ORAL ARGUMENT HELD ON APRIL 23, 2008

No. 07-5276

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 (PLF), Judge Paul L. Friedman)

REPLY IN SUPPORT OF PETITION FOR REHEARING *EN BANC*

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October 6, 2008

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INTRODUCTION

The Panel's decision has turned antitrust law on its head. As if in a time warp, the Panel eclipsed decades of leading cases – including this Court's decisions in *Heinz* and *Baker Hughes*, which require an analysis of the competitive effects of a merger under modern economic principles – and dusted off a series of cases dating back to the 1960s that have long been discarded by modern antitrust decisions. The result is a regrettable and dramatic departure from contemporary antitrust analysis, which opens the door for questionable and speculative intervention by the FTC to halt free-market activity without a sound economic foundation. As the dissent pointed out, the Panel decision "calls to mind the bad old days when mergers were viewed with suspicion regardless of their economic benefits." *FTC v. Whole Foods Market, Inc.*, 533 F.3d 869, 893 (D.C. Cir. 2008) ("*Whole Foods III*") (Kavanaugh, J., dissenting) (citing Robert H. Bork, The Antitrust Paradox (1978)).

As the Federal Trade Commission's Response to the Petition for Rehearing En Banc ("FTC Response") makes clear, the FTC has already embraced the Panel's departure from economic principles, ensuring that the impact of the Panel's decision will extend far beyond the confines of this case. Under this new approach, the FTC apparently has unbridled authority to block a merger – without any showing of an adverse effect on competition and without even defining a relevant market, which, as Judge Kavanaugh said in his dissent, "allows the FTC to just snap its fingers and block a merger." 533 F.3d at 892. Moreover, because the opportunity for judicial review of an FTC decision to block a merger has been so sharply curtailed, merging parties will likely be deterred from pressing forward with mergers that benefit

consumers and pose no realistic threat of harm to competition. This Court should grant rehearing en banc to ensure that the FTC's decisions to block mergers are subject to meaningful judicial review and that they are required to pass muster under the economic analysis that is central to modern antitrust law.

I. Merger Analysis Cannot Conclude With An Analysis Of Market Concentration.

The FTC argues that the Court should pay no attention to Whole Foods' arguments (at pages 13-15 of the Petition) relating to the transaction's likely effect on competition. *See* FTC Response at 14. The FTC would have this Court simply ignore the district court's extensive analysis and findings relating to competitive effects – including the district court's findings relating to the impact of competitive "repositioning" by other supermarkets to compete head-to-head with so-called "premium, natural, and organic supermarkets." *See FTC v. Whole Foods Market, Inc.*, 502 F. Supp. 2d 1, 38-48 (D.D.C. 2007) ("*Whole Foods I*"). The Panel opinion likewise paid no attention to the district court's competitive effects analysis – the "realities of the marketplace as reflected in credible evidence presented in this proceeding" that the district court found to overcome any presumption to which the FTC claimed it was entitled under its contrived market definition. *Id.* at 39. Rather, the Panel held that the FTC can satisfy its burden merely by showing even the slightest chance that it can define a market and (apparently) showing a high level of concentration in such a market. *Whole Foods III*, 533 F.3d at 881.

But the Panel's approach – now championed by the FTC – represents a clear departure from long-settled precedent. Indeed, this Court explicitly rejected such an

approach in *United States v. Baker Hughes Inc.*, 908 F.2d 981 (D.C. Cir. 1990), holding that a merger analysis under Section 7 cannot conclude with an analysis of market concentration. Instead, "[e]vidence of market concentration simply provides a convenient *starting point* for a broader inquiry into future competitiveness," including whether there is "evidence of ease of entry" that shows that concentration statistics "inaccurately portrayed" the likely competitive effects of a merger. *Id.* at 984 (emphasis added). This Court emphasized that "[t]he existence and significance of barriers to entry are frequently, of course, crucial considerations" in a merger analysis. *Id.* at 987; *accord FTC v. H.J. Heinz Co.*, 246 F.3d 708, 717 n.13 (D.C. Cir. 2001) ("Barriers to entry are important in evaluating whether market concentration statistics accurately reflect the pre- and likely postmerger competitive picture.").

