On 29 July 2008, in a major victory for the Federal Trade Commission (‘FTC’), a divided three-judge panel (Brown, Tatel, and Kavanaugh) of the US Court of Appeals for the District Columbia Circuit reversed a district court’s ruling that had denied the FTC’s request for an injunction against the merger of Whole Foods and Wild Oats. The DC Circuit ruled that the district court had erred when it determined that the product market comprised all supermarkets rather than just premium natural organic supermarkets (‘PNOS’). Whole Foods sought a rehearing en banc. In a highly unusual move, on 21 November 2008, all three judges who participated in the July 2008 decision issued new opinions, with Judge Tatel no longer ‘joining’ Judge Brown’s ‘judgment of the court’ so as to create a ‘majority opinion’, but choosing instead merely to concur with Judge Brown that the district court erred when overlooking or mistakenly rejecting evidence supporting the FTC’s market definition. Simultaneously with the issuance of these new opinions, the DC Circuit indicated that a majority of the appellate panel reaffirms that the proper role of the district court in considering whether to grant the Commission’s request for a preliminary injunction is limited to whether the case raises sufficiently serious and substantial issues so as to make them fair grounds for litigation during the full trial on the merits in the administrative proceedings. Judge Kavanaugh correctly concludes that ‘[a]t a minimum, this confused decision will invite years of uncertainty over what the holding of this case is – a separate but important problem with the Court’s approach’.

Background
On 21 February 2007, Whole Foods, the largest US supermarket chain focusing on natural and organic products, announced its proposed acquisition of Wild Oats, the second-largest US operator of such supermarkets. The parties responded to the FTC’s
Request for Additional Information and Documentary Material, better known as a ‘Second Request’, quickly, resulting in the waiting period’s expiration approximately four months from the transaction’s announcement. On 6 June 2007, the FTC filed a complaint in the US District Court for the District of Columbia, and sought a temporary restraining order and preliminary injunction to block the merger pending an FTC administrative trial on the merits. After expedited discovery, Judge Paul L Friedman held a two-day hearing and, on 16 August 2007, issued an opinion denying the FTC’s motion for a preliminary injunction.4 In doing so, Judge Friedman found that the relevant product market included traditional supermarkets and that the FTC failed to establish the required likelihood of success on the merits.5

On 23 August 2007, the DC Circuit denied the FTC’s motion for an injunction pending appeal on the ground that the FTC had failed to meet its burden to show that the district court abused its discretion by making erroneous factual findings or errors of law.6 On 28 August 2007, the transaction closed.

The FTC then took a highly unusual step. It pursued the appeal, even though the deal had been consummated.7 Typically, the agency has dropped appeals where the courts have allowed a transaction to close, even where it has continued to challenge the transaction on the merits in an administrative proceeding. The Whole Foods district court decision was the latest in a series of preliminary injunction losses suffered by the FTC on the basis that it had not met its burden of proof. The FTC’s purpose in pursuing the appeal was not simply to challenge the transaction, but to clarify the burden of proof that it would need to meet in all future merger challenges.

The FTC’s appeal thus raised a broad challenge to what it perceived to be the district court’s lack of appropriate deference to the FTC’s authority under the Federal Trade Commission Act (FTC Act). The FTC asserted that section 5 of that statute makes the FTC the ultimate adjudicator of whether transactions within its jurisdiction violate the Clayton Act, subject only to review in the courts of appeals.8 The FTC noted that the statute gives the FTC the legal authority to condemn a merger through administrative proceedings, regardless of whether it succeeds in persuading a district court to issue a preliminary injunction. Thus, the FTC argued the purpose of a preliminary injunction is merely to preserve the practical ability of the FTC to exercise its ultimate power to enforce the law. As a result, the FTC asserted that when it asks a district court preliminarily to enjoin a merger, it should not be subject to a standard as exacting as that applied to the Department of Justice (DOJ) because the ultimate decision maker in a challenge by the DOJ is the court, not the DOJ. The FTC further argued that the district court in Whole Foods ‘flouted’ the statutory standard and ‘effectively usurped the adjudicative role of the Commission’ by ‘repeatedly impos[ing] on the Commission a burden of making its case on the merits, as if the proceedings before the district court were the plenary adjudication’, and that it ‘compounded its error, moreover, by ruling that…it had no need to consider whether the public interest supported issuance of a preliminary injunction’.9

The FTC has advanced the same argument elsewhere. In a 3 July 2008 speech, FTC Commissioner J Thomas Rosch suggested that the FTC had ‘arguably abdicated’ its responsibility to judge unfair competition cases – which he contends includes merger challenges – and allowed that responsibility to fall onto federal district courts. Commissioner Rosch believes that Congress did not originally intend such an outcome.

Congress concluded that it was in the public interest to grant this judicial authority to the Commission instead of to the federal district courts. That too is apparent from the language of section 5(b). Nowhere in that provision is concurrent judicial authority – or any authority to review Commission decisions – given to the federal district courts. To the contrary, the power to review Commission decisions is given exclusively to the federal appellate courts. Again, this was no accident. In proposing the new agency to the House of Representatives, President Wilson expressed scepticism that federal district courts were equipped ‘to adjust the remedy to the wrong in the way that will meet all other circumstances of the case’ and confidence that the Commission could and would do so.10

Commissioner Rosch posits that ‘for the last five years, the Congressional intent has arguably been turned on its head. First, in Arch Coal, and more recently in the challenges to the Western/Giant and Whole Foods/Wild Oats mergers, federal district courts in section 13(b) proceedings made the Commission’s likelihood of success on the merits at a plenary trial, instead of the public interest, the ultimate issue. Indeed, in Arch Coal and Whole Foods the courts essentially turned proceedings on the Commission’s application for a preliminary injunction into plenary trials on the merits’.11

