PUBLIC VERSION

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

FEDERAL TRADE COMMISSION Plaintiff, vs. STAPLES, INC. and OFFICE DEPOT, INC. Defendants.	)	Case No.: 1:97CV00701 Judge: TFH

PLAINTIFF'S MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF MOTIONS FOR TEMPORARY RESTRAINING ORDER AND PRELIMINARY INJUNCTION

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PRELIMINARY STATEMENT

The proposed merger of Staples, Inc. and its leading rival, Office Depot, Inc., threatens significant consumer harm: the loss of competition between the only office supply superstores (hereafter "office superstores") in many metropolitan areas and between two of only three office superstores in many other areas. As a result, office supplies will cost more for the millions of small businesses and consumers who today benefit from the fierce competition between Staples and Office Depot. Therefore, the Federal Trade Commission ("Commission") seeks to enjoin the proposed transaction pursuant to Section 13(b) of the Federal Trade Commission Act ("FTC Act"), 15 U.S.C. § 53(b).[1/]

Unless enjoined, Staples and Office Depot will be free to consummate the acquisition after April 14, 1997. Injunctive relief is necessary to preserve the status quo pending a full trial on the merits in an administrative proceeding. Preliminary relief is justified to prevent the serious harm to consumers that the transaction is likely to produce in the interim, and to avoid the difficulty of obtaining adequate relief in the future if the merger is allowed to go forward. The Commission asks this Court to provide temporary and preliminary relief under the express standards of Section 13(b) of the FTC Act, which authorizes a preliminary injunction "upon the court's determination, after 'weighing the equities and considering the Commission's likelihood of ultimate success,' that such relief 'would be in the public interest.'" FTC v. PPG Industries, Inc., 798 F.2d 1500,

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1/ Section 13(b) of the FTC Act authorizes the Commission to seek, and empowers this Court to grant, preliminary relief pending the completion of administrative proceedings challenging the proposed acquisition. Section 13(b) further provides that the Commission must commence its administrative proceeding within 20 days after the issuance by a federal court of any preliminary injunction or temporary restraining order. Pertinent portions of Sections 5 and 13(b) of the FTC Act, 15 U.S.C. §§ 45, 53(b), and Sections 7, 7A and 11 of the Clayton Act, 15 U.S.C. §§ 18, 18A, 21, are set out in Appendix I to this memorandum. The Commission is empowered to bring an administrative complaint challenging the transaction under Sections 7 and 11 of the Clayton Act, 15 U.S.C. §§ 18, 21, and under Section 5 of the FTC Act, 15 U.S.C. § 45.

1501-02 (D.C. Cir. 1986) (citing 15 U.S.C. § 53(b)); FTC v. Exxon Corp., 1979-2 Trade Cas. (CCH) ¶ 62,763 (D.D.C. 1979) (granting TRO). Particularly given that the Commission's burden respecting likely success is satisfied if it raises "questions going to the merits so serious, substantial, difficult and doubtful as to make them fair ground for thorough investigation, study, deliberation and determination by the FTC in the first instance and ultimately by the Court of Appeals," FTC v. Beatrice Foods Co., 587 F.2d 1225, 1229 (D.C. Cir. 1978), the Commission easily satisfies the criteria for preliminary injunctive relief in this case.

This case is about how competition among office superstores has brought lower prices to consumers and how a merger threatens those present and future benefits. Staples and Office Depot pioneered the office superstore concept within months of each other in 1986. Plaintiff's Exhibit (hereafter "PX") 9 at ix-x. Over the next ten years, they and a number of other firms seized on the same strategy: providing a convenient, reliable and economical source of office supplies for small businesses and individuals with home offices. PX 5 at 3; PX 6 at 7. These firms competed aggressively, developing office superstores as a one-stop destination, carrying a full line of over [ ] consumable office supply items as well as assorted other products.[2/] PX 5 at 3; PX 6 at 7-8; PX 168 ¶ 2; PX 207 at 20-21. Staples and Office Depot have been immensely successful: today, Staples has almost 500 stores and Office Depot has more than 500 stores nationwide; they compete head-to-head in 42 metropolitan areas across the country. Both companies planned to continue growing for the foreseeable future, and, absent the merger, the

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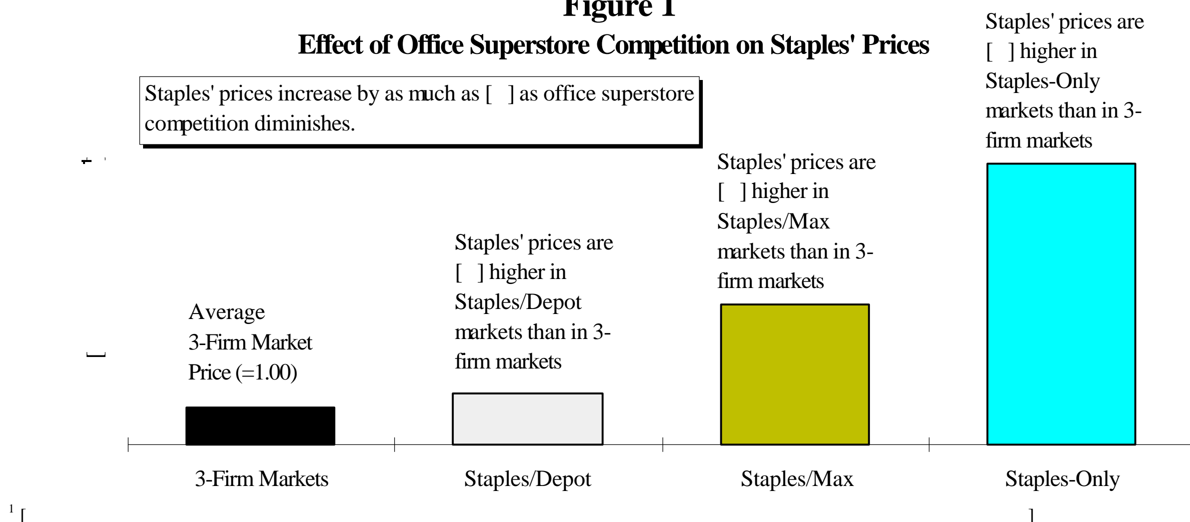
2/ Superstores carry up to [ ]or more stock-keeping units ("SKU's") of office supplies, computers and computer-related products, and office furniture. Approximately ; [ ] or more of these are traditional "consumable" office supply items, such as pads, paper and writing instruments. PX 203 at 54. Office superstores devote significant shelf space to office supplies and maintain a large inventory to ensure the convenience of one-stop shopping for consumers. We use the term "office supplies" throughout this brief to mean consumable office supplies.

areas of head-to-head competition between the two firms would have increased significantly by the year 2000. [ ].

Their success has redefined the retailing of office supplies in the United States, driving thousands of independent stationers out of business and eliminating by acquisition or bankruptcy some [ ] rivals who sought to compete in the office superstore market. PX 7 at 8666. In the process, they have created a unique competitive arena where these two and the only other surviving office superstore -- OfficeMax -- do battle. This intense competitive rivalry -- particularly between Staples and Office Depot -- has redounded to the benefit of consumers. Each has slashed prices, driven costs down, developed innovative approaches to marketing, distribution and store layout, and expanded into new areas of the country, bringing increasing numbers of consumers the convenience of one-stop shopping at low prices. Office Depot has been the most aggressive and lowest-price competitor, in turn forcing Staples and OfficeMax to compete more aggressively. This merger would end this competitive battle and leave the merged firm free to raise prices significantly.

In evaluating the legality of a merger, the antitrust laws essentially require a prediction as to whether the deal is likely to lead to less competition and, consequently, higher prices for consumers. Usually, that prediction is by necessity based on inferences derived from market concentration levels. Here, the court need not rely on market share based predictions alone. There is real world direct evidence -- based on the defendants' pricing behavior [ ] [ ] -- showing that this merger will likely lead to substantially higher prices for



[1] [ ]

consumers. [ ] Staples and Office Depot today charge higher prices in those parts of the country where they do not compete against each other and lower prices where they are rivals.

As shown in Figure 1, Staples' office supply prices are lowest in cities where all three of the national office superstores (Staples, Office Depot and OfficeMax) compete. Prices are[ ]% higher in markets where the only other competitor is OfficeMax and [ ]% higher in those areas of the country where Staples faces no other superstore rival.

This means that consumers in Columbus, Ohio (where Staples competes with OfficeMax) pay $[ ] for a box of manila file folders, while consumers in Cincinnati (a three-player market) pay $[ ]. PX 132 at 9799. Similarly, Office Depot -- the low-price competitor -- charges significantly higher prices where it faces little or no superstore competition. As shown in Figure 2, consumers in Orlando (where all three office superstores compete) pay $17.99 for a box of copy paper at Office Depot, while shoppers in nearby Leesburg, Florida (where Office Depot faces no competition) pay $24.99 for the same item. PX 3 at Tab A.

Figure 2 **Comparison of Office Depot's Advertised Prices** **Cover Page of January 1997 Local Sunday Paper Supplement**			
	Orlando, Fl. (3 firms)	Leesburg, Fl. (Depot only)	Percent Difference
Copy Paper	$17.99	$24.99	**39%**
Envelopes	$2.79	$4.79	**72%**
Binders	$1.72	$2.99	**74%**
File Folders	$1.95	$4.17	**114%**
Uniball Pens	$5.75	$7.49	**30%**

Source: PX 165; PX 3 at Tab A.[3/]

Of course, other retailers sell some office supplies, but none of them offers the one-stop shopping convenience of the office superstores. Most importantly, these retailers do not prevent superstores from charging anticompetitive prices. By contrast, superstores do. In city after city, the level of competition between superstores determines the prices consumers will pay for office supplies.