The district court in this case, like the district court in *Baker Hughes*, analyzed the evidence relating to entry, including the evidence that other supermarkets "have already proven themselves adept at repositioning and proving competitive in the premium natural and organic field" and that such "repositioning is likely to accelerate" if prices were to rise after the merger. *Whole Foods I*, 502 F. Supp. 2d at 43. The district court here and in *Baker Hughes* concluded that the defendants had successfully rebutted the government's prima facie case. In *Baker Hughes*, this Court affirmed the district court's conclusions regarding competitive effects under a deferential standard of review, finding that the court's findings were "not clearly erroneous." 908 F.2d at 984; *accord Heinz*, 246 F.3d at 713 ("We review a district court order denying preliminary injunctive relief for abuse of discretion, and will set aside the court's factual findings only if they are 'clearly erroneous.'" (internal citations omitted)). The

Panel in this case should have applied the same standard of review, and affirmed the district court's findings on entry/repositioning and competitive effects. Instead, the Panel reversed without even referring to the district court's findings, much less requiring a showing that those findings were clearly erroneous.

The FTC concedes, as it must, that the Panel failed to consider a competitive effects analysis. It argues instead that such an analysis is "inapposite" because *Baker Hughes* addressed the merits of a Section 7 claim instead of a Section 13(b) preliminary injunction. *See* FTC Response at 14 n.6. But in a Section 13(b) proceeding, a district court must "consider[] the Commission's likelihood of ultimate success" – not just whether it might possibly establish a relevant market – and therefore must follow the Section 7 framework in making this prediction. As this Court explained in *Heinz*:

> Although *Baker Hughes* was decided at the merits stage as opposed to the preliminary injunctive relief stage, we can nonetheless use its analytical approach in evaluating the Commission's showing of likelihood of success.

246 F.3d at 715. The *Heinz* court devoted over nine pages to applying the *Baker Hughes* framework, including the required analysis of competitive effects. *Id.* at 715-25. In this case, by contrast, the Panel failed to follow the *Baker Hughes* framework, and instead concluded its analysis upon determining that the FTC had shown some possibility of establishing a relevant market.

In disregarding the district court's findings regarding competitive effects, the Panel has taken merger analysis back more than 40 years, to the antitrust cases of the 1960s in which a firm's market share was accepted as "virtually conclusive proof of its market power." *See Baker Hughes*, 908 F.2d at 990. Until now, that approach had long

been discarded – in both the Supreme Court's and this Court's decisions – in favor of a more complete analysis of "the relevant transaction's probable effect on future competition." *Id.* at 990-91. This case warrants en banc consideration to correct a decision that promises to return merger analysis to "the bad old days when mergers were viewed with suspicion regardless of their economic benefits." *Whole Foods III*, 533 F.3d at 893 (Kavanaugh, J., dissenting).

II. The Panel's Market Definition Analysis Is A Relic Of A Bygone Era.

The Panel compounded the error of its market-definition-only approach by adopting an analysis of market definition that pays only lip-service to the economic analysis required by this Court's modern antitrust jurisprudence. The Panel's opinion contains no economic analysis of whether the merged company could profitably raise prices after the merger, and no economic analysis of cross-price elasticity of demand among so-called "premium, natural, and organic supermarkets" and all other supermarkets (such as Safeway, Giant, Kroger, Supervalu, and Wegmans). *Cf. Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210, 218-19 (D.C. Cir. 1986). Instead, the Panel again turned back the clock, holding that the FTC could meet its burden merely by demonstrating some of the "practical indicia" described in *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962). *See Whole Foods III*, 533 F.3d at 880 ("[w]e look to the *Brown Shoe* indicia"). But those "practical indicia" were "never intended to exclude economic analysis altogether," including "an analysis of cross-price elasticity of demand." *See Reifert v. South Cent. Wisc. MLS Corp.*, 450 F.3d 312, 320 (7th Cir. 2006); *see also Rothery Storage*, 792 F.2d at 218.

