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I. Introduction

In July 2023, a federal district court rejected the Federal Trade Commission's bid to block Microsoft's acquisition of video game company Activision[2]—the latest in a string of three defeats for the Government in federal court vertical merger challenges that also included *AT&T/Time Warner* (2018) and *UnitedHealth/Change* (2022). This losing streak in vertical mergers stands in stark contrast to the agencies' historically outstanding litigation record in merger challenges: According to research by Georgetown Law professor Steve Salop and his co-authors, between 2001 and 2020, the Government won 65% of litigated outcomes and has an 85% success rate including post-complaint abandonments—an impressive litigation record that was largely compiled in horizontal merger challenges.[3]

This disparity is not entirely surprising. The legal doctrine that governs challenges to vertical and horizontal mergers is very different. When challenging a horizontal merger, the Government benefits from a presumption of competitive harm that shifts the burden to the merging parties if the merger significantly increases concentration and results in a highly concentrated market.[4] The structural presumption tilts the playing field in the Government's favor in horizontal merger challenges. But because a vertical merger does not involve direct competitors, it cannot create the "undue concentration" that underpins the presumption of harm in horizontal mergers.[5] With no presumption to rely on, the Government typically tries to satisfy its initial burden by showing that the merged firm will have (and the merger increases) the ability and incentive to foreclose competitors or otherwise harm competition—for instance, by denying competitors a critical input needed for production or making such an input available on worse terms. This usually comes down to predicting the firm's conduct after the merger—an inherently speculative exercise, particularly where the Government has to rely on economists' hypothetical models of the merged firm's incentives in the face of credible fact-witness testimony explaining why the Government's predictions do not reflect business reality or the company's plans. *Microsoft/Activision* played out much like the Government's two previous vertical merger losses—the court was unconvinced that the merged firm would use the acquired input (*Call of Duty* and other video game franchises) to foreclose competition from rival consoles.

While vertical merger doctrine has historically lacked a structural presumption, that may be about to change. The FTC and the DOJ recently proposed draft Merger Guidelines[6] that would introduce a share-based presumption for vertical mergers. The Guidelines do not create new law, but courts have viewed prior iterations of the Guidelines as persuasive authority, and

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[2] *FTC v. Microsoft Corp. ("Microsoft/Activision")*, No. 23-CV-02880-JSC2023 WL 4443412 (N.D. Cal. July 10, 2023).

[3] Logan Billman & Steven C. Salop, *Merger Enforcement Statistics: 2001–2020*, 85 ANTITRUST L. J. 1, 6 (2023).

[4] *See, e.g.*, *United States v. Anthem, Inc.*, 855 F.3d 345, 349 (D.C. Cir. 2017), *United States v. Baker Hughes, Inc.*, 908 F.2d 981, 982 (D.C. Cir. 1990).

[5] *See Baker Hughes*, 908 F.2d at 982; *see also Republic Tobacco Co. v. N. Atl. Trading Co.*, 381 F.3d 717, 737 (7th Cir. 2004) ("As horizontal agreements are generally more suspect than vertical agreements, we must be cautious about importing relaxed standards of proof from horizontal agreement cases into vertical agreement cases."), 4AAREEDA & HOVENKAMP, ANTITRUST LAW ¶ 1000a ("[T]he basic economic reason for limiting horizontal mergers is well-founded and rather generally accepted: horizontal mergers increase market concentration, and high market concentration can substantially lessen competition among rivals, particularly with respect to price. Unfortunately, there is no comparable theoretical basis for dealing with vertical mergers.").

[6] UNITED STATES DEP'T OF JUSTICE & FED. TRADE COMM'N, MERGER GUIDELINES (2023) [hereinafter Draft Guidelines], https://www.justice.gov/d9/2023-07/2023-draft-merger-guidelines_0.pdf. These draft Guidelines are in the public comment stage and are not yet final.

many provisions have seeped into the caselaw.[7] In particular, courts have treated the Guidelines' horizontal HHI-based thresholds[8] as persuasive in applying a presumption that a merger will lessen competition.[9] It remains to be seen how courts will react to the new Guidelines, and whether the Guidelines will alter the Government's litigation gameplan for vertical merger challenges.