Section 13(b) authorises the FTC in a ‘proper’ case to seek permanent injunctive relief against entities that have violated or threatened to violate any of the laws it administers. The statute provides an injunction may be granted only ‘[u]pon a p...
of success on the merits. The circuits have not reached agreement on what the FTC’s burden of proof should be. Reference to a ‘public interest’ criterion has resulted in some circuits relaxing the standard imposed on the FTC from the traditional equitable standards applicable to the DOJ and other plaintiffs in an injunctive proceeding. Some courts have referred to a requirement that the FTC show a ‘reasonable’ or ‘substantial’ likelihood of success on the merits, some have required that the FTC show a ‘fair and tenable chance’ of ultimate success on the merits, while others merely require that the FTC raise serious, substantial, and difficult questions going to the merits. Before determining that the FTC has met its burden, courts have looked at the strength of the FTC’s arguments and asserted facts, and it has not been unusual for district judges to hold evidentiary hearings over days or even weeks, to determine whether the record warrants an injunction.

Prior to Whole Foods, the definitive word in the DC Circuit on what the FTC needed to show to satisfy the section 13(b) standards came in the 2001 decision in FTC v HJ Heinz Co.

The Congress determined that the traditional standard was not ‘appropriate for the implementation of a Federal statute by an independent regulatory agency where the standards of the public interest measure the propriety and the need for injunctive relief’. The courts had evolved an approach to cases in which government agencies, acting to enforce a federal statute, sought interim relief. The agency, in such cases, was not held to the high thresholds applicable where private parties seek interim restraining orders. The FTC is not required to establish that the proposed merger would in fact violate section 7 of the Clayton Act. That adjudicatory function is vested in the FTC in the first instance.

The DC Circuit then discussed what it means, in the context of the FTC, to determine the likelihood of success on the merits:

‘This court and others have suggested that the standard for likelihood of success on the merits is met if the FTC has raised questions going to the merits so serious, substantial, difficult and doubtful as to make them fair ground for thorough investigation, study, deliberation and determination by the FTC in the first instance and ultimately by the Court of Appeals,…In United States v Baker Hughes Inc we explained the analytical approach by which the government establishes a section 7 violation. First the government must show that the merger would produce “a firm controlling an undue percentage share of...
decisions and in and of itself is not alarming.

Judge Brown’s opinion then potentially creates a lopsided playing field in favour of the FTC. For instance, the decision indicates that: ‘[A] district court must not require the FTC to prove the merits’, because the ‘responsibility’ under the FTC Act ‘to determine whether the antitrust laws... are about to be violated... lies with the FTC’. In particular Judge Brown indicates ‘[t]he district court should bear in mind the FTC will be entitled to a presumption against the merger on the merits, and therefore does not need detailed evidence of anti-competitive effect at this preliminary phase’. 

Judge Brown also notes that ‘[t]o be consistent with the [FTC Act, 15 USC] § 53(b) standard, [the district court’s] decision must have rested on a conviction the FTC entirely failed to show a likelihood of success’. Judge Brown even states that the FTC need not settle on a single product or geographic market definition or a theory of harm at the preliminary injunction phase. The FTC, according to Judge Brown, need not commit to a specific relevant product and geographic market definition because ‘it is quite conceivable that the FTC might need to seek such relief before it has settled on the scope of the product and geographic markets implicated by a merger’. Rather, the FTC ‘just has to raise substantial doubts about a transaction. One may have such doubts without knowing exactly what arguments will eventually prevail’. According to Judge Brown, if, and only if, the district court’s certainty in rejecting the FTC’s argument was justified, would it be appropriate for the court not to balance the likelihood of the FTC’s success against the equities. Judge Brown then finds that the district court analysed the product market incorrectly.

Judge Brown’s decision to reverse the district court rests on a theory of competitive harm that was never raised by the FTC or its expert witness. The decision engages in a results-orientated analysis (the hallmark of cases from the 1960s) that contradicts some of the most significant developments in antitrust jurisprudence over the last three decades. Although some of the language used in the opinion is found in earlier decisions including the *Heinz* decision, the overall thrust of the court’s procedural analysis appears to be a marked shift in favour of the FTC.

Judge Tatel’s opinion concurring in the judgment suffers from many of the same problems as Judge Brown’s opinion, and, therefore, is also troubling. Judge Tatel indicates that the ‘district court’s task is not “to determine whether the antitrust laws have been or are about to be violated. That adjudicatory function is vested in the FTC in the first instance.”’Judge Tatel ‘part[s] ways with the district court when it comes to assessing the FTC’s evidence in support of its contention that Whole Foods and Wild Oats occupy a distinct market and agrees with Judge Brown that the ‘District court erred in concluding that the FTC failed to “raise[] questions going to the merits so serious, substantial, difficult and doubtful as to make them fair ground for thorough investigation, study, deliberation and determination by the FTC in the first instance and ultimately by the Court of Appeals”’.

Both Judges Brown and Tatel find that the district court analysed the product market incorrectly. Both Judges Brown and Tatel rely on the ‘practical indicia’ test of *Brown Shoe*, and reject the price-effects market definition approach contained in the Horizontal Merger Guidelines to conclude that the FTC had presented enough evidence to raise ‘serious, substantial’ questions that are ‘fair ground for thorough investigation, study, deliberation, and determination by the FTC.’

