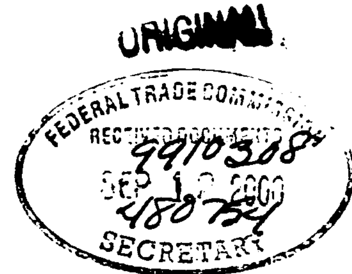
Comment #2



In the Matter
of
Establissements Delhaize Freres et Cie "Le Lion" S.A.,
Delhaize America, Inc.,
and
Hannaford Bros. Co.
FTC File No. 991-0308

COMMENT ON CONSENT SETTLEMENT FILED BY NATIONAL GROCERS ASSOCIATION

The National Grocers Association (N.G.A.) applauds the Commission's action in approving and requiring the divestiture of all of the supermarkets in the Hannaford Bros. Co.'s southeastern division in North Carolina and Virginia. We believe the divestiture is in the long term interest of consumers except, however, that in one of the affected Virginia markets, Richmond, the Commission's policies and process yielded an unwarranted result, which, in the long run, will lessen competition in the Richmond inner city. This comment will address three issues raised by those policies and the divestiture process presently employed. They are, (1) small retailers in the geographic market in which divestiture must occur should not be prevented from expanding their businesses and becoming more effective competitors because of the mechanical application of policies preventing incumbents from increasing their market share and requiring that all stores to be divested in the market be sold to a single buyer; (2) the Commission must adopt a fairer, more open and pro-competitive divestiture process in order to assure that qualified buyers have a fair opportunity to bid on and acquire stores that must be divested; and (3) an up-front buyer should not be permitted to acquire the divested stores prior to entry of the final order.

Factual Background

In the Fall of 1999, Food Lion, a subsidiary of Delhaize America, Inc., announced its agreement to acquire Hannaford Bros. Co. (HBC). On September 21, 1999, counsel for a small, Richmond independent retail supermarket company, Marketplace Holdings, Inc. (MPH), wrote to the FTC New York office, which was conducting an investigation of the acquisition. The letter expressed concern about the increase in concentration the acquisition would have in the Richmond area, and the interest of MPH in acquiring stores in the event divestiture was required.

In November, MPH's president and owner, Johnny Johnson, sent an offer, in the form of a letter of intent (LOI), to the CEO of Food Lion, offering to purchase all of the HBC stores in the Richmond market. That interest was reaffirmed on February 22 of this year when Mr. Johnson sent a letter to Food Lion's CFO and a renewed offer to purchase the stores to the Food Lion

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president. A few days later, on February 28, Mr. Johnson received a letter from a Food Lion vice president acknowledging receipt of Mr. Johnson's confidentiality agreement and transmitting a list of Food Lion and HBC stores that might have to be sold in order to satisfy FTC objections to the transaction. Mr. Johnson was asked for an expression of his interest in the event those stores had to be divested.

In response to that letter, Mr. Johnson sent a revised LOI to the Food Lion CEO on March 20, offering to purchase ten Food Lion and two HBC stores in the Richmond market. The following day, Mr. Johnson received a new bid package from Food Lion. This package contained only HBC stores and required submission of a new LOI on specific outlets no later than March 31st. Although he preferred to acquire Food Lion stores, Mr. Johnson submitted a timely offer to purchase five of the HBC stores listed in the latest bid package.

Four weeks later, on April 28, Mr. Johnson called the Food Lion vice president to inquire about the status of his last offer. He was informed that Food Lion would have liked to sell the stores to him, but that the FTC's criteria made that impossible for two reasons. First, all ten HBC stores had to be sold to a single buyer, and, second, the FTC would not permit the increase in MPH's market share were Food Lion to sell all ten HBC stores to it. Mr. Johnson was told that, reluctantly, Food Lion had no choice other than selling all of the Virginia stores to Kroger, the only bidder for the Richmond stores that satisfied the FTC's criteria.

