrupt seller coordination by refusing to deal with those entrants or by materially raising the prices it charges them.
3. *Facilitation of tacit coordination through greater firm homogeneity*. As related markets become more structured as vertical silos through vertical integration, firms become more alike (homogeneous), which better aligns their profit-maximizing incentives and so facilitates horizontal tacit coordination.
4. *Anticompetitive information conduits*. In a market otherwise conducive to oligopolistic coordination, *except* that information on which to coordinate is not readily available, a vertical merger can provide a mechanism for obtaining this information. In the canonical case where supplier prices are not transparent, a supplier's vertical acquisition of a distributor that purchases from all suppliers allows the merged firm to see its competitors' prices.

Coordinated effects theories are usually employed, if at all, to support a challenge to vertical mergers for foreclosure or raising rivals' costs. The exception is a vertical merger that acts as an anticompetitive information conduit, which the agencies have challenged without also alleging foreclosure or raising rivals' costs.[1]

Efficiencies. At least since the early 1980s and continuing until recently, the enforcement agencies regarded most vertical mergers as efficiency-enhancing and unlikely to raise competitive concerns. Firms at different levels of production and distribution often need to

[1] *See, e.g.*, Merck & Co., 127 F.T.C. 156 (1999) (consent order settling complaint that Merck's acquisition of Medco, a pharmacy benefit manager that purchases drugs from all of Merck's competitors, would be an anticompetitive information conduit).

coordinate to design, manufacture, and distribute their products. Vertical mergers may increase the efficiency of this process by improving communication, sharing more information, and harmonizing the incentives of the merging firms.

Moreover, vertical integration can reduce costs by eliminating so-called *double marginalization*. Double marginalization is the distortion caused by the successive markups of independent firms in a distribution channel. In theory, vertical integration eliminates the incentive to mark up the product of the upstream firm to the downstream firm (since it is a wash on the combined profits of the merged firm), which can reduce consumer prices, increase output, *and* increase aggregate profits. The idea that the elimination of double marginalization increases the vertically integrated firm's profit led to a presumption in antitrust circles that vertically integrated firms always eliminate double marginalization, so there was no need to present affirmative proof of the elimination. However, there is good reason to believe that, due to the nature of compensation systems within large firms, vertical integration may not entirely eliminate—or eliminate at all—double markups. From an enforcement perspective, the Trump and Biden antitrust enforcement agencies have been skeptical that vertical mergers eliminate double marginalization. If the merging parties claim the elimination of double marginalization as an efficiency in an agency investigation, they will have to prove it in the circumstances of their merger. Moreover, although not yet tested in court, under the *Baker Hughes* burden-shifting paradigm, the merging parties in their rebuttal case should bear the burden of production on eliminating double marginalization in Step 2, not the plaintiff's prima facie case in Step 1.[2]

Enforcement and relief. Since the 1980s, the enforcement agencies have challenged very few vertical mergers. The Supreme Court last heard a vertical merger case in 1972.[3] Until recently, the last adjudicated vertical case ended in 1979, when the Second Circuit denied enforcement to an FTC challenge.[4]

In the interim, the agencies have challenged several vertical mergers. Since the principal harm of vertical merger is foreclosure/RRC, and the agencies were willing to accept behavioral consent decrees requiring the merged firm to deal with rivals postmerger on fair, reasonable, and nondiscriminatory terms, all of these challenges were resolved by consent decree.[5]

Things changed dramatically in the Trump administration when then-Assistant Attorney General Makan Delrahim took the position that the Division would no longer accept behavioral consent

[2] The class notes review double marginaliztion on slides 19-25. If you understand the general idea explained in the text and look at the Marginal Revolution University's YouTube video, there is no need for you to go further than slide 19. If you want more, however, look at the graph and numerical example on slides 20-25 and the math in the appendix (slides 56-62).

[3] Ford Motor Co. v. United States, 405 U.S. 562 (1972) (*Ford/Autolite*).

[4] Fruehauf Corp. v. FTC, 603 F.2d 345 (2d Cir. 1979), *denying enforcement*, Fruehauf Corp., 91 F.T.C. 132 (1978).

[5] *See, e.g.*, United States v. Comcast Corp., 808 F. Supp. 2d 145 (D.D.C. 2011) (*Comcast/NBC Univeral*); United States v. Google Inc., No. 1:11-cv-00688 (D.D.C. Oct. 5, 2011) (*Google/ITA*); United States v. United Techs. Corp., 946 F. Supp. 2d 135 (D.D.C. 2013) (*UTC/Goodrich*); United States v. Monsanto Co., No. 1:07-cv-00992, 2008 WL 5636384 (D.D.C. Nov. 6, 2008) (*Monsanto/Delta & Pine Land*); United States v. Charter Commc's, Inc., No. 1:16-cv-00759-RCL (D.D.C. Sept. 9, 2016); General Elec. Co., F.T.C. 255 (2013) (*GE/Avio*); *In re* Pepsico, Inc., 150 F.T.C. 231 (2010) (*Pepsi/PBG*); Coca-Cola Co., 150 F.T.C. 520 (2010) (*Coca-Cola/CCE*); Press Release, U.S. Dep't of Justice, Comcast Corporation Abandons Proposed Acquisition of Time Warner Cable after Justice Department and the Federal Communications Commission Informed Parties of Concerns (Apr. 24, 2015) (*Comcast/Time Warner Cable*); Press Release, U.S. Dep't of Justice, Lam Research Corp. and KLA-Tencor Corp. Abandon Merger Plans (Oct. 5, 2016) (*Lam/KLA*).

