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The American
Antitrust Institute

December 20, 2002

Donald Clark
Secretary
Federal Trade Commission
600 Pennsylvania Ave., N.W.
Washington, D.C. 20580

e mail to [*redacted*]
fax to 202-326-2496

Re: Matter # 021-0090

Dear Mr. Clark:

This is a public comment by the American Antitrust Institute in regard to In the Matter of Wal-Mart Stores, Inc. and Supermercados Amigo, Inc., File No. 021 0090, issued November 21, 2002.

The American Antitrust Institute is an independent, non-profit education, research, and advocacy organization dedicated to promoting the laws and institutions of antitrust. Information about the AAI may be found at www.antitrustinstitute.org.

Recently, we published an article commending the Commission for the transparency it exhibited in its handling of the cruise mergers, a case in which the proposed mergers were approved without a consent order.[1] Not only did the Commission explain in detail its reasoning, accompanied by a dissenting statement that provided further enlightenment, but the Directors of two bureaus have also gone out of their way to elaborate extensively. Nor has this been the only evidence of this Commission's positive attitude toward greater transparency. We recently applauded, for example, the Commission's innovation of using the Internet to provide Frequently Asked Questions (and answers, of course) in regard to merger enforcement.[2]

The cruise merger statements were especially noteworthy because they were discretionary, in that there was no consent order. Where there is a consent order, the Commission has committed itself under 16 CFR, §2.34, to "place on the public record an explanation of the provisions of the order and the relief to be

[1] See "Three Cheers for Transparency," an AAI column that appeared in FTC: WATCH on November 18, 2002, and is reprinted at http://www.antitrustinstitute.org/recent2/217.cfm.

[2] See http://www.antitrustinstitute.org/recent2/210.cfm.

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obtained thereby and any other information that it believes may help interested persons understand the order."

Unfortunately, we are writing this time to say that, in our opinion, the Commission's **Analysis of the Complaint and Proposed Decision and Order to Aid Public Comment in the Matter of Wal-Mart Stores and Supermercados Amigo** fails to convey sufficient information to genuinely aid public comment. Indeed, the Analysis ignores various theories of illegality that should have been discussed and provides insufficient information to facilitate public evaluation of the remedy that was established as the condition for approving the merger.

This is an acquisition by the world's largest retailer, Wal-Mart, of the leading chain of supermarkets in Puerto Rico, Amigo. We are told that Wal-Mart is currently in the Puerto Rico market, operating nine traditional Wal-Mart stores, a supercenter, and eight SAM's Clubs. Amigo operates thirty-six supermarkets. We are not told what share of the overall Puerto Rico market either party holds[3] or what their trends or the trends within the industry have been, or whether the parties had plans to expand absent the merger.[4]

The Commission alleges that the merger would violate Section 5 of the FTC Act, but says its concerns will be satisfied if four Amigo supermarkets are divested to a purchaser named Supermercados Maximo, Inc.

The following comments are not intended to state a position as to whether the merger should have been challenged or whether the remedy is appropriate. Rather, we ask questions about the sufficiency of the disclosures that were made to the public. This request for more insight into the FTC's decision process and evidence is important not only in obtaining useful public comments, but to help guide business so it knows what is allowed and what is not.

I. On What Basis Was the Market Definition Determined?

The first important question here, as in most mergers, is how the market definition was determined. In this case, the Commission did something new by concluding that traditional Wal-Mart stores, supercenters, and clubs (we will call

[3] According to the pre-FTC complaint by the government of Puerto Rico, Wal-mart entered the Puerto Rico supermarket market in 1992. Amigo is the main competitor with an approximate average of 19.3% of the market share in all of Puerto Rico's geographic sectors and Wal-Mart is the third most important competitor in the market, with an approximate average of 14.5% of the market share in all of Puerto Rico's geographic sectors. Cooperativa de Consumidores del Noroeste, Inc. et al. v. Wal-Mart Stores, Inc. et al., Commonwealth of Puerto Rico Court of First Instance, Superior Court, San Juan Part, Docket KPE 022503, filed Oct. 25, 2002.

[4] We believe that as a matter of course the Commission should disclose pre- and post-merger HHI numbers for the entire area in which the merging parties operate and for all geographic markets in which post-merger concentration levels would come under scrutiny in accordance with the Federal Horizontal Merger Guidelines.

all of these "big box" retailers) all belong in the same product market as a traditional supermarket. Until now, the traditional supermarket was not deemed to be in the same product market as big box retailers. The Commission says, "The determination that club stores are included in the relevant product market in this proceeding does not, of course, determine what the relevant product market will be in future supermarket investigations by the Commission." But because something new has been done and because it is likely that the meaning of this precedent will be a critical issue in future supermarket mergers, the Commission should take special pains to explain its reasoning.

