

MERGER ANTITRUST LAW

LAW 1469
Georgetown University Law Center
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Tuesdays and Thursdays, 3:30 pm – 5:30 pm
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Class 18 (October 27): Staples/Office Depot (Unit 9)¹

On deck is the Staples/Office Depot case study, the companies' second attempt to merge. In 1997, Staples and Office Depot, then the country's two largest office superstores (OSSs), abandoned a merger after the FTC obtained a preliminary injunction blocking the deal.² In that case, the Commission successfully argued that the proposed merger of two of the nation's three office superstores would likely substantially lessen competition in the sale of consumable office supplies through office superstores.

In 2013, however, the FTC allowed Office Depot and OfficeMax, the nation's second- and third-largest office superstores, to merge without taking any enforcement action.³ The Commission found that, unlike in 1997, retail customers looked beyond office superstores for office supply products and relied more heavily on non-OSS, brick-and-mortar retailers such as Costco and Sam's Club. The Commission also found explosive growth in online commerce for office supplies and that online retailers, such as Amazon, stock a vast array of office supply products and can deliver them quickly anywhere in the country at nominal cost.

About fifteen months after the Office Depot/OfficeMax combination closed, Staples and Office Depot sought to revive their merger, relying on these same changes in the marketplace. It did not work. The FTC's 2015 challenge focused not on retail sales but on sales to large business customers, whose procurement and service requirements left them with fewer competitive alternatives than retail purchasers.

The 2013 closing statement. The FTC's 2013 statement on closing the Office Depot/OfficeMax merger investigation is a good place to start and worth a careful read (pp. 4-6). In that investigation, the Commission examined retail and contract sales separately. In retailing, changes in purchasing patterns and pricing practices, along with econometric evidence, showed that office superstores faced substantial competition from other retailers and online sellers.

In the contracting channel, the FTC concluded that Office Depot and OfficeMax were rarely each other's closest competitors for most large customers and that Staples would remain a strong alternative. Customers also could source some categories separately, and the Commission credited competition from regional suppliers. Thus, the 2013 decision did not establish that any further office supply merger would be harmless. Combining the second- and third-largest firms left Staples in place as an alternative for large customers; combining Staples and Office Depot would eliminate the rivalry between the two firms those customers regarded as their principal

¹ A reasonably complete set of the most important filings in the litigation may be found [here](http://www.appliedantitrust.com) on AppliedAntitrust.com (if necessary, search for Staples/Office Depot).

² *FTC v. Staples, Inc.*, 970 F. Supp. 1066 (D.D.C. 1997). The filings in this litigation may be found [here](http://www.appliedantitrust.com). The 1997 opinion is background and is not assigned for this class.

³ See Fed. Trade Comm'n, [Statement Concerning the Proposed Merger of Office Depot, Inc. and OfficeMax, Inc.](http://www.ftc.gov/pressroom/2013/11/staples-office-depot-merger), FTC File No. 131-0104 (Nov. 1, 2013).

options. The competitive relationship between the particular merging firms and the alternatives available to the affected customers still mattered.

The proposed transaction. The announcement materials present the companies' business explanation for the 2015 transaction: declining retail sales, competition from other channels, and anticipated annual cost savings of at least \$1 billion. If you like, you can skim the press release, investor presentation, and investor call (pp. 8-52). However, if you are not familiar with investor calls, this is a good one to read.

The challenge. The FTC alleged that Staples and Office Depot were each other's closest competitors in supplying consumable office supplies to large business customers in the United States. The District of Columbia and the Commonwealth of Pennsylvania joined the FTC as co-plaintiffs, which is why the opinion refers to "Plaintiffs." The plaintiffs sought a preliminary injunction under Section 13(b) of the FTC Act to prevent consummation while the Commission adjudicated the merger's legality in an administrative proceeding. The stipulated temporary restraining order preserved the status quo before the court decided the preliminary-injunction motion. Do a quick read of the FTC press release, the complaint, and the order of the court entering a temporary restraining order (pp. 53-84).

The court's framework. The real action, of course, is in the memorandum opinion supporting the entry of a preliminary injunction against consummating the Staples/Office Depot transaction.⁴ Two standards structure the opinion. Under Section 13(b), the FTC must show a likelihood of success on the merits and that the equities tip in favor of injunctive relief. The FTC can establish a likelihood of success by raising questions going to the merits "so serious, substantial, difficult and doubtful" as to warrant thorough investigation and determination by the Commission in the first instance, and the court weighs the likelihood of success against the equities on a sliding scale (pp. 101-03).

The court evaluated the FTC's likelihood of success under the *Baker Hughes* burden-shifting framework. Evidence of a high combined market share and undue concentration created a presumption of likely competitive harm. The defendants then had the burden of producing evidence rebutting that inference, while the ultimate burden of persuasion remained with the plaintiffs.

