Federal Trade Commission

GCR Live
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"***FTC v. Sysco*: Old-School Antitrust With Modern Economic Tools**"

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I am pleased to be back at GCR Live New York, having given my first speech as Bureau Director here two years ago at your inaugural event. It's

national customers and broadline foodservice distribution to local customers. The court granted a preliminary injunction and Sysco announced shortly thereafter that it would not pursue the merger.

The court's decision in *Sysco* is a worthwhile read for anyone who wants to learn more about U.S. merger analysis. Every element of a Section 7 claim was in dispute: product and geographic market definition, market shares, entry, effects and efficiencies. But as the judge noted, the "primary battlefield" was over market definition, and the court spent nearly 40 pages discussing the evidence bearing on the product dimensions of competition among broadline foodservice distributors. Our view was that Sysco and US Foods were competitors in the market for *broadline* foodservice distribution, while defendants argued that the market included other foodservice distributors, such as specialty distributors, systems distributors, and cash-and-carry stores.[5] In their view, the combined firm would account for only a 25 percent share of foodservice sales.

What is clear from the court's decision is that, even after more than 50 years, the Supreme Court's teachings from *Brown Shoe Co. v. United States, 370 U.S. 294 (1962)* still provide the legal framework for assessing the market in which the merging companies compete. The significance of a decades-old case might be surprising to those who are not steeped in antitrust practice (and seems to vex experienced practitioners who want to relegate *Brown Shoe* to the history books). Yet *Brown Shoe*'s

distributors. But the district court found that "[t]hough the customers may be varied, . . . the industry, from the perspective of both sellers and buyers, perceives broadline to be a separate mode of food distribution."[8] The court pointed to other FTC merger cases in which courts found a subset of outlets to be a relevant product market.

market for national customers.[15] The court thus found that the dynamics of competition among broadline food distributors supported a separate relevant product market for broadline foodservice distribution services sold to national customers.

The defendants called this market "contrived." The court acknowledged that "defining a *product* market based on the type of *customer* seems incongruous. After all, one ordinarily thinks of a customer as purchasing a product in the market, and not as the product market itself." But the court explained: "Broadline distributors must offer a particular kind of 'product' – a cluster of goods and services that can be delivered across a broad geographic area – to compete for national customers. In that sense, the customer's requirements operate to define the product offering itself."[16]

Indeed, the notion that the competitive effects from a merger may vary for different customers is firmly rooted in the Merger Guidelines. The 2010 revisions to the Guidelines added a new section on Targeted Customers 7 1.11 0 Tjg 1.11 hea 0 Tj 1.1 rg thi cust Tj 1.11er C w

Where such price discrimination is feasible, a merger may differentially harm distinct groups of customers depending on the transaction and the market dynamics. For instance, the Commission has examined customer-specific effects in several mergers involving retail pharmacy chains. In 1997, the Commission challenged the merger of CVS and Revco, alleging that the proposed merger would substantially reduce competition in the market for the retail sale of pharmacy services to third-party payors such as insurance carriers and others who pay discounted prices for pharmaceuticals.[23] In 2007, the Commission

Litigating the Fix

In addition to challenging each element of our *prima facie* case, the parties argued that they had fixed any potential problems created by the merger by entering into a separate agreement to divest assets to a smaller competitor in the market, a standard structural remedy in merger cases. The defendants agreed to sell eleven of US Foods' 61 distribution centers to Performance Food Group, a regional broadline competitor with 24 distribution centers of its own. The agreement with PFG was signed during the Commission's investigation in an effort to avoid litigation, but the Commission determined that, even with the divestitures to PFG, Sysco's acquisition of US Foods would likely result in anticompetitive harm.

We were thus confronted with the need not only to litigate the initial case presented to us, but also the transaction with the fix. This, of course, is a familiar challenge for the antitrust agencies. The Commission has found itself litigating both the original merger proposal and a modified version in previous matters. On January 14, 2002, the Commission filed for a preliminary injunction to stop the merger of Libbey and Anchor Hocking, two leading suppliers of commercial glassware. One week later, the defendants amended their proposed merger agreement: Libbey would still acquire all of the stock of Anchor Hocking, but Anchor's parent company, Newell Rubbermaid, would retain certain assets that the defendants alleged would allow it to compete in the market. After acknowledging that it was "[o]perating on what appears to be a clear slate," [29] the court found that both agreements were subject to scrutiny under Section 7. Upon review of all the evidence, including post-

barriers to entry. During the FTC investigation,

step approach is consistent with how the Commission analyzes

efficiencies claims during the merger review process and incorporates insights from our non-merger work. That framework was added in 1997 in response to concerns that the Supreme Court’s stated hostility to an “efficiencies defense” in some older *merger* cases[47] conflicted with the Court’s recognition of credible efficiencies claims in subsequent *non-merger* cases such as *NCAA*,[48] *BMI*,[49] and *GTE Sylvania.*[50] Although the Supreme Court itself has not addressed that tension since the 1997 version of the Merger Guidelines was issued, lower courts now routinely consider evidence offered by defendants to show that merger-specific efficiencies are relevant to the competitive analysis.

Under Section 10 of the Merger Guidelines, efficiencies must meet several criteria to be credited. First, they must be merger-specific in that they could not likely be accomplished in the absence of the merger. Second, they must not be vague or speculative. Finally, they must be cognizable, by which we mean the efficiencies are verified and do not arise from anticompetitive reductions in output. If merger-specific cognizable efficiencies are substantial enough that the merger is not likely to be anticompetitive, the Commission is unlikely to challenge the transaction.

Generally speaking, firms can reduce their costs by combining complementary assets, eliminating duplicative activities, or achieving scale economies. Cost savings may be generated from the firm’s variable costs (e.g., raw materials) or fixed costs (e.g., rent on office space). Variable cost savings are more likely to result in lower prices than efficiencies gained from fixed cost reductions. There are exceptions to this general rule—for instance, where contract terms provide for cost-plus pricing or require pass-th(er)--plusixed cost sainghe firm’s v-rm-4(f)-1(i)-6(r)-1(m)-16(s)-

The challenges of mounting a successful efficiencies claim are well-known.

offset any plausible price increase.[58] But as the potential for anticompetitive effects rises, the magnitude of efficiencies required to offset the harm rises, as does the degree to which those cost savings must be passed through to customers.[59]

I also want to address how we think about efficiencies in a few particular situations.

First, there is a question of how we analyze the likelihood that efficiencies will be passed through. In bid markets, economics teaches us that costs savings are not likely to be passed through if the first and second bidders merge because the merged firm can still win the bid at the higher price. Even where the parties are not the first and second, there may be limited pass-through depending on the circumstances. In other cases, to determine whether cost reductions are likely to be passed through, we may look at empirical studies of the effect of cost savings (or sometimes cost increases) in an industry or whether prior cost reductions have led to price reductions to customers. For example, the district court in *Staples* found that Staples and Office Depot had a proven track record of achieving cost savings through efficiencies and then passing those savings on to consumers in the form of lower prices, but found that the companies' projected pass , the t as)s'

of how those processes and practices will benefit patients through improved care. In addition, we