United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

Argued April 23, 2008 Decided July 29, 2008

No. 07-5276

FEDERAL TRADE COMMISSION,
APPELLANT

v.

WHOLE FOODS MARKET, INC., ET AL.,
APPELLEES

Appeal from the United States District Court
for the District of Columbia
(No. 07cv01021)

Marilyn E. Kerst, Attorney, Federal Trade Commission, argued the cause for appellant. With her on the briefs were *John F. Daly*, Deputy General Counsel, and *Richard B. Dagen* and *Thomas H. Brock*, Attorneys.

Paul T. Denis argued the cause for appellees. With him on the brief were *Paul H. Friedman*, *Nory Miller* and *Rebecca*

I

Whole Foods Market, Inc. ("Whole Foods") and Wild Oats Markets, Inc. ("Wild Oats") operate 194 and 110 grocery stores, respectively, primarily in the United States. In February 2007, they announced that Whole Foods would acquire Wild Oats in a transaction closing before August 31, 2007. They notified the FTC, as the Hart-Scott-Rodino Act required for the $565 million merger, and the FTC investigated the merger thr

blog postings in which Mr. Mackey touted Whole Foods and denigrated other supermarkets as unable to compete. The FTC's expert economist, Dr. Kevin Murphy, analyzed sales data from the companies to show how entry by various supermarkets into a local market affected sales at a Whole Foods or Wild Oats store.

On the other hand, the defendants' expert, Dr. David Scheffman, focused on whether a hypothetical monopolist owning both Whole Foods and Wild Oats would actually have power over a distinct market. He used various third-party market studies to predict that such an owner could not raise prices without driving customers to other supermarkets. In addition, deposition testimony from other supermarkets indicated they regarded Whole Foods and Wild Oats as critical competition. Internal documents from the two defendants reflected their extensive monitoring of other supermarkets' prices as well as each other's.

The district court concluded that PNOS was not a distinct market and that Whole Foods and Wild Oats compete within the broader market of grocery stores and supermarkets. Believing such a basic failure doomed any chance of the FTC's success, the court denied the preliminary injunction without considering the balance of the equities.

On August 17, the FTC filed an emergency motion for an injunction pending appeal, which this court denied on August 23. *FTC v. Whole Foods Market, Inc.*, No. 07-5276 (D.C. Cir. Aug. 23, 2007). Freed to proceed, Whole Foods and Wild Oats consummated their merger on August 28. The dissent argues that our holding today contradicts this earlier decision, but our standard of review then was very different, requiring the FTC to show "such a substantial indication of probable success" that there would be "justification for the

court's intrusion into the ordinary processes of . . . judicial review." *Wash. Metro. Area Transit Comm'n v. Holiday Tours, Inc.*, 559 F.2d 841, 843 (D.C. Cir. 1977). It is hardly remarkable that the FTC could fail to meet such a stringent standard and yet persuade us the district court erred in applying the much less demanding § 53(b) preliminary injunction standard.

II

At the threshold, Whole Foods questions our jurisdiction to hear this appeal. The merger is a *fait accompli*, and Whole Foods has already closed some Wild Oats stores and sold others. In addition, Whole Foods has sold two complete lines of stores, Sun Harvest and Harvey's, as well as some unspecified distribution facilities. Therefore, argues Whole Foods, the transaction is irreversible and the FTC's request for an injunction blocking it is moot.

Only in a rare case would we agree a transaction is truly irreversible, for the courts are "clothed with large discretion" to create remedies "effective to redress [antitrust] violations and to restore competition." *Ford Motor Co. v. United States*, 405 U.S. 562, 573 (1972). Indeed, "divestiture is a common form of relief" from unlawful mergers. *United States v. Microsoft Corp.*, 253 F.3d 34, 105 (D.C. Cir. 2001) (en banc). Further, an antitrust violator "may . . . be required to do more than return the market to the *status quo ante*." *Ford Motor*, 405 U.S. at 573 n.8. Courts may not only order divestiture but may also order relief "designed to give the divested [firm] an opportunity to establish its competitive position." *Id*. at 575. Even remedies which "entail harsh consequences" would be appropriate to ameliorate the harm to competition from an antitrust violation. *United States v. E.I. du Pont de Nemours & Co.*, 366 U.S. 316, 327 (1961).

Of course, neither court nor agency has found Whole Foods's acquisition of Wild Oats to be unlawful. Therefore, the FTC may not yet claim the right to have any remedy necessary to undo the effects of the merger, as it could after such a determination, *du Pont*, 366 U.S. at 334. But the whole point of a preliminary injunction is to avoid the need for intrusive relief later, since even with the considerable flexibility of equitable relief, the difficulty of "unscrambl[ing] merged assets" often precludes "an effective order of divestiture,"

FTC. As to the distribution facilities, neither party has described what they are, suggested Wild Oats would not be a viable competitor without them, or explained why the district court could not order some provisional substitute. Moreover, the FTC is concerned about eighteen different local markets. If, as appears to be the situation, it remains possible to reopen or preserve a Wild Oats store in just one of those markets, such a result would at least give the FTC a chance to prevent a § 7 violation in that market.

