Statement of Commissioner Joshua D. Wright
In the Matter of Graco, Inc.

FTC File No. 101-0215

April 17, 2013

The Commission has voted to issue a Complaint and Order against Graco, Inc. ("Graco") to remedy the allegedly anticompetitive effects of Graco's acquisition of Gusmer Corp. ("Gusmer") in 2005 and GlasCraft, Inc. ("GlasCraft") in 2008. I supported the Commission's decision because there is reason to believe Graco's acquisitions substantially lessened competition in the market for fast-set equipment in violation of Section 7 of the Clayton Act. I want to commend staff for their hard work in this matter. Staff has conducted a thorough investigation and developed strong evidence that Graco's acquisition of Gusmer and GlasCraft likely resulted in higher prices and fewer choices for consumers.

I write separately to discuss two aspects of the Order with which I respectfully disagree, namely the provisions prohibiting Graco from entering into exclusive dealing contracts with distributors and establishing purchase and inventory thresholds that must be satisfied in order for distributors to obtain discounts. Both provisions are aimed at prohibiting exclusivity or, in the case of purchase and inventory thresholds, loyalty discounts that might be viewed as *de facto* exclusive arrangements. I am not persuaded in this case that prohibiting exclusive dealing contracts and regulating loyalty discounts will make consumers better off. To the contrary, these provisions may lead to reduced output or higher prices for consumers. I therefore do not believe the limitations on such arrangements imposed by the Order are in the public interest.

I. Appropriate Use of Behavioral Remedies

The majority and I agree that although the most suitable remedy for an anticompetitive merger usually is a divestiture of assets, under certain circumstances behavioral remedies may be appropriate.[1] One scenario in which behavioral remedies may be appropriate is when the challenged merger has long since been consummated and divestiture or other structural remedies are not a viable option for restoring competition to pre-merger levels. Given that Graco has fully integrated Gusmer and Glascraft and discontinued their product lines, divestiture is not an option and the Commission should rightly consider whether behavioral remedies in this case would protect consumers.

As with merger remedies generally, when deciding whether and what behavioral remedy to impose, the Commission must ultimately be guided by its mission of protecting consumers.[2]

[1] *See e.g.*, Fed. Trade Comm'n, Statement of Federal Trade Commission's Bureau of Competition on Negotiating Merger Remedies, at 5 (2012), *available at* http://www.ftc.gov/bc/bestpractices/merger-remediesstmt.pdf (stating the Commission favors structural relief, such as divestitures, in horizontal mergers, but that behavioral relief may be appropriate in some cases).

[2] The Commission should keep in mind that ours is not a binary choice simply between imposing a structural or a behavioral remedy. The most attractive option from a consumer welfare point of view for any given circumstance may be to block the merger in its entirety, allow the merger to proceed without any remedy, or a hybrid solution combining some aspects of each of these options. Having ruled out structural remedies in this case, the question is

Because behavioral remedies displace normal competitive decision-making in a market, they pose a particularly high risk of inadvertently reducing consumer welfare and should be examined closely prior to adoption to ensure consumers' interests are best served. In particular, effective behavioral remedies must be "tailored as precisely as possible to the competitive harms associated with the merger to avoid unnecessary entanglements with the competitive process."[3] Merely showing high market shares and the unavailability of structural remedies does not justify restricting conduct that typically is procompetitive because these conditions do not make the conduct any more likely, much less generally likely, to be anticompetitive.[4] A minimum safeguard to ensure remedial provisions – whether described as fencing-in relief or otherwise – restore competition rather than inadvertently reduce it is to require evidence that the type of conduct being restricted has been, or is likely to be, used anticompetitively to harm consumers.

