970 F.Supp. 1066
United States District Court,
District of Columbia.

FEDERAL TRADE COMMISSION, Plaintiff,
v.
STAPLES, INC., and Office Depot, Inc.,
Defendants.

Civil No. 97-701 (TFH). | June 30, 1997.

REDACTED MEMORANDUM OPINION

THOMAS F. HOGAN, District Judge.

Plaintiff, the Federal Trade Commission ("FTC" or "Commission"), seeks a preliminary injunction pursuant to Section 13(b) of the Federal Trade Commission Act, 15 U.S.C. § 53(b), to enjoin the consummation of any acquisition by defendant Staples, Inc., of defendant Office Depot, Inc., pending final disposition before the Commission of administrative proceedings to determine whether such acquisition may substantially lessen competition in violation of Section 7 of the Clayton Act, 15 U.S.C. § 18, and Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45. The proposed acquisition has been postponed pending the Court's decision on the motion for a preliminary injunction, which is now before the Court for decision after a five-day evidentiary hearing and the filing of proposed findings of fact and conclusions of law. For the reasons set forth below, the Court will grant the plaintiff's motion. This Memorandum Opinion constitutes the Court's findings of fact and conclusions of law.

BACKGROUND

*****[SOME FACTS OMITTED]*****

Defendants are both corporations which sell office products-including office supplies, business machines, computers and furniture-through retail stores, commonly described as office supply superstores, as well as through direct mail delivery and contract stationer operations. Staples is the second largest office superstore chain in the United States with approximately 550 retail stores located in 28 states and the District of Columbia, primarily in the Northeast and California. In 1996 Staples' revenues from those stores were approximately $4 billion through all operations. Office Depot, the largest office superstore chain, operates over 500 retail office supply superstores that are located in 38 states and the District of Columbia, primarily in the South and Midwest. Office Depot's 1996 sales were approximately $6.1 billion. OfficeMax, Inc., is the only other office supply superstore firm in the United States.

On September 4, 1996, defendants Staples and Office Depot, and Marlin Acquisition Corp. ("Marlin"), a wholly-owned subsidiary of Staples, entered into an "Agreement and Plan of Merger" whereby Marlin would merge with and into Office Depot, and Office Depot would become a wholly-owned subsidiary of Staples. According to the Agreement and Plan of Merger, the transaction would be structured as a pooling of interests, in which each share of Office Depot common stock would be exchanged for 1.14 shares of Staples' ***1070** common stock. Pursuant to the Hart-Scott-Rodino Improvements Act of 1976, 15 U.S.C. § 18a, Staples and Office Depot filed a Premerger Notification and Report Form with the FTC and Department of Justice on October 2, 1996. This was followed by a seven month investigation by the FTC. The FTC issued a Second Request for Information on November 1, 1996, to both Staples and Office Depot. The Commission further initiated a second Second Request on January 10, 1997. In addition to the hundreds of boxes of documents produced to the FTC during this time, the FTC took depositions of 18 Staples and Office Depot officers and employees. The FTC also undertook extensive *ex parte* discovery of third-party documents and, in lieu of subpoenas, obtained at least 36 declarations from third parties.

On March 10, 1997, the Commission voted 4-1 to challenge the merger and authorized commencement of an action under Section 13(b) of the Federal Trade Commission Act, 15 U.S.C. § 53(b), to seek a temporary restraining order and a preliminary injunction barring the merger. Following this vote, the defendants and the FTC staff negotiated a consent decree that would have authorized the merger to proceed on the condition that Staples and Office Depot sell 63 stores to OfficeMax. However, the Commission voted 3-2 to reject the proposed consent decree on April 4, 1997. The FTC then filed this suit on April 9, 1997, seeking a temporary retraining order and preliminary injunction against the merger pursuant to Section 13(b) of the Federal Trade Commission Act, 15 U.S.C. § 53(b), pending the completion of an administrative proceeding pursuant to Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45, and Sections 7 and 11 of the Clayton Act, 15 U.S.C. §§ 12, 21.

Because of the urgency of this matter, the Court authorized expedited discovery and held a five-day evidentiary hearing beginning on May 19, 1997. Closing arguments were heard on June 5, 1997. In the meantime, the defendants agreed to postpone the merger pending the

Court's decision on the motion for a preliminary injunction, thus making the plaintiff's motion for a temporary restraining order moot.

*****[SOME BACKGROUND REMOVED]*****

DISCUSSION

I. Section 13(B) Standard for Preliminary Injunctive Relief

Section 7 of the Clayton Act, 15 U.S.C. § 18, makes it illegal for two companies to merge "where in any line of commerce or in any activity affecting 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." Whenever the Commission has reason to believe that a corporation is violating, or is about to violate, Section 7 of the Clayton Act, the FTC may seek a preliminary injunction to prevent a merger pending the Commission's administrative adjudication of the merger's legality. *See* Section 13(b) of the Federal Trade Commission Act, 15 U.S.C. § 53(b). However, in a suit for preliminary relief, the FTC is not required to prove, nor is the Court required to find, that the proposed merger would in fact violate Section 7 of the Clayton Act. *FTC v. Alliant Techsystems Inc.,* 808 F.Supp. 9, 19 (D.D.C.1992), ***1071** *FTC v. PPG Indus.,* 628 F.Supp. 881, 883, n. 3 (D.D.C.), *aff'd in part rev'd in part,* 798 F.2d 1500 (D.C.Cir.1986). The determination of whether the acquisition actually violates the antitrust laws is reserved for the Commission and is, therefore, not before this Court. *See Alliant,* 808 F.Supp. at 19. The only question before this Court is whether the FTC has made a showing which justifies preliminary injunctive relief.

Section 13(b) of the Federal Trade Commission Act, 15 U.S.C. § 53(b), 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, and after notice to the defendant, a temporary restraining order or a preliminary injunction may be granted without bond"[2] Courts have interpreted this to mean that a court must engage in a two-part analysis in determining whether to grant an injunction under section 13(b). (1) First, the Court must determine the Commission's likelihood of success on the merits in its case under Section 7 of the Clayton Act, and (2) Second, the Court must balance the equities. *See FTC v. Freeman Hospital,* 69 F.3d 260, 267 (8th Cir.1995), *FTC v. University Health, Inc.,* 938 F.2d 1206, 1217-18 (11th Cir.1991), *FTC v. Warner Communications Inc.,* 742 F.2d 1156, 1160 (9th Cir.1984); *FTC v. Occidental Petroleum Corp.,* 1986-1 Trade Cases ¶ 67.071, 1986 WL 952 (D.D.C.1986).

A. Likelihood of Success on the Merits

Likelihood of success on the merits in cases such as this means the likelihood that the Commission will succeed in proving, after a full administrative trial on the merits, that the effect of a merger between Staples and Office Depot "may be substantially to lessen competition, or to tend to create a monopoly" in violation of Section 7 of the Clayton Act. The Commission satisfies its burden to show likelihood of success 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 Commission in the first instance and ultimately by the Court of Appeals." *FTC v. University Health, Inc.,* 938 F.2d 1206, 1218 (11th Cir.1991). *****[CITATIONS REMOVED]*****

1072** It is not enough for the FTC to show merely that it has a "fair and tenable chance" of ultimate success on the merits as has been argued and rejected in other cases. *See FTC v. Freeman Hospital,* 69 F.3d 260, 267 (8th Cir.1995). **[CITATIONS REMOVED]***** However, the FTC need not prove to a certainty that the merger will have an anti-competitive effect. That is a question left to the Commission after a full administrative hearing. Instead, in a suit for a preliminary injunction, the government need only show that there is a "reasonable probability" that the challenged transaction will substantially impair competition. *****[CITATIONS REMOVED]*****

In order to determine whether the Commission has met its burden with respect to showing its likelihood of success on the merits, that is, whether 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 FTC in the first instance and ultimately by the Court of Appeals and that there is a "reasonable probability" that the challenged transaction will substantially impair competition, the Court must consider the likely competitive effects of the merger, if any. Analysis of the likely competitive effects of a merger 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* ***1073** *United States v. Marine Bancorporation,* 418 U.S. 602, 618-23, 94 S.Ct. 2856, 2868-71, 41 L.Ed.2d 978 (1974), *FTC v. Harbour Group Investments, L.P.,* 1990-2 Trade Cas (CCH) ¶ 69,247 at 64,914 n. 3, 1990 WL 198819 (D.D.C.1990).