III

"We review a district court order denying preliminary injunctive relief for abuse of discretion." *FTC v. H.J. Heinz Co.*, 246 F.3d 708, 713 (D.C. Cir. 2001). However, if the district court's decision "rests on an erroneous premise as to the pertinent law," we will review the denial *de novo* "in light of the legal principles we believe proper and sound." *Id.*

Despite some ambiguity, the district court applied the correct legal standard to the FTC's request for a preliminary injunction. The FTC sought relief under 15 U.S.C. § 53(b), which allows a district court to grant preliminary relief "[u]pon a proper showing that, weighing the equities and considering the Commission's likelihood of ultimate success, such action would be in the public interest." The relief is temporary and must dissolve if more than twenty days pass without an FTC complaint. *Id.* Congress recognized the traditional four-part equity standard for obtaining an injunction was "not appropriate for the implementation of a Federal statute by an independent regulatory agency." *Heinz*, 246 F.3d at 714. Therefore, to obtain a § 53(b) preliminary injunction, the FTC need not show any irreparable harm, and the "private equities" alone cannot override the FTC's

independent judgment" about the questions § 53(b) commits to it. *Weyerhaeuser*, 665 F.2d at 1082. Thus, the district court must evaluate the FTC's chance of success on the basis of all the evidence before it, from the defendants as well as from the FTC. *See FTC v. Beatrice Foods Co.*, 587 F.2d 1225, 1229–30 (D.C. Cir. 1978) (App'x to Stmt. of MacKinnon & Robb, JJ.) ("[W]e are also required to consider the inroads that the appellees' extensive showing has made . . . [S]everal basic contentions of the FTC are called into serious question."). The district court should bear in mind the FTC will be entitled to a presumption against the merger on the merits, *see Elders Grain*, 868 F.2d at 906, and therefore does not need detailed evidence of anticompetitive effect at this preliminary phase. Nevertheless, the merging parties are entitled to oppose a § 53(b) preliminary injunction with their own evidence, and that evidence may force the FTC to respond with a more substantial showing.

The district court did not apply the sliding scale, instead declining to consider the equities. To be consistent with the § 53(b) standard, this decision must have rested on a conviction the FTC entirely failed to show a likelihood of success. Indeed, the court concluded "the relevant product market in this case is not premium natural and organic

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certainty was justified, it was appropriate for the court not to balance the likelihood of the FTC's success against the equities.

IV

However, the court's conclusion was in error. The FTC contends the district court abused its discretion in two ways: first, by treating market definition as a threshold issue; and second, by ignoring the FTC's main evidence. We conclude the district court acted reasonably in focusing on the market definition, but it analyzed the product market incorrectly.

A

First, the FTC complains the district court improperly focused on whether Whole Foods and Wild Oats operate within a PNOS market. However, this was not an abuse of discretion given that the district court was simply following the FTC's outline of the case.

Inexplicably, the FTC now asserts a market definition is not necessary in a § 7 case, Appellant's Br. 37–38, in contravention of the statute itself, *see* 15 U.S.C. § 18 (barring an acquisition "where in any line of commerce . . . the effect of such acquisition may be substantially to lessen competition"); *see also Brown Shoe Co. v. United States*, 370 U.S. 294, 324 (1962) (interpreting "any line of commerce" to require a "determination of the relevant market" to find "a violation of the Clayton Act"); *Elders Grain*, 868 F.2d at 906 ("[A]ll this assumes a properly defined market."). The FTC suggests "market definition . . . is a means to an end—to enable some measurement of market power—not an end in itself." Appellant's Br. 38 n.26. But measuring market power is not the only purpose of a market definition; only

"examination of the particular market—its structure, history[,] and probable future—can provide the appropriate setting for judging the probable anticompetitive effect of the merger." *Brown Shoe*, 370 U.S. at 322 n.38.

That is not to say market definition will always be crucial to the FTC's likelihood of success on the merits. Nor does the FTC necessarily need to settle on a market defintion at this preliminary stage. Although the framework we have developed for a *prima facie* § 7 case rests on defining a market and showing undue concentration in that market, *United States v. Baker Hughes Inc.*, 908 F.2d 981, 982–83 (D.C. Cir. 1990), this analytical structure does not exhaust the possible ways to prove a § 7 violation on the merits, *see, e.g.*, *United States v. El Paso Natural Gas Co.*, 376 U.S. 651, 660 (1964), much less the ways to demonstrate a likelihood of success on the merits in a preliminary proceeding. Section 53(b) preliminary injunctions are meant to be readily available to preserve the status quo while the FTC develops its ultimate case, and it is quite conceivable that the FTC might need to seek such relief before it has settled on the

B

Thus, the FTC assumed the burden of raising some question of whether PNOS is a well-defined market. As the FTC presented its case, success turned on whether there exist core customers, committed to PNOS, for whom one should consider PNOS a relevant market. The district court assumed "the 'marginal' consumer, not the so-called 'core' or 'committed' consumer, must be the focus of any antitrust analysis." *Whole Foods*,

recognition of the submarket as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors." *Id*.