As discussed further below, the analysis undertaken by Judges Brown and Tatel is reminiscent of antitrust merger law under many now long-discredited US Supreme Court decisions from the 1960s. Those decisions prompted Justice Potter Stewart to say at the time that ‘the sole consistency that I can find is that in litigation under § 7, the Government always wins’. Not surprisingly, their reasoning prompted the dissenting judge, Judge Kavanaugh, to note that ‘the law does not allow the FTC to just snap its fingers and block a merger’. Judge Kavanaugh notes that the opinions of Judge Brown and Judge Tatel dilute the standard for preliminary injunction relief such that the FTC need not demonstrate a likelihood of success on the merits and finds the ‘serious questions’ approach they adopt to be inconsistent with the relevant statutory test and more aligned with the approach recently repudiated by the US Supreme Court in *Manaf v Geren*. Judge Kavanaugh concludes that under the proper standard that ‘the FTC may obtain a preliminary injunction only by establishing a likelihood of success – namely, a likelihood that, among other things, the merged entity would possess market power and could profitably impose a significant and nontransitory price increase.’ As to the specifics in this case, Judge Kavanaugh finds ‘the FTC’s case is weak and seems a relic of a bygone era when antitrust law was divorced from basic economic principles...’

The FTC’s likely strategy going forward provides it with considerable potential leverage for the agency

After the *Whole Foods* decision, the FTC is likely to combine an application for preliminary injunction in the District Court in the Washington DC Circuit with the simultaneous commencement of an administrative proceeding prescribing an aggressive schedule to counter charges of ‘hardships’ to the defendants in not being able to close before the FTC decides the merits in an administrative proceeding. The FTC has sought to
address the criticisms raised in prior cases\(^4\) that its Part 3 administrative adjudicatory process is too protracted by proposing ‘expedited’ decision-making in a Notice of Proposed Rulemaking issued on 25 September 2008 (‘Notice’) \(^4\), which were issued as interim final rules on 23 December 2009 (‘Final Rules’). \(^4\) The Notice acknowledges that:

‘Protracted Part 3 proceedings have at least three undesirable consequences. First, in merger cases, such protracted proceedings may result in parties abandoning transactions before their antitrust merits can be adjudicated. Secondly, protracted Part 3 proceedings may result in substantially increased litigation costs for the Commission and respondents…Thirdly, protracted proceedings do not necessarily result in decisions that are more just or fair. To the contrary, there is some truth to the adage that ‘justice delayed, is justice denied’…The Commission believes that any adjudicative process should balance three factors: the public interest in a high quality decision-making process; the interests of justice in an expeditious resolution of litigated matters; and the very real interest of the parties in litigating matters economically without unnecessary expense.’ \(^4\)\(^3\)

Among other things, the new rules: (1) require, absent extraordinary circumstances, that the evidentiary hearing be set five months from the date of the complaint; (2) limit the length of hearings to 210 hours (the equivalent of 30 seven-hour trial days), absent a showing of good cause; (3) require the initial decision within 70 days of the last filed proposed findings, but in any event, within one year. In response to the commenters concerns, the Final Rules set a time period for a final Commission decision at 100 days after the initial decision. The common practice of the Commission is to ‘hear the case de novo, regardless of what the ALJ does’. \(^4\)\(^4\) While the schedule imposed in the proposed rulemaking is an improvement in the timing of the discovery (albeit during the initial phase entirely at the expense of the defendant’s time to prepare their defence), it remains unlikely that the merging parties will be able to keep a proposed transaction alive long enough to be able to obtain judicial review of an adverse decision by the ALJ, or ultimately, the Commission. Although it is not clear how a district court would view this time frame under the equities test, it is highly unlikely that the typical transaction could be kept alive pending the ‘expedited’ review contemplated by the FTC.

It is for these reasons the ABA Section of Antitrust Law stated in comments to the FTC that:

‘The Section is concerned that the proposed rules will not expedite Part 3 proceedings nearly enough to make them practicable for unconsummated mergers. For that reason, the Section believes that Part 3 litigation should not serve as a substitute for fully developed and far quicker proceedings in federal district court…Federal courts typically recognize that, as a practical matter, the preliminary injunction hearing is determinative and, while setting an aggressive schedule, permit an evidentiary hearing with live witnesses. Thus, district court judges typically have allowed the defence to conduct discovery in challenging the FTC’s case, including depositions of trial witnesses, third parties, and experts. And the FTC usually deposes defense witnesses, sometimes even those whose testimony was taken in investigational hearings during the Hart-Scott-Rodino (HSR) investigation.’

Such discovery and live testimony have proven valuable both to the parties and the court, as credibility determinations have been significant in determining whether the FTC has raised the ‘substantial questions’ necessary to justify a Part 3 trial…[F]ull proceedings at the preliminary injunction stage in the district court – the procedure that has been followed for many years – afford an opportunity for prompt but thorough review…In each case, the federal proceedings were comprehensive and fair, and they were over long before the Commission would have issued a final order under its proposed rules. These [proposed Part III] changes could reduce the average time from complaint to initial decision in conduct cases to a maximum (assuming no extensions are granted) of approximately 12.5 months.\(^4\)\(^5\) Such a time frame is not workable for most proposed transactions to remain alive.

Moreover, the decision of the ALJ is subject to appeal to the full Commission, which could add on significant additional time and uncertainty. A review of the FTC’s records in administrative hearings over the least 25 years disclosed that in almost every single contested Sherman Act case with disputed facts, the FTC ruled in favor of complaint counsel, even where the Administrative Law Judge had ruled for the parties.\(^4\)\(^6\) In many of those cases, the courts of appeals or the Supreme Court subsequently reversed the FTC. Although these cases did not involve merger challenges, it nevertheless suggests that there may be a bias against defendants and, unlike a Sherman Act case, it is unlikely that a merger will remain intact long enough to prevail in a Court of Appeals.

