There’s Nothing New Under the Sun:
Why Professor Roger Blair of the University of Florida
Is Still Right About Vertical Integration

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I. INTRODUCTION

Good afternoon! Many thanks to my alma mater, the University of Florida (UF), for having me here today. I was thrilled when I heard that UF would be hosting an antitrust conference, and I’m honored to be able to participate with you. I’m a proud Floridian and a proud UF graduate. By way of proof, back home in Washington D.C., I drive a green Jeep we call the Gator. And yes, it has an Al E. Gator spare tire cover.

Before I go on, I must give the standard disclaimer: The views I express today are my own, and do not necessarily reflect the views of the Federal Trade Commission (FTC) or any other Commissioner.

UF may have warm weather, smart people, and winning sports teams (I was here during Steve Spurrier’s heyday), but I will always cherish it for a different reason. Importantly, it is the place where I first decided I wanted to be an antitrust lawyer. I still remember it vividly – it was the summer of 1990, and as an undergraduate, I was in Professor Roger Blair’s graduate level Antitrust Law and Economics class. During the first week or two of class, he drew a diagram on the board and began to explain the Williamson trade-off, which models the welfare effects of a horizontal merger. Crucially, it analyzes both the increase in price that accompanies an increase in market power and the reduction in marginal cost the merged entity achieves. The magnitude of these two values depends on a variety of factors, so the net effect on total welfare may be either positive or negative. The implication, of course, is that cost savings should “save” some horizontal mergers from condemnation under the Clayton Act.¹

I know I sound like a geek when I say this, but I found the simplicity and elegance of the Williamson model captivating. Shortly thereafter, I visited Professor Blair during office hours to

declare that this was the field in which I wanted to pursue a career. Those of you who know him will not be surprised to hear that he responded with encouragement and assistance. When it came time to apply to law schools, he helped me narrow the field to schools with strong antitrust programs. He also wrote me a very kind letter of recommendation. Because I decided then that I ultimately wanted to help enforce the antitrust laws so as to achieve perfect efficiency in the marketplace, I chose Georgetown University Law Center (GULC), close to the headquarters of both federal antitrust agencies.

Of course, I have learned a great deal since those early days. Most notably, I have come to realize that achieving perfect efficiency in the marketplace through sound enforcement of the antitrust laws is a worthy goal — but one that is, unfortunately, unattainable. I have also had the blessing of meeting and working with three other inspiring and invaluable mentors since then: GULC Professor Steve Salop, former Department of Justice Antitrust Division Assistant Attorney General James F. Rill, and FTC recidivist (and now former FTC Chairman) Timothy J. Muris, for whom I served as Chief of Staff. But Professor Blair was the first professional mentor that I had, and perhaps the most important one. Without him, I doubt I would be serving my third stint at the FTC today. So I am thrilled that Professor Blair — maybe I can call him Roger now? — could join us here today. Roger, I will be forever indebted to you for launching me on the amazing journey that has been my professional career.

Among other things, Roger taught me to focus on the empirical effects of the conduct at issue. Which makes sense — as an economist, Roger himself was necessarily focused on observable and measurable activity. So allow me to cite a few empirical measures of Roger’s impressive body of work. HeinOnline, which covers mostly legal publications, contains 107 articles authored or co-authored by Roger that, collectively, have been cited more than 1,000
times by other academics. JSTOR, which contains mostly economics journals, includes more than 30 additional articles by Roger, including several published in leading journals like the *American Economic Review*. And yet another database, Westlaw, reports that courts cited Roger’s work in 53 federal district court opinions and 26 federal circuit court of appeals opinions. His most often-cited legal publication is *Antitrust Policy and Monopsony*, a *Cornell Law Review* article he co-authored in 1990 – the very year I took his class – with long-time collaborator Jeffrey Harrison. That article was also cited by the U.S. Supreme Court in *Weyerhaeuser*, one of six times the Court has cited Roger’s work.3