To facilitate this analysis, the Department of Justice and the FTC developed a technique called the SSNIP ("small but significant non-transitory increase in price") test, which both Dr. Murphy and Dr. Scheffman used. In the SSNIP method,

these customers would switch to Whole Foods, thus making the closure profitable for a hypothetical PNOS monopolist.

customers, operating in parallel with the broader market but featuring a different demand curve. *See United States v. Rockford Mem'l Corp.*, 898 F.2d 1278, 1284 (7th Cir. 1990). Sometimes, for some customers a package provides "access to certain products or services that would otherwise be unavailable to them." *Phillipsburg Nat'l Bank & Trust*, 399 U.S. at 360. Because the core customers require the whole package, they respond differently to price increases from marginal customers who may obtain portions of the package elsewhere. Of course, core customers may constitute a submarket even without such an extreme difference in demand elasticity. After all, market definition focuses on what products are *reasonably* substitutable; what is reasonable must ultimately be determined by "settled consumer preference." *United States v. Phila. Nat'l Bank*, 374 U.S. 321, 357 (1963).

In short, a core group of particularly dedicated, "distinct customers," paying "distinct prices," may constitute a recognizable submarket, *Brown Shoe*, 370 U.S. at 325, whether they are dedicated because they need a complete "cluster of products," *Phila. Nat'l Bank*, 374 U.S. at 356, because their particular circumstances dictate that a product "is the only realistic choice," *SuperTurf, Inc. v. Monsanto Co.*, 660 F.2d 1275, 1278 (8th Cir. 1981), or because they find a particular product "uniquely attractive," *Nat'l Collegiate Athletic Ass'n v. Bd. of Regents of the Univ. of Okla.*, 468 U.S. 85, 112 (1984). For example, the existence of core customers dedicated to office supply superstores, with their "unique combination of size, selection, depth[,] and breadth of inventory," was an important factor distinguishing that submarket. *FTC v. Staples, Inc.*, 970 F. Supp. 1066, 1078–79 (D.D.C. 1997). As always in defining a market, we must "take into account the realities of competition." *Weiss v. York Hosp.*, 745 F.2d 786, 826 (3d Cir. 1984). We look to the

Brown Shoe indicia, among which the economic criteria are primary, *see Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210, 219 n.4 (D.C. Cir. 1986).

The FTC's evidence delineated a PNOS submarket catering to a core group of customers who "have decided that natural and organic is important, lifestyle of health and ecological sustainability is important." *Whole Foods*, 502 F. Supp. at 223 (citing Hr'g Tr. 43–44, Aug. 1, 2007). It was undisputed that Whole Foods and Wild Oats provide higher levels of customer service than conventional supermarkets, a "unique environment," and a particular focus on the "core values" these customers espoused. *Id*. The FTC connected these intangible properties with concrete aspects of the PNOS model, such as a much larger selection of natural and organic products, FTC's Proposed Findings of Fact 13–14 & ¶ 66 (noting Earth Fare, a PNOS, carries "more than 45,000 natural and organic SKUs") and a much greater concentration of perishables than conventional supermarkets, *id*. 14–15 & ¶ 69–70 ("Over 60% of Wild Oats' revenues" and "[n]early 70% of Whole Foods sales are natural or organic perishables."). *See also Whole Foods*, 502 F. Supp. 2d at 22–23 (citing defendants' depositions as evidence of Whole Foods's and Wild Oats's focus on "high-quality perishables" and a large variety of products).

Further, the FTC documented exactly the kind of price discrimination that enables a firm to profit from core customers for whom it is the sole supplier. Dr. Murphy compared the margins of Whole Foods stores in cities where they competed with Wild Oats. He found the presence of a Wild Oats depressed Whole Foods's margins significantly. Notably, while there was no effect on Whole Foods's margins in the product category of "groceries," where Whole Foods and Wild Oats compete on the margins with conventional

customers who share the Whole Foods "core values." FTC Proposed Findings of Fact ¶ 135.

Against this conclusion the defendants posed evidence that customers "cross-shop" between PNOS and other stores and that Whole Foods and Wild Oats check the prices of conventional supermarkets. *Whole Foods*, 502 F. Supp. 2d at 30–32. But the fact that PNOS and ordinary supermarkets "are direct competitors in some submarkets . . . is not the end of the inquiry," *United States v. Conn. Nat'l Bank*, 418 U.S. 656, 664 n.3 (1974). Of course customers cross-shop; PNOS carry comprehensive inventories. The fact that a customer might buy a stick of gum at a supermarket or at a convenience store does not mean there is no definable groceries market. Here, cross-shopping is entirely consistent with the existence of a core group of PNOS customers. Indeed, Dr. Murphy explained that Whole Foods competes actively with conventional supermarkets for dry groceries sales, even though it ignores their prices for high-quality perishables.

In addition, the defendants relied on Dr. Scheffman's conclusion that there is no "clearly definable" core customer. *Whole Foods*, 502 F. Supp. 2d at 28. However, this conclusion was inconsistent with Dr. Scheffman's own report and testimony. Market research had found that customers who shop at Whole Foods because they share the core values it champions constituted at least a majority of its customers. Scheffman Expert Report 56–57. Moreover, Dr. Scheffman acknowledged "there are core shoppers [who] will only buy organic and natural" and for that reason go to Whole Foods or Wild Oats. Hr'g Tr. 31, July 31, 2007. He contended they could be ignored because the numbers are not "substantial." *Id*. Again, Dr. Scheffman's own market data undermined this assertion.

has taken place. We remind the district court that a "risk that the transaction will not occur at all," by itself, is a private consideration that cannot alone defeat the preliminary injunction. *See id.*; *Weyerhaeuser*, 665 F.2d at 1082–83.

