1968 MERGER GUIDELINES

1. **Purpose.** The purpose of these guidelines is to acquaint the business community, the legal profession, and other interested groups and individuals with the standards currently being applied by the Department of Justice in determining whether to challenge corporate acquisitions and mergers under Section 7 of the Clayton Act. (Although mergers or acquisitions may also be challenged under the Sherman Act, commonly the challenge will be made under Section 7 of the Clayton Act and, accordingly, it is to this provision of law that the guidelines are directed.) The responsibilities of the Department of Justice under Section 7 are those of an enforcement agency, and these guidelines are announced solely as a statement of current Department policy, subject to change at any time without prior notice, for whatever assistance such statement may be in enabling interested persons to anticipate in a general way Department enforcement action under Section 7. Because the statements of enforcement policy contained in these guidelines must necessarily be framed in rather general terms, and because the critical factors in any particular guideline formulation may be evaluated differently by the Department than by the parties, the guidelines should not be treated as a substitute for the Department's business review procedures, which make available statements of the Department's present enforcement intentions with regard to particular proposed mergers or acquisitions.

2. **General Enforcement Policy.** Within the over-all scheme of the Department's antitrust enforcement activity, the primary role of Section 7 enforcement is to preserve and promote market structures conducive to competition. Market structure is the focus of the Department's merger policy chiefly because the conduct of the individual firms in a market tends to be controlled by the structure of that market, *i.e.*, by those market conditions which are fairly permanent or subject only to slow change (such as, principally, the number of substantial firms selling in the market, the relative sizes of their respective market shares, and the substantiality of barriers to the entry of new firms into the market). Thus, for example, a concentrated market structure, where a few firms account for a large share of the sales, tends to discourage vigorous price competition by the firms in the market and to
encourage other kinds of conduct, such as use of inefficient methods of production or excessive promotional expenditures, of an economically undesirable nature. Moreover, not only does emphasis on market structure generally produce economic predictions that are fully adequate for the purposes of a statute that requires only a showing that the effect of a merger "may be substantially to lessen competition, or to tend to create a monopoly," but an enforcement policy emphasizing a limited number of structural factors also facilitates both enforcement decision-making and business planning which involves anticipation of the Department's enforcement intent. Accordingly, the Department's enforcement activity under Section 7 is directed primarily toward the identification and prevention of those mergers which alter market structure in ways likely now or eventually to encourage or permit non-competitive conduct.

In certain exceptional circumstances, however, the structural factors used in these guidelines will not alone be conclusive, and the Department's enforcement activity will necessarily be based on a more complex and inclusive evaluation. This is sometimes the case, for example, where basic technological changes are creating new industries, or are significantly transforming older industries, in such fashion as to make current market boundaries and market structure of uncertain significance. In such unusual transitional situations application of the normal guideline standards may be inappropriate; and on assessing probable future developments, the Department may not sue despite nominal application of a particular guideline, or it may sue even though the guidelines, as normally applied, do not require the Department to challenge the merger. Similarly, in the area of conglomerate merger activity, the present incomplete state of knowledge concerning structure-conduct relationships may preclude sole reliance on the structural criteria used in these guidelines, as explained in paragraphs 17 and 20 below.

3. **Market Definition.** A rational appraisal of the probable competitive effects of a merger normally requires definition of one or more relevant markets. A market is any grouping of sales (or other commercial transactions) in which each of the firms whose sales are included enjoys some
advantage in competing with those firms whose sales are not included. The advantage need not be
great, for so long as it is significant it defines an area of effective competition among the included
sellers in which the competition of the excluded sellers is, *ex hypothesi*, less effective. The process of
market definition may result in identification of several appropriate markets in which to test the
probable competitive effects of a particular merger.

A market is defined both in terms of its product dimension ("line of commerce") and its
geographic dimension ("section of the country").

