Comments on the Food Marketing Institutes' Submission to the FTC Titled "Supermarket Merger Investigations and Remedies"

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I. Introduction

On June 18, 2002 the Federal Trade Commission held a workshop on merger investigations and remedies. The Food Marketing Institute prepared a substantial white paper for that workshop. Christopher MacAvoy, an attorney at Howrey, Simon, Arnold, and White, forwarded the report to the FTC; however the report identifies no authors. In this paper we analyze and discuss the FMI positions. The intent is to provide additional insights on the two underlying issues, i.e. the scope and content of the questions asked by the FTC in its second request when investigating a merger or acquisition, and the Commissions' policies and procedures for ordering divestitures as a condition for approving supermarket mergers. Our additional insights include a tabulation and analysis of divestitures completed in supermarket retailing since 1995.

With a few exceptions, the FMI comments are substantive and specific points. One needs to recognize that FMI does not speak for all firms that wholesale and retail food products, and they do not speak for consumers, the primary target group that the antitrust laws are designed to protect. Hence a careful review of their points and additional perspective on the underlying issues may contribute to the Commission's review of its practices.

The following section of this paper analyzes and discusses FMI comments on the FTC Second Request questions for supermarkets. The third section comments on the FMI critique of FTC divestiture practices and analyzes actual divestitures since 1995 in supermarket retailing.

* The assistance of Andrew Franklin and Matthew Schwane is gratefully acknowledged. This work was commissioned by Wakefern Food Corporation. Responsibility for contents remains exclusively with the author.

II. Second Requests for Information in Supermarket Mergers and Acquisitions.

II. A. General Comments

At the most general level the FMI comments on the FTC's second request for information are implicitly positioned in a cost-benefit framework. Let's make that framework explicit. FMI identifies particular second request questions that it believes are particularly time consuming, i.e. costly, for firms to answer relative to the benefits that FMI perceives from the information attained. At issue here is the magnitude of the costs and benefits of additional information for merger review. FMI openly requests that firms be required to supply less information. In no instances do they suggest that the FTC ask more questions or acquire more information. The clear implication is that the FTC can enforce the antitrust laws, at least to the satisfaction of FMI, with less information and analysis.

Understandably, the cost of providing information will always be greater than the benefit to supermarket firms if it inhibits their desired course of action, i.e. merger. But that is not the relevant cost benefit comparison for the FTC. The agency must ask whether the costs of supplying the information are greater than the benefits that would accrue to consumers from more effective antitrust enforcement? Consider the following facts. Nearly all of the supermarket mergers where second requests are issued involve dozens of stores, hundreds of millions, and usually billions of dollars of supermarket sales in relevant geographic markets. Ineffective antitrust enforcement in the supermarket industry can quickly cost consumers millions of dollars. For example, a single large supermarket in a large chain routinely sells over 50 million dollars per year. A one percent overcharge in one such store for two years would generate one million dollars in consumer losses. Now compare this to the cost of compliance to a second request. Admittedly lawyers (and economists) are costly but a million dollars still goes a long way toward complying with a second request. It would be useful for FMI to provide

estimates of such costs. The total cost of all the information requests that FMI finds burdensome, certainly, in practice is less than a million dollars.

In a large merger that involves dozens of stores, many markets, and billions of dollars, the potential payoff to consumers from granting economists a "fishing license" (FMI p. 3) and allowing legal staff review of the requested information can very easily exceed the cost of providing such information. Continuing FMI's analogy, catch one $50 million fish (store) and payoff exists.

In fact, the Government Performance Results Act, passed by Congress in the 1990's, requires the FTC to estimate consumer savings due to its enforcement activities. The FTC Performance Report for the fiscal year 1999 estimates that merger enforcement activities saved consumers $1.2 billion and that a large proportion of this amount is due to successful merger enforcement activities in the supermarket industry (FTC, 1999b, p. 20). The FTC states:

> In calculating these savings, we take into consideration the size of the markets involved, the percentage increase in the price that would likely have resulted from the merger, and the likely duration of the price increase… We derive these estimates from a thorough analysis of company documents and detailed pricing data, which FTC attorneys and economists routinely conduct as part of their investigations. In some cases, the available information allows us to estimate with specificity the extent to which prices would rise as a result of an anticompetitive merger. Where we do not have definitive information, we conservatively estimate that an anticompetitive merger would lead to a price increase of at least one percent absent enforcement action, lasting two years (FTC 1999. p. 19).

Our single store example, therefore, is a very conservative example of the potential impact of antitrust enforcement in the supermarket industry.

A second general observation pertains to FMI's objection to the Commission staff's willingness to drop a certain question if the firms are willing to stipulate that they will not pursue the related avenue for justifying the merger. This objection seems unfounded. An example is a willingness to drop efficiency questions if the firm stipulates that it offers no efficiency defense.