Given our limited time together, today I want to focus on his work on vertical integration. Both groundbreaking and lasting in its implications, this work remains relevant even now. Never one to mince words, Roger once characterized the topic of vertical integration as “an intellectual battleground” “[l]ike the fields of the Mekong Delta” that once “seemed destined to host an almost continuous struggle between opposing armies.”4 Yet in the early 1980s, Roger expressed “guarded optimis[m]”5 that the war was winding down, and he was largely right, as a consensus emerged that vertical integration – whether by contract or merger – was typically either procompetitive or competitively benign.6

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5 Id.
6 See, e.g., D. Bruce Hoffman, Vertical Merger Enforcement at the FTC: Remarks at Credit Suisse 2018 Washington Perspectives Conference, at 4, Jan. 10, 2018, available at https://www.ftc.gov/system/files/documents/public_statements/1304213/hoffman_vertical_merger_speech_final.pdf (“To summarize, overall there is a broad consensus in competition policy and economic theory that the majority of vertical mergers are beneficial because they reduce costs and increase the intensity of interbrand competition. That consensus has support in the empirical research. Does that mean all vertical mergers are benign? No, it doesn’t.”).
The emergence of that consensus was due in no small part to Roger himself. Over the course of a decade beginning in the late 1970s, Roger gradually fleshed out the case for treating various types of vertical conduct the same. And, just to be sure he wasn’t misunderstood by enthusiasts of *per se* rules, he prescribed the rule of reason across the board.

In doing so, he taught us two important lessons. First, echoing the old proverb that we should not judge a book by its cover, we should not judge the lawfulness of a practice by its label, but rather by its economic effects. Second, once we understand these economic effects, we should construct antitrust rules that are internally consistent.

Some now question the consensus Roger helped build, yearning instead for a return to more proscriptive vertical rules. Given that resurgence, Roger’s work on vertical integration is as important today as it was when he wrote it. As the federal antitrust agencies consider whether (and if so, how) to revise our approach to vertical conduct, both merger and non-merger, we should remember his twin insights that we should focus upon effects and construct internally consistent rules.

II. ROGER BLAIR’S CONTRIBUTIONS TO VERTICAL INTEGRATION

So let us now turn to Roger’s work, and let me begin by placing it within the context of the law and economics of its time.

Like other areas of our common law, the antitrust rules for vertical integration developed primarily from one case to the next. By the 1950s, they were such a confused jumble that, in

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Robert Bork’s words, “a comparison of the law and economics of vertical integration makes it clear that the two bear little resemblance.”

Thankfully, we had many excellent economists – including Roger – willing to take on the challenge.

The central problem was that antitrust law applied a range of different legal rules – from \textit{per se} illegality to \textit{per se} legality – to what appeared to be similar strategies. Consider a hypothetical monopolist of an input, like patches with the Gator logo. Few, if any, consumers buy a Gator logo patch all by itself; rather, they buy shirts, hats, and even dog sweaters emblazoned with the Gator logo. So, to reach consumers, the Gator patch monopolist needs to participate in the downstream apparel market in some way.

The Gator patch manufacturer has at least four options. First, it could open a new factory and start making its own apparel, which even 1950s-era antitrust rules regarded as \textit{per se} lawful. Second, it could buy an existing apparel manufacturer, a vertical merger, which was afforded something like rule of reason treatment. Third, it could use contractual terms to align upstream and downstream incentives, like licensing the intellectual property rights in exchange for a royalty, which was typically \textit{per se} lawful. Or, fourth, it could contractually tie its Gator patch to some other input, like orange thread, which was \textit{per se} unlawful.

Roger and several others slowly chipped away at this odd legal facade by demonstrating that the welfare effects of these different forms of vertical integration were often \textit{identical}. Between 1978 and 1988, Roger and his co-author David Kaserman – who began the period as an

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9 See, \textit{e.g.}, Florida Gators Dog Sweater, MAJORLEAGUEPETS.COM, \url{https://majorleaguepets.com/products/zmpfl4003} (last accessed Oct. 30, 2019).
FTC staff economist, I might add – published several articles and a book on the topic. Let me trace their arc.