relief. At the time, AT&T was seeking to acquire Time Warner in a deal that closely matched the earlier Comcast/NBC Universal combination, which everyone (including the merging parties) believed would be resolved through an analogous behavioral consent decree. When the Division refused to accept the proffered consent decree, the parties put the Division to its proof in court. The Division lost in a rather spectacular fashion.

Since AT&T/Time Warner**,** the enforcement agencies have filed complaints against several vertical mergers with mixed results:

- Litigated wins
  - *Illumina/GRAIL* (FTC 2023)[6]
- Litigated losses
  - *Sabre/Farelogix* (DOJ 2020)[7]
  - *UnitedHealth/Change* (DOJ 2022)[8]
  - *Microsoft/Activision* (FTC 2023)[9]
  - *Tempur Sealy/Mattress Firm* (FTC 2024)[10]
- Abandonments after complaints
  - *NVIDIA/Arm* (FTC 2021)[11]
  - *Lockheed/Aerojet* (FTC 2022)[12]
- Settlements
  - ICE/Black Knight (FTC 2023)[13]

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[6] *See* Initial Decision, Illumina, Inc., No. 9401 (F.T.C. Sept. 9, 2022) (ALJ finding for respondents), *rev'd*, Final Decision, Illumina, Inc., No. 9401 (F.T.C. Mar. 31), *vacated and remanded*, Illumina, Inc. v. FTC, 88 F.4th 1036 (5th Cir. Dec. 15, 2023) (affirming finding of liability; reversing and remanding on remedy). Copies of the major filings in the case may be found here.

[7] United States v. Sabre Corp., 452 F. Supp. 3d 97 (D. Del. 2020), *vacated*, No. 20-1767, 2020 WL 4915824 (3d Cir. July 20, 2020). The DOJ appealed. Although the DOJ failed to obtain an injunction, the United Kingdom's Competition and Markets Authority (CMA) did block the deal. When Sabre and Farelogix terminated their merger agreement in light of the U.K. decision, the DOJ moved in the court of appeals to vacate the lower court's decision. The Third Circuit granted the motion "because Sabre Corporation mooted the parties' dispute by terminating its acquisition of Farelogix." 2020 WL 4915824 (citing U.S. Bancorp Mortg. Co. v. Bonner Mall P'ship, 513 U.S. 18, 25 (1994) (explaining that vacatur is merited "when mootness results from unilateral action of the party who prevailed below")). Copies of the major filings in the case may be found here.

[8] United States v. UnitedHealthcare Group Inc., 630 F.Supp.3d 118 (D.D.C. Sept. 21, 2022). Copies of the major filings in the case may be found here.

[9] FTC v. Microsoft Corp., 681 F. Supp. 3d 1069 (N.D. Cal. July 10, 2023). Copies of the major filings in the case may be found here.

[10] FTC v. Tempur Sealy Int'l, Inc., 768 F. Supp. 3d 787 (S.D. Tex. 2025). Copies of the major filings in the case may be found here.

[11] See Complaint, Nvidia Corp., No. 9404 (F.T.C. issued Dec. 2, 2021); Press Release, Fed. Trade Comm'n, Statement Regarding Termination of Nvidia Corp.'s Attempted Acquisition of Arm Ltd. (Feb. 14, 2022). Copies of the major filings in the case may be found here.

[12] *See* Complaint, Lockheed Martin Corp., No. 9405 (F.T.C. issued Jan. 25, 2022); Press Release, Lockheed Martin Corp., *Lockheed Martin Terminates Agreement to Acquire Aerojet Rocketdyne* (Feb. 13, 2022). Copies of the major filings in the case may be found here.

[13] *See* Complaint, Intercontinental Exchange, Inc., No. 9413 (F.T.C. issued Mar. 9, 2023), *settled*, Decision and Order, Intercontinental Exchange, Inc., No. 9413 (F.T.C. Nov. 3, 2023). The case involved considerable federal court and administrative litigation before settling. Copies of the major filings in the case may be found here.

We will examine *UnitedHealth/Change*, *Microsoft/Activision*, and *Tempur Sealy/Mattress Firm* in Classes 23, 24, and 25, respectively. We will also touch upon *Illumina/GRAIL* in Class 25 on the issue of remedies.

