DOJ Challenges Non-reportable US$3 Million Deal on Buyer Power Theory

On May 10, 2011, the Antitrust Division of the US Department of Justice (DOJ) filed suit in *United States* v. *George's Foods*, 5:11CV00043 (W.D.Va.) to unwind a non-reportable transaction that signed and closed just three days earlier while under investigation by the Division. This case demonstrates that DOJ, regardless of the size of a transaction or the difficulty of a case, will stand its ground when it suspects anticompetitive harm may occur.

On March 18, 2011, chicken processor George's announced its intent to acquire a processing facility from Tyson Foods located nearby a George's facility.[1] Given the US$3 million purchase price, the transaction was well below the "size of transaction" threshold for requiring a pre-merger notification filing under the Hart-Scott-Rodino (HSR) Act, and the parties were thus not obligated to abide by a statutory waiting period for the antitrust authorities to review the deal. Nevertheless, following announcement of the deal, DOJ opened an investigation and issued Civil Investigative Demands (CIDs) to obtain information about the transaction. According to the complaint, the parties were still actively discussing the production of material with DOJ when, without prior notice, they signed a merger agreement and closed on Saturday, May 7, 2011. DOJ promptly responded on Tuesday, May 10, by filing a complaint to unwind the transaction. DOJ's complaint alleged that the merger will result in monopsony or buyer power by reducing the number of processors who purchase grower services in the local region, thereby harming competition for growers and resulting in reduced compensation and degraded contract terms.

1 Press Release, Tyson Foods, George's Announces Intent to Buy Tyson's Harrisonburg Operations (Mar. 18, 2011), *available at*: http://www.tysonfoods.com/Media-Room/News-Releases/2011/03/George-s-Announces-Intent-to-Buy-Tyson-s-Harrisonburg-Operations.aspx.

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Chicken Processing in the Shenandoah Valley

DOJ's complaint alleges that the relevant geographic market is the Shenandoah Valley region of Virginia and West Virginia where George's, Tyson, and Pilgrim's Pride were the only processors of broiler chickens. According to the complaint, "transportation costs are such that processors typically contract only with growers within" a close proximity of the processing facility.[2] The Tyson and George's facilities in this market were just 30 miles apart. By combining the second and third largest competitors by market share, the transaction resulted in George's holding 43 percent of the processing capacity in the relevant market. DOJ alleged that Pilgrim's Pride, the sole remaining competitor, lacked the capacity to absorb a significant amount of growers in the event of a unilateral reduction in compensation paid to growers.

DOJ's Theory of Harm: Protecting Growers

The Antitrust Division has taken particular interest in the agriculture sector in recent years. In 2010, DOJ and the Department of Agriculture held five joint workshops exploring the role of antitrust enforcement in the industry. Unlike the typical concerns of the potential for higher prices resulting from market concentration in horizontal mergers, in the George's Food challenge, DOJ alleged a theory of monopsony or buyer power that could harm growers. Consistent with the Horizontal Merger Guidelines, DOJ made Herfindahl-Hirschman Index calculations showing that the transaction would result in a highly concentrated market for grower services such that there should be a presumption that the transaction would enhance George's market power.

DOJ specifically alleged that the reduction in competition in the Shenandoah Valley could harm the competition for grower services either through a direct reduction in grower compensation or a reduction in the benefits provided by other contract provisions, such as provisions requiring producers to help cover the cost of capital improvements to grow houses. Indeed, this type of complaint was the very subject of one of the joint DOJ/Department of Agriculture workshops.[3]

In addition to harming sellers (who receive less for their product), mergers that create buyer power can also harm consumers where the reduction in the price paid to sellers causes them to reduce their output. This reduction in output by sellers leads to reduced availability of inputs at the next stage in the market, and thus ultimately can result in reduced output and higher prices for consumers.

