DELAY AND EVENTUAL MERGER OF WHOLE FOODS MARKET, INC. AND WILD OATS MARKETS, INC.

By: Leslie Morrow

Introduction

On February 21, 2007, the nation's two leading purveyors of natural and organic foods, Whole Foods Market, Inc. ("Whole Foods") and Wild Oats Markets, Inc. ("Wild Oats"), entered into an agreement and plan of merger (the "Agreement").[1] Under the terms of the Agreement, Whole Foods and its wholly-owned acquisition subsidiary WFMI Merger Co., ("WFMI") commenced a tender offer to purchase all of the outstanding shares of Wild Oats at a purchase price of $18.50 per share.[2] The initial expiration date for the offer was set for March 27, 2007,[3] but due to allegations that the merger would violate federal antitrust laws, the transaction ultimately did not close until August 28, 2007. In the interim, the parties went to bat with the Federal Trade Commission (the "FTC") in federal court, and the egotistical, unethical, and perhaps illegal web postings of Whole Foods' CEO John Mackey were revealed to the public. In this paper, I will outline the events that caused the delay of the merger, highlight their effect on the transaction and how they were addressed in the deal documents, and explore the potential illegality of Mr. Mackey's online blogging.

How the Agreement Foreshadowed Subsequent Events

Whole Foods' and Wild Oats' respective obligations under the Agreement were expressly conditioned upon the absence of any judgment, order, or injunction by any governmental entity that would have "the effect of making illegal or directly or indirectly restraining or prohibiting

[1] Whole Foods Market, Inc., Current Report (Form 8-K), at Exhibit 2.1 (Feb. 21, 2007) (hereinafter "Agreement").
[2] *See* Agreement at Section 1.1(a)(i).
[3] *See* Whole Foods Market, Inc., Tender Offer Statement by Third Party (Schedule TO), at Exhibit 99(a)(1)(A) (Feb. 21, 2007) (hereinafter "Offer to Purchase"), at ii.

the consummation of the Merger."[4] Further, the Agreement provided for termination by either party if any court or governmental entity issued a final ruling permanently prohibiting the transaction.[5]

With respect to government approvals, the parties agreed to use their "reasonable best efforts"[6] to take all actions necessary to consummate the merger. More specifically, such actions included filing a Notification and Report Form and submitting any additional information required by the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (the "HSR Act") and causing the expiration of the applicable waiting periods under the HSR Act.[7] In the event the FTC instituted an investigation, administrative proceeding, or judicial action challenging the transaction, the parties agreed to cooperate with each other and to contest the action so that the transaction ultimately could succeed.[8]

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[4] Agreement at Section 6.1(c).

[5] *See* Agreement at Section 7.2(a). The Agreement also provides for termination by either party if the merger "shall not have been consummated by the Outside Date," Agreement at Section 7.2(b), or if the merger failed to receive the required stockholder approval. Agreement at Section 7.2(c); *see also* Agreement at Section 6.1(a).

[6] This standard is ambiguous, as the modifiers "reasonable" and "best" are inherently contradictory. Some courts have interpreted a "best efforts" clause to impose "an almost fiduciary level duty on the part of the burdened party." GEORGE W. KUNEY, THE ELEMENTS OF CONTRACT DRAFTING WITH QUESTIONS AND CLAUSES FOR CONSIDERATION 75 (2d ed. 2003). Perhaps the parties included the word "reasonable" to prevent a court from later imposing such a heightened standard of performance, but if so, a better drafting choice would have been simply the phrase "reasonable efforts."

In addition, a "best efforts" clause generally is problematic unless it defines "best efforts" and "provides an objective measure (such as dollars or time spent) for when the standard is met." *Id.* In Section 5.10(e) of the Agreement, the parties agree that "reasonable best efforts … shall not obligate [WFMI or Whole Foods] to divest or otherwise hold separate …, or take any other action … with respect to (i) any business, asset or property that was owned by [Whole Foods] prior to the Effective Time or (ii) the Surviving Corporation's businesses, assets or properties …." While this section provides for one type of action that is *not* required of the parties under the "best efforts" clause, the Agreement fails to adequately outline objective standards for the parties' efforts to obtain government approvals for the transaction.

