Feds sue to stop Sysco merger

Regulators: Deal would threaten competition

By Erin Mulvaney and Sarah Scully

A divided panel of federal regulators took sides Thursday in a debate that could affect how much millions of consumers pay for the food they’re served in restaurants, hotels, hospitals and school cafeterias, filing suit to stop the planned merger of Houston-based distributor Sysco Corp. with its largest competitor.

The Federal Trade Commission said in its complaint that combining Sysco with US Foods would give the new company 75 percent of national market share and more than half of market share in 32 local markets. Commissioners decided in a 3-2 vote the deal would concentrate too much power, and they were joined by 10 states and the District of Columbia.

Sysco, which had tried to address antitrust concerns in recent weeks by offering to sell 11 distribution centers currently owned by US Foods, said it will fight the FTC decision. Its CEO said the commissioners do not understand how foodstuffs are distributed. The company describes the market as largely fragmented and competitive on a local scale.

But the FTC said the merger would hurt competition on a national scale, at the expense of customers who rely on national distributors.

“This proposed merger would eliminate significant competition in the marketplace and create a dominant national broadline food service distributor,” Debbie Feinstein, director of the FTC’s Bureau of Competition, said in a statement. “Consumers across the country, and the businesses that serve them, benefit from the healthy competition between Sysco and US Foods, whether they eat at a restaurant, hotel, or a hospital.”

The FTC also called Sysco’s divestiture offer — more than double the original merger terms — inadequate. The company said this month that it would sell 11 US Foods distribution centers that generated a combined $4.6 billion in annual revenue.

“"The FTC thinks the combination of these two competitors will harm the market so much, divestitures will not work,” said Darren Bush, an antitrust law professor at the University of Houston.

Sysco said Thursday it intends to sell the US Foods centers.
Effects on consumers

Regulators had been reviewing the proposed merger since it was announced in December 2013.

“The fear is, whether this is founded or not, is that the combined entity would be able to charge higher prices and give worse service,” said Randy Gordon, chairman of the antitrust and trade regulation practice at the Dallas law firm Gardere Wynne Sewell. “The other side of it is that — and I’m sure they’ll argue this to the FTC — in fact, combining the entities will save money and they’ll be able to pass those savings on to their consumers.”

Bill DeLaney, president and CEO of Sysco, expressed confidence the deal will go forward.

“The facts are strongly in our favor and we look forward to making our case in court,” he said in a statement. “Those of us who work in this industry every day know it is fiercely competitive. Customers of all types have access to food distribution services from a wide variety of companies and any number of channels. In fact, the overwhelming majority of restaurants and food operators choose their food-service distributor locally, where they have choices among many excellent companies.”

But the FTC countered in its lawsuit that if the merger between Sysco and Illinois-based US Foods goes forward as proposed, its customers would have limited options and could face higher prices and diminished service. The commission is seeking a temporary restraining order to prevent the parties from going forward with the merger.

Texas was not among the states joining the FTC complaint. Signing on were California, Illinois, Iowa, Maryland, Minnesota, Nebraska, Ohio, Pennsylvania, Tennessee, Virginia and the District of Columbia.

Huge market share

The FTC complaint argues the merger would harm national and local customers. On the national level, the complaint says Sysco and US Foods compete “vigorously” with each other as the only broadline distributors.

The third-largest competitor, DMA, has just 11 percent of national market share, the FTC determined.

“The scale of Sysco and US Foods ... is similar to each other and dwarfs the next-largest broadline distributor,” the FTC wrote.

Regulators also said the barriers to entry would be too high for new competitors: “Other broad-line distributors are many years and significant capital investments away from being in a position to replace the competition currently provided by US Foods.”

Charlie O'Shea, an analyst with Moody’s Investors Services, said Sysco and US Foods are no doubt the largest competitors, but there are players in the regional markets, including Costco, Sam’s Club and Wal-Mart.
“There are all sorts of places where a good percentage of the customers will go other than the combined US Foods and Sysco,” O’Shea said.

Large customers, such as hospital systems, universities and major companies, could be affected, he said, because few companies can handle the scale of service they require.

DeLaney said regulators misunderstand the market.

“They believe that there’s a national market,” he told investors this month. “They believe that there are customers out there that will only buy from distributors who have a national footprint.”

Rather, he said, Sysco competes with many regional distributors and some customers buy from more than one distributor.

Sysco’s stock dropped 3.38 percent Thursday to close at $38.56.