UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

FEDERAL TRADE COMMISSION,	)	**FILED UNDER SEAL**
	)	
Plaintiff,	)	
v.	)	Civ. No. 1:00CV01688 (JR)
	)	
H.J. HEINZ COMPANY, *et al.*,	)	
	)	
	)	
Defendants.	)	

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POST TRIAL MEMORANDUM IN SUPPORT OF THE FEDERAL TRADE COMMISSION’S MOTION FOR PRELIMINARY INJUNCTION

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INTRODUCTION AND SUMMARY

The central issue presented by this merger can be simply stated: Is the proposed baby food duopoly, with two firms controlling 98 percent of the market, likely to be more competitive than the present three-firm structure, which the Third Circuit recently concluded is “highly competitive”?[1] The law presumes that it will not, and the evidence presented by the Federal Trade Commission demonstrates that the presumption is correct. It is well established that when a merger results in undue concentration in the market, it “ must be enjoined in the absence of evidence clearly showing that the merger is not likely to have such anticompetitive effects.” *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 363 (1962).

Millions of parents rely on prepared baby food for their infants and toddlers. The U.S. market for prepared baby food is $800 million, over 75 percent of which is jarred baby food. The issues raised by this merger deserve full consideration by the FTC in an administrative proceeding. Preliminary injunctive relief pursuant to Section 13(b) of the FTC Act is fully

[1] *In re Baby Food Antitrust Litigation*, 166 F.3d 112, 126 (3d Cir. 1999).

[2] 15 U.S.C. § 53(b). Under Section 13(b), the Court’s “task is not to make a final determination on whether the proposed [acquisition] violates Section 7, but rather to make only a preliminary assessment of the [acquisition]’s impact on competition.” *FTC v. University Health*, 938 F.2d 1206, 1218 (11th Cir. 1991); *FTC v. Warner Communications, Inc.*, 742 F.2d 1156,1162 (9th Cir. 1984); *see FTC v. Cardinal Health, Inc.*, 12 F. Supp.2d 34, 45 (D.D.C. 1998); *FTC v. Staples, Inc.*, 970 F. Supp. 1066, 1070-71 (D.D.C. 1997). This Court need not resolve all conflicts of evidence or analyze extensively all antitrust issues. Such final resolution is the province of the administrative proceeding. *Warner Communications*, 742 F.2d at 1164.

[3] The U.S. Department of Justice and the Federal Trade Commission Horizontal Merger Guidelines (April 2, 1992) ("*Merger Guidelines*") measure concentration using the Herfindahl-Hirschman Index ("HHI"). A merger that results in an HHI over 1800 indicates a highly concentrated market; an increase in the HHI of 50 points in a highly concentrated market raises significant antitrust concerns. Where the post-merger HHI is over 1800 and the increase in the HHI is over 100 points, it is presumed that the merger will be anticompetitive. *Merger Guidelines*,§ 1.51, at 16-17. In this merger the HHI would increase by almost 600 points to over 5400 in a national jarred baby food market.

[4] In this memorandum we refer to the Memorandum in Support of Plaintiff's Motion for Preliminary Injunction as "FTCB"; the Reply Memorandum in Support of Plaintiff's Motion for a Preliminary Injunction as "FTCRB"; the Plaintiff'

As described below, based on the “overwhelming” level of concentration and the compelling evidence of likely anticompetitive effects, the Commission has met its burden under Section 13(b) by raising questions going to the merits of this proposed merger so serious and substantial that a preliminary injunction is required.[5] This merger poses a significant threat of both unilateral and coordinated anticompetitive effects. In a market in which most retailers want to carry only two brands of baby food, one of which is Gerber, there is now intense competition between Heinz and Beech-Nut for the second slot on retailers’ shelves. After the merger that competition will disappear, and so will the benefits that it generates for retailers and consumers in the form of lower prices, higher quality, and innovation. With competitive pressure from Beech-Nut eradicated, several unilateral anticompetitive effects are likely:

C In the numerous metropolitan markets where Heinz and Beech-Nut compete head-to-head, there will be increased prices and a reduction in direct to consumer promotion. Moreover, absent this merger, increased distribution competition between Heinz and Beech-Nut likely would provide additional millions of consumers with access to all three brands, as the two firms gain retail accounts in the other’s traditional distribution territories.

C By eliminating its closest and only rival for the second baby food slot on grocers’ shelves, Heinz will be able unilaterally to eliminate the benefits of intense competition with Beech-Nut to gain or retain that slot. The bid competition between the firms involves many millions of dollars in “trade spending” to win retail accounts – payments to retailers, discounts and allowances, coupons for consumers, and other marketing expenditures. Some of these sums, such as coupons, go directly to consumers; others get passed on to consumers by retailers. With Beech-Nut out of the way, Heinz no longer will have to offer these concessions to win the second baby food slot on grocers’ shelves.

C The merger would reduce competitive pressures to innovate. Heinz and Beech-Nut have competed to gain access to retailers’ shelves in part by developing new products and new packaging, improving product quality and safety, and increasing services to retailers. Heinz no longer will have to do that to gain distribution.

[5] *See* fn 2.

C The merger would remove the competitive pressures of Beech-Nut's potential introduction of a private label baby food, which would threaten Heinz's value positioning. By eliminating Beech-Nut and its excess capacity, Heinz removes that threat as well as its own incentive to develop a private label to preempt Beech-Nut.

C Consumers will also suffer a reduction in choice from the three distinct brands that currently exist. Both the Heinz value-priced brand and the premium Beech-Nut brand will disappear, to be replaced by a single "rationalized" baby food line to be produced by Heinz. The high-quality production from Beech-Nut's plant will no longer exist, to be replaced by Heinz's historically trouble-plagued production. *See Seeburg Corp. v. FTC,* 425 F.2d 124, 128 (6th Cir. 1970) ("It is the purpose of Section 7 to preserve buyers the choice" arising from competing offers).

