



**United States of America  
Federal Trade Commission**

# **Vertical Merger Policy: What Do We Know and Where Do We Go?**

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\* The views expressed in these remarks are my own and do not necessarily reflect the views of the Federal Trade Commission or any other Commissioner. Many thanks to my Attorney Advisor, Keith Klovers, for assisting in the preparation of these remarks.

## **I. Introduction**

Thanks to the team at Global Competition Review for inviting me to speak today. And thanks also to those of you who have traveled to be here. Some of you have come from abroad, while others – like me – have selflessly sacrificed a few blissful days in the Polar Vortex to be here in warm and sunny South Miami Beach.

Being in South Florida is a homecoming of sorts for me. I was born in Orlando, grew up in South Florida, and studied under Professor Roger Blair at the University of Florida during my undergraduate career. (Coincidentally, given the topic of my talk today, Professor Blair co-authored a book on vertical integration that still sits on my bookshelf.<sup>1</sup>)

Before launching into the substance, I must provide the standard disclaimer: The views I express today are my own, and do not necessarily reflect the views of the Federal Trade Commission or any other Commissioner.

With the administrative details out of the way, I would like to spend our time together this morning on the topic of vertical merger policy. Specifically, over the next 30 minutes I will summarize the FTC’s recent action and statements in the Staples / Essendant matter; build on the issues raised in the various Commission statements by reviewing what we know about the likely competitive effects of vertical mergers; and, given what we know, examine whether it makes sense for the Commission to set out its views on vertical merger analysis, either by issuing new Vertical Merger Guidelines or publishing those views in some other format.

## **II. The Staples / Essendant Decision**

### **A. The Commission Order and Statements**

You may have heard that, earlier this week, the Commission accepted a consent order to resolve potential competitive concerns associated with Staples’ acquisition of Essendant.<sup>2</sup>

The transaction combined Staples, a leading retailer of office supplies, with Essendant, a leading wholesaler. Both firms serve medium-sized business customers. Staples does so directly, albeit with only limited success. Essendant does so indirectly by supplying smaller dealers who in turn supply these customers. As a technical matter, the merger was not vertical in nature, as Essendant is neither upstream nor downstream from Staples. Instead, Essendant is adjacent to Staples, serving medium-sized business customers through a separate distribution chain. But the transaction raised a standard vertical merger problem – information sharing – because owning Essendant would allow Staples to understand the cost structure of some of its competitors (namely, the small dealers who purchased supplies from Essendant).

The Commission accepted the consent agreement by a vote of three to two. Chairman Joseph Simons, Commissioner Noah Phillips, and I voted “yes,” whereas Commissioners Rohit

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<sup>1</sup> ROGER D. BLAIR & DAVID L. KASERMAN, LAW AND ECONOMICS OF VERTICAL INTEGRATION AND CONTROL (1983).

<sup>2</sup> See Press Release, FTC, FTC Imposes Conditions on Staples’ Acquisition of Office Supply Wholesaler Essendant Inc., Jan. 28, 2019, <https://www.ftc.gov/news-events/press-releases/2019/01/ftc-imposes-conditions-staples-acquisition-office-supply>

Chopra and Rebecca Slaughter dissented.<sup>3</sup> Altogether, the Commissioners issued four statements – one by the majority and three separate statements by Commissioners Chopra, Slaughter, and me.<sup>4</sup> Although I commend all of the statements to you, allow me to summarize.

Broadly speaking, the statements fell into two categories. First, the majority and our dissenting colleagues debated various points related to the case itself. For example, the statements addressed whether the firewall we imposed was sufficient to remedy the only source of likely anticompetitive harm arising from the transaction.<sup>5</sup> Commissioner Chopra also asserted that there were other viable theories of harm that needed to be remedied.<sup>6</sup> In that vein, the majority and Commissioner Chopra debated whether the Commission should have given more credence to monopsony theories of harm and whether the Commission should view acquisitions by private equity firms differently.<sup>7</sup>

Second, Commissioner Slaughter and I used this opportunity to explain our views on vertical merger policy generally. It is that broader policy question to which I now turn.