Fortunately, the absence of a clear standard did not affect the outcome of the transaction because the parties' interests were aligned and they cooperated during their litigation with the F.T.C. However, under different circumstances (e.g., if one of the parties had decided to back out once the F.T.C. challenged the deal), this vague standard of performance could have had grave consequences.

[7] Agreement at Section 5.10(a). The HSR Act requires that parties to a transaction with a value above a certain threshold submit specified documentary materials to the FTC and wait for a specified 15-day waiting period to lapse before consummating the deal. *See* Offer to Purchase at 33.

[8] Agreement at Section 5.10(b)-(d).

The Agreement also expressly conditioned WFMI's obligation to Wild Oats' shareholders to pay for their tendered shares upon certain "Offer Conditions."[9] The Offer Conditions included (1) the expiration of the applicable waiting period under the HSR Act;[10] (2) the absence of any injunction by any governmental entity that would prohibit the consummation of the transaction;[11] and (3) the absence of any pending action by any governmental entity challenging the transaction.[12] In the event that any of these conditions were not satisfied, WFMI would be entitled, but not required, to extend the tender offer for periods of up to twenty days.[13]

In its Offer to Purchase filed with the Securities and Exchange Commission (the "SEC") February 27, 2007, Whole Foods cautioned Wild Oats' shareholders of the possibility that the FTC could challenge the merger on antitrust grounds and seek a permanent injunction to prohibit the transaction if it believed that the transaction "would violate the U.S. federal antitrust laws by substantially lessening competition in any line of commerce affecting U.S. consumers…."[14] Whole Foods warned that "[i]f any such action is threatened or commenced by the FTC, the Antitrust Division or any state or any other person, [Whole Foods] may not be obligated to consummate the offer or the Merger." Such a statement was likely a necessary word of caution to investors, required of Whole Foods by federal securities laws.[15] It is unclear whether the statement also was supported by the parties' actual fear that a challenge by the FTC was on the horizon, but if so, that fear would soon become a reality.

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[9] *Id.* at Section 1.1(a)(i).
[10] *Id.* at Exhibit A, Section 1(b).
[11] *Id.* at Exhibit A, Section 2(a).
[12] *Id*. at Exhibit A, Section 2(b).
[13] *See* Offer to Purchase at ii.
[14] Offer to Purchase at Section 15.
[15] Section 14(e) of the Securities Exchange Act of 1934 makes it unlawful, "in connection with any tender offer" for any person to "omit to state any material fact necessary in order to make the statements made, in light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive, or manipulative acts or practices…."

The FTC Challenges the Merger

On March 14, 2007, Whole Foods announced that it had received what is known as a "second request" from the FTC for additional information about the merger.[16] According to one market analyst, the request was no surprise since Whole Foods would acquire fifty-five Wild Oats stores within a five-mile radius of an existing Whole Foods store.[17] Other market observers agreed:

> "…the upcoming Whole Foods acquisition of rival Wild Oats Markets consolidates the natural foods retail segment into one major player and creates the largest, most-prominent retailer in its segment. While the merge does not affect a relatively large number of stores..., it does significantly alter the retail niche occupied by the two chains. The combined company has the potential to become a sort of 'natural foods Wal-Mart,' perhaps lowering prices enough to make natural and organic foods even more accessible to the general public."[18]

On the flip side, other commentators pointed to the recent "blurring of lines"[19] between organic food chains and traditional supermarkets, pointing to the fact that Wild Oats and Whole Foods encountered stiff competition in the market from grocery giants and discount stores such as Safeway, Supervalu, Kroger, Wal-Mart, and Costco Wholesale, all of whom recently had been attempting to expand their selection of natural and organic foods in order to compete for grocery

[16] Wild Oats Markets, Inc., Current Report (Form 8-K) (Mar. 13, 2007) ("The effect of the second request is to extend the waiting period imposed by the HSR Act until 10 days after WFM has substantially complied with the request, unless that period is extended voluntarily by the parties or terminated sooner by the FTC."). *See also* Angela Moore, *FTC Seeks More Information On Whole Foods, Wild Oats Deal*, MARKETWATCH, March 15, 2007.
[17] *See* Moore, *supra* note 16.
[18] *Six Retail Chains—Three Huge Mergers*, PR NEWSWIRE, Apr. 24, 2007.
[19] Angela Moore, *Whole Foods Saw Wild Oats Deal as a Way to Fight Competition: FTC*, MARKETWATCH, June 19, 2007.

