ORAL ARGUMENT NOT YET SCHEDULED

No. 18-5214

IN THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

UNITED STATES OF AMERICA,
Plaintiff-Appellant,

v.

AT&T INC.; DIRECTV GROUP HOLDINGS, LLC; AND TIME WARNER INC.,
Defendants-Appellees.

On Appeal from the
United States District Court for the District of Columbia,
No. 1:17-cv-2511 (Hon. Richard J. Leon)

BRIEF OF THE CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA, NATIONAL ASSOCIATION OF MANUFACTURERS, BUSINESS ROUNDTABLE, SMALL BUSINESS & ENTREPRENEURSHIP COUNCIL, U.S. BLACK CHAMBERS, INC., AND THE LATINO COALITION AS *AMICI CURIAE* IN SUPPORT OF DEFENDANTS-APPELLEES

Justin P. Raphael
MUNGER, TOLLES & OLSON LLP
560 Mission Street, 27th Floor
San Francisco, CA 94105-3089
Telephone: (415) 512-4000
Justin.Raphael@mto.com

Donald B. Verrilli, Jr.
MUNGER, TOLLES & OLSON LLP
1155 F Street N.W., 7th Floor
Washington, D.C. 20004-1361
Telephone: (202) 220-1100
Donald.Verrilli@mto.com

Counsel for Amici Curiae

Additional counsel on inside cover

Steven P. Lehotsky
Daryl Joseffer
U.S. CHAMBER LITIGATION CENTER
1615 H Street, NW
Washington, DC 20062
(202) 463-5337

Counsel for Amicus Curiae *the Chamber of Commerce of the United States of America*

Peter C. Tolsdorf
Leland P. Frost
MANUFACTURERS' CENTER FOR LEGAL ACTION
733 10th Street, NW, Suite 700
Washington, DC 20001
(202) 637-3000

Counsel for Amicus Curiae *the National Association of Manufacturers*

Liz Dougherty
BUSINESS ROUNDTABLE
300 New Jersey Avenue
NW Suite 800
Washington, DC 20001
(202) 872-1260

Counsel for Amicus Curiae *Business Roundtable*

CERTIFICATE AS TO PARTIES, RULINGS AND RELATED CASES

A. Parties and *amici*

With the exception of the undersigned amici, all parties, intervenors, and amici are listed in the Certificate as to Parties, Rulings Under Review, and Related Cases filed by Plaintiff-Appellants in this Court on August 6, 2018 and the briefs filed on August 13, 2018.

B. Rulings under review

References to the rulings at issue appear in the Certificate as to Parties, Rulings Under Review, and Related Cases filed by Plaintiff-Appellant in this Court on August 6, 2018.

C. Related cases

The case now pending before this Court was not previously before this Court or any Court other than the district court below. *Amici* are not aware of any cases related to this appeal.

CORPORATE DISCLOSURE STATEMENT

Pursuant to Federal Rule of Civil Procedure 26.1, each of *amici curiae* the Chamber of Commerce of the United States of America, the National Association of Manufacturers, the Business Roundtable, the Small Business & Entrepreneurship Council, US Black Chambers, Inc., and The Latino Coalition certifies that it is a non-profit organization, that it does not have a parent corporation, and that no publicly held corporation owns more than ten percent of its stock.

STATUTES AND REGULATIONS

The pertinent statute is 15 U.S.C § 18, which is reprinted in the addendum to the Appellant's brief filed on August 6, 2018.

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Page

CASES

TABLE OF AUTHORITIES
(Continued)

Page

TABLE OF AUTHORITIES
(Continued)

Page

TABLE OF AUTHORITIES
(Continued)

Page

TABLE OF AUTHORITIES
(Continued)

TABLE OF AUTHORITIES
(Continued)

Page

STATEMENT OF INTEREST OF *AMICI CURIAE*[1]

Amici curiae identified in Appendix A represent a broad and diverse set of American businesses concerned that the novel approach to vertical mergers by the Government, its supporting amici and amici in support of neither party contravenes longstanding antitrust principles. If embraced by this Court, that approach would undermine myriad transactions that generally benefit consumers.

Over the past several decades, a broad legal and economic consensus in favor of vertical mergers gave the business community confidence to invest in numerous transactions that made American industries more efficient, thereby producing enormous consumer benefits. The vague legal standard that the Government and some amici advocate would cloud the business community's ability to ascertain whether vertical mergers are lawful, making it more difficult

[1] In accordance with Federal Rule of Appellate Procedure 29(a)(4)(E), amici certify that (1) this brief was authored entirely by counsel for amici curiae and not by counsel for any party, in whole or part; (2) no party or counsel for any party contributed money to fund preparing or submitting this brief; and (3) apart from amici curiae and their counsel, no other person contributed money to fund preparing or submitting this brief. All parties have consented to the filing of this amicus brief.

to invest in transactions with enormous potential to lower prices and enhance innovation-all of which benefit a diverse array of customers.

The undersigned amici respectfully urge this Court to decline to upend the longstanding consensus that vertical mergers are presumptively procompetitive and thus lawful.

SUMMARY OF ARGUMENT

In its brief, AT&T establishes that the district court properly found that the Government in this case failed to adduce "case-specific evidence" that the challenged vertical merger "is likely to substantially lessen competition." *United States v. AT & T, Inc.*, 310 F. Supp. 3d 161, 194 (D.D.C. 2018). Amici do not seek in this brief to replow that factual ground, but instead address a fundamental flaw in the Government's theory behind this case: it is inconsistent with the widely accepted principle that vertical mergers generally benefit consumers. This brief focuses on that fundamental issue and responds to the contrary economic arguments advanced by the Government's amici. This Court should decline the Government and amici's invitation to revolutionize antitrust law's approach to vertical mergers. Rather, to provide clear guidance for courts and businesses in future cases, this Court should affirm that a vertical merger is lawful unless the Government makes a threshold showing that the merger would enable the merged firm to deny rivals access to essential inputs or a substantial share of potential customers.