This behavior is not "unfair" (FMI p. 3) to the firms. If there are substantial benefits to firms and consumers then the firms would provide the information.

Similarly, if firms object to providing information that may provide evidence that the merger is unlawful (stonewalling) the FTC is justified in pursuing such requests or negotiating alternative avenues of investigation. FMI's contention that some questions are so costly and burdensome to answer that a respondent firm must acquiesce to other FTC demands to avoid this cost and burden, possibly leading to "unfair" or overzealous antitrust enforcement and the blocking of multi-billion dollar mergers that otherwise are in the public interest, is specious. If the respondent has nothing to hide and the merger is otherwise lawful and beneficial, the respondent would quickly answer such questions. For a specific example on this point, see the discussion of second requisition specification 19, provision of price information, below.

Our last general comment addresses a common thread in many FMI objections. FMI objects to requests that are open ended and/or so far back in time that the firms cannot with reasonable effort provide a responsive answer. FMI, however, ignores clear statements by the FTC that deal with such situations. The first is in the Code of Federal Regulations:

> A complete response shall be supplied to each item on the Notification and Report Form (H.S.R. Premerger Notification) and to any request for additional information (second request) pursuant to section 7A(e) and §803.20. Whenever the person filing notification is unable to supply a complete response, that person shall provide, for each item for which there is less than a complete response has been supplied, a statement of reasons for noncompliance. The statement of reasons for noncompliance shall contain all information upon which a person relies in explanation of its noncompliance (16 C.F.R. §803.3, parenthetical clarifications added by this author).

The second is instruction Q of the 1995 model second request document that is available on the FTC website. Instruction Q states:

> If the company is unable to answer any question fully, supply such information as is available. Explain why such answer is incomplete, the efforts made by the company to obtain the information, and the source from which the complete answer may be obtained.

> If books and records that provide accurate answers are not available, enter best estimates and describe how the estimates were derived, including the sources or bases of such estimates. Estimated data should be followed by the notation "est." If there is no reasonable way for the company to make an estimate, provide an explanation (FTC, 1995).

Finally, instruction M of the 1995 model second request document generally limits all requests, unless otherwise specified, to the past three years. Based on these explicit statements of FTC procedures, we conclude that respondent firms are not required to answer "impossible" questions by expending great amounts of time assembling or reconstructing information.

II. B. Specific Comments

Turning now to specific points raised by FMI, they object to Specification 2b, the request for a color photograph of each store operated by the respondent and specification 3c, for "all competing retail stores." FMI correctly notes that in a large merger "this can amount to thousands of photographs" (FMI p. 5). The adage "a picture is worth a thousand words" is in play here. In many instances pictures can convey information that could otherwise only be obtained by an on site visit, a far more expensive alternative. Pictures of a store and shopping plaza convey useful information not easily put into words, i.e. the external presentation and parking that consumers face when making a shopping trip. Firms should continue to provide pictures.

FMI objects to specification 2(d), which requires a company to state when, it "first considered" opening each supermarket at its current location and when it "first considered opening any supermarket in or near the same city, town, or other political subdivision." FMI plausibly claims that this requires a search through archived real estate files. Note however that once the firm has done this, it can retain this information at little cost for future second requests.

Also if the request is truly burdensome for special reasons, a respondent can refuse by citing C.F.R. 803.3 or Instruction Q.

The sole use of this information appears to be as evidence on the timeliness of entry. The Commission is most interested in how timely entry is today, not 25 years ago, or for that matter 10 years ago. Yet information from earlier years provides perspective on how "timely entry" is changing over time. The Commission should not change the wording of this specification.

FMI objects to specification 2(g) which requests data for each store on the total number of stock keeping units (SKUs), the number excluding pharmacy SKUs and the number for each department in the store. They state that these numbers are different for each store, yet that is precisely why the FTC asks for this store level information. FMI requests that ranges or averages be sufficient, yet if these are across the entire supermarket chain they provide little useful store level information.

Specification 3c (FMI appendix, p.4) requests even more detailed SKU information on competitors' stores as well as the respondents, but FMI does not object to this request. This information is clearly intended to aid in the evaluation of product market definition. Do supermarkets compete with club stores, convenience stores, mass merchandisers such as Big Kmarts, and/or drug stores? Perhaps FMI does not object because this inquiry can only benefit merging firms. Currently the standard product market definition is supermarket sales.[1] Broadening the product market would reduce market shares and expand the number of firms in any competitive effects analysis. Since FMI does not object to this more burdensome request they have no basis for objecting to specification 2(g).