II. The Geographic Market

One of the few issue about which the parties to this case do not disagree is that metropolitan areas are the appropriate geographic markets for analyzing the competitive effects of the proposed merger. A geographic market is that geographic area "to which consumers can practically turn for alternative sources of the product and in which the antitrust defendant faces competition." *Morgenstern v. Wilson,* 29 F.3d 1291, 1296 (8th Cir.1994), *cert. denied,* 513 U.S. 1150, 115 S.Ct. 1100, 130 L.Ed.2d 1068 (1995). In its first amended complaint, the FTC identified forty-two such metropolitan areas[5] as well as future areas which could suffer anti-competitive effects from the proposed merger.[6] Defendants have not challenged the FTC's geographic market definition in this proceeding. Therefore, the Court will accept the relevant geographic markets identified by the Commission.

III. The Relevant Product Market

In contrast to the parties' agreement with respect to the relevant geographic market, the Commission and the defendants sharply disagree with respect to the appropriate definition of the relevant product market or line of commerce. As with many antitrust cases, the definition of the relevant product market in this case is crucial. In fact, to a great extent, this case hinges on the proper definition of the relevant product market.

The Commission defines the relevant product market as "the sale of consumable office supplies through office superstores,"[7] with "consumable" meaning products that consumers buy recurrently, i.e., items which "get used up" or discarded. For example, under the Commission's definition, "consumable office supplies" would not include capital goods such as computers, fax machines, and other business machines or office furniture, but does include such products as paper, pens, file folders, post-it notes, computer disks, and toner cartridges. The defendants characterize the FTC's product market definition as "contrived" with no basis in law or fact, and counter that the appropriate product market within which to assess the likely competitive consequences of a Staples-Office Depot combination is simply the overall sale of office products, of which a combined Staples-Office Depot accounted for 5.5% of total sales in North America in 1996. In addition, ***1074** the defendants argue that the challenged combination is not likely "substantially to lessen competition" however the product market is defined. After considering the arguments on both sides and all of the evidence in this case and making evaluations of each witness's credibility as well as the weight that the Court should give certain evidence and testimony, the Court finds that the appropriate relevant product market definition in this case is, as the Commission has argued, the sale of consumable office supplies through office supply superstores.

The general rule when determining a relevant product market is that "[t]he outer boundaries of a product market are determined by the reasonable interchangeability of use [by consumers] or the cross-elasticity of demand between the product itself and substitutes for it." *Brown Shoe v. United States,* 370 U.S. 294, 325, 82 S.Ct. 1502, 1523-24, 8 L.Ed.2d 510 (1962); *see also United States v. E.I. du Pont de Nemours and Co.,* 351 U.S. 377, 395, 76 S.Ct. 994, 1007-08, 100 L.Ed. 1264 (1956). Interchangeability of use and cross-elasticity of demand look to the availability of substitute commodities, i.e. whether there are other products offered to consumers which are similar in character or use to the product or products in question, as well as how far buyers will go to substitute one commodity for another. *E.I. du Pont de Nemours,* 351 U.S. at 393, 76 S.Ct. at 1006. In other words, the general question is "whether two products can be used for the same purpose, and if so, whether and to what extent purchasers are willing to substitute one for the other." *Hayden Pub. Co. v. Cox Broadcasting Corp.,* 730 F.2d 64, 70 n.8 (2d Cir.1984).

Whether there are other products available to consumers which are similar in character or use to the products in question may be termed "functional interchangeability." *See, e.g., E.I. du Pont de Nemours,* 351 U.S. at 399, 76 S.Ct. at 1009 (recognizing "functional interchangeability" between cellophane and other flexible wrappings). *United States v. Archer-Daniels-Midland Co.,* 866 F.2d 242, 246 (8th Cir.1988) (discussing "functional interchangeability" between sugar and high fructose corn syrup), *cert. denied,* 493 U.S. 809, 110 S.Ct. 51, 107 L.Ed.2d 20 (1989). This case, of course, is an example of perfect "functional interchangeability." The consumable office products at issue here are identical whether they are sold by Staples or Office Depot or another seller of office supplies. A legal pad sold by Staples or Office Depot is "functionally interchangeable" with a legal pad sold by Wal-Mart. A post-it note sold by Staples or Office Depot is "functionally interchangeable" with a post-it note sold by Viking or Quill. A computer disk sold by Staples-Office Depot is "functionally interchangeable" with a computer disk sold by CompUSA. No one disputes the functional interchangeability of consumable office supplies. However, as the government has argued, functional interchangeability should not end the Court's analysis.

The Supreme Court did not stop after finding a high degree of functional interchangeability between cellophane and other wrapping materials in the *E.I. du Pont de Nemours* case. Instead, the Court also found that "an element for consideration as to cross-elasticity of demand between products is the responsiveness of the sales of one product to price changes of the other." *Id.* at 400, 76 S.Ct. at 1010. For example, in that case, the Court explained, "[i]f a slight decrease in the price of cellophane causes a considerable number of customers of other flexible wrappings to switch to cellophane, it would be an indication that a high cross-elasticity of demand exists between [cellophane and other flexible wrappings], [and therefore] that the products compete in the same market." *Id.* Following that reasoning in this case, the Commission has argued that a slight but significant increase in Staples-Office Depot's prices will not cause a considerable number of Staples-Office Depot's customers to purchase consumable office supplies from other non-superstore alternatives such as Wal-Mart, Best Buy, Quill, or Viking. On the other hand, the Commission has argued that an increase in price by Staples would result in consumers turning to another office superstore, especially Office Depot, if the consumers had that option. Therefore, the Commission concludes that the sale of consumable office supplies by ***1075** office supply superstores is the appropriate relevant product market in this case, and products sold by competitors such as Wal-Mart, Best Buy, Viking, Quill, and others should be excluded.

The Court recognizes that it is difficult to overcome the first blush or initial gut reaction of many people to the definition of the relevant product market as the sale of consumable office supplies through office supply superstores. The products in question are undeniably the same no matter who sells them, and no one denies that many different types of retailers sell these products. After all, a combined Staples-Office Depot would only have a 5.5% share of the overall market in consumable office supplies. Therefore, it is logical to conclude that, of course, all these retailers compete, and that if a combined Staples-Office Depot raised prices after the merger, or at least did not lower them as much as they would have as separate companies, that consumers, with such a plethora of options, would shop elsewhere.

The Court acknowledges that there is, in fact, a broad market encompassing the sale of consumable office supplies by all sellers of such supplies, and that those sellers must, at some level, compete with one another. However, the mere fact that a firm may be termed a competitor in the overall marketplace does not necessarily require that it be included in the relevant product market for antitrust purposes. The Supreme Court has recognized that within a broad market, "well-defined submarkets may exist which, in themselves, constitute product markets for antitrust purposes." *Brown Shoe Co. v. United States,* 370 U.S. 294, 325, 82 S.Ct. 1502, 1524, 8 L.Ed.2d 510 (1962), *see also Rothery Storage & Van Co. v. Atlas Van Lines, Inc.,* 792 F.2d 210, 218 (D.C.Cir.1986) (Bork, J.), *cert. denied,* 479 U.S. 1033, 107 S.Ct. 880, 93 L.Ed.2d 834 (1987). With respect to such submarkets, the Court explained "[b]ecause Section 7 of the Clayton Act prohibits any merger which may substantially lessen competition 'in any line of commerce,' it is necessary to examine the effects of a merger in each such economically significant submarket to determine if there is a reasonable probability that the merger will substantially lessen competition. If such a probability is found to exist, the merger is proscribed." *Id.* There is a possibility, therefore, that the sale of consumable office supplies by office superstores may qualify as a submarket within a larger market of retailers of office supplies in general.

