All Over the Map: Grocery Store Enforcement from *Von's* to *Whole Foods*

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THE RECENT WAVE OF GROCERY mergers is nothing new to antitrust enforcers. For over fifty years, the antitrust agencies have closely scrutinized grocery store consolidation. While only a few cases have been litigated, the government has sought at least some remedy in a great number of these transactions.

The history of merger enforcement in supermarket combinations to some extent mirrors the general trends in merger enforcement—from the days where even mergers with a combined firm share under 10 percent would be challenged to the current, growing recognition that not every merger is problematic. Yet, despite the FTC's investigation of dozens of supermarket transactions, no consistent framework of analysis is detectable. Not only has the analytical approach varied, the FTC has struggled—and in some cases downright failed—to keep pace with the fundamental shifts in consumer trends and business practices affecting the grocery store industry. Examining the history of supermarket merger enforcement, from *Von's* through the FTC's recent loss in challenging the Whole Foods/Wild Oats transaction, may help suggest an approach to analyzing supermarket mergers (and retail mergers more generally) that protects against anticompetitive effects while at the same time accounts for the business realities that exist today in the industry and will occur in the future.

A Retrospective

***From* Von's *to* Red Foods.** Starting in 1966, with the FTC's challenge in *United States v. Von's Grocery Co.*,[1] the FTC pursued an aggressive antitrust policy with respect to food retailers. In *Von's* the FTC persuaded the Supreme Court to block a merger between grocery store chains in the Los Angeles area with a combined market share of only approximately 7.5 percent. The Supreme Court accepted the FTC's structural argument in finding that that the market was "characterized by a long and continuous trend toward fewer and fewer owner-competitors, which is exactly the sort of trend which Congress . . . declared must be arrested."[2]

Five years later, the FTC continued the aggressive pursuit of limiting grocery chain acquisitions by requiring Kroger to divest itself of three discount food departments located in Gold Circle Discount Stores acquired from Federated Department Stores in the Dayton, Ohio area.[3] Despite the publication of the 1968 Merger Guidelines, the FTC based its argument solely on market structure, alleging the market was already concentrated. On this basis, it challenged the combination of Kroger (with its 20 percent share) and Gold (which had a 2.5 percent share).

The FTC obtained modest store divestitures in two notable transactions in the late 1980s. First, the FTC conducted an extensive investigation of Von's purchase of 172 Safeway stores, which resulted in a consent order requiring Von's to divest twelve stores.[4] Second, American Store's, which owned over 252 stores in California acquired Lucky Stores, which had over 300 stores in California, culminating in a consent order requiring a divestiture of thirty-one to thirty-seven stores.[5] The state of California, however, was not satisfied with the FTC remedy and successfully filed suit alleging that even with the divestitures, the acquisition violated federal antitrust laws.[6] In the end, the parties agreed to resolve the case with a divestiture of 161 stores.

After almost two decades of numerous defeats, the grocery store operators closed the 1980s with a victory over the FTC.[7] In 1989 the FTC challenged Red Food Stores, Inc.'s acquisition of seven Kroger stores in the Chattanooga, Tennessee MSA. The court noted that "the FTC's most persuasive evidence is the high market concentration," with the FTC claiming Red Food's post-acquisition share would be 75 percent and even Red Food offering only a slightly lower share—at 67 percent.[8] Nevertheless the court, citing the Department of Justice Merger Guidelines and the FTC Statements Concerning Horizontal Mergers and pointing to recent entry, stated: "the FTC has not shown a likelihood that Red Food, if it acquires the seven Kroger stores, will be able to exercise market power."[9]

The Mid-1990s and the Evolving Consent Decree Requirements. Small regional grocery store chain mergers were the rave in the mid-1990s and the FTC, along with occasional cooperation from state authorities, continued to take an active enforcement role. The *Red Food* loss did not deter the FTC from challenging deals. Additionally, over time, the FTC began increasingly to place additional requirements on the manner in which grocery store divestitures were conducted.

In *Schnuck*, the FTC required divestiture of twenty-four stores in St. Louis to a Commission approved buyer within

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twelve months.[10] However, by the time of the divestiture, the stores had begun to degrade because Schnuck failed to maintain the stores properly, leading to a significant drop off in sales. The Commission brought an action against Schnuck for violation of the Order on the basis that it did not maintain the assets to be divested.[11]

In *Stop & Shop*, the FTC applied the lesson it learned from *Schnuck* and shortened the divestiture window to nine months.[12] It also required a single buyer for all divested stores in one of the three areas of concern to ensure the existence of a strong competitor with economies of scale.[13]

The FTC continued to refine its remedy requirement in *Ahold/Stop & Shop*, where the consent order called for the identification of up-front buyers and cut the divestiture period to just thirty days.[14] The FTC also required up-front buyers in the *Jitney-Jungle/Delchamps*,[15] *Albertson's/Buttrey*,[16] and *Ahold/Giant*[17] mergers. After its experience in *Schnuck*, FTC staff has indicated it would always require that the divested stores be sold at the time of the closing of the main deal, rather than some months later.

The Rise of the Wal-Mart SuperCenter and the Competitive Response. The exponential growth and expansion of Wal-Mart into food retailing changed the grocery store industry forever. Wal-Mart opened its first SuperCenter in Washington, Missouri in 1988 with a stated objective of "low, low pricing." By 1999, Wal-Mart had over 500 SuperCenters. Significant economies of scale combined with an automatic replenishment inventory management system allowed Wal-Mart to lower costs dramatically. Moreover, Wal-Mart uses many of its grocery products as loss leaders to draw customers into its stores to purchase other items, particularly higher margin durable products outside of the grocery section.