## **B. The Broader Debate about Vertical Merger Policy**

As she explains in her statement, Commissioner Slaughter believes federal merger policy, including vertical merger policy, has been too permissive. In her view, we are having a “great debate,” both in Washington and “around the country at family dinner tables,” about “the consequences for American citizens of fewer and more dominant companies controlling large swaths” of the economy.<sup>8</sup>

In Commissioner Slaughter’s view, “vertical mergers that integrate trading partners can be just as pernicious [as horizontal mergers] in sapping our economy’s vitality.”<sup>9</sup> Moreover, she expressed concern “that our conclusions depend on unreliable assumptions and predictions about how a vertically integrated firm will conduct itself and are too credulous about claimed procompetitive benefits unique to vertical integration.”<sup>10</sup>

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<sup>3</sup> *Id.*

<sup>4</sup> Statement of Chairman Simons, Commissioner Phillips, and Commissioner Wilson, Sycamore Partners II, L.P., No. 181-0180, Jan. 28, 2019 [hereinafter Majority Statement]; Statement of Commissioner Chopra, Sycamore Partners II, L.P., No. 181-0180, Jan. 28, 2019 [hereinafter Chopra Statement]; Statement of Commissioner Slaughter, Sycamore Partners II, L.P., No. 181-0180, Jan. 28, 2019 [hereinafter Slaughter Statement]; Statement of Commissioner Wilson, Sycamore Partners II, L.P., No. 181-0180, Jan. 28, 2019 [hereinafter Wilson Statement].

<sup>5</sup> Majority Statement, *supra* note 4, at 1-3; Chopra Statement, *supra* note 4, at 1-4.

<sup>6</sup> Chopra Statement, *supra* note 4, at 2-4 (identifying harm to “upstream trading partners,” “a strong incentive to rapidly increase margins,” the possibility that Sycamore, as a private equity firm, “will operate assets much differently than a typical buyer,” and potential “abuse of data”).

<sup>7</sup> *Id.*; Majority Statement, *supra* note 4, at 3 (“The evidence here did not support any monopsony theory, and instead was consistent with procompetitive cost reductions. . . . The Commission does not dwell on motives that have no relevance to how the acquiring company would use the acquired business to harm the competitive process.”).

<sup>8</sup> Slaughter Statement, *supra* note 4, at 1.

<sup>9</sup> *Id.*

<sup>10</sup> *Id.* at 4.

Finally, Commissioner Slaughter called upon the Commission to conduct more merger retrospectives of “close cases” – a category into which she would put Staples / Essendant. She cites several benefits to this approach, including the fact it “would allow the Commission to challenge the consummated merger or any anticompetitive behavior by the merged entity.”<sup>11</sup>

I have great respect for Commissioner Slaughter – but I view vertical mergers quite differently. Although my statement is more detailed, I will condense it today into the following four points.

First, vertical merger policy is part of a broader debate. My dissenting colleagues argue that U.S. merger policy, including vertical merger policy, has been too permissive.<sup>12</sup> Yet there is scant evidence that markets are less competitive today than they were in some ill-defined golden age of yore. Moreover, the evidence my colleagues do cite is both methodologically flawed and unable to measure changes in market power in relevant antitrust markets.<sup>13</sup>

Second, it is folly to think the Commission unilaterally can “fix” a perceived laxity in antitrust enforcement simply by being more aggressive. Ultimately we must try our cases, either in the first instance or on appeal, before federal judges. Therefore, we as enforcers do not have the last word. Given judicial review of our actions, attempts to be more aggressive – for example, if the FTC were to bring suit in a case where the agency cannot provide evidence of anticompetitive harm – may well backfire by creating binding precedents that constrain future challenges to problematic deals.

Third, there is no reason to fundamentally “rethink” vertical merger policy given how much we know about the economics of vertical integration. We are not making decisions based on a blank slate – economic analysis has taught us much about the competitive effects of vertical mergers, and we continue to add to that body of knowledge. To date we have used, and going forward we should continue to use, this learning to shape our approach to vertical merger enforcement. Additional retrospectives on vertical mergers should further enable us to advance our learning and refine our enforcement policies.

Fourth, when we identify a vertical merger that presents meaningful antitrust problems, we must choose a remedy that is narrowly tailored to address the likely competitive harms without doing collateral damage. More on this, too, a bit later.

