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## Courts Deny Preliminary Injunction Against Organic Foods Retailing Merger Despite Company Documents Suggesting Anticompetitive Intent

### Introduction

In June 2007, the Federal Trade Commission (“FTC”) filed suit in federal district court to enjoin Whole Foods Market, Inc.’s (“Whole Foods”) acquisition of Wild Oats Markets, Inc. (“Wild Oats”) pending completion of an administrative proceeding before the FTC in which the commission’s staff alleged that the acquisition is likely to reduce substantially competition in the market for premium natural and organic supermarkets in cities in which both companies operated stores. In its complaint, the FTC relied heavily upon inflammatory comments from Whole Food’s CEO to company insiders regarding how the transaction would eliminate Whole Foods’ competition and protect the company from the entry of new competition.

In denying the FTC’s request for a preliminary injunction, the trial court made virtually no mention of the candid statements of Whole Foods’ CEO. Instead, the trial court focused on the issue of defining the relevant market. Relying on expert testimony from an economist and a food marketing expert, as well as documents from traditional supermarkets indicating that such retailers were increasing their own emphasis on natural and organic foods, the trial court found that a single relevant product market encompasses all supermarkets, not just premium natural and organic supermarkets. In that broader market, a consolidation of Whole Foods and Wild Oats does not represent a large enough market share to create a danger to competition.

When the FTC appealed the district court’s decision to the District of Columbia Circuit and requested an injunction pending a decision of the appeal, the commission highlighted the trial court’s apparent disregard of the provocative documents. Denying the injunction on August 23, 2007, the court of appeals declared that “[a]lthough the FTC has raised some questions about the district court’s decision,” it failed to show that the district court “abused its discretion by making clearly erroneous factual findings or errors of law.”

Courts have a mixed history with respect to the significance they have placed upon statements from customers or in the merging parties’ documents ascribing adverse competitive effects to the merger under review. In some instances, economic analysis is afforded greater importance than the parties’ lurid language or expressions of concern from unhappy customers who may have a limited factual basis for their concerns.

Nevertheless, the inflammatory language from the Whole Foods CEO to his own board of directors was clearly a critical factor in precipitating the FTC’s challenge to the merger. Although Whole Foods succeeded in diverting the trial court’s attention from the disturbing statements of its CEO to the more mundane matters of its economist’s testimony and industry marketing studies, merging parties would be well-served to be careful about how their personnel describe the competitive impact of proposed mergers. Indeed, although the FTC typically does not persist with administrative challenges to acquisitions for which they

have been denied a preliminary injunction, it will be interesting to see whether they make an exception in this case.<sup>1</sup>

## Background

Whole Foods operates 194 supermarkets in the United States offering an array of conventional, natural, organic, prepared and specialty foods. Wild Oats operates 115 stores in the United States under three different trade names. It sells natural and organic foods, including dry groceries, produce, meat, seafood, dairy, frozen and prepared foods. Its stores are generally smaller than Whole Foods' and its prices higher. Wild Oats and Whole Foods are the only two national-scale premium natural and organic supermarket chains. Their only rivals in that niche are two regional chains.

In a communication to his board of directors describing the transaction, Whole Foods' CEO indicated that the deal would both insulate Whole Foods from immediate pricing competition and erect barriers to entry into Whole Foods' retailing segment:

By buying [Wild Oats] we will . . . avoid nasty price wars in Portland (both Oregon and Maine), Boulder, Nashville and other cities which will harm [Whole Foods'] gross margin and profitability. By buying [Wild Oats] . . . we eliminate forever the possibility of Kroger, Super Value or Safeway using their brand equity to launch a competing natural organic food chain to rival us. . . . [Wild Oats] is the only existing company that has the brand and number of stores to be a meaningful springboard for another player to get into this space. Eliminating them means eliminating this threat forever, or almost forever.

These opinions expressed by the acquiring company's CEO seem to suggest that Whole Foods' and Wild Oats' customers do not readily substitute purchases from traditional supermarkets for the foods they buy from Whole Foods and Wild Oats and that traditional supermarket companies cannot readily diversify into the natural and organic food retailing segment. Nevertheless, the trial court refused to enjoin the transaction on the grounds that Whole Foods and Wild Oats were simply a part of a broad product market "at least" as extensive as "all supermarkets."