While the Commission reports that it considered several different kinds of evidence, as best we can tell, the Commission was ultimately persuaded by its conclusion that "A substantial portion of retail purchasers in Puerto Rico regard full-service supermarkets, supercenters, and club stores as reasonably interchangeable for the purpose of purchasing substantially all of their weekly food and grocery shopping requirements in a single shopping visit." Without knowing what the Commission means by " a substantial portion" of retail purchasers" or "substantially all of their weekly…shopping requirements,"[5] it is unnecessarily difficult for public commenters to say whether or not they agree with the Commission's market definition.

II. Why Has the Commission Ignored Potential Competition as a Theory of Liability?

The doctrine of potential competition has strong economic and legal support.[6] Based on their histories of growth, one would think that Wal-Mart would be the most likely entrant into markets where the largest supermarket chain in Puerto Rico operates, and that Amigo would be the most likely entrant into markets that Wal-Mart does now or may in the future occupy. The Commission complaint notes that entry barriers are high and that a number of geographic markets are highly concentrated.

Anyone who has observed the food retailing industry would have no difficulty predicting that Wal-Mart will expand in Puerto Rico, utilizing a variety of formats, and that other food retailers (along with many other retailers) will be dealt a devastating blow. Only the strongest competitors will likely survive this behemoth's entry and few, if any, will be capable of challenging Wal-Mart by opening stores in geographic markets within Wal-Mart's large drawing radius.

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[5] Nor is there an explanation of why "weekly one-stop shopping" was made the test in this case. Does the Commission anticipate applying a similar test in the future?

[6] See John E. Kwoka, "Non-Incumbent Competition: Mergers Involving Constraining and Prospective Competitors," 52 Case W. Res. L. Rev. 173 (2001).

Logic suggests that the largest chain would be best positioned to go up against Wal-Mart and that this merger would meet the tests for the elimination of actual potential competition.[7] Yet none of this is discussed by the Commission's Analysis.[8]

III. Why Has the Commission Ignored Possible Problems Relating to Monopsony, Vertical Distributional Effects and the Raising of Rivals' Costs?

Monopsony can in theory be as anticompetitive as monopoly, and the possibility of its creation, expansion, or abuse are to be considered in the normal course of merger evaluation.[9] The Government of Puerto Rico has alleged that this merger will destroy or at least strongly disadvantage the distribution system that supplies the remaining competitors, thereby raising the costs of Wal-Mart's rivals.[10] But, without explanation, the Commission ignores Wal-Mart's buying power, which-- enhanced by the elimination of the leading customer of many suppliers-- would seem to have the potential for dramatically changing the competitive structure of Puerto Rico's food industry.

The public cannot tell whether the Commission considered the impact of Wal-Mart's enhanced buyer power in Puerto Rico or if it did and concluded that this would not be relevant, why it reached that conclusion.

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[7] If Amigo operates on an Every Day Low Price strategy, as alleged in the Puerto Rico complaint, note 3 supra, this would likely earn it a low-price reputation among consumers, making it an even more important competitor against Wal-Mart. The Analysis does not provide information with respect to the pricing strategies of Amigo or any of the remaining supermarket firms. We are also not informed whether the remaining supermarket firms are as well-financed or profitable as Amigo was. Was Amigo, as the largest chain on the island, the low-cost competitor?

[8] According to the Government of Puerto Rico, both Wal-Mart and Amigo are growing chains with plans for further growth in Puerto Rico. Note 3 supra. In the FTC's Staples case, the Court enjoined the merger based in part on the loss of potential competition. "Allowing the defendants to merge would eliminate significant future competition. Absent the merger, the firms are likely, in fact, have planned, to enter more of each other's markets, leading to deconcentration of the market, and, therefore, increased competition between the superstores." FTC v. Staples, Inc., 970 F. Supp. 1066, 1082 (D. D. C. 1997). The public cannot know from the Analysis how the Commission distinguishes this case from Staples.

[9] The 2002 Economic Report of the President in the chapter "Realizing Gains from Competition" describes the Continental-Cargill merger and notes that even though the merger "had the potential to lower operating and capital costs" it might have also depressed grain prices to farmers. The report suggests that "cases such as this one can be seen as a manifestation of an increasingly thoughtful and adaptive competition policy." At 116.

[10] Note 3 supra.

IV. Why Has the Commission Approved Divestiture to This Particular Buyer?

If a merger would violate the antitrust law, it may nevertheless be permitted if the merger is restructured to eliminate the anticompetitive aspect. An acceptable divestiture must result in preservation of the state of competition in all affected product and geographic markets and all relevant dimensions of competition prior to the announcement of the proposed merger, with due allowance for any changes in the state of competition that would predictably have occurred absent the announcement.

