[Antitrust in the 21st Century]

Casebook

Module 4 – Mergers

Merger Basics

While the Sherman Act also covers mergers, Congress passed the Clayton Act in 1914 to provide a stricter and more structured form of merger control. In 1950, Congress strengthened the law with the Celler-Kefauer amendment.

When you read these cases, consider the following issues:

- Because mergers are almost always challenged before they happen, we can rarely know for sure what their effect on competition will be. How do courts respond to this uncertainty?
- What might be some competitive benefits of a merger, and how do courts weigh these against the risk to competition?
- Are decentralized markets better *only* because they have more competition? Or are there other benefits to a more decentralized economy? Should antitrust doctrine care about these benefits?

Required reading

Clayton Act §7, 15 U.S.C. §18 (as amended)

Brown Shoe Co. v. United States, 370 U.S. 294 (1962)

Recommended reading

United States v. Columbia Steel Co., 334 U.S. 495 (1948)

United States v. Philadelphia National Bank, 374 U.S. 321 (1963)

United States v. General Dynamics Corp., 415 U.S. 486 (1974)

Enforcement Guidance

Although the early cases provide helpful interpretations of the Clayton Act, enforcement is now primarily driven by agency priorities, as outlined in their enforcement guidelines. Because companies want to close their mergers quickly, many merger cases settle by consent decrees with the agencies, and few reach the appellate courts.

The federal agencies' approach is reflected in their Horizontal and Vertical merger guidelines. (However, the FTC withdrew its endorsement of the Vertical Merger Guidelines in 2021, after only one year of use, so those guidelines are less influential.) In short, the guidelines are concerned with whether a merger will lessen competition in a way that is likely to increase prices, reduce quality, or lessen innovation. While reading the guidelines, consider whether they are consistent with the appellate cases in this module (see *Staples*).

Required reading

Horizontal Merger Guidelines (2010 or most recent version), U.S. Department of Justice and Federal Trade Commission

Recommended reading

Vertical Merger Guidelines (2020, withdrawn), U.S. Department of Justice and Federal Trade Commission

The guidelines have led to a more structured analysis of merger cases. There are two steps: 1) define the market; and 2) assess the harm the merger may pose to competition.

1) Define the market

To define a company's market, the agency will assess which companies compete with it for customers. To decide whether firms make up a market, agencies commonly use the "hypothetical monopolist" or "SSNIP" test. The test imagines that all the firms under consideration are controlled by a single monopolist who raises the prices of all their relevant products by 5% (a "small but significant non-transitory increase in price"). If consumers would not leave the proposed market in large numbers, the price increase is profitable for the hypothetical monopolist, and the market under consideration is valid. See the Horizontal Guidelines for more about this test.

Although market definition is a popular tool for merger analysis, consider whether this tool might overshadow what merger control ultimately cares about: the analysis of competitive effects. Is market definition too static a tool for certain types of markets? (See Podszun.)

Mergers are called horizontal if the combining companies compete head-to-head, vertical if they operate in related markets, and conglomerate if they operate in unrelated markets. The agencies are much more lenient toward vertical and conglomerate mergers than toward horizontal ones.

Required reading

United States v. E.I. Du Pont de Nemours & Co., 351 U.S. 377 (1956)

Eastman Kodak Co. v. Image Technical Services, Inc., 504 U.S. 451 (1992)

FTC v. Staples Inc. & Office Depot Inc., 190 F. Supp.3d 100 (D.D.C. 2016)

Background reading

Rupprecht Podszun, *The Arbitrariness of Market Definition and an Evolutionary Concept of Markets*, Antitrust Bulletin (2016), 61(1), 121–32.

2) Assess harm to competition

Required reading

Complaint, *United States of America v. Anheuser-Busch InBev SA/NV et al.*

Recommended reading

FTC v. H.J. Heinz Co., 246 F.3d 708 (D.C. Cir. 2001)

Background reading

United States v. H&R Block, Inc., 833 F. Supp. 2d 36 (D.D.C. 2011)

Steves & Sons Inc. v. Jeld-Wen Inc., 988 F.3d 690 (2021)

Procedure

The Hart-Scott-Rodino Act sets up a system for merger preclearance. Companies above certain sizes must notify the antitrust agencies before merging. If the merger raises competitive concerns, the agencies may require the companies to provide more information and hold off closing the deal.

Often, merging companies can allay the agencies' concerns by agreeing to settlements that require structural or behavioral remedies. For example, one of the merging companies might agree to spin off a division that directly competes with the other.

If the parties cannot reach a settlement, then the agencies can sue to block the merger. The agencies can also sue retrospectively to unwind a merger, but this is rarer.

Required reading

Hart-Scott-Rodino Antitrust Improvements Act of 1976

Background reading

United States v. E.I. Du Pont de Nemours & Co., 353 U.S. 586 (1957)

Contents

Clayton Act § 7, 15 U.S.C. § 18 (as amended)

> No person engaged in commerce or in any activity affecting commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital and no person subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of another person engaged also in commerce or in any activity affecting commerce, where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly.
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> No person shall acquire, directly or indirectly, the whole or any part of the stock or other share capital and no person subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of one or more persons engaged in commerce or in any activity affecting commerce, where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition, of such stocks or assets, or of the use of such stock by the voting or granting of proxies or otherwise, may be substantially to lessen competition, or to tend to create a monopoly.
>
> This section shall not apply to persons purchasing such stock solely for investment and not using the same by voting or otherwise to bring about, or in attempting to bring about, the substantial lessening of competition. Nor shall anything contained in this section prevent a corporation engaged in commerce or in any activity affecting commerce from causing the formation of subsidiary corporations for the actual carrying on of their immediate lawful business, or the natural and legitimate branches or extensions thereof, or from owning and holding all or a part of the stock of such subsidiary corporations, when the effect of such formation is not to substantially lessen competition…

Comment

The Clayton Act does not apply to stock acquisitions "solely for investment." But given the debate over common ownership—which we will discuss later in the semester—should that omission be reconsidered?

Brown Shoe Co. v. United States, 370 U.S. 294 (1962)

This suit was initiated in November 1955 when the Government filed a civil action in the United States District Court for the Eastern District of Missouri alleging that a contemplated merger between the G. R. Kinney Company, Inc. (Kinney), and the Brown Shoe Company, Inc. (Brown), through an exchange of Kinney for Brown stock, would violate § 7 of the Clayton Act, 15 U. S. C. § 18….

A motion by the Government for a preliminary injunction *pendente lite* was denied, and the companies were permitted to merge provided, however, that their businesses be operated separately and that their assets be kept separately identifiable. The merger was then effected on May 1, 1956. (at 296)

…

The Industry.

The District Court found that although domestic shoe production was scattered among a large number of manufacturers, a small number of large companies occupied a commanding position. Thus, while the 24 largest manufacturers produced about 35% of the Nation's shoes, the top 4 -- International, Endicott-Johnson, Brown (including Kinney) and General Shoe -- alone produced approximately 23% of the Nation's shoes or 65% of the production of the top 24…

The District Court found that men's, women's, and children's shoes are normally produced in separate factories… The District Court found a "definite trend" among shoe manufacturers to acquire retail outlets… Brown, itself, with no retail outlets of its own prior to 1951, had acquired 845 such outlets by 1956. Moreover, between 1950 and 1956 nine independent shoe store chains, operating 1,114 retail shoe stores, were found to have become subsidiaries of these large firms and to have ceased their independent operations.

And once the manufacturers acquired retail outlets, the District Court found there was a "definite trend" for the parent-manufacturers to supply an ever increasing percentage of the retail outlets' needs, thereby foreclosing other manufacturers from effectively competing for the retail accounts. Manufacturer-dominated stores were found to be "drying up" the available outlets for independent producers.

Another "definite trend" found to exist in the shoe industry was a decrease in the number of plants manufacturing shoes. And there appears to have been a concomitant decrease in the number of firms manufacturing shoes. In 1947, there were 1,077 independent manufacturers of shoes, but by 1954 their number had decreased about 10% to 970. (at 300-301)

Brown Shoe.

Brown Shoe was found not only to have been a participant, but also a moving factor, in these industry trends. Although Brown had experimented several times with operating its own retail outlets, by 1945 it had disposed of them all. However, in 1951, Brown again began to seek retail outlets by acquiring the Nation's largest operator of leased shoe departments, Wohl Shoe Company

(Wohl), which operated 250 shoe departments in department stores throughout the United States. Between 1952 and 1955 Brown made a number of smaller acquisitions: Wetherby-Kayser Shoe Company (three retail stores), Barnes & Company (two stores), Reilly Shoe Company (two leased shoe departments), Richardson Shoe Store (one store), and Wohl Shoe Company of Dallas (not connected with Wohl) (leased shoe departments in Dallas). In 1954, Brown made another major acquisition: Regal Shoe Corporation which, at the time, operated one manufacturing plant producing men's shoes and 110 retail outlets.

The acquisition of these corporations was found to lead to increased sales by Brown to the acquired companies. Thus although prior to Brown's acquisition of Wohl in 1951, Wohl bought from Brown only 12.8% of its total purchases of shoes, it subsequently increased its purchases to 21.4% in 1952 and to 32.6% in 1955. Wetherby-Kayser's purchases from Brown increased from 10.4% before acquisition to over 50% after. Regal, which had previously sold no shoes to Wohl and shoes worth only $ 89,000 to Brown, in 1956 sold shoes worth $ 265,000 to Wohl and $ 744,000 to Brown.

During the same period of time, Brown also acquired the stock or assets of seven companies engaged solely in shoe manufacturing. As a result, in 1955, Brown was the fourth largest shoe manufacturer in the country, producing about 25.6 million pairs of shoes or about 4% of the Nation's total footwear production. (at 302-303)

Kinney.

Kinney is principally engaged in operating the largest family-style shoe store chain in the United States. At the time of trial, Kinney was found to be operating over 400 such stores in more than 270 cities. These stores were found to make about 1.2% of all national retail shoe sales by dollar volume. Moreover, in 1955 the Kinney stores sold approximately 8 million pairs of nonrubber shoes or about 1.6% of the national pairage sales of such shoes. Of these sales, approximately 1.1 million pairs were of men's shoes or about 1% of the national pairage sales of men's shoes; approximately 4.2 million pairs were of women's shoes or about 1.5% of the national pairage sales of women's shoes; and approximately 2.7 million pairs were of children's shoes or about 2% of the national pairage sales of children's shoes.

In addition to this extensive retail activity, Kinney owned and operated four plants which manufactured men's, women's, and children's shoes and whose combined output was 0.5% of the national shoe production in 1955, making Kinney the twelfth largest shoe manufacturer in the United States.

Kinney stores were found to obtain about 20% of their shoes from Kinney's own manufacturing plants. At the time of the merger, Kinney bought no shoes from Brown; however, in line with Brown's conceded reasons for acquiring Kinney, Brown had, by 1957, become the largest outside supplier of Kinney's shoes, supplying 7.9% of all Kinney's needs.

It is in this setting that the merger was considered and held to violate § 7 of the Clayton Act. The District Court ordered Brown to divest itself completely of all stock, share capital, assets or other interests it held in Kinney, to operate Kinney to the greatest degree possible as an independent concern pending complete divestiture, to refrain thereafter from acquiring or having any interest in Kinney's business or assets, and to file with the court within 90 days a plan for carrying into effect the divestiture decreed. The District Court also stated it would retain jurisdiction over the cause to enable the parties to apply for such further relief as might be necessary to enforce and apply the judgment. Prior to its submission of a divestiture plan, Brown filed a notice of appeal in the District Court. It then filed a jurisdictional statement in this Court, seeking review of the judgment below as entered. (at 303-304)

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This case is one of the first to come before us in which the Government's complaint is based upon allegations that the appellant has violated § 7 of the Clayton Act, as that section was amended in 1950.[18] The amendments adopted in 1950 culminated extensive efforts over a number of years, on the parts of both the Federal Trade Commission and some members of Congress, to secure revision of a section of the antitrust laws considered by many observers to be ineffective in its then existing form. Sixteen bills to amend § 7 during the period 1943 to 1949 alone were introduced for consideration by the Congress, and full public hearings on proposed amendments were held in three separate sessions. In the light of this extensive legislative attention to the measure, and the broad, general language finally selected by Congress for the expression of its will, we think it appropriate to review the history of the amended Act in determining whether the judgment of the court below was consistent with the intent of the legislature. See *United States* v. *E. I. du Pont de Nemours & Co*., 353 U.S. 586, 591-592; *Schwegmann Bros*. v. *Calvert Distillers Corp*., 341 U.S. 384, 390-395; *Federal Trade Comm'n* v. *Morton Salt Co*., 334 U.S. 37, 43-46, 49; *Corn Products Refining Co*. v. *Federal Trade Comm'n*, 324 U.S. 726, 734-737.

As enacted in 1914, § 7 of the original Clayton Act prohibited the acquisition by one corporation of the *stock* of another corporation when such acquisition would result in a substantial lessening of competition *between the acquiring and the acquired* companies, or tend to create a monopoly in any line of commerce. The Act did not, by its explicit terms, or as construed by this Court, bar the acquisition by one corporation of the *assets* of another. Nor did it appear to preclude the acquisition of stock in any corporation other than a direct competitor. Although proponents of the

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[18] Material in italics was added by the amendments; material in brackets was deleted. "No corporation engaged in commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital *and no corporation subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets* of another corporation engaged also in commerce, where *in any line of commerce in any section of the country*, the effect of such acquisition may be [to] substantially *to* lessen competition [between the corporation whose stock is so acquired and the corporation making the acquisition, or to restrain such commerce in any section or community], or *to* tend to create a monopoly [of any line of commerce]." Other paragraphs of § 7 were also amended in details not relevant to this case. The only other cases to reach this Court, in which the Government's complaints were based, in part, on amended § 7, were *Maryland & Virginia Milk Producers Assn*. v. *United States*, 362 U.S. 458, and *Jerrold Electronics Corp*. v. *United States*, 365 U.S. 567. However, a detailed analysis of the scope and purposes of the 1950 amendments was unnecessary to our disposition of the issues raised in those cases.

1950 amendments to the Act suggested that the terminology employed in these provisions was the result of accident or an unawareness that the acquisition of assets could be as inimical to competition as stock acquisition, a review of the legislative history of the original Clayton Act fails to support such views. The possibility of asset acquisition was discussed, but was not considered important to an Act then conceived to be directed primarily at the development of holding companies and at the secret acquisition of competitors through the purchase of all or parts of such competitors' stock. (at 311-314)

It was, however, not long before the Federal Trade Commission recognized deficiencies in the Act as first enacted. Its Annual Reports frequently suggested amendments, principally along two lines: first, to "plug the loophole" exempting asset acquisitions from coverage under the Act, and second, to require companies proposing a merger to give the Commission prior notification of their plans. The Final Report of the Temporary National Economic Committee also recommended changes focusing on these two proposals. Hearings were held on some bills incorporating either or both of these changes but, prior to the amendments adopted in 1950, none reached the floor of Congress for plenary consideration. Although the bill that was eventually to become amended § 7 was confined to embracing within the Act's terms the acquisition of assets as well as stock, in the course of the hearings conducted in both the Eightieth and Eighty-first Congresses, a more far-reaching examination of the purposes and provisions of § 7 was undertaken. A review of the legislative history of these amendments provides no unmistakably clear indication of the precise standards the Congress wished the Federal Trade Commission and the courts to apply in judging the legality of particular mergers. However, sufficient expressions of a consistent point of view may be found in the hearings, committee reports of both the House and Senate and in floor debate to provide those charged with enforcing the Act with a usable frame of reference within which to evaluate any given merger.

The dominant theme pervading congressional consideration of the 1950 amendments was a fear of what was considered to be a rising tide of economic concentration in the American economy. Apprehension in this regard was bolstered by the publication in 1948 of the Federal Trade Commission's study on corporate mergers. Statistics from this and other current studies were cited as evidence of the danger to the American economy in unchecked corporate expansions through mergers.[27] Other considerations cited in support of the bill were the desirability of retaining "local

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[27] F. T. C., The Present Trend of Corporate Mergers and Acquisitions, reprinted in Hearings on H. R. 515, at 300-317; F. T. C., The Merger Movement: A Summary Report, *passim*; 95 Cong. Rec. 11500-11507; 96 Cong. Rec. 16433, 16444, 16457; S. Rep. No. 1775, 81st Cong., 2d Sess. 3. The House Report on the amendments summarized its view of the situation:

"That the current merger movement [during the years 1940-1947] has had a significant effect on the economy is clearly revealed by the fact that the asset value of the companies which have disappeared through mergers amounts to 5.2 billion dollars, or no less than 5.5 percent of the total assets of all manufacturing corporations -- a significant segment of the economy to be swallowed up in such a short period of time." H. R. Rep. No. 1191, 81st Cong., 1st Sess. 3.

control" over industry and the protection of small businesses.[28] Throughout the recorded discussion may be found examples of Congress' fear not only of accelerated concentration of economic power on economic grounds, but also of the threat to other values a trend toward concentration was thought to pose.

What were some of the factors, relevant to a judgment as to the validity of a given merger, specifically discussed by Congress in redrafting § 7?

First, there is no doubt that Congress did wish to "plug the loophole" and to include within the coverage of the Act the acquisition of assets no less than the acquisition of stock. (at 314-316)

Second, by the deletion of the "acquiring-acquired" language in the original text, it hoped to make plain that § 7 applied not only to mergers between actual competitors, but also to vertical and conglomerate mergers whose effect may tend to lessen competition in any line of commerce in any section of the country.

Third, it is apparent that a keystone in the erection of a barrier to what Congress saw was the rising tide of economic concentration, was its provision of authority for arresting mergers at a time when the trend to a lessening of competition in a line of commerce was still in its incipiency. Congress saw the process of concentration in American business as a dynamic force; it sought to assure the Federal Trade Commission and the courts the power to brake this force at its outset and before it gathered momentum.

Fourth, and closely related to the third, Congress rejected, as inappropriate to the problem it sought to remedy, the application to § 7 cases of the standards for judging the legality of business combinations adopted by the courts in dealing with cases arising under the Sherman Act, and which may have been applied to some early cases arising under original § 7.[33]

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[28] See, *e. g*., 95 Cong. Rec. 11486, 11489, 11494-11495, 11498; 96 Cong. Rec. 16444, 16448, 16450, 16452, 16503 (remarks by the cosponsors of the amendments, Representative Celler and Senator Kefauver, and by Representatives Bryson, Keating and Patman and Senators Murray and Aiken). Cf. *United States* v. *Aluminum Co. of America*, 148 F.2d 416, 429 (C. A. 2d Cir., per Learned Hand, J.): "Throughout the history of these [antitrust] statutes it has been constantly assumed that one of their purposes was to perpetuate and preserve, for its own sake and in spite of possible cost, an organization of industry in small units which can effectively compete with each other."

[33] The Report of the House Judiciary Committee on H. R. 515 recommended the adoption of tests more stringent than those in the Sherman Act. H. R. Rep. No. 596, 80th Cong., 1st Sess. 7. A vigorous minority thought no new legislation was needed. *Id*., at 11-18. Between the issuance of this Report and the Committee's subsequent consideration of H. R. 2734, this Court had decided *United States* v. *Columbia Steel Co*., 334 U.S. 495, which some understood to indicate that existing law might be inadequate to prevent mergers that had substantially lessened competition in a section of the country, but which, nevertheless, had not risen to the level of those restraints of trade or monopoly prohibited by the Sherman Act. See 96 Cong. Rec. 16502 (remarks of Senator Kefauver); H. R. Rep. No. 1191, 81st Cong., 1st Sess. 10-11. Numerous other statements by Congressmen and Senators and by representatives of the Federal Trade Commission, the Department of Justice and the President's Council of Economic Advisors were made to the Congress suggesting that a standard of illegality stricter than that imposed by the Sherman Act was needed. See, *e. g*., H. R. Hearings on H. R. 2734, at 13, 29, 41, 117; S. Hearings on H. R. 2734, at 22, 23, 47, 66, 319. The House Judiciary Committee's 1949 Report supported this concept unanimously although five of the nine members who had dissented two years

Fifth, at the same time that it sought to create an effective tool for preventing all mergers having demonstrable anticompetitive effects, Congress recognized the stimulation to competition that might flow from particular mergers. When concern as to the Act's breadth was expressed, supporters of the amendments indicated that it would not impede, for example, a merger between two small companies to enable the combination to compete more effectively with larger corporations dominating the relevant market, nor a merger between a corporation which is financially healthy and a failing one which no longer can be a vital competitive factor in the market. The deletion of the word "community" in the original Act's description of the relevant geographic market is another illustration of Congress' desire to indicate that its concern was with the adverse effects of a given merger on competition only in an economically significant "section" of the country. Taken as a whole, the legislative history illuminates congressional concern with the protection of *competition*, not *competitors*, and its desire to restrain mergers only to the extent that such combinations may tend to lessen competition.

Sixth, Congress neither adopted nor rejected specifically any particular tests for measuring the relevant markets, either as defined in terms of product or in terms of geographic locus of competition, within which the anticompetitive effects of a merger were to be judged. Nor did it adopt a definition of the word "substantially," whether in quantitative terms of sales or assets or market shares or in designated qualitative terms, by which a merger's effects on competition were to be measured.

Seventh, while providing no definite quantitative or qualitative tests by which enforcement agencies could gauge the effects of a given merger to determine whether it may "substantially" lessen competition or tend toward monopoly, Congress indicated plainly that a merger had to be functionally viewed, in the context of its particular industry. That is, whether the consolidation was to take place in an industry that was fragmented rather than concentrated, that had seen a recent trend toward domination by a few leaders or had remained fairly consistent in its distribution of market shares among the participating companies, that had experienced easy access to markets by suppliers and easy access to suppliers by buyers or had witnessed foreclosure of business, that had witnessed the ready entry of new competition or the erection of barriers to prospective entrants, all were aspects, varying in importance with the merger under consideration, which would properly be taken into account.

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earlier in H. R. Rep. No. 596 were still serving on the Committee. H. R. Rep. No. 1191, 81st Cong., 1st Sess. 7-8. The Senate Report was explicit: "The committee wish to make it clear that the bill is not intended to revert to the Sherman Act test. The intent here . . . is to cope with monopolistic tendencies in their incipiency and well before they have attained such effects as would justify a Sherman Act proceeding. . . . [The] various additions and deletions -- some strengthening and others weakening the bill -- are not conflicting in purpose and effect. They merely are different steps toward the same objective, namely, that of framing a bill which, though dropping portions of the so-called Clayton Act test that have no economic significance [the reference would appear to be primarily to the "acquiring-acquired" standard of the original Act], reaches far beyond the Sherman Act." S. Rep. No. 1775, 81st Cong., 2d Sess. 4-5.

Eighth, Congress used the words "*may be* substantially to lessen competition" (emphasis supplied), to indicate that its concern was with probabilities, not certainties. Statutes existed for dealing with clear-cut menaces to competition; no statute was sought for dealing with ephemeral possibilities. Mergers with a probable anticompetitive effect were to be proscribed by this Act. (at 316-323)

It is against this background that we return to the case before us.

IV.

THE VERTICAL ASPECTS OF THE MERGER.

Economic arrangements between companies standing in a supplier-customer relationship are characterized as "vertical." The primary vice of a vertical merger or other arrangement tying a customer to a supplier is that, by foreclosing the competitors of either party from a segment of the market otherwise open to them, the arrangement may act as a "clog on competition," *Standard Oil Co. of California* v. *United States*, 337 U.S. 293, 314…

The "area of effective competition" must be determined by reference to a product market (the "line of commerce") and a geographic market (the "section of the country").

The Product Market.

The outer boundaries of a product market are determined by the reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it. However, within this broad market, well-defined submarkets may exist which, in themselves, constitute product markets for antitrust purposes. *United States* v. *E. I. du Pont de Nemours & Co*., 353 U.S. 586, 593-595.The boundaries of such a submarket may be determined by examining such practical indicia as industry or public recognition of the submarket as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors. Because § 7 of the Clayton Act prohibits any merger which may substantially lessen competition "in *any* line of commerce" (emphasis supplied), it is necessary to examine the effects of a merger in each such economically significant submarket to determine if there is a reasonable probability that the merger will substantially lessen competition. If such a probability is found to exist, the merger is proscribed.