During a phone conversation between MPH's and Food Lion's antitrust counsel on June 2, the latter made the following points. (1) Food Lion would have preferred selling the Richmond stores to MPH. (2) Throughout its negotiations with the FTC staff, Food Lion was told repeatedly that no increase in market share of Richmond incumbents would be permitted above those permitted by the Horizontal Merger Guidelines. (3) The Commission staff insisted on a single buyer for all ten HBC stores in the Richmond area, making it impossible for Food Lion to accept HBC's last offer to purchase five of those stores. (4) The FTC's policies on divestiture made it impossible to sell either five or ten of the Richmond stores to MPH. The sale of five stores would violate the one-buyer policy; the sale of all ten stores would violate the market share policy. On June 6, Food Lion's antitrust counsel reiterated these points in a letter to Mr. Johnson.

The Commission announced that it had reached a negotiated settlement with Delhaize and HBC in a July 25 news release. Official notice was published in the Federal Register on August 1, and the matter was placed on the public record for comment. Under the settlement, Food Lion will divest thirty-seven HBC supermarkets and one building site to three different buyers. N.G.A.'s comments are directed to issues of policy and process as they relate to the divestiture in the Richmond, Virginia market, although these issues can raise similar problems in other markets.

Divestiture Criteria Should Not Prevent Independent Retailers like Marketplace Holdings from Expanding And Becoming More Effective Competitors

Marketplace Holdings is the largest African-American owned retail supermarket chain in the United States, but it operates only eight stores. Five of them serve the Richmond inner city; the other three are in outlying areas of Richmond, serving a more affluent clientele. The inner city stores, doing business under the Community Pride banner, are the only supermarkets serving the inner city population. If the Community Pride stores close, a significant portion of the Richmond population will have no convenient access to a supermarket.[1] This population is essentially financially disadvantaged, immobile and it contains a substantial elderly component. Mr. Johnson sought to acquire additional stores in the outlying areas of Richmond in order to purchase in higher quantities and at lower prices, thereby enabling his company to continue to absorb the higher cost of inner city operations[2] and maintain competitive prices, even though he faces virtually no significant competition in this area of his business.

The MPH situation is illustrative of the broader problem of how two of the Commission's policies defining acceptable buyers can prevent an otherwise qualified buyer from receiving consideration in its attempt to purchase stores that must be divested. The one buyer, or clean sweep, policy prevented MPH from purchasing less than all ten Hannaford stores in the Richmond market. Food Lion was constantly being told by the Commission staff that Hannaford's market share was too high to permit an incumbent to acquire all the stores. These criteria sent Food Lion a clear message: No sale to MPH would be approved; sell all the stores to a new entrant. We examine some of the long-range implications of that result in the Richmond market.

The buyer of the Richmond Hannaford stores, Kroger, is the nation's largest supermarket chain, with annual grocery sales expected to reach nearly $50 billion this year.[3] There can be little doubt that Kroger can be expected to expand its presence in the Richmond market beyond the ten former Hannaford locations. Because Richmond already is substantially over-stored, Richmond will experience a scenario that has happened time and time again in other markets. Kroger will build additional stores, reduce prices in order to build market share, jeopardize the ability of existing stores to survive (especially independents that have far fewer financial resources and no realistic protection from federal enforcement of the Robinson-Patman Act). With the exit of numerous competitors from the market, concentration will increase significantly (translation:

[1] May 31, 2000 letter to Bureau Director Richard G. Parker from Alec C. Covington, President & COO, RICHFOOD.

[2] Because of the age and relative immobility of its customer base, MPH operates a fleet of vans that pick customers up at their homes, bring them to the store and return them with their groceries. MPH also has an extensive (and expensive) training program that gives unemployed and unemployable inner city residents jobs in the company's stores.

[3] *Supermarket News,* August 21, 2000, p. 9.

higher retail prices),[4] and shoppers will have fewer competitors and a reduced product mix from which to choose. These results will spring in large measure from the exit or reduced competitive vigor of independent retailers, and they are results that are not peculiar to the Richmond market.[5] Consumers get very short-term artificial benefits in exchange for long-term pain.

