October 6, 2022

Chair Lina Khan
Federal Trade Commission
600 Pennsylvania Avenue NW
Washington, DC 20580

Assistant Attorney General Jonathan Kanter
U.S. Department of Justice, Antitrust Division
950 Pennsylvania Avenue, NW
Washington, D.C. 20530-0001

Re: Protecting Small Restaurants from Monopolistic Foodservice Distributors

Dear Ms. Khan and Mr. Kanter:

We write today to convey the concerns of independent restaurants over apparent price gouging, price coordination, commercial discrimination, and other unfair and deceptive business practices by the dominant "broadline" foodservice distributors.[1]

Since the beginning of the COVID-19 pandemic, independent restaurants have reported facing a succession of seemingly unjustifiable and synchronous price increases by the largest foodservice distributors. They have also reported dealing with apparent volume-based discrimination by those distributors in favor of large purchasers, on pricing, delivery, and other terms. These practices have not only undermined the profits of independent restaurants — whose margins are thin even in the best of times — but also pressured restaurants to depress workers' wages and raise diners' prices. In effect, the consolidated foodservice distribution industry has been using the cover of pandemic-related supply-chain and inflation issues to flex its market power over its smallest customers — and thereby extract ever-more wealth from local communities.

As we detail below, the dominant distributors' consolidation and abuse of power raises significant concerns about violations of the antitrust laws. To ensure a level playing field for America's independent restaurants, we urge the Department of Justice (DOJ) and Federal Trade Commission (FTC) to: (1) conduct a thorough investigation of the pricing, supply allocation, delivery routing, and other practices of dominant distributors; (2) prosecute any violations of the antitrust laws by those distributors, including violations of the Robinson-Patman Act; (3) adopt regulations and enforcement policies to restrain abusive conduct in foodservice distribution; (4) block further consolidation among broadline distributors; and (5) challenge durable monopoly and oligopoly power in the foodservice distribution industry.

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[1] The American Economic Liberties Project would like to thank Basel PLLC for the research and drafting of this letter.

I. Dominant Broadliners Have Eliminated Competition & Disempowered Restaurants

Broadline foodservice distributors, or "broadliners," are a critical source of supplies for independent restaurants, especially those located in rural communities.[2] Broadliners warehouse, sell and deliver a "broad line" of food and food-related products — from meat and produce, to dairy and beverages, to janitorial supplies and paper goods — so they can supply most, if not all, of a restaurant's core needs.[3] Although specialty distributors and cash-and-carry stores can supply a restaurant with niche products or tide a restaurant over in a pinch, their narrower product offerings, lesser (or non-existent) delivery capabilities, and lack of value-added services (such as menu planning) make them poor substitutes for broadliners.[4] Since independent restaurants also typically lack the bandwidth and volume to purchase directly from food producers and other manufacturers, they must rely on access to broadliners to keep their businesses stocked and running.[5]

In this context, a small restaurant cannot bargain with a broadliner on equal terms unless there are numerous broadliners competing for its business.[6] Through successive waves of consolidation over the past 4 decades, however, the largest broadliners have made sure that is not the case.

A. Dominant Broadliners Have Consolidated the Market Through Mergers & Acquisitions

Sysco — the largest broadliner today with a market capitalization exceeding $40 billion — was formed in 1969 out of a merger of nine distributors funded by Goldman Sachs.[7] By the 1980s, similar roll-ups had reshaped the entire foodservice distribution industry, transforming a once-fragmented industry with tens of thousands of small, locally-owned distributors into a consolidated industry dominated by a handful of large regional and national players.[8]

Since emerging from the industry's "big roll-up years" of the 1970s and 1980s, the mega-distributors have aggressively pursued mergers and acquisitions to cement their dominant positions and further chip away at competition.[9] Sysco, for example, has acquired at least 150

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[2] *See* Phillip H. Howard, Concentration and Power in the Food System: Who Controls What We Eat? 42 (2021).

[3] *See id.*

[4] *See FTC v. Sysco Corjennp.*, 113 F.Supp.3d 1, 27-30 (D.D.C. 2015). *See also* FTC Complaint at 6-9, *FTC v. Sysco Corp.*, 113 F.Supp.3d 1 (D.D.C. 2015).

[5] *Cf.* Phillip H. Howard, Concentration and Power in the Food System: Who Controls What We Eat? 42-43 (2021).

[6] *See id.* at 39-40.

[7] *See id.* at 42.

[8] *See id.* at 42-46; Food & Water Watch, Letter to Deborah L. Feinstein, Director, Bureau of Competition, Federal Trade Commission Regarding Sysco-US Foods Merger 3 (June 8, 2014) (available at: https://bit.ly/3xwuy2i); First Midwest bank, "How Consolidations Are Affecting the Food & Beverage Industry", We Have Ideas: The First Midwest Bank Blog (June 10, 2021) ("These are the latest such moves [mergers and acquisitions] in an industry that once consisted of hundreds of small, family-owned food distributors but has become increasingly dominated by a few large, national players over the past 40 years.")

[9] *See* Phillip H. Howard, Concentration and Power in the Food System: Who Controls What We Eat? 42-46 (2021); Food & Water Watch, Letter to Deborah L. Feinstein, Director, Bureau of Competition, Federal Trade Commission Regarding Sysco-US Foods Merger 3 (June 8, 2014) (available at: https://bit.ly/3xwuy2i).

other companies or divisions since its founding.[10] In the 2000s, the industry's dominant firms purchased more than 100 independent food distributors — with the five largest at the time (Sysco, US Foods, Performance, Gordon, and Reinhart) purchasing about three-quarters of all foodservice distributors sold between 2008 and 2013.[11] This appetite for consolidation among the largest distributors was not abated by the FTC's challenge to Sysco's proposed acquisition of US Foods in 2015. Not only did the industry's third-largest distributor, Performance Food Group (PFG), acquire the fifth-largest, Reinhart, in 2019 — but Sysco and US Foods themselves completed more than 30 acquisitions by decade's end, increasing their revenue by $12 billion and $4 billion, respectively.[12]

The result is a highly-concentrated, rigidly-stratified broadline foodservice distribution sector, with precious few broadliners for small, independent restaurants to choose from. In 2013, Food & Water Watch found that the top 10 broadline foodservice distributors controlled more than half (56-percent) of the sector's national sales — with the lion's share (48-percent) going to the top 4 firms and Sysco alone controlling approximately a quarter of the market (24-percent).[13] This level of concentration reflected fast-growing consolidation and stratification in the industry, as the ten largest broadliners captured all of the sector's growth between 2003 and 2010 — a third went to Sysco alone — and the top-four firms increased their share of national sales by more than 10-percentage points between 2003 and 2013.[14] There is no reason to believe these trends have slowed down since 2013; on the contrary, it appears from industry commentary and corporate earning calls that the pandemic crisis only accentuated the advantages of the largest broadliners and accelerated pressures toward consolidation.[15] **Today, we conservatively**

[10] *See* Phillip H. Howard, Concentration and Power in the Food System: Who Controls What We Eat? 43 (2021). *See also* Chuck Carnevale, "Sysco Is a Solid Company But Be Cautious When Buying Its Shares", The Street (June 27, 2014) (http://bit.ly/1D99DA7).

[11] *See* Food & Water Watch, Letter to Deborah L. Feinstein, Director, Bureau of Competition, Federal Trade Commission Regarding Sysco-US Foods Merger 3-4 (June 8, 2014) (available at: https://bit.ly/3xwuy2i).

[12] *See* Phillip H. Howard, Concentration and Power in the Food System: Who Controls What We Eat? 43-45 (2021); "How Consolidations Are Affecting the Food & Beverage Industry", We Have Ideas: The First Midwest Bank Blog (June 10, 2021); Eric Gardner, "Foodservice Distributors and CPG – COVID, concentration, and what it means for CPG companies", www.ericgardner.net (May 19, 2021); Tim York, "Foodservice consolidation brings new challenges, opportunities", The Packer (Sept. 20, 2019); Benjamin Gordon, *"Foodservice Distribution: A Consolidating Market"*, Supply Chain (Aug. 2, 2019).

[13] *See* Food & Water Watch, Letter to Deborah L. Feinstein, Director, Bureau of Competition, Federal Trade Commission Regarding Sysco-US Foods Merger 6 (June 8, 2014) (available at: https://bit.ly/3xwuy2i).

[14] *See id.* at 3, 6.