Applying these considerations to the present case, we conclude that the record supports the District Court's finding that the relevant lines of commerce are men's, women's, and children's shoes. These product lines are recognized by the public; each line is manufactured in separate plants; each has characteristics peculiar to itself rendering it generally noncompetitive with the others; and each is, of course, directed toward a distinct class of customers.

Appellant, however, contends that the District Court's definitions fail to recognize sufficiently "price/quality" and "age/sex" distinctions in shoes. Brown argues that the predominantly medium-priced shoes which it manufactures occupy a product market different from the predominantly low-priced shoes which Kinney sells. But agreement with that argument would be equivalent to holding that medium-priced shoes do not compete with low-priced shoes.

We think the District Court properly found the facts to be otherwise. It would be unrealistic to accept Brown's contention that, for example, men's shoes selling below $ 8.99 are in a different product market from those selling above $ 9.00.

This is not to say, however, that "price/quality" differences, where they exist, are unimportant in analyzing a merger; they may be of importance in determining the likely effect of a merger. But the boundaries of the relevant market must be drawn with sufficient breadth to include the competing products of each of the merging companies and to recognize competition where, in fact, competition exists. Thus we agree with the District Court that in this case a further division of product lines based on "price/quality" differences would be "unrealistic."

Brown's contention that the District Court's product market definitions should have recognized further "age/sex" distinctions raises a different problem. Brown's sharpest criticism is directed at the District Court's finding that children's shoes constituted a single line of commerce. Brown argues, for example, that "a little boy does not wear a little girl's black patent leather pump" and that "[a] male baby cannot wear a growing boy's shoes." Thus Brown argues that "infants' and babies'" shoes, "misses' and children's" shoes and "youths' and boys'" shoes should each have been considered a separate line of commerce. Assuming, *arguendo*, that little boys' shoes, for example, do have sufficient peculiar characteristics to constitute one of the markets to be used in analyzing the effects of this merger, we do not think that in this case the District Court was required to employ finer "age/sex" distinctions than those recognized by its classifications of "men's," "women's," and "children's" shoes. Further division does not aid us in analyzing the effects of this merger. Brown manufactures about the same percentage of the Nation's children's shoes (5.8%) as it does of the Nation's youths' and boys' shoes (6.5%), of the Nation's misses' and children's shoes (6.0%) and of the Nation's infants' and babies' shoes (4.9%). Similarly, Kinney sells about the same percentage of the Nation's children's shoes (2%) as it does of the Nation's youths' and boys' shoes (3.1%), of the Nation's misses' and children's shoes (1.9%), and of the Nation's infants' and babies' shoes (1.5%). Appellant can point to no advantage it would enjoy were finer divisions than those chosen by the District Court employed. Brown manufactures significant, comparable quantities of virtually every type of nonrubber men's, women's, and children's shoes, and Kinney sells such quantities of virtually every type of men's, women's, and children's shoes. Thus, whether considered separately or together, the picture of this merger is the same. We, therefore, agree with the District Court's conclusion that in the setting of this case to subdivide the shoe market further on the basis of "age/sex" distinctions would be "impractical" and "unwarranted."

The Geographic Market.

We agree with the parties and the District Court that insofar as the vertical aspect of this merger is concerned, the relevant geographic market is the entire Nation. The relationships of product value, bulk, weight and consumer demand enable manufacturers to distribute their shoes on a nationwide basis, as Brown and Kinney, in fact, do. The anticompetitive effects of the merger are to be measured within this range of distribution.

The Probable Effect of the Merger.

Once the area of effective competition affected by a vertical arrangement has been defined, an analysis must be made to determine if the effect of the arrangement "may be substantially to lessen competition, or to tend to create a monopoly" in this market.

Since the diminution of the vigor of competition which may stem from a vertical arrangement results primarily from a foreclosure of a share of the market otherwise open to competitors, an important consideration in determining whether the effect of a vertical arrangement "may be substantially to lessen competition, or to tend to create a monopoly" is the size of the share of the market foreclosed. However, this factor will seldom be determinative. If the share of the market foreclosed is so large that it approaches monopoly proportions, the Clayton Act will, of course, have been violated; but the arrangement will also have run afoul of the Sherman Act. And the legislative history of § 7 indicates clearly that the tests for measuring the legality of any particular economic arrangement under the Clayton Act are to be less stringent than those used in applying the Sherman Act. On the other hand, foreclosure of a *de minimis* share of the market will not tend "substantially to lessen competition."

Between these extremes, in cases such as the one before us, in which the foreclosure is neither of monopoly nor *de minimis* proportions, the percentage of the market foreclosed by the vertical arrangement cannot itself be decisive. In such cases, it becomes necessary to undertake an examination of various economic and historical factors in order to determine whether the arrangement under review is of the type Congress sought to proscribe.

A most important such factor to examine is the very nature and purpose of the arrangement. Congress not only indicated that "the tests of illegality [under § 7] are intended to be similar to those which the courts have applied in interpreting the same language as used in other sections of the Clayton Act," but also chose for § 7 language virtually identical to that of § 3 of the Clayton Act, 15 U. S. C. § 14, which had been interpreted by this Court to require an examination of the interdependence of the market share foreclosed by, and the economic purpose of, the vertical arrangement. Thus, for example, if a particular vertical arrangement, considered under § 3, appears to be a limited term exclusive-dealing contract, the market foreclosure must generally be significantly greater than if the arrangement is a tying contract before the arrangement will be held to have violated the Act. Compare *Tampa Electric Co*. v. *Nashville Coal Co*., 365 U.S. 320, and *Standard Oil Co. of California* v. *United States, supra*, with *International Salt Co*. v. *United States*, 332 U.S. 392. The reason for this is readily discernible. The usual tying contract forces the customer to take a product or brand he does not necessarily want in order to secure one which he does desire. Because such an arrangement is inherently anticompetitive, we have held that its use by an established company is likely "substantially to lessen competition" although only a relatively small amount of commerce is affected. *International Salt Co*. v. *United States, supra*. Thus, unless the tying device is employed by a small company in an attempt to break into a market, cf. *Harley-Davidson Motor Co*., 50 F. T. C. 1047, 1066, the use of a tying device can rarely be harmonized with the strictures of the antitrust laws, which are intended primarily to preserve and stimulate competition. See *Standard Oil Co. of California* v. *United States, supra*, at 305-306. On the other hand, requirement contracts are frequently negotiated at the behest of the customer who has chosen the particular supplier and his product upon the basis of competitive merit. See, *e. g., Tampa Electric Co*. v. *Nashville Coal Co., supra*. Of course, the fact that requirement contracts are not inherently anticompetitive will not save a particular agreement if, in fact, it is likely "substantially to lessen competition, or to tend to create a monopoly." *E. g., Standard Oil Co. of California* v. *United States, supra*. Yet a requirement contract may escape censure if only a small share of the market is involved, if the purpose of the agreement is to insure to the customer a sufficient supply of a commodity vital to the customer's trade or to insure to the supplier a market for his output and if there is no trend toward concentration in the industry. *Tampa Electric Co*. v. *Nashville Coal Co., supra*. Similar considerations are pertinent to a judgment under § 7 of the Act.

The importance which Congress attached to economic purpose is further demonstrated by the Senate and House Reports on H. R. 2734, which evince an intention to preserve the "failing company" doctrine of *International Shoe Co*. v. *Federal Trade Comm'n*, 280 U.S. 291. Similarly, Congress foresaw that the merger of two large companies or a large and a small company might violate the Clayton Act while the merger of two small companies might not, although the share of the market foreclosed be identical, if the purpose of the small companies is to enable them in combination to compete with larger corporations dominating the market.

The present merger involved neither small companies nor failing companies. In 1955, the date of this merger, Brown was the fourth largest manufacturer in the shoe industry with sales of approximately 25 million pairs of shoes and assets of over $ 72,000,000 while Kinney had sales of about 8 million pairs of shoes and assets of about $ 18,000,000. Not only was Brown one of the leading manufacturers of men's, women's, and children's shoes, but Kinney, with over 350 retail outlets, owned and operated the largest independent chain of family shoe stores in the Nation. Thus, in this industry, no merger between a manufacturer and an independent retailer could involve a larger potential market foreclosure. Moreover, it is apparent both from past behavior of Brown and from the testimony of Brown's President, that Brown would use its ownership of Kinney to force Brown shoes into Kinney stores. Thus, in operation this vertical arrangement would be quite analogous to one involving a tying clause.[55]

Another important factor to consider is the trend toward concentration in the industry. It is true, of course, that the statute prohibits a given merger only if the effect of *that* merger may be substantially to lessen competition. But the very wording of § 7 requires a prognosis of the probable *future* effect of the merger.

The existence of a trend toward vertical integration, which the District Court found, is well substantiated by the record. Moreover, the court found a tendency of the acquiring manufacturers to become increasingly important sources of supply for their acquired outlets. The necessary corollary of these trends is the foreclosure of independent manufacturers from markets otherwise

[55] Moreover, ownership integration is a more permanent and irreversible tie than is contract integration. See Kessler and Stern, Competition, Contract, and Vertical Integration, 69 Yale L. J. 1, 78 (1959).

open to them. And because these trends are not the product of accident but are rather the result of deliberate policies of Brown and other leading shoe manufacturers, account must be taken of these facts in order to predict the probable future consequences of this merger. It is against this background of continuing concentration that the present merger must be viewed.

…

The District Court's findings, and the record facts, many of them set forth in Part I of this opinion, convince us that the shoe industry is being subjected to just such a cumulative series of vertical mergers which, if left unchecked, will be likely "substantially to lessen competition."

We reach this conclusion because the trend toward vertical integration in the shoe industry, when combined with Brown's avowed policy of forcing its own shoes upon its retail subsidiaries, may foreclose competition from a substantial share of the markets for men's, women's, and children's shoes, without producing any countervailing competitive, economic, or social advantages.

V.

THE HORIZONTAL ASPECTS OF THE MERGER.

An economic arrangement between companies performing similar functions in the production or sale of comparable goods or services is characterized as "horizontal." The effect on competition of such an arrangement depends, of course, upon its character and scope. Thus, its validity in the face of the antitrust laws will depend upon such factors as: the relative size and number of the parties to the arrangement; whether it allocates shares of the market among the parties; whether it fixes prices at which the parties will sell their product; or whether it absorbs or insulates competitors. Where the arrangement effects a horizontal merger between companies occupying the same product and geographic market, whatever competition previously may have existed in that market between the parties to the merger is eliminated. Section 7 of the Clayton Act, prior to its amendment, focused upon this aspect of horizontal combinations by proscribing acquisitions which might result in a lessening of competition between the acquiring and the acquired companies. The 1950 amendments made plain Congress' intent that the validity of such combinations was to be gauged on a broader scale: their effect on competition generally in an economically significant market.

Thus, again, the proper definition of the market is a "necessary predicate" to an examination of the competition that may be affected by the horizontal aspects of the merger. The acquisition of Kinney by Brown resulted in a horizontal combination at both the manufacturing and retailing levels of their businesses. Although the District Court found that the merger of Brown's and Kinney's *manufacturing* facilities was economically too insignificant to come within the prohibitions of the Clayton Act, the Government has not appealed from this portion of the lower court's decision. Therefore, we have no occasion to express our views with respect to that finding. On the other hand, appellant does contest the District Court's finding that the merger of the companies' *retail* outlets may tend substantially to lessen competition.

The Product Market.

Shoes are sold in the United States in retail shoe stores and in shoe departments of general stores. These outlets sell: (1) men's shoes, (2) women's shoes, (3) women's or children's shoes, or (4) men's, women's or children's shoes. Prior to the merger, both Brown and Kinney sold their shoes in competition with one another through the enumerated kinds of outlets characteristic of the industry.

In Part IV of this opinion we hold that the District Court correctly defined men's, women's, and children's shoes as the relevant lines of commerce in which to analyze the vertical aspects of the merger. For the reasons there stated we also hold that the same lines of commerce are appropriate for considering the horizontal aspects of the merger. (323-337)

The Geographic Market.

…

The parties do not dispute the findings of the District Court that the Nation as a whole is the relevant geographic market for measuring the anticompetitive effects of the merger viewed vertically or of the horizontal merger of Brown's and Kinney's manufacturing facilities. As to the retail level, however, they disagree….

We therefore agree that the District Court properly defined the relevant geographic markets in which to analyze this merger as those cities with a population exceeding 10,000 and their environs in which both Brown and Kinney retailed shoes through their own outlets. Such markets are large enough to include the downtown shops and suburban shopping centers in areas contiguous to the city, which are the important competitive factors, and yet are small enough to exclude stores beyond the immediate environs of the city, which are of little competitive significance.

The Probable Effect of the Merger.

Having delineated the product and geographic markets within which the effects of this merger are to be measured, we turn to an examination of the District Court's finding that as a result of the merger competition in the retailing of men's, women's and children's shoes may be lessened substantially in those cities in which both Brown and Kinney stores are located… (338-341)

The market share which companies may control by merging is one of the most important factors to be considered when determining the probable effects of the combination on effective competition in the relevant market. In an industry as fragmented as shoe retailing, the control of substantial shares of the trade in a city may have important effects on competition. If a merger achieving 5% control were now approved, we might be required to approve future merger efforts by Brown's competitors seeking similar market shares. The oligopoly Congress sought to avoid would then be furthered and it would be difficult to dissolve the combinations previously approved. Furthermore, in this fragmented industry, even if the combination controls but a small share of a particular market, the fact that this share is held by a large national chain can adversely affect competition. Testimony in the record from numerous independent retailers, based on their actual experience in the market, demonstrates that a strong, national chain of stores can insulate selected outlets from the vagaries of competition in particular locations and that the large chains can set and alter styles in footwear to an extent that renders the independents unable to maintain competitive inventories. A third significant aspect of this merger is that it creates a large national chain which is integrated with a manufacturing operation. The retail outlets of integrated companies, by eliminating wholesalers and by increasing the volume of purchases from the manufacturing division of the enterprise, can market their own brands at prices below those of competing independent retailers. Of course, some of the results of large integrated or chain operations are beneficial to consumers. Their expansion is not rendered unlawful by the mere fact that small independent stores may be adversely affected. It is competition, not competitors, which the Act protects. But we cannot fail to recognize Congress' desire to promote competition through the protection of viable, small, locally owned businesses. Congress appreciated that occasional higher costs and prices might result from the maintenance of fragmented industries and markets. It resolved these competing considerations in favor of decentralization. We must give effect to that decision.

Other factors to be considered in evaluating the probable effects of a merger in the relevant market lend additional support to the District Court's conclusion that this merger may substantially lessen competition. One such factor is the history of tendency toward concentration in the industry. As we have previously pointed out, the shoe industry has, in recent years, been a prime example of such a trend. Most combinations have been between manufacturers and retailers, as each of the larger producers has sought to capture an increasing number of assured outlets for its wares. Although these mergers have been primarily vertical in their aim and effect, to the extent that they have brought ever greater numbers of retail outlets within fewer and fewer hands, they have had an additional important impact on the horizontal plane. By the merger in this case, the largest single group of retail stores still independent of one of the large manufacturers was absorbed into an already substantial aggregation of more or less controlled retail outlets. As a result of this merger, Brown moved into second place nationally in terms of retail stores directly owned. Including the stores on its franchise plan, the merger placed under Brown's control almost 1,600 shoe outlets, or about 7.2% of the Nation's retail "shoe stores" as defined by the Census Bureau, and 2.3% of the Nation's total retail shoe outlets. We cannot avoid the mandate of Congress that tendencies toward concentration in industry are to be curbed in their incipiency, particularly when those tendencies are being accelerated through giant steps striding across a hundred cities at a time. In the light of the trends in this industry we agree with the Government and the court below that this is an appropriate place at which to call a halt.

At the same time appellant has presented no mitigating factors, such as the business failure or the inadequate resources of one of the parties that may have prevented it from maintaining its competitive position, nor a demonstrated need for combination to enable small companies to enter into a more meaningful competition with those dominating the relevant markets. On the basis of the record before us, we believe the Government sustained its burden of proof. We hold that the District Court was correct in concluding that this merger may tend to lessen competition substantially in the retail sale of men's, women's, and children's shoes in the overwhelming majority of those cities and their environs in which both Brown and Kinney sell through owned or controlled outlets. (at 343-346)

Comment

1. The Court's opinion contains one of the most contentious phrases in antitrust:

> "**It is competition, not competitors, which the Act protects**. But we cannot fail to recognize Congress' desire to promote competition through the protection of viable, small, locally owned businesses. Congress appreciated that occasional higher costs and prices might result from the maintenance of fragmented industries and markets. It resolved these competing considerations in favor of decentralization. We must give effect to that decision." (emphasis added)

This paragraph highlights many of the challenges that antitrust law grapples with: what it means to protect competition in the market, how to weigh the benefits and costs of protecting small producers, and how to respond to the political reaction to economic concentration. Beware: the antitrust community often invokes the "competition not competitors" line without noting the caveat that follows.

2. Merger advocates often claim many procompetitive effects, like synergies or that the merger will create a new, strong market rival. Think about which procompetitive effects the court thought were potentially relevant here, and which it entirely ignored.

3. Mergers can be hard to unwind once they are complete. How did the district court try to get around this problem?

United States v. Columbia Steel Co., 334 U.S. 495 (1948)

[Columbia Steel, a U.S. Steel subsidiary, sought to purchase Consolidated Steel's assets after World War II. U.S. Steel produced over a third of the steel made in the US, with sales of nearly $1.5 billion. Consolidated had average sales of around $20 million annually.]

The theory of the United States in bringing this suit is that the acquisition of Consolidated constitutes an illegal restraint of interstate commerce because all manufacturers except United States Steel will be excluded from the business of supplying Consolidated's requirements of rolled steel products, and because competition now existing between Consolidated and United States Steel in the sale of structural fabricated products and pipe will be eliminated. In addition, the government alleges that the acquisition of Consolidated, viewed in the light of the previous series of acquisitions by United States Steel, constitutes an attempt to monopolize the production and sale of fabricated steel products in the Consolidated market. The appellees contend that the amount of competition which will be eliminated is so insignificant that the restraint effected is a reasonable restraint not an attempt to monopolize and not prohibited by the Sherman Act. On the record before us and in agreement with the trial court we conclude that the government has failed to prove its contention that the acquisition of Consolidated would unreasonably lessen competition in the three respects charged, and therefore the proposed contract is not forbidden by § 1 of the Sherman Act. We further hold that the government has failed to prove an attempt to monopolize in violation of § 2. (at 508)

…

It seems clear to us that vertical integration, as such without more, cannot be held violative of the Sherman Act. It is an indefinite term without explicit meaning. Even in the iron industry, where could a line be drawn -- at the end of mining the ore, the production of the pig-iron or steel ingots, when the rolling mill operation is completed, fabrication on order or at some stage of manufacture into standard merchandise? No answer would be possible and therefore the extent of permissible integration must be governed, as other factors in Sherman Act violations, by the other circumstances of individual cases. Technological advances may easily require a basic industry plant to expand its processes into semi-finished or finished goods so as to produce desired articles in greater volume and with less expense.

It is not for courts to determine the course of the Nation's economic development. Economists may recommend, the legislative and executive branches may chart legal courses by which the competitive forces of business can seek to reduce costs and increase production so that a higher standard of living may be available to all. The evils and dangers of monopoly and attempts to monopolize that grow out of size and efforts to eliminate others from markets, large or small, have caused Congress and the Executive to regulate commerce and trade in many respects. But no direction has appeared of a public policy that forbids, *per se*, an expansion of facilities of an existing company to meet the needs of new markets of a community, whether that community is nation-wide or county-wide. On the other hand, the courts have been given by Congress wide powers in monopoly regulation. The very broadness of terms such as restraint of trade, substantial competition and purpose to monopolize have placed upon courts the responsibility to apply the Sherman Act so as to avoid the evils at which Congress aimed. The basic industries, with few exceptions, do not approach in America a cartelized form. If businesses are to be forbidden from entering into different stages of production that order must come from Congress, not the courts.

Applying the standards laid down in the *Paramount* case, we conclude that the so-called vertical integration resulting from the acquisition of Consolidated does not unreasonably restrict the opportunities of the competitor producers of rolled steel to market their product. We accept as the relevant competitive market the total demand for rolled steel products in the eleven-state area; over the past ten years Consolidated has accounted for only 3% of that demand, and if expectations as to the development of the western steel industry are realized, Consolidated's proportion may be expected to be lower than that figure in the future. Nor can we find a specific intent in the present case to accomplish an unreasonable restraint, for reasons which we discuss under heading III of this opinion. (at 526-7)

…

We conclude that in this case the government has failed to prove that the elimination of competition between Consolidated and the structural fabricating subsidiaries of United States Steel constitutes an unreasonable restraint. If we make the doubtful assumption that United States Steel could be expected in the future to sell 13% of the total of structural steel products in the Consolidated trade area and that Consolidated could be expected to sell 11%, we conclude that where we have the present unusual conditions of the western steel industry and in view of the facts of this case as developed at pages 512 to 516, of this opinion, it can not be said there would be an unreasonable restraint of trade. To hold this does not imply that additional acquisitions of fabricating facilities for structural steel would not become monopolistic. Notwithstanding some differences as to the business of Consolidated and United States Steel in respect to the character of structural steel products fabricated by each, there is competition between the two for both light and heavy work. The western steel industry is developing. Fontana and Geneva as well as other producers are making available for fabricators larger supplies of rolled steel so that the West is becoming less dependent on eastern suppliers. We are of the opinion, moreover, in view of the number of West Coast fabricators (see pp. 502-503) and the ability of out-of-the-area fabricators to compete because of the specialized character of structural steel production in regard to orders and designs, that this acquisition is permissible. (at 530)

…

We turn last to the allegation of the government that United States Steel has attempted to monopolize the production and sale of fabricated steel products in the Consolidated market. We think that the trial court applied too narrow a test to this charge; even though the restraint effected may be reasonable under § 1, it may constitute an attempt to monopolize forbidden by § 2 if a specific intent to monopolize may be shown. To show that specific intent, the government recites the long history of acquisitions of United States Steel, and argues that the present acquisition when viewed in the light of that history demonstrates the existence of a specific intent to monopolize.