The reading. Please read the class notes (slides 1-25) for background. Then, carefully review Guidelines 5 and 6 of the 2023 Merger Guidelines (pp. 58-69).

With this background, read the class notes on *Ford/Autolite* (slides 26-31). This Supreme Court decision provides the classical structuralist treatment of vertical mergers. Ford's acquisition of Autolite eliminated Ford as a potential competitor in the aftermarket for spark plugs and was found to foreclose a meaningful portion of the market by converting an independent supplier into a captive source. The Court viewed the merger through Section 7's incipiency lens, emphasizing the loss of potential competition and the danger of foreclosure without requiring detailed proof of postmerger conduct or pricing effects. The district court ordered a sweeping divestiture and imposed a ten-year ban on Ford manufacturing spark plugs, illustrating how aggressively courts of that era used structural and conduct remedies to preserve market access for rivals.

GE/Avio (pp. 71-84), a 2013 FTC case, illustrates the modern, behavioral remedy phase of vertical enforcement, preceding *AT&T/Time Warner*. General Electric, a leading jet-engine manufacturer, sought to acquire Avio's aviation business, a supplier of components used in competing engines. The FTC alleged that the merger could allow GE to foreclose or disadvantage rival engine makers by restricting component supply or misusing Avio's technical data. The Commission accepted a consent order rather than blocking the deal, requiring information firewalls, nondiscrimination clauses, and supply assurance provisions to protect competitors, such as Rolls-Royce. GE/Avio thus marks the late-Obama era preference for detailed conduct remedies where structural relief was deemed impractical.

Comcast/NBCUniversal (slides 32-37)**,** a 2011 DOJ case, deserves careful attention as the precursor to *AT&T/Time Warner*. Cleared with coordinated DOJ and FCC consent decrees, the case became the template for behavioral relief in complex vertical integrations. Comcast, the nation's largest cable and broadband provider, proposed to acquire NBCUniversal, a major programmer and content producer with broadcast networks, cable channels, and a stake in Hulu. The DOJ and FCC identified risks that Comcast could foreclose or disadvantage rival multichannel video distributors and online video providers by restricting access to NBCU programming or raising content prices. Rather than seeking structural relief, the agencies approved the transaction subject to an elaborate consent decree imposing nondiscriminatory licensing, arbitration rights for online distributors, and Hulu-governance safeguards. The case exemplified the agencies' pre-2017 reliance on behavioral remedies to address vertical harms, a strategy the Division would soon abandon in *AT&T/Time Warner*.

This brings us to *AT&T/Time Warner*. The transaction closely paralleled *Comcast/NBCUniversal* in structure: both combined a dominant cable or broadband distributor with a major programmer and content producer. AT&T, the nation's largest multichannel video distributor through DirecTV and a leading wireless carrier, proposed to acquire Time Warner, owner of Turner Broadcasting, HBO, and Warner Bros. Like *Comcast/NBCU*, the merger joined a large distribution platform with "must-have" programming, creating potential leverage over rival distributors and online video services. The Division, however, departed from its earlier policy of accepting behavioral conditions and instead chose to litigate. Its complaint alleged that AT&T would have both the ability and incentive to raise content prices to competing MVPDs, thereby disadvantaging emerging online distributors and potentially coordinating with other vertically integrated firms. The case thus marks the first full judicial test of vertical merger theories under modern economic analysis and stands as the turning point from negotiated behavioral remedies to contested litigation.

For this class, we will introduce the case only through the pleadings and surrounding commentary. Please read the AT&T press release announcing the transaction (pp. 86-92). You may skim or skip the remaining deal-announcement materials (pp. 93-112). Read Senator Franken's letter to Attorney General Jeff Sessions expressing concern about the merger (pp. 113-20) as an example of congressional engagement in high-visibility transactions. Also read the Department of Justice press release announcing its suit (pp. 121-22), but you may skim or skip the complaint itself (pp. 123-45). AT&T's public-relations response to the complaint (pp. 146-50) helps understand how the merging parties frame their public defense.

We will read the *AT&T/Time Warner* opinion (pp. 151-323) for Classes 21 and 22. Feel free to read ahead.

Please email me if you have any questions. See you in class![14]

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[14] If time permits, skim the 2020 and 2021 materials (pp. 5-56) for additional context. These materials trace an interesting regulatory history: The 2020 Vertical Merger Guidelines were issued jointly by the DOJ and FTC near the end of the Trump administration. After Lina Khan became FTC chair during the Biden administration, giving Democrat-appointed commissioners a voting majority, the FTC withdrew from the guidelines. The FTC's withdrawal created an unusual situation in which the 2020 VMG technically remained in effect at the DOJ, while the FTC operated without formal guidelines. This state of affairs continued until December 18, 2023, when the DOJ and FTC issued new joint Merger Guidelines addressing vertical mergers.