### **III. What Do We Know about the Likely Competitive Effects of Vertical Mergers?**

I said a moment ago that we know much about the economics of vertical integration. For today’s purposes, I will focus on four concepts.

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<sup>11</sup> *Id.* at 6.

<sup>12</sup> *Id.* at 2 & n.6 (“I am particularly concerned that the current approach to vertical integration has led to substantial under-enforcement. . . . I am also concerned about under-enforcement of horizontal mergers.”); Chopra Statement, *supra* note 4, at 2 (“I share the concerns raised by Commissioner Slaughter and agree that our approach can lead to lax enforcement.”).

<sup>13</sup> See Wilson Statement, *supra* note 4, at 1-3.

First, we know that competitive harm is less likely to occur in a vertical merger than in a horizontal one. Vertical mergers by definition combine firms that operate at different levels of production. Consequently, a vertical merger does not alter concentration in any relevant market.<sup>14</sup> Purely vertical mergers therefore do not implicate many of the key competitive dynamics – and particularly the elimination of current competition between the merging firms – at play in horizontal mergers.<sup>15</sup> Indeed, Professor Steven Salop, another former mentor of mine who has written extensively on the potential harms from vertical mergers, agrees that competitive harm is likely to occur only in a narrow set of circumstances.<sup>16</sup>

Second, we know that integrating operations at different levels of production often yields clear economic benefits.<sup>17</sup> The most often cited of these is the elimination of double marginalization (EDM). Some commentators, including Professor Carl Shapiro, view EDM as a phenomenon “*inherent*” in vertical mergers.<sup>18</sup> The FTC’s Director of the Bureau of Competition, Bruce Hoffman, has said likewise.<sup>19</sup>

Vertical mergers create other benefits, as well. They allow firms at successive levels of the supply chain to coordinate their production, design, or innovation activities, thereby reducing costs, increasing quality, and speeding the introduction of new products.<sup>20</sup> They also incentivize

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<sup>14</sup> For example, if a merger unites a firm with 30 percent of the upstream market and a firm with 25 percent of the downstream market, immediately after close the combined firm would still control 30 percent of the upstream market and 25 percent of the downstream market. Its shares would not have changed, and neither would those of its competitors. In contrast, a horizontal merger combining firms with 25 and 30 percent of the same relevant antitrust market would result in a combined firm with 55 percent market share and a marketplace with one fewer competitor.

<sup>15</sup> See, e.g., D. Bruce Hoffman, Director, FTC Bureau of Competition, Vertical Merger Enforcement at the FTC: Remarks at the Credit Suisse 2018 Washington Perspectives Conference, at 2-3, Washington D.C., Jan. 10, 2018, available at [https://www.ftc.gov/system/files/documents/public\\_statements/1304213/hoffman\\_vertical\\_merger\\_speech\\_final.pdf](https://www.ftc.gov/system/files/documents/public_statements/1304213/hoffman_vertical_merger_speech_final.pdf) (“In contrast [to horizontal mergers], vertical mergers do not combine substitutes, and in fact often involve complements . . . . Where horizontal mergers reduce competition on their face . . . vertical mergers do not.”).

<sup>16</sup> See Michael H. Riordan & Steven C. Salop, *Evaluating Vertical Mergers: Reply to Reiffen and Vita Comment*, 63 ANTITRUST L.J. 943, 944 (1995) (agreeing with other commentators that “efficiency benefits provide the rationale for many vertical mergers, can lead to increased competition and consumer welfare, and are sufficient to offset potential competitive harms in many cases”); Steven C. Salop, Revising the Vertical Merger Guidelines: Presentation at the FTC Hearings on Competition and Consumer Protection in the 21st Century, at 8 (Nov. 1, 2018), available at [https://www.ftc.gov/system/files/documents/public\\_events/1415284/ftc\\_hearings\\_5\\_georgetown\\_slides.pdf](https://www.ftc.gov/system/files/documents/public_events/1415284/ftc_hearings_5_georgetown_slides.pdf) (“A stronger overarching procompetitive presumption for vertical mergers does not make sense in oligopoly markets.”)

