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New Merger Guidelines Feature Prominently in FTC Handbag Merger Challenge

- The FTC recently sued to block Tapestry's proposed acquisition of Capri, alleging that the effect of the combination of the companies' handbag brands may be to substantially lessen competition.
- The complaint relies heavily on the December 2023 FTC-DOJ Merger Guidelines and presents one of the first opportunities for a federal court to weigh in on the validity of several theories of harm described in those guidelines.

On April 22, 2024, the Federal Trade Commission (FTC) initiated administrative and federal district court proceedings to block Tapestry, Inc.'s (Tapestry) proposed \$8.5 billion acquisition of Capri Holdings Limited (Capri), which, if consummated, would bring the Coach, Kate Spade and Michael Kors handbag brands together under the same holding company. The FTC alleges that the execution of the parties' merger agreement was, and the proposed acquisition would be, an "unfair method of competition" in violation of Section 5 of the FTC Act and that the effect of the proposed acquisition "may be substantially to lessen competition, or to tend to create a monopoly" in violation of Section 7 of the Clayton Act. In its complaints, the FTC asserts several theories of competitive harm described in the new December 2023 FTC-DOJ [Merger Guidelines](#), and this litigation presents one of the first opportunities for a federal court to weigh in on the validity of those guidelines. The court has scheduled an evidentiary hearing on the FTC's motion for preliminary injunction to begin on September 9.

The FTC's Allegations

The FTC alleges that the proposed acquisition would violate the law in several ways: (i) it would result in the elimination of significant head-to-head competition between the handbag brands; (ii) it would significantly increase concentration in an alleged market for "accessible luxury" handbags in the United States; (iii) it would result in significant effects on the wages, benefits and working conditions of employees of the merging parties; and (iv) it is part of Tapestry's "anticompetitive pattern and strategy for acquisitions." Each of these theories of competitive harm is discussed in the 2023 Merger Guidelines.

In light of the heavy reliance on the new merger guidelines, it is notable that the FTC's vote to commence the litigation was 5-0, meaning that the two recently sworn-in Republican commissioners voted with their Democratic colleagues. However, this does not necessarily mean that all of the commissioners agreed on every theory of harm asserted. Indeed, according to the FTC's [press release](#), Commissioner Holyoak voted in favor of the enforcement action "because she has reason to believe that the merger will eliminate substantial head-to-head competition between the parties." The statement does not elaborate on Commissioner Holyoak's views on any of the other theories of harm.

Elimination of Direct Head-to-Head Competition

Guideline 2 of the 2023 Merger Guidelines outlines how the agencies look at the degree of competition between the merging firms to predict whether a merger may substantially lessen competition in violation of Section 7. Similarly, under the prior [Horizontal Merger Guidelines](#) the agencies also "consider[ed] whether the merging firms have been . . . substantial head-to-head

competitors.” The discussion in the new guidelines lists a “variety of indicators to identify substantial competition,” including evidence that the two firms make strategic decisions in the ordinary course of business with reference to each other and evidence of “competitive actions by one of the merging firms” impacting the other merging firm.

Product Competition

Consistent with Guideline 2 of the 2023 Merger Guidelines, the FTC alleges that the proposed acquisition would eliminate head-to-head competition between Coach, Kate Spade and Michael Kors and this would result in “increased prices, fewer discounts and promotions, [and] decreased innovation . . .” The FTC cites internal documents that purport to show Tapestry and Capri closely monitoring each other’s business strategies and responding to the other’s competitive decision-making. Coach, Kate Spade and Michael Kors, according to the FTC, have a “laser-like focus on each other” for pricing and discounting, marketing, brick-and-mortar stores and innovation and design. The FTC goes on to allege that Tapestry “intends to raise prices for Michael Kors through reducing discounts and promotions and pulling back on wholesale.”