Nor is the FTC, on appeal from its own decision, put to the same burden of proof as either the DOJ or a private
party challenging the legality of a proposed merger. Assuming that the staff wins before the Commission, the merger parties may appeal the decision to any circuit court of appeals in which the ‘violation occurred’ or they ‘reside or carry on business’.\textsuperscript{47} Factual findings by the Commission, if supported by evidence, are conclusive; a reviewing court may not ‘make its own appraisal of the testimony, picking and choosing for itself among uncertain and conflicting instances’.\textsuperscript{46} Two former FTC staff members argue:

‘[T]he Commission’s final decisions, when appealed to the circuit courts of appeals, are subject to a standard of review more deferential than that applied to district court judgments. The Commission’s findings of fact are reviewed under the relatively lenient “substantial evidence” standard, which asks whether there is evidence in the record that “a reasonable mind might accept as adequate” to support the Commission’s conclusion. The Commission’s conclusions of law, while generally reviewed 	extit{de novo}, are given deference to the extent that they involve the interpretation and application of the statutes it is charged with enforcing as an expert administrative agency, such as the FTC Act.’\textsuperscript{49}

Thus, as one litigator who has experience both inside and outside the FTC has concluded ‘any FTC decision that relies upon lengthy factual findings should be difficult to be reversed on appeal’.\textsuperscript{50} Accordingly, the FTC’s utilisation of the administrative process, when coupled with a low burden of proof for obtaining a preliminary injunction, has the potential to be outcome determinative and, at a minimum, imposes substantial consummation delay. If unchecked, the cumulative effects of these procedural tools may be to provide the FTC with considerable bargaining leverage when negotiating remedies during the initial HSR review process.

What’s next on the standards issue?

The long-term impact of the DC Circuit’s \textit{Whole Foods} decisions remains to be seen. The implications of \textit{Whole Foods} may be influenced by what the district court judge does on remand and by its interpretation in future decisions. Judges in the future may consider the \textit{Whole Foods} decision as distinguishable on several grounds, including the failure of the district court to discuss the issue of the equities and the balancing test as well as the inflammatory documents created by Whole Foods’ CEO and instead return to the approach taken in \textit{Heinz}.

Now that there is no longer a ‘majority’ opinion it is unlikely that the US Supreme Court will grant \textit{certiorari}. Judge Kavanaugh notes ‘[t]he issues presented in [Whole Foods] are important to antitrust regulators and practitioners, to potentially merging companies, and ultimately to the overall economy. The splintered panel opinions will create enormous uncertainty, debate, and litigation. . . . And to the extent common principles and holdings are derived from the opinions of Judge Brown and Judge Tatel, those principles will authorise the FTC to obtain preliminary injunctions and block mergers based on a watered-down preliminary injunction standard and without sufficient regard for the economic principles that have undergirded modern antitrust law. That will give the FTC far greater power to block mergers than the statutory text or Supreme Court precedents permit.’\textsuperscript{51}

Moreover, the \textit{Whole Foods} decision puts directly into play whether there should be different standards for the FTC and DOJ in merger cases. Did Congress really intend that the FTC be able to enjoin mergers without needing to make a prima facie case to an impartial district court and then embark in a lengthy adjudication on the merits, with parties only then able to have judicial review by an appellate court? Moreover, even assuming that Congress had intended to treat the FTC differently in all regards several decades ago, does this scheme make sense in today’s economy?

The legislative history of the FTC Act does not establish an express intent by Congress to give the FTC unfettered discretion to cause transactions to be blocked by virtue of the review process it, alone, can exercise in a merger case. Congress established the FTC in 1914 as an independent regulatory agency to administer the FTC Act, section 5 of which declares ‘unfair methods of competition…unlawful’. In 1938, the Wheeler-Lea Amendments expanded the agency’s section 5 jurisdiction to include ‘unfair or deceptive acts or practices’. Under this mandate, the FTC’s powers extend to a wide variety of business practices. An FTC proceeding must remain in the public interest throughout its pendency.

Until 1973, the only way that the FTC could obtain preliminary injunctive relief outside of the context of food and drug advertising was from a Court of Appeals ‘in and of’ the appellate court’s prospective jurisdiction under the All Writs Act, 28 USC, section 1651(a). In \textit{FTC v Dean Foods Co},\textsuperscript{52} the US Supreme Court reversed and remanded the Seventh Circuit’s decision to decline jurisdiction under the All Writs Act to enjoin the proposed merger of Dean Foods and Bowman Dairy Company to preserve the status quo pending determination of legality of the merger under Clayton section 7 (interestingly, no reference was made
by the Court to section 5 of the FTC Act). The Court held that the court of appeals had jurisdiction to issue a preliminary injunction preventing the consummation of the merger upon a showing that: (1) there is a reasonable probability that the merger would violate section 7 of the Clayton Act; and (2) an effective remedial order, once the merger was implemented, would otherwise be virtually impossible, thus rendering the enforcement of any final decree of divestiture futile.\textsuperscript{55}

Justice Clark, writing for the majority, provided a summary of Congressional consideration of the FTC’s injunctive powers. He noted that since 1956, the Commission had repeatedly sought authority to grant preliminary injunctions itself or to proceed in the district court as the DOJ may under the Clayton Act.\textsuperscript{56} Congress simply did not act on these proposals.\textsuperscript{55} The majority opinion viewed such injunctive relief to be within the mandate of the Court of Appeals only.\textsuperscript{56}

On 5 April 1973, the Second Circuit denied an action for a preliminary injunction by the FTC in connection with the proposed acquisition of Rheingold by PepsiCo after applying a balancing of the equities and instead imposing a hold separate condition.\textsuperscript{56}

On 16 November 1973, Congress enacted as section 408(f) of the Trans-Alaska Pipeline Authorization Act, PL 93-153, section 13(b) of the FTC Act. The Conference Report merely states that:

“Section 408(f) relates to the standard of proof to be met by the Federal Trade Commission for the issuance of a temporary restraining order or a preliminary injunction. It is not intended in any way to impose a totally new standard of proof different from that which is now required of the Commission. The intent is to maintain the statutory or ‘public interest’ standard which is now applicable, and not to impose the traditional ‘equity’ standard of irreparable damage, probability of success on the merits, and that the balance of equities favor the petitioner. This latter standard derives from common law and is appropriate for litigation between private parties. It is not, however, appropriate for the implementation of a Federal statute by an independent regulatory agency where the standards of the public interest measure the propriety of issuance of a temporary restraining order or a preliminary injunction.