[15] *See* Bob Goldin & Barry Friends, "Outpacing the Market: 'Big 3' Distributors 2021 Third Quarter Results Reflect Share Growth", Pentallect POV (November 15, 2021):

> **In this supply challenged environment, the "Big 3" are effectively leveraging their size, scale, resources, and strategic investments to achieve "above market" sales and case volume growth and greatly improved profitability.** Customers of all type, including major chains, are prioritizing reliable and secure supply sources, and the "Big 3" have invested heavily in inventory, processes and people to enable them to provide competitively superior service to "customers that matter" to them. While the "Big 3" are experiencing ongoing and serious product shortages and other supply chain disruptions like others in foodservice and other industries, their supply chains are relatively strong and resilient. **We expect the customer "flight to safety" will continue to benefit the "Big 3" and selected other uniquely advantaged distributors; it is also likely to benefit many established brands.**

(emphasis added). *See also* Eric Gardner, "Foodservice Distributors and CPG – COVID, concentration, and what it means for CPG companies", www.ericgardner.net (May 19, 2021); Sysco Corporation, Fiscal Year 2021 Q4 Earnings Call (Aug. 10, 2021) (available at: https://bit.ly/3n0AID1) ("I just want to come back to one of your key points, which is we, Sysco can and will win during this environment. . . . I'm also proud to say that we have a balance sheet that affords us the stability and flexibility to navigate this rapidly changing business environment.").

estimate that the top 10 broadliners control 60-to-70-percent of the sector's national sales, the top 5 control over 50-percent, and Sysco alone controls over 30-percent.[16]

Only the largest three broadliners — Sysco, US Foods, and PFG — possess the network of distribution centers, trucks, and sales representatives required to serve customers nationwide.[17] These first-tier, "national" broadliners dwarf their lower-tier competitors, each possessing many multiples of the number of distribution centers, trucks, and sales representatives fielded by smaller distributors.[18] The second-tier, "regional" broadliners include Gordon Food Service, Shamrock Foods, Maines Paper & Foodservice, and Ben E. Keith — all of which only possess distribution capabilities in discrete regions of the country.[19] The third-tier, "local" broadliners include all other broadliners.[20] These generally operate in single localities or metro areas, have

[16] Others have derived much higher estimates of concentration in this sector — pegging the Big Three's market share at 50- to 60-percent and Sysco's market share at north of 40-percent. *See* Amy Huo, "How Ecolab Cleans Up the Competition in Keeping U.S. Restaurants Sanitary", Food & Power (July 22, 2022) (relying on data from CSI market). Although comprehensive data is not publicly available on the post-pandemic market shares of dominant broadliners, there are several reasons to believe consolidation in this segment has increased from its 2013 levels at least along the lines we estimate.

First, there are no indications that the largest broadliners have lost market share since 2013. To the contrary, industry commentary and the broadliners' own communications suggest the opposite. *See, e.g.*, George Holm, Chairman, President & CEO, Performance Food Group, Presentation to Consumer Analyst Group of New York 12 (February 19, 2019) (showing that top 3 broadliners — Sysco, US foods, and PFG — consistently increased their market share in foodservice distribution between 2011 and 2017); Eric Gardner, "Foodservice Distributors and CPG – COVID, concentration, and what it means for CPG companies", www.ericgardner.net (May 19, 2021) (estimating that, as of 2019 but before PFG acquired Reinhart, "the top 6 distributors capture around 50 percent" of foodservice distribution sales").

Second, the pandemic has created an even more favorable environment for the national broadliners to exploit their financial power and distributional capacity to grab market share — allowing them to consolidate, in the words of US Foods executives on a recent earnings call, "a more attractive industry structure than historically." *See* US Foods Holding, Fiscal Year 2022 Q1 Earnings Call (May 12, 2022) (available at: https://bit.ly/3OdCJHN). *See also supra* n. 14.

Finally, mergers and acquisitions have continued while no significant market entrants or upstart competitors have appeared. Significantly, the third-largest broadliner, Performance Food Group, has acquired the fifth-largest, Reinhart, while the second-largest broadliner, US Foods, has acquired the seventh-largest, Services Group of America — consolidating an additional 4-to-5 percent of the market in the hands of the top 3 broadliners. Indeed, an analysis by Pentallect, an industry consulting firm, has estimated that the Big 3 gained 6-7 share points between Q3 2019 and Q3 2021 — in large part through corporate acquisitions. *See* Bob Goldin & Barry Friends, "Outpacing the Market: 'Big 3' Distributors 2021 Third Quarter Results Reflect Share Growth", Pentallect POV (November 15, 2021) ("As shown below, third quarter 2021 sales[1] of the "Big 3" are well ahead (32% on average[2]) of what they were in the comparable 2019 period, fueled in large part by US Foods and PFG's acquisitions. **[This] implies that the "Big 3" have gained 6 – 7 share points. This represents a very significant structural development with major implications to all industry participants.**") (emphasis added).

[17] *See FTC v. Sysco Corp.*, 113 F.Supp.3d 1, 5-6, 44-52 (D.D.C. 2015); FTC Complaint at 4-6, 12, 14-15, 17, 19-20, *in FTC v. Sysco Corp.*, 113 F.Supp.3d 1 (D.D.C. 2015); Food & Water Watch, Letter to Deborah L. Feinstein, Director, Bureau of Competition, Federal Trade Commission Regarding Sysco-US Foods Merger 4-7 (June 8, 2014) (available at: https://bit.ly/3xwuy2i).

[18] *See FTC v. Sysco Corp.*, 113 F.Supp.3d 1, 5-6 (D.D.C. 2015); FTC Complaint at 4-6, 12, 14-15, 17, 19-20, *in FTC v. Sysco Corp.*, 113 F.Supp.3d 1 (D.D.C. 2015); Food & Water Watch, Letter to Deborah L. Feinstein, Director, Bureau of Competition, Federal Trade Commission Regarding Sysco-US Foods Merger 4-7 (June 8, 2014) (available at: https://bit.ly/3xwuy2i).

[19] *See FTC v. Sysco Corp.*, 113 F.Supp.3d 1, 5-6 (D.D.C. 2015); FTC Complaint at 4-6, 12, 14-15, 17, 19-20, *in FTC v. Sysco Corp.*, 113 F.Supp.3d 1 (D.D.C. 2015); Food & Water Watch, Letter to Deborah L. Feinstein, Director, Bureau of Competition, Federal Trade Commission Regarding Sysco-US Foods Merger 4-7 (June 8, 2014) (available at: https://bit.ly/3xwuy2i). *See also* Tim York, "Foodservice consolidation brings new challenges, opportunities", The Packer (Sept. 20, 2019) ("Since that time [2013], US Foods purchased Services Group of America, Sysco purchased J. Kings Food Service and Performance Food Group announced the acquisition of Reinhart Foodservice (a Markon member), among others. With these acquisitions, there will be three large public players — Sysco, US Foods and Performance Food Group. Markon members Gordon Food Service, Shamrock Foods, Maines Paper, and Ben E. Keith are privately held fast-growth mega-regional distributors.")

[20] *See FTC v. Sysco Corp.*, 113 F.Supp.3d 1, 5-6 (D.D.C. 2015); FTC Complaint at 4-6, 12, 14-15, 17, 19-20, *in FTC v. Sysco Corp.*, 113 F.Supp.3d 1 (D.D.C. 2015); Food & Water Watch, Letter to Deborah L. Feinstein, Director, Bureau of Competition, Federal Trade Commission Regarding Sysco-US Foods Merger 4-7 (June 8, 2014) (available at: https://bit.ly/3xwuy2i).

fewer than five distribution centers, and are minuscule in comparison to the national and regional broadliners — controlling no more than 0.5-percent of national sales each (and usually far less).[21]

B. Consolidation Has Left Restaurants With Little Choice — and Less Bargaining Power

This picture of a nationally concentrated and stratified industry is dire — but it is a rosy one compared to the reality of distributor consolidation that independent restaurants face on the ground in more specific geographic markets. As the FTC established in its challenge to Sysco's proposed acquisition of US Foods in 2015, restaurants with one location or a few locations in a single geographic area must generally purchase supplies from distributors with proximate distribution centers — narrowing the number of broadliners they can choose from.[22] In the best-case scenario of a restaurant located in one of the few metro areas around the country with a healthy local distribution industry, this generally means having a choice of one or two national broadliners, one or two regional broadliners, and one or more local broadliners. Even then, however, only the national and (to varying degrees) regional broadliners will provide a true "full-line" of products, private-label offerings, and important value-added services such as menu planning and nutritional information.[23]

Restaurants in rural communities have even less choice among broadliners. For decades now, the local, family-owned distributors that traditionally served rural communities have been disappearing — either selling out to regional firms or going out of business.[24] As a result, restaurant owners in rural communities today can rarely find a local broadliner. They must instead rely on the national or regional broadliners that serve their communities — sometimes as few as one or two. In all markets, but especially in rural ones, the range of broadliners to which small restaurants have access is further narrowed by minimum purchase requirements.[25] As national and regional broadliners have grown larger, they have increasingly optimized their operations for, and focused their sales efforts on, large customers with large orders.[26] Concomitantly, their incentive — and even capacity — to efficiently fulfill small orders from independent restaurants has deteriorated,[27] further reducing the number of broadliners that a small restaurant might have access to.

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[21] *See FTC v. Sysco Corp.*, 113 F.Supp.3d 1, 5-6 (D.D.C. 2015); FTC Complaint at 4-6, 12, 14-15, 17, 19-20, *in FTC v. Sysco Corp.*, 113 F.Supp.3d 1 (D.D.C. 2015); Food & Water Watch, Letter to Deborah L. Feinstein, Director, Bureau of Competition, Federal Trade Commission Regarding Sysco-US Foods Merger 4-7 (June 8, 2014) (available at: https://bit.ly/3xwuy2i).

[22] *See FTC v. Sysco Corp.*, 113 F.Supp.3d 1, 61-66 (D.D.C. 2015); FTC Complaint at 2, 11-12, *in FTC v. Sysco Corp.*, 113 F.Supp.3d 1 (D.D.C. 2015).