In 1978, Roger’s paper in the *American Economic Review (AER)* proved that a vertical merger and a tying arrangement were economically equivalent with respect to both their private and social effects under certain circumstances. Specifically, he found that “identical effects” arise from these two arrangements when downstream firms can vary the proportion of the input used in the finished product, like using more or less orange thread to sew a Gators patch onto a hat. And because the Single Monopoly Profit theorem applies to situations involving a fixed input proportion, Roger had effectively shown that differing antitrust treatment of vertical mergers and tying was unsupported by economic theory. He therefore argued that these two arrangements deserve symmetric treatment under the antitrust laws so as to avoid biasing managerial decisions toward inefficient outcomes.

That same year, Roger and Kaserman demonstrated in a different paper – this time published in the *Southern Economic Journal* – that vertical integration is procompetitive because it allocates risk to the party most willing to bear it. Specifically, Roger relaxed the typical assumption that each firm has the same aversion to risk. He then considered various permutations in which a monopolistic upstream supplier and competitive downstream producers had differing appetites for risk. He found that “[v]ertical integration, which allows risk to be borne by the firm or firms with the least aversion to it, results in increased output of the final good and a reduced expected price,” thereby serving as “a hybrid form of insurance without the

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11 Id. at 401.
moral hazards.”\textsuperscript{13} Or, to return to my example, the monopolistic Gator patch manufacturer might be more willing to take a significant risk – like purchasing costly new equipment – than a small apparel manufacturer.

In 1980 Roger further expanded this work, which had come to be known as the variable proportions incentive for vertical integration. In another article co-authored with Kaserman, Roger found that the welfare effects of four forms of vertical integration – vertical merger, tying, a two-part tariff, and a per-unit royalty on downstream sales – were “economic equivalents.”\textsuperscript{14} Roger extended this insight in two ways. First, he noted that in practice firms may prefer one strategy over another due to transaction costs and other frictions.\textsuperscript{15} For example, if the Gator patch maker can’t effectively monitor the number of hats an apparel maker produces, it will be difficult to charge a per-unit royalty for its patches and a vertical merger may be more efficient. Second, he noted that continued disparate legal treatment for various types of vertical arrangements, as advocated by Justice White in his concurrence in \textit{GTE Sylvania},\textsuperscript{16} could bias the input monopolist’s choice of arrangement toward comparatively safe control mechanisms at the expense of more economically efficient mechanisms.\textsuperscript{17}

Roger synthesized much of this work in his 1988 article (as always, with Kaserman) in the \textit{Connecticut Law Review}.\textsuperscript{18} Echoing his earlier work, he first demonstrated that five forms of

\textsuperscript{13} Id. at 272.
\textsuperscript{14} Roger D. Blair & David L. Kaserman, \textit{Vertical Control with Variable Proportions: Ownership Integration and Contractual Equivalents}, 46 S. Econ. J. 1118, 1127 (1980) [hereinafter \textit{Vertical Control}].
\textsuperscript{15} Id. at 1127.
\textsuperscript{16} Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 59-71 (1977) (White, J., concurring in the judgment) (recognizing the economic similarity between resale price maintenance and other vertical restraints but arguing that a “concern for the freedom of the businessman to dispose of his goods as he sees fit” explains why the legal rules for these restraints varied).
\textsuperscript{17} \textit{Vertical Control}, supra note 14, at 1127.
vertical control – vertical mergers, tying, two-part tariffs, and two types of royalty payments – were “economically equivalent.” He then explained why a monopolist “is unlikely to view these control options equally,” focusing in particular on informational asymmetries and transaction costs. Always one to note nuances, Roger said that “the optimal strategy … will vary according to the particular set of circumstances encountered” – that is, the facts – and the “legal constraints” imposed by antitrust law. Roger then traced the development of these different legal constraints, concluding that “public policy toward vertical control is incoherent.” He argued that “[t]here is no principled basis for according different treatment to economic equivalents,” that “[t]his incoherent policy” imposes real costs on our economy, and that the law should be harmonized by applying the rule of reason to “all vertical restraints” to ensure that “only those restraints that are, on balance, anticompetitive will be condemned.”

