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Last month's *Whole Foods*[1] decision by the U.S. Court of Appeals for the D.C. Circuit can be viewed from a variety of perspectives. Our focus in this commentary is how the decision is likely to reinforce the U.S. Federal Trade Commission's ("FTC's") determination to change the way it challenges mergers. Just a year ago, FTC merger enforcement efforts seemed to be making little headway. The district court's decision in August 2007 not to enjoin the merger of Whole Foods and Wild Oats was the third time in just over three months that the FTC had seen its judgment on a merger questioned by a federal district court.

The initial *Whole Foods* outcome in the district court was the most visible defeat for the agency. When the FTC sued last summer to block the acquisition of Wild Oats, to all appearances it was a straightforward, fact-specific merger challenge. Was there a market for premium and natural organic supermarkets and did the combination of Whole Foods and Wild Oats lessen competition in such a market? The district court opinion refusing to enjoin the transaction addressed the key questions of market definition, the likelihood of entry, and the competitive effects of the transaction. And while the district

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[1] FTC v. Whole Foods, Market, Inc., 533 F.3d 869 (D.C. Cir. July 29, 2008).

court opinion offered a lengthy and interesting discussion of these key issues, there seemed not to be any novel analysis or far-reaching ramifications. Indeed, the opinion may have been most interesting for what it did not address: the role of inflammatory CEO statements and Whole Foods' plans to close a number of stores after the transaction.

In contrast, the D.C. Circuit's decision in July of this year, reversing the district court opinion and remanding to the district court for further proceedings, appears to have significant implications for future transactions and advances many of the FTC's recently articulated goals in improving its merger enforcement record.

I. FTC EFFORTS TO IMPROVE ITS MERGER ENFORCEMENT

An assessment of the D.C. Circuit's decision starts with the back-drop of the FTC's recent merger enforcement activity. The FTC had lost a series of high-profile merger challenges, with *Foster*[2] and *Equitable Resources*[3] in 2007 and *Arch Coal*[4] in 2004.[5]

Frustrated with its inability to convince district court judges to enjoin transactions, the FTC has recently tried to improve its ability to block mergers it believes to be

[2] FTC v. Foster, 2007-1 Trade Cases ¶ 75,725, 2007 WL 1793441 (D.N.M. 2007) (denying FTC's motion for preliminary injunction to enjoin the merger of Western Refining, Inc. and Giant Industries, Inc. because the FTC failed to show a likelihood of success on the merits).

[3] FTC v. Equitable Res., Inc., 512 F. Supp. 2d 361 (W.D. Pa. 2007) (dismissing the FTC's complaint for a preliminary injunction because the merging companies were both Pennsylvania public utilities who qualified for state action immunity from the federal antitrust laws). Pending the FTC's appeal of this case, the parties abandoned the transaction.

[4] FTC v. Arch Coal, Inc., 329 F. Supp. 2d 109 (D.D.C. 2004) (denying the FTC's request for preliminary injunction because despite making out a prima facie case, the FTC failed to prove an ultimate likelihood of success after the merging parties rebutted the presumption of lessened competition).

[5] The FTC's one successful challenge occurred seven years post-closing and in a case brought in an administrative proceeding, rather than a federal district court. Authored by the Commission, the opinion in In re Evanston Northwestern Healthcare Corp., FTC Docket No. 9315 (Aug. 6, 2007), *available at* http://www.ftc.gov/os/adjpro/d9315/070806opinion.pdf, affirmed the finding of the administrative law judge that the 2000 hospital merger in question had enabled the merged firm to exercise market power in violation of Section 7 of the Clayton Act based, in part, on price increases observed after closing.

anticompetitive. These steps include: (i) arguing that the federal district courts need to impose a more lenient standard in deciding whether to grant a preliminary injunction; (ii) urging that the product market need not be defined precisely—especially in a preliminary injunction proceeding; and (iii) emphasizing FTC administrative trials as the place where the merits are litigated.