We appreciate that the district court expedited the proceeding as a courtesy to the defendants, who wanted to consummate their merger just thirty days after the hearing, *Whole Foods*

TATEL, *Circuit Judge*, concurring: I agree with my colleagues that the district court produced a thoughtful opinion under incredibly difficult circumstances, that this case presents a live controversy, and that the district court generally applied the correct standard in reviewing the Federal Trade Commission's request for a preliminary injunction. I also agree with Judge Brown that the district court nonetheless erred in concluding that the FTC failed to "raise[] questions going to the merits so serious, substantial, difficult and doubtful as to make them fair ground for thorough investigation, study, deliberation and determination by the FTC in the first instance and ultimately by the Court of Appeals." *FTC v. H.J. Heinz Co.*, 246 F.3d 708, 714-15 (D.C. Cir. 2001). I write separately because although I agree with Judge Brown that the district court erred in focusing only on marginal customers, I believe the district court also overlooked or mistakenly rejected evidence supporting the FTC's view that Whole Foods and Wild Oats occupy a separate market of "premium natural and organic supermarkets." Also, given the complicated posture of this case, I hope to clarify the district court's task on remand.

I.

"Section 7 of the Clayton Act prohibits acquisitions, including mergers, 'where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly.'" *Id.* at 713 (quoting 15 U.S.C. § 18). "Congress used the words '*may be* substantially to lessen competition,' to indicate that its concern was with probabilities, not certainties." *Brown Shoe Co. v. United States*, 370 U.S. 294, 323 (1962).

When the FTC believes an acquisition violates section 7 and that enjoining the acquisition pending an investigation "would be in the interest of the public," section 13(b) of the Federal Trade Commission Act authorizes the Commission to ask a federal district court to block the acquisition. 15 U.S.C. § 53(b); *Heinz*, 246 F.3d at 714. Because Congress concluded that the FTC—an

Food Town Stores, Inc., 539 F.2d 1339, 1342 (4th Cir. 1976)). As Judge Posner has explained:

> One of the main reasons for creating the Federal Trade Commission and giving it concurrent jurisdiction to enforce the Clayton Act was that Congress distrusted judicial determination of antitrust questions. It thought the assistance of an administrative body would be helpful in resolving such questions and indeed expected the FTC to take the leading role in enforcing the Clayton Act . . . .

Hosp. Corp. of Am. v. FTC, 807 F.2d 1381, 1386 (7th Cir. 1986). Thus, though the dissent never acknowledges as much, the district court's task—as well as ours on review—is limited to determining whether the FTC has raised "serious, substantial" questions meriting further investigation. *Heinz*, 23289 Tws m-7(n 11.52145,yton Act9.62 c hJ13.1)nz913.62eeISonc0 Tr an adm

the market will tend to harm competition in that market. If, on the other hand, the defendants are merely differentiated firms

are not "reasonabl[y] interchangeab[le]" with conventional supermarkets and do not compete directly with them.

To begin with, the FTC's expert prepared a study showing that when a Whole Foods opened near an existing Wild Oats, it reduced sales at the Wild Oats store dramatically. *See* Expert Report of Kevin M. Murphy ¶¶ 48-49 & exhibit 3 (July 9, 2007) ("Murphy Report"). By contrast, when a conventional supermarket opened near a Wild Oats store, Wild Oats's sales were virtually unaffected. *See id.* This strongly suggests that although Wild Oats customers consider Whole Foods an adequate substitute, they do not feel the same way about conventional supermarkets. Rejecting this study, the district court explained that it was "unwilling to accept the assumption that the effects on Wild Oats from Whole Foods' entries provide a mirror from which predictions can reliably be made about the effects on Whole Foods from Wild Oats' future exits if this transaction occurs." *Whole Foods*, 502 F. Supp. 2d at 21. But even if exit and entry events differ, this evidence suggests that consumers do not consider Whole Foods and Wild Oats "reasonabl[y] interchangeab[le]" with conventional supermarkets. *Brown Shoe*, 370 U.S. at 325.

The FTC also highlighted Whole Foods's own study—called "Project Goldmine"—showing what Wild Oats customers would likely do after entry proceeding [illegible]

many consumers consider conventional supermarkets inadequate substitutes for Wild Oats and Whole Foods. The district court cited the Project Goldmine study for the opposite conclusion, pointing only to cities in which Whole Foods expected to receive a low percentage of Wild Oats's business. *Whole Foods*, 502 F. Supp. 2d at 34. These examples, however, do not undermine the study's broader conclusion that Whole Foods would capture most of the revenue from the closed Wild Oats, and the district court never mentioned the FTC expert's testimony that the diversion ratio estimated here "is at least **{Sealed}** *times* the diversion ratio[] needed to make a price increase of 5% profitable for a joint owner of the two stores." Murphy Rebuttal ¶ 32. The dissent also ignores this testimony, saying incorrectly that the Project Goldm

difficulty competing with Whole Foods and Wild Oats: if conventional stores offer a lot of organic products, they don't sell enough to their existing customer base, leaving the stores with spoiled products and reduced profits. But if conventional stores offer only a narrow range of organic products, customers with a high demand for organic items refuse to shop there. Thus, "the conventionals have a very difficult time getting into this business." Investigational Hearing of Perry Odak 77-78 (quoted in Murphy Report ¶ 77) ("Odak Hearing"). The district court mentioned none of this.

