Albertsons/Safeway: Significant Overlaps Likely To Lead to Divestitures; FTC Bureau of Competition Chief Could Lead to More Industry-Friendly Review, but State AGs Present Additional Deal Risk

Conclusion

On March 6, 2014, Cerberus Capital Management, the owner of Albertsons supermarket chain, announced an agreement to acquire Safeway in a deal valued at about $9.2 billion. The combined Albertsons/Safeway would be the nation’s number two supermarket chain, behind Kroger, and the nation’s number three grocer, trailing Walmart and Kroger.

Given the significant geographic overlap between the two chains, especially in Southern California, stakeholders should expect an extended FTC review, culminating in an Albertsons agreement with the FTC to divest a number of overlapping stores. Specifically, the FTC is very likely to push for divestitures in two-to-one geographic markets, while three-to-two markets in which a Walmart SuperCenter is the only remaining competitor will also draw significant Commission scrutiny.

The Albertsons/Safeway review will also give stakeholders insight into the influence of FTC Bureau of Competition head Deborah Feinstein, as this deal is the FTC’s first major supermarket merger review of her tenure. During her time in private practice, Feinstein publicly criticized the FTC’s approach to supermarket review, advocating more expansive geographic and product market definitions—both of which would work to Albertsons’ advantage. That said, state Attorneys General are often heavily involved in supermarket merger review, and may push for divestitures above and beyond what the FTC, acting alone, would have required.

Points for stakeholders to consider include:

- **Geographic markets in FTC supermarket reviews are intensely local.** Although the FTC’s review will be highly fact specific, the FTC generally defines supermarket geographic markets as limited to a three to four mile radius surrounding a store.

- **Significant geographic overlap likely to lead to divestitures.** Albertsons and Safeway overlap significantly in Southern California, Dallas-Fort Worth, Las Vegas, Seattle, Portland, Phoenix, and Denver, among other MSAs. In geographic markets in which Albertsons/Safeway is a two-to-one, the FTC will very likely push for divestitures, while three-to-two markets in which the remaining competitor is a non-supermarket retail format, such as a Walmart SuperCenter, will likewise draw a hard look from the Commission.

- **Supermarket pricing experts view Albertsons as unlikely to initiate post-merger price hikes in more competitive markets.** Because Safeway and Albertsons price at a consistently higher level than larger competitors such as Kroger and Walmart, retail pricing experts to whom we spoke believe it is unlikely that Albertsons would be able to increase prices at most stores post-merger.

- **Bureau of Competition chief Feinstein appears sympathetic to industry arguments.** Both personally, and on behalf of Kroger, Feinstein has urged the FTC to take a more expansive view of geographic and product market definition in supermarket merger reviews—both approaches would benefit Albertsons. Note, however, that Feinstein represented a Cerberus subsidiary (Cerberus-Plasma).
Holdings) in 2009, and there is a chance that she will recuse herself from this review. However, even if she does not lead the review, her arguments are likely to influence FTC staff.

- **State Attorneys General represent additional risk.** Although state AGs are generally not a significant factor in merger reviews, because of the intensely local nature of supermarket competition, state AGs have aggressively reviewed supermarket deals in the past, and are likely to do so here.

- **Deal likely to close by fourth quarter of 2014.** The parties expect the deal to close in the fourth quarter of 2014. Assuming the parties are forthcoming with divestitures, stakeholders should expect that the deal will most likely close on time.

**Key Points**

**Deal and timing overview.** The Albertsons/Safeway [merger agreement](#) provides that, in the event the deal is not consummated for certain reasons, including if Albertsons is unable to obtain antitrust clearance, Cerberus must pay Safeway a $400 million reverse termination fee, representing about 4.4% of the transaction value.

The parties expect the deal to close in the fourth quarter of 2014. In furtherance of this goal, the merger agreement contains specific language on timing, providing that the parties will use “reasonable best efforts” to comply with the FTC’s second request “no later than six (6) months after receipt of such second request and to produce documents on a rolling basis.” Given that supermarket merger reviews typically involve extensive review of granular, store-level data—the FTC will likely request documents and data on hundreds of stores—six months, with production on a rolling basis, is a timeline geared to speed review.

