

# Kavanaugh's Dissent in the Proposed Whole Foods Merger: The Transformation of the Grocery Industry

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While sitting on the D.C. Court of Appeals, then-Judge Brett Kavanaugh wrote a dissenting opinion in the action by the Federal Trade Commission to enjoin the proposed merger of Whole Foods and Wild Oats. During the nomination process for his appointment to the U.S. Supreme Court, Kavanaugh was asked questions about his dissenting opinion. The questions suggested that he is hostile to merger enforcement and pre-disposed to side with businesses in antitrust cases.<sup>1</sup> Other commentary has suggested that Kavanaugh's dissent put him "outside the mainstream bipartisan consensus supporting antitrust enforcement."<sup>2</sup> Looking back at Kavanaugh's dissent, though, his willingness to consider economic evidence indicating that transformative forces were at work in the grocery industry appears in retrospect to have been correct. Furthermore, his embrace of economic evidence related to the transformation occurring in the grocery industry as justification for allowing the merger to proceed is consistent with both prior merger analysis by U.S. courts and with established economic theory.

## Background of the Proposed Merger

In February 2007, Whole Foods and Wild Oats, two purveyors of natural and organic foods, entered into a merger agreement whereby Whole Foods would acquire 100 percent of the voting shares of Wild Oats.<sup>3</sup> In what was then a confidential memo that Whole Foods submitted to its board of directors (but has since become public through discovery), Whole Foods offered a number of reasons for acquiring Wild Oats, including the apparent "elimination of an acquisition opportunity for a conventional supermarket" and the apparent "elimination of a competitor."<sup>4</sup> The FTC filed suit challenging the merger.<sup>5</sup>

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<sup>1</sup> In the preamble to one of the questions posed to Kavanaugh by Senator Amy Klobuchar, she stated, "I'm concerned that the Court, the Roberts Court, is going down the wrong path and your major antitrust opinions would have rejected challenges to mergers that majorities found to be anticompetitive." Senator Klobuchar went on to conclude that "I'm afraid you're going to move it even further down the path." See *US: Klobuchar Questions Kavanaugh on Antitrust*, COMPETITION POL'Y INT'L (Sept. 6, 2018), <https://www.competitionpolicyinternational.com/us-sen-klobuchar-questions-kavanaugh-on-antitrust/>; see also Matthew Perlman, *Kavanaugh Sidesteps Tough Questions on Merger Opinions*, LAW360 (Sept. 5, 2018), <https://www.law360.com/articles/108011/kavanaugh-sidesteps-tough-questions-on-merger-opinions>.

<sup>2</sup> See Am. Antitrust Inst., *AAI Opposes Nomination of Judge Kavanaugh to Supreme Court: Analysis Shows Hostility to Antitrust Plaintiffs and Leniency to Big Business* (July 17, 2018), <https://www.antitrustinstitute.org/work-product/aii-opposes-nomination-of-judge-kavanaugh-to-supreme-court-analysis-shows-hostility-to-antitrust-plaintiffs-and-leniency-to-big-business/>.

<sup>3</sup> Press Release, Fed. Trade Comm'n, *FTC Seeks to Block Whole Foods Markets Acquisition of Wild Oats Markets* (June 5, 2007), <https://www.ftc.gov/news-events/press-releases/2007/06/ftc-seeks-block-whole-foods-markets-acquisition-wild-oats-markets>.

<sup>4</sup> John Mackey, *Whole Foods Market, Wild Oats, and the Federal Trade Commission*, JOHN MACKEY'S BLOG (June 19, 2007), <https://www.wholefoodsmarket.com/blog/john-mackeys-blog/whole-foods-market-wild-oats-and-federal-trade%2%A0commission>. Whole Foods subsequently contended that elimination of a competitor is not necessarily anticompetitive.

<sup>5</sup> Complaint for Temporary Restraining Order and Preliminary Injunction Pursuant to Section 13(b) of the Federal Trade Commission Act, *FTC v. Whole Foods Market, Inc.* (filed June 6, 2007).

