

ORAL ARGUMENT HELD ON APRIL 23, 2008

NO. 07-5276

IN THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

FEDERAL TRADE COMMISSION,
Appellant,

v.

WHOLE FOODS MARKET, INC.,
Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE
DISTRICT OF COLUMBIA (CIV. NO. 07-1021, PAUL L. FRIEDMAN, J.)

**RESPONSE OF FEDERAL TRADE COMMISSION
TO PETITION FOR REHEARING EN BANC**

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GLOSSARY

For ease of reference, the following abbreviations and citation forms are used in this brief:

JA – Joint Appendix

PNOS – Premium Natural and Organic Supermarket

SSNIP – Small but Significant and Nontransitory Increase in Price

INTRODUCTION

In this case, the Federal Trade Commission (“FTC” or “Commission”) sought a preliminary injunction to stop the merger of the two leading premium natural and organic supermarket (“PNOS”) chains. The district court denied relief, and a panel of this Court reversed. The Panel’s ruling breaks no new legal ground; rather, it reaffirms this Court’s standard for preliminary injunctions under Section 13(b) of the Federal Trade Commission Act (“FTC Act”), 15 U.S.C. § 53(b), as most recently articulated in *FTC v. H.J. Heinz Co.*, 246 F.3d 708, 714-15 (D.C. Cir. 2001). The Panel held that the district court applied that standard erroneously, however, by ignoring abundant evidence showing that the merging parties uniquely constrained one another’s pricing and by analyzing the merger instead according to an unsupported and unduly narrow view of the market dynamic.

The petition for rehearing fails to identify an issue of law on which the Panel erred, much less one requiring the attention of the *en banc* Court. The Panel applied established standards to the specific factual setting of this case, and rendered a ruling that focused on the evidence adduced by the FTC. In concluding that the FTC had satisfied its burden of raising “serious, substantial” questions on the merits of its claim, the Panel did not rule that merger analysis must focus exclusively on core customers. Rather, it held that the district court should evaluate the FTC’s likelihood of success by considering *all* of the evidence

presented – in light of both the FTC claim and the preliminary nature of the inquiry in a Section 13(b) injunction proceeding.

STATEMENT OF THE CASE

Whole Foods Market, Inc. and Wild Oats Markets, Inc. set themselves apart from conventional food retailers by focusing on premium natural and organic products (with a wide variety of perishables), high quality and service, a commitment to healthy living and environmental sustainability, and an attractive shopping experience.¹ That shared focus led to a longstanding and vigorous rivalry, *see JA346*, which was brought to an abrupt halt by their merger. The FTC administrative complaint alleged that Wild Oats was Whole Foods’s principal competitor in at least 17 local markets, and that the acquisition violated §7 of the Clayton Act.

To preserve its ability to render meaningful relief, on June 6, 2007, the FTC filed a motion for a preliminary injunction pursuant to Section 13(b) of the FTC Act, to enjoin the completion of the merger during the pendency of the FTC’s proceedings. After expedited discovery and one day of testimony by the economic experts, the district court denied the FTC’s motion, declaring that “the FTC has not met its burden to prove that ‘premium natural and organic supermarkets’ is the relevant product market in this case for antitrust purposes.” *FTC v. Whole Foods*

¹ The food retailing industry recognized the competitively significant and distinctive nature of such retailers by referring to them as “super naturals.” JA467.

Market, Inc., 502 F. Supp. 2d 1, 36 (D.D.C. 2007) (“*Whole Foods I*”). On August 28, 2007, while this appeal was pending, the merger was consummated.

On July 29, 2008, a panel of this Court reversed. *FTC v. Whole Foods Market, Inc.*, 533 F.3d 869 (D.C. Cir. 2008) (“*Whole Foods II*”). Although it found “some ambiguity” in the decision below, the Panel held that “the district court applied the correct legal standard to the FTC’s request for a preliminary injunction,” and that it “acted reasonably in focusing on the market definition.” *Id.* at 875, 876. The Panel concluded, however, that the district court “analyzed the product market incorrectly.” *Id.* It noted that “in assuming market definition must depend on marginal consumers,” the district court “underestimated the FTC’s likelihood of success on the merits,” *id.* at 873, by “ignor[ing] FTC evidence that strongly suggested Whole Foods and Wild Oats compete[d] for core consumers within a PNOS market, even if they also compete[d] on individual products for marginal consumers in the broader market.” *Id.* at 878. On August 26, 2008, Whole Foods filed the instant petition for rehearing en banc.

