The American Antitrust Institute

February 25, 2014

The Honorable Edith Ramirez, Chairwoman
Federal Trade Commission
600 Pennsylvania Avenue, NW
Washington, D.C. 20580

Via Electronic Delivery Re: Proposed Merger of Sysco and US Foods

Dear Chairwoman Ramirez:

I. Introduction

The American Antitrust Institute (AAI) has been active in supporting a strong response to impediments to competition in all segments of the U.S. agricultural supply chain. This includes mergers, exclusionary conduct, and collusion that potentially harm competition and consumers in production, processing, food manufacturing, distribution, and retail grocery markets.[1] Major themes raised by industry participants in the joint U.S. Department of Justice (DOJ)/U.S. Department of Agriculture workshops held in 2010 coalesced around concerns over market concentration, merger enforcement, and monopsony.[2]

The proposed merger of Sysco and US Foods comes on the heels of a series of large mergers in the U.S. agriculture and food industries – transactions that extend and exacerbate the concerns raised in the 2010 joint workshops. The combination would enhance Sysco-US Foods' market power in the increasingly important broadline foodservice distribution market and create a monopoly in the national broadline foodservice market. The merger would likely result in higher prices; lower quality, reliability, and food safety; and less innovation – to the detriment of foodservice outlets and consumers of food that is prepared away from the home. The proposed merger also raises the specter of enhanced buyer market power and higher entry barriers for smaller, innovative or alternative food producers and systems.

For the reasons discussed in this letter, the proposed merger of Sysco and US Foods should be carefully scrutinized, not only in the context of the relevant markets identified, but also in terms of how it will alter the competitive dynamics between different segments of our increasingly concentrated food supply chain. The AAI urges the Federal Trade Commission (FTC) and state attorneys general investigating the proposed merger of Sysco and US Foods to collaborate with the DOJ. Both agencies have reviewed the mergers that have created the extraordinary levels of concentration and incentives for strategic competitive conduct in inter-related segments of the food supply chain. This letter frames out what the AAI believes are the key competitive issues raised by

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[1] The AAI is an independent non-profit education, research, and advocacy organization. Its mission is to advance the role of competition in the economy, protect consumers, and sustain the vitality of the antitrust laws. AAI is managed by its Board of Directors, which alone has approved this letter. For more information, see www.antitrustinstitute.org.
[2] U.S. Department of Justice, COMPETITION AND AGRICULTURE: VOICES FROM THE WORKSHOPS ON AGRICULTURE AND ANTITRUST ENFORCEMENT IN OUR 21ST CENTURY ECONOMY AND THOUGHTS ON THE WAY FORWARD (May 2012), at 4. Available http://www.justice.gov/atr/public/reports/283291.pdf.

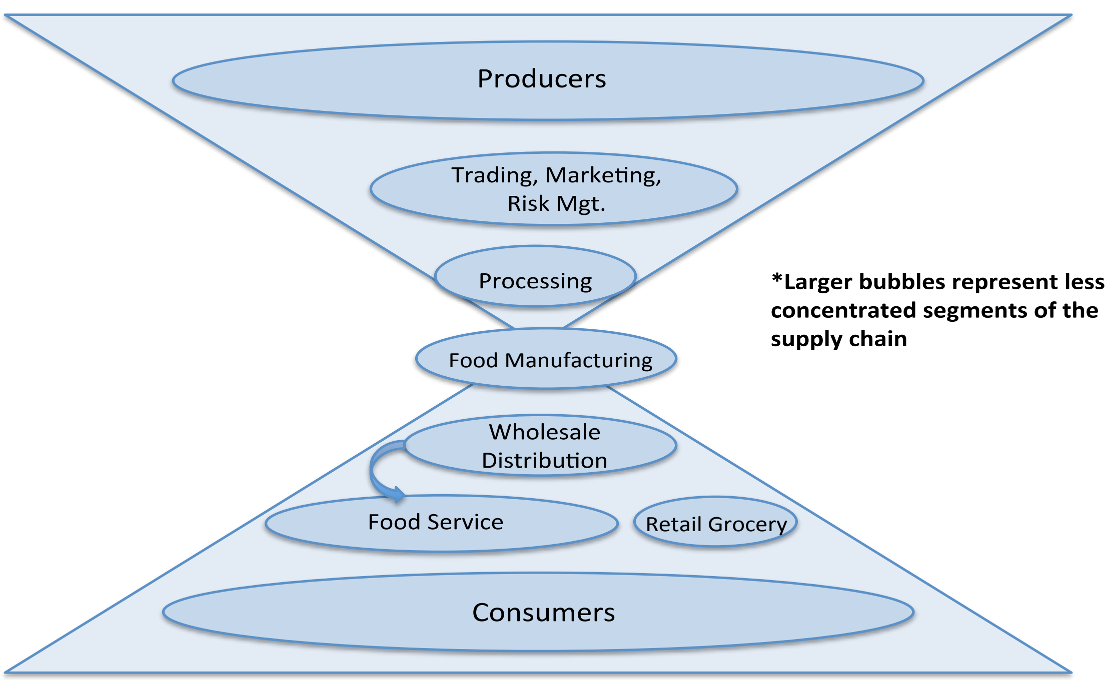
the proposed merger, as well as important context and background that the agencies might consider in reviewing it.

