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Supermarket Merger Enforcement

by David A. Balto[1]

Like many other industries, food retailing is experiencing a period of dramatic consolidation. This restructuring is not unique; rather, the food retailing industry in going down the same road being traveled by banks, drug stores, and other retail businesses in which chain identity is becoming increasingly important. Some of the largest supermarket mergers in history have been announced in the past few years. Five mergers reviewed by the Federal Trade Commission in just the past twelve months have involved firms with total sales of over $110 billion, including Albertson's acquisition of American Stores (the second and fourth largest chains in the U.S.) and Kroger's acquisition of Fred Meyer, which created the largest U.S. supermarket chain. The number of supermarket mergers has increased from 20 in 1996, to 25 in 1997, to 35 in 1998.[2] As one would expect from these numbers, the concentration levels of the industry have also increased. In 1992, the top five supermarket chains had 19% of the market; in 1999 that share has almost doubled to 33%.[3]

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[2]See "How Big is Too Big? The Role of the FTC in Supermarket Industry Mergers," 2 Grocery Headquarters 24 (Feb 1, 1999).

[3]See "Food for thought: Going into the Grocery Business," 39 Discount Merchandiser 5 (May 1999);

The vast majority of supermarket mergers do not raise competitive concerns. Yet in the last four years the FTC has taken more than ten enforcement actions involving supermarket mergers, more than in any other industry except pharmaceuticals. Most of these enforcement actions have been efficiently resolved through divestitures in those areas in which there were competitive overlaps.

This article describes some of the most important transactions and enforcement actions, with the goal of providing an account of how supermarket enforcement has evolved. In particular, I discuss recent important enforcement initiatives and illuminate some emerging principles of analysis that follow from these actions. By explaining the current thinking on these issues, I hope to provide a roadmap for the analysis of future mergers and acquisitions in the supermarket industry.

The article begins with an analysis of litigated retail mergers, describing three cases more than three decades apart. These are *Von's*, the most important early supermarket case, the *American Stores* decision, one of the few recent litigated supermarket mergers, and the *Staples* case, which involved office superstores in a more contemporary retail setting. The second section addresses the analytical framework for supermarket merger analysis, including relevant product and geographic market, competitive effects, entry, and efficiencies. The third section addresses FTC enforcement actions, describing eight supermarket merger cases recently resolved by consent orders. The discussion focuses on the remedies used in these cases, particularly the FTC's increased preference for committed up-front buyers of divested assets.

Litigation of retail mergers: from *Von's* to *Staples*

Much of the jurisprudence of supermarket mergers is in the form of negotiated consent orders. Ultimately, however, all consent negotiations should and do reflect the parties' assessments of how a court would rule if called upon to do so. The relatively few litigated cases in this industry have special importance because they establish the framework and parameters for much that follows.

In terms of economic history, supermarkets are a relatively new kind of retail competitor. Thus, supermarket merger enforcement began only in the 1960s with *United States v. Von's Grocery Co.*,[4] the Justice Department's challenge to Von's acquisition of Shopping Bag Food Stores, a merger that would have resulted in a firm with just under 9% of the market in the Los Angeles/Orange County area. In a case that preceded the first federal Merger Guidelines, which were published in 1968, the government defined grocery store market broadly so that it included practically any retail store selling food, including corner markets, so that there were almost 4,000 firms in the market, over 3,700 of which were single store entities. The government's case centered primarily on the decrease in the number of single store firms in the market. From 1950 to 1963, three years after the merger, the number of single store firms in the Los Angeles decreased from 5,365 to 3,590. The district court rejected the government challenge based on numerous economic factors. First, entry into the market seemed simple, because there were many experienced supermarket executives available to lend managerial expertise, and some entry had occurred at the cost of only $5,000 a store. Second, the market shares of the largest firms in the relevant market, Safeway and Ralph's, had declined. Third, new competitors such as discount stores had emerged to compete with grocery stores.

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[4] 384 U.S. 270 (1966).

The Supreme Court reversed, focusing primarily on the fact that there was an increasing trend toward consolidation in the market. The Court noted the continuation of that trend, citing an FTC study that showed that "acquisitions and mergers in the Los Angeles retail grocery market have continued at a rapid rate since the merger."[5] The Court did not address the more contemporary concerns of market definition, entry or competitive effects .[6] It was in *Von's* that dissenting Justice Potter Stewart noted that "the sole consistency that I can find is that in litigation under § 7, the Government always wins."[7] He also observed that "Section 7 was never intended by Congress for use by the Court to roll back the supermarket revolution."[8]

Following the issuance of the 1968 Merger Guidelines there were some litigated supermarket mergers in the 1970s and 1980s with ambiguous results, but not a lot of substantive clarity. Only after the Merger Guidelines were revised in 1982 did supermarket merger analysis began to mature. The application of the analysis set out in the Guidelines took full form in the *California v. American Stores Co.*[9] decision. This case grew out of the State of California's 1988 challenge to American Store's acquisition of Lucky Stores. American Stores Company was one of the largest supermarket chains in the country, owning over 1,500 retail grocery stores in forty states. In California, American Stores owned 252 stores and Lucky owned over 300. The FTC conducted an extensive investigation and entered into a settlement agreement which

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[5] *Von's*, 384 U.S. at 274.

[6] *Id.* at 278..

[7] *Von's*, 384 U.S. 270, 301 (1966)(Stewart, J., dissenting).

[8] *Id.* at 288.

[9] 495 U.S. 271 (1990).

required divestiture of between thirty-one and thirty-seven stores in California.[10] American divested the required stores, and in June 1988, consummated the transaction.

California, however, did not believe the divestiture sufficient. On the day after the FTC gave its final approval to the merger, California filed suit in federal court alleging that the merger, even as restructured, was unlawful, and seeking a permanent injunction against the acquisition by American of all Lucky assets in California.[11]

Litigation of the case focused on four issues: relevant product market, relevant geographic market, entry, and competitive effects. First the state argued that the relevant product market was the sale of food by supermarkets – with "supermarkets" defined as full line grocery stores of more than 10,000 square feet. That contention was based on the argument that only full line supermarkets were able to provide the one-stop shopping that consumers desired. In addition, the state presented evidence that the defendant's own marketing documents focused on supermarket shoppers and competition from other supermarkets, not on other retail suppliers of groceries.

Defendants argued that the relevant product market included retail grocery purchases from a far wider range of outlets, including "mom and pop" retail grocery stores, community grocery stores, and non-grocery outlets such as department stores and gasoline service stations. The court defined the relevant market as supermarkets. It accepted that some of the smaller outlets did offer competition on a few food items such as bread and milk. But that was not

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[10] *American Stores Co.*, 111 F.T.C. 80 (1988).

[11] *California v. American Stores Co.*, 697 F.Supp. 1125 (C.D. Cal. 1988). The FTC had negotiated a hold separate order with American. Although the defendants maintained that the merger had already been consummated and that California's request for an injunction was in reality a request for divestiture, the court held that it was not, based on the hold separate order.

sufficient to justify inclusion of all retail sales from "whatever outlet in the relevant product market."[12]

In terms of relevant geographic market, the defendants argued that they consisted of 14 individual metropolitan statistical areas ("MSAs"). The state countered that those areas were too large to constitute true antitrust geographic markets because they ignored natural boundaries and practical realities. The state contended that there were a number of distinct markets within these 14 MSAs, representing as many as 62 relevant geographic markets. The court assumed that the defendant could prevail at trial on the relevant geographic market issue, but did not find the issue dispositive because, even if the defendants' relevant market was used, the "numbers indicate the proposed merger would result in further concentration of an already highly concentrated market."[13]

Even within the defendants' broader geographic markets the court had little difficulty in finding significant anticompetitive effects. It found that statistical evidence concerning post-merger market shares and concentration, as well as a trend towards increasing concentration, "overwhelmingly creates" a "presumption that increased concentration" would result from the proposed merger and that concentration would "substantially lessen competition in the markets."[14]

Turning to the issue of entry barriers, the court placed the burden on the defendant to demonstrate that entry barriers were so low that any anticompetitive impact of the merger would

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[12] *Id.* at 1129.

