

Class 16 slides

Unit 8: Sysco/US Foods

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Good things
come from
Sysco

US.
FOODS™
KEEPING KITCHENS COOKING.™

Five new concepts

1. *Cluster markets* in product market definition
2. *Targeted customer markets* in product market definition
3. Use of *overlapping draw areas* to define geographic markets
4. *Auction* theory of unilateral effects
5. “Litigating the fix”

The Background

The deal

- Sysco Corporation to acquire US Foods
 - ❑ Announced December 8, 2013
 - ❑ \$3 billion of Sysco common stock (13% of combined company)
 - ❑ +\$500 million of cash
 - ❑ Assumption of \$4.7 billion of USF debt
 - ❑ Total transaction value: \$8.2 billion
 - ❑ Agreement expires September 8, 2015 (21 months)



The parties

■ Sysco

- ❑ Publicly traded “broadline” distributor
- ❑ Sales = \$44 billion in food distribution sales 2013
- ❑ #1 with about 17% of total food distribution sales nationally
- ❑ 72 distribution facilities nationwide



■ US Foods

- ❑ Privately owned broadline distributor (Clayton, Dubilier & Rice and KKR)
- ❑ Sales = \$22 billion in food distribution sales in 2013
- ❑ #2 with about 8.6% of total food distribution sales nationally
- ❑ 61 distribution facilities nationwide



Deal rationale

1. Creates a company with \$65 billion in sales

- ❑ Sysco (#1 w/17%) + USF (#2 w/8.6%) = Combined (#1 w/25.6% of total food distribution sales nationally)
 - Number 3: Performance Group (2.4%)
- ❑ Would employ over 14,000 sales reps
 - No other company employs more than 1600
- ❑ Would operate over 13,000 trucks
 - No other company operates more than 1600 trucks

2. Immediately accretive to earnings

3. Annual recurring synergies > \$600 million (after 3-4 years)

- ❑ Eliminate duplicative overhead
- ❑ More leverage to lower costs of goods (COGS)
- ❑ Optimize distribution facilities and logistics
- ❑ Integrate sales force
- ❑ Bigger platform for enhanced innovation and development of exclusive products

Industry background

- Food service distribution
 - Total industry sales nationwide = \$231 billion (2015)
 - Supply a broad range of fresh, frozen, canned and dry food and non-food products to away-from-home food service operations
 - Customers include—
 - Independently owned single location restaurants, regional and national chain restaurants (majority of sales)
 - Hotels, motels, and resorts
 - Hospitals
 - Schools
 - Government and military facilities
 - Retail locations

Industry background

- Types of food distributors: Product range/channel
 1. Broadline
 - “One-stop” shop—carry everything
 2. Specialized
 - Meat
 - Seafood
 - Produce
 - Baked goods
 3. Systems distributors
 - “Customized” distributors for fast food, casual chain restaurants (e.g., Burger King, Wendy’s, Applebees)
 - Small number of SKUs
 - Often proprietary to chain
 - Very small sales forces
 4. Cash-and-carry and club stores
 - E.g., Restaurant Depot, Costco, Sam’s Club
 - Do not deliver
 - No sales force dedicated to individual customers
 - Typical customer: independent restaurant

Industry background

- Types of food distributors: Geographical distribution footprint
 - National
 - Regional
 - Local

Industry background

- Largest food distributors in the United States

Distributor	Distribution Footprint	Distribution Centers
Sysco	Nationwide	72
US Foods	Nationwide	61
Performance Food Group	Eastern/Southern U.S.	24
Gordon Food Service	Midwest, Florida, TX	10
Reinhart Foodservice	East, Mideast	24
Ben E. Keith Co.	Texas and bordering states	7
Food Services of Am.	Northwest	10
Shamrock Foods	Southwest, Southern Calif.	4
Local distributors	Local	1-5 each

Industry background

- Distribution centers
 - Key for broadline distribution



- 28-foot clear-height ceilings
- “Super-flat” insulated floor systems to meet strict temperature control standards
- Zoned to accommodate the storage of both perishable and dry goods

Distribution centers

- US Food distribution centers in 2017
 - Only three more centers than in 2013

A look at US Foods



250,000
Customers

350,000
SKUs

5,000
Suppliers

25,000
Employees

4,000
Sales
Associates

64
Distribution
Facilities

6,000
Trucks

GREAT FOOD. MADE EASY.