Staples fully appreciates the significance of superstore competition. As all three superstore chains have expanded, Staples has found itself competing head-to-head in a growing number of markets and facing increasing pressure to cut prices. [ ]

[ ]

[ ] PX 32-35;36 at 9007-08; PX 37; PX 203 at 466-67, 473-75; PX 210 at 156. While neither of those past efforts was successful, it now proposes merging with Office Depot, the low price leader.

3/ PX 3 provides a summary and overview of the documentary and pricing evidence from defendants' files showing office superstore competition and the likely anticompetitive effects of the proposed transaction.

Staples has long recognized Office Depot as its chief competitive threat. Staples' prices and profit margins are lowest in markets where it competes with Office Depot. Fig. 1, supra at p. 4; PX 15 at 3183; PX 203 at 433-34. Staples' strategic planning documents recognize that [ ]. PX 14 at 5501, 5510, 5512; PX 15 at 3183; 3193, 3218-20. [ ] [ ] [ ]. PX 15 at 3183. [ ] [ ], PX 15 at 3183, [ ] PX 13 at 5536; PX 14 at 5512. This merger thus threatens to injure both consumers who benefit from today's rivalry between Staples and Office Depot and those who otherwise would enjoy the future benefits of office superstore competition.

The investment community too sees reduced competition as the inevitable result of this merger. One industry analyst stated that, by merging, "Staples and Office Depot have taken a major step towards avoiding the destructive price competition which would have accompanied approaching market saturation." [ ]. Another was equally blunt: "The just announced merger of Staples and Office Depot permanently eliminates the lingering fear of intensified competition in three [superstore] markets." [ ] [ ].

The likely harm to consumers is not mere speculation; it is already occurring. Immediately after announcing the merger, [ ]

[ ]. PX 211 at

149-50; PX 121 at 3310.

These real world facts paint a clear picture -- this merger will harm consumers. The Commission demonstrates here that the sale of office supplies (sometimes called "consumables") through office superstores offers consumers a unique combination of convenience, selection and price and therefore is the appropriate relevant product market; that the metropolitan areas that are likely to be affected by the proposed acquisition are relevant geographic markets; and that the proposed transaction would combine the only two competitors in many markets and would leave only one other superstore competitor in the others. Even in the absence of direct evidence, anticompetitive effects -- the power to raise prices to consumers -- are presumed where a merger gives a firm such a dominant market position. See United States v. Philadelphia Nat'l Bank, 374 U.S. 321, 364 (1962); PPG Indus., 798 F.2d at 1506. Here that presumption is confirmed by the defendants' own documents and testimony, and by pricing data which demonstrate that office superstores are able to charge much higher prices where they face little or no office superstore competition.

The Commission will show that this acquisition threatens significant harm to millions of small businesses and consumers. The public's interest in free and open competition, both during the administrative trial and ultimately if the transaction is found to be illegal, mandates a preliminary injunction.

STATEMENT OF FACTS

I. THE PARTIES

A. Staples

Staples, Inc. ("Staples"), a Delaware corporation headquartered in Westborough, Massachusetts, is the second-largest office superstore chain in the United States, with almost 500 stores in 28 states and the District of Columbia. PX 6 at 3; PX 7 at 667; PX 9 at xx. Staples pioneered the office superstore concept in 1986. PX 6 at 3. The rationale for the superstore concept was simple: while big businesses were able to purchase office supplies through high volume contract stationers, small businesses and individuals had no comparably convenient, low cost source of office supplies and other business related products. PX 9 at 7-9. Office superstores have filled a void: since 1986, Staples has grown to almost 500 superstores nationwide, and continues to expand. PX 9 at xx; PX 203 at 164. Last year alone, Staples added over [ ] new stores, and its expansion plans, [ ] [ ]. PX 15 at 3205; PX 17 at 4749; PX 203 at 164. Staples' revenues [ ]. Staples' total sales for the fiscal year ending January 31, 1997, were approximately [ ], up from $8.8 million in 1987. PX 203 at 436; PX 9 at xi. Approximately 52% of Staples' revenues [ ] of its profits are derived from sales of office supplies; the balance is accounted for from the sale of computers, office furniture and other business related items. PX 6 at 8; PX 15 at 3172.

B. Office Depot

Office Depot, Inc. ("Office Depot") is the largest office superstore chain in the United States. According to Office Depot's 1995 Annual Report, "Office Depot continued to lead the office products industry, remaining <u>first</u> in total number of stores, <u>first</u> in average sales per store,

first in average weekly store sales, first in total delivery sales, and most important to our shareholders, first in net earnings." PX 10 at 3 (emphasis in original). Most importantly, Office Depot is the lowest price competitor among office superstore chains. [ ]. Headquartered in Delray Beach, Florida, Office Depot also operates more than 500 retail office superstores in 38 states and the District of Columbia. PX 5 at 1; PX 212 at 132. Office Depot's retail operations mirror those of Staples: it sells a wide range of general office supplies, computers, office furniture and other business related items, and its primary customer base is small businesses and individuals with home offices. [ ]. Like Staples, Office Depot has grown at a steady and increasing pace since its founding in 1986. PX 5 at 5. In 1996, Office Depot opened [ ] new stores, and, absent the merger, planned to continue its aggressive growth by opening [ ] to [ ] new stores per year. PX 212 at 132. Office Depot's total sales for 1996 were approximately $6.1 billion; 47% of which were accounted for by office supplies. [ ] [ ] 25; PX 5 at 3.

ARGUMENT

I. SECTION 13(b) OF THE FEDERAL TRADE COMMISSION ACT ESTABLISHES A PUBLIC INTEREST STANDARD FOR GRANTING INJUNCTIVE RELIEF

In authorizing this suit, the Commission found reason to believe that the effect of the proposed acquisition "may be substantially to lessen competition or to tend to create a monopoly" in the sale of office supplies sold through office superstores, in violation of Section 7 of the

Clayton Act and Section 5 of the Federal Trade Commission Act,[4/] and that a preliminary injunction would be in the public interest.

As this Court has held, the District Court is not called upon to reach a final determination on the antitrust issues in a preliminary injunction proceeding.[5/] Therefore, Section 13(b) does not contemplate a full-blown trial type hearing in District Court. FTC v. PPG Indus., 628 F. Supp. 881, 883 n.3 (D.D.C.), aff'd, 798 F.2d 1500 (D.C. Cir. 1986). That adjudication is left to the Commission, which conducts a full trial on the merits before an administrative law judge.[6/] Rather, Section 13(b) of the FTC Act provides that "[u]pon a proper showing that, weighing the equities and considering the Commission's likelihood of ultimate success, such action would be in the public interest . . . a temporary restraining order or a preliminary injunction may be granted . . . ." Under Section 13(b) "a preliminary injunction should issue if the FTC has raised questions going to the merits so serious, substantial, difficult and doubtful as to make them fair ground for thorough investigation, study, deliberation and determination by the [Commission] in the first instance and ultimately by the Court of Appeals." Beatrice Foods Co., 587 F.2d 1225, 1229 (D.C. Cir. 1978); accord, FTC v. University Health, Inc., 938 F.2d 1206, 1218 (11th Cir. 1991); FTC v. Warner Communications, 742 F.2d 1156, 1162 (9th Cir. 1984); Alliant

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4/ 15 U.S.C. §§ 18, 45. Section 7 of the Clayton Act, by its terms, prohibits the acquisition of stock or assets where "the effect of such acquisition may be substantially to lessen competition, or tend to create a monopoly." 15 U.S.C. § 18. For the purposes of this case, Section 5 of the FTC Act, which outlaws unfair methods of competition, may be assumed to duplicate Section 7 of the Clayton Act. 15 U.S.C. § 45; see PPG Indus., 798 F.2d at 1501 n.2.

5/ The determination of whether the acquisition actually violates the antitrust laws is reserved for the Commission and is not before this court. FTC v. Alliant Techsystems Inc., 808 F. Supp. 9, 19 (D.D.C. 1992); see n.1, supra.

6/ Any order issued by the Commission in its proceeding is reviewable in a Court of Appeals. 15 U.S.C. § 45(c); Alliant Techsystems, Inc., 808 F. Supp. at 19; FTC v. Lancaster Colony Corp., 434 F. Supp. 1088, 1091 (S.D.N.Y. 1977).

Techsystems, 808 F. Supp. at 19. The Commission has a "likelihood of success" if it shows "preliminarily, by affidavits or other proof, that it has a fair and tenable chance of ultimate success on the merits." Beatrice Foods, 587 F.2d at 1229 (quoting Lancaster Colony Corp., 434 F. Supp at 1090).

The ultimate test under Section 13(b) is whether injunctive relief would be "in the public interest." PPG Indus., 798 F.2d at 1502. The statute directs the court to issue injunctions where they are in the public interest and not to apply traditional equity standards. See University Health, Inc., 938 F.2d at 1217-18; FTC v. Weyerhaeuser Co., 665 F.2d 1072, 1081-82 (D.C. Cir. 1987); see H.R. Rep. No. 624, 93d Cong., 1st Sess. 31 (1973) (Congressional conferees "did not intend, nor do they consider it appropriate, to burden the Commission with the requirements imposed by the traditional equity standard which the common law applies to private litigants.").[7/] Foremost among the equities in any merger case is the need to protect the public's interest in effective enforcement of the antitrust laws. The Commission will show that there are serious and substantial questions about the legality of the proposed transaction and that injunctive relief is in the public interest.