Although this Court held in 1920 that United States Steel had not violated § 2 through the acquisition of 180 formerly independent concerns, we may look to those acquisitions as well as to the eight acquisitions from 1924 to 1943 to determine the intent of United States Steel in acquiring Consolidated. (at 532)

… United States Steel, despite its large sales, many acquisitions and leading position in the industry, has declined in the proportion of rolled steel products it manufactures in comparison with its early days. In 1901 it produced 50.1%; in 1911, 45.7%; in 1946, 30.4%. For the period 1937-1946, it produced 33.2%. Its size is impressive. Size has significance also in an appraisal of alleged violations of the Sherman Act. But the steel industry is also of impressive size and the welcome westward extension of that industry requires that the existing companies go into production there or abandon that market to other organizations. (at 533)

Dissent (Justice Douglas)

This is the most important antitrust case which has been before the Court in years. It is important because it reveals the way of growth of monopoly power -- the precise phenomenon at which the Sherman Act was aimed. Here we have the pattern of the evolution of the great trusts. Little, independent units are gobbled up by bigger ones. At times the independent is driven to the wall and surrenders. At other times any number of "sound business reasons" appear why the sale to or merger with the trust should be made. If the acquisition were the result of predatory practices or restraints of trade, the trust could be required to disgorge. *Schine Chain Theatres, Inc*. v. *United States*, 334 U.S. 110. But the impact on future competition and on the economy is the same though the trust was built in more gentlemanly ways. (at 535)

We have here the problem of bigness. Its lesson should by now have been burned into our memory by Brandeis. *The Curse of Bigness* shows how size can become a menace -- both industrial and social. It can be an industrial menace because it creates gross inequalities against existing or putative competitors. It can be a social menace -- because of its control of prices. Control of prices in the steel industry is powerful leverage on our economy. For the price of steel determines the price of hundreds of other articles. Our price level determines in large measure whether we have prosperity or depression -- an economy of abundance or scarcity. Size in steel should therefore be jealously watched. In final analysis, size in steel is the measure of the power of a handful of men over our economy. That power can be utilized with lightning speed. It can be benign or it can be dangerous. The philosophy of the Sherman Act is that it should not exist. For all power tends to develop into a government in itself. Power that controls the economy should be in the hands of elected representatives of the people, not in the hands of an industrial oligarchy. Industrial power should be decentralized. It should be scattered into many hands so that the fortunes of the people will not be dependent on the whim or caprice, the political prejudices, the emotional stability of a few self-appointed men. The fact that they are not vicious men but respectable and social-minded is irrelevant. That is the philosophy and the command of the Sherman Act. It is founded on a theory of hostility to the concentration in private hands of power so great that only a government of the people should have it. (at 536)

The Court forgot this lesson in *United States* v. *United States Steel Corp*., 251 U.S. 417, and in *United States* v. *International Harvester Co*., 274 U.S. 693. The Court today forgets it when it allows United States Steel to wrap its tentacles tighter around the steel industry of the West. (at 537)

This acquisition can be dressed up (perhaps legitimately) in terms of an expansion to meet the demands of a business which is growing as a result of superior and enterprising management. But the test under the Sherman Act strikes deeper. However the acquisition may be rationalized, the effect is plain. It is a purchase for control, a purchase for control of a market for which United States Steel has in the past had to compete but which it no longer wants left to the uncertainties that competition in the West may engender. This in effect it concedes. It states that its purpose in acquiring Consolidated is to insure itself of a market for part of Geneva's production of rolled steel products when demand falls off.

But competition is never more irrevocably eliminated than by buying the customer for whose business the industry has been competing. The business of Consolidated amounts to around $ 22,000,000 annually. The competitive purchases by Consolidated are over $ 5,000,000 a year. I do not see how it is possible to say that $ 5,000,000 of commerce is immaterial. It plainly is not *de minimis*. And it is the character of the restraint which § 1 of the Act brands as illegal, not the amount of commerce affected. *Montague & Co*. v. *Lowry*, 193 U.S. 38; *United States* v. *Socony-Vacuum Oil Co*., 310 U.S. 150, 225, n. 59; *United States* v. *Yellow Cab Co*., 332 U.S. 218, 225. At least it can be said here, as it was in *International Salt Co*. v. *United States*, 332 U.S. 392, 396, that the volume of business restrained by this contract is not insignificant or insubstantial. United States Steel does not consider it insignificant, for the aim of this well-conceived project is to monopolize it. If it is not insubstantial as a market for United States Steel, it certainly is not from the point of view of the struggling western units of the steel industry. (at 537-8)

It is unrealistic to measure Consolidated's part of the market by determining its proportion of the national market. There is no safeguarding of competition in the theory that the bigger the national market the less protection will be given those selling to the smaller components thereof. That theory would allow a producer to absorb outlets upon which small enterprises with restricted marketing facilities depend. Those outlets, though statistically unimportant from the point of view of the national market, could be a matter of life and death to small, local enterprises.

The largest market which must be taken for comparison is the market actually reached by the company which is being absorbed. In this case Consolidated's purchases of rolled steel products are a little over 3 per cent of that market. By no standard -- United States Steel's or its western competitors -- can that percentage be deemed immaterial. Yet consideration of the case from that viewpoint puts the public interest phase of the acquisition in the least favorable light. A surer test of the impact of the acquisition on competition is to be determined not only by consideration of the actual markets reached by Consolidated but also by the actual purchases which it makes. Its purchases were predominantly of plates and shapes -- 76 per cent from 1937-1941. This was in 1937 13 per cent of the total in the Consolidated market. That comparison is rejected by the Court or at least discounted on the theory that competitors presently selling to Consolidated can probably convert from plates and shapes to other forms of rolled steel products. But a surer test of the effect on competition is the actual business of which competitors will be deprived. We do not know whether they can be sufficiently resourceful to recover from this strengthening of the hold which this giant of the industry now has on their markets. It would be more in keeping with the spirit of the Sherman Act to give the benefits of any doubts to the struggling competitors. (at 539)

It is, of course, immaterial that a purpose or intent to achieve the result may not have been present. The holding of the cases from *United States* v. *Patten*, 226 U.S. 525, 543, to *United States* v. *Griffith*, 334 U.S. 100, is that the requisite purpose or intent is present if monopoly or restraint of trade results as a direct and necessary consequence of what was done. We need not hold that vertical integration is *per se* unlawful in order to strike down what is accomplished here. The consequence of the deliberate, calculated purchase for purpose of control over this substantial share of the market can no more be avoided here than it was in *United States* v. *Reading Co*., 253 U.S. 26, 57, and in *United States* v. *Yellow Cab Co., supra*.I do not stop to consider the effect of the acquisition on competition in the sale of fabricated steel products. The monopoly of this substantial market for rolled steel products is in itself an unreasonable restraint of trade under § 1 of the Act.

The result might well be different if Consolidated were merging with or being acquired by an independent West Coast producer for the purpose of developing an integrated operation. The purchase might then be part of an intensely practical plan to put together an independent western unit of the industry with sufficient resources and strength to compete with the giants of the industry. Approval of this acquisition works in precisely the opposite direction. It makes dim the prospects that the western steel industry will be free from the control of the eastern giants. United States Steel, now that it owns the Geneva plant, has over 51 per cent of the rolled steel or ingot capacity of the Pacific Coast area. This acquisition gives it unquestioned domination there and protects it against growth of the independents in that developing region. That alone is sufficient to condemn the purchase. Its serious impact on competition and the economy is emphasized when it is recalled that United States Steel has one-third of the rolled steel production of the entire country. The least I can say is that a company that has that tremendous leverage on our economy is big enough. (at 540)

Comment

Columbia Steel shows how courts' attitude toward merger enforcement had evolved since the passage of the Clayton Act. Compare the tone of the majority and the dissent.

Shortly after *Columbia Steel*, Congress amended the Clayton Act to strengthen merger control in the face of rising corporate consolidation.

Philadelphia National Bank, 374 U.S. 321 (1963)

Commercial banking in this country is primarily unit banking. That is, control of commercial banking is diffused throughout a very large number of independent, local banks -- 13,460 of them in 1960 -- rather than concentrated in a handful of nationwide banks, as, for example, in England and Germany. There are, to be sure, in addition to the independent banks, some 10,000 branch banks; but branching, which is controlled largely by state law -- and prohibited altogether by some States -- enables a bank to extend itself only to state lines and often not that far. It is also the case, of course, that many banks place loans and solicit deposits outside their home area. But with these qualifications, it remains true that ours is essentially a decentralized system of community banks. Recent years, however, have witnessed a definite trend toward concentration. Thus, during the decade ending in 1960 the number of commercial banks in the United States declined by 714, despite the chartering of 887 new banks and a very substantial increase in the Nation's credit needs during the period. Of the 1,601 independent banks which thus disappeared, 1,503, with combined total resources of well over $ 25,000,000,000, disappeared as the result of mergers. (at 325-6)

…

The governmental controls of American banking are manifold. First, the Federal Reserve System, through its open-market operations, see 12 U. S. C. §§ 263 (c), 353-359, control of the rediscount rate, see 12 U. S. C. § 357, and modifications of reserve requirements, see 12 U. S. C. §§ 462, 462b, regulates the supply of money and credit in the economy and thereby indirectly regulates the interest rates of bank loans…

Entry, branching, and acquisitions are covered by a network of state and federal statutes. A charter for a new bank, state or national, will not be granted unless the invested capital and management of the applicant, and its prospects for doing sufficient business to operate at a reasonable profit, give adequate protection against undue competition and possible failure…

But perhaps the most effective weapon of federal regulation of banking is the broad visitatorial power of federal bank examiners. Whenever the agencies deem it necessary, they may order "a thorough examination of all the affairs of the bank," whether it be a member of the FRS or a nonmember insured bank. 12 U. S. C. §§ 325, 481, 483, 1820 (b); 12 CFR § 4.2. Such examinations are frequent and intensive…

Federal supervision of banking has been called "probably the outstanding example in the federal government of regulation of an entire industry through methods of supervision . . . . The system may be one of the most successful [systems of economic regulation], if not the most successful." *Id.*, § 4.04, at 247. To the efficacy of this system we may owe, in part, the virtual disappearance of bank failures from the American economic scene. (at 328-330)

The Proposed Merger of PNB and Girard.

The Philadelphia National Bank and Girard Trust Corn Exchange Bank are, respectively, the second and third largest of the 42 commercial banks with head offices in the Philadelphia metropolitan area, which consists of the City of Philadelphia and its three contiguous counties in

Pennsylvania. The home county of both banks is the city itself; Pennsylvania law, however, permits branching into the counties contiguous to the home county, Pa. Stat. Ann. (1961 Supp.), Tit. 7, § 819-204.1, and both banks have offices throughout the four-county area. PNB, a national bank, has assets of over $ 1,000,000,000, making it (as of 1959) the twenty-first largest bank in the Nation. Girard, a state bank, is a member of the FRS and is insured by the FDIC; it has assets of about $ 750,000,000. Were the proposed merger to be consummated, the resulting bank would be the largest in the four-county area, with (approximately) 36% of the area banks' total assets, 36% of deposits, and 34% of net loans. It and the second largest (First Pennsylvania Bank and Trust Company, now the largest) would have between them 59% of the total assets, 58% of deposits, and 58% of the net loans, while after the merger the four largest banks in the area would have 78% of total assets, 77% of deposits, and 78% of net loans.

The present size of both PNB and Girard is in part the result of mergers. Indeed, the trend toward concentration is noticeable in the Philadelphia area generally, in which the number of commercial banks has declined from 108 in 1947 to the present 42. Since 1950, PNB has acquired nine formerly independent banks and Girard six; and these acquisitions have accounted for 59% and 85% of the respective banks' asset growth during the period, 63% and 91% of their deposit growth, and 12% and 37% of their loan growth. During this period, the seven largest banks in the area increased their combined share of the area's total commercial bank resources from about 61% to about 90%. (at 332-334)

…

III. THE LAWFULNESS OF THE PROPOSED MERGER UNDER SECTION 7.

The statutory test is whether the effect of the merger "may be substantially to lessen competition" "in any line of commerce in any section of the country." We analyzed the test in detail in *Brown Shoe Co*. v. *United States*, 370 U.S. 294, and that analysis need not be repeated or extended here, for the instant case presents only a straightforward problem of application to particular facts.

We have no difficulty in determining the "line of commerce" (relevant product or services market) and "section of the country" (relevant geographical market) in which to appraise the probable competitive effects of appellees' proposed merger. We agree with the District Court that the cluster of products (various kinds of credit) and services (such as checking accounts and trust administration) denoted by the term "commercial banking," see note 5, *supra*, composes a distinct line of commerce…

We part company with the District Court on the determination of the appropriate "section of the country." The proper question to be asked in this case is not where the parties to the merger do business or even where they compete, but where, within the area of competitive overlap, the effect of the merger on competition will be direct and immediate. See Bock, Mergers and Markets (1960), 42. This depends upon "the geographic structure of supplier-customer relations." Kaysen and Turner, Antitrust Policy (1959), 102. In banking, as in most service industries, convenience of location is essential to effective competition. Individuals and corporations typically confer the bulk of their patronage on banks in their local community; they find it impractical to conduct their banking business at a distance. See *Transamerica Corp*. v. *Board of Govs. of Fed. Res. Sys*., 206 F.2d 163, 169 (C. A. 3d Cir. 1953). The factor of inconvenience localizes banking competition as effectively as high transportation costs in other industries. See, *e. g., American Crystal Sugar Co*. v. *Cuban-American Sugar Co*., 152 F.Supp. 387, 398 (D. C. S. D. N. Y. 1957), aff'd, 259 F.2d 524 (C. A. 2d Cir. 1958). Therefore, since, as we recently said in a related context, the "area of effective competition in the known line of commerce must be charted by careful selection of the market area in which the seller operates, *and to which the purchaser can practicably turn for supplies," Tampa Elec. Co*. v. *Nashville Coal Co*., 365 U.S. 320, 327 (emphasis supplied); see *Standard Oil Co*. v. *United States*, 337 U.S. 293, 299 and 300, n. 5, the four-county area in which appellees' offices are located would seem to be the relevant geographical market… (at 357-360)

Having determined the relevant market, we come to the ultimate question under § 7: whether the effect of the merger "may be substantially to lessen competition" in the relevant market. Clearly, this is not the kind of question which is susceptible of a ready and precise answer in most cases. It requires not merely an appraisal of the immediate impact of the merger upon competition, but a prediction of its impact upon competitive conditions in the future; this is what is meant when it is said that the amended § 7 was intended to arrest anticompetitive tendencies in their "incipiency." See *Brown Shoe Co., supra*, at 317, 322. Such a prediction is sound only if it is based upon a firm understanding of the structure of the relevant market; yet the relevant economic data are both complex and elusive. See generally Bok, Section 7 of the Clayton Act and the Merging of Law and Economics, 74 Harv. L. Rev. 226 (1960). And unless businessmen can assess the legal consequences of a merger with some confidence, sound business planning is retarded. See *Crown Zellerbach Corp*. v. *Federal Trade Comm'n*, 296 F.2d 800, 826-827 (C. A. 9th Cir. 1961). So also, we must be alert to the danger of subverting congressional intent by permitting a too-broad economic investigation. *Standard Oil Co*. v. *United States*, 337 U.S. 293, 313. And so in any case in which it is possible, without doing violence to the congressional objective embodied in § 7, to simplify the test of illegality, the courts ought to do so in the interest of sound and practical judicial administration. See *Union Carbide Corp*., Trade Reg. Rep., FTC Complaints and Orders, 1961-1963, para. 15503, at 20375-20376 (concurring opinion). This is such a case.

We noted in *Brown Shoe Co., supra*, at 315, that "the dominant theme pervading congressional consideration of the 1950 amendments [to § 7] was a fear of what was considered to be a rising tide of economic concentration in the American economy." This intense congressional concern with the trend toward concentration warrants dispensing, in certain cases, with elaborate proof of market structure, market behavior, or probable anticompetitive effects. Specifically, we think that a merger which produces a firm controlling an undue percentage share of the relevant market, and results in a significant increase in the concentration of firms in that market, is so inherently likely to lessen competition substantially that it must be enjoined in the absence of evidence clearly showing that the merger is not likely to have such anticompetitive effects. See *United States* v. *Koppers Co*., 202 F.Supp. 437 (D. C. W. D. Pa. 1962).

Such a test lightens the burden of proving illegality only with respect to mergers whose size makes them inherently suspect in light of Congress' design in § 7 to prevent undue concentration.

Furthermore, the test is fully consonant with economic theory. That "competition is likely to be greatest when there are many sellers, none of which has any significant market share," is common ground among most economists, and was undoubtedly a premise of congressional reasoning about the antimerger statute.

The merger of appellees will result in a single bank's controlling at least 30% of the commercial banking business in the four-county Philadelphia metropolitan area. Without attempting to specify the smallest market share which would still be considered to threaten undue concentration, we are clear that 30% presents that threat. Further, whereas presently the two largest banks in the area (First Pennsylvania and PNB) control between them approximately 44% of the area's commercial banking business, the two largest after the merger (PNB-Girard and First Pennsylvania) will control 59%. Plainly, we think, this increase of more than 33% in concentration must be regarded as significant… (at 363-366)

Of equally little value, we think, are the assurances offered by appellees' witnesses that customers dissatisfied with the services of the resulting bank may readily turn to the 40 other banks in the Philadelphia area. In every case short of outright monopoly, the disgruntled customer has alternatives; even in tightly oligopolistic markets, there may be small firms operating. A fundamental purpose of amending § 7 was to arrest the trend toward concentration, the *tendency* to monopoly, before the consumer's alternatives disappeared through merger, and that purpose would be ill-served if the law stayed its hand until 10, or 20, or 30 more Philadelphia banks were absorbed. This is not a fanciful eventuality, in view of the strong trend toward mergers evident in the area, see p. 331, *supra*; and we might note also that entry of new competitors into the banking field is far from easy.

…

We turn now to three affirmative justifications which appellees offer for the proposed merger. The first is that only through mergers can banks follow their customers to the suburbs and retain their business. This justification does not seem particularly related to the instant merger, but in any event it has no merit. There is an alternative to the merger route: the opening of new branches in the areas to which the customers have moved -- so-called *de novo* branching. Appellees do not contend that they are unable to expand thus, by opening new offices rather than acquiring existing ones, and surely one premise of an antimerger statute such as § 7 is that corporate growth by internal expansion is socially preferable to growth by acquisition.

Second, it is suggested that the increased lending limit of the resulting bank will enable it to compete with the large out-of-state banks, particularly the New York banks, for very large loans. We reject this application of the concept of "countervailing power." Cf. *Kiefer-Stewart Co*. v. *Joseph E. Seagram & Sons*, 340 U.S. 211.If anticompetitive effects in one market could be justified by procompetitive consequences in another, the logical upshot would be that every firm in an industry could, without violating § 7, embark on a series of mergers that would make it in the end as large as the industry leader. For if all the commercial banks in the Philadelphia area merged into one, it would be smaller than the largest bank in New York City. This is not a case, plainly, where two small firms in a market propose to merge in order to be able to compete more successfully with the leading firms in that market. Nor is it a case in which lack of adequate banking facilities is causing hardships to individuals or businesses in the community. The present two largest banks in Philadelphia have lending limits of $ 8,000,000 each. The only businesses located in the Philadelphia area which find such limits inadequate are large enough readily to obtain bank credit in other cities.

This brings us to appellees' final contention, that Philadelphia needs a bank larger than it now has in order to bring business to the area and stimulate its economic development. See p. 334 and note 10, *supra*. We are clear, however, that a merger the effect of which "may be substantially to lessen competition" is not saved because, on some ultimate reckoning of social or economic debits and credits, it may be deemed beneficial. A value choice of such magnitude is beyond the ordinary limits of judicial competence, and in any event has been made for us already, by Congress when it enacted the amended § 7. Congress determined to preserve our traditionally competitive economy. It therefore proscribed anticompetitive mergers, the benign and the malignant alike, fully aware, we must assume, that some price might have to be paid. (at 371-372)

…

The judgment of the District Court is reversed and the case remanded with direction to enter judgment enjoining the proposed merger.

Comment

The Court's discussion of banking regulations highlights how the dynamics of competition in the banking industry have been extensively shaped by financial industry regulations and institutions. What other industries is this true of? (Hint: think about intellectual property)

The Court held that a decline in competition in one market cannot be offset by an increase in another market. Does that make sense? Is it equitable?

United States v. General Dynamics Corp., 415 U.S. 486 (1974)

[General Dynamics acquired two other coal mining companies creating the nation's fifth largest coal miner with a 44% market share in the local geographic market for coal in Illinois. The DOJ sued to reverse the merger.]

While the statistical showing proffered by the Government in this case, the accuracy of which was not discredited by the District Court or contested by the appellees, would under this approach have sufficed to support a finding of "undue concentration" in the absence of other considerations, the question before us is whether the District Court was justified in finding that other pertinent factors affecting the coal industry and the business of the appellees mandated a conclusion that no substantial lessening of competition occurred or was threatened by the acquisition of United Electric. We are satisfied that the court's ultimate finding was not in error. (at 497-8)

First, it found that coal had become increasingly less able to compete with other sources of energy in many segments of the energy market…

Third, and most significantly, the court found that to an increasing degree, nearly all coal sold to utilities is transferred under long-term requirements contracts, under which coal producers promise to meet utilities' coal consumption requirements for a fixed period of time, and at predetermined prices… (at 499)

Because of these fundamental changes in the structure of the market for coal, the District Court was justified in viewing the statistics relied on by the Government as insufficient to sustain its case. Evidence of past production does not, as a matter of logic, necessarily give a proper picture of a company's future ability to compete. In most situations, of course, the unstated assumption is that a company that has maintained a certain share of a market in the recent past will be in a position to do so in the immediate future. Thus, companies that have controlled sufficiently large shares of a concentrated market are barred from merger by § 7, not because of their past acts, but because their past performances imply an ability to continue to dominate with at least equal vigor. In markets involving groceries or beer, as in *Von's Grocery, supra*, and *Pabst, supra*, statistics involving annual sales naturally indicate the power of each company to compete in the future. Evidence of the amount of annual sales is relevant as a prediction of future competitive strength, since in most markets distribution systems and brand recognition are such significant factors that one may reasonably suppose that a company which has attracted a given number of sales will retain that competitive strength… (at 501)

… United's relative position of strength in reserves was considerably weaker than its past and current ability to produce… (at 502)

While under normal circumstances a delineation of proper geographic and product markets is a necessary precondition to assessment of the probabilities of a substantial effect on competition within them, in this case we nevertheless affirm the District Court's judgment without reaching these questions. By determining that the amount and availability of usable reserves, and not the past annual production figures relied on by the Government, were the proper indicators of future ability to compete, the District Court wholly rejected the Government's prima facie case. Irrespective of the markets within which the acquiring and the acquired company might be viewed as competitors for purposes of this § 7 suit, the Government's statistical presentation simply did not establish that a substantial lessening of competition was likely to occur in any market. By concluding that "divestiture [would not] benefit competition even were this court to accept the Government's unrealistic product and geographic market definitions," 341 F.Supp., at 560, the District Court rendered superfluous its further determinations that the Government also erred in its choice of relevant markets. Since we agree with the District Court that the Government's reliance on production statistics in the context of this case was insufficient, it follows that the judgment before us may be affirmed without reaching the issues of geographic and product markets. (at 510-511)

Comment

Is *General Dynamics* consistent with *Brown Shoe*, or does it signal a more permissive approach to merger control?

Horizontal Merger Guidelines, US DOJ and FTC (2010)

The Agencies seek to identify and challenge competitively harmful mergers while avoiding unnecessary interference with mergers that are either competitively beneficial or neutral. Most merger analysis is necessarily predictive, requiring an assessment of what will likely happen if a merger proceeds as compared to what will likely happen if it does not. Given this inherent need for prediction, these Guidelines reflect the congressional intent that merger enforcement should interdict competitive problems in their incipiency and that certainty about anticompetitive effect is seldom possible and not required for a merger to be illegal… (at 1)

The unifying theme of these Guidelines is that mergers should not be permitted to create, enhance, or entrench market power or to facilitate its exercise. For simplicity of exposition, these Guidelines generally refer to all of these effects as enhancing market power. A merger enhances market power if it is likely to encourage one or more firms to raise price, reduce output, diminish innovation, or otherwise harm customers as a result of diminished competitive constraints or incentives. In evaluating how a merger will likely change a firm's behavior, the Agencies focus primarily on how the merger affects conduct that would be most profitable for the firm.

A merger can enhance market power simply by eliminating competition between the merging parties. This effect can arise even if the merger causes no changes in the way other firms behave. Adverse competitive effects arising in this manner are referred to as "unilateral effects." A merger also can enhance market power by increasing the risk of coordinated, accommodating, or interdependent behavior among rivals. Adverse competitive effects arising in this manner are referred to as "coordinated effects." In any given case, either or both types of effects may be present, and the distinction between them may be blurred…

Enhancement of market power by sellers often elevates the prices charged to customers. For simplicity of exposition, these Guidelines generally discuss the analysis in terms of such price effects. Enhanced market power can also be manifested in non-price terms and conditions that adversely affect customers, including reduced product quality, reduced product variety, reduced service, or diminished innovation. Such non-price effects may coexist with price effects, or can arise in their absence. When the Agencies investigate whether a merger may lead to a substantial lessening of non-price competition, they employ an approach analogous to that used to evaluate price competition. Enhanced market power may also make it more likely that the merged entity can profitably and effectively engage in exclusionary conduct. Regardless of how enhanced market power likely would be manifested, the Agencies normally evaluate mergers based on their impact on customers. The Agencies examine effects on either or both of the direct customers and the final consumers. The Agencies presume, absent convincing evidence to the contrary, that adverse effects on direct customers also cause adverse effects on final consumers.