This new language is intended to codify the decisional law of Federal Trade Commission v National Health Aids, 108 F Supp 340, and Federal Trade Commission v Sterling Drug, Inc, 317 F 2d 669, and similar cases which have defined the judicial role to include the exercise of such independent judgment. The Conferees did not intend, nor do they consider it appropriate, to burden the Commission with the requirements imposed by the traditional equity standard which the common law applies to private litigants.”\textsuperscript{55}

No mention is made of the US Supreme Court’s Dean Foods decision or the then recently decided PepsiCo case or, for that matter, any other merger-related decision. Each case cited in the Conference Report involved a petition for a preliminary injunction in a district court pending a Commission determination of allegations of false advertisements relating to medical products under section 5 of the FTC Act. In both cases, the district court considered whether the Commission had made a ‘proper showing’ that the public would reasonably be misled by the advertisement in question. Thus, despite the prior debate at the US Supreme Court level regarding the right of the FTC to seek a preliminary injunction in a merger case, the Congressional record is silent as to whether the intent was to include mergers within the mandate of this new provision. Such a silence is particularly telling given the numerous prior times that the FTC had sought congressional authority and the fact that the FTC challenged mergers under Clayton section 7, not section 5 of the FTC Act. Indeed, as demonstrated by the Fourth Circuit’s FTC v Atlantic Richfield Co decision, as recently as 1977, one court found no authority for the FTC to enjoin a merger solely on section 5 grounds.\textsuperscript{56}

Reference to Congressional intent for courts to enjoin mergers while leaving it to the FTC to decide the merits, therefore, seems misplaced given that: (1) there is nothing in the legislative history of the 1914 Act to provide for merger challenges solely on section 5 grounds; (2) the history at the time of enactment of section 13(b) was for the FTC to bring merger challenges under Clayton section 7, not section 5 of the FTC Act. Indeed, as demonstrated by the Fourth Circuit’s FTC v Atlantic Richfield Co decision, as recently as 1977, one court found no authority for the FTC to enjoin a merger solely on section 5 grounds.\textsuperscript{56}

Nor does it appear that Congress expressly considered the differing standards that supposedly would exist between the FTC and DOJ when it provided the agencies with concurrent jurisdiction to review mergers under the Hart-Scott-Rodino Act. Finally, there is nothing in the FTC Act that prohibits a district court’s adjudication of the merits and issuance of a preliminary injunction, which would be consistent with the procedure followed by the DOJ. Section 13(b), the very section that the FTC relies on for preliminary injunctions, also provides for permanent injunctions.

Even assuming, however, that Congress did intend to give the FTC such leverage and discretion over three decades ago, the continuation of such a ‘double standard’ seems ill-advised. The Antitrust Modernization Commission (‘AMC’) report issued in 2007 repeatedly noted that any differences, real or perceived, between the FTC and the DOJ in their merger challenges can...
The Federal Trade Commission should:

‘Parties to a proposed merger should receive comparable treatment and face similar burdens regardless of whether the FTC or the DOJ reviews their merger. A divergence undermines the public’s trust that the antitrust agencies will review transactions efficiently and fairly. More important, it creates the impression that the ultimate decision as to whether a merger may proceed depends in substantial part on which agency reviews the transaction. In particular, the divergence may permit the FTC to exert greater leverage in obtaining the parties’ assent to a consent decree...[T]he commission makes three interrelated recommendations for administrative action and legislative change that, together, will ensure that parties before either agency face comparable procedural approaches and burdens when an injunction is sought, regardless of which agency reviews the merger.

[1] The Federal Trade Commission should adopt a policy that when it seeks injunctive relief in Hart-Scott-Rodino Act merger cases in federal court, it will seek both preliminary and permanent injunctive relief, and will seek to consolidate those proceedings so long as it is able to reach agreement on an appropriate scheduling order with the merging parties... 

[2] Congress should amend section 13(b) of the Federal Trade Commission Act to prohibit the Federal Trade Commission from pursuing administrative litigation in Hart-Scott-Rodino Act merger cases... 

[3] Congress should ensure that the same standard for the grant of a preliminary injunction applies to both the Federal Trade Commission and...[DOJ]...the Federal Trade Commission to specify that, when the Federal Trade Commission seeks a preliminary injunction in a Hart-Scott-Rodino merger case, the Federal Trade Commission is subject to the same standard for the grant of a preliminary injunction as the [DOJ].

The application of different standards depending on which agency reviews a merger is a cause for great concern. The parties’ ability to close a merger should depend on the merits of the proposed transaction and the competitive issues it raises, not procedural issues relating to which agency happens to draw the case. If the Whole Foods decision is determined to establish different standards for injunctive relief depending on whether the challenge is brought by the FTC or the DOJ, a legislative remedy appears imperative.