II. THE APPROPRIATE STANDARD FOR JUDICIAL REVIEW

The FTC brings its preliminary injunction actions under Section 13(b) of the Federal Trade Commission Act. Section 13(b) permits the FTC to enjoin a merger when it "has reason to believe" a violation of the Clayton Act will result from the merger. In order to obtain this relief it must make a "proper showing that, weighing the equities and considering the Commission's likelihood of ultimate success, such action would be in the public interest."[6] Under this standard, courts have placed the initial burden on the government to make out a prima facie case that the merger will substantially lessen competition; meeting this burden creates a presumption in favor of the injunction. The defendants can then rebut the presumption with their own contrary evidence and shift the burden back to the government who must make a higher evidentiary showing of its potential for success on the merits.

Recent FTC losses preceding the D.C. Circuit's decision in *Whole Foods* gave little deference to the FTC's judgment. For example, in applying the Section 13(b) standard, the district court in *Arch Coal* stressed that "antitrust theory and speculation cannot trump facts, and even Section 13(b) cases must be resolved on the basis of the

[6] Federal Trade Commission Act § 13(b), 15 U.S.C. § 53(b).

record evidence relating to the market and its probable future."[7] In *Arch Coal* the court found that while the FTC had made out a prima facie case, that case was weak and successfully rebutted by the defendant's evidence that the government's market concentration calculation was flawed and its theory of a harm from post-merger tacit anticompetitive coordination was unsupported. Under Section 13(b), the court denied the request for injunctive relief because the FTC had failed to demonstrate a likelihood of success on the merits and held that absent such a showing, "equities alone will not justify an injunction," though the court did make an independent determination that the equities also weighed against an injunction.[8]

Likewise, in *Whole Foods*, the district court applied the Section 13(b) standard by evaluating whether the FTC was substantially likely to prove its product market definition. The FTC had argued that the relevant market was not all grocery stores but rather the submarket of premium, natural, and organic supermarkets ("PNOS"). The court concluded that the FTC's definition was fatally flawed because it focused on "core" or "committed" customers as opposed to "marginal" customers.[9] In light of the broader market in which these marginal customers shop, the district court was able to conclude that the FTC was not likely to prove that the merger would substantially lessen competition as it had alleged was possible in the narrower PNOS market. Having found

[7] Arch Coal, Inc., 329 F. Supp. 2d at 116-17.

[8] *Id.* at 159.

[9] FTC v. Whole Foods Market, Inc., 502 F. Supp. 2d 1, 35-36 (D.D.C. 2007), rev'd 533 F.3d 869 (D.C. Cir. 2008).

the absence of a likelihood on the merits, the court resolved there was nothing to balance against the equities and so declined to evaluate them and denied the injunction.[10]

Courts traditionally have viewed their role under the Section 13(b) injunction standard as one requiring a fulsome consideration of the facts. Their resulting practice has been to hold evidentiary hearings which regularly take several days and sometimes weeks to complete because of the volume of material presented.[11]

In recent cases the FTC has argued that the standard has been wrongly applied. It has argued that the determination of whether to grant a preliminary injunction should focus on the public interest.[12] In doing so, the FTC has implicitly argued that there is little role for the federal district court judge beyond deferring to the FTC's preliminary view that a merger is problematic.[13] One commissioner has expressed public concern over the standard. During a speech in July, Commissioner Rosch expressed his desire to place the

[10] *Id.* at 49-50.

[11] FTC v. Tenet Health Care Corp., 17 F. Supp. 2d 937, 939 (E.D. 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 (W.D. Mich. 1996) (the court held a five-day hearing "toured 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 (W.D. Mo. 1995) ("evidentiary hearing held on March 23 and 24, 1995"); FTC v. Staples, Inc., 970 F. Supp. 1066, 1069 (D.D.C. 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, Inc., 12 F. Supp. 2d 34, 26 (D.D.C. 1998) ("From June 9, 1998 to July 17, 1998, this Court held an extensive evidentiary hearing in the matter.").