(i) **Line of commerce.** The sales of any product or service which is distinguishable
as a matter of commercial practice from other products or services will ordinarily constitute a
relevant product market, even though, from the standpoint of most purchasers, other products
may be reasonably, but not perfectly, interchangeable with it in terms of price, quality, and use.
On the other hand, the sales of two distinct products to a particular group of purchasers can
also appropriately be grouped into a single market where the two products are reasonably inter-
changeable for that group in terms of price, quality, and use. In this latter case, however, it may
be necessary also to include in that market the sales of one or more other products which are
equally interchangeable with the two products in terms of price, quality, and use from the
standpoint of that group of purchasers for whom the two products are interchangeable.

The reasons for employing the foregoing definitions may be stated as follows. In
enforcing Section 7 the Department seeks primarily to prevent mergers which change market
structure in a direction likely to create a power to behave non-competitively in the production
and sale of any particular product, even though that power will ultimately be limited, though not
nullified, by the presence of other similar products that, while reasonably interchangeable, are
less than perfect substitutes. It is in no way inconsistent with this effort also to pursue a policy
designed to prohibit mergers between firms selling distinct products where the result of the
merger may be to create or enhance the companies' market power due to the fact that the products, though not perfectly substitutable by purchasers, are significant enough alternatives to constitute substantial competitive influences on the production, development or sale of each.

(ii) **Section of the Country.** The total sales of a product or service in any commercially significant section of the country (even as small as a single community), or aggregate of such sections, will ordinarily constitute a geographic market if firms engaged in selling the product make significant sales of the product to purchasers in the section or sections. The market need not be enlarged beyond any section meeting the foregoing test unless it clearly appears that there is no economic barrier (e.g., significant transportation costs, lack of distribution facilities, customer inconvenience, or established consumer preference for existing products) that hinders the sale from outside the section to purchasers within the section; nor need the market be contracted to exclude some portion of the product sales made inside any section meeting the foregoing test unless it clearly appears that the portion of sales in question is made to a group of purchasers separated by a substantial economic barrier from the purchasers to whom the rest of the sales are made.

Because data limitations or other intrinsic difficulties will often make precise delineation of geographic markets impossible, there may often be two or more groupings of sales which may reasonably be treated as constituting a relevant geographic market. In such circumstances, the Department believes it to be ordinarily most consistent with the purposes of Section 7 to challenge any merger which appears to be illegal in any reasonable geographic market, even though in another reasonable market it would not appear to be illegal.

The market is ordinarily measured primarily by the dollar value of the sales or other transactions (e.g., shipments, leases) for the most recent twelve month period for which the necessary figures for the merging firms and their competitors are generally available. Where such figures are clearly unrepresentative, a different period will be used. In some markets, such
as commercial banking, it is more appropriate to measure the market by other indicia, such as total deposits.

I. HORIZONTAL MERGERS

4. Enforcement Policy. With respect to mergers between direct competitors (i.e., horizontal mergers), the Department's enforcement activity under Section 7 of the Clayton Act has the following interrelated purposes: (i) preventing elimination as an independent business entity of any company likely to have been a substantial competitive influence in a market; (ii) preventing any company or small group of companies from obtaining a position of dominance in a market; (iii) preventing significant increases in concentration in a market; and (iv) preserving significant possibilities for eventual deconcentration in a concentrated market.

In enforcing Section 7 against horizontal mergers, the Department accords primary significance to the size of the market share held by both the acquiring and the acquired firms. ("Acquiring firm" and "acquired firm" are used herein, in the case of horizontal mergers, simply as convenient designations of the firm with the larger market share and the firm with the smaller share, respectively, and do not refer to the legal form of the merger transaction.) The larger the market share held by the acquired firm, the more likely it is that the firm has been a substantial competitive influence in the market or that concentration in the market will be significantly increased. The larger the market share held by the acquiring firm, the more likely it is that an acquisition will move it toward, or further entrench it in, a position of dominance or of shared market power. Accordingly, the standards most often applied by the Department in determining whether to challenge horizontal mergers can be stated in terms of the sizes of the merging firms' market shares.
5. **Market Highly Concentrated.** In a market in which the shares of the four largest firms amount to approximately 75% or more, the Department will ordinarily challenge mergers between firms accounting for, approximately, the following percentages of the market:

<table>
<thead>
<tr>
<th>Acquiring Firm</th>
<th>Acquired Firm</th>
</tr>
</thead>
<tbody>
<tr>
<td>4%</td>
<td>4% or more</td>
</tr>
<tr>
<td>10%</td>
<td>2% or more</td>
</tr>
<tr>
<td>15% or more</td>
<td>1% or more</td>
</tr>
</tbody>
</table>

(Percentages not shown in the above table should be interpolated proportionately to the percentages that are shown.)

