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Staples/Essendant as a Window into FTC Vertical Merger Enforcement

by Maureen K. Ohlhausen and Anthony W. Swisher

Vertical merger enforcement has received plenty of attention recently, even prompting the DOJ Antitrust Division and the Federal Trade Commission to consider development of guidelines for future matters. The most newsworthy recent enforcement matter is the Antitrust Division's failed challenge to the vertical *AT&T/Time Warner* transaction. But vertical issues have not been confined to DOJ; vertical enforcement remains a key issue at the FTC as well. The FTC has had at least two high-profile vertical enforcement matters in the last year—*Northrop Grumman/Orbital ATK* and *Staples/Essendant*. The more recent of those two—the Commission's decision allowing the vertical combination of Staples and Essendant to proceed with only limited conduct relief—provides a window into the FTC's views on vertical merger analysis, as well as insights on the Commission's approach to merger enforcement more broadly. In an unusual circumstance, a very limited consent decree generated four statements from the Commission: the majority statement, two dissenting statements from Commissioners Chopra and Slaughter (who were skeptical of the relief obtained and suggested that blocking the merger entirely might be more appropriate), and a concurring statement from Commissioner Wilson. Taken together, these statements reveal some interesting insights about the current state of Commission antitrust enforcement—in vertical mergers, certainly, but more generally as well.

The *Staples/Essendant* Transaction. In September 2018, Staples announced the acquisition of Essendant, Inc., an office supply wholesaler selling to independent office supply distributors, who in turn provide office supplies principally to mid-sized companies. Staples is the world's largest office supply retailer. Staples and Essendant thus are not principally competitors; they instead stand in a vertical relationship. Essendant is a supplier to firms that compete with Staples downstream to provide office supplies to companies. As a vertical deal, the Staples/Essendant transaction falls into a category of transaction that has attracted little antitrust scrutiny since the waning days of the hyper-aggressive antitrust enforcement period of the late 60s and early 70s. Vertical theories have enjoyed something of a renaissance lately, however, with DOJ's unsuccessful attempt to block the *AT&T/Time Warner* transaction based on a vertical theory. *Staples/Essendant* represents the FTC's most recent foray into this field and suggests that the Commission's approach to vertical mergers might best be summarized as "follow the evidence."

The FTC's Statement. Chairman Simons, joined by Commissioners Phillips and Wilson, issued a statement to accompany the FTC's decision to accept a conduct remedy. While accepting Staples' commitment to erect firewalls between its retail business and the acquired wholesale business, the majority Commissioners emphasized the lack of greater competitive concerns and the need to allow the merger to close without seeking further remedy. The majority's statement reflects a focus on the need for concrete evidence supporting a theory of harm—not just an economic model—and the importance of allowing a transaction to proceed when the evidence does not support the economic theory. The majority found that the only competitive concern supported by the evidence was the danger of Staples accessing competitively sensitive information on Essendant's dealer customers and the

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Maureen K. Ohlhausen is Co-Chair of the Antitrust and Competition Law Practice at Baker Botts and former Acting Chairman of the Federal Trade Commission. **Anthony W. Swisher** is a Partner in the Antitrust and Competition Law Practice at Baker Botts and teaches Antitrust Policy at the University of Virginia.

cusomters of those dealers.[1] The imposition of safeguards such as firewalls in the consent agreement resolved this issue.[2]

The majority Commissioners considered other potential vertical theories of harm investigated by staff but concluded that the evidence did not support a finding of likely harm. These included the possibility that Staples might cause Essendant to raise its prices, secure in the knowledge that Staples would recapture some portion of the resulting lost sales when downstream customers switched to Staples.[3] However, according to the majority opinion, the evidence showed that many distributor customers would switch to S.P. Richards, Essendant's largest competitor, or would resort to other methods of procuring office supplies, such as buying directly from manufacturers, rather than accept a price increase.[4] Additionally, Staples had a small share of the downstream market for mid-sized businesses, and according to the majority, was not a particularly close substitute as those businesses tended to value high-touch customer service that was not Staples' focus.[5]

The majority Commissioners emphasized the Commission's willingness to challenge vertical deals where a challenge is supported by the evidence, pointing to a prior matter in which the FTC obtained divestiture and a deal the parties abandoned after the Commission voted to block it.[6] But the Commissioners also emphasized their obligation "to establish more than a theoretical concern—it must be probable (not certain) and substantial. Simply theorizing a harm that might arise out of a merger is not enough…. [The FTC] must provide evidence."[7]

The majority statement is broadly consistent with recent FTC vertical merger enforcement trends. Specifically, the Commissioners have shown a willingness to accept conduct relief in other vertical mergers, such as Northrop Grumman Corporation's acquisition of Orbital ATK, Inc. in 2018. There, the FTC voted 4 to 0 (with Commissioner Wilson not participating) to approve a similar conduct remedy without divestiture.[8] Northrop, characterized by the FTC as "one of only a few companies capable of acting as a prime contractor for tactical, missile defense, and strategic missile systems for [the U.S. Department of Defense],"[9] was acquiring Orbital ATK, the leading producer of solid rocket motors (SRMs), an essential input for missile systems.[10] To ensure that Northrop could not use the acquisition to disadvantage its competitors by withholding access to or raising prices of SRMs, the FTC required Northrop to make SRMs and related services available to all competitors on a non-discriminatory basis, and to implement a firewall between the SRM business and the rest of the company to prevent misuse of competitively-sensitive information,[11] similar to the proposed firewall in *Staples/Essendant*.