II. Consolidation of the U.S. Agricultural and Food Supply Chains

In evaluating the proposed Sysco-US Foods merger, it is important to consider the broader picture of consolidation involving the U.S. agricultural and food supply chains. The weakened competitive health of the overall supply chain is depicted in the figure below. The upstream production segment is relatively atomistic and competitive. We note, however, that many of the antitrust immunities and exemptions in agriculture (e.g., the Capper-Volstead Act and Agricultural Agreement Marketing Act) that were originally intended to give producers bargaining power against powerful "middlemen" are now outdated. Many immunized cooperatives and associations have grown into large vertically and horizontally integrated entities that wield significant market power, exacerbating the plight of the independent, nonmember producer.

The upstream segment narrows significantly to a competition "bottleneck" in midstream food processing and manufacturing, both of which have become more concentrated over the last several years. The downstream food distribution and grocery segments have also experienced significant consolidation. The DOJ Antitrust Division has typically evaluated competitive issues involving the upper to middle portions of the agricultural supply chain while the FTC has handled some midstream industries, such as food manufacturing, and the downstream segments, including retail grocery mergers.

Consolidation in the Food Supply Cain



A brief look at merger enforcement statistics in agriculture and food provides important context for evaluating the Sysco-US Foods merger.[3] Almost 400 transactions in agriculture and food were reported under the Hart Scott Rodino (HSR) Premerger Notification Program over the last ten years (2003-2012). These transactions fall into three major categories: crop and animal production, food processing and manufacturing, and supermarkets and grocery stores. Crop and animal production account for only about six percent of food and agriculture-related merger transactions reported under the HSR program from 2003-2012, for which there were no second requests. At the downstream end of the supply chain, mergers of grocery stores account for about 13 percent of total HSR transactions reported, with a sporadic record of second requests over the period.

Consolidation in the grocery segment has continued relatively unabated over the several decades. Consumer food advocate Food & Water Watch (F&WW) explains that the "rise of the big-box food retailers like WalMart precipitated a wave of supermarket mergers starting in the 1990s that created a network of national supermarket chains."[4] WalMart's share of the national retail grocery market has increased from virtually nothing in the 1980s to 28 to 32 percent today.[5] Even in the absence of backward vertical integration, the presence of a dominant firm like WalMart is felt in virtually all segments of the supply chain through contracts and practices that affect prices, non-price terms and conditions, and even how food products are processed and manufactured.

About 81 percent of total reported HSR transactions from 2003-2012 involve food processing and manufacturing. Mergers in food production show a large increase in the mid-2000s (2006-2007), with a fall off until 2009, followed by a sharp rise in 2010. The rate of second requests involving food manufacturing mergers has trended downward since 2009, despite the uptick in merger activity in the same year. Food company consolidation continues, with predictions that merger activity will eventually reach the pre-2008 recession rate of 100 transactions annually.[6]

Beef packers, poultry processors, and food manufacturers have all responded to consolidation in the downstream portions of the supply chain by bulking up. Significant buyer and seller market power at the processing, food manufacturing, and grocery levels have induced a surge of consolidation to gain bargaining power in negotiating with input suppliers and customers. Examples of these deals – including some transactions that were challenged by the antitrust agencies – are: ConAgra-Ralcorp, ConAgra-Cargill-CHS Horizon Milling, U.S. v. George's Foods, LLC, George's Family Farms, LLC and George's, Inc., U.S. et al. v. Dean Foods Company, and U.S. et al. v. JBS S.A. and National Beef Packing Company, LLC.

