February 14, 2020

Department of Justice
Antitrust Division
950 Pennsylvania Avenue, NW
Washington DC 20530

Federal Trade Commission
Office of the Secretary
400 7th Street, SW, Suite 5610 (Annex A)
Washington, DC 20580

RE: Request for Comments on Draft Vertical Merger Guidelines (Matter Number P810034)

To Whom It May Concern:

The Information Technology and Innovation Foundation (ITIF) is pleased to submit these comments in response to the Department of Justice (DOJ) and the Federal Trade Commission (FTC) request for comment on the proposed changes to their Vertical Merger Guidelines.[1] ITIF is a nonprofit, nonpartisan public policy think tank committed to articulating and advancing a pro-productivity, pro-innovation, and pro-technology public policy agenda that spurs growth, prosperity, and progress. ITIF supports the decision by DOJ and FTC to update their guidelines but believes they could be strengthened by a deeper discussion of several key points about the role vertical mergers play in competitive markets.

THE NEW GUIDELINES ARE WELCOME

A lot has changed since 1984. Many sectors have been exposed to more competition as export barriers have been reduced and transportation costs lowered. At the same time advances in communications technology have made it easier to operate international supply chains. In addition, advances in information technology have enabled many service sectors to operate at greater scale, leading to an increase in average firm size, as well as the rise of multi-sided digital platforms.

[1] FTC and DOJ Extend Deadline for Public Comments on Draft Vertical Merger Guidelines, Announce Two Related Public Workshops, https://www.ftc.gov/news-events/press-releases/2020/02/ftc-doj-extend-deadline-public-comments-draft-vertical-merger.

The proposed guidelines and the 1984 guidelines they replace are quite general. In issuing guidelines, the agencies face an inevitable tension between providing courts, companies, and the general public with detailed guidance that helps them anticipate how both agencies will treat different mergers and preserving enough flexibility to allow them to respond to the specific fact pattern of each case. Ultimately, however, it is the agencies' actions themselves that matter most, not the specific wording of the guidelines. ITIF's comments therefore mainly address how DOJ and FTC should implement the guidelines going forward.

As the guidelines point out, vertical mergers can take many forms. For example, a food retailer may decide to sell its own branded products alongside those of its suppliers. To do this, it might subcontract with an existing processor (possibly one of its current suppliers), build its own production facility, or purchase an existing supplier. The last option would require a vertical merger. As another example, a large company may believe that it can lower the total cost of its products if it expands upstream to eliminate one or more levels of the supply chain by using its size to achieve efficiencies of scale. Not all mergers are good, however. A company with a dominant position in one market might try to extend that dominance into related markets by buying up either a supplier or a customer. Of course, the company could also build its own capacity rather than merge with an existing rival. Antitrust policy must be able to distinguish between the fact patterns that distinguish these cases from each other.

VERTICAL MERGERS CAN GENERATE SIGNIFICANT ECONOMIC BENEFITS

Vertical mergers can be the source of increased innovation and efficiency as a successful company tries to expand its innovations and efficiencies into other parts of the supply chain. The boundary between markets within the same supply chain can be arbitrary and fluid. They often change in response to technological and economic forces. These continual changes are usually subject to competitive pressures and often go unregulated, except when they are accomplished by merger. Yet they are usually beneficial. Specifically, as the guidelines point out, improved productivity is often motivated by allowing one company to combine profit margins from different parts of the supply chain, thereby giving it a greater incentive to reduce costs and lowering total margins in the industry. Over time strong competition in one part of the industry forces companies to become more efficient throughout the supply chain. These efficiencies are often gained when larger companies eliminate one or more levels of business. Antitrust policy should not unduly impede this process just because it is accomplished by merger rather than organically.

Over the last several decades, academics and courts have often acted under the premise that vertical mergers pose less of a risk to competition than horizontal mergers. ITIF believes that this assumption is correct: the immediate effect of vertical mergers is usually lower prices and more choice. Over time this increases productivity and living standards.

ITIF believes that antitrust decisions should be based on a careful investigation of the facts governing the specific markets involved. This empirical requirement can be difficult to fulfil. In many cases it is impossible to know both what the impact of a particular vertical merger is likely to be and how the markets will evolve if the merger does not take place. This is especially challenging in the case of multi-sided platforms because regulators must look at all sides of the platform, not just those that are immediately affected by a given action. Nevertheless, there is no substitute for such an investigation. General theories about the safety of vertical mergers or the threat posed by big companies paint with too broad a brush.