II. *AT&T, United, Microsoft:*[10] Similar Strategies and Similar Outcomes

A. United States v. AT&T Inc.[11]

In the first of the Government's recent vertical merger losses, District of Columbia Judge Richard Leon rejected the DOJ's challenge to the merger between AT&T (owner of multichannel video programming distributors DirecTV and U-verse) and Time Warner (owner of cable networks, including TNT, TBS, CNN, and HBO).[12]

The Government's lead theory of harm was that the merged firm would have the ability and incentive to use the threat of withholding cable networks from rival cable and streaming companies to force rivals pay more for those networks, ultimately making these rivals less attractive in the process.[13] This is a variation of input-foreclosure theory—instead of withholding an input (here, video content) entirely, a merged firm may make it available to rivals only at a higher price or on worse terms, raising rivals' costs and degrading their ability to compete. The Government supported its theory of harm with an economic model purporting to show that the merged firm would have greater leverage in negotiating fees for Time Warner's networks because it stood to lose less if no agreement was reached (due to AT&T's DirecTV and U-verse supposedly benefitting from their rivals not carrying Time Warner's networks).[14] The Government's economist predicted that greater leverage would lead to higher fees, which in turn would lead to higher cable prices that would outweigh the $352 million in cost savings generated by the merger for AT&T customers.[15]

The defendants not only rebutted the model (by showing that after correcting inputs, the model predicted *lower* rather than *higher* prices),[16] but also convinced Judge Leon that the economic prediction was inconsistent with real-world evidence. First, the court found no evidence that prior vertical integration had resulted in higher prices and credited testimony from vertically integrated rivals that vertical integration did not give cable networks more leverage to negotiate higher carriage fees.[17] The court also credited executive testimony that withholding Time Warner content would be too costly to serve as a credible threat and that it was squarely within the merged firm's interest to have its content

[7] *See, e.g.*, *Anthem*, 855 F.3d at 349 ("Although . . . the court is not bound by, and owes no particular deference to, the Guidelines, this court considers them a helpful tool, in view of the many years of thoughtful analysis they represent, for analyzing proposed mergers.") (citing *Baker Hughes*, 908 F.2d at 985–86); *FTC v. H.J. Heinz Co.*, 246 F.3d 708, 716 (D.C. Cir. 2001) (applying the HHI-based structural presumption citing the Guidelines).

[8] HHI, or the Herfindahl-Hirschman Index, is a measure of market concentration calculated by summing the squares of all market participants' market shares.

[9] *Heinz*, 246 F.3d at 716 ("Sufficiently large HHI figures establish the FTC's prima facie case that a merger is anti-competitive. . . . The merger . . . will increase the HHI by 510 points. This creates, by a wide margin, a presumption that the merger will lessen competition.").

[10] The FTC also challenged a vertical merger between genetic testing company Illumina and early cancer-detection test developer Grail in an administrative proceeding in March 2021. Complaint, In the Matter of Illumina, Inc. and Grail, Inc., FTC Dkt. No. 9401 (March 30, 2021). After the FTC lost in front of the administrative law judge the Commission overturned the decision. Final Order, *In the Matter of Illumina, Inc., and Grail, Inc.*, FTC Dkt. No. 9401 (April 3, 2023), https://www.ftc.gov/system/files/ftc_gov/pdf/d09401commissionfinalorder.pdf. The parties are currently appealing the Commission's decision to the Fifth Circuit Court of Appeals.

[11] 310 F. Supp. 3d 161 (D.D.C. 2018), *aff'd* 916 F.3d 1029 (D.C. Cir. 2019).

[12] *Id.*

[13] *Id.* at 198–201.

[14] *Id.* at 201.

[15] *Id.* at 199, 202–204.

[16] *Id.* at 219–42.

[17] *Id.* at 215–19.

distributed as widely as possible.[18] Judge Leon also found that the Government's economist failed to consider the defendants' commitment to not withhold content and to go to arbitration with licensees if they could not agree on fees.[19] Finally, Judge Leon credited the defendants' stated motivation for the merger: using video content to keep up with innovative competitors like Netflix rather than squeezing more revenue out of licensing Time Warner's networks.[20]

Ultimately, the court found that the Government could not meet its burden of showing that the merger was likely to substantially lessen competition based on its economic model that the court concluded "has not been supported by sufficient real-world evidence."[21] The Government's model could not overcome executive testimony about how the merger fit into the company's business strategy, evidence about how network licensing negotiations played out in real life, and analysis of historical vertical integration. As the court put it, "antitrust theory and speculation cannot trump facts."[22]

B United States v. UnitedHealth Group. Inc.[23]

Judge Nichols of the District for the District of Columbia handed the Government its second recent loss in a vertical merger challenge in September 2022, denying DOJ's bid to enjoin UnitedHealth Group's acquisition of Change Healthcare, a provider of first-pass claims-editing solutions and electronic data interchange ("EDI") clearinghouse services—i.e., "pipes" for transmitting information between healthcare providers and payers.[24]