For example, the Panel found significance in the fact that "Whole Foods's

prices for perishables are higher than those of conventional supermarkets." 533 F.3d at 881. But firms can charge different prices while still competing with each other. Indeed, price differences are one of the mechanisms by which firms compete. The simple fact that two firms price differently from one another cannot be a basis for segregating them into separate markets. *See, e.g., Brown Shoe*, 370 U.S. at 326 (refusing to define separate markets for medium-priced and low-priced shoes); *Nifty Foods Co. v. Great Atl. & Pac. Tea Co.*, 614 F.2d 832, 840 (2d Cir. 1980) (holding that national and private label brands were in the same market despite persistent differences in price).

The Panel likewise departed from a sound economic analysis with its focus on so-called "core" customers – an argument that the Panel simply invented (*see Whole Foods III*, 533 F.3d at 899 (Kavanaugh, J., dissenting)). The Panel's focus on core customers is a poor substitute for a proper market analysis based in economics. For example, the Panel fails to define core customers, much less consider *how many* core customers there might be. Nor does the Panel (or the FTC) offer any economic analysis about the point at which the purchases of core customers as a proportion of all sales becomes so great that core customers are not protected from economic exploitation by the threat that marginal customers will depart in response to opportunistic behavior. *Cf. Town Sound and Custom Tops, Inc. v. Chrysler Motors Corp.*, 959 F.2d 468, 489 (3d Cir. 1992) ("In most markets, so long as *some* buyers are knowledgeable and comparison shop, the rest are protected because the market mechanism will ensure one competitive price for all buyers."). Virtually every business that makes some effort to establish a brand or differentiate itself from competitors will have some "core customers." It simply cannot be the case that all

businesses that have "core customers" are in relevant markets unto themselves. *See, e.g., Grappone, Inc. v. Subaru of New England, Inc.*, 858 F.2d 792, 796-97 (1st Cir. 1988) (Breyer, J.) (rejecting purported market limited to one brand of vehicles; "[o]f course, virtually every seller of a branded product has *some* customers who especially prefer its product," but that fact cannot suffice to show market power).

The FTC now argues that, at some point, it "may" be able to provide a proper economic analysis of "the number of marginal customers likely to switch purchases" and the degree to which such switches would constrain opportunistic behavior. *See* FTC Response at 13. And the FTC speculates that it "may" be able to provide a proper market definition based on such an analysis – apparently conceding that such an analysis "may" contradict its proposed market definition. *Id.* These arguments simply highlight the Panel's abandonment of the longstanding standard under which courts evaluate a motion for a preliminary injunction under Section 13(b). That standard demands far more from the FTC than speculation about what the relevant market and competitive effects might be. *See, e.g., FTC v. Tenet Health Care Corp.*, 186 F.3d 1045, 1051 (8th Cir. 1999) ("fair or tenable" chance of success insufficient); *FTC v. Univ. Health, Inc.*, 938 F.2d 1206, 1218 (11th Cir. 1991) (requiring showing that FTC "likely will prevail"); *FTC v. Staples, Inc.*, 970 F. Supp. 1066, 1072 (D.D.C. 1997) (FTC must show more than "a 'fair and tenable chance' of ultimate success on the merits").

Even if it were assumed that there were some chance that the FTC might prevail in its Section 7 case, the FTC clearly has not shown that such a result is likely or substantial. The FTC is not entitled to a preliminary injunction blocking a merger on this record, regardless of the weight of the equities.

III. The Panel's Framework Will Turn A District Court's Review Under Section 13(b) Into A Mere Rubber Stamp.

Remarkably, the Panel suggested that the burden on the FTC in future cases may be even lower – that the FTC can obtain an injunction without even attempting to prove a relevant market. 533 F.3d at 877. But the only case cited by the Panel in support of this proposition is *United States v. El Paso Natural Gas Co.*, 376 U.S. 651 (1964) – yet another case that pre-dates modern antitrust analysis. Neither that case nor any of the other cases dusted off by the Panel during its time-travel back to the 1960s provides support for the remarkable notion that a Section 7 case under modern antitrust jurisprudence can be established without any showing of a relevant market.