In response to Wal-Mart's increasing presence and ferocious price competition, a number of national grocery store chains responded by growing through mergers to increase their economies of scale in an effort to price competitively with Wal-Mart. In the two notable transactions of the late 1990's, results of the agency's analysis differed dramatically.

KROGER/FRED MEYER. In 1999, Kroger responded to the Wal-Mart threat by agreeing to acquire 800 Fred Meyer supermarkets and multi-department stores that would provide significant operational synergies. This transaction was almost exclusively complementary from a geographic standpoint, and after a lengthy investigation, the FTC allowed the transaction to proceed with only an eight store divestiture.[18] Divestitures were not required in Phoenix and Tucson despite overlaps in those cities. The FTC, instead, appeared appropriately to place great importance on the likely future entry and expansion of Wal-Mart SuperCenters. This entry in fact did occur.

ALBERTSON'S/AMERICAN STORES. On the heels of Kroger's acquisition of Fred Meyer, two more of the nation's largest grocery store chains—Albertson's and American Stores—sought to merge. The combination would have created an entity with nearly 1800 supermarkets spanning thirty-two states. The FTC extensively investigated this transaction and required a divestiture of 144 stores and five land sites which was the largest divestiture required in a grocery store transaction.[19]

The FTC also took measures to ensure that the divested stores would remain competitive. First, the FTC noted that the proposed divestitures "consist of more profitable stores, rather than a divestiture of sales volume from unprofitable stores."[20] Moreover, in approximately 37 of the 57 overlap areas, the parties agreed to divest all of one firm's or the other's stores, commonly referred to as a "clean sweep," to buyers who did not already compete in that market. In the remaining markets, the FTC allowed a package of mixed assets to be divested, but the package had to provide essentially no increase in concentration in the market. At the time, the parties pointed to anticipated entry—notably by Wal-Mart SuperCenters—in many of the locations, but those arguments apparently fell on deaf ears.

The aggressiveness of the FTC's enforcement action in American Stores seemed to take some by surprise, particularly after its approach in the Kroger-Fred Meyer transaction. It ushered in an era where many practitioners discussed—only partly in jest—that there must be a secret "Supermarket Merger Guidelines" which bore little resemblance to the actual Merger Guidelines in that the entry section was deleted in its entirety and onerous burdens were imposed to show that the product market was broader than traditional supermarkets.

Filling in the Gaps: Targeted Synergistic Transactions. After the wave of the national mega-mergers, companies began to target acquisitions that filled in geographic gaps. Each FTC investigation seemed to bring a different mode of analysis—and a different result.

KROGER/WINN-DIXIE. In 2000, only a couple of years after Kroger's acquisition of Fred Meyer, Kroger entered into an agreement to acquire the Dallas-Fort Worth operations of Winn-Dixie consisting of 74 stores. The transaction was motivated by Kroger's and Winn-Dixie's historically poor performance in Dallas-Ft. Worth. Kroger anticipated synergies of approximately $40 million yearly as of the third year after the transaction and had every reason to expect it could achieve these synergies given its experience obtaining significant synergies from the Fred Meyer transaction[21] and with prior internal mergers of administrative functions of stores in a nearby geographic location. Kroger planned to continue operating virtually all of the acquired stores.

The Commission voted 5–0 to block the transaction. The FTC's press release claimed that the transaction combined the second and third largest players in Ft. Worth to create a "dominant" competitor,[22] despite the fact that the firms' combined share would be only about 30 percent and despite the presence of existing significant competitors such as Safeway, Albertson's, and Wal-Mart. Wal-Mart also had plans to add up to fifteen SuperCenters, five Sam's Club stores and numerous Neighborhood Markets. SuperTarget had begun construction on five sites in Dallas-Ft. Worth and HEB had announced plans to build stores in Dallas-Ft. Worth as well.

In a short and heavily redacted brief, the Commission argued that the high market shares and concentration, under *Philadelphia National Bank*,[23] created a presumption of illegality.[24] The Commission alleged both unilateral and coordinated anticompetitive effects arising from the transaction, suggesting (1) that Kroger would close stores, reduce couponing and move stores to higher priced zones and (2) that the market characteristics would lead to tacit collusion. With respect to entry, the Commission argued that Kroger's share would remain high and that the new entrants would lack the scale needed to counteract the anticompetitive effects. The parties abandoned the transaction, so no resolution of these issues occurred.

In analyzing Kroger/Winn-Dixie, the FTC appeared to alter its approach in two ways as compared to the previous two transactions. First, the FTC shifted away from viewing geographic markets based on metropolitan statistical areas, finding that Ft. Worth, rather than Dallas-Ft. Worth, was the relevant geographic market. Second, the FTC appeared to move back towards more of a structural argument that placed greater weight on market share and concentration levels, while relegating the importance of entry to a distant consideration.

As the parties had predicted, several years later Winn-Dixie in fact went out of business, selling those stores it could. Some stores were acquired by Kroger, with the FTC's approval. Some stores were purchased by other competitors. Yet, many of the Winn-Dixie stores were never acquired, instead staying dark.