The Court in *Brown Shoe* provided a series of factors or "practical indicia" for determining whether a submarket exists including "industry or public recognition of the submarket as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors." *Id.* Since the Court described these factors as "practical indicia" rather than requirements, subsequent cases have found that submarkets can exist even if only some of these factors are present. *See, e.g., Beatrice Foods Co. v. FTC,* 540 F.2d 303 (7th Cir.1976) (finding submarket based on industry recognition, peculiar characteristics of the product, and differences in production methods and prices). *International Telephone and Telegraph Corp. v. General Telephone & Electronics Corp.,* 518 F.2d 913, 932 (9th Cir.1975) (explaining that *Brown Shoe's* practical indicia were meant as "practical aids rather than with the view that their presence or absence would dispose, in talismanic fashion, of the submarket issue").

The Commission discussed several of the *Brown Shoe* "practical indicia" in its case, such as industry recognition, and the special characteristics of superstores which make them different from other sellers of office supplies, including distinct formats, customers, and prices. Primarily, however, the FTC focused on what it termed the "pricing evidence," which the Court finds corresponds with *Brown Shoe's* "sensitivity to price changes" factor. First, the FTC presented evidence comparing Staples' prices in geographic markets where Staples is the only office superstore, to markets where Staples competes with Office Depot or OfficeMax, or both. Based on the FTC's calculations, in markets where Staples faces no office superstore competition at all, something which was termed a one firm market during the hearing, ***1076** prices are 13% higher than in three firm markets where it competes with both Office Depot and OfficeMax. The data which underly this conclusion make it compelling evidence. Prices were compared as of January 1997, which, admittedly, only provides data for one specific point in time. However, rather than comparing prices from only a small sampling or "basket" of goods, the FTC used an office supply sample accounting for 90% of Staples' sales and comprised of both price sensitive and non price sensitive items. The

FTC presented similar evidence based on Office Depot's prices of a sample of 500 items, also as of January 1997. Similarly, the evidence showed that Office Depot's prices are significantly higher-well over 5% higher,[8] in Depot-only markets than they are in three firm markets.

Other pricing evidence presented by the FTC is less convincing on its own, due to limitations in the underlying data. For example, relatively small samplings or "baskets" of goods may have been used or it may not be clear how many stock keeping units ("SKUs") of supplies were included.

*****[SOME ANALYSIS REMOVED]*****

However, since additional evidence supports the same conclusion, the Court credits this evidence as confirmation of the general pricing trend.

The FTC also pointed to internal Staples documents which present price comparisons between Staples' prices and Office Depot's prices and Staples' prices and OfficeMax's prices within different price zones.[9] The comparisons between Staples and Office Depot were made in August 1994, January 1995, August 1995, and May 1996. Staples' prices were compared with OfficeMax's prices in August 1994, July 1995, and January 1996. For each comparison, Staples calculations were based on a fairly large "basket" or sample of goods, approximately 2000 SKUs containing both price sensitive and non-price sensitive items. Using Staples' data, but organizing it differently to show which of those zones were one, two, or three firm markets, the FTC showed once again that Staples charges significantly higher prices, more than 5% higher, where it has no office superstore competition than where it competes with the two other superstores.

The FTC offered similar price comparison evidence for Office Depot, comparing Office Depot's prices across Staples' zones.

*****[SOME ANALYSIS REMOVED]*****

On average, however, this evidence shows that Office Depot's prices are highest in its one firm markets, and lowest in its three firm markets.

This evidence all suggests that office superstore prices are affected primarily by other office superstores and not by non-superstore competitors such as mass merchandisers like Wal-Mart, Kmart, or Target, wholesale clubs such as BJ's, Sam's, and Price Costco, computer or electronic stores such as Computer City and Best Buy, independent retail office supply stores, mail orders firms like Quill and Viking, and contract stationers.

*****[SOME ANALYSIS REMOVED]*****

The evidence shows that the defendants change their price ***1078** zones when faced with entry of another superstore, but do not do so for other retailers. For example, Staples changed its price zone for Cincinnati to a lower priced zone when Office Depot and OfficeMax entered that area. New entry by Staples and OfficeMax caused a decline in prices at Office Depot's Greensboro stores. In July 1996, after OfficeMax entered Jackson, Michigan, Staples moved its Jackson store to a new zone, cutting prices by 6%. There are numerous additional examples of zones being changed and prices falling as a result of superstore entry. There is no evidence that zones change and prices fall when another non-superstore retailer enters a geographic market.

Though individually the FTC's evidence can be criticized for looking at only brief snapshots in time or for considering only a limited number of SKUs, taken together, however, the Court finds this evidence a compelling showing that a small but significant increase in Staples' prices will not cause a significant number of consumers to turn to non-superstore alternatives for purchasing their consumable office supplies. Despite the high degree of functional interchangeability between consumable office supplies sold by the office superstores and other retailers of office supplies, the evidence presented by the Commission shows that even where Staples and Office Depot charge higher prices, certain consumers do not go elsewhere for their supplies. This further demonstrates that the sale of office supplies by non-superstore retailers are not responsive to the higher prices charged by Staples and Office Depot in the one firm markets. This indicates a low cross-elasticity of demand between the consumable office supplies sold by the superstores and those sold by other sellers.

Turning back to the other *Brown Shoe* "practical indicia" of submarkets that the Commission offered in this case, the Commission presented and the Court heard a great deal of testimony at the hearing and through declarations about the uniqueness of office superstores and the differences between the office superstores and other sellers of office supplies such as mass merchandisers, wholesale clubs, and mail order firms as well as the special characteristics of office superstore customers. In addition, the Court was asked to go and view many of the different types of retail formats. That evidence shows that office superstores are, in fact, very different in appearance, physical size, format, the number and variety of SKU's offered, and the type of customers targeted and served than other sellers of office supplies.

The Court has observed that office supply superstores look far different from other sellers of office supplies. Office supply superstores are high volume, discount office supply chain stores averaging in excess of 20,000 square feet, with over 11,000 of those square feet devoted to traditional office supplies, and carrying over 5,000 SKUs of consumable office supplies in addition to computers, office furniture, and other non-consumables. In contrast, stores such as Kmart devote approximately 210 square feet to the sale of approximately 250 SKUs of consumable office supplies. Kinko's devotes approximately 50 square feet to the sale of 150 SKUs. Target sells only 400 SKUs. Both Sam's Club and Computer City each sell approximately 200 SKUs. Even if these SKU totals are low estimates as the defendants have argued, there is still a huge difference between the superstores and the rest of the office supply sellers.

In addition to the differences in SKU numbers and variety, the superstores are different from many other sellers of office supplies due to the type of customer they target and attract. The superstores' customer base overwhelmingly consists of small businesses with fewer than 20 employees and consumers with home offices. In contrast, mail order customers are typically mid-sized companies with more than 20 employees. Another example is contract stationers who focus on serving customers with more than 100 employees. While the Court accepts that some small businesses with fewer than 20 employees as well as home office customers do choose other sellers of office supplies, the superstores' customers are different from those of many of the purported competitors.