As the Supreme Court has held, "determination of the relevant market is a necessary predicate to finding a violation of the Clayton Act." *United States v. E.I. du Pont de Nemours & Co.*, 353 U.S. 586, 593 (1957). And as this Court has explained in the context of an FTC motion for preliminary injunction in a Section 7 case, "*[f]irst* the government *must* show that the merger would produce 'a firm controlling an undue percentage share of the relevant market, and would result in a significant increase in the concentration of firms in that market.'" *Heinz*, 246 F.3d at 715 (emphasis added; internal alterations omitted); *see also, e.g., FTC v. Arch Coal, Inc.*, 329 F. Supp. 2d 109, 117 (D.D.C. 2004). En banc consideration is necessary here to correct the confusion that will result from the Panel's view that the FTC can secure a preliminary injunction to block a merger without any showing of a relevant market.

The Panel's failure to require the FTC to show a likelihood of establishing a relevant market is representative of the Panel's abandonment of the "likelihood of success" standard applied by this Court to requests for injunctive relief under Section

13(b), *Heinz*, 246 F.3d at 714, and more generally, *Wash. Metro. Transit Comm. v. Holiday Tours, Inc.*, 559 F.2d 841 (D.C. Cir. 1977). *See* Petition at 1-3; *see also FTC v. Whole Foods Market, Inc.*, No. 07-5276 (Aug. 23, 2007) (denying motion for injunction pending appeal; finding that the FTC had failed to make a "strong showing that it is likely to prevail on the merits of its appeal" (quoting *Wash. Metro. Transit*, 559 F.2d at 843)). Tellingly, the FTC does not even contend that the Panel applied that standard. En banc review is necessary to ensure consistency, restore the proper standard under Section 13(b), and ensure that district courts are in a position to exercise independent judgment in reviewing an FTC decision to block a merger. As Judge Kavanaugh explained in his dissent, the Panel's framework "allows the FTC to just snap its fingers and block a merger." 533 F.3d at 892. Indeed, in the absence of a requirement to come forward with evidence of a relevant market (or, apparently, even to identify a market), and in the absence of a competitive effects analysis, it is unclear whether the FTC needs to offer any meaningful showing to obtain a preliminary injunction – except perhaps an expert report (no matter how disputable that report might be) and an assertion that the FTC intends to establish a case at some point in the future. Although this Court has previously explained that "we look at the FTC's prima facie case and the defendants' rebuttal evidence," *Heinz*, 246 F.3d at 715, it is unclear whether such a review now has any place, or whether a district court now has any role other than to rubber-stamp the FTC's request for an injunction.

The framework established by Congress demands far more. As another court explained in rejecting the FTC's argument that "it need only show a 'fair or tenable chance of ultimate success on the merits' in order to qualify for injunctive relief":

> Such a standard runs contrary to congressional intent and reduces the judicial function to a mere "rubber stamp" of the FTC's decisions. Because Congress expected courts to use independent judgment in reviewing preliminary injunction applications under Section 13(b), we have adopted a more stringent standard.

FTC v. Freeman Hosp., 69 F.3d 260, 267 (8th Cir. 1995) (internal citations omitted). En banc review is necessary to restore the "independent judgment" of district courts in reviewing preliminary injunction applications under Section 13(b).

CONCLUSION

Just last year, the Supreme Court described the evolution of antitrust law "to meet the dynamics of present economic conditions" and its adaptation to a modern understanding of economics. *See Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 127 S. Ct. 2705, 2720 (2007). Inexplicably, the Panel opinion has turned back the clock to "the bad old days when mergers were viewed with suspicion regardless of their economic benefits." *Whole Foods III*, 533 F.3d at 893 (Kavanaugh, J., dissenting). Apparently eager to embrace the resulting regime – in which its decisions to block mergers will no longer be subject to meaningful judicial review – the FTC has demonstrated that it is all-too-ready to endorse the Panel's flawed approach. En banc review is necessary to correct the errors in the Panel's opinion and restore the framework for analyzing an FTC motion for a preliminary injunction that has been applied for decades by this Court and others.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing Reply in Support of Petition for Rehearing En Banc was served this October 6, 2008, on the following persons by U.S. Mail and e-mail.

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