KROGER/RALEY'S. The Commission's investigation in Kroger/Raley's shows that the FTC eventually recognized changing competitive conditions. In the Albertson's/American Stores transaction, the parties had argued that Wal-Mart was entering Las Vegas, but the FTC met the argument with skepticism and insisted on divestitures of stores to Raley's, which stores Kroger sought to acquire in 2002. By then, Wal-Mart had in fact entered with five stores and had a market share higher than Raley's. Wal-Mart planned five more SuperCenters and four Neighborhood Markets. This time, the Commission, after a brief investigation, allowed the transaction to proceed. Its closing statement was headlined: "Unanticipated entry and expansion since issuance of prior order make anticompetitive effects unlikely."[25] The Commission explained that "At the time of the Albertson's/American Stores investigation, Wal-Mart had opened no SuperCenters in Las Vegas. . . . Since then, Wal-Mart has opened 5 SuperCenters."[26]

WAL-MART/AMIGO. In 2002, Wal-Mart sought to acquire Amigo, Puerto Rico's largest supermarket chain in dollar sales. Wal-Mart itself had nine traditional Wal-Mart Stores, one SuperCenter and eight SAM's Club stores in Puerto Rico. The FTC required divestiture of four stores to an up-front named buyer.[27] What is interesting about this transaction is that, after years of dismissing the parties' arguments in other matters that club stores were part of the product market, the Commission's theory of anticompetitive harm here was predicated on the fact that Wal-Mart had club stores. The Aid to Public Comment noted that:

> A substantial portion of retail purchasers in Puerto Rico regard full-service supermarkets, supercenters, and club stores as reasonably interchangeable for the purpose of purchasing substantially all of their weekly food and grocery shopping requirements in a single shopping visit.[28]

Grocery Shopping Without a Consistent Shopping List

In other investigations, no clear answers to the key supermarket questions were developed. Were club stores in the product market? Was the geographic market a city or the three miles around any supermarket? If Wal-Mart was entering, was a merger immune from challenge or did the entry have to be within a certain distance or entail a certain number of stores? Neither the parties involved nor the FTC had to answer these difficult questions because the transactions were not challenged, typically due to the competitiveness of the markets at issue or the imminent departure of the target firm from the market.

The recent announcement of three major supermarket deals offered the tantalizing possibility of a clear articulation of the Commission's current mode of analysis and enforcement philosophy for supermarket deals.

In SuperValu/Albertson's, SuperValu sought to acquire Albertson's and its 1,124 stores, but the deal stalled because of fear of possible antitrust issues in a number of geographic regions. In an effort to revive the deal and avoid the long and uncertain process of an FTC investigation that could have resulted in a significant divestitures, the parties restructured the transaction to include a private equity group and CVS, Inc. to address the antitrust concerns up-front. SuperValu sold its Cub Stores in Chicago to Cerberus. The FTC allowed the transaction to close without issuing a second request and without requiring any remedy. The A&P/Pathmark transaction is still under review. Thus, all eyes turned to the Whole Foods/Wild Oats transaction when the FTC issued a second request in that matter.[29]

FTC v. Whole Foods*: An Organic Change?* Before the FTC challenged the Whole Foods/Wild Oats merger, the last litigated grocery store transaction—*Red Food*—was nearly a quarter of a century old. Yet, a more recent decision seemed to underlie the FTC's challenge—the decision in *Staples* where the court enjoined Staples' proposed acquisition of Office Depot.[30] The cases had similarities from an outsider's perspective: both sets of retailers competed in broader markets, yet positioned themselves as having a unique niche. Staples and Office Depot plainly sold products that could be found in numerous other retailers, but as the court noted "[n]o one entering a Wal-Mart would mistake it for an Office Supply Superstore."[31] Whole Foods and Wild Oats similarly compete with traditional supermarkets for the dollars and attention of consumers, but sell not only organic products, but a lifestyle and a "food philosophy," in which they will not carry foods with additives, preservatives and the like. That the *Staples* decision was at the forefront of everyone's mind was made abundantly clear at trial when the first exhibit defense counsel used—and returned to repeatedly—was a chart showing the numerous ways in which the Whole Foods merger was not like the proposed Staples deal.

Although having this helpful precedent, the Commission also went into court against Whole Foods/Wild Oats on the heels of several recent court defeats in merger challenges. The conventional wisdom among merger practitioners as to what the FTC's fate would be was mixed. On the one hand, "premium natural and organic supermarkets" seemed like a gerrymandered product market destined for failure. Yet, while many had thought the same of "office-supply superstores," the evidence of close competition between Staples and Office Depot in that case proved compelling. So there was considerable interest in the evidence that would be presented at trial—so much so that the court had an overflow room to accommodate all who were interested.

Background. In February 2007, Whole Foods, the largest supermarket chain focusing on natural and organic products in the United States, announced it had entered into an agreement to purchase Wild Oats, the second largest operator focusing on natural and organic products in the United States. After a second request investigation of approximately four months, the FTC sought a temporary restraining order to enjoin the transaction.

The FTC alleged that the merger of these two uniquely close competitors would substantially lessen competition in the operation of premium natural and organic supermarkets in twenty-one geographic markets. The FTC contended that a merger would likely lead to higher prices, reduced quality, and fewer choices for consumers.

In defining the relevant markets, the Commission continued its practice of defining supermarket competition more narrowly than the parties believed was appropriate. It contended that premium natural and organic supermarkets, such as Whole Foods and Wild Oats, are differentiated from conventional retail supermarkets in a number of critical aspects—breadth and quality of their perishables, produce, meats, fish, bakery items, and prepared foods, as well as the selection and variety of natural and organic products and services and amenities they offer. In addition, premium natural and organic supermarkets seek a different customer than do traditional grocery stores. Whole Foods' and Wild Oats' customers are buying something more than just the food product—they are seeking a shopping "experience," where environment can matter as much as price.

The FTC argued that Whole Foods and Wild Oats were the only meaningful "premium natural and organic supermarkets," relying in part on the former Wild Oats CEO's statement that "[T]here's really only two players . . . of any substance in the organic and all natural, and that's Whole Foods and Wild Oats."[32] Similarly, Whole Foods referred to markets where only Wild Oats was present as "monopoly markets."[33] The FTC alleged that other supermarkets could not reposition without risking their core constituency, pointing to a Whole Foods document that stated: "Safeway . . . and other conventional . . . can't really effectively focus on Whole Foods core customers without abandoning 90 percent of their own customers."[34] They also pointed to a Whole Foods study that found entry by other premium and natural organic supermarkets had greater effect on Whole Foods sales and margins then entry by other retailers.