6. **Market Less Highly Concentrated.** In a market in which the shares of the four largest firms amount to less than approximately 75%, the Department will ordinarily challenge mergers between firms accounting for, approximately, the following percentages of the market:

<table>
<thead>
<tr>
<th>Acquiring Firm</th>
<th>Acquired Firm</th>
</tr>
</thead>
<tbody>
<tr>
<td>5%</td>
<td>5% or more</td>
</tr>
<tr>
<td>10%</td>
<td>4% or more</td>
</tr>
<tr>
<td>15%</td>
<td>3% or more</td>
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<tr>
<td>20%</td>
<td>2% or more</td>
</tr>
<tr>
<td>25% or more</td>
<td>1% or more</td>
</tr>
</tbody>
</table>

(Percentages not shown in the above table should be interpolated proportionately to the percentages that are shown.)

7. **Market With Trend Toward Concentration.** The Department applies an additional, stricter standard in determining whether to challenge mergers occurring in any market, not wholly unconcentrated, in which there is a significant trend toward increased concentration. Such a trend is considered to be present when the aggregate market share of any grouping of the largest firms in the market from the two largest to the eight largest has increased by approximately 7% or more of the market over a period of time extending from any base year 5-10 years prior to the merger (excluding
any year in which some abnormal fluctuation in market shares occurred) up to the time of the merger. The Department will ordinarily challenge any acquisition, by any firm in a grouping of such largest firms showing the requisite increase in market share, of any firm whose market share amounts to approximately 2% or more.

8. Non-Market Share Standards. Although in enforcing Section 7 against horizontal mergers the Department attaches primary importance to the market shares of the merging firms, achievement of the purposes of Section 7 occasionally requires the Department to challenge mergers which would not be challenged under the market share standards of Paragraphs 5, 6, and 7. The following are the two most common instances of this kind in which a challenge by the Department can ordinarily be anticipated:

(a) acquisition of a competitor which is a particularly "disturbing," "disruptive," or otherwise unusually competitive factor in the market; and

(b) a merger involving a substantial firm and a firm which, despite an insubstantial market share, possesses an unusual competitive potential or has an asset that confers an unusual competitive advantage (for example, the acquisition by a leading firm of a newcomer having a patent on a significantly improved product or production process).

There may also be certain horizontal mergers between makers of distinct products regarded as in the same line of commerce for reasons expressed in Paragraph 3(i) where some modification in the minimum market shares subject to challenge may be appropriate to reflect the imperfect substitutability of the two products.

9. Failing Company. A merger which the Department would otherwise challenge will ordinarily not be challenged if (i) the resources of one of the merging firms are so depleted and its prospects for rehabilitation so remote that the firm faces the clear probability of a business failure, and (ii) good faith efforts by the failing firm have failed to elicit a reasonable offer of acquisition more consistent with the purposes of Section 7 by a firm which intends to keep the failing firm in the market.
The Department regards as failing only those firms with no reasonable prospect of remaining viable; it does not regard a firm as failing merely because the firm has been unprofitable a period of time, has lost market position or failed to maintain its competitive position in some other respect, has poor management, or has not fully explored the possibility of overcoming its difficulties through self-help.

In determining the applicability of the above standard to the acquisition of a failing division of a multi—market company, such factors as the difficulty in assessing the viability of a portion of a company, the possibility of arbitrary accounting practices, and the likelihood that an otherwise healthy company can rehabilitate one of its parts, will lead the Department to apply this standard only in the clearest of circumstances.