In addition to all this direct evidence that Whole Foods

only two players of any substance in the organic and all natural [market], and that's Whole Foods and Wild Oats. . . . [T]here's really nobody else in that particular space." Odak Hearing 58. Executives from several conventional retailers agreed, explaining that Whole Foods and Wild Oats are not **{ Sealed material redacted** **}** Dep. of Rojon Diane Hasker 128-29 (July 10, 2007) ("Hasker Dep."). As Judge Bork explained, this evidence of "'industry or public recognition of the submarket as a separate economic' unit matters because we assume that economic actors usually have accurate perceptions of economic realities." *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210, 218 n.4 (D.C. Cir. 1986).

The FTC also presented strong evidence that Whole Foods and Wild Oats have "peculiar characteristics" distinguishing them from traditional supermarkets, another of the "practical indicia" the Supreme Court has said can be used to determine the boundaries of a distinct market. *Brown Shoe*, 370 U.S. at 325. Most important, unlike traditional grocery stores, both Whole Foods and Wild Oats carry only natural or organic products. *See* http://www.wholefoodsmarket.com/products/index.html ("We carry natural and organic products . . . unadulterated by artificial additives, sweeteners, colorings, and preservatives . . . ."). Glossing over this distinction, the dissent says "the dividing line between 'organic' and conventional supermarkets has been blurred" because "[m]ost products that Whole Foods sells are not organic" while "conventional supermarkets" have begun selling more organic products. Dissenting Op. at 9. But the FTC never defined its proposed market as "organic supermarkets," it defined it as "premium natural and organic supermarkets." And everything Whole Foods sells is natural and/or organic, while many of

the things sold by traditional grocery stores are not. *See, e.g.*, Hasker Dep. 130-34; http://www.wholefoodsmarket.com/products/unacceptablefoodingredients.html (explaining that Whole Foods refuses to carry any food item containing one of dozens of "unacceptable food ingredients," ingredients that can be found in countless products at traditional grocery stores).

Insisting that all this evidence of a separate market is irrelevant, Whole Foods and the dissent argue that the FTC's case must fail because the record contains no evidence that Whole Foods or Wild Oats charged higher prices in cities where the other was absent—i.e., where one had a local monopoly on the asserted natural and organic market—than they did in cities where the other was present. This argument is both legally and factually incorrect.

As a legal matter, although evidence that a company charges more when other companies in the alleged market are absent certainly indicates that the companies operate in a distinct market, *see, e.g.*, *Staples*, 970 F. Supp. at 1075-77, that is not the *only* way to prove a separate market. Indeed, *Brown Shoe* lists "distinct prices" as only one of a non-exhaustive list of seven "practical indicia" that may be examined to determine whether a separate market exists. 370

increase of 5% or more." Dissenting Op. at 3. Such evidence in a case like this, which turns entirely on market definition, would be enough *to prove* a section 7 violation in the FTC's administrative proceeding. *See Hosp. Corp.*, 807 F.2d at 1389 (stating that "[a]ll that is necessary" to prove a section 7 case "is that the merger create an appreciable danger of [higher prices] in the future"). Yet our precedent clearly holds that to obtain a preliminary injunction "[t]he FTC is not required to *establish* that the proposed merger would in fact violate section 7 of the Clayton Act." *Heinz*, 246 F.3d at 714. Moreover, the Merger Guidelines—which "are by no means to be considered binding on the court," *FTC v. PPG Indus., Inc.*, 798 F.2d 1500, 1503 n.4 (D.C. Cir. 1986)—specify how the FTC decides which cases to bring, "*not* . . . how the Agency will conduct the litigation of cases that it decides to bring," Horizontal Merger Guidelines § 0.1 (emphasis added); *see also id.* ("[T]he Guidelines do not attempt to assign the burden of proof, or the burden of coming forward with evidence, on any particular issue.").

In any event, the FTC did present evidence indicating that Whole Foods and Wild Oats charged more when they were the only natural and organic supermarket present. The FTC's expert looked at prices Whole Foods charged in several of its North Carolina stores before and after entry of a regional natural food chain called Earth Fare. Before any Earth Fare stores opened, Whole Foods charged essentially the same prices at its five North Carolina stores, but when an Earth Fare opened near the Whole Foods in Chapel Hill, that store's prices dropped 5% below those at the other North Carolina Whole Foods. *See* Tr. of Mots. Hr'g, Morning Session 125-30 (July 31, 2007); Supplemental Rebuttal Expert Report of Kevin M. Murphy ¶¶ 2-6 (July 16, 2007) ("Murphy Supp."). Prices at that store remained lower than at the other Whole Foods in North Carolina for **{**

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such an increase would exceed the "critical loss"—the point at which the revenue gained from raising prices equals the revenue lost from reduced sales. As the majority opinion explains, however, that study ignores core customers. Maj. Op. at 13-14. Moreover, using a slightly different methodology, the FTC's expert reached the exact opposite conclusion, finding that the combined company could impose a statistically significant non-transitory increase in price.

role when they choose between plausible, well-supported expert studies.

