Will Antitrust Reviews Of Supermarket Deals Change?

Law360, New York (May 22, 2014, 1:19 PM ET) -- The last year has seen a noticeable uptick in supermarket deal activity. Some commentators are even beginning to compare the recent surge of acquisition activity to the last merger wave that started in the late 1990s, a time of large deals and increased market-share concentration for the supermarket industry. That wave, however, also resulted in increased antitrust oversight by the Federal Trade Commission, intense investigatory action, and numerous consent decrees and divestitures. Many in the industry learned painful lessons about how FTC scrutiny could delay, threaten, change or even derail deals.

Merger activity often occurs in cycles, and perhaps a new one is starting for companies that compete to sell consumable goods to the public. It is a good time to ask, then, whether and how antitrust may play a role in shaping how deal activity plays out.

Antitrust M&A Legal Standards

Antitrust law at its most simple is about protecting competition. For merger activity, this means that deals among competitors often receive antitrust scrutiny by either of the two federal agencies empowered to investigate the possible competitive effects of a deal — the U.S. Department of Justice's Antitrust Division or the FTC. Traditionally, the FTC has reviewed supermarket and retail mergers.

Under the relevant legal standard set by Section 7 of the Clayton Act, either agency may seek an injunction to block a deal where the effect of such acquisition "may be substantially to lessen competition, or to tend to create a monopoly." And while the agencies use a highly complex set of principles and proposed tests set forth in their jointly issued Merger Guidelines, a starting assumption is that mergers or acquisitions between competitors lessen competition, as a reduction in the number of active competitors in a marketplace is presumed to decrease the overall competitive dynamics in that market. After a series of litigated merger cases, federal courts have given the Merger Guidelines authoritative weight.

The antitrust agencies are furthered empowered in the deal process by the Hart-Scott-Rodino Act, which requires parties involved in the most significant deals to seek premerger clearance. The premerger process starts with filing materials with the antitrust agencies to allow them an initial opportunity to scrutinize a merger or acquisition and might lead to a full-scale investigation. Critically, until this process plays out, parties are prohibited from closing deals.

Supermarket Deals Are Closely Scrutinized

For past supermarket deals, antitrust scrutiny has given rise to a set of quasi-precedents on how competitor combinations are analyzed and the process by which deals are examined.

On the merits, the FTC has developed an almost paint-by-number approach to its scrutiny. Supermarket competition is broken down into "product" and "geographic" market dimensions and likely competitive effects are assumed based largely on the combined market share.

In FTC matters, the supermarket "product" is strictly defined and limited to traditional one-stop-shop grocery stores that sell the full array of grocery goods, i.e., "one-stop shopping." Mass merchandisers, convenience stores, big-box drugstores, dollar stores, small grocers and other less traditional outlets that have been increasingly selling food and consumables (i.e., classic supermarket products) are ignored. The supercenter was also ignored — until the FTC had to concede, grudgingly, what was obvious to the entire industry — supercenters are a highly disruptive force. However, only part of supercenter sales were included "in the market."

As one example, in 2013, Bi-Lo Holdings (the parent company of the BI-LO and Winn-Dixie banners) agreed to acquire 154 stores located in Florida, Georgia and South Carolina from Delhaize America. The FTC investigated the deal and forced the parties to divest 12 stores. In explaining its position, the FTC noted that "hypermarkets," which it termed as supermarkets located within stores like Wal-Mart, were competitors "within the market." On the other hand, other grocery-like formats without a full complement of consumables were not. Without one-stop shopping, the FTC found, consumers would not view these retailers as adequate substitutes. It further noted that "although these other types of retailers offer some competition to supermarkets, supermarkets do not view them as providing as significant or close competition as traditional supermarkets."

Geographic markets have been defined both on a store-by-store basis and by "clusters" of stores. While the FTC claims that markets are defined based upon consumers' shopping travel patterns, this approach was highly flexible in finding competitive overlaps. By using both approaches, the FTC was often able to identify single store overlaps — which they would characterize as "mergers to monopoly" — or broader city, county, region or even state overlaps. Larger "overlaps" maximized the size and scope of the potential competitive problems.