ARGUMENT

I. THE PANEL APPLIED THE CORRECT STANDARD FOR SECTION 13(b) PRELIMINARY INJUNCTIONS

The appropriate standard for granting a preliminary injunction under Section 13(b) of the FTC Act, 15 U.S.C. § 53(b), has been well settled in this Circuit, was

correctly recited by the district court (albeit misapplied in a way that the FTC had argued was so flawed as to amount to applying an altogether different standard), and was explicitly re-affirmed by the Panel. *See Heinz*, 246 F.3d at 714-15 (Section 13(b) injunction appropriate “if the FTC ‘has raised questions going to the merits so serious, substantial, difficult and doubtful as to make them fair ground for thorough investigation * * *’”) (quoting *FTC v. Beatrice Foods Co.*, 587 F.2d 1225, 1229 (D.C. Cir. 1978) (Appendix to Statement of MacKinnon & Robb, JJ.); citing *FTC v. Staples, Inc.*, 970 F. Supp. 1066, 1071 (D.D.C. 1997); *FTC v. Warner Comms. Inc.*, 742 F.2d 1156, 1162 (9th Cir. 1984); *FTC v. Univ. Health, Inc.*, 938 F.2d 1206, 1218 (11th Cir. 1991)); *see also Whole Foods I*, 502 F. Supp. 2d at 5-6; *Whole Foods II*, 533 F.3d at 875. Whole Foods contends that the Panel held that an injunction may issue unless the FTC has “entirely failed” to demonstrate a likelihood of success. Pet. 6-8. Yet there is no basis in the Panel’s decision for that contention. Indeed, it is grounded entirely in a mischaracterization of a statement relating to the district court’s, not the Panel’s, reasoning.

As the Panel correctly explained, a district court considering a Section 13(b) injunction “must balance the likelihood of the FTC’s success against the equities, *under a sliding scale.*” *Whole Foods II*, 533 F.3d at 875 (emphasis added) (citing *Heinz*, 246 F.3d at 727; *FTC v. Elders Grain, Inc.*, 868 F.2d 901, 903 (7th Cir. 1989)). The stronger the showing of the likelihood of success on the merits, the

lower the threshold of equities favoring the issuance of the injunction. Comparably, a stronger showing of equities favoring an injunction would allow for a less stringent requirement for the likelihood of success. Moreover, the equities “will often weigh in favor of the FTC, since ‘the public interest in effective enforcement of the antitrust laws’ was Congress’s specific ‘public equity consideration’ in enacting the provision.” *Id.* (quoting *Heinz*, 246 F.3d at 726). The Panel reviewed the district court’s decision in light of these principles, and it observed that “[t]he district court did not apply the sliding scale, instead declining to consider the equities.” *Id.* at 876. Thus, “[t]o be consistent with the § 53(b) standard,” reasoned the Panel, “this decision must have rested on a conviction the FTC entirely failed to show a likelihood of success.” *Id.*

Whole Foods does not contest the fact that the district court failed to evaluate the equities in this case – as mandated by the statute and by this Circuit’s precedents. *See* 15 U.S.C. § 53(b) (“Upon a proper showing that, weighing the equities and considering the FTC’s likelihood of ultimate success, such action would be in the public interest, * * * a preliminary injunction may be granted”); *Heinz*, 246 F.3d at 727. Nor does Whole Foods contest the Panel’s observation that the equities involved in enjoining a merger pending administrative proceedings typically weighs in favor of issuing the injunction – at least until the merging parties come forward with some evidence to change that calculus. *See*

FTC v. Weyerhaeuser, 665 F.2d 1072, 1087 (D.C. Cir. 1981). Under these circumstances, it was entirely reasonable for the Panel to infer that the district court, by denying the FTC an injunction without any discussion of the equities involved, was operating on the premise that the FTC showed no likelihood of success whatsoever. For that is the only circumstance in which a district court would be justified in not undertaking the balancing inquiry mandated by the statute. *See Whole Foods II*, 533 F.3d at 876. Indeed, in the face of “FTC evidence that strongly suggested Whole Foods and Wild Oats compete[d] for core consumers within a PNOS market,” *id.* at 878, the district court’s effective “certainty” that the FTC “entirely failed” in showing any likelihood of success was utterly unjustified, and surely a reversible error.

