National Grocers Association

October 23, 2002

Daniel P. Ducore, Esq.
Assistant Director
Bureau of Competition
Federal Trade Commission
600 Pennsylvania Avenue, NW
Washington, DC 20580

Dear Mr. Ducore:

Enclosed is the statement of the National Grocers Association (N.G.A.) in response to the Commission's press release of March 15, 2002, announcing a review of practices and policies affecting merger investigations and remedies. We are pleased to participate in this important area of the Commission's enforcement responsibilities.

Our statement covers a number of issues of concern to the members of N.G.A. Following an extensive and detailed review by the Association's Legal Task Force, the statement was approved for submission by the unanimous vote of N.G.A.'s Board of Directors.

Please let me know if N.G.A. can be of any further assistance.

Sincerely,

Thomas K. Zaucha
President and CEO

Enclosure

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Submission of the
NATIONAL GROCERS ASSOCIATION

To the
Federal Trade Commission
Regarding

Merger Enforcement

and Remedies

October 23, 2002

BACKGROUND

In response to the March 15, 2002, announcement of the Federal Trade Commission's (FTC or Commission) review of practices and policies involved in merger investigations and merger remedies, these comments are submitted by the National Grocers Association (N.G.A. or Association) on behalf of its members. N.G.A. is the national trade association representing the retail and wholesale grocers that comprise the independent sector of the food distribution industry. An independent retailer is a privately owned or controlled food retail company operating in a variety of formats. A few are publicly traded but with controlling shares held by the family, and others are employee owned. Most independent operators are serviced by wholesale distributors, while others may be partially or fully self-distributing. Independents are the true "entrepreneurs" of the grocery industry and dedicated to their customers, associates, and communities.

As a general observation, N.G.A. believes that the FTC does an effective job of enforcing merger law, using traditional analyses, in this vital area of antitrust. N.G.A. believes that the traditional analysis is not capable of dealing with the changed structure of today's marketplace. A handful of chains now control a share of the national market that is unprecedented in our history.[1] There are predictions that unless something is done to reverse the present trend, the top five chains could represent seventy-five percent of all grocery sales by the end of this decade. Today it is necessary to analyze retail grocery mergers by looking at more than the market shares of the merging parties in a local geographic market, the proximity of the merging parties' retail outlets, and a merger's effects on competition in selling groceries in the geographic markets that are directly affected – the micro, or selling-side, analysis. In order to understand and, when warranted, curtail the anti-competitive affects of growing national concentration, we encourage the FTC also to analyze the merger's affects in the macro market – the potential impact on the buying side in the form of practices that can, and often do, result in mega-retailers receiving preferential payment terms, packaging, promotional allowances, product availability and pricing. These advantages on the macro side injure competition in the micro – selling side – markets just as surely as high concentration. But traditional merger analysis does not consider competitive injury in the micro markets that stems from mergers viewed in the macro markets. Today, effective merger enforcement of Section 7 of the Clayton Act must consider both.

Effective antitrust remedies are a vital element in maintaining competitive markets, which provide consumers the benefits of diversity – diversity among retailers, and in their product assortments, prices and service levels. Consumer choice and marketplace diversity are the central objectives of N.G.A.'s campaign to preserve competition by ensuring that all grocery retailers compete on a level playing field. There is no doubt that complying with a second request under the Hart-Scott-Rodino (HSR) Act imposes an added responsibility on the merging parties. We applaud the current effort to improve the

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[1] In 1993 the top five chains accounted for 17% of sales by supermarkets. By the end of 2000 those same chains controlled 39.3% of supermarket sales, and at the end of last year their share had grown to 40.4%.

process. We note, however, that improving the methods by which its enforcement activities are conducted is nothing new to the Commission. Improvement has always been an ongoing objective, and over the years significant improvements have been made.[2] We are happy to again add our views on how the process can be further improved and how some proposals would, in N.G.A.'s view, weaken the FTC's ability to deal effectively with anticompetitive transactions. These matters are discussed in more detail in the balance of this presentation.

MERGER INVESTIGATIONS

The Content and Scope of the Second Request

The second request is a primary means by which the FTC obtains the facts needed to assess the likely competitive effects of a merger, rebut common arguments used by merging parties in defense of the merger, determine the remedy needed to eliminate any likely lessening of competition, and have evidence necessary to obtain an injunction preventing the transaction, should that become necessary. In reviewing all of the statements submitted to the Commission to date, as well as the transcripts of prior workshop sessions, there was only one suggestion to curtail the FTC's ability to seek information in its second requests.[3] N.G.A. understands that the Commission has been notified by the submitter that the Statement's discussion of the second request issue is not the submitter's position and should not be considered. The Statement is still part of the record in these proceedings, and a statement of N.G.A.'s opposing view, therefore, is appropriate.