[13] *Id.* at 1130.

[14] *Id.* at 1131.

be deterred or eliminated by new entry into the market. Defendants argued that supermarkets in California could be opened rapidly without obstacles in response to any opportunity to earn a good level of return. The court found that there was very little evidence to support such a claim, however; in several instances where there was abundant space available, firms were reluctant to enter.

Finally, on the subject of efficiency, the court seemed to question both the legal basis for the claims, noting that an efficiency defense was rejected by the Supreme Court in *United States v. Philadelphia National Bank*,[15] and the factual basis. The merging firms suggested there would be annual cost savings of between $50 and $78 million. The court seemed to question whether those savings could really be achieved, however, due to the significant debt that the acquiring firm assumed in order to carry out the $2.5 billion buyout.

The District Court's substantive decision was affirmed by the Ninth Circuit.[16] That court, however, rejected the district court's finding that injunctive relief could be granted to the state of California. The court held that, under the Ninth Circuit standard, divestiture was not available as a form of relief to private parties under section 16 of the Clayton Act,[17] and that the merger had already taken place since American had acquired all of the outstanding shares of

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[15] 374 U.S. 3321 (1963).

[16] The Ninth Circuit opinion hinted that it might have reached different conclusions on the issues of entry and market definition, were those questions before it, but it applied an abuse of discretion standard and held that the conclusions reached by the trial court were within the proper range of its discretion at this stage of the proceedings. *See California v. American Stores*, 872 F.2d 837, 841, 842 (9th Cir. 1989).

[17] *See International Telephone & Telegraph Corp. v. General Telephone & Electronics Corp.*, 518 F.2d 913 (9th Cir. 1975).

Lucky.[18] The Supreme Court subsequently reversed the Ninth Circuit on the question of the availability of divestiture as allowable injunctive relief under section 16.[19] In the end the case was resolved with the divestiture of 161 stores.

Almost ten years later, the revolution in distribution had taken full effect in retailing. The changes in retailing affected more than sales of food products. They swept across all retail segments. One of the most important changes was the arrival of "superstores," very large stores which sell a wide variety of items of a particular class, in a single location. The key attribute of superstores is that they promise the opportunity for one-stop shopping. Thus, the product being provided is not only the actual goods purchased, but also the distinctive retailing environment.

This notion -- that one-stop-shopping can define a relevant market -- was critical to the relevant market outcome in *American Stores,* and was followed a decade later in *FTC v. Staples,*[20] a case which, although it did not concern food retailing, provided important guidance for future supermarket cases. In 1997, the FTC sued to block the proposed merger of Staples and Office Depot, two of the three largest chains of office supply superstores. The transaction was valued at $ 4 billion, would have involved approximately 1,000 such stores, and would have affected competition in approximately 40 metropolitan-area markets where the two firms competed directly. There the consolidation would have been from 3 firms to 2, or from 2 to 1.

To prevail, the FTC had to show that "office supply superstores" were a relevant product market. Otherwise, the two merging firms would have been lost in a sea of general-purpose

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[18] *American Stores,* 872 F.2d at 845.

[19] 495 U.S. 271 (1990).

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

channels for office supplies, including mail-order houses and small stores. Although *American Stores* provided some support for this definition, other cases had rejected a superstore market.[21] As in *American Stores,* the *Staples'* court found that office supply superstores did have a unique cluster of characteristics that seemed to distinguish them from others.[22] Unlike other retail store formats, office superstores offered small businesses and consumers the convenience of one-stop shopping for a wide variety of office supplies, computer products, and office furniture at deep discount prices.

The FTC relied on a rich variety of evidence to support its product market definition. First and foremost was the pricing evidence. Consumer preference for one-stop-shopping made these stores each other's closest competitors. In addition, there was evidence that prices were not significantly constrained by other retailers of office supplies. Prices were, however, systematically lower in cities where the two chains were present, and lower still in cities where a third chain was present as well. Second, there were several "practical indicia" of an office superstore market. The parties identified such a market in their documents, and they focused primarily on other superstore competitors in establishing price zones and checking prices. They focused on each other in making long range plans and entry decisions. Finally, Judge Thomas Hogan, the district court judge, actually visited various sellers of office supplies in Rockville, Maryland and found that office superstores offered shoppers a unique retail format. He explained that "office superstores are, in fact, very different in appearance, physical size, format, the number

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[21] *See Thurman Industries, Inc. v. Pay 'N Pak Stores, Inc.*, 875 F.2d 1369 (9th Cir. 1989).

[22] For a discussion of cluster markets see William Blumenthal and David A. Cohen, "Channels of Distribution as Merger "Markets": Interpreting *Staples* and *Cardinal,"* Antitrust Report 2 (Nov. 1998).

and variety of SKU's offered, and the type of customers targeted and served than other sellers of office supplies."[23]

Once the crucial issue of product market was decided, the rest of the case was relatively straightforward. The court went on to find a likelihood of anticompetitive effects, and to find that this competitive harm would not be overcome by entry or efficiencies (more on that later) . The court enjoined the merger in June 1997, and the transaction was then abandoned.

Analysis of supermarket mergers

What are the critical antitrust issues in analyzing supermarket mergers? Six general principles can be extracted from the cases and FTC enforcement actions: (1) the relevant product market continues to be "supermarkets;" (2) geographic markets are typically local; (3) competitive effects may rise from either unilateral or coordinated conduct; (4) concerns over potential competition may lead to enforcement action; (5) entry barriers may often be substantial; and (6) efficiency claims require careful scrutiny.

The relevant product market continues to be "supermarkets" – The critical first step in antitrust analysis is the definition of the relevant product market, within which competition takes place. The FTC has continued to follow the analysis in *American Stores* that "supermarkets" are the relevant product market. Scores of retailers sell food to varying degrees, including drug stores, specialty stores and convenience stores. Yet only supermarkets offer the opportunity to engage in one-stop shopping for a broad range of food and grocery products, as well as non-food products (more than 10,000 different items) and a deep inventory of those items. In its orders,

[23] *Staples*, 970 F.Supp. at 1078.

the FTC typically defines supermarkets as stores with at least 10,000 square feet of selling space and sales greater than $2 million per year.

The Commission's view that supermarkets constitute a relevant product market is buttressed by a wide range of evidence, confirmed in numerous investigations. Supermarkets price primarily against other supermarkets and internal documents show that they usually view other supermarkets as their primary competitors. Other specialty food stores or mass merchandisers, such as Wal-Mart, K-Mart or Target do not offer the same range of products that permit one-stop shopping, and thus are not seen as offering a significant competitive constraint.[24] Often supermarkets only price check other supermarkets.

Supermarkets are a cluster market in that they pull together a set of products and services in a single location. The concept of a cluster market has been criticized occasionally. In an insightful article on the subject, Bill Blumenthal and David Cohen attempt to characterize the factors that are essential to a viable cluster market.[25] One important factor is whether participants in the distribution channel perform a bundling function that reduces transactions costs. In addition, a cluster is more viable if : (1) the distribution channel is characterized by repeat purchases; (2) the average value of any individual component of the cluster is low relative to the cost of declustering; and (3) the goods do not require significant search costs. Supermarket purchases represent a prime example of each of these factors.