[1] Supermarket sales do not include sales of convenience stores, "small" grocery stores, limited assortment stores including bakeries, meat and seafood stores, and food sales in drug stores and mass merchandisers such as Big Kmart. They do not include food sales by wholesale or club stores such as Sam's, BJ's, or Costco. Supermarket sales, however, do include food and related nonfood grocery store items that are sold in Supercenters such as Wal-Mart or Kmart Supercenters.

FMI's objections to specifications 2(h) and 2(i), providing the number of parking spaces and checkouts for each store, are unconvincing. The cost of collecting this information is minimal, and the information can be very useful for the overall evaluation of a particular store. Parking can be a major constraint on a store's ability to compete and/or expand sales. The number of checkouts is a useful measure of store operating performance when combined with other information such as square feet of selling space, labor expenses, and customer service levels.

FMI objects to specification 2(l), requests, for each store, gross and net margin data for the store and its departments. They claim, "the burden of collecting and formatting this information likely far outweighs its utility to the Commission" (FMI, p.5). We disagree. FMI seems to object only to the departmental profit data because it does not object to store level profit requests in 2(n) (FMI Appendix p. 2). Store and department level profitability data are critical measures of performance. It is of value to the firm, any acquirer, including the current acquirer if the respondent is being acquired, and a potential buyer if the store is divested. Departmental data combined with information from 3(c) concerning SKU overlaps addresses competitive effects and the product market definition issue. For example, if a particular store "competes" with a meat market then profits in that store may be lower, ceteris paribus, than other stores.

We, however, question the definition of the net profit data that the Commission requests. In specification 2(l) net profit margin is defined as "after tax, excluding any allocations of corporate level expenses." At the store level net operating profit would be a more useful measure of operating performance. Net operating profit subtracts out only operating costs directly related to a particular store. It does not subtract from revenues the following items: corporate income taxes, corporate interest charges, and corporate overhead. Net operating profit more accurately measures the strategic and cost advantages that a store has in its market setting.

Corporate financial structure, for example, has nothing to do with the performance of a particular store.

FMI objects to specification 2(o) that requires creation of "a detailed database of information about lease terms, options etc." for each store. They maintain that parties should be permitted to supply "ordinary course of business documents such as lease abstracts" (FMI p.5) if the requested information is not readily available in electronic form. This FMI request creates more work for Commission staff to assemble information in a useable form. There are at least two other reasons why respondents should do this. Presumably they are informed users of the data and thus know how to extract relevant and comparable terms for all stores. Also, Commission staff has limited time to review documents after the parties are substantial compliance with the second request. Today, the parties are free to merge within 30 days after complying so the clock is ticking for the staff investigation.[2] Commercial real estate contracts are complex documents that take substantial time to review and collate key terms. Also, the request for the lease information eliminates the risk that the staff may misinterpret terms in these complex contracts.

FMI objects to specification 2(p), which requires creation of a database that provides all major revenues and expense items from an "income from operations" statement for each store. FMI states "creation of such a database where one does not exist can be very burdensome." Today it is hard to imagine any store in a chain supermarket where such an electronic database does not exist. The same comments that we provided for the prior specification hold here. Finally, the Commission has a clear and critical need for this information to evaluate store level costs and performance. This can contribute to competitive effects analyses and the divestiture process.

[2] Until recently, staff had only 20 days.

FMI objects to specification 2(t), maintaining that it is an extraordinarily broad and open-ended request. Specification 2(t) asks for "all documents relating to the condition, marketability, and viability of the supermarket." On this count recall that the model second request instructions limit this request to the past three years. This time frame is reasonable. However, we agree with FMI on the other component and would suggest tighter language. The Commission seeks only information about the current condition of the store and its marketability and viability whatever its current condition is. Perhaps the Commission could revise the request to read as follows: "All documents that discuss the store's physical condition, its physical condition relative to other stores in the firm, relative to competing stores, the store's marketability, and the store's viability as an operating unit." This eliminates the maintenance records that FMI reasonably requests that supermarkets not provide.

FMI lodges a blanket objection to the map requests of the Commission. It suggests that a respondent firm provide the underlying data including the latitude and longitude for each store and would have the Commission use map software to print its own maps, as it likes. The map requests should remain unchanged for the following reasons. The FTC has scarce resources. It may not have the equipment and specialized expertise to produce these maps in a timely and accurate fashion. Supermarket chains do have access to and routinely use mapping resources in their course of business. Printing of multiple copies of a set of maps is not that costly. Finally, our experience with staff suggests that they are willing to modify the second request if the parties have an alternative way to produce comparable maps.

FMI also objects to specification 19 which requests weekly price data on over 60 items for each of the respondents' stores, and competing stores for as far back as 1990 (FMI, Appendix p. 6). FMI states this specification "is a frequent source of compliance disputes. Moreover, it appears that the staff rarely, if ever, obtains useful data in response to this specification (FMI,

p.7)." FMI notes that this request has been eliminated from some recent requests and would like to see it permanently eliminated.