dollars.[20] In fact, 74 percent of natural and organic foods were then being sold through conventional grocery stores.[21]

Nevertheless, on June 6, 2007, the FTC filed a complaint with the United States District Court for the District of Columbia seeking to enjoin the merger.[22] Jeffrey Schmidt, director of the FTC's Bureau of Competition, stated, "Whole Foods and Wild Oats are each other's closest competitors in premium natural and organic supermarkets, and are engaged in intense head-to-head competition in markets across the country. If Whole Foods is allowed to devour Wild Oats, it will mean higher prices, reduced quality and fewer choices for consumers."[23] FTC documents stated that Whole Foods' founder and CEO John Mackey ("Mackey") told Whole Foods' board that the merger could "avoid nasty price wars" in several cities and "eliminate forever the possibility" of rival supermarkets "using their brand equity to launch a competing natural/organic food chain."[24]

In response, Mackey stated, "The FTC has failed to recognize the robust competition in the supermarket industry, which has grown more intense as competitors increase their offerings

[20] *See* Angela Moore, *Update: FTC Seeks More Information On Whole Foods, Wild Oats Deal*, DOW JONES BUS. NEWS, Mar. 15, 2007.
[21] Moore, *supra* note 20. "Between them, Whole Foods and Wild Oats own a bit more than 300 stores in the U.S., Canada and the United Kingdom. By comparison, Kroger, the second-largest supermarket chain behind Wal-Mart, owns about 2,500 grocery stores in 31 states. Wal-Mart, with about 3,000 stores in the U.S. that sell groceries, held a 19% share of overall U.S. retail-food sales last year…." David Kesmodel & John R. Wilke, *Why Whole Foods Deal is in Peril—Pending FTC Challenge To Wild Oats Deal Argues Firms are in Narrow Arena*, WALL ST. J., June 6, 2006.
[22] Complaint, FTC v. Whole Foods Market, Inc., No. 07-CV-01021-PLF, 2007 WL 1849944 (D.D.C. June 6, 2007). On June 12, Whole Foods and Wild Oats announced that the United States District Court for the District of Columbia had scheduled a preliminary injunction hearing for July 31, 2007 and that they had consented to a temporary restraining order pending the hearing. Wild Oats Markets, Inc., Current Report (Form 8-K), at Exhibit 99.1 (June 7, 2007).
[23] Andrew Martin, *F.T.C. to Sue In Bid to Halt Food Merger*, N.Y. TIMES, June 6, 2007.
[24] Moore, *supra* note 20.

of natural, organic and fresh products, renovate their stores and open stores with new banners and formats resembling Whole Foods Market."[25]

The disagreement between the FTC and Whole Foods boiled down to how narrowly to define the market in question—specifically, whether Wild Oats and Whole Foods were competing only with other natural and organic chains or in the larger market of conventional supermarkets.[26] In arguing over how to define the relevant market, the contentions of both Whole Foods and the FTC were fraught with inconsistencies. For example, Whole Foods has built its fortune on its reputation for being a "uniquely mission-driven" organization that sells only the highest quality foods.[27] In its complaint, the FTC quoted Mackey as saying, "'Wal-Mart doesn't sell high-quality perishables' and that is 'why Wal-Mart isn't going to hurt Whole Foods.'"[28] Mackey also claimed to have built his company by setting it apart from traditional grocery stores by offering "superior quality, superior service … and superior store experience."[29] However, in order to combat the FTC, Whole Foods had to argue that it was just another supermarket. Whole Foods had to admit that traditional supermarkets which offer a selection of natural and organic foods are its direct competitors and that the "superior store experience" at Whole Foods is not so unique as to create a distinct market for customers seeking that experience.