10. **Economies.** Unless there are exceptional circumstances, the Department will not accept as a justification for an acquisition normally subject to challenge under its horizontal merger standards the claim that the merger will produce economies (i.e., improvements in efficiency) because, among other reasons, (i) the Department's adherence to the standards will usually result in no challenge being made to mergers of the kind most likely to involve companies operating significantly below the size necessary to achieve significant economies of scale; (ii) where substantial economies are potentially available to a firm, they can normally be realized through internal expansion; and (iii) there usually are severe difficulties in accurately establishing the existence and magnitude of economies claimed for a merger.

II. **VERTICAL MERGERS**

11. **Enforcement Policy.** With respect to vertical mergers (i.e., acquisitions "backward" into a supplying market or "forward" into a purchasing market), the Department's enforcement activity under Section 7 of the Clayton Act, as in the merger field generally, is intended to prevent changes in market structure that are likely to lead over the course of time to significant anticompetitive consequences. In general, the Department believes that such consequences can be expected to occur
whenever a particular vertical acquisition, or series of acquisitions, by one or more of the firms in a supplying or purchasing market, tends significantly to raise barriers to entry in either market or to disadvantage existing non-integrated or partly integrated firms in either market in ways unrelated to economic efficiency. (Barriers to entry are relatively stable market conditions which tend to increase the difficulty of potential competitors’ entering the market as new sellers and which thus tend to limit the effectiveness of the potential competitors both as a restraint upon the behavior of firms in the market and as a source of additional actual competition.)

Barriers to entry resting on such factors as economies of scale in production and distribution are not questionable as such. But vertical mergers tend to raise barriers to entry in undesirable ways, particularly the following: (i) by foreclosing equal access to potential customers, thus reducing the ability of non-integrated firms to capture competitively the market share needed to achieve an efficient level of production, or imposing the burden of entry on an integrated basis (i.e., at both the supplying and purchasing levels) even though entry at a single level would permit efficient operation; (ii) by foreclosing equal access to potential suppliers, thus either increasing the risk of a price or supply squeeze on the new entrant or imposing the additional burden of entry as an integrated firm; or (iii) by facilitating promotional product differentiation, when the merger involves a manufacturing firm's acquisition of firms at the retail level. Besides impeding the entry of new sellers, the foregoing consequences of vertical mergers, if present, also artificially inhibit the expansion of presently competing sellers by conferring on the merged firm competitive advantages, unrelated to real economies of production or distribution, over non-integrated or partly integrated firms. While it is true that in some instances vertical integration may raise barriers to entry or disadvantage existing competitors only as the result of the achievement of significant economies of production or distribution (as, for example, where the increase in barriers is due to achievement of economies of integrated production through an alteration of the structure of the plant as well as of the firm), integration accomplished by a large vertical merger will usually raise entry barriers or disadvantage competitors.
to an extent not accounted for by, and wholly disproportionate to, such economies as may result from
the merger.

It is, of course, difficult to identify with precision all circumstances in which vertical mergers
are likely to have adverse effects on market structure of the kinds indicated in the previous paragraph.
The Department believes, however, that the most important aims of its enforcement policy on vertical
mergers can be satisfactorily stated by guidelines framed primarily in terms of the market shares of the
merging firms and the conditions of entry which already exist in the relevant markets. These factors
will ordinarily serve to identify most of the situations in which any of the various possible adverse
effects of vertical mergers may occur and be of substantial competitive significance. With all vertical
mergers it is necessary to consider the probable competitive consequences of the merger in both the
market in which the supplying firm sells and the market in which the purchasing firm sells, although
a significant adverse effect in either market will ordinarily result in a challenge by the Department.
("Supplying firm" and "purchasing firm," as used herein, refer to the two parties to the vertical merger
transaction, the former of which sells a product in a market in which the latter buys that product.)

12. **Supplying Firm's Market.** In determining whether to challenge a vertical merger on the
ground that it may significantly lessen existing or potential competition in the supplying firm's market,
the Department attaches primary significance to (i) the market share of the supplying firm, (ii) the
market share of the purchasing firm or firms, and (iii) the conditions of entry in the purchasing firm's
market. Accordingly, the Department will ordinarily challenge a merger or series of mergers between
a supplying firm, accounting for approximately 10% or more of the sales in its market, and one or
more purchasing firms, accounting in toto for approximately 6% or more of the total purchases in that
market, unless it clearly appears that there are no significant barriers to entry into the business of the
purchasing firm or firms.