This is not an acceptable solution. Business documents on pricing including the use and setting of different price zones for different supermarkets in a chain provide useful information on pricing. Price comparisons of competition done in the course of ordinary business are also extremely instructive. Nonetheless, a systematic price database such as that requested here can serve as the basis for econometric analysis of many different competitive effects issues. See for example Baker (1998) and Ashenfelter et al. (1998) in Staples Office Depot, Cotterill (1999) and Cotterill et al. (1999) in the Ahold Pathmark merger investigation, and Cotterill (2002 b) in the Ahold-Big V merger investigation.

As written, the request is purposely broad. No firm has weekly price data for all its stores on these items since 1990, much less such data since 1990 on its competitors. This clearly is a starting point for negotiation and determination of exactly what price data the firm has. The exact list of products, however, seems somewhat eclectic.[3] For example, too few private label products are included to conduct an analysis of private label as opposed to branded product pricing. Such analysis can reveal possibly significant changes in retail pricing after a merger. The FTC could improve this specification by ensuring that a sufficient number of prices are collected in key subgroups to analyze subgroup pricing and by periodically changing the product list.

Analysis of price levels among stores in different market configurations is fundamental to merger enforcement policy in this industry. It is not surprising that large chains involved in a

[3] The product list seems to closely imitate the list of product prices periodically available at the aggregate city level for all supermarkets from ACCRA. The city level ACCRA data are even less reliable than B.L.S. city food price data for antitrust analysis. There is no scientific justification for collecting store level prices for the ACCRA sample of products.

second request do not want to furnish such data. Nonetheless the FTC should collect it and use it to address competitive effects issues when at all possible.

FMI alleges that the FTC has a "scorched earth" attitude towards efficiency claims because they ask too many, too comprehensive questions about efficiencies that firms may achieve via merger or in a non-merger specific fashion.[4] FMI objects to "broad and vague" requests (p. 8). This position lacks logic. Respondents should be pleased that the Commission provides them with the opportunity to say anything that they want about efficiency. A narrow constrained focus in the questions might overlook efficiencies that these firms achieve.

Specifically, the request by the Commission for documentation of merger specific efficiencies that were achieved after prior mergers is extremely valuable. Have previous mergers and related claims of efficiency actually produced such results? Following Ashenfelter et al., Cotterill 2001, 2002, and Dhar and Cotterill 2002, what proportion of efficiency gains has actually been passed on to consumers? Firms that are repeat acquirers and routinely reappear before the Commission must be prepared to answer these questions. In fact, they should be pleased to answer them and demonstrate that what they said would happen did occur. Documentation of competitive, pro-consumer conduct after prior mergers in this industry would certainly strengthen any supermarket firm's position before the Commission and in other forums.

Without diminishing the importance of wide ranging, open-ended questions on efficiency and the importance of accountability over time for repeat acquirers, the language of the efficiency questions could be refined. When addressing efficiencies that are not related to the merger (specification 28a FMI, Appendix p. 8) the Commission defines efficiencies as any "cost savings, production increase, synergy or efficiency." Then in specification 29 when asking for

[4] The questions on efficiency are not specially tailored to the supermarket industry. Second requests in other industries also contain these questions.

efficiencies derived after prior mergers the Commission defines efficiency as any "cost saving, new product or service introductions, product or service improvements (FMI, Appendix p. 9). Consistent definitions and elaboration would be preferable. Moreover, the Commission should more clearly define what it means by efficiency and synergy. Cost savings or production increases individually say nothing about efficiency. Technical as opposed to allocative efficiency is the focus here, and it is measured by cost per unit of output. Another measure is services or goods provided per dollar of cost.

There are many different subcomponents of technical efficiency. Retail labor productivity is measured by sales per man-hour. Transport efficiency can be measured by the cost to move a ton one mile. Warehouse efficiency is measured by picking rates and units shipped per man-hour.

Some activities affect both technical and allocative efficiency and some measures capture the effects of both. Sometimes these two efficiency categories are described as real and pecuniary (buying power) economies. Real and pecuniary advertising efficiencies can be measured by group rating points (penetration) per thousand dollars of advertising expenditure. Procurement efficiency addresses activities such as slotting fees, trade promotions, private label programs, and the benefits, if any, of strategic partnerships and category captains. Procurement efficiencies can be real or pecuniary. They can be measured as the cost reduction per unit sold at retail. Solid information on real economies due to merger advances respondents' cause before the Commission.

A related issue is the provision of expert reports, possibly including econometric analysis of data by merging firms, as part of their response to the second request. These submissions should not pre-empt analysis by the Commission. If the second request drags out over several months, a silver lining in that cloud may be that the staff has time to conduct such analysis.