Finally, Whole Foods’s contention that the Panel’s decision deviates from precedent because “a preliminary injunction is an extraordinary intervention,” Pet. 8-9 & n.3, misapprehends the critical difference between an injunction grounded in traditional equity principles and one based on the statutory standard of Section 13(b), and ignores the nature of the inquiry in the latter context. Not surprisingly, *none* of the authorities which Whole Foods cites for its “extraordinary intervention” characterization (Pet. 9 n.3) is a Section 13(b) case. And for a good reason: Section 13(b) injunctions need not meet “the more stringent, traditional ‘equity’ standard for injunctive relief.” *Heinz*, 246 F.3d at 714. Unlike a conven-

tional injunction, for example, “the FTC need not show any irreparable harm, and the ‘private equities’ alone cannot override the FTC’s showing of likelihood of success.” *Whole Foods II*, 533 F.3d at 875 (citing *Weyerhaeuser*, 665 F.2d at 1082-83). As the Panel well recognized, Section 13(b) preliminary injunctions “are meant to be *readily available* to preserve the status quo while the FTC develops its ultimate case.” *Id.* at 877 (emphasis added); *see also Heinz*, 246 F.3d at 714 (Congress’s enactment of Section 13(b) “demonstrated its concern that injunctive relief be *broadly available* to the FTC by incorporating a *unique* public interest standard”) (emphasis added; citations and quotation marks omitted). Thus, contrary to Whole Foods’s contention, the Panel’s decision fully comports with the established standard for Section 13(b) injunctions.

II. THE PANEL CORRECTLY REJECTED THE DISTRICT COURT’S MARKET DEFINITION HOLDING FOR FAILURE TO CONSIDER “STRONG” EVIDENCE THAT SUPPORTS THE COMMISSION’S THEORY OF COMPETITIVE HARM

Whole Foods’s contention – that the Panel’s product market analysis conflicts with established precedents – misapprehends the Panel’s actual holding and confuses its reasoning. The Panel explicitly declined to delineate the appropriate product market in this case, noting that such determination is unnecessary in a Section 13(b) preliminary injunction proceeding. *See Whole Foods II*, 533 F.3d at 881 (“We do not say the FTC has in fact proved such a

market, which is not necessary at this point”). The Panel instead held that the district court’s rigid and formulaic market analysis had ignored “strong” direct and economic evidence that supported the Commission’s theory of competitive harm: that the merger likely forecloses vigorous (and in at least 17 local markets, *unique*) competition between Whole Foods and Wild Oats, which cannot be sufficiently replaced by Whole Foods’s competition with conventional supermarkets. Given the preliminary nature of the inquiry in a Section 13(b) injunction proceeding, the Panel correctly held that to be a reversible error.

The parties agreed that food retailers compete by differentiating themselves on the basis of some combination of price, quality, product mix, and service. The district court found that the merging parties, however, are in a distinctive class of retailers: “Whole Foods and Wild Oats are supermarkets, but ones that have focused on high-quality perishables, specialty and natural organic produce, prepared foods, meat, fish, and bakery goods, rather than on dry goods.” *Whole Foods I*, 502 F. Supp. 2d at 22. They “also emphasize high levels of customer service; they are ‘mission driven,’ with an emphasis on ‘social and environmental responsibility;’ they provide the customer with the confidence of a ‘lifestyle brand’ and a ‘unique environment,’ in stores that satisfy ‘core values’ of a lifestyle of health and ecological sustainability and provide a ‘superior store experience.’” *Id.* at 23. As a result of this focus, more than two-thirds of Whole Foods’s customers

identify themselves as sharing those “core values.” *Whole Foods II*, 533 F.3d at 880-81; See Scheffman Report, ¶¶160-161 [JA3046-47]. Despite these *undisputed* market characteristics, the district court ignored unrebutted documentary and econometric evidence that showed Whole Foods and Wild Oats uniquely constrained one another’s pricing because they positioned themselves very similarly to each other, and significantly unlike conventional supermarkets.

Contemporaneous pre-merger business documents of both parties (including strategic analyses, Board of Directors’ discussions, and statements to investors and to the SEC), for example, identified Whole Foods and Wild Oats as each other’s primary competitive threat, and showed the transaction to be a means to removing that threat. *See, e.g.*, JA366 (Whole Foods CEO describing Wild Oats to his Board as “the only existing company that has the brand and number of stores” to present a competitive threat; adding: “Eliminating them means eliminating this threat forever, or almost forever”; and justifying the high price for the transaction: “By buying [Wild Oats] we will * * * avoid nasty price wars in [several overlap markets] which will harm our gross margins and profitability”); JA410 (former Wild Oats CEO noting that “there’s really only two players * * * of any substance in the organic and all natural, and that’s Whole Foods and Wild Oats”); JA 320 (Whole Foods executive characterizing competitive position of Wild Oats in markets *not serviced* by the former as “[b]eing the only game in town”); JA356-61,

342-48, 373-75, 447-48, 649-79 (various Wild Oats plans to counter the “competitive intrusion” of Whole Foods).