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[24] In 1997 Stop & Shop petitioned the Commission to modify a 1995 order that required supermarket divestitures, in part due to new entry by Trader Joe's into the relevant Boston metropolitan market. The Commission rejected that argument, stating that "the Commission does not consider the Trader Joe's store to be a supermarket as that term is defined in the order." 121 F.T.C. 1721, 1725 (1997).

[25] Blumenthal & Cohen, *supra* at 16.

One interesting question on the horizon is whether warehouse membership clubs such as Costco or Sam's Club should be in the relevant product market for food sales. These stores require a membership fee and occasionally are limited to select groups and businesses. These stores generally offer a much more limited range of supermarket type items, however, and do not appear to constrain supermarket pricing as well as other supermarkets.

As retail formats change, club stores and discount stores may offer more food items. At what point do they become part of the relevant market? Is it simply a matter of the square footage devoted to groceries or the number of SKUs? Those will be factors, but probably even more important will be the type of "competitive interaction" and pricing evidence that was central to the decision in *Staples*. There, many firms, including club stores, sold office supplies. In some cases, these rivals offered a vast number of SKUs that seemed comparable to that offered at Staples and Office Depot. But the evidence demonstrated that only office superstores were able to compete effectively against and constrain one another. Still, grocery sales are a dynamic part of the retailing environment and other kinds of firms may become closer competitors for supermarkets in the future.

Geographic market definition is central in any antitrust case – The Commission's enforcement actions suggest that geographic markets in the supermarket business are typically local, although sometimes they may consist of entire metropolitan areas. In defining a geographic market, the Commission begins by looking at the area of competition between the individual stores (e.g., overlap markets). Obviously the area of competition will depend upon how far consumers are willing to travel to shop for groceries. After identifying the overlap trade areas, the relevant market is expanded to include other supermarkets serving the same customers

because these are the alternative sellers to whom the parties' customers would be likely to turn for supply if the initial pair of merging stores were to increase price after consummating the merger. This analytical process frequently results in the identification of an area of overlapping markets, through which prices across an extended area tend to be competitive with one another. This larger market can be as large as a metropolitan area, such as a MSA.[26] Other retail market mergers, such as bank, drug store, and department store mergers have also used MSAs as relevant markets. In fact, the relevant geographic market in *Staples* were MSAs.

Other factors may tend to break the continuity of the tentative market and result in smaller markets. These factors include both manmade and natural barriers to trade, such as waterways, mountains, parks and reserve lands, military installations, or lack of access.[27] Less-than-metropolitan markets may result from traffic density, population density, and specialized demographics.

The geographic market in any particular case can obviously be relatively small or very large. For example, in *Red Apple*, involving New York City, some of the geographic markets were limited to parts of individual neighborhoods.[28] Some special characteristics of Manhattan

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[26] In the Purity Supreme/Stop & Shop matter the Commission defined a geographic market that consisted of the Boston metropolitan area and parts therein. *The Stop & Shop Companies, Inc.*, C-3649 (April 2, 1996) (consent order). In the Schnucks/National case, the geographic market was defined as the Saint Louis MSA. *Schnuck Markets, Inc.*, C-3585 (April 2, 1995) (consent order).

[27] *See Vons Companies, Inc.*, 115 F.T.C. 710 (1992) (consent order) (relevant geographic market for the merger of two supermarkets was limited to San Luis Obispo, California due to surrounding ocean and mountain ranges).

[28] *Red Apple Supermarkets, Inc. v. Deltown Foods, Inc.*, 419 F.Supp. 1256 (D.C. N.Y. 1976).

tended to produce relatively small markets. Physical barriers like rivers and Central Park separate some areas, and mobility barriers, such as the fact that many Manhattan residents go shopping on foot, also tended to result in smaller markets. On the other hand, in the recent *Albertson's* enforcement action, large sections of more mobile, car-driving Los Angeles County were defined as a single large geographic market. In *FTC v. Food Town Stores, Inc.*,[29] the FTC defined the markets as cities and counties in rural areas in North Carolina.

It is important to remember that the test for a relevant geographic market does not require that the boundaries be absolutely airtight. The test is whether a sufficient number of consumers would continue to patronize the post-merger firm so that a price rise would be profitable over all -- that is, whether the additional profit from the price increase over the remaining customers exceeds the profit lost from the consumers on the fringe whose are likely to leave the geographic area. Consequently, consumers could still be lost on the fringes of a geographic market, and yet the market could still be sufficiently established for antitrust purposes. This observation is equally true for defining product markets.

Competitive effects can involve unilateral or coordinated conduct -- Once product and geographic markets are properly identified, the analysis then focuses on the core issue of whether anticompetitive effects are likely in those markets because of the merger. Although the Commission begins its analysis of competitive effects by measuring market shares and levels of concentration, it does not end there. Rather it analyzes whether the merger would result in anticompetitive effects -- either *unilateral* effects where the merged firm can unilaterally increase prices, or *coordinated* anticompetitive effects where the merger enhances the ability of firms in

[29] 547 F.2d 247 (4th Cir. 1977).

the market to coordinate a price increase. The analysis of supermarket mergers typically involves some combination of concerns over both unilateral and coordinated anticompetitive effects.

Under the Merger Guidelines,[30] unilateral anticompetitive effects typically arise where the supermarket has a post-merger market share above 35%. Unilateral anticompetitive effects may occur when the merging parties are close substitutes to each other in geographic proximity, store format, quality, or prices. Where the firms are particularly close in these respects, they may, after a merger, be able to raise prices even if other supermarkets remain in the market and do not assist or match the price increase. This is so because the other firms may be perceived by customers as significantly imperfect substitutes, and these customers will remain with the merging firms even though the terms of trade become less favorable to them. This is especially true when the two merging firms were particularly close substitutes in terms of price, as when the only two aggressive discounters in a market were to merge. These concerns may be buttressed where the merging parties directly target each other for their pricing decisions.

Some may question whether an individual supermarket chain can exercise market power. There is an interesting example that may be suggestive of concerns in this area. In 1997, the New York Attorney General settled charges against Wegman's, one of the two largest supermarket chains in western New York, and ten manufacturers alleging that they had conspired to reduce coupon issuance in Rochester, Buffalo, and Syracuse newspapers. The state alleged that Wegman's sought to induce manufacturers to eliminate or reduce their couponing.[31] The

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[30] United States Department of Justice and Federal Trade Commission, Horizontal Merger Guidelines (April 2, 1992), *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,104.

[31] Complaint, *In re Western New York Coupon Litigation*, Civ. No. 97 CV-0707A(M) (W.D.N.Y. Sept. 10, 1997).

manufacturers allegedly did so and reduced couponing from 1995-97. The case was settled with an agreement by the ten manufacturers to provide $4.2 million in newspaper coupons.[32] The case is similar to the FTC's case against Toys R Us, in which the Commission found that a large retailer was able to use its position as a powerful buyer to coordinate a conspiracy among manufacturers.[33]

The second type of anticompetitive effect may result from coordinated interaction. Here a firm cannot exercise power by itself, but may find that the merger has resulted in a market with so few players that a tacit agreement on higher prices becomes significantly more likely. In order for coordination to occur, firms need to have a mechanism to agree on prices, monitor competitors, and discipline those who vary from the collusive agreement. There are several factors that may suggest that coordinated interaction is a particular risk in a supermarket merger. These include: (1) the relatively small number of firms that would need to reach and enforce any agreement on coordinated behavior; (2) the relatively inelastic demand in the market, (i.e., relatively few consumers would actually switch to shopping in outlets other than supermarkets in response to small price increases); (3) relatively stable market conditions and relatively constant market demand; (4) price information that is readily available through mutual price checking, which enables the firms to easily signal price changes; (5) recognition of mutual interdependence (i.e., the firms all recognize that more vigorous price competition will reduce overall industry profits but will not significantly increase total industry sales); (6) the substantial increase in net profits

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[32] See "New York Settles Conspiracy Claims Against Manufacturers, Grocery Chain for Limiting Use of Coupons," NAAG Antitrust Report 11 (Sept./Oct. 1997).

