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FTC Scores Decisive Win in Challenge to Food Distribution Merger

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On Tuesday, a federal judge issued an injunction blocking the Sysco – US Foods ("USF") merger pending further administrative review by the FTC. The move, which ended Sysco's acquisition plans, represents a decisive victory for the FTC.

Background

The proposed $8.2 billion dollar Sysco/USF deal, first announced in December 2013, would have combined the two largest "broadline" food distribution firms in the United States. Broadline distributors – in contrast to specialist, systems, or "cash and carry" food sellers – provide a wide range of foods and food service products directly to customers at their place of business. According to the FTC's complaint, broadline firms are distinguished by their combination of product breadth and depth, private label inventory and customer service (including frequent and flexible delivery), setting them apart from other alternative suppliers.

In its opinion, the court found that the acquisition would create a single firm with a national broadline market share of 75% and local market shares approaching 100%. These market shares – and the accompanying HHIs – were held to trigger a presumption of illegality that the merging parties were unable to rebut, leading the court to find that the FTC had met its burden of proving that it would likely succeed at a full trial. While the court questioned some of the government's economic evidence, the parties' size and market position as reflected in industry and customer testimony proved decisive, with Judge Mehta ultimately holding that "there can be little doubt that the acquisition of the second largest firm in the market by the largest firm in the market will tend to harm competition in that market."[1]

[1] *FTC v. Sysco Corp.*, No. 15-cv-00256, Slip Op. at 127 (D.D.C. Jun. 26, 2015) ("Memorandum Opinion") (citing *FTC v. Whole Foods*, 548 F.3d 1028, 1043 (D.C. Cir. 2008) (Tatel, J.)).

A Structural Decision

As Judge Mehta noted, "[m]arket definition has been the parties' primary battlefield in this case."[2] In contrast to other FTC and DOJ merger cases that have emphasized price interaction[3] and so-called "bad documents"[4], the FTC's case against Sysco relied strongly on structural presumptions rooted in the market shares and market concentration. Citing the Supreme Court's 1962 *Philadelphia National Bank* opinion, the FTC's lawyers argued that the "overwhelming market share Sysco would attain" in broadline distribution alone rendered the merger presumptively unlawful.[5] According to the FTC, such high market shares would allow the parties to discriminate against Sysco and USF's core customers, who for various reasons "require a broadline distributor and are unwilling or unable to replace their broadliner with an alternative form of distribution."[6]

The appropriateness of a national broadline-only market definition was hotly disputed by the defendants, who argued that, far from relying solely on national broadline distributors, "the typical independent customer uses *twelve* different supply sources."[7] According to Sysco, the court should have considered the entire $231 billion foodservice distribution industry as a single market, within which the defendants compete with not only other broadliners, but also specialty distributors, systems distributors, and cash-and-carry stores like Restaurant Depot and Costco. This market definition would have resulted in combined shares of only approximately 25 percent.[8]

After extensive expert testimony as well as testimony from numerous customers and industry participants, the court ultimately accepted the FTC's argument that national broadline distribution is a separate market.[9]

Litigating the Fix

A significant feature of the litigation was Sysco's attempt to "fix" the deal by agreeing to divest 11 distribution centers in the west and Midwest to rival distributor Performance Foods Group ("PFG") once the merger closed. The divestiture was announced on February 2, 2015, only two weeks before the FTC formally filed suit. The divestiture would have given PFG, already the third largest distributor in the eastern US, a strong foothold in the west.

While the parties characterized the plan as designed to "fully address" the FTC's expressed concerns, the FTC disagreed, arguing that the divestiture would leave PFG with only 35 distribution centers as compared to USF's pre-transaction total of 61, as well as leaving PFG with "significant coverage gaps" in a number of local markets where Sysco and USF currently compete. In a signal of its hostility to the move, the FTC even opposed PFG's motion to enter an amicus brief explaining

[2] *Id.* at 18.

[3] *See FTC v. Staples Inc.*, 970 F.Supp. 1066 (D.D.C. 1997).

[4] *See United States v. Bazaarvoice Inc.*, 2014-1 Trade Cas. (CCH) ¶ 78,641 (N.D. Cal. Jan. 8, 2014).

[5] Plaintiff's Memorandum of Law at 5, 10, *FTC v. Sysco Corp.*, No. 15-cv-00256 (D.D.C. 2015).

[6] *Id.* at 12.

[7] Defendant's Opposition Brief at 5, *FTC v. Sysco Corp.*, No. 15-cv-00256 (D.D.C. 2015) (emphasis in original).