<sup>17</sup> For the seminal work, see R.H. Coase, *The Nature of the Firm*, 4 ECONOMETRICA 386 (1937).

<sup>18</sup> Transcript at 19, 25, 116, 141, FTC Hearings on Competition and Consumer Protection in the 21st Century, Hearing #5 (consumer welfare and vertical merger policy), available at [https://www.ftc.gov/system/files/documents/public\\_events/1415284/ftc\\_hearings\\_session\\_5\\_transcript\\_11-1-18.pdf](https://www.ftc.gov/system/files/documents/public_events/1415284/ftc_hearings_session_5_transcript_11-1-18.pdf) (statements of Prof. Shapiro) (“[T]here are some inherent efficiencies – at least possible efficiencies including elimination of double marginalization. . . . So I think what is fundamentally different is that how do we handle the efficiencies in the vertical deals than horizontal, and we are hearing from panels about these inherent efficiencies, which economists would agree with, including me.”)

<sup>19</sup> Remarks of D. Bruce Hoffman, *supra* note 15, at 3 (“Due to the elimination of double-marginalization and the resulting downward pressure on prices, vertical mergers come with a more built-in likelihood of improving competition than horizontal mergers.”).

<sup>20</sup> See, e.g., Salop, Revising the Vertical Merger Guidelines, *supra* note 16, at 13.

greater investment by harmonizing upstream and downstream incentives and by reducing transaction costs, “free-riding,” and the risk of hold-up.<sup>21</sup> Several current and former FTC economists explained in an academic paper that the efficiencies of vertical control, including especially EDM, “often rise[] monotonically with the level of pre-existing market power.”<sup>22</sup>

Third, we know that economic models that attempt to predict the net competitive effects of a given potential vertical merger are often more art than science. For example, Michael Salinger (a former head of the FTC’s Bureau of Economics) characterizes these models, and particularly those attempting to predict competitive harm, as “highly stylized” and “largely game-theoretic.”<sup>23</sup>

Fourth, retrospective empirical analyses confirm that vertical mergers are typically procompetitive. I cite a handful of academic studies in my Staples statement,<sup>24</sup> and the Global Antitrust Institute submission to the FTC does a nice job of collecting a variety of these retrospectives.<sup>25</sup> Not surprisingly, retrospectives of vertical mergers conclude that most vertical mergers turn out to be procompetitive.

In summary, we know: (i) vertical mergers raise different competitive dynamics than horizontal ones; (ii) vertical mergers often yield substantial efficiencies; (iii) forward-looking models are more art than science, and (iv) therefore should be considered only in tandem with the hard evidence collected during the investigation; and backward-looking models demonstrate that the typical vertical merger is procompetitive.

#### **IV. Given What We Know, Should We Craft New Vertical Merger Guidelines?**

Last fall, Chairman Simons launched a series of Hearings on Competition and Consumer Protection in the 21st Century.<sup>26</sup> During the FTC hearing on vertical mergers in November 2018, several presenters called for the agency to craft new vertical merger guidelines.

This call for guidelines raises three questions. First, why do the antitrust agencies issue guidelines, and do those motivations apply to vertical mergers? Second, are guidelines superior

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<sup>21</sup> See, e.g., Francine Lafontaine, Vertical Mergers: Presentation at the FTC Hearings on Competition and Consumer Protection in the 21st Century, at 86 (Nov. 1, 2018), *available at* [https://www.ftc.gov/system/files/documents/public\\_events/1415284/ftc\\_hearings\\_5\\_georgetown\\_slides.pdf](https://www.ftc.gov/system/files/documents/public_events/1415284/ftc_hearings_5_georgetown_slides.pdf)

<sup>22</sup> James C. Cooper, Luke M. Froeb, Dan O’Brien, & Michael G. Vita, *Vertical Merger Policy as a Problem of Inference*, 23 INT’L J. INDUS. ORG. 639, 658 (2005).

<sup>23</sup> Michael A. Salinger, *Vertical Mergers*, in I OXFORD HANDBOOK OF INTERNATIONAL ANTITRUST ECONOMICS 551, 574 (Roger D. Blair & D. Daniel Sokol eds., 2015).