Another anti-competitive result of the Commission's policies in this case is more peculiar to the Richmond market. It is unlikely that MPH will have another opportunity to grow by acquisition in this market. Its limited financial resources will not permit growth of the needed magnitude by building new stores. Therefore, it is likely that within a relatively few years the Community Pride (inner city) stores will have to be closed. That will leave the inner city without a single supermarket -- the ultimate injury to both competition and consumers.[6]

This case demonstrates that the clean sweep and market share policies are purely short-term expedients designed to maintain the competitive *status quo* at an instant in time. These policies ignore the dynamics of the industry and the ever-changing affects that these policies can have on the competitive environment.[7] The FTC's criteria of having a single buyer replace things as they are is inherently flawed and plays directly into the hands of power buyers. The FTC criteria do not recognize the inherent difference between the top five multi-billion dollar chains and privately owned regional and community retailers. One has the potential to utilize monopsony power to the detriment of consumers, while the other offers consumers marketplace choice and variety. Had MPH been able to acquire five (or all ten) of the Hannaford stores, the long-term prospects would have been much different. Marketplace Holdings' ability to remain in the inner city would have been enhanced substantially. As a new competitor, with significant coverage of the market, competition outside the inner city area would have benefited dramatically.

We note another apparent anomaly in the way the Commission staff dealt with this transaction. There is justifiable concern for an acquisition of ten stores, representing a 9% share of the market, by a firm that already has a substantial share. Indeed, that was why Food Lion was prohibited from acquiring the Richmond HBC stores in the first place. However, it does not follow that the acquisition of those stores by a firm such as MPH would have the same anticompetitive effect as would their acquisition by Food Lion. Put differently, while the acquisition of the HBC stores arguably would confer a degree of market power on Food Lion, it is apparent that the acquisition of those stores by MPH would not confer the same degree of

[4] We will assume that price increases will flow naturally from increased concentration, not from any predatory intent of Kroger's. See Cotterill, ***Post Merger Price Conduct: A Case Study of Pricing in Connecticut Markets After the 1996 Royal Ahold-Stop & Shop Merger***, Food Marketing Policy Center, Research Report 47 (1999). Also see American Antitrust Institute letter to Chairman Pitofsky, June 18, 1999; Cotterill, "Strategic Groups, Competition and Retail Food Prices," Competitive Strategy Analysis in the Food System (Boulder, CO, 1993) at 197, and Marion, "Competition in Grocery Retailing: The Impact of a New Strategic Group on BLS Price Increases, 13 Review of Industrial Organization, 381.398 (1998).

[5] Another result that will add further to the trend in concentration is an acceleration in the rate at which independent retailers are acquired by existing chains in the market. In many cases, these transactions are too small to be reportable under Hart-Scott-Rodino, making it highly unlikely that there will be any governmental intervention.

[6] See Covington letter.

[7] If the vigor of the independent sector is to be preserved, the Commission's policies cannot prevent the independent sector from growing by acquisition, just as they do not prevent the publicly held chains from acquiring each other. Today, these policies clearly discriminate against independent retailers.

market power upon a firm that is barely present in the market.[8] However, the staff apparently made no such distinction and communicated a rigid application of the Commission's policies to Food Lion throughout the period when MPH was trying to acquire additional stores in the market.

We are not aware of the market share data that the Commission staff and Food Lion used to conclude that MPH was not qualified to acquire any of the HBC stores because of its existing share of the Richmond MSA market.

The National Grocers Association believes, and fairness demands, that the Commission should exercise its power to reject Kroger as the buyer of the Richmond Hannaford stores.[9] The Commission should then require Food Lion to conduct a new sale of those stores in which MPH and other interested, qualified buyers are given an opportunity to compete with Kroger for the acquisition of the stores to be divested. In that process, it must be made clear to Food Lion and its attorneys that, as to MPH and other retailers in the Richmond market, there will be no mechanical application of the clean sweep policy or the prohibition against the acquisition of divested stores by firms already in the market. Instead, in approving a buyer, the Commission should evaluate each bidder and the effect each would have on the long-term interests of consumers. Incumbent retailers and their wholesalers must be allowed to acquire divested stores where the effect on concentration is marginal, or long range competitive benefits outweigh short-term increases in market shares.