Similarly, as the Panel noted, *unrebutted* testimony by Dr. Murphy, the FTC’s expert, showed that PNOS retailers such as Whole Foods and Wild Oats constrained each other’s prices in a way unmatched by non-PNOS supermarkets: the opening of a new Whole Foods in the vicinity of a Wild Oats caused the latter’s prices to drop significantly, while entry by non-PNOS stores had no such effect. JA483, 500-02, 595.² *See also* JA320 (Whole Foods executive attributing Wild Oats’s higher pricing in a market not serviced by Whole Foods to Wild Oats “[b]eing the only game in town”); JA504-06, JA597 (Wild Oats lowering its prices in local areas when Whole Foods opened stores nearby).

Against the weight of this (and other) evidence supporting the FTC’s theory, the district court nevertheless held that the FTC could not possibly succeed in establishing PNOS as a relevant market. Its only rationale was the existence of “marginal” customers in both Whole Foods and Wild Oats who purportedly could readily change their shopping destination if Whole Foods attempted a price increase. In particular, the court below relied on the “critical loss” analysis of

² Likewise, the opening of Earth Fare stores (another PNOS) near Whole Foods caused the latter’s prices to drop significantly (almost 6%) and immediately at its affected stores. JA502, 596. The opening of conventional supermarkets near those same stores, however, had no such effect. JA502. This evidence too was unrebutted.

Whole Foods's expert, Dr. Scheffman, which calculated the percentage of sales that would have to be lost to make a hypothetical across-the-board price increase unprofitable, and then simply *assumed* that Whole Foods would experience this level of loss, based principally on the fact that there are customers who "cross-shop" and therefore have the opportunity to shift some purchases. *See Whole Foods II*, 533 F.3d at 879 n.2.³

As the Panel recognized, the district court's focus on the possibility of some shifts in purchases by marginal customers led it to ignore the substantial direct evidence that the FTC adduced to show the unique nature of the competition among PNOS chains, and Whole Foods's own expectation that it would be able to profit from the destruction of that competition. *See Whole Foods II*, 533 F.3d at 878, 881. As discussed above, that evidence showed that, pre-merger, the ability of marginal customers to switch purchases had *not* been enough to constrain the pricing of either Whole Foods or Wild Oats when operating without the other in any local market.⁴ The district court failed to explain why those marginal

³ It was undisputed that Dr. Scheffman's critical loss analysis never calculated the actual loss of customers in response to a SSNIP. *See id.*; *Whole Foods I*, 502 F. Supp.2d at 18 ("There is no evidence in the record from which to determine cross-elasticity of demand between [PNOS] and other supermarkets. * * * Nor is there statistical evidence of actual loss"); *see also* JA78 (Dr. Scheffman acknowledging same).

⁴ Quite the contrary: their prices went down when a PNOS entered the market, but were *unaffected* by entry of non-PNOS retailers. *See, supra*, at 9-10.

customers, who could not constrain the prices of the merging parties in the past, would be able to do so post-merger.

The Panel recognized correctly that the realities of the particular market at issue here are more complex than the district court's analysis or Dr. Scheffman's model recognized. A key to the competitive dynamic in this case is the existence of committed "core" customers, who are drawn to the combination of products, services, and amenities uniquely offered by the PNOS market participants: high quality, organic products; a product mix geared toward fresh and prepared foods; high levels of service from knowledgeable staff; a commitment to environmental sustainability; and other amenities that create the unique food shopping experience sought by these customers. *See Whole Foods II*, 533 F.3d at 880.

Accordingly, the Panel suggested ways in which – consistent with the FTC's economic evidence, and with Whole Foods's own stated expectations – Whole Foods could be expected to profit from the elimination of PNOS competition. For example, regardless of whether the possibility of substitution may constrain Whole Foods's pricing with respect to some "dry grocery" items, the evidence showed that PNOS stores, when not competing against each other, were able to sustain higher prices on the perishables that constituted the bulk of their sales. *Id.* Moreover, Whole Foods's own projections showed that it could profit handsomely from the closure of Wild Oats stores, in light of the high "capture rate" it

anticipated (*far* greater than necessary to sustain a 5% price increase post-merger).