7/ As this Court has stated, "[t]his standard places a lighter burden on the FTC than that imposed by the traditional equity standard for issuance of a preliminary injunction. The FTC does not have to show the traditional equity standards of irreparably injury, probability of success on the merits and that the balance of equities favors the petitioners." FTC v. Harbour Group Invs., L.P., 1990-2 Trade Cas. (CCH) ¶ 69,247 at 64,913 n.1 (D.D.C. 1990) (citations omitted); see Weyerhaeuser , 665 F.2d at 1081-82.

II. UNDER THE STANDARDS ESTABLISHED BY SECTION 13(b) OF THE FTC ACT AND SECTION 7 OF THE CLAYTON ACT, THE PROPOSED ACQUISITION MUST BE ENJOINED

Section 7 of the Clayton Act prohibits any merger or acquisition "where in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition or to tend to create a monopoly." The focus of Section 7 is on arresting anticompetitive mergers "in their incipiency"[8/] and thus requires a prediction as to the merger's impact on future competition.[9/] United States v. Philadelphia Nat'l Bank, 374 U.S. 321, 362 (1962). In this case, the evidence [ ] [ ] provides a solid empirical foundation for assessing the likelihood of anticompetitive pricing: office superstores charge the highest prices for office supplies in those markets where they do not face competition from another office superstore [ ] [ ],[10/] and they charge the lowest prices where they face the two other superstore competitors [ ].[11/] The merger will turn the most competitive

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8/ S. Rep. No. 698, 63rd Cong., 2d Sess. 1 (1914); Brown Shoe Co. v. United States, 370 U.S. 294, 317 (1962); see also Grand Union v. FTC, 300 F.2d 92, 98-99 (2d Cir. 1962) (FTC Act "intended to be prophylactic: to stop in their incipiency acts which when full blown would lead to monopoly or undue hindrance of competition"), cert. denied, 372 U.S. 910 (1963).

9/ Because Section 7 addresses the probable future effects of an acquisition, it necessarily requires predictions and inherently "deals in probabilities, not certainties." Brown Shoe Co., 370 U.S. at 323. Accordingly, to establish a violation, the government need show only a reasonable probability, not a certainty, that the proscribed anticompetitive activity may occur. see Hospital Corp. of Am. v. FTC, 807 F.2d 1381, 1389 (7th Cir. 1986) ("All that is necessary is that the merger create an appreciable danger of [anticompetitive] consequences in the future. A predictive judgment, necessarily probabilistic and judgmental rather than demonstrable, is called for."), cert. denied, 481 U.S. 1038 (1987).

10/ [ ] [ ].

11/ [ ]

(continued...)

three-player markets into duopolies, and will transform markets where only Staples and Office Depot compete into superstore monopolies.

Defendants understand the anticompetitive potential of the proposed transaction. Indeed, eliminating competition is a primary motivation for the deal. Staples' documents reveal that --

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[ ]

[ ] PX 120 at 5330; PX 13 at 5336; PX 14 at 5501; PX 15 at 3218; PX 121 at 3310. [ ]

PX 35; PX 203 at 456-57, 464, 466-67. [ ]

[ ].[12] PX 37 at 8890-91; PX 203 at 477-78. [ ]

[ ]

[ ]. PX 32 at 8514; PX 33 at 8399; PX 34 at 8425. [ ]

[ ] (PX 13; PX 14; PX 15 at 3183; PX 31; PX 120) [ ]

[ ].[13] PX 30 at 8442; PX 31.

11/(...continued)
[ ]
growing subject of concern for both Staples and Office Depot. PX 14 at 5501, 5512; PX 15 at 3175, 3220; PX 204 at 82-84; PX 212 at 46-48, 130.

12/ Staples' CEO has conceded that this [ ]
[ ]
[ ]
[ ]
[ ]

13/ Anticompetitive motive as shown here is highly probative of the likely effect of the proposed merger on competition. Although a good motive will not justify a merger once it has (continued...)

This direct evidence of anticompetitive motive and the likely anticompetitive effects of a transaction simplifies the Court's task, which is to predict whether the transaction may adversely affect competition. That analysis requires determinations of (1) the "line of commerce" or product market in which to assess the transaction; (2) the "section of the country" or geographic market in which to assess the transaction; and (3) the transaction's probable effect on competition in the product and geographic markets. See United States v. Marine Bancorporation, 418 U.S. 602, 618-23 (1974); FTC v. Harbour Group Investments, L.P., 1990-2 Trade Cas. (CCH) ¶ 69,247 at 64,914 n.3 (D.D.C. 1990). In view of Staples' current pricing practices and its clear intent to diminish competition by acquiring its chief rival, it is not surprising that an analysis of the market's structure and characteristics confirms that Staples' acquisition of Office Depot will lead to less competition and higher prices.

A. The Relevant Product Market Is the Sale of Office Supplies Through Office Superstores

The lawfulness of an acquisition turns on the purchaser's "potential for creating, enhancing, or facilitating the exercise of market power -- the ability of one or more firms to raise prices above competitive levels for a significant period of time." United States v. Archer-Daniels-Midland Co., 866 F.2d 242, 246 (8th Cir. 1988), cert. denied, 493 U.S. 809 (1989). The leading antitrust treatise states that "[f]inding the relevant [product] market and its structure is not a goal in itself but a surrogate for market power." Areeda et al., IIA Antitrust Law ¶ 531a (1995); see FTC v. Indiana Fed'n of Dentists, 476 U.S. 447, 460-61 (1986) (evidence of actual anticompetitive effects -- such as output reductions or price increases -- can obviate the need for

13/(...continued)
been shown to be substantially anticompetitive, United States v. E.I. duPont de Nemours & Co., 353 U.S. 586, 607 (1957), "knowledge of intent may help the court to interpret facts and predict consequences." Chicago Bd. of Trade v. United States, 246 U.S. 231, 238 (1918).

extensive inquiry into market definition). The tools for defining a product market "help evaluate the extent competition constrains market power and are, therefore, indirect measurements of a firm's market power." Archer-Daniels-Midland Co., 866 F.2d at 244-45.

Product markets are defined by "the reasonable interchangeability of use or the cross-elasticity of demand" between the product itself and possible substitutes for it. Brown Shoe, 370 U.S. at 325; see Rothery Storage & Van Co. v. Atlas Van Lines, Inc., 792 F.2d 210, 218 (D.C. Cir. 1986), cert. denied, 479 U.S. 1033 (1987). The relevant product market "must be drawn narrowly to exclude any other product to which, within reasonable variations in price, only a limited number of buyers will turn . . . ." Times-Picayune Publishing Co. v. United States, 345 U.S. 594, 612 n.31 (1953). In other words, if prices go up, will so many consumers switch to substitutes that the price increase becomes unprofitable? If not, those possible substitutes are properly excluded from the relevant market. See Archer-Daniels-Midland Co., 866 F.2d at 248.

The courts and the antitrust enforcement agencies find a relevant product market where "sellers, if unified by a hypothetical cartel or merger, could raise prices significantly above the competitive level." H.J. Inc. v. International Tel. & Tel. Corp., 867 F.2d 1531, 1537 (8th Cir. 1989). The 1992 Horizontal Merger Guidelines provide an analytical framework for finding the relevant product market by taking the smallest possible grouping of competing products or distributors, here office superstores, and asking whether a "hypothetical monopolist over that [product or] group of products would profitably impose at least a 'small but significant and nontransitory' [price] increase." United States Department of Justice and Federal Trade Commission, 1992 Horizontal Merger Guidelines, reprinted in 4 Trade Reg. Rep. (CCH) ¶ 13,104

at § 1.11 (Apr. 1992) (hereinafter "Merger Guidelines")[14/]; Community Publishers v. Donrey Corp., 892 F. Supp. 1146, 1161 (W.D. Ark. 1995) ("the approaches to market definition endorsed by the Merger Guidelines and the case law are essentially consistent."). The Merger Guidelines use five percent as the usual approximation of a "small but significant and non-transitory" price increase. Merger Guidelines, § 1.11.[15/] The term "profitably impose" simply asks whether, in the face of a price increase, enough customers will continue to buy from the monopolist to offset any sales lost to other sellers. So long as the additional profit from the price increase exceeds the profits lost from those consumers who turned to substitutes, the price increase would be profitable overall and the particular grouping of products is deemed to be a separate market for antitrust purposes. U.S. Anchor Mfg., Inc. v. Rule Indus., Inc., 7 F.3d 986, 997 n.21 (11th Cir. 1993), cert. denied, 114 S. Ct. 2710 (1994).

In this case, the exercise need not be hypothetical. The defendants' own current pricing practices show that an office superstore monopolist has the ability profitably to raise prices above competitive levels. When Staples, Office Depot and OfficeMax all compete in a city, prices are lowest. In two firm markets where Staples faces only its arch rival Office Depot, it charges

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14/ The Merger Guidelines are attached to this brief as Appendix II. While the Merger Guidelines are not binding on the courts, courts have considered them in determining the impact on competition of a proposed acquisition. See University Health, Inc., 938 F.2d at 1211 n.12; PPG Indus., 798 F.2d at 1503.

