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LITIGATION ARTICLE

Kroger/Albertsons Ruling Provides Lessons for Merger Remedy Divestitures

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On December 10, a federal court in Oregon issued a preliminary injunction against Kroger's proposed $24.6 billion acquisition of Albertsons, which would have been the largest supermarket merger in US history (Albertsons terminated the merger agreement after the ruling).[1] The Federal Trade Commission, the District of Columbia, and eight States filed the suit in February 2024, alleging that the transaction would substantially lessen competition in violation of Section 7 of the Clayton Antitrust Act of 1914. The opinion by Judge Adrienne Nelson tackled a number of interesting antitrust issues, including the government's allegation that the merger would reduce competition not only for grocery store sales but also for union grocery store labor. However, one of the most instructive aspects of the opinion is the court's rejection of the defendants' proposed divestiture package.

We have outlined the scope of the competitive problem that the divestiture needed to mitigate, the parameters of the proposed divestiture, and the deficiencies the court found. Companies assuming that divestitures will eliminate regulatory concerns about the anticompetitive impact of a transaction should examine whether there is a divestiture package that is commercially acceptable and that can account for the concerns Judge Nelson highlighted; the antitrust agencies and courts will undoubtedly use this latest judicial decision as guidance when evaluating such proposals.

Competitive Problem

The government's economic expert offered what the court found to be a persuasive market concentration analysis showing the merger would be presumptively anticompetitive in 1,922 local geographic markets for "supermarkets" and 1,785 local geographic markets for "large format stores" (i.e., traditional supermarkets and supercenters, natural and gourmet food stores, club stores and limited assortment stores). The court also found evidence (ordinary course documents and witness testimony) of substantial head-to-head competition between the merging firms bolstered the government's case. Finally, the court credited the government's expert's analysis, showing that the loss of head-to-head competition would lead to price increases at numerous stores. The government thus put forth a multiprong *prima facie* showing that the merger would lessen competition substantially. On rebuttal, the defendants first sought to establish that competitive entry and merger efficiencies would mitigate the merger's anticompetitive effects, but the court was not convinced. The defendants then attempted to show that their proposed divestiture remedy would solve competitive concerns.

Divestiture Proposal

Defendants entered into an agreement — contingent on the merger closing — to divest 96 Kroger stores and 483 Albertsons stores to a third party. The proposed third-party divestiture buyer is primarily a wholesaler but has acquired retail chains in the past and currently operates approximately 25 stores. The divestiture package also included ownership of four store banners, a license to use two other banners in certain states, ownership

[1] *Federal Trade Commission v. Kroger Co. & Albertsons Cos., Inc.*, 2024 WL 5053016, No. 3:24-cv-00347 (D. Or. Dec. 10, 2024).

of five private label brands, a temporary license to use two other brands, six distribution centers and one dairy manufacturing plant. A transition services agreement provided the divestiture buyer the right to use certain of the defendants' services, technology and data for periods ranging from six months to four years.

Deficiencies

The court explained numerous ways in which the Kroger-Albertsons divestiture package was inadequate to sufficiently mitigate the anticompetitive effects of the merger and overcome the government's showing of a substantial lessening of competition:

- *Many markets unaddressed* – The court noted that 113 of the presumptively unlawful markets did not contain even a single store to be divested, meaning the divestiture would have done nothing to change the merger's anticompetitive effects in those markets. (The high number of unaddressed markets was in part a function of the fact that the defendants' economic expert utilized a market definition method and applied market concentration presumption thresholds that differed from those the government advanced and the court adopted.)
- *Many markets insufficiently addressed* – Other markets contained divestiture stores, but those divestitures were insufficient to take away a presumption of harm. Crediting the government's economic expert, the court noted that even if all the proposed divestitures were perfectly successful, the merger would still have been presumptively unlawful in 1,002 local supermarket markets and 551 large format store markets based on market concentration levels.
- *Risk of unsuccessful divestitures* – The court also agreed with the government's analysis showing that if divested stores were to lose sales or close, the number of presumptively problematic markets would rise significantly. For example, if the divested supermarkets were to lose 10 percent of their sales, the number of presumptively unlawful markets would increase from 1,002 to 1,035. If they lose 30 percent of their sales, the number would increase to 1,276.
- *Mixed and matched assets* – The divestiture package did not represent an existing, standalone, fully functioning company but rather a mix of stores, banners, private labels and other assets. This meant the buyer would have had to rebanner 286 of the 579 divested stores (and for some of these stores, the buyer would not be acquiring any banner currently used in the state). The court cited testimony from the government's expert in retail operations and consumer shopping behavior, as well as other witnesses, explaining that rebannering is complicated and risky. The divestiture buyer also would have eventually lost access to many Kroger and Albertsons private label brands that customers are familiar with and would need to replace those with new private label products. The court noted witness testimony emphasizing the importance of private label brand equity and recounting the time required to launch a new private label brand.
- *Divestiture size* – The court expressed concern that with only 604 total stores (25 existing stores plus the 579 divested stores), the divestiture buyer may not have replaced the competitive intensity lost from Kroger and Albertsons, each of which had thousands of stores.
- *Divestiture buyer's experience* – The court was concerned that the divestiture buyer had no experience running a large portfolio of retail grocery stores. The 579 divestiture stores included hundreds of pharmacies and fuel centers, whereas the buyer's current 25 stores include only one pharmacy and no fuel centers. The court also noted that the buyer's experience offering private label products was much more limited than what the divestiture stores demand. The buyer currently lacks any retail media capabilities, which would have taken three years to set up.
- *Divestiture buyer's track record* – The buyer has made divestiture purchases in the past, which the court noted have not been successful. Specifically, the buyer acquired 334 retail grocery stores between 2001 and 2012, only three remaining under its operation by the end of 2012 (the rest were closed or sold off). The court also cited evidence that the buyer's current stores are performing below expectations.

- *Transfer of employees* – Approximately 1,000 Albertsons employees agreed to transfer to the divestiture buyer, including Albertsons' current Chief Operating Officer, who had experience with prior divestiture integrations. The court found, however, that these transfers would not have fully mitigated the buyer's inexperience and lack of success in grocery retail and could not overcome difficulties inherent in the selection of assets and structure of the transition services agreement in the divestiture package.
- *Divestiture buyer's independence* – The court viewed the transition services agreement as broad in services and time. It noted that the buyer would remain interdependent with the merged firm for many years. The court expressed particular concern over the fact that Kroger would have provided sales forecasting data and a base pricing plan to the buyer, which the buyer could have adjusted only by communicating with Kroger's "clean room."

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