

ANTITRUST TRADE AND PRACTICE

Expert Analysis

The Staples-Office Depot Merger: More Than Meets the Eye?

For those who follow antitrust merger battles, 2015 was a good year for the Federal Trade Commission (FTC). Most recently, the FTC obtained an injunction in the Sysco-US Foods merger.¹ And now, as everybody knows, the FTC is staring down the parties to the proposed Staples-Office Depot merger, overtly relying on the same playbook—alleging a “2-to-1” merger in a national market—that was successful in Sysco. But this is really one to watch, should it go the distance, as the antitrust history of mergers in the office supply space is complex and rich. Yes, the FTC defeated the same merger in 1997, but there the FTC was protecting the “market” for us ordinary consumers of office supplies.²

This time around, the FTC has instead shown concern for large (and presumably sophisticated and powerful) “B-to-B” (business-to-business) customers. Even more intriguing, in 2013, the FTC cleared the Office Depot-OfficeMax merger (a “3-to-2” in the same “B-to-B” space), expressly explaining to the public why consolidation did not threaten these business customers.³

Perhaps the victory in Sysco generated new enthusiasm for attempting to define national markets around specific customers; or perhaps (and possibly), these large customers have had a change of heart in the short time since the OfficeMax deal. Either way, it will be interesting to see how both the FTC and the parties (and, no doubt, a slew of economists) deal with their respective historical baggage, which is why we thought a preview would be of interest.

Relevant Merger History

1997: Staples-Office Depot I. Staples first sought to acquire Office Depot in 1996 under a \$4 billion agreement. At the time, the two companies together accounted for roughly 5.5 percent of all U.S. sales of office supplies. Nevertheless, the FTC, largely relying on a then-novel econometric analysis, found that the deal would have anticompetitive effects. The commission intervened and sued to block the deal



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in federal district court. In a landmark victory for the FTC, Judge Thomas Hogan, of the D.C. District Court, enjoined the transaction based in significant part on the economic evidence that suggested the parties were particularly close competitors and that a merger would cause “unilateral” price effects (i.e., higher prices without collusion) in a relevant product market defined as, “the sale of consumable office sup-

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plies through office supply superstores.”⁴ This relatively narrow market definition meant that Staples and Office Depot were two of three players in the office superstore space, rather than two of a number of retailers selling office supplies. As a result, the court readily agreed with the commission that allowing two of the three major competitors to combine would permit the new company, with more than 1,100 stores and \$11 billion in annual sales, to raise prices.

2013: Office Depot-OfficeMax. In stark contrast, when Office Depot sought to acquire OfficeMax for \$1.2 billion in 2013, the commission cleared the transaction in its entirety, without divestitures. The commission found that the market for the retail sale of consumable office supplies had broadened as a result of competition from big-box stores and warehouse clubs, as well as from emerging online retailers like Amazon. Convincing the commission to broaden the relevant product market outside the confines

of “office supply superstores” proved crucial in pushing the deal across the finish line.

In its statement concerning the proposed merger, the commission specifically noted that the parties “ha[d] shown that the market for the sale of consumable office supplies has changed significantly in the intervening years,” and that as a result, office supply superstores “today face significant competition and...the proposed merger is unlikely to substantially lessen competition in the retail sale of consumable office supplies.”⁵

In addition to scrutinizing the retail market, the commission’s 2013 investigation honed in on another discrete segment of the market: the large business customer. Although this market was not at issue in 1997, the staff’s investigation focused on the sale of consumable office supplies to businesses and other customers on a long-term contract basis—the so-called “B-to-B” customer. The investigation focused in particular on large multi-regional and national customers, because they typically have the most demanding purchasing requirements and therefore have the fewest potential suppliers capable of meeting their needs. In its statement clearing the merger, the commission concluded that, “based on a substantial body of evidence...the proposed merger [was] unlikely to result in competitive harm in the contract channel.”⁶

2015: Sysco-US Foods. A mere two years later, the FTC took a decidedly different tact in assessing customers with national footprints in the Sysco-US Foods merger. Although Sysco had acquired dozens of smaller competitors over the years, the December 2013 announcement of its plan to acquire US Foods, its chief rival for national contracts, immediately raised concern with antitrust regulators.

