

SCHEDULED FOR ORAL ARGUMENT FEBRUARY 12, 2001

IN THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 00-5362

FEDERAL TRADE COMMISSION,
Plaintiff-Appellant,

vs.

H.J. HEINZ COMPANY, *et al.*,
Defendants-Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

REPLY BRIEF FOR PLAINTIFF-APPELLANT
FEDERAL TRADE COMMISSION
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CERTIFICATE AS TO PARTIES, RULINGS AND RELATED CASES

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(B) Rulings Under Review. References to the rulings at issue in the present appeal are as follows:

FTC v. H.J. Heinz, Co., No. 00CV01688 (JR) (D.D.C. Oct. 18, 2000) (Robertson, J.) (Order Denying Plaintiff-Appellant's Motion for Preliminary Injunction).

(C) Related Cases. This case has not previously been before this Court and there are no related cases pending in this or any other court.

TABLE OF CONTENTS

PAGE

**CERTIFICATE AS TO PARTIES, RULINGS AND RELATED
CASES**

TABLE OF AUTHORITIES*

CASES	PAGE
<i>American Hospital Supply Corp. v. Hospital Products Ltd.</i> , 780 F.2d 589 (7th Cir. 1986)	17
<i>In re Baby Food Antitrust Litigation</i> , 166 F.3d 112 (3d Cir. 1999)	19, 22
<i>Boeing Co., et al.</i> , 5 Trade Reg. Rep. (CCH) ¶ 24,295 (July 1, 1997)	6
<i>In re Brand Name Prescription Drugs Antitrust Litigation</i> , 123 F.3d 599 (7th Cir. 1997)	28
<i>Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.</i> , 509 U.S. 209 (1993)	17
<i>FTC v. Cardinal Health</i> , 12 F. Supp. 2d 34 (D.D.C. 1998)	27
<i>FTC v. PPG Industries, Inc.</i> , 628 F. Supp. 881 (D.D.C.), <i>aff'd</i> , 798 F.2d 1500 (D.C. Cir. 1986)	14
<i>FTC v. Staples, Inc.</i> , 970 F. Supp. 1066 (D.D.C. 1997)	20
<i>FTC v. Swedish Match</i> , No. 00-1501 (TFH) (D.D.C., Dec. 14, 2000)	10, 11, 12, 20
* <i>FTC v. University Health, Inc.</i> , 938 F.2d 1206 (11th Cir. 1991)	7, 10, 16

* Authorities upon which we chiefly rely are marked with asterisks.

FTC v. Warner Communications, Inc.
742 F.2d 1156 (9th Cir. 1984) 9, 27

Fishman v. Wirtz,
807 F.2d 520 (7th Cir. 1986) 27

Hanover Shoe, Inc. v. United Shoe Machinery Corp.,

STATUTES

Clayton Act:

Section 4, 15 U.S.C. § 15	26
Section 7, 15 U.S.C. § 18	<i>passim</i>

Federal Trade Commission Act:

Section 13(b), 15 U.S.C. § 53(b)	9
--	---

MISCELLANEOUS

Areeda, <i>Antitrust Law</i> (1998)	10, 15, 17
Bork, <i>The Antitrust Paradox</i> (rev. ed. 1993)	4, 16
Defense Science Board Task Force, <i>Antitrust Aspects of Defense Industry Consolidation</i> (1994)	6
FTC and Department of Justice Antitrust Division Horizontal Merger Guidelines, 4 Trade Reg. Rep. (CCH) ¶ 13,104 (1997)	11, 15
Kovacic, <i>Competition Policy in the Postconsolidation Defense Industry</i> , 41 Antitrust Bull. 421, 429-32 (Summer 1999)	6

GLOSSARY

1. Op. – District Court Opinion of October 18, 2000, denying preliminary injunction.
2. Mem. Op. – November 8, 2000, Memorandum of this Court granting injunction pending appeal.
3. Record Citations:
 - Tr. – trial transcript.
 - PX – plaintiff’s exhibit.
 - DX – defendants’ exhibit.
 - App. – Joint Appendix
4. FTC Br. – Brief of plaintiff-appellant, Federal Trade Commission.
5. Def. Br. – Joint Brief of defendants-appellees, H.J. Heinz Company and Milnot Holding Corporation.
6. CSEF Br. – amicus brief of Citizens for a Sound Economy Foundation.
7. GMA – amici Grocery Manufacturers of America, The National Association of Manufacturers, and the Manufacturers Alliance/MAPI, Inc.
8. GMA Br. – joint amicus brief of GMA.