Among the reasons advanced by the FTC for halting the merger was the claim that “in each of the markets in which they overlap, Whole Foods and Wild Oats are each other’s closest substitute” and that “[a]fter the merger, Whole Foods likely would be able to raise prices unilaterally, to the detriment of customers of premium natural and organic supermarkets.”<sup>6</sup> The FTC lost its request for an injunction, with the district court concluding that the FTC was unlikely to prevail on the merits of its case since it was unlikely that the FTC could prove its asserted product market or that the proposed merger would substantially lessen competition.<sup>7</sup> Days after the district court’s opinion, Whole Foods finalized its merger with Wild Oats.<sup>8</sup>

The FTC appealed the district court’s decision, despite Whole Foods’ claim that the merger was a *fait accompli* and could not be reversed.<sup>9</sup> As the court of appeals observed, “Only in a rare case would we agree a transaction is truly irreversible” and noted that “divestiture is a common form of relief from unlawful mergers.”<sup>10</sup> The court of appeals then disagreed with what it characterized as a “thoughtful” opinion by the district court, with the majority finding that the FTC had, in fact, successfully delineated a relevant product market limited to just the premium natural and organic supermarkets product space and that competition from Wild Oats had a specific effect on Whole Foods’ pricing.<sup>11</sup> Given its finding that the district court erred in its assessment of the relevant antitrust market, the court of appeals reversed and remanded the proceeding. Kavanaugh offered a dissenting opinion.<sup>12</sup>

The FTC ultimately reached a settlement with Whole Foods that required the divestiture of 32 former Wild Oats stores, including 19 stores that Whole Foods had closed but where leases still existed.<sup>13</sup> According to the FTC, the settlement would “restore competition in 17 geographic markets that were impacted by the acquisition” and “also could provide a ‘springboard’ from which an acquirer might expand into other geographic markets” through the purchase of the divested stores.<sup>14</sup>

### Kavanaugh’s Consideration of the Economic Evidence

Both the FTC and Whole Foods advanced economic evidence purporting to define the relevant antitrust markets as well as the likely effects on consumer prices stemming from the proposed merger. According to the FTC’s expert, Whole Foods and Wild Oats were each “highly differentiated, premium positioned brands” and even other upscale stores, such as Wegman’s, or specialty stores, such as Trader Joe’s, were “clearly significantly differentiated relative to the [merging] par-

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<sup>6</sup> Press Release, Fed. Trade Comm’n, FTC Seeks to Block Whole Foods Markets Acquisition of Wild Oats Markets (June 5, 2007), <https://www.ftc.gov/news-events/press-releases/2007/06/ftc-seeks-block-whole-foods-markets-acquisition-wild-oats-markets>.

<sup>7</sup> *FTC v. Whole Foods Market, Inc.*, 502 F. Supp. 2d 1 (D.D.C. 2007).

<sup>8</sup> *FTC v. Whole Foods Market, Inc.*, 548 F.3d 1028, 1033 (D.C. Cir. 2008).

<sup>9</sup> *Id.*

<sup>10</sup> *Id.*

<sup>11</sup> *See id.* at 1039–42.

<sup>12</sup> In the majority opinion, Kavanaugh’s colleagues accused him of “ignor[ing] both circuit precedent and Section 13(b)” of the Federal Trade Commission Act. *Id.* at 1043. Because of that, the majority contended, Kavanaugh’s dissent “misses the mark” by holding the FTC to too high of a standard of proof. *Id.* at 1046. The majority also claimed that Kavanaugh “gloss[ed] over [the] distinction” between a product market defined as just “organic” products in contrast to a product market defined as “premium natural and organic” products. *Id.* at 1045.

<sup>13</sup> Press Release, Fed. Trade Comm’n, FTC Consent Order Settles Charges that Whole Foods Acquisition of Rival Wild Oats Was Anticompetitive (Mar. 6, 2009), <https://www.ftc.gov/news-events/press-releases/2009/03/ftc-consent-order-settles-charges-whole-foods-acquisition-rival>.

<sup>14</sup> *Id.*

ties.”<sup>15</sup> With respect to “conventional supermarkets,” the FTC’s expert concluded that “[i]t is difficult for conventional markets to compete on organic offerings” and that “[d]ocumented attempts by conventional supermarkets to move closer to the Whole Foods/Wild Oats model have not impacted Whole Foods.”<sup>16</sup>

