UNITED STATES OF AMERICA
Federal Trade Commission
WASHINGTON, D.C. 20580

Office of Commissioner
Rohit Chopra

STATEMENT OF COMMISSIONER ROHIT CHOPRA

In the Matter of Sycamore Partners, Staples, and Essendant
Commission File No. 181-0180
January 28, 2019

Summary

- This transaction violates the law, and I am skeptical that this settlement is in the public interest. While Commission staff worked hard to explore key aspects of the transaction, I am concerned that the Commission is jumping to conclusions without further investigation into the buyer's plans, especially given the limitations of our economic models.
- Our investigation should have more closely analyzed how the buyer will flex its muscles with suppliers. The Commission seems too quick to assume this is an "efficiency" instead of a harm stemming from increased market power.
- In addition, the evidence points to potential harm to independent dealers, especially in geographic markets where Essendant is the market leader and where switching may be difficult.

Sycamore Partners, a private equity fund that controls office supply giant Staples, seeks to acquire Essendant (NASDAQ: ESND), the largest office products wholesale distributor in the U.S and supplier to thousands of independent dealers. The merger combines two powerhouses, each the largest competitor within their respective level of office supply distribution. The market for nationwide wholesale distribution of office supplies is particularly concentrated, where Essendant is one of only two U.S. wholesalers supplying a wide assortment of office products nationwide.

At first glance, the transaction is a vertical merger, but it also raises important horizontal concerns. I believe the Commission is relying on an insufficiently developed record that underestimates the likely anticompetitive harms on both of these fronts. I share the concerns raised by Commissioner Slaughter and agree that our approach can lead to lax enforcement.

Sycamore reportedly announced that it would put a "firewall" into place – regardless of whether or not the FTC required one[1] – to prevent Staples from exploiting sensitive dealer data from Essendant. The Commission has voted to put Sycamore's promise on paper, rather than seek additional measures to address anticompetitive harms or block the transaction altogether.

[1] *See* Andy Braithwaite, *Dealer Organisations Unite for FTC Letter*, OPI, Oct. 1, 2018, https://www.opi.net/news/dealer-organisations-unite-for-ftc-letter/.

Horizontal Concerns

Both Staples and Essendant source office supply products from a wide range of upstream trading partners, including small and large manufacturers alike. Proponents of the merger will claim that this will create "efficiencies" in the form of increased buyer power that reduces prices paid to suppliers. But is this an efficiency or a harm?

To start, efficiencies are far from a sure-fire defense to an anticompetitive merger.[2] Increased buyer power exerted by the combined firm against its upstream trading partners in this matter would not be an efficiency at all if it stems from an increase in market power on the buy side of the market.[3] Sycamore's expanded empire potentially allows it to squeeze its suppliers, in effect transferring income from those suppliers to the merged firm, with little or no resource savings.[4] In my view, the Commission's analysis did not adequately rule out the possibility of this type of harm from the merger.[5]

My colleagues voting for this settlement claim that the potential for this type of harm was ruled out after a thorough analysis and investigation. I disagree. If an independent fact-finder or a Court reviewed the same evidence, I think they would disagree too and find that there are many unanswered questions.

Manufacturers with market power and must-have brands may very well be able to protect themselves from an anticompetitive exercise of buyer power by the merged firm, but this is an area where we needed further analysis and investigation to reach a conclusion about potential monopsony power over a broad range of suppliers. Even if the wealth transfer from suppliers to Sycamore will translate into some cost savings for end-user purchasers, this is not necessarily an adequate legal justification.

Six months ago, this Commission ordered divestitures of blood plasma collection centers in the Grifols-Biotest merger, since the combined entity would be able to use its increased bargaining leverage to lower payments to suppliers of blood plasma.[6] The Commission rightfully did not

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[2] *See* Federal Trade Commission et al. v. Penn State Hershey Medical Center et al., 838 F.3d 327, 347 (3rd Cir. 2016), where Judge Michael Fisher, in a unanimous reversal siding with the Commission, noted that the Court has never formally adopted the efficiencies defense, and the Supreme Court has ". . . cast doubt on its availability." Judge Fisher added that ". . . we are skeptical that such an efficiencies defense even exists." *Id.* at 348.

[3] U.S. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines, § 12 (2010) [hereinafter Horizontal Merger Guidelines], http://www.ftc.gov/os/2010/08/100819hmg.pdf. *See also* C. Scott Hemphill & Nancy L. Rose, *Mergers That Harm Sellers*, 127 YALE LAW JOURNAL 2078 (2018); Jonathan Sallet, *Buyer Power in Recent Merger Reviews*, ANTITRUST, Vol. 32, No. 1, at 82 (Fall 2017).