15/ Commentators have noted that, for retail markets characterized by high volume of sales but low profit margin per dollar of sales, a hypothetical price increase lower than 5% is appropriate. Harris & Jorde, Market Definition in the Merger Guidelines: Implications for Antitrust Enforcement, 71 Calif. L. Rev. 464, 482 (1983) ("In the high-volume grocery business . . . net income typically represents 0.5% of sales, so a 5% increase in price would represent a 1000% increase in profit . . . . Surely, a sizable number of competitors not now in the market would enter if profits were running at that exorbitant level. Just as surely, the managers of any recently merged grocery firm would know better than to try to raise prices by 5% across the board.") Here, as we will show, the office superstore market is supported by even a 5% test.

slightly higher prices. But where Office Depot is not in the market and just Staples and OfficeMax are present, Staples raises its prices by [ ]. Fig. 1, supra at p. 4. Where Staples faces no office superstore competition, prices are [ ] higher than in three firm markets. Id.; PX 177; PX 3, Tabs B- D. In short, if Staples became a superstore monopolist, it would find it profitable to raise prices by much more than 5%.[16/]

This real world application of the Merger Guidelines market definition test demonstrates that the demand cross elasticity between office superstores and other retail sources of office supplies is low: that is, that, even in the face of significantly higher prices, not enough customers consider these other sources to be adequate substitutes for office superstores to force prices down to the competitive levels found in geographic areas where all three superstore chains compete. This evidence that customers do not, and will not, switch in sufficient numbers to other sources of office supply products to defeat an anticompetitive price increase establishes that office superstores constitute a relevant product market.

The pricing evidence reinforces what consumers and small businesses already know: office superstores offer a combination of one-stop shopping and competitive prices that no one else can match.[17/] [ ]

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16/ [ ]
[ ]

17/ [ ] "There are no other office supply retailers that offer such a broad array of office supply merchandise at comparably low prices."); [ ] "the only competitors to office superstores are the other office superstores").

[ ]
[ ]
[ ]

PX 168 at ¶ 10; PX 167 at ¶ 3. The CEO of Staples made the same point when he characterized office superstores [ ]

While other retailers also sell some office supplies, no other type of retail format offers the breadth of product line, inventory on hand, and convenience that office superstore customers require. Indeed, these retailers -- including [ ] [ ] -- confirm the defendants' own assessment that superstores offer a unique combination of office products and services.[18/]

Courts recognize that such a "cluster" of products and services may be a relevant product market, based on the benefit to consumers accruing from the convenience of purchasing complementary products from a single supplier. Supermarkets and commercial banking services (providing a combination of checking, savings and loan services) are but two examples.

18/ [ ] (warehouse clubs stores offer very limited line of office supplies compared to superstores); [ ] (office superstores offer much wider breadth of product compared to [ ] does not offer full range of items, variety, convenience, and focus on office supplies as do the superstores); [ ] [ ] has different customers, lacks breadth of product of office superstores); [ ] [ ] product line not competitive with office superstores on general consumable office supply items); [ ] office supply line too limited to attract broader customer base of office superstores); [ ] office supply offering is limited and does not attract superstore customers); [ ] limited offering of office supplies as a convenience, not as a destination point for office supplies customers); [ ] [ ] buying group of 200 independents: other retailers, including independents, are not "realistic alternatives for consumers who shop at the superstores"); [ ] [ ] Sworn statements similarly show that mail order and contract stationers cannot constrain the pricing of the superstores. [ ] (mail order has higher prices, does not compete with office superstores); [ ] (mail order and contract business is different from retail operations).

Philadelphia Nat'l Bank, 374 U.S. at 356 (banking services); Calif. v. American Stores, 697 F. Supp. 1125, 1129 (C.D. Cal. 1988) (supermarkets), aff'd in part and rev'd on other grounds, 872 F.2d 837 (9th Cir. 1989), rev'd on other grounds, 495 U.S. 271 (1990), reinstated in relevant part, 930 F.2d 776 (9th Cir. 1991).[19/]

Defendants have argued to the Commission that a relevant market of office superstores fails to account for office supplies sold by these other retailers. This argument misses the point. The mere fact that two different classes of retail vendors both sell a particular type of merchandise does not mean that they are in the same product market. Bon-Ton Stores, Inc. v. May Dep't Stores Co., 881 F. Supp. 860, 869 (W.D.N.Y. 1994); American Stores, 697 F. Supp at 1129 ("[e]ven if convenience stores competitively price a few food items, such as bread and milk, in direct competition with supermarkets, such is not sufficient to justify inclusion of all retail grocery sales from whatever outlet in the relevant product market").

The proper focus in product market definition is not on whether other retailers have anything in common with office superstores, but whether a sufficient number of consumers would defect to these alternatives to make a small but significant price increase unprofitable. U.S. Anchor Mfg., 7 F.3d at 995. Here the real world evidence tells the story. Despite the fact that there are other retailers such as Wal-Mart, Target, Sam's Club, Kmart, Best Buy and Computer City in towns and cities such as Fredericksburg, VA, Lynchburg, VA, New Orleans,

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19/ See also United States v. Grinnell Corp., 384 U.S. 563, 573 (1966) (central station protective services for burglary protection, fire protection and other services); General Indus. Corp. v. Hartz Mountain Corp., 810 F.2d 795, 805 (8th Cir. 1987) (pet supplies); Alliant Techsystems, 808 F. Supp. at 20 (munitions systems); In the Matter of Hospital Corp. of Am., 106 F.T.C. 361, 343-36, 465-66 (1985) (acute inpatient hospital services), aff'd, 807 F.2d 1381 (7th Cir. 1986), cert. denied, 481 U.S. 1038 (1987).

LA, Portland, ME, Buffalo, NY, Leesburg, FL, Reading, PA, and Jacksonville, FL, where there are no competing office superstores, the office superstore monopolist (be it Staples, Office Depot or OfficeMax) is still able to raise prices above levels in cities where there is superstore competition. Statistical analysis of these price differences by a leading economist confirms that the presence or absence of superstore competition -- *not* competition from other retailers -- explains these price differences. PX 202 (Decl. of Dr. Warren-Boulton). Because office superstores offer a unique combination of price, convenience and product offerings, not enough customers switch to other retailers to defeat anticompetitive pricing.

This Court has found documents from the defendants' own files -- exposing the "business reality" of "how the market is perceived by those who strive to profit in it" -- to constitute powerful evidence in support of a separate product market. FTC v. Coca-Cola Co., 641 F. Supp. 1128, 1132 (D.D.C. 1986), vacated mem., 829 F.2d 191 (D.C. Cir. 1987).[20/] Documents from the files of both Staples and Office Depot reveal that [ ] [ ] PX 61; PX 20 at 2875; PX 62; PX 13; PX 14; PX 15; PX 112; PX 23; PX 22; PX 19 at 1509; PX 16 at 8868; PX 75; PX 24 at 2202, 2388-2407; PX 83 at 2197-98; PX 25; PX 85. [ ]

20/ E.g., Beatrice Foods Co. v. FTC, 540 F.2d 303, 309 (7th Cir. 1976) (manufacturers of brushes and rollers do not consider aerosols or spray paints when setting price); Reynolds Metal Co. v. FTC, 309 F.2d 223, 228-29 (D.C. Cir. 1962) (finding florist foil to be a product market separate from other types of aluminum foil based on, *inter alia*, evidence in company documents); Community Publishers, 892 F. Supp. at 1153-54 (when firms routinely concentrate on some presumptively competitive products and ignore others, they may be providing a practical assessment of the products that are inside or outside the relevant product market); American Stores, 697 F. Supp at 1129 ("In fact, the State has presented evidence that defendants' own marketing documents focus on supermarket shoppers and competition from other supermarkets and do not evaluate convenience stores, gasoline service stations, etc. as competitors."); Coca-Cola Co., 641 F. Supp. at 1133 (noting that "pricing and marketing decisions [were] based primarily on comparisons with rival carbonated soft drink products, with little if any concern about competition from other beverages").

[ ] significant price differences between geographic areas are based primarily on the level of office superstore competition. [ ]
[ ]
[ ] PX 135-37. [ ]
[ ]
[ ]
[ ] PX 62; PX 63; PX 64; PX 75; PX 78; PX 79 at 1238, 1245; PX 85; PX 139; PX 203 at 146-47, 150; PX 214 at 143-61. [ ]
[ ] PX 15; PX 16; PX 21; PX 23; PX 24 at 2202, 2388-467; PX 75; PX 61; PX 62; PX 63; PX 75-90.

By contrast, [ ] Although defendants will point to occasions where they changed price in response to someone else, other retailers do not pose a competitive constraint in any way comparable to office superstores. Indeed, when entering a new market, both Staples and Office Depot [ ]
[ ]
[ ] PX 62 at 5255-56, 5360; PX 65; PX 66; PX 79 at 1238; PX 84 at 0185; PX 166 at ¶ 14; PX 167 at ¶ 6; PX 203 at 177.

Even if the market were broadened to include other office supply retailers that exhibit some limited competitive interplay with superstores, the basic analysis would not change. The ultimate question is not the precise boundaries of the market, but whether the merger is likely to have an adverse impact on competition. United States v. General Dynamics Corp., 415 U.S. 486, 521 (1974) ("the Government is not required to delineate Section 7 markets by 'metes and

bounds.'"). If the market is defined broadly, the fact remains that the office superstores within that broad market interact principally with each other. Courts have recognized this point, and found "submarkets" -- i.e., narrower relevant markets within broader markets, based on factors such as industry perception or the existence of different channels of distribution that demonstrate a special competitive interaction between some firms or product in the market. See Brown Shoe Co., 370 U.S. at 325. In this Circuit, the Court of Appeals has regarded "submarkets" as "evidentiary proxies for direct proof of substitutability." Rothery Storage & Van Co., 792 F.2d at 218.[21/] As shown above,[22/] industry perception, the pricing practices of office superstores, the significant differences between office superstores and other channels of distribution and the parties' own documents provide direct and substantial proof that, even within a broader market, office superstores constitute significant and unique competition for one another.

