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CLIENT MEMORANDUM

February 5, 2025

Court Rejects FTC's Challenge to Tempur Sealy-Mattress Firm Transaction

- A federal district court denied the FTC's motion for a preliminary injunction blocking the vertical merger of mattress manufacturer Tempur Sealy and mattress retailer Mattress Firm.

- The court found that the FTC failed to offer evidence sufficient to support its purported market for premium mattresses costing more than $2,000.

- The court also recognized that "vertical integration 'virtually never poses a threat to competition when undertaken unilaterally and in competitive markets.'"

On February 4, 2025, Judge Charles Eskridge of the U.S. District Court for the Southern District of Texas denied the motion of the Federal Trade Commission (FTC) for a preliminary injunction preventing the $4 billion vertical merger of Tempur Sealy International, Inc., a mattress manufacturer, with Mattress Firm Group, Inc., a multi-brand mattress retailer. The court found that the FTC failed to establish a prima facie case of competitive harm and was therefore not likely to succeed on the merits.

FTC Failed to Establish a Proper Relevant Market Based on "Premium Mattresses"

The court found that the FTC failed to meet its burden demonstrating that the relevant market was premium mattresses priced above $2,000 in the United States. According to the court, "[f]ailure to prove a relevant antitrust market alone requires denial of the preliminary injunction requested by the FTC."

- The FTC failed to demonstrate the product market using the "practical indicia" of markets as described in the Supreme Court's *Brown Shoe* opinion. Among other things:

  - The court found that the price cut-off was "arbitrary." Tempur Sealy inconsistently uses the $2,000 demarcation to assess its market share. Others in the industry identified a $1,000 price for a "premium" mattress.

  - "Witnesses testified (not surprisingly) that customers themselves shop across price points," and the FTC did not demonstrate a lack of substitution between differently priced mattresses.

  - The FTC failed to show that >$2,000 mattresses have "uses and characteristics peculiar to them that are different from the uses and characteristics of <$2000 mattresses."

  - "Testimony instead established that no distinct group of customers exists as to those who purchase mattresses above $2,000."

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  - "No witness testified that there are specialized retailers or sales processes for mattresses priced at or above $2,000."

- The court went on to evaluate an alternate way of establishing a market using the so-called Hypothetical Monopolist Test. The court found that the FTC's expert failed to perform the test correctly and that the expert used "parameters and inputs . . . designed to produce the outcome sought, without accord to market realities."

- The court also held that the FTC failed to meet its burden to establish a relevant geographic market, finding there is a local dimension to competition not captured by the FTC's alleged nationwide geographic market.

FTC Failed to Show that the Transaction would Harm Tempur Sealy Competitors

While the failure to prove a relevant market was sufficient for the court to deny the motion for preliminary injunction, the court went on to hold that the FTC failed to offer sufficient support for its vertical theory of harm, including because "ordinary-course documents and industry data wholly undermine its argument."

- The court agreed with the FTC's contention that by owning Mattress Firm, the merged company would have the ability to exclude rival manufacturers.

- As for incentive, the court found that the FTC established, including through "ordinary-course evidence," that the "combined firm will have a profit-aligned incentive to increase the sales of Tempur Sealy mattresses after acquisition by excluding rivals from the Mattress Firm floor." However:

  - The court stated that "acquisition presents a potential foreclosure share of somewhere between approximately one and nine percent, which isn't concerning given the competitive nature of the mattress industry on both the supply and retail side." It noted that vertical merger challenges "have been rejected on similarly low foreclosure percentages."

  - "[R]ivals can thrive without relying on Mattress Firm because just under seventy-five percent of mattresses priced at or above $2,000 are sold elsewhere than Mattress Firm."

  - "Tempur Sealy . . . has only a 24.8 percent share of the proposed relevant market at wholesale."

  - The FTC expert's opinion predicting a post-merger price increase was flawed, including because it failed to account for the elimination of double marginalization (profit margins paid to intermediaries in the supply chain) that is characteristic of vertical mergers.

- The court then addressed commitments made by the parties to resolve potential competition concerns, including an agreement to divest certain Mattress Firm stores to an independent retailer, Mattress Warehouse[1]; the commitment to reserve slots on the Mattress Firm floor "for at least five years for third-party mattresses priced $1,500 and above"; and "various post-close supply agreements with a number of mattress suppliers." The court concluded that these remedies "reasonably address any concerns on the margins." This is because the "divestiture guarantees further, reasonable retail alternatives for . . . rivals of Tempur Sealy by reducing both Mattress Firm's market share and the already-low total possible foreclosure percentage." And the slot commitments and supply agreements provided further assurance that third-party manufacturers will have access to distribution through Mattress Firm.

[1] Paul, Weiss represented Mattress Warehouse in this matter.

Significance

This case is significant because it re-affirms the principle that "vertical integration 'virtually never poses a threat to competition when undertaken unilaterally and in competitive markets,'" and that the elimination of double marginalization is very often a pro-competitive aspect of vertical mergers. The prior administration backed away from this view, but the decision in this case serves as an important reminder that the view still has currency in the judiciary.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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