FTC Announces Settlement with Whole Foods

The Federal Trade Commission ("FTC") announced on Friday, March 6, 2009, its settlement of charges that Whole Foods Market, Inc.'s 2007 acquisition of Wild Oats, Inc. violated antitrust laws by significantly hindering competition in the market for "premium natural and organic supermarkets."[1] The settlement requires Whole Foods to divest the Wild Oats brand, as well as "a significant portion of the Wild Oats stores [it] acquired," comprised of "13 currently operating and 19 formerly operating stores,"[2] including stores currently operating under the names of Whole Foods, Wild Oats, and Alfalfa's.[3] The settlement was reached after significant litigation in federal district and appellate courts and administrative courts, more than two years after the announcement of the merger, and over 18 months after the merger closed.

I. Case History

On February 21, 2007, Whole Foods and Wild Oats announced their merger agreement under which Whole Foods would acquire Wild Oats. On June 6, 2007, after an extensive investigation under the rules and procedures of the Hart-Scott-Rodino Act,[4] the FTC filed a motion in the U.S. District Court for the District of Columbia for a temporary restraining order and preliminary relief enjoining the consummation of the merger. The FTC asserted that the transaction would combine the two most significant players in the premium natural and organic supermarkets ("PNOS") market in violation of Section 7 of the Clayton Act.[5] On August 16, 2007, the court denied the motion, finding that "there is no substantial likelihood that the FTC can prove its asserted product market [of PNOS] and thus no likelihood that it can prove that the proposed merger may substantially lessen competition or tend to create a monopoly."[6]

On August 17, 2007, the FTC filed a notice of appeal and emergency motion for an injunction pending appeal with the D.C. Circuit. The D.C. Circuit denied the injunction motion. With no impediment to merger, notwithstanding the pending appeal, Whole Foods closed its acquisition of Wild Oats on August 27, 2007.

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1 Press Release, Federal Trade Commission, FTC Consent Order Settles Charges that Whole Foods' Acquisition of Rival Wild Oats was Anitcompetitive (March 6, 2009), www.ftc.gov/opa/2009/03/wholefoods.shtm.

2 *Id.* At the time the merger was announced, Wild Oats reportedly owned approximately 110 stores operated mostly in the western United States and Canada. Will Swarts, *Market Applauds Whole Foods-Wild Oats Merger*, SMART MONEY, February 22, 2007, http://www.smartmoney.com/investing/stocks/market-applauds-whole-foods-wild-oats-merger-20829/.

3 *In the Matter of Whole Foods Market, Inc.*, Decision and Order, F.T.C. No. 9324, app. A (March 6, 2009).

4 The Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, 15 U.S.C. § 18a (the "HSR Act"). Under the HSR Act, the proposed Whole Foods/Wild Oats transaction could not close until 30 days after the parties substantially complied with the Request for Additional Information (or Second Request), issued by the FTC at the end of the first 30-day waiting period.

5 15 U.S.C. § 18 ("No person shall acquire . . . the whole or any part of the stock or other share capital . . . or any part of the assets of one or more persons engaged in commerce or in any activity affecting commerce, where . . . the effect of such acquisition . . . may be substantially to lessen competition, or to tend to create a monopoly.").

6 *Id.* at 49. The district court determined that "core" customers unlikely to switch from PNOS to other supermarkets in response to price increases were not pertinent to defining the market for PNOS, but rather, the market was defined by "marginal" customers. *Id.* at 35.

In its July 29, 2008 decision, amended and reissued November 21, 2008, the D.C. Circuit reversed the district court's opinion and remanded the case to the district court.[7] The appellate decision does not have a single majority opinion, as Judge Brown wrote the opinion for the court, Judge Tatel wrote a separate concurrence agreeing with the result, and Judge Kavanaugh dissented. Judge Brown's opinion for the court disagreed with the argument that the market was determined by looking at marginal customers, who would buy natural and organic products at traditional supermarkets if PNOSs raise their prices, and focused instead on core PNOS customers, stating that "a core group of particularly dedicated, 'distinct customers,' paying 'distinct prices,' may constitute a recognizable submarket."[8]

Meanwhile, the Whole Foods-Wild Oats merger was well under way. The dissent in the D.C. Circuit case noted that by the time the circuit court reversed the district court opinion, "the merged entity ha[d] shut down, sold, or converted numerous Wild Oats stores and otherwise effectuated the merger,"[9] and the court's "splintered decision," post-closing, was an attempt to "unring the bell."[10]

Following various motions, on January 8, 2009, the district court determined that its remaining task was to weigh any equities against granting an injunction, and if those equities favored the FTC, to determine what relief to grant, such as "rescission of the transaction, or enjoining further integration," while the FTC administrative proceeding determined whether a Section 7 violation occurred.[11]

Instead of returning to district court and continuing the parallel administrative proceeding at the FTC, the parties reached a settlement agreement.

II. The Settlement

The terms of the settlement, embodied in an administrative consent decree, require Whole Foods to divest 32 stores and associated Wild Oats intellectual property, including the use of the Wild Oats name, to an FTC-approved buyer.[12] The FTC stated that the "divestiture will offer relief in 17 of the 29 geographic markets alleged

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7 *FTC* v. *Whole Foods Market, Inc.*, 548 F.3d 1028 (D.C. Cir. 2008). Judge Brown, writing the opinion of the court, stated that "the district court committed legal error in assuming market definition must depend on marginal customers." *Id.* at 1032. Judge Tatel stated he "believe[s] the district court overlooked or mistakenly rejected evidence supporting the FTC's view that Whole Foods and Wild Oats occupy a separate market of 'premium natural and organic supermarkets.'" *Id.* at 1042.

8 *Id.* at 1039. The D.C. Circuit's discussion of relevant market definition and the significance of core customers has been criticized by economists and others. *See, e.g.*, Mark D. Whitener & Larry Fullerton, Moderators, Round Table Discussion, *Developments--and Divergence--in Merger Enforcement*, 23 ANTITRUST 9, 15 (2008) (comments of Gregory K. Leonard) ("The question is not whether there are core or marginal customers; the question is what is the ratio between the two of them, and what does that mean for overall profitability if non-core customers are lost after a price increase.").

9 *Id.* at 1051 (Kavanaugh, J., dissenting).

10 *Id.*

11 *FTC* v. *Whole Foods Market, Inc.*, 592 F.Supp.2d 107, 110 (D.D.C. 2009).

12 Federal Trade Commission, Analysis of Agreement Containing Consent Orders to Aid Public Comment (March 6, 2009), *available at* http://www.ftc.gov/os/adjpro/d9324/090306wfanal.pdf. The consent decree does not expressly provide that the stores must be sold to a single buyer, leaving open the possibility that the divested stores will not be owned by one national chain.

in the amended administrative complaint, eliminating Whole Foods' monopoly position in these markets, and permitting consumers to once again enjoy the benefits of competition between PNOS operators."[13]

III. Observations

Resolution of merger-related anti-competition concerns is routinely negotiated between the government and the merging parties before the matter reaches the federal courts. In those cases where the parties do litigate, the federal district court's decision on a preliminary injunction is often the final word. But in this case, Whole Foods' and the FTC's persistence resulted in a transaction that at first closed after the federal courts refused to enjoin the merger and that subsequently — in the wake of the appellate decision accepting the FTC's narrowly-tailored relevant market — requires a post-consummation divestiture.

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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 e-mail Elai Katz at (212) 701-3039 or ekatz@cahill.com.

[13] *Id.* at 4.