B. The Relevant Geographic Markets Are the Metropolitan Areas Where Office Depot and Staples Compete

The second area of inquiry is to identify the "section of the country," or geographic market(s), that may be affected by the proposed acquisition. In this case, the relevant markets include 42 metropolitan areas where both Staples and Office Depot operate office superstores and the numerous metropolitan areas throughout the country where -- but for this merger -- Staples and Office Depot had planned to be competitors in the near future.

21/ Submarkets have been recognized in many decisions in this Circuit. Coca-Cola Co., 641 F. Supp. at 1133 (carbonated soft drinks); Reynolds Metals Co., 309 F.2d at 226-29 (florist foil).

22/ See supra at pp. 16-21. Moreover, even in a market that included the sales of office supplies by mass merchants, warehouse clubs, computer stores and independent stationers, the proposed transaction would dramatically increase concentration, triggering significant antitrust concerns. See infra at pp. 26-27.

The focus in defining relevant geographic markets is to determine which areas of the country would be affected adversely by an acquisition. Philadelphia Nat'l Bank, 374 U.S. at 357. The relevant geographic market must "correspond with the commercial realities of the industry . . . ." Brown Shoe Co., 370 U.S. at 336; FTC v. Imo Indus., 1992-2 Trade Cas. (CCH) ¶ 69,943 at 68,558 (D.D.C. 1989). Relevant geographic markets may be as large as the nation or the world, or as small as a metropolitan area or neighborhood. See Brown Shoe Co., 370 U.S. at 337. For all products and industries, the test for assessing the commercial realities is a practical one: can producers within certain geographic boundaries increase prices without triggering an outflow of customers to producers in other areas so as to make the price increase unprofitable overall? Coca-Cola Bottling Co. of the Southwest, 5 Trade Reg. Rep. (CCH) ¶ 23,681, at 23,422 (FTC Aug. 31, 1994), remanded on other grounds, 85 F.3d 1139 (5th Cir. 1996), complaint dismissed, 5 Trade Reg. Rep. (CCH) ¶ 24,103 (FTC Sept. 9, 1996); Merger Guidelines, § 1.21.

The fact that office superstores actually price higher in metropolitan areas where they face no office superstore competition demonstrates that they can charge supracompetitive prices without causing customers to travel elsewhere for office supplies. [ ]
[ ]
[ ] PX 203 at 98; PX 122; PX 125; PX 127; PX 140. They advertise primarily on a local basis, and advertised prices vary dramatically from city to city. See Fig. 2, supra at p. 5. The business realities,

therefore, demonstrate that metropolitan areas are relevant geographic markets for the purposes of assessing the merger's likely impact on competition.

Courts have found metropolitan areas to be relevant geographic markets in a broad range of retail industries. See, e.g., United States v. Von's Grocery Co., 384 U.S. 270, 272 (1965) (retail grocery); Philadelphia Nat'l Bank, 374 U.S. at 357-61 (banking services); Brown Shoe Co., 370 U.S. at 339 (retail shoe sales); F. & M. Schaefer Corp. v. C. Schmidt & Sons, 597 F.2d 814, 817 (2d Cir. 1979) (beer distribution); Bon-Ton Stores, Inc., 881 F. Supp. at 867 (department stores). In this case, the commercial reality of the office superstore market is similar to that of many other retail businesses: metropolitan areas are the sections of the country where the likely anticompetitive effects of the transaction will be most pronounced.

The geographic markets impacted by the proposed transaction include many of the most populous cities in the United States, across eighteen states and the District of Columbia. In 15 markets, the proposed merger will result in an office superstore monopoly.[23/] In another 27 metropolitan areas, the number of superstore competitors will be reduced from three to two.[24/] Finally, the merger eliminates future competition in many additional metropolitan areas, including

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23/ Salinas, San Diego, and Visalia-Tulare-Porterville, California; Lakeland-Winter Haven, Fort Pierce-Port St. Lucie, Tampa-St. Petersburg-Clearwater, and Ocala, Florida; Louisville, Kentucky; Champaign-Urbana, Illinois; Greenville, North Carolina; Baltimore, Maryland; Florence, South Carolina; Charlottesville, Virginia; Spokane, Washington; and Washington D.C.

24/ Los Angeles, Sacramento, San Francisco-Oakland-San Jose, and Stockton-Lodi, California; Orlando, Sarasota-Bradenton, and West Palm Beach-Boca Raton, Florida; Evansville, Indianapolis, and South Bend, Indiana; Springfield, Illinois; Kalamazoo-Battle Creek, Detroit-Ann Arbor-Flint, and Grand Rapids-Muskegon-Holland, Michigan; Middlesex County and Passaic County, New Jersey; Nassau-Suffolk, New York; Greensboro-Winston-Salem-High Point, and Raleigh-Durham, North Carolina; Cleveland and Cincinnati-Hamilton, Ohio; Portland-Vancouver, Oregon-Washington; Pittsburgh, Pennsylvania; Columbia, South Carolina; Chattanooga and Nashville, Tennessee; and Salt Lake City-Ogden, Utah.

four where Office Depot and Staples planned or had planned to compete with one another in the next few months.[25/]

C. There Is A Substantial Likelihood The Acquisition May Lessen Competition In Violation Of Section 7

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After the relevant product and geographic markets are established, the next step of the inquiry under Section 7 is evaluating the impact of the acquisition on competition: that is, determining whether the proposed merger may hurt consumers by facilitating anticompetitive pricing in these markets. To aid in this predictive determination, courts look first at market concentration and the increase in market concentration created by the transaction, then examine such other factors as the nature of competition between the merging firms, other market participants, and barriers to entry. The task of predicting the competitive impact of the Staples/Office Depot merger is simplified in this case. Since prices are significantly lower where Office Depot and Staples compete, eliminating their head-to-head competition will free the parties to charge higher prices.

1. The Proposed Transaction Will Increase Concentration Significantly

Mergers that significantly increase market concentration are presumptively unlawful because the fewer the competitors and the bigger the respective market shares, the greater the likelihood that a single firm, or a group of firms, could raise prices above competitive levels. Hospital Corp. of Am., 807 F.2d at 1389; Merger Guidelines, § 2.0. Market concentration may

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be measured by determining the market shares of industry leaders or by calculating the Herfindahl-Hirschman Index ("HHI").[26/] PPG Indus., 798 F.2d at 1503; Merger Guidelines, § 1.5. A merger that results in an HHI over 1800 indicates a highly concentrated market; it is presumed that mergers producing an increase in the HHI of more than 100 points in such markets are likely to create or enhance market power or facilitate its exercise. Merger Guidelines, § 1.51. Courts have adopted similar thresholds. Philadelphia Nat'l Bank, 370 U.S. at 364 (30% post-merger market share was sufficiently high as to be presumptively unlawful).

In this case, the combined shares of Staples and Office Depot in the office superstore market would be 100% in 15 metropolitan areas. In 27 other metropolitan areas, the post-merger market shares range from 45% to 94%, with HHIs ranging from 5,003 to 9049. PX 159, Table A. These percentages are far in excess of the levels raising a presumption of illegality.[27/]

Even were a market defined to include the other retailers of office supplies who the defendants contend compete at least to some degree with office superstores, the combined market

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26/ The HHI is calculated by squaring the individual market shares of all firms in the market and adding up the squares.

27/ Courts have barred mergers resulting in far lower HHI concentration levels or four-firm concentration ratios. FTC v. Elders Grain, Inc., 868 F.2d 901, 902 (7th Cir. 1989) (acquisition increased market shares of largest firm from 23% to 32%); PPG Indus., 798 F.2d at 1503 (combined market share of 53% and post-acquisition HHI's of 3295); Hospital Corp. of Am., 807 F.2d at 1384 (acquisition increased market share of second largest firm from 14% to 26%); Warner Communications, 742 F.2d at 1163 (four-firm concentration ratio of 75%); United States v. United Tote, Inc., 768 F. Supp. 1064, 1069-70 (D. Del. 1991) (merger between two firms with 13 and 27% of sales, increasing the HHI from 3940 to 4640, held presumptively unlawful); United States v. Ivaco, Inc., 704 F. Supp. 1409, 1419 (D. Mich. 1989) (joint ventures among two firms with 45% and 25.1% of sales, increasing the HHI from 3549 to 5809 held presumptively unlawful); Tasty Baking Co. v. Ralston Purina, Inc., 653 F. Supp. 1250, 1265 (E.D. Pa. 1987) (post-acquisition HHIs ranging from 2797 to 6420); Coca-Cola Co., 641 F. Supp. at 1134, 1139 (combined market share of 42% held presumptively unlawful); FTC v. Bass Bros. Enters., 1984-1 Trade Cas. (CCH) ¶ 66,041 at 68,609-10 (N.D. Ohio 1984) (acquisition increased market share of second largest firm from 20.9% to 28.5%).

share of the defendants raises competitive concern.[28/] Concentration is high and would increase significantly because of the merger. In the 42 geographic areas where Staples and Office Depot today compete, the post-merger HHI's average over 3000, ranging from approximately 1800 to over 5000. PX 159, Table F. Increases in HHI's are on average over 800 points, ranging from 162 to over 2000. Id.

In short, this acquisition is presumptively unlawful in either a superstore market or a market that includes those the defendants allege to be competitors.

2. Other Evidence Confirms That, After the Acquisition, Staples Will Have the Power to Raise Price

The Court need not look only at market shares to find this merger unlawful. Other evidence shows that, by eliminating Staples' most significant, and in many markets, only rival, this merger will allow Staples to increase prices. Merger Guidelines, § 2.2. [ ]

[ ] Office Depot is and has been the industry maverick, leading prices and costs down.