The Commission Must Adopt A Fairer, More Open, Pro-Competitive Divestiture Process

In numerous meetings with the Commission staff, the Director of the Bureau of Competition and members of the Commission, N.G.A has consistently been told that the Commission leaves the divestiture process in the hands of the party that must divest, that the Commission's role is merely to approve or disapprove the buyer presented to it by the party under order to divest. We suggest that the Commission must change the process to assure that all qualified buyers have a

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[8] We believe the geographic market could and should have been defined differently, and that MPH's existing market share should not have prohibited it from purchasing any or all of the HBC stores.

We believe there is strong evidence that inner city Richmond is a separate geographic market. Because of the demographics and relative immobility of its population, those familiar with the area have told us that price increases by MPH or price cuts in the outlying stores do not drive significant numbers of inner city shoppers to supermarkets outside the inner city; price increases by outlying stores or price cuts in the inner city do not result in increased sales by the Community Pride stores to customers from other parts of the MSA. It follows from these facts that the inner city and the balance of the MSA are different geographic markets. All ten of the HBC stores lie outside the inner city, a market in which MPH has only three stores with a share of 2.43%. Our data show that HBC's ten stores represent 8.95% of the market.

MPH's last bid was for five of the ten HBC stores. Assuming they are roughly equal in sales, five stores would represent roughly 4.5% of the market. The acquisition of those stores by MPH would have resulted in an increase in the HHI of a mere 21.9 points. Were MPH to have acquired all ten of the HBC stores, an increase in the HHI of only 43.5 points would have resulted. Even in a highly concentrated market, these increases are acceptable under §1.51(c) of the Horizontal Merger Guidelines (1992). The data add weight to N.G.A.'s belief that fairness requires a new bidding exercise for the Richmond stores.

[9] Order Paragraph II. A. (*proviso* paragraph).

fair chance to acquire the stores to be divested. It is apparent from the failed attempt of MPH to acquire HBC stores in Richmond, that unfairness can result, and that unfairness can have a direct and negative affect on the future competitiveness of the market and on consumers.

First, it is worth noting that the Commission already exercises a significant degree of control over the divestiture process, and that control has been increasing. For example, for many years, the divesting party in a retail grocery merger was permitted to pick and choose among the acquired stores and its own outlets to put together a package of stores to be sold. Experience taught the Commission that this process enabled the violator to rid itself of the least desirable stores and, on occasion, increase its share of the affected market. Gradually, new policies were implemented to address these problems. The Commission now plays a more active role in determining the stores to be divested, generally requiring divestiture of stores carrying a single banner. More recently, the policy was instituted that prevents increases in concentration and shares. The clean sweep policy is another example of Commission control over the process.

What N.G.A. suggests, therefore, is a change in the Commission's criteria to take a broader view of competition. It should eliminate the arbitrary preference for a clean sweep in which a single buyer takes all. The Commission should revise its policy to make acceptable a small increase in market share for a small incumbent acquiring divested stores.

In addition, we propose that when the Commission's approval of a buyer is sought, the divesting party be required to provide the following information and documents as part of the application:

1. a detailed description of the means used to identify and contact potential purchasers, together with copies of all documents used to communicate the availability of the stores or communicate directly with specific potential purchasers;
2. copies of all expressions of interest, letters of intent or bids received, together with copies of all supporting documents submitted with each;
3. the divesting party's evaluation of each bid, and the reasons, including the competitive justification, for accepting or rejecting it; and
4. the reasons for not pursuing any expression of interest or letter of intent, including the application of any applicable Commission policy.

The burden of implementing this fair and open process falls primarily on the party that made (or seeks to make) an illegal acquisition. We believe it is sound policy, and the adoption of these measures will assure a fairer divestiture procedure. At the same time, these requirements give the Commission a means of oversight that will enable it to consider longer-range competitive questions in the process of approving a buyer. The National Grocers Association urges the Commission to adopt these new policies and procedures.

