ICN report confirms that vertical merger challenges remain rare, but are a real global trend

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The debate over how to remedy vertical concerns is particularly front of mind in the U.S. these days as trial is currently underway in the U.S. Department of Justice's (DOJ's) effort to block AT&T's proposed acquisition of Time Warner. In the case, AT&T and Time Warner had offered to agree to certain behavioral remedies, including committing to arbitrate bargaining power disputes with distributors. DOJ, however, wanted the parties to commit to divesting certain assets as a condition of clearance.

As we await the outcome of that case though, the International Competition Network (ICN) recently made its own contribution to the ongoing discussions around vertical mergers. The ICN is an organization that facilitates dialogue and consensus building among national competition authorities (NCAs) around the world. Its membership is comprised of more than 130 competition agencies from over 120 countries.

At the ICN's recent annual conference in New Delhi, the Merger Working Group released a report summarizing the group's findings from a survey of NCAs on their approach to vertical mergers. Vertical mergers were a main theme of the conference and the conference also featured plenary panel discussions on the topic. The panel was moderated by the Canadian Commissioner of Competition and included the President of the French competition agency, the Chief Executive Officer of the UK competition agency, a Commissioner of the Japanese competition agency, and the Deputy Director General for Mergers at the European Commission's competition directorate.

Both the plenary panel and the report reflect the fact that "competition experts world-wide have different opinions on the degree to which, and the circumstances in which, vertical mergers and vertical restraints may be harmful to competition and consumers." Specifically, the survey concluded that "vertical concerns were most likely to be found in Europe, Australia and South Africa." However, the geographic breadth of the case studies highlighted in the report reflect that jurisdictions around the globe, including North America, Asia, and Latin America, are also closely scrutinizing vertical concerns in merger review.

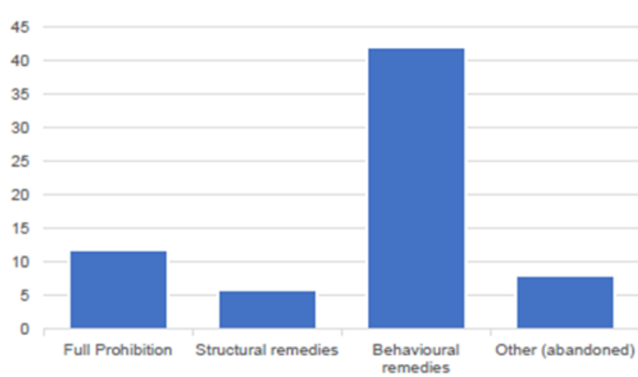
The majority of the 43 NCAs that responded to the survey reported having intervened in at least one vertical merger in the past three years, and these agencies stated that they give equal priority to horizontal and vertical merger concerns. However, the report also confirms the common perception that challenges to vertical mergers remain “relatively rare”—accounting for just one of every 10 transactions not cleared without remedies or conditions.[1]

The report opens by walking through the economic framework applicable to vertical mergers. While most vertical mergers are procompetitive, they can raise competition concerns if they result in foreclosure—either input foreclosure (i.e. the foreclosure of the combined firm’s downstream competitors) or customer foreclosure (i.e. the foreclosure of the combined firm’s upstream competitors). Vertical mergers may also harm competition by creating conditions for horizontal harm by providing the combined entity with access to competitively sensitive information about downstream or upstream competitors. Even where the combined firm may have the ability to engage in either input or customer foreclosure, however, a transaction is only anticompetitive if the merged entity would also have the incentive to do so and the foreclosure would harm end customers. Vertical mergers can also benefit consumers by achieving efficiencies, including “internalization of double mark-ups, reduced costs of transactions, and improved information flow and co-ordination.”

The second part of the report addressed how NCAs actually analyze vertical merger assessments in practice, including the legal framework in place (e.g., laws, guidelines, etc.), the theories of harm that are cognizable, and the evidence and techniques used to assess vertical mergers. The report indicates that while there is broad consistency across NCAs in terms of the analytical framework applied to vertical mergers, there is significantly less consistency in terms of the types of the economic evidence considered in applying the framework. For example, the report states that 28 of the 38 NCAs responding to this portion of the survey have never used the Vertical Gross Upward Pricing Pressure Index (vGUPPI), which estimates the incentive of a merged firm to raise upstream prices and is a common mode of analysis for vertical mergers in many leading competition agencies, including in Europe and the U.S.

The report also addresses how vertical concerns are remedied. The report confirms that the most commonly used tool for addressing vertical concerns is a “behavioral remedy” that regulates the combined firm on an ongoing basis. Behavioral remedies for vertical mergers often take the form of firewalls to restrict access to confidential information generated by competitors’ use of the combined firm’s facilities or products, or price caps on the combined firm. Notably, however, the report also states that approximately a third of cases were either blocked or required structural remedies (i.e., divestitures) as a condition of approval.

Figure 11: Outcomes of mergers not unconditionally cleared as a result of vertical concern in the last three years



Note: The data provided by some NCAs covers the period 2014-2016 instead of 2015-2017.

[1] The report examined “purely vertical mergers and mergers where theories of harm include both horizontal and vertical issues.”

This survey report is only the first phase of a two-part project of the Merger Working Group. The second phase of the project will focus on specific issues identified in the way in which vertical mergers are assessed such as “less common theories of harm” and may also result in additional ICN work product.

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