13. **Purchasing Firm's Market.** Although the standard of paragraph 12 is designed to identify
vertical mergers having likely anticompetitive effects in the supplying firm's market, adherence by the
Department to that standard will also normally result in challenges being made to most of the vertical mergers which may have adverse effects in the purchasing firm's market (i.e., that market comprised of the purchasing firm and its competitors engaged in resale of the supplying firm's product or in the sale of a product whose manufacture requires the supplying firm's product) since adverse effects in the purchasing firm's market will normally occur only as the result of significant vertical mergers involving supplying firms with market shares in excess of 10%. There remain, however, some important situations in which vertical mergers which are not subject to challenge under paragraph 12 (ordinarily because the purchasing firm accounts for less than 6% of the purchases in the supplying firm's market) will nonetheless be challenged by the Department on the ground that they raise entry barriers in the purchasing firm's market, or disadvantage the purchasing firm's competitors, by conferring upon the purchasing firm a significant supply advantage over unintegrated or partly integrated existing competitors or over potential competitors. The following paragraph sets forth the enforcement standard governing the most common of these situations.

If the product sold by the supplying firm and its competitors is either a complex one in which innovating changes by the various suppliers have been taking place, or is a scarce raw material or other product whose supply cannot be readily expanded to meet increased demand, the merged firm may have the power to use any temporary superiority, or any shortage, in the product of the supplying firm to put competitors of the purchasing firm at a disadvantage by refusing to sell the product to them (supply squeeze) or by narrowing the margin between the price at which it sells the product to the purchasing firm's competitors and the price at which the end-product is sold by the purchasing firm (price squeeze). Even where the merged firm has sufficient market power to impose a squeeze, it may well not always be economically rational for it actually to do so; but the Department believes that the increase in barriers to entry in the purchasing firm's market arising simply from the increased risk of a possible squeeze is sufficient to warrant prohibition of any merger between a supplier possessing significant market power and a substantial purchaser of any product meeting the above description.
Accordingly, where such a product is a significant feature or ingredient of the end-product manufactured by the purchasing firm and its competitors, the Department will ordinarily challenge a merger or series of mergers between a supplying firm, accounting for approximately 20% or more of the sales in its market, and a purchasing firm or firms, accounting in toto for approximately 10% or more of the sales in the market in which it sells the product whose manufacture requires the supplying firm's product.


(a) Although in enforcing Section 7 against vertical mergers the Department attaches primary importance to the market shares of the merging firms and the conditions of entry in the relevant markets, achievement of the purposes of Section 7 occasionally requires the Department to challenge mergers which would not be challenged under the market share standards of paragraphs 12 and 13. Clearly the most common instances in which challenge by the Department can ordinarily be anticipated are acquisitions of suppliers or customers by major firms in an industry in which (i) there has been, or is developing, a significant trend toward vertical integration by merger such that the trend, if unchallenged, would probably raise barriers to entry or impose a competitive disadvantage on unintegrated or partly integrated firms, and (ii) it does not clearly appear that the particular acquisition will result in significant economies of production or distribution unrelated to advertising or other promotional economies.

(b) A less common special situation in which a challenge by the Department can ordinarily be anticipated is the acquisition by a firm of a customer or supplier for the purpose of increasing the difficulty of potential competitors in entering the market of either the acquiring or acquired firm, or for the purpose of putting competitors of either the acquiring or acquired firm at an unwarranted disadvantage.

15. Failing Company. The standards set forth in paragraph 9 are applied by the Department in determining whether to challenge a vertical merger.
16. **Economies.** Unless there are exceptional circumstances, and except as noted in paragraph 14(a), the Department will not accept as a justification for an acquisition normally subject to challenge under its vertical merger standards the claim that the merger will produce economies, because, among other reasons, (i) where substantial economies of vertical integration are potentially available to a firm, they can normally be realized through internal expansion into the supplying or purchasing market, and (ii) where barriers prevent entry into the supplying or purchasing market by internal expansion, the Department's adherence to the vertical merger standards will in any event usually result in no challenge being made to the acquisition of a firm or firms of sufficient size to overcome or adequately minimize the barriers to entry.