In this preliminary injunction action, the Federal Trade Commission (“FTC” or “Commission”) seeks to prevent a drastic and likely irreversible reduction of competition in the manufacture and sale of jarred baby food – a product of importance (at one time or another) to nearly every American family. The court below recognized that “Heinz and Beech-Nut are competing and that a merger of the two companies will end that competition.” Tr. 31; App. 1332. It also recognized that high barriers make new entry into this market “difficult and improbable” (Op. 12; App. 1427), so that the merger would create an enduring duopoly consisting of Heinz and Gerber. The court nevertheless denied a preliminary injunction, predicting that Heinz will use its consolidated market position to compete and innovate, rather than seeking to profit – together with Gerber – from the lack of competition from any other challenger.

In seeking affirmance of this ruling – unprecedented in over 100 years of antitrust law – defendants ask this Court to condone at least three major departures from established law: (1) the approval of a merger-to-duopoly on the basis of “efficiencies,” where there is no reason (other than party promises) to expect that any savings will counteract likely anticompetitive effects; (2) the acceptance of conclusory assertions that two sophisticated corporations, insulated from other competition, cannot find a way to coordinate their activities so as to share monopoly

power and profits; and (3) the conclusion that lessening of competition in a wholesale market does not matter unless it has a quantifiable impact on prices in the downstream, retail market. These propositions fly in the face of long-established principles under Section 7 of the Clayton Act, 15 U.S.C. § 18, and invite further anticompetitive consolidations throughout the American economy, as number 2 and number 3 firms clamor to be allowed to merge, in order to compete with market leaders. This Court should reject these propositions and direct entry of a preliminary injunction.

SUMMARY OF ARGUMENT

Contrary to defendants' rhetoric, the Commission embraces "totality of circumstances

whether they will benefit customers and competition. The court below erred in uncritically accepting those claims as adequate to rebut the Commission's strong prima facie case. (Part II.)

Furthermore, any possible efficiencies are more than offset by the likelihood of anticompetitive price increases, particularly if the two remaining firms can collude or coordinate in pricing. In attempting to support the implausible conclusion that coordination between the two remaining firms is impossible, defendants rely on faulty statistics and conclusory testimony about supposed information-sharing difficulties, both of which are belied by objective market evidence. The Commission has shown that all the conditions that make an enduring duopoly dangerous – including an industry history of price leadership – are present here. (Part III.)

Finally, the court below gravely erred in supposing that the acknowledged, vigorous competition between Heinz and Beech-Nut at the wholesale level does not matter unless the Commission can show immediate effects on retail prices. The courts have uniformly applied Section 7 to preserve competition at all levels, understanding that consumers, and the economy, will ultimately benefit. (Part IV.)

ARGUMENT

I. THE DISTRICT COURT MISAPPLIED THE TOTALITY OF THE CIRCUMSTANCES ANALYSIS.

In their brief to this Court, defendants aim their fire particularly at what they suppose to be the Commission's position regarding "totality of the circumstances" in a merger preliminary injunction case, accusing the Commission of advocating "extreme" and "radical" changes in legal standards. *E.g.*, Def. Br. 26, 29. Such rhetoric is profoundly ironic, coming from parties who seek to burst antitrust barriers by pursuing a merger that would create an enduring duopoly in a market with high entry barriers.¹ Defendants' rhetoric is also wrong, for it is based on a gross misunderstanding of the Commission's position. The Commission fully agrees that courts may consider all arguably pertinent factors, including efficiencies, at the preliminary injunction stage. The district court's error was not in considering