However, once the second request is fully honored, the Commission has only 30 days, and realistically even less time for analysis prior to the decision to allow the merger or seek a preliminary injunction. Traditionally, expert reports enter the process once the Commission decides to seek a preliminary injunction. David Painter, Law and Economics Consulting Group, and the American Bar Association's comments on the submission of expert reports during the second request phase of merger review are most appropriate (Painter 2002, American Bar Assoc. 2000, p. 8). They maintain that when expert reports enter the process, the firms should provide all the underlying documents, data and computer programs that underlie them. Yet it is our opinion that even with full compliance and cooperation, the Commission and staff might still not be able to vet such reports in a short time frame. Moreover, they may wish to conduct additional analysis. In such cases, analysis of the reports should be deferred to the preliminary injunction stage of the process where full-fledged discovery and analysis can occur.

III. FTC Policies and Practices Regarding Supermarket Divestiture

III A. Background

Since 1990, the FTC has negotiated 17 orders in the supermarket industry that required divestiture of supermarkets to promote or preserve competition as a condition for approval of a merger. The FTC has also required divestitures as a condition for approving mergers in many other industries. In 1999, the FTC published "A Study of the Commission's Divestiture Process." That economy-wide study focused on the 35 consent orders issued in 1990-1994 that contained divestitures. Commission staff interviewed 37 of the 50 buyers to evaluate how the divested business performed (FTC 1999, p. 8). Some of these divestitures were in the

supermarket industry, however, the study does not break out or discuss divestiture policies, procedures, or performance by industry.

The 1999 study documents that there is an informational and bargaining imbalance between the divesting firms on the one hand and the FTC staff and buyers of divested assets on the other hand. The study's conclusions are:

> The report recommends that the Commission include a variety of order provisions and divestiture procedures to correct the informational and bargaining imbalance. Thus, negotiations between staff and respondents may focus more on the question of whether risks of a failed divestiture will be reduced than on whether a particular provision was included in a previously issued order. With this greater understanding of the incentives of respondents and buyers of divested assets, the discussion of order provisions and divestiture contracts can focus on the issues that are inherent in the divestiture process without impugning the integrity of any party.

Partly as a result of the Study, staff has begun recommending provisions that may provide greater assurances that the divested assets will be viable and that they will be able to compete in the market in which the Commission has found a competitive problem. In more recent orders, the Commission has, among other things:

- reduced the time it allows for respondents to complete their divestiture obligation;
- required the divestiture of related assets to ensure the viability of the divested business;
- limited the scope and duration of any on-going relationships between the buyer of the divested assets and the respondent;
- limited the rights of respondents to revoke rights granted under the divestiture contracts;
- relied less on the assessment of potential buyers about the viability of assets included in a divestiture order;
- required persons acquiring assets to submit an acceptable business plan for those assets;
- required that respondents facilitate the transfer of knowledgeable staff to the buyer;
- used auditor trustees to monitor the transfers of technology to the buyer and the technical assistance provided by the respondent;
- provided for the redivestiture of certain types of assets where the buyer fails to exploit them; and
- provided for the divestiture of additional assets by the divestiture trustee where the respondent has failed to fully divest assets within the time required by the order (FTC 1999b, p. iv).

Recently the Commission staff has published "Frequently Asked Questions About Merger Consent Order Provisions" (FTC, 2002). This provides guidance for firms who would negotiate settlement if a merger investigation via divestiture. As with the divestiture study, its scope is general. It does not focus solely on supermarkets or any other industry. In an answer to the question, "what is an acceptable divestiture package?" the Commission staff states:

> An acceptable divestiture package is one that maintains or restores competition in the relevant market. The divestiture of an entire business (that is, an on-going, stand-alone, autonomous business, and which may include assets relating to operations in other markets) of either the acquired or acquiring firm relating to the markets in which there is a concern about anticompetitive effects, is most likely to maintain or restore competition in the relevant market and thus will usually be an acceptable divestiture package…There have been instances in which the divestiture of one firm's entire business in a relevant market was not sufficient to maintain or restore competition in that relevant market and this was not an acceptable divestiture package. To assure effective relief, the Commission may thus order the inclusion of additional assets beyond those operating in the relevant market… On the other hand, there have been occasions when the respondent demonstrated with compelling evidence that is was not necessary or not efficient (from the eventual buyer's perspective) to require it to divest an entire business… In all cases, the objective is to effectuate a divestiture most likely to maintain or restore competition in the relevant market (FTC, 2002 p. 5).

Note that the goal "to maintain or restore competition in the relevant market" is invariant. The Commission staff states that divestiture of an "entire business" in a relevant market is "most likely" to achieve this goal, but there have been instances when fewer or more assets are required. This language provides guidance on how the Commission staff precedes when pursuing its goal but it does not demand a particular procedure or particular outcome.