In support of those conclusions, the FTC’s expert implemented the so-called “hypothetical monopolist test” to determine whether a sole-seller of products within the “premium natural and organic supermarkets” product space would be able to impose a small but significant, non-transitory increase in price (also known as a SSNIP) without losing so many customers as to make that price increase unprofitable.<sup>17</sup> Assuming a price increase of 1 percent persisting for two years, the FTC’s expert performed a SSNIP test, and concluded that the relevant antitrust product market was no larger than premium natural and organic supermarkets.<sup>18</sup> The FTC’s expert then concluded that, were Whole Foods and Wild Oats to merge, the combined entity would be able to profitably raise prices without losing too many customers to potential competitors.<sup>19</sup> The FTC’s expert also considered whether other stores might be able to “reposition” themselves in such a way as to discipline Whole Foods’ pricing subsequent to the proposed merger but concluded that they would not.<sup>20</sup>

The expert retained by Whole Foods concluded, in contrast, that even with a relatively small SSNIP the extent of the sales lost by a hypothetical monopolist would be sufficiently large so as to make that SSNIP unprofitable.<sup>21</sup> Furthermore, Whole Foods’ expert presented granular pricing analyses conducted at a regional level that purportedly showed that Whole Foods’ prices did not differ on the basis of whether other “organic supermarkets” were located in the same geographic vicinity as a Whole Foods store.<sup>22</sup> In particular, Whole Foods’ expert concluded that Whole Foods’ “prices are set across broad geographic areas” and that “differences in prices across stores are generally very small (less than one half of one percent and there is no systematic pattern as to the presence or absence of [organic-supermarket] competition.”<sup>23</sup> Thus, according to the district court, the evidence advanced by Whole Foods’ expert “demonstrates that the relevant product market must be broader than the market proposed by the FTC” and that the “relevant product market must encompass at least all supermarkets.”<sup>24</sup>

In considering the economic evidence and empirical analyses advanced by both sides’ experts, Kavanaugh agreed with the majority that the key issue in this case revolved around properly defining the relevant product market.<sup>25</sup> Kavanaugh also accepted that Whole Foods and Wild

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<sup>15</sup> See Expert Report of Kevin M. Murphy, Ph.D. ¶ 34, *FTC v. Whole Foods Market, Inc.*, 502 F. Supp. 2d 1 (D.D.C. 2007), <https://www.ftc.gov/sites/default/files/documents/cases/2007/08/070823murphy.pdf>.

<sup>16</sup> *Id.* ¶ 77.

<sup>17</sup> See *id.* § IX. In designing his test, the FTC’s expert relied upon the 1992 Horizontal Merger Guidelines. The Guidelines were subsequently updated in 2010, but it is not clear if using the updated Guidelines instead would have meaningfully changed his conclusions.

<sup>18</sup> See *id.* for a general discussion of the SSNIP test performed by the FTC’s expert.

<sup>19</sup> *Id.* ¶¶ 100, 104.

<sup>20</sup> *Id.* ¶¶ 139–140.

<sup>21</sup> *Whole Foods*, 502 F. Supp. 2d at 19.

<sup>22</sup> *Whole Foods*, 548 F.3d at 1053.

<sup>23</sup> *Id.* (quoting Scheffman Expert Report).

<sup>24</sup> *Whole Foods*, 502 F. Supp. 2d at 19.

<sup>25</sup> *Whole Foods*, 548 F.3d at 1051 (“As in many antitrust cases, the analysis comes down to one issue: market definition.”).

Oats were the only “significant competitors” in a market limited to just organic supermarkets and that a merger “would substantially lessen competition in such a narrowly defined market.”<sup>26</sup> Kavanaugh argued, however, that the relevant product market was *not* limited to just organic supermarkets and adopted the district court’s conclusion that “Whole Foods competes against all supermarkets and not just so-called organic stores.”<sup>27</sup> Kavanaugh largely based this conclusion on the evidence presented by Whole Foods’ expert that purportedly showed Whole Foods’ prices were set across broad geographic areas and did not differ on the basis of whether a Wild Oats store was located in close proximity to a Whole Foods store.<sup>28</sup>

Kavanaugh summarized, in his dissent, much of the economic analysis advanced by Whole Foods’ expert. Kavanaugh specifically homed in on the expert’s granular pricing analyses, noting that those analyses were “all-but-dispositive price evidence” that Whole Foods did not price in response to Wild Oats.<sup>29</sup> Kavanaugh drew a distinction between this merger and the merger proposed by Staples and Office Depot, observing that “the facts here contrast sharply with *Staples*, where Staples charged significantly different prices based on the presence or absence of office-superstore competitors in a particular area.”<sup>30</sup> Kavanaugh went on to conclude that the “evidence there showed that Staples charged prices 13 percent higher in markets without office-superstore competitors than in markets with such competitors” and that “[t]here is nothing remotely like that in this case.”<sup>31</sup> As a result, Kavanaugh affirmed that “the relevant market for evaluating this merger for antitrust purposes is all supermarkets; and the merger of Whole Foods and Wild Oats would not substantially lessen competition in a market that includes all supermarkets.”<sup>32</sup>