**III. CONGLOMERATE MERGERS**

17. **Enforcement Policy.** Conglomerate mergers are mergers that are neither horizontal nor vertical as those terms are used in sections I and II, respectively, of these guidelines. (It should be noted that a market extension merger, i.e., one involving two firms selling the same, product, but in different geographic markets, is classified as a conglomerate merger.) As with other kinds of mergers, the purpose of the Department's enforcement activity regarding conglomerate mergers is to prevent changes in market structure that appear likely over the course of time to cause a substantial lessening of the competition that would otherwise exist or to create a tendency toward monopoly.

At the present time, the Department regards two categories of conglomerate mergers as having sufficiently identifiable anticompetitive effects as to be the subject of relatively specific structural guidelines: mergers involving potential entrants (Paragraph 18) and mergers creating a danger of reciprocal buying (Paragraph 19).

Another important category of conglomerate mergers that will frequently be the subject of enforcement action--mergers which for one or more of several reasons threaten to entrench or enhance the market power of the acquired firm--is described generally in Paragraph 20.
As Paragraph 20 makes clear, enforcement action will also be taken against still other types of conglomerate mergers that on specific analysis appear anticompetitive. The fact that, as yet, the Department does not believe it useful to describe such other types of mergers in terms of a few major elements of market structure should in no sense be regarded as indicating that enforcement action will not be taken. Nor is it to be assumed that mergers of the type described in Paragraphs 18 and 19, but not covered by the specific rules thereof, may not be the subject of enforcement action if specific analysis indicates that they appear anticompetitive.

18. Mergers Involving Potential Entrants.

(a) Since potential competition (i.e., the threat of entry, either through internal expansion or through acquisition and expansion of a small firm, by firms not already or only marginally in the market) may often be the most significant competitive limitation on the exercise of market power by leading firms, as well as the most likely source of additional actual competition, the Department will ordinarily challenge any merger between one of the most likely entrants into the market and:

   (i) any firm with approximately 25% or more of the market;

   (ii) one of the two largest firms in a market in which the shares of the two largest firms amount to approximately 50% or more;

   (iii) one of the four largest firms in a market in which the shares of the eight largest firms amount to approximately 75% or more, provided the merging firm's share of the market amounts to approximately 10% or more; or

   (iv) one of the eight largest firms in a market in which the shares of these firms amount to approximately 75% or more, provided either (A) the merging firm's share of the market is not insubstantial and there are no more than one or two likely entrants into the market, or (B) the merging firm is a rapidly growing firm.

In determining whether a firm is one of the most likely potential entrants into a market, the Department accords primary significance to the firm's capability of entering on a competitively signifi-
cant scale relative to the capability of other firms (i.e., the technological and financial resources available to it) and to the firm's economic incentive to enter (evidenced by, for example, the general attractiveness of the market in terms of risk and profit; or any special relationship of the firm to the market; or the firm's manifested interest in entry; or the natural expansion pattern of the firm; or the like).

(b) The Department will also ordinarily challenge a merger between an existing competitor in a market and a likely entrant, undertaken for the purpose of preventing the competitive "disturbance" or "disruption" that such entry might create.

(c) Unless there are exceptional circumstances, the Department will not accept as a justification for a merger inconsistent with the standards of this paragraph 18 the claim that the merger will produce economies, because, among other reasons, the Department believes that equivalent economies can be normally achieved either through internal expansion or through a small firm acquisition or other acquisition not inconsistent with the standards herein.

