
# Comments to the Federal Trade Commission Regarding Forthcoming Merger Guideline Revisions

**Jessica Melugin**, Director, Center for Technology and Innovation, Competitive Enterprise Institute

**Ryan Young**, Senior Fellow, Competitive Enterprise Institute

Comment Period Closes: April 21, 2022

Comment Submitted: April 3, 2022

Docket No. FTC-2022-0003-0001

On behalf of the Competitive Enterprise Institute (CEI), we respectfully submit comments regarding the Federal Trade Commission's (FTC) revisions to merger guidelines. Founded in 1984, the Competitive Enterprise Institute is a non-profit research and advocacy organization that focuses on regulatory policy from a pro-market perspective. Our comments make three arguments and several related policy recommendations. The arguments are as follows.

- First, the process requires more transparency than the FTC is currently providing.
- Second, vertical mergers should be presumed to be competitive.
- Third, if the FTC's policy goal is to have fewer mergers, then the policy solution lies outside antitrust enforcement. Not everything is an antitrust issue.

Our policy recommendations for improving transparency include adopting a set procedure for guideline revisions. An off-the-shelf option is to follow the Administrative Procedure Act's (APA) notice-and-comment rulemaking process. Another option is an in-house version of the APA process that includes public drafts, open hearings, an expert panel, and a public comment period. Additionally, all merger cases should take place in independent Article III courts, not in the FTC's in-house administrative courts, where the agency pays the judges' salaries and sets the procedures.

Vertical mergers should be presumed competitive. They are a form of the old make-it-or-buy-it decision that every company, household, and individual faces daily. The answer to these decisions, whether at the individual or the firm level, often depends on which option has lower transaction costs. The FTC's

merger guidelines should require the agency to consider potential transaction cost savings in proposed deals.

The FTC, when reviewing vertical mergers, should also consider the potential elimination of double marginalization (EDM), which results in lower consumer prices. Every company in a vertical supply chain marks up the price to earn a profit. Vertical mergers eliminate some of these multiple-markup opportunities. The evidence shows that these EDM savings typically result in lower consumer prices.[1]

In merger reviews where the FTC can prove that a vertical merger would raise rivals' costs, this should be measured against consumer benefits due to EDM. The FTC's list of risks arising from mergers should be equally applied to risks of denying mergers—namely, whether blocking a merger "can lead to higher prices, fewer or lower-quality goods or services, or less innovation."[2] If consumers benefit on net, the deal should be presumed competitive. Antitrust policy is supposed to protect the competitive process, not this or that competitor.

Finally, if the FTC's policy goal is to reduce the number of mergers, the answers often lie outside of antitrust. The FTC's guidelines should require it to consider less intrusive policy alternatives. For example, post-Sarbanes-Oxley and Dodd-Frank financial regulations make raising capital and initial public offerings (IPOs) costly and difficult. By comparison, a firm in the process of scaling up may find it easier to be acquired than to run through the gamut of financial regulations to go public.

That said, the FTC should adopt an agnostic approach regarding the number and size of mergers. Mergers are neither inherently good nor bad; they are part of the ongoing competitive process.

More on each of these arguments and policy recommendations for the merger guideline revisions follows.

**Transparency.** The FTC's merger guidelines do not derive from congressional statute. The FTC creates them in-house as guidance. While they are not binding and not always followed to the letter, written guidelines are useful for several reasons. The two most important reasons are transparency and predictability. Companies considering a merger should be able to have a good idea in advance as to whether or not their proposed deal is likely to be approved. This can save both them and the FTC a great deal of time and expense.

Written guidelines that everyone can consult make this process much easier. They also make it predictable. Many deals take years to complete and may span across presidential administration and agency leadership changes. To be effective, guidelines should not change with the political winds. Written guidelines, if they are not revised too often, help to achieve this predictability, giving companies confidence that their long-term plans will not be favored by this year's political appointee, then blocked by the next.