ConAgra recently summed up the motivation for consolidation in the midstream and downstream segments of the food supply chain. In explaining its recent proposal to create Ardent Mills, a joint venture with Cargill/CHS Horizon Milling that would control over one-third of the U.S. wheat milling market, ConAgra stated: "Ardent Mills will set the new industry standard by addressing…the

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[3] Federal Trade Commission and U.S. Department of Justice, ANNUAL REPORTS TO CONGRESS PURSUANT TO THE HART-SCOTT-RODINO ANTITRUST IMPROVEMENTS ACT OF 1976, years 2003-2012. Available http://www.ftc.gov/policy/reports/policy-reports/annual-competition-reports.

[4] Food & Water Watch (F&WW), GROCERY GOLAITHS, December 5, 2013, at 3-4. Available http://www.foodandwaterwatch.org/reports/grocery-goliaths-how-food-monopolies-impact-consumers/.

[5] Grant Gerlock, *What Does Walmart Have To Do With Conagra's Move Into Store Brand Food?* April 10, 2013, NET News/Harvest Public Media, http://netnebraska.org/article/news/what-does-walmart-have-do-conagras-move-store-brand-food.

[6] F&WW, GROCERY GOLIATHS, *supra* note 4, at 5.

need for more cost-effective supply."[7] Another spokesman added: "The future of flour milling is tied to serving the innovation and supply chain management challenges of food producers."[8]

Much of the "domino effect" consolidation in midstream processing, food manufacturing, and retail grocery has adversely affected producers, who are squeezed by powerful processors and food manufacturers, who are in turn squeezed by powerful grocers. United Food & Commercial Worker Union data reveals that while the packers have actually defended or even increased their margins, the farmer's share of the food dollar has plummeted. For example, the rancher received $.59 of the beef dollar in 1990 but only $.42 in 2009. The pig farmer received $.45 of the pork dollar in 1990, but only $.25 in 2009.[9] At the other end of the supply chain, the consumer has higher prices, potentially greater food safety problems, and less choice to show for consolidation. Between 2010 and 2012, for example, grocery food prices rose twice as quickly as average wages.[10]

III. The Sysco-US Foods Merger in Context of Broader Supply-Chain Consolidation

Food distributors now appear to be joining ranks with powerful processors, food manufacturers, and grocers in order to exploit and respond to shifts in the balance of economic power in the midstream to downstream segments of the supply chain. To date, retail grocery consumers have battled rising prices, quality issues, and lack of choice. Now restaurants, schools, colleges, universities, healthcare facilities, the government and military, hotels, and business/industry will fall increasing victim to the ongoing parlay of countervailing market power between the midstream and downstream segments.

The proposed Sysco-US Foods merger extends consolidation in distribution with the largest deal to date. For example, F&WW estimates that in 2012, nine of the biggest 60 foodservice distributors with total revenue of about $3 billion were absorbed by mergers. Between 2008 and 2013, the five largest foodservice distributors purchased about three-quarters of the 86 independent foodservice distributors. In 2013 alone, Sysco purchased 14 companies with total revenue of more than $1 billion, representing about half of Sysco's revenue growth in 2013.[11]

Sysco is the largest U.S. firm in the sale, marketing, and distribution of food products to restaurants, healthcare and educational facilities, the hospitality industry, and other customers that specialize in meals away from home. Sysco also sells equipment and supplies for the foodservice and hospitality industries. The company operates 193 distribution facilities and has about $44 billion in revenue for fiscal year 2013.[12] US Foods is the second largest U.S. foodservice distributor to restaurants,

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[7] Carey Gillam, *Flour power: ConAgra, Cargill, CHS to create mega-miller*, newsandinsight.thomsonreuters.com, March 5, 2013, http://newsandinsight.thomsonreuters.com/Legal/News/2013/03_-_March/Flour_power_ConAgra,_Cargill,_CHS_to_create_mega-miller/ and *ConAgra Foods, Cargill and CHS announce agreement to form joint venture combining flour milling businesses into new company, Ardent Mills*, cargill.com, March 15, 2013, http://www.cargill.com/news/releases/2013/NA3071787.jsp.