19. **Mergers Creating Danger of Reciprocal Buying.**

(a) Since reciprocal buying (i.e., favoring one's customer when making purchases of a product which is sold by the customer) is an economically unjustified business practice which confers a competitive advantage on the favored firm unrelated to the merits of its product, the Department will ordinarily challenge any merger which creates a significant danger of reciprocal buying. Unless it clearly appears that some special market factor makes remote the possibility that reciprocal buying behavior will actually occur, the Department considers that a significant danger of reciprocal buying is present whenever approximately 15% or more of the total purchases in a market in which one of the merging firms ("the selling firm") sells are accounted for by firms which also make substantial sales in markets where the other merging firm ("the buying firm") is both a substantial buyer and a more substantial buyer than all or most of the competitors of the selling firm.
(b) The Department will also ordinarily challenge (i) any merger undertaken for the purpose of facilitating the creation of reciprocal buying arrangements, and (ii) any merger creating the possibility of any substantial reciprocal buying where one (or both) of the merging firms has within the recent past, or the merged firm has after consummation of the merger, actually engaged in reciprocal buying, or attempted directly or indirectly to induce firms with which it deals to engage in reciprocal buying, in the product markets in which the possibility of reciprocal buying has been created.

(c) Unless there are exceptional circumstances, the Department will not accept as a justification for a merger creating a significant danger of reciprocal buying the claim that the merger will produce economies, because, among other reasons, the Department believes that in general equivalent economies can be achieved by the firms involved through other mergers not inconsistent with the standards of this paragraph 19.

20. **Mergers Which Entrench Market Power and Other Conglomerate Mergers.**

The Department will ordinarily investigate the possibility of anticompetitive consequences, and may in particular circumstances bring suit, where an acquisition of a leading firm in a relatively concentrated or rapidly concentrating market may serve to entrench or increase the market power of that firm or raise barriers to entry in that market. Examples of this type of merger include: (i) a merger which produces a very large disparity in absolute size between the merged firm and the largest remaining firms in the relevant markets, (ii) a merger of firms producing related products which may induce purchasers, concerned about the merged firm's possible use of leverage, to buy products of the merged firm rather than those of competitors, and (iii) a merger which may enhance the ability of the merged firm to increase product differentiation in the relevant markets.

Generally speaking, the conglomerate merger area involves novel problems that have not yet been subjected to as extensive or sustained analysis as those presented by horizontal and vertical mergers. It is for this reason that the Department's enforcement policy regarding the foregoing category of conglomerate mergers cannot be set forth with greater specificity. Moreover, the
conglomerate merger field as a whole is one in which the Department considers it necessary, to a
greater extent than with horizontal and vertical mergers, to carry on a continuous analysis and study
of the ways in which mergers may have significant anticompetitive consequences in circumstances
beyond those covered by these guidelines. For example, the Department has used Section 7 to prevent
mergers which may diminish long-run possibilities of enhanced competition resulting from
technological developments that may increase interproduct competition between industries whose
products are presently relatively imperfect substitutes. Other areas where enforcement action will be
deeded appropriate may also be identified on a case-by-case basis; and as the result of continuous
analysis and study the Department may identify other categories of mergers that can be the subject of
specific guidelines.

21. **Failing Company.** The standards set forth in paragraph 9 are normally applied by the
Department in determining whether to challenge a conglomerate merger, except that in marginal cases
involving the application of Paragraph 18(a)(iii) and (iv) the Department may deem it inappropriate
to sue under Section 7 even though the acquired firm is not "failing" in the strict sense.

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
*** 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. *** 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. ***

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 restraining 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. §§ 12, 21. ***
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 15(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. The determination of whether the acquisition actually violates the antitrust laws is reserved for the Commission and is, therefore, not before this Court. 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.” 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.

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). ***

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 United States v. Marine Bancorporation, 418 U.S. 602, 618-23 (1974).
II. The Geographic Market
One of the few issues 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). In its first amended complaint, the FTC identified forty-two such metropolitan areas as well as future areas which could suffer anti-competitive effects from the proposed merger. 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,” 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, 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 (1962); see also *United States v. E.I. du Pont de Nemours and Co.*, 351 U.S. 377, 395 (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. ***

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7 The Commission also offered an alternative product market, that of the sale of consumable office supplies through retail stores to small businesses and individuals with home offices.
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. 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.

*** [T]he 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 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 (1962). 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 facil-
ities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors.”
*Id.* Since the Court described these factors as “practical indicia” rather than requirements, sub-
sequent cases have found that submarkets can exist if only some of these factors are pre-
sent.