¹ An added irony is that, after excoriating the Commission for supposedly seeking to cabin merger analysis unduly, defendants themselves (supported by an *amicus*) argue for a rule that any merger of two companies should be permitted as long as the resulting combination remains smaller than the market leader. Def. Br. 31-32; CSEF Br. 15-17. This unsupported proposal goes beyond prior suggestions (never accepted by the courts) that Section 7 should bar only such clearly anti-competitive combinations as "[h]orizontal mergers * * * that leave fewer than three significant rivals in any market." *See Bork, The Antitrust Paradox* 405-06 (rev. ed. 1993). Moreover, any attempt to apply a "small competitor" argument to the combination of these two large, successful companies ignores precedent and basic antitrust principles. *See* FTC Br. 53-56.

defendants' arguments, but in accepting highly speculative arguments, based chiefly on Heinz's promises about its own future behavior. *See* FTC Br. 21, 47-49. The court below compounded that error by imposing on the Commission a burden of proof wholly at odds with preliminary injunction standards. *See* p. 9, *infra*.

Contrary to defendants' supposition, the Commission fully recognizes that a "totality of the circumstances approach" controls in merger cases under Section 7. It is important to place in context, however, the way in which the courts have applied the "totality" principle, particularly in the cases on which defendants chiefly rely, *United States v. General Dynamics Corp.*, 415 U.S. 486 (1974), and *United States v. Baker Hughes, Inc.*, 908 F.2d 981 (D.C. Cir. 1990). *General Dynamics* involved the acquisition of a coal company, challenged solely on the basis of both firms' historic market shares. The Supreme Court recognized that, in light of the nature of the industry – dependent upon a depleting natural resource and increasingly dominated by long-term contracts – historic market share was virtually meaningless as an indication of future competitive significance; what mattered was the control of uncommitted coal reserves. 415 U.S. at 501-02. The Court therefore concluded that the acquired company was unlikely to be a significant competitor going

forward, since its reserves were seriously depleted and virtually all subject to long-term contractual commitments. *Id.* at 502-03.²

While the *General Dynamics* principle is important, it hardly signals an abandonment of market structure as an important focus of merger analysis. On the contrary, courts have recognized that *General Dynamics* “stand[s] for the unremarkable proposition that a defendant may rebut the government's prima facie case by

² The Commission demonstrated that it understands and embraces *General Dynamics* by declining to challenge the 1997 Boeing-McDonnell Douglas merger, which resulted in a duopoly and involved analogous market conditions. The Commission explained that “McDonnell Douglas, looking to the future, no longer constitutes a meaningful competitive force in the commercial aircraft market * * *,” because “the vast majority of airlines [would] no longer consider purchasing Douglas aircraft * * *.” *Boeing Co., et al.*, 5 Trade Reg. Rep. (CCH) ¶ 24,295, at 24,123-24 (July 1, 1997) (majority statement).

Oddly, *amicus* GMA points to Boeing and other mergers that enforcement authorities have *not* challenged as supporting defendants’ position here. GMA Br. 20-28. To the contrary, such instances demonstrate that the antitrust agencies engage in a comprehensive inquiry, analyzing each case on its particular facts and challenging only mergers – like the present one – that pose a genuine threat to competition. Like the Boeing matter, the other cases GMA mentions posed factors, not present here, that allayed competitive concerns. The cited defense cases, for example, involved either relatively unique procurement markets in which two remaining competitors likely were sufficient to preserve competition or markets that were only large enough for two rivals, and in which the federal government’s role as the principal or only purchaser greatly altered the competitive dynamic. *See* Defense Science Board Task Force, *Antitrust Aspects of Defense Industry Consolidation* 25-26 (1994); Kovacic, *Competition Policy in the Postconsolidation Defense Industry*, 41 Antitrust Bull. 421, 429-32 (Summer 1999).

showing that the government's market share statistics overstate the acquired firm's ability to compete in the future * * * .” *FTC v. University Health, Inc.*, 938 F.2d 1206, 1221 (11th Cir. 1991); *accord, Hospital Corp. of America v. FTC*, 807 F.2d 1381, 1385 (7th Cir. 1986).

