Antitrust Agencies' Capabilities On Full Display


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Law360, New York (December 10, 2015, 5:32 PM ET) -- Even casual observers of antitrust merger enforcement have seen a spate of litigated merger challenges in recent years. Some have attributed this to the more aggressive antitrust policy under the Obama administration. Others, such as Assistant Attorney General Bill Baer, attribute the increase to the uptick in deal activity, claiming that the percentage of deals posing competitive problems has not increased significantly. Regardless of the reason, it is clear that the Federal Trade Commission and the U.S. Department of Justice are willing to aggressively litigate when they feel it is warranted.

The FTC's and DOJ's litigation capabilities were on full display on Dec. 7, 2015. The DOJ achieved a high-profile win when General Electric Co. decided to abandon the proposed sale of its appliance unit to Electrolux AB in the face of an ongoing trial to block the deal. A few hours later, the FTC announced that it was suing to block Staples Inc.'s proposed acquisition of Office Depot Inc. Although the two cases involved different industries and different agencies, they highlight common threads between the FTC's and DOJ's recent approaches to merger challenges. Both cases mark a departure from prior agency precedent for clearing deals in the same industries without conditions. Both cases also reflect an apparent renewed affinity for advancing theories of harm based on price discrimination markets, i.e., relevant markets defined around identifiable groups of customers who are uniquely vulnerable to a merger's alleged competitive harm, even though the remaining customers, who purchase the same products, are unlikely to be harmed.

Electrolux/General Electric

After four weeks of trial in the U.S. District Court for the District of Columbia, GE terminated its $3.3 billion sale to Electrolux, walking away with a $175 million reverse break fee. Electrolux initially announced its acquisition of GE's appliance business back in September 2014, marking what would have been the largest-ever acquisition for the Swedish home appliance company. The deal aimed to make Electrolux more competitive with Whirlpool and allow GE to simplify its business, focusing on technology and infrastructure. However, on July 1, 2015, the Department of Justice sued Electrolux and GE to block the deal, arguing that the acquisition would substantially lessen competition in violation of Section 7 of the Clayton Act.

The DOJ's challenge came as a surprise to some given the DOJ's prior decision to unconditionally clear Whirlpool's acquisition of Maytag. Consistent with a generally competitive appliance marketplace, the DOJ's main antitrust concerns focused narrowly on sales of ranges, cooktops and wall ovens to "contract-channel" purchasers. According to the complaint, contract-channel purchasers are single-family homebuilders, multifamily homebuilders, property managers of apartments and condominiums, hotels and governmental entities that individually negotiate contracts for major cooking appliances with suppliers like GE and Electrolux. The DOJ alleged that GE, Electrolux and Whirlpool are the three biggest suppliers in this contract-channel market, accounting for more than 90 percent of sales. Furthermore, while firms like LG and Samsung had obtained a significant presence in the retail channel, they are virtually nonexistent in the contract channel.

Prior to abandoning the deal, GE and Electrolux ran into difficulties at trial. The DOJ's cross-examination of the companies' witnesses raised doubts about the strength of their testimony, and former executives testified that GE and Electrolux only factored in each other, and Whirlpool, when setting prices on cooking appliances. Electrolux also had to retract key portions of testimony from one of its top executives.

Staples/Home Depot

Shortly after the Electrolux/GE announcement, the FTC filed an administrative complaint challenging Staples' proposed $6.3 billion acquisition of Office Depot. The suit comes 18 years after the FTC successfully sued to block the same parties' merger attempt. The FTC's complaint alleges that the current Staples/Office Depot deal would violate antitrust laws by significantly reducing competition nationwide in the market for "the sale and distribution of consumable office supplies to large business-to-business customers in the United States." Business-to-business customers (referred to as B-to-B customers) are large customers that purchase consumable office supplies such as pens, pencils, notepads, sticky notes, file folders and paper clips.

The complaint marks a departure from the FTC's comments published just two years ago regarding its decision to clear Office Depot's merger with Office Max Inc. without remedies. In that statement, the FTC explained that it had examined the merger's potential impact in both the retail and contracting channels and found that the merger would not harm competition in either channel.