III B. FMI Requests Retrenchment

FMI objects to the application of the 1999 study conclusions to FTC divestiture actions on the grounds it "over extrapolates" and is not a substitute for "formal rule making procedures" (FMI p. 9). We have no expertise to comment on the latter point, but consider the FMI over extrapolation argument. The FTC moved to require up front buyers for divested stores after repeated failures to find buyers who could effectively compete once divestiture was ordered.

Failed supermarket divestitures prior to 1995 include Promode's acquisition of divested Red Apple stores in Tennessee and the Furr's divestiture in Texas and New Mexico. Failed ex-post divestitures also occurred in many other industries as well.

Is there any empirical basis for FMI's argument that the FTC has over reacted to this problem in the supermarket industry? FMI cites only one piece of empirical evidence for it's over extrapolation argument. It is the failure of the Schnuck's divestiture to Family Company of America and its principal, James Gibson in 1995 (Appendix p. A-3). FMI maintains that the FTC over reaction in the supermarket industry is due to this one experience. James Gibson, the buyer that Schnuck's found post-consent decree was ultimately convicted of investor fraud after the divested stores failed (FMI, p. 15).

Concerning the over extrapolation argument, note that the failed divestiture occurred in and after 1995, so it was not included in the 1990-1994 study. This additional information corroborates a conclusion based on prior information. As such, it supports the prior conclusion and was not the basis for that conclusion. Action based on Schnuck's and the divestiture study is not over extrapolation due to giving undue weight to the Schnuck's "bad" experience.

More fundamentally, FMI would discount the Gibson event as an extreme and unlikely event that is unrelated to the Commission's policies and procedure. But this approach is tantamount to arguing that the Commission can and need do nothing to ensure more effective divestitures, including direct up front participation in the selection of buyers.

According to FMI, the "market" works better with minimal oversight, but FMI cites no evidence on this point. FMI needs to demonstrate that requiring approval of buyers up front contributes nothing to the success of divestitures. They have not done this.

Turning now to the other primary written document on FTC divestiture procedures, the FMI finds "Frequently Asked Questions About Merger Consent Order Provisions" "helpful" but

maintains that it "provides incomplete description of the Commissions actual policies and practices regarding supermarket divestitures" (FMI, p. 10). Our reaction to this point is; given that the white paper is a general statement for the entire economy, it could hardly be otherwise.

FMI's review of supermarket divestiture policy and practice since 1996 documents an "ever tightening approach" (FMI p.10). The FMI argues the following points:

- Up front buyers should not be mandatory
- The zero delta policy (zero change in Herfindahl-Hirschman index of seller concentration) should be relaxed, divestitures to in market firms should be permitted
- When divestiture is required in a market, it should not be limited to all of either the acquirer or acquired firm stores.
- An acquiring firm should be allowed to trade up, i.e. divest all of its stores in return for obtaining all of the acquired firms stores in a market
- The Commission should not require divestiture of all stores in a market (an entire package) to a single buyer
- The Commission's supermarket divestiture policies should be even handed towards independents and small chains.

We question the FMI characterization that the Commission staff have progressively shifted to a tight set of rules that constrain divestiture results in a fashion that impedes attainment of their goal i.e. the promotion and/or restoration of effective competition in a market, post-merger. FMI provides no empirical evidence from recent (post 1994) mergers to support their requests for changes. Here we will discuss each point and provide some evidence from recent divestitures that have occurred since 1994 and thus are not in the FTC divestiture study.

Concerning up front buyers, FMI would dismiss the evidence from Schnuck's and many other cases where ex post buyers failed (including Promodes-Red Food, Schwegmanns-National, Furr's, Shaws-Star Markets). FMI also argues that requiring an up front buyer for a particular store can allow its landlord to "hold up" the divesting firm by extracting exorbitant payment for its consent. In fact, the opposite is often the case. If a problem with a particular landlord surfaces up front, the FTC and parties may be able to substitute a different store in the order.

Once the order is finalized, however, it is very cumbersome to go back to the Commission and change it.

Consider FMI's argument that there will be no hold up if a problem landlord is approached after the merger. This contention contradicts the fact that it is harder to change an order ex post. If the landlord knows this, then the landlord can extort a higher payment for its consent ex post. The most fundamental solution to this problem is not within the purview of the FTC. It is a contingency that must be addressed in the real estate contract.

We strongly believe that the FTC should continue to require up front buyers in all supermarket divestitures because it is a practice that engages respondents, the FTC and buyers in due diligence and thus helps to reduce the information asymmetry that the latter two parties face. The record is clear on this point. The Commission cannot rely on the respondent firm to sell the assets to a firm that will vigorously compete against it. The respondent firm has exactly the opposite incentive. It will sell to the weakest firm that it can find, i.e. someone like Mr. James Gibson. The up front position gives the FTC more leverage and is more likely to produce the desired divestiture result. Up front divestitures certainly increase the likelihood that stronger small chain and stronger independents will obtain divested stores.