In addition, the merger agreement requires the parties to file HSR notification within five business days (ten to fifteen is more typical) of the agreement. As a result, the parties very likely notified their deal by March 13, which implies a Second Request, assuming the FTC waits the full 30 days, by April 13th. Given the six month requirement, the parties would be scheduled to substantially comply with the second request by October 13, pushing the FTC, in the absence of a timing agreement, to make a final decision by November 13, 2014.

The FTC’s Mergers IV Section, which traditionally reviews grocery mergers, is directing the FTC’s investigation of the deal, while Dechert’s Paul Denis and James Fishkin are leading Albertsons’ antitrust team. Mr. Fishkin spent 15 years at the FTC, where, according to his [bio](#), he was “the prime architect of the Commission’s supermarket merger enforcement program.” More recently, Denis and Fishkin represented Whole Foods in the FTC’s challenge to its 2007 Wild Oats buy, as well as OfficeMax in the FTC’s unconditional clearance of its 2013 merger with Office Depot.

**FTC views supermarket geographic markets as intensely local.** Geographic market definition is the key issue in FTC supermarket merger reviews. The FTC’s view is that the primary factor driving grocery shoppers is convenience, and, as a result, most consumers do their shopping very close to where they live. And the statistics regarding consumer behavior bear this out—generally, about 70 percent of supermarket sales come from customers living within a three mile radius of a store, while some locations could see even smaller trade areas encompassing just a one to two mile radius. “Three miles is the general trade area that people would use” said retail strategy expert [Neil Stern](#), explaining that “trade areas [are] kind of gravity-driven so if you have a three mile trade area, you end up getting 50% of your sales from the first mile, maybe 25% from mile two and then it goes from there.”
The three mile geographic market is a starting point, not an end point. For example, grocery customers in rural areas may be more likely to drive a substantial distance to shop than consumers in more densely populated areas. Likewise, natural or man-made barriers, such as rivers or bridges may limit the distance supermarket shoppers are willing to travel. The Commission’s approach is intensely fact-specific—during the course of its review, FTC staff will examine detailed store-level data in an attempt to determine whether there are geographic markets, which could encompass anywhere from a one to ten mile radius around a store, in which a hypothetical supermarket monopolist could increase prices without losing a significant number of customers to supermarkets outside the area.

**FTC very likely to require divestitures in two-to-one geographic markets; status of three-to-twos may depend on format of remaining competitor.** Safeway and Albertsons both operate primarily west of the Mississippi, and, as a result, overlap significantly in a number of MSAs. In fact, based on our analysis, 344 of Albertsons’ 1,075 stores are within three miles of a Safeway (or Safeway-owned) supermarket. The chart below shows Albertsons locations by state, as well as the number of Albertsons stores within a three-mile radius of a Safeway:

<table>
<thead>
<tr>
<th>State</th>
<th># of Locations</th>
<th># of Locations within 3 miles of a Safeway</th>
</tr>
</thead>
<tbody>
<tr>
<td>CA</td>
<td>178</td>
<td>136</td>
</tr>
<tr>
<td>TX</td>
<td>71</td>
<td>19</td>
</tr>
<tr>
<td>WA</td>
<td>60</td>
<td>51</td>
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<tr>
<td>OR</td>
<td>43</td>
<td>37</td>
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<tr>
<td>AZ</td>
<td>41</td>
<td>32</td>
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<td>NV</td>
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<td>ID</td>
<td>33</td>
<td>3</td>
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<tr>
<td>MT</td>
<td>30</td>
<td>10</td>
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<td>NM</td>
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<td>CO</td>
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<td>LA</td>
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<tr>
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<td>FL</td>
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<td>ND</td>
<td>1</td>
<td>0</td>
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<td>AR</td>
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By far the most significant area of overlap is Southern California, where 136 Albertsons locations, primarily in Los Angeles and San Diego, are within three miles of a Safeway. The two chains also have significant overlapping locations in Seattle (33 Albertsons within three miles of a Safeway), Las Vegas (22), Phoenix (20), Dallas-Fort Worth (19), Portland (19), Denver (9), Spokane (9), and Tucson (7).
The FTC will almost certainly require divestiture of overlapping stores in geographic markets in which Albertsons/Safeway would be a two-to-one, or “merger to monopoly.” That said, few geographic markets, even defined by a three mile radius, are likely two-to-ones, given Kroger’s presence in all significant Albertson/Safeway overlap MSAs. In addition, the presence of regional chains in overlap MSAs, such as Red Apple in Seattle and Stater Bros. in Los Angeles, will further limit the number of two-to-one geographic markets.