One feature of the record shapes everything that follows. Staples and Office Depot rested after the plaintiffs' case without calling their own fact or expert witnesses, and they told the court they would not proceed with the merger if the injunction was granted (p. 91). Their economist, Jonathan Orszag, prepared several expert reports but was not called to testify (p. 106 n.8). They could challenge the FTC's proof through cross-examination and argument, but they still needed evidence supporting their rebuttal. Consider what the defendants hoped to gain from this strategy.

The opinion's introduction, factual background, and legal standards explain both the business setting and this procedural framework (pp. 88-105). Read them before turning to the substantive analysis below, which you should read with some care.

Defining the market. The parties agreed that the relevant geographic market was the United States. The dispute concerned the product market, which combined two concepts: cluster markets and targeted customer markets. As for cluster markets, pens, paper clips, and copy paper are not

⁴ FTC v. Staples, Inc., 190 F. Supp. 3d 100 (D.D.C. 2016).

substitutes for one another, but they can be analyzed together when the competitive conditions for supplying them are sufficiently similar.

The customer limitation captures the different alternatives available to large businesses. For his analysis, the FTC's economist, Carl Shapiro, used annual office supply spending of at least \$500,000 as the threshold for a large office supply customer. That was a practical boundary for his analysis, not a claim that competitive conditions necessarily change abruptly at that dollar amount. The complaint had described the market as including, but not limited to, customers buying \$1 million of consumable office supplies annually, and Shapiro testified that there was no "magic place" to draw the line (p. 110 n.10).

Large customers required more from their office supplies vendor than individual office products. They required nationwide delivery, sophisticated procurement and reporting systems, negotiated pricing, and dedicated service. The court relied on these requirements, the companies' recognition of a distinct business segment, and evidence of distinct prices and price sensitivity in applying the *Brown Shoe* practical indicia. Targeted harm also required that sellers could identify these customers and charge them different prices, without smaller customers defeating the increase through arbitrage. Buying a pen at a retail store did not provide an adequate substitute for the procurement arrangement a large national business required.

The court also found the hypothetical monopolist test satisfied. That test asks whether a hypothetical monopolist would likely impose at least a small but significant, nontransitory price increase. The opinion describes the test as whether the monopolist could profitably raise prices (p. 119). Still, as we will see in class, Shapiro applied the profit-maximizing version of the test. The court credited Shapiro's analysis and evidence that large customers obtained lower prices by making Staples and Office Depot compete against one another. Consider whether that evidence goes to market definition or to competitive effects. The proposed market included these customers' purchases through different channels, including online and retail purchases; it was not confined to purchases under primary-vendor contracts. The issue was whether those alternatives sufficiently constrained pricing to this customer group.

The defendants' attacks on the market. The defendants first argued that the FTC had drawn an artificially narrow market by excluding ink and toner, as well as "beyond office supplies" (BOSS) products such as janitorial supplies, breakroom supplies, and office furniture. The court accepted the exclusions because these products faced different competitive conditions than other consumable office supplies. Managed print services providers such as Xerox, Hewlett-Packard, Lexmark, and Ricoh supplied ink and toner together with printer and copier maintenance. Customers also obtained BOSS products from other sources. Best Buy purchased BOSS products from Kimberly-Clark, while AEP procured janitorial supplies through a cleaning-services contract and sourced office furniture separately (p. 124). Products appearing in the same contract need not belong in the same cluster when customers can source them separately and their competitive alternatives differ (pp. 123-24).

The defendants also argued that the market was inconsistent with the FTC's treatment of the industry in 1997 and 2013. The court found that the 1997 case, a retail case decided nearly twenty years earlier, had little precedential value, and it turned the FTC's 2013 statement against the defendants by quoting its observation that "yesterday's market dynamics may be very different" from today's (pp. 127-29).

Finally, the defendants argued that the merger “indisputably will benefit all retail customers, and more than 99 percent of business customers.” The court responded that antitrust laws “exist to protect competition, even for a targeted group” (p. 131). Significantly, the defendants themselves had used the proposed merger to pressure large customers to lock in prices before they lost negotiating leverage (pp. 132-33). Read the opinion’s market-definition analysis with these points in mind (pp. 105-34).

Concentration and the structural presumption. Shapiro requested purchasing data from Fortune 100 companies and received sufficiently detailed responses from 81. The data identified each company’s total office supply spending and its purchases from Staples and Office Depot. He used those responses to estimate the parties’ shares of the relevant market: Staples accounted for 47.3 percent and Office Depot for 31.6 percent, for a combined 79 percent. The opinion reports an HHI increase from 3,270 to 6,265.

Relying on judicial precedent and the 2010 Horizontal Merger Guidelines, the court found that the combined market share and the concentration statistics triggered the *PNB* presumption of likely competitive harm. Their force, however, depended on whether the market definition and the underlying purchasing data reasonably represented the competitive setting.