Substantive point of law: core customers versus marginal customers and the utility of critical loss analysis

The broad procedural language discussed in the first part of this paper raises significant concern, especially as applied in this case. Read literally, the Whole Foods decision appears to be a misguided rewriting of one of the most fundamental teachings of antitrust law and economics over the last several decades that economic decisions are made on the margin and that the margin is what counts. In particular, the failure in 1960s-1970s market-definition jurisprudence to focus on the marginal consumers is what relegated merger analysis to an exercise in ad hoc gerrymandering designed to achieve a predetermined result. The 1982 DOJ Merger Guidelines introduced rigour into market definition analysis with its hypothetical monopolist test, and helped bring US merger analysis out of the antitrust dark ages. That test and its implementations are widely recognised as major developments in antitrust analysis over the last 25 years. The opinions of Judge Brown and Judge Tatel reinvigorate the concept of submarkets in a way that will drain all rigour from the analysis and take us back to the bad old days when fuzzy results-orientated thinking blocked efficiency-generating mergers.

Both Judge Brown and Judge Tatel find the lower court’s decision flawed in its assumption that “the marginal” consumer, not the so-called “core” or “committed” consumer, must be the focus of any antitrust analysis. To the contrary, the court concluded, ‘core customers can, in appropriate circumstances, be worthy of antitrust protection’. It also claimed that the transaction parties’ expert focused only on marginal consumers while the FTC’s expert focused on the ‘average behavior of customers’. The district court had found that the FTC failed to prove that PNOS constituted a distinct product market because if PNOS were to raise their prices, a sufficient number of ‘marginal’ customers would shift their purchases to traditional supermarkets to make that price increase unprofitable. In reversing, Judge Brown and Judge Tatel concluded that it was legal error for the district court to focus solely on marginal customers and ignore so-called ‘core customers’ who would not shift their purchases away from PNOS if prices were to rise. Although Whole Foods and Wild Oats may compete against all supermarkets for certain fringe products (dry goods, for example) and certain fringe customers, the DC Circuit found that the FTC had presented substantial evidence that both companies served a base of core customers for whom shopping at a general supermarket did not constitute an alternative. This is the equivalent of saying that because some people will drink only Coca-Cola, it follows that Coca-Cola must be its own market for these ‘core customers’.
The Court of Appeals discussed two possible theories supporting a market focused on core consumers. First, the court suggested that the PNOS could price discriminate against such customers, citing the Merger Guidelines for the proposition that the ability of firms to engage in price discrimination supports narrower markets focused on such core consumers. Since PNOS stores could not charge different prices to different consumers for the same products, however, price discrimination per se was not possible. A potential theory to consider, though, was whether PNOS stores could have raised prices only of fresh produce (as opposed to non-perishables) as a proxy to discriminate against core customers. The usual way to refer to such a market, however, would have been the market for the sale of fresh produce through PNOS stores, rather than a broader market for PNOS stores. Neither the FTC nor its expert ever raised this theory or discussed such a narrower market, and although a potentially useful theory in appropriate circumstances, those circumstances were not to be found in this case.

The court next argued that distinct customers paying distinct prices may constitute a cognisable submarket under Brown Shoe. The court, however, appears to believe that markets defined under such an approach are consistent with defining price discrimination markets under the Merger Guidelines. They are not. Rather, the court conflates the discredited fuzzy analysis from the 1960s with the much more rigorous analysis from the Merger Guidelines. Judge Kavanaugh charges that ‘the Court’s decision resuscitates the loose antitrust standards of Brown Shoe...’ This is a problem because Brown Shoe’s brand of free-wheeling antitrust analysis has not stood the test of time.

As noted above, market delineation under the Merger Guidelines entails an analysis at the margin. The FTC, the parties, and the district court all understood this. Only Judges Brown and Tatel seem to have missed it, preferring to rely on the practical inducias laundry list contained in Brown Shoe rather than economically grounded market definition approaches. The expert for the transaction parties, David Scheffman, and the expert for the FTC, Kevin Murphy, both purported to apply the hypothetical monopolist test from the Merger Guidelines. Under this test, a market is defined as a group of products for which the only seller (a hypothetical monopolist or cartel) of such products could profitably impose a small but significant and non-transitory increase in the price above the previously prevailing level. The test is often referred to as the ‘SSNIP test’, which is an acronym for the type of price increase hypothesised.

In order to determine whether a price increase under this test is profitable, one has to measure the difference between two things: (1) the incremental margin on the sales to the customers that will be lost because of the price increase; and (2) the gains from increasing the price to the customers who continue to purchase after the price increase. The customers who stop purchasing or reduce their purchases are said to be ‘marginal’ consumers.

Both experts performed a critical loss analysis (‘CLA’) which relies entirely on marginal consumers. The CLA is a methodology to implement the SSNIP test and is essentially a ‘break-even’ analysis. The first step in the CLA is to determine, based on the incremental margin, the percentage of sales that must be lost by the hypothetical monopolist in order to break even. The percentage is generally known as the ‘critical loss’. The second step requires the estimation of the likely actual loss of sales from the hypothesised price increase. This estimate is known as the ‘actual loss’. If the actual loss exceeds the critical loss, then the price increase is unprofitable and the candidate market is not a market and must be expanded.

Professor Murphy also performed a modified version of CLA in which he calculated a critical diversion ratio. The diversion ratio indicates the extent of sales that would be diverted from the merged firm to others inside the candidate market. The critical diversion ratio is the diversion ratio above which a price increase is profitable because sufficient sales stay within a hypothetical cartel such that the gain on the price increase offsets the loss of margin on the customers not retained.

