# Public Comment to the Federal Trade Commission on the Preliminary Approval of the Staples - Essendant Merger

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A few weeks ago the FTC affirmed a Consent Agreement between Staples Inc., Sycamore Partners (owner of Staples), and Essendant Inc., allowing Staples to acquire all outstanding shares of Essendant's stock if the merging parties agree not to share certain commercially sensitive information.[1]

It has been nearly three years since Staples was blocked from merging with Office Depot. Now we see Staples attempting to achieve the same anti-competitive ends through vertical integration. This parallels what we have seen in other industries.

Lax enforcement of vertical mergers -- in part thanks to the US District Court's ruling against the DOJ in the AT&T-Time Warner merger -- has essentially opened a back door for bypassing horizontal merger enforcement by merging vertically and using foreclosure to gain horizontal market share. Two years ago, the Justice Department blocked the Aetna-Humana and Anthem-Cigna mergers. Those were horizontal mergers between top health insurance companies that if left unchallenged would leave the US with three dominant insurers -- the third one being United Healthcare.

Following the consummation of the AT&T-Time Warner merger, Aetna merged with CVS, to have access to its Pharmacy Benefit Manager (PBM), Caremark. Cigna purchased Express Scripts, the largest independent PBM. Hospitals integrating with medical practices is a common practice by which healthcare providers skirt limits on horizontal concentration. The use of vertical mergers to reduce horizontal competition represents a loophole in antitrust enforcement created by misguided economic theories that supposedly imply vertical mergers pose less of a competitive threat. As a result of those misguided theories, for example that the elimination of double-marginalization (EDM) is "automatic" for vertical mergers, merger law is far more lax for vertical mergers than for horizontal. **The economic theories that underly that differing enforcement posture are empirically false**.

The statement of the commission majority rejects the argument that the combined entity could exercise its monopsony power over suppliers, instead claiming that reductions in its costs would be pro-competitive, not anti-competitive.[2] It makes no statement about the effect of the

[1] Analysis of Agreement Containing Consent Order to Aid Public Comment.
[2] Statement of Chairman Joseph J. Simons, Commissioner Noah Joshua Phillips, and Commissioner Christine S. Wilson Concerning the Proposed Acquisition of Essendant, Inc. by Staples, Inc.

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labor markets. The fact that the FTC continues to ignore monopsony concerns in labor markets and among suppliers belies the Chairman's recent testimony in both houses of Congress.[3]

Staples went private in 2017 after declining for several years. Sycamore Partners, the private equity firm that owns Staples, is known for asset-stripping dying retail businesses. They acquired Anne Klein, Hot Topic, Talbots, and a few other brick-and-mortar stores and drove them to the ground while making enormous profits. They are known to use aggressive cost cutting strategies such as massive layoffs and take over the supply chain by using sourcing deals with other Sycamore-owned supply agents. For example, they took a stake in Aeropostale and offered $150 million in loans that included a sourcing deal to buy garments through MGF Sourcing. This way, they would profit regardless if Aeropostale was able to sell their merchandise. This is a good example of why lax vertical merger policy is empirically flawed: the idea that a retailer would source preferentially from an affiliated supplier is supposed to be "punished" by the threat of entry. It works nicely in theory, but it has nothing to do with reality, where vertically-affiliated segments often have enormous incentives to discriminate in ways that benefit insiders at the expense of the public and of the competitive process. Aeropostale went bankrupt and Sycamore's CEO, Stefan Kaluzny, attempted to purchase their remaining assets. In their bankruptcy filings, Aeropostale alleged Sycamore was responsible for overcharging them for goods and leading them to bankruptcy.[4]

The fact that commission was concerned that data shared between Essendant and Staples could aid in the foreclosure of Staples competitors raises questions as to whether the commission should could consider data as a competitive resource in other vertical merger enforcement. For example, in the Amazon-Whole Foods merger, the commission did not investigate whether Amazon would be able to gather data about Whole Foods customers (or vice versa) that would enable the combined entity to reduce competition or to price-discriminate in any of the markets where it is active. The acquisition of Whole Foods meant Amazon also owns their private label "365". Amazon has been known to compete with vendors on their site through their own private labels and have the advantage due to their data collection. Similar behavior with Whole Foods is expected but comes at a cost to both smaller and larger suppliers. Amazon's use of Prime discounts cuts their suppliers margins but leaves their private label profitable.[5] The Commissions acknowledgement of the potential harms of data sharing in the Essendant-Staples merger should therefore apply to Amazon retrospectively and to future vertical merger enforcement.

Given what has happened in other industries and Sycamore's recent history, we can lay out the potential anti-competitive harms from allowing this merger to proceed. Sycamore may use Essendant to foreclose Staples competitors in the business-to-business office supply sales. The Consent Agreement in place will supposedly limit the data sharing between the merging parties, but by the time a breach of the consent order might be litigated court, damage would be done. The Consent Agreement does not specifically state that preferential pricing between the merging parties over other competitors will not be allowed. In a market where there are

[3] For example, Chairman Simons's Senate testimony in October 2018: that the FTC staff had been instructed to "look for potential effects on the labor market in every merger they review."
[4] How One Investor Made a Fortune Picking Over the Retail Apocalypse.
[5] Whole Foods places new limits on suppliers, upsetting some small vendors.

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only two nationwide wholesale distributors, Essendant and S.P. Richards Company, Staples' competitors would be more sensitive to price spikes.[6] The strong potential for foreclosure of other business-to-business office supply firms should be grounds for blocking this merger.

[6] Statement of Commissioner Rebecca Kelly Slaughter In the Matter of Sycamore Partners, Staples, and Essendant

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