For its part, FTC officials sought to distinguish organic food stores, arguing that "the market for premium natural and organic groceries was different from that of conventional supermarkets because of the breadth and quality of their perishables" the "wide array of organic

[25] Whole Foods Market, Inc., Current Report (Form 8-K), at Exhibit 99.1 (June 5, 2007). *See also Whole Foods Market to Challenge FTC's Opposition to Wild Oats Merger*, PR NEWSWIRE, June 5, 2007.
[26] *See id.*
[27] *See* http://www.wholefoodsmarket.com/company/index.html.
[28] David Kesmodel, *CEO's Words May Cook Whole Foods*, WALL ST. J., June 20, 2007.
[29] *Id.*

and natural products" and the fact that their customers "are buying something more than just the food product—they are seeking a shopping 'experience,' where environment can matter as much as price."[30] The FTC based its argument on the fact that the merger would lessen competition for the surviving corporation, thereby decreasing the quality "experience" that Whole Foods' and Wild Oats' customers had come to rely upon. The inconsistency in this argument lies in the fact that if the quality and the "experience" of these natural-food stores decreased, they supposedly would begin to more closely resemble "ordinary" grocery stores—which, in the long run, would *increase* competition for Whole Foods.[31]

If the FTC could persuade the district court that the relevant market was that of premium natural and organic food stores, the transaction would most assuredly fail under the terms of the Agreement.[32] While Whole Foods suffered declines in its stock prices[33] and in its backing from market analysts following the announcement of the FTC challenge,[34] Wild Oats' shareholders were poised to feel the greatest effects of a termination of the merger. In its quarterly report filed with the SEC on May 9, 2007, Wild Oats disclosed several risk factors associated with the merger to its shareholders, including that "the current market price may reflect a market assumption that the Merger will occur, and a failure to complete the Merger could result in a decline in the market price of our common stock" and that "the proposed transactions disrupt[s] current business plans and operations [and] may create difficulties in attracting employees…."[35]

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[30] *Id.*
[31] *See Granola and Antitrust*, WALL ST. J., June 19, 2007.
[32] *See* Agreement at Section 7.2(a).
[33] Kesmodel, *supra* note 28.
[34] Angela Moore, *FTC Challenge to Whole Foods Could Hurt Deal, Operations*, MARKETWATCH, June 6, 2007 ("While we believe Whole Foods has a valid argument that the FTC should look at the broader grocery market, we believe risks are greater for no deal, significant store divestitures and a delaying timing if a deal is allowed, and management distraction caused by the dispute.").
[35] Wild Oats Markets, Inc., Quarterly Report (Form 10-Q), at pg. 26 (May 9, 2007).

In its quarterly report dated June 30, 2007 (after the FTC had filed its complaint), Wild Oats added three items to its list of risk factors associated with failure to complete the Merger:

- "the proposed Merger has delayed our ability to find and retain a permanent CEO and CFO to develop and implement a new, long-term strategic plan for the Company;
- the proposed Merger affects our ability to obtain additional financing at commercially reasonable rates; and
- the proposed Merger has diverted financial and management resources from pursuing growth initiatives, including investing in new stores and securing new locations for future stores."[36]

By comparison, Whole Foods' quarterly report dated July 1, 2007 did not list any risk factors related specifically to the merger or to the FTC litigation.[37] Under a section entitled "Legal Proceedings," Whole Foods merely stated that "The Company is subject to various legal proceedings and claims arising in the ordinary course of business."[38] Clearly Wild Oats and its shareholders had the most to lose from the FTC's challenge of the transaction.

Mackey's Mistakes in Cyberspace

On July 12, 2007, the media began reporting that one of the FTC's court documents alleged that Mackey (under the pseudonym "Rahodeb," a scramble of his wife's first name) had made at least 1,300 posts on Yahoo Finance's bulletin board between January 1999 and May 2006.[39] Many of the postings contained derogatory statements about Wild Oats while touting

[36] Wild Oats Markets, Inc., Quarterly Report (Form 10-Q), at 30 (June 30, 2007).
[37] Whole Foods Market, Inc., Quarterly Report (Form 10-Q) at 20 (July 1, 2007).
[38] *Id.*
[39] Christopher Caldwell, *Not Being There*, N.Y. TIMES, Aug. 12, 2007.