[12] Plaintiff Federal Trade Commission's Corrected Brief on its Mot. for Preliminary Injunction at 9, FTC v. Whole Foods Market, Inc., 502 F. Supp. 2d 1 (D.D.C. 2007) (No. 07-cv-01021) ("In enacting Section 13(b), Congress adopted a 'public interest' standard."); Proof Brief for Appellant Federal Trade Commission at 29, FTC v. Whole Foods Market, Inc., No. 07-cv-01021 (D.C. Cir. Jan. 14, 2008) ("Section 13(b) makes the ultimate issue in a 13(b) proceeding whether a preliminary injunction is 'in the public interest'"); *see* Plaintiffs' Mem. of P. & A. in Opp'n to Defs.' Mot. for a Scheduling Order & an Expedited Status Conference at 3, FTC v. Inova Health Sys. Found., No. 1:08-cv-460 (E.D. Va. May 20, 2008) ("[A] preliminary injunction would be in the public interest . . . . As the Fourth Circuit has held, the district court is *not* called upon to reach a final determination on the antitrust issues . . . .").

[13] Transcript of Hearing, FTC v. Inova Health Sys. Found., No. 1:08-cv-460, at 8 (E.D. Va. May 30, 2008) ("[T]he Fourth Circuit has said that the only purpose of a proceeding under Section 13, which is what brings us here today, is to preserve the status quo until the FTC can perform its function.").

Section 13(b) analytical emphasis squarely on the equities affecting the public interest, without regard for the likelihood of ultimate success:

> "although 'likelihood of success' is *one* factor to be taken into account, it is not the *only* factor. . . . In short, Congress recognized that even when success on the merits is not likely, it's generally in the public interest that the status quo be maintained until the merits can be fully examined in a plenary trial before the Commission."[14]

The FTC could hardly have hoped for a better ruling on the appropriate standard to be applied than the D.C. Circuit gave it in *Whole Foods*. Based on Congress's recognition that the traditional four-part equity test was not appropriate for implementation of a Federal statute by an independent regulatory agency, the D.C. Circuit determined that the FTC need not show any irreparable harm and that private equities alone cannot override the FTC's showing of likelihood for success. Moreover, the D.C. Circuit held 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 "just has to raise substantial doubts about a transaction. One may have such doubts without knowing exactly what arguments will eventually prevail."[15] In effect, the D.C. Circuit determined that a district court must use a sliding scale in balancing the likelihood of the FTC's success against the equities. It found that the district court misapplied this standard by focusing only on the FTC's likelihood of success and failing to consider the equities.

[14] J. Thomas Rosch, Comm'r, FTC, A Peek Inside: One Commissioner's Perspective on the Commissioner's Roles as Prosecutor and Judge, Remarks Presented at the NERA 2008 Antitrust & Trade Regulation Seminar (July 3, 2008), *available at* http://ftc.gov/speeches/rosch/080703nera.pdf at 12.

[15] *Id.* at 11.

The D.C. Circuit added that "[t]he equities will often weigh in favor of the FTC" and that "the FTC will usually be able to obtain a preliminary injunction blocking a merger by rais[ing] questions going to the merits so serious, substantial, difficult[,] and doubtful as to make them fair ground for thorough investigation."[16] The D.C. Circuit concluded that by raising such issues, the FTC creates a presumption favoring a preliminary injunction.

III. THE NEED TO DEFINE MARKETS

In recent months, the FTC has also begun to deemphasize the need to prove a relevant market. This too is a major change. Going back to *Brown Shoe*, the government has defined the market in which the parties compete and competitive concerns are likely ("determination of the relevant market is a necessary predicate to a finding of a violation of the Clayton Act. . . . Substantiality can be determined only in terms of the market affected."[17]). Indeed, the government's own Horizontal Merger Guidelines ("Guidelines") state that "[t]he Agency will first define the relevant product market with respect to each of the products of each of the merging firms."[18] On a product by product basis, the Guidelines require that the FTC "will take into account all relevant evidence" of the appropriate market definition and outlines a nonexhaustive list of evidentiary sources to be considered.[19]

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[16] *Id.* at 8 (internal citations and quotations omitted).

[17] Brown Shoe Co. v. United States, 370 U.S. 294, 324 (1962) (internal quotations omitted, quoting United States v. E.I. du Pont de Nemours & Co., 353 U.S. 586, 593 (1957)).