The scope of the relevant product market is determined by consumers' willingness to substitute purchases of one product (or in this case from one type of store) for another product (or for purchases from a traditional supermarket) in response to relative changes in the two sellers' prices. In this case, the trial judge found that enough customers were likely to switch a sufficient volume of their purchases from natural and organic supermarkets to traditional supermarkets to force Whole Foods to maintain its current pricing following the transaction. The court pointed to evidence that many individuals regularly buy from both organic supermarkets and traditional supermarkets. Further, supermarket industry documents, as well as testimony from food industry experts, showed both that traditional supermarkets already stock natural and organic foods and that, as a competitive strategy, many of the traditional supermarkets are increasing their emphasis on natural and organic foods. Accordingly, the court accepted the defense expert's critical loss analysis, which showed that if the merged company attempted to increase prices significantly, it would lose so many customers to supermarkets that the price increase would be unprofitable.

The trial court relied heavily on expert economic testimony regarding the substitutability of traditional for natural and organic supermarkets. Both parties presented the testimony of nationally distinguished economists; nevertheless, the court found the defendants' economist more persuasive. Although the FTC's testimony focused on core organic and natural food store shoppers who displayed a willingness to pay higher prices rather than to switch to traditional supermarkets, the judge agreed with the defendants' economist that the focus should be on the number of shoppers who would be willing to shift some or all of their purchases. Based upon 1) the number of crossover shoppers utilizing both traditional and natural and organic supermarkets; 2) the general price sensitivity of the grocery category; and 3) evidence of Whole Foods' use of regular price checks at traditional grocery stores to gauge its price competitiveness, the defendants' expert persuaded the trial court that even a 1% increase in its prices relative to those of traditional supermarkets would cause Whole Foods to lose enough business to its traditional rivals to compel it to rescind the price increase. The court also looked

<sup>1</sup> As of September 4, 2007, the FTC's docket indicates that the administrative case was stayed before trial pending completion of the preliminary injunction hearing in district court, but the case has not yet been dismissed.

to evidence that when Whole Foods opens a store in a new geographic territory in which Wild Oats already operates, much of Whole Foods' sales volume comes from customer shifts from traditional supermarkets, not from Wild Oats. Finally, the court accepted the defense expert's opinion that Whole Foods' and Wild Oats' prices are not systemically lower in locations where they compete with one another than in territories where they do not.

The market definition issue was decisive for the FTC's case. Since the combined market shares of Whole Foods and Wild Oats in a broad market for all supermarkets are not large enough to suggest that the proposed merger is likely to result in higher prices in that overall market, the trial court denied the FTC's request for an injunction.

In asking the Court of Appeals for the D.C. Circuit to grant an emergency injunction pending appeal, the FTC took issue with many of the trial court's findings of fact. It contended that the evidence showed that shoppers do not switch between traditional and natural or organic supermarkets and that Whole Foods' pricing is, contrary to the trial court's finding, higher in localities where Wild Oats is not present. The FTC also emphasized the absence in the district court's opinion of any reconciliation of its findings with, or even any discussion of, Whole Foods' provocative documents. The court of appeals, however, denied the requested injunction, explaining that while "the FTC has raised some questions about the district court's decision" it

has not shown that the trial court "abused its discretion by making clearly erroneous factual findings or errors of law."

## Conclusion

Determining the scope of the relevant market in a merger challenge is an issue of fact for the trial court's determination. In some cases, the courts have relied heavily on comments in the merging parties' documents or testimony from industry participants regarding the scope of the competitive universe or the likely competitive effects of the transaction.<sup>2</sup> In other instances, the courts have found such evidence to be conflicting or unpersuasive and have relied more heavily on economic testimony.<sup>3</sup>

Although in this instance the district court placed more emphasis on expert evidence and certain industry documents which it interpreted as showing an ability of the traditional supermarkets to compete with organic and natural food supermarkets, a different trier of fact could easily have given greater emphasis to Whole Foods' inflammatory documents and perhaps reached a contrary conclusion. Moreover, the FTC's challenge, while focused on those documents, certainly delayed the closing of the transaction and resulted in substantial litigation costs. Parties contemplating acquisitions would be well-served to ensure that their merger-related materials, as well as the business plans and other materials generated in the ordinary course of business, do not unnecessarily understate the breadth and the intensity of the competition they face.

<sup>2</sup> See, e.g., *FTC v. H.J. Heinz Co.*, 246 F.3d 708, 717 (D.C. Cir. 2001); *FTC v. Swedish Match*, 131 F. Supp. 2d 151, 162-168 (D.D.C. 2000); *FTC v. Cardinal Health, Inc.*, 12 F. Supp. 2d 34, 49, 63 (D.D.C. 1998).

<sup>3</sup> See, e.g., *United States v. Oreale Corp.*, 331 F. Supp. 2d 1098, 1136-45, 1153-54 (N.D. Cal. 2004); *FTC v. Arch Coal, Inc.*, 329 F. Supp. 2d 109, 136-142 (D.D.C. 2004).

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