The district court next emphasized that when a new Whole Foods store opens, it takes business from conventional grocery stores, and even when an existing Wild Oats is nearby, most of the new Whole Foods store's revenue comes from customers who previously shopped at conventional stores. According to the district court, this led "to the inevitable conclusion that Whole Foods' and Wild Oats' main competitors are other supermarkets, not just each other." *Whole Foods*, 502 F. Supp. 2d at 21. As the FTC points out, however, "an innovative [product] can create a new product market for antitrust purposes" by "satisfy[ing] a previously-unsatisfied consumer demand." Appellant's Opening Br. 50. To use the Commission's example, when the automobile was first invented, competing auto manufacturers obviously took customers primarily from companies selling horses and buggies, not from other auto manufacturers, but that hardly shows that cars and horse-drawn carriages should be treated as the same product market. That Whole Foods and Wild Oats have attracted many customers away from conventional grocery stores by offering extensive selections of natural and organic products thus tells us nothing about whether Whole Foods and Wild Oats should be treated as operating in the same market as conventional grocery stores. Indeed, courts have often found that sufficiently innovative retailers can constitute a distinct product market even when they take customers from existing retailers. *See, e.g.*, *Photovest Corp. v. Fotomat Corp.*, 606 F.2d 704, 712-14 (7th Cir. 1979) (finding a distinct market of drive-up photo-processing companies even though such companies took photo-processing customers from drugstores, camera stores, and supermarkets); *Staples*, 970 F. Supp. at 1077 (finding a distinct market of office supply superstores even though such

require an exclusive class of customers for each relevant submarket.").

In sum, much of the evidence Whole Foods points to is either entirely unpersuasive or rebutted by credible evidence offered by the FTC. Of course, this is not to say that the FTC will necessarily be able to prove its asserted product market in an administrative proceeding: as the district court recognized, Whole Foods has a great deal of evidence on its side, evidence that may ultimately convince the Commission that no separate market exists. But at this preliminary stage, the FTC's evidence plainly establishes a reasonable probability that it will be able to prove its asserted market, and given that this "'case hinges'—almost entirely—'on the proper definition of the relevant product market,'" *Whole Foods*, 502 F. Supp. 2d at 8 (quoting *Staples*, 970 F. Supp. at 1073), this is enough to raise "serious, substantial" questions meriting further investigation by the FTC, *Heinz*, 246 F.3d at 714.

III.

Because we have decided that the FTC showed the requisite likelihood of success by raising serious and substantial questions about the merger's legality, all that remains is to "weigh the equities in order to decide whether enjoining the merger would be in the public interest." *Id.* at 726. Although in some cases we have conducted this weighing ourselves, *see*, *e.g.*, *id.* at 726-27, three factors lead me to agree with Judge Brown that the better course here is to remand to the district court for it to undertake this task. First, in cases in which we have weighed the equities, the district court had already done so, giving us the benefit of its factfinding and reasoning. *See*, *e.g.*, *id.* Here, by contrast, the district court never reached the equities and the parties have not briefed the issue, leaving us without the evidence needed to decide this question. *See Whole Foods*, 502 F. Supp. 2d at

50. Second, this case stands in a unique posture, for in cases where we reversed a district court's denial of a section 13(b) injunction, either the district court or this court had enjoined the merger pending appeal. *See Heinz*, 246 F.3d at 713; *PPG Indus.*, 798 F.2d at 1501 n.1. Here, by contrast, the companies have already merged, and although this doesn't moot the case, it may well affect the balance of the equities, likely requiring the district court to take additional evidence. Finally, given this case's unique posture, the usual remedy in section 13(b) cases—blocking the merger—is no longer an option. Therefore, if the district court concludes that the equities tilt in the FTC's favor, it will need to craft an alternative, fact-bound remedy sufficient to achieve section 13(b)'s purpose, namely allowing the FTC to review the transaction in an administrative proceeding and reestablish the premerger status quo if it finds a section 7 violation. To

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transaction, we must afford such concerns little weight, lest we undermine section 13(b)'s purpose of protecting the public-at-large, rather than the individual private competitors." *Heinz*, 246 F.3d at 727 n.25 (quoting *FTC v. Univ. Health, Inc.*, 938 F.2d 1206, 1225 (11th Cir. 1991)) (internal quotation marks omitted). Moreover, "[w]e do not rank as a private equity meriting weight a mere expectation of private gain from a transaction the FTC has shown is likely to violate the antitrust laws." *Weyerhaeuser*, 665 F.2d at 1083 n.26. In other words, even if allowing the merger to proceed would increase Whole Foods's profits, that is irrelevant to the private equities under section 13(b).