[18] U.S. Dep't of Justice & FTC, Horizontal Merger Guidelines § 1.1 (Apr. 2, 1992), *reprinted in* 4 Trade Reg. Rep (CCH) ¶ 13,104.

[19] *Id.* § 1.11.

Yet, in its appeal in *Whole Foods*, the FTC sought to move away from making market definition the necessary first step in the process. This change in emphasis was foreshadowed in a joint Commentary on the Guidelines issued by the U.S. Department of Justice ("DOJ") and FTC in March 2006 which articulated an "integrated approach" to their application where "[t]he ordering of [the] elements in the Guidelines . . . is not itself analytically significant."[20] The Commentary argued that creating a "market definition is not isolated from the other analytic components in the Guidelines. The Agencies do not settle on a relevant market definition before proceeding to address other issues."[21] Commissioner Rosch squarely addressed the analytical role of market definition in a recent speech on June 2, 2008. He argued that it is a "mistake" for courts to "focus[] on market definition as a 'threshold issue' in merger litigation"[22] and that an "emphasis on market definition . . . is wrong as a matter of law and as a matter of economics."[23] While not calling for the elimination of a market definition altogether, he stressed its diminished utility because, in some cases, the answer to the ultimate question of whether a transaction will substantially lessen competition does not have to turn on market definition and therefore the market definition "should not be the focus of the analysis."[24]

[20] U.S. Dep't of Justice & FTC, Commentary on the 1992 Horizontal Merger Guidelines at 2 (Mar., 2006), *available at* http://www.ftc.gov/os/2006/03/CommentaryontheHorizontalMergerGuidelinesMarch2006.pdf.

[21] *Id.* at 5.

[22] J. Thomas Rosch, Comm'r, FTC, Litigation Merger Challenges: Lessons Learned, Remarks Presented at the Bates White Fifth Annual Antitrust Conference (June 2, 2008), *available at* http://ftc.gov/speeches/rosch/080602litigatingmerger.pdf, at 2.

[23] *Id.* at 4.

[24] *Id.* at 2.

On this issue, too, the *Whole Foods* opinion greatly aided the FTC's efforts. The FTC had asserted a market of PNOS in the district court and the D.C. Circuit decided the case on that basis. However, the D.C. Circuit commented that "[i]nexplicably, the FTC now asserts that market definition is not necessary in a § 7 case."[25] Notwithstanding that critical comment, the D.C. Circuit seemed to agree stating that "a merger between two close competitors can sometimes raise antitrust concerns due to unilateral effects in highly differentiated markets. In such a situation, it said, it might not be necessary to understand the market definition to conclude a preliminary injunction should issue."[26] This is the closest any court in a merger decision has come to stating that market definition takes a back seat where competitive effects can be proven.

IV. THE ROLE OF ADMINISTRATIVE PROCEEDINGS

The FTC's most striking move to change merger enforcement may be the attempted revival of the administrative trial as a meaningful tool in its merger enforcement arsenal. In the late 1980's and early 1990's it was fairly common for the FTC to bring administrative proceedings even after it lost in federal court. However, in the mid 1990's, the FTC issued a policy statement on the factors it would assess in deciding to continue with an administrative proceeding when a court had refused to enjoin the transaction. In a case by case assessment, the FTC stated it would consider: (1) the findings of fact or law made by the district or appellate court, (2) new evidence presented in the preliminary injunction hearing, (3) "whether the transaction raises important issues of fact, law, or merger policy that need resolution in an administrative

[25] *Whole Foods*, 533 F.3d at 876.

[26] *Id.* at 877 n.1 (internal citation omitted).

litigation," (4) "an overall assessment of the costs and benefits of further proceedings," and (5) any other matters affecting the public interest in favor of proceeding with the administrative proceeding.[27]

More recently, the FTC has changed gears. It has brought administrative proceedings and, in some cases, sought to conduct them at the same time as the federal court injunction proceeding. For instance, in *Inova,*[28] the FTC contradicted its usual practice and filed an administrative complaint two days before seeking a preliminary injunction in federal court. In doing so, the FTC refused to stay the administrative proceeding pending the outcome of the federal court proceeding (which it had done in the *Whole Foods* administrative proceeding). This was apparently done in an attempt to convince the federal court that the "real" trial should be an administrative trial and that the merits should not be seriously addressed at the preliminary injunction stage. Similarly, in *Equitable Resources*,[29] the Commission filed an administrative complaint and, a month later, an action in district court for injunctive relief. The Commission rejected a request to stay the administrative proceeding during the district court case and issued a full scheduling order including a trial date. The Commission continued with the administrative proceeding even after losing in district court on state immunity grounds, until the parties finally abandoned the transaction.