Concerning the Commission staff's rejection of in-market divestitures that would increase the delta, we would ask FMI for empirical evidence that the impact of an increase in market concentration would be offset for consumers by the "local market knowledge" of the in-market operators (FMI p. 18). We know of no study where the "in-market knowledge" of firms has negated the impact of increases in market concentration.

The next FMI request is that divestiture of supermarkets in a relevant market not be limited to all of either the acquirer or the acquiring firms stores, i.e. the all A or B divestiture option. Mixed divestitures should be allowed. We are most skeptical of FMI's characterization

of current FTC practices on this point in this industry. Appendix A gives relevant details for all of the FTC consent orders in the supermarket industry since 1995. There were 14 divestitiure orders and there is no clear pattern over time that suggests all A or B divestitures are now a requirement. As such, this FMI criticism is a red herring.

The next FMI point constitutes a retreat towards reality. They state that IF the FTC allows an all A or B option, then an acquiring firm should be allowed to trade up, i.e. divest all of its stores in return for all of the acquired firms stores in a relevant market. Again this is a red herring. The FTC does not, before investigation of the facts in a case, categorically prohibit this divestiture solution.

FMI apparently believes it does because the FTC allowed this behavior in the Albertson-American divestiture order but refused it when investigating the Ahold-Pathmark merger (FMI p. 13). On Ahold-Pathmark, the Commission staff did provide a public explanation of their thinking (Parker and Balto, 2000). Commission staff was concerned that a divested Edwards's chain would not be as viable a competitor as it is in the Ahold group (FMI p. 13). FMI would reject this conclusion and have the Commission state that all trade-ups should be allowed in a per se fashion.

The Commission staff must be allowed to analyze the facts of each case on the trade-up issue. In Ahold-Pathmark, the Commission staff felt that the merger violated the law in such a pervasive fashion that they did not want to consider divestiture as an alternative to a preliminary injunction (Parker and Balto). Reading the FMI report gives the impression that the sole purpose of the antitrust laws is to craft consent orders to promote competition. One should not forget the Commission's other option, legal challenge to stop the merger. The Albertson-American merger involved many markets where there was no overlap. One needed no "fix" in those markets.

Ahold-Pathmark was one big overlap throughout the metro New York area. At some point, fix gives way to challenge.[5]

The next FMI point is that the Commission staff should not require divestiture of all stores in a market to a single buyer. FMI maintains that there are no scale advantages related to market share in a relevant market. This assertion simply is not supported by extensive research in economics and business strategy. FMI claims that a single store independent can effectively compete in any market structure. It is a false extension of the observation that independent supermarkets exist and some do very well.

Consider for example a market with entry barriers that is supplied by a dominant firm with several stores and a market share of 90%. There also are two independent single store operators with 5% each. These independents may "compete" in the FMI sense, i.e. survive and do very well as fringe firms in a dominant firm market, but competition that benefits consumers would not exist.

Alternatively, consider a loose oligopoly that is to be preserved via divestiture to promote competition. Rather than divest several stores to one new player so that player has comparable cost conditions to other firms, the FTC divests each store to a new or existing independent operator in the market. Consequently the leading firms institute a price or marketing war that severely punishes and possibly eliminates some of the independent firms. The oligopolists capture more market share and establish themselves as the price leaders. They achieve via the market what the FTC attempted to prevent via divestiture.

This strategic behavior in fact occurred after the Ahold-Stop & Shop divestitures in Connecticut (Cotterill 1999, Cotterill et al. 1999) [6]. The divested stores competed vigorously

[5] This is another successful example of eschewing the fix it first approach. In the Kroger-Winn Dixie (2000) matter which concerned the sales of the Texas-Oklahoma division of Winn Dixie to Kroger, the parties abandoned the merger before an impending trial for a preliminary injunction.

under new ownership only for a few months. Thereafter, Stop & Shop responded with punishing low prices and when Stop & Shop subsequently elevated prices the firms with divested stores followed the price lead. Price competition in Connecticut was significantly diminished with the disappearance of the Edwards supermarket chain in the Ahold (Edwards)-Stop & Shop merger.

Ex post evidence from Rhode Island, in fact suggests that even when the FTC divests all stores in a market to an independent operator, the result can be failure. Originally, the FTC and the state of Rhode Island wanted to divest six stores in the Providence market to Star Markets, a regional chain that at the time was operated by executives that were cashiered when Ahold acquired First National/ Edwards. Bargaining between these two groups was contentious and ultimately failed because Ahold's offer price was more than Star was willing to pay. Ahold then offered the stores at a substantially lower price to Ro-Jacks.

