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Changes to Vertical M&A Transactions: Will Digital Start-Ups Feel the Effects?

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Executive Summary

While antitrust enforcers in the United States and abroad traditionally have approached vertical M&A transactions with relatively lenient scrutiny, recent actions by U.S. authorities signal that this attitude is changing. "Vertical Transactions" are mergers between suppliers or input providers and customers. Last year, the Federal Trade Commission ("FTC") withdrew its Vertical Merger Guidelines and started to increase its enforcement against vertical transactions. The change in position creates uncertainty for certain kinds of transactions that, in the past, would have closed without any, or very little, challenge. The new approach may be especially significant to acquisitions of start-ups within the digital platform market.

WITHDRAWAL OF VERTICAL MERGER GUIDELINES

In September of 2021, the FTC's Chair Lina M. Kahn, Commissioner Rohit Chopra, and Commissioner Rebecca Kelly Slaughter issued a statement to withdraw the FTC's Vertical Merger Guidelines that had just been issued in 2020. The statement emphasized the agency's view that the Clayton Act prohibits any merger or acquisition that "may" substantially lessen competition in any line of commerce or activity affecting commerce. In addition, the FTC announced that it would expand its approach and assess potential market structure-based presumptions to identify certain practices and characteristics as presumptively illegal, evaluate past remedial practices, and expand its view of potential harms from vertical transactions, such as harms to the labor market.

RECENT FTC CHALLENGES TO VERTICAL TRANSACTIONS UNDER NEW THEORIES OF ALLEGED HARM

Lockheed-Aerojet: Lockheed Martin Corporation, a U.S. aerospace, arms, defense, information security and technology manufacturer ("Lockheed"), had proposed a $4.4 billion acquisition of Aerojet Rocketdyne Holdings Inc, a U.S. rocket and missile propulsion supplier ("Aerojet"), whose missile propulsion systems are used in missiles made by Lockheed and other defense contractors. The FTC challenged the transaction and argued that it would lessen competition because it would give Lockheed control over critical components that

Lockheed's competitors and propulsion suppliers need to engage in the market. Further, the FTC alleged that Aerojet, as a supplier, holds competitively sensitive information about Lockheed's competitors and that the transaction would grant Lockheed access to such information. Missile maker Raytheon Technologies had welcomed the FTC challenge.

In response, Lockheed and Aerojet offered remedies, specifically to create a firewall to ensure that Aerojet continue to work equally with all other large defense prime contractors. This approach was similar to the remedy that was put in place to allow Northrop Grumman's acquisition of Orbital ATK in the summer of 2018. However, the FTC rejected Lockheed's and Aerojet's proposed remedy and filed suit, seeking to enjoin the deal. Shortly thereafter, Lockheed elected not to defend the lawsuit and terminated the merger agreement

NVIDIA-Arm: NVIDIA Corporation ("NVIDIA"), a semi-conductor chip supplier, sought to acquire Arm, Ltd. ("Arm"), a U.K. based chip designer in a $40 billion transaction that would have been one of the biggest semiconductor mergers of all time. The FTC sued to block the transaction, alleging that the transaction would provide NVIDIA with control over critical technology designed by Arm, enabling the limiting of production and preventing Arm from licensing its innovations that conflict with NVIDIA's business interest. Further, the FTC alleged that the merger would provide NVIDIA with competitively sensitive information of Arm's licensees, many of which are NVIDIA's rivals.

To address the FTC's concerns, NVIDIA and Arm offered to spin-off Arm's licensing business as an independent entity, even though ultimately controlled by NVIDIA. The FTC rejected the proposed remedy and NVIDA and Arm terminated the proposed transaction.

Both examples show how the FTC's new leadership is challenging vertical merger transactions under a new theory of harm, in addition to the traditional economic analysis. Specifically, the FTC seems to focus on the potential harm to competitor's ability to compete and engage with the market. Moreover, both challenged transactions received bipartisan consensus, potentially marking a new era of increasing scrutiny of M&A transactions that has continued across administrations.

KEY TAKEAWAYS

The FTC's approach to non-horizontal mergers clearly has changed. This change may be especially significant to the digital platforms market and acquisitions of start-ups within that market. In stepping away from focusing on the traditional economic analysis, i.e., procompetitive benefits to consumers, such as lower prices and efficiency, the FTC will likely stress non-price discrimination, such as revoking access policies or gaming algorithms. Moreover, safeguards for competition that may have been acceptable in the past, may no longer suffice. Lastly, the FTC seems to have recognized that digital platforms are characterized by significant network externalities and that many acquisitions within the digital platform market typically fall below the Hart-Scott-Rodino (HSR) reporting thresholds. It remains to be seen how the FTC will revise its Vertical Merger Guidelines, but more scrutiny of vertical transactions is to be expected.

Please contact Riebana E. Sachs or a member of the Corporate, Finance or Acquisition Group with any questions.