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FTC Wins Significant D.C. Circuit Reversal in Whole Foods/Wild Oats Merger Challenge

The Federal Trade Commission recently won, at least temporarily, a significant victory in its challenge to the $565 million acquisition by Whole Foods Market, Inc. ("Whole Foods") of Wild Oats Markets, Inc. ("Wild Oats"), when the U.S. Court of Appeals for the D.C. Circuit reversed a district court ruling denying the FTC a preliminary injunction. *FTC v. Whole Foods Market, Inc.*, No. 07-7526 (D.C. Cir. July 29, 2008) ("*Whole Foods*"). Given the posture of the case — the parties having already consummated the merger more than a year ago, after the FTC's petitions for a preliminary injunction and then an injunction pending appeal were denied — and the consequences of the decision for the FTC's review of future transactions, we believe *Whole Foods* is likely to be reviewed by the D.C. Circuit sitting *en banc*, or by the Supreme Court. Unless it is vacated or reversed, however, the following aspects of the decision have the most potential to affect companies that are the subject of future FTC merger investigations:

The court has only a limited role when the FTC applies for a preliminary injunction: Unlike the Department of Justice, with which it shares jurisdiction to enforce the Clayton Act, the FTC is an independent agency with the authority to conduct its own quasi-judicial administrative proceedings to assess the legality of a proposed merger. Since such proceedings can take months, or even years, to complete, the FTC typically must apply to a federal district court for a preliminary injunction to bar the merger for the duration of its administrative proceeding, and the FTC did so in the Whole Foods/Wild Oats merger.

Pursuant to 15 U.S.C. § 53(b), to obtain such a preliminary injunction, the FTC must demonstrate that "weighing the equities and considering the Commission's likelihood of ultimate success, [an injunction] would be in the public interest." The *Whole Foods* district court concluded that the FTC had failed to show any likelihood of success. The D.C. Circuit disagreed, however, and both the majority opinion, written by Judge Janet Rogers Brown, and the concurring opinion by Judge David Tatel emphasize two key points: First, since "the effective enforcement of the antitrust laws was Congress's specific public equity consideration in enacting [§ 53(b)]," the FTC will usually need only to "rais[e] questions so serious, substantial, difficult, and doubtful as to make them fair ground for thorough investigation." *Whole Foods*, at 8. Just as importantly, "a district court must not require the FTC to prove the merits, because, in a § 53(b) proceeding, a court is not authorized to determine whether the antitrust laws . . . are about to be violated. That responsibility lies with the FTC." *Id.* Rather, the court must consider all of the evidence presented by the FTC and the defendants merely to determine whether the FTC has raised sufficiently serious questions, while bearing in mind that the FTC "does not need detailed evidence of anticompetitive effect at this preliminary phase." *Id.* at 8-9.

Judge Tatel, in his concurring opinion, went even farther, concluding that the district court had erred when it discounted the expert economic testimony that the FTC had presented in support of its proposed market definition. "Although courts certainly must evaluate the evidence in section [53(b)] proceedings and may safely reject expert testimony they find unsupported," he wrote,

"they trench on the FTC's role when they choose between plausible, well-supported expert studies." *Whole Foods* (Tatel, J., concurring) at 13-14. If Judge Tatel's rule is maintained and adopted, it is likely to embolden the FTC to bring more cases where its staff (including the Bureau of Economics) believes it has a strong case, even where the defendants have presented an alternative expert and theory.

Since the issuance of a preliminary injunction is frequently the "death knell" of a merger, if this ruling stands, it will give the FTC a decided advantage over the Department of Justice or private parties in blocking mergers.

Product markets can be drawn narrowly to protect "core customers," even where "marginal customers" may have reasonable alternatives: The key substantive dispute in *Whole Foods* turned on the question of whether, as the FTC argued, "premium, natural, and organic supermarkets" ("PNOS") constituted a relevant product market of its own, or whether it was simply part of a broader market including, at minimum, all supermarkets. For both the district court and the dissent, the determining factor in favor of the defendants' view was the evidence that "marginal" consumers viewed conventional supermarkets as alternatives to Whole Foods and Wild Oats for many grocery products. The court majority, however, concluded that "core consumers can, in appropriate circumstances, be worthy of antitrust protection," and thus that the lower court had erred in ignoring evidence offered by the FTC to show that Whole Foods and Wild Oats competed with one another, to the exclusion of other supermarkets, for a "core group of customers" who strongly believed in the importance of natural and organic food, health, and ecological sustainability.