[23] *See* The Hale Group, Foodservice Distributors of the Future – The Evolution of the Foodservice Distributor Sector 4 (2013) (available at: https://bit.ly/3bw0qwX).

[24] *See* International Foodservice Distributors Association, History of the Foodservice Distribution Industry 39 (available at: https://bit.ly/3BF54n2).

[25] *See* Food & Water Watch, Letter to Deborah L. Feinstein, Director, Bureau of Competition, Federal Trade Commission Regarding Sysco-US Foods Merger 12 (June 8, 2014) (available at: https://bit.ly/3xwuy2i).

[26] *See* Phillip H. Howard, Concentration and Power in the Food System: Who Controls What We Eat? 45 (2021); Food & Water Watch, Letter to Deborah L. Feinstein, Director, Bureau of Competition, Federal Trade Commission Regarding Sysco-US Foods Merger 12 (June 8, 2014) (available at: https://bit.ly/3xwuy2i).

[27] *See* Phillip H. Howard, Concentration and Power in the Food System: Who Controls What We Eat? 45 (2021); Food & Water Watch, Letter to Deborah L. Feinstein, Director, Bureau of Competition, Federal Trade Commission Regarding Sysco-US Foods Merger 12 (June 8, 2014) (available at: https://bit.ly/3xwuy2i); Gustavo Guida, "Are Major Food Distributors Failing Small Restaurants?", For My Business: The Cheetah Technologies Blog (Sept. 8, 2021).

In short, the consolidation of the foodservice distribution industry has not only eliminated meaningful competition among broadliners, but also created behemoth distributors with little concern for earning or losing the business of any single restaurant. The result has been a market structure that drastically disempowers restaurants in bargaining for the supplies they need from distributors — and creates ripe conditions for abuse of market power by broadliners.

II. Dominant Broadliners Use Their Market Power to Extract Wealth, Privilege Size

The dominant broadliners have exploited their market power to make it progressively harder and more expensive for small, independent restaurants to secure supplies over the past two decades — a trend that has only accelerated in the wake of the COVID-19 pandemic.

A. Broadliners Raised Prices, Degraded Services for Decades Before Covid-19 Pandemic

At least since the mid-2000s — and possibly earlier — growing consolidation in the foodservice distribution industry has been accompanied by rising prices and worsening service for the industry's customers. A 2010 study by the Grocery Manufactures' Association found that, between 2005 and 2010, foodservice distributors hiked prices for their customers repeatedly, even as their logistics and sourcing costs were declining and even as they instituted consolidated order-shipment practices that reduced the frequency and convenience (*i.e.*, quality) of their delivery services.[28] Correspondingly, a 2013 analysis by Technomic, an industry-friendly research firm, estimated that foodservice distribution mark-ups averaged around 25-percent above manufacturer's prices overall — and up to 50-percent on some products.[29]

The opaque pricing practices of dominant broadliners have made it difficult for their customers, especially smaller ones, to gauge and police the markups they are being charged — creating ripe conditions for price gouging and other unfair or deceptive practices.[30] For example, US Foods and Sysco have been the subjects of numerous allegations of fraudulent price padding, including procuring supplies through shell intermediaries to pump up the nominal cost of goods sold and justify higher prices for their customers.[31] One of these allegations was made in a 2006 class-action lawsuit on behalf of restaurants and hospitals that had signed cost-plus contracts with US Foods.[32] Remarkably, US Foods responded to this lawsuit by arguing that customers should *expect* broadliners to engage in shell-intermediary-markup schemes — which it said had become a "common industry practice."[33]

In this context of rising prices and deteriorating service, it is well-recognized in the industry that small, independent restaurants get the shortest end of the stick from dominant

[28] *See* Grocery Manufacturers Association, The GMA 2010 Logistics Benchmark Report 4-5 (March 2010).

[29] *See* Food & Water Watch, Letter to Deborah L. Feinstein, Director, Bureau of Competition, Federal Trade Commission Regarding Sysco-US Foods Merger 3-4 (June 8, 2014) (available at: https://bit.ly/3xwuy2i); Annie Gasparro & Jesse Newman, "Restaurants Fear Clout of a New Food Giant", Wall Street Journal (Jan. 6, 2014).

[30] *See* Annie Gasparro & Jesse Newman, "Restaurants Fear Clout of a New Food Giant", Wall Street Journal (Jan. 6, 2014).

[31] *See id.*

[32] *See id.*

[33] *See id.*

broadliners. Large establishments and national chains have the heft to demand lower prices, transparency as to costs, protection against excessive markups or price escalations, priority distribution routes, and other preferential terms from national and regional broadliners.[34] Small restaurants have no such leverage — so they pay the highest margins, are given limited-to-no-visibility into distributors' costs, and receive the least priority in supply allocation and distribution routing.[35] Although exact price-comparison data is not publicly available, at a minimum, we know that the broadliners' price discrimination in favor of large chains has been substantial enough to deeply undermine the capacity of independent restaurants to compete with chains on price.[36]

B. Covid-19 Pandemic Turbocharged Broadliners' (Abuse of) Market Power

Before the COVID-19 pandemic, dominant broadliners exercised their market power primarily through incremental price hikes or quality reductions that significantly affected small customers but were discreet enough not to attract public notice. Over the past two years, however, the dominant broadliners have used the supply-chain disruptions and unusual inflation conditions arising from the COVID-19 pandemic as cover to exercise their market power more boldly — not only to pass enormous cost escalations onto their customers, but also to extract greater profits.

i. Pandemic Profiteering, Broadliner-Style

From March 2020 through the first year of the pandemic, small restaurants saw broadliner prices skyrocket for a wide variety of products — doubling and tripling in the case of many basic food and food-related products. For example, a case of gloves (10 boxes per case, 100 gloves per box) from Sysco or Shamrock Foods cost restaurants in Boise, Idaho, around \$60 before the pandemic; its price shot up to \$120 in March 2020 and continued to climb until it reached \$240 a few months later.[37] Restaurants in Tampa Bay, Florida, paid around \$1.87 for a pound of chicken wings in July 2019; that price jumped to \$2.12 by the Fall of 2020, reached \$2.47 in December of that year, and was at \$3.91 by June of 2021.[38] Other products — from other types of PPE to beef and seafood to mayonnaise and cooking oil — experienced comparable price surges.[39] Simultaneously, broadliners were restricting what independent restaurants could order,

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[34] *See* Phillip H. Howard, Concentration and Power in the Food System: Who Controls What We Eat? 45 (2021); Barry Friends & Bob Goldin, *"Foodservice Cost Inflation and Full Service Restaurants: A Hazardous Gap"*, Pentallect POV (December 13, 2021); Food & Water Watch, Letter to Deborah L. Feinstein, Director, Bureau of Competition, Federal Trade Commission Regarding Sysco-US Foods Merger 11-12 (June 8, 2014) (available at: https://bit.ly/3xwuy2i); Annie Gasparro & Jesse Newman, "Restaurants Fear Clout of a New Food Giant", Wall Street Journal (Jan. 6, 2014).

[35] *See* Phillip H. Howard, Concentration and Power in the Food System: Who Controls What We Eat? 45 (2021); Annie Gasparro & Jesse Newman, "Restaurants Fear Clout of a New Food Giant", Wall Street Journal (Jan. 6, 2014).

[36] *See, e.g.*, Tovia Smith, "Restaurants that Survived the Pandemic Are now Threatened by Inflation", NPR (May 11, 2022).

[37] *See* Lex Nelson, "Dinner Bill Too High? You Could Blame the Gloves: Rising supply costs burden already-stretched restaurant budgets", Just Eat Local (June 24, 2021).

[38] *See* Helen Freund, "Food costs are way up, and Tampa Bay restaurants are feeling the crunch", Tampa Bay Times (June 19, 2021).

[39] *See, e.g.*, Helen Freund, "Food costs are way up, and Tampa Bay restaurants are feeling the crunch", Tampa Bay Times (June 19, 2021); Lex Nelson, "Dinner Bill Too High? You Could Blame the Gloves: Rising supply costs burden already-stretched restaurant budgets", Just Eat Local (June 24, 2021); Jennie Geisler, et al., "Chicken wing shortage forcing Pennsylvania restaurants to raise prices, alter menus", Erie Times-News (May 7, 2021); Mackensy Lunsford, "Chicken wing

delaying their shipments, and even cutting them off entirely as they prioritized servicing national chains and large customers.[40]

Although supply-chain disruptions may have justified broadliners' steep price hikes early in the pandemic, by the middle of 2021 supply chains were reportedly on the mend.[41] In a competitive market, one would expect competing broadliners to respond to healing supply chains with efforts to undercut rivals' prices and capture market share. Yet we have found no evidence of aggressive price competition among broadliners for the business of independent restaurants and other so-called "street" customers during this period. Instead, it appears that distributors' prices for food, alcohol, and paper products stabilized at elevated levels slightly below pandemic peaks around the middle of 2021 — before starting to increase again by the beginning of 2022.[42]

Each of the national broadliners — Sysco, US Foods, and PFG — reported around 12-percent year-over-year price inflation in earnings reports for Q3 of 2021, a rate not seen since the early 1980s.[43] Since the broadliners' major chain customers tend to have inflation buffers, commodity hedges, and other protections against price escalation embedded in their purchasing contracts, the reported price inflation was likely passed through mostly to customers that *did not* have such protections — independent restaurants and other small operators.[44] On Sysco's Q3 2021 earnings call, CEO Kevin Hourican boasted that the giant's price hikes reflected an "efficient pass-through of [cost] inflation" and enabled Sysco to increase its gross profits per case.[45] CFO Aaron Alt added that Sysco had "not seen much pushback on [its] ability to pass along" a 13.4-percent spike in supply costs — and "expect[s] to be successful in passing through whatever infla-

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shortage? Yet another strange pandemic complication coming to a bar near you", Asheville Citizen-Times (April 22, 2021); Bobby Tanzilo, "Soaring wings prices hit local restaurants when they're down", OnMilwaukee (Nov. 9, 2020).