<sup>24</sup> See Wilson Statement, *supra* note 4, at 7 n.34.

<sup>25</sup> See Global Antitrust Institute, Antonin Scalia Law Sch., Geo. Mason Univ., Comment Submitted in the Federal Trade Commission’s Hearings on Competition and Consumer Protection in the 21st Century, Vertical Mergers, at 5-9 (filed Sept. 6, 2018) [hereinafter GAI Comments].

<sup>26</sup> Press Release, FTC Announces Hearing on Competition and Consumer Protection in the 21st Century, June 20, 2018, <https://www.ftc.gov/news-events/press-releases/2018/06/ftc-announces-hearings-competition-consumer-protection-21st> (quoting Chairman Simons and setting out a detailed agenda).

to all other possible approaches? Third, if we do decide to issue guidelines, what topics should they cover?

**A. Are New Vertical Merger Guidelines Consistent with the Reasons We Issue Antitrust Guidelines?**

Several folks have thought deeply about why the agencies issue guidelines. Therefore I must note at the outset that I am indebted to the excellent work that Greg Werden, Paul Yde, the Global Antitrust Institute at George Mason, and others previously have done on the topic.<sup>27</sup>

Drawing upon their work, I submit there are at least four reasons why the antitrust agencies issue guidelines.

First, the agencies may use guidelines as a way to summarize the law, just as the American Law Institute issues Restatements of the laws of contracts, property, and other topics.

Second, the agencies may use guidelines to clarify how they intend to approach topics on which there is no clear binding precedent. For example, Werden explains that the 1968 Horizontal Merger Guidelines “were a measured response” designed to address the “cloud of uncertainty” that hung over federal merger law following the Supreme Court decisions in *Von’s Grocery*, *Pabst Brewing*, and *Proctor & Gamble*.<sup>28</sup> In particular, Werden believes these guidelines clarified how the agencies would assess topics on which the “cases articulated no meaningful limits.”<sup>29</sup>

Third, guidelines may disclose and formalize an approach the agencies have heretofore used informally. For example, Werden notes that the 1992 Horizontal Merger Guidelines formally “codified” several unilateral effects analyses the Antitrust Division of the Department of Justice (DOJ) had been using for years.<sup>30</sup>

Fourth, the agencies may use Guidelines to advance new analytic techniques. For example, the 1982 Horizontal Merger Guidelines adopted, and subsequently popularized, the hypothetical monopolist test. The 2010 Guidelines likewise sought to popularize GUPPIS.<sup>31</sup>

In each case, the ultimate goal is to promote transparent and predictable agency enforcement. Each of the goals I just listed – and in particular clarifying unsettled law and

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<sup>27</sup> See Gregory J. Werden, *Should the Agencies Issue New Merger Guidelines?*, 16 GEO. MASON L. REV. 839 (2009); Paul Yde, *Non-Horizontal Merger Guidelines: A Solution in Search of a Problem?*, ANTITRUST 74 (Fall 2007); GAI Comments, *supra* note 25.

<sup>28</sup> Werden, *supra* note 27, at 841.

<sup>29</sup> *Id.*

<sup>30</sup> *Id.* at 842.

<sup>31</sup> See, e.g., Serge Moresi, *The Use of Upward Price Pressure Indices in Merger Analysis*, THE ANTITRUST SOURCE, at 1 (Feb. 2010) (tracing the development of the Upward Pricing Pressure (UPP) model – which has since become GUPPI – to academic work that Professors Farrell and Shapiro conducted before they “became chief economists at the FTC and DOJ”); U.S. DEP’T OF JUSTICE & FED. TRADE COMM’N, HORIZONTAL MERGER GUIDELINES § 6.1 (issued Aug. 19, 2010) [hereinafter HORIZONTAL MERGER GUIDELINES] (adopting, during the tenure of Professors Farrell and Shapiro, the UPP analysis “[w]here sufficient data are available” and noting UPP merger simulations “need not rely on market definition or the calculation of market shares and concentration”).

codifying existing agency practice – help the public understand how the agencies are likely to evaluate a given proposed transaction. We therefore ensure that parties contemplating an anticompetitive transaction know we are likely to challenge it. On the other side of the coin, we also ensure we do not chill procompetitive transactions that we are unlikely to challenge. Guidelines similarly inform Congress, the press, and other constituencies.