[ ] (Depot acknowledges its maverick status). Over the years, Office Depot's innovative approaches to office supply retailing -- such as low price guarantees and high volume "mega stores" [ ]

[ ] Staples' documents reflect

[ ] PX 13; PX 14; PX 15 at 3193, 3218-20; PX 23 at 4491; PX 30 at 8442; PX 32 at 8510; PX 120; PX 113; PX 113. Staples' 1996 strategic plan even [ ]

28/ The firms include: Wal-Mart, Kmart, Target, Sam's Club, BJ's Warehouse Clubs, Price/Costco, Best Buy, Computer City, and CompUSA. It also includes estimated sales of office supplies by independent stationers in each city.

[ ] PX 14 at 5501, 5510, 5512; see also PX 15 at 3218-20. This fear [ ] [ ] explains why Staples seeks to acquire Office Depot. [ ]

Courts have recognized that the elimination of a particularly aggressive competitor in a highly concentrated market increases the risk that prices will rise after the merger. FTC v. Food Town Stores, Inc., 539 F.2d 1339, 1345 (4th Cir. 1976) (enjoining merger when merging firms have been "aggressive competitors in the past," opening up stores in each other's market and increasing sales by greater than the industry sales average); Ivaco, 704 F. Supp. at 1419-20 (parties to joint venture were "especially" vigorous price competitors, viewing "each other as their primary competitor" in the relevant market).

Even were a market defined to include other retailers, superstores offer a distinct combination of convenience, product offering and price that differs significantly from other sellers of office supplies. This means that, for consumers, office superstores are particularly close substitutes for each other. The Merger Guidelines describe the potential anticompetitive effects of a merger of two rivals who are closer competitors than most others in the market:

> A merger between firms in a market for differentiated products [and services] may diminish competition by enabling the merged firm to profit by unilaterally raising the price of one or both products above the premerger level. Some of the sales loss due to the price rise merely will be diverted to . . . the merger partner and, depending on relative margins, capturing such sales loss through the merger may make the price increase profitable even though it would not have been profitable premerger . . . . **The price rise will be greater the closer substitutes are the products of the merging firms, i.e., the more the buyers of one product consider the other product to be their next choice.**

Merger Guidelines, § 2.21 (emphasis added); Areeda et al., Antitrust Law ¶ 901'd (1996 Supp.); Hovenkamp, Federal Antitrust Policy § 12.7a2 (1994).

The similarities between Staples and Office Depot and the intense nature of their rivalry are reflected in the pricing behavior of the two firms. Each prices low where the other is present and higher where they are not head-to-head competitors. Indeed, investment analysts view the elimination of close competition between Staples and Office Depot as a "benefit" to this merger. See, supra p. 6. Wall Street recognizes that, if this deal is approved, Staples will do what it has done consistently in the past -- maximize prices wherever it faces reduced superstore competition.

Staples' change [ ]
[ ] confirms the investment analysts' predictions that the elimination of this rivalry will be costly for consumers. [ ]
[ ]
[ ]
[ ]
[ ]
[ ] would have saved consumers millions of dollars per year. [ ]
[ ]
[ ] Without competition from Office Depot, Staples evidently concluded that neither OfficeMax nor any other retailer would force it to decrease prices.

The elimination of this unique competitive relationship between Staples and Office Depot is what makes the merger so pernicious. If allowed, Staples will acquire significant additional power over price and consumers will be forced to pay millions of dollars in higher prices. In 15 cities Staples will have a post-merger monopoly and be free to charge consumers the same high prices it charges today in markets where it faces no office superstore competition. This means prices will rise as much as [ ] percent per year in those 15 cities alone. See Fig. 1, supra at p. 4.

In the 27 markets where the merger reduces the superstore presence from 3 to 2, Staples' current pricing demonstrates that the reduction in competition will allow it to increase prices to consumers in those cities by [ ] or more per year.[29/] Using Staples' current pricing in one, two and three firm markets as a guide, the merger exposes consumers to substantial annual price increases in cities where Staples and Office Depot compete.

3. The Proposed Merger Will Eliminate Future Competition Between Office Depot and Staples

The merger of Staples and Office Depot also threatens to eliminate future competition in the many cities where the two firms had planned to open new stores. Before this merger, Staples and Office Depot were systematically expanding the competitive battlefield, moving into each other's markets, providing consumers with the benefits of heightened competition. Recent estimates prepared for Staples and Office Depot showed Staples opening an additional [ ] new stores and Office Depot opening an additional [ ] new stores by the year 2000. PX 31 at 109. Staples predicts that it will face competition from Office Depot in [ ] of its store base by the year 2000 (PX 15 at 3183), compared to the [ ] overlap between the two companies in 1996. PX 13 at 5536; PX 14 at 5512. Without the merger, Office Depot had planned to become

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29/ For example, consumers in Columbus, Ohio (where Staples and OfficeMax compete) pay approximately [ ] higher prices for office supplies than in nearby Cincinnati (where Office Depot is present as well). PX 3 at Tabs D - 1; PX 117. Similarly, consumers in two-superstore Charlotte, North Carolina pay [ ] higher prices for office supplies than consumers in nearby Greensboro, a three-superstore market. PX 156. [ ] [ ] PX 3 at Tab E - 4, 5. An outside analyst, Prudential Securities, found the same result on its own: it undertook a similar analysis in March, 1996 and found prices in Totowa, New Jersey, a three-player market, approximately 5% lower than prices in nearby Paramus, a two-player market. PX 47 at 1. In all three instances, the one common characteristic of the markets with the higher prices -- Columbus, Charlotte, and Paramus -- is the absence of competition between Staples and Office Depot.

the third superstore chain in Bergen County, NJ; Fayetteville, NC; and Albany-Schenectady-Troy NY [ ] and had planned to become the second superstore chain in Fredericksburg, VA. [ ] This merger thus eliminates planned additional competition that would have driven prices down in many more areas.

Given that the superstore market is highly concentrated, the loss of this actual potential competition by the only chains uniquely situated to enter, and with actual plans to enter and provide effective competition, also violates Section 7. FTC v. Procter & Gamble Co., 386 U.S. 568, 577 (1967) (instructing that a court must look at a merger's impact on competition "present and future").[30/] The elements of an actual potential competition case are met here. First the markets are highly concentrated. Marine Bancorporation, 418 U.S. at 631. Second, independent entry will result in significant procompetitive effects. Id. at 633. Third, Staples and Office Depot are two of only a few equally likely potential entrants. Procter & Gamble Co., 386 U.S. at 581. Fourth, Staples and Office Depot would have been likely entrants but for this merger.

30/ PPG Indus., 798 F.2d at 1503 (anticompetitive effects in markets for currently sold aircraft window transparencies as well as for research and development for future transparencies); Yamaha Motor Co. v. FTC, 657 F.2d 971, 978-79 (8th Cir. 1981) (finding joint venture unlawful where both objective and subjective evidence supported FTC's position that joint venture partner, a Japanese maker of outboard engines, was a likely entrant into the United States market for outboard engines), cert. denied, 456 U.S. 915 (1982); Mercantile Texas Corp. v. Board of Governors, 638 F.2d 1255, 1265-70 (5th Cir. 1981) (merger involving Texas banks who were uniquely situated to move into each other's geographic areas of current service).

Marine Bancorporation, 418 U.S. at 633; see United States v. Phillips Petroleum Co., 367 F. Supp. 1226, 1257 (C.D. Cal. 1973), aff'd, 418 U.S. 906 (1974). Finally, entry into these markets by either or both of these firms would occur in the near future. BOC Int'l Ltd. v. FTC, 557 F.2d 24, 29 (2d Cir. 1977).

In sum, the Court has direct evidence, buttressed by the parties' pricing and other documents, establishing that this merger eliminates the low cost firm that competes most closely with Staples and will result in the loss of present as well as future competition. The harm to consumers from a merger has never been so clear.

D. The Relevant Market Is Insulated From New Entry and Expansion or Repositioning by Other Retailers

The analysis of the conditions of new entry into a relevant market is part of a determination of the likely anticompetitive effects of any acquisition, because if entry is unlikely, the merged entity can raise prices without attracting new competition. Calif. v. American Stores, 697 F. Supp. at 1131; see Procter & Gamble Co., 386 U.S. at 579. In assessing the conditions of entry, the ultimate issue is whether entry is so easy that it "would likely avert anticompetitive effects from [the] acquisition . . . ." United States v. Baker Hughes, Inc., 908 F.2d 981, 989 (D.C. Cir. 1990).

The Merger Guidelines articulate the conditions under which entry would likely avert anticompetitive pricing. Entry is considered "easy" if it would be "timely, likely and sufficient in its magnitude, character and scope to deter or counteract the [anti]competitive effects" of a proposed transaction. Merger Guidelines, § 3.0, quoted with approval, Rebel Oil Co., Inc. v. Atlantic Richfield Co., 51 F.3d 1421, 1440 (9th Cir.), cert. denied, 116 S. Ct. 515 (1995). Entry is timely if a new entrant would have a significant market impact within two years. Merger

Guidelines, § 3.2. Entry is likely if it would be profitable at premerger prices. Id. at § 3.3. Entry is sufficient if it would be on a large enough scale to counteract the anticompetitive effects of the transaction. Id. at § 3.4.

The defendants have argued that entry either by a new superstore chain or by repositioning of an existing retailer will be enough to avert anticompetitive effects from the acquisition. Current market realities indicate otherwise.