[40] *See, e.g.*, Dion Lefler, "What's a restaurant without food? Witchita may find out as big supplier halts delivery", The Wichita Eagle (Aug. 2, 2021); Alexander Shur, "Local restaurants suffer from food distribution cut-offs, delays", Jackson Hole News & Guide (July 21, 2021); Jennie Geisler, et al., "Chicken wing shortage forcing Pennsylvania restaurants to raise prices, alter menus", Erie Times-News (May 7, 2021); Gustavo Guida, "Are Major Food Distributors Failing Small Restaurants?", For My Business (Sept. 8, 2021). *See also* Rob Veidenheimer, Bob Goldin, et al., "Food Industry Supply Chain Recovery: Getting Back on Track", Pentallect POV (February 2, 2022).

[41] *See, e.g.*, First Midwest Bank, "How Consolidations Are Affecting the Food & Beverage Industry", We Have Ideas: The First Midwest Bank Blog (June 10, 2021).

[42] *See* Bureau of Labor Statistics, BLS Data Viewer: 2020-2022 Producer Price Index By Commodity—Wholesale Trade Services: Food & Alcohol Wholesaling (WPU 578) (available at: https://beta.bls.gov/dataViewer/view/timeseries/WPU578); Bureau of Labor Statistics, BLS Data Viewer: 2020-2022 Producer Price Index By Commodity—Wholesale Trade Services: Food Wholesaling (WPU 578101) (available at: https://beta.bls.gov/dataViewer/view/timeseries/WPU578101); Bureau of Labor Statistics, BLS Data Viewer: 2020-2022 Producer Price Index By Commodity—Wholesale Trade Services: Alcohol Wholesaling (WPU 578102) (available at: https://beta.bls.gov/dataViewer/view/timeseries/WPU578102); Bureau of Labor Statistics, BLS Data Viewer: 2020-2022 Producer Price Index By Commodity—Wholesale Trade Services: Paper & Plastic Products Wholesaling (WPU 576) (available at: https://beta.bls.gov/dataViewer/view/timeseries/WPU576). *See also* Bureau of Labor Statistics, BLS Data Viewer: 2020-2022 Producer Price Index By Industry—Merchant Wholesalers, Nondurable Goods (NAICS 424) (available at: https://beta.bls.gov/dataViewer/view/timeseries/PCU424---424---).

[43] *See* Barry Friends & Bob Goldin, *"Foodservice Cost Inflation and Full Service Restaurants: A Hazardous Gap"*, Pentallect POV (December 13, 2021).

[44] *See id.*

[45] *See* Sysco Corporation, Fiscal Year 2022 Q1 Earnings Call (November 9, 2021) (available at: https://bit.ly/3QwNZkb).

Bureau of Labor Statistics (BLS) Data Suggests Distributors Have Dramatically Increased Prices & Gross Margins Since Mid-2021

According to the latest BLS data, the price index for *inputs* to the Food Services & Drinking Places industry (NAICS 722) — excluding capital investment and labor — increased by over 19-percent between January 2021 and July 2022. This is consistent with the change in the BLS's commodity price index for wholesale food and alcohol products, which increased by nearly 17 percent between July 2021 and July 2022.

Over the same period, the BLS price indexes for the *margins* of the industry groupings for merchant wholesalers of grocery, alcohol, and paper products increased by approximately 16.7 percent, 13.2 percent, and 32.8-percent, respectively. Unlike most BLS price indices, the indices for merchant wholesales are measured by *gross margins* rather than total prices — so the increases in the wholesalers' indices represent growth purely in their middleman markups. If wholesalers were only passing on rising input costs to their customers, their gross margins would have remained stable—but that is not what has happened. Their gross margins have increased sharply.

Meanwhile, between January 2021 and July 2022, the price index for *inputs* to the Merchant Wholesalers of Nondurable Goods industry (NAICS 424) only increased by a little under 15 percent — or 4 percentage points *less* than the input price index for the Food Services & Drinking Places industry increased over the same period. All of these data points suggest that, in the wake of the pandemic, wholesale distributors have not only passed on input-cost inflation, but also padded their profits.

-ation throws at us . . . as we carry forward."[46] Overall, Sysco and US Foods reported Q3 2021 net profits of $429.9 million and $64 million, respectively — realizing a year-over-year increase of 147.9% for Sysco and 800% for US Foods.[47]

By the end of 2021, Sysco was reporting higher gross profits per case than it reported in 2019, US Foods was reporting its highest gross profits per case since 2016, and the foodservice distribution industry as a whole had posted 16-percent higher operating profits than in 2019.[48] In US Foods' year-end earnings call, CFO Dirk Locascio reported that the company had enjoyed a 32-percent year-over-year increase in net quarterly sales.[49] He attributed 13-percent of that YOY increase in net sales to volume growth, 14.4-percent to passed-on cost inflation, and the remainder to what he euphemistically called "sales mix" — or charging some customer segments higher margins than others.[50] **Specifically in the independent-customer segment,**

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[46] *See id.*

[47] *See* Peter Romeo, "Sysco Says It Passed Along A 13.4% Cost Spike To Customers With Little Pushback", Restaurant Business (Nov. 9, 2021); Peter Romeo, "US Foods Raised Prices 11.5% in Q3, but Says Worst May Be Over", Restaurant Business (Nov. 8, 2021).

[48] *See* Sysco Corporation, Fiscal Year 2022 Q2 Earnings Call (Feb. 8, 2022) (available at: https://bit.ly/3Ot5ZKl); US Foods Holding, Fiscal Year 2021 Q4 Earnings Call (Feb. 17, 2022) (available at: https://bit.ly/39BGQ1e); Bob Goldin & Rob Veidenheimer, "Food Industry 2021 Results: Sales Recovering, Profits Lagging", Pentallect POV (April 20, 2022).

[49] US Foods Holding, Fiscal Year 2021 Q4 Earnings Call (Feb. 17, 2022) (available at: https://bit.ly/39BGQ1e).

[50] *See id.*

Mr. Locascio said, the company had "<u>increased gross margin per case more than opex [operating expenses] per case</u>, driving operating leverage gains over multiple years pre-pandemic[.]"[51] Wall Street analysts on US Foods' earnings call noted that year-end results for US Foods and its peers — particularly their increasing gross profits per case — reflected their "really strong pricing power" vis-à-vis customers.[52] Executives for US Foods all but openly agreed, stating the company's enhanced gross profits per case were "likely to stay."[53]

ii. Broadliners Emerging From Pandemic: "We're Not Going to Use Price to Win Share"

Neither US Foods nor Sysco has reported facing competitive pressures to limit their cost-passing, margin-increasing price hikes on customers. Instead of losing market share to more responsive competitors after raising prices and restricting access to supplies, the dominant broadliners have reported consolidating "a more attractive industry structure than historically" over the course of the pandemic.[54] This consolidation, according to US Foods' Chief Commercial Officer Andrew Iacobucci, has enabled the company to charge even its large, national-chain customers "margins that are much closer to independent restaurants."[55] In their Q1 2022 earnings calls, both companies signaled their intent to continue passing through cost inflation at "appropriate levels" — limited, it seems, only by the amount of inflation that end-consumers will bear.[56]

Interestingly, since the pandemic began, both companies have launched center-led pricing technologies focused on "margin enhancement" through "customer profitability optimization."[57] Fundamentally, these tools reduced pricing freedom for sales representatives competing in the field — suggesting a re-orientation of pricing strategy toward maximum profit extraction instead of winning and keeping customers. In Sysco's case, CEO Kevin Hourican made that re-orientation all but explicit, stating on Sysco's most recent earnings call:

> [With] the pricing tool that we have, we're better positioned to be able to be, as [CFO] Aaron [Alt] said in his comments, right on price. What we mean by that is that we're not going to be too high and we're not going to be too low. **We're not going to use price as a strategic lever to win share.** That is, we believe, a non-sustainable strategy and not something we're

[51] *See id.*

[52] *See id.*

[53] *See id.*

[54] *See* US Foods Holding, Fiscal Year 2022 Q1 Earnings Call (May 12, 2022) (available at: https://bit.ly/3OdCJHN); Sysco Corporation, Fiscal Year 2022 Q3 Earnings Call (May 10, 2022) (available at: https://bit.ly/3yfNQdX).

[55] *See* US Foods Holding, Fiscal Year 2022 Q1 Earnings Call (May 12, 2022) (available at: https://bit.ly/3OdCJHN).