[33] *Toys "R" Us, Inc.*, FTC Dkt. No. 9278 (Oct. 14, 1998). This case is currently on appeal to the Seventh Circuit.

that could be realized through coordinated behavior (e.g., given the slim margins in the industry, a one percent price increase may double net profits); (7) the ease of detecting cheating on any tacit agreement, since each firm's prices are publicly posted; and (8) the ability to discipline cheating by retaliating against the firm that defects from the agreement.

The key factor supporting a likelihood of coordinated interaction is the level of concentration. Economic studies have suggested that price and concentration in grocery markets are related.[34] Thus, the higher the level of concentration, the higher is the risk that an increase in concentration will lead to higher prices through collusion.

The suggestion is sometimes made that coordination is unlikely in the supermarket industry, since it offers such a large mix of products and services that agreement on the price of all these items would not be feasible. However, effective coordination does not require firms to agree on the price on every item or even each group of items. As the 1992 Merger Guidelines note, the terms of coordination may be imperfect and incomplete -- inasmuch as they omit some market participants, omit some dimensions of competition, omit some customers, yield elevated prices short of monopoly levels, or lapse into episodic prices wars -- and still result in significant competitive harm. Coordination could concern one aspect of competition and still be successful in such a way that it harmed consumers -- for example, a tacit agreement to end the practice of doubling manufacturers' coupons. Firms might also be able to increase profit significantly if

[34] Cotterill, "Measuring Market Power in the Demsetz Quality Critique in the Retail Food Industry," 15 Agribusiness 101 (1999); Marion, Bruce, "Competition in Grocery Retailing: The Impact of a New Strategic Group on BLS Price Increases," 13 Rev. Ind. Org. 381 (1998); Lamm, "Prices and Concentration in the Food Retailing Industry," 30 J. of Ind. Econ. 67 (1981).

they are able to reach agreement only on certain prominent "destination" products such as eggs or milk.

Potential competition remains relevant – Potential competition may also raise competitive concerns in these cases. The concept of "potential competition" refers to situations in which one of the merging firms is not currently present in the relevant market, so that its disappearance through merger may not deprive the market of a current participant, but where the firm is so positioned on the edge of the market that it nonetheless exerts a beneficial effect on competition. Potential competition effects may be of two kinds: perceived potential competition, in which incumbent firms are aware of the potential entrant in the wings and act accordingly, as may be the case if they begin to practice limit pricing in order to dissuade entry; and actual potential competition, in which incumbent firms are not necessarily aware of the entrant, but where the entrant still carries the possibility of actually increasing competition in the market if it were to come in at a future time.[35]

Several recent cases involve concerns over the loss of actual potential competition. For example, in the Kroger-Fred Meyer merger, Kroger was already planning to enter the market in Cheyenne, Wyoming, and would have come into competition with the Fred Meyer stores already in that market. The FTC therefore required divestiture of those stores. The same theory was present in a more subtle way in *Ahold/Giant*. There the FTC discovered one market in Pennsylvania where Ahold owned a shopping center but had not yet built a grocery store in it.

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[35] *See United States v. Falstaff Brewing Corp.*, 410 U.S. 526, 533-34 & n.13 (1973). Potential competition theories generally require a number of other elements as well, such as a showing that the market is already concentrated, that the merging firm is one of a limited number of potential entrants, and similar factors.

Nearby was a Super G owned by Giant. Since the Commission believed that Ahold might well develop the shopping center site in the future, it required that the Super G be included in the divestiture package. In *Albertson's/American Stores*, there were 4 markets where Albertson's was a potential competitor with American Stores and one market where American Stores was a potential competitor with Albertson's. In all five markets the proposed consent required divestiture of supermarket sites or stores. In each of these cases, the potential entry would have resulted in significant deconcentration in markets that were highly concentrated.

Entry--- Notwithstanding the existence of possible anticompetitive mechanisms such as unilateral or coordinated market power, a particular merger still may not raise concerns as long as entry or expansion in the relevant market is relatively easy. Firms then know that they cannot raise prices without attracting new competitors into the area.

The possibility of entry is frequently insufficient to allay concerns in the supermarket context, however. Entry will reduce competitive concerns only if it is likely to be sufficient, likely, and timely -- the latter concept being generally taken to mean that the entry must take place within two years. In supermarket context there are several reasons why de novo entry within a two-year period may be difficult. These include: (1) the difficulty of acquiring suitable sites; (2) governmental preconditions to construction, such as zoning laws, building permits and other regulatory requirements; (3) the unprofitability of entry or expansion where the market is mature or growing slowly, and (4) stagnant or declining demand in certain geographic markets, particularly central urban areas.

There is an interesting example that illustrates the existence of entry barriers and how an incumbent firm may act strategically to deter entry. In *Tops Market v. Quality Markets*,[36] Tops alleged that Quality, which has a dominant market share (72%) in Jamestown, N.Y. sought to retain that dominance by purchasing part of a land parcel in central Jamestown that Tops sought to develop for a new store. Tops sued, claiming that this was an act of illegal monopolization, and the Second Circuit permitted it to proceed on an attempted monopolization claim.

Perhaps the most important single factor bearing on the likelihood of entry is the difficulty that an entrant may encounter in assembling a critical mass of stores.[37] This critical mass may be necessary before a grocery chain can engage in market-wide advertising, particularly in big-city markets where the principal newspapers will serve a population larger than the customers of a single store. A critical mass of stores may also be needed to justify the entrant in constructing its own dedicated warehouse and distribution facility, something that will be particularly important in isolated markets that cannot be well served from the entrant's existing facilities. In the Purity Supreme/Stop & Shop merger, the FTC required that all seven Cape Cod stores be divested to a single buyer, based on the importance of critical mass in enabling the acquiring firm to compete in that market. Dividing the stores between two or three acquirers may have meant that none of the firms would have had the necessary scale to restore the rivalry lost from the merger.

The exact size of the critical mass at issue will vary with the market, but is probably not small, or easy to attain. Even in fast growing markets, a new entrant would probably need a

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[36] 142 F.3d 90 (2d Cir. 1998).

[37] See "Splurge 'N Merge," Supermarket News 1 (June 29, 1998) (quoting CEO of Ralph's, "It's harder to enter new markets one store at a time. It's much easier to leverage off critical mass.").

substantial number of supermarkets to enter. The presence of large incumbents may stymie entry on this scale because the incumbent firms will often have already opened stores in all or most of the most desirable locations in the most densely populated parts of the market, and may well have purchased options on most of the best locations in areas where future growth is projected. This is likely to force new entrants to open supermarkets in peripheral, sparsely populated, developing areas where the stores may operate unprofitably for several years until development of the area is completed.

Efficiencies -- One of the reasons given for the recent supermarket merger wave is the search for efficiency.[38] The two primary efficiencies sought by these mergers are increased buying power and economies of scale. But are these efficiencies enough to reverse the anticompetitive effects of a problematic merger?

