ISBN 978-1-869454-50-

Statement of Preliminary Issues

Staples, Inc / Office Depot, Inc

17 April 2015

Introduction

1. On 2 April 2015, the Commerce Commission received an application from Staples, Inc (Staples), seeking clearance to acquire all of the shares of Office Depot, Inc (Office Depot). The acquisition forms part of a global merger.

2. The public version of the application is available on our website at:

   http://www.comcom.govt.nz/business-competition/mergers-and-acquisitions/clearances/clearances-register/detail/857

3. This Statement of Preliminary Issues outlines the key competition issues we currently consider will be important in deciding whether or not to grant clearance. The issues highlighted in this statement are based on the information available at the time of publication and may change as our assessment of the application for clearance progresses. Therefore, the issues highlighted in this statement are not binding on us.

4. We invite interested parties to make comment on the likely competitive effects of the proposed acquisition and request that parties who wish to make a submission do so by **1 May 2015**.

5. All information we receive is subject to the principle of availability under the Official Information Act 1982.

6. However, we recognise that preserving the confidentiality of commercially sensitive information and providing protection against disclosure is necessary. If your submission contains confidential information, please clearly identify this.

The transaction and the parties

7. Staples and Office Depot are two USA-based companies that supply a range of work place products in a number of countries, including New Zealand.

8. In New Zealand, Staples operates through two 100%- owned subsidiaries:

   8.1 Staples New Zealand Limited, which supplies work place products to a range of businesses, government agencies and other institutional buyers; and

   8.2 Teacher Direct Limited, an online retailer of educational supplies.

9. In New Zealand, Office Depot, through its subsidiary OfficeMax Holdings Limited, owns 100% of:

9.1 OfficeMax New Zealand Limited, a supplier of work place products direct to businesses, government agencies and other institutional purchasers. It is also a retailer of these products through its 16 bricks and mortar stores.

9.2 Croxley Stationery Limited, a manufacturer/wholesaler of various stationery, technology and kitchen appliance products in New Zealand.

9.3 65% of Armidale Industries Limited, a manufacturer and wholesaler of suspension filing systems.

10. Staples submitted that the merging parties overlap in the supply of the following products to businesses, government and other institutional buyers:

10.1 commercial stationery (including a range of "core" office products such as pens, paper and exercise books);

10.2 technology solutions (including business machines, computers and accessories);

10.3 office furniture;

10.4 educational supplies (including education specific products to educational institutions, such as art supplies and text books);

10.5 cafeteria supplies (including tea, coffee and office kitchen equipment);

10.6 janitorial, hygiene and medical products (including paper-based tissues, towels and cleaning products);

10.7 safety products (including personal protective equipment and apparel);

10.8 packaging products; and

10.9 print solutions (including arranging for the printing of various documents for businesses).

Our framework

11. As required by the Commerce Act 1986, we assess whether an acquisition of shares is likely to result in a substantial lessening of competition. How we assess this is set out in our Mergers and Acquisitions Guidelines.[1]

12. We ask whether an acquisition is likely to substantially lessen competition in a market by comparing the likely state of competition if the acquisition proceeds (the scenario with the acquisition, often referred to as the factual), with the likely state of

[1] Commerce Commission, *Mergers and Acquisitions Guidelines*, July 2013. Available on our website at www.comcom.govt.nz

competition if the acquisition does not proceed (the scenario without the acquisition, often referred to as the counterfactual).[2]

13. A tool often used to assess competitive effects is market definition. Market definition provides a framework to help identify and assess the close competitive constraints the merged firm would likely face.[3] A market is defined in the Commerce Act as a market in New Zealand for goods or services as well as other goods or services that are substitutable for them as a matter of "fact and commercial common sense".[4]

14. We define markets in the way that we consider best isolates the key competitive constraints on the merging parties. In many cases this may not require us to precisely define the boundaries of a market.

15. We analyse the extent of competition in each relevant market both with and without the acquisition to determine whether the acquisition would be likely to substantially lessen competition.

16. We assess the following three factors when considering whether this is likely to be the case.

    16.1 Existing competition – the degree to which existing competitors compete.

    16.2 Potential competition – the extent to which existing competitors would expand their sales or new competitors would enter and compete effectively if prices were increased.

    16.3 The countervailing market power of buyers – the potential for a business to be sufficiently constrained by purchaser's ability to exert substantial influence on negotiations.

17. A comparison of the extent of competition both with and without the acquisition enables us to assess the degree by which the proposed acquisition might lessen competition. If the lessening is likely to be substantial, we may not give clearance to the proposed acquisition.

Preliminary issues

18. We will investigate whether the proposed acquisition is likely to substantially lessen competition in the relevant markets by focusing on the unilateral and conglomerate effects that might result from this acquisition. In particular, we will consider:

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2 *Commerce Commission v Woolworths Limited* (2008) 12 TCLR 194 (CA) at [63].

3 *Commerce Commission v New Zealand Bus Limited* (2006) 11 TCLR 679 (HC), at [123]. *Brambles New Zealand Ltd v Commerce Commission* (2003) TCLR 868 (HC) at [137].

4 Similarly, the courts have said that "[t]he boundaries of the market are defined by substitution between one product and another and between one source of supply and another, in response to changing prices". See *Commerce Commission v New Zealand Bus Limited* (HC), above n 3 at [123] citing *Re Queensland Co-operative Milling Association Ltd* (1976) ATPR 40-012 at 17,247.