Coordinated anticompetitive effects are also a serious concern. No environment could be more conducive to coordinated interaction than a duopoly. As this Court has observed, a duopoly provides "a fertile medium for interdependent anticompetitive conduct" and "the relative lack of competitors eases coordination of actions, explicitly or implicitly, among the remaining few to approximate the performance of a monopolist." *FTC v. PPG Indus., Inc.*, 628 F. Supp. 881, 885 & n.9 (D.D.C.), *aff'd in part*, 798 F.2d 1500 (D.C. Cir. 1986). And because of the substantial entry barriers in this market it is without doubt that this duopoly is forever.

Under Section 7, a merger may be illegal if the remaining firms will be more likely to engage in conduct that is likely to result in higher prices, even if that conduct, in itself, would be entirely lawful.[6] That kind of competitive problem is a major concern raised by this merger. It is

[6] As the leading antitrust treatise observes, Section 7 "is concerned with far more than 'collusion' in the sense of an illegal conspiracy; it is very much concerned with 'collusion' in the sense of tacit coordination not amounting to conspiracy." Phillip Areeda, IV Antitrust Law ¶ 916, at 85 (rev. ed. 1998). *See Cardinal*, 12 F. Supp. 2d at 65 ("Although the Court is not convinced from the record that the Defendants actually engaged in wrongdoing, it is persuaded that in the event of a merger, the Defendants would likely have an increased ability to coordinate their pricing practices."); *Merger Guidelines,* § 2.1.

brought about by a tightening of oligopoly market conditions, and it lies at the heart of the purpose of Section 7. Such coordination:

> is feared by antitrust policy even more than express collusion, for tacit coordination, even when observed, cannot easily be controlled directly by the antitrust laws. It is a central object of merger policy to obstruct the creation or reinforcement by merger of such oligopolistic market structures in which tacit coordination can occur.[7]

The parties themselves believe that tacit coordination can occur.[8] For example, in an attempt to increase profits as part of its turnaround strategy in 1998, Beech-Nut management proposed to "Send a clear signal to Gerber (and to a lesser extent Heinz) that the competitive environment is less hostile." PFF 347. Heinz was aware of this strategy because Beech-Nut's intent was restated in a Debt Offering Memorandum that Heinz in fact obtained. PFF 351. Fortunately for consumers, the competition between Beech-Nut and Heinz to be carried as the second baby food on retailers'

[7] Areeda, IV Antitrust Law, ¶ 901b2 at 9. *See also Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 229-30 (1993)("[i]n the § 7 context, it has long been settled that excessive concentration, and the oligopolistic price coordination it portends, may be the injury to competition the Act prohibits"); *Hospital Corp. of Am. v. FTC*, 807 F.2d 1381, 1386 (7th Cir. 1986), *cert. denied*, 481 U.S. 1038 (1987).

[8] The Third Circuit has recognized the vulnerability of this industry as well. In a price fixing case against these defendants, the court stated: "We are cognizant that the baby food industry is highly concentrated with only three companies controlling the nationwide manufacture and distribution of their baby food products. We realize that such a scenario could facilitate explicit or tacit price-fixing." *In re Baby Food Antitrust Litigation*, 166 F.3d 112, 138 (3d Cir. 1999).

To rebut the presumption of illegality, defendants must demonstrate that the "overwhelming" level of concentration is misleading. No court has ever approved a merger that would result in a duopoly in the presence of significant entry barriers. Thus, the defendants must ask this court to rewrite over a century of antitrust law to approve this presumptively illegal merger. Although defendants may suggest that the opinion in *United States v. Baker Hughes,* 908 F.2d 981 (D.C. Cir. 1990), somehow changes the governing law, the ultimate holding of *Baker Hughes* is that "a defendant seeking to rebut a presumption of anticompetitive effect must show that the prima facie case inaccurately predicts the relevant transaction's probable effect on future competition." *Id.* at 991. Defendants clearly fail to make such a showing.

Defendants rely on four contrived arguments for approving the merger: (1) that Beech-Nut and Heinz are geographically-constrained rivals unable to expand into each other's traditional distribution territories; (2) to the extent they overlap, those overlaps are not important because Heinz and Beech-Nut are not found on the same shelves; (3) bidding competition to be the second baby food on grocers' shelves is not worth protecting because it is just a sideline that does not affect consumers; and (4) even if there were some anticompetitive effects, those should be tolerated because this merger is the only means to take on Gerber's alleged monopoly. Defendants also argue that their alleged efficiencies will be passed on to consumers even in a duopoly. But defendants' arguments are inconsistent with the "business realit[ies]" as described in scores of their everyday documents – which expose "how the market is perceived by those who strive to profit in it." *FTC v. Coca-Cola Co.*, 641 F. Supp. 1128, 1132 (D.D.C. 1986), *vacated mem. as moot*, 829 F.2d 191 (D.C. Cir. 1987) (transaction abandoned). What defendants are really asking this Court to do is to ignore the evidence of intense competition, common sense, the usual economic principles that apply to merger analysis, the legal precedent that has never permitted a merger to duopoly in a market that is nearly impenetrable by new entry, and help them re-engineer the market to their liking so they won't have to compete as hard.

The suggestion that Heinz and Beech-Nut are locked into core areas reflects an outdated snapshot view of competition and does not comport with the competition reflected in defendants' documents. A rising tide of retailer consolidation has forced these companies to compete more and more aggressively against one another, bringing consumers better prices, innovation, and increased choice of products. These mergers have enhanced the ability of Beech-Nut and Heinz to effectively invade each other's traditional distribution territories, making competition increasingly nationwide.

PFF 60, 138-43. Indeed, an October 1999 map shows Heinz invading Beech-Nut territories and vice versa. PFF136. For example, Heinz's acquisition of the Albertson's account enabled it to invade Beech-Nut's traditional strongholds in Chicago, Philadelphia, and California. If this merger is blocked these firms will continue to expand their territories, offering consumers greater choice and competition. This court recently enjoined a merger where "absent the merger, the firms [were] likely, and in fact have planned, to enter more of each other's markets, leading to a deconcentration of the market, and, therefore, increased competition . . . ." *Staples,* 970 F. Supp. at 1082.