[56] *See* US Foods Holding, Fiscal Year 2022 Q1 Earnings Call (May 12, 2022) (available at: https://bit.ly/3OdCJHN); Sysco Corporation, Fiscal Year 2022 Q3 Earnings Call (May 10, 2022) (available at: https://bit.ly/3yfNQdX).

[57] *See* US Foods Holding, Fiscal Year 2021 Q4 Earnings Call (May 12, 2022) (available at: https://bit.ly/3OdCJHN) (referring to "margin enhancement" and "customer profitability enhancement" through "next-generation pricing" and "dynamically optimizing prices" using a technology platform from Zilliant); Sysco Corporation, Fiscal Year 2020 Q4 Earnings Call (Aug. 11, 2020) (available at: https://bit.ly/3QwZt77) ("Additionally, we are deploying a digital pricing tool. With the implementation of our new pricing tool, we can simultaneously increase sales and create margin expansion."); Sysco Corporation Fiscal Year 2021 Q4 Earnings Call (available at: https://bit.ly/3n0AID1) ("Finally, our merchandising transformation includes implementation of center-led pricing technology and other changes . . . We restructured our field organization to become more efficient, more agile, more lean, and to be more center-led from a strategy perspective.").

> interested in doing. We want to be right on price. **So, as inflation is occurring, we're able to leverage the technology to ensure that we're passing through that inflation at an appropriate level**.[58]

This was not the first time Sysco had telegraphed its intention not to compete on price or, at least, to pass on cost inflation since the beginning of the pandemic.[59] That Sysco — the leader in a mostly commoditized industry with, presumably, the most efficient operations and the greatest buying power — will openly forego price competition is an indication of how entrenched its dominant position has become. It is also an invitation for rival broadliners to tacitly collude with Sysco, to forego price competition themselves, and thereby to maintain high prices across the industry.[60] Fundamentally, Sysco seems to be engaging in price leadership — using inflationary conditions as an opportunity to administer new "focal points"[61] for industry prices that will not only pass through cost increases, but also maintain and potentially enhance the industry's profit margins over pre-pandemic levels.

This pattern of behavior by Sysco and other major broadliners is consistent with longstanding economic research on how monopolized industries "administer prices" to achieve target "cost-plus" margins during economic recessions and periods of high inflation.[62] It is also consistent with recent empirical research by economist Hal Singer showing that, in 2021, concentrated industries raised prices by substantially higher percentages than other industries.[63] Singer's results were corroborated recently by a study from the Boston Federal Reserve, which found that higher industry concentration empowered firms to pass more of their cost increases onto customers.[64]

iii. Effects on Independent Restaurants, Workers, and Consumers

[58] *See* Sysco Corporation, Fiscal Year 2022 Q3 Earnings Call (May 10, 2022) (available at: https://bit.ly/3yfNQdX).

[59] *See, e.g.*, Sysco Corporation, Fiscal Year 2021 Q4 Earnings Call (Aug. 10, 2021) (available at https://bit.ly/3n0AID1) ("[G]iven our scale, given the advantages we have, all right, we have been successful and expect to be successful in passing through whatever inflation throws at us by commodity type as we carry forward.").

[60] *Cf. Hearing on the Impact of Corporate Power on Workers and Consumers Before the H. Comm. on Economic Disparity & Fairness in Growth*, 117th Cong. (2022) (statement of Hal Singer, Managing Director, Econ One Research) (available at: https://bit.ly/3y3wdxM).

[61] *Cf. id.*

[62] *See generally* Howard Sherman, *Monopoly Power and Stagflation*, 11(2) J. Econ. Issues 269 (1977). For a review of the literature on administered pricing in monopolized industries, *see* Christina Kelton, The Administered-Price Thesis: Literature Review and Methodological Discussion, Working Paper 43, The Food System Research Group, Department of Agriculture Economics, University of Wisconsin—Madison (June 1980) (available at: https://bit.ly/39zl6TP). *See also* Howard Sherman, Stagflation: A Radical Theory of Unemployment and Inflation (1976); The Roots of Inflation (John Blair ed. 1975); John Blair, Economic Concentration (1972); Michael Kalecki, Theory of Economic Dynamics (1968); Kathleen Pulling, *Cyclical Behavior of Profit Margins*, 12(2) J. Econ. Issues 287 (1978); Richard Edwards, *The Impact of Industrial Concentration on the Economic Crisis, in* The Economic Crisis Reader 217 (David Mermelstein, ed. 1975); John Blair, *Market Power and Inflation*, 8(2) J. Econ. Issues 453 (1974); Alfred Eichner, *A Theory of the Determination of the Mark-Up Under Oligopoly*, 83(4) Econ. J. 1184 (1973). *Cf.* Bennett Harrison, "Inflation by Oligopoly: Two Case Histories", Nation Magazine (August 30, 1975).

[63] *See Hearing on the Impact of Corporate Power on Workers and Consumers Before the H. Comm. on Economic Disparity & Fairness in Growth*, 117th Cong. (2022) (statement of Hal Singer, Managing Director, Econ One Research) (available at: https://bit.ly/3y3wdxM).

[64] Falk Brauning, Jose Fillat, et al., *Cost-Price Relationships in a Concentrated Economy*, Current Policy Perspectives: Federal Reserve Bank of Boston (May 23, 2022).

The exercise of market power by dominant broadliners is squeezing the already-thin profit margins of independent restaurants, leading to depressed wages for restaurant workers and higher prices for restaurant consumers.

A recent analysis by Pentallect, a food-industry consulting firm, examined how an average restaurant's profitability might have been affected by the national broadliners' dramatic 2021 price hikes.[65] The average restaurant earns a 3-to-6-percent operating profit.[66] Whether they fare better or worse, the "prime cost" for a restaurant — calculated by combining its cost of goods sold and labor expenses — typically runs between 50- and 70-percent of gross revenues, with quick-service restaurants (QSRs) skewing lower and full-service restaurants (FSRs) skewing higher.[67] Nearly all QSRs are chains, while the majority of independent restaurants are FSRs.[68]

In this industry context, Pentallect estimated that the broadliners' 12-percent price hike in 2021 translated into a 4-percent increase in the average restaurant's cost of goods sold (assuming constant menu prices).[69] During the same year, the Bureau of Labor Statistics (BLS) reported that restaurant wages rose 14.1-percent. **So, between the two prime cost components for a restaurant, Pentallect estimated that, by the end of the 2021, the typical small operator had absorbed an increase in operating expenses equal to 8.5-percent of its revenues.**[70] All of that is before accounting for fixed expenses such as rent, utilities, insurance, and maintenance — which, according to Pentallect, themselves increased in 2021 by an estimated 2-to-4-percent.[71]

Yet the USDA's accounting of Food Away-from-Home (FAFH) prices — a blended rate of what consumers pay for food and beverages that somebody else prepared for them, including at restaurants — revealed only a 5.8-percent increase in 2021.[72] Since restaurants, unlike broadliners, sell their food in competitive markets, they have not been able to pass all of their increased costs onto consumers.[73] According to Pentallect, this has left the average restaurant down approximately 350 basis points in operating margin — a dip in profitability that is sufficient to threaten the liquidity of thousands of operations.[74]

Some 90,000 restaurants have closed down temporarily or permanently since the pandemic began, according to the National Restaurant Association.[75] Those that survived are

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[65] *See* Barry Friends & Bob Goldin, *"Foodservice Cost Inflation and Full Service Restaurants: A Hazardous Gap"*, Pentallect POV (December 13, 2021).

[66] *See id.*

[67] *See id.*

[68] *See id.*

[69] *See id.*

[70] *See id.*

[71] *See id.*

[72] *See id.*

[73] *See, e.g.*, Tovia Smith, "Restaurants that Survived the Pandemic Are now Threatened by Inflation", NPR (May 11, 2022) ("Rock City Pizza [an independent restaurant in Boston] is one of the countless restaurants around the nation that are struggling with sky-high food prices— as well as higher costs for rent, labor, gasoline, and cooking gas—but are limited in how much of these increases they can pass on to their customers. It's especially challenging for lower-priced places, as their profit margins are typically tighter and their clientele tends to be more price-sensitive.")

[74] *See* Barry Friends & Bob Goldin, *"Foodservice Cost Inflation and Full Service Restaurants: A Hazardous Gap"*, Pentallect POV (December 13, 2021); Tovia Smith, "Restaurants that Survived the Pandemic Are now Threatened by Inflation", NPR (May 11, 2022).