Although our dialogue internally and with the antitrust community is ongoing, I offer the following preliminary observations.

First, because the forward-looking vertical merger models that predict anticompetitive harm in potential transactions are more art than science, I do not believe we should use new vertical merger guidelines to advance new analytic techniques.

Second, given my dissenting colleagues’ desire to question our existing agency practices, there may be some value in publicly disclosing and identifying what those practices are. To be clear, the analysis we use for vertical mergers is hardly a secret. However, the existence of the DOJ’s 1984 Non-Horizontal Merger Guidelines,<sup>32</sup> even though they have been effectively withdrawn given the Division’s announced intention to draft new ones,<sup>33</sup> might lead some astray. As a result, there may be some value in codifying our practices in one tidy package that clearly replaces and supersedes the 1984 Guidelines.

Third, given the pending appeal in the AT&T-Time Warner merger,<sup>34</sup> I believe it is too soon to try to restate the law or clarify unsettled questions. We should revisit these rationales once the case is over.

In summary, issuing new vertical merger guidelines is, *at least conceivably*, compatible with at least one of the reasons we issue guidelines, identifying and codifying existing agency practices. I express no opinion today about whether that is, by itself, a *sufficient* reason to issue new guidelines.

## **B. Are There Any Alternatives to Issuing New Vertical Merger Guidelines?**

As in any case, we must identify the full range of alternatives to issuing new vertical merger guidelines.

Starting with the obvious, we could decline to issue vertical merger guidelines and say nothing at all. Indeed, we do not have Conglomerate Merger Guidelines, and for good reason.

There is also a range of alternatives between the two extremes of issuing guidelines and saying nothing. For example, the agencies could provide guidance on a case-by-case basis, just as the courts do, by issuing statements explaining our analysis in each vertical merger. Indeed, we have already begun this process with the many statements in the Staples / Essendant matter.

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<sup>32</sup> U.S. DEP’T OF JUSTICE, NON-HORIZONTAL MERGER GUIDELINES (issued June 14, 1984), *available at* <https://www.justice.gov/sites/default/files/atr/legacy/2006/05/18/2614.pdf>.

<sup>33</sup> See Bryan Koenig, *DOJ Vertical Merger Guidelines Called “Badly Out of Date,”* LAW360.COM, Nov. 1, 2018 (recounting comments by AAG Delrahim at the INCOMPAS Show).

<sup>34</sup> United States v. AT&T, No. 18-5214 (D.C. Cir.).

Alternatively, the agencies could provide “soft” guidance through other official agency documents. For example, in 2006 the FTC and DOJ jointly issued the Commentary on the Horizontal Merger Guidelines.<sup>35</sup>

Finally, the agencies could provide “soft” guidance through individual statements by the senior leadership of both agencies. This speech is one example – although it of course reflects my personal view, not the official agency view. This limitation means individual statements provide even less definitive guidance on what the agencies might do, either today or in the future.

### **C. If New Vertical Merger Guidelines Were Issued, What Topics Should They Cover?**

Let us assume for a moment that the agencies should issue new vertical merger guidelines. What topics should they cover?

At a minimum, I see four broad topics.

#### **1. Legal Presumptions**

If we do issue new guidelines, they should make clear that, consistent with the general Clayton Act jurisprudence, we begin with a rebuttable presumption that vertical mergers are lawful. This starting presumption then frames the manner in which the agencies assess anticompetitive effects, which are necessary to rebut the presumption, and potential merger defenses.

#### **2. *Prima Facie* Evidence of Anticompetitive Harm**

Drawing upon the economic literature, any guidelines should synthesize the various theories of potential harm in vertical mergers *and* identify the circumstances in which these harms are likely to occur. In short, the guidelines would explain the evidence that, in the agencies’ view, is sufficient to rebut the initial presumption that the transaction is lawful. This practice would effectively identify safe harbor zones in which the agencies are unlikely to find harm, and therefore in which a challenge is unlikely even in the absence of offsetting efficiencies.