The competition between Heinz and Beech-Nut for placement on the supermarket shelf occurs on an ongoing basis as retailers seek better deals, and as Heinz and Beech-Nut each try to displace the other from existing accounts as the second brand. PFF 112. This competition leads to increased "trade spending" in the form of discounts, allowances, and other promotions that accrue to the benefit of consumers.[9] PFF 174. For example, Beech-Nut bid $ million in trade spending over three years to try to get the Albertson's account; Heinz won the account with a bid of $ million. PFF 173. Both firms have competed aggressively against one another for shelf space on numerous other occasions.[10] Large sums of trade spending are involved. For example, Beech-Nut's total trade spending is about $28 million per year. Tr. at 899-900 (Meader). This bid competition benefits consumers even if the two brands do not end up on the same supermarket shelves. Moreover, there are numerous metropolitan areas where Heinz and Beech-Nut have a substantial presence and compete from different supermarkets and the amount of commerce in these markets exceeds $100 million. PFF 82.

Fundamentally, the parties' argument that bid competition doesn't matter misperceives the nature of competition. Even if a firm is not the successful bidder, the fact that it bids is an important form of competition. In many instances Heinz or Beech-Nut must increase discounts

[9] In an effort to minimize the importance of bidding competition, at trial the defendants engaged in an lengthy discourse about the difference between "fixed" and "variable" promotional payments. However, both Mr. Meader and Ms. Quinn acknowledged that variable trade payments are likely to benefit consumers, and variable payments constitute a major portion of the total. PFF 174, 177, 178. The defendants are also wrong to imply that fixed trade payments do not benefit consumers. PFF 188. Fixed vs variable is a distinction without a difference. As Mr. Davidson of Ahold and Mr. Long of Winco testified that even fixed payments result in lower consumer prices and other benefits. Tr. 143-44 (Long); 844-46 (Davidson). Regardless of how these payments are classified, consumers ultimately benefit in the form of lower prices or better services. PFF 192. Moreover, this Court has enjoined mergers that would have diminished similar types of distribution competition. *See Coca-Cola*, 641 F. Supp. at 1139 n.24.

[10] *E.g.*, PFF 141, 173.

or allowances in order to avoid losing a contest.[11]

[11] PFF 155.

[12] PFF 119
; PFF 222

[13] Even if Gerber were a monopolist and had engaged in exclusionary conduct, that would not justify an anticompetitive merger. *See* FTCRB at 8-9; PCL ¶ 118 n.14.

[14] *See* FTCB at 11 n.23 (and cases cited therein); FTCRB at 4-5 (collecting cases).

assumption that the merged firm will keep all the Heinz and Beech-Nut customers. They are not cognizable because they result from a reduction in consumer choice and quality. Their is tangible. As the Supreme Court has recognized : "firms in a concentrated market might in effect share monopoly power, setting their prices at a profit-maximizing, supracompetitive level by recognizing their shared economic interests and their interdependence with respect to price and output decisions." *Brooke Group*, 509 U.S. at 227.

In sum, the FTC has presented compelling evidence that this acquisition poses a significant competitive threat to competition. Injunctive relief is necessary to preserve the status quo pending a full trial on the merits in an administrative proceeding. Preliminary relief is justified both to prevent the serious harm to consumers that the transaction is likely to produce in the interim, and to avoid the difficulty of obtaining adequate relief in the future if the merger were allowed to take place.

ARGUMENT

I. SECTION 7 OF THE CLAYTON ACT PROHIBITS MERGERS THAT MAY SUBSTANTIALLY LESSEN COMPETITION

The Supreme Court has instructed that Section 7 of the Clayton Act "creates a relatively expansive definition of antitrust liability," by requiring a showing that the merger's effect "*may be* substantially to lessen competition." *California v. American Stores Co.*, 495 U.S. 271, 284 (1990) (emphasis in original). Section 7 does not require a certainty, or even a high probability, that a merger will substantially lessen competition. *FTC v. Elders Grain, Inc.*, 868 F.2d 901, 906 (7th Cir. 1989). All that is required is a reasonable probability, and all "doubts are to be resolved against the transaction." *Id.* Accordingly, to establish a violation, the FTC need show only a reasonable probability, not a certainty, that the proscribed anticompetitive activity may occur. As Judge Posner has explained, "[a]ll that is necessary is that the merger create an appreciable danger of [anticompetitive] consequences in the future." *Hospital Corp. of Am.*, 807 F.2d at 1389. Hence, the ultimate question in any Section 7 case is whether the transaction creates an "appreciable danger" of anticompetitive effects. *Id.* at 1386. The answer to this question depends upon (1) the "line of commerce," or product market, affected by the transaction; (2) the "section of the country," or geographic market, in which the transaction will have an effect, and (3) the transaction's probable effect on competition in the relevant market.

II. JARRED BABY FOOD IS A RELEVANT PRODUCT MARKET

The pivotal question in defining a relevant product market is whether an increase in price for one group of products – here, prepared baby foods – would cause a sufficient number of

[16] While the Commission believes that another relevant product market is the broader prepared baby food market, which includes infant cereals, bottled juices, and water, the Court may treat jarred baby food as the relevant product market for purposes of this preliminary proceeding.

[17] The *Merger Guidelines* ask this question in terms of where a customer could turn for supplies in the event of a small (*e.g.*, five percent) but significant and nontransitory increase in

manufacturers is a realistic alternative for U.S. retailers, wherever located, in response to a price increase by the other firms.[18] *See FTC v. Illinois Cereal Mills, Inc.*, 691 F. Supp. 1131, 1142 (N.D. Ill. 1988) (national geographic market where all producers "ship their products nationally, customers look to each of them for supplies and producers consider each other to be competitors"), *aff'd sub nom. FTC v. Elders Grain,* 868 F.2d 901 (7th Cir. 1989).

Heinz and Beech-Nut compete nationally even if they do not have retail accounts in each and every locality. *See Illinois Cereal Mills,* 691 F. Supp. at 1142 ("The inquiry . . . does not focus on where the parties do business or where they presently compete, but rather it focuses on where, within the area of competitive overlap, the effect of the merger or acquisition on competition will be direct and immediate.") In *Illinois Cereal Mills*, the defendants contended that mills located on opposite sides of the Mississippi River did not compete against each other because of special transportation costs incurred in crossing the river. Nonetheless, the evidence showed that firms did ship across the river, and the court found a national market. *Id.* Likewise, both Heinz and Beech-Nut have sought to expand their sales beyond their "core areas" and in fact ship across the country. PFF 60. Unlike *Illinois Cereal Mills,* however, the "core

[18] PFF 58. Defendants concede that competition between baby food manufacturers for the business of retailers (*i.e*., competition at the wholesale level) is not confined to local areas. DB 41 n. 20; DX 617 at ¶ 20 (Baker Report). Defendants' economic expert, Professor Baker, testified that wholesale competition for shelf space is regional or national. Tr. at 970 (Baker).