[27] Statement of Federal Trade Commission Policy Regarding Administrative Merger Litigation Following the Denial of a Preliminary Injunction, 60 Fed. Reg. 39,741 (Aug. 3, 1995).

[28] *See* In re Inova Health Sys. Found., FTC Docket No. 9326, *available at* http://www.ftc.gov/os/adjpro/d9326/index.shtm.

[29] *See* In re Equitable Resources, Inc., FTC Docket No. 9322, *available at* http://ftc.gov/os/adjpro/d9322/index.shtm.

In a recent speech, Commissioner Rosch explained the motivation for the increased use of administrative proceedings. "Congress concluded that it was in the public interest to grant this judicial authority to the Commission *instead of to the federal district courts*" and according to Commissioner Rosch, the recent trend of cases in effect holding "plenary trials on the merits" is contrary to this original congressional intent.[30]

At one level, the D.C.Circuit's decision, by utilizing a standard that gives great deference to the FTC, supports the FTC's attempts to move the substance of any merger challenge to an administrative proceeding. At the same time, the D.C Circuit suggests nothing inappropriate about Judge Friedman's hearing of live testimony and the use of extensive discovery in the district court proceeding. Indeed, the D.C. Circuit suggested that Judge Friedman expedited the proceeding as a courtesy to the defendants, but "should have taken whatever time it needed to consider the FTC's evidence fully."[31] In that sense, the D.C. Circuit did not endorse the approach the FTC advocated in *Inova*—that there need be no discovery, no cross-examination, no live witnesses, and merely an hour hearing to decide the FTC's motion for preliminary injunction.

V. GOING FORWARD

Our bottom line view is that *Whole Foods* advances many of the Commission's goals in strengthening its ability to block mergers.

[30] J. Thomas Rosch, Comm'r, FTC, A Peek Inside: One Commissioner's Perspective on the Commissioner's Roles as Prosecutor and Judge, Remarks Presented at the NERA 2008 Antitrust & Trade Regulation Seminar (July 3, 2008), *available at* http://ftc.gov/speeches/rosch/080703nera.pdf. at 11-13 .

[31] *Whole Foods*,533 F.3d at 882.

- Without an initial requirement of proving market definition, the FTC will have much greater flexibility to bring cases because the FTC need not take a position on a key aspect of the case it must eventually prove.
- In finding that the FTC's request for a preliminary injunction creates a presumption favoring the granting of such relief by raising serious and substantial questions on the merits, the D.C. Circuit has suggested the courts should largely defer to the FTC's determination that it has "reason to believe" a transaction violates Section 7, leaving final resolution of the legality of a merger to the FTC's administrative proceeding. At least in the D.C. Circuit, this lowers the barrier for the FTC to obtain preliminary injunctive relief.
- This decision reinforces the FTC's strategy of minimizing the role of the courts and increasing the role of the FTC's administrative process in merger enforcement. However, the decision adds to the current confusion among the circuits as to how extensive a hearing should be held in considering an FTC motion for preliminary injunction—cursory and on the papers or extensive with live witnesses and considerable discovery and cross-examination.

* * *

The Whole Foods saga is far from over. Having found that the FTC's market definition could potentially support a Section 13(b) injunction, the D.C. Circuit remanded the case for the district court to "address the equities . . . and see whether for some reason there is a balance against the FTC that would require a greater likelihood of success."[32] The Commission has also lifted the stay on the administrative proceedings, making clear it intends to pursue the case in that forum as well. What the ultimate outcome for Whole Foods will be remains to be seen. The more immediate and far-reaching impact of the

[32] *Id.* at 881.

decision, though, may be on transactions coming before the FTC in the months and years ahead.