[8] *Id.*

[9] The meat packer's share of the beef dollar increased from $.08 in 1990 to $.09 in 2009. The pork packer's share of the pork dollar increased from $.10 in 1990 to $.14 in 2009. *See,* United Food and Commercial Workers, ENDING WALMART'S RURAL STRANGLEHOLD (2010), at 3-4. Available http://grist.files.wordpress.com/2010/09/ag_consolidation_white_paper2.pdf?CFID=10082208&CFTOKEN=55376804.

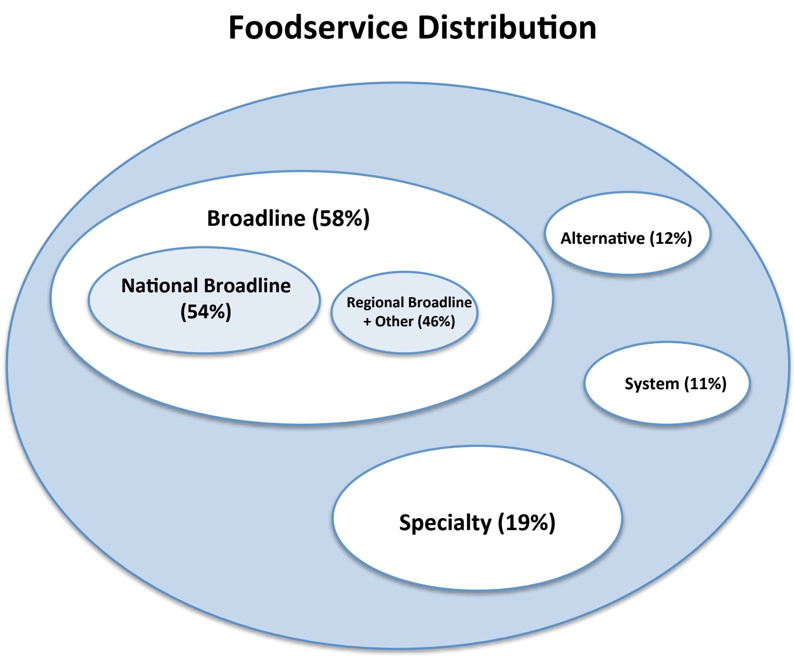
[10] F&WW, GROCERY GOLIATHS, *supra* note 4, at 2.

[11] Food & Water Watch, letter to Deborah L. Feinstein, Director, Bureau of Competition Office of Policy and Coordination, Federal Trade Commission, January 8, 2014, at 3-4.

[12] The Sysco Story, http://sysco.com/about-sysco.html.

healthcare and hospitality facilities, government operations and educational institutions. In 2013, US Foods had $22 billion in annual revenue with more than 60 locations nation-wide.[13]

As shown in the figure below, there are a number of important distinctions regarding the foodservice distribution market that are relevant to the proposed Sysco-US Foods combination. Foodservice is a subset of the wholesale food distribution market, with a value of about $175 billion in the U.S. in 2010.[14] Industry experts generally include four different types of distributors in the foodservice market: broadline distributors, system distributors, specialty distributors (e.g., dairy, produce, etc.), and alternative distributors (e.g., Costco, etc.).[15] Based on 2010 data, Sysco had about a 20 percent share of the total foodservice market, followed by US Foods with 11 percent. They are followed by Performance Food Group (PFG), with about a 6 percent share, and Gordon Food Service, with about 4 percent of the market.[16] Notably, Sysco accounted for about 36 percent of the growth in the foodservice industry from 2003-2010.[17]