[75] Tovia Smith, "Restaurants that Survived the Pandemic Are now Threatened by Inflation", NPR (May 11, 2022).

running on razor-thin margins, often as little as 1 percent of sales.[76] And wholesale food costs are still increasing — running, on average, 17 percent higher in March 2022 than the same time last year, according to the Bureau of Labor Statistics.[77] Even sharper price spikes have been reported on foodservice staples like basic paper goods (bags, plates, containers, etc.) — the price for which has reportedly quadrupled for some restaurants.[78]

"Inflation is just ridiculous now," said Joseph Charles, the owner of Rock City Pizza in Boston, recently to NPR. "It's harder to do business than it was in the pandemic."[79] Unable to pass dramatically escalating costs onto customers in recent months, Charles has had to pull steak and chicken off the menu — eighty-sixing even his bestselling Buffalo Chicken pizza.[80] "It's scary times," he said.[81] Opening Rock City Pizza in 2003 was his dream come true.[82] He worked hard to turn his pizza joint into a successful business before the pandemic — and worked even harder to stay in business after the pandemic hit.[83] Now, he wonders if he will be able to make it through inflation.[84] "It's like you thought you won, but we're not done yet," he said. "It's really tough to stay afloat right now, [and] it's drastic enough to reevaluate the situation." Everything, he sighed, "is on the table."[85]

iv. Effects on Distribution Services

At the same time as the broadline food distributors have forced independent restaurant customers to shoulder an array of price hikes, they have also subjected those restaurants to sixteen months of ruinously poor, abusive service. For example, since the Summer of 2021, Sysco and US Foods have imposed frequent last-minute service disruptions — and even unilateral and indefinite "pauses" in all service — on independent restaurants in dozens of markets across the country.[86] The dominant broadliners have done this in more remote markets — where their

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[76] *See id.*

[77] *See id.*

[78] *See id.*

[79] *See id.*

[80] *See id.*

[81] *See id.*

[82] *See id.*

[83] *See id.*

[84] *See id.*

[85] *See id.*

[86] On US Foods generally, *see* Action News, "After delay worries, more than 50 Pennsylvania school districts expect food delivery soon," 6abc.com (August 25, 2021); Shelby Caseese, "US Foods temporarily pauses deliveries to some local customers," KDKA Newsradio (September 23, 2021). On US Foods dropping service to Washington state's Long Beach Peninsula following its 2019 acquisition of dominant regional distributor Food Services of America, *see* Luke Whittaker, "Local restaurants reel after food distributor severs service," Chinook Observer (July 23, 2021). On Sysco generally, see Theodore Tauscher, "Camp closes for season after food supply issues," Concord Monitor (July 6, 2021); Tagan Tahoon, "CORONAVIRUS: With Sysco halting deliveries, EVCO and other distributors straining to meet new demand," KVOE (August 4, 2021); Madeline Reida, "Food supplier stops delivering"Hillsboro Star-Journal (August 26, 2021); Marlo Lundak, "Sysco employee shortages impact Omaha restaurant food deliveries," WOWT.com (August 17, 2021); Priscilla Totiyapungprasert, "5 things to know about how Sysco delivery cancellations are impacting Arizona restaurants," Arizona Republic (October 22, 2021;) Annabelle Morris, "Dining Services Facing Staffing and Supply Shortages," Colgate Maroon-News (September 9, 2022).

acquisitions of regional distributors often left restaurants totally bereft of alternative sources of supply — as well as in urban centers like Chicago and Phoenix. Indeed, in those two urban markets, Sysco and US Foods unapologetically forced restaurants to suffer chronic and routine last-minute order cancellations as part of a strategy of slow-walking negotiations with labor unions.[87]

Instead of negotiating in good faith with labor unions and managing their broader workforces to maintain sustainable and resilient distribution networks, the dominant broadliners have opted to strong-arm their workers — at the cost of enormous dysfunction for their customers. Operating with atrophied workforces, the broadliners have repeatedly hiked the minimum order size required for smaller restaurants to obtain delivery service — only to sometimes cut off service to those restaurants anyway.[88] Both companies have become notorious for imposing bizarre and unusable substitutions on small restaurants who have effectively no recourse or alternatives.[89] US Foods even recently began including a mandatory arbitration agreement on its invoices — forcing restaurants to arbitrate any disputes arising from erroneous, delayed, and missed deliveries.[90] All in all, according to an anonymous survey conducted by the National Restaurants Association, 96-percent of restaurants reported being plagued by product shortages and service disruptions in 2021.[91]

Yet most small restaurant owners have endured this abuse in silence — in no small part out of fear of retaliation by the broadliners on which they have become dependent. Notably, some restaurants that have complained about the quality of Sysco's service have later found themselves receiving deliveries scheduled for 10 A.M. in the middle of dinner service, or having perishable foods dumped outside their freezers in the wee hours of the morning.[92]

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[87] *See* Ashok Selvam, "Chicago Restaurants Worry About Food Supplies Due to Sysco Strike," Eater Chicago (August 31, 2021); Mark H. Anbinder, "Adding to food supply chain issues, local drivers for Sysco may not be driving this week," 14850.com, (August 26, 2021); International Brotherhood of Teamsters, "Teamsters Vote to Authorize Strike at Sysco Arizona," Longview News-Journal (July 7, 2022).

[88] As one Connecticut chef explained to a trade publication: "They can't handle the workload so to minimize the workload and still maintain an effective business, they are getting rid of smaller customers and favoring larger customers who spend more money. They say, if you can't make the minimum, we can't help you, [putting] small restaurants… in a position where they have to play a dangerous game, ordering larger volume, instead of being based on need, to get the things that they do need. We run the risk of having too large an inventory and if it's perishable, of it going to waste before it gets utilized." *See* Susan Dunne, "Labor, Food Shortages in Supply Chain Take Toll on Restaurants," Hartford Courant (June 25, 2021).

[89] Chefs frequently post photographs of botched deliveries from broadliners to the "r/kitchenconfidential" subreddit message board. *See* r/KitchenConfidential: A Place for Foodservice Industry & Hospitality Workers, Reddit.com (last accessed on Sep. 29, 2022) (available at: https://www.reddit.com/r/KitchenConfidential). For example, one Sysco customer recently posted a photo of eight buckling crates of corn labeled as Russet potatoes. *See* u/lxraverxl, "Isn't Sysco the greatest? This is what I walked into this morning instead of the potatoes I ordered", Reddit.com (May 7, 2022) (available at: https://bit.ly/3dRGd62).

[90] *See* u/Sunbath3r, "On an invoice from US Foods. What exactly does this mean? Is it basically saying that I cannot sue them for any reason?", Reddit.com (Aug. 31, 2021) (available at: https://bit.ly/3LTiIps).

[91] *See* National Restaurant Association, *Supply Chain Shortages Still Affecting Industry*, Restaurant.org (Jan. 13, 2022) ("[In November 2021,] an Association survey found that 96% of operators experienced supply delays or shortages of key food or beverage items, and that the impact was felt across all segments of the industry. Furthermore, another 8 in 10 operators said they experienced supply delays or shortages of equipment or service items.") (internal quotations omitted).

[92] In 2014 Sysco paid $19.4 million to settle allegations it had stored perishable animal proteins in unrefrigerated sheds. *See* County of Santa Clara, Office of the District Attorney, "Sysco Pays $19.4 Million to Settle Consumer Protection Lawsuit, Held Perishable Food in Unrefrigerated Sheds", Press Release (July 17, 2014) (available at: https://bit.ly/3C31UIq). Chefs continue to report receiving unsafe products from the company. *See supra* n. 88-89.

III. The Antitrust Agencies Should Take Action to Restore Competition & End Abusive Practices in Broadline Distribution

The publicly available information reviewed in this letter raises significant concerns about potential antitrust violations by the dominant broadliners. These potential violations include: (1) price coordination in violation of the Sherman Act; (2) commercial discrimination and exclusive dealing in violation of the Clayton Act and the Robinson-Patman Act; and (3) unfair methods of competition that run afoul of, and are subject to regulation under, Section 5 of Federal Trade Commission Act. To restore competition in the foodservice distribution industry, prevent abuse of market power by dominant broadliners, and ensure a level playing field for America's independent restaurants, we urge the DOJ and the FTC to take the following actions.

A. Conduct a thorough investigation of the pricing, supply allocation, and other potentially abusive practices of dominant broadliners

The FTC should launch an inquiry under Section 6(b) of the Federal Trade Commission Act into the broadline distribution industry focusing on the seven national and regional broadliners — Sysco, US Foods, PFG, Gordon, Shamrock, Maines Paper, and Ben E. Keith — that currently dominate the industry. At a minimum, the FTC's inquiry should aim to shed light on:

- Price mark-ups by dominant broadliners since the COVID-19 pandemic began, whether such mark-ups have been justified by underlying costs, and how they have affected small, independent restaurants and their workers, consumers, and local communities;
- Commercial discrimination by dominant broadliners — including in terms of pricing, supply allocation, distribution priority, and other services provided to customers — and how it affects small, independent restaurants and other small foodservice operators;
- Coordination among dominant broadliners, whether tacit or expressed, to set or administer prices, control output, divide markets, lock in customers, or otherwise engage in parallel accommodating conduct;
- Whether dominant broadliners have exercised their buying power to extract price concessions unjustified by economies of scale or other legitimate business reasons, impose exclusive deals, or otherwise establish unfair arrangements with suppliers;
- Whether the buying power of dominant broadliners has pressured suppliers to raise prices for smaller distributors (*i.e.*, created a "waterbed" effect) or otherwise undermined the ability of smaller distributors to access needed supplies; and
- Generally, the extent to which the consolidation of broadline distribution markets by dominant firms, their exercise of buyer or seller power, or their sheer size in terms of distribution capacity, financial power, or other factors have created barriers to entry or had other anticompetitive consequences.