When the FTC ultimately filed suit to enjoin the proposed merger, it did not rest its case upon the consolidation of power in the overall market, but rather zeroed in on the so-called “broadline food service” market for customers with national footprints. As the FTC saw it, even with the divestiture package offered by the parties, a Sysco takeover of US Foods would create an uncomfortably dominant force in the customer-specific broadline food service marketplace. In February of 2015, the FTC sued to block the deal, and several months later, Judge Amit Mehta of the D.C. Federal District Court ruled in its favor (days after the decision was handed down, the parties abandoned the deal).

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2015: Staples-Office Depot II. On Feb. 4, 2015, roughly 18 years after regulators shot down their first attempt, Staples and Office Depot announced a renewed plan to join the two office supply superstore empires by which Staples would acquire Office Depot for \$6.3 billion. In evaluating the viability of the deal, Staples and Office Depot presumably counted on the shift in market dynamics for regular retail customers (who shopped online more than ever), and on the commission's statement set forth in Office Depot-OfficeMax as to the B-to-B customers—one could see why the parties had some confidence that this do-over would be better received.

Yet as 2015 wore on, the FTC stepped up its probe of the proposed takeover, and it soon became clear that getting approval would be no easy feat. Finally, in December 2015, the FTC rejected Staples' offer to divest \$1.25 billion worth of commercial business contracts, up from the \$500 million divestiture package offered earlier in the year. The agency did not propose a counteroffer, and opted to file for a preliminary injunction seeking to prevent the parties from consummating the deal pending the outcome of an administrative proceeding. It appeared that the FTC was now working out of the Sysco playbook.

Market Definition

With the hearing date set to start on May 10 of this year, both sides are gearing up for a fight, and many are speculating that this case once again will hinge on market definition. Similar to its position in *Sysco*, the FTC is asserting that a discrete customer segment will be harmed by the transaction. Specifically, in its administrative complaint, the FTC argues that the merger would hinder competition and lead to higher prices for consumable office supplies sold to large business customers: "The Commission has reason to believe that the proposed merger between Staples and Office Depot is likely to eliminate beneficial competition that large companies rely on to reduce the costs of office supplies," said FTC Chairwoman Edith Ramirez. "The FTC's complaint alleges that Staples and Office Depot are often the top two bidders for large business customers."⁷

According to the complaint, many large businesses buy consumable office supplies for their own use under contracts with either Staples or Office Depot. In addition to competitive prices on a wide range of consumable office supply products, office supply superstores provide businesses with fast and reliable nationwide delivery, dedicated customer service, customized online catalogs, integration of procurement systems, and detailed utilization reports. The complaint further alleges that, in competing against each other, Staples and Office Depot can provide the low prices and wide range of services that these businesses require; and, by eliminating the competition between Staples and Office Depot, the transaction would lead to higher prices and lower quality for these business customers. Lastly, the complaint asserts that entry or expansion into the market would not be timely, likely, or sufficient to counteract the anticompetitive effects of the merger.⁸

The gambit, of course, is that if the court sees the merger as a "2-to-1" (even with a small "fringe"

of other suppliers), then the FTC can ask for a "presumption" of anticompetitive effects under *U.S. v. Philadelphia National Bank*⁹ and its progeny—indeed, the FTC has fared well of late invoking the presumption in *H&R Block*,¹⁰ *Bazaarvoice*,¹¹ and *Sysco*. Thus, if the FTC is able to convince the court that the market definition should be narrowed around a specific set of customers, the merger would be viewed as a "2-to-1" and Staples and Office Depot would effectively be saddled with overcoming a rebuttable presumption of illegality under the Clayton Act.

But this is where it gets interesting, as the FTC (and perhaps even some of its customer witnesses) will not be writing on a clean slate. The FTC will have to deal with the apparent inconsistency between its current stance and its statement released in connection with the 2013 Office Depot-OfficeMax merger. What's more, underlying that recent position may be a lot of analysis—economic or otherwise—that would be of interest to the court should the FTC have to provide it. Either way, defining the market may not be as smooth as an antitrust outsider may expect.