First, the law has probably changed since the district court in *American Stores* expressed skepticism about whether efficiencies were cognizable as a matter of law. Since that decision the Justice Department and the FTC have amended the Merger Guidelines to take more careful consideration of efficiency claims, and several courts have considered such claims.[39]

But those Merger Guidelines establish an important standard. For efficiencies to be considered they must be merger-specific and cognizable. Merger specific means that the efficiencies can not be accomplished in a less anticompetitive fashion. Cognizable efficiencies are

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[38] See "Food for thought: Going into the Grocery Business," 39 Discount Merchandiser 5 (May 1999); "Everybody is doing it, mergers are old hat in the supermarket industry," 4 Progressive Grocer 31 (Apr. 1998).

[39] *See FTC v. Alliant Techsystems, Inc.*, 808 F.Supp. 9 (D. D.C. 1992); *FTC v. University Health, Inc.*, 938 F.2d 1206 (11th Cir. 1991).

those that can be verified and do not arise from anticompetitive reductions in output or service. A merger will not be challenged if the efficiencies "are of a character and magnitude such that the merger is not likely to be anticompetitive in any relevant market."[40] This is not simply a matter of comparing the magnitudes of the anticompetitive effects and the estimated efficiencies. Rather, it is essential to determine how the claimed efficiencies will affect market behavior. Where the potential anticompetitive consequences of a merger are substantial, the merger likely will be anticompetitive unless the efficiencies are extraordinarily great.

To date, efficiency claims have not been dispositive in any supermarket enforcement action. However, the analysis of efficiency claims in *Staples* may provide a useful illustration of how such claims are to be assessed.

Staples pointed to many efficiencies expected as a result of the combination of Staples and Office Depot stores, but the principal one was that the combined firm would have augmented purchasing power and could extract better prices from its various vendors.[41] The court rejected the efficiency claims on two principal grounds. First, it found that the claims were not based on "credible evidence," and appeared to be grossly exaggerated. The defendants' claims were "in large part unverified, or at least the defendants failed to produce the necessary documentation for verification."[42]

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[40] Merger Guidelines ¶ 4.

[41] Increased buying power is not an economic efficiency in the sense that it does not equate with producing higher output with fewer resources. Increased buying power merely extracts wealth from one set of economic actors (sellers) and transfers it to another (buyers). Unless that wealth is passed-on to consumers, it cannot be considered a merger-specific "efficiency."

[42] *Staples*, 970 F.Supp. at 1089.

But more important for future merger analysis is that the court noted that the efficiencies were not merger specific. Both parties to the merger were expanding rapidly by opening new stores, as many as 100 or 150 new stores per year for each, so that increased buying power, even assuming it could be used to extract better prices from vendors, would have occurred as a result of internal expansion absent the merger. If there was an efficiency in the merger, it involved the fact that the larger enterprise would be created immediately rather than over a period of 3 or 4 years. Those efficiencies would have been temporary and declining in significance, however. The merger, on the other hand, and its anticompetitive effects, would have been permanent.

In hindsight that assessment seems on the mark. Just three years after the proposed merger both Staples and Office Depot have achieved the size (about 1000 stores) that the single firm would have achieved through the merger. Thus, whatever efficiencies would have been accomplished through greater size are probably being achieved by both firms today without an attendant loss of competition.

For supermarkets, the merger specific requirement will be important. Many of the efficiencies sought through merger, especially that of increasing buying power and certain economies of scale, can be achieved though an out-of-market acquisition.[43] Thus, geographic expansion, rather than an in-market acquisition that will inevitably increase market power, may be a safer course.

FTC enforcement actions and remedies

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[43] Increased buying power may also increase the risk that a firm could extract discriminatory price concessions from its suppliers in violation of the Robinson-Patman Act, 15 U.S.C. § 13. Any allegation of price discrimination would ordinarily be pursued apart from merger review.

The vast majority of supermarket mergers that involve antitrust problems result in negotiated consents requiring the divestiture of stores in markets where competitive concerns are raised. While this development has involved many issues of both substance and procedure, the most striking feature of these cases is the increasing emphasis placed on the practical implementation of the divestitures. In supermarket mergers, as in other industries, the FTC increasingly scrutinizes whether its orders are as effective as they should be, and strengthens its order provisions where appropriate. This approach to relief is important for merger enforcement generally, beyond the immediate context of this market.

This story properly begins with the Schnucks/National merger in 1995. Schnucks and National were two large chains in the Midwest. That case marked a turning point in enforcement policy in a number of respects. It involved a major metropolitan market -- St. Louis -- and one of the largest divestitures in history--24 stores. It was one of the first cases of state-federal cooperation, brought with the Missouri attorney general. And most important, problems with this divestiture led the Commission to reconsider its approach to remedies in general.

The problems centered around the divestiture in St. Louis. The July 1995 order required divestiture to a Commission-approved buyer within 12 months. The stores were in fact divested in March 1996. However, by that time they no longer resembled the stores Schnucks had originally acquired in several important respects. In a subsequent civil penalty action, the Commission alleged that during the divestiture period Schnucks failed to maintain the stores properly: it operated the supermarkets to be divested differently from its other stores; it reduced staffing, provided inadequate signage and inadequate customer service; it failed to carry out routine cleaning, repair, and maintenance; it used non-published telephone numbers; and it failed

to make available certain promotional features and other ancillary services for customers. Not surprisingly, because of these actions sales at the divested stores fell significantly.[44] Moreover, one week before the stores were to be divested, Schnucks issued customers at the divested stores check-out coupons informing them that the issuing supermarket would soon close and directing them to shop at an alternative location that would remain a Schnucks market.

The objective of divestiture is simply to restore the status quo ante. The integrity of the process clearly requires that the assets actually be maintained. That is the purpose of the asset maintenance agreement issued in divestiture cases. In 1997, after a thorough investigation, the Commission sued Schnucks alleging that it had violated the provision of the asset maintenance agreement in which it agreed that it "shall maintain the viability, competitiveness, and marketability of the Assets." The Commission and Schnucks settled this compliance action on terms that were notable in a number of respects.[45] First, Schnucks paid a $3 million civil penalty, the second highest penalty ever assessed in a competition case. Second, in order to remedy the competitive harm created by the firm's actions, the Commission required the divestiture of two additional properties – stores that had been closed by Schnucks but that, presumably, could be reopened by a new buyer. Finally, the investigation and enforcement action were brought with the assistance of the Missouri attorney general.

Since the original *Schnucks* investigation, the Commission has brought many other order enforcement actions. These reflect an increasing determination to ensure that divestitures are

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[44] The press reports that sales dropped approximately 37%. *See A Grocer Drove Off Customers on Purpose, Competitor Contends*, WALL ST. J., July 10, 1997, at A1.

[45] *FTC v. Schnucks Markets, Inc.*, Civ. No. 01330 (E.D. Mo., filed Sept. 5, 1997).

made in a prompt and effective fashion. The FTC's approach to this issue can be traced in an eight-case evolution that runs from *Purity Supreme,* to *Stop and Shop,* to *Jitney-Jungle,* to *Buttrey,* to *Giant,* to *Kroger,* to *Albertson's,* to *Shaw's.*

Purity Supreme -- Late in 1995, two of the three largest supermarket chains in Eastern Massachusetts, Stop & Shop and Purity Supreme, sought to merge. There were potentially anticompetitive overlaps in five Massachusetts communities, including the Boston metropolitan area and parts thereof, the South Shore, and Cape Cod. After an extensive investigation by the FTC and the State of Massachusetts, the parties agreed to a consent agreement that called for divestiture of seventeen stores.