The FTC’s approach to three-to-two markets is less clear. If the remaining competitor in a three-to-two market is a grocer of a different retail format, namely a Walmart SuperCenter (which combines a supermarket and a standard Walmart in a single big box), the FTC is more likely to push for divestitures. Although the FTC does recognize that Walmart SuperCenters limit supermarkets’ pricing power, the Commission has concluded that “[s]tores with similar formats located nearby each other provide a greater competitive constraint on each other’s pricing than do stores of different formats or stores located farther apart from each other.” (emphasis added). In other words, while Walmart SuperCenters do competitively constrain supermarkets, the FTC views supermarkets (with no attached mass merchant) as uniquely close and vigorous competitors.

In its two most recent supermarket enforcement actions, the FTC has required divestitures in three-to-two markets only when the remaining competitor was a Walmart SuperCenter. In Bi-Lo/Delhaize (2014), four of the twelve divestiture markets were two-to-ones, while the remaining eight were three-to-twos, with Walmart SuperCenter the remaining competitor. Likewise, the two divestiture markets in Albertsons/United (2013) were three-to-twos in which a Walmart Supercenter was the sole post-merger competitor. However, in its Koninklijke/Safeway (2012) review, the FTC did require divestiture of a store in a three-to-two market, in which the remaining competitor was Acme, a traditional supermarket.

Supermarket pricing experts see little room for post-merger price increases. In reviewing whether the Safeway acquisition would give Albertsons the ability to increase prices in certain markets, the FTC will closely examine Albertsons’ zone pricing, which could potentially give the grocer a tool to raise prices in less competitive sections of an MSA while keeping prices in more competitive areas unchanged.

Retail pricing expert Jon Hauptman told The Capitol Forum that supermarket zone pricing is typically “driven by the competitive environment” explaining “it’s very often that zones are driven by predominant competitor in the area,” rather than by number of other competitors in the area. In setting price zones across an MSA, “[y]ou’ll have a zone for your stores focused on a supercenter or a low-cost competitor, and then you’ll have zones that focus on more traditional competitors, and then you might have a zone that’s more rural.” Hauptman did say that supermarkets do have the ability to increase pricing in non-competitive zones, noting “if there really isn’t any competition [in the area] maybe you charge a little bit more.”

Retail strategy expert Neil Stern agreed, noting, from a supermarket perspective, “if I have a Walmart SuperCenter nearby, then I’m going to price differently than if I’m in a neighborhood where I don’t have a lot of competition…[price zones] tend to be more competitively driven” than by demographics or costs. Zone pricing is “so dependent on who that competitor is,” explains Stern. “Safeway is running some of the higher retail prices in the market, so if I’m competing against a Safeway, I know I have more leeway to price up than if I was competing against Kroger, for example…and certainly Walmart,” he added.
Despite the ability to zone price by competitive environment, Mr. Hauptman views post-merger unilateral price increases as unlikely. “Neither Safeway nor Albertsons are known as low-price players” notes Hauptman, “that’s where somebody like Kroger can hurt them because Kroger typically has lower prices.” He added, “Albertsons and Safeway separately are vulnerable [on price] so to become more vulnerable doesn’t make any sense.” Whether their competition is Kroger or Walmart, Albertsons is “going to be up against somebody in virtually all their stores they’re going to be up against somebody who’s beating them on price…I don’t see any room for them to creep up,” concluded Hauptman.

Stern concurred with Hauptman’s view, explaining “if anything is going to happen, prices are going to go down” post-merger. “The reason Safeway is being acquired is because it really wasn’t running with a winning proposition,” said Stern, “the biggest problem with Safeway is they had their price/value equation out of whack, i.e. they were high on price.” “Likely what [Albertsons] is going to do if they take [Safeway] over is adjust the pricing strategy… [it’s] highly unlikely they’re going up and much more likely that they’re going to go down” on price, concluded Stern.

Hauptman views two factors as making it unlikely that Kroger would price in a coordinated manner with Albertsons: first, Kroger “always keeps an eye on Walmart” and second, Kroger is likely to view undercutting Albertsons on price during the post-merger transition as a way to gain market share. Stern agreed, noting that in three-to-two markets, “Kroger is probably going to be the mitigating factor that doesn’t allow [Safeway] to raise prices.”