Jurists, scholars and the United States have long agreed that "the overwhelming majority of vertical mergers increase efficiency." Roundtable on Vertical Mergers, *Note by the Delegation of the United States to the Organization for Economic Co-operation and Development, Competition Committee* ("OECD Note") at 7, ¶ 26 (Feb. 15, 2007).[2] As the Director of the Federal Trade Commission's (FTC's) Bureau of Competition summarized, "there is a broad consensus in competition policy and economic theory that the majority of vertical mergers are beneficial because they reduce costs and increase the intensity of interbrand competition." D. Bruce Hoffman, *Vertical Merger Enforcement at the FTC* at 4, Jan. 10, 2018.[3] Indeed, a member of this

[2] https://www.ftc.gov/sites/default/files/attachments/us-submissions-oecd-and-other-international-competition-fora/07RoundtableonVertical Mergers.pdf.

[3] https://www.ftc.gov/system/files/documents/public_statements/1304213/hoffman_vertical_merger_speech_final.pdf.

Court's recent survey of economic studies found that "consumers mostly benefit from vertical integration."[4]

For decades, this consensus gave companies confidence that vertical mergers generally are lawful. Courts condemned or modified vertical mergers only in rare cases where they enabled a merged firm to freeze rivals out of essential inputs or a substantial portion of potential customers. And government enforcement actions themselves were sparing. The FTC and the Antitrust Division challenged only a couple of vertical mergers each year and did not bring any such case to trial in the last forty years.

The Government's approach to this case has supplanted a clear policy framework and replaced it with a highly uncertain and unpredictable standard, chilling vertical mergers that the Government itself agrees are usually "procompetitive or competitively neutral." U.S.

---

[4] Tad Lipsky, Joshua D. Wright, Douglas H. Ginsburg & John M. Yun, *The Federal Trade Commission's Hearings on Competition and Consumer Protection in the 21st Century, Vertical Mergers, Comment of the Global Antitrust Institute, Antonin Scalia Law School,* George Mason Law & Economics Research Paper No. 18-27 at 8 (Sept. 6, 2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3245940.

Br. at 2. The Supreme Court, however, has recognized that "unless business[es] can assess the legal consequences of a merger with some confidence, sound business planning is retarded." *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 362 (1963).

To that end—and consistent with the longstanding consensus among antitrust scholars, economists and policymakers strongly favoring vertical mergers—a vertical merger should be lawful unless, at a minimum, it enables the merged firm to deny rivals access to essential inputs or a substantial share of potential customers.[5]

That rule is consistent with decades-old precedent regarding vertical mergers. It aligns vertical merger law with well-recognized standards for evaluating other vertical restraints. It provides the bright-line rule businesses need to invest in transactions that can reshape key industries to consumers' advantage. And it suffices to affirm the judgment because the Government concedes that the merged firm in this case will not deny rival television distributors any

[5] Since the United States does not contend on appeal that Defendants were poised to compete with each other or that the merger would facilitate collusion, amici do not address the proper application of Section 7 to a merger on those facts.

programming content.

The Government and some amici oppose this threshold requirement, arguing that district courts in each case should forecast whether the merger is reasonably probable to harm competition based on a holistic review of case-specific record facts. That approach is even more amorphous than the standard used for *horizontal* mergers. Neither the Government nor amici, however, offer any roadmap for how district courts in future cases should sort through the record to "weigh[] the parties' competing visions of the future of the relevant market and the challenged merger's place within it." *AT & T*, 310 F. Supp. 3d at 165. They do not identify any particular form of evidence as particularly salient or probative. They do not supply anything resembling the tests or statistical indexes that courts and agencies use to predict horizontal mergers' effects. And they do not provide any standard for when "increased bargaining leverage," U.S. Br. at 33, crosses the line from competitive advantage to anticompetitive harm.

In short, the Government and amici would have this Court replace a clear consensus in favor of vertical mergers with a regime in which courts act as economic weathermen without so much as a barometer.

To make matters worse, they articulate no clear legal principle that this Court could use to review a district court's industrial prognostication without engaging in its own fact-finding mission. Indeed, the Government's appeal to clear error review underscores that it cannot identify a legal rule for this Court to apply. The most the Government can say is that "[e]conomics has long been the principal source of wisdom and logic in antitrust law," U.S. Br. at 45, while amici offer only that a vertical merger's competitive effects are an "empirical question." Br. of 27 Antitrust Scholars Supporting Neither Party at 16.

These truisms may be the beginning of a sound antitrust analysis of vertical mergers, but they cannot be the end. Businesses considering vertical mergers and courts trying to make sense of them need clear, administrable rules of law, not an invitation to jam the voluminous record into a crystal ball. "When everything is relevant, nothing is dispositive. Any one factor might or might not outweigh another, or all of the others, in the factfinder's contemplation. The formulation offers no help to businesses planning their conduct." Frank H. Easterbrook, *The Limits of Antitrust*, 63 Tex. L. Rev. 1, 12–13 (1984). Indeed, the Government does not identify any set of vertical mergers that courts could evaluate or clear without imposing on the parties the "staggering" costs of expedited litigation and months, if not years, of delay. *AT & T*, 310 F. Supp. 3d at 253.

This Court should therefore follow the Supreme Court's directive to formulate clear antitrust rules and affirm the judgment on the additional ground that the Government admittedly lacks evidence that the merged firm will freeze rivals out of essential inputs or a substantial share of customers.