Id. at 881.⁵

Contrary to Whole Foods's arguments in its Petition, these observations by the Panel do not represent a rejection of marginal customers as a proper focus of antitrust analysis in the bulk of cases. Rather, the Panel's ruling represents a recognition that market definition must turn on an analysis of the evidence in specific cases, including any unusual features of the market in question. Here, for example, a more fulsome factual development may simply show that the number of marginal customers likely to switch purchases is simply too small to make up for the higher prices that a large number of core customers are willing to pay. Or it may be that the market will ultimately need to be refined, such as by excluding certain types of products. As the Panel correctly concluded, however, determinations of this sort are best left to merits proceedings before the FTC. For present purposes, the Panel correctly concluded that evidence ignored by the court below confirmed the likelihood that Whole Foods would be able to profit from its dominance of the PNOS market, and thus supported the grant of a preliminary injunction, under the applicable standard. *Whole Foods II*, 533 F.3d at 881.

⁵ The availability of such means of extracting additional profit shows how Whole Foods could indeed succeed in exercising its enhanced market power even without price discrimination in the narrow sense of charging different customers different prices for an identical product. Accordingly, Whole Foods's protestations that this sort of discrimination is not possible (Pet. 11-12) ignore the complexities (and its current pricing practices) that the Panel properly took into account.

III. THE PANEL PROPERLY FOCUSED ON MARKET DEFINITION AS THE BASIS FOR THE DISTRICT COURT'S ERRONEOUS RULING

Whole Foods's last argument is essentially a hybrid re-statement of the first two, and is similarly without merit. *See Pet.* 14 (faulting the Panel for focusing on market definition and not following *United States v. Baker Hughes*, 908 F.2d 981 (D.C. Cir. 1990), for assessing the merger's anticompetitive effects). As discussed above, the district court's denial of the preliminary injunction was based entirely on its rejection of a PNOS product market. *See Whole Foods I*, 502 F. Supp.2d at 49-50 ("There is no substantial likelihood that the FTC can prove its asserted product market and thus no likelihood that it can prove that the proposed merger may substantially lessen competition"). Thus, it was reasonable for the Panel to likewise focus on whether the district court's market definition analysis was sound. Having concluded that it was not, the Panel appropriately remanded the case for further proceedings before the district court.⁶

In any event, further consideration of the abundant evidence of likely competitive effects that the FTC in fact adduced could only have reinforced the

⁶ Specifically, Whole Foods's contention the Panel should have followed the *Baker Hughes* framework misapprehends the proper inquiry in this proceeding. *Baker Hughes* set forth this Circuit's framework for the proper standard and allocation of proof, but only for the merits stage under Section 7 of the Clayton Act. Although this Court, in *Heinz*, used that approach to structure its consideration of the parties' evidentiary burdens, it explicitly cautioned that *Baker Hughes* "was decided at the merits stage as opposed to the preliminary injunctive relief stage." *Heinz*, 246 F.3d at 715. The Panel's refusal to replicate the district court's mistaken reliance on inapposite authority can hardly be inconsistent with this Circuit's precedents.

Panel’s determination. As the concurring opinion notes, for example, the FTC adduced extensive “evidence that Whole Foods and Wild Oats charged more when they were the only natural and organic supermarket present.” *Whole Foods II*, 533 F.3d at 887. That evidence corroborates the prediction of Whole Foods’s own CEO that the very purpose of the merger was to ““avoid nasty price wars.”” *Id.*, *cf.* JA366. In light of such evidence, it is little wonder that Whole Foods can point to no solid basis to suppose that it could overcome the presumption of anticompetitive harm likely to ensue from its dominance of a properly-defined market.⁷ In view of the preliminary nature of the issues before it and the pertinent statutory standard, the panel committed no error in declining to address this issue in detail.

CONCLUSION

For the foregoing reasons, the petition for rehearing en banc should be denied.

⁷ The district court discussion on which Whole Foods bases its argument consisted chiefly of a reiteration of that court’s rejection of the FTC’s evidence regarding market definition, and a flawed pricing “snapshot” presented by Whole Foods’s expert. See Pet. 14 n.6; *Whole Foods I*, 502 F. Supp. 2d at 39-40; *cf. Whole Foods II*, 533 F.3d at 887 (explaining flaws in the latter evidence, which clearly resembled the flaws in *Heinz*, see 246 F.3d at 718).

Respectfully submitted,

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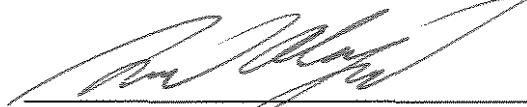
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I certify that on September 12, 2008, I caused two copies of the foregoing brief to be delivered by overnight courier to:

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