Whole Foods and its potential for future success.[40] For example, the FTC quoted Rahodeb as posting, "Whole Foods is systematically destroying [Wild Oats's] viability as a business—market by market, city by city."[41] The following is a list of some of Rahodeb's more suspicious comments:

- October 2000: "[O]nce the market figures out [Whole Foods] isn't going to buy [Wild Oats], [Wild Oats is] headed to $3.00—or less."[42]
- January 2005: "Would Whole Foods buy OATS? Almost surely not at current prices. What would they gain? OATS locations are too small."[43] Rahodeb speculated that Wild Oats eventually would be sold after sliding into bankruptcy or when its stock fell below $5.
- January 2005: When Whole Foods' stock was at a split-adjusted price of about $47, Rahodeb posted: "13 years from now Whole Foods will be a $800+ stock before splits."[44] Two and a half years later, on July 11, 2007, Whole Foods' stock closed at $39.50.[45]
- February 2005: Wild Oats management "clearly doesn't know what it is doing … OATS has no value and no future."[46]
- March 2006: At Whole Foods' 2006 annual meeting, Mackey stated that the company would hit $12 billion in sales by 2010, doubling its sales in five years. Less than a week later, Rahodeb posted: "The upgraded prediction of $12 billion is most likely

[40] Angela Moore, *FTC Case Against Whole Foods Deal Looks Strong: Analyst*, MARKETWATCH, July 12, 2007.
[41] *Id.*
[42] Caldwell, *supra* note 39.
[43] David Kesmodel & John R. Wilke, *Whole Foods is Hot, Wild Oats a Dud—So Said "Rahodeb"—Then Again, Yahoo Poster Was a Whole Foods Staffer, The CEO to Be Precise*, WALL ST. J., July 12, 2007.
[44] *Id.*
[45] *Id.*
[46] *Id.*

conservative. Won't surprise me if the number ends up close to $14 billion in 5 years."[47]

- March 2006: "[O]perating cash flow for 2006 will be up at least another 20% just as it is every year."[48] In fact, operating cash flow in 2006 rose only 10.2%.[49]
- June 2006: "So long as Whole Foods same store sales are in double digits the next 2 quarters, the stock won't trade below $50 per share (and probably not below $60)."[50]
- June 2006: "[Wild Oats] still stinks and remains grossly overvalued based on very weak fundamentals. The stock is up now, but if it doesn't get sold in the next year or so it is going to plummet back down. Wait and see."[51]

On July 17, 2007, the SEC opened an informal inquiry into Mackey's postings.[52] While the SEC has not yet released any information about its investigation, it is likely considering whether Mackey's blog postings constituted forward-looking statements,[53] unaccompanied by sufficiently detailed cautionary language,[54] which violated Section 17 of the Securities Act of 1933.[55] Section 17 makes it unlawful to sell securities "by means of any untrue statement or any omission to state a *material* fact necessary in order to make the statements made, in light of the

[47] Erin White, Joann S. Lublin & David Kesmodel, *Executives Get the Blogging Bug—More CEOs Openly Post Their Views on Work, Life; The Tale of a Colonoscopy*, WALL ST. J., July 13, 2007, at B1.
[48] *Id.*
[49] *Id.*
[50] Andrew Martin, *Chief of Whole Foods Extolled His Stock Online*, N.Y. TIMES, July 13, 2007.
[51] David Kesmodel & Jonathan Eig, *Unraveling Rahodeb: A Grocer's Brash Style Takes Unhealthy Turn—Were Posts by Mackey, CEO of Whole Foods, A Case of Ethics, or Ego?*, WALL ST. J., July 20, 2007, at A1.
[52] Whole Foods Market, Inc., Current Report (Form 8-K), at Exhibit 99.2 (July 17, 2007). Whole Foods stated that it intended to cooperate fully with the SEC and that it did not expect to comment further while the inquiry was pending. *Id.*
[53] The definition of "forward-looking statement" includes: (1) a statement containing a projection of revenues, income, or earnings; (2) a statement of the plans or objectives of management; and (3) a statement of future economic performance. 15 U.S.C. § 77z-2(i)(1)(A)-(C) (2000).
[54] Section 27A provides a safe harbor for a forward-looking statement if it is (1) identified as a forward-looking statement and accompanied by "meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement;" or (2) immaterial. 15 U.S.C. § 77z-2(c)(1)(A) (2000).
[55] 15 U.S.C. § 77q(a)(2) (2000).