With this analytical framework in mind, I support those remedies in the Order that seek to restore pre-merger competition by imposing restrictions closely linked to the evidence of anticompetitive harm in this case. For instance, staff uncovered evidence Graco threatened distributors that considered carrying fast-set equipment sold by competing manufacturers, and that these threats actually led to distributors not purchasing the competing products. Staff also learned that distributors refused to purchase fast-set equipment from Gama/PMC, one of the few fringe competitors remaining after Graco's acquisitions, because of the uncertainty resulting from Graco's lawsuit against Gama/PMC. The Order thus appropriately prohibits Graco from retaliating against distributors that consider purchasing fast-set equipment from other manufacturers[5] and requires Graco to settle its lawsuit against Gama/PMC.

In contrast, and as is discussed in more detail below, there is insufficient evidence linking the remedial provisions in the Order prohibiting exclusive dealing contracts and regulating loyalty discounts to the anticompetitive harm in this case.

II. Prohibitions on Exclusive Dealing

It is widely accepted that exclusive dealing and *de facto* exclusive contracts – while generally efficiency enhancing – can lead to anticompetitive results when certain conditions are satisfied. The primary competitive concern is that exclusive dealing may be used by a monopolist to raise rivals' costs of distribution by depriving them the opportunity to compete for distribution sufficient to achieve efficient scale, and ultimately harm consumers by putting competitors out of

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which, if any, of the non-structural alternatives best improves consumer welfare. *See* Ken Heyer, *Optimal Remedies for Anticompetitive Mergers*, 26 ANTITRUST 27 (2012) (arguing behavioral remedies are not justified simply because structural remedies are unavailable, and that an agency should weigh the economic costs and benefits of each non-structural alternative, including doing nothing).

[3] U.S. Dep't of Justice Antitrust Div., Antitrust Division Policy Guide to Merger Remedies, at 7 n.12 (June 2011), *available at* http://www.justice.gov/atr/public/guidelines/272350.pdf; *see also*, Heyer, *supra* note 2, at 27-28 ("[A]mong the most important considerations in devising a behavioral remedy is that there be a close nexus between the remedy imposed and the theory of harm motivating its use.").

[4] In fact, efficiencies justifications for exclusive dealing contracts apply, and some even more strongly, when a firm has market power.

[5] Such retaliatory conduct alone is outside the normal competitive process and has no plausible procompetitive benefit. Its proscription therefore is unlikely to harm consumers. Of course, a decision by Graco to refuse to sell to distributors who do not enter into an exclusive contract should not itself be proscribed as illegitimate retaliation.

business.[6] On the other hand, the economic literature is replete with procompetitive justifications for exclusive dealing, including aligning the incentives of manufacturers and distributors, preventing free-riding, and facilitating relationship-specific investments.[7] In fact, the empirical evidence substantially supports the view that exclusive dealing arrangements are much more likely to be procompetitive than anticompetitive.[8]

Because exclusive dealing contracts typically are procompetitive and a part of the normal competitive process, the Commission should only restrict the use of such arrangements when there is sufficient evidence that they have or are likely to decrease consumer welfare. This ensures consumers the merger remedy does not deprive them the fruits of the competitive process. The evidence in this case is insufficient to conclude that Graco has used, or intends to use, exclusive dealing or *de facto* exclusive contracts to foreclose rivals and ultimately harm consumers. To the contrary, the Commission's Complaint describes the fast-set equipment market as one particularly well suited for exclusive arrangements. Specifically, the Complaint acknowledges the sale of fast-set equipment demands specialized third party distributors that possess the technical expertise to teach consumers how to use and maintain the manufacturer's equipment.[9] One could therefore easily imagine that manufacturers might only be willing to provide training to distributors if they have some assurance that current or future competitors will be unable to free ride on their investments in the distributors' technical expertise. Exclusive dealing arrangements with distributors are one well-known and common method of preventing such free riding.

The provisions in the Order prohibiting exclusive contracts therefore may needlessly harm consumers by deterring potentially procompetitive arrangements. For that reason, I do not believe that provision is in the public interest.