Several courts heard Roger’s call to rationalize the legal treatment of vertical integration. Judge Easterbrook cited Roger’s work twice in the 1980s, first in a unanimous opinion (Will v. Comprehensive Accounting Corp.), and then in a dissent (Fishman v. Estate of Wirtz). In a unanimous panel opinion penned by Judge Wilkinson in 2016, the Fourth Circuit explained that “it is no surprise that vertical integration has generally been permitted despite its apparent similarity to tying,” cited Roger, and added that “[a] single firm incorporating separate but closely related production processes can often be far more efficient than various independent

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19 Id. at 540.
20 Id. at 544.
21 Id. at 567.
22 Id.
23 Id.
24 Id. at 567-68.
25 776 F.2d 665, 671 n.2 (7th Cir. 1985).
26 807 F.2d 520, 563 (7th Cir. 1986) (Easterbrook, J., dissenting).
entities transacting to produce the same good or bundle of goods.” But then-Chief Judge Brieant of the Southern District of New York may have said it best when, in 1988, he credited Roger and a few other academics you may have heard of – Areeda, Bork, Posner, and Turner – for supplying “[n]ew learning in the field of economic behavior” that “has exploded myths of economic conduct” used in many antitrust cases.

III. APPLYING ROGER’S INSIGHTS TO THE MODERN DEBATE

Although Roger’s work on vertical integration is itself useful, I draw two larger lessons from it. First, Roger eschewed labels and legal presumptions in favor of actual economic effects. Second, Roger strove for internally consistent explanations of the law and economics. Whereas others, even Supreme Court justices, were willing to tolerate internally inconsistent treatment in the name of one favored goal or another, Roger argued – respectfully but insistently – that we should treat like conduct alike. Both of these lessons remain relevant to vertical antitrust policy today.

A. Focus on Effects, Not Labels

In some antitrust circles, labels are now back in vogue. To take one current example, several months ago a coalition of labor unions and left-leaning think tanks filed a petition asking the FTC to ban all non-competes, full stop. They argued this approach was necessary because

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28 Jaffee v. Horton Mem. Hosp., 680 F. Supp. 125, 127 (S.D.N.Y. 1988) (“This case presents an almost classic example of use of the antitrust laws to obtain relief of doubtful social or economic value, which was never contemplated by the 19th Century trustbusters who drafted these laws. New learning in the field of economic behavior has exploded myths of economic conduct upon which the twin concepts of trebled damages and legal fee shifting, so attractive to pleaders, rested.” (citations omitted)).
29 Open Markets Institute et al., Petition for Rulemaking to Prohibit Worker Non-Compete Clauses, at 1 [hereinafter Petition], available at https://openmarketsinstitute.org/wp-content/uploads/2019/03/Petition-for-Rulemaking-to-Prohibit-Worker-Non-Compete-Clauses.pdf (seeking a rule that would “prohibit employers from presenting a non-compete clause to a worker …, conditioning employment or the purchase of a worker’s labor on the worker’s acceptance of a non-compete clause, or enforcing, or threatening to enforce, a non-compete clause against a worker”).
“[n]on-competes, in general, function as contracts of adhesion that impair labor market mobility” and therefore necessarily “reduce wages, depress business formation, and lock workers into discriminatory, hostile, or unsafe workplaces.”

Recognizing – at least implicitly – that courts have routinely upheld reasonably limited non-competes for hundreds of years, the petition explained that “the business justifications for non-compete clauses are fallacious.”

More broadly, we see bald labels used in proposals to regulate “platforms,” without distinguishing among different types of platforms, let alone the conduct in which they engage.

The trouble with relying upon labels – whether for non-competes, platforms, or vertical integration – is that they often oversimplify economic concepts and obscure important qualifications. For example, critics of vertical integration, like Elizabeth Warren and Lina Khan, sometimes assert that some firms should be prohibited entirely from vertically integrating, by merger or otherwise. Such a ban would only be proper if the consumer welfare effects of