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### Changes in the Grocery Industry Support Kavanaugh’s Analysis and Conclusions

In addition to relying on the pricing analyses advanced by Whole Foods’ expert, Kavanaugh accepted the economic evidence that Whole Foods’ expert presented, based on trade journals and other industry information, showing that the “*dividing line between ‘organic’ and conventional supermarkets has blurred*” and that “[t]his is an industry in transition.”<sup>33</sup> This evidence, as interpreted by Kavanaugh and as written in his dissent, indicated:

Whole Foods has pioneered a product differentiation that in turn has caused other supermarket chains to update their offerings. These are not separate markets; this is a market where all supermarkets including so-called organic supermarkets are clawing tooth and nail to differentiate themselves, beat the competition, and make money.<sup>34</sup>

Many merging parties, of course, claim that their industry is one in transition. In the particular instance of Whole Foods, though, the district court—and ultimately, Kavanaugh—found the evidence of transition to be more than mere speculation. The district court, in fact, directly confront-

<sup>26</sup> *Id.*

<sup>27</sup> *Id.*

<sup>28</sup> *Id.* at 1053–54.

<sup>29</sup> *Id.*

<sup>30</sup> *Id.*

<sup>31</sup> *Id.*

<sup>32</sup> *Id.*

<sup>33</sup> *Id.* at 1054–55 (emphasis added).

<sup>34</sup> *Id.*

ed the FTC's claim that potential competitors to Whole Foods would be unable to "reposition" themselves in such a way to provide effective pricing discipline, observing that "[t]he problem with the FTC's analysis is that the evidence shows that retailers *have already begun* repositioning their formats, services and product selection in order to respond to the growing consumer demand for natural and organic foods and to better compete against Whole Foods."<sup>35</sup> After then describing the repositioning of six potential competitors to Whole Foods, including such large industry participants as Safeway, Publix, and Kroger, the district court concluded that "the snapshot of the marketplace today is very different than it may have been a few years ago" and "[t]o put it colloquially, this train has already left the station."<sup>36</sup> Kavanaugh specifically cited the district court's metaphor, as well as the district court's extensive consideration of the economic evidence of repositioning, in accepting that the grocery industry was in transition.<sup>37</sup>

Whole Foods was already experiencing pressure from other industry participants' repositioning at the time of the proposed merger. Leading up to the proposed merger, Whole Foods had the reputation of being a high-priced grocer.<sup>38</sup> In response to the repositioning observed by the district court, however, Whole Foods began to focus more attention on pricing issues. In fact, Whole Foods disclosed that in early 2009 it "made a shift from being fairly reactionary on pricing to being much more strategic."<sup>39</sup> As Whole Foods explained, "we survey 63 competitors on 400 items across the country to just stay on track of where we are. . . . We check all the competitors. It's everything from sunflower sprouts all the way to Wal-Mart. We're checking them all."<sup>40</sup> Whole Foods subsequently observed that "one of the big things we've really tried to work on the last couple of years is improving our price competitiveness . . . [a]nd so we monitor and follow many more competitors than we did a couple of years ago."<sup>41</sup> This change in pricing strategy is consistent with Kavanaugh's interpretation of the economic evidence indicating the marketplace was becoming increasingly competitive.

Industry-wide changes that have unfolded over the past decade are also consistent with Kavanaugh's interpretation of the economic evidence. In an earnings call in 2016, Whole Foods itself observed:

There's a lot more competitors in the marketplace, and there's a lot of new formats in the marketplace from home meal replacement through meal kits, fast casual restaurant growth, more entrants in the natural and organic food space . . . mainstreaming of natural and organic . . . [S]o people may not be driving as frequently as far as they used to because they can stop by a Kroger or a HEB or a Wegmans [to get products that they] used to only be able to get at Whole Foods.<sup>42</sup>

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<sup>35</sup> *Whole Foods*, 502 F. Supp. 2d at 42–43 (emphasis added).

<sup>36</sup> *Id.* at 48.

<sup>37</sup> *Whole Foods*, 548 F.3d at 1054–55.