The Statement's suggestion, if adopted, would eliminate many important questions from second requests in grocery mergers, rather than using existing modification and appeal procedures for eliminating actual, unreasonable burdens. These proposals would deny the agency important data and documents. One might conclude that the real purpose of these suggestions is to ease the compliance burden on some of the industry's largest chains, those that make many of the grocery mergers reported to the Commission under the HSR Act. Had those restrictions been the policy in the past, the FTC might have been unable to ask relevant and critical questions regarding the attempted acquisitions by Royal Ahold of Pathmark and Big V Supermarkets. N.G.A. believes that these suggestions are not in the consumer's interest, and certainly are not in the best interests of independent grocers, or the grocery industry as a whole.

There is some support for the notion that second requests in general, and perhaps those used in grocery mergers, have grown in detail and complexity over the years. That growth parallels the growth and complexity of factual, legal and economic approaches

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[2] For example, the model second request was adopted in response to the urging of the private sector as a means of alerting clients of what to expect if a second request is received.

[3] Food Marketing Institute Submission to the Federal Trade Commission Workshops on Merger Investigations And Remedies, June 18, 2002 (Statement).

used by the agency to analyze mergers, as well as by the lawyers and economists who defend them. Contrary to the Statement's suggestion, it *is* the FTC staff's job "to protect the Commission against every conceivable issue that might come up . . . in subsequent litigation."[4] The second request is the FTC's primary tool in doing that job. If the parties do not intend to raise an issue on which a question has been asked, the solution is a simple stipulation.

The Statement's suggestion that second requests are used as "fishing licenses" for economists[5] is unwarranted. Economists representing the merging parties employ the most sophisticated economic theories and models to justify their transactions. The effect of this position would weaken the Commission's ability to deal with this problem by denying the FTC's economists the data they will need to rebut the position of the parties' economists and to prove their own economic theories. In the days before economic analysis played such a major role in the analytical process, life may well have been simpler for those on both sides who deal with the antitrust aspects of mergers and acquisitions. But today, economic evidence is part of the process.

The Statement then turns to the use of price and store data, computerization, maps, photos and expected efficiencies. These factors go to the heart of the micro-side competitive environment presented by a merger. The routine use of computerized data is undoubtedly an outgrowth of the limited time in which the Commission has to analyze the response to a second request. Store photos appear to be an *efficient* method by which the staff can roughly assess the quality of competition (store age, size, and condition) offered by other firms in the affected trade areas, as well as those of the merging parties. In the latter regard, these factors can be critical in fashioning a competitively sensible divestiture package.

N.G.A. believes that the proper way to deal with a potential second request burden issue is the way suggested by numerous other workshop participants: improve and speed up the procedure for dealing with the burden issue. The burden on the parties must be weighed against the FTC's need for information. That is integral to the negotiation of changes in the second request. The FTC has always had a mechanism for dealing with the burden problem, and a formal procedure is now incorporated into the Commission's Rules, as required by subsection 7A(e)(1)(B) of the HSR Act. The FTC should be sensitive to the time and cost burdens imposed, particularly where the information is not kept in the ordinary course of business. But, if anticompetitive mergers are to be prevented, the FTC bears the burden of proving their illegality. It must be able to ask the questions. This includes questions described as "secondary or tertiary,"[6] but which may bear, for example, on anticompetitive conduct used by the acquiring party, and which could spread to new geographic areas served by the acquired party. Anticompetitive land banking is an example of such a practice.

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[4] Statement at 2.
[5] Statement at 3.
[6] *Id*.

N.G.A.'s definition of land banking does not include legitimate competition for new store locations that enable competing retailers to grow their businesses. Land banking, under N.G.A.'s definition, is a practice that a company uses to shield itself from competition at a location, and that denies consumers a shopping alternative. An actual example: Company A, a supermarket chain, and the owner of an empty retail location (not previously a supermarket) had agreed on a price at which Company A would purchase the property. Closing was set for a Monday. Over the weekend prior to the closing, Company B, a competing supermarket chain, learned of Company A's plans and purchased the location for twice the agreed price. At the time of the purchase of the vacant property, Company B was building a new supermarket across the street. Three years have now passed. Company B's new store is now open, and the vacant store is still unoccupied and for sale. Company B purchased the property for the sole purpose of preventing competition across the street from its new supermarket. It has done nothing more than deny consumers in the neighborhood another place to buy groceries. This is an example of the type of activity that should be the legitimate concern of the Commission. In fact, we have already given the Commission evidence of specific instances of this type of land banking practice. Land banking is not only an area of fair inquiry in a second request, it also warrants Commission enforcement action outside the context of a merger investigation.

