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4 Things You Should Know About FTC V. Sysco

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On June 29, 2015, following an eight-day evidentiary hearing, a federal district court granted the Federal Trade Commission's[1] request for a preliminary injunction to block an $8.2 billion proposed merger between the two largest foodservice distribution companies in the United States:[2] Sysco Corporation and US Foods Inc. (USF). See FTC v. Sysco Corp., No. 15-cv-00256-APM (D.D.C. June 29, 2015).

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In a long opinion heavy on cites to the record, the court found that the proposed merger, which would eliminate USF, was likely to result in high market concentrations in two relevant markets — broadline foodservice distribution[3] to national customers and broadline foodservice distribution to local customers. True to their prehearing representations to the court, Sysco and USF have since announced that they have abandoned the transaction.

Here are four things you should know about the Sysco decision and its effect on your business:

1. If a customer's requirements serve as the basis for a product offering, then that customer may define a relevant market.

The Sysco court defined a product market around national customers like health care group purchasing organizations, foodservice management companies, and large hotel and restaurant chains. While recognizing that defining a market around a customer "is not free from controversy,"[4] the district court relied on "the ordinary factors that courts consider in defining a market" — including the practical-indicia test from Brown Shoe Co. v. United States, 370 U.S. 294, 325 (1962) — to find that broadline distribution to national customers was indeed a relevant product market.

To compete for national customers, broadline distributors had to offer "a cluster of goods and services that [could] be delivered across a broad geographic area." And the evidence and hearing testimony revealed that the defendants leveraged their comprehensive distribution networks to serve national customers, and that "either Sysco or USF essentially wins every RFP issued by a national customer." The court rejected the defendants' counterexamples of large customers who use regional suppliers as inconsistent with "the actual purchasing habits of the industry's largest customers," who still used Sysco and USF. Ultimately, the court accepted the opinion of the FTC's expert that the post-merger combined

market share of the parties in the national broadline distribution market would be 59 percent, and found that the merger would substantially lessen competition.

2. Divestiture is not always the answer.

During the FTC's investigation of the merger, Sysco and USF had announced an asset purchase agreement with the third-largest broadline distributor, Performance Food Group Inc. (PFG), whereby PFG would acquire the assets and employees at 11 USF distribution centers for $4.5 billion — a move that would increase PFG's geographic footprint in the western half of the United States. The defendants argued that the divestiture of these 11 distribution centers to PFG, which had independent plans for expanding its regional scope, would replace any competitive intensity lost as a result of the merger.

Without any "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 looked to the U.S. Department of Justice's 2004 and 2011 "Policy Guide to Merger Remedies." Both guides provided that "the divestiture assets must be substantial enough to enable the purchaser to maintain the premerger level of competition, and should be sufficiently comprehensive that the purchaser will use them in the relevant market and be unlikely to liquidate or redeploy them." Based on this guidance, the court was "not persuaded that post-merger PFG will be able to step into USF's shoes to maintain ... the pre-merger level of competition that characterizes the present marketplace."[5] Post-merger PFG was projected to achieve less than half of USF's current national customer sales in 2020, would face higher acquisition costs and offer fewer SKUs than the merged Sysco-USF entity, and would not be a truly independent competitor due to its reliance on the merged entity to license USF private-label products for a three-year period.

3. An efficiencies defense remains a tough sell.

Noting the absence of any cases in which the merging parties had successfully rebutted the government's prima facie case based on efficiencies, the court found that the defendants' efficiencies defense fell short. While the court was "unpersuaded" by the defense expert's opinion that there would be $490 million in merger-specific savings, it calculated that, if the expert's number were to be accepted, the total estimated merger-specific efficiencies would only amount to less than one percent of the merged entity's annual revenue. So, "even a modest increase in price could offset any cost savings generated by the efficiencies," such that the efficiencies were insufficient to overcome the benefits achieved through existing competition.

4. The acquisition of the second largest firm in the market by the largest firm in the market will tend to draw a regulatory challenge.

In its conclusion, the Sysco court quoted from the concurring opinion in FTC v. Whole Foods Market Inc.: "[T]here 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." 548 F.3d 1028, 1043 (D.C. Cir. 2008) (Tatel, J., concurring) (quoting FTC v. Whole Foods Market Inc., 502 F. Supp. 2d 1, 8 (D.D.C. 2007)). While this statement cannot always be correct, as there are many markets where the largest and second-largest firms could merge without any objective competitive concern, it is indicative of the heightened regulatory and judicial scrutiny that any merger of two market leaders attracts.

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[1] The District of Columbia and 11 states joined the FTC.

[2] Foodservice distribution is a $231 billion industry with more than 16,000 companies participating in the marketplace.

[3] According to the Sysco court, "[b]roadline distribution is characterized by several key features, including: (i) product breadth and depth; (ii) availability of private-label products; (iii) frequent and flexible delivery, including next-day service; and (iv) 'value-added' services, such as menu and nutrition planning."

[4] Compare FTC v. Whole Foods Market, Inc., 548 F.3d 1028, 1037 (D.C. Cir. 2008) (Brown, J.) (explaining that "core customers" can be "worthy of antitrust protection"), with id. at 1062 (Kavanaugh, J., dissenting) ("[T]here is no support in the law for that singular focus on the core customer.").

[5] In fact, even PFG initially believed that it would need more than 11 distribution centers to establish a national broadline network.