That said, the FTC will be keenly interested in the manner in which Safeway and Albertsons currently use zone pricing, and the extent to which the combined entity would have the ability to extend the practice to geographic markets in which the merger lessens competition. To the extent that either chain shows higher base prices in zones that are “less competitive” or “non-competitive,” with either one, or no other supermarket chains in the area, the FTC will have serious, and justified, concern that lessened competition would lead to more consumers living and shopping in higher priced zones.

**Bureau of Competition chief Deb Feinstein may drive more expansive view of the geographic market.** The FTC’s long-established approach to supermarket merger review is characterized by narrow geographic and relevant product market definitions. However, Bureau of Competition head Deborah Feinstein, who became the Bureau’s chief in July of 2013, could drive a number of changes to the review—all of which would benefit Albertsons.

Feinstein came to the FTC from the Washington, DC office of Arnold & Porter, where she served as long-time antitrust counsel to The Kroger Company. In a Fall 2007 article published in Antitrust, Feinstein provided a number of criticisms of the FTC’s traditional approach to supermarket mergers. Although the article noted that she had represented Kroger for many years, it appears Feinstein authored the article in her capacity as a partner at Arnold & Porter, rather than on behalf of Kroger.

In the piece, Feinstein urged the FTC to eschew the localized market definition typical of prior reviews, and instead consider an MSA-level approach to geographic market definition, writing: “the Commission should recognize that an MSA can be a market even though consumers will not drive from one end of the MSA to the other. As long as enough consumers in a local area will move a few miles over to the next local area in response to a price increase, the various local areas are linked and thus geographic market cannot be limited to a few mile radius around a given store.” The larger the scope of the geographic market, of course, the more competitors are...
included in the marketplace. Under this approach to geographic market definition, a Walmart SuperCenter or supermarket located anywhere in an MSA could be viewed as part of the competitive set, rendering it almost impossible for the FTC to identify two-to-one geographic markets.

Speaking at a 2007 FTC conference, this time explicitly on behalf of Kroger, Feinstein argued that, even if the relevant geographic market is not MSA-wide, the presence of a Walmart SuperCenter enlarges the geographic market beyond the three to four mile radius typical of FTC reviews, noting: “the data show that people routinely drive nine, ten, or more miles to go to a [Walmart] SuperCenter, more the way you think about driving to the mall. And I think that's important in thinking about both the geographic dimension and the impact that a supercenter can have on a market, even if geographically looking at it on a map, it's more on the fringe rather than in the middle of town.”

Feinstein’s proposed approach to defining the geographic market would lead the FTC to seek significantly fewer divestitures than it would under its traditional approach. However, the extent to which Feinstein was speaking on behalf of Kroger (rather than expressing her own views), as well as the extent to which her views will lead to a significant change in staff’s approach to supermarket review, remains to be seen.

**FTC views relevant product market as supermarket and supercenter only.** Relevant product market definition will likewise be a key issue in the FTC’s review—if Albertsons can show that grocery items sold through non-supermarket retail formats should be included in the relevant product market, market concentration and share numbers will be lower, even if geographic markets are limited.

The FTC has consistently concluded that supermarkets compete in the relevant product market of “the retail sale of food and other grocery products in supermarkets,” defining “supermarket,” as “any full-line retail grocery store that enables customers to purchase substantially all of their weekly food and grocery shopping requirements in a single shopping visit.”

The FTC’s position is that while hypercenters (which combine a supermarket and mass-merchandiser within a single big box) such as SuperTarget and Walmart SuperCenter compete with supermarkets, other, non-supermarket retail formats, such as mass merchants, hard discounters (such as Aldi and Meijer), and drugstores, do not. While these other retail formats do sell food and grocery products, the FTC’s view is that they do not constrain supermarket pricing, because they offer a limited assortment of items, and do not “provide consumers with the convenience of one-stop shopping for food and grocery products.”

**Feinstein could likewise drive more expansive view of the relevant product market.** In her Fall 2007 Antitrust article, Feinstein questioned the FTC’s approach to product market definition, instead arguing for a much broader approach. While noting that the FTC had recognized that supercenters compete with supermarkets, Feinstein wrote:

“…they should not stop there. They should recognize the extent to which there is a blurring of the channel distinctions, with supermarkets increasing their product range to include such products as organics to compete on the high end and with mass merchants and drug stores increasing their food sales—both shelf-stable and refrigerated—to compete on the low end. Where there is evidence that grocery operators (or other retailers) price check, set prices against and follow the competitive strategies of other competitors, such evidence should be given significant weight.”