Baker Hughes concerned a market (specialized drilling rigs) in which sales were sporadic and uneven and a single contract could vault a firm’s market share from last to first place in any given year. 908 F.2d at 986. Because market shares were “volatile and shifting” and entry barriers were low, this Court concluded that, as in *General Dynamics*, existing market share statistics did not accurately demonstrate the firms’ future competitive strength. *Id.* at 986-87, 989. In the present case, by contrast, there is no reason to question the reliability of market shares that have been stable for decades, and there are high entry barriers that will protect incumbent firms’ ability to exercise market power.

The *General Dynamics* and *Baker Hughes* courts based their predictive judgments on concrete evidence, outside the merging parties’ future control. Here, only Heinz’s promises were available to support the district court’s prediction that the merger is likely to increase competition. In particular, defendants’ case boils down chiefly to their efficiencies arguments, which the district court relied upon as supposedly overcoming the Commission’s prima facie case. *See* Op. 20-25; App.

1435-40. To reach that result, the district court had to conclude that Heinz will actually succeed in achieving production efficiencies, that Heinz will actually innovate, and that Heinz will lower its prices rather than continuing its practice of following Gerber's lead. Such speculation and unrealized promises, not the sort of observable market conditions at issue in *General Dynamics* and *Baker Hughes*, are all that defendants have offered here, and they are inadequate to rebut the Commission's strong prima facie case.

Moreover, as this Court has previously held, efficiencies afford "a novel defense, which the Supreme Court has not addressed since the 1960s (and then, unfavorably), [and] which this court has never addressed * * * ." Mem. Op. at 2; App. 1473. In pointing out the novelty of efficiencies arguments, neither the Commission nor the stay panel has implied that efficiencies should be ignored at any stage of Section 7 proceedings. But this Court's stay order recognizes the need for caution in evaluating such arguments – caution that the court below failed to exercise. As we have shown, the alleged efficiencies are highly speculative, may not be passed on to consumers, and could easily be swamped by anticompetitive price increases should Heinz choose to take advantage of the opportunities afforded by a stable two-seller market. FTC Br. 45-56. The court below – while correct in

considering the totality of circumstances – erred in giving dispositive weight to defendants’ speculative showing.

Furthermore, in concluding that the Commission failed to show a likelihood of success on the merits, the district court also effectively imposed on the Commission an improperly high burden of proof – holding, for example, that it could not
“

inextricably tied to speculation about the merging firms' future conduct, the public interest requires that such "serious, substantial, difficult and doubtful" issues should be resolved on the basis of a fully developed trial record. *See FTC v. University Health*, 938 F.2d at 1218; *FTC v. Swedish Match*, No. 00-1501, slip op. 7 (D.D.C., Dec. 14, 2000). A preliminary injunction should therefore issue.

II. THE CLAIMED EFFICIENCIES DO NOT REBUT THE COMMISSION'S SHOWING THAT THE MERGER WILL LIKELY HARM COMPETITION.

As this Court has recognized, the level and proposed increase in market concentration in this case exceed, "by a wide margin," levels that denote a strong presumption of competitive harm, and any showing of efficiencies must therefore be "extraordinary" to rebut the prima facie case. Mem. Op. 1, 2 (citing IV.A Areeda, *Antitrust Law* ¶ 971f (1998)); App. 1472-73. This conclusion is fully consistent with this Court's observation, in *Baker Hughes*, that "[t]he more compelling the prima facie case, the more evidence the defendant must present to rebut it successfully." 908 F.2d at 991. And, because it is highly unlikely that a firm in a two-firm market will pass efficiencies on to customers, the agencies' Merger Guidelines state that "[e]fficiencies almost never justify a merger to monopoly or near-monopoly." *See* FTC and Department of Justice Antitrust Division Horizontal Merger Guidelines, 4 Trade Reg. Rep. (CCH) ¶ 13,104 ("Merger Guidelines") at

§ 4 (1997); App. 1496. Indeed, no court has ever allowed efficiencies to justify a merger to duopoly. *See* FTC Br. 48 n.26.