#### **3. Rebuttal Evidence of Offsetting Efficiencies and Other Merger Defenses**

As I discussed a few minutes ago, we know vertical mergers often, and perhaps even always, generate efficiencies. Therefore, any guidelines should explain how the agencies evaluate and credit these efficiencies and any other relevant merger defenses. For example, the Horizontal Merger Guidelines explain that the agencies “credit” only those efficiencies that are cognizable, verifiable, substantial, and merger-specific.<sup>36</sup>

Recall that in the Staples matter my dissenting colleagues argued that the agencies are far too credulous of efficiency claims.<sup>37</sup> That is *not* my experience, at least over the past 20-odd

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<sup>35</sup> FED. TRADE COMM’N & U.S. DEP’T OF JUSTICE, COMMENTARY ON THE HORIZONTAL MERGER GUIDELINES (Mar. 2006), available at <https://www.ftc.gov/sites/default/files/attachments/merger-review/commentaryonthehorizontalmergerguidelinesmarch2006.pdf>

<sup>36</sup> HORIZONTAL MERGER GUIDELINES, *supra* note 31, § 10.

<sup>37</sup> See *supra* note 10 & accompanying text.

years of practice. Of course, in Staples the Commission found only one competitive harm and fully rectified it by imposing a firewall. Therefore, as the majority statement says, we had no need to consider whether there were offsetting efficiencies in that case.<sup>38</sup>

In any event, in contrast to horizontal guidelines, the economics in vertical mergers indicate efficiencies are much more likely. Professor Shapiro went so far as to call them “inherently” likely at our hearing.<sup>39</sup> Given this dynamic, it may be appropriate to *presume* that certain vertical efficiencies are verifiable and substantial in the absence of strong evidence to the contrary, even if we would not do so in a horizontal merger case.

What we say also depends upon which welfare standard we apply, which was another topic of conversation at the November 2018 hearing.<sup>40</sup> For example, if we were to adopt a total welfare standard, we would no longer need to evaluate whether and to what extent cost savings would be passed through to consumers.

We should similarly address how we would assess merger specificity. As I explained a moment ago, in horizontal mergers we credit only efficiencies that the parties can demonstrate are merger-specific. The Horizontal Merger Guidelines also state that “the Agencies do not insist upon a less restrictive alternative that is merely theoretical.”<sup>41</sup> Given the different economic dynamics in vertical mergers, a different merger-specificity rule may be warranted.

Indeed, considering the many ways firms can structure a vertical relationship, a standard that includes everything but “merely theoretical” less restrictive alternatives does not provide a meaningful limiting principle when applied to vertical mergers. Moreover, many economists, including Paul Joskow, Ben Klein, and Oliver Williamson, recognize that vertical contracting may be possible but less efficient than vertical integration by merger for several reasons.<sup>42</sup> Merging also eliminates various transaction costs inherent to contracting models. Under these circumstances, I believe it would be appropriate to set a high bar for less restrictive alternatives

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<sup>38</sup> See Majority Statement, *supra* note 4, at 1 (“[T]he Commission has voted 3-2 to issue a complaint and accept a settlement, which would resolve the only competitive concern arising out of this transaction that is supported by the evidence. . . . To resolve this issue, the Commission’s proposed order imposes firewalls and other safeguards to protect the competitively sensitive information of Essendant’s dealer customers, as well as the sensitive information of the customers of those dealers.”).

<sup>39</sup> See *supra* note 18 & accompanying text.

<sup>40</sup> See FTC Hearings on Competition and Consumer Protection in the 21st Century, Hearing #5 (consumer welfare and vertical merger policy), available at <https://www.ftc.gov/news-events/events-calendar/ftc-hearing-5-competition-consumer-protection-21st-century>

<sup>41</sup> HORIZONTAL MERGER GUIDELINES, *supra* note 31, § 10.