[8] Memorandum Opinion at 19.

[9] *Id.* at 28.

the transaction, characterizing the brief as an attempted "end run" around page limits by a party with interests identical to those of the defendants.[10]

Noting that "there is a lack of clear precedent providing an analytical framework for addressing the effectiveness of a divestiture that has been proposed to remedy an otherwise anticompetitive merger," the court nonetheless agreed with the FTC that the parties had not met their burden of showing that the PFG divestiture would "remedy the anticompetitive effects of the merger."[11] In particular, the court cited internal emails between PFG decision-makers saying that "we need the package size to be bigger [than the 11 distribution centers offered by the parties] to… ever compete nationally."[12] While Sysco argued that this internal discussion represented a "bargaining strategy" by PFG to secure more assets,[13] the court found that the proposed divestiture size was insufficient to make "PFG… a viable alternative to the merged entity on day one."[14]

Conclusion

In the wake of the decision, Sysco has announced that it will terminate its merger agreement with USF.[15] In light of the court's intensive review of the evidence in a detailed 128-page opinion and reliance on well-accepted statements of black letter merger antitrust law, an appeal likely would have little chance of success.

Coming on the heels of the DOJ's successful opposition to the Applied Materials/Tokyo Electron merger [16] and the Comcast/Time Warner deal[17] as well as the FTC's recent decision to challenge the Steris/Synergy merger,[18] it is clear that the US agencies are very willing to bring challenges and are more confident than ever of their ability to obtain blocking injunctions in court.

The decision also reinforces that despite a more recent focus on upward pricing pressure and direct analysis of competitive effects during the merger investigation phase, when it comes to litigation, the agencies and courts continue to

[10] Opposition to Motion by Performance Food Group, Inc., to File a Brief as Amicus Curiae, *FTC v. Sysco Corp.*, No. 15-cv-00256 (D.D.C. 2015). The court ultimately accepted PFG's amicus brief over the FTC's objections.

[11] Memorandum Opinion at 100-101, 110 (holding that under *Baker Hughes*, once plaintiffs have shown undue concentration, the burden shifts to the defendant to rebut the presumption of anticompetitive effect).

[12] *Id.* at 104.

[13] *Id.* at 106.

[14] *Id.* at 110.

[15] Press Release, Sysco Corporation, Sysco Terminates Merger Agreement With US Foods, Jun. 29, 2015, *available at* http://investors.sysco.com/press-releases/Press-Release-Details/2015/Sysco-Terminates-Merger-Agreement-With-US-Foods/default.aspx.

[16] Press Release, U.S. Dep't of Justice, Applied Materials Inc. and Tokyo Electron Ltd. Abandon Merger Plans After Justice Department Rejected Their Proposed Remedy, Apr. 27, 2015, *available at* http://www.justice.gov/opa/pr/applied-materials-inc-and-tokyo-electron-ltd-abandon-merger-plans-after-justice-department.

[17] Press Release, U.S. Dep't of Justice, Comcast Corporation Abandons Proposed Acquisition of Time Warner Cable After Justice Department and the Federal Communications Commission Informed Parties of Concerns, Apr. 24, 2015, available at http://www.justice.gov/opa/pr/comcast-corporation-abandons-proposed-acquisition-time-warner-cable-after-justice-department.

[18] In re Steris Corp., FTC File No. 151-0032 (May 29, 2015).

apply an orthodox approach that has changed little in decades and that is heavy on market definition, market shares and presumptions of anticompetitive effects.

While the decision breaks little new ground in substance, the decision is to be welcomed for not relying on the very deferential "serious questions" test[19] in deciding to grant the FTC a preliminary injunction. Instead, Judge Mehta found that the FTC showed a "likelihood of success on the merits." It is to be hoped that other courts adopt this approach to aligning DOJ and FTC litigation standards in merger challenges.

[19] Under this standard, the Commission meets its burden if it "raise[s] 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." *FTC v. Warner Commc'ns*, 742 F.2d 1156, 1162 (9th Cir. 1984) (collecting citations); *accord FTC v. H.J. Heinz Co.*, 246 F.3d 708, 714-15 (D.C. Cir. 2001); *FTC v. CCC Holdings, Inc.*, 605 F. Supp. 2d 26, 30 (D.D.C. 2009); *FTC v. Whole Foods Mkt., Inc.*, 548 F.3d 1028, 1035 (D.C. Cir. 2008) (Brown, J.); *id*. at 1042 (Tatel, J.).

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