*****[SOME ANALYSIS REMOVED]*****

Superstores are simply different in scale and appearance from the other retailers. No one entering a Wal-Mart would mistake it for an office superstore. No one entering Staples or Office Depot would mistakenly think he or she was in Best Buy or CompUSA. You certainly know an office superstore when you see one. *Cf. Bon-Ton Stores, Inc. v. May Department Stores,* 881 F.Supp. 860, 870 (W.D.N.Y.1994) ("Customers know a department store when they see it.")

Another of the "practical indicia" for determining the presence of a submarket suggested by *Brown Shoe* is "industry or public recognition of the submarket as a separate economic entity." *****[CITATIONS REMOVED]***** The Commission offered abundant evidence on this factor from Staples' and Office Depot's documents which shows that both Staples and Office Depot focus primarily on competition from other superstores. The documents reviewed by the Court show that the merging parties evaluate their "competition" as the other office superstore firms, without reference to other retailers, mail order firms, or independent stationers. In document after document, the parties refer to, discuss, and make business decisions based upon the assumption that "competition" refers to other office superstores only. For example, Staples uses the phrase "office superstore industry" in strategic planning documents. PX 15 at 3186. Staples' 1996 Strategy Update refers to the "Big Three" and "improved relative competitive position" since 1993 and states that Staples is "increasingly recognized as [the] industry leader." PX 15 at 3153. A document analyzing a possible acquisition of OfficeMax referenced the "[b]enefits from pricing in [newly] noncompetitive markets," and also the fact that there was "a potential margin lift overall as the industry moves to 2 players." PX 33 at 8393, 8399.

When assessing key trends and making long range plans, Staples and Office Depot focus on the plans of other superstores. In addition, when determining whether to enter a new metropolitan area, both Staples and Office Depot evaluate the extent of office superstore competition in the market and the number of office superstores the market can support. When selecting sites and markets for new store openings, defendants repeatedly refer to markets without office superstores as "non-competitive," even when the new store is adjacent to or near a warehouse club, consumer electronics store, or a mass merchandiser such as Wal-Mart. In a monthly report entitled "Competitor Store Opening/Closing Report" which Office Depot circulates to its Executive Committee, Office Depot notes all competitor store closings and openings, but the only competitors referred to for its United States stores are Staples and OfficeMax. PX 75 at 1309.

While it is clear to the Court that Staples and Office Depot do not ignore sellers such as warehouse clubs, Best Buy, or Wal-Mart, the evidence clearly shows that ***1080** Staples and Office Depot each consider the other superstores as the primary competition. For example, Office Depot has a Best Buy zone and Staples has a warehouse club zone. However, each still refers to its one firm markets with no other office superstore as "non-competitive" zones or markets. In addition, it is clear from the evidence that Staples and Office Depot price check the other office superstores much more frequently and extensively than they price check other retailers such as BJ's or Best Buy, and that Staples and Office Depot are more concerned with keeping their prices in parity with the other office superstores in their geographic areas than in undercutting Best Buy or a warehouse club.

For the reasons set forth in the above analysis, the Court finds that the sale of consumable office supplies through office supply superstores is the appropriate relevant product market for purposes of considering the possible anti-competitive effects of the proposed merger between Staples and Office Depot. The pricing evidence indicates a low cross-elasticity of demand between consumable office products sold by Staples or Office Depot and those same products sold by other sellers of office supplies. This same evidence indicates that non-superstore sellers of office supplies are not able to effectively constrain the superstores prices, because a significant number of superstore customers do not turn to a non-superstore alternative when faced with higher prices in the one firm markets. In addition, the factors or "practical indicia" of *Brown Shoe* support a finding of a "submarket" under the facts of this case, and "submarkets," as *Brown Shoe* established, may themselves be appropriate product markets for antitrust purposes. 370 U.S. at 325, 82 S.Ct. at 1523-24.[11]

******[SOME ANALYSIS REMOVED]*****

IV. Probable Effect on Competition

After accepting the Commission's definition of the relevant product market, the Court next must consider the probable effect of a merger between Staples and Office Depot in the geographic markets previously identified. One way to do this is to examine the concentration statistics and HHIs within the geographic markets.[12] If the relevant product market is defined as the sale of consumable office supplies through office supply superstores, the HHIs in many of the geographic markets are at problematic levels even before the merger. Currently, the least concentrated market is that of Grand Rapids-Muskegon-Holland, Michigan, with an HHI of 3,597, while the most concentrated is Washington, D.C. with an HHI of 6,944. In contrast, after a merger of Staples and Office Depot, the least concentrated area would be Kalamazoo-Battle Creek Michigan, with an HHI of 5,003, and many areas would have HHIs of 10,000. The average increase in HHI caused by the merger would be 2,715 points. The concentration statistics show that a merged Staples-Office Depot would have a dominant market share in 42 geographic markets across the country. The combined shares of Staples and Office Depot in the office superstore market would be 100% in 15 metropolitan areas. It is in these markets the post-merger HHI would be 10,000. In 27 other metropolitan areas, where the number of office superstore competitors would drop from three to two, the post-merger market shares would range from 45% to 94%, with post-merger HHIs ranging from 5,003 to 9,049. Even the lowest of these HHIs indicates a "highly concentrated" market.

According to the Department of Justice Merger Guidelines, a market with an HHI of less than 1000 in "unconcentrated." An HHI between 1000 and 1800 indicates a "moderately concentrated" market, and any market with an HHI over 1800 qualifies as "highly concentrated." *See FTC v. PPG Indus., Inc.,* 798 F.2d 1500, 1503 (D.C.Cir.1986) (citing the U.S. Department of Justice and Federal Trade Commission Horizontal Merger Guidelines) (hereinafter "Merger Guidelines"). Further, according to the *Merger Guidelines,* unless mitigated by other factors which lead to the conclusion that the merger is not likely to lessen competition, an increase in the HHI is excess of 50 points in a post-merger highly concentrated market may raise significant competitive concerns. In cases where the post-merger HHI is less ***1082** than 1,800, but greater than 1,000, the *Merger Guidelines* presume that a 100 point increase in the HHI is evidence that the merger will create or enhance market power. The *Merger Guidelines,* of course, are not binding on the Court, but, as this Circuit has stated, they do provide "a useful illustration of the application of the HHI," *Id.* at 1503 n. 4, and the Court will use that guidance here. In addition, though the Supreme Court has established that there is no fixed threshold at which an increase in market concentration triggers the antitrust laws, *see, e.g., United States v. Philadelphia National Bank,* 374 U.S. 321, 363-65, 83 S.Ct. 1715, 1741-43, 10 L.Ed.2d 915 (1963), this is clearly not a borderline case. The pre-merger markets are already in the "highly concentrated" range, and the post-merger HHIs show an average increase of 2,715 points. Therefore, the Court finds that the plaintiff's have shown a likelihood of success on the merits. With HHIs of this level, the Commission certainly has shown a "reasonable probability" that the proposed merger would have an anti-competitive effect.[13]

The HHI calculations and market concentration evidence, however, are not the only indications that a merger between Staples and Office Depot may substantially lessen competition. Much of the evidence already discussed with respect to defining the relevant product market also indicates that the merger would likely have an anti-competitive effect. The evidence of the defendants' own current pricing practices, for example, shows that an office superstore chain facing no competition from other superstores has the ability to profitably raise prices for consumable office supplies above competitive levels. The fact that Staples and Office Depot both charge higher prices where they face no superstore competition demonstrates that an office superstore can raise prices above competitive levels. The evidence also shows that defendants also change their price zones when faced with entry of another office superstore, but do not do so for other retailers. Since prices are significantly lower in markets where Staples and Office Depot compete, eliminating this competition with one another would free the parties to charge higher prices in those markets, especially those in which the combined entity would be the sole office superstore. In addition, allowing the defendants to merge would eliminate significant future competition. Absent the merger, the firms are likely, and in fact have planned, to enter more of each other's markets, leading to a deconcentration of the market and, therefore, increased competition between the superstores.