Options for B-to-B Customers

Even assuming the court agrees that the FTC can meet its burden on market definition, the court

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will still have to assess whether the merger is likely to have sustainable anticompetitive effects. And while that inquiry often significantly overlaps with the market definition question, the central issue will be not what customers can do now, but what they could do in the event that the merged company attempts to raise prices or reduce service or quality. Hence, the court must look to the actual and potential options for customers following the merger. And this, of course, is where the customer (and economic) testimony will be most critical, as customers often think in terms of what they can do in the here and now, rather than where their incentives and options lie in the event of a different supply structure.

According to Roland Smith, chairman and CEO of Office Depot, "The combination of Staples and Office Depot is based on creating an organization able to compete in a vibrant market with strong regional players and powerful new national entrants."¹² By the FTC's own stipulation in its 2013 statement on Office Depot-OfficeMax, Smith's assertion may not be without merit. "Large customers use a variety of tools to ensure that they receive competitive pricing such as ordering certain products (like ink and toner) directly from manufacturers... The parties... face strong competition from... a host of non-OSS [office supply superstores] competitors, such as W.B. Mason

Co., Inc.... Non-OSS competitors are growing in number and strength and have demonstrated the ability to win large multi-regional and national customer contracts. In particular, regional office supply competitors have developed and utilized various strategies to compete successfully for large national accounts, including working with office supply wholesalers and joining cooperatives of independent office supply dealers to create a distribution network capable of meeting the needs of large multi-regional and national customers."¹³

It will be most interesting to see how the FTC (and its witnesses) deal with these conclusions so soon after approving what it would now have to say was a "3-to-2" merger in the same product space—itsself "presumptively" illegal. Moreover, the FTC will also have to deal with the issue of potential competition, as in 2013 it stated: "Potential competitors in adjacent product categories, such as janitorial and industrial products, have existing contractual relationships with large office supply customers and can leverage those relationships to enter the office supply distribution market."¹⁴

Conclusion

In sum, the Staples-Office Depot merger has more than meets the eye, especially if one assumes that the earlier OfficeMax merger was in fact based on a thorough review of industry participants and dynamics (which it undoubtedly was). As usual, customer and expert testimony will be central, and should the challenge proceed to trial, it will be quite compelling to see how the parties deal with the present while the FTC deals with the recent past.

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1. *FTC v. Sysco*, 83 F.Supp.3d 271 (D.D.C. 2015).
2. *FTC v. Staples*, 970 F.Supp. 1066 (D.D.C. 1997).
3. FTC, FTC File No. 131-0104, Statement of the Federal Trade Commission Concerning the Proposed Merger of Office Depot, Inc. and OfficeMax, Inc. (2013).
4. *FTC v. Staples*, 970 F.Supp. 1066, 1074 (D.D.C. 1997).
5. FTC, FTC File No. 131-0104, Statement of the Federal Trade Commission Concerning the Proposed Merger of Office Depot, Inc. and OfficeMax, Inc., 2 (2013).
6. FTC, FTC File No. 131-0104, Statement of the Federal Trade Commission Concerning the Proposed Merger of Office Depot, Inc. and OfficeMax, Inc., 3 (2013).
7. Press Release, Edith Ramirez, Chairwoman of Fed. Trade Comm'n., FTC Challenges Proposed Merger of Staples, Inc. and Office Depot, Inc., (Dec. 7, 2015).
8. Compl. ¶1-19, *In the Matter of Staples, Inc. and Office Depot, Inc.*, Docket No. 9367 (Dec. 7, 2015).
9. *United States v. Phila. Nat'l Bank*, 374 U.S. 321 (1963).
10. *United States v. H&R Block*, 835 F.Supp.2d 36 (D.D.C. Nov. 10, 2011).
11. *United States v. Bazaarvoice*, No. 13-cv-00133-WHO, 2014 WL 203966 (N.D. Cal. Jan. 8, 2014).
12. Press Release, Roland Smith, Chairman and Chief Executive Officer of Office Depot, Staples and Office Depot to Contest FTC's Attempt to Block Office Depot Acquisition, (Dec. 7, 2015).
13. FTC, FTC File No. 131-0104, Statement of the Federal Trade Commission Concerning the Proposed Merger of Office Depot, Inc. and OfficeMax, Inc., 2-3 (2013).
14. FTC, FTC File No. 131-0104, Statement of the Federal Trade Commission Concerning the Proposed Merger of Office Depot, Inc. and OfficeMax, Inc., 3 (2013).