The Government advanced a vertical foreclosure theory that United would use its control of Change's EDI clearinghouse to disadvantage rival insurers by withholding or delaying the sale of EDI-related innovations.[25] As in *AT&T* (and with frequent citations to Judge Leon's *AT&T/Time Warner* opinion), the court found that the Government's predictions did not overcome the real-world evidence defendants presented.[26] First, the court found that United had never withheld prior innovations from its rivals, citing testimony from United's former CEO that the "business is fiercely multi-payer" and that he could not "think of any instance where [United] withheld product and services to rivals."[27] The court also found that United had never degraded the products it sold to rivals and had strong incentives not to jeopardize "sales to over 80 percent of the market" and "up to 40 percent of its total revenue" by doing so, again supported heavily by executive testimony.[28] Finally, despite the Government's contention that the merger would change United's incentives because these losses would be "offset by downstream gains in commercial health insurance markets" based on its expert's economic model, the court concluded that the testimony of United's CEO and other executives "is far more probative of post-merger behavior than" the Government's expert's "independent weighing of costs and benefits."[29]

The Government was unable to carry its initial burden under its vertical foreclosure theory. Just like in *AT&T*, the court chose to credit executive testimony and real-world facts rather than the

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[18] *Id.* at 222–24.

[19] *Id.* at 217–18.

[20] *Id.* at 182, 210 ("At trial, the evidence showed that defendants view the proposed merger as an essential response to the industry dynamics described above—that is, the increasing importance of web- and mobile-based content offerings; the explosion in targeted, digital advertising; and the limitations attendant with AT&T's and Time Warner's respective business models.").

[21] *Id.* at 224.

[22] *Id.* at 221 (quoting *FTC v. Arch Coal, Inc.*, 329 F. Supp. 2d 109, 116 (D.D.C. 2004)).

[23] 630 F. Supp. 3d 118 (D.D.C. 2022), *dismissed,* No. 22-5301, 2023 WL 2717667 (D.C. Cir. Mar. 27, 2023).

[24] *Id.* at 123–24.

[25] *Id.* at 152. Though the Government also put forth a horizontal theory and a vertical data-misuse theory, we focus on the foreclosure theory for the purposes of this article.

[26] *Id.* at 152–55.

[27] *Id.* at 153.

[28] *Id.* ("The evidence also established, and the Court finds, that Optum has never sold one version of a product to UHC while selling a degraded version to other customers.").

[29] *Id.* at 154.

Government's forecasts of how the merged firm might behave.

C. FTC v. Microsoft Corp. ("Microsoft/Activision")[30]

The Government's most recent defeat in a vertical merger challenge came in July 2023, when Judge Corley of the Northern District of California rejected the FTC's bid to block Microsoft's acquisition of video game company Activision Blizzard.[31] The FTC's case centered around its theory that the transaction would empower Microsoft (owner of the Xbox video game console, a gaming subscription service, and a cloud gaming platform) to foreclose its rivals' access to Activision's popular video game titles, particularly the popular *Call of Duty* franchise.

The Government supported its foreclosure theory with an economic model purporting to show that the combined firm would profit from making *Call of Duty* an Xbox exclusive, with increased console sales outweighing the loss of game sales on PlayStation consoles.[32] But the defendants successfully argued that the government's estimate of the key input in this model, the percentage of PlayStation users who would switch to Xbox if that were the only way to play *Call of Duty*, was speculative, "not based on evidence," and conveniently set just high enough to push Xbox exclusivity into profitability—when lowered "just a bit," it would yield a finding that Xbox exclusivity "would *not* be profitable."[33] The court also faulted the Government's model for not taking into account Microsoft's commitments to make *Call of Duty* available on rival platforms and the "reputational harm to Microsoft from pulling *Call of Duty* from millions of players."[34] Rejecting the Government's model, the court instead relied on witness testimony that the merged firm has no plans for *Call of Duty* exclusivity, that any potential profits of exclusivity would be outweighed by reputational harm and the loss of revenue from non-Xbox users, and that Microsoft has made commitments to several console and PC competitors to continue providing *Call of Duty* titles on fair terms.[35]

Turning to the game-subscription services market, the court assumed up front that the merged firm *would* make *Call of Duty* exclusive to Microsoft's subscription service.[36] But the court held that this exclusivity would not "substantially lessen competition in the subscription services market"[37] because, as the Activision CEO testified, Activision would not have made its games available on ***any*** subscription service without the merger.[38] The court found that the FTC's evidence did not credibly dispute the procompetitive effect of the transaction bringing Activision titles to the subscription market, even if only to Microsoft's service.[39]

In rejecting the FTC's challenge, the court continued the trend of crediting defendants' evidence about the rationale for the merger over the Government's predictions based on economic models of the merged firm's incentives. Like prior courts weighing vertical merger challenges, the court found persuasive executives' testimony about future plans, commitments not to foreclose rivals, and arguments that the company had reputational or

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[30] *Fed. Trade Comm'n v. Microsoft Corp.*, No. 23-CV-02880, 2023 WL 4443412 (N.D. Cal. July 10, 2023)

[31] Though the FTC lost the preliminary injunction hearing in district court, it issued an order returning the matter to administrative adjudication, setting an evidentiary hearing for "twenty one days after the

United States Court of Appeals for the Ninth Circuit issues its opinion regarding the appeal of

the district court decision." *See* Order Returning Matter to Adjudication, *In re: Microsoft Corp*., Dkt. No. 9412 (Fed. Trade Comm'n, Sep. 26, 2023), *available at* https://www.ftc.gov/system/files/ftc_gov/pdf/608644.2023.09.25_d09412_-_order_returning_matter_to_adjudication.pdf. So the FTC is preserving its ability to seek to unwind the merger through administrative adjudication.