In addition, direct evidence shows that by eliminating Staples' most significant, and in many markets only, rival, this merger would allow Staples to increase prices or otherwise maintain prices at an anti-competitive level.[14] ***1083** The merger would eliminate significant head-to-head competition between the two lowest cost and lowest priced firms in the superstore market. Thus, the merger would result in the elimination of a particularly aggressive competitor in a highly concentrated market, a factor which is certainly an important consideration when analyzing possible anti-competitive effects. *****[CITATIONS OMITTED]***** It is based on all of this evidence as well that the Court finds that the Commission has shown a likelihood of success on the merits and a "reasonable probability" that the proposed transaction will have an anti-competitive effect.

By showing that the proposed transaction between Staples and Office Depot will lead to undue concentration in the market for consumable office supplies sold by office superstores in the geographic markets agreed upon by the parties, the Commission establishes a presumption that the transaction will substantially lessen competition. *See United States v. Citizens & Southern Nat'l Bank,* 422 U.S. 86, 95 S.Ct. 2099, 45 L.Ed.2d 41 (1975). *United States v. Philadelphia Nat'l Bank,* 374 U.S. 321, 83 S.Ct. 1715, 10 L.Ed.2d 915 (1963). Once such a presumption has been established, the burden of producing evidence to rebut the presumption shifts to the defendants. *See, e.g., United States v. Marine Bancorporation,* 418 U.S. 602, 631, 94 S.Ct. 2856, 2874-75, 41 L.Ed.2d 978 (1974); *United States v. General Dynamics Corp.,* 415 U.S. 486, 496-504, 94 S.Ct. 1186, 1193-97, 39 L.Ed.2d 530 (1974). To meet this burden, the defendants must show that the market-share statistics give an inaccurate prediction of the proposed acquisition's probable effect on competition. *See United States v. Baker Hughes, Inc.,* 908 F.2d 981, 991 (D.C.Cir.1990) (rejecting argument that a defendant should be required to "clearly" disprove future anti-competitive effects, because that would impermissibly shift the ultimate burden of persuasion). *See also Marine Bancorporation,* 418 U.S. at 631, 94 S.Ct. at 2874-75 (finding presumption may be overcome by a showing that the statistics do not accurately reflect the probable effect of the proposed merger on competition). In order to rebut the FTC's showing with respect to the likely anti-competitive effects of a merger, defendants challenged the FTC's market-share statistics in this case in various ways, such as criticizing the Commission's definition of the relevant product market and introducing evidence to counter the FTC's pricing information. Defendants' also made allegations of "cherry-picking" on the part of the Commission, pointing to data which tend to show the opposite from the Commission's contentions. Finally, the defendants argued that the price differentials between one, two, and three firm markets shown by the Commission do not accurately reflect market power because the Commission failed to take into account factors such as the differences in marketing costs between stores.

In their criticism of the Commission's pricing evidence, the defendants accused the FTC of "cherry-picking" its data and pointed to specific examples which contradict the Commission's conclusions. For example, the defendants focused on the FTC's comparison prices on manila folders in two Ohio towns, Columbus which has two superstores and Cincinnati which has all three superstore chains. For 1995-96, the prices of those manila folders were shown to be, on average, 51% higher in the two firm market than in the three firm market.[15] The defendants argued that in contrast to the Ohio example, a comparison of two Indiana towns, Kokomo with two firms and Elkhart/South Bend with all three firms, shows the opposite. In fact, the defendants' comparison ***1084** of the average prices of manila folders for 1996 in Kokomo and Elkhart/South Bend shows that the prices in Kokomo, the two firm market, were 30% lower than in the three firm market.

The Court acknowledges that there is some evidence of this type in the record, and the Court has considered all of it. However, the fact that there may be some examples with respect to individual items in individual cities which contradict the FTC's evidence does not overly concern the Court. A few examples of isolated products simply cannot refute the power of the FTC's evidence with respect to the overall trend over time, which is that Staples' and Office Depot's prices are lowest in three firm markets and highest where they do not compete with another office superstore.

*****[SOME ANALYSIS REMOVED]*****

Defendants also argued that the regional price differences set forth in the FTC's pricing evidence do not reflect market power, because the reason for those differentials is not solely the presence or absence of other superstore competition. Instead, argued the defendants, these differentials are the result of a host of factors other than superstore competition. As examples of other factors which cause differences in pricing between geographic markets, the defendants offered sales volume, product mix, marketing or advertising costs, and distribution costs. Defendants also argued that there are differences in wages and rent which cause the differences in pricing between certain stores. The Court, however, cannot find that the evidence submitted by the defendants with respect to other reasons for the differences in pricing between one, two, and three firm markets is sufficient to rebut the Commission's evidence.

The Court generally accepts that per-store advertising costs, such as those incurred for a newspaper insert, will likely be lower in markets where Staples or Office Depot has a larger number of stores as those costs may be spread over a larger number of stores, and the defendants have provided some concrete evidence that the price differentials shown by the FTC may be somewhat affected by marketing costs. Donna Rosenberg, Vice President of Marketing Strategy at Staples, testified by declaration that Staples has the lowest average marketing costs per store in Staples/Office Depot areas and the highest marketing costs per store in Staples only areas. Exhibit H to her declaration shows, more specifically, that in 1996 Staples stores in three firm areas had an average marketing expense of 202,112. In Staples/Office Depot areas, Staples' stores had an average marketing expense of 185,905. Staples stores in Staples/OfficeMax areas paid an average of 218,500, and the stores in Staples only markets had an average marketing expense of 243,763. These numbers do suggest a correlation between the prices charged by Staples and marketing costs as average marketing costs are higher in the one firm markets than the three firm markets. However, the marketing cost evidence also shows that marketing costs are lower in Staples/Depot areas than in Staples/OfficeMax areas and, in fact, that costs are higher in Staples/OfficeMax areas than in the three firm markets, which does not correspond with the pricing trend. Staples generally charges lower prices where it competes with Office Depot than where it competes with OfficeMax and generally charges lower prices in three firm markets than in Staples/OfficeMax areas. In addition, the differences in marketing costs are not so large that they alone could account for the significant price differentials shown by the FTC.

***1085** As the Court has already noted, the defendants, of course, point to other factors besides marketing costs. However, unlike the comparison of average marketing costs between one, two, and three firm markets, the defendants produced no concrete evidence in support of these other factors. For example, the Court believes that it is probably true that distribution costs are higher for stores which are the farthest from either company's distribution centers. Yet, the defendants introduced no evidence to show that the one firm markets are, in fact, the farthest from distribution centers or that in the three firm markets, the stores are the closest to the distribution centers. Nor did the defendants introduce any evidence showing the actual differences in distribution costs based on a store's distance from a distribution center. The only evidence that the Court heard on this point was the testimony of Thomas Stemberg, Chairman and CEO of Staples, who testified at the hearing that "typically the smaller markets are further away from the distribution hubs. It costs you a lot more to haul freight up to Bangor, Maine, than it does from Hagerstown to Washington." The Court cannot find that the FTC's pricing evidence is seriously undermined by such a general statement.

The defendants' evidence is similar with respect to sales volume, rent and wages. For example, Steven Mandel, Senior Managing Director of Tiger Management Corporation, testified at the hearing that single store markets are typically smaller markets. He continued by explaining that even though the costs of rent and labor may be lower in a smaller market, they would be higher as a percentage of sales because the volume of sales are also typically lower in these smaller markets. Therefore, in order to come out with a decent return on investment, it will be necessary to have a modestly higher gross margin in those markets. While this seems logical to the Court, again, the only evidence presented on the point is very general and the Court cannot give it much weight.