Consistent with longstanding precedent, Judge Hogan less than a month ago ruled that a defendant had failed to rebut the government's prima facie case, in a merger leading to high concentration, on the basis of claimed efficiencies. *FTC v. Swedish Match, supra*, slip op. 38. In doing so, he acknowledged this Court's statement, in the present case, concerning the novelty of such an efficiencies defense. *Id.*, citing Mem. Op. 2; App. 1473. Judge Hogan correctly concluded that, "[e]ven assuming that it is a viable defense in some cases," it was "inappropriate" in the case before him because the acquisition would generate undue market share and increased concentration. *Id.* at 39. Tellingly, in *Swedish Match*, the top two firms in the relevant market would have controlled over 90% of the market, *id.* at 9, 28, somewhat less than the market share of the two firms that would remain in this case. Judge Hogan added: "even i i

squarely on evidence about “the efficiencies realized by the merger, and about the enhanced prospects of the merged entity to introduce innovative products to compete with Gerber.” Op. 20 (citing *Baker Hughes*); App. 1435. It did so, moreover, without subjecting defendants’ claims to the sort of careful scrutiny displayed in *Swedish Match* or other cases (see FTC Br. 43 n.20), or acknowledging the highly speculative nature of defendants’ contentions. This unprecedented finding is inconsistent with *Baker Hughes*, because speculative efficiency savings and possible new product introductions in no way discredit the data underlying the initial presumption in the government’s favor, nor do they affirmatively show that the transaction is unlikely to substantially lessen competition. See 908 F.2d at 991.³

³ In fact, because defendants’ claimed efficiencies depend on the elimination of 120 to 130 versions of jarred baby food, they are more likely to decrease competition by eliminating consumer choice. Defendants’ only response is that the Commission’s expert “misinterpreted” the document showing 47% brand loyalty to Heinz. Def. Br. 40. But Dr. Hilke only testified that he had read the document too narrowly; he nowhere stated that it formed the entire basis of his analysis, and indeed, it did not. See PX 782 ¶¶ 66-77; App. 4035-39. Thus, the key facts – elimination of 120 to 130 (largely Heinz) jarred baby food products; preference of many current Heinz purchasers for Heinz; and the loss of choice to customers who use the products that are eliminated – stand undisputed. See also PX 533 at 1161; PX 482 at 88 (Albertson’s customers upset by switch from Beech-Nut to Heinz); App. 3055, 2893. Moreover, contrary to defendants’ rhetoric (Def. Br. 39-40), the Commission is not claiming that elimination of a brand via merger will never be a cognizable efficiency. But eliminating 125 choices from product lines in which consumers demonstrably value variety and are loyal to favorite items is qualitatively different from eliminating a supplier of coal or grain.

Defendants’ efforts to sustain this extraordinary ruling are crippled by at least three fundamental defects. First, the amount of the claimed efficiencies remains highly uncertain. While the court credited the \$9.4 to \$12 million efficiencies put forth by defendants’ expert, Op. at 21; App. 1436 – even though those included anticipated savings on juice and cereal as well as jarred baby food, App. 791-92, and even though defendants’ experts expressed uncertainty about the extent to which the savings would benefit consumers – defendants now inflate their efficiencies claim fourfold, to \$45 million. Def. Br. 9, 40. Such ever-ballooning claims only buttress the Commission’s showing that the predicted efficiencies are speculative.

Second, defendants contend that the efficiencies will be passed through to consumers, based on a statement by their expert that “any firm that experiences a variable cost decline will have an incentive to lower prices after that cost reduction * * * lowering prices means that the firm will sell more. So it will be able to expand output as a result.” Def. Br. 41 (citing App. 1108-09).⁴ But Heinz cannot

⁴ Defendants have virtually nothing to say (*see* Def. Br. 35-42) about the innovations that the merger will ostensibly permit, by dint of Heinz’s presence in a larger percentage of grocery stores. Heinz has never cited a single business document to support its claim (*id.* at 15) that it can introduce innovative products only if it achieves a *** “ACV” (*i.e.*, placement in *** of grocery stores) – and we have found none. Moreover, the single page in the record that relates to this assertion

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expand output significantly if the other firm in this duopoly takes countermeasures to discipline any competitive initiatives, as Gerber has consistently done in the past. *See* Op. 18; App. 1433. Also, defendants’ argument proves far too much. It means that, whenever two firms achieve variable cost reductions – even two firms merging to a monopoly – the merger should be permitted because the resulting firm will have an incentive to lower price. Courts should not credit such theories when only two

does not support it at all. DX 1; App. 4302. That page consists of a chart portraying revenue (not profits) for 27 new product launches. Fifteen of those launches were associated with ACVs of *****; 20 with ACVs of *** ***** . Only one “highly successful” product (according to defendants’ expert) can be associated with an ACV of ***.