ARGUMENT

I. VERTICAL MERGERS GENERALLY BENEFIT CONSUMERS.

This Court has recognized that "vertical integration creates efficiencies for consumers." *National Fuel Gas Supply Corp. v. FERC.*, 468 F.3d 831, 840 (D.C. Cir. 2006); *see also Tenneco Gas v. FERC*, 969 F.2d 1187, 1201 (D.C. Cir. 1992) (absent market power "vertical integration produces permissible efficiencies that cannot by themselves be considered uses of monopoly power") (quotation marks omitted). Specifically, "[v]ertical integration and vertical contracts in a competitive market encourage product innovation, lower costs for businesses, and create efficiencies—and thus reduce prices and lead to better goods and services for consumers." *Comcast Cable Commc'ns, LLC v. FCC*, 717 F.3d 982, 990 (D.C. Cir. 2013) (Kavanaugh, J., concurring).[6]

As a form of vertical integration, "most vertical mergers are procompetitive." Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law: An Analysis of Antitrust Principles & Their Application* ("*Antitrust Law*") (3rd and 4th Editions, 2018 Cum. Supp. 2010-2017), ¶1000. Indeed, while horizontal mergers are often efficient, "it is widely conceded that as a general matter, vertical mergers are inherently more likely to create substantial efficiencies than horizontal mergers." David T. Scheffman & Richard S. Higgins, *Vertical Mergers: Theory and Policy*, 12 Geo. Mason L. Rev. 967 (2004). Likewise, "respected scholars question the anticompetitive effects of vertical mergers in general."

[6] *Cf.* Douglas H. Ginsburg, *Vertical Restraints: De Facto Legality Under the Rule of Reason*, 60 Antitrust L.J. 67, 76 (1991) ("Antitrust law is a bar to the use of vertical restraints only in markets in which there is no apparent interbrand competition to protect consumers from a potentially welfare-decreasing restraint on intrabrand competition."); Robert H. Bork, *The Antitrust Paradox* 226, 237 (1978) ("Vertical mergers are means of creating efficiency, not of injuring competition.").

Alberta Gas Chemicals Ltd. v. E.I. Du Pont De Nemours & Co., 826 F.2d 1235, 1244 (3d Cir. 1987).

For these reasons, even as the United States agrees that most horizontal mergers are lawful, U.S. Br. at 2, it has long taken the position that "vertical mergers generally raise fewer competitive concerns than do horizontal mergers." OECD Note at 10, ¶ 37. Indeed, the Government's own Non-Horizontal Merger Guidelines provide that "non-horizontal mergers are less likely than horizontal mergers to create competitive problems." U.S. Department of Justice, *Non-Horizontal Merger Guidelines*, § 4.0 (June 14, 1984).

This explains why "vertical integration has generally been permitted," *It's My Party, Inc. v. Live Nation, Inc.*, 811 F.3d 676, 689 (4th Cir. 2016), and why the enforcement agencies challenged fewer vertical mergers in the last quarter century than the number of horizontal mergers they challenged in Fiscal Years 2016 and 2017 alone.[7] Even in those rare instances where the Government challenged

[7] *Compare* Steven C. Salop & Daniel P. Culley, *Vertical Merger Enforcement Actions: 1994-July 2018* (Aug. 23, 2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2684107, *with* Federal Trade Commission & Department of Justice, *Hart-Scott-Rodino*

vertical mergers, it did so because the mergers would combine potential competitors, facilitate horizontal information sharing among rivals, or result in denying essential inputs to rivals or freezing them out of a large portion of their customer base. What is more, the Government resolved nearly all of those challenges with remedies tailored to prevent foreclosure or collusion. No vertical merger case went to trial.[8]

The business community has been able to rely on courts', commentators' and enforcement agencies' clear favor for vertical mergers when investing in vertical integration that benefits consumers and makes the American economy more competitive.

Annual Report: Fiscal Year 2017 (April 2018), https://www.ftc.gov/system/files/documents/reports/federal-trade-commission-bureau-competition-department-justice-antitrust-division-hart-scott-rodino/p110014_fy_2017_hsr_report_final_april_2018.pdf; Federal Trade Commission & Department of Justice, *Hart-Scott-Rodino Annual Report: Fiscal Year 2016* (October 2017), https://www.ftc.gov/system/files/documents/reports/federal-trade-commission-bureau-competition-department-justice-antitrust-division-hart-scott-rodino/p110014_fy_2016_hsr_report_final_october_2017.pdf.

[8] *Id.*

II. THE CONSENSUS FAVORING VERTICAL MERGERS REFLECTS SOUND ECONOMICS.

That expectation reflected sound economics, for "on both theoretical and empirical grounds, the economic presumption is that vertical mergers are likely efficiency enhancing and good for consumers." Jeffrey Church, *Vertical Mergers*, 2 Issues in Competition Law and Policy 1455, 1463 (ABA Section of Antitrust Law 2008).

"Restraints imposed by agreement between competitors have traditionally been denominated as horizontal restraints, and those imposed by agreement between firms at different levels of distribution as vertical restraints." *Business Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 730 (1988).

"A 'horizontal merger' involves firms selling the same or similar products in a common geographical market." *FTC v. H.J. Heinz Co.*, 246 F.3d 708, 715 n.8 (D.C. Cir. 2001). The "effect on competition of such an arrangement depends, of course, upon its character and scope." *Brown Shoe Co. v. United States*, 370 U.S. 294, 334 (1962). In some cases, however, a horizontal merger "can enhance market power simply by eliminating competition between the merging parties." Federal

Trade Commission and Department of Justice, *Horizontal Merger Guidelines*, 2, § 1 (2010).

Although most horizontal mergers do not harm competition, *see* U.S. Br. at 2, vertical mergers are even less likely to do so because "[a] vertical merger, unlike a horizontal one, does not eliminate a competing buyer or seller from the market." *Fruehauf Corp. v. FTC*, 603 F.2d 345, 351 (2d Cir. 1979). "By definition, non-horizontal mergers involve firms that do not operate in the same market." *Non-Horizontal Merger Guidelines*, § 4.0. Vertical mergers involve mergers of "companies standing in a supplier-customer relationship." *Brown Shoe*, 370 U.S. at 323. "It necessarily follows that such mergers produce no immediate change in the level of concentration in any relevant market . . . ." Non-Horizontal Merger Guidelines, § 4.0.