Commissioner Wilson's Concurring Statement. Commissioner Wilson—who joined the majority statement—also issued a concurring statement to address some of the wider antitrust policy positions Commissioners Slaughter and Chopra brought up in their dissents. Commissioner Wilson expressed skepticism that the FTC should alter its approach to vertical merger policy, writing that statistics regarding size of large businesses, increases in the number of mergers, or increased revenue shares within an industry are not necessarily

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[1] Statement of Chairman Joseph J. Simons, Commissioner Noah Joshua Phillips, and Commissioner Christine S. Wilson, at 1.
[2] *Id.*
[3] *Id.* at 1-2.
[4] *Id.* at 2.
[5] *Id.* at 2.
[6] *Id.* at 5-6.
[7] *Id.* at 6.
[8] *See* FTC Press Release, "FTC Approves Modified Final Order Imposing Conditions on Northrop Grumman's Acquisition of Solid Rocket Motor Supplier Orbital ATK, Inc.," Dec. 4, 2018, https://www.ftc.gov/news-events/press-releases/2018/12/ftc-approves-modified-final-order-imposing-conditions-northrop.
[9] FTC, "Analysis of Proposed Agreement Containing Consent Order to Aid Public Comment *In the Matter of Northrop Grumman Corporation and Orbital ATK, Inc.*, File No. 181-0005," p. 1, https://www.ftc.gov/system/files/documents/cases/1810005_northrop_grumman_orbital_analysis_6-5-18.pdf.
[10] *Id.* at 2.
[11] *See* Decision and Order, *In the Matter of Northrop Grumman Corporation and Orbital ATK, Inc.*, Dec. 3, 2018, https://www.ftc.gov/system/files/documents/cases/181_0005_c-4652_northrop_grumman_orbital_atk_modified_decision_and_order_12-4-18.pdf.

indicative of increased market power or risk of consumer harm in relevant antitrust markets.[12] She pushed back on the idea that the agencies had been under-enforcing potentially anticompetitive vertical mergers, pointing to the body of scholarship indicating that vertical mergers are anticompetitive only in a narrow set of circumstances, while the economic benefits of vertical mergers, including the elimination of double marginalization, are common and often significant.[13]

Commissioner Wilson further stressed the importance of considering real-world evidence in conjunction with theoretical models, rather than relying on models alone. The economic evidence regarding completed vertical transactions, she wrote, "indicates that the typical vertical merger does not harm competition."[14] Commissioner Wilson also said that while other vertical arrangements short of a merger can produce similar benefits, she had not seen any evidence that other vertical arrangements could replicate all the benefits of a full merger.[15] She also discussed her concerns related to the notion of increased enforcement aggression on the part of the agencies, cautioning against implementing remedies that have the potential to backfire and harm consumers.[16] In a particularly prescient observation, she pointed to DOJ's then-pending, now-failed, challenge to the *AT&T/Time Warner* merger as an example of how "aggressive agency enforcement may well backfire by creating binding precedents that constrain future challenges to problematic deals."[17]

The Dissents. Commissioners Chopra and Slaughter dissented from the majority statement. In his dissent, Commissioner Chopra wrote that the *Stapes/Essendant* transaction violates antitrust law, with the evidence suggesting harm to independent dealers, "especially in geographic markets where Essendant is the market leader and where switching may be difficult,"[18] and that he was skeptical of the efficacy of the remedy approved by the majority.[19] In his view, the investigation conducted by the FTC should have looked more closely at horizontal buy-side concerns, such as whether the merged firms might leverage increased buyer power with their upstream suppliers. He expressed concern that increased buying power achieved as a result of the transaction was a potential harm reflecting market power, rather than an efficiency.[20] He also articulated a vertical theory of harm, speculating that the merged firm might raise Essendant's prices to dealers, and attempt to recapture resulting lost sales by those dealers.[21]

Commissioner Slaughter dissented as well, focusing her remarks almost entirely on larger enforcement policy issues around vertical transactions. In Commissioner Slaughter's view, the modern approach to vertical mergers that has held sway at both agencies prior to DOJ's *AT&T/Time Warner* challenge "has led to substantial underenforcement."[22] Vertical mergers, Commissioner Slaughter wrote, are rarely challenged outright and are often settled without divestitures, even where they may present a potential harm to competition.[23] In her view, the Commission often concludes that a merger will result in no harm to competition based on unreliable assumptions, and is too quick to accept merging parties' claimed efficiencies.[24] Commissioner Slaughter proposed that retrospective analyses should be done after a close case in which there were "meaningful competitive concerns, but where [the Commission has] not identified sufficient evidence to justify a court challenge," and if necessary, the Commission should be ready to challenge an already completed merger.[25] Commissioner Slaughter's remarks largely mirror policy themes put forth in the Senate Democrats' recent "A Better Deal"

