

FTC Wins Preliminary Injunction of “Accessible Luxury” Handbag Transaction

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A New York federal court’s recent decision to enjoin the merger of two fashion companies gave the Federal Trade Commission (FTC) and the 2023 Merger Guidelines a boost. Since the issuance of the draft merger guidelines in July 2023, commentators and practitioners have questioned whether the courts will accept the more pro-enforcement and interventionist guidance, particularly given the fact that the FTC had no sitting Republican commissioners at the time the draft guidance was issued. Court rulings, like last week’s, provide counselors and merging parties with some insight into whether and how the 2023 Merger Guidelines should be taken into account in transaction-related risk assessments.

Background

Earlier this year, the FTC voted unanimously (5-0) to challenge Tapestry, Inc.’s proposed \$8.5 billion acquisition of Capri Holdings. According to the FTC complaint, the parties “compete on everything from clothing to eyewear to shoes” but compete “most fiercely” and have “eye-popping market shares” in accessible luxury handbags. Accessible luxury handbags are well-built and made largely of leather, unlike mass-market handbags, and are affordable, unlike luxury handbags.

In addition to alleging a narrow product market, the FTC’s complaint was noteworthy for its repeated citation to Guideline 8 of the 2023 Merger Guidelines for the proposition that “a firm that engages in an anticompetitive pattern or strategy of multiple acquisitions in the same or related business lines may violate Section 7” of the Clayton Act. The agency alleged that Tapestry, having previously acquired two other significant handbag brands in 2015 and 2017, is “engaged in an anticompetitive pattern and strategy of acquisitions in the ‘accessible luxury’ market and intends to continue this pattern and strategy.”

Serial acquisitions was not the only 2023 Merger Guidelines theory highlighted by the FTC as relevant to the proposed transaction. Specifically, the FTC also alleges that Tapestry’s acquisition of Capri will substantially harm competition in the labor market because it will eliminate the incentives for the two companies to compete for employees, thereby limiting wages and benefits.

Although in the past the agencies could and did challenge transactions based on niche market definitions, including premium fountain pens and “superpremium ice cream,” the 2023 Merger Guidelines articulated a very narrow approach to relevant market definition, allowing the agencies to ignore the impact of “significant substitutes” that may not fit within the narrowly defined relevant market. The Tapestry/Capri court’s decision turns entirely on acceptance of the FTC’s niche relevant product market for “accessible luxury handbags,” despite the

existence of significant substitutes both at lower and higher price points.

The Injunction Decision

The court's analysis rests on the nature of the competition between the parties, the product market definition, the concentration of the market and the parties' alleged market shares. The "central dispute" is the FTC's claim that within a broader market of more than 150 alleged handbag brands, there are three distinct submarkets — "mass market," "accessible luxury," and "true luxury" — and that mass-market handbags and luxury handbags are not reasonably interchangeable with accessible-luxury handbags and therefore are not part of the relevant product market.

The court recognized that accessible luxury handbags function similarly to mass market and luxury handbags: "One can carry a wallet, a phone, or a personal item in a Trader Joe's tote bag just as effectively as in an Hermès Birkin." The court noted, however, that even when two products are functionally fungible, consumers may not view them as reasonably interchangeable. The court also concluded that brands play a role in consumers' selection of which handbag to purchase.

The court also examined the premise that higher-quality, higher-priced products may constitute a separate market than lower-quality, lower-priced products. It found, among other things, the following distinguishing factors:

- The materials and craftsmanship commonly used in accessible luxury handbags compared to mass market handbags.
- Manufacturing location distinguishes accessible luxury handbags:
 - Accessible luxury brands outsource almost all manufacturing to third parties in Southeast Asia; and
 - Most luxury brands are made in European countries such as France and Italy, with little (if any) manufacturing presence in Asia.
- Price and pricing method differences between mass market, accessible luxury, and luxury brands:
 - Accessible luxury handbags have an entry price point of approximately \$100 and rarely approach or exceed \$1,000, heavily relying on discounts and other promotions;
 - Mass market handbags generally are priced below \$100; and
 - Luxury brands generally are priced over \$1,000 and discount less frequently.

The Tapestry/Capri court noted that even if alternative submarkets exist or if there are broader markets that might exist, the viability of such additional markets does not render the one identified by the FTC inappropriate.

Although the court acknowledged that the distinguishing factors above, alleged by the FTC, do not apply

consistently to the products at issue, the court found that the factors still weigh in favor of a separate mid-tier or accessible luxury market. The court also discounted the importance of consumer preference with respect to some factors.

Perhaps most importantly, the court found the evidence of head-to-head competition between the parties compelling. Because the court found the competition between the parties on pricing, discounting, and marketing efforts compelling, it determined that it need not reach the FTC's arguments that the parties also compete regarding handbag design, brick-and-mortar presence, and sustainability efforts.

Generally, the court found the FTC's expert analysis more compelling than that of the merging parties' expert. For example, the court accepted the FTC's expert's inclusion of wholesale prices along with retail prices when defining a market based on price, thereby rejecting the defendants' approach. The agency's expert calculates that the post-merger market concentration would be 3,646 points, with a merger-induced change in concentration of 1,449 points. Under the Merger Guidelines, the post-merger market concentration exceeded the highly concentrated range of 1,800 points and the change in market concentration exceeded the 100 points necessary for the FTC to assert the structural presumption that the proposed transaction would substantially lessen competition. The FTC estimated that the post-merger market share of the parties would be 59%.

Conclusions

The Tapestry/Capri challenge appears to support the agencies' pro-enforcement policy and is interesting for several reasons.

- The current nature of the competition between the parties should not be underestimated. Even if other competitors are also important, if the parties' internal documents and external statements arguably focus on each other, the potential for loss of competition and the parties' risks will likely be amplified.
- At least some courts will embrace the 2023 Merger Guidelines' more aggressive approach to merger analysis.
- Niche submarkets within broad markets, including those with many competitors, will not get a pass from the agencies. Parties should consider a more in-depth review into their products' characteristics and how they might be used to narrow the relevant product market.
- The merging parties' statements to the investment community and in internal documents should be taken into account in any review of potential market definitions.
- The FTC's focus is not limited to transactions involving kitchen table items and hot-button industries, such as health care, agriculture, or tech, and the 2023 Merger Guidelines apply equally to all industries.
- Even where parties already separately operate brands or divisions, the parties' assurances that the brands will continue to compete post-closing are not likely to save a transaction otherwise seen as problematic.
- The agencies will likely continue to file cases in jurisdictions they believe are willing to embrace the 2023 Merger Guidelines and go beyond the majority of existing precedent.

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