Enhancement of market power by buyers, sometimes called "monopsony power," has adverse effects comparable to enhancement of market power by sellers. The Agencies employ an analogous framework to analyze mergers between rival purchasers that may enhance their market power as buyers.

2. Evidence of Adverse Competitive Effects

2.1 Types of Evidence

2.1.1 Actual Effects Observed in Consummated Mergers

When evaluating a consummated merger, the ultimate issue is not only whether adverse competitive effects have already resulted from the merger, but also whether such effects are likely to arise in the future. Evidence of observed post-merger price increases or other changes adverse to customers is given substantial weight. The Agencies evaluate whether such changes are anticompetitive effects resulting from the merger, in which case they can be dispositive. However, a consummated merger may be anticompetitive even if such effects have not yet been observed, perhaps because the merged firm may be aware of the possibility of post-merger antitrust review and moderating its conduct. Consequently, the Agencies also consider the same types of evidence they consider when evaluating unconsummated mergers.

2.1.2 Direct Comparisons Based on Experience

The Agencies look for historical events, or "natural experiments," that are informative regarding the competitive effects of the merger. For example, the Agencies may examine the impact of recent mergers, entry, expansion, or exit in the relevant market. Effects of analogous events in similar markets may also be informative. The Agencies also look for reliable evidence based on variations among similar markets. For example, if the merging firms compete in some locales but not others, comparisons of prices charged in regions where they do and do not compete may be informative regarding post-merger prices. In some cases, however, prices are set on such a broad geographic basis that such comparisons are not informative. The Agencies also may examine how prices in similar markets vary with the number of significant competitors in those markets.

2.1.3 Market Shares and Concentration in a Relevant Market

The Agencies give weight to the merging parties' market shares in a relevant market, the level of concentration, and the change in concentration caused by the merger. See Sections 4 and 5. Mergers that cause a significant increase in concentration and result in highly concentrated markets are presumed to be likely to enhance market power, but this presumption can be rebutted by persuasive evidence showing that the merger is unlikely to enhance market power.

2.1.4 Substantial Head-to-Head Competition

The Agencies consider whether the merging firms have been, or likely will become absent the merger, substantial head-to-head competitors. Such evidence can be especially relevant for evaluating adverse unilateral effects, which result directly from the loss of that competition. See Section 6. This evidence can also inform market definition. See Section 4.

2.1.5 Disruptive Role of a Merging Party

The Agencies consider whether a merger may lessen competition by eliminating a "maverick" firm, i.e., a firm that plays a disruptive role in the market to the benefit of customers. For example, if one of the merging firms has a strong incumbency position and the other merging firm threatens to 3 disrupt market conditions with a new technology or business model, their merger can involve the loss of actual or potential competition. Likewise, one of the merging firms may have the incentive to take the lead in price cutting or other competitive conduct or to resist increases in industry prices. A firm that may discipline prices based on its ability and incentive to expand production rapidly using available capacity also can be a maverick, as can a firm that has often resisted otherwise prevailing industry norms to cooperate on price setting or other terms of competition…

3. Targeted Customers and Price Discrimination

When examining possible adverse competitive effects from a merger, the Agencies consider whether those effects vary significantly for different customers purchasing the same or similar products. Such differential impacts are possible when sellers can discriminate, e.g., by profitably raising price to certain targeted customers but not to others. The possibility of price discrimination influences market definition (see Section 4), the measurement of market shares (see Section 5), and the evaluation of competitive effects (see Sections 6 and 7). When price discrimination is feasible, adverse competitive effects on targeted customers can arise, even if such effects will not arise for other customers. A price increase for targeted customers may be profitable even if a price increase for all customers would not be profitable because too many other customers would substitute away. When discrimination is reasonably likely, the Agencies may evaluate competitive effects separately by type of customer. The Agencies may have access to information unavailable to customers that is relevant to evaluating whether discrimination is reasonably likely.

For price discrimination to be feasible, two conditions typically must be met: differential pricing and limited arbitrage….

4. Market Definition

… Evidence of competitive effects can inform market definition, just as market definition can be informative regarding competitive effects. For example, evidence that a reduction in the number of significant rivals offering a group of products causes prices for those products to rise significantly can itself establish that those products form a relevant market. Such evidence also may more directly predict the competitive effects of a merger, reducing the role of inferences from market definition and market shares….

Market definition focuses solely on demand substitution factors, i.e., on customers' ability and willingness to substitute away from one product to another in response to a price increase or a corresponding non-price change such as a reduction in product quality or service. The responsive actions of suppliers are also important in competitive analysis. They are considered in these Guidelines in the sections addressing the identification of market participants, the measurement of market shares, the analysis of competitive effects, and entry.

Customers often confront a range of possible substitutes for the products of the merging firms. Some substitutes may be closer, and others more distant, either geographically or in terms of product attributes and perceptions. Additionally, customers may assess the proximity of different products differently. When products or suppliers in different geographic areas are substitutes for one another to varying degrees, defining a market to include some substitutes and exclude others is inevitably a simplification that cannot capture the full variation in the extent to which different products compete against each other. The principles of market definition outlined below seek to make this inevitable simplification as useful and informative as is practically possible. Relevant markets need not have precise metes and bounds.

Defining a market broadly to include relatively distant product or geographic substitutes can lead to misleading market shares. This is because the competitive significance of distant substitutes is unlikely to be commensurate with their shares in a broad market. Although excluding more distant substitutes from the market inevitably understates their competitive significance to some degree, doing so often provides a more accurate indicator of the competitive effects of the merger than would the alternative of including them and overstating their competitive significance as proportional to their shares in an expanded market.

Market shares of different products in narrowly defined markets are more likely to capture the relative competitive significance of these products, and often more accurately reflect competition between close substitutes. As a result, properly defined antitrust markets often exclude some substitutes to which some customers might turn in the face of a price increase even if such substitutes provide alternatives for those customers. However, a group of products is too narrow to constitute a relevant market if competition from products outside that group is so ample that even the complete elimination of competition within the group would not significantly harm either direct customers or downstream consumers. The hypothetical monopolist test (see Section 4.1.1) is designed to ensure that candidate markets are not overly narrow in this respect.

4.1 Product Market Definition

When a product sold by one merging firm (Product A) competes against one or more products sold by the other merging firm, the Agencies define a relevant product market around Product A to evaluate the importance of that competition. Such a relevant product market consists of a group of substitute products including Product A. Multiple relevant product markets may thus be identified.

4.1.1 The Hypothetical Monopolist Test

The Agencies employ the hypothetical monopolist test to evaluate whether groups of products in candidate markets are sufficiently broad to constitute relevant antitrust markets. The Agencies use the 8 hypothetical monopolist test to identify a set of products that are reasonably interchangeable with a product sold by one of the merging firms.

The hypothetical monopolist test requires that a product market contain enough substitute products so that it could be subject to post-merger exercise of market power significantly exceeding that existing absent the merger. Specifically, the test requires that a hypothetical profit-maximizing firm, not subject to price regulation, that was the only present and future seller of those products ("hypothetical monopolist") likely would impose at least a small but significant and non-transitory increase in price ("SSNIP") on at least one product in the market, including at least one product sold by one of the merging firms. For the purpose of analyzing this issue, the terms of sale of products outside the candidate market are held constant. The SSNIP is employed solely as a methodological tool for performing the hypothetical monopolist test; it is not a tolerance level for price increases resulting from a merger.

Groups of products may satisfy the hypothetical monopolist test without including the full range of substitutes from which customers choose. The hypothetical monopolist test may identify a group of products as a relevant market even if customers would substitute significantly to products outside that group in response to a price increase.

> Example 5: Products A and B are being tested as a candidate market. Each sells for $100, has an incremental cost of $60, and sells 1200 units. For every dollar increase in the price of Product A, for any given price of Product B, Product A loses twenty units of sales to products outside the candidate market and ten units of sales to Product B, and likewise for Product B. Under these conditions, economic analysis shows that a hypothetical profit-maximizing monopolist controlling Products A and B would raise both of their prices by ten percent, to $110. Therefore, Products A and B satisfy the hypothetical monopolist test using a five percent SSNIP, and indeed for any SSNIP size up to ten percent. This is true even though two-thirds of the sales lost by one product when it raises its price are diverted to products outside the relevant market.

When applying the hypothetical monopolist test to define a market around a product offered by one of the merging firms, if the market includes a second product, the Agencies will normally also include a third product if that third product is a closer substitute for the first product than is the second product. The third product is a closer substitute if, in response to a SSNIP on the first product, greater revenues are diverted to the third product than to the second product.

> Example 6: In Example 5, suppose that half of the unit sales lost by Product A when it raises its price are diverted to Product C, which also has a price of $100, while one-third are diverted to Product B. Product C is a closer substitute for Product A than is Product B. Thus Product C will normally be included in the relevant market, even though Products A and B together satisfy the hypothetical monopolist test.

The hypothetical monopolist test ensures that markets are not defined too narrowly, but it does not lead to a single relevant market. The Agencies may evaluate a merger in any relevant market satisfying the test, guided by the overarching principle that the purpose of defining the market and measuring market shares is to illuminate the evaluation of competitive effects. Because the relative competitive significance of more distant substitutes is apt to be overstated by their share of sales, when the Agencies rely on market shares and concentration, they usually do so in the smallest relevant market satisfying the hypothetical monopolist test.

> Example 7: In Example 4, including cars in the market will lead to misleadingly small market shares for motorcycle producers. Unless motorcycles fail the hypothetical monopolist test, the Agencies would not include cars in the market in analyzing this motorcycle merger.

4.1.2 Benchmark Prices and SSNIP Size

The Agencies apply the SSNIP starting from prices that would likely prevail absent the merger. If prices are not likely to change absent the merger, these benchmark prices can reasonably be taken to be the prices prevailing prior to the merger. If prices are likely to change absent the merger, e.g., because of innovation or entry, the Agencies may use anticipated future prices as the benchmark for the test. If prices might fall absent the merger due to the breakdown of pre-merger coordination, the Agencies may use those lower prices as the benchmark for the test. In some cases, the techniques employed by the Agencies to implement the hypothetical monopolist test focus on the difference in incentives between pre-merger firms and the hypothetical monopolist and do not require specifying the benchmark prices.

The SSNIP is intended to represent a “small but significant” increase in the prices charged by firms in the candidate market for the value they contribute to the products or services used by customers. This properly directs attention to the effects of price changes commensurate with those that might result from a significant lessening of competition caused by the merger. This methodology is used because normally it is possible to quantify “small but significant” adverse price effects on customers and analyze their likely reactions, not because price effects are more important than non-price effects.

The Agencies most often use a SSNIP of five percent of the price paid by customers for the products or services to which the merging firms contribute value. However, what constitutes a “small but significant” increase in price, commensurate with a significant loss of competition caused by the merger, depends upon the nature of the industry and the merging firms’ positions in it, and the Agencies may accordingly use a price increase that is larger or smaller than five percent. Where explicit or implicit prices for the firms’ specific contribution to value can be identified with reasonable clarity, the Agencies may base the SSNIP on those prices.

> Example 8: In a merger between two oil pipelines, the SSNIP would be based on the price charged for transporting the oil, not on the price of the oil itself. If pipelines buy the oil at one end and sell it at the other, the price charged for transporting the oil is implicit, equal to the difference between the price paid for oil at the input end and the price charged for oil at the output end. The relevant product sold by the pipelines is better described as “pipeline transportation of oil from point A to point B” than as “oil at point B.”

> Example 9: In a merger between two firms that install computers purchased from third parties, the SSNIP would be based on their fees, not on the price of installed computers. If these firms purchase the computers and charge their customers one package price, the implicit installation fee is equal to the package charge to customers less the price of the computers.

Example 10: In Example 9, suppose that the prices paid by the merging firms to purchase computers are opaque, but account for at least ninety-five percent of the prices they charge for installed computers, with profits or implicit fees making up five percent of those prices at most. A five percent SSNIP on the total price paid by customers would at least double those fees or profits. Even if that would be unprofitable for a hypothetical monopolist, a significant increase in fees might well be profitable. If the SSNIP is based on the total price paid by customers, a lower percentage will be used.

4.1.3 Implementing the Hypothetical Monopolist Test

The hypothetical monopolist's incentive to raise prices depends both on the extent to which customers would likely substitute away from the products in the candidate market in response to such a price increase and on the profit margins earned on those products. The profit margin on incremental units is the difference between price and incremental cost on those units. The Agencies often estimate incremental costs, for example using merging parties' documents or data the merging parties use to make business decisions. Incremental cost is measured over the change in output that would be caused by the price increase under consideration.

In considering customers' likely responses to higher prices, the Agencies take into account any reasonably available and reliable evidence, including, but not limited to:

- how customers have shifted purchases in the past in response to relative changes in price or other terms and conditions;
- information from buyers, including surveys, concerning how they would respond to price changes;
- the conduct of industry participants, notably:
    - sellers' business decisions or business documents indicating sellers' informed beliefs concerning how customers would substitute among products in response to relative changes in price;
    - industry participants' behavior in tracking and responding to price changes by some or all rivals;
- objective information about product characteristics and the costs and delays of switching products, especially switching from products in the candidate market to products outside the candidate market;
- the percentage of sales lost by one product in the candidate market, when its price alone rises, that is recaptured by other products in the candidate market, with a higher recapture percentage making a price increase more profitable for the hypothetical monopolist;
- evidence from other industry participants, such as sellers of complementary products;
- legal or regulatory requirements; and
- the influence of downstream competition faced by customers in their output markets.

When the necessary data are available, the Agencies also may consider a "critical loss analysis" to assess the extent to which it corroborates inferences drawn from the evidence noted above. Critical loss analysis asks whether imposing at least a SSNIP on one or more products in a candidate market would raise or lower the hypothetical monopolist's profits. While this "breakeven" analysis differs from the profit-maximizing analysis called for by the hypothetical monopolist test in Section 4.1.1, merging parties sometimes present this type of analysis to the Agencies. A price increase raises profits on sales made at the higher price, but this will be offset to the extent customers substitute away from products in the candidate market. Critical loss analysis compares the magnitude of these two offsetting effects resulting from the price increase. The "critical loss" is defined as the number of lost unit sales that would leave profits unchanged. The "predicted loss" is defined as the number of unit sales that the hypothetical monopolist is predicted to lose due to the price increase. The price increase raises the hypothetical monopolist's profits if the predicted loss is less than the critical loss…

Even when the evidence necessary to perform the hypothetical monopolist test quantitatively is not available, the conceptual framework of the test provides a useful methodological tool for gathering and analyzing evidence pertinent to customer substitution and to market definition. The Agencies follow the hypothetical monopolist test to the extent possible given the available evidence, bearing in mind that the ultimate goal of market definition is to help determine whether the merger may substantially lessen competition.

4.1.4 Product Market Definition with Targeted Customers

If a hypothetical monopolist could profitably target a subset of customers for price increases, the Agencies may identify relevant markets defined around those targeted customers, to whom a hypothetical monopolist would profitably and separately impose at least a SSNIP. Markets to serve targeted customers are also known as price discrimination markets. In practice, the Agencies identify price discrimination markets only where they believe there is a realistic prospect of an adverse competitive effect on a group of targeted customers.

> Example 11: Glass containers have many uses. In response to a price increase for glass containers, some users would substitute substantially to plastic or metal containers, but baby food manufacturers would not. If a hypothetical monopolist could price separately and limit arbitrage, baby food manufacturers would be vulnerable to a targeted increase in the price of glass containers.

The Agencies could define a distinct market for glass containers used to package baby food. The Agencies also often consider markets for targeted customers when prices are individually negotiated and suppliers have information about customers that would allow a hypothetical monopolist to identify customers that are likely to pay a higher price for the relevant product. If prices are negotiated individually with customers, the hypothetical monopolist test may suggest relevant markets that are as narrow as individual customers (see also Section 6.2 on bargaining and auctions). Nonetheless, the Agencies often define markets for groups of targeted customers, i.e., by type of customer, rather than by individual customer. By so doing, the Agencies are able to rely on aggregated market shares that can be more helpful in predicting the competitive effects of the merger.

4.2 Geographic Market Definition

The arena of competition affected by the merger may be geographically bounded if geography limits some customers' willingness or ability to substitute to some products, or some suppliers' willingness or ability to serve some customers. Both supplier and customer locations can affect this. The Agencies apply the principles of market definition described here and in Section 4.1 to define a relevant market with a geographic dimension as well as a product dimension.

The scope of geographic markets often depends on transportation costs. Other factors such as language, regulation, tariff and non-tariff trade barriers, custom and familiarity, reputation, and service availability may impede long-distance or international transactions. The competitive significance of foreign firms may be assessed at various exchange rates, especially if exchange rates have fluctuated in the recent past.

In the absence of price discrimination based on customer location, the Agencies normally define geographic markets based on the locations of suppliers, as explained in subsection 4.2.1. In other cases, notably if price discrimination based on customer location is feasible as is often the case when delivered pricing is commonly used in the industry, the Agencies may define geographic markets based on the locations of customers, as explained in subsection 4.2.2.

4.2.1 Geographic Markets Based on the Locations of Suppliers

Geographic markets based on the locations of suppliers encompass the region from which sales are made. Geographic markets of this type often apply when customers receive goods or services at suppliers' locations. Competitors in the market are firms with relevant production, sales, or service facilities in that region. Some customers who buy from these firms may be located outside the boundaries of the geographic market.

The hypothetical monopolist test requires that a hypothetical profit-maximizing firm that was the only present or future producer of the relevant product(s) located in the region would impose at least a SSNIP from at least one location, including at least one location of one of the merging firms. In this exercise the terms of sale for all products produced elsewhere are held constant. A single firm may operate in a number of different geographic markets, even for a single product.

> Example 12: The merging parties both have manufacturing plants in City X. The relevant product is expensive to transport and suppliers price their products for pickup at their locations. Rival plants are some distance away in City Y. A hypothetical monopolist controlling all plants in City X could profitably impose a SSNIP at these plants. Competition from more distant plants would not defeat the price increase because supplies coming from more distant plants require expensive transportation. The relevant geographic market is defined around the plants in City X.

When the geographic market is defined based on supplier locations, sales made by suppliers located in the geographic market are counted, regardless of the location of the customer making the purchase…

4.2.2 Geographic Markets Based on the Locations of Customers

When the hypothetical monopolist could discriminate based on customer location, the Agencies may define geographic markets based on the locations of targeted customers. Geographic markets of this type often apply when suppliers deliver their products or services to customers' locations. Geographic markets of this type encompass the region into which sales are made. Competitors in the market are firms that sell to customers in the specified region. Some suppliers that sell into the relevant market may be located outside the boundaries of the geographic market.

The hypothetical monopolist test requires that a hypothetical profit-maximizing firm that was the only present or future seller of the relevant product(s) to customers in the region would impose at least a SSNIP on some customers in that region. A region forms a relevant geographic market if this price increase would not be defeated by substitution away from the relevant product or by arbitrage, e.g., customers in the region travelling outside it to purchase the relevant product. In this exercise, the terms of sale for products sold to all customers outside the region are held constant…

When the geographic market is defined based on customer locations, sales made to those customers are counted, regardless of the location of the supplier making those sales…

5. Market Participants, Market Shares, and Market Concentration

The Agencies normally consider measures of market shares and market concentration as part of their evaluation of competitive effects. The Agencies evaluate market shares and concentration in conjunction with other reasonably available and reliable evidence for the ultimate purpose of determining whether a merger may substantially lessen competition.

Market shares can directly influence firms' competitive incentives. For example, if a price reduction to gain new customers would also apply to a firm's existing customers, a firm with a large market share may be more reluctant to implement a price reduction than one with a small share. Likewise, a firm with a large market share may not feel pressure to reduce price even if a smaller rival does. Market shares also can reflect firms' capabilities. For example, a firm with a large market share may be able to expand output rapidly by a larger absolute amount than can a small firm. Similarly, a large market share tends to indicate low costs, an attractive product, or both.

5.1 Market Participants

…Firms that are not current producers in a relevant market, but that would very likely provide rapid supply responses with direct competitive impact in the event of a SSNIP, without incurring significant sunk costs, are also considered market participants…

5.2 Market Shares

… The Agencies measure market shares based on the best available indicator of firms' future competitive significance in the relevant market. This may depend upon the type of competitive effect being considered, and on the availability of data. Typically, annual data are used, but where individual transactions are large and infrequent so annual data may be unrepresentative, the Agencies may measure market shares over a longer period of time….

In most contexts, the Agencies measure each firm's market share based on its actual or projected revenues in the relevant market. Revenues in the relevant market tend to be the best measure of attractiveness to customers, since they reflect the real-world ability of firms to surmount all of the obstacles necessary to offer products on terms and conditions that are attractive to customers. In cases where one unit of a low-priced product can substitute for one unit of a higher-priced product, unit sales may measure competitive significance better than revenues. For example, a new, much less expensive product may have great competitive significance if it substantially erodes the revenues earned by older, higher-priced products, even if it earns relatively few revenues. In cases where customers sign long-term contracts, face switching costs, or tend to re-evaluate their suppliers only occasionally, revenues earned from recently acquired customers may better reflect the competitive significance of suppliers than do total revenues.

In markets for homogeneous products, a firm's competitive significance may derive principally from its ability and incentive to rapidly expand production in the relevant market in response to a price increase or output reduction by others in that market. As a result, a firm's competitive significance may depend upon its level of readily available capacity to serve the relevant market if that capacity is efficient enough to make such expansion profitable. In such markets, capacities or reserves may better reflect the future competitive significance of suppliers than revenues, and the Agencies may calculate market shares using those measures…

5.3 Market Concentration

In analyzing mergers between an incumbent and a recent or potential entrant, to the extent the Agencies use the change in concentration to evaluate competitive effects, they will do so using projected market shares. A merger between an incumbent and a potential entrant can raise significant competitive concerns. The lessening of competition resulting from such a merger is more likely to be substantial, the larger is the market share of the incumbent, the greater is the competitive significance of the potential entrant, and the greater is the competitive threat posed by this potential entrant relative to others.

The Agencies give more weight to market concentration when market shares have been stable over time, especially in the face of historical changes in relative prices or costs…

The Agencies often calculate the Herfindahl-Hirschman Index ("HHI") of market concentration. The HHI is calculated by summing the squares of the individual firms' market shares, and thus gives proportionately greater weight to the larger market shares. When using the HHI, the Agencies consider both the post-merger level of the HHI and the increase in the HHI resulting from the merger. The increase in the HHI is equal to twice the product of the market shares of the merging firms. Based on their experience, the Agencies generally classify markets into three types:

- Unconcentrated Markets: HHI below 1500
- Moderately Concentrated Markets: HHI between 1500 and 2500
- Highly Concentrated Markets: HHI above 2500

The Agencies employ the following general standards for the relevant markets they have defined:

- Small Change in Concentration: Mergers involving an increase in the HHI of less than 100 points are unlikely to have adverse competitive effects and ordinarily require no further analysis.
- Unconcentrated Markets: Mergers resulting in unconcentrated markets are unlikely to have adverse competitive effects and ordinarily require no further analysis.
- Moderately Concentrated Markets: Mergers resulting in moderately concentrated markets that involve an increase in the HHI of more than 100 points potentially raise significant competitive concerns and often warrant scrutiny.
- Highly Concentrated Markets: Mergers resulting in highly concentrated markets that involve an increase in the HHI of between 100 points and 200 points potentially raise significant competitive concerns and often warrant scrutiny. Mergers resulting in highly concentrated markets that involve an increase in the HHI of more than 200 points will be presumed to be likely to enhance market power. The presumption may be rebutted by persuasive evidence showing that the merger is unlikely to enhance market power.

