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Federal Judge Preliminarily Enjoins Sysco-US Foods Merger and Parties Abandon the Transaction

In a decision released on June 26, 2015, a federal district court judge in Washington, D.C. ruled in favor of the Federal Trade Commission and issued a preliminary injunction blocking the consummation of the merger of Sysco Corporation with US Foods, Inc. After an eight day hearing in May, Judge Amit Mehta held “that there is a reasonable probability that the proposed merger will substantially impair competition in the national customer and local broadline [foodservice distributor] markets.” Order, *FTC v. Sysco Corp.*, No. 15-cv-00256 (D.D.C. June 23, 2015). The court’s order prevents the companies from merging pending the outcome of the FTC’s administrative proceeding; however, as a result of the ruling, the parties have abandoned the merger. See Annie Gasparo, *Sysco Walks Away From US Foods Merger*, Wall St. J., June 29, 2015, available at <http://www.wsj.com/articles/sysco-walks-away-from-us-foods-merger-1435580019>.

Background

In February 2015, the FTC, along with several states and the District of Columbia, sought a temporary restraining order and preliminary injunction under section 13(b) of the Federal Trade Commission Act to enjoin the consummation of the merger of Sysco and US Foods during the pendency of the FTC’s challenge to the merger in the Commission’s administrative proceeding. See Compl., *FTC v. Sysco Corp.*, No. 15-cv-00256 (D.D.C. Feb. 20, 2015). The FTC alleged that Sysco and US Foods are “the two largest broadline foodservice distributors in the United States and each other’s closest competitor.” *Id.* at ¶ 1.

Much of the court’s hearing on whether to issue the injunction was devoted to testimony concerning the definition of the relevant antitrust market. The FTC urged that the appropriate product market was “broadline foodservice distribution” (which “entails the warehousing, sale, and distribution of a wide range of product categories and a variety of products within those categories”). *Id.* at ¶ 32. The defendants, on the other hand, argued that the FTC’s “broadline” market was improperly based on “an unrepresentative sample of subjective customer preferences,” and “fail[ed] to account for customers’ demonstrable ability to spread their purchases freely across multiple distribution channels simultaneously.” Memo. of Defs. in Opp’n to Plfs.’ Mot. For a Preliminary Injunction, *FTC v. Sysco Corp.*, No. 15-cv-00156 (D.D.C. Apr. 29, 2015) (“Defs.’ Opp.”), at 17.

The FTC had alleged that the proper geographic market was national, and that Sysco and US Foods are “by far” the largest distributors who serve “National Customers,” Compl. at ¶ 63 – *i.e.*, “[c]ustomers with numerous facilities dispersed nationally or across multiple regions of the United States . . . such as

national hotel chains, foodservice management companies, and group purchasing organizations.” *Id.* at ¶ 4. It had also alleged that competitive harm is likely to occur in numerous local markets for customers with “a single location or a few locations geographically concentrated in a single local area.” *Id.* at ¶ 50. Sysco and US Foods, on the other hand, asserted that there is no proper distinction between national and local customers, and that the FTC’s separation of these two groups of customers was calculated by the FTC to artificially raise the combined firm’s market share. *See* Defs.’ Opp. at 12-16. During the hearing, the court heard testimony from various customers, as well as economists supporting the government and the parties to the proposed merger, in support of each side’s position.

The Court’s Opinion

As is many times the case, the central fight in this challenge was over the definition of the relevant market, which, in this instance, required the court to delve deeply into the evidence submitted by the parties. The resulting determination of the relevant market was, for all practical purposes, dispositive.

In a lengthy and detailed opinion, the court agreed with the FTC that “broadline foodservice distribution” is the proper relevant product market. In support of this holding, the court found “that other modes of foodservice distribution are not functionally interchangeable with broadline foodservice distribution” because they lacked “product breadth and diversity” and scale. Op. at 23. It also found that broadline food service distribution was regarded in the foodservice industry as distinct from other modes of distribution, and that broadline distributors have distinct customers, distinct pricing, the ability “to offer frequent and flexible delivery schedules” and customer service that other modes of distribution lacked. Op. at 26-28. Thus, the court held that the alternative distribution modes put forward by the defendants were not reasonably interchangeable with broadline distribution. Importantly, the court held that “the fact that Defendants *sometimes* compete against other channels of distribution in the larger marketplace does not mean that those alternative channels belong in the relevant product market for purposes of merger analysis.” Op. at 30 (emphasis added). Finally, siding with the FTC’s expert economist, the court held that a sufficient number of broadline foodservice distribution customers would not switch to alternative modes of distribution in response to a hypothetical broadline market that was controlled by a monopolist. Op. at 39.

In addition, the court held that the *Brown Shoe* market-definition factors supported the FTC’s assertion that there is also an antitrust market for “broadline distribution to national customers” based, in part, on “distinct customer needs” of these customers which have broad geographic operations. Op. at 44, 48.

The court went on to analyze the probable effects on competition resulting from a merger of Sysco and US Foods in the relevant markets, and found that the increase in market concentration that would result from the merger established “a rebuttable presumption that the merger will substantially lessen competition” in these markets. Op. at 72, 81. This increased concentration, the court held, could lead to increased

prices by eliminating a competitor. Op. at 82. The parties to the merger failed to overcome this presumption. Op. at 100.

Significance

Because this challenge was brought under the FTC Act, the Commission's burden was governed not by the traditional standards of equity for preliminary injunctions, but rather by the FTC Act's less stringent "public interest" standard. This standard requires "a proper showing that, weighing the equities and considering the Commission's likelihood of ultimate success, [issuing a preliminary injunction] would be in the public interest."¹ 15 U.S.C. § 53(b). According to the court, this requires only a finding that the Commission "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."² Op. at 15 (internal quotation marks omitted).

The parties' decision to abandon the deal in response to the court's preliminary injunction highlights the importance of this phase of a merger challenge. In nearly all litigated FTC merger challenges, a district court injunction will cause the parties to abandon their deal, rather than attempt to persuade the FTC – in an in-house proceeding before a Commission-appointed administrative law judge – to reject the FTC staff recommendation and allow the deal to proceed. The length of time such a proceeding will take (added on to the significant time a deal has spent in an investigatory phase) and the high odds of an adverse finding, are very often enough to outweigh the benefits to the parties of continuing to push for the merger.

Finally, this ruling marks yet another in a series of recent successful merger-related challenges by the FTC. See, e.g., Paul, Weiss Client Memorandum, Court of Appeals Upholds Decision Unwinding Consummated Merger of Two Physician Groups Following FTC Suit (Feb. 17, 2015), *available at* <http://www.paulweiss.com/media/2795966/17feb15alert.pdf> (describing successful FTC challenge to St. Luke's Health System acquisition of Saltzer Medical Group).

¹ By contrast, when a merger challenge is brought by the Antitrust Division of the Department of Justice, the DOJ must satisfy the traditional equity standard in order to secure a preliminary injunction (i.e., "(1) irreparable damage, (2) probability of success on the merits and (3) a balance of the equities favoring the plaintiff.") Op. at 14-15.

² Some in Congress believe the differing standards governing DOJ and FTC challenges should be harmonized, and have introduced legislation which would, among other reforms, apply the traditional equity standard to FTC challenges. Standard Merger and Acquisition Reviews Through Equal Rules Act of 2015, H.R. 2745, 114th Cong. § 3 (2015).

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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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