Even with prices elevated in many markets across the country, entry is not occurring. On the contrary, firms have been exiting the market: over the past few years, the number of superstore chains has dropped from [ ] to just three. PX 7 at 8666-67; PX 168 at ¶ 12.[31/] Office 1, for example, entered in 1991 and grew to thirty-five stores in eleven states by 1996,[ ]
[ ]
[ ] Office 1 is now in bankruptcy. A total of [ ] office superstores have exited the market altogether or have been acquired by one of the market incumbents. PX 7 at 8666-67; PX 168 at ¶ 12. The failed entrants in this industry run the gamut of very large, well-known retail establishments from Kmart and Montgomery Ward to Ames and Zayres. PX 168 at ¶ 13.

The evidence that so many firms have exited and that no one is attempting to enter the market reflects the significant disadvantages facing a new challenger. De novo entry into the office superstore market is tantamount to starting a marathon when the other runners are in the last mile. There is too much ground to make up and no one with any sense is likely to try. A new entrant into the office superstore market must enter both at the local and national level to check

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31/ The Supreme Court has specifically warned courts to be wary of mergers when there is a trend toward concentration, which is certainly the case here. Philadelphia Nat'l Bank, 374 U.S. at 367.

anticompetitive pricing by market incumbents. Entry at the local level entails establishing a sufficiently large presence in each of the affected markets that the new entrant can achieve economies of distribution and advertising and can effectively constrain pricing by local market participants. But, in order to compete effectively in a given local market, a new firm has to establish the "critical mass" of stores necessary to achieve scale economies of advertising and distribution.[32/] PX 9 at 69; PX 170 at ¶ 12; PX 203 at 255; PX 212 at 82; PX 213 at 64, 216-17; PX 214 at 141, 176, 187-88. In many markets, entry cannot occur at a sufficiently large scale to achieve the requisite critical mass because there is little, if any, room for new stores. Staples, Office Depot and OfficeMax have been expanding into new markets for over ten years, and are in the process of entering more every day. Staples and Office Depot are constantly evaluating the markets they currently participate in, as well as potential new markets [ ]

[ ] PX 64; PX 25; PX 203 at 146-47; PX 212 at 109-10; PX 214 at 192-93. These analyses show that [ ]

[ ]

[ ]

[ ]

[ ] PX 25 at 0782; PX 214 at 161-62; PX 203 at 254 [ ]

[ ] Similar results apply to the Washington, D.C. area where

32/ As one Staples official has stated, "it's really tough to steal the customers from a direct competitor when you don't have the economies of advertising leverage." PX 9 at 67. This is particularly true in major markets, where the costs of advertising are extraordinarily expensive. Staples' CEO explained[ ]
[ ] PX 203 at 154-55.
Likewise, Office Depot's CEO estimates that a superstore chain requires a minimum [ ]
stores [ ]

Staples and Office Depot operate 24 and 14 stores, respectively, [ ]
[ ] PX 85 at 2728; PX 214 at 175.

In order to match the cost and distribution structures of the market incumbents, a new entrant would not only have to establish a presence in each of the local markets affected by the transaction, but would also have to enter on a nationwide scale. Staples, Office Depot and OfficeMax each has a nationwide network of approximately 500 or more stores. By operating at such a large scale, each of these firms is able to leverage their huge volumes into price concessions from their suppliers. [ ]
[ ] They also are able to distribute most efficiently by setting up regional transshipping centers.[33/] In order to match the efficient cost structure of the current office superstore firms, a new entrant would have to open, on a national level, multiple stores in multiple geographic areas. Entry at the national level, of course, entails entry into scores of local markets. The hurdles that must be overcome to enter each of these markets are, therefore, exponentially greater if entry is attempted on a national level. See Warner Communications, 742 F.2d at 1163-64 (9th Cir. 1984) (need for national scale for successful distribution constitutes a high entry barrier).

The defendants have argued in the alternative that the functional equivalent of entry would be repositioning by an existing retailer to attract office superstore customers. The likely "repositioners," they assert, are retailers such as Target, Wal-Mart, and Kmart, and computer superstores catering to small businesses, such as Best Buy. But it is instructive that these

33/ A successful distribution network is key to offering consumers immediate access to a full stocking of a wide range of products -- a hallmark of a successful office superstore. PX 5 at 3-4.

companies have not repositioned today in markets where Staples and Office Depot charge customers higher prices. [ ]

[ ]

[ ] It would require a dramatic change to the entire nature of their operations:

[ ]

[ ]

[ ] Such changes, [ ]

[ ] would not be undertaken. [ ]

[ ]

[ ]
[ ]
[ ]
[ ]
[ ]

[ ] Staples' CEO does not consider Wal-Mart to be a competitive threat. Less than three weeks before the merger with Office Depot was announced, he flatly stated, "In our industry, Wal-Mart has never been a factor." [ ] Other retailers, including [ ] and independents have also testified that they could not profitably reposition to attract office superstore business even if Staples increased prices anticompetitively. PX 171 at ¶ 9 [ ]

[ ] PX 172 at ¶ 6 [ ]; PX 175 at ¶ 5 [ ]; PX 177 at ¶ 7

[ ]; PX 178 at ¶ 7; PX 198 at ¶ 6 [ ]; PX 199 at ¶ 8[ ]; PX 201 at ¶ 15 [ ]

[ ]

One of these firms -- Best Buy -- actually attempted to reposition itself as an office supply retailer in 1994. Best Buy, an electronics retailer that carries a broad range of computers and business machines, sought to capture additional business by creating a separate office supply department [ ]

[ ]

[ ]
[ ]
[ ]
[ ]
[ ]

[ ] Two years later, Best Buy gave up [ ]

[ ]

[ ]

In short, since the entry of new superstore chains is unlikely and because retailers that today offer some office supplies would not find it profitable to compete more directly with office superstores even if prices increased, there is no effective constraint on Staples if this merger goes through. Absent an injunction, Staples will have gained the power to raise its prices in many areas across the country.

E. Defendants Will Not Show that the Proposed Transaction Will Enhance Competition by Producing Cognizable Efficiencies

Defendants have asserted in arguments before the Commission that the proposed acquisition would generate significant cost savings. They claim that if they are allowed to merge, they may well be able to reduce their costs by using the "best purchasing practices" of each company and by pressuring suppliers to give them bigger discounts. The evidence, however, will show that the claimed efficiencies are not likely to benefit consumers, are speculative, and can be

achieved through means that do not have the dramatic anticompetitive effect of the merger. As a result, efficiencies are not a defense to the anticompetitive effects likely to result from this merger.

The acid test of efficiencies is whether they benefit competition. As this Court has explained:

> A merger the effect of which may be to substantially lessen competition is not saved because, on some ultimate reckoning of social or economic debits and credits, it may be deemed beneficial. A value choice of such magnitude is beyond the ordinary limits of judicial competence, and in any event has been made for us already, by Congress.

Alliant Techsystems, Inc., 808 F. Supp. at 23 (quoting Philadelphia Nat'l Bank, 374 U.S. at 371). Many courts, including this one, have interpreted the Supreme Court's admonitions as effectively precluding an efficiencies defense.[34/] Other courts have nevertheless held that, in appropriate circumstances, efficiencies generated by mergers can promote competition, University Health, Inc., 938 F.2d at 1222, United States v. Rockford Mem. Corp., 717 F. Supp. 1251, 1288 (N.D. Ill. 1989), aff'd, 898 F.2d (7th Cir.), cert. denied, 498 U.S. 920 (1990), just as the antitrust agencies consider appropriate efficiencies in evaluating a merger's likely competitive effect. Merger Guidelines, § 4.0. Indeed, just this week the Commission and the Justice Department's Antitrust Division revised Section 4 of the Merger Guidelines to articulate how the agencies

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34/ This court, among others, has held that efficiencies are irrelevant to Section 7 analysis. As Judge Gesell wrote: "Any federal judge considering regulatory aims such as those laid down by Congress in Section 7 of the Clayton Act should hesitate before grafting onto the Act an untried economic theory such as the wealth-maximization and efficiency-though-acquisition doctrine expounded by [defendants]. . . . To be sure, efficiencies that benefit consumers were recognized [by Congress] as desirable but they were to be developed by dominant concerns using their brains, not their money by buying out troubling competitors. The Court has no authority to move in a direction neither the Congress nor the Supreme Court has accepted." Coca-Cola Co., 641 F. Supp. at 1141; see Alliant Techsystems, Inc., 808 F. Supp. at 23.

weigh efficiency claims in merger investigations. See FTC Press Release, "FTC/DOJ Announce Revised Guidelines on Efficiencies in Mergers" (Apr. 8, 1997) (attached as Appendix II).

Even under the standard of University Health and the Section 4 of the Merger Guidelines, it is not enough for defendants to show cost savings resulting from the transaction. Defendants must show that competition will not be adversely affected by the merger:

> [A] defendant who seeks to overcome a presumption that a proposed acquisition would substantially lessen competition must demonstrate that the intended acquisition would result in significant economies and that these economies would benefit competition and, hence, consumers.

University Health Inc., 983 F.2d at 1223; see Rockford Mem. Corp., 717 F. Supp. at 1289.