<sup>38</sup> See, e.g., Hadley Freeman, *Over the Top and Over Here: "Disney World" of Food Opens First UK Store*, THE GUARDIAN (June 7, 2007), <https://www.theguardian.com/business/2007/jun/07/retail.supermarkets>. Of course, having higher prices than competitors does not by itself mean that Whole Foods does not compete against its lower-priced competitors. As Whole Food explains, "We've never been, and we never will be, trying to be the lowest-priced supermarket." Whole Foods Market, Inc., *Q1:2015 Earnings Call*, S&P GLOBAL MARKET INTELLIGENCE 13 (Feb. 11, 2015). Nor did Whole Foods want to become a "commodity where [it is] trying to just compete on the basis of price." Rather, Whole Foods claims to compete on the basis of "differentiation, innovation, service, quality and overall experience" that it provides to its customers. See Whole Foods Market, Inc., *Q2:2014 Earnings Call*, S&P GLOBAL MARKET INTELLIGENCE 15 (May 6, 2014).

<sup>39</sup> Whole Foods Market, Inc., *Q1:2010 Earnings Call*, S&P GLOBAL MARKET INTELLIGENCE 11 (Feb. 16, 2010).

<sup>40</sup> *Id.*

<sup>41</sup> Whole Foods Market, Inc., *Q4:2010 Earnings Call*, S&P GLOBAL MARKET INTELLIGENCE 15 (Nov. 3, 2010).

<sup>42</sup> Whole Foods Market, Inc., *Q3:2016 Earnings Call*, S&P GLOBAL MARKET INTELLIGENCE 12 (July 27, 2016).

Other supermarket chains have likewise acknowledged these types of changes unfolding in the grocery industry. In language nearly identical to that used by Kavanaugh in his dissent, Kroger observed:

[T]he natural/organic customer is changing and growing in numbers, and those that shop the grocery store are also crossing over, and the blurring of grocery and natural foods is becoming more and more difficult when you look around the store and you can see organic items on the regular grocery shelf . . . . There's a lot of product innovation in that space as well.<sup>43</sup>

This transition observed by both Kavanaugh and market participants means that Whole Foods has increasingly come into competition with more mainstream supermarkets (to the extent that it was not already competing with them). As one indication of the competitive overlap between Whole Foods and other supermarkets, on the day that Amazon laid out its strategy for integrating Whole Foods into the Amazon ecosystem, the stock prices of major supermarket chains such as Kroger fell over 5 percent.<sup>44</sup> Such stock price declines suggest a sufficient competitive overlap between Whole Foods and other supermarkets that investors were concerned that any new strategy implemented by Whole Foods—such as reducing prices would negatively impact other supermarkets' profitability.<sup>45</sup>

Also consistent with Kavanaugh's reasoning, a number of new services and products have emerged, which, in retrospect, could have exerted further pricing discipline on a merged Whole Foods-Wild Oats entity. One example is Good Eggs, an online grocery service that has been described as a "digital version of a farmer's market" and that "bring[s] local produce to customers who [don't] have time to shop in person."<sup>46</sup> After obtaining over \$50 million in funding, at least one industry source believes that Good Eggs is well-positioned to compete against Whole Foods, particularly since the size of Whole Foods makes it difficult for Whole Foods to source locally across all of its stores.<sup>47</sup>

Examples of alternative products that could have exerted pricing discipline include so-called meal kits, sold by companies such as Blue Apron and Hello Fresh, which delivers all the ingredients needed to assemble a meal to customers. Both Blue Apron and Hello Fresh specifically advertise the quality of their ingredients, noting their ingredients are sourced by family-owned and environmentally-sustainable farms.<sup>48</sup>

## Merger Analysis by U.S. Courts and Economic Theory Support Kavanaugh's Reasoning

In adopting a view that antitrust law should account for and credit changing conditions in the marketplace, Kavanaugh's dissent was in line with at least one prior court decision denying an agency

<sup>43</sup> Kroger, *Q2:2014 Earnings Call*, BLOOMBERG 13 (Sept. 11, 2014) (emphasis added).

<sup>44</sup> Antoine Gara, *Amazon Lays Out Its Whole Foods Strategy and Shakes Up Wall Street Anew*, FORBES (Aug. 24, 2017), <https://www.forbes.com/sites/antoinegara/2017/08/24/amazon-lays-out-its-whole-foods-strategy-and-shakes-up-wall-street-anew/#4348265956f1>.