<sup>42</sup> See, e.g., Paul L. Joskow, *Vertical Integration*, in HANDBOOK OF NEW INSTITUTIONAL ECONOMICS 321 (C. Menard & M. Shirley eds., 2008) (summarizing the literature on various forms of vertical integration, from contracting to merger, and explaining that “[c]ontractual incompleteness, and its interaction with the attributes of different types of transactional attributes including asset specificity, complexity, and uncertainty, plays a central role in the evaluation of the relative costs of governance through market-based bilateral contracts versus governance through internal organization”); Oliver E. Williamson, *The Theory of the Firm as Governance Structure: From Choice to Contract*, 16 J. ECON. PERSP. 171, 179-192 (2002) (describing the “make-versus-buy” decision, graphing the relative attractiveness of various options, and addressing its application to vertical integration); Benjamin Klein, Robert G. Crawford, & Armen A. Alchian, *Vertical Integration, Appropriable Rents, and the Competitive Contracting Process*, 21 J. L. & ECON. 297 (1978) (identifying “the possibility of post-contractual opportunistic behavior” as one reason a firm may choose “an intrafirm rather than an interfirm transaction”).

in vertical merger cases, ruling out far more than the “merely theoretical” options we exclude in horizontal cases.

#### 4. Remedies

When we as enforcers craft a remedy, we must take care not to impose a cure that is worse than the disease. As my Attorney Advisor Keith Klovers and I have written previously, misguided behavioral remedies – particularly in vertical mergers – have sometimes decreased competition and harmed consumers.<sup>43</sup> To take just one of several egregious examples, a few years ago one of the agencies imposed a behavioral remedy requiring a firm to create a product that did not yet exist *and then* license it on FRAND terms.<sup>44</sup>

Yet we should not foreclose all behavioral remedies. There are a handful of limited, tried-and-true behavioral remedies that can be appropriate under the right circumstances. For example, both agencies have long used firewalls, which are frequently effective and sufficient. I voted with the majority to impose just such a firewall in the Staples / Essendant matter. Moreover, it is perfectly appropriate for the agencies to use targeted merger retrospectives to assess the efficacy of past remedies and adjust them as necessary in future cases.<sup>45</sup>

However, I am not willing to go as far as my colleague Commissioner Slaughter, who believes it is perfectly appropriate to use merger retrospectives to hover over mergers we have cleared in case their post-merger activity gives us a reason to challenge and unwind the transaction years later.<sup>46</sup>

## V. Conclusion

In summary, the Staples / Essendant merger demonstrates the diversity of thinking on vertical merger policy and its place in a broader policy debate. We know that vertical mergers present competitive dynamics that differ from those presented by horizontal mergers, and that these differences make vertical mergers systematically less likely to be anticompetitive. Before committing to issue new vertical merger guidelines, we should think carefully about whether they satisfy one of the four goals of past guidelines, which have sought (i) to restate the current law, (ii) to clarify unsettled areas of law, (iii) to codify and explain existing agency practice, or (iv) to develop and advance new analytic techniques. We should also consider alternatives, including softer, more flexible, and less definitive guidance. And in the interim, we should

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<sup>43</sup> Christine Wilson & Keith Klovers, *Yes We Can, But Should We? Merger Remedies During the First Obama Administration*, COMP. POL’Y INT’L ANTITRUST CHRONICLE, at 2 (Dec. 2014).

<sup>44</sup> *Id.* at 2 (discussing DOJ’s remedy in Google / ITA).

<sup>45</sup> Indeed, I have long advocated for such an approach. See Dynamic Efficiencies in Merger Analysis ¶ 58, Submission of the Business and Industry Advisory Committee, Presented by Christine S. Wilson to the OECD Competition Committee (June 6, 2007) (asserting that “it would be instructive for enforcement agencies to perform retrospective studies of merger enforcement decisions . . . to assess the efficacy of merger policy generally, and would be particularly useful in assessing the impact of dynamic efficiencies, given that benefits from such efficiencies may accrue over extended periods of time”).

<sup>46</sup> Slaughter Statement, *supra* note 4, at 9-10 (“With the benefit of pre-commitment, hindsight, and ongoing monitoring, we may be able to refine and bolster confidence in our analysis and deter or prosecute future anticompetitive conduct by Staples. Ultimately, if there is sufficient evidence of actual anticompetitive effects as a result of the transaction, we can and should bring an enforcement action to break-up the merger.”).

continue to conduct merger retrospectives, including vertical merger retrospectives, to further advance our learning and refine our enforcement policies.