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And presenting on behalf of Kroger at the 2007 FTC conference, Feinstein disputed a number of the FTC’s fundamental supermarket product market definition assumptions. With regard to supermarkets as “one-stop shopping” destinations, Feinstein argued: “The one-stop shop that people used to talk about is long gone, I think, and people typically now have one store for perishables and another for the center store items, the dry goods, that sort of thing…. Supermarkets are rapidly losing their shares of the food dollars to every format every year…[s]o it's clear customers are shopping multiple locations to find what they want at the best prices.”

Feinstein also made the case for club stores (“Kroger sees club stores as very real competitors”), mass merchandisers (“very real competitors to supermarkets”) and drugstores (“they’re taking sales away from the traditional supermarkets”). “So all of these are formats that Kroger is paying a lot of attention to and has for some time now,” Feinstein noted, concluding that “[t]o ignore them is to ignore a very real element of supermarket competition.”

Expanding the product market definition to include all retail formats through which grocery items are sold would very significantly reduce market concentration and share concerns. Whether Feinstein’s previous public statements accurately represent her current views on supermarket competition is unclear. However, to the extent they do, her leadership could drive a significantly less skeptical review of Albertsons/Safeway relative to past FTC supermarket merger reviews.

**State AGs represent additional risk.** Because competition is localized, and supermarkets are widely-shopped and uniquely in the public eye, state Attorneys General tend to have particular interest in grocery deals. States often open their own investigations into supermarket mergers in parallel with the FTC—in particular, fears that mergers would result in store closings that would not have happened but for the merger can drive skepticism at the local, and ultimately, state level.

State Attorneys General and the FTC typically review grocery deals collaboratively, and the FTC will oftentimes proactively contact state AGs, who are generally better positioned to investigate competitive effects at the regional level. In determining the appropriate scope of geographic markets, the FTC may defer to state AGs on localized questions, such as traffic patterns and the effect of natural or man-made barriers (rivers, bridges) surrounding overlap stores.

And indeed, state AGs have taken an unusually active role in supermarket mergers. In 1999, for example, Albertsons entered into consents with the FTC and the California, Nevada, and New Mexico Attorneys General, agreeing to divest 135 stores, including 117 in California alone, in order to complete its acquisition of American Stores. In 2003, Puerto Rico’s Attorney General actually moved to block Walmart’s acquisition of Supermercados Amigo Inc., weeks after the FTC had cleared the deal—the suit eventually settled. And state AGs in New York, New Jersey, and Pennsylvania conducted investigations alongside the FTC into the 2007 A&P/Pathmark grocery deal, concluding with New York AG Andrew Cuomo entering into a separate agreement on divestitures (although under the same terms as the FTC) with the parties.

A number of Attorneys General in overlap states may be positioned to investigate the Albertsons/Safeway merger, and eventually push for divestitures above and beyond what the FTC would have, acting alone, required. Texas Attorney General Greg Abbott joined DOJ’s August 2013 US Airways/American complaint, eventually dropping his participation in return for a number of Texas-specific concessions, including New American commitments to maintain its Dallas-Fort Worth-area headquarters and continue scheduled air service
to a number of rural Texas airports. Abbott is in the midst of a heated gubernatorial election, and has shown a willingness to use antitrust law to advance Texas-specific interests.

Arizona Attorney General Tom Horne likewise joined DOJ’s US Airways/American suit—although many viewed his participation as a bid to extract concessions from US Airways management, which, while headquartered in Phoenix, planned to re-locate to Dallas-Fort Worth post-merger. Likewise, California AG Kamala Harris is viewed as enforcement minded, with higher political aspirations. Because the most significant overlap is in Southern California, the California AG office could be particularly likely to launch a parallel investigation of the deal.

Given states’ unique interest in the Albertsons/Safeway merger, stakeholders should expect state AGs to work closely with FTC, and possibly open their own investigations into the deal. And state AGs may be positioned to push for more aggressive divestitures than the FTC, acting alone, would have—especially if Feinstein’s leadership drives a less aggressive approach to divestitures than the Commission has taken in the past.