<u>As A Matter Of Sound Policy, The Commission Should Not Permit Divestiture Of Stores Prior To Entry Of The Final Order</u>

The order to which the Commission and the respondents have agreed contains provisions that N.G.A. finds both unusual, if not unique, and troublesome. We refer to the *provisos* contained in paragraphs II.A., B. and C. Despite the fact that we have urged the Commission to exercise its ability under the *proviso* in paragraph II.A. to reject the sale of the Richmond stores to Kroger, we believe that these provisions are not good policy and have the potential to diminish the competitive value of the stores, thereby injuring competition.[10]

If there was a real prospect that the power granted to the Commission by the *provisos* might have to be exercised as a result of comments received, there was no justification for permitting the divestitures to occur prior to the end of the comment period and the Commission's consideration of those received. On the other hand, if the *provisos* are a mere formality, it would seem that placing the divestiture proposals on the public record for comment makes the comment process a meaningless exercise. We implore the Commission to abandon this approach.

The order requires that the stores be divested within ten days after the order becomes final. The *provisos,* however make it clear that divestiture can take place at any time prior to the order's finality, even prior to the end of the period during which the settlement is subject to public comment. As an apparent attempt to preserve the Commission's options in the event of such a premature divestiture, the *provisos* permit the Commission to reject any of the up-front buyers identified in the order, and require rescission of the sales to them. In that event, the *provisos* require a second divestiture of the stores within three months following the date on which the order becomes final.

Using the sale of the Richmond stores to Kroger as an example, we examine the scenario assuming a sale of those stores during the comment period and rejection of Kroger as the buyer thereafter. Prior to the sale, the HBC stores did business under the Hannaford banner. Once the sale is completed and the stores are reopened, they will carry the Kroger banner. Once the sale to Kroger is rejected by the Commission, the sale to Kroger is rescinded, meaning they revert to Delhaize ownership and, presumably either the Food Lion or the Hannaford banner until they are resold. At that time, they carry a fourth banner. The effect of these order provisions is to permit these stores to do business under four different names in a period of just a few months. It is not just the name on the front of the stores that change. Merchandise layouts will be altered, requiring customers to search for products in new, constantly changing locations. They may not be able to find some products, because the selection will change each time the store changes

[10] There may be some justification for the approach taken in the *provisos* when divesting a factory that produces a commodity product. But supermarkets attempt to differentiate themselves, at least in part, by their store layouts, product mix and private label programs. The same rules cannot safely be applied to both.

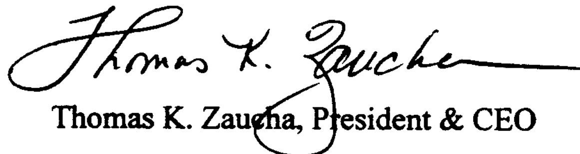
hands. This problem is especially acute in the private label area, because each chain has its own program.

We doubt that anyone could intentionally devise a scheme more effective in angering and confusing consumers, driving customers of those stores to competing outlets, and thereby reducing the competitive value of the locations subject to divestiture. We have no way of knowing whose idea this was, but it's a bad one. The solution, at least for supermarket divestitures, is to retain the Commission's prior practice, and prohibit divestiture until the order becomes final and the Commission has had an opportunity to address the issues raised in the comments. Then, the purchasers can be approved or rejected without subjecting the stores to unwarranted depreciation and driving the customers of those stores to other outlets.

To summarize N.G.A.'s position, the Commission should (1) reject the sale of the ten HBC stores in Richmond to Kroger and require a new round of bidding, (2) adopt new policies and procedures so that the divestiture process is more fair and open and (3) not permit the sale of stores before the divestiture order becomes final. We believe the proper discharge of the Commission's responsibilities and the public interest demand no less.

Respectfully submitted,

NATIONAL GROCERS ASSOCIATION



Thomas K. Zaucha, President & CEO

September 6, 2000

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