Prepared Testimony of

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Chairman Klobuchar, Ranking Member Lee, and distinguished members of the Senate Judiciary Subcommittee on Competition Policy, Antitrust and Consumer Rights, it is an honor to be back before you today. My testimony today will discuss vertical mergers and their enforcement under U.S. antitrust laws. My views are animated both by my perspectives today as a practitioner, and by my experiences during my time as Assistant Attorney General for the Antitrust Division. I speak today solely in my personal capacity, and needless to say, not on behalf of my law firm, any of the firm's clients or the Department of Justice.

To provide some background, vertical mergers describe transactions that combine firms or assets at different levels of the same supply chain. To preview some of the terminology for vertical mergers, "downstream" players describe the stages closer to final consumers (such as distributors, retailers, or finished goods manufacturers), and "upstream" describes the stages further away from the end consumers (such as suppliers, wholesalers, or input manufacturers). In contrast, horizontal transactions combine firms or assets at the same level of the supply chain.

Many transactions, however, could have both horizontal and vertical elements. That is not mere coincidence. Businesses of all shapes and sizes have long recognized that there are efficiencies and procompetitive profit opportunities to be realized through vertical integration. A classic example is the drilling, refining, and retail of fossil fuels. We may not know it, but we all encounter that example directly when we fill up at a local gas station.

Another way to think about a so-called vertical transaction is when we hire a pool cleaning service. We outsource that activity to the pool service. I could buy that pool service's business and incorporate it into my home business. Or I could go and purchase the equipment and train my child to do it. Each will achieve the same objective, getting my pool cleaned; but each comes with different economic costs and efficiencies for me.

Using the retail gasoline example, as many of you likely know: Exxon, which until 1973 was Standard Oil of New Jersey, is the legacy descendant of the Standard Oil corporation of John D. Rockefeller. That company in many ways spurned the legislative reform that led to the enactment of federal antitrust laws at the turn of the twentieth century. Indeed, one of the primary

complaints leveled against Standard Oil at the turn of the century was that it had vertically integrated across the oil refining supply chain and used its market power across the supply chain to eliminate competition at different levels. This complex interplay between vertical integration and horizontal competition has led some antitrust scholars, including my esteemed colleague on the panel, Professor Rose, to observe that "all theories of harm from vertical mergers posit a horizontal interaction that is the ultimate source of harm."

The interplay between horizontal and vertical theories of harm to competition is not as simple as labeling a transaction "vertical" or "horizontal." The complex transactions that are the focus of the Division and the Federal Trade Commission enforcement priorities can raise intersecting vertical and horizontal competition concerns. There are, however, certain analytical methods and economic policies that guide antitrust merger enforcement practices depending on whether a transaction presents horizontal or vertical theories of antitrust harm—the guiding principle for evaluating all types of mergers is whether the proposed transaction is likely to substantially lessen competition in one or more product and geographic markets.

In my comments today, I will share the legal framework for assessing vertical mergers, some potential procompetitive benefits of vertical integration, and finally enforcement considerations for vertical mergers, including remedies.

Legal Framework

As you know, Section 7 of the Clayton Act prohibits any merger or acquisition if, "in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly." This provision applies to vertical mergers, as Congress made plain in the 1950 amendments to the Clayton Act. In fact, the House Committee Report accompanying that amendment specifically states that Section 7 "applies to all types of mergers and acquisitions, vertical and conglomerate, as well as horizontal."

Unlike with horizontal mergers, the Division and FTC cannot rely on a legal presumption of anticompetitive effects by simply showing that a challenged vertical merger would increase market concentration above a certain threshold. Of course, these presumptions are the outgrowth of ever evolving antitrust common law and are not in the text of the Clayton Act. One must wonder if the current Supreme Court were presented with the question, would it still read any presumption into Section 7?

For vertical mergers, courts have agreed that there is no presumption of harm based on market shares or market concentration. Instead, the framework asks whether, despite a vertical merger's conceded procompetitive effects, the government has met its burden of proof in demonstrating that a particular transaction—given the fact-specific evidence at issue—is likely to substantially lessen competition. Once the government meets its burden of proof, the burden shifts to the defendant to prove that the government's case fails to accurately predict the likely effect on competition, including presenting evidence of procompetitive efficiencies. The burden then shifts back to the government to produce evidence sufficient to sustain its burden, i.e., a showing that a merger is likely to substantially lessen competition in a relevant antitrust market.

