



Insight

Is a Hot Dog a Sandwich? Accurately Identifying the Relevant Market

FRED ASHTON | DECEMBER 14, 2023

Executive Summary

- The Federal Trade Commission (FTC) is reportedly investigating whether the addition of the Subway franchise to Roark Capital's menu of sandwich shops leaves the firm with a monopoly.
- A potential lawsuit will likely target Roark Capital's roll-up strategy – a multi-merger tactic targeting companies in a particular market – a common practice among private equity firms that the FTC has stated warrants more intense scrutiny.
- The FTC must convince the court that the relevant market of fast-food sandwich shops is sufficiently broad enough to include all market-disciplining competitors; in other words, the agency will need to end the debate over whether a hot dog is a sandwich.

Introduction

The Federal Trade Commission (FTC) is reportedly investigating whether Roark Capital's \$10 billion acquisition of Subway to its menu of sandwich shops will create a monopoly. A potential complaint will likely focus on the private equity firm's alleged roll-up strategy, a common practice among private equity firms that involves a series of acquisitions targeting companies in a particular market. The FTC has stated that this tactic warrants more intense scrutiny from antitrust enforcers.

With the acquisition of Subway, Roark Capital will own [four of the top seven largest U.S. sandwich chains based on 2022 sales](#), including Arby's, Jimmy John's, and McAlister's Deli. The firm also owns Schlotzsky's.

[Reports of the investigation](#) were met with fanfare from Senator Elizabeth Warren (D-MA), who tweeted that the deal “could lead to higher food prices for consumers” and “creates a sandwich shop monopoly.”

Convincing the court that the narrowly defined limited-service restaurant sandwich shop is a credible relevant market could prove difficult for the FTC. The agency will need to demonstrate that other limited-service restaurants – from hot dog stands to fast-food chains – do not apply a sufficient competitive constraint on Roark Capital's ability to raise prices.

Roll-up Strategies

Roll-up strategies involve numerous, and often small, acquisitions in a particular industry. A common tactic among private equity firms, the process begins with the purchase of one company, followed over time with the acquisition of several additional small firms, to create one large organization. In turn, the larger organization can leverage economies of scale, reducing costs while expanding products and services offered, to the benefit of

consumers. Acquisitions included in a roll-up strategy can take place over a period of years, or even decades.

The FTC and the Department of Justice (DOJ) are skeptical of this rationale. The agencies believe that this strategy is often used to lessen competition. In a [September 2023 opinion piece](#), FTC Chair Lina Khan stated a reason that “enforcers may not have scrutinised the impact of roll-ups previously is the relatively small size of each acquisition. Roll-ups are executed through a series of smaller acquisitions, in which each may fall below the dollar threshold that triggers reporting to federal antitrust agencies.”

In June 2023, the [FTC and DOJ announced changes to the rules governing the Hart-Scott-Rodino Act \(HSR\)](#). Included in the proposal are changes to help remedy Chair Khan’s concerns. Current reporting criteria require acquiring firms to disclose prior acquisitions made within the last five years. The proposed changes would expand the scope to include the same information from the acquired entity. The agencies would also require the time frame be extended from five years to 10 years.

Requiring the acquired firm to disclose past acquisitions is designed to reveal whether the acquiring firm is purchasing an already rolled-up entity. Extending the time frame would provide the agencies with a longer history of acquisitions that may be part of an alleged roll-up strategy.

Moreover, the antitrust enforcement agencies included a section specifically addressing roll-up strategies in the July 2023 [draft Merger Guidelines](#). Guideline 9 warned businesses and antitrust practitioners that “a firm that engages in an anticompetitive pattern or strategy of multiple small acquisitions in the same or related business lines may violate Section 7 [of the Clayton Act], even if no single acquisition on its own would risk substantially lessening competition or tending to create a monopoly.” The agencies added that “when a merger is part of multiple acquisitions, the agencies may examine the whole series.”

The proposed changes to the HSR rules and the draft Merger Guidelines work in conjunction to address roll-up strategies.

In September, the [FTC sued U.S. Anesthesia Partners \(USAP\) and private equity firm Welsh, Carson, Anderson & Stowe \(Welsh Carson\)](#), alleging the two consolidated anesthesiology practices in Texas to harm competition using a roll-up strategy. The complaint claims that in 2012, Welsh Carson created USAP made several acquisitions that involved “over a dozen practices, 1,000 doctors, and 750 nurses.”