Rather, "[v]ertical relationships differ fundamentally from horizontal ones, in that vertical relationships involve complementary goods." OECD Note at 3, ¶ 10. And "[v]ertical mergers have a stronger claim to being efficient than do horizontal mergers, given the fundamentally different effects of improved coordination between complements versus substitutes." *Id.* at 7, ¶ 24.

"Improved coordination between suppliers of *complementary* goods is an essential aspect of efficiency." *Id.* at 3, ¶ 11. "A single firm incorporating separate but closely related production processes can often be far more efficient than various independent entities transacting to produce the same good or bundle of goods." *It's My Party*, 811 F.3d at 689. Thus, as amici acknowledge, "[v]ertical mergers can lead to efficiencies by combining complementary assets, reducing costs and harmonizing incentives in the distribution chain, or creating economies of scope." Br. of 27 Antitrust Scholars Supporting Neither Party at 6.

For example, vertical mergers reduce consumer prices by eliminating a problem known as "Double Marginalization," "the situation in which two different firms in the same industry, but at different levels in the supply chain, each apply their own markups (reflecting their own margins) in pricing their products." *AT & T*, 310 F. Supp. 3d at 197. "Those 'stacked' margins are both incorporated into the final price that consumers have to pay for the end product." *Id.* "By vertically integrating two such firms into one, the merged company is able to shrink that total margin so there's one instead of two, leading to lower prices for consumers." *Id.* (quotation marks omitted); *see also Alberta Gas Chemicals Ltd.*, 826 F.2d at 1245 ("Because of post-merger efficiencies allowing it to purchase the acquiring company's output at a better price than in the marketplace, the acquired company's purchasing costs would fall—a procompetitive benefit capable of being passed on via lower prices for its products."). That benefit is present here: the Government's expert conceded that the merger would lead to $352 million in cost savings per year. *AT & T*, 310 F. Supp. 3d at 193.

Indeed, more generally, "empirical work has tended to show that vertical mergers (and vertical restraints) are typically procompetitive." Hoffman, *Vertical Merger Enforcement at the FTC* at 4. According to a review of economic literature by the most recent Deputy Assistant Attorney General for Economics in the Antitrust Division and other scholars, "there is a paucity of support for the proposition that vertical restraints/vertical integration are likely to harm consumers." James C. Cooper, Luke M. Froeb, Dan O'Brien, & Michael G. Vita, *Vertical Antitrust Policy as a Problem of Inference*, 23 Int. J. of Indus. Org. 639, 648 (2005).

Judge Ginsburg's recent survey of the economic literature likewise found that "[w]hile vertical integration can certainly foreclose rivals in theory, there is only limited empirical evidence supporting that finding in real markets." *The Federal Trade Commission's Hearings on Competition and Consumer Protection in the 21st Century, Vertical Mergers, Comment of the Global Antitrust Institute, Antonin Scalia Law School, George Mason University* at 8 (Sept. 6, 2018) (FTC Vertical Merger Hearing Comment).

Rather, a "far greater number of studies found that the use of vertical restraints in the particular context studied improved welfare unambiguously (i.e., resulted in lower prices and larger quantities)." Cooper, et al., *Vertical Antitrust Policy* 23 Int. J. of Indus. Org. at 648. Indeed, the "vast majority [of studies] support" the conclusion that "vertical-integration decisions are efficient, not just from the firms' but also from the consumers' points of view." Francine Lafontaine & Margaret Slade, *Vertical Integration and Firm Boundaries: The Evidence*, 45 J. of Econ. Literature 629, 680 (2007). *See also* Church, *Vertical Mergers* at 1500 ("The survey of both the theoretical and empirical literatures suggests a presumption that vertical mergers are efficient and beneficial for consumers.”).

III. THIS COURT SHOULD ESTABLISH A BRIGHT-LINE TEST AND AFFIRM ON THE ADDITIONAL GROUND THAT THE GOVERNMENT CONCEDEDLY FAILED TO PROVE THAT THE MERGED FIRM WOULD WITHHOLD INPUTS OR FORECLOSE CUSTOMERS.

“[T]he modern antitrust approach to vertical mergers should reflect the empirical reality that vertical relationships are generally procompetitive.” *FTC Vertical Merger Hearing Comment* at 8-9. Indeed, a procompetitive presumption for vertical mergers “aligns with the views of a number of authorities, including judges from this Circuit.” *AT & T*, 318 F. Supp. 3d at 194 n.20. This Court should make clear that, apart from theories of potential competition or collusion, vertical mergers are lawful unless they enable the merged firm to withhold essential inputs from competitors or foreclose competitors from a substantial proportion of potential customers. That rule is sufficient to affirm the judgment below because the Government has expressly disclaimed any argument that the merged firm would deny rivals access to television programming as an input to their distribution networks. *Id.* at 201 (quoting Government expert's testimony that "[t]his is not a foreclosure-withholding story").

Clarifying this "safe harbor" would give effect to Supreme Court precedent that has "repeatedly emphasized the importance of clear rules in antitrust law." *Pacific Bell Tel. Co. v. Linkline Commc'ns, Inc.*, 555 U.S. 438, 452 (2009). In fact, more than 50 years ago, the Supreme Court instructed that "in any case in which it is possible, without doing violence to the congressional objective embodied in [§] 7, to simplify the test of illegality, the courts ought to do so in the interest of sound and practical judicial administration." *Philadelphia Nat'l Bank*, 374 U.S. at 362; *see also* Church, *Vertical Mergers* at 1463 ("[T]o enjoin a vertical merger, the facts of the case must be particularly persuasive and supportive of the alleged theory of harm and, to the extent possible, rule out competing case theories.").