[13] US Foods, *About Us: First in Food*, http://www.usfoods.com/about-us.html.
[14] In 2007 foodservice was estimated to account for just over 20 percent of total wholesale food sales. *See* U.S. Department of Agriculture (USDA), Economic Research Service (ERS), *Retailing and Wholesale*, http://www.ers.usda.gov/topics/food-markets-prices/retailing-wholesaling/wholesaling.aspx#.Uwwm9Ci2pD4. *See also* FOODSERVICE DISTRIBUTORS OF THE FUTURE – THE EVOLUTION OF THE FOODSERVICE DISTRIBUTOR SECTOR, IFMA's Foodservice 2020 Strategic Issues Series, The Hale Group (no date), at 1-2, http://www.halegroup.com/~halegrou/wp-content/uploads/2013/01/Distributor-of-the-Future.pdf. *See also Focus on Foodservice Distribution*, The Hale Group (April 11, 2013), http://enterprisectr.org/wp-content/uploads/2013/04/MacPhail-Distribution-Ent-Cent-Program-10-April.pdf. Estimated sales by the foodservice industry in the U.S. in 2012 are $226 billion. *See* http://www.ifdaonline.org/About-IFDA/Who-Are-Foodservice-Distributors.
[15] USDA-ERS, *supra* note 14, and The Hale Group, *supra* note 14, at 2.
[16] *Id. See also* Sysco: INVESTOR DAY 2010, December 2, 2010, http://files.shareholder.com/downloads/SYY/1124004662x0x425013/e7a21c77-2b2e-4cf6-b6c0-9b059aa02865/Investor_Day_2010_FInal_8-K.pdf.
[17] The Hale Group, *supra* note 14, at 3.

Broadliners (national and regional) comprise almost 60 percent of the total foodservice market. They distribute food and paper and plastic products to schools and universities, hospitals, military bases, chain and independent restaurants, catering services, and hospitality outlets. Broadliners display economies of scale in distribution with the ability to buy an array of foods in large volumes, with well-developed distribution networks of sales and delivery personal, and the ability to deliver products to multiple types of outlets. Likewise, foodservice consumers rely on broadliners for economies of purchasing, their vast distribution networks, and one-stop-shop procurement.

Broadline foodservice distribution has grown in importance over time. For example, in 1995, broadline distribution (national and regional) accounted for 45 percent of total foodservice sales. By 2010, this share had risen to 58 percent.[18] As shown in the table below, Sysco accounts for about 35 percent of the broadline foodservice market, while US Foods accounts for about 19 percent. Together, Sysco and US Foods would control about 54 percent of the broadline market – a significantly higher market share than they possess in all foodservice (31 percent).[19] The merger would increase concentration by 1,307 HHI points, resulting in a highly concentrated market (3,169 HHI). In a broadline foodservice market, the proposed merger far exceeds the tolerance limits for changes in concentration and post-merger concentration that are set forth in the DOJ/FTC 2010 HORIZONTAL MERGER GUIDELINES.

In the national broadline foodservice market, the merger of Sysco and US Foods is a merger to monopoly, with an increase in market concentration (as measured by the HHI) of 4,515 points, and post-merger concentration of 10,000 HHI.[20] From the perspective of consumers that rely on national broadliners to satisfy their demand for products, the market is far from "highly fragmented," as Sysco attests.[21]

Table: Market Shares of Sysco and US Foods in Foodservice Markets

	Market Shares of Sysco and US Foods (2010)		
Firm	**All Foodservice Market[22]**	**Broadline Foodservice Market**	**National Broadline Foodservice Market**
Sysco	20%	35%	66%
US Foods	11%	19%	34%
Merged Firm	31%	54%	100%
Change in HHI	-	1,307	4,515
Post-merger HHI	-	3,169	10,000

IV. A Sysco-US Foods Combination Raises a Number of Competitive Issues

The dynamics in the broader food supply chain bring the proposed merger of Sysco and US Foods into sharper focus. As shown in the figure, foodservice distribution – particularly broadline distribution – is a major input to foodservice. The merger of Sysco and US Foods will combine two

18 *Id.,* at 2.
19 Gordon Foodservice is the largest regional broadliner. *See* Sysco INVESTOR DAY 2010, *supra* note 16.
20 Sysco appears to consider Performance Food Group to be a national broadliner. See, e.g., *supra* note 16, at 6. However, we note that PFG is one-fifth the size of Sysco and one-fourth the size of US Foods in terms of number of distribution centers. *See, e.g.,* http://www.foodservice.com/foodshow/foodservice_distributors.cfm.
21 Sysco INVESTOR DAY 2010, *supra* note 16, at 6.
22 Based on 2013 data, Sysco and US Foods would have a combined share of 35 percent. *See What the Sysco/US Foods merger means for foodservice manufacturers,* The Hale Group, December 11, 2013, http://www.ifmaworld.com/articles/what-the-sysco-us-foods-merger-means-to-foodservice-manufacturers/.

