



Portfolio Media, Inc. | 648 Broadway, Suite 200 | New York, NY 10012 | www.law360.com
Phone: +1 212 537 6331 | Fax: +1 212 537 6371 | customerservice@portfoliomedia.com

A Potentially Dramatic Shift In Merger Enforcement

Law360, New York (November 24, 2008) -- Almost a year after the Whole Foods Wild Oats merger was consummated, the D.C. Court of Appeals reversed the district court's denial of the Federal Trade Commission's ("FTC") motion for a preliminary injunction seeking to block the merger. *FTC v. Whole Foods Market Inc.*, 533 F.3d 869 (D.C. Cir. 2008).

The D.C. Circuit's decision creates the possibility that more than a year after the merger was completed, Whole Foods may have to divest some or all of the assets it acquired. Aside from the difficulties this raises for Whole Foods, the D.C. Circuit's decision raises two fundamental issues that could affect merger enforcement more broadly.

First, the decision creates a much lower standard for the FTC to obtain a preliminary injunction than exists for its sister antitrust enforcement agency, the Antitrust Division of the U.S. Department of Justice ("DOJ").

This lower standard, along with the FTC's move toward administrative hearings on proposed mergers, will have a profound effect on how antitrust lawyers advise clients contemplating mergers that FTC is likely to investigate.

Second, the D.C. Circuit's opinion turns on a flawed view of the significance of marginal customers and a misunderstanding of the importance of price discrimination in analyzing potential competitive effects.

Background On The Whole Foods-Wild Oats Merger

Whole Foods and Wild Oats, grocers emphasizing premium natural and organic foods, signed a merger agreement on February 21, 2007, and made their premerger notification filings with the FTC and DOJ. FTC received clearance to investigate and spent several months examining the proposed transaction.

On June 6, 2007, FTC filed suit in district court seeking a preliminary injunction. The agency also filed an administrative action against the merger, but stayed that proceeding pending the preliminary injunction hearing.

The district court held a two-day evidentiary hearing and, on Aug. 16, 2007, the court denied FTC's motion in a lengthy opinion that thoroughly examined the evidence.

The court found that FTC failed to show a likelihood of success on the merits primarily because it found that FTC did not prove that grocers focusing on premium natural and organic foods constituted a market distinct from traditional supermarkets. The D.C. Circuit refused to enter an injunction pending appeal or to expedite FTC's appeal.

Whole Foods closed its acquisition of Wild Oats and integrated Wild Oats' stores into its system, closing some stores and distribution centers and re-branding other stores.

Almost a year later, the D.C. Circuit reversed the District Court's denial of the preliminary injunction. Whole Foods filed a petition for rehearing en banc.

Meanwhile, on Aug. 8, 2008, the FTC rescinded the stay on its administrative action, and recently set the administrative trial for February 16, 2009.

The D.C. Circuit Lowers The Standard For FTC To Obtain A Preliminary Injunction

Section 13(b) of the FTC Act, 15 U.S.C. § 53(b), authorizes a court to grant the FTC's request for a preliminary injunction "[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."

Prior to the D.C. Circuit's Whole Foods decision, Section 13(b) had been interpreted as requiring FTC to make a substantial showing that a challenged merger was likely to have anticompetitive effects in a properly defined market. See, *FTC v. H.J. Heinz Co.*, 246 F.3d 708 (D.C. Cir. 2001).

In Whole Foods, the D.C. Circuit read Section 13(b) as imposing a significantly lower standard on FTC. The court went so far as to hold that FTC may obtain an injunction without establishing a relevant market:

Section 53(b) preliminary injunctions are meant to be readily available to preserve the status quo while the FTC develops its ultimate case, and it is quite conceivable that the FTC might need to seek such relief before it has settled on the scope of the product or geographic markets implicated by a merger ... [A]t this preliminary stage [FTC] just has to raise substantial doubts about the

transaction.

Whole Foods, 533 F.3d at 877. The dissent took issue with this new injunction standard stating: "With all due respect, I do not believe that the law allows FTC to just snap its fingers and block a merger." Id. at 892. The dissent added, "we have always held that the FTC must show a likelihood of success to obtain a preliminary injunction in a § 7 case." Id. at 893 n.3.

The new, lower injunction standard for FTC stands in stark contrast to the DOJ's burden to obtain a preliminary injunction. Courts have required DOJ to prove a reasonable likelihood that the proposed transaction will have an anticompetitive effect in a relevant market. See, e.g., *United States v. Baker Hughes Inc.*, 908 F.2d 981 (D.C. Cir. 1990)

The Lower FTC Standard Could Have A Chilling Effect On Certain Mergers

The impact of FTC's lower bar for obtaining a preliminary injunction is compounded by the agency's recent push to have the merits of mergers resolved in its administrative hearings, not in court.

Until recently, the merger review process at FTC and DOJ was substantially the same. Both agencies seeking to block a transaction would seek a preliminary injunction in district court and would have to establish a likelihood of success on the merits.

Thus, the preliminary injunction hearing typically involved a substantive evidentiary hearing on the merits regardless of which agency was bringing the challenge. If the agency succeeded in obtaining a preliminary injunction, the parties would, in most instances, abandon the transaction.