30 Id. at 49.
32 Petition, supra note 29, at 49.
33 See, e.g., Elizabeth Warren, Here’s How We Can Break Up Big Tech, MEDIUM.COM, Mar. 8, 2019, https://medium.com/@teamwarren/heres-how-we-can-break-up-big-tech-9ad9e0da324e (“In this tradition, my administration would restore competition to the tech sector by taking two major steps: First, by passing legislation that requires large tech platforms to be designated as “Platform Utilities” and broken apart from any participant on that platform.”).
34 See, e.g., Kevin Roose, A Better Way to Break Up Big Tech, N.Y. TIMES, Mar. 13, 2019, https://www.nytimes.com/2019/03/13/technology/elizabeth-warren-tech-companies.html (“Ms. Warren, a Massachusetts Democrat and presidential candidate, argues that the companies should be required to do one or the other — sell their own goods or run a third-party marketplace — but not both. ‘You can be an umpire or you can own teams,’ she said. ‘But you can’t be an umpire and own one of the teams that’s in the game.’”); Lina M. Khan, The Separation of Platforms and Commerce, 119 COLUM. L. REV. 973, 980 (2019) (“This Article argues that these combined problems of discrimination and information appropriation invite recovering common carriage’s forgotten cousin: structural separations. Structural separations place clear limits on the lines of business in which a firm can engage.”); Kevin Carty, Leah Douglas, and Lina Khan, 6 Ideas to Rein in Silicon Valley, Open Up the Internet, and Make Tech Work for Everyone, N.Y. MAGAZINE, Dec. 11, 2017, http://nymag.com/intelligencer/2017/12/open-markets-institute-antitrust-for-silicon-valley.html (Idea #5, authored by Leah Douglas) (“To prevent these harms, Amazon should not only be blocked from future grocery acquisitions but its purchase of Whole Foods should be unwound.”).
vertical integration were unambiguously negative, and the practice therefore unambiguously anticompetitive.

As Roger himself showed, however, vertical integration – whether by merger or by contract – is often procompetitive. We have known since Roger’s 1978 article both (i) that vertical integration is an efficient way to shift risk to the party most willing to bear it and (ii) that efficiently allocating risk will expand output and benefit consumers. And we have known for even longer that vertical mergers are often welfare-enhancing. The best way to distinguish potentially anticompetitive vertical mergers from procompetitive ones is not to ban them all; rather, following Roger’s lead, it is to take each merger on its own terms, using empirical tools to assess the likely economic effects of each one. Indeed, the Williamson model that so transfixed me as an undergraduate counsels caution even for horizontal mergers. Consequently, any categorical rule against a particular type of vertical integration is at best an oversimplification and at worst economic doublespeak.

As the FTC digests input on vertical mergers received in connection with its Hearings on Competition and Consumer Protection in the 21st Century, it is important to apply the lessons that Roger and others have taught. Any new vertical merger guidance should focus squarely upon economic effects, not labels. The Director of the FTC’s Office of Policy Planning, Bilal Sayyed, recently addressed this issue within the context of platforms, which can encompass many different vertical relationships. In a speech at GULC, Bilal said that, when evaluating platform businesses, “it is necessary for the Commission (and courts) to start with a careful evaluation of the effect of the conduct under review, not its label.”

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B. Internal Consistency

As we reassess vertical merger policy, we also must ensure that our overall policy with respect to vertical integration remains internally consistent.

To take one example, one of my other cherished mentors, Professor Steve Salop, has argued that “the efficiencies from vertical mergers, including EDM, are neither inevitable nor necessarily merger-specific,” and in fact “[v]ery often … can be achieved by conduct short of merger.”36 Roger’s work suggests two qualifications to this argument.

First, as a matter of economic theory, although the economic effects of vertical mergers and vertical contracts may be equivalent, the transactions costs and degree of information asymmetry frequently are not. For example, Roger recognized in 1978 that moral hazard made standard insurance contracts less effective than tighter forms of vertical integration, particularly vertical mergers.37 Although economists have long ignored transactions costs – as Ronald Coase famously did in his Theorem38 – Roger recognized that they are often both non-zero and heterogenous.39 Therefore, even economic theory suggests that some – if not many – vertical mergers produce merger-specific efficiencies because contracting is an imperfect (and second-best) substitute.