largest broadline distributors and only two national broadliners. The proposed merger raises at least four competitive issues, by: (1) perpetuating domino-like consolidation in the supply chain, leading to instability, safety and reliability problems, and lack of choice, (2) eliminating head-to-head competition between major rivals, (3) increasing concentration in local and regional geographic markets, and (4) enhancing buyer market power and barriers to entry for smaller or alternative food systems.

A. The proposed merger perpetuates "domino-like" consolidation in the supply chain

As noted earlier, the proposed merger of Sysco and US Foods is likely motivated by the acquisition of bargaining market power in dealing with major food manufacturers and processors. By amassing dominance in the distribution segment, Sysco and US Foods will enhance their buyer power vis-à-vis these midstream entities. A Sysco-US Foods merger will perpetuate the cycle of consolidation in the midstream segment. If approved, there is no logical end to this kind of "domino effect" consolidation, which would erect enormous barriers to entry for smaller and innovative food producers, promote a lack of redundancy and diversity of suppliers, eliminate consumer choice, and potentially increase food safety and reliability problems.

The merger will therefore exchange price determination through market forces for bargaining between powerful suppliers and customers. This is an inferior outcome from the perspective of foodservice outlets that feed a major part of the consuming public when they eat away from home. Vigorous enforcement of the U.S. merger law is a key tool for preventing a bad situation from getting worse. At the same time, however, the government must also begin a process of decentralization up and down the supply chain through advocacy of legislative reform.

B. Sysco and US Foods are likely each other's closest rivals for foodservice outlets that require national broadline distribution

Large chain restaurants, healthcare facilities, schools, and other large foodservice customers require the economies of purchasing associated with one-stop shopping and large distribution networks. Sysco and US Foods are the only two national broadline suppliers with the scale and scope to meet these needs. Together, they will command 54 percent of the broadline foodservice market and 100 percent of the national broadline foodservice market. In light of this dominance, the AAI encourages the FTC to explore the unilateral effects of the proposed merger, for several reasons.

First, if a relevant product market is defined to be broadline foodservice distribution, Sysco and US Foods are very likely to be each other's closest competitors. The proposed merger would eliminate this vital head-to-head competition. For example, in the event of a price increase by either Sysco or US Foods, a high proportion of sales to foodservice customers that require broadline services would be diverted to the merging partner. The fact that the merging partners would capture the bulk of each other's sales in the event of a price increase means that a post-merger price increase would likely be profitable. Upward pricing pressure should therefore a significant concern. In national broadline foodservice, the merger of Sysco and US Foods is a merger to monopoly. The diversion of sales from one merging partner to the other would be so significant as to guarantee upward pricing pressure.

Second, it is unlikely that regional broadliners could have the capacity or ability to respond to a price increase by expanding their business. There is no other truly national broadliner. PFG is one-fifth the size of Sysco and one-fourth the size of US Foods in terms of number of distribution centers.[23] PFG and regional broadliners may have neither the existing scale, nor ability to expand on a national scale in response to a post-merger price increase. They may also be non-viable alternatives from the consumer perspective. Larger foodservice outlets utilize national broadliners to exploit purchasing economies, extensive distribution networks, and lower transactions costs, as opposed to patching sourcing together from regional or local distributors. And even if regional broadliners could absorb the demand from Sysco-US Foods customers, switching costs associated with shifting purchases are likely to be high.