[32] *Id.* at *16.

[33] *Id.*

[34] *Id.* at *17.

[35] *Id.* at *14–15.

[36] *Id.* at *19–20.

[37] *Id.* at *20.

[38] *Id.*

[39] *Id.*

other business reasons to continue dealing with rivals.

III. Do the New Merger Guidelines Portend a Change in Vertical Merger Enforcement?

Just nine days after Judge Corley handed down the *Microsoft* opinion, the FTC and the DOJ released the long-anticipated revised draft Merger Guidelines. While the Guidelines reflect traditional vertical merger doctrine (including the foreclosure theory featured in recent failed challenges) they also contain two key additions absent in the previous version of the vertical guidelines.[40] First, the Guidelines introduce a share-based presumption for vertical mergers: If the merging firm has at least 50 percent market share for some product or service used by its rivals, the merger will be presumed to be anticompetitive.[41] Second, the Guidelines state that the agencies will give little weight to claims that a firm will not foreclose rivals due to risk of reputational harm, commitments not to foreclose, or the claimed intent of the companies' executives[42]—precisely the type of evidence district courts have found persuasive in recent vertical merger trials.

The Guidelines are not the law and are not binding on the courts—they describe purported agency practice, not judicial rules. Nevertheless, it is premature to conclude that the Guidelines will not impact courts' approach to vertical mergers. Prior versions of the Guidelines have proven influential with the courts. As noted above, courts have largely picked up the HHI-based presumption of anticompetitive effects for horizontal mergers.[43] It is true that unlike a vertical structural presumption, a market-share-based structural presumption for horizontal mergers is rooted in Supreme Court precedent— the famous *United States v. Philadelphia National Bank* holding that horizontal mergers resulting in market share over 30 percent are presumptively anticompetitive.[44] But courts have found the prior Guidelines persuasive even in the absence of clear precedent. As Carl Shapiro and Howard Shelanski show, the 2010 revisions to the Guidelines drove increased judicial acceptance of unilateral effects theories (based on loss of direct competition between the merging firms) and markets defined around targeted customers.[45] It is an open question whether the new vertical presumption and the de-emphasis on evidence that has helped vertical merger defendants in recent cases will influence the courts.

Also in question is how the Government will approach vertical merger challenges going forward:

- Will it follow the same playbook that resulted in losses in *AT&T, United,* and *Microsoft*?
- Will it try to leverage the Guidelines to persuade the courts to apply a share-based presumption? If so, will it try to generate more support for the presumption, perhaps via empirical studies or merger retrospectives showing the presumption is justified?
- Will it accept that district courts appear to put more stock in real-world facts than in hypothetical models of future incentives, and try to select cases where real-world facts strongly support the Government's theory—admittedly somewhat of a challenge in cases where the key question requires the court to predict future conduct?
- Will it adjust the substance or framing of the economic models used to support vertical

[40] *See* Draft Guidelines, *supra* note 6, at 16–17. There is also a notable omission: unlike the prior Vertical Merger Guidelines, the new Guidelines do not mention procompetitive efficiencies associated with vertical mergers, such as the elimination of double marginalization.

[41] *Id.* § II.6.A.

[42] *Id.* § II.5.A.

[43] *See FTC v. H.J. Heinz Co.*, 246 F.3d 708, 716 (D.C. Cir. 2001).

[44] *United States v. Philadelphia Nat. Bank,* 374 U.S. 321, 363–64 (1963) ("[A] merger which produces a firm controlling an undue percentage share of the relevant market, and results in a significant increase in the concentration of firms in that market is so inherently likely to lessen competition substantially that it must be enjoined in the absence of evidence clearly showing that the merger is not likely to have such anticompetitive effects.").

[45] *See* Carl Shapiro & Howard Shelanski, *Judicial Response to the 2010 Horizontal Merger Guidelines*, 58 REV. INDUS. ORG. 51, 60–62, 65–69 (2021).

merger challenges—for example, making models more robust to reasonable changes in inputs and assumptions, or using models which can be explained using an accessible narrative that incorporates factual evidence?

The only thing that is certain is that with vertical mergers continuing to be a key focus for antitrust enforcers, the answers to these questions will be hotly anticipated by the antitrust bar.