In addition, wholesale competition within a local or regional area is affected by the threat of expansion by Heinz or Beech-Nut from another geographic area. PFF 58. Both firms know that if they do not remain competitive, retailers can turn to the other supplier.

Competition between the firms also takes place on a national basis along numerous non-price dimensions, including product innovation, product formulations, packaging and labeling, and establishing brand recognition and reputation for quality. PFF 278-303; *see* PX 343 at 78

In each of these respects, both firms seek to further their positions as national players.[19]

In addition, theses firms will have to compete on a broader geographic scale as a result of the changing dynamics of the industry. To the extent Heinz or Beech-Nut do not already sell in

[19] The geographic market is no larger than the United States because there are no competitively significant imports of baby foods into the United States. PFF 63.

second baby food line chain-wide.[20] Heinz and Beech-Nut inevitably will have a geographical reach at least as broad as those chains. Both companies have recognized this changing dynamic.

B. Metropolitan Areas Within The United States Also Constitute Relevant Geographic Markets

Competition can have both national and regional or local dimensions. *E.g., United States v. Pabst Brewing Co.*, 384 U.S. 546, 551-52 (1966) (entire nation, three state area, one state); *Coca-Cola-Co.,* C3.2 ulphin-, 5

[20] Even if competition currently were localized, Heinz and Beech-Nut are potential competitors for each others' "core markets." This merger will eliminate that potential competition. The elimination of a potential competitor in a market such as this – high concentration, high entry barriers, and no other potential entrants – is illegal under Section 7. *E.g., Yamaha Motor Co. v. FTC,* 657 F.2d 971, 977-980 (8th Cir. 1981) (affirming Commission decision that acquisition of a potential entrant violated Section 7 under the actual potential competition theory); *United States v. Philips Petroleum Co.,* 367 F. Supp. 1226, 1232-34 (C.D. Cal. 1973), *aff'd mem.,* 418 U.S. 906 (1974). *See also Staples,* 970 F. Supp. at 1082 (granting preliminary injunction against horizontal merger but also stating: "In addition, allowing the defendants to merge would eliminate significant future competition. Absent the merger, the firms are likely, and in fact have planned, to enter more of each other's markets, leading to a deconcentration of the market and, therefore, increased competition between the superstores.") The competition arising from geographic expansion that Judge Hogan found likely in *Staples* is precisely what is occurring in the baby food market. Geographic expansion for both companies is highly likely as regional supermarkets consolidate and select a single chain-wide source for their second baby food slot, thereby easing Heinz and Beech-Nut expansion into areas they may not currently serve.

advertising, merchandising payments, consumer couponing, and new product introductions to meet or intensify local competition without affecting demand and supply elsewhere. PFF 69. Such local targeting of discounts and allowances can create localized differences in prices that cannot be readily arbitraged. PFF 67. Thus, wholesale and retail prices for baby food often differ by geographic region. PFF 70. The ability to maintain such localized price differences, and thus discriminate among retailers located in different metropolitan areas, is evidence of localized geographic markets. PX 782 at ¶ 20 (Hilke); *Merger Guidelines* § 1.22; *see also Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451, 475-77 (1992) (price discrimination in sales of parts to different classes of customers supports separate market for sales to customers facing discrimination). In addition, Heinz and Beech-Nut closely track each other's sales and promotional activities in local areas, thus indicating their recognition of localized competition. PFF 73.   In sum, the evidence demonstrates that metropolitan areas constitute relevant geographic markets.

IV. THIS MERGER WILL SIGNIFICANTLY REDUCE COMPETITION IN THE MARKET FOR JARRED BABY FOOD IN THE UNITED STATES AND NUMEROUS METROPOLITAN MARKETS THEREIN

[21] *Merger Guidelines,*§ 1.51; *see Philadelphia Nat'l Bank*, 374 U.S. at 364; *PPG Indus.*, 798 F.2d at 1502-03.

[22] See PX 781 (Hilke Exhibit); see also DX 617 at Appendix B (Baker Report).

[23] Courts have barred mergers resulting in substantially lower concentration levels. *Elders Grain*, 868 F.2d at 902 (acquisition increased market shares of largest firm from 23% to 32%); *Hospital Corp. of Am.*, 807 F.2d at 1384 (acquisition increased market share of second largest firm from 14% to 26%); *Warner Communications*, 742 F.2d at 1163 (acquisition increased market share of second largest firm from 19% to 26%; four-firm concentration ratio of 75%); *Cardinal Health*, 12 F. Supp. 2d at 52 (mergers increasing HHIs from 1648 to 2450 and

[24] *See, e.g.*, *Elders Grain,* 868 F.2d at 905; *PPG. Indus.*,

This level of “overwhelming” concentration establishes a presumption of unlawfulness

Defendants’ suggestion that the Guidelines’ 35 percent threshold creates a “safe harbor” for market shares below that level is a figment of their imagination. The Guidelines simply state that market shares above 35 percent may be entitled to presumption of likely unilateral effects. *Merger Guidelines* § 2.2. Whether Heinz ends up with a market share slightly below or above 35 percent is not the decisive factor, because it is clear that retailers will be left with *no* choice for the second baby food slot; they will have to carry Heinz if they want to carry two brands of baby foods. Thus, as a practical matter, unilateral effects are likely in every market where Heinz and Beech-Nut compete, because the merger would eliminate Heinz’s only rival for the second slot.