The FTC proffered the testimony of Dr. Kevin Murphy, an economist at the University of Chicago Business School, for analysis of the likely anticompetitive effect of the transaction and evidence that Whole Foods and Wild Oats placed significant competitive constraints on each other. Dr. Murphy found that Whole Foods' store-level margins varied according to the presence or absence of local competition from Wild Oats, i.e., that the Whole Foods' margins are lower in areas where a Wild Oats is present. He also found that Whole Foods' entry in certain markets had a significant impact on Wild Oats' sales and margins, and that this effect was greater than the effects of entry by other stores. He inferred that an exit of Wild Oats would have the same effect as Whole Foods entry, though in the opposite direction.

Dr. Murphy appears to have done no analysis comparing prices in Whole Foods markets with and without Wild Oats. Curiously, Whole Foods' CEO John Mackey stated on his blog "the FTC did not bother to actually gather any pricing information from Whole Foods or Wild Oats . . . . [T]he FTC did not go to the trouble of actually comparing prices in any of our markets."[35] Mr. Mackey stated that the FTC asked for an extension of time towards the end of the investigation and asked for pricing information, which the parties refused to provide.

The FTC argued that the relevant geographic market extended to the range of five to six miles, instead of the three to four miles that it said it had found in recent typical grocery store transactions, ignoring that in the past it had often defined the relevant geographic market as an entire MSA. The FTC contended that Whole Foods had been entering areas where Wild Oats was present and planned to enter into further such areas, and that a merger would substantially lessen that potential competition. Lastly, the Commission alleged that Whole Foods, as part of its "aptly-named" Project Goldmine Strategy, planned to close many of the Wild Oats stores and, essentially, was paying to put its competition out of business.

The FTC based much of its case on statements made in emails and other documents by Mr. Mackey. In a memo to the Board, Mr. Mackey explained:

> By buying them we will . . . avoid nasty price wars in Portland (both Oregon and Maine), Boulder, Nashville, and several other cities which will harm our gross margins and profitability. OATS may not be able to defeat us but they can still hurt us. Furthermore, we eliminate forever the possibility of Kroger, Super Value, or Safeway using their brand equity to launch a competing national natural/organic food chain to rival us. . .[36]

He reiterated this view in testimony:

> So it is either Whole Foods buy them or we potentially see someone like Kroger or Safeway or Tesco or God knows who else, a private equity firm, buy them and recapitalize them, potentially bring in new management. And we would rather not see that happen.[37]

> One of the motivations is to eliminate a competitor. I will not deny that. That is one of the reasons why we are doing this deal. That is one of the reasons we are willing to pay $18.50 for a company that has lost $60 million in the last six years. If we can't eliminate those stores, then Wild Oats, frankly, isn't worth buying.[38]

The FTC pointed to examples of intense competition between the companies as well.

- Whole Foods' reduction of prices 10 percent across the board in response to a planned opening of a Wild Oats store in Boulder.
- Whole Foods complaining of low margins in Louisville because of "having to match some ridiculously low special pricing" at Wild Oats.
- Increased spending on remodeling and updating stores, and adding amenities when confronting one another.
- Whole Foods responding to a 20 percent off sale by Wild Oats through price matching, free samples and taste tests.

Whole Foods and Wild Oats contended that the transaction would not substantially lessen competition in any area because the two competitors did not uniquely constrain each other. The parties pointed to market research showing that their customers: (1) frequently shop at other supermarkets; (2) purchase the same categories of products from the same departments at other supermarkets; and (3) spend the majority of their grocery dollars at other supermarkets.[39] Additionally, they pointed to actions they were taking in response to other competitors. The parties argued that typical supermarket chains, such as Kroger, Wal-Mart and Safeway, sell a wide array of the same or equivalent natural and organic products, and continually expand their selection of these types of goods. In addition, Whole Foods' and Wild Oats' pricing and promotional activity is not materially affected by the proximity of the other. The parties, instead, contended that they price check, monitor, and respond to all traditional grocery stores present in each area.

The defendants relied on Dr. David Scheffman, who twice led the Bureau of Economics at the FTC. He conducted a critical loss analysis showing that the loss of sales from a price increase by a hypothetical monopolist would outweigh the gains from a price increase such that the price increase would not be profitable. Critical loss analysis seeks to determine how many sales must be lost for a price increase to be unprofitable. He focused on marginal customers, i.e., "someone who would switch where he or she shops in a response to a small but significant and nontransitory price increase."[40] He found that marginal consumers constituted a significant portion of the business and that a very small sales loss would make a price increase unprofitable. He also conducted a pricing analysis of item-specific register prices for a given day in June 2007 to demonstrate that Whole Foods' prices were not higher in the absence of a nearby Wild Oats.[41]

The Decision. *Market Definition.* In a 93-page decision, Judge Paul Friedman found that the FTC had not met its burden of demonstrating that the transaction was anticompetitive. He began by noting that "As in *Staples*, 'this case hinges'—almost entirely—'on the proper definition of the relevant product market.'"[42] The court relied heavily on Dr. Scheffman's analysis of critical loss in defining the relevant product market. The court agreed with Dr. Scheffman's conclusion that "because so many people are cross-shopping for natural and organic foods and are marginal rather than core customers, the actual loss from a [small but significant and nontransitory price increase] would exceed the critical loss."[43] From this finding, the court concluded that "the relevant product market within which to evaluate the proposed transaction must be at least as broad as the retail sale of food and grocery items."[44]

The court also pointed to other findings by Dr. Scheffman to support its conclusion of a broad product market:

- When Whole Foods enters it generates substantial sales that are overwhelmingly captured from the local traditional or conventional supermarkets and grocery retailers regardless of whether there are other premium natural and organic supermarkets in the areas.
- Combined Whole Foods and Wild Oats revenues after entry of Whole Foods are much greater than the revenues of the Wild Oats store prior to entry.