[4] The Department of Justice's lawsuit challenging the proposed merger of Anthem and Cigna alleged that the increased buyer power of the combined firm would give Anthem enhanced leverage over physician practices and hospitals, likely reducing the rates that both types of providers earn. Although the complaint predicted likely reductions in output from hospitals and physicians, the Department of Justice argued that the court did not need to make such a finding. *See* Complaint at 27 and Plaintiff's Supplemental Memorandum on the Buy-Side Case, at 2 [hereinafter Department of Justice Buy-Side Memo], United States v. Anthem, Inc., No. 16-1493 (ABJ) (D.D.C. 2017).

[5] I am also concerned that Sycamore might use its increased buyer power to extract favorable non-price terms from suppliers to give itself preferential treatment over its rivals, further hampering vigorous competition. *See* Hemphill & Rose, *supra* note 3, at 2103-2104.

[6] *In the Matter of Grifols, S.A., and Grifols Shared Services North America, Inc.*, C-4654, Sept. 18, 2018, https://www.ftc.gov/news-events/press-releases/2018/09/ftc-approves-final-order-requiring-grifols-sa-divest-assets.

seek to determine whether the reduced supply costs would be passed through to final consumers, since the reduction was caused by the merged firm's increased market power.[7]

Here, it is possible there will be some legitimate resource savings that are not merely the result of increased market power on the buy side of the market, such as supply chain improvements. However, it is unclear whether these are substantial or even merger-specific. Moreover, while benefits to downstream consumers might be weighed against harm to suppliers as a matter of prosecutorial discretion, it is not a bulletproof defense as a matter of law.[8]

Vertical Concerns

The record evidence and the buyer's track record suggest that Sycamore will have a strong incentive to rapidly increase margins to make a clear case to a potential future acquirer.[9] Absent this transaction, Essendant cannot easily raise prices or reduce service to its dealers, because Essendant would lose sales either because dealers would switch to another wholesaler, such as S.P. Richards, or because the dealers would pass on price increases to their B2B customers, some of whom would then switch to competing dealers, including Staples. After this transaction, however, Sycamore would capture revenue from B2B customers that switch to Staples in reaction to a price increase or reductions in customer service from Essendant. This strategy seems even more likely given Sycamore's actions to date since taking ownership of Staples.

The evidence in the record points to regional differences across markets in the country. The risk of steering to Staples will be particularly high in geographic markets where Essendant is the market leader.[10] Regional managers incentivized on sales and operating margin targets will be particularly susceptible to this type of conduct. This is not nefarious – this is just obvious.

The Commission has put great faith in its interpretation of the economic evidence to justify its conclusion. However, Commissioner Wilson rightfully notes in her statement that economic models are often more art than science. We must be humble about their predictive power, and this matter is a perfect illustration. The Commission's economic model predicts competitive harm, but largely ignored regional differences. I agree with Commissioner Slaughter that our prediction likely *underestimates* the harmful effects. How can the majority confidently reach an accurate conclusion on the vertical effects of this transaction without a closer look at specific geographic markets where effective switching would be particularly difficult?

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[7] This competitive harm is within the purview of the Clayton Act and is well recognized in the 2010 Horizontal Merger Guidelines. Horizontal Merger Guidelines, *supra* note 3, at § 12 ("Example 24: Merging Firms A and B are the only two buyers in the relevant geographic market for an agricultural product. Their merger will enhance buyer power and depress the price paid to farmers for this product, causing a transfer of wealth from farmers to the merged firm and inefficiently reducing supply. These effects can arise even if the merger will not lead to any increase in the price charged by the merged firm for its output."). *See* Sallet, *supra* note 3, at 84. *See also* Judge Millett's opinion in United States v. Anthem, Inc.: "[I]ncreased bargaining power is not a procompetitive efficiency when doing so 'simply transfers income from supplier to purchaser without any resource savings.'" United States v. Anthem, Inc. 855 F.3rd 345, 371(D.C. Cir. 2017).

[8] Case law supports the assertion that harm in one market cannot be offset by benefits in another. United States v. Philadelphia National Bank, 374 U.S. 321, 370-71 (1963); Department of Justice Buy-Side Memo, *supra* note 4, at 10 (citing *Philadelphia National Bank* for this conclusion).

[9] Private equity firms generally take controlling equity stakes in firms with the hope of realizing significant gains through sale to a buyer or an exit through public markets.

[10] While I was open to counterarguments that existing competitors could constrain these price increases, there was not conclusive evidence that allayed concerns about anticompetitive effects in regions where Essendant is the market leader.