---

[1] Gopal Das Varma & Martino DeStefano, "Equilibrium Analysis of Vertical Mergers," *The Antitrust Bulletin,* Vol. 65, Issue 3 (September 2020), pp. 445-458, https://journals.sagepub.com/doi/abs/10.1177/0003603X20929138. Francine LaFontaine and Margaret Slade, "Vertical Integration and Firm Boundaries: The Evidence," *Journal of Economic Literature*, Vol. 45, (September 2007), pp. 629-680, https://masonlec.org/site/rte_uploads/files/Masten_Lafontaine-Slade_JEL_2007(1).pdf.

[2] Federal Trade Commission website, Guide to Antitrust Laws, Mergers section, accessed March 11, 2022, https://www.ftc.gov/tips-advice/competition-guidance/guide-antitrust-laws/mergers.

The FTC reviews more than 1,000 mergers each year. Several of them are multi-billion-dollar deals, such as T-Mobile/Sprint and Disney/Fox. Other recent mergers, such as the early cancer detection test companies Illumina and GRAIL, are smaller, but could have life-and-death effects.[3]

Nearly any substantive change in the FTC's merger guidelines would likely meet Executive Order 12866's threshold for economic significance in new rules, which is $100 million of economic impact in at least one year.[4] While EO 12866 applies to certain guidance documents as well as to formal rules, the FTC's proposed policy revisions may not technically qualify as either a rule or a guidance document. This likely makes the merger guideline revisions exempt from the notice-and-comment rulemaking process and its transparency requirements, such as review by the Office of Management and Budget. Information such as estimated compliance costs, paperwork-hours, and net economic effects are missing from this agency action.

This is essential information even in normal times. With the economy still dealing with the effects of the COVID-19 pandemic, geopolitical uncertainty surrounding Vladimir Putin's invasion of Ukraine and Xi Jinping's growing authoritarianism in China, and an ongoing bipartisan goal of increasing American companies' competitiveness, transparency is especially important right now.

During the last merger guideline revisions in 2010, the FTC circulated drafts, held hearings, convened expert panels, issued guidance documents, and made changes to the revisions as a result of this process.

These actions all fall short of the APA's notice-and-comment process for formal rules—and again, merger guideline revisions likely do not qualify as formal rules. But those previous agency actions at least attempted to use transparency and outside input to improve the quality of FTC policy.

The current round of revisions has featured few such transparency measures. The public comment period, of which these documents are a part, are one of the few opportunities for outside experts, stakeholders, and consumers to raise concerns and offer improvements.

This lack of transparency and recent measures to limit opportunities for FTC staff to discuss competition policy issues in public create the perception that the agency has already made up its mind on the merger guideline revisions, and outside comments are likely *pro forma* and will not influence policy decisions. This perception may or may not accurately reflect the FTC's decision-making process. Nonetheless, it exists.

For this and future rounds of merger guideline revisions, the FTC should credibly commit itself to proper transparency. A relatively easy way to do this would be to follow the Administrative Procedure Act's notice-and-comment process, which other agencies follow in their rulemakings. While merger guidelines are likely not formal rules, their large economic effects mean that they deserve a high level of scrutiny and transparency. The APA process is an off-the-shelf option that is widely understood and easy to implement.

---

[3] Federal Trade Commission, "Illumina, Inc., and GRAIL, Inc., In the Matter of," accessed on March 9, 2022, https://www.ftc.gov/enforcement/cases-proceedings/201-0144/illumina-inc-grail-inc-matter.

[4] President William J. Clinton, "Regulatory Planning and Review," Executive Order 12866, September 30, 1993, Federal Register, Vol. 58, No. 190, October 4, 1993 https://www.archives.gov/files/federal-register/executive-orders/pdf/12866.pdf.

Another option would be for the FTC to create and implement its own transparency process. This could take many forms. One option would be to require circulating at least one advance draft of any guideline revisions to the public on the FTC's website and in the *Federal Register*, with a minimum six-month waiting period before the guidelines may be finalized. The first 90 days of that waiting period would include a public comment period, with at least one week's advance notice in the *Federal Register*. The FTC would be required to convene at least one expert panel to examine the draft, with each FTC Commissioner selecting one panelist from outside the agency. The guideline revisions would not be allowed to become final until a) the panel's recommendations are made public on the FTC's website and b) an agency response to the panel's findings are published both on the FTC's website and in the *Federal Register*.

