With Bruce Hoffman

In this month's edition of CPI Talks we have the pleasure of speaking with Bruce Hoffman of the Federal Trade Commission ("FTC"). Mr. Hoffman is Director of the Bureau of Competition at the FTC.

Thank you, Mr. Hoffman, for sharing your time for this interview with CPI.

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CPI has asked for my thoughts on several questions relating to vertical mergers.[1] As an important preface, vertical mergers involve areas of law and economics that are under considerable current scrutiny and development, including (among others) extensive treatment at the FTC's Hearings on Competition and Consumer Protection Law in the 21st Century. Given the analysis and research under way in this area, any views expressed today may be subject to change as our understanding of the relevant issues advances.

With that important caveat, I have been asked to respond to three questions. The questions and responses follow.

1. **Under what circumstances, if any, should behavioral remedies be accepted to remedy the likely anticompetitive effects of vertical mergers?**

As I have discussed on previous occasions, we are cautious about accepting behavioral remedies as solutions for likely anticompetitive effects of vertical mergers. Our general preference is for structural solutions. Behavioral remedies raise two sets of concerns that are generally less applicable to structural remedies. First, behavioral remedies normally leave the incentive to engage in the harmful conduct unchanged; that is, the benefit to the merged firm of (for example) using information about a downstream competitor to put that competitor at a disadvantage, or of raising the price of an input to a downstream competitor, will continue to exist notwithstanding the remedy. Rather than change incentives — as structural remedies typically do — behavioral remedies rely on rules and consequences (such as the penalties for order violations) to constrain firms from acting on their incentives. This always presents some risk. Second, behavioral remedies typically require fairly robust monitoring and activity by us. They put our staff (or, where applicable, monitors or others) in the position of ensuring compliance with a set of rules for conduct over the term of the order. That imposes burdens on us, and requires us to possess or develop expertise, information, and the other tools necessary to effectuate the remedy.

That said, behavioral remedies have been shown to be effective parts of the FTC's merger tool kit. Research at the FTC has found that the behavioral remedies have succeeded in past transactions. That is consistent with my experience — I have seen behavioral remedies work well, under the right conditions.

We consider behavioral remedies where appropriate and necessary. In a very broad sense, behavioral remedies may be viable options where a vertical merger presents a competitive problem that cannot be addressed by a structural remedy (or where the cost or difficulty of a structural remedy is prohibitive); where the merger offers significant benefits that would be lost if it was not consummated (or that would be lost if a structural remedy was implemented); and where we have a significant degree of confidence that a behavioral remedy would be effective, administrable, and not unduly burdensome to us. The latter point includes situations where we have institutional familiarity with the remedy (such

1 Please note that these responses reflect my views, and do not necessarily represent the views of the Federal Trade Commission or any of its Commissioners.

as firewalls to prevent information-sharing, where the vertical concern involves information sharing). Parties should expect, however, that we will be cautious and skeptical about behavioral remedies, and may require substantial persuasion and assistance from the parties in verifying their efficacy (and in implementing them where we reach the conclusion that they are warranted).

2. What are your views on the use of merger retrospectives of "close cases"? Should more retrospectives be used (in cases of vertical mergers specifically), fewer retrospectives, or are things "just right"?

I view merger retrospectives (including of "close cases") as very important and helpful. Chairman Simons has emphasized the use of retrospectives as valuable tools to enhance our understanding of the effects of mergers, and the FTC, primarily through the Bureau of Economics, is expanding our efforts in this area. I do think that it is important to understand that retrospectives are not always easy or feasible. The costs involved can be high, and it can be difficult to identify the effects of consummated mergers and to properly control for other intervening events and factors. As a result, not every merger, or even every "close case" merger, is necessarily a good candidate for a retrospective, and of course we need to consider resource allocation in deciding what retrospectives to conduct.

3. Are the competitive effects of vertical and horizontal merger inherently different?

This is a very broad question addressing a very fact-specific issue. I don't think it's necessarily the case that every competitive effect of every horizontal merger is inherently different from every competitive effect of every vertical merger. That said, as I and others have previously observed, there is a significant baseline difference between the general competitive effects of vertical and horizontal mergers. Horizontal mergers have an inherent competition-reducing dimension, in that by definition they internalize an externality the merging firms previously inflicted on each other through competition. That effect can be minimal or insignificant, or offset by cost savings or other efficiencies, but it remains the case that the first-order consequence of a horizontal merger is at least some reduction in competition. That is not the case with vertical mergers. Vertical mergers do not have an inherent effect on competition in the way that horizontal mergers do. Rather, vertical mergers can provide substantial procompetitive benefits, but also can harm competition by (for example) providing the means and incentives for the merged firm to degrade rivals' ability to compete. Determining which effect exists, and which predominates, is a fact-specific question.

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