There are two major problems with this that the circuit court used Professor Murphy’s testimony on critical diversion. First, his testimony does not depend on the ‘average loss of customers’ as the court used the term. As Professor Murphy stated in his testimony, ‘the type of diversion ratio considered in the critical diversion formulation refers to the marginal customers...’ He went on to say, however, that where the hypothetical monopolist is expected to close a store rather than just raise prices, then the average diversion ratio is appropriate. But the average diversion ratio in this context equals the marginal diversion ratio because the entire store is marginal by definition. That is, the hypothetical monopolist is losing all sales from the store in this example. Moreover, if store closings are the focus of concern for exercising market power, then clearly price discrimination is not the issue since a store closing impacts all customers of the closed store. In addition, it is unusual in applying the SSNIP test to define product markets to assume that the hypothetical monopolist will close a store rather than just raise prices across the board, which leads into the second problem with the critical diversion analysis itself as a market definition tool.

The universal way that the courts and the federal agencies have used the SSNIP test is by assuming that the hypothetical monopolist raises price across the board. The critical diversion analysis done by Professor...
Murphy and the economists he cites does something completely different. That analysis assumes that the hypothetical monopolist only raises the price of one of the products (or in this case, products at one of the stores) in the candidate market.  

This approach, which follows the work of O’Brien/Wickelgren and Katz/Shapiro, has very little or no practical application in the market-definition context. This research focuses on raising the price of only one of the products of the merging firms as a means of market definition. Although this arguably is technically in the Merger Guidelines, we are not aware of any court or the FTC (or the DOJ) stating publicly that they delineated a relevant market in any investigation in this way. In practice, the test is performed as either an across-the-board price increase, or a price discrimination against certain customers or certain products that can serve as proxies for those customers (but again, across the board to all of those consumers/products that are being discriminated against).

There is good reason why this is so and why the approach suggested by O’Brien/Wickelgren and Katz/Shapiro is not used in the real world.

We can illustrate the logic of this conclusion with a hypothetical, which is summarised in the illustration infra. In the hypothetical we assume there are ten equally situated firms, respectively producing differentiated products A–J. We evaluate the market definition for a merger of firms 1 and 2, which would thus control products A and B. We further assume that the firms have a margin of 30 per cent, which means the critical loss for a ten per cent price increase is 25 per cent. Additionally, we assume that when the combined firm raises the price of product A by ten per cent, four per cent of the volume diverts equally to each of the other products B–J. Thus a ten per cent increase causes product A to lose 36 per cent of its volume to products C–J combined (ie, the eight products that it does not control). Under these assumptions, the merged firm cannot raise price profitably by itself, but a hypothetical monopolist controlling firms 1–5 would find it profitable to increase price.

Let us go through the maths. When the combined firm raises the price of product A ten per cent, it loses four per cent of its volume to each of products C–J for a total loss of volume of 32 per cent. Since the critical loss is 25 per cent, the actual loss exceeds the critical loss and the merged firm cannot be its own market. However, a hypothetical monopolist controlling products A–E (eg, the combination of firms 1–5) could profitably raise the price of product A as follows. This hypothetical monopolist raises the price of product A ten per cent, but only loses sales to products F–J since it controls by definition products A–E. As a result, it only loses 20 per cent of its volume (four per cent x the other five firms/products that it does not control), and the actual loss (20 per cent)
RECENT DC CIRCUIT DECISIONS IN WHOLE FOODS LEAVE STANDARD FOR FUTURE MERGERS UNSETTLED

does not exceed the critical loss (25 per cent).

Under these assumptions, O’Brien/Wickelgren and Katz/Shapiro would say that products A–E are a market. But the purpose of going through this exercise is not apparent because there is no unilateral effect possible since increasing the price of product A is not profitable to the merged firm itself, and coordinated interaction is not possible unless there are side payments from firms 3–5 to the merged firm. So, why would we ever define a market like this? Should we not be looking for things that matter?

It was ill-advised for the court to adopt the approach it did based on interpreting the FTC’s expert without a firm understanding of the consequences. It was not clear from the testimony of the FTC’s expert that he was applying such a novel approach and hypothesising only a limited price increase. Such an approach could result in dramatically narrower market definitions without any basis that ties the market definition to competitive effects analysis in any logical way. In other words, using this approach to define markets on a generalised basis would likely produce narrow, more concentrated markets with no proof that such ‘markets’ and the associated concentration are at all suggestive of likely competitive effects. Mergers that would be extremely unlikely to produce anti-competitive effects would be deemed to involve very narrow markets with high concentration, generating antitrust scrutiny that is undeserved. The use of this approach to define markets thus would seriously undermine the ability of market definition to provide the screening function for anti-competitive effects that it generally serves today.

Conclusion

The opinions of Judge Brown and Judge Tatel in Whole Foods appear to rewrite certain fundamental elements of modern antitrust law. If followed, they threaten to alter the likelihood of obtaining an injunction to block a merger when it is sought by the FTC thereby threatening to have the decision as to which agency reviews the merger (FTC or DOJ) potentially affect the outcome of the review. It also injects elements of uncertainty into well-accepted market definition principles for no apparently good reason and based on little evidence. These errors arise from a failure to appreciate the Guidelines approach to market definition and a misunderstanding of the economic evidence submitted by the FTC.

The opinions are a mess and reflective of the equally messy history of the case in the DC Circuit: a denial of an interim stay suggesting that a majority of the court did not believe the FTC would succeed on the merits, followed by a 2:1 opinion that seeks to rewrite fundamentals of antitrust procedural and substantive law, followed by a rewritten series of opinions with unclear precedential value, accompanied by a note by two judges not on the Panel further muddying the precedential waters. Although the questionable precedential value of the opinion makes it highly unlikely that the US Supreme Court will take certiorari, we believe it would be appropriate for it to do so or risk several years of confused and confusing FTC injunction applications.