THE CONSUMER WELFARE STANDARD SHOULD CONTINUE TO GOVERN ANTITRUST DECISIONS

ITIF believes that the consumer welfare standard should continue to govern antitrust decisions.[2] This standard, which actually tries to maximize total economic welfare, has provided important guidance and consistency over the last several decades. Although experts often disagree about the best policy to promote consumer welfare, the importance of this goal cannot be understated. In applying the standard to specific cases, it is important that the agencies not confuse the harm suffered by firms that lose out to legitimate competition with harm to competition in general. Although the former harms are real, they are the inevitable result of the competitive process that antitrust policy is meant to protect. Protecting firms from legitimate competition will slow the growth in productivity and living standards.

The guidelines' discussion of both efficiencies and double marginalization reflects the fact that vertical mergers can help consumers even if they also help the companies participating in the merger. Companies with a greater span of control over the supply chain of an industry have a greater incentive to eliminate costs through both efficiencies of scale and scope and the use of bargaining power. In competitive markets, these cost savings eventually get passed on to consumers. As the guidelines indicate, any market in which the merged parties have less than 20 percent of the market is likely to be competitive. But the measure of concentration should occur at the level most relevant to the customer. Recent evidence shows that, although many

[2] Joe Kennedy, "Why the Consumer Welfare Standard Should Remain the Bedrock of Antitrust Policy, (ITIF, October 2018), https://itif.org/publications/2018/10/04/why-consumer-welfare-standard-should-remain-bedrock-antitrust-policy.

industries have become slightly more concentrated at the national level, concentration in many has actually decreased at the local level.[3]

One of the most significant business changes since 1984 has been the increased collection and use of data. Many people have expressed concern about the importance of data as a strategic resource. The fear is that companies in a position to accumulate much greater quantities of data than their rivals can enjoy a lasting competitive advantage. In the context of vertical mergers, access to more data could make it easier to compete with rivals in other parts of the supply chain. Better use of data can improve performance throughout the supply chain. Where it is used to outcompete a rival, perhaps by obtaining access to data on suppliers or customers, consumers often benefit from the lower prices or greater innovation that this competition brings about.

However, data by itself seldom confers a great advantage. As MIT economist Catherine Tucker and others have shown, data's advantage is often less strong than is commonly feared.[4] Specifically, a great deal of data is non-rival, non-exclusive, cheap, and/or perishable. The marginal benefit of additional data is often much less than assumed. When the accumulation of information does seem to create significant wealth, it is usually due to the algorithms and business model applied to the data rather than the data itself. While the discussion of data is helpful, it should be treated the same as any other potential strategic resource.[5] Antitrust policy should not be used to protect companies who have been less efficient in their use of resources, including data.

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[3] Esteban Rossi-Hansberg, Pierre-Daniel Sarte, and Nicholas Trachter, "Diverging Trends in National and Local Concentration," (NBER Working Paper 25066, September 2018), https://www.nber.org/papers/w25066; Kevin Rinz, "Labor Market Concentration, Earnings Inequality, and Earnings Mobility," (U.S. Census Bureau, Center for Administrative Records Research and Applications, Working Paper Series, Working Paper 2018-10), September 2018, https://www.census.gov/content/dam/Census/library/working-papers/2018/adrm/carra-wp-2018-10.pdf.

[4] See, Catherine Tucker, "Digital Data, Platforms and the Usual [Antitrust] Suspects: Network Effects, Switching Costs, Essential Facility," (SSRN, February 2019,) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3326385, and Anja Lambrecht and Catherine E. Tucker, "Can Big Data Protect a Firm from Competition?" (SSRN, December 2015), https://ssrn.com/abstract=2705530.

[5] Joe Kennedy, "The Myth of Data Monopoly: Why Antitrust Concerns About Data Are Overblown, (ITIF, March 2017), http://www2.itif.org/2017-data-competition.pdf.

THERE ARE ALTERNATIVES TO STOPPING VERTICAL MERGERS

The government's response to vertical mergers is not limited to stopping them. In some cases it might make sense for DOJ and FTC to require certain agreements regarding fair dealing when companies both compete and interact with other market participants. This would lessen the potential harm of some vertical mergers, making it easier for DOJ and FTC to approve them and preserving the creation of efficiencies. These standards should be aimed at ensuring that all parties get to compete on an even field. They should not, however, limit industry disruption or add significant complexity. Structural rules that limit entry into related markets by merger or otherwise are almost always unwise, especially in the context of rapidly evolving technology.

Thank you for the opportunity to submit these comments. ITIF would be pleased to testify at one of the workshops on this issue. ITIF is not affiliated with any entity that has provided funding for research, analysis, or commentary on relevant topics.

Sincerely,

Robert D. Atkinson,
President, ITIF