*****[SOME ANALYSIS REMOVED]*****

The defendants also argued that the variations in product mix between different stores account for some of the differences in prices between one, two, and three firm markets. For example, defendants argued that Staples' mix of general office supplies is highest in three superstore towns (37.29% of retail sales), lower in Staples/Office Depot areas (36.14%), lower yet in Staples/OfficeMax areas, and lowest in Staples-only areas (26.68%). On the other hand, defendants argue, computer mix is highest in Staples-only areas (30.36%), and lowest in three superstore areas (13.62%). Computer sales make up 40% of store sales in Bangor, Maine, for example, but only 10% in Los Angeles. Pointing to evidence showing that Staples' sale of computers in 1996 generated a net loss of 10.6%, defendants argued that stores with higher computer sales must have higher margins on their other products to generate sufficient total returns. Therefore, defendants explained that the higher prices of consumable office supplies in these areas are a result of economic costs and do not imply that Staples has more market power in Staples-only markets. The Court cannot agree. While the higher percentage of computer sales in a one firm market such as ***1086** Bangor, Maine, may be one of the reasons that Staples chooses to charge higher prices for consumable office supplies in that location, it does not change the fact that Staples is able to charge those higher prices. The primary reason that computer sales generate a very small or even negative return is the competition among sellers of computers. Individual competitors are effectively constrained from raising prices on computers.

The fact that Staples can raise its prices for consumable office supplies in order to offset the low or negative returns on the sale of computers shows the opposite-that Staples is not constrained by non-superstore competitors from raising prices on consumable office supplies.

The above discussion covers some of the ways in which the defendants have challenged the FTC's market-share statistics in this case, including the highly debated issue of the relevant product market definition as well as the defendants' allegations of "cherry-picking" on the part of the Commission, and the defendants' argument that regional price differentials do not reflect market power because of the other factors such as marketing costs involved. However, in addition to attempting to discredit the Commission's evidence with respect to the combined company's market share and ability to raise prices, the defendants focused specifically on two other areas in an attempt to rebut the presumption that the proposed transaction will substantially lessen competition-entry into the market and efficiencies.

V. Entry Into the Market

"The existence and significance of barriers to entry are frequently, of course, crucial considerations in a rebuttal analysis [because] [i]n the absence of significant barriers, a company probably cannot maintain supra-competitive pricing for any length of time." *Baker Hughes, Inc.,* 908 F.2d at 987. Thus, the Court must consider whether, in this case, "entry into the market would likely avert anticompetitive effects from [Staples'] acquisition of [Office Depot]." *Id.* at 989. If the defendants' evidence regarding entry showed that the Commission's market-share statistics give an incorrect prediction of the proposed acquisition's probable effect on competition because entry into the market would likely avert any anti-competitive effect by acting as a constraint on Staples-Office Depot's prices, the Court would deny the FTC's motion. The Court, however, cannot make such a finding in this case.

The defendants argued during the hearing and in their briefs that the rapid growth in overall office supply sales has encouraged and will continue to encourage expansion and entry. One reason for this, according to Dr. Hausman's declaration, is that entry is more attractive when an industry is growing, because new entrants can establish themselves without having to take all of their sales away from existing competitors. In addition, the defendants' impressive retailing expert, Professor Maurice Segall, testified at the hearing that there are "no barriers to entry in retailing," and defendants pointed to the fact that all office superstore entrants have entered within the last 11 years.

In addition to this general testimony regarding entry, defendants emphasized specific examples of recent or planned entry. For example, defendants offered testimony from John Ledecky, Chairman and CEO of U.S. Office Products, regarding U.S. Office Products' acquisition of Mailboxes, Etc., an acquisition that was coincidentally announced the night before Mr. Ledecky's testimony in this case. Through this acquisition, U.S. Office Products, an organization or co-op of approximately 165 contract stationers located throughout the country, will acquire the 3300-unit Mailboxes, Etc. franchise operation. Defendants also offered testimony regarding Wal-Mart's plans to revamp and expand the office supply section in its stores. According to the deposition testimony of William Long, Vice President for Merchandizing at Wal-Mart, and David Glass, President and CEO of Wal-Mart, Wal-Mart will modify its office supplies department, called "Department 3," beginning in May 1997 and continuing through the summer. Though Mr. Long was not certain of the exact number of SKUs of office supplies Wal-Mart's new Department 3 will offer, he estimated the range to ***1087** be 2,600 to 3,000 SKUs.[17] Finally, defendants offered testimony regarding the general ability of mass merchandisers, computer superstores, and warehouse clubs to change store configurations and shift shelf space to accommodate new demands or popular products.

There are problems with the defendants' evidence, however, that prevent the Court from finding in this case that entry into the market by new competitors or expansion into the market by existing firms would likely avert the anti-competitive effects from Staples' acquisition of Office Depot. For example, while it is true that all office superstore entrants have entered within the last 11 years, the recent trend for office superstores has actually been toward exiting the market rather than entering. Over the past few years, the number of office superstore chains has dramatically dropped from twenty-three to three. All but Staples, Office Depot, and OfficeMax have either closed or been acquired. The failed office superstore entrants include very large, well-known retail establishments such as Kmart, Montgomery Ward, Ames, and Zayres. A new office superstore would need to open a large number of stores nationally in order to achieve the purchasing and distribution economies of scale enjoyed by the three existing firms. Sunk costs would be extremely high. Economies of scale at the local level, such as in the costs of advertizing and distribution, would also be difficult for a new superstore entrant to achieve since the three existing firms have saturated many important local markets. For example, according to the defendants' own saturation analyses, Staples estimates that there is room for less than two additional superstores in the Washington, D.C. area and Office Depot estimates that there is room for only two more superstores in Tampa, Florida.

The Commission offered Office 1 as a specific example of the difficulty of entering the office superstore arena. Office 1 opened its first two stores in 1991. By the end of 1994, Office 1 had 17 stores, and grew to 35 stores operating in 11 Midwestern states as of October 11, 1996. As of that date, Office 1 was the fourth largest office supply superstore chain in the United States. Unfortunately, also as of that date, Office 1 filed for Chapter 11 bankruptcy protection. Brad Zenner, President of Office 1, testified through declaration, that Office 1 failed because it was severely undercapitalized in comparison with the industry leaders, Staples, Office Depot, and OfficeMax. In addition, Mr. Zenner testified that when the three leaders ultimately expanded into the smaller markets where Office 1 stores were located, they seriously undercut Office 1's retail prices and profit margins. Because Office 1 lacked the capitalization of the three leaders and lacked the economies of scale enjoyed by those competitors, Office 1 could not remain profitable.

For the reasons discussed above, the Court finds it extremely unlikely that a new office superstore will enter the market and thereby avert the anti-competitive effects from Staples' acquisition of Office Depot. The defendants, of course, focused their entry argument on more than just the entry of additional superstores, pointing also to the expansion of existing companies such as U.S. Office Products and Wal-Mart. The Court also finds it unlikely that the expansions by U.S. Office Products and Wal-Mart would avert the anti-competitive effects which would result from the merger.

The problems with the defendants' evidence regarding U.S. Office Products are numerous. In contrast to Staples and Office Depot, U.S. Office Products is a company which is focused on a contract stationers business servicing primarily the medium corporate segment. The Mailboxes stores recently acquired by U.S. Office Products carry only 50-200 SKUs of office supplies in stores of approximately 1,000-4,000 square feet with no more than half of that area devoted to consumable office supplies. In addition to their small size and limited number of SKUs, the Mailboxes stores would not actually be new entrants. U.S. Office Products is acquiring existing stores, and, besides Mr. Ledecky's plans to put a U.S. Office Products catalogue in every Mailboxes store, there was no testimony regarding plans to expand the ***1088** number of SKUs available in the retail stores themselves or to increase the size of the average Mailboxes store. Finally, though Mr. Ledecky testified that if Staples and Office Depot were to raise prices after the merger he would look on that as an opportunity to take business away from the combined entity, he later clarified that statement by explaining that he meant in the contract stationer field.