I am also less confident than the majority that Essendant-supplied dealers can easily switch to S.P. Richards to discipline any attempt by Sycamore to disadvantage Staples's rivals. Record evidence indicates that some dealers have high switching costs. In addition, the majority's conclusion that Staples is a poor substitute for Essendant-backed dealers seems to assume that the industry will operate as it has in the past, despite being known for rapid changes. If anything, there will be even greater change.

Buyer Incentives

The Commission's decision to wave through this transaction with few strings attached rests on an incomplete picture of the competitive landscape over the long term, since we did not conduct rigorous analysis on what the buyer plans to do post-purchase.

Section 7 of the Clayton Act is a forward-looking statute, requiring enforcers to make certain predictions about how a transaction might change competitive dynamics in a market. We are much wiser when we consider the buyer's plans and track record. This will also help us determine how other market participants will respond so we can analyze the impact on competition. For example, an investigation might uncover that a buyer who is a dominant player is purchasing a company that poses a threat to their dominance to shut off potential competition. This is just one example of many where a buyer's plans have a major impact on competition.

In this matter, the buyer, Sycamore, is a well-known private equity fund specializing in retail and consumer investments. While some investment firms have strategies to invest substantial capital to grow and nurture a business, other investment firms might not have a strategy that is aligned with vigorous competition. Sycamore's investment approach and track record suggest that the fund will operate assets much differently than a typical buyer, in ways that lead to higher margins, without any guarantee of greater output and service offerings.[11] This is not the first time Sycamore Partners has come before the FTC. In 2015, the agency approved the fund as a divestiture buyer in the dollar store market. But Sycamore quickly resold the assets.[12] The majority seems to believe we should wear blindfolds when it comes to this type of buyer evidence.

At a minimum, our failure to consider Sycamore's incentives gives me less confidence in our ability to accurately predict the likely competitive outcome of this transaction using our traditional merger analysis tools.[13] In addition, Sycamore and Staples have been buying up a range of companies in the supply chain, and this transaction will likely force the hand of its competitors to consolidate more quickly, leading to greater reductions in competition over the long term. Going forward, I hope the Commission can conduct in-depth analysis on buyer

[11] *See* Khadeeja Safdar & Miriam Gottfried, *How One Investor Made a Fortune Picking Over the Retail Apocalypse*, Wall Street Journal, Mar. 21, 2018, https://www.wsj.com/articles/how-one-investor-made-a-fortune-picking-over-the-retail-apocalypse-1521643491.

[12] *See* Commission letter approving application filed by Sycamore Partners II, L.P. to permit Dollar Express to sell and assign stores and leases to Dollar General Corporation, *In the Matter of Dollar Tree, Inc., and Family Dollar Stores, Inc.*, C-4530, April 27, 2017, https://www.ftc.gov/news-events/press-releases/2017/04/ftc-approves-sycamore-partners-ii-lp-application-sell-323-family.

[13] Commissioner Slaughter's statement argues for more retrospective analysis of consummated mergers. I agree, and it will be especially important to pursue these lookbacks when we have not carefully considered buyer-specific incentives.

incentives and long-term market impact to inform how we can best exercise our prosecutorial discretion.

Abuse of Data

The Commission is codifying a firewall reportedly promised by Sycamore (regardless of any action on the Commission's part), overseen by a monitor, to prevent Sycamore from exploiting commercially-sensitive data. Essendant's business model gives it access to detailed data about the purchase history and usage for its dealers and their customers. Many B2B suppliers in the U.S., like Essendant, collect sensitive financial data in order to set sales terms. Dealers are rightfully concerned this data will be weaponized against them. In addition, if Staples can get its hands on how much end-users are currently paying through an existing dealer, it might bid *less* aggressively for their business.

While the firewall will reduce the chance of misuse of data, it does not eliminate it. Given the hundreds of customers and resellers of Essendant, it may be difficult to police the firewall, especially with oral communications. We could have sought the return of detailed data to customers, who would be free to continue to keep their data with Essendant, but only if they chose to. If this data was portable, this could even reduce switching costs and foster competition, since prospective wholesalers could use the data to ensure proper service and customized offerings.

Conclusion

I agree with the Commission's complaint that this transaction violates the Federal Trade Commission Act and the Clayton Act. The Commission's proposed remedy takes steps to safeguard against some of the potential anticompetitive conduct stemming from the vertical aspects of this transaction. But, based on my review of the evidence, there are unresolved issues regarding other aspects of competition that may be harmed from this transaction. I am skeptical that this proposed settlement is in the public interest.

My colleagues voting in favor of this settlement acknowledge that it is critical for the Commission's actions to be based on facts and sound analysis. But in this matter, the Commission is simply jumping to conclusions.