MERGER REMEDIES

The Package of Assets to Be Divested; Manner of Divestiture; Buyer Issues

In grocery mergers, the most-often divested assets are retail stores in market areas served by stores of the merging parties. In the past, the FTC has used policies that have tilted the scales in favor of large chains as buyers of stores to be divested. Whenever multiple-store divestitures have been required in a geographic market, a single buyer for all the stores was required. Competitors in the market were barred from taking parts of the divestiture package, because their market shares would increase. Underlying these, and other divestiture policies, are FTC beliefs that large chains are preferable to independents as buyers of the stores, and that competition is best served by maintaining all the divested stores as a competitive unit, rather than breaking them up.

N.G.A. urges that both of these beliefs are erroneous, and has argued this position with the past administration. The Commission has no factual basis for the belief that independent grocers are less capable operators than chains. Much of the available evidence is to the contrary. The policies of preventing incumbents from acquiring divested stores and of requiring a single buyer for them ("clean sweep"), should be abandoned. They, in effect, force a new entrant into the market, most often a large

chain.[7] In the medium to long term, that can result in a more concentrated market than existed at the time of the divestiture. With that increase in concentration comes a decrease in consumer choice – choice of stores, products and services – as well as higher prices.

N.G.A. reaffirms its support of principles that will enable independent retailers to have greater access to divested stores.[8] When acquiring companies were allowed to pick the stores to be divested, the least competitive stores were put up for sale. This ultimately resulted in the FTC's requirement that all of the acquired stores or the acquirer's existing stores in the affected geographic market must be sold. However, this often resulted in the acquirer increasing its market share as the result of an otherwise unlawful acquisition: if the acquired stores had a larger market share than the acquiring company's existing stores, the existing stores were sold, and the acquirer kept the stores with the higher share. There is little justification for a divestiture policy that allows a party to increase its market share as part of the remedy for an otherwise illegal acquisition. While such results may not have been intended, FTC's policies should prevent this type of unwarranted trade-up benefit. It is especially unfair to competitors in the market, particularly to independents, that cannot purchase divested stores because of the "zero delta" policy, while at the same time allowing large chains to increase their shares by selecting the stores to be divested. If the zero delta policy is to apply at all, it should apply to the respondent, not to independents in the market.

Because of the store data at the Commission's disposal as the result of a second request, and the information that it receives as part of the buyer approval process, remedy guidelines can be crafted to make grocery store divestitures as effective as possible. First, the track records of the buyers of the stores to be divested should give the FTC reasonable assurance that the stores can be successfully operated. This buyer qualification process must occur whether the stores are being divested to one buyer or multiple buyers.

Second, the Commission's divestiture policies should be a matter of public record, and there must be consistency between Commission policy and staff action. For example, if the clean sweep policy has been abandoned at the Commission level, the staff must not discourage divestiture to multiple buyers.

Third, in order to maintain the efficiency and competitive effectiveness of the independent sector, wholesale grocers should have access to divestiture packages, especially when the divested stores are their customers. The loss of a major customer can have an anticompetitive effect on the wholesaler's remaining customers in geographic markets that would otherwise be unaffected by the merger.

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[7] This is exactly what happened recently in Richmond, Virginia, when these policies prevented a small, local independent from acquiring any of the divested stores, all of which were sold to one of the nation's largest chains, enabling it to enter the Richmond market.

[8] Comment on Consent Settlement Filed by National Grocers Association, Sept.6, 2000, FTC File Number 991-0308. A copy of that comment was submitted for the record of these workshop proceedings on June 20, 2002, and is incorporated herein by reference.

Fourth, the policy against allowing incumbents in the market to obtain divested stores must be abandoned. Its effect is to make it virtually impossible for independent operators to grow by acquisition in their markets.

Fifth, in situations in which wholesalers seek to acquire divested stores, two types of situations arise. In one case, the wholesaler may wish to buy stores and then sell them to its retail customers who are seeking to expand. This provides added safeguards to the FTC, because the wholesaler will most often supply partial financing for the resale of the stores and, therefore, place them with the most qualified independent operators. In the other situation, the wholesaler may wish to operate the stores. In such situations, not unlike those in which a wholesaler seeks to purchase a customer who wishes to sell the family business, the analysis should focus on the wholesaler's position as a retailer in the affected geographic market(s), and there should be no aggregation of the market share of the stores to be acquired and the shares of other stores supplied by the wholesaler. Those other stores are, in most cases, independents that set their own prices, product mixes and service levels.