The only conditions that the Commission has negotiated relate to divestiture of four of Amigo's stores in regions where Wal-Mart already has or is about to open a store. There is no discussion of why the Commission limited its concern to these four markets and the information that would permit comment on this crucial aspect of the remedy is not provided.[11]

An up-front buyer, Maximo, is identified in the remedy. Although we applaud the requirement of an up-front buyer in this situation, more information is needed to evaluate the likely effectiveness of the remedy. Who is Maximo and why should the public believe this firm can preserve the pre-existing state of competition?

The Commission states, "The divestitures are to an up-front newly-formed entity founded by experienced supermarket owners which would be a new entrant in the relevant geographic markets and which the Commission has evaluated for competitive and financial viability. The Commission's evaluation process consisted of analyzing the financial condition of the proposed acquirer to determine that it is well qualified to operate the divested stores." The only other background supplied with regard to this purchaser's ownership, history, or capacity for providing a sufficient level of competitive performance, is: "Purchaser includes as its founders and management two former long-time members of Amigo's board of directors. All of the managers at the four stores are expected to remain in place (and each store is headed by management teams that have worked together for over three years)."

The "experienced supermarket owners" who will own and manage Amigo's divested assets are two former long-time members of Amigo's board of directors. The Analysis mentions but does not spell out that which has been extensively reported in the Puerto Rican press, that the purchaser really was a new entrant: it didn't exist as of the time the acquisition was announced. It was created by members of the family that sold Amigo for the express purpose of facilitating the merger.

[11] The government of Puerto Rico in its complaint alleged seven geographic markets in which the combined HHI would be 1787 or more and the increase in HHI 346 or more. Note 3 supra. There is no discussion of why no assets were required to be divested in the city of San Juan, which would have given the asset buyer a base in the most important metropolitan area.

Nowhere does the Analysis suggest how a newly-created four-store chain will operate as efficiently or as aggressively as four stores within a healthy, long-functioning 36-store chain (e.g., is there a supply arrangement in place? will there be economies in advertising or supervision because of the four stores' locations? what working capital is available?); or why the particular shareholders and directors of Amigo can be expected to be effective rivals of Wal-Mart (one could speculate that if they really wanted to compete against Wal-Mart, they would have chosen to do so with the island's leading chain rather than with a brand new four-store chain); or why there were no stronger candidates to be the up-front buyer.[12] In short, the Analysis suggests reasons to be leery of this new entrant buyer, but does not provide sufficient information to aid the public in evaluating whether the consent decree is in the public interest.

Conclusion

By its own rule, 16 CFR - CHAPTER I - PART 2, § 2.34, the Commission commits itself to "place on the public record an explanation of the provisions of the order and the relief to be obtained thereby and any other information that it believes may help interested persons understand the order." We believe that neither the rule nor the transparency goal to which this Commission has repeatedly said and often demonstrated it is committed has been satisfied in the Wal-Mart/Amigo Analysis. We urge the Commission to address the areas we have noted and to provide both the information necessary and the explanation of Commission reasoning so that interested persons can understand and evaluate the order.

Going further, we urge the Commission to take a fresh look at what it means to provide an *explanation* of a decision to close an investigation or accept a consent order. We suggest that the purpose of such disclosures be to provide the interested public with enough information and explanation so that the public can evaluate the Commission's reasoning and the factual basis for its reasoning, with respect to executing the relevant laws in the public interest. In doing this, the Commission should generally address each of the principal arguments presented to it during the investigation by interested parties or other knowledgeable persons. A review of transparency procedures should take into account the expenses associated with more demanding procedures and the problems associated with discussing decisions that to some extent will be based on confidential proprietary information. (The cruise mergers discussion shows that confidential data need not be disclosed.) Presumably, greater effort should be devoted to cases that are deemed to be of greater importance in terms of such

[12] The implication seems to be that no existing supermarket chain, from the mainland or local, was interested in buying these assets and that the purchase may have been financed by the sale to Wal-Mart. This speculation raises two questions: (1) if there was so little interest in the assets, can they really be deployed in a competitive manner? And (2) if the financing was made possible by Wal-Mart, will the assets be utilized to compete vigorously against Wal-Mart?

factors as economic impact, legal nuance, interesting or new analytical issues, or political salience.

Sincerely,

Albert A. Foer
President[13]

[13] The author received comments for this letter from a variety of sources, including many members of the AAI Advisory Board. The letter does not purport to represent the views of any or all Advisory Board members. AAI in the past received a contribution to its general funds from a trade association some of whose membersmay be affected by the precedent of the Wal-Mart/Amigo case.