Finally, the FTC's merger guidelines should require the agency to pursue all merger cases in independent Article III courts, not its own in-house courts, where it pays the judges and sets procedural rules. The merger review process, from start to finish, should be as transparent and neutral as possible so that cases may be decided on the merits.

These transparency proposals would help the FTC allay concerns that it is leaping before it looks, or that it does not take others' opinions into account. Improved transparency would also give affected businesses some certainty. Many mergers and acquisitions are multi-year processes. Better knowledge of potential policy changes can help merging companies follow the guidelines in advance and stop costly litigation before it begins, saving both agency and respondents' resources.

**Vertical Mergers.** Vertical mergers should be presumed to be competitive. An overlooked reason, which deserves inclusion in the FTC's merger guidelines, is transaction costs. Former FTC chair Timothy J. Muris and former FTC Bureau of Economics director Bruce H. Kobayashi argue that, "Unlike horizontal product mergers, in pure vertical product mergers, concentration in either the upstream or downstream markets remains unchanged, and any theoretical or empirical link between structure and effects are limited to nonexistent."[5]

Every company faces several make-or-buy decisions each day. Is it more efficient to make something or to buy it on the market? If a company needs legal counsel, would it be better off hiring in-house attorneys or an outside firm? If it needs accounting services, should it hire its own staff or outsource to an accounting firm? Should it hire its own cleaning staff or use an outside firm? The answer is different for every company, and can change over time inside the same company. The reason is transaction costs.[6] Companies will often choose whether to make or buy something based on whichever has lower transaction costs.

Transaction cost savings is what motivates many vertical mergers, up and down the supply chain. If a company is currently sourcing some of its supplies, it might be able to lower its costs by making those supplies in-house instead. It can start its own operations, or save time and expense by buying a supplier and using existing resources more efficiently.

---

[5] Timothy J. Muris and Bruce H. Kobayashi, Screening Out Innovation: Vertical Merger Principles and the FTC's Misapplication in the Illumina-GRAIL Case," Competitive Enterprise Institute, August 2021, p. 3, https://cei.org/studies/screening-out-innovation/.

[6] Michael C. Munger, "Giants among us: do we need a new antitrust paradigm?" *Journal of Political Economy*, (2021), https://link.springer.com/article/10.1007/s10602-021-09350-w.

Vertical mergers also reduce the number of price markups at each step in the vertical supply chain. This elimination of double margins (EDM) results in cost savings to consumers. For example, many states banned oil refiners from also owning and operating gas stations. This resulted in higher prices and reduced station hours in those states, just as the EDM hypothesis predicts.[7]

A counter to the EDM argument is that a company buying a supplier that also does business with rivals will raise those rivals' costs. But if the net effect is lower prices for consumers, then the market has become more competitive. As noted, antitrust policy seeks to protect the competitive process, not this or that competitor.

Some mergers concerning lifesaving innovations are subject to an "invisible coffins" problem, where an agency blocks actions that could save lives. The resulting coffins are real, but they are also invisible, because while the agency is responsible for some of them, it is often impossible to pinpoint exactly which individuals' lives could have been saved by more liberal policies.

This is the case with the proposed Illumina-GRAIL merger, which the FTC is seeking to block under the current merger guidelines, and will likely continue to oppose under the revised guidelines if the action is not resolved.

These two health care companies are working on making lifesaving cancer screening available to patients. They are not competitors, but produce complementary products and services. Illumina provides next generation DNA sequencing (NGS) platforms. GRAIL researches and develops NGS-based oncology tests, including a multi-cancer early detection (MCED) test.

On September 20, 2020, Illumina signed an agreement and plan of merger with GRAIL. Then on March 30, 2021, the FTC filed an administrative complaint alleging that the merger would reduce competition "in the market for the research, development, and commercialization of MCED tests." The FTC's theory of harm rested on a speculative theory of foreclosure in an alleged "pre-commercial" market that does not yet exist.

The FTC's theory of "standalone harm to innovation through future exclusion of hypothetical competitors in a pre-commercial market" lacks merit. It is likely that the vertical merger could produce downward pricing pressure from the elimination of double marginalization and verifiable and merger-specific efficiency justifications in the near term that are not likely to be outweighed by the FTC's speculative and far-in-the-future foreclosure harms.