Sixth, the FTC has maintained a policy of total neutrality among qualified buyers. This policy has resulted, in N.G.A.'s opinion, in a missed opportunity to use the divestiture process to improve the competitiveness of grocery markets. Rarely does the Commission consider the trends of competition in a market in which a merger is occurring. Existing market shares are examined, and a divestiture package is fashioned to maintain the competitive *status quo.* Examination of industry and market-specific concentration trends may result in selection of buyers that offer the greatest potential to deconcentrate markets. One objective of antitrust is to increase consumer welfare, and this approach, therefore, is completely consistent with the mission of the Commission.

Seventh, divestiture orders should prohibit acquiring firms that have employed land banking practices from closing acquired or existing stores and imposing restrictions that prevent their future use as supermarkets.

Finally, the Commission should play a more active role in the process by which the stores are divested to assure that all qualified buyers, including independents in the affected geographic market(s), have an equal opportunity to bid for the stores. Once the staff and the acquiring company have agreed on the stores to be divested, and before any potential buyer is contacted, there should be notice to the trade, describing the divestiture package in detail sufficient to attract all potential bidders. When presenting the selected buyer(s) to the Commission for approval, the acquiring company could then be required to inform the Commission of the identity of all firms expressing interest in all or part of the stores, submit copies of all bids received, and an explanation of how each bid was evaluated and the selected bidder was chosen. This would not involve the Commission in the divestiture process directly. It would, however, provide the Commission with sufficient information to assure that the divestiture process is open and fair to all interested buyers.

Timing of Divestiture

In a recent grocery store divestiture, the consent agreement contained provisions that (1) allowed the buyer of all the divested stores to acquire the stores while the divestiture was still on the public record for comment, and (2) reserved the Commission's right to order the stores returned to the original owner for subsequent sale to another buyer, if the comments received cause the Commission to disapprove the original divestiture.[9] N.G.A. believes this procedure should not be employed, especially when retail stores are involved, and store names will change as a result of the transfer of ownership.

Follow-Up on Divestiture Success

N.G.A. believes that the success of any grocery store divestiture can be best measured by whether consumers are being better served than they were prior to the divestiture. This can be assessed by following the competitive complexion of the market(s) in which divestiture occurred, and what has happened to the divested stores under new ownership. A number of questions should be asked at various intervals, perhaps one year and five years after the divestiture was completed. The following questions are suggestive of others that might be asked.

1. Are the stores still in operation, and if not, why?
2. Are the stores still owned by the original buyer in the divestiture?
3. Have the market shares of the individual stores risen, declined or remained the same?
4. Has concentration in the geographic market risen, declined or remained steady?
5. Have changes in concentration and market share been due to entry into, or exit from, the market?
6. Has the new owner improved the stores by remodeling or enlarging?
7. Has the format of the store been changed?

CONCLUSION

N.G.A. applauds the FTC's effort to continue improving the merger investigation and remedy processes. The record of these proceedings will contain valuable input to aid in that endeavor. The entire process can be improved by the use of a broader approach to merger analysis, one that includes examination of both the macro issues on the buying side and the micro issues on the selling side. In addition, merger and Robinson-Patman enforcement programs must be integrated to protect the marketplace from power buyers and sellers.

[9] The transaction is referred to in fn. 8, and this problem is discussed in greater detail at pages 7-8 of the N.G.A. Comment. Although order provisions of this nature may be appropriate in other industries, they are particularly unsuited to the retail trade.

It is N.G.A.'s belief that questions asked in the second request process are necessary to the Commission's investigatory needs. Internal reviews at the Bureau and Commission level before issuance of a second request, and the modification and appeal procedure available afterwards, are adequate protection for those extraordinary instances in which an over-zealous staff crosses the line of unnecessary burden.

The competitive value of independent grocery retailers and their wholesalers must be recognized, and the divestiture process should assure their access to divested stores. All policies that bias the divestiture process against independent retailers and their wholesalers should be abandoned, if the Commission has not already done so. And the Commission's policies, whatever they are, should be matters of public record; staff action must be consistent with those policies. The Commission should adopt procedures that assure that all potential buyers of stores to be divested are informed of their availability before the selection of a buyer or buyers is made.

We appreciate this opportunity to present our views. N.G.A. will continue to be available to assist the Commission in its efforts to preserve competition, diversity in the marketplace and consumer choice.