KAVANAUGH, *Circuit Judge*, dissenting: The Federal

case; it completely failed to make the economic showing that is Antitrust 101. Unbowed by the lack of economic underpinnings to the FTC's case, the FTC's counsel actually said at oral argument that the merger should be blocked even if there is no separate organic-stores market, a rather stunning suggestion at odds with modern antitrust law. Tr. of Oral Arg. at 17. By seeking to block a merger without a plausible showing that so-called organic stores constitute a separate product market and that the merged entity could impose a significant and nontransitory price increase, the FTC's

that statutory directive and recognize that the key initial step in the analysis is proper product-market definition. *See* Horizontal Merger Guidelines § 1.11; *see also* 2B PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 536, at 284-85 (3d ed. 2007). Proper product-market analysis focuses on products' interchangeability of use or cross-elasticity of demand. A product "market can be seen as the array of producers of substitute products that could control price if united in a hypothetical cartel or as a hypothetical monopoly." *Id.* ¶ 530a, at 226. In the merger context, the inquiry therefore comes down to whether the merged entity could profitably impose a "small but significant and nontransitory increase in price" typically defined as five percent or more. *See* Horizontal Merger Guidelines § 1.11 (internal quotation marks omitted). If the merged entity could profitably impose at least a five percent price increase (because the price increase would not cause a sufficient number of consumers to switch to substitutes outside of the alleged product market), then there is a distinct product market and the proposed merger likely would substantially lessen competition in that market, in violation of § 7 of the Clayton Act.

In considering whether the merged entity could increase prices, courts of course recognize that "future behavior must be inferred from historical observations." Abe Ashan p26thereforh

stores, but he nonetheless found that office-supply superstores constituted a distinct product market. One key fact led Judge Hogan to that conclusion: In areas where Staples was the only office superstore, it was able to set prices significantly higher than in areas where it competed with other office superstores (Office Depot and OfficeMax). *See id.* at 1075-76. For example, the FTC presented "compelling evidence" that Staples's prices were 13 percent higher in areas where no office-superstore competitors were present. *Id.* Judge Hogan ultimately concluded that "[t]his evidence all suggests that office superstore *prices* are affected primarily by other office superstores and not by non-superstore competitors." *Id.* at 1077 (emphasis added). For that reason, he enjoined the merger of Staples and Office Depot.

B

Consistent with the statute, the Executive Branch's

[Whole Foods] and [Wild Oats] price higher" where they face no competition from so-called organic supermarkets compared with where they do face such competition. Scheffman Expert Report ¶ 292, at 113. At a regional level, his studies revealed that only a "very small percentage" of products vary in price within a region, indicating that "prices are set across broad geographic areas." *Id.* ¶ 300, at 116. He also analyzed prices at the individual store level, examining how many products sold at a specific store have prices that differ from the most common pric

supermarkets, meaning that "all supermarkets" is the relevant product market and that the Whole Foods-Wild Oats merger will not lessen competition in that product market.

In addition to the all-but-dispositive price evidence,[4] the District Court identified other factors further demonstrating that the relevant market consists of all supermarkets.

First, the record shows that Whole Foods makes site selection decisions based on all supermarkets and checks prices against all supermarkets, not only so-called organic supermarkets. As Dr. Scheffman concluded, Whole Foods "price checks a broad set of competitors . . . nationally, regionally and locally." *Id.* ¶ 224, at 86. This "demonstrates that [Whole Foods] views itself as competing with a broad range of supermarkets and that these supermarkets, in fact, constrain the prices charged by [Whole Foods]." *Id.* Those other supermarkets include conventional supermarkets such as Safeway, Albertson's, Wegman's, HEB, and Harris Teeter, as well as so-called organic supermarkets like Wild Oats. *Id.* ¶¶ 225-26, at 86-87. As Professors Areeda and Hovenkamp have explained, a "broad-market finding gains some support

In sum, while all supermarket retailers, including Whole Foods, attempt to differentiate themselves in some

factors include intangible qualities such as customer service and tangible factors such as a focus on perishables.

This argument reflects the key error that permeates the FTC's flawed approach to this case. Those factors demonstrate only product differentiation, and product differentiation does not mean different product markets. "For antitrust purposes, we apply the differentiated label to products that are distinguishable in the minds of buyers but not so different as to belong in separate markets." 2B PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 563a, at 385 (3d ed. 2007). As the District Court noted, supermarkets including so-called organic supermarkets differentiate themselves by emphasizing specific benefits or characteristics to attract customers to their stores. *See FTC v. Whole Foods Mkt., Inc.*, 502 F. Supp. 2d 1, 24-26 (D.D.C. 2007). They may differentiate themselves along dimensions such as "low price, ethnic appeal, prepared foods, health and nutrition, variety within a product category, customer service, or perishables such as meats or produce." Stanton Expert Report ¶ 23, at 6.

The key to distinguishing product differentiation from separate product markets lies in price information. As Professors Areeda and Hovenkamp have stated, differentiated sellers "generally compete with one another sufficiently" that the prices of one are "greatly constrained" by the prices of others. AREEDA & HOVENKAMP, ANTITRUST LAW ¶ 563a, at 384. To distinguish differentiation from separate product markets, courts thus must "ask whether one seller could maximize profit" by charging "more than the competitive price" without "losing too much patronage to other sellers." *Id.* ¶ 563a, at 385. Here, in other words, could so-called organic supermarkets maximize profit by charging more than a competitive price without losing too much patronage to

conventional supermarkets? Based on the evidence regarding Whole Foods's pricing practices, the District Court correctly found that the answer to that question is no. So-called organic supermarkets are engaged in product differentiation; they do not constitute a product market separate from all supermarkets.