There were two interesting aspects to relief in this case. First, the divestiture period was reduced from 12 to 9 months. Second, the order appeared to limit the characteristics of an acceptable purchaser, not by naming a particular firm, but by specifying that the seven listed Purity supermarkets on Cape Cod must be divested to a single buyer. A single buyer was appropriate because this market offered particular economies of scale in transportation and advertising, which would be lost if the stores were divided among different buyers.

Ahold/Stop & Shop – In July 1996, a year after the agreement on the initial *Schnucks* divestiture, and at a time when Schnucks' failure to maintain the stores was becoming apparent, the Commission issued an order settling its concerns over the acquisition of the Stop & Shop chain by Ahold. Ahold operated five supermarket chains, including the Edwards chain with 69 supermarkets in the northeast. Stop & Shop operated 157 supermarkets in the same region, including some just acquired from Purity Supreme. Competitively significant overlaps appeared to exist in 14 communities, including Hartford, Connecticut, Providence, Rhode Island, and some

smaller towns in Massachusetts. The merger would have given Ahold a greater than 55% market share in Connecticut alone. The markets at issue included over 3 million people and had annual grocery sales of over $4 billion. The FTC conducted its investigation in collaboration with the Attorneys General of the three affected states. The settlement agreement required divestiture of a total of 30 supermarkets (or future market locations) in those communities.

Remedy received far more scrutiny than before. The Commission identified up front buyers: Star Markets to buy seven named properties; Buzzuto's (a grocery wholesaler) to buy four; Shaw's Supermarkets to buy fourteen properties; and Big Y Foods to buy the last five. The orders also required divestiture in a short timetable (30 days) and for divestiture through a trustee if need be.

This order still had its weaknesses, however. The contemplated buyers had only signed letters of intent, and were not formally bound to execute on the deal, and one of the purchases in fact fell through.

Jitney-Jungle – In *Jitney-Jungle,* the FTC continued the trend toward a more rigorously committed up-front buyer, which in this case was contractually bound to close the deal. This case arose out of the merger of Jitney-Jungle and Delchamps, two firms with combined sales of approximately $2.2 billion. They operated a total of 223 supermarkets in Mississippi, Alabama, and other Gulf Coast states. The settlement required divestiture of 10 of these supermarkets, mainly in Gulfport, Biloxi, Hattiesburg, Vicksburg, and Pensacola. The divestiture here was to Supervalu, a wholesaler, which was contractually committed to the deal. Supervalu then had the option of running those stores itself as corporate-owned stores, or selling some of them to two independent store chains, which were also pre-approved as buyers.

Albertson's/Buttrey – Sometimes mergers will involve geographic extension, where a chain moves into a region adjoining its current marketing area. This was the situation in Albertson's acquisition of Buttrey's. Albertson's operated 916 supermarkets in 23 Western, Midwestern, and Southern states, and had annual sales of approximately $14.7 billion. Buttrey, headquartered in Great Falls, Montana, operated 44 supermarkets in Montana, Wyoming, and North Dakota, and had annual sales of $300 million. Much of the merger did not raise competitive concerns, but in eleven communities in Montana and Wyoming – including Billings, Cheyenne, and Laramie -- there were significant overlaps. Total annual supermarket sales in those communities were over $850 million. The FTC required the divestiture of fifteen supermarkets in these markets. Buyers for each of the divested stores were identified in the proposed consent agreement. Thirteen of the supermarkets were to be sold to Smith's Food and Drug Centers, and two supermarkets to Supervalu.

Unlike previous divestitures, the spinoff under this consent was essentially immediate, to be made ten days after the actual acquisition. (Other, more recent cases, have decided that somewhat longer time periods are acceptable.)

Ahold/Giant – Ahold, which had a prominent position in the northeast, moved into the mid-Atlantic through the acquisition of Giant, a large regional chain serving the Baltimore-Washington area. Ahold had 822 stores and Giant had 179. The two firms had combined sales of approximately $18 billion. Although both chains were large, the competitively significant overlap was relatively small, confined to small markets in southern Pennsylvania and northern Maryland. The settlement called for divestitures of 10 stores in eight specific markets, including Frederick and Westminster in Maryland, and Norristown in Pennsylvania. Here too buyers for the stores

were identified in the consent agreement. The divestitures here were to be made within 20 days of the acquisition, or four months after the companies signed the proposed consent order, whichever was earlier.

This case dealt explicitly with some of the procedural problems created by the use of short timetables in divestitures. The divestitures in *Giant* were actually completed even before the Commission made the order final. In order to protect the Commission's ability to make the ultimate decision, the agreement with Ahold provided that the Commission could rescind any divestiture if the Commission decided to reject the up-front buyers when the order is made final.

Kroger/Fred Meyer – Earlier this year, the Commission issued a proposed consent settling charges that Kroger's acquisition of Fred Meyer would reduce competition. Kroger is the largest supermarket chain in the country, with over 1300 stores, and Fred Meyer operated over 800. The two firms have combined annual sales of about $42 billion.

Notwithstanding the large size of the merger, the competitive issues appeared to be confined to a few particular markets, and the FTC limited its remedy accordingly. There was, in fact, relatively little geographic overlap. Kroger operated in twenty-four states, and Fred Meyer in twelve, mainly in the west, but they competed in only three. The FTC therefore concluded that it could resolve competitive concerns by ordering the divestiture of eight supermarkets located in seven communities in Arizona, Wyoming, and Utah. Entry considerations limited its concern elsewhere. The FTC did not seek divestiture in some other cities, because it believed that the combination of existing firms, expansion, and/or new entry would be sufficient to prevent anticompetitive effects.

This case also added procedural refinements in FTC orders. A wholesaler, which is an up-front buyer and intends to resell the stores, is a party to the consent. Adding this third party to the consent will permit the FTC to more effectively enforce the order to assure that the wholesaler does re-sell the stores as planned.

Albertson's/American Stores – The Kroger/Fred Meyer transaction was quickly followed by another merger with a national scope between Albertson's and American Stores. These were respectively the fourth and second largest grocery chains in the country and the proposed merger would have resulted in a firm with combined retail sales of over $35 billion and nearly 1800 supermarkets operating in 32 states. Because the two chains were focused on different geographic areas, however, the competitive concerns were limited to sixty local markets in New Mexico, Nevada, and, primarily, in California. Supermarket sales in these markets totaled approximately $20 billion per year, and, on the assumption that there would have been a 1 percent price rise in the absence of enforcement action, consumer savings from the divestitures are estimated at $200 million per year.

After an extensive investigation by the FTC and the Attorneys General of California, New Mexico and Nevada, the parties entered into an order providing for the largest divestiture in history. To resolve the competitive concerns, the proposed consent requires the parties to divest 144 supermarkets and 5 land sites in these states. These divestitures were divided among a number of parties: 31 stores to Certified Grocers, a cooperative and the largest supermarket wholesaler in California, which intends to re-transfer the stores to identified members; 27 supermarkets and 1 site to Raley's, a regional chain that operates 120 supermarkets in Nevada and Northern California; 40 supermarkets and 2 sites to Ralph's, a subsidiary of Kroger/Fred

Meyer, but which does not operate any stores in the areas where it would be acquiring these; 43 supermarkets and one site to Stater, a local chain operating over 100 supermarkets in inland Southern California; and 3 supermarkets and 1 site to Von's, a subsidiary of Safeway.

