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How did Whole Foods ever manage to pull it off?

Jon B. Dubrow and Carla A. R. Hine / Special to The National Law Journal
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The Federal Trade Commission's (FTC) recent unsuccessful challenge to Whole Foods Market Inc.'s acquisition of Wild Oats Markets Inc. provides merging parties with useful insights into how to navigate the regulatory review process. While the FTC lost this case, companies should not view this as signaling a retreat from the "narrow market" cases the FTC and U.S. Department of Justice (DOJ) historically have pursued. This case highlights how, in light of the agency's practice of narrowly defining relevant markets when analyzing transactions, merging parties can help themselves resolve deals raising antitrust issues through early development of helpful facts and evidence.

On Aug. 16, the U.S. District Court for the District of Columbia denied the FTC's motion for a preliminary injunction to block the merger of Whole Foods and Wild Oats. This matter received significant press coverage, including editorials criticizing the FTC for bringing a case based on a narrow product market limited to "premium natural and organic supermarkets." See, e.g., Holman W. Jenkins Jr., "Lessons of a Food Fight," *Wall St. J.*, Aug. 29, 2007, at A14; Dan Mitchell, "Lots of Froth but No Bubble," *N.Y. Times*, June 9, 2007.

Despite its loss in the D.C. district court, and the U.S. Circuit Court of Appeals for the District of Columbia's subsequent denial of the FTC's request to stay the case pending appeal, and the parties' consummation of the merger, the FTC is pressing forward with its appeal of the D.C. district court's decision.

Citing heavily to documents prepared by Whole Foods describing Wild Oats as a critical competitor, and to deposition testimony from the former chief executive officer of Wild Oats, the FTC sought to prevent Whole Foods and Wild Oats from consummating their transaction. However, the FTC was unable to convince the D.C. district court that the merger was likely to lessen competition in the narrow market of premium natural and organic supermarkets. Citing the earlier decision in *FTC v. Staples*, 970 F. Supp. 1066 (D.D.C. 1997), the court noted that "[a]s 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." *FTC v. Whole Foods Market Inc.*, 2007 U.S. Dist. Lexis 61331, at *15 (D.D.C. Aug. 16, 2007). A decade earlier, the same court accepted the FTC's position in *Staples* that the merger of Staples Inc. and Office Depot Inc. likely would have anti-competitive effects in what many observers viewed as an artificially narrow market for "the sale of consumable office supplies through office superstores." *FTC v. Staples*, 970 F. Supp. at 1073. A comparison of the *Whole Foods* and *Staples* cases reveals that the divergent outcomes do not reflect a change in legal standards, but rather show how different facts drove the decisions.

The FTC's arguments in *Whole Foods* were closely analogous to its arguments in *Staples*. However, the evidence the FTC presented in *Staples* that convinced the court to find that office superstores comprised a narrow market was lacking in the *Whole Foods* case.

First, the FTC had more robust pricing data and event studies in *Staples*. In *Staples*, the FTC demonstrated that in cities where Staples was the only office superstore, its prices were 13% higher than in cities where it competed with another office superstore. *Id.* at 1075-76.

Where Office Depot was the only office superstore, its prices were more than 5% higher than in areas where it competed with other office superstores. *Id.* at 1076. These pricing differences were not affected by the presence of other retailers (such as Wal-Mart Stores Inc. and Best Buy Co.). The FTC also proved that when a second office superstore entered a one-firm market, the incumbent office superstore lowered its prices, but it did not lower prices in response to entry by other nonoffice superstore retailers. *Id.* at 1077-78. Conversely, in *Whole Foods*, the court found that there was no significant economic proof that prices were lower in cities where Whole Foods and Wild Oats were both present. *Whole Foods*, 2007 U.S. Dist. Lexis 61331, at *59. The court also concluded there was no strong evidence that entry of a second premium natural and organic supermarket into an area had any effect on the incumbent firm's prices. *Id.*

Documentary evidence

Second, in *Staples*, the parties' internal competitive plans and strategy documents provided strong support for a narrow product market definition. In *Staples*, internal documents clearly indicated that Staples and Office Depot uniquely competed against one another and Office Max Inc. The parties regarded only other office superstores as their competition, not other retailers or mail order firms, making business and pricing decisions based only on competition from other office superstores. *Staples*, 970 F. Supp. at 1076. However, in *Whole Foods*, company and third-party testimony and documents demonstrated that Whole Foods made key decisions, such as pricing, based on competition from conventional supermarkets rather than on competition from the premium natural and organic market Wild Oats. *Whole Foods*, 2007 U.S. Dist. Lexis 61331, at *66-*67, *79-*81.

Third, in both cases the FTC argued that the unique characteristics of the stores supported narrow product market definitions. The court in *Staples* found that, when considered in conjunction with the other pricing evidence the FTC presented, the unique characteristics of office superstores, such as large size and scale and commitment of more floor space to consumable office supplies than other retailers, distinguished them so much from other retailers that they comprised a separate relevant product market. *Staples*, 970 F. Supp. at 1078-79. On the contrary, the court did not find the unique characteristics of premium natural and organic supermarkets, such as their focus on high-quality perishables and specialty and natural organic produce, and emphasis on social and environmental responsibility, compelling enough to warrant such a narrowly defined product market when the pricing and other evidence was considered. *Whole Foods*, 2007 U.S. Dist. Lexis 61331, at *70-*71.

Market definition often drives the results of merger challenges, and market definition is a fact-intensive exercise. The opinions in *Staples* and *Whole Foods* illustrate that subjecting two very different sets of facts to the same analytical exercise can lead to two opposite outcomes.