The defendants challenged the representativeness of Shapiro’s customer sample, his attribution to the defendants of sales made through the Tier 1 diversity suppliers that partnered with them, and his treatment of “leakage” (unreported discretionary purchases of office supplies by employees). The court accepted Shapiro’s analysis as a reasonable approximation of the market as a whole. The court credited his checks on the sample, his treatment of the Tier 1 suppliers, and evidence that leakage did not materially undermine the estimates. Significantly, the defendants did not supply an alternative analysis showing that the asserted weaknesses changed the competitive picture. Read the concentration analysis and the responses to these objections (pp. 134-43).

Evidence of lost head-to-head competition. The FTC also offered evidence independent of the concentration presumption. Bidding records showed that the parties frequently competed for the same large accounts and lost business mainly to each other: 81 percent of Staples’ bid losses were to Office Depot, and 78 percent of Office Depot’s bid losses were to Staples (p. 145). Their ordinary course documents identified one another as particularly close rivals, and customers described using competing bids to obtain concessions. The opinion recounts an example in which Staples withdrew a proposed price reduction for a customer, HPG, until Office Depot was invited to bid (p. 146).

Although the court does not use the term, this evidence explains the unilateral effects mechanism: common ownership would eliminate the incentive to undercut the other firm to win the customer’s business. Large purchasing volume did not protect customers whose negotiating leverage depended on having these two alternatives. The court found the combined bidding, documentary, and customer evidence persuasive without calculating a specific postmerger price increase. Read this additional evidence of competitive harm (pp. 143-48).

Expansion as a rebuttal. The defendants’ only rebuttal argument was that Amazon Business and regional office supply companies would expand and replace the competition lost through the merger. The relevant inquiry was whether expansion would be timely, likely, and sufficient to counteract the threatened harm within two to three years, and the defendants bore the burden of producing that evidence (p. 149).

Amazon Business had launched in April 2015, only about a year before the court's decision (p. 99). Amazon's brand, technology, and ambitions were substantial, but the court found that, at the time, its capabilities did not provide sufficient competition for large business accounts within the relevant period. Among other limitations, large business customers did not yet regard Amazon Business as a viable alternative to Staples and Office Depot; Amazon Business had bid on few RFPs and had not yet won a primary-vendor contract; and it could not control the prices or delivery performance of independent sellers on its marketplace. The court evaluated the evidence and forecasts available in 2016; its decision should not be read as a description of Amazon's capabilities today.

The regional-supplier argument raised related capability and commitment problems. W.B. Mason, a distant third with less than one percent of the relevant market, lacked the nationwide operations many large customers needed, and its CEO would not commit to nationwide expansion even if the merging parties financed it. Smaller suppliers also faced purchasing-cost disadvantages. A collection of local alternatives did not establish that customers could obtain the nationwide service they would lose. The court therefore found the proposed expansion inadequate to rebut the FTC's showing. Read the discussion of Amazon Business and regional suppliers (pp. 148-59).

Remedies and efficiencies. The defendants bore the burden of showing that any proposed remedy would negate the merger's anticompetitive effects and that their claimed efficiencies were merger-specific and reasonably verifiable. Their public claims of substantial synergies were not a substitute for proof of verifiable, merger-specific efficiencies. Because they called no witnesses to support their remedy or efficiencies arguments, the court found that they had not met their burden. The opinion addresses that failure of proof briefly in a footnote at the end of its discussion of the equities (p. 161 n.15).

The equities. For preliminary relief, the court emphasized the public interest in effective antitrust enforcement and in preserving the FTC's ability to provide a meaningful remedy after administrative proceedings. Integration could make restoration of the premerger competitors difficult. The court rejected the defendants' contention that benefits, or the absence of harm, to other customers justified allowing the transaction to proceed despite the likely harm to large business customers, for the same reasons it had rejected that argument in defining the market. Read the balancing of the equities and the conclusion (pp. 159-62), together with the separate order granting the preliminary injunction (pp. 85-87).

The outcome. The preliminary injunction was only an interim judicial remedy, but its practical effect was to end the transaction. On May 10, 2016, the companies announced that they would not appeal and planned to terminate their agreement effective May 16. The announcements also describe the business consequences, including the \$250 million antitrust reverse termination fee that Staples owed Office Depot and Staples' plans after the failed acquisition. Finally, take a quick look at the press releases announcing the termination of the transaction (pp. 163-65) and the stock charts (p. 166).

There are no separate class notes for this unit. Review the Unit 5A market-definition, Unit 5B anticompetitive-effects, and Unit 5C defenses class notes as needed. The GUPPI material in the Unit 5B class notes (slides 103-112) will be useful when we discuss the bidding evidence in class.

Enjoy the reading! Email me if you have any questions.