



Americans for Financial Reform Education Fund

February 27, 2019

Federal Trade Commission
Office of the Secretary
Constitution Center
400 7th Street SW
Washington, DC 20024

Re: Proposed Consent Agreement in the Matter of Staples/Essendant, Inc., File No. 1810180

To Whom It May Concern:

Americans for Financial Reform Education Fund (AFR) appreciates the opportunity to comment on the above referenced Proposed Consent Agreement (the “Agreement”) by the Federal Trade Commission (the “Commission”). AFR is a coalition of more than 200 national, state, and local groups who have come together to advocate for reform of the financial industry. Members of AFR include consumer, civil rights, investor, retiree, community, labor, faith based, and business groups.¹

The Staples/Essendant merger raises important questions concerning the market power that can be created by vertical mergers, as well as the incentives of private equity companies such as Staples parent owner Sycamore to take advantage of such market power. We believe that the remedies in the Agreement are unlikely to halt exploitation of the market power gained in the merger, and particularly unlikely to do so given the incentives of private equity owners such as Sycamore. “Firewalls” such as those proposed in the Agreement have been used for decades as part of financial regulation and there is strong evidence that they tend to be ineffective.

The Commission has recently re-examined the level of scrutiny that should be given to vertical mergers, including by reviewing recent scholarships that highlights the potential harms of vertical mergers.² While the impacts of vertical mergers can vary widely, the acquisition of Essendant is particularly likely to cause competitive harms. Essendant is one of only two nationwide wholesale distributors of office supplies and as such is a critical supplier to Staples retail competitors.³ The merger with Essendant could give Staples access to extremely detailed information on these retail competitors, as well as the ability to price services differentially to competitors. The Commission’s staff analysis concludes that in the absence of a remedy the

¹ A list of coalition members is available at: <http://ourfinancialsecurity.org/about/our-coalition/>.

² See: Proceedings from *Hearings on Competition and Consumer Protection in the 21st Century*, a Federal Trade Commission and Georgetown University event, November 1, 2018. Available at: <https://bit.ly/2Q7viUI>. Also see: Steven C. Salop, Invigorating Vertical Merger Enforcement, *The Yale Law Journal*, Vol. 127, 1962-1994 (2018). Available at: <https://bit.ly/2IBCt7Z>.

³ U.S. Federal Trade Commission, Analysis of Agreement Containing Consent Order to Aid Public Comment in the Matter of Sycamore Partners II, L.P., Staples, Inc., and Essendant Inc., File No. 181-0180, Docket No. C-4667. Available at: <https://bit.ly/2Xo3NtU>.

availability of sensitive commercial information to Staples through its ownership of Essendant would “substantially lessen competition in the market for the sale and distribution of office products to midmarket business-to-business customers by eliminating direct and substantial competition between Staples and Essendant’s resellers, which could result in higher prices to midmarket end customers.”⁴

The proposed remedy in the Agreement is to require Sycamore to create a “firewall” separating Essendant’s wholesale selling functions from Staples retail end customer sales functions. The Agreement will provide that “only those Staples employees performing wholesale, legal and regulatory, or shared services functions or members of a prescribed management oversight group will have access to the Protected Commercially Sensitive Information, and only to the extent necessary to perform their assigned functions.”⁵

We believe that it is highly unlikely that this proposed “firewall” solution will be effective in preventing the abuse of commercially sensitive information in the newly merged firm. Firewalls have a long history in areas of securities and banking regulation with which AFR is highly familiar. The evidence from this history indicates that these kind of firewalls tend to be ineffective in preventing deliberate abuse of inside information. As one study put it, “Chinese Walls are more successful in preventing the accidental flow of inside information than they are in preventing purposeful misconduct and conspiracies to share information”.⁶ Recent studies by academic economists have repeatedly found powerful empirical evidence that informational firewalls are extremely porous and that traders and executives in diversified financial firms are able to access and misuse information obtained across internal firewalls.⁷

Further, one would expect the firewall proposed in this Agreement to be even less effectively enforced than the informational firewalls in financial firms. The Commission has less oversight resources than banking and securities regulators charged with enforcing the firewalls against conflicts of interest in financial firms. In addition, a “prescribed management oversight group”, likely involving personnel from Sycamore, would be able to see over the firewall and access information from both sides of the business. As Commissioner Chopra’s dissent points out, the record of aggressive business practices and short-term incentives in the private equity space will make it extremely challenging to ensure that a private equity firm like Sycamore will refrain from accessing the competitive advantages to be gained by using commercially sensitive information.

⁴ Id. at 3

⁵ Id. at 4

⁶ Christopher M. Gorman, Are Chinese Walls the Best Solution to the Problems of Insider Trading and Conflicts of Interest in Broker-Dealers?, *Fordham Journal of Corporate & Financial Law*, Vol. 9, No. 2, Article 5 (2004). Available at: <https://bit.ly/2BVITdy>.

⁷ For two recent examples of such research, see: H. Nejat Seyhun, Insider Trading and Effectiveness of Chinese Walls in Securities Firms, *The Journal of Law, Economics & Policy*, Vol. 4, 369, (2007), available at: <https://bit.ly/2TkIHnQ>.

And, S. Burcu Avci, Cindy A. Schipani & H. Nejat Seyhun, Eliminating Conflicts of Interest in Banks: The Significance of the Volcker Rule, *35 Yale Journal on Regulation* 343 (2018), available at: <https://bit.ly/2tD5i9W>.

Since the Commission’s own analysis indicates that the information sharing made possible by this merger will damage competitive balance, we urge the Commission to simply overrule the merger rather than rely on the dubious solution of a “firewall” that will be difficult for the Commission to oversee and enforce.

Although the Agreement focuses only on the issue of information sharing, this is not the only issue. As Commissioner Savage points out in her dissent, Essendant’s ability to price goods differentially to Staples’ competitors is likely to create competitive harm, given that there is only one other nationwide wholesaler of office supplies and it may be costly for independent retailers to switch from Essendant to S.P. Richards.⁸ Commissioner Chopra in his dissent also points out that the newly formed firm will gain additional monopsony buying power relative to suppliers, creating harms that are not counterbalanced by benefits to downstream consumers.⁹

In sum, it is irresponsible for the Commission to wave through a major merger that its own analysis finds will create competitive harms, based simply on an agreement to create an informational firewall between different parts of the business. We urge the Commission to follow the logic of its own staff analysis and overrule this merger.

Thank you for the opportunity to comment on this Agreement. If you have questions, please contact Marcus Stanley, AFR’s Policy Director, at 202-466-3672 or marcus@ourfinancialsecurity.org

Sincerely,

Americans for Financial Reform Education Fund

⁸ U.S. Federal Trade Commission, Statement of Commissioner Rebecca Kelly Slaughter In the Matter of Sycamore Partners, Staples, and Essendant, Commission File No. 181-0180, January 28, 2019. Available at: <https://bit.ly/2BcXOi5>.

⁹ U.S. Federal Trade Commission, Statement of Commissioner Rohit Chopra In the Matter of Sycamore Partners, Staples, and Essendant, Commission File No. 181-0180, January 28, 2019. Available at: <https://bit.ly/2DI0QLj>. See also, C. Scott Hemphill & Nancy L. Rose, Mergers that Harm Sellers, *The Yale Law Journal*, Vol. 127, No. 7, (2018), available at: <https://bit.ly/2GMfmGh>.