MERGERS & ACQUISITIONS

Business 33304
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Governing Law

- **Clayton Act Section 7**
  - Prohibits mergers if “in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or tend to create a monopoly.”

- **DOJ—FTC Merger Guidelines [2010]**
  - “The agencies seek to identify and challenge competitively harmful mergers while avoiding unnecessary interference with mergers that are either competitively beneficial or neutral. Most merger analysis is necessarily predictive…. [T]hese guidelines reflect the congressional intent that merger enforcement should interdict competitive problems in their incipiency and that certainty about competitive effects is seldom possible and not required for a merger to be illegal.”
Two Recent Examples

- Staples — Office Depot, 1997
  - 9/96: Staples (28 states) to acquire OD (38 states)
  - $4B, offered to sell some assets to OfficeMax
  - Rejected by FTC, Court decision 7/97

- Whole Foods — Wild Oats, 2007
  - WF (191 stores) to acquire WO (101 stores) for $671M
  - 19 WO stores in local markets where WF competes
  - WF to close 9 of the 19 WO stores
  - Rejected by FTC, allowed by district court
  - District court overruled on appeal
  - 2009: Divestiture of some former WO assets

- Similar — mergers alleged to affect competition in local markets
Why Might a Merger be Anticompetitive?

- Equilibrium is less competitive — internalize the externality from cutting price
- Collusion—coordination more likely (tacit v. actual)
- Short Run v. Long Run effects (R&D incentives, entry barriers)
Why Might a Merger be Pro-competitive?

- Efficiencies—cost side or demand side
- Leveraging scarce assets: output increasing
  - Technologies
  - Capabilities
  - Brand
- Standard: consumer or social welfare?
  - Procompetitive in some areas, anticompetitive in others
  - Do efficiencies need to be entirely passed through?
Process

- Hart-Scott-Rodino (1978) notification
  - Avoid having to unscramble the egg
  - Can still challenge ex-post, but rare
    - Evanston/Highland Park hospitals—7 years
    - Forced to price separately
  - Agencies will request info
    - Financials, description of all businesses, planning docs

- 2nd requests are large & costly
  - Depose senior execs, customers, competitors
  - Collect huge amount of info in discovery

- Can seek injunction to block
  - If parties wish to fight it, big expensive trial

- Can seek remedies—e.g. sale of assets
Economic Analysis and Related Evidence

- Market Definition—”relevant antitrust market”
  - Hypothetical monopolist—SSNIP test
- Competitive effects
  - Coordination
- Entry
  - Too little attention to potential entry as constraint on pricing
- Efficiencies
- Non-Economic evidence
  - Managerial intent
  - Customers
  - Competitors—but generally they would benefit from anticompetitive merger. Hence less weight
Whole Foods—Wild Oats

- FTC Claim that merger would harm competition
  - “Premium Natural and Organic Supermarkets” (PNOS) are a relevant antitrust market
  - Hypothetical monopolist of PNOS could maintain SSNIP
  - WF “Goldmine” strategy was to eliminate competition from WO in overlapping local markets
  - Economic analysis, testimony and company docs indicate anticompetitive intent and impact
    - Closing of WO stores in competitive locales

- WF claim that merger was procompetitive
  - PNOS too narrow—prices constrained by supermarkets generally
  - Merged firm would not be able to sustain SSNIP
  - Cost efficiencies
  - Merged firm would leverage superior business model/superior product—WF always won the competitive battle
What Not to Say

- Clayton Act Section 7
  - Prohibits mergers if “in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or tend to create a monopoly.”

- John Mackey, CEO of Whole Foods, on the reasons for “Project Goldmine” (acquiring Wild Oats, closing 19 WO stores):
  - “[I]t self-evidently will lessen competition in those markets that we are competing with Wild Oats in when we are going to intend to close stores….One of the motivations is to eliminate a competitor. I will not deny that…That is one of the reasons we are willing to pay $18.50 for a company that has lost $60 million in the last six years. If we can’t eliminate those stores, then Wild Oats, frankly, isn’t worth buying.” [Investigational Hearing of John Mackey]
What Evidence Would You Look At?

- If Market=PNOS, then FTC appears to have a strong case
- If Market=Supermarkets, then WF appears to have a strong case
Entry by Whole Foods Reduced Wild Oats Sales Volume
(Entry by Whole Foods within 5 Miles of a Wild Oats store)
WF Stores that Faced PNOS Entry Cut Prices Relative to Stores That Did Not Face Entry

Date of Earth Fare's Opening in Chapel Hill (6/15/2005)

Date of Earth Fare's Opening in Raleigh/Durham (8/31/2005)
Whole Foods—Wild Oats
Ultimate Outcome

- District Court ruling in favor of merger
  - Merger went forward, WO stores acquired, some shut
- FTC appeal, appeal upheld
  - DC ignored relevant evidence on pricing
- “Unscramble the egg”
  - Given that the merger went forward, should/can it be undone?
    - WF required to divest WO assets in certain markets
- Should the merger have been allowed in the first place?
  - Legally? (Recall language of Clayton Section 7)
  - Economically?
    - Is SSIP too rigid here?
    - WF & WO are by definition good substitutes
Other Examples

- **Thomson-Reuters**
  - Competition in terminals—Bloomberg the market leader
  - Does the merger create a stronger competitor to the market leader?
  - Defining markets, some likely benefit, others harmed
  - Key issue—would/does potential entry constrain prices? If so, then merger may not harm competition even if # of sellers is small
  - Correct analysis should incorporate potential entry

- **Live Nation—Ticketmaster (Vertical)**
  - LN largest concert promoter, TM largest seller of concert tickets
  - Horizontal—LN had recently entered ticketing
  - Potential competition: How unique is LN’s ability to enter?
  - DOJ ultimately approved, with restrictions
    - TM must license ticketing software to rivals
    - After 5 years, rival can purchase the software

- **McDonnell-Douglas—Boeing**
  - Failing firm (M-D) defense. Why not let it fail and sell assets in bankruptcy?
  - What is the market? International competition
  - Why did Airbus complain?