D.C. Circuit Reverses District Court Denial of the FTC's Efforts to Block Whole Foods' Acquisition of Wild Oats

In *FTC v. Whole Foods Market, Inc.*,[1] a decision that may have significant impact on antitrust challenges to mergers, the United States Court of Appeals for the D.C. Circuit ruled that the district court erred when it denied the government's request to block the combination of two natural and organic supermarket chains last summer. Some of the key aspects of the opinion include a relatively lenient interpretation of the preliminary injunction standard applicable to the FTC and a critique of an economic analysis focused on "marginal" customers relied upon by the lower court in determining the relevant product market.

I. Factual and Procedural Background

The Federal Trade Commission ("FTC") had sought a preliminary injunction to prevent the merger of Whole Foods Market, Inc. ("Whole Foods") and Wild Oats Markets, Inc. ("Wild Oats") to permit the Commission to conduct an administrative hearing to determine if the acquisition violated Section 7 of the Clayton Act.[2] The FTC alleged that the combination would create monopolies in eighteen cities where Whole Foods and Wild Oats were the only premium, natural, and organic supermarkets ("PNOS").[3]

The district court had accepted Whole Foods' contention that it faced competition from traditional supermarkets and concluded that the FTC's preliminary injunction motion must be denied because it was not likely to succeed on the merits in showing that the Whole Foods/Wild Oats merger would have an anticompetitive effect in a market that the court broadly defined to include all supermarkets.[4]

After the district court's decision, but before the transaction closed, the FTC filed an emergency motion in the D.C. Circuit Court seeking to enjoin the closing pending appeal. A three-judge panel denied the motion because the FTC failed to show "such a substantial justification of probable success" to justify the "court's intrusion into the ordinary processes of . . . judicial review."[5] On August 28, 2007, Whole Foods completed its acquisition of Wild Oats.

II. The D.C. Circuit Opinion

On appeal, the D.C. Circuit reversed the district court's order in a split decision, holding that the lower court erred in adopting a market definition based on marginal customers and in ruling that the FTC could not prove a distinct PNOS submarket where the merged firms were the only two significant national players.[6] Circuit Judge Brown wrote the majority opinion, with Circuit Judge Tatel concurring and Circuit Judge Kavanaugh dissenting.

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1 *FTC v. Whole Foods Market, Inc.*, No. 07-5276, __ F.3d __, 2008 WL 2890688, at *1 (D.C. Cir. July 29, 2008).

2 *Id.*

3 *Id*. at *2.

4 *Id*. See *FTC v. Whole Foods Market, Inc.*, 502 F. Supp. 2d 1 (D.D.C. 2007).

5 *FTC v. Whole Foods Market, Inc.*, No. 07-5276 (D.C. Cir. Aug. 23, 2007). The emergency appeal was heard before a panel of Circuit Judges Santelle, Tatel, and Kavanaugh.

6 *Whole Foods Market, Inc.*, 2008 WL 2890688, at *3. The appellate court had decided that the action was not moot even though the merger had already been consummated. *Id*.

The D.C. Circuit stated that the district court applied the correct preliminary injunction standard under Section 13(b) of the FTC Act, which permits the district court to confer preliminary relief "upon a proper showing that, weighing the equities and considering the Commission's likelihood of success, such action would be in the public interest."[7] The court observed that Congress designated a special standard to enable the FTC as an independent administrative agency charged with protecting the public interest to litigate antitrust matters in an administrative setting, and thus, the district court "must not require the FTC to prove the merits."[8] The appellate court stated that that the Commission could meet this standard by "rais[ing] questions going to the merits so serious, substantial, difficult and doubtful as to make them fair ground for thorough investigation."[9]

The D.C. Circuit rejected as inexplicable the FTC's argument that market definition is not necessary to a Section 7 case, noting that the Commission itself made market definition central to its case,[10] but explained that due to the nature of a preliminary proceeding, 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."[11]

In addressing the lower court's rejection of the FTC's proposed relevant market, the appellate court ruled that the district court incorrectly focused on the "marginal" consumers in lieu of "core" consumers who share Whole Foods' core values of healthy lifestyle, ecological sustainability, and a preference for natural and organic foods.[12] The district court had concluded that evidence showing "marginal" customers would switch to shop at conventional supermarkets in the event of a small but significant increase in Whole Foods' prices undercut the FTC's claim that there was a distinct PNOS market. The appellate court disagreed and stated that the FTC presented sufficient evidence of the possibility of a submarket where Whole Foods and Wild Oats competed principally with each other for "core" customers at the same time as they competed with many other supermarkets for "marginal" customers.[13] The Circuit Court held that "core" customers may be an appropriate subject of antitrust concern, particularly when a few firms differentiate themselves by offering a unique package of goods and services and "fringe competition" for individual products within the package may not protect those customers "for whom only that package will do."[14]

In a somewhat different formulation of this theme, the appellate court found that Whole Foods and Wild Oats competed directly with each other in the sale of high-quality perishables and competed with other supermarkets principally on dry grocery items.[15] The FTC's economic evidence showed that the presence of a Wild Oats store near a Whole Foods store had no effect on Whole Foods' pricing margins for dry goods, yet significantly affected margins for perishables.[16]

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7 *Id*. (citing 15 U.S.C. § 53(b)).

8 *Id*. at *3-*4.

9 *Id.* at *3 (quoting *FTC v. H.J. Heinz Co.*, 246 F.3d 708, 714-15 (D.C. Cir. 2001)).

10 *Id*. at *5.