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 su-
perstore, 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, 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, in Depot-only markets than they
are in three firm markets. ***

The FTC also pointed to internal Staples documents which present price comparisons be-
tween 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.
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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. Though the FTC did not present the Court
with evidence regarding the precise amount of non-superstore competition in each of Staples’

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\(^9\) It was established at the hearing that Staples and Office Depot do not maintain nationally uniform prices in their stores.
Instead, both companies currently organize their stores into price zones which are simply groups of one or more stores that
have common prices.
and Office Depot’s one, two, and three firm markets, it is clear to the Court that these competitors, albeit in different combinations and concentrations, are present in every one of these markets.***

The evidence with respect to the wholesale club stores is consistent. *** For example, Staples’ maintains a “warehouse club only” price zone, which indicates a zone where Staples exists with a warehouse club but without another office superstore. The data presented by the Commission on Staples’ pricing shows only a slight variation in prices (1%-2%) between “warehouse club only” zones and one superstore markets without a warehouse club. Additionally, in May 1996, two price comparison studies done by Staples, first using 2,084 SKUs including both price sensitive and non-price sensitive items and then using only 244 SKUs of price sensitive items, showed that prices in the “club only” zones, on average, were over 10% higher than in zones where Staples competes with Office Depot and/or OfficeMax.

There is also consistent evidence with respect to computer and/or consumer electronics stores such as Best Buy. For example, Office Depot maintains a separate price zone, which it calls “zone 30,” for areas with Best Buy locations but no other office supply superstores. However, the FTC introduced evidence, based on a January 1997 market basket of “top 500 items by velocity,” that prices in Office Depot’s “zone 30” price zone are almost as high as in its “non-competitive” price zone, the zone where it does not compete with another office superstore.

There is similar evidence with respect to the defendants’ behavior when faced with entry of another competitor. The evidence shows that the defendants change their price 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. *** 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. ***

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.” 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. 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.” 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.” ***

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. ***

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. 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.

*** 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 (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.
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.

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.

V. Entry Into the Market

*** 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. *** 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 advertising 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’ 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. For example, even in the superstores’ anti-competitive zones where either Staples or Office Depot does not compete with other superstores, no retailer has successfully expanded its consumable office supplies to the extent that it constrains superstore pricing. Best Buy attempted such an expansion by creating an office supplies department in 1994, offering 2000 SKUs of office supplies, but found the expansion less profitable than hoped for and gave up after two years. For these reasons, the Court also cannot find that the ability of many sellers of office supplies to reconfigure shelf space and add SKUs of office supplies is likely to avert anti-competitive effects from Staples’ acquisition of Office Depot. The Court will next consider the defendants’ efficiencies defense.

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 Supreme Court, however, in *FTC v. Procter & Gamble Co.*, 386 U.S. 568, 579 (1967), stated that “[p]ossible economies 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. Assuming that it is a viable defense, however, the Court cannot find in this case that the defendants’ efficiencies evidence rebuts the presumption that the merger may substantially lessen competition or shows that the Commission’s evidence gives an inaccurate prediction of the proposed acquisition’s probable effect. ***

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. *** 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 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. *** 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. However, in addition to the non-merger specific projected savings, Mr. Painter also revealed problems with the defendants’ methodology in making some of the projections. For example, in calculating the projected cost savings from vendors, Staples estimated cost savings for a selected group of vendors, and then extrapolated these estimated savings to all other vendors. Mr. Painter testified that, although Hewlett Packard is Staples’ single largest vendor, it was not one of the vendors used for the savings estimate. In addition, the evidence shows that Staples was not confident that it could improve its buying from Hewlett Packard. Yet, Staples’ purchases and sales of Hewlett Packard products were included in the “all other” vendor group, and defendants, thereby, attributed cost savings in the amount of $207 million to Hewlett Packard even though Staples’ personnel did not believe that they could, in fact, achieve cost savings from Hewlett Packard.

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. *** [I]n 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.

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. 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. **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.**

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. **The public equities raised by the defendants simply do not outweigh those offered 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 inception 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.

CONCLUSION
**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. 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. *** The FTC’s motion for a preliminary injunction shall be granted.