The purpose of these thresholds is not to provide a rigid screen to separate competitively benign mergers from anticompetitive ones, although high levels of concentration do raise concerns. Rather, they provide one way to identify some mergers unlikely to raise competitive concerns and some others for which it is particularly important to examine whether other competitive factors confirm, reinforce, or counteract the potentially harmful effects of increased concentration. The higher the post-merger HHI and the increase in the HHI, the greater are the Agencies' potential competitive concerns and the greater is the likelihood that the Agencies will request additional information to conduct their analysis.

6. Unilateral Effects

The elimination of competition between two firms that results from their merger may alone constitute a substantial lessening of competition. Such unilateral effects are most apparent in a merger to monopoly in a relevant market, but are by no means limited to that case.

6.1 Pricing of Differentiated Products

The extent of direct competition between the products sold by the merging parties is central to the evaluation of unilateral price effects. Unilateral price effects are greater, the more the buyers of products sold by one merging firm consider products sold by the other merging firm to be their next choice. The Agencies consider any reasonably available and reliable information to evaluate the extent of direct competition between the products sold by the merging firms…

Substantial unilateral price elevation post-merger for a product formerly sold by one of the merging firms normally requires that a significant fraction of the customers purchasing that product view products formerly sold by the other merging firm as their next-best choice. However, unless premerger margins between price and incremental cost are low, that significant fraction need not approach a majority. For this purpose, incremental cost is measured over the change in output that would be caused by the price change considered. A merger may produce significant unilateral effects for a given product even though many more sales are diverted to products sold by non-merging firms than to products previously sold by the merger partner…

In some cases, the Agencies may seek to quantify the extent of direct competition between a product sold by one merging firm and a second product sold by the other merging firm by estimating the diversion ratio from the first product to the second product. The diversion ratio is the fraction of unit sales lost by the first product due to an increase in its price that would be diverted to the second product. Diversion ratios between products sold by one merging firm and products sold by the other merging firm can be very informative for assessing unilateral price effects, with higher diversion ratios indicating a greater likelihood of such effects. Diversion ratios between products sold by merging firms and those sold by non-merging firms have at most secondary predictive value.

Adverse unilateral price effects can arise when the merger gives the merged entity an incentive to raise the price of a product previously sold by one merging firm and thereby divert sales to products previously sold by the other merging firm, boosting the profits on the latter products. Taking as given other prices and product offerings, that boost to profits is equal to the value to the merged firm of the sales diverted to those products. The value of sales diverted to a product is equal to the number of units diverted to that product multiplied by the margin between price and incremental cost on that product. In some cases, where sufficient information is available, the Agencies assess the value of diverted sales, which can serve as an indicator of the upward pricing pressure on the first product resulting from the merger. Diagnosing unilateral price effects based on the value of diverted sales need not rely on market definition or the calculation of market shares and concentration. The Agencies rely much more on the value of diverted sales than on the level of the HHI for diagnosing unilateral price effects in markets with differentiated products. If the value of diverted sales is proportionately small, significant unilateral price effects are unlikely.

Where sufficient data are available, the Agencies may construct economic models designed to quantify the unilateral price effects resulting from the merger. These models often include independent price responses by non-merging firms. They also can incorporate merger-specific efficiencies. These merger simulation methods need not rely on market definition. The Agencies do not treat merger simulation evidence as conclusive in itself, and they place more weight on whether their merger simulations consistently predict substantial price increases than on the precise prediction of any single simulation.

A merger is unlikely to generate substantial unilateral price increases if non-merging parties offer very close substitutes for the products offered by the merging firms. In some cases, non-merging firms may be able to reposition their products to offer close substitutes for the products offered by the merging firms. Repositioning is a supply-side response that is evaluated much like entry, with consideration given to timeliness, likelihood, and sufficiency. See Section 9. The Agencies consider whether repositioning would be sufficient to deter or counteract what otherwise would be significant anticompetitive unilateral effects from a differentiated products merger.

6.2 Bargaining and Auctions

… Some highly structured forms of such competition are known as auctions. Negotiations often combine aspects of an auction with aspects of one-on-one negotiation, although pure auctions are sometimes used in government procurement and elsewhere…

Anticompetitive unilateral effects in these settings are likely in proportion to the frequency or probability with which, prior to the merger, one of the merging sellers had been the runner-up when the other won the business. These effects also are likely to be greater, the greater advantage the runner-up merging firm has over other suppliers in meeting customers' needs. These effects also tend to be greater, the more profitable were the pre-merger winning bids. All of these factors are likely to be small if there are many equally placed bidders…

6.4 Innovation and Product Variety

Competition often spurs firms to innovate. The Agencies may consider whether a merger is likely to diminish innovation competition by encouraging the merged firm to curtail its innovative efforts below the level that would prevail in the absence of the merger. That curtailment of innovation could take the form of reduced incentive to continue with an existing product-development effort or reduced incentive to initiate development of new products.

The first of these effects is most likely to occur if at least one of the merging firms is engaging in efforts to introduce new products that would capture substantial revenues from the other merging firm. The second, longer-run effect is most likely to occur if at least one of the merging firms has capabilities that are likely to lead it to develop new products in the future that would capture substantial revenues from the other merging firm. The Agencies therefore also consider whether a merger will diminish innovation competition by combining two of a very small number of firms with the strongest capabilities to successfully innovate in a specific direction.

The Agencies evaluate the extent to which successful innovation by one merging firm is likely to take sales from the other, and the extent to which post-merger incentives for future innovation will be lower than those that would prevail in the absence of the merger. The Agencies also consider whether the merger is likely to enable innovation that would not otherwise take place, by bringing together complementary capabilities that cannot be otherwise combined or for some other merger-specific reason.

The Agencies also consider whether a merger is likely to give the merged firm an incentive to cease offering one of the relevant products sold by the merging parties. Reductions in variety following a merger may or may not be anticompetitive. Mergers can lead to the efficient consolidation of products when variety offers little in value to customers. In other cases, a merger may increase variety by encouraging the merged firm to reposition its products to be more differentiated from one another…

7. Coordinated Effects

A merger may diminish competition by enabling or encouraging post-merger coordinated interaction among firms in the relevant market that harms customers. Coordinated interaction involves conduct by multiple firms that is profitable for each of them only as a result of the accommodating reactions of the others. These reactions can blunt a firm's incentive to offer customers better deals by undercutting the extent to which such a move would win business away from rivals. They also can enhance a firm's incentive to raise prices, by assuaging the fear that such a move would lose customers to rivals.

Coordinated interaction includes a range of conduct. Coordinated interaction can involve the explicit negotiation of a common understanding of how firms will compete or refrain from competing. Such conduct typically would itself violate the antitrust laws. Coordinated interaction also can involve a similar common understanding that is not explicitly negotiated but would be enforced by the detection and punishment of deviations that would undermine the coordinated interaction. Coordinated interaction alternatively can involve parallel accommodating conduct not pursuant to a prior understanding. Parallel accommodating conduct includes situations in which each rival's response to competitive moves made by others is individually rational, and not motivated by retaliation or deterrence nor intended to sustain an agreed-upon market outcome, but nevertheless emboldens price increases and weakens competitive incentives to reduce prices or offer customers better terms. Coordinated interaction includes conduct not otherwise condemned by the antitrust laws.

The ability of rival firms to engage in coordinated conduct depends on the strength and predictability of rivals' responses to a price change or other competitive initiative. Under some circumstances, a merger can result in market concentration sufficient to strengthen such responses or enable multiple firms in the market to predict them more confidently, thereby affecting the competitive incentives of multiple firms in the market, not just the merged firm.

7.1 Impact of Merger on Coordinated Interaction

… The Agencies seek to identify how a merger might significantly weaken competitive incentives through an increase in the strength, extent, or likelihood of coordinated conduct. There are, however, numerous forms of coordination, and the risk that a merger will induce adverse coordinated effects may not be susceptible to quantification or detailed proof. Therefore, the Agencies evaluate the risk of coordinated effects using measures of market concentration (see Section 5) in conjunction with an assessment of whether a market is vulnerable to coordinated conduct. See Section 7.2. The analysis in Section 7.2 applies to moderately and highly concentrated markets, as unconcentrated markets are unlikely to be vulnerable to coordinated conduct.

Pursuant to the Clayton Act's incipiency standard, the Agencies may challenge mergers that in their judgment pose a real danger of harm through coordinated effects, even without specific evidence showing precisely how the coordination likely would take place. The Agencies are likely to challenge a merger if the following three conditions are all met: (1) the merger would significantly increase concentration and lead to a moderately or highly concentrated market; (2) that market shows signs of vulnerability to coordinated conduct (see Section 7.2); and (3) the Agencies have a credible basis on which to conclude that the merger may enhance that vulnerability. An acquisition eliminating a maverick firm (see Section 2.1.5) in a market vulnerable to coordinated conduct is likely to cause adverse coordinated effects.

7.2 Evidence a Market is Vulnerable to Coordinated Conduct

The Agencies presume that market conditions are conducive to coordinated interaction if firms representing a substantial share in the relevant market appear to have previously engaged in express collusion affecting the relevant market, unless competitive conditions in the market have since changed significantly. Previous express collusion in another geographic market will have the same weight if the salient characteristics of that other market at the time of the collusion are comparable to those in the relevant market. Failed previous attempts at collusion in the relevant market suggest that successful collusion was difficult pre-merger but not so difficult as to deter attempts, and a merger may tend to make success more likely. Previous collusion or attempted collusion in another product market may also be given substantial weight if the salient characteristics of that other market at the time of the collusion are closely comparable to those in the relevant market.

A market typically is more vulnerable to coordinated conduct if each competitively important firm's significant competitive initiatives can be promptly and confidently observed by that firm's rivals. This is more likely to be the case if the terms offered to customers are relatively transparent. Price transparency can be greater for relatively homogeneous products. Even if terms of dealing are not transparent, transparency regarding the identities of the firms serving particular customers can give rise to coordination, e.g., through customer or territorial allocation. Regular monitoring by suppliers of one another's prices or customers can indicate that the terms offered to customers are relatively transparent.

A market typically is more vulnerable to coordinated conduct if a firm's prospective competitive reward from attracting customers away from its rivals will be significantly diminished by likely responses of those rivals. This is more likely to be the case, the stronger and faster are the responses the firm anticipates from its rivals. The firm is more likely to anticipate strong responses if there are few significant competitors, if products in the relevant market are relatively homogeneous, if customers find it relatively easy to switch between suppliers, or if suppliers use meeting-competition clauses. A firm is more likely to be deterred from making competitive initiatives by whatever responses occur if sales are small and frequent rather than via occasional large and long-term contracts or if relatively few customers will switch to it before rivals are able to respond.

A firm is less likely to be deterred by whatever responses occur if the firm has little stake in the status quo. For example, a firm with a small market share that can quickly and dramatically expand, constrained neither by limits on production nor by customer reluctance to switch providers or to entrust business to a historically small provider, is unlikely to be deterred. Firms are also less likely to be deterred by whatever responses occur if competition in the relevant market is marked by leapfrogging technological innovation, so that responses by competitors leave the gains from successful innovation largely intact.

A market is more apt to be vulnerable to coordinated conduct if the firm initiating a price increase will lose relatively few customers after rivals respond to the increase. Similarly, a market is more apt to be vulnerable to coordinated conduct if a firm that first offers a lower price or improved product to customers will retain relatively few customers thus attracted away from its rivals after those rivals respond.

The Agencies regard coordinated interaction as more likely, the more the participants stand to gain from successful coordination. Coordination generally is more profitable, the lower is the market elasticity of demand.

Coordinated conduct can harm customers even if not all firms in the relevant market engage in the coordination, but significant harm normally is likely only if a substantial part of the market is subject to such conduct. The prospect of harm depends on the collective market power, in the relevant market, of firms whose incentives to compete are substantially weakened by coordinated conduct. This collective market power is greater, the lower is the market elasticity of demand. This collective market power is diminished by the presence of other market participants with small market shares and little stake in the outcome resulting from the coordinated conduct, if these firms can rapidly expand their sales in the relevant market.

Buyer characteristics and the nature of the procurement process can affect coordination. For example, sellers may have the incentive to bid aggressively for a large contract even if they expect strong responses by rivals. This is especially the case for sellers with small market shares, if they can realistically win such large contracts. In some cases, a large buyer may be able to strategically undermine coordinated conduct, at least as it pertains to that buyer's needs, by choosing to put up for bid a few large contracts rather than many smaller ones, and by making its procurement decisions opaque to suppliers.

8. Powerful Buyers

Powerful buyers are often able to negotiate favorable terms with their suppliers. Such terms may reflect the lower costs of serving these buyers, but they also can reflect price discrimination in their favor.

The Agencies consider the possibility that powerful buyers may constrain the ability of the merging parties to raise prices. This can occur, for example, if powerful buyers have the ability and incentive to vertically integrate upstream or sponsor entry, or if the conduct or presence of large buyers undermines coordinated effects. However, the Agencies do not presume that the presence of powerful buyers alone forestalls adverse competitive effects flowing from the merger. Even buyers that can negotiate favorable terms may be harmed by an increase in market power…

Furthermore, even if some powerful buyers could protect themselves, the Agencies also consider whether market power can be exercised against other buyers.

9. Entry

As part of their full assessment of competitive effects, the Agencies consider entry into the relevant market. The prospect of entry into the relevant market will alleviate concerns about adverse competitive effects only if such entry will deter or counteract any competitive effects of concern so the merger will not substantially harm customers…

10. Efficiencies

Competition usually spurs firms to achieve efficiencies internally. Nevertheless, a primary benefit of mergers to the economy is their potential to generate significant efficiencies and thus enhance the merged firm's ability and incentive to compete, which may result in lower prices, improved quality, enhanced service, or new products. For example, merger-generated efficiencies may enhance competition by permitting two ineffective competitors to form a more effective competitor, e.g., by combining complementary assets. In a unilateral effects context, incremental cost reductions may reduce or reverse any increases in the merged firm's incentive to elevate price. Efficiencies also may lead to new or improved products, even if they do not immediately and directly affect price. In a coordinated effects context, incremental cost reductions may make coordination less likely or effective by enhancing the incentive of a maverick to lower price or by creating a new maverick firm. Even when efficiencies generated through a merger enhance a firm's ability to compete, however, a merger may have other effects that may lessen competition and make the merger anticompetitive.

The Agencies credit only those efficiencies likely to be accomplished with the proposed merger and unlikely to be accomplished in the absence of either the proposed merger or another means having comparable anticompetitive effects. These are termed merger-specific efficiencies…

Efficiencies are difficult to verify and quantify, in part because much of the information relating to efficiencies is uniquely in the possession of the merging firms. Moreover, efficiencies projected reasonably and in good faith by the merging firms may not be realized…

Efficiency claims will not be considered if they are vague, speculative, or otherwise cannot be verified by reasonable means. Projections of efficiencies may be viewed with skepticism, particularly when generated outside of the usual business planning process. By contrast, efficiency claims substantiated by analogous past experience are those most likely to be credited…

In the Agencies' experience, efficiencies are most likely to make a difference in merger analysis when the likely adverse competitive effects, absent the efficiencies, are not great. Efficiencies almost never justify a merger to monopoly or near-monopoly. Just as adverse competitive effects can arise along multiple dimensions of conduct, such as pricing and new product development, so too can efficiencies operate along multiple dimensions. Similarly, purported efficiency claims based on lower prices can be undermined if they rest on reductions in product quality or variety that customers value…

11. Failure and Exiting Assets

Notwithstanding the analysis above, a merger is not likely to enhance market power if imminent failure, as defined below, of one of the merging firms would cause the assets of that firm to exit the relevant market…

The Agencies do not normally credit claims that the assets of the failing firm would exit the relevant market unless all of the following circumstances are met: (1) the allegedly failing firm would be unable to meet its financial obligations in the near future; (2) it would not be able to reorganize successfully under Chapter 11 of the Bankruptcy Act; and (3) it has made unsuccessful good-faith efforts to elicit reasonable alternative offers that would keep its tangible and intangible assets in the relevant market and pose a less severe danger to competition than does the proposed merger.

12. Mergers of Competing Buyers

Mergers of competing buyers can enhance market power on the buying side of the market, just as mergers of competing sellers can enhance market power on the selling side of the market. Buyer market power is sometimes called "monopsony power."

To evaluate whether a merger is likely to enhance market power on the buying side of the market, the Agencies employ essentially the framework described above for evaluating whether a merger is likely to enhance market power on the selling side of the market. In defining relevant markets, the Agencies focus on the alternatives available to sellers in the face of a decrease in the price paid by a hypothetical monopsonist…

13. Partial Acquisitions

When the Agencies determine that a partial acquisition results in effective control of the target firm, or involves substantially all of the relevant assets of the target firm, they analyze the transaction much as they do a merger. Partial acquisitions that do not result in effective control may nevertheless present significant competitive concerns and may require a somewhat distinct analysis from that applied to full mergers or to acquisitions involving effective control. The details of the post-acquisition relationship between the parties, and how those details are likely to affect competition, can be important. While the Agencies will consider any way in which a partial acquisition may affect competition, they generally focus on three principal effects.

First, a partial acquisition can lessen competition by giving the acquiring firm the ability to influence the competitive conduct of the target firm. A voting interest in the target firm or specific governance rights, such as the right to appoint members to the board of directors, can permit such influence. Such influence can lessen competition because the acquiring firm can use its influence to induce the target firm to compete less aggressively or to coordinate its conduct with that of the acquiring firm.

Second, a partial acquisition can lessen competition by reducing the incentive of the acquiring firm to compete. Acquiring a minority position in a rival might significantly blunt the incentive of the acquiring firm to compete aggressively because it shares in the losses thereby inflicted on that rival. This reduction in the incentive of the acquiring firm to compete arises even if cannot influence the conduct of the target firm. As compared with the unilateral competitive effect of a full merger, this effect is likely attenuated by the fact that the ownership is only partial.

Third, a partial acquisition can lessen competition by giving the acquiring firm access to non-public, competitively sensitive information from the target firm. Even absent any ability to influence the conduct of the target firm, access to competitively sensitive information can lead to adverse unilateral or coordinated effects. For example, it can enhance the ability of the two firms to coordinate their behavior, and make other accommodating responses faster and more targeted. The risk of coordinated effects is greater if the transaction also facilitates the flow of competitively sensitive information from the acquiring firm to the target firm.

Partial acquisitions, like mergers, vary greatly in their potential for anticompetitive effects. Accordingly, the specific facts of each case must be examined to assess the likelihood of harm to competition. While partial acquisitions usually do not enable many of the types of efficiencies associated with mergers, the Agencies consider whether a partial acquisition is likely to create cognizable efficiencies.

Comment

The Horizontal Merger Guidelines are essential reading for any antitrust student. You should come back and reread them at the end of the semester. But is the agencies' consumer-focused analysis consistent with *Brown Shoe*?

For examples of how the guidelines have affected merger litigation, see *FTC v. Staples Inc. & Office Depot Inc.*, *United States v. H&R Block, Inc.*, and the complaint in *U.S. v. Anheuser-Busch InBev SA/NV and Grupo Modelo S.A.B. de C.V.*

United States v. E.I. Du Pont de Nemours & Co. 351 U.S. 377 (1956)

The United States brought this civil action under § 4 of the Sherman Act against E. I. du Pont de Nemours and Company. The complaint, filed December 13, 1947, in the United States District Court for the District of Columbia, charged du Pont with monopolizing, attempting to monopolize and conspiracy to monopolize interstate commerce in cellophane and cellulosic caps and bands in violation of § 2 of the Sherman Act… After a lengthy trial, judgment was entered for du Pont on all issues. (at 378)

…

During the period that is relevant to this action, du Pont produced almost 75% of the cellophane sold in the United States, and cellophane constituted less than 20% of all "flexible packaging material" sales. (at 379)

…

The Government asserts that cellophane and other wrapping materials are neither substantially fungible nor like priced. For these reasons, it argues that the market for other wrappings is distinct from the market for cellophane and that the competition afforded cellophane by other wrappings is not strong enough to be considered in determining whether du Pont has monopoly powers. Market delimitation is necessary under du Pont's theory to determine whether an alleged monopolist violates § 2. The ultimate consideration in such a determination is whether the defendants control the price and competition in the market for such part of trade or commerce as they are charged with monopolizing. Every manufacturer is the sole producer of the particular commodity it makes but its control in the above sense of the relevant market depends upon the availability of alternative commodities for buyers: *i. e*., whether there is a cross-elasticity of demand between cellophane and the other wrappings. This interchangeability is largely gauged by the purchase of competing products for similar uses considering the price, characteristics and adaptability of the competing commodities. The court below found that the flexible wrappings afforded such alternatives. This Court must determine whether the trial court erred in its estimate of the competition afforded cellophane by other materials… (at 380-381)

…

II. *The Sherman Act and the Courts.* -- The Sherman Act has received long and careful application by this Court to achieve for the Nation the freedom of enterprise from monopoly or restraint envisaged by the Congress that passed the Act in 1890. Because the Act is couched in broad terms, it is adaptable to the changing types of commercial production and distribution that have evolved since its passage. Chief Justice Hughes wrote for the Court that "As a charter of freedom, the Act has a generality and adaptability comparable to that found to be desirable in constitutional provisions." *Appalachian Coals, Inc*. v. *United States*, 288 U.S. 344, 359-360. Compare on remedy, Judge Wyzanski in *United States* v. *United Shoe Machinery Corp*., 110 F.Supp. 295, 348. It was said in *Standard Oil Co*. v. *United States*, 221 U.S. 1, 50, that fear of the power of rapid accumulations of individual and corporate wealth from the trade and industry of a developing national economy caused its passage. Units of traders and producers snowballed by combining into so-called "trusts." Competition was threatened. Control of prices was feared. Individual initiative was dampened. While the economic picture has changed, large aggregations of private capital, with power attributes, continue. Mergers go forward. Industries such as steel, automobiles, tires, chemicals, have only a few production organizations. A considerable size is often essential for efficient operation in research, manufacture and distribution. (at 385-386)

…

Senator Hoar, in discussing § 2, pointed out that monopoly involved something more than extraordinary commercial success, "that it involved something like the use of means which made it impossible for other persons to engage in fair competition."[15] … (at 389-391)

If cellophane is the "market" that du Pont is found to dominate, it may be assumed it does have monopoly power over that "market." Monopoly power is the power to control prices or exclude competition. It seems apparent that du Pont's power to set the price of cellophane has been limited only by the competition afforded by other flexible packaging materials. Moreover, it may be practically impossible for anyone to commence manufacturing cellophane without full access to du Pont's technique. However, du Pont has no power to prevent competition from other wrapping materials… (at 391-392)

Determination of the competitive market for commodities depends on how different from one another are the offered commodities in character or use, how far buyers will go to substitute one commodity for another. For example, one can think of building materials as in commodity competition but one could hardly say that brick competed with steel or wood or cement or stone in the meaning of Sherman Act litigation; the products are too different. This is the interindustry competition emphasized by some economists. See Lilienthal, Big Business, c. 5. On the other

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[15] 21 Cong. Rec. 3151 at 3152:

"Mr. HOAR. I put in the committee, if I may be permitted to say so (I suppose there is no impropriety in it), the precise question which has been put by the Senator from West Virginia, and I had that precise difficulty in the first place with this bill, but I was answered, and I think all the other members of the committee agreed in the answer, that 'monopoly' is a technical term known to the common law, and that it signifies -- I do not mean to say that they stated what the signification was, but I became satisfied that they were right and that the word 'monopoly' is a merely technical term which has a clear and legal signification, and it is this: It is the sole engrossing to a man's self by means which prevent other men from engaging in fair competition with him.