While the case is ongoing, the FTC will likely use the same theory in any potential case against Roark Capital and its assembly of sandwich shops.

Defining the Relevant Market

To block the merger, the FTC will need to show that the effect of Roark Capital’s acquisition of Subway as its latest piece in the alleged roll-up strategy may be substantially to lessen competition, or tend to create a monopoly, in violation of the Clayton Act. It may prove difficult for the FTC to convince the court that a narrowly defined relevant market of limited-service restaurant sandwich shops accurately reflects the competitive environment of the industry.

[The relevant market definition is often a point of contention in antitrust litigation](#). Companies accused of antitrust law violations will claim that the agency’s analysis was conducted using a relevant market that was too narrowly defined, leading to a higher perceived level of market power. The outcome of many antitrust cases

hinges on the relevant market definition.

The [2010 Horizontal Merger Guidelines \(HMG\)](#) explains the importance of properly defining the relevant market: “market definition helps specify the line of commerce and section of the country in which the competitive concerns arise” and “allows the agencies to identify market participants and measure market shares and market concentration.”

To accurately determine the relevant market, the HMG outlines the hypothetical monopolist test. The test is intended to help antitrust enforcers “evaluate whether groups of products in candidate markets are sufficiently broad to constitute relevant antitrust markets.” In the case of a merger or acquisition, the agencies will use the test to “identify a set of products that are reasonably interchangeable with a product sold by one of the merging firms.” In other words, products or services that apply a reasonable competitive restraint on the merging firms must be considered.

The test requires that the hypothetical monopolist will be able to profitably impose a “small but significant and non-transitory increase in price (SSNIP).” The antitrust agencies typically model a 5 percent to 10 percent price increase.

Implementing the Hypothetical Monopolist Test

[Section 4.1.3](#) of the 2010 Horizontal Merger Guidelines describes how the agencies implement the test.

Using the potential Subway case as an example, the agency would first test whether Roark Capital’s ensemble of sandwich shops can profitably impose an SSNIP in the most narrowly defined limited-service sandwich shop market. If it can, the relevant market is properly defined. If not, that is evidence that there are competitive restraints applied to the industry outside of sandwich shops as strictly defined. The agency must broaden its definition to include reasonably substitutable products until the hypothetical monopolist can profitably increase prices.

If the FTC uses the narrowly defined relevant market of limited-service sandwich shops in its lawsuit, the agency will be faced with proving other limited-service restaurants do not pose competition. In other words, it will have to demonstrate that a hot dog, burrito, and other lunch delicacies are not reasonable substitutes.

Market of Sandwich Shops

Roark Capital’s assortment of sandwich shops includes four of the top seven largest U.S. sandwich chains based on 2022 sales: Arby’s, Jimmy John’s, McAlister’s Deli, and now Subway. Subway, Arby’s, and Jimmy John’s have the greatest number of locations of sandwich shops in the U.S.

Data from the *2017 Economic Census*, however, showed that there were over 157,000 limited-service restaurant firms operating nearly 253,000 establishments in the United States. The 50 largest firms accounted for 16.6 percent of all sales, far below the threshold for what would be considered concentrated. While the category of limited-service restaurants is broader than just sandwich shops, the data suggest most of these establishments are independently owned small businesses with one or two locations. The market expands further when supermarkets and grocery stores selling made-to-order sandwiches are included.

Moreover, when assessing the proper relevant market in a potential case against Roark Capital and Subway, the

FTC will need to consider whether the fierce competition among purveyors of the lunchtime staple extends beyond other sandwich vendors to include sellers of burritos, tacos, hamburgers, mobile food trucks, and yes, the corner hot dog cart.

It is also reasonable to further broaden the relevant market definition to include all limited-service restaurants, including various fast-food franchises. McDonald's alone had \$48.7 billion in U.S. sales in 2022, dwarfing the \$18.6 billion in combined sales among Subway, Arby's, Jimmy John's, McAlister's Deli, and Schlotzsky's.

These reasonable substitutes (or other sandwiches in the case of the hot dog) impose competitive restraints on price increases.

Conclusion

The crux of any potential lawsuit will likely target Roark Capital's roll-up strategy. To successfully block the merger, the FTC must convince the court that the relevant market of fast-food shops is sufficiently broad enough to include all market-disciplining competitors.