11 *Id*. at *5. In giving the FTC the benefit of the doubt in a "preliminary" proceeding, the court seems to give little or no weight to the information gleaned and analysis undertaken during the typical merger review process under the Hart-Scott-Rodino Act, where the FTC usually conducts an intense investigation involving a "Second Request" lasting for several months before moving for a preliminary injunction.

12 *Id*. at *8-*9.

13 *Id*. at *8.

14 *Id.* at *7.

15 *Id*. at *8.

16 *Id.* This articulation of a narrow, high-quality perishables market does not appear to be directly tied to the core-marginal dichotomy, and the court does not provide guidance to the lower court as to what evidence might show that marginal customers come to Whole Foods or Wild Oats principally to buy dry or canned items.

After finding the FTC met its burden under the "serious questions" standard, the D.C. Circuit remanded the case to the district court to weigh the equities to decide whether injunctive relief of some sort would be in the public interest.[17] The concurring opinion explained that while this balancing test typically favors the public's interest in antitrust protection, substantial parts of Whole Foods and Wild Oats had already merged, and this case might warrant special consideration.[18] Despite the difficulties of "unscrambl[ing] merged assets,"[19] the D.C. Circuit concluded that the district court and FTC could impose appropriate remedies, should the merger be found unlawful in an administrative hearing.[20]

III. The Dissent

Judge Kavanaugh dissented, arguing that the district court properly denied the preliminary injunction.[21] Emphasizing his view that the majority conflates the difference between product differentiation and an antitrust product market, the dissent stated that the pricing evidence showed that Whole Foods prices did not change based on the presence or absence of a Wild Oats store in the area, while conventional supermarkets constrained Whole Foods' prices.[22]

The dissent took issue with the FTC's suggestion that only minimal evidence was necessary to satisfy the showing of a "likelihood of success on the merits" due to the FTC's statutorily assigned role in antitrust merger enforcement[23] and remarked that the court's precedents require that the Commission must have some "solid evidence that the post-merger company could profitably impose a small but significant and nontransitory increase in price"[24] to meet this standard. The dissent also criticized the majority for rendering a different outcome from the D.C. Circuit's year-old, unanimous denial of the Commission's request for an injunction pending appeal, rejecting the argument that a more stringent standard applied to that motion.[25]

IV. Observations

1. This decision strengthens the FTC's argument that it does not have to establish the merits of its case during a preliminary injunction hearing and can evaluate the merger in an administrative trial. This view may have significant impact on the outcomes of mergers investigated by the FTC in contrast to mergers investigated by the Department of Justice ("DOJ"), which, some have argued, is as a practical matter subject to a different standard. The difference in approaches to preliminary injunctions sought by the FTC and DOJ is the product of differences in statutes and procedure. Though these differences were previously de-emphasized, the opinion as well as recent statements by an FTC Commissioner bring the differences into sharp focus.[26] The FTC

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17 *Id*. at *9 ("It remains to address the equities, which the district court did not reach, and see whether for some reason there is a balance against the FTC that would require a greater likelihood of success.").

18 *Id*. at *17-*18.

19 *Id*. at *2 (internal quotations and citations omitted).

20 *Id*. at *2-*3. The majority suggested the courts may, at a minimum, impose a hold separate order and also may order divestitures. *Id*.

21 *Id*. at *19.

22 *Id*. at *20.

23 *Id*.

24 *Id.*

25 *Id*. at *19.

26 *See, e.g.*, J. Thomas Rosch, *A Peek Inside: One Commissioner's Perspective on the Commission's Roles as Prosecutor and Judge*, NERA 2008 Antitrust & Trade Regulation Seminar (July 3, 2008), *at* http://www.ftc.gov/speeches/rosch/080703nera.pdf. The court's opinion seems to lend support to Commissioner Rosch's view.

has statutory authority to secure permanent relief through administrative litigation.[27] Without this authority, the DOJ typically combines the hearing for a preliminary and permanent injunction, resulting in a potentially higher standard of review in the courts as the DOJ must prove its case by a preponderance of the evidence in the court while the FTC may garner preliminary relief based on the "serious questions" standard.[28] This raises substantial policy questions regarding the consistent application of the antitrust laws because certain industries are historically assigned to FTC review (*e.g.*, healthcare and supermarkets) while other industries usually are reviewed by DOJ (*e.g.*, financial services and forest products). For those industries that do not fall into one of those historically allocated categories, this decision emphasizes the impact that clearance to one or another agency may have on the ultimate outcome.

2. The court's opinion rebuts recent statements by an FTC Commissioner that market definition is not necessary for Section 7 merger litigation, although the opinion can be read to suggest that the FTC does not need to conclusively establish the market definition at the preliminary injunction hearing.

3. In those industries where firms sell a bundle or package of goods, often differentiated retailers, the "core" consumer should be considered in defining the relevant market, at least in D.C. Circuit, where the FTC brings many preliminary injunction motions.

4. This case also re-emphasizes the importance of internal company documents describing the rationale for a transaction. The concurrence discussed in detail documents written by Whole Foods' CEO stating that the acquisition will "avoid nasty price wars"[29] and keep Whole Foods' most serious rival from becoming a "meaningful springboard for another player to get into [the natural and organic] space."[30]

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Elai Katz at 212.701.3039 or ekatz@cahill.com or Dean Ringel at 212.701.3521 or dringel@cahill.com.

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27 15 U.S.C. § 45(b).

28 ANTITRUST MODERNIZATION COMMISSION, REPORT AND RECOMMENDATIONS 138 (Apr. 7, 2007). The Antitrust Modernization Commission criticized this difference and recommended amending Section 13(b) of the FTC Act. *Id.* at 141.

29 *Whole Foods Market, Inc.*, 2008 WL 2890688, at *14.

30 *Id.* at *16.