circumstances under which they were made, not misleading."[56] The SEC will likely evaluate "whether Mackey posted information about his company that contradicted its past public statements, and whether the posts were overly optimistic about the company's performance."[57] Mackey's posts could be viewed as containing information and financial predictions that were false or misleading. However, the relevant question is whether the information included in the posts were "material," which would probably turn upon whether the information would have influenced a reasonable investor's decision to buy or sell Whole Foods' securities.[58] On the one hand, a reasonable investor probably would not rely upon anonymous postings on an internet message board because he or she would have no way of confirming whether the information was fact or opinion. On the other hand, Rahodeb's statements were written with an air of legitimacy and a reasonable investor may have assumed that he was a Whole Foods insider with privileged knowledge.

On July 17, 2007, Whole Foods' board formed a Special Committee to conduct an independent internal investigation into Mackey's postings.[59] As of September 18, 2007, the SEC was still conducting its informal investigation and Whole Foods was declining to comment.[60]

Results of the Litigation and Conclusion

On August 16, 2007, the United States District Court for the District of Columbia denied the FTC's request for a preliminary injunction.[61] Judge Paul L. Friedman concluded that if,

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[56] *Id.* (emphasis added).
[57] John Letzing, *Whole Foods' Mackey Becomes Subject of SEC Inquiry: Report*, MARKETWATCH, July 13, 2007.
[58] *See* Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1988) (applying a "reasonable investor" test to determine whether a statement is "material" under Section 10(b) of the Securities Exchange Act of 1934, which is virtually identical to Section 17 of the Securities Act of 1933).
[59] *See* Whole Foods Market, Inc., Current Report (Form 8-K) at Exhibit 99.1 (July 17, 2007,).
[60] *PR Roundup*, PR NEWSWIRE, Sept. 2007.
[61] *Court Denies FTC's Request for Preliminary Injunction Related to Whole Foods Market and Wild Oats Markets Proposed Merger*, PR NEWSWIRE, Aug. 16, 2007. Whole Foods and Wild Oats agreed with FTC not to close the merger until noon on August 20, 2007. *Id*. *See also* Wild Oats Markets, Inc., Current Report (Form 8-K) at Exhibit 99.1 (Aug. 16, 2007).

"after the merger, Whole Foods raised its prices or permitted its quality to decline, customers could and would easily shift their purchases of natural and organic products from Whole Foods to other supermarkets."[62] Therefore, the FTC failed to meet its burden to prove that "'premium natural and organic supermarkets' is the relevant product market in this case for antitrust purposes."[63]

The FTC promptly announced that it would appeal. On August 20, 2007, the United States Court of Appeals for the District of Columbia Circuit issued an order enjoining the merger pending further order.[64] However, just three days later, the appellate court denied the FTC's request for a stay and dissolved the administrative injunction, allowing the parties to consummate the merger.[65] On August 28, 2007, Whole Foods announced that it had purchased 96.8% of the outstanding shares of Wild Oats common stock, and that it would soon acquire the remaining shares by way of a Delaware short-form merger,[66] thus signaling the close of the transaction. While Whole Foods may suffer ongoing embarrassment and media attention, and perhaps formal sanctions by the SEC, as results of the misguided web postings of its CEO, its victory over the FTC signals its formal entry into the conventional grocery market, and its merger with Wild Oats solidifies its potential to be a major player within that market.

[62] FTC v. Whole Foods Market, Inc., No. 07-1021, 2007 WL 2377000, at *34 (D.D.C. Aug. 16, 2007).
[63] *Id.*
[64] *See* Wild Oats Markets, Inc., Current Report (Form 8-K) (Aug. 20, 2007).
[65] *See* Wild Oats Markets, Inc., Current Report (Form 8-K) at Exhibit 99.1 (Aug. 23, 2007).
[66] *See* Whole Foods Market, Inc., Current Report (Form 8-K) (Aug. 28, 2007). Delaware allows a parent corporation that owns at least 90% of the outstanding shares of another corporation to conduct a cash-out merger, thereby eliminating the subsidiary's minority shareholders. *See* DEL. CODE ANN. tit. 8, § 253 (2001).