Vegans (and Foodies) Rejoice: D.C. Circuit Rules for FTC in Whole Foods Merger Case

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In a two to one decision, the United States Court of Appeals for the District of Columbia has given the FTC a major victory for its merger enforcement jurisdiction. The Court of Appeals held that the district court had abused its discretion in ruling against the FTC's effort to enjoin the merger of Whole Foods Market, Inc. ("Whole Foods") and Wild Oats Markets, Inc. ("Wild Oats"). In so doing, the D.C. Circuit not only created the very real possibility that Whole Foods may end up having to divest some assets or undertake other actions to cure potential anticompetitive effects from the merger, it also reaffirmed some important principles that apply to mergers in industries involving differentiated products (including most high-technology industries).

As with most merger cases, market definition was the critical issue. The district court had held that the FTC's narrow market definition was entirely unsupportable. The Court of Appeals agreed that the outcome turned on market definition, but sharply disagreed as to the facts and emphasized the relatively relaxed standard that applies to FTC actions to block mergers pending a full trial.

The acquisition agreement was announced in February 2007. After a pre-merger investigation under the Hart-Scott-Rodino Act, the FTC sought a preliminary injunction to block the merger. The FTC alleged that the merger violated Section 7 of the Clayton Act because it combined the two largest companies in the market for premium, natural, and organic supermarkets ("PNOS"). The district court concluded that the FTC's market definition failed because of competition from conventional supermarkets, which sold similar grocery items and were moving increasingly into the natural and organic foods area. Because of that competition, the district court concluded that the merged entity would not be able profitably to impose a small but significant non-transitory increase in price (SSNIP) as required by the DOJ and FTC horizontal merger guidelines.

The district court's decision was surprising. The FTC had reputable economic testimony and evidence supporting its market definition and the potential competitive harm from the merger. Such evidence included the fact that the margins for perishable goods (the bulk of PNOS business) in Whole Food's stores in cities where Wild Oats was present were substantially lower than in other cities. In addition, the FTC had particularly strong email messages from the chairman of Whole Foods talking about the unique position that Wild Oats had as a competitor and predicting that the merger would eliminate significant price competition in several markets. In discussing the evidence, the majority opinion reaffirmed the relevance of potential harm to "core" customers—*i.e.*, a subgroup of "particularly dedicated, 'distinct customers' paying 'distinct prices'" —as a basis for antitrust concern. The Court of Appeals found that the FTC had made a sufficient showing that there is a core group of customers who prefer natural and organic products offered by Whole Foods and Wild Oats to such a degree that they could be subject to price increases that might be avoided by more "marginal" customers.

Moreover, as the Court of Appeals stressed, the law is clear that the FTC does not have to *prove* its case to obtain a preliminary injunction. Congress enacted a special statutory provision governing such cases. 15 U.S.C. § 53(b). The FTC need only raise “questions going to the merits so serious, substantial, difficult[,] and doubtful as to make them fair ground for thorough investigation.” *FTC v. H.J. Heinz Co,* 246 F.3d 708, 714-15 (D.C. Cir. 2001). Although a court must still balance the equities, the Court of Appeals noted that evidence raising such “substantial” questions creates a presumption in favor of preliminary relief. Because it found that the FTC’s market definition failed completely, the district court had not considered the equities at all. On remand, it now must determine whether the public (as opposed to Whole Food’s private) interest is better served by allowing the merged parties to continue acting without restriction while a full trial proceeds.

The purpose of pre-merger notification under the Hart-Scott-Rodino Act is to allow the antitrust enforcement agencies to review mergers before they are completed. Despite the fact that this merger had been completed, the Court of Appeals rejected Whole Foods argument that the issue was now moot, leaving open a range of possible relief on remand to preserve competition pending a full trial on the merits, including an order to hold Wild Oats’ assets separate, limiting further integration, or even requiring partial divestiture. The Court of Appeals chose to remand to the district court to consider the possible equities, but the rather clear message was that, although full relief in the form of prohibiting the transaction is no longer possible, the FTC is likely to get some relief to ameliorate the possible anti-competitive effects of the merger.

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