We need not rely upon pure theory – this dynamic is exactly what we observe in the wild. Several years ago, Francine Lafontaine and Margaret Slade surveyed the empirical literature on vertical integration and found that most vertical combinations increased both profits and

37 Uncertainty, supra note 12, at 272.
39 Vertical Integration, supra note 18, at 540-45.
consumer welfare. More recent papers, such as one covering the cable television industry, similarly find substantial cost reductions resulting from vertical integration. Lafontaine helpfully summarized this literature at one of our recent hearings, explaining that contractual attempts to achieve vertical efficiencies “do not easily generate the same outcome as what a vertical merger could do because of demand uncertainty, risk aversion, information asymmetries, [and] all sort[s] of incentive problems.” Or, to put it rhetorically, if these efficiencies are always available via contract, why haven’t firms had such contracts in place all along?

Second, we should recognize that the leading vertical efficiency – the elimination of double-marginalization (EDM) – and the leading vertical theory of harm – raising rivals’ costs (RRC) – are closely related. At bottom, EDM reflects the merged firm’s recognition that it can maximize its total profits when it sells the vertically integrated input to itself at cost. Consumers benefit because EDM decreases the downstream price and expands output. The flip side of the coin is the harm entailed by RRC, which reflects the merged firm’s recognition that – under some circumstances – it can maximize its total profits by raising the price at which it sells the vertically integrated input to its rivals.

Not everyone believes RRC and EDM should be symmetric. For example, Salop and several co-authors argue that RRC is common, and EDM rare, by assuming that vertically integrated firms often sell to rivals but rarely to themselves. Specifically, Salop and his co-authors believe “there are no interfirm input transfers in almost half of the vertically integrated

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42 Tr. at 73, Federal Trade Commission, Hearings on Competition and Consumer Protection in the 21st Century, Nov. 1, 2018 (statement of Prof. Francine LaFontaine).
firms,”43 and therefore no opportunity for EDM, whereas “[v]ertical mergers create an inherent exclusionary incentive”44 – apparently in every case – to raise its downstream rivals’ input costs or foreclose them from the input entirely.45

Although assuming asymmetry is an interesting theory, the evidence indicates otherwise. Recent work by Gopal Das Varma and Martino De Stefano shows that these two dynamics are closely correlated.46 That is, a vertical merger likely to create significant harms from RRC is also likely to produce significant benefits from EDM. Or, as Roger might put it, EDM and RRC are economically symmetric, and therefore should be treated symmetrically in the law.

IV. CONCLUSION

In some ways, we have come full circle. Forty years ago, the law and economics of vertical integration was a jumbled mess of different rules based primarily, if not solely, upon assumptions and labels. It was simply taken as a matter of faith that tying was always and everywhere pernicious, and vertical mergers suspect, while other vertical practices were per se lawful.

Over the course of a decade, Roger worked tirelessly to separate fact from fiction. Rather than propose a unified theory of vertical integration in one fell swoop, he worked incrementally, stripping away the labels and rhetoric and focusing instead on economic effects. Starting from the groundbreaking insight that several forms of vertical integration were economically equivalent, Roger built – one paper at a time – until he had a unified theory.

44 Id. at 7-11.
45 Id. at 8 (input foreclosure); id. at 9 (RRC).
We need more Roger Blairs today. I fear that too much of the current debate relies upon labels and assumptions, like the assumption that RRC must be common and EDM rare. I likewise worry that proposals to impose asymmetric legal rules upon two economically symmetric effects, RRC and EDM, rest upon little more than assumptions and economic theory. Although economic theory is a necessary element of sound antitrust enforcement, it is not alone sufficient.

We also need solid evidence, including empirical work. And to date the empirical work – exemplified by the papers I mentioned a few moments ago – proves two points. First, validating the long-standing consensus, most (but not all) vertical mergers increase consumer welfare. And second, the evidence to date suggests that RRC and EDM move in tandem, and therefore are economically symmetric. Or, as Frank Sinatra said in a very different context, “you can’t have one without the other.”

On a more personal note, I also have come full circle. I began my antitrust career in Gainesville learning about vertical integration from Roger. Today, almost 30 years later, I’m back in Gainesville, and I’m still learning about vertical integration from Roger. So I’d like to close by thanking Roger both for his extensive body of incredibly important work and for opening my eyes in 1990 to the possibility of a career in the field of antitrust law and economics. Eight months shy of a full thirty years later, I can honestly say there hasn’t been a day in my career when I wished I’d chosen another field of law.