Broadly, the FTC should seek to understand the structure of the broadline distribution industry, the mechanisms by which dominant broadliners have consolidated and exercised power in that industry, and the effects thereof on foodservice operators, competing distributors, suppliers, and other stakeholders. The DOJ should support the FTC's investigation or launch its own industry-wide investigation, focusing on potential violations of the antitrust laws.

B. Prosecute any violations of the antitrust laws by dominant broadliners, including violations of the Robinson-Patman Act

The antitrust agencies should vigorously prosecute violations of the antitrust laws in foodservice distribution, including through "industry-wide" cases if appropriate. The goal of such prosecutions should be to restructure anti-competitive arrangements that suppress competition or enable dominant broadliners to leverage their market power to extract value from suppliers or customers. Toward that end, it is critical that the antitrust agencies revitalize the Clayton and Robinson-Patman Acts' prohibitions on commercial discrimination — a key mechanism by which the largest broadliners have been able to use their financial and market power to entrench their dominance.

In the absence of enforcement under the Robinson-Patman Act and Sections 2 and 3 of the Clayton Act over the past four decades, the dominant broadliners have been free to extract preferential pricing and exclusive arrangements from suppliers; suppress competitors through predatory pricing; and extract higher profits and exclusionary terms from smaller customers such as independent restaurants. A revival of the Robinson-Patman and Clayton Acts would align prices — for both suppliers and customers — with underlying costs and other legitimate business factors, not with the monopoly or monopsony power of dominant broadliners. Those firms would once again have to compete on the merits — on delivering lower mark-ups by realizing actual productive efficiencies, for example — instead of being able to reap profits simply by using their market power to extort near-captive suppliers and customers. The ultimate result would be a level playing field for upstart competitors to the dominant broadliners — and improved chances of de-consolidation in the industry overall.

C. Adopt regulations and enforcement policies to restrain abusive conduct in foodservice distribution and aid small businesses in seeking fair treatment from broadliners

The FTC should use its expansive investigative and rulemaking authority to affirmatively identify, prohibit, and create mechanisms for small restaurants — as well as small suppliers and other small foodservice operators — to report unfair methods of competition by dominant firms in the foodservice distribution industry. Historically, the FTC has sought to define unfair methods of competition under Section 5 of the Federal Trade Commission Act through case-by-case adjudication. This approach has yielded only vague standards that, on the one hand, fail to clearly identify prohibited conduct for market participants and, on the other hand, impose enormous litigation burdens on enforcers seeking to challenge anti-competitive practices.[93] Simultaneously, judicial interpretation of the Sherman Act and the Clayton Act has atrophied *their* prohibitions on restraints of trade, commercial discrimination, and exclusive dealing.[94] As Chair Khan and former FTC Commissioner Rohit Chopra have argued, the FTC should use its rulemaking

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[93] *See* Rohit Chopra & Lina Khan, *The Case for "Unfair Methods of Competition" Rulemaking*, 87 U. Chi. L. Rev. 357, 359-63 (2020).

[94] *See* Lina Khan & Sandeep Vaheesan, *Market Power and Inequality: The Antitrust Counterrevolution and Its Discontents*, 11 Harv. L. & Pol'y Rev. 235, 285-8 (2017).

authority to remedy these defects in the current antitrust framework — and create an antitrust system "that is more predictable, efficient, and participatory."[95]

Toward that end, we urge the FTC to promulgate rules that clearly define certain types of exclusionary or anticompetitive conduct in the foodservice distribution industry and declare them presumptively unfair methods of competition when used by dominant or near-dominant firms. Specifically, the FTC should promulgate rules prohibiting national and regional broadliners from:

- Engaging in deceptive cost or price padding or otherwise misrepresenting the underlying cost of goods sold or the price markups they are charging to customers;
- Raising prices in tacit collusion with each other;[96]
- Discriminating against small, independent restaurants in prices charged or services offered without legitimate business justifications, such as demonstrable economies of scale;[97]
- Imposing exclusive contracts, market-share discounts, or related arrangements on customers;[98]
- Using below-cost or otherwise predatory pricing to suppress smaller competitors;[99]
- Extracting exclusive arrangements or price concessions from suppliers that are not justified by demonstrable economies of scale or other legitimate business reasons;[100] and
- Using generally proscribed practices—such as violations of labor, consumer protection, or environmental laws—in competition.[101]

In addition to rulemaking designed to constrain the exercise of financial or market power by dominant broadliners, we urge the FTC and DOJ to establish enforcement policies that empower small restaurants and other small participants in the foodservice distribution industry. Most importantly, the agencies should issue formal enforcement guidelines — much as they do

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[95] *See* Rohit Chopra & Lina Khan, *The Case for "Unfair Methods of Competition" Rulemaking*, 87 U. Chi. L. Rev. 357, 374 (2020).

[96] *See generally* Brendan Ballou, *The 'No Collusion' Rule*, 32 Stanford L. & Pol'y Rev. 213 (2021).

[97] *See, e.g.*, Sandeep Vaheesan, *The Morality of Monopolization Law*, 63(6) W&M L. Rev. Online 119, 136-39 (2022); Sandeep Vaheesan, *Resurrecting "A Comprehensive Charter of Economic Liberty": The Latent Power of the Federal Trade Commission*, 19(3) U. Penn. J. Bus. L. 645, 680-82 (2017).

[98] *See* Sandeep Vaheesan, *The Morality of Monopolization Law*, 63(6) W&M L. Rev. Online 119, 136-39 (2022); Sandeep Vaheesan, *Resurrecting "A Comprehensive Charter of Economic Liberty": The Latent Power of the Federal Trade Commission*, 19(3) U. Penn. J. Bus. L. 645, 680-82 (2017). *See also* Open Markets Institute et al., Petition for Rulemaking to Prohibit Exclusionary Contracts Filed with the FTC (July 21, 2020).

[99] *See* Sandeep Vaheesan, *The Morality of Monopolization Law*, 63(6) W&M L. Rev. Online 119, 136-39 (2022); Sanjukta Paul, *Recovering the Moral Economy Foundations of the Sherman Act*, 131 Yale L. J. 175, 250-52 (2021); Sandeep Vaheesan, *Resurrecting "A Comprehensive Charter of Economic Liberty": The Latent Power of the Federal Trade Commission*, 19(3) U. Penn. J. Bus. L. 645, 680-82 (2017).

[100] *See* Sandeep Vaheesan, *The Morality of Monopolization Law*, 63(6) W&M L. Rev. Online 119, 136-39 (2022); Sandeep Vaheesan, *Resurrecting "A Comprehensive Charter of Economic Liberty": The Latent Power of the Federal Trade Commission*, 19(3) U. Penn. J. Bus. L. 645, 680-82 (2017). *See also* Open Markets Institute et al., Petition for Rulemaking to Prohibit Exclusionary Contracts Filed with the FTC (July 21, 2020).

[101] *See* Sandeep Vaheesan, *The Morality of Monopolization Law*, 63(6) W&M L. Rev. Online 119, 136-39 (2022); Sandeep Vaheesan, *Resurrecting "A Comprehensive Charter of Economic Liberty": The Latent Power of the Federal Trade Commission*, 19(3) U. Penn. J. Bus. L. 645, 680-82 (2017).

for merger review now — de-prioritizing antitrust enforcement against economic coordination by small, independent restaurants engaged in collective bargaining with dominant broadliners.[102] Additionally, if during its investigation the FTC finds that coordination between smaller, independent food operators is a necessary and beneficial practice to serve as a counterweight to the unfair bargaining power of dominant broadliners, we urge the FTC to recommend that the relevant antitrust statutes be changed to make such coordination entirely legal.

Across the board, to support the enforcement of its rules against unfair competition, the FTC should establish a confidential reporting mechanism for small restaurants and other small participants in foodservice distribution to inform the FTC of abusive conduct by dominant firms.

D. Block national and regional broadliners, and other large foodservice distributors, from engaging in additional mergers or acquisitions

Consolidation is continuing in the foodservice distribution industry — and the broadline segment specifically — "at a rapid pace."[103] After slowing down during the pandemic, "the M&A market roared back" in 2021, according to M&A consultancy Keiter Advisors.[104] "[A]s distributors, processors, and other participants in the foodservice industry saw financial results rebound significantly" over the past year, they closed at least 33 corporate transactions — making 2021 "the busiest year [for M&A] in the industry since 2017."[105] As an investment banker recently explained, "Now that supply is back to pre-COVID levels and the market continues to open up, we're seeing greater attention and focus on mergers and acquisition in the [foodservice distribution] industry." Notably, he said, "the tier behind giants Sysco and U.S. Foods are chasing scale and geographies to remain relevant[.]"[106]

The antitrust agencies should send a clear signal to national and regional broadliners that any further mergers or acquisitions they attempt would be presumptively unlawful and elicit a prompt challenge from enforcers. Many such transactions — especially any which involve other broadliners — would substantially increase concentration in broadliner markets. Others, such as acquisitions of specialty or local distributors, would enhance dominant broadliners' capacity to

[102] *See* Sanjukta Paul, *Recovering the Moral Economy Foundations of the Sherman Act*, 131 Yale L. J. 175, 252-54 (2021).

[103] *See* First Midwest Bank, "How Consolidations Are Affecting the Food & Beverage Industry", We Have Ideas: The First Midwest Bank Blog (June 10, 2021).