⁵ Defendants also rely on the “independent” study prepared for Heinz by Booz-Allen. Def. Br. 41. That study was commissioned by Heinz “to support” the acquisition and was prepared as part of the parties’ anticipated “joint defense” of this case. *See* PX 755 at 14, 33-34, 37, 204-05. It was completed just days before the parties publicly announced their agreement. Neither of defendants’ principal efficiencies witnesses (Messrs. Campbell and Painter) was able to evaluate the accuracy of any of the Booz-Allen findings. PX 696 at 174-75; PX 762 at 42-44; Tr. 771-72: App. 3715, 3869, 855-56.

Indus., 628 F. Supp. 881, 885 (D.D.C.) (“experience 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.”), *aff’d*, 798 F.2d 1500 (D.C. Cir. 1986); *see also* FTC Br. 45-46 n.25. Notably, the district court’s finding of savings of \$9.4 to \$12 million (Op. 21; App. 1436) was based on testimony by an expert who confessed that he was not testifying that the claimed efficiencies would be passed along to consumers in any form. Tr. 767; App. 851. And another expert, who testified that at least 50% of the cost savings may be passed through to consumers, admitted that he had not done an econometric analysis to determine Heinz’s historical pass-through rate. Tr. 1036-37; App. 1147-48.⁶

⁶ Defendants criticize as “meaningless” (Def. Br. 40 n.13) the Commission’s showing that the claimed efficiencies would be swamped by just a small anticompetitive price increase in the relevant market. *See* FTC Br. 47. Defendants are wrong. A leading treatise concludes that, in highly concentrated markets, “efficiencies must be at least 8 percent across the entire output in the market where competition is threatened,” IV.A Areeda, *Antitrust Law*, ¶ 976d, and that an efficiencies defense in such markets should only be recognized when *both* firms are inefficient. *Id.* at ¶ 976b. Regardless whether the \$865 million to \$1 billion retail market or the \$665 million wholesale market is the relevant benchmark, the efficiencies found by the court in no way approach the requisite 8% (nor are both firms inefficient). Moreover, logic and traditional antitrust analysis dictate that, just as the competitive effects of a merger are measured in the relevant market, the efficiencies that are claimed to counteract any anticompetitive effects must be weighed against possible price effects throughout the market, and not simply with

Third, as noted above, there is a critical difference between the sort of objective, external factors that were dispositive in *Baker Hughes* and *General Dynamics* and the efficiency claims that defendants proffer here. Defendants have failed to rebut the Commission's showing of likely anticompetitive effects because it remains altogether speculative to what extent defendants' efficiencies are achievable (*see* FTC Br. 49-51 & n.28); to what extent the efficiencies are obtainable without the merger (FTC Br. 52-53); whether defendants will pocket any efficiencies that do result, or pass them on to their customers (*see* Tr. 1163-64, App. 1275-76); and whether, even if achieved and passed on, the efficiencies would counteract the likely anticompetitive effects. *See also* Bork, *supra*, 125-29 (measuring efficiencies is notoriously difficult, if not impossible).