These facts, the court concluded, demonstrated that Whole Foods' and Wild Oats' main competitors are other supermarkets, not just each other.

The court considered Dr. Murphy's analysis in which he studied instances of a Whole Foods store entering within five miles of an existing Wild Oats store. Dr. Murphy found that the margins and volume in those Wild Oats stores decreased after Whole Foods entered. He concluded by analogy that if Whole Foods closed a Wild Oats store that prices of the Whole Foods store would increase. The Court, however, was "unwilling to accept the assumption that the effects on Wild Oats from Whole Foods' entries provide a mirror from which predictions can reliably be made about the effects on Whole Foods from Wild Oats' future exits if this transaction occurs."[45]

The court also considered evidence of consumer demand for natural and organic products. The court noted that "a typical Whole Foods store carries all the traditional categories of products" and "each [of Whole Foods and Wild Oats] target a large base of supermarket shoppers who shop for larger categories of food products in competition with other supermarkets."[46] It recognized also that they emphasize high levels of customer service and "have an emphasis on 'social and environmental' responsibility."[47] While the FTC focused on "customers that have decided that natural and organic is important," the Court concluded that "the effect of the proposed merger on marginal consumers is more important than the effect on such core consumers, as it is the marginal consumers for whom the stores must and do compete vigorously."[48]

The court pointed to Whole Foods internal documents indicating that it faced "eroding product differentiation," and to evidence that Whole Foods' supermarket competitors reacted to consumer demands for fresh, natural and organic foods, such as by launching their own private label store brands of natural and organic foods.[49] In sum, the court concluded that "differentiation . . . does not equate to a unique relevant product market for antitrust purposes."[50]

With that conclusion, the court said the question is not "are there any differences" but "would customers switch?"[51] On that point, there was evidence that "the majority of natural and organic goods sold in the United States are sold by so-called 'conventional' supermarkets" and that Whole Foods and Wild Oats customers cross-shop at conventional supermarkets and vice versa.[52]

The court recited the various evidence that showed that Whole Foods and Wild Oats competed with conventional supermarkets and vice versa. While the information as to other supermarkets' views of Whole Foods was largely redacted, the several pages devoted to that subject showed the evidence must have been extensive and persuasive. In addition, the court pointed to evidence of (1) Whole Foods pricing against other supermarkets and being price-checked by them and (2) Whole Foods' consideration of every significant supermarket chain as a potential competitor when it reviews a potential store location. "In sum, the evidence before the Court demonstrates that other supermarkets . . . compete today for the food purchases of customers who shop at Whole Foods and Wild Oats and that Whole Foods' customers already turn for some of their food purchases to the full range of supermarkets."[53]

Finally, the court rejected the notion that Whole Foods and Wild Oats uniquely constrained each other. It determined that:

- "Whole Foods does not have any specific competitive policies, practices, or strategies directed specifically at Wild Oats,"
- Wild Oats' prices are generally higher than Whole Foods, and
- The proportion of Wild Oats sales that might transfer to Whole Foods after a merger was a small portion of Wild Oats sales.[54]

On the basis of all this evidence, the court concluded that the FTC had failed to prove that "premium natural and organic supermarkets" is the relevant product market.[55]

Analysis of Harm to Competition. The court then turned to an analysis of the competitive effects of the transaction, holding that the evidence overcame any presumption of anticompetitive effects.

First, the court concluded that "Whole Foods and Wild Oats pricing practices do not differ based on the presence or absence of the other in the area."[56] Whole Foods does not have price zones or other pricing policies that depend on whether a Whole Foods store competes with a Wild Oats store. In one example, after Wild Oats closed its store, the Whole Foods store experienced no increase in margins.

Second, in light of the fact that Wild Oats prices are consistently higher, the court held that it offers no unique constraint on Whole Foods. In fact, Whole Foods often does not price check Wild Oats for that reason.

Third, the court held there has been significant repositioning and entry by other retailers into premium natural and organic products and that such repositioning and entry is continuing. Going through numerous retailers' strategies in some detail, the court concluded that there are "firms that have already proven themselves adept at repositioning and proving competitive in the premium natural and organic food field."[57]

Defenses and Other Matters. The court made short shrift of any possible affirmative defenses finding quickly that there was insufficient evidence of any efficiencies and no basis to conclude that Wild Oats is a "flailing firm."

As interesting as what the court did say is what the court did not. There was no mention of two fundamental points the FTC emphasized. First, the court made no mention of the various documents of Whole Foods that indicated this deal was motivated by a desire to eliminate significant competition and "avoid nasty price wars." This is somewhat puzzling in light of the significant focus the FTC placed on these statements. Second, the court did not address the issue of whether store closings were inherently anticompetitive. Perhaps this was unnecessary in light of the overall finding that the deal was not generally anticompetitive. But an analysis of whether store closings alone can be viewed as tantamount to evidence of a price increase, as the FTC had argued, would have been instructive.