Labor Competition

Again reflecting Guideline 2, the FTC also alleges that the proposed acquisition would eliminate head-to-head competition between the companies for workers, resulting in “reduced wages and employee benefits.” Among other things, the FTC alleges that the companies compete with each other for workers on several dimensions, including work environment, compensation, leave policies, promotions and training programs. The FTC argues that the proposed acquisition would result in “substantial effects on employment wages, benefits and conditions for people who work for or seek employment from the parties and their brands.” The focus on labor is also consistent with Guideline 10, which notes that the FTC and DOJ will examine whether a merger between “buyers of labor” may substantially lessen competition and result in “lower wages or slower wage growth, worsening benefits or working conditions, or other degradation of workplace quality.” Labor was not mentioned in the previous merger guidelines.

Significant Increases in Concentration

Consistent with Guideline 1 of the 2023 Merger Guidelines, the FTC alleges that the proposed acquisition is presumptively unlawful because it would significantly increase concentration in the “accessible luxury” handbag market – a moniker the complaint notes Coach “gave birth to” two decades ago. This is the only theory in the complaint that explicitly relies on a defined product market. In alleging this purported market, the FTC relies heavily on the parties’ ordinary course business documents, including those that describe “accessible luxury” as a distinct handbag product with a distinct customer base in contrast with the “mass-market” and “true luxury” segments of the handbag industry.

Market Definition

Consistent with the 2023 Merger Guidelines, the FTC’s product market definition is based on evidence of substantial competition between the merging parties for the sale of “accessible luxury” handbags as well as evidence of observed market characteristics (“practical indicia”). For the latter, the FTC relies on a range of evidence, including usage of the term in the parties’ 10-Ks and earnings calls as well as more broadly by industry participants such as the press and analysts. Lastly, the FTC outlines the various “peculiar characteristics” of the “accessible luxury” handbag. These include unique quality materials and craftsmanship, discounting and promotional activity, omnichannel approach and sales experiences, and production facilities that set it apart from the other segments of the handbag industry.

Asserting that “a relevant antitrust market can be defined solely based on qualitative evidence regarding market characteristics,” the FTC devotes just a single paragraph of its complaint to the hypothetical monopolist test, which was a mainstay of market definition in under the old merger guidelines. The FTC notes that a relevant product market is properly drawn if a “single firm . . . seeking to maximize profits controlled all sellers of a set of products or services and likely would undertake a small but significant and non-transitory increase in price or other worsening of terms” (SSNIPT). (The “or other worsening of terms” language” is new.) The FTC summarily states that a “hypothetical monopolist of accessible luxury handbags likely would undertake a SSNIPT on consumers” and could do so profitably. This is because the FTC states that consumers would not switch to mass-market or true luxury handbags “in sufficient volumes to render the price increase unprofitable.”

Market Concentration

Referencing the Herfindahl-Hirschman index (HHI) measure of market concentration, the FTC argues that the proposed acquisition will both (1) create a firm with a market share over 30 percent and increase the HHI by more than 100 points and (2) is likely to create or enhance market power as the post-merger HHI exceeds 1800 and increases the HHI by more than 100 points. While redacting the purported combined Tapestry/Capri market share, the FTC argues that Tapestry's post-acquisition market share of the "accessible luxury" handbag market would be "considerably more than 30 percent."

History of Serial Acquisitions

Consistent with Guideline 8 of the 2023 Merger Guidelines, the FTC argues that Tapestry has engaged in an "anticompetitive pattern and strategy of acquisition in the accessible luxury market" with plans to continue this strategy as part of its proposed acquisition of Capri. Consistent with Guideline 7 of the 2023 Merger Guidelines, the FTC notes that over the last decade, Tapestry has already consolidated Coach, Kate Spade and Stuart Weitzman and that Capri has consolidated Michael Kors, Versace and Jimmy Choo. As a result, the FTC argues that Tapestry will become an "accessible luxury handbag powerhouse" that will enable it to continue to acquire rivals and entrench its position (consistent with Guideline 6 of the 2023 Merger Guidelines).

Significance

New Versus Old Merger Guidelines

One way to measure the effect of the new merger guidelines is to look at what would have happened but for their release. When the 2023 Merger Guidelines were issued, the consensus was that over time they could lead the government to challenge certain deals that likely would not have been subjected to agency action in the past. The Tapestry-Capri challenge is one of the first data points that could potentially be used to test a hypothesis about the effect of the new guidelines. Redactions in the complaint prevent a thorough analysis of whether this complaint would have also been brought under the old guidelines, but the exercise in comparison is nevertheless informative.