Further, in contrast to the factors in *Baker Hughes* and *General Dynamics* that assured the merged firm could not exercise market power – low entry barriers or depleted finite resources – here future competition depends on Heinz's incentives to compete or coordinate with Gerber. While the efficiencies Heinz has touted may allow it better to compete, they do not compel it to do so. Only competition – which is unlikely to be vigorous in a duopoly – ensures that efficiencies will be

reference to defendants' sales. *See* Merger Guidelines, § 4; App. 1496.

achieved and passed on. *See FTC v. University Health*, 938 F.2d at 1223. The current situation thus sharply differs from that in *General Dynamics*, where there was no question whether the small acquired firm was inclined to compete; it was simply *unable* to compete. 415 U.S. at 506. Because defendants' efficiencies claims are highly uncertain and any market effect depends on a duopolist's future incentives, they do not render the Commission's prima facie case an inaccurate predictor of future competition. *See United States v. Ivaco, Inc.*, 704 F. Supp. 1409, 1425-29 (W.D. Mich. 1989). The court below erred in finding that the claimed efficiencies defeated the Commission's entitlement to a preliminary injunction.

III. DEFENDANTS HAVE FAILED TO REBUT THE PRESUMPTION THAT CREATION OF A STABLE DUOPOLY WILL PROMOTE ANTI-COMPETITIVE COLLUSION OR TACIT COORDINATION.

As we have explained (FTC Br. 34-42), one of the chief evils that Section 7 is geared to prevent is the creation of markets in which it is reasonably likely that a small number of competitors will "in effect share monopoly power, setting their prices at a profit-maximizing, supracompetitive level * * * ." *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 227 (1993); *see* IV Areeda, *Antitrust Law* ¶ 911a & n.1 ("duopoly markets typically perform quite poorly. * * *

Indeed, depending on assumptions, output may be no higher, and price no lower, in

⁷ Defendants also rely on several Gerber documents, which supposedly reflect prospects for enhanced competition in a two-firm market. *E.g.*

Defendants rely, for example, on a curious syllogism: because Heinz and Beech-Nut supposedly do not compete now, removing one of them cannot make it any more likely that Heinz will collude with Gerber in the future. Def. Br. 43. The premise of this argument, however, is fatally flawed. As the court below recognized, Heinz and Beech-Nut are engaged in ongoing, vigorous competition, to induce retailers to carry them as the “second brand” in supermarkets. Op. 14-15; App. 1429-30. Despite the defendants’ constant efforts to minimize the importance of such all-or-nothing competition, it is a pervasive aspect of their marketing efforts, since retailers can and do switch their business, depending upon the terms that Heinz and Beech-Nut offer. See PX 782, ¶¶ 33-42; App. 4021-26; see also Part IV, *infra*. As the Commission showed in the court below, the presence of such ongoing competition has effectively precluded an ik

⁸ Defendants’ only other support for their claim that today’s market reflects a “two-brand dynamic” that “will be no different post-merger” is an unfounded reading of the Third Circuit’s opinion in *In re Baby Food Antitrust Litigation*, 166 F.3d 112 (3d Cir. 1999). Def. Br. 44 n.17. That court ultimately held that there was insufficient evidence to prove a price-fixing agreement among the three baby food manufacturers. But it did not remotely indicate that its findings would be the same in a two-firm market, and its opinion in no way reflects a two-brand market dynamic. Rather, it contains Heinz documents that state that “[e]very attempt to dislodge

Defendants err, moreover, in supposing that their econometric evidence or the district court's reliance on it can "vitiating" the impact of such competition. Def. Br. 43. Even crediting the finding of defendants' expert that the actual presence of "two or three competitors" makes little difference in retail shelf prices (Op. 14; App. 1429), that hardly shows that Heinz and Beech-Nut do not constrain each other competitively. On the contrary, it simply reflects that the ever-present threat of loss of wholesale sales to each other affects their competitive actions *regardless* of whether they are actually present in a particular local market. *See* FTC Br. 3, 11. Moreover, as we have already shown (FTC Br. 33 n.11), defendants' econometric evidence deserved no weight, for its author acknowledged that it also supports the absurd result that Heinz and Beech-Nut baby foods are not even in the same product market.⁹

Beech-Nut was met with defensive programs that were substantial," 166 F.3d at 127, and describes "aggressive competitor activity" between Beech-Nut and Heinz to "oust" each other from markets and accounts. *Id.* at 136.