If the agency failed to obtain a preliminary injunction, the transaction would close and the agencies would abandon any further challenge, except for occasional appeals. Under this process, merger review at both agencies, from the initial premerger filing through completion of the preliminary injunction hearing, was typically completed in less than twelve months.

FTC has now embarked on a process of initiating administrative hearings on proposed transactions at the same time as it seeks a preliminary injunction in district court. FTC has taken the position that the court should not hold an evidentiary hearing on the merits of the transaction.

Rather, the court should simply enjoin the transaction to preserve the status quo and defer consideration of the merits to FTC through its administrative process. One court has accepted FTC's position, causing the merging parties to abandon their transaction. See *FTC v. Inova Health Sys.*, No. 08-CV-00460 (E.D. Va. filed May 12, 2008).

If other courts follow the lead of *Inova*, and employ the low preliminary injunction threshold established in *Whole Foods*, merging parties before FTC will be prevented from closing their proposed transaction until after an administrative hearing at FTC.

Even with FTC's Sept. 25, 2008 proposal to amend its rules for administrative hearings, it could take nine months to complete the administrative hearing. 73 Fed. Reg. 195 (Oct. 7, 2008).

This is on top of the at least six months it normally takes for the FTC to decide whether to challenge a transaction under the Hart-Scott process.

If FTC has its way, under the best of circumstances, merging parties may have to wait for fifteen months or more to see if they will be permitted to consummate their transaction.

Companies are often unwilling to live with such uncertainty for that length of time, given the impact of an announced but unclosed transaction on the seller's employees, customers, and suppliers.

In contrast, for mergers reviewed by DOJ, the process from the initial premerger filing through a preliminary injunction hearing typically can be completed in less than a year.

Such differences between the two antitrust enforcement agencies on merger review processes and injunction standards is contrary to the public interest.

At a minimum, such differences create a far greater level of uncertainty for proposed mergers facing an FTC investigation. The time that it takes for a determination to be made on a merger, and the standard applied in making that determination, should not depend on which antitrust agency reviews the transaction.

Under such a scenario, mergers raising the same competitive issues will be treated differently depending on the industry or companies involved or the relative work load at the agencies. This does not lead to rational, predictable merger enforcement.

Without a predictable, unified merger review process and injunction standard, companies may be dissuaded from pursuing pro-competitive mergers.

The D.C. Circuit's Erroneous Legal And Economic Analysis

From a substantive merger review perspective, the D.C. Circuit's decision turns on its erroneous definition of two antitrust submarkets, core customers and marginal customers, its unwarranted finding that marginal customers cannot protect core customers from anticompetitive pricing, and its

unsupported conclusion that it is possible to price discriminate between these two customer groups.

“Core customers,” as the D.C. Circuit explains, are consumers who are so committed to purchasing from Whole Foods and Wild Oats, that they would continue to purchase from Whole Foods, post-merger, even if prices increased by a small but significant amount. By contrast, the court defines “marginal customers” as consumers who would switch some or all of their purchasing to a conventional supermarket if Whole Foods’ prices increased.

The court dismissed, without explanation, the defendants’ expert testimony that the loss of marginal customers would make it unprofitable for Whole Foods to increase prices, leading the court to mistakenly conclude that Whole Foods’ core customers constitute the relevant antitrust market.

The court’s analysis is fundamentally flawed because it fails to establish how Whole Foods can discriminate in pricing between core and marginal customers. As a matter of basic economics, unless Whole Foods can identify core customers and discriminate in its pricing to them, Whole Foods’ pricing decisions must be based on its sales to both core and marginal customers.

In a retail grocery context, it is virtually impossible to see how core and marginal customers could be charged different prices – absent some perverse customer loyalty program that identifies and charges higher prices to the most loyal customers. Contrary to the D.C. Circuit’s holding, Whole Foods’ marginal customers protect its core customers from increased prices.

Advising Clients In The Wake Of Whole Foods

One traditional task of the antitrust lawyer is to predict for his or her client which agency, FTC or DOJ, is likely to review a proposed transaction. In light of Whole Foods lowered bar for FTC injunctions and FTC’s push to have all merits decisions deferred to its administrative hearing, that task has taken on greater importance.

Now, when a lawyer concludes that a transaction has a substantial likelihood of being reviewed by FTC, the lawyer must advise his or her client that the lower preliminary injunction standard and the FTC’s emphasis on administrative hearings mean that it may take 18 months or more before the client will know if it will be permitted to close the transaction.

Faced with such lengthy uncertainty, if the client is still interested in pursuing the transaction, the prospect of FTC review under this new paradigm may well affect the merging parties’ negotiations over the provisions in the merger agreement dealing with the allocation of the antitrust risks, the

duties of the parties to cooperate in the investigation and contest any challenge, the size of any reverse breakup fee, and the timing and grounds for termination of the merger agreement.

--By Scott M. Mendel, Jeffrey B. Aaronson and Lauren N. Norris, Bell Boyd & Lloyd LLC

Scott Mendel and Jeff Aaronson are partners with Bell Boyd & Lloyd in the firm's Chicago office.

Lauren Norris is an associate with the firm in the Chicago office.

All Content © 2003-2008, Portfolio Media, Inc.