The defendants' evidence regarding Wal-Mart's expansion of Department 3 has similar weaknesses.

*****[SOME ANALYSIS REMOVED]*****

The defendants' final argument with respect to entry was that existing retailers such as Sam's Club, Kmart, and Best Buy have the capability to reallocate their shelf space to include additional SKUs of office supplies. While stores such as these certainly do have the power to reallocate shelf space, there is no evidence that they will in fact do this if a combined Staples-Office Depot were to raise prices by 5% following a merger. In fact, the evidence indicates that it is more likely that they would not.

*****[SOME ANALYSIS REMOVED]*****

VI. Efficiencies

Whether an efficiencies defense showing that the intended merger would create significant efficiencies in the relevant market, thereby offsetting any anti-competitive effects, may be used by a defendant to rebut the government's prima facie case is not entirely clear. The newly revised efficiencies section of the *Merger Guidelines* recognizes that, "mergers have the potential to generate significant efficiencies by permitting a better utilization of existing assets, enabling the combined firm to achieve lower costs in producing a given quality and quantity than either firm could have achieved without the proposed transaction." *See Merger Guidelines* § 4. This coincides with the view of some courts that "whether an acquisition would yield significant efficiencies in the relevant market is an important consideration in predicting whether the acquisition would substantially lessen competition.... [T]herefore, ... an efficiency defense to the government's prima facie case in section 7 challenges is appropriate in certain circumstances." *FTC v. University Health,* 938 F.2d 1206, 1222 (11th Cir.1991). The Supreme Court, however, in *FTC v. Procter & Gamble Co.,* 386 U.S. 568, 579, 87 S.Ct. 1224, 1230, 18 L.Ed.2d 303 (1967), stated that "[p]ossible economics cannot be used as a defense to illegality in section 7 merger cases." There has been great disagreement regarding the meaning of this precedent and whether an efficiencies defense is permitted. *Compare* ***1089** *RSR Corp. v. FTC,* 602 F.2d 1317, 1325 (9th Cir.1979) (finding that the efficiencies argument has been rejected repeatedly), *cert. denied,* 445 U.S. 927, 100 S.Ct. 1313, 63 L.Ed.2d 760 (1980) *with University Health,* 938 F.2d at 1222 (recognizing the defense). Neither the Commission or the defendants could point to a case in which this Circuit has spoken on the issue. *****[CITATIONS REMOVED]*****

The Court agrees with the defendants that where, as here, the merger has not yet been consummated, it is impossible to quantify precisely the efficiencies that it will generate. In addition, the Court recognizes a difference between efficiencies which are merely speculative and those which are based on a prediction backed by sound business judgment. Nor does the Court believe that the defendants must prove their efficiencies by "clear and convincing evidence" in order for those efficiencies to be considered by the Court. That would saddle Section 7 defendants with the nearly impossible task of rebutting a possibility with a certainty, a burden which was rejected in *United States v. Baker Hughes, Inc.,* 908 F.2d 981, 992 (D.C.Cir.1990). Instead, like all rebuttal evidence in Section 7 cases, the defendants must simply rebut the presumption that the merger will substantially lessen competition by showing that the Commission's evidence gives an inaccurate prediction of the proposed acquisition's probable effect. *See id.* at 991. Defendants, however, must do this with credible evidence, and the Court with respect to this issue did not find the defendants' evidence to be credible.

Defendants' submitted an "Efficiencies Analysis" which predicated that the combined company would achieve savings of between \$4.9 and \$6.5 billion over the next five years. In addition, the defendants argued that the merger would also generate dynamic efficiencies. For example, defendants argued that as suppliers become more efficient due to their increased sales volume to the combined Staples-Office Depot, they would be able to lower prices to their other retailers. Moreover, defendants argued that two-thirds of the savings realized by the combined company would be passed along to consumers.

Evaluating credibility, as the Court must do, the Court credits the testimony and Report of the Commission's expert, David Painter, over the testimony and Efficiencies Study of the defendants' efficiencies witness, Shira Goodman, Senior Vice President of Integration at Staples. Mr. Painter's testimony was compelling, and the Court finds, based primarily on Mr. Painter's testimony, that the defendants' cost savings estimates are unreliable. First, the Court notes that the cost savings estimate of \$4.947 billion over five years which was submitted to the Court exceeds by almost 500% the figures presented to the two Boards of Directors in September 1996, when the Boards approved the transaction. The cost savings claims submitted to the Court are also substantially greater than those represented in the defendants' Joint Proxy Statement/Prospectus "reflecting the best currently available estimate of management," and filed with the Securities and Exchange Commission on January 23, 1997, or referenced in the "fairness opinions" rendered by the defendants' investment bankers which are contained in the Proxy Statement.

The Court also finds that the defendants' projected "Base Case" savings of \$5 billion are in large part unverified, or at least the defendants failed to produce the necessary documentation for verification.

*****[SOME ANALYSIS REMOVED]*****

As with the failure to deduct the Staples stand-alone savings from the new Hagerstown and Los Angeles full line distribution centers from the projected distribution cost savings, the evidence shows that the defendants did not accurately calculate which projected cost savings were merger specific and which were, in fact, not related to the merger. For example, defendants' largest cost savings, over \$2 billion or 40% of the total estimate, are projected as a result of their expectation of obtaining better prices from vendors. However, this figure was determined in relation to the cost savings enjoyed by Staples at the end of 1996 without considering the additional cost savings that Staples would have received in the future as a stand-alone company. Since Staples has continuously sought and achieved cost savings on its own, clearly the comparison that should have been made was between the projected future cost savings of Staples as a stand-alone company, not its past rate of savings, and the projected future cost savings of the combined company. Thus, the calculation in the Efficiencies Analysis included product cost savings that Staples and Office Depot would likely have realized without the merger. In fact, Mr. Painter testified that, by his calculation, 43% of the estimated savings are savings that Staples and Office Depot would likely have achieved as stand-alone entities.

There are additional examples of projected savings, such as the projected savings on employee health insurance, which are not merger specific, but the Court need not discuss every example here.

*****[SOME ANALYSIS REMOVED]*****

In addition to the problems that the Court has with the efficiencies estimates themselves, the Court also finds that the defendants' projected pass through rate-the amount of the projected savings that the combined company expects to pass on to customers in the form of lower prices-is unrealistic. The Court has no doubt that a portion of any efficiencies achieved through a merger of the defendants would be passed on to customers. Staples and Office Depot have a proven track record of achieving cost savings through efficiencies, and then passing those savings to customers in the form of lower prices. However, in this case the defendants have projected a pass through rate of two-thirds of the savings while the evidence shows that, historically, Staples has passed through only 15-17%. Based on the above evidence, the Court cannot find that the defendants have rebutted the presumption that the merger will substantially lessen competition by showing that, because of the efficiencies which will result from the merger, the Commission's evidence gives an inaccurate prediction of the proposed acquisition's probable effect. Therefore, the only remaining issue for the Court is the balancing of the equities.