<sup>45</sup> Attributing any given movement in stock price to a specific event can often require sophisticated econometric analysis to isolate the possible effects of that event relative to other factors.

<sup>46</sup> Adele Peters, *How Good Eggs Came Back from the Brink—and Plans to Take On Amazon*, FAST COMPANY (May 15, 2018), <https://www.fastcompany.com/40554143/how-good-eggs-came-back-from-the-brink-and-plans-take-on-amazon>.

<sup>47</sup> *Id.*

<sup>48</sup> See HelloFresh, <https://www.hellofresh.com/meet-our-suppliers/?redirectedFromAccountArea=true> (last visited Mar. 22, 2019) and Blue Apron, <https://www.blueapron.com/pages/vision> (last visited Mar. 22, 2019).

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challenge to a proposed merger. Although not explicitly referenced by Kavanaugh in his dissent, the district court's decision in the proposed merger between Oracle and PeopleSoft contains many of the same themes and relies on much of the same type of economic evidence. Kavanaugh's reasoning in *Whole Foods* regarding competitive conditions in the marketplace thus was consistent with the reasoning contemporaneously adopted by at least one other jurist.

In the proposed merger between Oracle and PeopleSoft, which the Department of Justice challenged in 2004, one item the court highlighted was the likelihood of entry into the enterprise resource planning (ERP) marketplace by vendors other than those identified by the DOJ as already participating in that marketplace.<sup>49</sup> In particular, one of the witnesses called at trial testified, with respect to Microsoft's likely entry into the ERP marketplace, that it was "pretty clear they're coming."<sup>50</sup>

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Based on that testimony, the court accepted that, even though Microsoft might not yet be a competitor, it would be "able to extend its reach into an arena in which plaintiffs contend that only Oracle, PeopleSoft and SAP now compete." The court also noted that Microsoft had the money, the reputation and the sales force necessary "to become a major competitor."<sup>51</sup> Given Microsoft's ability to discipline any potential price increases after the merger, the court rejected the conclusion advanced by the plaintiffs' expert that a SSNIP would be possible. The court also noted that "Microsoft's entry into competition may be achieved by a business model different from that followed" by the existing vendors.<sup>52</sup>

Both the *Oracle* court's conclusion that likely entry can be sufficient to defeat a SSNIP, as well as its conclusion that such entry might follow a different business model than the incumbents, would have been relevant to Kavanaugh's consideration of how the grocery industry might react in the wake of the proposed merger between Whole Foods and Wild Oats. At the time of Kavanaugh's dissent, the district court had already identified many potential competitors that could have played the role Microsoft served in *Oracle*, and would have had the resources necessary to begin marketing natural and organic products. In particular, the district court found Safeway, Publix, and Kroger, among others, had "already proven themselves adept at repositioning and proving competitive in the premium natural and organic food field" and noted that these were large, national chains with thousands of stores among them.<sup>53</sup>

Such potential competitors would not have had to create new standalone outlets focusing just on natural and organic products, as Whole Foods did, but rather could have pursued a different business model and added those products as complementary business lines within their existing stores. In fact, that is what many of the competitors identified by the district court did. Kroger, for example, launched its own private label brand, Simple Truth, in 2012 specifically for natural and organic products. By 2015, sales of Simple Truth products exceeded one billion dollars annually while, across all of its product lines, Kroger's annual sales of organic and natural products were around \$11 billion. In comparison, Whole Foods' system-wide annual sales at the same time were only slightly higher, at around \$14 billion.<sup>54</sup>

<sup>49</sup> See, e.g., *United States v. Oracle Corp.*, 331 F. Supp. 2d 1098, 1135 (N.D. Cal. 2004).

<sup>50</sup> *Id.*

<sup>51</sup> *Id.* at 1135, 1160.

<sup>52</sup> *Id.* at 1135.

<sup>53</sup> *Whole Foods*, 502 F. Supp. 2d at 43–48.

<sup>54</sup> See Beth Kowitz, *Is the Largest Natural-Foods Brand Even Sold at Whole Foods?* FORTUNE (Oct. 28, 2015), <http://fortune.com/2015/10/28/kroger-natural-organic-food/>.