Beyond *Whole Foods* and *Staples*, other FTC and DOJ enforcement actions make clear that the agencies are not shying away from adopting narrow market definitions in challenging proposed transactions. Both agencies have brought cases alleging narrow product markets in a variety of industries with mixed success.

For example, in 2001 the FTC successfully blocked Libbey Inc.'s proposed acquisition of Anchor Hocking Corp. in the market for soda-lime glassware sold to the food service industry. *FTC v. Libbey Inc.*, 211 F. Supp. 2d 34, 55 (D.D.C. 2002). In 2004, the FTC challenged Arch Coal Inc.'s acquisition of Triton Coal Co., alleging that the merger would lessen competition in, inter alia, the market for 8800-BTU Southern Powder River Basin coal.

However, based on the economic evidence and the evidence that customers used 8400-BTU and 8800-BTU coal interchangeably, the FTC was unable to convince the court of its narrow market definition. *FTC v. Arch Coal Inc.*, 329 F. Supp. 2d 109, 119-23 (D.D.C. 2004).

Fountain pens

In 1993, DOJ attempted to block The Gillette Co.'s acquisition of Parker Pen Holdings Ltd. Gillette manufactured pens under the Waterman brand, and DOJ argued the merger would have anti-competitive effects in the market for premium fountain pens. While the court accepted DOJ's distinction between "premium" and "base" fountain pens, it concluded that "premium" fountain pens competed with "premium" mechanical pencils and "premium" ball point and rollerball pens, and that therefore DOJ's market definition was too narrow. *U.S. v. Gillette Co.*, 828 F. Supp. 78 (D.D.C. 1993).

In 2001, DOJ filed suit to block SunGard Data Systems Inc.'s proposed acquisition of Comdisco Inc., claiming that the transaction likely would have anti-competitive effects in the market for "shared hot-site disaster recovery services for large scale enterprise computer processing centers in North America." Given the availability of quick-ship and internal solutions to meet customers needs, the court could not "accept the government's overly narrow and static definition of the product market." *U.S. v. SunGard Data Sys.*, 172 F. Supp. 2d 172, 193 (D.D.C. 2001).

In 2004, DOJ challenged Oracle Corp.'s proposed acquisition of PeopleSoft Inc., alleging that the merger would eliminate competition in the market for high-function enterprise resource planning software. In part because DOJ could not prove its narrow market, the court did not block the deal. *U.S. v. Oracle Corp.*, 331 F. Supp. 2d 1098 (N.D. Calif. 2004).

Most merger challenges, however, take the form of negotiated consent orders rather than litigation. The agencies have accepted many consent orders in very narrow product markets, such as "superpremium ice cream" and "intense breath mints." See *Nestle' Holdings Inc.*, Analysis to Aid Public Comment, 68 Fed. Reg. 39564 (July 2, 2003); and *Philip Morris Cos. Inc. and Nabisco Holdings Corp.*, Analysis to Aid Public Comment, 65 Fed. Reg. 82378 (Dec. 28, 2000). Because consent orders are settlements, the alleged product markets are not proven in an adversarial process, but nevertheless show that the agencies focus on narrow markets.

The agencies continue to seek to define markets narrowly when challenging proposed acquisitions, but careful preparation and development of facts and themes can help merging parties move their deal through the FTC or DOJ and avoid a protracted government inquiry. In preparation for getting a deal through the FTC or DOJ, merging parties should consider their ideal position vis-à-vis the agency, and gather the facts and data in support of that position. For example, defining the market narrowly may, in some situations, be advantageous to the merging parties, particularly when the parties may want to differentiate their operations from one another and show they do not compete in the same market. Alternatively, if the merging parties clearly are in the same market, they may want to show that market is broad, so they are only two of many competitors. Companies should expect the agencies to start their analysis with the narrowest plausible market definition, and the parties will need to offer countervailing evidence to disprove the proposed market definition while advocating their own view of the relevant market. However, diligent preparation, including understanding the companies' documents and collecting helpful pricing data, can help resolve the agencies' concerns quickly while reducing expense.

'Macho posturing'

Parties should anticipate that internal documents prepared in the ordinary course of business, and documents prepared in connection with the proposed transaction, will be a ripe source of information regarding the scope of competition between the merging parties and the potential competitive impact of the transaction. For example, in *Whole Foods*, the FTC relied heavily on highly publicized e-mails that the chief executive officer sent to members of Whole Foods' board declaring that the acquisition of Wild Oats would enable Whole Foods "to avoid nasty price wars" and would reduce the risk that a conventional grocery retailer could acquire Wild Oats and reposition itself to compete more against Whole Foods. Whole Foods dismissed these comments as "macho posturing," and although executives make such comments in the context of trying to sell a deal, these documents highlight how business bravado can work to delay a transaction. Ultimately, the court did not give much weight to these documents when balanced against other facts, but these documents undoubtedly complicated review of the merger and resulted in increased expense and delays.

Objective evaluation of market definition and other dispositive issues, and thorough preparation for the agency review, can help speed the regulatory review process. In some cases that may involve developing the strategy and facts to convince the government it has no case, and ultimately to beat the government in court if necessary. In others, it may mean identifying and admitting discrete problem areas quickly so they can be resolved through a consent order, enabling the broader transaction to proceed without delay. In all cases, it is better to be prepared early so that parties can improve their odds of a quick and efficient merger review.

Jon B. Dubrow is a partner, and Carla A.R. Hine is an associate, in the Washington office of McDermott, Will & Emery; they are members of the firm's antitrust and competition practice group.

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