[104] *See* Keiter Advisors, "2021: M&A is Back", www.keiteradvisors.com/news (Jan. 5, 2022). For a comprehensive analysis of 2020-2021 M&A activity in foodservice distribution, *see* Capstone Partners, M&A Activity Remains Resilient, Foodservice Players Explore Retail End Markets (June 2021).

[105] *See* Keiter Advisors, "2021: M&A is Back", www.keiteradvisors.com/news (Jan. 5, 2022).

[106] *See* First Midwest Bank, "How Consolidations Are Affecting the Food & Beverage Industry", We Have Ideas: The First Midwest Bank Blog (June 10, 2021). *See also* Gary Karp, Barry Friends, et al., "Foodservice Distribution M&A", Pentallect POV (April 6, 2022):

> As the industry continues to mature and supply chain issues "normalize", Pentallect expects the pace of distributors acquisitions to increase. Further, given the sector size and relative stability, Pentallect anticipates greater interest from private equity/financial firms.
>
> The big three public distributors, Sysco, Performance Food Group and US Foods will likely focus on "horizontal expansion" to increase target segment and category growth.
>
> Regional/mid-size distributors will likely seek to get larger and the potential of larger regional distributors to create new alliances or tighten their existing alliances. Also, it is likely that independent distributors will take even greater advantage of services offered by the distributor co-ops to which they belong.

foreclose competition *between industry segments* by locking customers into their own cross-segment distribution ecosystems.[107] Finally, all such transactions would contribute to the maintenance of a broadliner oligopoly whose possession of market power against suppliers, competitors, and customers could be amply supported with direct evidence.

This places mergers and acquisitions by dominant broadliners squarely within the scope of the Clayton Act's prohibition on mergers that "tend to create a monopoly" — particularly as that prohibition has been defined by FTC Commissioner Rebecca Slaughter and other enforcers in recent statements.[108] More broadly, as Farm Action recently argued in comments to the FTC and DOJ regarding merger enforcement standards, Section 7 of the Clayton Act — if applied in keeping with its text and legislative history — prohibits all mergers and acquisitions involving corporations larger than small businesses.[109] The antitrust agencies should not permit dominant broadliners to engage in any more illegal mergers and acquisitions.

E. Challenge durable and harmful monopoly and oligopoly power in the broadline distribution industry

Finally, the antitrust agencies should use existing legal authorities to challenge the possession of damaging monopoly and oligopoly power by dominant national and regional broadliners. For at least a decade now, the oligopoly of national and regional broadliners has exercised market power over small restaurants — which, especially when located in rural communities, have practically become captive customers of the dominant broadliners operating in their localities.[110] The ability of this oligopoly to exercise its market power has not been constrained by local broadliners, non-broadline distributors, or new market entrants — partly, no doubt, because the largest broadliners' have exercised their tremendous leverage over suppliers to extract unfairly low prices and impose exclusive dealing arrangments.[111]

This situation presents exactly the kind of monopoly or oligopoly power that "last[s] for an extended period of time," is entrenched in a market "with highly inelastic demand," and "imposes substantial costs on the public," which Chair Khan has previously argued enforcers should seek to challenge.[112] Accordingly, where appropriate, we urge the agencies not to hesitate in prosecuting Sherman Act claims against the dominant broadliners and to seek break-ups and behavioral remedies that will restore competition in the foodservice distribution industry. We also urge the agencies to investigate significant mergers and acquisitions closed by dominant

[107] *Cf.* Benjamin Gordon, "Foodservice Distribution: A Consolidating Market", Supply Chain (Aug. 2, 2019) ("Acquisitions have enabled Sysco and US Foods to expand into new geographies; deepen their solutions offerings to better serve customers; acquire new customers and promote cross-selling; and add new technology capabilities, such as e-commerce, analytics and customer reward platforms to drive more value-added solutions for customers.").

[108] *See* Rebecca Slaughter, Commissioner, Federal Trade Commission, "Storming the Concentration Castle: Antitrust Lessons from the Princess Bride", Greg Lastowka Memorial Lecture at Rutgers Law School (March 31, 2022); Nate Soderstrom, "FTC, DOJ Officials Emphasize Clayton Act's 'Tend to Create a Monopoly' Prong, Broadening Scope of Deals in Agency Crosshairs", The Capitol Forum (April 28, 2022).

[109] *See* Farm Action, Comment Responding to FTC & DOJ Request for Information on Merger Enforcement (April 21, 2022).

[110] *See supra* Part II.

[111] *See* Food & Water Watch, Letter to Deborah L. Feinstein, Director, Bureau of Competition, Federal Trade Commission Regarding Sysco-US Foods Merger 12-13 (June 8, 2014) (available at: https://bit.ly/3xwuy2i). *See also supra* Parts I & II.

[112] *See* Lina Khan & Sandeep Vaheesan, *Market Power and Inequality: The Antitrust Counterrevolution and Its Discontents*, 11 Harv. L. & Pol'y Rev. 235, 285-8 (2017). *Cf.* Sandeep Vaheesan, *Resurrecting "A Comprehensive Charter of Economic Liberty": The Latent Power of the Federal Trade Commission*, 19(3) U. Penn. J. Bus. L. 645, 684-87 (2017).

broadliners in recent years and to seek to unwind those which violated Section 7 of the Clayton Act. Transactions of interest should include, among others, PFG's acquisitions of Reinhart, Eby-Brown, Core-Mark,[113] Ellenbee Leggett, and Kinnealey; US Foods' acquisition of Food Service of America; Ben E. Keith's acquisition of Florida Foodservice; and Sysco's acquisitions of specialty distributors Greco Foods, Coastal Foods, and Paragon.

IV. Conclusion

The patterns of pandemic profiteering and monopolistic abuse documented in this letter are not unique to the foodservice distribution industry. Groundwork Collaborative has documented myriad recent episodes in which CEOs of dominant firms in critical industries — from Tyson Foods in meat processing to Johnson & Johnson in sanitary products — boasted about their newfound ability to exercise pricing power under the cover of inflation.[114] A recent study by the Economic Policy Institute found that, across the nonfinancial corporate sector, over half (53.9 percent) of the growth in unit prices between Q2 2020 and Q4 2021 was attributable to fatter profit margins — compared to only 11.4 percent during the preceding 40 years.[115] Taking advantage of their market power and consumers' ignorance about their underlying costs, "major firms have been increasing prices well beyond their cost increases, bragging loudly about it on earnings calls, and explaining that their market power allows them to do this[.]"[116]

This is not the first time the FTC and DOJ have been called upon to combat a "profit-price" inflationary spiral fueled by large corporations exploiting their market power in a time of crisis. In the mid-1930s, as the country was emerging from the Great Depression, the monopolized sectors of the economy used supply-chain shocks as cover to raise prices dramatically.[117] Complaints about price gouging and price-fixing poured into the FTC at an unprecedented rate — with over 500 reaching the agency per month in 1937.[118] The FTC responded by launching investigations into dozens of industries, resulting in a 700-page report that found anticompetitive, controlled prices in most of the industries examined.[119] With detailed information on price-fixing and monopoly control in many industries, the DOJ launched a 10-year trustbusting campaign that successfully reined in corporate power and restored freedom of enterprise in the nation's markets.[120]

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[113] For a fairly comprehensive analysis of the anticompetitive consequences of PFG's acquisition of Core-Mark, *see* Nate Soderstrom, "Performance Food Group/Core-Mark: Deal Avoids FTC Second Request, Confounding Expectations", 9 The Capitol Forum 282 (August 13, 2021).

[114] Groundwork Collaborative, The Real Culprit Behind Rising Prices: Corporate Greed (February 2022); Groundwork Collaborative, The Real Inflation Problem: Corporate Profiteering (March 2022). *See also* Rakeen Mabud, "Stop blaming workers for inflation: Corporate greed is a much bigger factor", Salon (March 18, 2022); Singer, "Neoliberal Economists Are Giving Biden Bad Advice on Inflation", ProMarket (June 17, 2022).

[115] *See* Josh Bivens, "Corporate profits have contributed disproportionately to inflation. How should policymakers respond?", Working Economics Blog: Economic Policy Institute (April 21, 2022). *See also* Mike Konczal, Niko Lusiani, Roosevelt Institute, Prices, Profits, and Power: An Analysis of 2021 Firm-Level Markups (June 21, 2022) (available at: https://bit.ly/3HHfJP0).

[116] *See* Erik Peinert, "Inflation, Corporate Power, and the Forgotten New Deal", ProMarket (April 13, 2022).

[117] *See id.*

[118] *See id.*

[119] *See id.*

[120] *See id.*

As they did the last time America saw the present mix of price inflation, corporate profiteering, and uncertain economic recovery, the FTC and DOJ should not leave the fate of America's independent businesses, workers, and consumers in the hands of corporate masters.[121] Instead, the agencies should "move in," as a senior adviser to President Roosevelt recommended in 1937, "with all the executive and legislative powers and fight along the whole front to keep prices down and buying power up."[122]

Sincerely,

American Economic Liberties Project
American Sustainable Business Network
Farm Action
Independent Restaurant Coalition
Protect Our Restaurants

[121] *See id.*

[122] *See id.*