One of the usual ways of trying to rebut the presumption is by showing ease of entry into the market. *See Baker Hughes,* 908 F.2d 981. But defendants essentially concede that no entry into the U.S. jarred baby food market is likely for the foreseeable future. It would take many years and the expenditure of high non-recoverable costs to establish brand awareness and consumer acceptance. PFF 378, 381. Even then, gaining distribution would be problematic because the entrant would have to displace one of the two established incumbents to gain the second spot on retail shelves. PFF 384. There has been no entry into the U.S. market for decades, except for small niche players. PFF 379. Defendants cannot meet the standard of "timely, likely, and sufficient" entry.[27]

Even assuming *arguendo* that defendants could produce evidence to rebut the presumption that their proposed merger would substantially lessen competition, the Commission has presented additional evidence that easily satisfies its "ultimate burden of persuasion" that the proposed merger will in fact substantially reduce competition in the jarred baby food market in two ways. First, the proposed merger would eliminate substantial head-to-head competition between Beech-Nut and Heinz for the second baby food slot on grocers' shelves, thus enabling the merged firm to increase its prices unilaterally. Second, by reducing the number of competitors in the jarred baby food market from three to two, the proposed merger would significantly increase the likelihood that the merged firm and Gerber would engage in coordinated behavior.[28]

[27] *See* FTCB at 37-39 and authorities cited therein; *Merger Guidelines*, § 3.0.

[28] Numerous cases have involved competition at the wholesale level, with similar implications for harm to consumers. *E.g., Pabst*; *Cardinal Health*; *Coca-Cola.*

B. The Merger Will Result in a Substantial Likelihood of Unilateral Anticompetitive Effects

A merger of Heinz and Beech-Nut is likely to result in unilateral anticompetitive effects by eliminating retailers' ability to choose between two close substitutes for the second baby food slot on their shelves. *See Merger Guidelines* § 2.2. Heinz and Beech-Nut not only are close substitutes, they are the *only* brands that can serve retailers' needs for the second baby food slot. PFF 158. Substitution occurs at both the retailer level and at the consumer level, despite (and perhaps because of) the brand differentiation that each firm tries to achieve. Both firms actively bid against each other to gain or retain the second slot. PFF 109. This competition continues on an ongoing basis as retailers seek better deals, as Heinz and Beech-Nut try to displace the other from existing accounts, and as retailers merge. PFF 173. The presence of both firms in the market has numerous competitive benefits, including lower prices, increased innovation, and consumer choice, which will be lost as a result of the merger.

1. Elimination of Significant Price Competition Between Heinz and Beech-Nut

Heinz and Beech-Nut are engaged in direct and increasing competition to be the second baby food line on retail shelves, and for ultimate sales to consumers. PFF 108-111. Competition involves price terms, incentive payments to retailers, discounts and allowances, coupons for consumers, and other marketing techniques. PFF 167. Competition takes place both in areas where the two brands are widely distributed as well as in areas where one firm is trying to gain distribution and the other is trying to retain its place on retail shelves,[29] and it is

[29] Even if Heinz and Beech-Nut were correctly viewed as not competing in certain areas, they are potential competitors for each others' "core markets." This merger will eliminate that potential competition. *See* PCL ¶ 93 *et seq.*

clear that retail pricing is affected by competition at the wholesale level. Many retailers attest that the benefits of wholesale competition in price terms, incentive payments to retailers, discounts, and allowances are passed on to consumers in the form of lower prices and other consumer benefits. PFF 248. They also attest that the retail pricing of Heinz and Beech-Nut at competing stores affects their own pricing. PFF 96. Defendants' own documents show that Beech-Nut prices are lower in mixed markets in which Heinz is also competing than in Beech-Nut core markets in which Heinz has little or no presence. PFF 92. In addition, Dr. Hilke, the Commission's economic expert, found that Gerber's market share tends to be significantly lower in mixed markets than in which it faces substantial competition from only one other firm. PFF 112. Thus, three-firm markets are more competitive than two-firm markets, as one would expect. This means that, with Beech-Nut out of the way, Heinz will have greater ability to increase prices.

Competition for shelf space is important even when a firm fails to win a bid, because the discounts and allowances that it offers may force the other firm to raise its discounts and allowances in order to win the bid. PFF 147. The loss of an account also will prompt the losing firm to compete harder at other accounts to make up the volume. PFF 160-61. The loss of this bidding competition is a significant concern. *See PPG Indus.,* 798 F.2d at 1505 (enjoining merger of firms engaged in bid competition for aircraft transparencies); *FTC v. Alliant Techsystems Inc.,* 808 F. Supp. 9 (D.D.C. 1992) (enjoining merger of the only two competitors in bidding for sole-source contract for Department of Defense munitions); *FTC v. Imo Indus.,* 1992-2 Trade Cas. (CCH) ¶ 69,943 (D.D.C. 1992) (enjoining merger of competitors in Department of Defense bid market for night vision devices); *United Tote,* 768 F. Supp. at 1071 (unsuccessful bids led to lower prices). As the Supreme Court has stated, "[u]nsuccessful bidders are no less competitors than the successful one." *El Paso Natural Gas,* 376 U.S. 651; *see also Grumman Corp. v. LTV Corp.,* 665 F.2d 10, 12 (2d Cir. 1981); *Seeburg Corp. v. FTC,* 425 F.2d 124, 128 (6th Cir. 1970).[30]

Heinz and Beech-Nut also aggressively promote their products *prior* to bidding on accounts because they must demonstrate a track record of good market performance in order to be considered for a bid. Retailers choose the second brand based not only on price, but also on how well Beech-Nut and Heinz have performed in the past. PFF 144. Heinz and Beech-Nut also compete in areas where they are not actively bidding against the other for distribution. Each firm uses various customer inducements in an effort to grow sales in its traditional distribution ("core") areas in order to make themselves look good to prospective purchasers in other areas. PFF 146. In so doing, they are also competing with Gerber. PFF 146. The discounts, coupons, and other promotions involved in this competition clearly benefit consumers. PFF 175-78.