Likewise, other Courts of Appeals have decided the legality of vertical mergers based on whether they enable the merged firm to deny rivals an essential input or a major portion of their customer base. *See Alberta Gas Chemicals Ltd.*, 826 F.2d at 1246 (affirming dismissal to challenge to vertical merger absent evidence that it "precluded the plaintiff from selling any of its products"); *Fruehauf Corp.*, 603 F.2d at 360 (upholding vertical merger absent evidence that it "deprives rivals from major channels of distribution, much less . . . excludes them from the market altogether") (footnote omitted). *Compare Heatransfer Corp. v. Volkswagenwerk, A. G.*, 553 F.2d 964, 985 (5th Cir. 1977) (vertical merger unlawful where it "did more than merely keep [plaintiff] and other competitors from gaining sales" but "virtually precluded any of the competitors in the [relevant] market from openly competing with the [merged] company").

The Supreme Court likewise focused on this kind of foreclosure even before antitrust law and economics fully appreciated vertical integration's benefits, explaining that "[t]he primary vice of a vertical merger or other arrangement tying a customer to a supplier is that, by foreclosing the competitors of either party from a segment of the market otherwise open to them, the arrangement may act as a clog on competition." *Brown Shoe*, 370 U.S. at 323–24 (citation and quotation marks omitted); *see also* Church, *Vertical Mergers* at 1472 ("The traditional antitrust concern with vertical mergers is foreclosure:

postmerger, some buyers and some sellers are precluded from the market.").

Over the last several decades, as the Supreme "Court's treatment of vertical restraints has progressed," *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877, 900 (2007), antitrust law has required a similar proof to condemn other vertical restraints that "are generally more defensible than horizontal restraints." *State Oil Co. v. Khan*, 522 U.S. 3, 14 (1997). As such, requiring, at a minimum, that the merged firm would substantially foreclose customers or withhold inputs would harmonize vertical merger law with antitrust principles applicable to other forms of vertical integration.

For example, like vertical mergers, "[p]urely vertical refusals to deal, often referred to as exclusive dealing agreements, frequently have procompetitive justifications, such as limiting free riding and increasing specialization." *MM Steel, L.P. v. JSW Steel (USA) Inc.*, 806 F.3d 835, 849 (5th Cir. 2015). They are "a presumptively legitimate business practice." *United States v. Microsoft Corp.*, 253 F.3d 34, 69 (D.C. Cir. 2001); *see also Republic Tobacco Co. v. North Atl. Trading Co.*, 381 F.3d

717, 736 (7th Cir. 2004) ("Rather than condemning exclusive dealing, courts often approve them because of their procompetitive benefits.").

As such, exclusive dealing arrangements cannot be unlawful unless, at a minimum, they "freeze[] out a significant fraction of buyers or sellers from the market." *Geneva Pharm. Tech. Corp. v. Barr Labs. Inc.*, 386 F.3d 485, 508 (2d Cir. 2004). Indeed, "'the opportunities for other traders to enter into or remain in th[e] market must be significantly limited.'" *Microsoft*, 253 F.3d at 69 (quoting *Tampa Elec. Co. v. Nashville Coal Co.*, 365 U.S. 320, 328 (1961)). Such foreclosure also must be significant enough to inhibit rivals from putting competitive pressure on the defendant—for example, by preventing rivals from reaching efficient scale—that the foreclosure enhances the defendant's market power to "raise prices substantially above the competitive level," *Microsoft*, 253 F.3d at 51. *See id.* at 71 (exclusive contracts anticompetitive where they kept "usage of Navigator below the critical level necessary for Navigator or any other rival to pose a real threat to Microsoft's monopoly"); *see also McWane, Inc. v. FTC*, 783 F.3d 814, 838 (11th Cir. 2015) (same where exclusive dealing contracts deprived defendant's rivals "of distribution sufficient to achieve efficient scale") (quotation marks omitted).

The law applicable to a vertical tying arrangement, "an agreement by a party to sell one product but only on the condition that the buyer also purchases a different (or tied) product," *Northern Pac. Ry. Co. v. United States*, 356 U.S. 1, 5 (1958), reflects similar premises. *Cf. It's My Party, Inc.*, 811 F.3d at 689 (noting vertical integration's "apparent similarity to tying").

"Bundling obviously saves distribution and consumer transaction costs" and "can also capitalize on certain economies of scope." *Microsoft*, 253 F.3d at 87. "Recognizing the potential benefits from tying," *id.*, the Supreme Court has "refused to condemn tying arrangements unless a substantial volume of commerce is foreclosed thereby" and has held tying is lawful if "no portion of the market which would otherwise have been available to other sellers has been foreclosed." *Jefferson Par. Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 16, (1984), *abrogated on other grounds by Illinois Tool Works Inc. v. Independent Ink, Inc.*, 547 U.S. 28 (2006). Tying arrangements can be anticompetitive only when "the buyer is prevented from seeking alternative sources of supply for the tied product" and "competing suppliers of the tied product are foreclosed from that part of the market which is subject to the tying arrangement." *It's My Party,* 811 F.3d at 684 (citation omitted).

Even with these benefits, exclusive dealing and tying arrangements impose transaction costs. The benefits of vertical integration can "be better internalized by the [firms'] vertical merger, which would tend to result in lower prices or a quickened pace of quality improvement." OECD Note at 3, ¶ 11; *see also It's My Party*, 811 F.3d at 689. Because vertical mergers are even more likely than contractual arrangements to capture the procompetitive benefits of vertical integration, antitrust law should not condemn them absent the evidence required to condemn exclusive dealing and tying agreements.

Finally, prior to this case, both the Government and some amici appear to have supported a higher threshold showing to condemn vertical mergers. The Government now argues that vertical mergers should be evaluated case-by-case based on the totality of the circumstances. U.S. Br. at 4-5. Previously, however, the United States' position was that "vertical mergers merit a stronger presumption of being efficient than do horizontal mergers, and should be allowed to proceed except in those few cases where convincing, fact-based evidence relating to the specific circumstances of the vertical merger indicates likely competitive harm." OECD Note at 2, ¶ 1.