The first rule of regulators should be to do no harm. And most importantly, the harm to consumers of blocking the Illumina/Grail merger could be measured in "invisible coffins." In the words of former FTC Chairman Tim Muris:

> It would be tragic if the FTC's misapplication of the appropriate standards for evaluating a vertical merger were to delay the American people access to such an important lifesaving breakthrough in cancer treatment for the benefit of a hypothetical future competition.

---

[7] Francine LaFontaine and Margaret Slade, "Vertical Integration and Firm Boundaries: The Evidence," *Journal of Economic Literature*, (Vol. 45, September 2007) p. 676, https://masonlec.org/site/rte_uploads/files/Masten_Lafontaine-Slade_JEL_2007(1).pdf.

**Startup Acquisitions.** Big tech companies' habit of acquiring smaller startups has gotten to the point where many startups openly plan to be acquired in their written business plans and pitches to investors. But their reasons can have more to do with financial regulations than with competition policy.

Startups have several options for raising capital. One is direct investment from individual investors or financial institutions. Another is to go public through an initial public offering (IPO). A third is to be acquired by a bigger company with abundant capital and other resources.

Financial regulations have gotten more numerous and more complex in recent years, due in part to the 2002 Sarbanes-Oxley and the 2010 Dodd-Frank financial regulation legislation. Despite partial fixes such as the JOBS Act,[8] many companies look at the increased time and expense of the IPO process, or of soliciting investors, and choose to be acquired instead. Again, not everything is an antitrust issue.

That regulatory burden has led Facebook and other post-Sarbanes-Oxley firms to choose not to go public until they were already multi-billion dollar companies.[9] President Obama's Council on Jobs and Competitiveness found that about 80 percent of public companies went public with IPOs of less than $50 million before Sarbanes-Oxley, while 80 percent were above that value following the legislation's passage.

In 2011, the year after Dodd-Frank passed, the inflation-adjusted median market value of IPOs nearly doubled from the previous year, from $482 million to $951 million.[10] This at least partly reflected the difficulty smaller firms had complying with new regulations, causing them to turn to other capital-raising options instead, such as acquisition. That left only larger firms that already had substantial regulatory compliance resources able to afford entering the IPO market. While average IPO valuations went down somewhat in the following years as companies got used to the new rules, they remained larger than in the pre-Dodd-Frank era, adjusted for inflation.

As such, the FTC's merger guideline revisions should require the FTC to look at non-antitrust reasons for why companies might seek to merge, and take those into account when deciding whether to bring a case.

If the FTC's policy goal is to reduce the number of mergers, the most effective way to reach that goal may sometimes lie outside its jurisdiction. In such cases, it should work with Congress and relevant agencies such as the Securities and Exchange Commission or the Treasury Department to revise their policies that push startups to pursue acquisition over growth. It is better to treat the disease than its symptoms.

At a more fundamental level, the FTC should not have a policy goal related to merger frequency. mergers are neither inherently good nor bad. Companies continuously merge and separate in an ongoing discovery process of finding ways to cut prices, grow supplies, save costs, cut losses, lower transaction costs, take advantage of economies of scale, gain flexibility by becoming smaller, find new

---

[8] John Berlau, testimony before the House Financial Services Committee, Subcommittee on Capital Markets, Securities, and Investment, "The Cost of Being a Public Company in Light of Sarbanes-Oxley and the Federalization of Corporate Governance," July 18, 2017, https://cei.org/sites/default/files/John%20Berlau%20-%20Sarbanes-Oxley%20Testimony%2007182017.pdf.

[9] Ibid.

[10] Jay R. Ritter, "Initial Public Offerings: Updated Statistics," February 21, 2022, Table 4f, p. 20, https://site.warrington.ufl.edu/ritter/files/IPO-Statistics.pdf.

purposes for resources, hire superstar talent or technologies by buying their firms, separating from them when it doesn't work, or nearly any combination of the above.

The FTC's merger revision process needs transparency, a rethink of its treatment of vertical mergers, and an admission that not everything is an antitrust issue.