The majority and concurring opinions relied on evidence, including FTC studies, showing lower profit margins for "perishables" at Whole Foods stores competing with nearby Wild Oats stores than at those elsewhere and that prices at both Whole Foods and Wild Oats stores declined when other PNOS, but not conventional supermarkets, opened nearby. Further, Whole Foods had projected that if a Wild Oats store were to close, the majority of its customers would switch to a Whole Foods, rather than other nearby supermarkets. For the D.C. Circuit majority, those factors (among others) demonstrated the existence of a distinct "submarket," as described in *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962).

In recent years, most courts and commentators have avoided reliance on *Brown Shoe*, believing that the economically-based criteria in the Federal Trade Commission/Department of Justice Horizontal Merger Guidelines had supplanted the factors the Supreme Court had found significant in *Brown Shoe*. Whether this part of the ruling will be followed in future cases will be very important for the development of merger law.

"Hot documents" can be crucial to the outcome of any antitrust case, including merger litigation: One of the certainties of modern merger practice is that, as a result of the ever-larger productions required to comply with HSR Second Requests, the agencies have access to a huge amount of company documents relating to the transaction under review. As was much publicized at the time, the FTC introduced into evidence at the initial preliminary injunction hearing a number of colorful documents created by Whole Foods' CEO, including several in which he described Wild Oats as his company's only real competitor in the natural/organic

market and the merger as a way of eliminating that competitive threat forever. Unfortunately, such documents are not uncommon in the business world, and *Whole Foods* is a reminder of the need to counsel executives to avoid, as much as possible, hyperbolic or "macho" language, particularly in documents that are created in connection with a potential transaction.

The presence of "hot documents" has always been a key factor both in determining whether an HSR investigation will continue and in the government's ultimate success if it challenges a merger. Combined with the lower bar the *Whole Foods* decision sets for FTC preliminary injunction applications, however, their significance is only likely to increase.

Companies should be mindful of the difference between the ability to close a transaction and the ability to close a transaction without undue risk: *Whole Foods* reached the court of appeals in an unusual procedural posture since the FTC had pursued its appeal of the denial of a preliminary injunction even after the parties had consummated the merger; as the concurring opinion notes, in previous cases in which the D.C. Circuit had reversed the denial of an FTC request for preliminary injunction, either the district court or the court of appeals itself had granted an injunction pending appeal, which was denied in *Whole Foods*. Now, Wild Oats no longer exists as a distinct entity, many of its stores have been reflagged as Whole Foods, and the integration of the two chains is far along. The majority took note of those concerns, but held that the FTC was entitled to apply to the district court for whatever preliminary injunctive relief was still possible, and remanded to the district court for a consideration of the equities of such relief. It is clear, however, that whatever post-closing relief the FTC now obtains is likely to be much more complicated and intrusive for the parties than a preliminary injunction or hold separate order would have been prior to closing. There are, of course, many benefits to closing transactions as quickly as possible, but *Whole Foods* highlights the need for a potentially difficult assessment of whether the government is likely to proceed with, and ultimately prevail on, an appeal, and whether it is worth assuming the risk of having to undo the transaction at a later date (either preliminarily or permanently).

Can market definition be avoided? On appeal, the FTC suggested for the first time that it did not have to define an appropriate line of commerce if it could show actual anticompetitive effect. The court of appeals disagreed, holding that because the FTC had not raised or argued the position below and, on the contrary, had made its "PNOS" market definition a "key" element of its case, it could not avoid the market definition exercise. However, the court noted in dictum that market definition will not always be crucial to the FTC's ability to obtain preliminary injunctions in other cases, as the FTC is only required to raise "substantial doubts" about a transaction to prevail at the preliminary injunction stage. The court pointed out that in appropriate cases, including perhaps all so-called "unilateral effects" cases involving close competitors offering differentiated products, it might not be necessary to define markets at all, and in other cases, not necessary to do so at the preliminary injunction stage of the case. If this precedent is followed in the future, it will fundamentally alter the nature of FTC merger litigation, since in the past it has been the norm for such cases to turn on market definition.

Final Thoughts: Given the significance of the case, the fact that the parties have already closed the transaction, and the majority's approach to the FTC's preliminary injunction standard and market definition, there is a good chance that the D.C. Circuit will grant rehearing *en banc*

and/or that the Supreme Court will grant *certiorari*, if the parties do not work out a settlement before then. Particularly if the Supreme Court were to grant review, *Whole Foods* has the potential to be one of the most important merger cases in recent years. In the meantime, however, the FTC is likely to view *Whole Foods* as greatly strengthening its hand in dealing with future mergers, and companies would be wise to adjust their assessments of antitrust risk appropriately.

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