The inevitable question raised by the *Whole Foods* decision is why was the result different than in the seemingly similar *Staples* matter? The simple answer is the pricing data. In its closing argument, Whole Foods' counsel repeatedly came back to a slide showing the differences between the Staples/Office Depot combination and the Whole Foods/Wild Oats combination. Four of the six points related to pricing data.[58]

- While the FTC focused on pricing evidence in *Staples*, the FTC's analysis focused on margin evidence in *Whole Foods*.
- Staples priced "13 percent higher" in one-firm markets than in three-firm markets.[59] In contrast, "Whole Foods

and Wild Oats pricing practices do not differ based on the presence or absence of the other in the area."[60]

- The merging parties in *Staples* had price zones with higher prices where there were no other office supply superstores,[61] whereas "Whole Food does not have price zones or other pricing policies that depend on whether a Whole Foods store is competing with a Wild Oats store."[62]
- Finally, Office Depot was a "particularly aggressive competitor,"[63] whereas "Wild Oats prices are consistently higher than Whole Foods prices . . . [and] higher than other competitors."[64]

The *Whole Foods* matter may yet shed more light on antitrust enforcement in the supermarket industry. Although FTC staff lost its bid to enjoin the transaction pending appeal, it continues to pursue an appeal of the district court decision.[65] The FTC's administrative complaint is pending.

The Future of Supermarket (and Other Retail) Analyses. The *Whole Foods* opinion, against the backdrop of the history of supermarket enforcement, shows the range of issues and arguments that must be carefully considered by both practitioners and the FTC in analyzing the competitive effects of a transaction.

THERE IS A BROAD RANGE OF SUPERMARKET COMPETITION. In supermarkets, like other retail markets, product market definition is often the beginning and end of the analysis. And the appropriate product market definition has changed over time as competitive conditions have changed. As the court noted in *Staples*, office supply superstores were fairly new competitors to the scene at the time of the decision. And certainly, the *Von's* court would have never imagined the likes of "premium natural and organic" supermarkets. But these distinctions, by themselves, do not define a product market. As the court noted in *Whole Foods*, "differentiation . . . does not equate to a unique relevant product market."[66]

Over time, the FTC has come to recognize that SuperCenters and, in some cases, club stores are part of the competitive set supermarkets face. We believe they should not stop there. They should recognize the extent to which there is a blurring of the channel distinctions, with supermarkets increasing their product range to include such products as organics to compete on the high end and with mass merchants and drug stores increasing their food sales—both shelf-stable and refrigerated—to compete on the low end. Where there is evidence that grocery operators (or other retailers) price check, set prices against and follow the competitive strategies of other competitors, such evidence should be given significant weight.

GEOGRAPHIC MARKET ANALYSIS MUST BE REFINED. The FTC's case in *Winn-Dixie*, which defined the market as the Ft. Worth MSA, was premised on the notion that Dallas and Ft. Worth were different markets, notwithstanding that they were in the same price zone and had the same newspaper advertising and promotions with the same prices. In other cases, such as *Whole Foods*, the FTC has defined the market narrowly, such as a six-mile radius around each of the acquired stores even where there was evidence that pricing and advertising was done across large regional areas to reflect the supermarkets' view that it could not treat consumers in the same market differently. More articulation of the basis for the different geographic market definitions and the analytical underpinnings would be useful. In particular, the Commission should recognize that an MSA can be a market even though consumers will not drive from one end of the MSA to the other. As long as enough consumers in a local area will move a few miles over to the next local area in response to a price increase, the various local areas are linked and thus the geographic market cannot be limited to a few mile radius around a given store.

ENTRY AND EXPANSION CONTINUE TO OCCUR AND CANNOT BE IGNORED. In all of the Commission's challenges, the FTC staff has alleged that entry would be insufficient to eliminate a post-merger anticompetitive effect. Yet, as the decision in *Kroger/Raley's* shows, the Commission's ability to predict the extent of entry—even when it has been argued by the parties—has often been inadequate. While a number of supermarket operators have been forced out of business, other operators are continuing to expand. Along with traditional grocery store operators, Wal-Mart SuperCenters, Whole Foods, Costco and Trader Joe's stores are expanding and entering into new markets. Even Tesco, a British retailer, is entering the U.S. with new stores. And, as the court noted in *Whole Foods*, many of these retailers are repositioning their product line to appeal to a wide range of customers.

INCREASED CONCENTRATION DOES NOT MEAN INCREASED PRICES. We have, in the past, heard some FTC staff express concern that Wal-Mart has led to increased concentration in the industry, and that increased concentration leads to higher prices. True, Wal-Mart's entry has increased concentration in some areas—but by forcing out weak, inefficient small competitors and replacing them with low-priced Wal-Marts. That in turn has led the traditional supermarkets to become more price competitive. Increased concentration does not necessarily lead to higher prices; indeed, when it allows for economies of scale, increased concentration can led to lower prices. Wal-Mart's entry and the resulting price pressure on its competitors has benefited consumers, even if the market has become more concentrated in terms of market shares and the number of players. The entry of Wal-Mart simply cannot be considered to have hurt consumers.

STORE CLOSINGS ARE NOT INHERENTLY ANTICOMPETITIVE. The FTC argued in *Whole Foods*, as it has in other matters, that the fact that the acquiring party might close some of the target's stores was presumptively anticompetitive and tantamount to a price increase. This is a puzzling position. Closing a store does not typically reduce output. It is not as though customers are suddenly unable to buy as many groceries as they were before; they must just do it elsewhere (usually a few blocks away). Nor is it evidence of a price increase. The fact that some amount of the target's sales are expected to be retained—at the acquiring firm's same prices—does not necessarily allow one to infer what would occur if prices at the acquiring firm's stores increased. And closing stores may reduce costs. Indeed, in other industries, that sort of consolidation is often considered to be procompetitive, even if it is not viewed as the type of efficiency that will get passed on to consumers and thus constitute a defense under the Merger Guidelines.