[30] This case is similar to the competitive situation in the abandoned Coca-Cola/Dr Pepper merger. *Coca-Cola,* 641 F. Supp. 1128. There the two companies were in a heated battle to gain or retain placement as the "pepper" drink in fountain accounts. Coca-Cola Company had developed its own "pepper" drink and had targeted all convenience store fountain sales in an attempt to dislodge Dr Pepper, including offering $320,000 for Circle K's termination of Dr Pepper, and Dr Pepper responded with additional marketing and advertising dollars. *Id.* at 1139 n.23. A Dr Pepper executive declared: "[w]e must reach some arrangement with Coca-Cola that neither one of us continue to throw money away attempting to preclude one or the other from the business or spend excessive money to maintain our position in the business. This is only a waste of both of our resources." *Id.* at 1139 n.24. Defendants here are saying the same thing as the Dr Pepper executive: Let's stop this wasteful competition. In *Coca-Cola,* the court rejected the argument and enjoined the merger. Even though Dr Pepper had only a 4.6% market share, the merger was prohibited because "if the proposed acquisition is consummated there will be one less independent factor in the market to challenge the dominance of Coca-Cola Company." 641 F. Supp. at 1138.

The presence of an alternative for the second slot also constrains Heinz and Beech-Nut from raising prices to existing accounts. *E.g.*, PFF 234; PX 42 at 905

; PX 36 at 783

. Competition between and from Heinz and Beech-Nut also forces Gerber to respond with price competition and promotions for consumer sales. PFF 242.

As a result of this merger, Heinz will be able unilaterally to reduce competition at the wholesale level because it will have eliminated its only competitor for the second baby food slot on retailers' shelves. The likely – indeed, high likely – effect will be a reduction in trade payments, allowances, discounts, and consumer promotions, and thus higher prices and lower consumer benefits of other types. PFF 230.

post-merger market could restrain Heinz from imposing the price increase. In fact, it likely would be welcomed by Gerber.

2. Elimination of Consumer Choice Between Heinz and Beech-Nut Brands and Quality

Product quality is a major dimension of competition between Heinz and Beech-Nut. While Heinz has focused on its "value" positioning, Beech-Nut differentiated its product on the basis of quality. PFF 310. In addition to quality ingredients, quality control and safety are and produce a single "rationalized" product line. PFF 475. This is a major change in a differentiated product market. PFF 476-478, 480. Consumers value choice and a large percentage of baby food consumers purchase both Heinz and Beech-Nut even though they may prefer one brand over another. These consumers value variety and to the extent they lose their preferred brand, recipe, quality, or price "there will be substantial consumer disappointment." Tr. 1160 (Hilke).

Moreover, absent the merger, more and more consumers are likely to gain access to all three brands as Heinz and Beech-Nut continue to gain retail accounts in the other's traditional distribution area.

3. __Elimination of Significant Non-Price Competition Between Heinz and Beech-Nut__

Innovation competition in matters such as new products, development of new packaging, product quality, product safety, and services to retailers is a major selling point in the competition to be the second brand on the shelf. PFF 278. Both firms believed that it was necessary to innovate in order to maintain or gain an edge in the competition for the second spot on the shelf. PFF 279, 292. Defendants' claim that they are too small to innovate is belied by their history of successful innovations. Both firms have successful track records in innovation. Innovation has played an important competitive role in this market, and Beech-Nut and Heinz have competed aggressively in new product development and product differentiation. For example, Beech-Nut was the first firm to put baby food in glass jars when others used lead-soldered metal cans, the first to use stages based on age levels, the first to remove salt from all baby foods, and the first to eliminate unnecessary starches and sugars. PFF 288. Beech-Nut has important patents on additives that improve the nutritional value of the baby food. PFF 289-291 Heinz also has numerous important innovations. Tr. 1154-56 (Hilke). Heinz has a global baby food program in which it has been developing aseptic products, and it recently launched its new Nature's Harvest product line. As a general matter size does not necessarily hinder innovation. As Professor Baker has observed, smaller firms often play a critical role in bringing innovation to the market. For example, Royal-Crown Cola, not Coke or Pepsi, produced the first diet cola, the first caffeine-free soft drinks, and the first soft drinks in cans.[49]

This merger will eliminate that stimulus to innovate. A lessening of innovation is an anticompetitive effect, just as an increase in price is an anticompetitive effect. *See PPG Indus.*, 798 F.2d 1500 (merger of firms engaged in design competition for aircraft transparencies); *Merger Guidelines,* § 0.1 ("Sellers with market power also may lessen competition on dimensions other than price, such as product quality, service, or innovation."); *id.* §1.11.

4. **Elimination of the Threat of Private Label Entry**

The elimination of excess capacity through this merger threatens to lessen competition because excess capacity can spur firms to compete more aggressively to increase sales. *See Cardinal Health*, 12 F. Supp.2d at 63-64.

[49] *See* Jonathan B. Baker, "Fringe Firms and Incentives to Innovate" 63 Antitrust L.J. 621 (1995) (*citing* "The Innovative Royal Crown," N.Y. Times (Jan. 14, 1984) at 27).

Post-merger incentives for Heinz to introduce private label baby food (and the threat of such action by Beech-Nut) would diminish with the acquisition for several reasons. First, there would no longer be any areas where Heinz could introduce private label baby food without immediate concern about extensive cannibalization of its existing sales. Second, current incentives for geographic extensions are at least partly due to extensive excess capacity. PFF 320.

Third, Heinz was spurred by concern that Beech-Nut might move into supplying private label baby foods. PFF 320. Beech-Nut will no longer exist as an independent entity threatening Heinz with introduction of private label baby foods in Heinz accounts.

C. The Merger Would Substantially Increase the Likelihood of Coordinated Interaction

By creating a duopoly, the proposed merger would substantially ease the ability of the Gerber and Heinz to coordinate their behavior. The ability of firms to pull their competitive punches, with the expectation that their competitors would do the same, is one of the central concerns of the antitrust laws, as discussed above. Courts recognize that "significant market concentration makes it '

[50] *See, e.g.*, *PPG Indus.*, 798 F.2d 1500; *Staples*, 970 F. Supp. 1066; *United Tote*, 768 F.

anticompetitive conduct without fear that new entrants will be attracted by the lure of supracompetitive profits.

A number of other post-merger conditions render this market “

[51] Professor Baker has written that technology exists to obtain up-to-the-minute information: “Today we are increasingly able to observe prices and quantities sold on a weekly, daily, hourly, and even transaction-by-transaction basis.” Jonathan Baker, “Contemporary Empirical Merger Analysis, 5:3 Geo. Mason L. Rev. 347,348 (1997).

