Staples-Office Depot Mergers, 1997 v. 2016: Changed Industry, Same Result

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If you have any questions regarding the matters discussed in this memorandum, please contact the following attorneys or call your regular Skadden contact.

Clifford H. Aronson
New York
212.735.2644
clifford.aronson@skadden.com

Matthew P. Hendrickson
New York
212.735.2066
matthew.hendrickson@skadden.com

Maria Raptis
212.735.2425
New York
maria.raptis@skadden.com

Kenneth B. Schwartz
New York
212.735.2731
ken.schwartz@skadden.com

Steven C. Sunshine
Washington, D.C.
202.371.7860
steve.sunshine@skadden.com

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Four Times Square
New York, NY 10036
212.735.3000

skadden.com

On May 17, 2016, one week after announcing his decision, Judge Emmet Sullivan of the U.S. District Court for the District of Columbia released a public version of his opinion siding with the Federal Trade Commission in its challenge of the proposed transaction between Staples and Office Depot. Under the terms of the deal, Staples will pay Office Depot a $250 million break-up fee.

As Judge Sullivan's detailed opinion made clear to those familiar with the FTC's challenge to the proposed merger of Staples and Office Depot in 1997, the market for office supplies has undergone fundamental changes in the past 20 years. The rationale underlying Judge Thomas Hogan's decision in 1997 to block the merger — of two brick-and-mortar superstores that priced more aggressively when their stores were in close geographic proximity — played no part in the decision. Instead, the FTC's theory now focused on competition between the merging parties for sales to business customers ("B-to-B" customers), not from physical stores but through RFPs offering products and services delivered to the customers at all of their nationwide offices. Notwithstanding this vastly different competitive landscape, the two decisions blocking the mergers agreed on one overarching theme: Staples and Office Depot are each other's closest competitors, and the next best substitute is far behind.

In a strong opinion, Judge Sullivan found for the FTC on every meaningful point of contention. However, the opinion hinged on two key issues: whether the FTC had correctly defined the relevant market and met their burden of establishing a *prima facie* case against the deal, and whether Staples and Office Depot had shown that Amazon Business (Amazon's new B-to-B office-supply business) would adequately restore lost competition to the B-to-B office-supply space in a timely and sufficient manner. Judge Sullivan agreed that the FTC's market definition was appropriate, and rejected the defense's contention that Amazon Business was on the verge of posing a significant competitive threat (if not radically reshaping the industry).

The decision by the merging parties to rest after conclusion of the FTC's affirmative case rather than put forward evidence of their own played a key role in the decision. Throughout the opinion, Judge Sullivan cited the lack of rebuttal evidence as driving the factual conclusions underlying his analysis. For example, on the key issue of market definition, and whether the FTC had improperly excluded ink and toner from the relevant market in order to artificially inflate the defendants' post-transaction market share, Judge Sullivan wrote: "To the extent defendants sought to show that exclusion of ink and toner radically altered defendants' market share, defendants could have presented expert testimony to support that position." With respect to the defendants' argument that Amazon Business would reshape the industry, Judge Sullivan noted, "Defendants did not offer testimony from other industry experts or offer any other credible evidence." Similarly, in weighing the equities as to whether the transaction should be enjoined, Judge Sullivan reiterated, "[b]ecause Defendants rested at the close of Plaintiffs' case-in-chief and called no witnesses to support their arguments related to remedies or efficiencies, they have not met their burden."

The parties' decision not to put on an affirmative case may have been informed in part by not wanting to subject company executives to cross-examination on highly provocative internal documents. As in almost all successful agency challenges to mergers, the companies' ordinary course documents were critical sources of evidence that Judge Sullivan found probative of the issues. The parties' ordinary course documents highlighted the closeness of competition between the parties and the limited options that B-to-B customers had in the marketplace. According to Staples' own documents, "there are only two real choices" for B-to-B customers: Staples and Office Depot. Staples' ordinary

course documents also highlighted that Office Depot was its "key" and "most direct" competitor, as well as the "[t]oughest and most aggressively priced national competitor."

Equally problematic were Staples' documents related to the transaction, including documents used with customers suggesting that those customers would lose negotiating leverage "if and when" the merger were approved. Staples' communications also highlighted for customers that it would "have no reason to make this offer" if the merger with Office Depot were approved, and that customers should take the opportunity to "leverage the competition" and "drive down expenses" before the transaction closed. As Staples told one customer, the merger would "remove your ability to evaluate your program with two competitors," because after the transaction, "[t]here will only be one."

In addition to the parties' documents, the FTC presented bidding data and customer testimony that demonstrated extensive competition between the merging firms. The bidding data showed that 78 percent of Office Depot bid losses were to Staples, and 81 percent of Staples bid losses were to Office Depot. Customer testimony echoed these results. As one large B-to-B customer put it, after Staples and Office Depot they were "in trouble," because they did not think they had "a good option after that."

Overall, the *Staples* decision does not break new ground for merger analysis. Rather, the decision, as well as the FTC's theories and evidence advanced at trial, largely tracks the FTC's 2015 victory in enjoining the *Sysco-US Foods* transaction. Both recent challenges involved product markets defined around national competitors that allegedly faced limited or no competition from regional or smaller firms, as bolstered by the merging parties' ordinary course documents, bid data and customer testimony. In addition, the FTC's economic experts relied principally on similar analytical models in both cases. Finally, in both the *Staples* and *Sysco* matters, the parties sought to cure antitrust issues by entering into agreements to divest assets to third parties in advance of litigation. In both instances, the FTC pressed its case, claiming that the proposed remedies fell short of adequately addressing the FTC's concerns. This has been a consistent theme at both antitrust agencies (including in the recent Baker Hughes/Haliburton and GE/Electrolux challenges brought by the DOJ) — their willingness to gamble on litigation rather than accept a fix that may not fully restore competition.

Additional Contacts

Simon Baxter
Brussels
32.2.639.0310
simon.baxter@skadden.com

C. Benjamin Crisman, Jr.
Washington, D.C.
202.371.7330
benjamin.crisman@skadden.com

Frederic Depoortere
Brussels
32.2.639.0334
frederic.depoortere@skadden.com

Paul M. Eckles
New York
212.735.2578
paul.eckles@skadden.com

Shepard Goldfein
New York
212.735.3610
shepard.goldfein@skadden.com

Peter E. Greene
New York
212.735.3620
peter.greene@skadden.com

James A. Keyte
New York
212.735.2583
james.keyte@skadden.com

Karen Hoffman Lent
New York
212.735.3276
karen.lent@skadden.com

John H. Lyons
Washington, D.C.
202.371.7333
john.h.lyons@skadden.com

Matthew M. Martino
New York
212.735.2402
matthew.martino@skadden.com

Jeffrey A. Mishkin
New York
212.735.3230
jeffrey.mishkin@skadden.com

John M. Nannes
Washington, D.C.
202.371.7500
john.nannes@skadden.com

Neal R. Stoll
New York
212.735.3660
neal.stoll@skadden.com

Ingrid Vandenborre
Brussels
32.2.639.0336
ingrid.vandenborre@skadden.com

James S. Venit
Brussels
32.2.639.0300
james.venit@skadden.com