The reasoning in Kavanaugh's dissent is supported by a long strand of economic theory on the effect of innovation on competition and is consistent with his belief that it is relevant to consider how an "industry in transition" might look in a few years' time.<sup>55</sup> Beginning with the publication of Joseph Schumpeter's *Capitalism, Socialism and Democracy* in 1942, which popularized the idea of creative destruction as constantly changing the existing economic order of industries, a number of economists have argued that innovation will invariably drive competition and that existing market shares within an industry are not necessarily an accurate proxy for the ability of firms to exercise market power.<sup>56</sup>

As explained by Schumpeter:

[I]t is not that kind of [price] competition that counts but the competition that comes from the new commodity, the new technology, the new source of supply, the new type of organization . . . competition which commands a decisive cost or quality advantage and which strikes not at the margins or the profits and the outputs of the existing firms but at their foundations and their very lives. . . . It is hardly necessary to point out that competition of the kind we now have in mind acts not only when in being but also *when it is merely an ever-present threat*. It disciplines before it attacks.<sup>57</sup>

It was the threat of future entry by Microsoft that caused the court in *Oracle* to conclude that a SSNIP would ultimately be unsuccessful.<sup>58</sup> As explained by Richard Schmalensee, a professor at MIT, in the software industry in particular, "[c]ategory leaders are not generally threatened by 'me too' products competing on price, but as in Schumpeter's vision, they risk being obliterated by the superior products that regularly emerge from intense dynamic competition."<sup>59</sup> Likewise, in *Whole Foods*, Kavanaugh based his dissent in large part on the threat of mainstream supermarkets introducing organic and natural products and initiating greater competition against Whole Foods. Such a threat ultimately materialized given that within two years of the merger being unwound, Whole

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<sup>55</sup> See, e.g., J. Gregory Sidak & David J. Teece, *Dynamic Competition in Antitrust Law*, 5 J. COMPETITION L. & ECON. 581, 623–24 (2009) (noting that Kavanaugh's dissent in *Whole Foods* reflected the importance of innovation over static competition and was consistent as well with the position of Thomas Barnett, the Assistant Attorney General at that time); see also Thomas O. Barnett, *Maximizing Welfare Through Technological Innovation* 5 Presentation to the George Mason Univ. L. Rev. 11th Annual Symposium on Antitrust (Oct. 31, 2007), <https://www.justice.gov/atr/file/519216/download> ("Antitrust policy must embrace a more sophisticated model of competition, one that recognizes the importance of innovation and other factors that increase efficiency.").

<sup>56</sup> See, e.g., Richard Schmalensee, *Antitrust Issues in Schumpeterian Industries*, 90 AM. ECON. REV. 192, 193 (2000) ("In particular, when innovation is rapid, market shares that depend almost entirely on intellectual property are likely to lack predictive power. To assess fragility, one must either consider the intensity of dynamic competition directly or look for indirect evidence of its effects.") A review of the modern scholarship discussing the application of Schumpeter's ideas to antitrust can be found in Thomas McCraw, *Joseph Schumpeter on Competition*, 8 COMPETITION POL'Y INT'L 194 (Spring 2012). See also Tom Nicholas, *Why Schumpeter Was Right: Innovation, Market Power and Creative Destruction in 1920s America*, 63 J. ECON. HIST. 1023, 1055 (Dec. 2003) ("[T]he threat of creative destruction does discipline the product market . . . The lesson for policy makers is that antitrust intervention in product markets may disturb the very incentive structures that lead to rapid technological change.").

<sup>57</sup> JOSEPH SCHUMPETER, *CAPITALISM, SOCIALISM AND DEMOCRACY* 84–85 (George Allen & Unwin 1976) (1942) (emphasis added).

<sup>58</sup> This reasoning on the part of Schumpeter has led at least some economists to conclude that the two-year window in which to assess the potential effects of a SSNIP (as suggested by § 3.2 of the U.S. Department of Justice and Federal Trade Commission 1992 Horizontal Merger Guidelines, relied upon by the FTC's expert in *Whole Foods*) might be too short given that the competition exerted by potential new entry or by potential new technology could take a longer period of time to fully develop. See Thomas Jorde & David Teece, *Introduction*, in *ANTITRUST, INNOVATION, AND COMPETITIVENESS* 9 (Thomas Jorde & David Teece eds., 1992). In fact, the current version of the Horizontal Merger Guidelines now omits references to new entry occurring within two years of a merger and instead contends that "entry must be rapid enough to make unprofitable" the actions "thus leading to entry." See U.S. Dep't of Justice & Fed. Trade Comm'n, *Horizontal Merger Guidelines* § 9.1 (2010).