[52] Two-brand retailers will have no choice but to carry both Heinz and Gerber, so they lack leverage. Moreover, defendants' power buyer defense does not apply in a case such as this, where there are scores of supermarket purchasers. *See* Reply Memorandum in Support of Plaintiff's Motion for Preliminary Injunction at 18-19.

Defendants also incorrectly assume that post-merger collusion is unlikely because Heinz will have an incentive to act as a maverick as a result of cost savings generated by the merger. Tr. at 997-98 (Baker); The shakiness of that assumption was demonstrated by the analysis of the Commission's economic expert. *See* PX 809. Tr. 1166-69. Heinz will not have an incentive to act as a maverick. Rather, its profit maximizing strategy very likely would be to raise price even if all the cost savings are realized. *Id.* Those incentives are magnified by investor pressures to increase profits and stock prices. While those pressures exist in any industry, Gerber and Beech-Nut will find it much easier to increase prices and profits without the three-way competition that currently exists.

Heinz has already indicated its desire for a less competitive market:

Beech-Nut also signaled its desire for a less competitive environment. Its integration/turnaround plan after its acquisition by Milnot stated that it should become "a quick follower to Gerber on pricing . . . ." PX 532 at 380. Heinz similarly has noted that it is

[52] Switching to a one-brand strategy because of the non-competitive situation created by this merger would, in itself, restrict consumer choice and would be an anticompetitive effect of this transaction.

Before the Heinz-Beech-Nut merger announcement, distribution competition between the two firms prevented them from fully acting on their desire to be passive

[53] Retailers are reluctant to carry only a single brand of baby food, for fear of not providing their customers a choice.   PX 95 at 620

[54] PFF 364 . While defendants contend that coordination would be difficult, Professor Baker has written that firms could establish "focal points," such as a market share agreement, would be a way to coordinate even in complex markets. *See* Jonathan B. Baker, "Predatory Pricing After Brooke Group: An Economic Perspective," 61 Antitrust L.J. 585, 600 n.74 (1994). Heinz and Gerber could establish similar focal points here. PFF 372. Professor Baker stated in the same article that "coordination may be harmful even if it is imperfect and incomplete." *Id.* at 602. *See* PFF 372.

[55] American Bar Association, Mergers and Acquisitions 153 (2000).

and found them insufficient to reverse the anticompetitive effects of the mergers. Those decisions confirm the instruction of the Merger Guidelines that "[e]fficiencies almost never justify a merger to monopoly or near-monopoly." *Merger Guidelines,* § 4.0.

Efficiency claims must be assessed within the competitive context of the transaction because competition is the force that drives efficiency[56] and it is the force that allows consumers to receive the benefits that the market can produce. In addition, efficiency claims are easier to assert than to achieve,[57] which is why the courts impose a "very rigorous" evidentiary burden on efficiency claims. *United States v. Rockford Mem. Corp.*, 717 F. Supp. 1251, 1289 (N.D. Ill. 1989), *aff'd*, 898 F.2d 1278 (7th Cir.), *cert. denied*, 498 U.S. 920 (1990); *see FTC v. University Health*, 938 F.2d 1206, 1222-23 (11th Cir. 1991). Specifically, defendants must demonstrate that claimed efficiencies:

(1) are identified with precision, are not based on "speculation," can be verified and actually will be achieved, *Staples*; *see University Health*, 938 F.2d at 1223; *United States v. Mercy Health Services*, 902 F. Supp. 968, 987-88 (N.D. Iowa 1995);

[56] Indeed, as recognized by this Court, "[E]xperience teaches that without worthy rivals ready to exploit lapses in competitive intensity, incentives to develop better products, to keep prices at a minimum, and to provide efficient service over the long term are all diminished to the detriment of consumers." *PPG Indus*., 628 F. Supp. at 885; *see also United States v. Western Elec. Co*., 592 F. Supp. 846, 874 (D.D.C. 1984), *appeal dismissed*, 777 F.2d 23 (D.C. Cir. 1985) (competition results in "lower prices, highest quality, and the greatest material progress").

[57] Some studies show that firms often fail to accomplish the projected cost savings from a merger. *See generally,* Craig W. Conrath and Nicholas A. Widnell, "Efficiency Claims in Merger Analysis: Hostility or Humility?" 7 George Mason L. Rev. 685 (1999)(describing cases where efficiency claims failed to be achieved); Joseph Brodley, "Proof of Efficiencies in Mergers and Joint Ventures," 64 Antitrust L.J. 576 (1996); KPMG, " Mergers and Acquisitions: Global Research Report (1999) (83% of mergers failed to add to shareholder value).

(2) are “cognizable,” *i.e.*, they do not result from an anticompetitive reduction in output or quality; *Cardinal Health*, 12 F. Supp.2d at 62-62; *NCAA v. Law*, 134 F.3d 1010, 1022 (10th Cir. 1998);[58]

(3) are “ merger-specific,” *i.e.*, they cannot be achieved by other means less restrictive of competition, *Cardinal Health*, 12 F. Supp.2d at 62-63; *Mercy Health*, 902 F. Supp. at 987, n.4; *United States v. Ivaco*, 704 F. Supp. at 1425; *Rockford, supra*;

(4) will be passed on, and produce a significant economic benefit to consumers,

[58] *See also* Robert Pitofsky, “Efficiencies in Defense of Mergers,” 7 Geo. Mason L. Rev. 485, 486-87 (1999) (“efficiencies must not arise from anticompetitive reductions in output, service, or other competitively significant categories such as innovation.”).

correcting for a known error. Variable production cost efficiencies, which defendants' expert agrees are the most important, are estimated at $ million after correcting for a known error. Only the portions properly allocated to the jarred baby food market are relevant. Defendants did not make that allocation, but conservatively assuming it is 90 percent, and the efficiencies are conversion cost for the Canajoharie plant in fiscal year 2000 was __ cents per case less than as assumed by defendants' efficiency witnesses. PFF 424. This reduces the variable cost savings estimate by $ million dollars. PFF 424. Defendants also relied upon outdated cost information for the Heinz plants. PFF 425.