"Of course a monopoly granted by the King was a direct inhibition of all other persons to engage in that business or calling or to acquire that particular article, except the man who had a monopoly granted him by the sovereign power. I suppose, therefore, that the courts of the United States would say in the case put by the Senator from West Virginia that a man who merely by superior skill and intelligence, a breeder of horses or raiser of cattle, or manufacturer or artisan of any kind, got the whole business because nobody could do it as well as he could was not a monopolist, but that it involved something like the use of means which made it impossible for other persons to engage in fair competition, like the engrossing, the buying up of all other persons engaged in the same business."

hand, there are certain differences in the formulae for soft drinks but one can hardly say that each one is an illegal monopoly… (at 393-394)

IV. *The Relevant Market.* -- When a product is controlled by one interest, without substitutes available in the market, there is monopoly power. Because most products have possible substitutes, we cannot, as we said in *Times-Picayune Co*. v. *United States*, 345 U.S. 594, 612, give "that infinite range" to the definition of substitutes. Nor is it a proper interpretation of the Sherman Act to require that products be fungible to be considered in the relevant market…

But where there are market alternatives that buyers may readily use for their purposes, illegal monopoly does not exist merely because the product said to be monopolized differs from others. If it were not so, only physically identical products would be a part of the market. To accept the Government's argument, we would have to conclude that the manufacturers of plain as well as moistureproof cellophane were monopolists, and so with films such as Pliofilm, foil, glassine, polyethylene, and Saran, for each of these wrapping materials is distinguishable. These were all exhibits in the case. New wrappings appear, generally similar to cellophane: is each a monopoly? What is called for is an appraisal of the "cross-elasticity" of demand in the trade. See Note, 54 Col. L. Rev. 580. The varying circumstances of each case determine the result. In considering what is the relevant market for determining the control of price and competition, no more definite rule can be declared than that commodities reasonably interchangeable by consumers for the same purposes make up that "part of the trade or commerce," monopolization of which may be illegal. As respects flexible packaging materials, the market geographically is nationwide… (at 394-395)

Cellophane differs from other flexible packaging materials. From some it differs more than from others. The basic materials from which the wrappings are made and the advantages and disadvantages of the products to the packaging industry are summarized in Findings 62 and 63. They are aluminum, cellulose acetate, chlorides, wood pulp, rubber hydrochloride, and ethylene gas. It will adequately illustrate the similarity in characteristics of the various products by noting here Finding 62 as to glassine. Its use is almost as extensive as cellophane, Appendix C, *post*, p. 412, and many of its characteristics equally or more satisfactory to users. (at 397)

It may be admitted that cellophane combines the desirable elements of transparency, strength and cheapness more definitely than any of the others… (at 398)

But, despite cellophane's advantages, it has to meet competition from other materials in every one of its uses. Cellophane's principal uses are analyzed in Appendix A, Findings 281 and 282. Food products are the chief outlet, with cigarettes next. The Government makes no challenge to Finding 283 that cellophane furnishes less than 7% of wrappings for bakery products, 25% for candy, 32% for snacks, 35% for meats and poultry, 27% for crackers and biscuits, 47% for fresh produce, and 34% for frozen foods. Seventy-five to eighty percent of cigarettes are wrapped in cellophane. Finding 292. Thus, cellophane shares the packaging market with others. The over-all result is that cellophane accounts for 17.9% of flexible wrapping materials, measured by the wrapping surface. Finding 280, Appendix A, *post*, p. 405.

Moreover a very considerable degree of functional interchangeability exists between these products, as is shown by the tables of Appendix A and Findings 150-278. It will be noted, Appendix B, that except as to permeability to gases, cellophane has no qualities that are not possessed by a number of other materials. Meat will do as an example of interchangeability. Findings 205-220. Although du Pont's sales to the meat industry have reached 19,000,000 pounds annually, nearly 35%, this volume is attributed "to the rise of self-service retailing of fresh meat." Findings 212 and 283. In fact, since the popularity of self-service meats, du Pont has lost "a considerable proportion" of this packaging business to Pliofilm. Finding 215. Pliofilm is more expensive than cellophane, but its superior physical characteristics apparently offset cellophane's price advantage. While retailers shift continually between the two, the trial court found that Pliofilm is increasing its share of the business. Finding 216. One further example is worth noting. Before World War II, du Pont cellophane wrapped between 5 and 10% of baked and smoked meats. The peak year was 1933. Finding 209. Thereafter du Pont was unable to meet the competition of Sylvania and of greaseproof paper. Its sales declined and the 1933 volume was not reached again until 1947. Findings 209-210. It will be noted that greaseproof paper, glassine, waxed paper, foil and Pliofilm are used as well as cellophane, Finding 218. Findings 209-210 show the competition and 215-216 the advantages that have caused the more expensive Pliofilm to increase its proportion of the business.

An element for consideration as to cross-elasticity of demand between products is the responsiveness of the sales of one product to price changes of the other. If a slight decrease in the price of cellophane causes a considerable number of customers of other flexible wrappings to switch to cellophane, it would be an indication that a high cross-elasticity of demand exists between them; that the products compete in the same market. The court below held that the "great sensitivity of customers in the flexible packaging markets to price or quality changes" prevented du Pont from possessing monopoly control over price. 118 F.Supp., at 207. The record sustains these findings. See references made by the trial court in Findings 123-149.

We conclude that cellophane's interchangeability with the other materials mentioned suffices to make it a part of this flexible packaging material market.

The Government stresses the fact that the variation in price between cellophane and other materials demonstrates they are noncompetitive. As these products are all flexible wrapping materials, it seems reasonable to consider, as was done at the trial, their comparative cost to the consumer in terms of square area. This can be seen in Finding 130, Appendix C. Findings as to price competition are set out in the margin. Cellophane costs two or three times as much, surface measure, as its chief competitors for the flexible wrapping market, glassine and greaseproof papers. Other forms of cellulose wrappings and those from other chemical or mineral substances, with the exception of aluminum foil, are more expensive. The uses of these materials, as can be observed by Finding 283 in Appendix A, are largely to wrap small packages for retail distribution.

The wrapping is a relatively small proportion of the entire cost of the article. [30] Different producers need different qualities in wrappings and their need may vary from time to time as their products undergo change. But the necessity for flexible wrappings is the central and unchanging demand. We cannot say that these differences in cost gave du Pont monopoly power over prices in view of the findings of fact on that subject…. (at 399-401)

…

The facts above considered dispose also of any contention that competitors have been excluded by du Pont from the packaging material market. That market has many producers and there is no proof du Pont ever has possessed power to exclude any of them from the rapidly expanding flexible packaging market… (at 403)

Dissent (Justice Warren)

This case, like many under the Sherman Act, turns upon the proper definition of the market. In defining the market in which du Pont's economic power is to be measured, the majority virtually emasculate § 2 of the Sherman Act. They admit that "cellophane combines the desirable elements of transparency, strength and cheapness more definitely than any of" a host of other packaging materials. Yet they hold that all of those materials are so indistinguishable from cellophane as to warrant their inclusion in the market. We cannot agree that cellophane, in the language of *Times-Picayune Publishing Co*. v. *United States*, 345 U.S. 594, 613, is "the selfsame product" as glassine, greaseproof and vegetable parchment papers, waxed papers, sulphite papers, aluminum foil, cellulose acetate, and Pliofilm and other films… (at 414-5)

If the conduct of buyers indicated that glassine, waxed and sulphite papers and aluminum foil were actually "the selfsame products" as cellophane, the qualitative differences demonstrated by the comparison of physical properties in Finding 59 would not be conclusive. But the record provides convincing proof that businessmen did not so regard these products. During the period covered by the complaint (1923-1947) cellophane enjoyed phenomenal growth. Du Pont's 1924 production was 361,249 pounds, which sold for $ 1,306,662. Its 1947 production was 133,502,858 pounds, which sold for $ 55,339,626. Findings 297 and 337. Yet throughout this period the price of cellophane was far greater than that of glassine, waxed paper or sulphite paper. Finding 136 states that in 1929 cellophane's price was seven times that of glassine; in 1934, four times, and in 1949 still more than twice glassine's price. Reference to DX-994, the graph upon which Finding 136 is based, shows that cellophane had a similar price relation to waxed paper and that sulphite paper sold at even less than glassine and waxed paper. We cannot believe that buyers, practical businessmen, would have bought cellophane in increasing amounts over a quarter of a century if

[30] See, *e. g*., R. 4846.

close substitutes were available at from one-seventh to one-half cellophane's price. That they did so is testimony to cellophane's distinctiveness. (at 416-417)

The inference yielded by the conduct of cellophane buyers is reinforced by the conduct of sellers other than du Pont. Finding 587 states that Sylvania, the only other cellophane producer, absolutely and immediately followed every du Pont price change, even dating back its price list to the effective date of du Pont's change. Producers of glassine and waxed paper, on the other hand, displayed apparent indifference to du Pont's repeated and substantial price cuts. DX-994 shows that from 1924 to 1932 du Pont dropped the price of plain cellophane 84%, while the price of glassine remained constant. And during the period 1933-1946 the prices for glassine and waxed paper actually increased in the face of a further 21% decline in the price of cellophane. If "shifts of business" due to "price sensitivity" had been substantial, glassine and waxed paper producers who wanted to stay in business would have been compelled by market forces to meet du Pont's price challenge just as Sylvania was. The majority correctly point out that: "An element for consideration as to cross-elasticity of demand between products is the responsiveness of the sales of one product to price changes of the other. If a slight decrease in the price of cellophane causes a considerable number of customers of other flexible wrappings to switch to cellophane, it would be an indication that a high cross-elasticity of demand exists between them; that the products compete in the same market."

Surely there was more than "a slight decrease in the price of cellophane" during the period covered by the complaint. That producers of glassine and waxed paper remained dominant in the flexible packaging materials market without meeting cellophane's tremendous price cuts convinces us that cellophane was not in effective competition with their products.

Certainly du Pont itself shared our view. From the first, du Pont recognized that it need not concern itself with competition from other packaging materials… Du Pont's every action was directed toward maintaining dominance over cellophane… (at 417-418)

This further reveals its misconception of the antitrust laws. A monopolist seeking to maximize profits cannot raise prices "arbitrarily." Higher prices of course mean smaller sales, but they also mean higher per-unit profit. Lower prices will increase sales but reduce per-unit profit. Within these limits a monopolist has a considerable degree of latitude in determining which course to pursue in attempting to maximize profits. The trial judge thought that, if du Pont raised its price, the market would "penalize" it with smaller profits as well as lower sales. Du Pont proved him wrong. When 1947 operating earnings dropped below 26% for the first time in 10 years, it increased cellophane's price 7% and boosted its earnings in 1948. Du Pont's division manager then reported that "If an operative return of 31% is considered inadequate then an upward revision in prices will be necessary to improve the return." It is this latitude with respect to price, this broad power of choice, that the antitrust laws forbid. Du Pont's independent pricing policy and the great profits consistently yielded by that policy leave no room for doubt that it had power to control the price of cellophane. The findings of fact cited by the majority cannot affect this conclusion. For they merely demonstrate that, during the period covered by the complaint, du Pont was a "good monopolist," *i. e.*, that it did not engage in predatory practices and that it chose to maximize profits by lowering price and expanding sales. Proof of enlightened exercise of monopoly power certainly does not refute the existence of that power. (at 422-423)

…

The majority hold in effect that, because cellophane meets competition for many end uses, those buyers for other uses who need or want only cellophane are not entitled to the benefits of competition within the cellophane industry. For example, Finding 282 shows that the largest single use of cellophane in 1951 was for wrapping cigarettes, and Finding 292 shows that 75 to 80% of all cigarettes are wrapped with cellophane. As the recent report of the Attorney General's National Committee to Study the Antitrust Laws states: "In the interest of rivalry that extends to *all* buyers and *all* uses, competition among rivals within the industry is always important." (Emphasis added.) Furthermore, those buyers who have "reasonable alternatives" between cellophane and other products are also entitled to competition within the cellophane industry, for such competition may lead to lower prices and improved quality.

The foregoing analysis of the record shows conclusively that cellophane is the relevant market. Since du Pont has the lion's share of that market, it must have monopoly power, as the majority concede… (at 424-425)

Comment

This majority makes an analytic error. The lapse is so famous that it is now known as the "cellophane fallacy."

The Court observed that Du Pont had no power to increase its prices further without losing customers. As a result, it reasoned, Du Pont had no market power. But this ignores the fact that *Du Pont had already raised its rates to monopoly prices*. In other words, the Court failed to consider the market power that Du Pont had already exercised. The correct way to measure market power is to ask whether a company could increase prices above the *competitive* level—which DuPont surely could have done, and indeed had done.

Eastman Kodak Co. v. Image Technical Services, Inc., 504 U.S. 451 (1992)

The principal issue here is whether a defendant's lack of market power in the primary equipment market precludes -- as a matter of law -- the possibility of market power in derivative aftermarkets.

Petitioner Eastman Kodak Company manufactures and sells photocopiers and micrographic equipment. Kodak also sells service and replacement parts for its equipment. Respondents are 18 independent service organizations (ISO's) that in the early 1980's began servicing Kodak copying and micrographic equipment. Kodak subsequently adopted policies to limit the availability of parts to ISO's and to make it more difficult for ISO's to compete with Kodak in servicing Kodak equipment… (at 455)

For service and parts to be considered two distinct products, there must be sufficient consumer demand so that it is efficient for a firm to provide service separately from parts. *Jefferson Parish Hospital Dist. No. 2* v. *Hyde*, 466 U.S. 2, 21-22, 80 L. Ed. 2d 2, 104 S. Ct. 1551 (1984). Evidence in the record indicates that service and parts have been sold separately in the past and still are sold separately to self-service equipment owners. Indeed, the development of the entire high-technology service industry is evidence of the efficiency of a separate market for service.

Kodak insists that because there is no demand for parts separate from service, there cannot be separate markets for service and parts. Brief for Petitioner 15, n. 3. By that logic, we would be forced to conclude that there can never be separate markets, for example, for cameras and film, computers and software, or automobiles and tires. That is an assumption we are unwilling to make. "We have often found arrangements involving functionally linked products at least one of which is useless without the other to be prohibited tying devices." *Jefferson Parish*, 466 U.S. at 19, n. 30.

Kodak's assertion also appears to be incorrect as a factual matter. At least some consumers would purchase service without parts, because some service does not require parts, and some consumers, those who self-service for example, would purchase parts without service. Enough doubt is cast on Kodak's claim of a unified market that it should be resolved by the trier of fact.

Finally, respondents have presented sufficient evidence of a tie between service and parts. The record indicates that Kodak would sell parts to third parties only if they agreed not to buy service from ISO's.

FTC v. Staples Inc. and Office Depot Inc., 190 F. Supp.3d 100 (D.D.C. 2016)

Drawing an analogy to the fate of penguins whose destinies appear doomed in the face of uncertain environmental changes, Defendant. Staples Inc: ("Staples") and Defendant Office Depot, Inc. ("Office Depot") (collectively "Defendants") argue they are like "penguins on a melting iceberg," struggling to survive in an increasingly digitized world and an office-supply industry soon to be revolutionized by new entrants like Amazon Business. Prelim. Inj. Hrg Tr. ("Hrg Tr.") 60:15 (Opening Statement of Diane Sullivan, Esq.). Charged with enforcing antitrust laws for the benefit of American consumers, the Federal Trade Commission ("FTC") and its co-plaintiffs, the. Commonwealth of Pennsylvania and the District of Columbia, commenced this action in an effort to block Defendants' proposed merger and alleged that the merger would "eliminat[e] direct competition between Staples and Office Depot" resulting in "significant harm" to large businesses that purchase office supplies for their own use. Compl., Docket No. 3 at 4. The survival of Staples' proposed acquisition of Office Depot hinges on two critical issues: (1) the reliability of Plaintiffs' market definition and market share analysis; and (2) the likelihood that the competition resulting from new market entrants like Amazon Business will be timely and sufficient to restore competition lost as a result of the merger… (at 108)

Upon consideration of the evidence presented during the hearing, the parties' proposed findings of fact and conclusions of law, and the relevant legal authority, the Court concludes that the Plaintiffs have established their *prima facie* case by demonstrating that Defendants' proposed merger is likely to reduce competition in the Business to Business ("B-to-B") contract space for office supplies. Defendants' response relies in large part on the prospect that Amazon Business will replace any competition lost because of the merger. Although Amazon Business may transform how some businesses purchase office supplies, the evidence presented during the hearing fell short of establishing that Amazon Business is likely to restore lost competition in the B-to-B space in a timely and sufficient manner. For the reasons discussed in Section IV *infra*, Plaintiffs' Motion for Preliminary Injunction is **GRANTED**…[4] (at 111)

Staples and Office Depot are publicly traded corporations. Compl. ¶¶ 29 and 30. Staples is the largest office supplier of consumable office supplies to large B-to-B customers in the United States and operates in three business segments: (1) North American stores and online sales; (2) North American commercial; and (3) international operations. *Id.* ¶ 29. In fiscal year 2014, Staples generated $22.5 billion in sales, with more than half of all sales coming from office supplies. *Id.* In fiscal year 2013, 34.8 percent of Staples' total revenue came from the North American commercial segment. *Id.*

[4] The Court appreciates the tremendous amount of time, money and effort Defendants put into this case, and understands that they genuinely believe this merger would be best for their companies, the industry and the public. While the Court's decision is surely a great disappointment to Defendants, the Court is optimistic that Defendants will find ways to innovate, evolve and remain relevant in the rapidly changing office supply industry.

Office Depot is the second largest office supplier of consumable office supplies to large B-to-B customers in the United States. *Id.* ¶ 30. Like Staples, Office Depot operates in similar business segments: (1) North America retail; (2) North American business solutions; and (3) an international division. *Id.* In fiscal year 2014, Office Depot made $16.1 billion in revenue, with nearly half of those sales coming from office supplies and 37.4 percent of overall sales from B-to-B business. *Id.*

Staples' "commercial" and Office Depot's "business solutions" segments focus on the B-to-B contracts at issue in this case. While both companies serve businesses of all sizes, this case focuses on large B-to-B customers, defined by Plaintiffs as those that spend $500,000 or more per year on office supplies. Hrg Tr. 30:4-6. Approximately 1200 corporations in the United States are included in this alleged relevant market. Hrg Tr. 2473:17-18.

…

WB Mason is a regional supplier that targets its business to thirteen northeastern states plus the District of Columbia (known in the industry as "Masonville"). *Id.* WB Mason "ranks a distant third" behind Staples and Office Depot. PX03021-002, Meehan Decl. ¶ 6. In fiscal year 2015, WB Mason generated approximately $1.4 billion in total revenue. *Id.* WB Mason has no customers in the Fortune 100 and only nine in the Fortune 1000. Hrg Tr. 1611:21-1611:24. According to WB Mason's CEO, Leo Meehan, "Staples and Office Depot are the only consumable office supplies vendors that meet the needs of most large B2B customer[s] across the entire country, or even most of it." Meehan Decl. ¶ 19.

WB Mason recently abandoned a plan to expand nationwide. Hrg Tr. 1672 (Mr. Meehan: "And then I just got cold feet about it [TEXT REDACTED BY THE COURT] .") When asked during the hearing if WB Mason would accept a divestiture of cash assets from the Defendants to cover the expenses of nationwide expansion, Mr. Meehan would not commit to accepting such a proposal. *Id.* 1790 (Mr. Meehan: "I don't know if I would. That's a big challenge.").

E. Amazon Business

…

Although in its infancy, Amazon's vision is for Amazon Business to be the "preferred marketplace for all professional, business and institutional customers worldwide." DX00030 at 1. Amazon Business has several undisputed strengths: tremendous brand recognition, a user-friendly marketplace, cutting edge technological innovation, and global reach. Hrg Tr. 663:13 (Vice President of Amazon Business, Prentis Wilson: "We actually don't worry a lot about our competitors. Our focus has been on serving our customers."). Amazon Business also has several weaknesses with regard to its entry into the B-to-B space. One weakness is that Amazon Business is inexperienced in the RFP process. Amazon Business has not bid on many RFPs and has yet to win a primary vendor contract. Hrg Tr. 551:11-13 ("Q: Has Amazon Business ever won an RFP for the role as primary supplier of office supplies? A: No."). Amazon Business' marketplace model is also at odds with the B-to-B industry because half of the sales made through the marketplace are from independent third-party sellers over whom Amazon Business has no control. Hrg Tr. 843: 7-9 ("Q: You have no plans to force the third parties to offer particular prices? A: No, we'll never do that. No."). (at 112-114)

…

C. *Baker Hughes* Burden-Shifting Framework

In *United States v. Baker Hughes, Inc.*, 908 F.2d 981, 982-83, 285 U.S. App. D.C. 222 (D.C. Cir. 1990), the U.S. Court of Appeals for the D.C. Circuit established a burden-shifting framework for evaluating the FTC's likelihood of success on the merits. *See Heinz*, 246 F.3d at 715. The government bears the initial burden of showing the merger would result in "undue concentration in the market for a particular product in a particular geographic area." *Baker Hughes*, 908 F.2d at 982. Showing that the merger would result in a single entity controlling such a large percentage of the relevant market so as to significantly increase the concentration of firms in that market entitles the government to a presumption that the merger will substantially lessen competition. *Id.*

The burden then shifts to the defendants to rebut the presumption by offering proof that "the market-share statistics [give] an inaccurate account of the [merger's] probable effects on competition in the relevant market." *Heinz*, 246 F.3d at 715 (quoting *United States v. Citizens & S. Nat'l Bank*, 422 U.S. 86, 95 S. Ct. 2099, 45 L. Ed. 2d 41 (1975) (alterations in original)). "The more compelling the prima facie case, the more evidence the defendant must present to rebut it successfully." *Baker Hughes*, 908 F.2d at 991. "A defendant can make the required showing by affirmatively showing why a given transaction is unlikely to substantially lessen competition, or by discrediting the data underlying the initial presumption in the government's favor." *Id.*

"If the defendant successfully rebuts the presumption, the burden of producing additional evidence of anticompetitive effect shifts to the government, and merges with the ultimate burden of persuasion, which remains with the government at all times." *Id.* at 983. "[A] failure of proof in any respect will mean the transaction should not be enjoined." *Arch Coal*, 329 F. Supp. 2d at 116. The court must also weigh the equities, but if the FTC is unable to demonstrate a likelihood of success on the merits, the equities alone cannot justify an injunction. *Id. (at 116)*

…

a. Consumable office supplies as cluster market

Cluster markets allow items that are not substitutes for each other to be clustered together in one antitrust market for analytical convenience. Shapiro Report at 007 (noting that cluster markets are "commonly used by antitrust economists.") The Supreme Court has made clear that "[w]e see no barrier to combining in a single market a number of different products or services where that combination reflects commercial realities." *United States v. Grinnell Corp.*, 384 U.S. 563, 572, 86 S. Ct. 1698, 16 L. Ed. 2d 778 (1966).

Here, Plaintiffs allege that items such as pens, file folders, Post-it notes, binder clips, and paper for copiers and printers are included in this cluster market. Compl. ¶¶ 36-37. Although a pen is not a functional substitute for a paperclip, it is possible to cluster consumable office supplies into one market for analytical convenience. *ProMedica Health Sys., Inc. v. FTC*, 749 F.3d 559, 565-68 (6th Cir. 2014). Defining the market as a cluster market is justified in this case because "market shares and competitive conditions are likely to be similar for the distribution of pens to large customers and the distribution of binder clips to large customers." Shapiro Report at 007; *see also* PX02167 (Orszag Dep. 91:11-15) ("So, for example, pens may not often be substitutes for notebooks in the context of this case, but a cluster market would be the aggregation of those two and then the analysis of those together for, as we talked about earlier, analytical simplicity.").

b. Large B-to-B customers as target market

Another legal principle relevant to market definition in this case is the concept of a "targeted" or "price discrimination" market. According to the Merger Guidelines:

When examining possible adverse competitive effects from a merger, the Agencies consider whether those effects vary significantly for different customers purchasing the same or similar products. Such differential impacts are possible when sellers can discriminate, e.g., by profitably raising price to certain targeted customers but not to others. [...]

When price discrimination is feasible, adverse competitive effects on targeted customers can arise, even if such effects will not arise for other customers. A price increase for targeted customers may be profitable even if a price increase for all customers would not be profitable because too many other customers would substitute away.

U.S. Dep't of Justice & FTC Horizontal Merger Guidelines §3 (2010) (hereinafter Merger Guidelines).