Price Increases as a Result of Acquisitions Are Counter to the Rationale of These Transactions. Transactions in this industry are being done to lower costs to increase competitiveness, not to increase prices. In none of the Kroger transactions, including the challenged Winn-Dixie transaction, did the FTC staff point to a single document that suggested that Kroger planned to increase prices post-transaction. To the contrary, the evidence showed that Kroger's prices were lower than that of its acquisition target and Kroger planned to reformat the acquired stores to be Kroger stores, leading to an immediate price reduction, even if no other efficiencies were realized.

It seems doubtful that coordination could ever occur in this industry in the face of Wal-Mart and other SuperCenter competitors. Wal-Mart and the other SuperCenters have no incentive in the world to collude because they are operating under a different business model than traditional supermarkets. If SuperCenters wanted to raise prices on groceries, they would do so—and would still be below the prices of the vast majority of other competitors in the marketplace. Instead, by keeping their grocery prices low, SuperCenters provide incentives for people to come into their stores to buy general merchandise at higher margins. In response to this business strategy of SuperCenters, the traditional supermarkets are just trying to keep their prices as low as possible in order to compete.

For the same reasons, careful thought should be given as to whether a supermarket would unilaterally increase prices after an acquisition unless accompanied by increased services of value to customers. There should be strong economic evidence of the likelihood of such an effect—based on rigorous pricing analysis, not a few sdocuments—before a determination is made that a transaction is likely to be anticompetitive.

Efficiencies Are Real. In both the *Staples* and *Whole Foods* decisions, the courts gave little or no weight to the parties' claims of efficiencies based on the evidence presented. But there is no doubt that efficiencies do arise from transactions in this industry, as the experience of Kroger in its Fred Meyer transaction shows. The problem is that it can be difficult to quantify the efficiencies, particularly given the constraints on information sharing while a deal is under review. Therefore, we may never see an efficiencies defense that passes muster in the grocery industry. Nevertheless, the very real likelihood of efficiencies helps explain why companies are motivated to undertake these transactions. ■

1 384 U.S. 270 (1966).

2 *Id.* at 278.

3 Kroger Co., 79 F.T.C. 636, 1971 WL 128670 (Oct. 26, 1971).

4 1988 Annual Report at 37 (FTC Sept. 30, 1988), *available at* http://www.ftc.gov/os/annualreports/ar1988.pdf.

5 *Id.* at 34.

6 The Ninth Circuit upheld the lower court's finding of a violation and ruled that private parties were not entitled to divestiture as injunctive relief under the Clayton Act, but the Supreme Court reversed on the injunctive relief question. Cal. v. American Stores Co., 872 F.2d 837, 845 (9th Cir. 1989), *rev'd*, 495 U.S. 271 (1990).

7 FTC v. Promodes S.A., 1989-2 Trade Cas. (CCH) ¶ 68,688, 1989 WL 103748, at *1 (Apr. 14, 1989).

8 *Id.*

9 *Id.*

10 Schnuck Mkt., Inc., 119 F.T.C. 798, 806, 1995 WL 17012624, at *5 (June 8, 1995). Interestingly, one of the divestiture buyers was Wild Oats.

11 Complaint at ¶¶ 19–20, FTC v. Schnuck Mkt., Inc., 4:97-cv-01830-CEJ (E.D. Mo. Sept. 9, 1997), *available at* http://www.ftc.gov/os/1997/09/schnuckcmp.htm. Schnuck settled the matter, agreeing to divestitures and the payment of civil penalties.

12 The Stop & Shop Co., Inc., 121 F.T.C. 427, 434, 1996 WL 33412044, at *5 (Apr. 2, 1996).

13 The Stop & Shop Co., Inc., 123 F.T.C. 1721, 1721, 1997 WL 33483283, at *1 (June 20, 1997).

14 Koninklijke Ahold NV, et al., 122 F.T.C. 248, 248, 1996 WL 33412170, at *1 (Sept. 30, 1996).

15 Jitney-Jungle Stores of Am., Inc., 125 F.T.C. 311, 1998 WL 34077350 (Jan. 28, 1998).

16 Albertson's, Inc., 126 F.T.C. 800, 1998 WL 34300628 (Dec. 8, 1998).

17 Koninklijke Ahold NV, 127 F.T.C. 404, 1999 WL 33912994 (Apr. 5, 1999).

18 Kroger Co., FTC No. 991-0024, 1999 WL 33915970 (May 27, 1999), *available at* http://www.ftc.gov/os/1999/05/krogeragree.htm.

19 Agreement Containing Consent Order, FTC Docket No. C-3986 (Dec. 8, 2000), Albertson's, Inc. and American Stores Co., *available at* http://www.ftc.gov/os/1999/06/alameristoresagree.pdf. *See also* Press Release, Fed. Trade Comm'n., FTC Agreement with Albertson's and American Stores Requires Selling of 144 Stores in Order to Preserve Supermarket Competition in California, Nevada and New Mexico (June 22, 1999), *available at* http://www.ftc.gov/opa/1999/06/american.shtm.

20 Analysis of the Draft Complaint and Proposed Consent Order to Aid Public Comment, Albertson's, Inc. and American Stores Co., FTC No. 9810339 at 8 (June 22, 1999), *available at* http://www.ftc.gov/os/1999/06/alameristoresana.pdf.

21 Some time after the transaction closed, Kroger publicly stated that it had achieved synergies in the hundreds of millions, in excess of what it projected at the time of the transaction.

22 Press Release, Fed. Trade Comm'n., FTC to Seek Injunction to Block Kroger Co. Purchase of Winn-Dixie Supermarkets in Texas and Oklahoma (June 2, 2000), *available at* http://www.ftc.gov/opa/2000/06/krogerwinndixie.shtm.