5

The FTC investigation and litigation

- FTC investigated for one year
 - Second request issued on February 18, 2014 (a little over two months after signing)
 - Investigation ended February 20, 2015
- Fix-it-first solution:
 - On February 16, 2015, Sysco signed a deal to sell 11 of 61 USF distribution centers to #3 Performance Food Group
 - Announced Feb. 16, 2015
 - Conditioned on closing main deal
 - The centers to be divested largely located in the western U.S.
 - PFG had only one center in the West
 - PFG had 24 centers in East/South
 - Accounted for \$4.5 billion in sales
 - About 20% of USF premerger sales
 - Would give PFG a total of \$10.5 billion in sales
 - Compare to \$60.5 billion for the combined firm post-divestiture
- FTC rejected the fix and brought suit
 - Joined by 11 states seeking relief under Clayton Act § 16 in their sovereign capacity
 - Parties “litigated the fix”

FTC complaint

■ Plaintiffs:

- Federal Trade Commission
- 10 states plus the District of Columbia

■ *Filed*: February 20, 2015

- 14 months after signing

■ *Claim*: Acquisition, if consummated, would violate Section 7 in—

1. Nationwide foodservice distribution to “national” customers

- Combined first and second largest broadline foodservice distributions
- Results in a combined share of 59%-71% share and HHI deltas of 1500-1966 (depending on metric)
- Auction unilateral effects

2. 32 local markets

- With combined shares as high as 90.3% and deltas as high as 4123
- Auction unilateral effects

■ Prayer:

- Preliminary injunction blocking the deal pending a final adjudication of the merits
- *Query*: Should the states also have sought a permanent injunction?

The District Court

- Tried in the District Court of the District of Columbia
 - Judge Amit P. Mehta
 - Appointed by President Obama
 - Assumed office: December 19, 2014
 - Assigned case: February 20, 2015

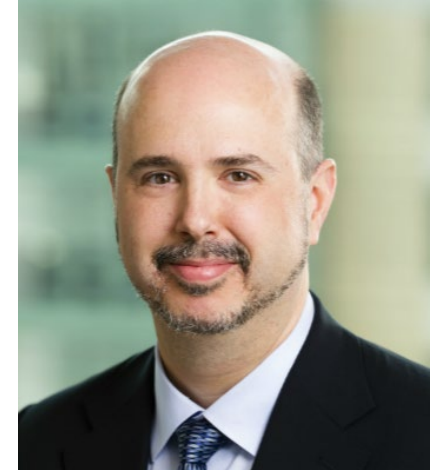


- Case was tried with the understanding that the parties would terminate their merger agreement if the PI was entered

Testifying experts

■ FTC: Dr. Mark A. Israel

- Senior Managing Director, Compass-Lexecon
- Ph.D in Economics, Stanford University (2001)
- Extensive testifying experience in antitrust cases (especially merger antitrust cases)



■ Parties: Dr. Jerry Hausman

- Professor of Economics, MIT
- D.Phil, Oxford (1972)
- Leading academic econometrician
- Extensive testifying experience in antitrust cases (including merger antitrust cases)



The District Court

- Entered the preliminary injunction blocking the deal
 - Relevant markets
 - Nationwide broadline foodservice distribution to national customers
 - Local broadline foodservice distribution to local customers
 - Anticompetitive effects (upward pricing pressure)
 - *PNB* presumption
 - Unilateral effects in the national broadline customer market
 - Unilateral effects in local broadline markets
 - Defenses insufficient to put the prima facie case into dispute
 - The PFG “fix”
 - Dealing regionally by national customers
 - Entry/expansion
 - Efficiencies
 - Equities favored the entry of a preliminary injunction

PI entered: June 23, 2015
Deal terminated: June 29, 2015

Parties abandon the merger

■ Costs to Sysco

- ❑ \$300 million breakup fee to US Foods
- ❑ \$25 million breakup fee to divestiture buyer Performance Food Group
- ❑ \$265 million to redeem financing
- ❑ \$258 million on integration planning and advisers
- ❑ \$100 million in historical financing costs, and
- ❑ \$53 million in computer systems integration

Total cost to Sysco: \$1 billion