Amici also argue that "there is no good reason to apply a different standard of proof to horizontal and vertical merger cases, or to adopt a presumption that any efficiencies from a vertical merger likely will outweigh its anticompetitive effects." Br. of 27 Antitrust Scholars Supporting Neither Party at 3. Yet Amicus Professor Hovenkamp takes a different position in his treatise: "Most instances of vertical integration, including those that result from mergers, are economically beneficial. As a result, the presumptions in favor of vertical mergers should be stronger than the presumptions favoring horizontal mergers." Areeda & Hovenkamp, *Antitrust Law*, ¶ 1020.

IV. THE GOVERNMENT'S AND AMICI'S OPEN-ENDED APPROACH WILL CHILL AND ERRONEOUSLY CONDEMN MERGERS THAT BENEFTIT CONSUMERS.

The United States and amici now argue that academics have postulated certain theories about how vertical mergers could harm consumers. Citing these academic theories, amici contend that "whether any particular merger is likely to generate sufficient merger-specific efficiencies sufficient to outweigh any anticompetitive effects is an empirical question that needs to be decided on a case-by-case basis." Br. of 27 Antitrust Scholars Supporting Neither Party at 15-16.

Such an approach in which "[t]he burden of proving a violation of Section 7 is the same whether a merger is vertical or horizontal," Br. of Am. Antitrust Inst., *et al.* at 6, fails to "formulate antitrust principles in accordance with the appreciated differences in economic effect between vertical and horizontal agreements." *Leegin*, 551 U.S. at 888 ("reject[ing] the approach of reliance on rules governing horizontal restraints when defining rules applicable to vertical ones").

Even a horizontal merger's likely competitive effect "is not the kind of question which is susceptible of a ready and precise answer in most cases." *Philadelphia Nat'l Bank*, 374 U.S. at 362. Thus, this Court has adopted a presumption that a merger that "will lead to undue concentration" is reasonably likely to harm competition. *United States v. Anthem, Inc.*, 855 F.3d 345, 349 (D.C. Cir. 2017) (citation omitted). If the defendant can negate that inference, "the burden of producing additional evidence of anticompetitive effect shifts to the [plaintiff]." *Id.* at 350 (citation omitted; brackets in original).

Under the Government's proposed approach, every vertical merger case would begin with such an inquiry into "evidence of anticompetitive effect." *See* U.S. Br. at 2-6. The district court properly held that the Government had failed to sustain its threshold burden even under its misconceived approach. But the Government's proposed legal standard is flawed. As the Government has acknowledged, a vertical merger "produce[s] no immediate change in the level of concentration in any relevant market." Non-Horizontal Merger Guidelines, § 4.0. The Government should not start *every* vertical merger case in the same position as if it had proven an increase in market concentration that it concededly cannot prove in *any* vertical merger case. As the Government's own economic expert testified, vertical mergers require a "somewhat different" analysis than horizontal mergers. *AT & T*, 310 F. Supp. 3d at 193.

Regardless, even if amici were right that vertical mergers can in theory harm competition, the "paucity" of empirical evidence (confirmed by the record here) that vertical mergers actually harm competition, Cooper, et al., *Vertical Antitrust Policy* 23 Int. J. of Indus. Org. at 648, suggests that few do. And "[a]gainst the slight benefits of antitrust intervention here, we must weigh a realistic assessment of its costs." *Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 414 (2004). The speculative and marginal benefits of upending decades of antitrust consensus do not justify the likely costs of the Government's open-ended approach.

A. The Government's Vague Proposed Standard Would Chill Mergers that Benefit Consumers

Subjecting vertical mergers to the Government's vague standard would chill investments in vertical mergers that generally benefit consumers. *See* Church, *Vertical Mergers* at 1463 ("The cost of false injunctions not only includes foregoing benefits to consumers in the case at hand but potentially casting a 'chill' over other potentially procompetitive vertical mergers.").

Antirust rules "must be clear enough for lawyers to explain them to clients." *Town of Concord v. Boston Edison Co.*, 915 F.2d 17, 22 (1st Cir. 1990) (Breyer, C.J.). The Supreme Court has in fact cautioned courts against "the danger of . . . permitting a too-broad economic investigation" into a merger's effects. *Philadelphia Nat'l Bank*, 374 U.S. at 362. The Government's and amici's position, however, essentially is that vertical mergers should be subject to "antitrust law's unruly rule of reason," *FTC v. Actavis, Inc.*, 570 U.S. 136, 173 (2013) (Roberts, C.J., dissenting), which "requires the factfinder to decide whether under all the circumstances of the case the restrictive practice imposes an unreasonable restraint on competition." *Arizona v. Maricopa Cty. Med. Soc'y*, 457 U.S. 332, 343 (1982). *See* Br. of 27 Antitrust Scholars Supporting Neither Party at 13 (comparing approach to "rule of reason analysis under section 1").

Even where courts have evidence about how the challenged restraint has operated in the marketplace, an "elaborate inquiry into the reasonableness of a challenged business practice entails significant costs. Litigation of the effect or purpose of a practice often is extensive and complex." *Maricopa Cty. Med. Soc'y*, 457 U.S. at 343. And "the result of the process in any given case may provide little certainty or guidance about the legality of a practice in another context." *Id.* That is one reason why courts addressing forms of procompetitive vertical integration such as exclusive dealing have adopted a clear rule requiring "a significant degree of foreclosure." *Microsoft*, 253 F.3d at 69.

The Government, however, provides no rule of thumb that would "serve[] a useful screening function," *id.*, for a court assessing a vertically integrative merger. It proposes an open-ended inquiry into vertical mergers' "anti-competitive consequences" that will lead to even more "unpredictable results," *Kimble v. Marvel Entm't, LLC*, 135 S. Ct. 2401, 2411 (2015), and thus cast a shadow over prospective transactions. *Cf. Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 775 (1984) ("Subjecting a single firm's every action to judicial scrutiny for reasonableness would threaten to discourage the competitive enthusiasm that the antitrust laws seek to promote.").