***1091 VII. The Equities**

Where, as in this case, the Court finds that the Commission has established a likelihood of success on the merits, a presumption in favor of a preliminary injunction arises. *FTC v. PPG Indus., Inc.,* 798 F.2d 1500, 1507 (D.C.Cir.1986); *FTC v. Alliant Techsystems, Inc.,* 808 F.Supp. 9, 22-23 (D.D.C.1992). Despite this presumption, however, once the Court has determined the FTC's likelihood of success on the merits, it must still turn to and consider the equities. The D.C. Circuit has held that in cases such as the one now before the Court, a judge is obligated "to exercise independent judgment on the propriety of issuance of a temporary restraining order or preliminary injunction." *FTC v. Weyerhaeuser Co.,* 665 F.2d 1072, 1082 (D.C.Cir.1981) (quoting H.R.Rep. No. 624 at 31). "Independent judgment is not exercised when a court responds automatically to the agency's threshold showings. To exercise such judgment, the court must take genuine amount of 'the equities.' " *Id.*

There are two types of equities which the Court must consider in all Section 13(b) cases, private equities and public equities. In this case, the private equities include the interests of the shareholders and employees of Staples and Office Depot. The public equities are the interests of the public, either in having the merger go through or in preventing the merger. An analysis of the equities properly includes the potential benefits, both public and private, that may be lost by a merger blocking preliminary injunction. *Id.* at 1083. In addition, the Court notes that in balancing the equities, it is important to keep in mind that while private equities are important, "[w]hen the Commission demonstrates a likelihood of ultimate success, a counter showing of private equities alone would not suffice to justify denial of a preliminary injunction barring the merger." *Id.* at 1083. After examining the evidence in this case, the Court finds that in light of the public equities advanced by the plaintiff, the equities, both public and private, set forth by the defendants are insufficient to overcome the presumption in favor of granting a preliminary injunction.

The strong public interest in effective enforcement of the antitrust laws weighs heavily in favor of an injunction in this case, as does the need to preserve meaningful relief following a full administrative trial on the merits. "Unscrambling the eggs" after the fact is not a realistic option in this case. Both the plaintiff as well as the defendants introduced evidence regarding the combined company's post-merger plans, including the consolidation of warehouse and supply facilities in order to integrate the two distribution systems, the closing of 40 to 70 Office Depot and Staples stores, changing the name of the Office Depot stores, negotiating new contracts with manufacturers and suppliers, and, lastly, the consolidation of management which is likely to lead to the loss of employment for many of Office Depot's key personnel. As a result, the Court finds that it is extremely unlikely, if the Court denied the plaintiff's motion and the merger were to go through, that the merger could be effectively undone and the companies divided if the agency later found that the merger violated the antitrust laws. It would not simply be a matter of putting the old Office Depot signs back on the stores. Office Depot would have lost its name, many of its stores, its distribution centers, and key personnel. It would also be behind in future plans to open new stores and expand on its own.

More importantly, in addition to the practical difficulties in undoing the merger, consumers would be at risk of serious anti-competitive harm in the interim. Without an injunction, consumers in the 42 geographic markets where superstore competition would be eliminated or significantly reduced face the prospect of higher prices than they would have absent the merger. These higher charges could never be recouped even if the administrative proceeding resulted in a finding that the merger violated the antitrust laws. Failure to grant a preliminary injunction also would deny consumers the benefit of any new competition that would have occurred, absent the merger, between Staples and Office Depot as those stores continued to enter and compete in each other's markets. Both parties had aggressive expansion plans before the merger, many of which have been put on hold pending the outcome of this case.

***1092** The public equities raised by the defendants simply do not outweigh those offered by the FTC. In addition, given some of the Court's earlier findings, several of the public equities submitted by the defendants are without factual support. For example, the defendants argued that the public equities favor the merger because prices will fall for all products, in all markets, following the merger.

*****[SOME ANALYSIS REMOVED]*****

While the Court believes that there would be some efficiencies realized by the merger, though not at the level argued by the defendants, the Court cannot find that those efficiencies would result in the creation of so many additional jobs that the public equity would outweigh those argued by the plaintiff.

Finally, according to the defendants, the public equities also include the benefits consumers will derive from even greater product selection and the benefits the U.S. economy will derive from increased international trade as the combined company through its increased efficiencies and improved distribution system will be poised for a dramatic expansion into foreign markets. Defendants, however, have provided no specific evidence regarding the probable increase in product selection or the likelihood that a combined Staples-Office Depot will expand overseas. In addition, the Court is not convinced that this is an appropriate equity which the Court may consider in this case. The Court, therefore, cannot find that the public equities regarding increased product selection for consumers and expansion into foreign markets overcome the public equities set forth by the FTC.

Turning finally to the private equities, the defendants have argued that the principal private equity at stake in this case is the loss to Office Depot shareholders who will likely lose a substantial portion of their investments if the merger is enjoined. The Court certainly agrees that Office Depot shareholders may be harmed, at least in the short term, if the Court granted the plaintiff's motion and enjoined the merger. This private equity alone, however, does not suffice to justify denial of a preliminary injunction.

The defendants have also argued that Office Depot itself has suffered a decline since the incipiency of this action. It is clear that Office Depot has lost key personnel, especially in its real estate department. This has hurt this year's projected store openings. The defendants argue, therefore, that Office Depot, as a separate company, will have difficulty competing if the merger is enjoined. While the Court recognizes that Office Depot has indeed been hurt or weakened as an independent stand-alone company, the damage is not irreparable. The evidence shows that Office Depot, which of the three superstores has been the low-priced aggressive maverick of the group, would continue generating sales volume and turning a substantial profit. In reaching this conclusion, the Court credits one of the defendants' own expert witnesses, Steven Mandel, who testified that, in his opinion, Office Depot would be fine even if the merger did not go through. He described Office Depot as a very strong and well-run company, and said that it would certainly have a little bit of a hole to dig out of if the merger were enjoined. However, his ultimate conclusion was that the company would recover. Certainly Office Depot is in a better position to recover and move forward now if the Court grants the plaintiff's motion than it would be if the merger was allowed to go forward and ***1093** then later the two companies were ordered to separate.

CONCLUSION

*****[SOME CONCLUSION REMOVED]*****

In light of the undeniable benefits that Staples and Office Depot have brought to consumers, it is with regret that the Court reaches the decision that it must in this case. This decision will most likely kill the merger. The Court feels, to some extent, that the defendants are being punished for their own successes and for the benefits that they have brought to consumers. In effect, they have been hoisted with their own petards. *See* William Shakespeare, *Hamlet,* act 3, sc 4. In addition, the Court is concerned with the broader ramifications of this case. The superstore or "category killer" like office supply superstores are a fairly recent phenomenon and certainly not restricted to office supplies. There are a host of superstores or "category killers" in the United States today, covering such areas as pet supplies, home and garden products, bed, bath, and kitchen products, toys, music, books, and electronics. Indeed, such "category killer" stores may be the way of retailing for the future. It remains to be seen if this case is *sui generis* or is the beginning of a new wave of FTC activism. For these reasons, the Court must emphasize that the ruling in this case is based strictly on the facts of this particular case, and should not be construed as this Court's recognition of general superstore relevant product markets.

Despite the Court's sympathy toward the plight of the defendants in this case, the Court finds that the Commission has shown a "reasonable probability" that the proposed merger between Staples and Office Depot may substantially impair competition and likewise 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 FTC in the first instances and ultimately by the Court of Appeals." Therefore, the Court finds that the Commission has shown a likelihood that it will succeed in proving, after a full administrative trial on the merits, that the effect of the proposed merger between Staples and Office Depot "may be substantially to lessen competition" in violation of Section 7 of the Clayton Act. In addition, the Court has weighed the equities and finds that they tip in favor of granting a preliminary injunction. A preliminary injunction is, therefore, found to be in the public interest. The FTC's motion for a preliminary injunction shall be granted.

*****[SOME CONCLUSION REMOVED]*****

An appropriate order accompanies this Memorandum Opinion.