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Ill-Fated Strategy in Staples-Office Depot Deal

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A federal judge’s order last week ending the planned merger of Staples and Office Depot took many in the antitrust community by surprise, but only slightly more so than the decision of the lead defense lawyer, Diane Sullivan, to rest without presenting evidence.

One must ask what such courtroom bravado — her firm’s website quotes The American Lawyer as saying that Ms. Sullivan “isn’t a hired gun; she’s more like a hired bazooka” — says about the self-confidence of merging parties and their counsel. Their strategy came as the vigor in federal merger enforcement had apparently been revived, and even exaggerated, even though this deal was in so many other ways big and audacious. One must also ask whether the firm will take action quite this risky again.

At the time of the order, no one yet knew its details, as Judge Emmet G. Sullivan of the Federal District Court for the District of Columbia issued only a bare-bones order and the promise of a later written opinion. The ruling was released on Tuesday, and it strongly endorses competition and antitrust.

Though it hardly breaks legal ground, the 75-page opinion emphasizes that mergers this breathtakingly big will not be taken lightly. It reaffirmed a pro-enforcement stance on “market definition” (that imperfect, art-and-science effort by which courts gauge a merger’s competitive effects), relying extensively on another big Federal Trade Commission victory in the 2014 case challenging ProMedica’s acquisition of its rival St. Luke’s Hospital, and reaffirmed merger law’s once-strong “incipiency” rule, which takes competitive threats seriously enough to stop even those deals that merely threaten some potential harm.
The proposed merger of Staples and Office Depot was audacious from the beginning. It reprised a merger that the F.T.C. stopped in 1997, it flouted the F.T.C.’s earlier success in a way that the commission could not lightly tolerate, the defendants were caught telling customers to buy soon before the merger raised prices, and Staples deliberately antagonized President Obama administration during the review. But most of all, the deal itself was so brazenly big.

A merger would have combined the first- and second-largest office supply chains, just a few years after one of them had already acquired the third-largest. It would have doubled the market’s concentration, and it would have produced a company 15 times larger than its nearest rival.

Perhaps the defense was nevertheless so confident because, as the intense media coverage emphasized, Judge Sullivan had expressed doubts about the case, including claims of government misconduct, doubts about some testimony and expert evidence and a suggestion, widely taken to disparage the government’s case, that the parties settle. But if those were the tea leaves the defense lawyers read, they were badly misled.

Judge Sullivan took his strongest stance on market definition. The F.T.C. argued, and the court accepted, that it was a market in “consumable office supplies to large business-to-business customers (excluding ink, toner, janitorial and break-room supplies).”

Defendants not surprisingly called that definition “gerrymandered and artificial,” because including ink and toner would substantially reduce their market share. And admittedly, it brings to mind certain stinging government losses on narrow market definitions, like that Whole Foods Market and Wild Oats competed only with “premium, natural, and organic supermarkets,” or that Oracle’s purchase of PeopleSoft would restrain competition in “high function financial and human resource management enterprise resource planning software.”

But the commission’s definition in its challenge of the proposed merger of Staples and Office Depot did just what market definition is supposed to do. It heuristically gauged probable market effects, or as Judge Sullivan wrote, it was intended for “analytical convenience.” And where any plausible definition generates concentration data as huge as this one, that ought to be enough. The best-settled rule in merger law — and one quoted conspicuously in the ruling — is supposed to be that Congress’s “concern was with probabilities, not certainties.”

Neither is it surprising that Judge Sullivan rejected defense claims concerning new entry, which was that the market would be kept healthy by online competition or by competitors like Target and Walmart. After all, people said the same thing about the 1997 merger, and the government proved them wrong in an overwhelmingly impressive econometric demonstration that the two companies were one another’s only real rivals.

And as Judge Sullivan emphasized in the ruling released on Tuesday, the claim that Amazon’s nascent business supplies division would discipline the new megaretailer — a point that defendants asserted — was “pure speculation.”

Why the defense would rest without evidence, with so much going against it, will no doubt remain between the lawyers and their clients. Perhaps Ms. Sullivan did not make the call herself, as Staples’ chief executive, Ronald L. Sargent, apparently fancies himself an antitrust specialist. He was disappointed that the judge “failed to define the relevant market correctly,” despite the F.T.C. failing “woefully short of proving its case.”

Whatever may be the case, Judge Sullivan quietly, decorously confirmed that resting without evidence was probably rash. He resolved a half-dozen or more points of uncertainty because “defendants did not present a case.”

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