Whereas a court applying the rule of reason generally has evidence of the restraint's "actual effect," *Ohio v. American Express Co.*, 138 S. Ct. 2274, 2284 (2018), evaluating a merger's effects involves "the uncertain task of assessing probabilities." *United States v. Baker Hughes Inc.*, 908 F.2d 981, 991 (D.C. Cir. 1990). Because a court generally must analyze a merger at its "incipiency," *United States v. Penn-Olin Chem. Co.*, 378 U.S. 158, 171 (1964), before the merged firm has operated in the market, "a predictive judgment, necessarily probabilistic and judgmental rather than demonstrable, is called for."

H.J. Heinz Co., 246 F.3d at 719 (quoting *Hospital Corp. of Am. v. FTC*, 807 F.2d 1381, 1389 (7th Cir. 1986)).

In those circumstances, "allocation of the burdens of proof assumes particular importance," *Baker Hughes*, 908 F.2d at 991, which is why this Court applies a presumptive burden-shifting framework using the Herfindahl–Hirschman Index test in horizontal merger cases. *See Anthem*, 855 F.3d at 349. However, that "'familiar' horizontal merger playbook is of little use" because a vertical merger "produce[s] no immediate change in the level of concentration in any relevant market." *AT & T*, 310 F. Supp. 3d at 192 (quoting *Non-Horizontal Merger Guidelines*, § 4.0). Accordingly, amici's position that there is "no reason to alter the legal standard or burden-shifting framework that applies," Br. of 27 Antitrust Scholars Supporting Neither Party at 12, would leave district courts at sea without any legal guidance for sorting through "complex and elusive" economic data to make "a prediction [of a merger's] impact upon competitive conditions in the future." *Philadelphia Nat'l Bank*, 374 U.S. at 362. And it would leave this Court with little choice other than to investigate the facts to make its own prediction.

In fact, the Government's proposed approach would lead to the untenable scenario in which vertical merger law is less clear than horizontal merger law even though vertical mergers' consumer benefits are even clearer than those of horizontal mergers.

Under the Government's proposed standard, the legality of vertical mergers that can "shape the future," U.S. Br. at 1, would turn largely on whether an expert can generate a model predicting that academic theories of how vertical mergers can harm consumers will actually come to pass. "But the problem is that those theories don't generally predict harm from vertical mergers; they simply show that harm is possible under certain conditions." Hoffman, *Vertical Merger Enforcement at the FTC* at 3. Those "models that exist have a far shorter track record than those used in assessing horizontal mergers." *Id.* As Judge Ginsburg recently found in surveying the economic literature, "[w]hile vertical integration can certainly foreclose rivals in theory, there is only limited empirical evidence supporting that finding in real markets." *FTC Vertical Merger Hearing Comment* at 8.

Companies cannot commit to the investments required for vertical mergers based on "predictions about the post-merger conduct of the merged firm where theoretical predictions are ambiguous." Hoffman, *Vertical Merger Enforcement at the FTC* at 3. It is one thing for firms to predict how courts will apply tools with a long track record to assess concentration or power in a market in which the firms already do business. It is quite another for firms to proceed with a vertical merger that a court will evaluate based on an expert's theoretical model of how the merged firm might bargain with its competitors. *Cf. Brooke Grp. Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 242 (1993) ("Expert testimony is useful as a guide to interpreting market facts, but it is not a substitute for them.").

Merger enforcement also must be more reliable than enforcers' ability to cherry-pick "gotcha" documents from slide decks that the district court here rightly held have only "marginal probative value." *AT & T*, 310 F. Supp. 3d at 204. *See A.A. Poultry Farms, Inc. v. Rose Acre Farms, Inc.*, 881 F.2d 1396, 1402 (7th Cir. 1989) ("Lawyers rummage through business records seeking to discover tidbits that will sound impressive (or aggressive) when read to a [factfinder]. Traipsing through the warehouses of business in search of misleading evidence both increases the costs of litigation and reduces the accuracy of decisions."). Such "sources of evidence, in addition to being highly idiosyncratic for each transaction, also tend to be non-public, and thus difficult for outside observers to assess when attempting to predict or critique [government] enforcement decisions." Hoffman, *Vertical Merger Enforcement at the FTC* at 3.

B. The Government's Approach Would Erroneously Block Mergers that Benefit Consumers

Courts forecasting possible anticompetitive effects without any presumptions or clear standards will unintentionally but inevitably block mergers that benefit consumers. The Government's approach of giving equal weight to vertical mergers' theoretical anticompetitive effects and their well-recognized procompetitive benefits provides no safeguard against such "false positives." *Trinko*, 540 U.S. at 414. Under Supreme Court precedent, that "counsels against an undue expansion of [antitrust] liability." *Id.*

The Supreme Court, in fact, has declined "to endorse a new theory of liability" based on amici's academic proposals for how a vertically integrated firm engaged in generally procompetitive practices "may harm competition" in some scenarios. *Linkline*, 555 U.S. at 455 (rejecting price squeeze claim where it was difficult to see any consequences "apart from the consequences of vertical integration itself") (quotation marks omitted).

This Court should likewise reject the Government's position that it can force companies to defend a vertical merger at a multi-week trial as long it has a theoretical expert model and testimony from self-interested rivals. "An overly aggressive enforcement posture toward vertical mergers would run the risk of hindering the ongoing realignment of firm boundaries that is necessary to maintaining an efficient allocation of resources in a dynamic economy." OECD Note at 10, ¶ 37. *Cf. It's My Party, Inc.*, 811 F.3d at 689 ("With advances in modern technology comes even greater potential for efficient integration, increased compatibility among products, and ties that are technological as much as or more than contractual. It would be unfortunate if an overly aggressive tying doctrine were to impede that innovation.").