This case illustrates both the continuation of, and the exceptions to, the Commission's general policy of requiring divestiture of all the stores that one or the other merging party owns in a problematic market (known by some as the "all of A or all of B" policy). In 37 of the 57 geographic markets, the merging firms did agree to divest one or the other's stores to buyers who did not currently operate supermarkets in the market. In the remaining twenty markets, however, a package of mixed assets is to be divested. This reflects the Commission's willingness "to evaluate and, under certain conditions, accept other divestiture packages if and when the parties can satisfy the Commission that the divestiture will eliminate the anticompetitive effects of concern."[46] In nineteen of the twenty markets using this alternative form of divestiture, the packages were constructed so that there was either no increase or no significant increase in concentration as a result of the merger. Moreover, the Commission noted in its Analysis to Aid Public Comment that it was also concerned about the profitability of the stores being divested, and that the proposed divestitures "consist of more profitable stores, rather than a divestiture of sales volume from unprofitable stores."[47]

Shaw's/Star – The Commission's most recent supermarket case involves the acquisition of Star Markets by Shaw's Supermarkets, which returns us to New England. Both were large chains

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[46] *American Stores Co.*, FTC File No. 981 0339 (proposed consent order) (June 22, 1999), Analysis to Aid Public Comment at 7.

[47] *Id.* at 8.

in the region, with annual sales of $2.8 and $1.0 billion respectively. The anticompetitive effects were primarily confined to the Boston metropolitan area, however. To remedy these effects the merging firms agreed to divest ten supermarkets – three Shaw's supermarkets and seven Star Markets stores – in eight communities. These communities are generally suburbs surrounding Boston such as Waltham, Quincy, and the Salem-Lynn area.

In terms of remedy: (1) most of the divestitures are to be made to named buyers; (2) the divestitures to the two up-front buyers are to be concluded within 10 or 20 days after certain triggering events; and (3) the divestitures are to include a provisional rescission clause in case the Commission decides against a particular proposed buyer after the public comment period.

The Remedy "Roadmap"

What are the general principles for divestitures in supermarket mergers? Four issues merit particular special attention: (1) designating up-front buyers, (2) divesting all the stores in a single market to a single buyer; (3) requiring a short period for divestiture, and (4) encouraging the merging parties to divest, in markets where there is a problem, all of the stores that were previously owned by either the buyer or the seller. Although these principles are set forth for supermarket mergers, they also have been applied to other types of mergers, especially in retailing.

Committed up-front buyers are critical – Probably the most important change in the Commission's approach to supermarket merger remedies since *American Stores* is that it now seeks to identify and select buyers before the proposed order is issued.[48] This means that the

[48]For a general description of innovations in the Commission's approach to remedies see George S. Cary & Marian Bruno, "Merger Remedies," 49 Admin. L. Rev. 875 (Fall 1997).

parties must identify buyers, enter into private divestiture agreements, and the staff must determine that these buyers can effectively restore competition, *before* the proposed order is submitted to the Commission. This requires a thorough and careful review of the strengths and weaknesses of both the potential buyers and the stores that are proposed for divestiture.

There are several advantages to an up-front buyer policy. First, divestitures are completed in a far shorter period of time. The average time of divestiture is now less than 3 months, whereas in the past it was well over one year. In retailing, where consumers are particularly concerned over service, a lengthy divestiture period can lead to the quick demise of the stores to be divested. Second, a proposed settlement will have been "market tested" before Commission approval. The fact that a buyer is willing to purchase the assets is strong evidence that the asset package is viable. Third, the identification of an up-front buyer gives the Commission the opportunity to evaluate the adequacy of the divestiture package with more concrete evidence, and to insist that additional assets are divested if necessary to attract additional buyers and restore competition. Although the up-front buyer policy may lengthen investigations, consumers are ultimately better off because a tested asset package is divested quickly.

Although the events in *Schnucks* were part of the reason for the change in policy, they were not the only reason. Permitting a lengthy period for divestiture of supermarkets in retrospect seems like a poor decision. Supermarkets being held for divestiture appear to deteriorate rather quickly and may cease being attractive to potential acquirers. In four supermarket divestiture orders from the early 1990s (*Penn Traffic, Red Apple, Stop & Shop* and *Promodes*) the Commission ultimately relieved the parties from the obligations of divesting certain

stores. In some cases, the parties were relieved of their obligations because no buyers could be found.

Consumers are not the only beneficiaries of the up-front buyer policy. Buyers of these assets also benefit because they are negotiating at a point where they have more flexibility in structuring the divestiture package. Ultimately, the up-front buyer policy also benefits the merging parties, by relieving them of the obligation of maintaining a divestiture package until a buyer can be found. If there are difficulties in finding a buyer, the divestiture period can last a long time while the merged party operates the divested assets, often at a loss. That was one of the reasons the Commission lifted the divestiture requirement in *Promodes*.[49]

All types of firms are considered as potential up-front buyers, including large-chains, small chains, independents, or wholesalers that will eventually spin off the stores to still other buyers. In *Jitney-Jungle*, for example, the two pre-approved buyers to whom the stores could be resold were ones that operated, respectively, 18 and 21 stores -- hardly giant chains. Some of the divestitures in *Buttrey*, *Giant*, and *Kroger* were made to wholesalers who planned either to operate the stores or to find an independent retailer acceptable to the Commission.

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[49] *Promodes, S.A.*, 116 F.T.C. 377 (1994)("Continuation of the requirement to divest and the requirement to maintain the viability and marketability of the stores – which are steadily losing sales – imposes unanticipated costs on the respondents that impede their ability to compete.").

Some commentators have suggested that the FTC's agnosticism in this respect has gone too far.[50] They suggest that some divestitures to small local firms may not have been successful and that perhaps divestitures to supermarket chains outside the region would be preferable.

Some buyers moreover, are clearly not acceptable. Proposed buyers that are already in the market are unlikely to be approved where the divestiture will lead to an increase in concentration. For example, in 1996 the Commission declined to approve the divestiture of a Stop & Shop store in Watertown, Massachusetts to Star Market as part of the *Purity Supreme* order, because Star already had two stores relatively close to the divested store.

Divestiture to a single buyer in a single market is preferred -- As in many areas, the divestiture of all of the assets in a single market to a single buyer is a preferable approach to a piecemeal divestiture. Separating the divested assets and selling them to numerous buyers may reduce the ability of those assets to serve as a competitive force in the market. A piecemeal divestiture may eliminate efficiencies of scale in advertising, distribution, and reduce the buying power formerly possessed by the acquired firm. Nevertheless, in some instances, such as some large markets in *Albertson's*, the Commission has approved divestitures in which stores in a market were sold to more than a single buyer.

Only a short time for divestiture will be permitted -- As the Commission found out in *Schnuck's*, the time for divestiture is critical. Operations may deteriorate during the pendency of a divestiture, stores may not be operated effectively, and dissatisfied consumers may ultimately

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[50] *See* Open Letter to Chairman Robert Pitofsky from Albert A. Foer, President, The American Antitrust Institute, concerning mergers in the food industry (June 18, 1999); http: //www.antitrustinstitute.org.

defect to the merged firm.[51] To prevent this, in the Commission's most recent cases the divestitures have been required to be made no later than the earlier of: (1) a stated number of days (which can vary from 10 to 120 days, but is often 20) from when the merger is consummated, or (2) four months after the Commission accepts the agreement for public comment. This approach promotes more prompt divestiture, critical in retailing, where reputation and goodwill are such an important part of the assets being transferred, and can easily be dissipated.

Policy generally favors "all of A" or "all of B" **–** When a competitive problem is identified, the preferable remedy is a divestiture that will spin off all of the buyer's assets or all of the seller's assets in particular markets. Divesting this entire group of stores provides greater confidence that the *status quo ante* has been restored, and that competition will not suffer. These packages are easier to sell, and give greater confidence that competition will be preserved. The fact that a single chain's stores are being sold suggest that the package of assets is capable of competing in the market. The FTC used this approach in *Kroger* and in the greater part of this year's *Albertson's* divestitures.