C. The proposed merger will likely have a significant adverse effect on regional and local geographic markets

The proposed merger also raises concerns about its effect on smaller chains and independent restaurants, catering firms, and hotels as well as schools, hospitals, and other foodservice outlets in local and regional geographic markets. In these markets, Sysco and US Foods may compete to some extent with regional broadline distributors, other regional distributors, and local distributors. While these markets may appear to contain a significant range and number of competitors, it is clear that many of them are likely to be concentrated. Publicly available information indicates that there are overlaps between Sysco and US Foods distribution centers in an estimated 30 U.S. cities. F&WW has analyzed regional foodservice distribution center concentration for nine regions of the U.S. and found that the proposed merger will increase concentration in some regions beyond the tolerance limits set forth in the DOJ/FTC 2010 HORIZONTAL MERGER GUIDELINES.[24]

The AAI encourages the FTC to look closely at geographic market overlaps involving regional and local distribution and consider a number of issues that bear on competition in regional and local food distribution markets. First, larger foodservice outlets are unlikely to satisfy their purchasing needs from smaller local distributors. For example, local competition may not offer the same breadth of products or distribution networks that Sysco or US Foods can provide.

Second, the AAI would caution against overreliance on the role of distributors of locally sourced ingredients such as meat and produce as a constraint on the pricing of larger distributors. Sysco acknowledges this industry trend in its most recent Form 10-K: "Non-traditional competitors are becoming more of a factor in terms of competition within our industry, and consumer spending trends are gradually shifting more to fresh, natural and sustainably-produced products."[25] This observation should be interpreted as a signal that Sysco needs to enhance efforts to obtain locally-sourced ingredients, as opposed to concern over the impact of local distribution on tempering its significant market power. While the effects of the locally sourced ingredient movement may be felt on the margin, it is likely that only a small proportion of foodservice customers focus on consumer demand in this niche market. Local providers do not have the ability to impose pricing restraint on national or regional foodservice distributors, or other types of food distributors.

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[23] Foodservice.com, *supra* note 20.
[24] F&WW letter to the FTC, *supra* note 11.
[25] Sysco Form 10-K (period ending August 29, 2013) at 18, August 27, 2013, http://sysco.q4cdn.com/960c5a82-89cd-4828-9d4b-be722a91725b.pdf.

D. The proposed merger is likely to enhance buyer power and raise barriers to entry for alternative food producers and systems

As noted earlier, the proposed merger of Sysco and US Foods is likely motivated by the acquisition of bargaining power in dealing with major food manufacturers and processors. By amassing dominance in the distribution segment, Sysco and US Foods will enhance their buyer power vis-à-vis these midstream entities. For those smaller food processors and producers, there is a real chance that a merged Sysco-US Foods could exercise its enhanced monopsony power in distribution to depress the prices paid for their products.

The effects of enhanced buyer power exercised by Sysco and US Foods would be felt by food processers and producers in directly adjacent markets, and also further upstream. For example, as processors and producers are squeezed, they respond by squeezing their own input suppliers – especially those who are powerless. Hence, the response to buyer pressure is often to drive further down the prices paid for inputs from those providers who cannot resist effectively, i.e., those with high switching costs, high sunk costs, or no viable alternative outlets.

A Sysco-US Foods merger also opens a "Pandora's box" of potential incentives to impose or pressure foodservice customers into exclusive or sole source contracts and complex, potentially exclusionary bundling of foodservice products. As we have observed in the healthcare industry (e.g., Group Purchasing Organizations), this type of concentration in aggregation and distribution has led to the exclusion of smaller drug and medical device manufacturers, thus hampering innovation, reducing redundancy in the supply chain, and reducing benefits to consumers. To the extent that alternative food systems are attempting to gain a foothold in the market, the prospect of dealing with a merged Sysco-US Foods that would deal only with large food processors and manufacturers is likely to make entry and expansion of those systems more difficult.

V. Conclusion

The AAI strongly encourages the FTC to consider the issues raised in this letter when evaluating the potential competitive effects of a Sysco-US Foods merger. Adverse effects could be felt at any number of stages in the food supply chain, raising concerns about prices, food quality and safety, innovation, and choice. We appreciate your attention to this matter. If the AAI can be of further assistance, please feel free to contact us.

Sincerely,

Diana L. Moss

Diana Moss
Vice-President, American Antitrust Institute

cc:
The Honorable William J. Baer, Assistant Attorney General, U.S. Department of Justice Antitrust Division
The Honorable Julie Brill, Commissioner, Federal Trade Commission
The Honorable Maureen K. Ohlhausen, Commissioner, Federal Trade Commission
The Honorable Joshua D. Wright, Commissioner, Federal Trade Commission
Deborah Feinstein, Director, Bureau of Competition, Federal Trade Commission