Defining a market around a targeted consumer, therefore, requires finding that sellers could "profitably target a subset of customers for price increases . . ." *See Sysco*, 113 F. Supp. 3d at 38 (citing Merger Guidelines Section 4.1.4.). This means that there must be differentiated pricing and limited arbitrage. Dr. Shapiro concluded that arbitrage is limited here because "it is not practical or attractive for a large customer to purchase indirectly from or through smaller customers." *Id.* (at 117-118)

…

B. Application of, relevant legal principles to Plaintiffs' market definition

The concepts of cluster and targeted markets inform the Court's critical consideration when defining the market in this case: the products and services with which the Defendants' products compete. *Arch Coal, Inc.*, 329 F. Supp. 2d. at 119. The parties vigorously disagree on how the market should be defined. As noted *supra*, Plaintiffs argue that the relevant market is a cluster market of "consumable office supplies" which consists of "an assortment of office supplies, such as pens, paper clips, notepads and copy paper, that are used and replenished frequently." Compl. ¶¶ 36-37. Plaintiffs' alleged relevant market is also a targeted market, limited to B-to-B customers, specifically large B-to-B customers who spend $500,000 or more on office supplies annually. Hrg Tr. 30:4-6.

Defendants, on the other hand, argue that Plaintiffs' alleged market definition is wrong because it is a "gerrymandered and artificially narrow product market limited to *some*, but not all, consumable office supplies sold to only the most powerful companies in the world." Defs.' FOF ¶ 4 (emphasis in original). In particular, Defendants insist that ink and toner must be included in a proper definition of the relevant product market. *Id.* ¶ 101. Defendants also argue that no evidence supports finding sales to large B-to-B customers as a distinct market. *Id.* ¶ 77.

1. *Brown Shoe* "Practical Indicia"

The *Brown Shoe* practical indicia support Plaintiffs' definition of the relevant product market. The *Brown Shoe* "practical indicia" include: (1) industry or public recognition of the market as a separate economic entity; (2) the product's peculiar characteristics and uses; (3) unique production facilities; (4) distinct customers; (5) distinct prices; (6) sensitivity to price changes; and (7) specialized vendors. *Brown Shoe*, 370 U.S. at 325. Courts routinely rely on the *Brown Shoe* factors to define the relevant product market. *See, e.g. Staples*, 970 F. Supp. at 1075-80; *Cardinal Health*, 12 F. Supp. 2d at 46-48; *FTC v. Swedish Match*, 131 F. Supp. 2d 151, 159-64 (D.D.C. 2000); *FTC v. CCC Holdings*, 605 F. Supp. 2d 26, 39-44 (D.D.C. 2009); *United States v. H & R Block*, 833 F. Supp. 2d 36, 51-60 (D.D.C. 2011).[11]

The most relevant *Brown Shoe* indicia in this case are: (a) industry or public recognition of the market as a separate economic entity; (b) distinct prices and sensitivity to price changes; and (c) distinct customers that require specialized vendors that offer value-added services, including: (i) sophisticated information technology (IT) services; (ii) high quality customer service; and (iii) expedited delivery. (at 118-119)

…

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[11] The Court is aware of the academic observation that "the rationale for market definition in *Brown Shoe* was very different from and at odds with the rationale for market definition in horizontal merger cases today." Phillip E. Areeda and Herbert Hovenkamp, ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION at 237 (CCH, Inc. 2015).

> Today the concern is that the post-merger firm might be able to raise prices without causing too much output to be lost to its rivals. In contrast, the *Brown Shoe* concern was that by reducing its price' (or improving quality at the same price), the post-merger firm could deprive rivals of output, thus forcing them out altogether or relegating them to niche markets.

Id. at 240. Nevertheless, the Court finds the *Brown Shoe* factors a useful analytical tool, and as Judge Amit P. Mehta recognized in *Sysco, "Brown Shoe* remains the law, and this court cannot ignore its dictates." *Sysco*, 113 F. Supp. 3d at 27 n2.

As discussed in Section IV.A.2.a-c *supra*, the nature of how large B-to-B customers operate, including the services they demand, supports a finding that they are a targeted customer market for procurement of consumable office supplies. There is overwhelming evidence in this case that large B-to-B customers constitute a market that Defendants could target for price increases if they are allowed to merge. Significantly, Defendants themselves used the proposed merger to pressure B-to-B customers to lock in prices based on the expectation that they would lose negotiating leverage if the merger were approved. *See e.g.*, PX05236 (ODP) at 001 ("This offer is time sensitive. If and when the purchase of Office Depot is approved, Staples will have no reason to make this offer."); PX05249 (ODP) at 001 ("[The merger] will remove your ability to evaluate your program with two competitors. There will only be one."); PX05514 (ODP) at 003 ("Today, the FTC announced 45 days for its final decision. You still have time! You would be able to leverage the competition, gain an agreement that is grandfathered in and drive down expenses!"). (at 127)

D. Conclusions regarding the definition of the relevant market

The "practical indicia" set forth by the Supreme Court in *Brown Shoe* and Dr. Shapiro's expert testimony support the conclusion that Plaintiffs' alleged market of consumable office supplies (a cluster market) sold and distributed by Defendants to large B-to-B customers (a targeted market) is a relevant market for antitrust purposes. The *Brown Shoe* factors support Plaintiffs' argument that the sale and distribution of consumable office supplies to large B-to-B customers is a proper antitrust market because the evidence supports the conclusion that: (1) there is industry or public recognition of the market as a separate economic entity; (2) B-to-B customers demand distinct prices and demonstrate a high sensitivity to price changes; and (3) B-to-B customers require specialized vendors that offer value-added services. Dr. Shapiro's unrebutted testimony also supports Plaintiffs' alleged market definition because, in his opinion, "the elimination of competition would lead to a significant price increase to large customers," which implies the HMT is satisfied. Finally, for the reasons discussed in detail in Section IV.C *supra*, Defendants arguments against Plaintiffs' market definition fail.

E. Analysis of the Plaintiffs' arguments relating to probable effects on competition based on market share calculations

…

The Plaintiffs can establish their *prima facie* case by showing that the merger will result in an increase in market concentration above certain levels. *Id.* "Market concentration is a function of the number of firms in a market and their respective market shares." *Arch Coal*, 329 F. Supp. 2d at 123. The Herfindahl-Hirschmann Index ("HHI") is a tool used by economists to measure changes in market concentration. Merger Guidelines § 5.3. HHI is calculated by "summing the squares of the individual firms' market shares," a calculation that "gives proportionately greater weight to the larger market shares." *Id.* An HHI above 2,500 is considered "highly concentrated"; a market with an HHI between 1,500 and 2,500 is considered "moderately concentrated"; and a market with an HHI below 1,500 is considered "unconcentrated". *Id.* A merger that results in a highly concentrated market that involves an increase of 200 points will be presumed to be likely to enhance market power." *Id.*; *see also Heinz*, 246 F.3d at 716-17. (at 128)

…

G. Conclusion regarding Plaintiffs' market share analysis

Plaintiffs have met their burden of showing that the merger would result in "undue concentration" in the relevant market of the sale and distribution of consumable office supplies to large B-to-B customers in the United States. The relevant HHI would increase nearly 3,000 points, from 3270 to 6265. These HHI numbers far exceed the 200 point increase and post-merger concentration level of 2500 necessary to entitle Plaintiffs to a presumption that the merger is illegal… (at 131)

[The Court rejected the Defendants' arguments that their merger would nonetheless not harm competition, and that they were constrained by competition from WB Mason and Amazon on the basis that WB Mason did not have the resources or ambition to challenge the defendants nationally, and Amazon Business was to undeveloped to effectively compete in the medium term.]

V. Conclusion

As Judge Mehta observed in *Sysco*, "There can be little doubt that the acquisition of the second largest firm in the market by the largest firm in the market will tend to harm competition in that market." 113 F. Supp. 3d at 88 (quoting J. Tatel in *Whole Foods*, 548 F.3d at 1043). The Court concludes that Plaintiffs have met their burden of showing by a "reasonable probability" that Staples' acquisition of Office Depot would lessen competition in the sale and distribution of consumable office supplies in the large B-to-B market in the United States. The evidence offered by Defendants to rebut Plaintiffs' showing of likely harm was inadequate as a matter of law. Plaintiffs have therefore carried their ultimate burden of showing that they are likely to succeed in proving, after a full administrative hearing on the merits, that the proposed merger "may be substantially to lessen competition, or to tend to create a monopoly" in violation of Section 7 of the Clayton Act. (at 138)

Comment

This case shows how market definition can be dispositive. Once a court decides that a market includes only the merging parties and few others, the structural presumption applies and defendants will have a hard time prevailing.

United States of America v. Anheuser-Busch InBev SA/NV et al. Complaint.

The United States of America, acting under the direction of the Attorney General of the United States, brings this civil action under the antitrust laws of the United States to enjoin the proposed acquisition by Anheuser-Busch InBev SA/NV ("ABI") of the remainder of Grupo Modelo S.A.B. de C.V. ("Modelo") that it does not already own, and to obtain equitable and other relief as appropriate.

1. … The U.S. beer industry – which serves tens of millions of consumers at all levels of income – is highly concentrated with just two firms accounting for approximately 65% of all sales nationwide. The transaction that is the subject of this Complaint threatens competition by combining the largest and third-largest brewers of beer sold in the United States. The United States therefore seeks to enjoin this acquisition and prevent a serious violation of Section 7 of the Clayton Act.

2. Today, Modelo aggressively competes head-to-head with ABI in the United States. That competition has resulted in lower prices and product innovations that have benefited consumers across the country. The proposed acquisition would eliminate this competition by further concentrating the beer industry, enhancing ABI's market power, and facilitating coordinated pricing between ABI and the next largest brewer, MillerCoors, LLC…

3. Defendants' combined national share actually understates the effect that eliminating Modelo would have on competition in the beer industry, both because Modelo's share is substantially higher in many local areas than its national share, and because of the interdependent pricing dynamic that already exists between the largest brewers. As the two largest brewers, ABI and MillerCoors often find it more profitable to follow each other's prices than to compete aggressively for market share by cutting price. Among other things, ABI typically initiates annual price increases in various markets with the expectation that MillerCoors' prices will follow. And they frequently do.

4. In contrast, Modelo has resisted ABI-led price hikes. Modelo's pricing strategy – "The Momentum Plan" – seeks to narrow the "price gap" between Modelo beers and lower-priced premium domestic brands, such as Bud and Bud Light. ABI internal documents acknowledge that Modelo has put "increasing pressure" on ABI by pursuing a competitive strategy directly at odds with ABI's well-established practice of leading prices upward.

5. Because Modelo prices have not closely followed ABI's price increases, ABI and MillerCoors have been forced to offer lower prices and discounts for their brands to discourage consumers from "trad[ing] up" to Modelo brands. If ABI were to acquire the remainder of Modelo, this competitive constraint on ABI's and MillerCoors' ability to raise their prices would be eliminated.

6. The acquisition would also eliminate the substantial head-to-head competition that currently exists between ABI and Modelo. The loss of this head-to-head competition would enhance the ability of ABI to unilaterally raise the prices of the brands that it would own post-acquisition, and diminish ABI's incentive to innovate with respect to new brands, products, and packaging…

8. For no substantial business reason other than to avoid liability under the antitrust laws, ABI has entered into an additional transaction contingent on the approval of its acquisition of the remainder of Modelo. Specifically, ABI has agreed to sell Modelo's existing 50% interest in Crown Imports LLC ("Crown") – which currently imports Modelo beer into the United States – to Crown's other owner, Constellation Brands, Inc. ("Constellation"). ABI and Constellation have also negotiated a proposed Amended and Restated Importer Agreement (the "supply agreement"), giving Constellation the exclusive right to import Modelo beer into the United States for ten years. Constellation, however, would acquire no Modelo brands or brewing facilities under this arrangement – it remains simply an importer, required to depend on ABI for its supply of Modelo-branded beer. At the end of the ten-year period, ABI could unilaterally terminate its agreement with Constellation, thereby giving ABI full control of all aspects of the importation, sale, and distribution of Modelo brands in the United States.

IV. THE RELEVANT MARKET

A. Description of the Product

28. ABI groups beer into four segments: sub-premium, premium, premium plus, and highend…

30. Beers compete with one another across segments. Indeed, ABI and Modelo brands are in regular competition with one another. For example, Modelo, acting through Crown in the United States, usually selects "[d]omestic premium" beer, namely, ABI's Bud Light, as its benchmark for its own brands' pricing.

B. Relevant Product Market

31. Beer is a relevant product market and line of commerce under Section 7 of the Clayton Act. Other alcoholic beverages, such as wine and distilled spirits, are not sufficiently substitutable to discipline at least a small but significant and nontransitory increase in the price of beer, and relatively few consumers would substantially reduce their beer purchases in the event of such a price increase. Therefore, a hypothetical monopolist producer of beer likely would increase its prices by at least a small but significant and non-transitory amount.

C. Relevant Geographic Market

33. The relevant geographic markets for analyzing the effects of this acquisition are best defined by the locations of the customers who purchase beer, rather than by the locations of breweries. Brewers develop pricing and promotional strategies based on an assessment of local demand for their beer, local competitive conditions, and local brand strength. Thus, the price for a brand of beer can vary by local market…

37. There is also competition between brewers on a national level that affects local markets throughout the United States. Decisions about beer brewing, marketing, and brand building typically take place on a national level. In addition, most beer advertising is on national television, and brewers commonly compete for national retail accounts. General pricing strategy also typically originates at a national level. A hypothetical monopolist of beer sold in the United States would

likely increase its prices by at least a small but significant and non-transitory amount. Accordingly, the United States is a relevant geographic market under Section 7 of the Clayton Act.

V. ABI'S PROPOSED ACQUISITION IS LIKELY TO RESULT IN ANTICOMPETITIVE EFFECTS

A. The Relevant Markets are Highly Concentrated and the Merger Triggers a Presumption of Illegality in Each Relevant Market

41. The beer industry in the United States is highly concentrated and would become substantially more so as a result of this acquisition. Market share estimates demonstrate that in 20 of the 26 local geographic markets identified in Appendix A, the post-acquisition HHI exceeds 2,500 points, in one market is as high as 4,886 points, and there is an increase in the HHI of at least 472 points in each of those 20 markets. In six of the local geographic markets, the post-merger HHI is at least 1,822, with an increase of the HHI of at least 387 points, and in each of those six markets the parties combined market share is greater than 30%.

42. In the United States, the Defendants will have a combined market share of approximately 46% post-transaction. The post-transaction HHI of the United States beer market will be greater than 2800, with an increase in the HHI of 566.

43. The market concentration measures, coupled with the significant increases in concentration, described above, demonstrate that the acquisition is presumed to be anticompetitive.

B. Beer Prices in the United States Today are Largely Determined by the Strategic Interactions of ABI, MillerCoors, and Modelo

1. ABI's Price Leadership

44. ABI and MillerCoors typically announce annual price increases in late summer for execution in early fall. The increases vary by region, but typically cover a broad range of beer brands and packs. In most local markets, ABI is the market share leader and issues its price announcement first, purposely making its price increases transparent to the market so its competitors will get in line. In the past several years, MillerCoors has followed ABI's price increases to a significant degree.

45. The specifics of ABI's pricing strategy are governed by its "Conduct Plan," a strategic plan for pricing in the United States that reads like a how-to manual for successful price coordination. The goals of the Conduct Plan include: "yielding the highest level of followership in the short-term" and "improving competitor conduct over the long-term."

46. ABI's Conduct Plan emphasizes the importance of being "Transparent – so competitors can clearly see the plan;" "Simple – so competitors can understand the plan;" "Consistent – so competitors can predict the plan;" and "Targeted – consider competition's structure." By pursuing these goals, ABI seeks to "dictate consistent and transparent competitive response." As one ABI

executive wrote, a "Front Line Driven Plan sends Clear Signal to Competition and Sets up well for potential conduct plan response." According to ABI, its Conduct Plan "increases the probability of [ABI] sustaining a price increase."

47. The proposed merger would likely increase the ability of ABI and the remaining beer firms to coordinate by eliminating an independent Modelo – which has increasingly inhibited ABI's price leadership – from the market.

2. Modelo Has Constrained ABI's Ability to Lead Prices Higher

48. In the past several years, Modelo, acting through Crown, has disrupted ABI's pricing strategy by declining to match many of the price increases that were led by ABI and frequently joined by MillerCoors.

49. In or around 2008, Crown implemented its "Momentum Plan" with Modelo's enthusiastic support. The Momentum Plan is specifically designed to grow Modelo's market share by shrinking the price gaps between brands owned by Modelo and domestic premium brands. By maintaining steady pricing while the prices of premium beer continues to rise, Modelo has narrowed the price gap between its beers and ABI's premium beers, encouraging consumers to trade up to Modelo brands. These narrowed price gaps frustrate ABI and MillerCoors because they result in Modelo gaining market share at their expense…

C. The Elimination of Modelo Would Likely Result in Higher Coordinated Pricing by ABI and MillerCoors

61. Competition spurred by Modelo has benefitted consumers through lower beer prices and increased innovation. It has also thwarted ABI's vision of leading industry prices upward with MillerCoors and others following. As one ABI executive stated in June 2011, "[t]he impact of Crown Imports not increasing price has a significant influence on our volume and share. The case could be made that Crown's lack of increases has a bigger influence on our elasticity than MillerCoors does." ABI's acquisition of full ownership and control of Modelo's brands and brewing assets will facilitate future pricing coordination.

D. The Loss of Head-to-Head Competition Between ABI and Modelo Would Likely Result in Higher Prices on ABI-Owned Brands…

63. ABI would have strong incentives to raise the prices of its beers were it to acquire Modelo. First, lifting the price of Modelo beers would allow ABI to further increase the prices of its existing brands across all beer segments. Second, as the market leader in the premium and premium-plus segments, and as a brewer with an approximate overall national share of approximately 46% of beer sales post-acquisition, coupled with its newly expanded portfolio of brands, ABI stands to recapture a significant portion of any sales lost due to such a price increase, because a significant percentage of those lost sales will go to other ABI-owned brands…

E. The Loss of Head-to-Head Competition Between ABI and Modelo Will Harm Consumers Through Reduced New Product Innovation and Product Variety…

67. The proposed acquisition's harmful effect on product innovation is already evident. If ABI were to acquire Modelo and enter into the supply agreement with Constellation, ABI would be forbidden from launching a "Mexican-style Beer" in the United States. Further, ABI would no longer have the same incentives to introduce new brands to take market share from the Modelo brands.

F. Summary of Competitive Harm from ABI's Acquisition of the Remainder of Modelo

68. The significant increase in market concentration that the proposed acquisition would produce in the relevant markets, combined with the loss of head-to-head competition between ABI and Modelo, is likely to result in unilateral price increases by ABI and to facilitate coordinated pricing between ABI and remaining market participants.

VI. ABSENCE OF COUNTERVAILING FACTORS

69. New entry and expansion by existing competitors are unlikely to prevent or remedy the acquisition's likely anticompetitive effects. Barriers to entry and expansion within each of these harmed markets include: (i) the substantial time and expense required to build a brand reputation; (ii) the substantial sunk costs for promotional and advertising activity needed to secure the distribution and placement of a new entrant's beer products in retail outlets; (iii) the difficulty of securing shelf-space in retail outlets; (iv) the time and cost of building new breweries and other facilities; and (v) the time and cost of developing a network of beer distributors and delivery routes.

70. Although ABI asserts that the acquisition would produce efficiencies, it cannot demonstrate acquisition-specific and cognizable efficiencies that would be passed-through to U.S. consumers, of sufficient size to offset the acquisition's significant anticompetitive effects.

FTC v. H.J. Heinz Co., 246 F.3d 708 (D.C. Cir. 2001)

Four million infants in the United States consume 80 million cases of jarred baby food annually, representing a domestic market of $ 865 million to $ 1 billion. *FTC v. H.J. Heinz, Co.*, 116 F. Supp. 2d 190, 192 (D.D.C. 2000). The baby food market is dominated by three firms, Gerber Products Company (Gerber), Heinz and Beech-Nut. Gerber, the industry leader, enjoys a 65 per cent market share while Heinz and Beech-Nut come in second and third, with a 17.4 per cent and a 15.4 per cent share respectively. *Id*. The district court found that Gerber enjoys unparalleled brand recognition with a brand loyalty greater than any other product sold in the United States. *Id*. at 193. Gerber's products are found in over 90 per cent of all American supermarkets.

By contrast, Heinz is sold in approximately 40 per cent of all supermarkets. Its sales are nationwide but concentrated in northern New England, the Southeast and Deep South and the Midwest. *Id*. at 194. Despite its second-place domestic market share, Heinz is the largest producer of baby food in the world with $ 1 billion in sales worldwide. Its domestic baby food products with annual net sales of $ 103 million are manufactured at its Pittsburgh, Pennsylvania plant, which was updated in 1991 at a cost of $ 120 million. *Id*. at 192-93. The plant operates at 40 per cent of its production capacity and produces 12 million cases of baby food annually. Its baby food line includes about 130 SKUs (stock keeping units), that is, product varieties (*e.g.*, strained carrots, apple sauce, etc.). Heinz lacks Gerber's brand recognition; it markets itself as a "value brand" with a shelf price several cents below Gerber's.

Beech-Nut has a market share (15.4%) comparable to that of Heinz (17.4%), with $ 138.7 million in annual sales of baby food, of which 72 per cent is jarred baby food. Its jarred baby food line consists of 128 SKUs. Beech-Nut manufactures all of its baby food in Canajoharie, New York at a manufacturing plant that was built in 1907 and began manufacturing baby food in 1931. Beech-Nut maintains price parity with Gerber, selling at about one penny less. It markets its product as a premium brand… (at 711-712)

Under the terms of their merger agreement, Heinz would acquire 100 per cent of Beech-Nut's voting securities for $ 185 million. Accordingly, they filed a Premerger Notification and Report Form with the FTC and the United States Department of Justice pursuant to the Hart-Scott-Rodino Antitrust Improvement Act of 1976, 15 U.S.C. § 18a. On July 7, 2000 the FTC authorized this action for a preliminary injunction under section 13(b) of the FTCA and, on July 14, 2000, it filed a complaint and motion for preliminary injunction…

In *United States v. Baker Hughes Inc.*, 285 U.S. App. D.C. 222, 908 F.2d 981, 982-83 (D.C. Cir. 1990), we explained the analytical approach by which the government establishes a section 7 violation. First the government must show that the merger would produce "a firm controlling an undue percentage share of the relevant market, and [would] result[] in a significant increase in the concentration of firms in that market." *Philadelphia Nat'l Bank*, 374 U.S. at 363. Such a showing establishes a "presumption" that the merger will substantially lessen competition. *See Baker Hughes*, 908 F.2d at 982. To rebut the presumption, the defendants must produce evidence that "shows that the market-share statistics [give] an inaccurate account of the [merger's] probable effects on competition" in the relevant market. *United States v. Citizens & S. Nat'l Bank*, 422 U.S. 86, 120, 45 L. Ed. 2d 41, 95 S. Ct. 2099 (1975). "If the defendant successfully rebuts the presumption [of illegality], the burden of producing additional evidence of anticompetitive effect shifts to the government, and merges with the ultimate burden of persuasion, which remains with the government at all times." *Baker Hughes Inc.*, 908 F.2d at 983; *see also Kaiser Aluminum & Chemical Corp. v. FTC*, 652 F.2d 1324 at 1340 & n.12. Although *Baker Hughes* was decided at the merits stage as opposed to the preliminary injunctive relief stage, we can nonetheless use its analytical approach in evaluating the Commission's showing of likelihood of success. Accordingly, we look at the FTC's prima facie case and the defendants' rebuttal evidence…

Sufficiently large HHI figures establish the FTC's prima facie case that a merger is anti-competitive… The district court found that the pre-merger HHI "score for the baby food industry is 4775"--indicative of a highly concentrated industry… The merger of Heinz and Beech-Nut will increase the HHI by 510 points. This creates, by a wide margin, a presumption that the merger will lessen competition in the domestic jarred baby food market. *See* Horizontal Merger Guidelines, *supra*, § 1.51…

Finally, the anticompetitive effect of the merger is further enhanced by high barriers to market entry. The district court found that there had been no significant entries in the baby food market in decades and that new entry was "difficult and improbable." *H.J. Heinz*, 116 F. Supp. 2d at 196. This finding largely eliminates the possibility that the reduced competition caused by the merger will be ameliorated by new competition from outsiders and further strengthens the FTC's case. *See University Health*, 938 F.2d at 1219 & n.26.