In settling the 2013 investigation of Albertsons' acquisition of United's 51 stores in Texas, the FTC focused on narrow, geographic overlaps. It defined two localized markets that were portions of two relatively small Texas towns. By defining the geographic market in this way, the FTC found that the deal resulted in a reduction of three competitors in those markets to only two.

Finally, for each set of identified competitive overlaps, the FTC appeared to apply certain market-share rules of thumb. In general — but not always — an overlap that resulted in less than a calculated 30

percent share and left two or more other strong competitors was unlikely to be challenged. A combination with a calculated share of over 50 percent was presumptively anti-competitive. Cases in the middle of the two positions remain in a gray area.

The FTC Review Process

The application of these approaches affects the review process. In deals involving hundreds of stores or more, a detailed and lengthy analysis has to occur. And FTC prosecutors have significant flexibility in applying the tests to help argue for numerous competitive fixes. Single-store overlaps, for example, often can occur in a large deal, and the FTC can threaten to enjoin entire deals to fix a handful of problematic locations. The FTC prosecutor also can use the leverage of one competitive overlap to argue that other competitive overlaps — often with smaller combined shares — need to be addressed too. Deals often result in complicated divestiture agreements in which each set of different identified store overlaps has to be remedied — often by selling them at fire-sale prices to pre-approved, upfront buyers — before the larger deal can go through. Each and every piece of the divestiture puzzle needs to fit before the full deal can be consummated.

During investigations, FTC lawyers also often would reject new competitive arguments or approaches by referring to past case "precedent." On the other hand, over time the FTC also proved more than willing to change or even ignore past precedent when it identified what it viewed as unique competitive concerns raised by each new deal.

Mass-market stores were not "in the market" until the FTC argued they were when Wal-Mart, which operates in many different formats, acquired a traditional supermarket operator, Amigo, in Puerto Rico. A high-end outlet operating under a high-low pricing approach with significant services was counted equally as an everyday-low-price operator with a no-frills approach until the Whole Foods/Wild Oats merger was challenged in federal court. The FTC accused these two high-end chains of being "uniquely close competitors" that operated in an alleged antitrust-relevant market composed of "premium natural and organic supermarkets."

As a result, while major industry participants can analyze potential deals under past approaches, there always is some uncertainty over whether a specific deal would be treated like its predecessors.

The reality is that supermarket competition — and retailing in general — is viewed by the FTC as an essential, consumer pocketbook area. Unlike many of the more esoteric or intermediary goods markets looked at by the FTC, food is a day-to-day essential for all consumers. Moreover, those consumers include FTC lawyers and staff. Thus, for institutional — and perhaps political — reasons, the FTC is highly cautious in approving deals and should be assumed always to be inclined to find a way to justify imposing a remedy in any case involving merging supermarket or retail competitors.

Looking Forward

What does this history mean for current and future deals?

- Antitrust scrutiny will be driven by deal activity. A paucity of recent investigations (and divestitures) is a product of the deal flow — not a different regulatory approach.
- The antitrust analysis will at least start based upon past precedent in merger reviews — not where the industry may be today.
- The FTC will err on the side of opposing a deal and seeking fixes. Indeed, despite the history of intense antitrust oversight and large divestures in past supermarket deals, the FTC in late 2012 issued an economic working paper that claimed that increased supermarket concentration over a 10-year period (1998 through 2007) led to measurable increases in consumer prices, despite a history of rigorous enforcement and negotiated settlements.
- Companies and their deal advisers and lawyers should preplan for antitrust scrutiny by studying past precedent. Deals can be structured to eliminate or address obvious antitrust overlaps and avoid long and costly investigations. But advisers also have to be sufficiently nimble in understanding how a particular deal may present an opportunity for the FTC lawyers to change course or establish new precedent.
- Companies and their counsel should argue their particular facts about competitive effects but recognize that arguments alone will not be availing. To be effective, arguments need to be backed up by evidence and probably detailed economic analysis and presentations. Arguing, for example, that big-box retailing has increased competitive pressures on supermarket operators will likely have little effect. Documenting and measuring actual competitive responses might be persuasive.

Is the past prologue? Only time will tell. But at least a sensible starting point for understanding deal risk presented by antitrust issues is to study the existing agency roadmap laid out in past settlements and consent decrees.

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