The Government's approach portends that danger because "it is difficult to distinguish welfare-enhancing from welfare-reducing vertical practices based on evidence because the theory of vertical control tells us only that anticompetitive effects are possible. Until theory can be used to determine how likely it is that a restraint will lead to an anticompetitive outcome, it does not give us a way to interpret evidence in most cases." Cooper, et al., *Vertical Antitrust Policy* 23 Int. J. of Indus. Org. at 661-662.

As the United States itself explained in terms nearly clairvoyant of its failure of proof in this case: "Theoretical models of vertical merger typically reach ambiguous conclusions about competitive effects, or reach conclusions that exemplify the potential for competitive harm from vertical merger but are not robust to plausible changes in the models' underlying assumptions. Given the fragility of these theoretical results, they offer no sound general guidance to vertical merger enforcement policy." OECD Note at 8, § 30.

CONCLUSION

The judgment of the district court should be affirmed.

September 27, 2018

By: */s/Donald B. Verrilli, Jr.*

Donald B. Verrilli, Jr.
MUNGER, TOLLES & OLSON LLP
1155 F Street N.W., 7th Floor
Washington, D.C. 20004-1361
Telephone: (202) 220-1100
Fax: (202) 220-2300
Donald.Verrilli@mto.com

Justin P. Raphael
MUNGER, TOLLES & OLSON LLP
560 Mission Street, 27th Floor
San Francisco, CA 94105-3089
Telephone: (415) 512-4000
Fax: (415) 512-4077
Justin.Raphael@mto.com

Counsel for Amici Curiae

Peter C. Tolsdorf
Leland P. Frost
MANUFACTURERS' CENTER FOR LEGAL ACTION
733 10th Street, NW, Suite 700
Washington, DC 20001
(202) 637-3000

Counsel for Amicus Curiae *the National Association of Manufacturers*

Steven P. Lehotsky
Daryl Joseffer
U.S. Chamber Litigation Center

1615 H Street, NW
Washington, DC 20062
(202) 463-5337

Counsel for Amicus Curiae the Chamber of Commerce of the United States of America

Liz Dougherty
BUSINESS ROUNDTABLE
300 New Jersey Avenue
NW Suite 800
Washington, DC 20001
(202) 872-1260

Counsel for Amicus Curiae *Business Roundtable*

CERTIFICATE OF COMPLIANCE

1. This document complies with the word limit of Fed. R. App. P. 32(a)(7) because, excluding the parts of the document exempted by Fed. R. App. P. 32(f), this document contains 6,454 words, according to the word-processing program used to prepare it.

2. This document complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type-style requirements of Fed. R. App. P. 32(a)(6) because it uses proportionally spaced 14-point New Century Schoolbook typeface.

September 27, 2018

/s/ Donald B. Verrilli, Jr.
Donald B. Verrilli, Jr.

CERTIFICATE OF SERVICE

I hereby certify that on September 27, 2018, I caused a true and correct copy of the foregoing to be served on all counsel of record through the Court's CM/ECF system.

September 27, 2018 */s/ Donald B. Verrilli, Jr.*

Donald B. Verrilli, Jr.

APPENDIX A

The **Chamber of Commerce of the United States of America** is the world's largest business federation. It represents 300,000 direct members and indirectly represents the interests of 3 million companies and professional organizations of every size, in every industry sector, and from every region of the country. An important function of the Chamber is to represent the interests of its members in matters before Congress, the Executive Branch, and the courts. To that end, the Chamber regularly files *amicus curiae* briefs in cases that raise issues of concern to the Nation's business community.

The **National Association of Manufacturers (NAM)** is the largest manufacturing association in the United States, representing small and large manufacturers in every industrial sector and in all 50 states. Manufacturing employs more than 12 million men and women, contributes $2.25 trillion to the U.S. economy annually, has the largest economic impact of any major sector and accounts for more than three-quarters of all private-sector research and development in the nation. The NAM is the voice of the manufacturing community and the leading advocate for a policy agenda that helps manufacturers compete in the global economy and create jobs across the United States.

Business Roundtable is an association of chief executive officers of leading U.S. companies working to promote a thriving U.S. economy and expanded opportunity for all Americans. Business Roundtable members lead companies that together have more than $7 trillion in annual revenues and employ nearly 16 million employees. Business Roundtable was founded on the belief that businesses should play an active and effective role in the formation of public policy, and the organization regularly participates in litigation as *amicus* where important business interests are at stake.

The **Small Business & Entrepreneurship Council (SBE Council)** is an advocacy, research and education organization dedicated to promoting entrepreneurship and small business growth. For nearly 25 years, SBE Council has worked on a range of policy and educational initiatives to promote a healthy ecosystem for strong entrepreneurship, investment, innovation and vigorous economic growth. Its members have a strong interest in maintaining a policy environment that supports economic efficiencies, entrepreneurial opportunity and innovative business models that fuel economic dynamism.

U.S. Black Chambers, Inc. (USBC) is an association of over 100 Black Chambers and small business associations nationwide that provides visionary leadership and advocacy for the realization of economic empowerment. Through the creation of resources and initiatives, USBC supports African American Chambers of Commerce and business organizations in their work of developing and growing Black enterprises. Those enterprises have a strong interest in clear legal rules that do not inhibit investments in transactions that make industries more efficient and reduce prices for businesses and consumers.

The Latino Coalition (TLC) was founded in 1995 by a group of Hispanic business owners from across the country to research and develop policies relevant to Latinos. TLC is a non-profit nationwide organization based in Southern California, with offices in Washington, DC and Mexico. TLC addresses policy issues that directly affect the well-being of Hispanics in the United States. TLC's agenda is to develop initiatives and partnerships that will foster economic equivalency and enhance overall business, economic and social development of Latinos. TLC analyzes and report to the public about the impact of Federal, State and local legislation, and government regulations, has on the Latino communities. TLC is a 501 (c) (6) membership organization.