Here the cost savings cannot be credited for three distinct reasons. First, they will not overcome the injury to competition resulting from this merger. Merger Guidelines, § 4.0 ("[t]he Agency will not challenge a merger if cognizable efficiencies are of a character and magnitude such that the merger is not likely to be anticompetitive in any relevant market."). Without the competitive rivalry provided by Office Depot, the force that has driven Staples to reduce costs and pass on these reduced costs in the form of lower prices will be lost. Once the competitive dynamic between Office Depot and Staples is removed, Staples will be free to increase its prices and retain any cost savings as additional profits.[35/] Indeed, if the past history of the two

35/ Indeed, as recognized by this Court, "[E]xperience teaches that without worthy rivals ready to exploit lapses in competitive intensity, incentives to develop better products, to keep prices at a minimum, and to provide efficient service over the long term are all diminished to the detriment of consumers." PPG Indus., 628 F. Supp. at 885; see also United States v. Western Elec. Co., 592 F. Supp. 846, 874 (D.D.C. 1984), appeal dismissed, 777 F.2d 23 (D.C. Cir. 1985) (competition results in "lower prices, highest quality, and the greatest material progress").

companies is any guide, cost savings tend to be passed on to consumers where there is superstore competition and retained as profit where there is not. See Fig. 1, supra at p. 4; United Tote, Inc., 768 F. Supp. at 1084-85 (rejecting efficiency defense in merger to duopoly; efficiencies insufficient to outweigh the loss of competition since "even if the merger resulted in efficiency gains, there are no guarantees that these savings would be passed on to the consuming public."); Merger Guidelines, § 4.0 ("When the potential adverse competitive effect of a merger is likely to be particularly large, extraordinarily great cognizable efficiencies would be necessary to prevent the merger from being anticompetitive . . . . Efficiencies almost never justify a merger to monopoly or near-monopoly.").[36/]

A second limitation on efficiencies is that the claimed efficiencies may not be speculative. Because efficiencies are difficult to verify and quantify, the role that efficiencies play in merger analysis has been carefully circumscribed. Merger Guidelines, § 4.0; University Health Inc., 938 F.2d at 1222 n.30 ("[I]t may further the goals of antitrust policy to limit the availability of an efficiency defense, even when a defendant can demonstrate that its proposed acquisition would produce significant efficiencies."); Rockford Mem. Corp., 717 F. Supp. at 1289 (defendant's

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36/ Courts have uniformly rejected an efficiencies justification in highly concentrated markets. Alliant Techsystems, Inc., 808 F. Supp. at 23 (where merger would create firm with market power, efficiency claims are "insufficient to override the public's clear and fundamental interest in promoting competition"); Imo Indus., 1992-2 Trade Cas. (CCH) ¶69,943 at 68,560 (rejecting production efficiencies where firms had "such a controlling position in the market that there is a substantial likelihood they could raise prices."). Commentators agree. Pitofsky, Proposals for Revised United States Merger Enforcement in a Global Economy, 81 Geo. L.J. 195, 219 (1992) (limiting defense to firms with market share of 35% or less); Areeda & Hovenkamp, III Antitrust Law ¶ 701h (1996) ("[A]lthough there is clearly a social interest in preventing wasteful duplication and unnecessary business failures, there is a peculiarly strong interest in preventing unjustified mergers that create or reinforce monopoly . . . . Accordingly, an efficiency defense cannot be allowed in monopoly cases in the absence of an overwhelming demonstration that substantial efficiencies are involved and either cannot be achieved in other ways or will inevitably destroy the other firms. We know of no such case outside the public utility field.").

efficiency argument subjected to "a very rigorous standard"). As the Supreme Court cautioned: "Possible economies cannot be used as a defense to illegality." Procter & Gamble, 386 U.S. at 580 (emphasis added). "To hold otherwise would permit a defendant to overcome a presumption of illegality based solely on speculative, self-serving assertions." University Health Inc., 938 F.2d at 1223.

Defendant's efficiency claims are the essence of the speculative, self-serving assertions that the University Health court cautioned against. Since the time the Commission began its investigation of the proposed merger, the defendants' claimed efficiencies have escalated [ ] [ ] beyond what the defendants estimated when their respective boards of directors approved the transaction last September. PX 160. Such litigation-driven efficiency estimates should be viewed with considerable suspicion. See Rockford Mem. Corp., 717 F. Supp. at 1289.

Third, defendants must also show that the efficiencies are specific to the merger. "[T]he Agency will consider only those efficiencies likely to be accomplished with the proposed merger and unlikely to be accomplished in the absence of either the proposed merger or another means having comparable anticompetitive effects." Merger Guidelines, § 4.0; see University Health, 938 F.2d at 1222 n.30; United States v. Mercy Health Services, 902 F. Supp. 968, 987 (N.D. Iowa 1995); Rockford Mem. Hosp., 717 F. Supp. at 1289-91; Ivaco, 704 F. Supp. at 1425-26.[37/]

37/ Section 7 of the Clayton Act protects competition, not competitors. Brown Shoe Co., 370 U.S. at 320. Because savings that would be achieved in another manner benefit only the merging parties, the only savings relevant for determining procompetitive efficiencies are those that are made possible only through the merger. See Rockford Mem. Corp., 717 F. Supp. at 1289.

Defendants' likely efficiency claims must fail because any cost savings they attribute to a merger with Office Depot can be, and most likely will be, achieved through other means that do not adversely affect competition.

The major sources of defendants' claimed cost savings are possible cost reductions associated with volume purchasing and the utilization of best purchasing practices. Because both Staples and Office Depot are expanding rapidly, as is the office superstore market as a whole, the volume of products these companies purchase will increase with or without this merger. Each party to this merger had previously projected expanding within the next few years [ ] [ ] [ ] PX 31 at 109; PX 17 at 4749; PX 69 at 8944; PX 203 at 164; PX 212 at 132-33. Professor Areeda has cautioned that in such rapidly expanding markets, such efficiencies are not merger specific because the parties can usually achieve such efficiencies via internal expansion. Areeda & Turner, IV Antitrust Law ¶ 946a (1980) ("where market demand is expanding significantly . . . an economies defense may be presumptively rejected unless entry into the market is relatively easy."). Similarly, improved purchasing practices are achieved by the parties internally every day by searching for lower cost sources of supply. They are also available by hiring talented and proven purchasing representatives, and through the acquisition of other vendors of office supplies. The efficiencies claimed here are likely to accrue with or without the proposed transaction, since in a competitive environment both companies would seek out improved purchasing methods and would continue to increase the volume of products they purchase as they continue their inexorable expansion. Rockford Mem. Corp., 717 F. Supp. at 1291 (rejecting "best practices" efficiencies claims precisely because such efficiencies can be

achieved without merging). Accordingly, defendants' cost savings are not merger specific, and therefore not cognizable under Section 7.

III. THE FACTS OF THIS CASE DEMONSTRATE THE NEED FOR INJUNCTIVE RELIEF

Where, as here, the Commission has raised serious and substantial questions about the legality of a proposed transaction under Section 7, defendants face a difficult task of "justifying anything less than a full stop injunction." PPG Indus., 798 F.2d at 1506. The strong presumption in favor of a preliminary injunction can be overcome only if: (1) significant equities compel that the transaction be permitted; (2) a less drastic remedy would preserve the Commission's ability to obtain eventual relief; and (3) a less drastic remedy would check interim competitive harm. Id. at 1506-07.

In this case, the considerations supporting the need for a preliminary injunction are clear, and there are no public or private equities which suggest that a lesser remedy would be more appropriate. One of the principal reasons for enjoining potentially illegal transactions stems from the historic difficulty of effectively splitting a combined operation into viable entities after a merger. The ineffectiveness of divestiture as a remedy, and the need for injunctive relief to maintain the status quo, was demonstrated so frequently that by 1966 it became the subject of judicial notice by the Supreme Court in FTC v. Dean Foods Co., 384 U.S. 597, 606 n.5 (1966). The enactment of Section 13(b) manifests Congressional recognition of this problem. See Weyerhaeuser Co., 665 F.2d 1072 at 1085 n.31. As the Court noted in FTC v. Rhinechem Corp.:

> Section 13(b) in part reflects Congress' dissatisfaction with the efficacy of divestiture as a remedy in antitrust cases. To achieve its goal of facilitating successful governmental intervention before the eggs are even cracked, thereby relieving the government from the necessity of trying to unscramble them at some later date, Congress rendered the traditional equity requirements inapplicable in a Section 13(b) suit.

459 F. Supp. 785, 790 (N.D. Ill. 1978). The proposed acquisition will eliminate a price-cutting competitor and Staples' most fervent rival. Once Office Depot's separate identity is destroyed, it would be virtually impossible to restore competition in the marketplace by re-creating two independent companies after a full trial on the merits.

Another compelling reason to halt illegal acquisitions before they occur is to prevent the interim harm to competition that would result even if a suitable divestiture remedy could be devised. Given the risk of anticompetitive pricing that the merger raises, it is paramount that the benefits of competition not be dissipated during the pendency of an administrative proceeding in this case. Bass Bros. Enters., 1984-1 Trade Cas. (CCH) ¶ 66,041 at 68,622 ("Later remedies cannot remove retroactively the harm that has already occurred. Courts should, therefore, prohibit consummation of a merger pursuant to Section 13(b) where serious questions are raised about its legality.") (emphasis added). In deciding whether a significant showing has been made, doubts are to be resolved against the transaction and in favor of a preliminary injunction. Elders Grain, 868 F.2d at 906 (citing Philadelphia Nat'l Bank, 374 U.S. at 362-63).

The Commission has not only demonstrated the appropriate product and geographic markets, the unlikelihood of entry, the industry trend toward concentration, and the high post-merger market shares of the merged entity, but has provided evidence from the parties that if the acquisition is consummated prices will increase -- the ultimate issue in any horizontal merger case. The evidence amply demonstrates that the Commission has a substantial likelihood of prevailing in the administrative proceeding and that injunctive relief is necessary to preserve the benefits of free and open competition for the public.

CONCLUSION

For the reasons set forth above, the Court should grant the Commission's request for a preliminary injunction in order to maintain the status quo pending the outcome of the Commission's administrative proceeding.

Respectfully submitted,

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