! Fifth, defendants relied on unverified assumptions. For example, just prior to providing efficiency estimates to Commission investigators on March 31, 2000, Heinz's Mr. Campbell increased his estimate of variable production cost savings by $ million from $ to $ million by eliminating, for still-unexplained reasons, a utility cost "plug." PFF 411; Tr. at 712-13 (Campbell).

Mr. Campbell also increased his estimate of purchase cost savings from $ million to $ million during the course of litigation based on his interpretation of four non-specific letters solicited from suppliers. PFF 415. Defendants' efficiency expert (to his credit) testified that only $ million in purchase cost savings were cognizable. PFF 419.

Defendants also relied on estimates prepared by a consulting firm, Booz Allen, and admitted that they lacked the necessary mathematical or statistical expertise to evaluate the results. PFF 426-27. Defendants' efficiency expert likewise did not undertake an independent review of those results. PFF 428. To the extent they tried to replicate the Booz Allen results, their estimates were lower than the amounts presented by Mr. Campbell. PFF 429.

! Sixth, defendants' efficiencies assume that volume will stay constant – they do not account for a likely decrease in volume as some consumers, dissatisfied with the loss of choice between Heinz and Beech-Nut, defect to Gerber, or as some consumers switch to Heinz's touted aseptic packaging, if and when that product is introduced. PFF 436, 438-39. Defendants also assumed, without analysis, that variable unit production costs would remain constant regardless of volume. PFF 437. Defendants also made several methodological errors. *See* PFF 430-33. For example, there are deficiencies in their estimates of depreciation and other expenses (PFF 430-32), and they did not take into account the increased costs associated with aseptic production, when that occurs. PFF 433.

2. Defendants' Production Efficiency Claims Are Not Cognizable

For those consumers who prefer the recipe that is not selected or prefer Beech-Nut's assurance of product quality and safety (Heinz has a greater rate of product recalls), the merger will result in a significant reduction in choice, particularly since these products are differentiated and there are only three brands to begin with. PFF 479, 480-84. PX 782 at ¶¶ 99-102 (Hilke Report).

In addition, while defendants' efficiency claims assume no change in quality – in contrast to their argument that baby foods are heterogeneous products, with Beech-Nut having superior quality – the efficiencies in reality may be based on an apples-to-oranges comparison. To the extent Heinz is unable to duplicate Beech-Nut

[59] Other errors in defendants’ estimates are unquantifiable at this time. *See*

baby food sales. PFF 499. Even applying a conservative estimate that 90 percent of the cost savings are attributable to jarred food, the outer limit for variable cost efficiencies is $ million, and the outer limit for variable production cost efficiencies is $ million. That sum, even assuming a 100 percent pass-through, is smaller than the competitive harm from a minimal price increase of 2 percent in the $600 million jarred baby food market. PFF 505. *Cf. Rockford*, 717 correspondingly lower. Thus, for example, Heinz may find – its current intentions notwithstanding – that it must increase prices after the merger in order to maximize profits and shareholder returns. Indeed, alternative profitability scenarios based on defendants' business plan, DX 1, indicate that Heinz's profits would be greater by pricing its new baby food product line at or close to Beech-Nut's current prices. *See* PX 809; PFF 485; Tr. 1166-69 (Hilke).

Ultimately, the basis for claimed consumer benefits is defendants' confidence that they can achieve the substantial efficiencies and "promise" they will pass on those savings. But "trust me" is not the standard of proof adopted by the courts. *See University Health*, 938 F.2d at 1223 ("defendant [cannot] overcome a presumption of illegality based solely on speculative, self-serving assertions"); *see Ivaco*, 704 F. Supp. at 1428 (rejecting claims because defendants not obligated to produce new product). Defendants' business plan in fact implies that they will not pass on any of the alleged efficiencies. *See* DX 1; PX 809, PFF 328.

B. Promises of Beneficial New Competition Are Not Merger-Specific

Defendants claim that they will be able to offer innovative new products and achieve national distribution, and thus will be better able to compete with Gerber. Defendants' promises are not cognizable because they could be achieved by less anticompetitive means. First, as discussed above, after Heinz came in with a large offer, Beech-Nut's owners did not seriously consider alternatives to a merger with Heinz.

Second, both firms are successful and profitable and have been able to innovate on their own. Some of the "new" products defendants are promising already are available, and others would be available without the merger. For example:

!

Thus, the promised new competition is not merger specific.

! Heinz promises high quality recipes at value prices after the merger. (DB at 49)

!

However, Heinz's "plans" for the U.S. may be more fiction than fact – they were developed for government review. Defendants realized they need to create a "tangible growth plan" to obtain "trade buy in" or the deal would be "DOA in Washington." [PFF 446 [PX 440]

Further, assuming aseptic is a viable product, Heinz may be able to enter into a co-packing arrangement with another company, just as it co-packs baby cereal with Beech-Nut. PX 821 at 1-3 (Hilke).

! Heinz's promise of "revolutionary quality control" (DB at 49) adds nothing to the

Defendants assert that a preliminary injunction is "an extraordinary and drastic remedy." (DB at 19.) To the contrary, it is Congress's designated remedy to preserve the status quo pending plenary FTC investigation and deliberation. This Circuit has "consistently held" that where the Commission has raised serious and substantial questions about the legality of a proposed merger, "there is a 'presumption in favor of a preliminary injunction.'" *Alliant Techsystems,* 808 F. Supp. at 22-23 (quoting *PPG Indus*., 798 F.2d at 1507); *Cardinal Health,* 12 F. Supp. 2d at 66. "The statute itself indicates that likelihood of success on the merits weighs heavily in favor of an injunction." *PPG Indus.*, 798 F.2d at 1508; *Staples,* 970 F. Supp. at 1091. An injunction is especially important in this case because

An effective post-merger remedy after an administrative trial is likely to be futile. That is precisely the situation Section 13(b) was intended to prevent.

Defendants are strangely silent on the question of public equities, suggesting only that absent the merger " who will compete with Gerber?" (DB at 56.) As is eminently clear, this argument is wrong on both the law and the facts. The law does not countenance the acquisition of market power in order to "counteract" market power. Defendants' argument is wrong on the facts, because Heinz and Beech-Nut do offer significant competition in the market which

CONCLUSION

For the foregoing reasons, the Court should grant the Commission's motion for a preliminary injunction against the proposed acquisition.

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