In contrast, some mergers that create buyer power have no anticompetitive effects in the downstream market because—even if they result in reduced purchases—the downstream market remains competitive. For example, if the market for processed chicken were broader than the market that processors look to for growers and competitive with many players, a reduction of output in response to lower compensation in the Shenandoah Valley grower market would have no effect on chicken consumers who are supplied from a broader, competitive geographic area. DOJ nonetheless deems such mergers anticompetitive because they distort competition by reducing the output of input suppliers. Example 24 of the Guidelines notes that a merger can "enhance buyer power and depress the price paid to farmers for [a] product, causing a transfer of wealth from farmers to the merged firm and inefficiently reducing supply. These effects can arise even if the merger will not lead to any increase in the price charged by the merged firm for its output."[4]

Although a reduction in input costs without an accompanying reduction in purchases or output could be characterized as

2 Complaint ¶ 3, *United States* v. *George's Foods*, 5:11CV00043 (W.D.Va. May 10, 2010).

3 *See* Transcript of Public Workshops Exploring Competition in Agriculture, Poultry Workshop (May 21, 2010), *available at:* http://www.justice.gov/atr/public/workshops/ag2010/alabama-agworkshop-transcript.pdf.

4 US Dep't of Justice Antitrust Div. & Fed. Trade Comm'n, Horizontal Merger Guidelines §12 (Aug. 19, 2010), *available at* : http://www.justice.gov/atr/public/guidelines/hmg-2010.html#12.

an efficiency, the Horizontal Merger Guidelines distinguish cost reductions that result from buyer power from those that result from other factors:

> The Agencies distinguish between effects on sellers arising from a lessening of competition and effects arising in other ways. A merger that does not enhance market power on the buying side of the market can nevertheless lead to a reduction in prices paid by the merged firm, for example, by reducing transactions costs or allowing the merged firm to take advantage of volume-based discounts. Reduction in prices paid by the merging firms not arising from the enhancement of market power can be significant in the evaluation of efficiencies from a merger . . . .[5]

The Antitrust Guidelines for Collaborations Among Competitors likewise appear to focus on whether joint purchasing will "depress output below what likely would prevail in the absence of the relevant agreement."[6]

The Horizontal Merger Guidelines thus provide that the agencies will challenge mergers that result in buyer power even when there is harm only to sellers, not to consumers, and even when that harm is manifested only in lower prices paid, not a reduction in output. "The Agencies do not view a short-run reduction in the quantity purchased as the only, or best, indicator of whether a merger enhances buyer market power. Nor do the Agencies evaluate the competitive effects of mergers between competing buyers strictly, or even primarily, on the basis of effects in the downstream markets in which the merging firms sell."[7]

The DOJ complaint focuses solely on harm to growers that will allegedly receive less value when they sell their chickens. DOJ does not allege harm to consumers in the form of higher prices or reduced supply of processed chicken. Nor does DOJ allege that the transaction will result in reduced purchases of chickens, the "distortion" of competition through reduced output of input suppliers described in Example 24 of the Guidelines. To the contrary, the complaint specifically alleges that the reduction in prices paid to growers will not result in a reduction in chicken sales by growers.[8] The complaint is silent regarding whether any reduction in the processors' cost of chicken will be passed on to consumers in the form of lower chicken prices.

Although consistent with the approach in the Guidelines, *George's Foods* nonetheless presents a challenging case. In the absence of a reduction in purchases, it is not clear how DOJ will distinguish an anticompetitive reduction in prices paid from the efficient "quantity discount" that the Merger Guidelines indicate would not be problematic.

Antitrust Division is Willing to Follow Through When Tested

According to the complaint, George's and Tyson had not yet produced information pursuant to DOJ's CIDs when the parties decided to proceed by signing the merger agreement and closing on the same day. Likely because DOJ was undertaking an investigation, and because it filed its complaint so quickly after the transaction was closed, DOJ took the unusual step of seeking rescission, rather than the usual remedy of a post-closing divestiture to a third party of the overlapping assets.

Though the acquisition by George's was non-reportable due to the small purchase price, this case—as well as a recent successful Federal Trade Commission challenge to an unreportable hospital transaction—demonstrates that there is no practical *de minimus* safe harbor against an enforcement action. DOJ's willingness to pursue enforcement is also striking in this case in light of the uphill battle the case may face with no obvious consumer harm resulting from the transaction. Companies should

5 *Id.*

6 US Dep't of Justice Antitrust Div. & Fed. Trade Comm'n, Antitrust Guidelines for Collaborations Among Competitors §3.31(a) (Apr. 2000), *available at*: http://www.ftc.gov/os/2000/04/ftcdojguidelines.pdf.

7 *Id.*

8 Complaint ¶ 26.

give careful consideration to the competitive issues of any transaction, including harm to suppliers—even in situations when the relevant asset values may fall substantially below the HSR filing thresholds.

If you have any questions about any of the topics discussed in this Advisory, please contact your Arnold & Porter attorney or any of the following attorneys:

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