Notes

* The authors thank Barry C Harris of Economists Inc and Ronald A Stern for their insightful comments and input. The views expressed in this article are those of the authors and are not to be attributed to their firms or clients.

1 FTC v Whole Foods Mkt, Inc, 555 F 3d 869 (DC Cir 2008).
5 Ibid at 56.
7 See Federal Trade Commission’s Opposition to Motion To Dismiss the Appeal As Moot, FTC v Whole Foods Mkt, Inc, No 07-5276 (DC Cir filed 22 October 2007), available at www.ftc.gov/os/caselist/070114/071022motion.pdf. (‘FTC Appeal’).
8 Ibid at 4; see also Plaintiff Federal Trade Commission’s corrected Brief on its Motion for Preliminary Injunction, No 07-5276 at 0–10 (DDC filed 1 August 2007) (‘the court’s task is not to make a final determination on whether the proposed acquisition violates Section 7, but rather to make only a preliminary assessment of the acquisition’s impact on competition’) (internal citations and quotations omitted) available at www.ftc.gov/os/caselist/070114/080107ocorbrief.pdf.
10 Ibid at 12–13.
11 15 USC §15(b).
14 See eg FTC v Truist Health Care Corp, 186 F 3d 1045, 1051 (8th Cir 1999); FTC v Warner Commcs, 742 F 2d 1156, 1162 (9th Cir 1984).
15 FTC v Truist Health Care Corp, 17 F Supp 2d 937, 939 (ED Mo 1998) (‘the court held a five-day hearing on the request for preliminary injunction’); FTC v Butterworth Health Corp, 946 F Supp 1285, 1302 (WD Mich 1996) (the court held a five-day hearing ‘audited each of the would be merging hospitals ... (and) received considerable testimony from the witness stand in which the Court actively participated through its own questioning of witnesses’); FTC v Freeman Hospital, 911 F Supp 1213, 1216 (WD Mo 1995) (‘evidentiary hearing held on March 23 and 24, 1995’); FTC v Stolpho, Inc, 970 F Supp 1066, 1069 (DDC 1997) (reaching a decision ‘after a five-day evidentiary hearing and the filing of proposed findings of fact and conclusions of law’); FTC v Cardinal Health,
Interestingly, the FTC had adopted a policy in 1995 of not pursuing FTC v Atlantic Richfield Co, 2523, 2533.


Ibid. at 9.

Ibid. at 7.

Ibid. at 8–9 (citation omitted).

Ibid. at 7.

Ibid. at 13.

Ibid. at 7.

Ibid. at 9.

Ibid. at 1.

Ibid. at 8.

Ibid. at 7.

Ibid. at 1.

Ibid. at 9.

Ibid. at 1.

Ibid. at 8.

Ibid. at 7.

Ibid. at 1.

Ibid. at 9.

Ibid. at 7.

Ibid. at 8.

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Ibid. at 8.

Ibid. at 9.

Ibid. at 7.

Ibid. at 8.

Ibid. at 9.

Ibid. at 7.

Ibid. at 8.

Ibid. at 9.

Ibid. at 7.

58 See AMC, Antitrust Modernization Commission Report and Recommendations (April 2007), available at http://govinfo.library.unt.edu/amc/report_recommendation/amc_final_report.pdf, at 138, 139. See also Comments of the Section of Antitrust Law of the American Bar Association in Response to the Antitrust Modernization Commission’s Request for Public Comment Regarding Government Enforcement Institutions: Differential Merger Enforcement Standards (28 October 2005) at 1 ("The Antitrust Section believes that these differences do not serve any policy purpose as applied to the pre-consummation review of mergers and should, as much as possible, be eliminated.").


60 Ibid.


62 Supra n 1 at 878.

63 Ibid.

64 Ibid.


66 Supra n 1 at 878.

67 See n 71 infra for a description of the appropriate analysis.

68 Supra n 4 at 19 (‘The record evidence, including market research studies and evidence of how both consumers and retailers are actually acting in the marketplace, suggests that because so many people are cross-shopping for natural and organic foods and are marginal rather than core customers, the actual loss from a SSNIP would exceed the critical loss.’).

69 Kavanaugh Opinion at 16.


72 Ibid (emphasis added).

73 Ibid at 31 n 17.

74 Evaluating whether a merger enables the merged firm profitably to close a store or plant can be appropriate as part of unilateral effects analysis, but not as market definition divorced from competitive effects analysis.


76 Such an approach may be relevant for analysing competitive effects in unilateral effects cases, but that is a different issue. For example, in a market for supermarkets, it is possible that the combined firm would find it profitable to raise price by closing stores and thus produce an anti-competitive effect. In such a case, however, the concentration would not be sufficiently high to generate a prima facie case and the FTC would have a more difficult burden to overcome.

77 To illustrate, it is possible that the core customers buy their fresh produce only or largely from PNOS stores, in which case it might make sense to investigate whether a hypothetical PNOS monopolist can profitably raise only the prices of fresh produce in all of its stores (ie, raise fresh produce prices across the board). In such case, however, careful attention must be paid to the lost margin by such a monopolist. The lost margin includes the margin on lost fresh produce sales resulting from the price increase, but it also must include the lost margin on any sales of other products that suffer volume declines because some customers may be driven away entirely or in part as a result of the price increase on fresh produce and buy more or all of their non-perishables in regular supermarkets. This analysis was not performed or even suggested by the FTC.

78 Supra n 71. The example further assumes that the firms have constant marginal costs for ease of exposition. There is no magic to picking a ten per cent price increase, and examples can be just as easily constructed using other price increase thresholds.