Vertical Mergers Provide Procompetitive Benefits

While horizontal mergers among direct competitors can raise competition concerns, vertical combinations are different. The reason is that vertical mergers, by their nature, have the potential to generate substantial efficiencies and synergies that benefit consumers, suppliers, and distributors. Antitrust practitioners, economists, and scholars across the political spectrum have acknowledged that vertically-integrated firms can provide significant procompetitive benefits.

Judge Robert Bork, of course, going back to his book, the "Antitrust Paradox," described vertical mergers as a "means of creating efficiency."

More recently, scholars such as Professor Steve Salop, who teaches at Georgetown, has mapped out several efficiency benefits arising from vertical combinations, including cost and quality efficiencies, increased investment incentives, reduced potential for coordination, design and production improvements, and the elimination of double marginalization—which is the technical economic term for eliminating double mark-up of costs. When independent firms operate at different levels of the supply chain, upstream suppliers have the incentive to charge a profit-maximizing price that only accounts for the sale of a single product. Downstream suppliers are similarly incentivized to charge a second, additional markup, which is passed on to consumers. But when firms vertically integrate, the incentive to charge two mark-ups is eliminated because the combined firm would prefer to sell more widgets at a presumably reduced mark-up. Both the merged firm and consumers often are better off by collaborating to sell more products at a single, profit-maximizing margin—and a lower cost to consumers than when the firms operated separately.

Enforcement of Anti-Competitive Vertical Mergers

Calibrating enforcement of vertical mergers can create complex policy decisions. On the one hand, blocking vertical mergers may deprive consumers of procompetitive benefits of the very kind that the antitrust laws should support. On the other hand, competitors sometimes argue that a vertical merger forecloses a firm from having a necessary input or raises that competitor's costs.

Historically, the Antitrust Division has sought to prevent transactions where it believes that post-merger the combined firm would have been both a major producer of a product and the only supplier of critical components to one of its top competitors. This would have provided the merged firm with the opportunity and incentive to withhold or delay delivery of critical inputs to a close competitor. This type of potential foreclosure on certain facts can potentially leave competitors without access to necessary inputs and makes it less likely that competition will discipline commercial interactions in the marketplace. The Division, in the past has in some cases sought what it terms a "structural" remedy through divestitures to mitigate the potential harm from such transactions.

Of course, as you know, around five years ago, many television pundits all of a sudden became vertical merger antitrust experts. That was when the Division was forced to litigate the proposed transaction between AT&T/DirecTV and Time Warner. In the decade prior to my leadership of the Division, the Antitrust Division reviewed the vertical mergers of Google / ITA and Comcast / NBC Universal—to name a few. In these vertical cases, the investigation ended

with a remedy allowing the merger to proceed, or abandonment of the transaction, so there was no litigation.

United States v. AT&T was the first merger case litigated to judgment in 40 years. Nobody likes to lose a case and nobody should resort to litigation if there are remedies available to solve a dispute. The Division and the parties were unable to reach an agreement on remedies, the case was litigated and, of course, the Division did not prevail.

But that case and its history, nevertheless present a learning opportunity for enforcers and for merging parties, which I think is helpful as you perform your oversight here. First, the theory. The Division challenged the merger on the theory that it would substantially lessen competition among traditional video distributors and empower AT&T to raise the prices for Time Warner's popular television networks, a cost that would be passed on to American consumers. The Division believed that the merger would disrupt competition from online video distributors, which—at that time—charged low prices for more video content. During the trial and appeal, AT&T/DirecTV and Time Warner repeatedly emphasized that the merged firm would arbitrate renewal disputes with rival distributors if they disagreed with the value of content, and that distributors would retain the right to carry Time Warner networks pending the arbitration process. The court took this remedy into account as it evaluated the alleged competitive harms. The Division, of course, for the first time, I believe, conceded significant efficiencies from the elimination of double marginalization. Although the Division was not required to do so, it nevertheless did, believing it to be the honest course of conduct. That efficiency also factored into the court's decision.

Merger enforcement in general is a predictive exercise, and it is even more challenging where the enforcement is in the context of a vertical merger where there have been no precedents for more than forty years. That is just reality, and the courts today want real world examples of alleged harms. Theory alone won't win cases. And, of course, the Division could not point to Guidelines as support: the 1984 DOJ Non-Horizontal Merger Guidelines were woefully out of date and of no help to the courts, the Division or any merging party.