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[12] Statement of Commissioner Christine S. Wilson, at 1-2.
[13] *See id.* at 4-6.
[14] *Id.* at 7.
[15] *Id.* at 6.
[16] *Id.* at 8.
[17] *Id.* at 4.
[18] Statement of Commissioner Rohit Chopra, at 1.
[19] *Id.* at 5.
[20] *Id.* at 1.
[21] *Id.* at 3.
[22] Statement of Commissioner Rebecca Kelly Slaughter, at 2.
[23] *Id.* at 3.
[24] *Id.* at 4.
[25] *Id.* at 5.

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antitrust proposals, including a call for more aggressive merger enforcement generally and retrospective reviews of completed transactions,[26] and thus may provide insight into antitrust policy debates to come.

Takeaways from the FTC's Decision. The *Staples/Essendant* matter provides a window into the current enforcement environment at the FTC. Antitrust enforcement necessarily requires a careful balancing of the benefits that will flow from a transaction and its potential to produce anticompetitive effects. The prior administration was dubious of the benefits that can flow from a merger, and often eschewed merger remedies that would have preserved those benefits in favor of blocking a merger outright. This view basically put into practice a zero-risk-tolerance approach to antitrust enforcement but reflected a decided skepticism when it comes to allowing parties to realize the benefits that can flow from transactions. The *Staples/Essendant* transaction suggests that the new Commission leadership may be more receptive to merger remedies, recognizing the benefits that can flow from mergers and the risks associated with inhibiting those benefits.

As to vertical issues, Commissioners on both sides of the *Staples/Essendant* decision noted their skepticism over the assumptions that are baked into vertical economic modeling. Where Commissioner Slaughter suggested that skepticism ought to result in even greater scrutiny of vertical mergers, the majority Commissioners—and Commissioner Wilson in particular—took the opposite approach. The majority recognized that the burden to prove competitive harm rests with the Commission; it is not the parties' burden to disprove an economic theory. Modeling is helpful, to be sure, but where the evidence does not support the model, the Commission should stand down. Additionally, merger enforcement—both horizontal and vertical—is predictive in nature and necessarily involves a degree of uncertainty. This is true of horizontal enforcement, which by definition involves the combination of competitors and draws upon the Horizontal Merger Guidelines that have been developed through multiple iterations and reflect generations of economic thinking and enforcement experience. In vertical enforcement, where the transaction does not combine competitors and the agencies have a far less well-developed toolkit to draw from, the uncertainty surrounding antitrust enforcement is even greater. In the face of this uncertainty, the same humility that should inform merger enforcement generally applies to an even greater degree in vertical mergers where there is no competitive overlap and no increase in market concentration, but an opportunity for the merged firm to achieve significant efficiencies through vertical integration. The current Commission majority appears to have applied that approach in *Staples/Essendant*, which is a welcome sign for those with matters before the Commission in the future.

Going forward, it is reasonable to expect that vertical enforcement will remain an important issue at the FTC, as well as the DOJ. The DOJ has announced that it is revisiting the 1984 Non-Horizontal Merger Guidelines and has invited input and collaboration from the FTC. This effort undoubtedly will provide a useful opportunity for the antitrust community to consider the issues around vertical enforcement, to look at the tools currently available for evaluating vertical mergers, and to consider how those tools might most effectively be used to help identify vertical mergers that truly pose a threat to competition. Also helpful would be a public study of vertical merger enforcement, drawing on prior vertical mergers and the agencies' experience to evaluate what the past might teach us about enforcement going forward. It is encouraging that both Commissioner Slaughter and Commissioner Wilson have expressed in interest in a retrospective vertical merger study. Ideally, such a study would take a cue from the work of the Antitrust Modernization Commission which took a holistic view of antitrust issues and identified not only areas where the economy might benefit from continued active enforcement, but also areas where a less aggressive approach could yield benefits. To be most useful, such a study should include consideration not just of transactions that were investigated or challenged, but also the overwhelming number of vertical transactions that posed no competitive concerns at all. Understanding what the merging parties were able to accomplish through those deals will help the agencies to provide context to their future vertical enforcement efforts. Ideally, it will also remind them of the benefits that can flow from vertical transactions and the need for caution when bringing government antitrust enforcement to bear.

[26] Senate Democratic Leadership, "A Better Deal: Cracking Down on Corporate Monopolies," at 2, https://www.democrats.senate.gov/imo/media/doc/2017/07/A-Better-Deal-on-Competition-and-Costs-1.pdf.

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