As far as we can determine, no court has ever approved a merger to duopoly under similar circumstances. (at 714-717)

b. Rebuttal Arguments

In response to the FTC's prima facie showing, the appellees make three rebuttal arguments, which the district court accepted in reaching its conclusion that the merger was not likely to lessen competition substantially. For the reasons discussed below, these arguments fail and thus were not a proper basis for denying the FTC injunctive relief.

1. Extent of Pre-Merger Competition

The appellees first contend, and the district court agreed, that Heinz and Beech-Nut do not really compete against each other at the retail level. Consumers do not regard the products of the two companies as substitutes, the appellees claim, and generally only one of the two brands is available on any given store's shelves. Hence, they argue, there is little competitive loss from the merger.

This argument has a number of flaws which render clearly erroneous the court's finding that Heinz and Beech-Nut have not engaged in significant pre-merger competition… (at 718)

2. Post-Merger Efficiencies

The appellees' second attempt to rebut the FTC's prima facie showing is their contention that the anticompetitive effects of the merger will be offset by efficiencies resulting from the union of the two companies, efficiencies which they assert will be used to compete more effectively against Gerber. It is true that a merger's primary benefit to the economy is its potential to generate efficiencies. *See generally* 4A Phillip E. Areeda, Herbert Hovenkamp & John L. Solow, *Antitrust Law* P 970 at 22-25 (1998). As the Merger Guidelines now recognize, efficiencies "can enhance the merged firm's ability and incentive to compete, which may result in lower prices, improved quality, or new products." Horizontal Merger Guidelines, *supra*, § 4…

Nevertheless, the high market concentration levels present in this case require, in rebuttal, proof of extraordinary efficiencies, which the appellees failed to supply. *See University Health*, 938 F.2d at 1223 ("[A] defendant who seeks to overcome a presumption that a proposed acquisition would substantially lessen competition must demonstrate that the intended acquisition would result in significant economies and that these economies ultimately would benefit competition and, hence, consumers."); Horizontal Merger Guidelines, *supra*, § 4 (stating that "efficiencies almost never justify a merger to monopoly or near-monopoly"); 4A Areeda, *et al.*, *Antitrust Law* P 971f, at 44 (requiring "extraordinary" efficiencies where the "HHI is well above 1800 and the HHI increase is well above 100"). Moreover, given the high concentration levels, the court must undertake a rigorous analysis of the kinds of efficiencies being urged by the parties in order to ensure that those "efficiencies" represent more than mere speculation and promises about post-merger behavior. The district court did not undertake that analysis here… (at 720-721)

Finally, and as the district court recognized, the asserted efficiencies must be "merger-specific" to be cognizable as a defense. *H.J. Heinz*, 116 F. Supp. 2d at 198-99; *see* Horizontal Merger Guidelines, *supra*, § 4; 4A Areeda, *et al.*, *supra*, P 973, at 49-62. That is, they must be efficiencies that cannot be achieved by either company alone because, if they can, the merger's asserted benefits can be achieved without the concomitant loss of a competitor. *See generally* 4A Areeda, *et al.*, *supra*, P 973. Yet the district court never explained why Heinz could not achieve the kind of efficiencies urged without merger. As noted, the principal merger benefit asserted for Heinz is the acquisition of Beech-Nut's better recipes, which will allegedly make its product more attractive and permit expanded sales at prices lower than those charged by Beech-Nut, which produces at an inefficient plant. Yet, neither the district court nor the appellees addressed the question whether Heinz could obtain the benefit of better recipes by investing more money in product development and promotion--say, by an amount less than the amount Heinz would spend to acquire Beech-Nut. At oral argument, Heinz's counsel agreed that the taste of Heinz's products was not so bad that no amount of money could improve the brand's consumer appeal. Oral Arg. Tr. at 54. That being the case, the question is how much Heinz would have to spend to make its product equivalent to the Beech-Nut product and hence whether Heinz could achieve the efficiencies of merger without eliminating Beech-Nut as a competitor. The district court, however, undertook no inquiry in this regard. In short, the district court failed to make the kind of factual determinations necessary to render the appellees' efficiency defense sufficiently concrete to offset the FTC's prima facie showing.

3. Innovation

The appellees claim next that the merger is required to enable Heinz to innovate, and thus to improve its competitive position against Gerber. Heinz and Beech-Nut asserted, and the district court found, that without the merger the two firms are unable to launch new products to compete with Gerber because they lack a sufficient shelf presence or ACV. *See H.J. Heinz*, 116 F. Supp. 2d at 199-200. This kind of defense is often a speculative proposition. *See* 4A Areeda, *et al.*, *supra*, P 975g (noting "truly formidable" proof problems in determining innovation economies). In this case, given the old-economy nature of the industry as well as Heinz's position as the world's largest baby food manufacturer, it is a particularly difficult defense to prove. The court below accepted the appellees' argument principally on the basis of their expert's testimony that new product launches are cost-effective only when a firm's ACV is 70% or greater (Heinz's is presently 40%; Beech-Nut's is 45%). That testimony, in turn, was based on a graph that plotted revenue against ACV. According to the expert, the graph showed that only four out of 27 new products launched in 1995 had been successful--all for companies with an ACV of 70% or greater.

The chart, however, does not establish this proposition and the court's consequent finding that the merger is necessary for innovation is thus unsupported and clearly erroneous. All the chart plotted was revenue against ACV and hence all it showed was the unsurprising fact that the greater a company's ACV, the greater the revenue it received. Because the graph did not plot the profitability (or any measure of "cost-effectiveness"), there is no way to know whether the expert's claim--that a 70% ACV is required for a launch to be "successful" in an economic sense--is true… (at 721-723)

The combination of a concentrated market and barriers to entry is a recipe for price coordination. *See University Health*, 938 F.2d at 1218 n.24 ("Significant market concentration makes it 'easier for firms in the market to collude, expressly or tacitly, and thereby force price above or farther above the competitive level.'" (citation omitted)). "Where rivals are few, firms will be able to coordinate their behavior, either by overt collusion or implicit understanding, in order to restrict output and achieve profits above competitive levels." *PPG*, 798 F.2d at 1503. The creation of a durable duopoly affords both the opportunity and incentive for both firms to coordinate to increase prices. The district court recognized this when it questioned Baker on whether the merged entity will, up to a point, expand its market share but "then [with Gerber will] find a nice equilibrium and they'll all get along together." 9/8/2000 Tr. 1014…

Although we recognize that, post-hearing, the FTC may accept the rebuttal arguments proffered by the appellees, including their efficiencies defense, and permit the merger to proceed, we conclude that the FTC succeeded in "raising questions going to the merits so serious, substantial, difficult and doubtful as to make them fair ground for thorough investigation, study, deliberation and determination by the FTC." *Warner Communications*, 742 F.2d at 1162. The FTC demonstrated that the merger to duopoly will increase the concentration in an already highly concentrated market; that entry barriers in the market make it unlikely that any anticompetitive effects will be avoided; that pre-merger competition is vigorous at the wholesale level nationwide and present at the retail level in some metropolitan areas; and that post-merger competition may be lessened substantially… (at 725-726)

We conclude that the FTC has raised serious and substantial questions. We also conclude that the public equities weigh in favor of preliminary injunctive relief and therefore that a preliminary injunction would be in the public interest. Accordingly, we reverse the district court's denial of preliminary injunctive relief and remand the case for entry of a preliminary injunction pursuant to section 13(b) of the Federal Trade Commission Act. (at 727)

United States v. H&R Block, Inc., 833 F. Supp. 2d 36 (2011)

… In this case, the United States, through the Antitrust Division of the Department of Justice, seeks to enjoin a proposed merger between two companies that offer tax software products – H&R Block and TaxACT – on the grounds that the merger violates the antitrust laws and will lead to an anticompetitive duopoly in which the only substantial providers of digital tax software in the marketplace would be H&R Block and Intuit, the maker of the popular "TurboTax" software program. After carefully considering all of the evidence, including documents and factual and expert testimony, the applicable law, and the arguments before the Court, the Court will enjoin the proposed merger for the reasons explained in detail below… (at 42)

In evaluating the relevant product market here, the Court considers business documents from the defendants and others, the testimony of the fact witnesses, and the analyses of the parties' expert economists. This evidence demonstrates that DDIY [digital do-it-yourself tax preparation products] is the relevant product market in this case… (at 52)

In this case, market concentration as measured by HHI is currently 4,291, indicating a highly concentrated market under the Merger Guidelines. GX 121 (Warren-Boulton Rep.) at 38. The most recent measures of market share show Intuit with 62.2 percent of the market, HRB with 15.6 percent, and TaxACT with 12.8 percent. GX 27. These market share calculations are based on data provided by the IRS for federal tax filings for 2010, the most recent data available…

The proposed acquisition in this case would give the combined firm a 28.4 percent market share and will increase the HHI by approximately 400, resulting in a post-acquisition HHI of 4,691. *Id.* These HHI levels are high enough to create a presumption of anticompetitive effects. *See, e.g., Heinz,* 246 F.3d at 716 (three-firm to two-firm merger that would have increased HHI by 510 points from 4,775 created presumption of anticompetitive effects by a "wide margin"); *Swedish Match,* 131 F. Supp. 2d at 166-67 (60 percent market share and 4,733 HHI established presumption). Accordingly, the government has established a prima facie case of anticompetitive effects… (at 72)

2. Defendants' Rebuttal Argumentsa. Barriers to Entry

Defendants argue that the likelihood of expansion by existing DDIY companies besides Intuit, HRB, and TaxACT will offset any potential anticompetitive effects from the merger. Courts have held that likely entry or expansion by other competitors can counteract anticompetitive effects that would otherwise be expected. *See Heinz,* 246 F.3d at 717 n.13 ("Barriers to entry are important in evaluating whether market concentration statistics accurately reflect the pre- and likely post-merger competitive picture."); *Baker Hughes,* 908 F.2d at 987 ("In the absence of significant barriers, a company probably cannot maintain supracompetitive pricing for any length of time."). According to the Merger Guidelines, entry or expansion must be "timely, likely, and sufficient in its magnitude, character, and scope to deter or counteract the competitive effects of concern." Merger Guidelines § 9; *see also CCC Holdings,* 605 F. Supp. 2d at 47; *United States v. Visa USA, Inc.,* 163 F. Supp. 2d 322, 342 (S.D.N.Y. 2001) (entry must be "timely, likely, and [of a] sufficient scale to deter or counteract any anticompetitive restraints"). "Determining whether there is ease of entry hinges upon an analysis of barriers to new firms entering the market or existing firms expanding into new regions of the market." *CCC Holdings,* 605 F. Supp. 2d at 47 (quoting *FTC v. Cardinal Health, Inc.,* 12 F. Supp. 2d 34, 55 (D.D.C. 1998)). In this case, the parties essentially agree that the proper focus of this inquiry is on the likelihood of expansion by existing competitors rather than new entry into the market. *See* Defs.' Post-Trial Mem. at 21-22. Since the government has established its prima facie case, the defendants carry the burden to show that ease of expansion is sufficient "to fill the competitive void that will result if [defendants are] permitted to purchase" their acquisition target. *Swedish Match,* 131 F. Supp. 2d at 169…

Upon consideration of all of the evidence relating to barriers to entry or expansion, the Court cannot find that expansion is likely to avert anticompetitive effects from the transaction. The Court will next consider whether the evidence supports a likelihood of coordinated or unilateral anticompetitive effects from the merger. (at 76-77)

b. Coordinated Effects

Merger law "rests upon the theory that, where rivals are few, firms will be able to coordinate their behavior, either by overt collusion or implicit understanding in order to restrict output and achieve profits above competitive levels." *CCC Holdings,* 605 F. Supp. 2d at 60 (quoting *Heinz,* 246 F.3d at 715). The government argues that the "elimination of TaxACT, one of the 'Big 3' Digital DIY firms" will facilitate tacit coordination between Intuit and HRB. Pl.'s Post-Trial Mem. at 15. "Whether a merger will make coordinated interaction more likely depends on whether market conditions, on the whole, are conducive to reaching terms of coordination and detecting and punishing deviations from those terms." *CCC Holdings,* 605 F. Supp. 2d at 60 (internal quotation omitted). Since the government has established its prima facie case, the burden is on the defendants to produce evidence of "structural market barriers to collusion" specific to this industry that would defeat the "ordinary presumption of collusion" that attaches to a merger in a highly concentrated market. *See Heinz,* 246 F.3d at 725… (at 77)

What the Court finds particularly germane for the "maverick" or "particularly aggressive competitor" analysis in this case is this question: Does TaxACT consistently play a role within the competitive structure of this market that constrains prices? *See Staples,* 970 F. Supp. at 1083 (finding "merger would result in the elimination of a particularly aggressive competitor in a highly concentrated market" where the merger would remove competition between "the two lowest cost and lowest priced firms" in the market); Merger Guidelines § 2.1.5 (noting maverick concerns may arise where "one of the merging firms may have the incentive to take the lead in price cutting or [with] . . . a firm that has often resisted otherwise prevailing industry norms to cooperate on price setting or other terms of competition."). The Court finds that TaxACT's competition does play a special role in this market that constrains prices. Not only did TaxACT buck prevailing pricing norms by introducing the free-for-all offer, which others later matched, it has remained the only competitor with significant market share to embrace a business strategy that relies primarily on offering high-quality, full-featured products for free with associated products at low prices.

Moreover, as the plaintiff's expert, Dr. Warren-Boulton, explained, the pricing incentives of the merged firm will differ from those of TaxACT pre-merger because the merged firm's opportunity cost for offering free or very low-priced products will increase as compared to TaxACT now. *See* Warren-Boulton, 9/9/11 p.m., at 14-16. In other words, the merged firm will have a greater incentive to migrate customers into its higher-priced offerings – for example, by limiting the breadth of features available in the free or low-priced offerings or only offering innovative new features in the higher-priced products. *See* Commentary on the Horizontal Merger Guidelines (2006) at 24 (noting the importance of asking "whether the acquired firm has behaved as a maverick and whether the incentives that are expected to guide the merged firm's behavior likely would be different.").

While the defendants oppose the government's maverick theory, they do not deny that TaxACT has been an aggressive competitor. Indeed, they submit that "that's why H&R Block wants to buy them." Defs.' Closing Argument, TT, 10/3/11 a.m., at 132. HRB contends that the acquisition of TaxACT will result in efficiencies and management improvements that "will lead to better, more effective, and/or cheaper H&R Block digital products post-merger" that are better able to compete with Intuit. Defs.' Post-Trial Mem. at 17. This argument is quite similar to the argument of the defendants in *Heinz,* which some commentators have described as arguing that the merger would create a maverick. *Heinz,* 246 F.3d at 720-22; *see* Jonathan B. Baker, *Mavericks, Mergers, and Exclusion: Proving Coordinated Competitive Effects Under the Antitrust Laws,* 77 N.Y.U. L. Rev. 135, 184 (2002). While the district court in *Heinz* accepted this argument that the merger would enhance rather than stifle competition, the D.C. Circuit reversed, finding that the "district court's analysis [fell] short of the findings necessary for a successful efficiencies defense" in that case. *Heinz,* 246 F.3d at 721. As explained more fully in Section III.B.2.d below, the defendants' efficiency arguments fail here for some of the same reasons the D.C. Circuit identified in *Heinz.*

Finally, the defendants suggest that coordinated effects are unlikely because of the ease of expansion for other competitors in the market. As detailed above in the Court's discussion of barriers to entry and expansion, the Court does not find that ease of expansion would counteract likely anticompetitive effects.

Accordingly, the defendants have not rebutted the presumption that anticompetitive coordinated effects would result from the merger. To the contrary, the preponderance of the evidence suggests the acquisition is reasonably likely to cause such effects. *See id.* at 711-12 (finding, in market characterized by high barriers to entry and high HHI figures, that "no court has ever approved a merger to duopoly under similar circumstances."). (at 80)

c. Unilateral Effects

A merger is likely to have unilateral anticompetitive effect if the acquiring firm will have the incentive to raise prices or reduce quality after the acquisition, independent of competitive responses from other firms. *See Swedish Match,* 131 F. Supp. 2d at 169; Merger Guidelines § 6 ("The elimination of competition between two firms that results from their merger may alone constitute a substantial lessening of competition."). "The extent of direct competition between the products sold by the merging parties is central to the evaluation of unilateral price effects." Merger Guidelines § 6.1… (at 80)

On balance, and considering the evidence as a whole, the Court finds that, absent efficiencies, the plaintiff has demonstrated a reasonable likelihood of unilateral effects by a preponderance of the evidence. *See Swedish Match,* 131 F. Supp. 2d at 169 (finding likelihood of unilateral price increase where merger would eliminate one of the larger merging firm's "primary direct competitors," "the third largest selling" brand "that has consistently played a role in constraining the price" of the larger firm's products); *see also Staples* 970 F. Supp. at 1083 (finding anticompetitive effects where the "merger would eliminate significant head-to-head competition between the two lowest cost and lowest priced firms in the . . . market.").

The Court will now turn to the defendants' final rebuttal argument – the existence of significant, merger-specific efficiencies… (at 89)

The testimony at the hearing confirmed that TaxACT's recurring cost estimates were largely premised on its managers experiential judgment about likely costs, rather than a detailed analysis of historical accounting data. *See, e.g.,* Dunn, TT, 9/8/11 p.m. (sealed), at 28-31. While reliance on the estimation and judgment of experienced executives about costs may be perfectly sensible as a business matter, the lack of a verifiable method of factual analysis resulting in the cost estimates renders them not cognizable by the Court. If this were not so, then the efficiencies defense might well swallow the whole of Section 7 of the Clayton Act because management would be able to present large efficiencies based on its own judgment and the Court would be hard pressed to find otherwise. The difficulty in substantiating efficiency claims in a verifiable way is one reason why courts "generally have found inadequate proof of efficiencies to sustain a rebuttal of the government's case." *Heinz,* 246 F.3d at 720 (citation omitted); *see also Staples,* 970 F. Supp. at 1089 (finding "defendants failed to produce the necessary documentation for verification" of efficiencies).

Particular scrutiny of HRB's efficiencies claims is also warranted in light of HRB's historical acquisitions. In 2006, HRB acquired a software company called TaxWorks, which was renamed "RedGear." Bowen, TT, 9/15/11 p.m. (sealed), at 84. For the RedGear acquisition, which was much smaller in scale than the proposed TaxACT deal, HRB projected a total of ${redacted} million in efficiencies over three years. GX 1459 (February 2009 "Taxworks Financial Analysis") at 5. HRB failed to achieve these {efficiencies} {redacted}. *Id.* In this case, the efficiency estimates are much more aggressive, in that defendants are claiming approximately ${redacted} million in efficiencies for 2013 and ${redacted} million in annual savings going forward thereafter, as opposed to ${redacted} million over three years. *See* Bowen, TT, 9/15/11 p.m. (sealed), at 77-78. While HRB has attempted to learn from the mistakes of the RedGear acquisition, *id.* at 85-87, the Court finds that this history only underscores the need for any claimed efficiencies to be independently verifiable in order to constitute evidence that can rebut the government's presumption of anticompetitive effects.

Considering all of the evidence regarding efficiencies, the Court finds that most of the defendants' claimed efficiencies are not cognizable because the defendants have not demonstrated that they are merger-specific and verifiable.

IV. CONCLUSION

The Court concludes that the proposed merger between HRB and TaxACT violates Section 7 of the Clayton Act because it is reasonably likely to cause anticompetitive effects. The law of this Circuit supports this conclusion. In *Heinz,* the Court of Appeals reversed a district court's denial of a preliminary injunction against a merger involving the second- and third-largest jarred baby food companies. 246 F.3d at 711-12. After noting the high barriers to entry and high HHI figures that characterized the market, the D.C. Circuit observed that "[a]s far as we can determine, no court has ever approved a merger to duopoly under similar circumstances." *Id.* at 717. The situation in this case is similar. The government established a prima facie case indicating that anticompetitive effects are likely to result from the merger. The defendants have not made a showing of evidence that rebuts the presumption of anticompetitive effects by demonstrating that the government's market share statistics give an inaccurate account of the merger's probable effects on competition in the relevant market. To the contrary, the totality of the evidence confirms that anticompetitive effects are a likely result of the merger, which would give H&R Block and Intuit control over 90 percent of the market for digital do-it-yourself tax preparation products.

Accordingly, the Court will enjoin H&R Block's proposed acquisition of TaxACT. An appropriate Order will accompany this Memorandum Opinion. (at 91-92)

United States v. E.I. Du Pont de Nemours & Co. 353 U.S. 586 (1957)

[Du Pont acquired 23% of General Motors' stock, starting in around 1917, and became GM's primary supplier for many automotive chemicals and components.]

The primary issue is whether du Pont's commanding position as General Motors' supplier of automotive finishes and fabrics was achieved on competitive merit alone, or because its acquisition of the General Motors' stock, and the consequent close intercompany relationship, led to the insulation of most of the General Motors' market from free competition, with the resultant likelihood, at the time of suit, of the creation of a monopoly of a line of commerce. (at 589)

…

We hold that any acquisition by one corporation of all or any part of the stock of another corporation, competitor or not, is within the reach of the section whenever the reasonable likelihood appears that the acquisition will result in a restraint of commerce or in the creation of a monopoly of any line of commerce. Thus, although du Pont and General Motors are not competitors, a violation of the section has occurred if, as a result of the acquisition, there was at the time of suit a reasonable likelihood of a monopoly of any line of commerce. (at 592)

…

Determination of the relevant market is a necessary predicate to a finding of a violation of the Clayton Act because the threatened monopoly must be one which will substantially lessen competition "within the area of effective competition." Substantiality can be determined only in terms of the market affected. The record shows that automotive finishes and fabrics have sufficient peculiar characteristics and uses to constitute them products sufficiently distinct from all other finishes and fabrics to make them a "line of commerce" within the meaning of the Clayton Act. Cf. *Van Camp & Sons Co*. v. *American Can Co*., 278 U.S. 245. Thus, the bounds of the relevant market for the purposes of this case are not coextensive with the total market for finishes and fabrics, but are coextensive with the automobile industry, the relevant market for automotive finishes and fabrics.

The market affected must be substantial. *Standard Fashion Co*. v. *Magrane-Houston Co*., 258 U.S. 346, 357. Moreover, in order to establish a violation of § 7 the Government must prove a likelihood that competition may be "foreclosed in a substantial share of . . . [that market]." Both requirements are satisfied in this case. The substantiality of a relevant market comprising the automobile industry is undisputed. The substantiality of General Motors' share of that market is fully established in the evidence. (at 593-5)

…

The fact that sticks out in this voluminous record is that the bulk of du Pont's production has always supplied the largest part of the requirements of the one customer in the automobile industry connected to du Pont by a stock interest. The inference is overwhelming that du Pont's commanding position was promoted by its stock interest and was not gained solely on competitive merit… du Pont purposely employed its stock to pry open the General Motors market to entrench itself as the primary supplier of General Motors' requirements for automotive finishes and fabrics. (at 606)

…The statutory policy of fostering free competition is obviously furthered when no supplier has an advantage over his competitors from an acquisition of his customer's stock likely to have the effects condemned by the statute. We repeat, that the test of a violation of § 7 is whether, at the time of suit, there is a reasonable probability that the acquisition is likely to result in the condemned restraints. The conclusion upon this record is inescapable that such likelihood was proved as to this acquisition. The fire that was kindled in 1917 continues to smolder. It burned briskly to forge the ties that bind the General Motors market to du Pont, and if it has quieted down, it remains hot, and, from past performance, is likely at any time to blaze and make the fusion complete. (at 607)

Comment

Note the decades-long gap between the first transaction and when the government sued.