18.1 whether there is a single differentiated product market for the supply of different work place products or whether separate markets exist for such products;

18.2 the closeness of competition between the merging parties and other suppliers;

18.3 the ability for new suppliers to enter, or for existing suppliers to expand, including by extending the range of their work place products, or their geographic reach; and

18.4 whether the merger is likely to increase the merged entity's ability and/or incentive to foreclose competition by, for example, bundling together complementary products, or by refusing to sell these products to customers unless they also buy a second product from it (tying).

Market definition

19. Staples submitted that the products in which overlap will occur fall within a single differentiated market for work place products with no clear delineation between different sizes of customers and no distinct groupings of customers with different needs.

20. We consider that potentially there are a number of markets ranging from one single differentiated market incorporating all work place products sold to all customers nationwide to a large number of different markets based on specific products, regional locations and different customer types.

21. We will consider:

21.1 the various customer types and characteristics, including their size, preferences (eg, "one stop shops" or multiple suppliers) and any combination of these factors;

21.2 the geographic dimension, including whether there may be national geographic markets for larger corporate and government customers who require nationwide "one stop shops", and regional markets for small or medium-sized commercial customers; and

21.3 the potential interplay between the three different market dimensions (product, geographic and customer).

Existing competition

22. Staples submitted that there is significant competition in the supply of each and every work place product, including from firms that supply a broad range of products and firms who supply individual product categories (eg, cafeteria supplies).

23. Given the acquisition may involve markets that are differentiated in terms of the products supplied and geographic location, our investigation will focus on the

closeness of competition between the merging parties and the closeness of competition between the merging parties and other competitors in respect of different products, customer types and geographic location.

24. Staples considers that the merging parties' key competitors include Warehouse Stationery, Office Products Depot, New Zealand Office Supplies, Fuji Xerox and Corporate Consumables, all of which supply a broad range of work place products. In addition, Staples has identified a number of other competitors, including those firms that supply in a specific product category such as Café Express, a supplier of cafeteria/office kitchen products.

25. We will consider whether the merged entity would be effectively constrained from raising its prices above the competitive level, or reducing its range of products and/or the quality of its services. This will include an assessment of the constraint likely to be provided by suppliers of a broad range of work place products as well as those manufacturers and suppliers of specific products that service their customers directly. We will also assess whether there are any major costs involved in customers switching between suppliers and the likely impact of the acquisition on their ability to switch.

Potential competition

26. Staples submitted that the barriers to entry and expansion in the affected market are low with suppliers facing no material costs to enter into, or expand across different categories. Further, that expansion merely involves accessing a wholesale source of supply of additional products of which alternatives are readily available.

27. We will assess whether entry by new competitors or expansion by existing competitors is likely, of sufficient extent and will occur in a timely fashion to prevent a substantial lessening of competition. For example, we will consider whether entry or expansion in any product and/or customer market may involve substantial fixed costs, such as establishing a distribution network, and investment in Electronic Document Interchange (EDI) systems.[5]

Countervailing power

28. Staples submitted that all customers will readily switch suppliers and even if specific customer categories were identified (eg, government, larger and small to medium businesses), each customer group will continue to have a large number of competitive alternatives for their work place product requirements.

29. We will consider whether the countervailing power of customers will be sufficient to constrain the merged entity from profitably increasing prices, including for instance by switching suppliers, by self-supplying or by sponsoring entry and/or expansion by suppliers.

[5] EDI systems enable the linking of computer systems to allow direct ordering and handling of billing and account management information by electronic means.

Conglomerate effects

30. A conglomerate merger is a merger between firms that supply products that may be complementary. For example, in this merger, a number of stationery lines and technology solutions. Such mergers may in certain situations increase a merged firm's ability/and or incentive to foreclose competitors.

31. Foreclosure may be achieved in a conglomerate merger by, for example, a merged entity providing bundled discounts where customers buy products together rather than separately, or tying the purchase of one product to the purchase of a second product from it. Such bundled discounts or tying may mean that competitors that cannot sell the same range of products as the merger may be foreclosed. This means these competitors would not provide a competitive constraint on the merged entity for the product both firms sell.

32. We will assess whether as a result of the merger:

    32.1 the merged entity would have the increased ability and/or incentive to foreclose competitors, including through providing bundled discounts or by tying; and if so

    32.2 whether that foreclosure is likely to have the effect of substantially lessening competition in the affected market(s).

Next steps

33. We are currently aiming to make our decision by **30 May 2015.** However, this date may change as the investigation progresses.

34. To keep up to date with any changes to our deadline and to find relevant documents, visit our clearance register on our website at http://www.comcom.govt.nz/clearances-register/

35. As part of our investigation, we will identify the parties we believe will provide the best information to help us assess the preliminary issues identified above. We will be contacting those parties over the next few weeks.

36. We also invite submissions from any other parties who consider they have information relevant to our consideration of this matter. If you wish to make a submission, please send it to us at registrar@comcom.govt.nz with the reference Staples /Office Depot in the subject line of your email, or The Registrar, PO Box 2351, Wellington 6140 by close of business **1 May 2015**. Please clearly identify any confidential information contained in the submission and provide contact details.

37. If your submission contains confidential information, please clearly identify this.