Second, the FTC points to internal Whole Foods studies and other evidence showing that if a Wild Oats near a Whole Foods were to close, most of the Wild Oats customers would shift to Whole Foods. But that says nothing about whether Whole Foods could impose a five percent or more price increase and still retain those customers (and its other customers), which is the relevant antitrust question. In other words, the fact that many Wild Oats customers would shift to Whole Foods does not mean that those customers would stay with Whole Foods, as opposed to shifting to conventional supermarkets, if Whole Foods significantly raised its prices. And even if one could infer that all of those former Wild Oats customers would so prefer Whole Foods that they would shop there even in the face of significant price increases, that would not show whether Whole Foods could raise prices without driving out a sufficient number of *other* customers as to make the price increases unprofitable. In sum, this argument is a diversion from the economic analysis that must be conducted in antitrust cases like this. The District Court properly found that the expert evidence in the record leads to the conclusion that Whole Foods awithout .5(er-hout .5(W)9.2.51a rais5 -D0)4.7(es,5 -Drthat.

Fourth, the FTC says that a study by its expert, Dr. Murphy, demonstrates that Whole Foods's profit margins decreased in geographic areas where it competed against Wild Oats. But the relevant inquiry under the Merger Guidelines is prices. And Dr. Murphy did not determine whether Whole Foods *prices* ever differed as a result of competition from Wild Oats.

Moreover, there was only a slight difference between Whole Foods margins when Wild Oats was in the same area and when it was not. The overall difference was 0.7 percent, which Dr. Murphy himself recognized was not statistically significant. The FTC's evidence on margins is wafer-thin and does not suffice to show that organic stores constitute their own product market.

Fifth, the FTC points to evidence that Whole Foods's entry into a particular area, unlike the entry of conventional supermarkets, caused Wild Oats to lower its prices. Dr. Murphy's reliance on Wild Oats's reaction to Whole Foods's entry is questionable. Dr. Murphy based his entire analysis on a meager two events, hardly a large sample size. In addition, Dr. Murphy's analysis did not control for the reaction of conventional supermarkets to Whole Foods's entry. In other words, he *assumed* that the relevant product market was so-called organic supermarkets (the point he was trying to prove) and therefore assumed that all changes in Wild Oats's prices were directly caused by Whole Foods's entry. But if conventional supermarkets also lowered prices to compete with Whole Foods when Whole Foods entered, Wild Oats's price decreases may well have been due to the overall reduction in prices by all supermarkets in the area. If that were true, the relevant product market would obviously be all supermarkets, not just so-called organic supermarkets.

qualify as "nontransitory." *See* AREEDA & HOVENKAMP, ANTITRUST LAW ¶ 537a, at 290. Moreover, the entry of a Safeway store in Boulder, Colorado, had a similar short-term impact on Whole Foods, indicating that whatever inference should be drawn from the Earth Fare entries cannot be limited to so-called organic supermarkets but rather applies to conventional supermarkets.

The FTC's reference to Earth Fare mistakenly focuses on a few isolated trees instead of the very large forest indicating a competitive market consisting of all supermarkets. In short, I fail to see how Whole Foods's *temporary* price changes to compete against three Earth Fare stores in North Carolina could possibly be a hook to block this nationwide merger of Whole Foods and Wild Oats.[6]

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[6] As two antitrust commentators perceptively stated:

> The basic problem with the FTC's position in *Whole Foods* was that it lacked the pricing evidence it had in *Staples*, which showed that customers did not go elsewhere if the office superstores increased their prices. *Whole Foods* is an attempt by the FTC to persuade a court that if you take a CEO's statements about a merger and stir it in with evidence showing the existence of several "practical indicia" from *Brown Shoe*, the resulting mixture should trump objective evidence about how customers would react in the event of a price increase. It was not successful, and the court's decision underscores the dominant influence of economic evidence in merger cases today.

Carlton Varner & Heather Cooper, *Product Markets in Merger Cases: The* Whole Foods *Decision* (Oct. 2007), www.antitrustsource.com.

III

There are many surprising aspects of today's decision. But perhaps most startling is that the majority opinion reverses the District Court based primarily on an argument that the FTC has not made to this Court. In reaching its decision, the majority opinion relies on a distinction between marginal consumers and core consumers. But the FTC never once referred to, much less relied on, the distinction between marginal and core consumers in 86 pages of briefing or at oral argument. The terms "marginal consumer" and "core consumer" are nowhere to be found in its briefs. It's of course not our usual role to gin up new arguments that the

economic principles. The record does not show that Whole Foods priced differently based on the presence or absence of Wild Oats in the same area. The reason for that and the conclusion that follows from that are the same: Whole Foods competes in an extraordinarily competitive market that includes all supermarkets, not just so-called organic supermarkets. There is no good legal basis to block further implementation of this merger.

* * *

I respectfully dissent.