23 United States v. Philadelphia Nat'l Bank, 374 U.S. 321 (1963).

24 Plaintiff's Memorandum of Points and Authorities in Support of Motion for Preliminary Injunction at 14, FTC v. The Kroger Co., No. 3-00CV1196-R (N.D. Tex. June 2, 2000), *available at* http://www.ftc.gov/os/2000/06/krogerbrief.pdf.

[25] Press Release, Fed. Trade Comm'n., Investigation of Kroger/Raley's Supermarkets Transaction Closed (Nov. 13, 2002), *available at* http://www.ftc.gov/opa/2002/11/krogerraley.shtm.

[26] *Id.* The Commission also pointed to significant expansion from the major competitors existing at the time of the American Stores/Albertson's matter and the declining competitive significance of Raley's, which had not opened any new stores.

[27] Decision and Order, Wal-Mart Stores, Inc., and Supermercados Amigo, Inc., FTC Docket No. C-4066 (Feb. 27, 2003), *available at* http://www.ftc.gov/os/2003/02/walmartdo.htm.

[28] Analysis of the Complaint and Proposed Decision and Order to Aid Public Comment, FTC No. 021-0090 (Nov. 21, 2002), *available at* http://www.ftc.gov/os/2002/11/walmartamigoanalysis.htm.

[29] Interestingly, in the midst of this activity the Bureau of Economics held a workshop on supermarket enforcement to gain insights into supermarket competition. Press Release, Fed. Trade Comm'n., A Conference on Grocery Store Antitrust: Historical Retrospective & Current Developments (May 24, 2007), *available at* http://www.ftc.gov/be/grocery/index.shtm.

[30] FTC v. Staples, Inc., 970 F. Supp. 1066 (D.D.C. 1997).

[31] *Id.* at 1079.

[32] Memorandum in Support of Plaintiff's Motions for Temp. Restraining Order and Preliminary Injunction at 1, FTC v. Whole Foods Mkt., Inc. and Wild Oats Mkt., Inc., No. 07-1021 (D.D.C. June 6, 2007), *available at* http://www.ftc.gov/os/caselist/0710114/070710PublicVersiontromemo.pdf [hereinafter Plaintiff's Memorandum for Temp. Restraining Order].

[33] *Id.* at 4, 27.

[34] *Id.* at 4, 30.

[35] John Mackey, Executive Summary, *Whole Foods Market, Wild Oats, and the Federal Trade Commission* (June 19, 2007), http://www.wholefoodsmarket.com/blogs/jm/archives/2007/06/hole_foods_mark.html.

[36] Plaintiff's Memorandum for Temp. Restraining Order, *supra* note 32, at 1.

[37] *Id.*

[38] Plaintiff's Memorandum for Temp. Restraining Order, *supra* note 32, at Exhibit 2, 75:13-21; Plaintiff FTC's Corrected Brief on Its Motion for Preliminary Injunction at 2, FTC v. Whole Foods Mkt., Inc. and Wild Oats Mkt., Inc., No. 07-1021 (D.D.C. Aug. 1, 2007).

[39] Public Version of Joint Reply Memorandum of Points and Auth. of Whole Foods Mkt., Inc. and Wild Oats Mkt., Inc. in Opposition to Motions for a Preliminary Injunction at 4, FTC v. Whole Foods Mkt., Inc. and Wild Oats Mkt., Inc., No. 07-1021 (D.D.C. July 25, 2007).

[40] FTC v. Whole Foods Mkt., Inc. and Wild Oats Mkt., Inc., No. 07-1021, 2007 WL 2377000, at *14 (D.D.C. Aug. 16, 2007).

[41] It is unusual that the pricing analysis covered only a single day. It may be that only limited data were available.

[42] *Whole Foods*, 2007 WL 2377000 at *5 (citation omitted).

[43] *Id.* at *16 (citation omitted).

[44] *Id.* at *17 (citation omitted).

[45] *Id.* at *19.

[46] *Id.* at *20.

[47] *Id.* at *20, *26.

[48] *Id.* at *21.

[49] *Id.* at *22.

[50] *Id.* at *24.

[51] *Id.*

[52] *Id.* at *25.

[53] *Id.* at *30.

[54] *Id.* at *31, *32.

[55] Having made that determination, consideration of the relevant geographic market was unnecessary but the court agreed that defining the geographic market as a 3 to 6 mile radius around at given store was reasonable in the context of this case. *Id.* at *32, *34–*35.

[56] *Id.* at *37.

[57] *Id.* at *42.

[58] The other two were that (i) in *Staples*, the FTC had 36 third-party declarations, while the FTC has only one in *Whole Foods,* and (ii) defendants' documents, in *Staples* "focus primarily on competition from other superstores," citing *Staples*, 970 F. Supp. at 1079, while Whole Foods and Wild Oats' documents focus primarily on other supermarkets.

The authors thank Paul Denis of Dechert LLP for providing them a copy of this slide.

[59] *Staples*, 970 F. Supp. at 1075–76.

[60] *Whole Foods*, 2007 WL 2377000, at *37.

[61] 970 F. Supp. at 1075–76.

[62] *Whole Foods*, 2007 WL 2377000, at *37.

[63] 970 F. Supp. at 1083.

[64] *Whole Foods*, 2007 WL 2377000, at *38.

[65] Order, FTC v. Whole Foods Market, Inc., No. 07-5276 (D.C. Cir. Aug. 23, 2007) (per curiam), *available at* http://www.ftc.gov/os/caselist/0710114/0710114.shtm.

[66] *Id.* at *24.