At that time this author did an extensive study of the Ro-Jacks deal for the Rhode Island Attorney General. That study found that Ro-Jacks operated stores approximately one half the size of the divested stores. Many of them were dirty suggesting inadequate internal store operations procedures and controls. Ro-Jacks' financial structure was not transparent and reported financials for the operating subsidiary indicated that the firm had no financial cushion to survive any transition problems including strategic moves in marketing and pricing by the market leader, Stop and Shop.

The FTC deferred to Rhode Island. There seemed to be no better alternative divestiture. A key part of the divestiture was Supervalu's willingness to underwrite purchase of the stores. The Rhode Island Attorney General approved the divestiture to Ro-Jacks over the objections of my report and staff concerns. Ultimately Ro-Jacks failed and declared bankruptcy.

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[6] The author served as expert economist in that 1996 merger for the Connecticut, Massachusetts and Rhode Island Attorney Generals and worked with the FTC staff to fashion the divestiture order. In retrospect, it was inadequate.

The message is clear. One needs well managed independents who are experienced operators of superstores, i.e. large supermarkets who also have strong support from cooperative or voluntary wholesalers. Strong support includes more than financial underwriting of a purchase. It includes a strong private label program, a strong procurement and trade promotion program, a strong group-advertising program, and strong management training and assistance programs. A niche market operator of 20,000 square foot stores cannot easily make the transition to operating stores with more than 50,000 square feet, nor can it easily operate both within the same organization. Recall that a chain's advantage is repetition, i.e. duplication of this same store (size and activities) at several different locations. Ro-Jacks was attempting to more than double its sales volume and store numbers by adding large chain stores to its small neighborhood supermarket operation.

These comments on Ro-Jacks provide perspective on the last FMI point. FMI maintains that the Commission has not favored independents as buyers of divested stores. FMI requests that the Commission be more even-handed towards independents and small chains. Table 1 documents how the FTC has required divestiture of stores in 14 merger inquiries since 1995. Small chains and independents have not been shut out nor have they received token treatment. Large chains defined as firms with $1 billion in annual sales have purchased 176 divested stores. However, small chains (less than $1 billion in sales) and independents (firms with 10 or fewer stores) have purchased 53 and 93 divested stores respectively. The FTC has a record of working with cooperative and voluntary wholesalers who serve small chains and independents. They seem willing to divest to them. The devil is in the details. Again, an up front approach where independents and their cooperative or voluntary wholesalers can openly negotiate for divested stores under FTC supervision seems most conducive to the independents cause.

In a more subtle but basic fashion the FMI recommendation is truly in the twilight zone. If the FTC challenged and stopped more large mergers, small chains and independents would be able to compete more effectively via the standard avenue, i.e. organic internal growth of their businesses over time. On this point, stopping mergers and enforcement of other aspects of the antitrust laws can be more effective than divestiture. Require large chains to grow via internal expansion, and compete on the merits when antitrust issues reverberate in the marketplace. FMI's general preference for a relaxation of antitrust enforcement in this industry is not friendly to the growth and expansion of small chains and independents.

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Table 1. Disposition of Divested Supermarkets: FTC Consent Orders 1995-2001

Divestiture	Date	Large Chains[1]	Small Chains[2]	Independent[3]
Penn Traffic and Acme	Jan. 1995	0	0	2
Schnucks and National Tea	Mar. 1995	1	24	1
Schwegmann and National Tea	Mar 1995	0	0	7
Stop & Shop and Purity	Nov. 1995	0	11	4
AHOLD and Stop & Shop	July 1996	19	0	10
Jitney Jungle and Delchamps	Sept. 1997	0	0	10
Albertson's and Buttrey Food & Drug	Sept. 1998	13	0	2
AHOLD and Giant Food Inc.	Oct. 1998	1	0	9
Kroger and Fred Meyer	May 1999	1	0	7
Albertson's and American Stores	June 1999	118	0	31
Shaw's and Star Markets	June 1999	1	6	1
Kroger and John Groub	August 1999	0	0	3
Food Lion and Hannaford	July 2000	20	13	5
AHOLD and Bruno's	Dec. 2001	2	0	0
Total		176	53	93

Source: Appendix A

[1] Large Chains have sales of $1.0 billion or more.
[2] Small chains have sales below $1.0 billion.
[3] All stores divested to cooperatives or voluntary wholesalers are assumed sold to independent operators. An independent operator is defined as a firm with 10 or fewer supermarkets. Five voluntary wholesalers participated in 8 divestitures and purchased 30 stores. One cooperative wholesaler participated in a divestiture and purchased 18 stores.

Appendix A

FTC Ordered Divestitures in the Supermarket Industry 1995-2001