Both the old and the new merger guidelines describe the potential for competitive harm – and thus the potential for a merger challenge – where a merger would lead to a loss of substantial head-to-head competition. (The 2023 Merger Guidelines state that this "can demonstrate that a merger threatens competitive harm independent from an analysis of market shares.") While the loss of substantial head-to-head competition could very well have supported a challenge under the old guidelines, it is fair to say that it is unlikely that a complaint would have been brought on that ground alone. As in the current complaint, allegations about the loss of head-to-head-competition would likely have been accompanied by allegations about an increase in market concentration.

This leads us to the only theory of harm in the complaint that requires defining a market. This is notable because market definition has long been the lynchpin of merger analysis and often is the most important point of contention in merger challenges – a point at which cases are won or lost. In this case, while market definition is important, it is not central to the FTC's case (assuming the court agrees that the other theories of competitive harm are viable).

Both the old and new guidelines indicate that a merger would violate the law if it increases market concentration above a certain threshold (though the threshold in the new guidelines is appreciably lower). In order to measure market concentration, one must define a relevant market. Both the old and new guidelines focus on the "hypothetical monopolist test" (HMT) as a tool to define a market. Evidence of substantial head-to-head competition is also relevant to the task in both sets of guidelines. The new guidelines, however, also state that, under *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962), a "relevant market can be identified from evidence on observed market characteristics ('practical indicia'), such as industry or public recognition . . . , the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors." In the old guidelines, these factors were relevant, but mainly as inputs into the HMT. In the new guidelines, they serve as a standalone method for market definition.

To support its purported "accessible luxury" handbag market, in the Tapestry complaint, the FTC relies mainly on allegations about head-to-head competition and practical indicia, but it does also allege, albeit in a fairly conclusory way, that the market is

supported by the HMT. It is therefore unclear whether, but for the new merger guidelines, the FTC would have found a different relevant market and thus declined to challenge this merger. Put another way: Would *this* FTC have found the same relevant market using the *old* merger guidelines? Perhaps. Would a *different* FTC have found a different relevant market using the *new* guidelines? Perhaps.

Assuming the market definition is proper (which is highly contestable), Tapestry's acquisition of Capri meets the threshold of presumptive illegality in the new guidelines, according to the complaint. However, based on the complaint, one cannot determine whether the higher threshold in the old guidelines would have been met because the market shares relevant to the calculation are redacted. Without knowing these numbers, it is difficult to say whether the old guidelines would have supported a challenge.

The ensuing litigation may shed more light on the question of whether or not this challenge, centered as it is in the new guidelines, would also likely have been brought under the old guidelines. Perhaps more importantly, though, this litigation may reveal at least how one federal court views the 2023 Merger Guidelines as a statement of merger law. In any event, it will likely take several years and a number of litigated merger challenges to get a real sense of whether the 2023 Merger Guidelines reflect the current state of merger law as interpreted by the courts or whether they are instead a normative set of policy preferences.

Ordinary Course Documents

This action is also notable because it once again highlights the weight the FTC places on contemporaneous, ordinary course business documents when initiating a merger challenge. Throughout the complaint, the FTC cites internal business documents as purported evidence of the parties "closely monitoring each other's business strategy," the basis for the "accessible luxury" handbag market, Tapestry's purported decades-long acquisition strategy to "solidify its dominance in accessible luxury," and Tapestry's post-acquisition plans to raise prices for Michael Kors.

Enforcer Divergence

One final note: the European Commission (EC) and Japan both recently cleared Tapestry's proposed acquisition last week. In its [press release](#), the EC noted that it "concluded that the notified transaction would not raise competition concerns in the European Economic Area (EEA), given (i) the companies' relatively low combined market shares in the EEA; (ii) the limited role that Coach and Kate Spade New York have in the EEA; and (iii) the presence of a large number of alternative suppliers in the EEA."

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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