<sup>59</sup> Schmalensee, *supra* note 56, at 193.

Foods was already experiencing competition from a number of supermarkets that had begun to reposition themselves. Other forms of competition, such as those posed by home delivery services and meal kits, perhaps could have been anticipated given how dynamic the grocery industry was becoming.

In retrospect, one might infer that Kavanaugh's reasoning has portended a more general shift towards viewing potential anticompetitive concerns in a dynamic context. An article from 2008, published about the same time as Kavanaugh's dissent, observes that the "static focus of modern industrial organization is a problem both for itself as a branch of economic science and as a body of knowledge that is relevant to the big issues within antitrust."<sup>60</sup> The Assistant Attorney General for the Antitrust Division of the DOJ, Makan Delrahim, stated a decade later that "we must be careful in analyzing the real-world competitive dynamics before ascribing market power to a firm."<sup>61</sup> Delrahim then elaborated:

[O]ne might infer that

Kavanaugh's reasoning

has portended a more

general shift towards

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anticompetitive

concerns in a

dynamic context.

High market shares can be fleeting, especially in dynamic markets. A high market share or high profit margins may reflect the advantage that comes with being the "first mover." High profits enable firms to recoup investment in sunk costs and provide incentives to take on the risks inherent in innovation. Sustained high prices also can serve as an engine of innovation, inviting entry and even disruption by new competitors. . . . Firms that fail to innovate are often left behind in the dust.<sup>62</sup>

Delrahim's observation that high market shares and profit margins might simply reflect that a given firm was one of the first to enter a particular industry aligns closely with Kavanaugh's own observation. A decade earlier Kavanaugh had observed that Whole Foods in fact largely created, or at least made mainstream, the natural and organic product category and that, as supermarkets began to compete in that product category, they would begin to erode any advantages Whole Foods initially might have had.<sup>63</sup>

Other scholars have also begun to echo the observations of Delrahim and Kavanaugh. One recent article observed that the "reality is that current (and historical) market shares are of little moment when it comes to analyzing dynamic competition" and that "[c]urrent market shares and market positions are often at best only a very weak proxy for competitive position."<sup>64</sup> This article goes on to argue that "[a]ntitrust policy needs to pivot to a deeper understanding of innovation processes and competition over the long run" and that a "singular focus on short-term price impacts infects too many aspects of our national policy."<sup>65</sup>

<sup>60</sup> David S. Evans & Keith N. Hylton, *The Lawful Acquisition and Exercise of Monopoly Power and Its Implications for the Objectives of Antitrust*, 4 COMPETITION POL'Y INT'L 203, 240 (Autumn 2008).

<sup>61</sup> See Makan Delrahim, Remarks at the Federal Telecommunications Institute's Conference in Mexico City (Nov. 7, 2018), <https://www.justice.gov/opa/speech/assistant-attorney-general-makan-delrahim-delivers-remarks-federal-institute>. Delrahim himself has explicitly drawn a link between his views on antitrust policy and the work of Schumpeter. See Makan Delrahim, "Start Me Up": Start-Up Nations, Innovation, and Antitrust Policy, Remarks at the University of Haifa in Israel (Oct. 17, 2018), <https://www.justice.gov/opa/speech/assistant-attorney-general-makan-delrahim-delivers-remarks-university-haifa-israel> ("It is, however, the process of 'inventing around' and creating disruptive technologies—what economist Joseph Schumpeter called the 'perennial gale of creative destruction'—that results in the greatest innovations and benefits for consumers and society.").

<sup>62</sup> *Id.*

<sup>63</sup> See *Whole Foods*, 548 F.3d at 1054–55.

<sup>64</sup> David J. Teece, *Pivoting Toward Schumpeter: Makan Delrahim and the Recasting of U.S. Antitrust Towards Innovation, Competitiveness, and Growth*, ANTITRUST, Spring 2018, at 33, 35.

<sup>65</sup> *Id.* at 38.

## Conclusion

Kavanaugh's dissent indicates a willingness to consider, and credit as determinative, economic evidence on how an industry might look in the future. Such a treatment is consistent both with prior merger analysis and with mainstream economic theory and scholarship. Given the number of new competitors that have emerged in the grocery industry and the new products that have since been developed, Kavanaugh's approach appears to have been vindicated. Some recent scholarship also suggests that merger policy over the next few years might indeed tack fairly closely to Kavanaugh's reasoning. ●