Vertical Merger Guidelines

After the experience with the AT&T case, and a few transactions immediately after that, including the CVS/Aetna transaction, I initiated a major initiative to update the old 1984 DOJ vertical merger guidelines. For some time leading up to the revision of the vertical guidelines, many antitrust practitioners believed that the antitrust agencies' approach to vertical enforcement over the prior decades had been vague and unclear. The only published guidance, up to the time of my tenure at Division, included the 1984 Non-Horizontal Merger Guidelines. To add more transparency to the business community, bar, and enforcers on vertical merger enforcement, the Division worked with the FTC, experts in academia and the bar, and the business community to craft and publish the 2020 Vertical Merger Guidelines. Rather than creating new methods of evaluating vertical mergers, the 2020 Guidelines explained the agencies' investigative practices toward vertical combinations as they have been applied, based on the past four decades of

experience, and informed by modern economics and enforcement experiences. The goal was to provide greater clarity and predictability to market participants.

Transparency in antitrust enforcement is a goal that benefits all stakeholders. The great Robert H. Jackson, who served both in the role of Assistant Attorney General for the Antitrust Division and as a well-known Supreme Court jurist, characterized prior antitrust enforcement as alternating between being "aggressively vague and passively vague." He stated that "[e]very antitrust problem is economic as well as legal," and aimed to articulate a standard for antitrust enforcement "intelligible both to those expected to comply with it and to those expected to enforce it." Our mandate in crafting the guidelines was to provide a similar solution of transparency for vertical merger enforcement.

When then-Assistant Attorney General William Baxter faced criticism that the 1982 Merger Guidelines were too clear and provided too much guidance, he rejected criticisms that expressed an inherent hostility to mergers themselves and emphasized that mergers are "an important and extremely valuable capital market phenomenon" and that "it is socially desirable that uncertainty and risk be removed wherever possible to do so, subject of course, to the very important limitation that where a merger threatens significantly to lessen competition, it should be halted."

Further, in contrast to the 1984 Non-Horizontal Merger Guidelines that were issued unilaterally by the Division, the 2020 Vertical Merger Guidelines followed workshops and public comments that brought together diverse views from the antitrust bar and academics on vertical mergers. Some comments advocated for what would amount to changing the law to favor vertical mergers as *per se* legal. Other commentators advocated for changing the law to disfavor vertical mergers. What was clear, though, was that the end result should reflect the lodestar of antitrust, which is an appreciation of competitive market realities.

Importantly, the 2020 Vertical Guidelines encouraged the Division and FTC to evaluate the positive, potential procompetitive effects of vertical transactions. Under the Guidelines, the agencies considered economic efficiencies resulting from the merged firm's enhanced ability to streamline production and distribution. And the agencies also considered whether the merger could lead to the creation of innovative products that would otherwise not be achieved. Finally, the Guidelines affirmatively stressed that the Division and FTC would consider the benefits created by the elimination of double marginalization resulting from the merged firms incurring lower costs for upstream inputs. Resulting procompetitive effects were to be weighed against anticompetitive effects in determining whether to challenge the merger.

In 2021, the FTC unilaterally withdrew the 2020 Vertical Merger Guidelines, but the Division kept them in place, pending an overall review of both the horizontal and vertical merger guidelines and while seeking public comment. I thought the decision to withdraw those guidelines and not have another set in place was ill-advised and associate myself with the views of the dissenting FTC Commissioners Wilson and Phillips, who opposed withdrawal.

While I do not know when the Division and FTC will issue new finalized guidance on vertical mergers, I urge them to propose a route forward that will provide all stakeholders, including enforcers, lawmakers, judges, practitioners, and the business community, with clarity on

how the agencies will continue to carry out vertical merger enforcement. Effective and accurate guidance depends on the agencies contending with current case law from their recent vertical merger challenges—as well as accepted economic principles. I urge them to resist any urge to use guidelines as a prescriptive document to represent what they wish the laws to be rather than what the laws actually are. If the laws need to be changed, the appropriate branch of government to do so is this body, Congress. If the guidelines are not supported by the case law and economic evidence, I fear the courts will simply disregard them, resulting in the loss of the positive effects they have had, as a consensus recipe book for both the business community and the courts, for the past 40 years.

Although some see antitrust law as a means to address broader concerns about the economy, I do not believe the antitrust laws are bent towards values other than competition. As Justice Black explained in *Northern Pacific Railway v. United States*, the Sherman Act, our first U.S. antitrust law, is "aimed at preserving free and unfettered competition as the rule of trade" and "the policy unequivocally laid down by the Act is competition."

Thank you again for this opportunity to provide these views. I look forward to your questions.