III. Restrictions on Loyalty Discounts

The primary anticompetitive concerns with loyalty discounts are analytically similar to those associated with exclusive dealing and *de facto* exclusive contracts.[10] As with exclusive dealing, the economic literature also supports the view that loyalty discounts more often than not are procompetitive.[11] The Commission's competition mission therefore is best served by an

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6 *See e.g.,* Alden F. Abbott & Joshua D. Wright, *Antitrust Analysis of Tying Arrangements and Exclusive Dealing, in* ANTITRUST LAW AND ECONOMICS 183, 194-96 (Keith N. Hylton ed., 2d ed. 2010). There also are novel theories of anticompetitive harm, including models exploring the possibility that certain types of discount programs effectively impose a tax upon distributors' choice to expand rivals' sales and thereby potentially prevent rivals from acquiring a sufficient number of retailers to cover the fixed costs of entry. *See e.g.*, Joe Farrell, et al., *Economics at the FTC: Mergers, Dominant-Firm Conduct, and Consumer Behavior*, 37 (4) REV. INDUS. ORG. 263 (2010).

7 *See e.g.*, Abbott & Wright, *supra* note 6, at 200-01; Francine Lafontaine & Margaret Slade, *Exclusive Contracts and Vertical Restraints: Empirical Evidence and Public Policy, in* HANDBOOK OF ANTITRUST ECONOMICS, 393-94 (Paolo Buccirossi, ed., 2008); Benjamin Klein & Kevin Murphy, *Exclusive Dealing Intensifies Competition for Distribution*, 75 ANTITRUST L. J. 433, 465 (2008).

8 *See e.g.*, Abbott & Wright, *supra* note 6, at 200-01; Lafontaine & Slade, *supra* note 7, at 393-94.

9 Complaint ¶ 24, Graco, Inc., FTC File No.101-0215, (April 17, 2013).

10 *See generally* Bruce H. Kobayashi, *The Economics of Loyalty Discount and Antitrust Law in the United States*, 1 COMP. POL'Y INT'L 115 (2005).

11 *Id.*

approach that counsels against imposing restrictions on loyalty discounts unless there is sufficient evidence to establish that such arrangements have or are likely to harm competition and consumers.

The Order permits Graco to enter into certain loyalty discount agreements that require distributors to meet annual purchase and inventory thresholds to qualify for discounted prices.[12] The Order, however, restricts the scope of these loyalty discounts by prescribing the maximum threshold levels Graco may set in 2013 and by only allowing those maximums to increase by 5 percent year to year. Although there is evidence that Graco in some instances increased the inventory and purchase thresholds it required distributors to meet to receive discounts on fast-set equipment following its acquisitions, I have not seen evidence sufficient to link these increases to the anticompetitive effects of the mergers alleged in the Commission's Complaint. For example, I have seen no evidence that a distributor dropped Gama/PMC or any other fringe competitor in response to Graco's increased thresholds. Further, although there appears to be evidence that at least some distributors are unable to both meet the thresholds necessary to receive Graco's discounts and carry competing manufacturers' products, there is nothing barring these distributors from forgoing those discounts in order to carry multiple products lines. It has been several years since Graco increased the thresholds. In the absence of evidence this change harmed competition, the fact that some distributors prefer to take the discounts is not a sufficient reason to believe that prohibiting these contracts will protect consumers. Moreover, it is unlikely that the Commission is best positioned to gauge what the appropriate threshold should be for each distributor over time and as market conditions change.

As a result, based upon the available evidence, I am concerned the restrictions on loyalty discounts in the Order ultimately may reduce consumer welfare rather than protect competition. Thus, I do not believe this aspect of the Order is in the public interest.

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For these reasons, I voted in favor of the Commission's Complaint and Order, but respectfully disagree with the Order provisions prohibiting exclusive contracts and restricting loyalty discounts. To the extent the majority believes Graco may use such arrangements to engage in anticompetitive conduct in the future, the Commission's willingness and ability to bring a monopolization claim where the evidence indicates it is appropriate would protect consumers against the competitive risks posed by these arrangements without depriving consumers of their potential benefits.

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[12] Decision & Order § III(6)(c), Graco, Inc., FTC File No.101-0215, (April 17, 2013).