In the retail channel, the FTC found that the Office Depot/Office Max merger was unlikely to substantially lessen competition because the combined company would continue to face competition from non-office supply superstore (OSS) competitors, such as mass merchants like Wal-Mart and Target and club stores like Costco and Sam's Club. The FTC also cited the "explosive growth of online commerce," which had taken substantial volume from brick-and-mortar stores. According to the FTC, competition from online retailers had caused OSSs to move away from regional pricing based on local competition to national pricing meant to match online prices.

In the contracting channel, the FTC distinguished between small and medium-sized businesses on the one hand, and large businesses on the other hand. The FTC found that there are dozens, if not hundreds, of firms that could serve small and medium-sized business. Its investigation therefore focused on sales to large contract customers. The FTC ultimately found that the merger would not harm competition for these customers due to competition from a host of sources in addition to Staples, including direct sales by manufacturers, regional vendors like W. B. Mason, and competitors in adjacent product categories, such as janitorial and industrial products. The current Staples/Office Depot complaint dismisses these firms as viable options for large B-to-B customers because they lack the product breadth, geographic scope and efficiency of the merging companies.

The FTC's current complaint alleges that sales to large business customers are a separate relevant market, distinct from the more competitive retail markets for office supplies sold to consumers. Many large business customers buy consumable office supplies under a contract, and, in addition to providing these customers with a wide range of office supplies, the vendor also provides them with fast and reliable nationwide delivery, dedicated customer service, customized online catalogs, integration of procurement systems and detailed utilization reports. The FTC's complaint alleges that "Staples and Office Depot are the only two office supplies vendors that can provide on their own the low prices, nationwide distribution, and combination of services and features that many large B-to-B customers require." The complaint also asserts that entry or expansion into the market — by other vendors, manufacturers, wholesalers or online retailers of office supplies — would not be timely, likely or sufficient to counteract the anti-competitive effects of the merger.

The FTC successfully blocked the previously attempted combination of Staples and Office Depot back in 1997. Although the parties are the same, the FTC's current theory of harm is different, reflecting the impact of the online sales on distribution for certain customer segments. In 1997, the FTC was concerned about the importance of the brick-and-mortar retail channel for superstores, alleging that the superstores priced differently when close to other brick-and-mortar superstores, regardless of emerging online and other competition. In contrast to its earlier theory of harm, in this action the FTC is not focused on the brick-and-mortar aspect of superstores, but on the unique attributes required to provide B-to-B customers competitive distribution, including online ordering, a full product line, timely delivery and value-added services.

Analysis

Although the Electrolux/GE and Staples/Office Depot cases involve different industries and different antitrust agencies, both merger challenges are similar in that they are based on alleged competitive harm in narrow relevant markets centered around large customers with specialized needs. The DOJ's challenge of the Electrolux/GE deal focused on the elimination of competition for the sale of ranges, cooktops and wall ovens to the contract channel. Similarly, the Staples/Office Depot administrative complaint focuses on contract sales to large business customers.

So-called "price discrimination markets" are based on the theory that for some products firms are able to charge different prices for different customers. As the 2010 Horizontal Merger Guidelines explain, "[w]hen price discrimination is feasible, adverse competitive effects on targeted customers can arise, even if such effects will not arise for other customers." However, price discrimination markets are not always easy to prove in court.

For example, in the Whole Foods/Wild Oats merger, the FTC was unable to convince the trial court that there was a relevant market for premium and natural organic supermarkets because the agency failed to show that the merging parties could discriminate between shoppers who would switch to a traditional supermarket in response to a price increase and those who would not. And even though the trial court decision was reversed on appeal, there was sharp disagreement between the reviewing judges on this issue.

The FTC's successful challenge of Sysco's attempted acquisition of US Foods appears to have shifted the playing field in the agencies' favor. In that case, the court found that the FTC had met its burden of showing that the merger would have substantially lessened competition for broadline food service distribution to large national customers, such as health care group purchasing organizations and large hotel and restaurant chains. In reaching its decision, the court relied heavily on Brown Shoe's practical indicia test, finding that national broadline customers had distinct needs and were recognized by the industry as a distinct customer group. The FTC's victory appears to be paying quick dividends, as both the Electrolux/GE and Staples/Office Depot complaints borrow from the same playbook. Antitrust litigators will be watching to see if the FTC is equally successful in the Staples/Office Deport matter.

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