In most cases, there is also a practical advantage to parties in following the "all of A" or "all of B" approach. This allows a consent to be negotiated much more quickly because the buyer of the divested assets steps into the shoes of one of the two incumbents and acquires stores with common operating procedures, policies, and systems. Negotiating store by store is a longer, more

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[51] Of course, the Commission's orders have an asset maintenance agreement that require the merged firm to operate the stores in a fashion that continues their competitive viability. The *Schnucks'* enforcement action demonstrates the Commission takes these agreements seriously. But an asset maintenance agreement, no matter how effective, cannot substitute for an immediate divestiture.

complex process because the FTC needs to make sure that cherry-picking won't leave it with non-viable stores or consumers with diminished choice.

This policy is a preference. There may be occasions where a more attractive divestiture package can be put together by putting together a package from the stores of both parties. In some cases, such as *Albertson's*, the Commission has been willing to consider more of a mix and match approach. It may do so again in the future, but only where the proposed divestiture package is as strong as the one that would be secured in an "all of A or all of B" approach.

Several factors are considered in determining which stores should be included when a mix and match approach is taken. The first and most important is profitability. It is highly unlikely that the parties will be permitted to divest unprofitable stores in markets that are already of concern. Concerns will also be raised where a store's profits are trending down even if they were still profitable. A second factor is whether there is reason to think that the stores' historic financial performance does not reflect their probable future performance. The staff examines how well a store has been able to meet new entry or expansion in its market. Third, the staff will typically reject the divestiture of stores chosen for exit from the market. Fourth, the staff will typically reject stores that are old or unlikely to be expanded. Finally, the staff will analyze the geographic pattern of the stores proposed for divestiture, in order to determine whether they offer the range and market coverage needed to make an attractive package to an appropriate purchaser.

Closing Observations

We close with some observations of some issues that may receive increasing attention in the future, and a final observation about federal-state cooperation.

Potential competition **--** As noted earlier, potential competition is increasingly a concern in FTC enforcement actions. As supermarket chains continue their drive for acquiring economies of scale, they will increasingly expand into new markets. This drive to expand offers the potential for new competition in numerous markets. The loss of this potential competition may raise serious competitive concerns, especially where barriers to entry are high and potential rivals are few. In *Staples*, the court enjoined the merger on this basis: "allowing the defendants to merge would eliminate significant future competition. Absent the merger, the firms are likely, and in fact have planned, to enter more of each other's markets, leading to a deconcentration of the market and, therefore, increased competition between the superstores."[52] Potential competition may be an increasingly important issue in supermarket chain mergers where the chains compete in the same regions. In these cases, each chain may be a potential entrant into any local markets within the region in which it does not currently compete.

Supermarkets as drug stores **--** Many supermarket chains have expanded into the sales of pharmaceuticals over the past few years. The FTC has brought several enforcement actions involving the mergers of drug store chains.[53] For example in 1996 the FTC challenged the proposed merger between Rite Aid and Revco the two largest pharmacy chains in the U.S.[54] The underlying theory was that it would have permitted the merged firm to raise prices to Pharmaceutical Benefit Managers by combining the two firms that otherwise could have served as anchor pharmacy chains for these PBMs in several metropolitan areas. Supermarket chains

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[52] *Staples*, 970 F.Supp. at 1082.

[53] *See CVS Corp.*, C-3762 (Aug. 13, 1997) (consent order).

[54] The parties abandoned the transaction in the face of the Commission's challenge.

are increasingly participating in PBMs and these concerns could be raised in future supermarket mergers.

Concerns over power buyers -- One of the more controversial issues is whether the increased size of the supermarket chains, which makes the merged firms more powerful buyers, will ultimately benefit consumers. This is hardly a new controversy. After all, concerns over the power of supermarket chains led to the enactment of the Robinson-Patman Act. The recent spate of mergers has led to renewed concerns. As the American Antitrust Institute has suggested:

"The sheer size of the mega-chains looms as a lever -- the manufacturers must get their products onto the shelves of the largest retailers, even if they have to pay higher, even exorbitant, slotting and other allowances and make other costly concessions -- which they are forced to do so. As a result manufacturers may rise their prices to all customers in order to earn an acceptable rate of return. In that case, all other customers subsidize the mega-chains."[55]

A closing word about federal-state cooperation – Most recent supermarket enforcement actions have involved effective cooperation between state and federal agencies, and in many cases the states filed simultaneous enforcement actions. The FTC has gone a great distance in improving cooperation since California and the FTC took different courses in the 1988 American Stores/Lucky's merger. Now the FTC frequently confers with the states on supermarket matters, just as the Antitrust Division confers with them on other matters involving local markets, such as banks and waste collection. The result is that the FTC and the states generally agree on the goals and the mode of analysis for supermarket mergers. Joint

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[55] Open Letter to Chairman Robert Pitofsky, *supra* at 7.

supermarket investigations have become more common in the past few years, as the FTC has become able to share HSR information more freely, and as the merging firms have decided that it generally makes sense to consent to this sharing rather than to deal with separate subpoenas from the states. Ultimately, in almost all cases the states and the FTC seek the same relief.[56]

Some may wonder if shared enforcement offers the opportunity to establish a "separate peace," or to play one enforcement agency off against another. While the agencies cannot prevent firms from trying this, at the end of the day this course seems unlikely to succeed, and could raise some risk of multiple litigation.

Conclusion

The grocery industry is one of the largest industries in the economy, one of the most important to individual consumers, and one in which any anticompetitive effects are immediately and most keenly felt. For all these reasons it is an industry in which active antitrust enforcement is vital to competition and consumers. Food represents perhaps the largest regular repeated purchase for most consumers. But merely bringing enforcement actions does not assure that consumers are fully protected. That is why over the past four years the FTC has focused special attention to the issue of remedies, making them timely and truly effective in fully restoring competition, by stressing prompt sales to designated up-front buyers. The challenge is a continuing one and the Commission is continually adapting its analytical tools and approach to remedies to protect competition during a period of rapid change and consolidation in this industry.

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[56]There are some cases where the state alone may secure relief. In 1998, California reviewed the merger of Ralph's and Hughes and secured a divestiture of 19 stores in several markets in the Los Angeles area. See NAAG Antitrust Report (March 4, 1998).

Case	Market	Divestiture
Red Apple/Sloan Dkt. 9266 3/29/95	Parts of Manhattan	6 stores
Schnuck's/National C-3585 6/8/95	St. Louis	24 stores
Schwegman/National C-3584 7/5/95	New Orleans	7 stores
Stop & Shop/Purity Supreme C-3649 4/2/96	5 markets including Boston and Cape Cod	17 stores
Ahold/Stop & Shop 981-0086 7/25/96	14 markets in Rhode Island and Connecticut including Providence and Hartford	30 stores
Jitney Jungle/Delchamps 971-0093 9/23/98	4 markets in Mississippi and Florida	10 stores
Albertson's/Buttrey 981-0134 9/22/98	11 markets in Montana and Wyoming	15 stores
Ahold/Giant 981-0254 10/20/98	8 markets in Arizona, Wyoming and Utah	10 stores
Kroger/Fred Meyer 991-0024 6/7/99	7 markets in Arizona, Wyoming and Utah	8 stores
Albertson's/American Stores 981-0339 6/30/99	57 markets in California, Nevada and New Mexico	144 stores and 5 sites
Shaw's/Star 991-0075 7/6/99	8 markets in Massachusetts	10 stores