⁹ Defendants take the Commission to task for not adducing econometric evidence here, holding up the Commission's showing in *FTC v. Staples, Inc.*, 970 F. Supp. 1066 (D.D.C. 1997), as a supposed standard for what is required. Def. Br. 24-25. But the econometrics in *Staples* were principally directed to the issue of product market definition, which defendants here do not challenge. *See* 970 F. Supp. at 1075-78, 1080. In any event, the same district court recently recognized that "the same degree and type of pricing evidence the Court found compelling in *Staples*" is *not* necessary in order for the Commission to prevail, even when product market is in dispute. *Swedish Match, supra*, slip op. 15.

The Commission adduced a broad range of evidence pertinent to collusion and coordination issues. *See* FTC Br. 37. In addition to the basic structural issue of merger to a duopoly, the Commission showed that the merger would eliminate the disruptive element of direct competition for wholesale customers, that high entry barriers would preserve the duopoly indefinitely, that reduced excess production capacity and increased product homogeneity would further facilitate coordination, and that this market has already displayed signs of coordination, as Heinz and Beech-Nut have followed Gerber's price leadership and have pulled their competitive punches in response to pressures from Gerber. *Id.* at 37-41. Accordingly, defendants' refrain that the Commission has relied solely on market share statistics (*e.g.*, Def. Br. 24) rings hollow.

In response, defendants offer only their own expert

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The district court’s own finding that “Heinz has tended to follow Gerber’s prices” (Op. 4-5; App. 1419-20) contradicts any notion that coordination is impossible even now, much less in the simplified, two-firm market defendants seek. Plainly, if Heinz can now gather sufficient information to follow Gerber prices,¹⁰ - monitoring and coordination will be even easier in a two-firm market. *See United States v. Ivaco, Inc.*, 704 F. Supp. at 1428 & n.18. And, as we have shown previously (FTC Br. 41), slight differences between Heinz and Gerber products do not diminish their ability to collude or otherwise engage in coordinated action. Any argument about an “information gap” defies the evidence and the court’s finding of Heinz’s propensity to follow Gerber’s pricing,¹¹ and defies common sense about how two-firm markets can operate.

The above considerations also show why defendants’ “maverick” theory (Def. Br. 45), which the court below did not embrace, is implausible. Even assuming that a corporation starting with nearly one-third of a major national market

¹⁰ *See Baby Food Antitrust Litigation*, 166 F.3d at 133 (three baby food manufacturers were sophisticated corporations able to obtain competitive information concerning their rivals’ product prices and promotions).

¹¹ In the *Baby Food Antitrust Litigation*, *supra*, Heinz explained (in defending itself from charges of outright price fixing) that *****
***** App. 2470-71.

with only two players could ever meaningfully be considered a “maverick,” Heinz’s track record as a price follower belies the notion that it will find it impossible to arrive at a mutually advantageous detente with Gerber in the future. And, while defendants point to cost structure and excess capacity (*id.*), we have shown that the merger will make Heinz more similar to Gerber in its cost structure and will greatly reduce present excess capacity. FTC Br. 40; *see also* Tr. 507 (if merger is completed, Heinz “will have very good cost competition with Gerber”); App. 589.

The conclusory opinion testimony on which defendants rely comes down to the notion that Heinz will not be satisfied with its new, combined market share but will want more. Tr. 1012-13; App. 1123-24. Regardless of Heinz’s current aspirational testimony, however, a firm’s paramount interest is typically in increasing profits, not market share. Moreover, any attempt to increase share must face Gerber’s own considerable power to discipline competitive initiatives, which it has successfully exercised in the past. *See* Op. 17-18; App. 1432-33. Furthermore, defendants and their expert have ignored the abiding nature of the opportunities this merger will create for collusion or tacit coordination. There has been no new entry into the baby food market for decades, and defendants agree that entry is highly unlikely. Op. 12; App. 1427. Thus, Heinz and Gerber will be facing each other (and no one else) for a long time. As we have noted previously, defendants’ own

expert has espoused the common-sense proposition that players in such repeat games can and do learn to coordinate over time. *See* FTC Br. 40 n.18. And, even if Heinz competes long enough to capture some additional market share, it and Gerber could modulate their competition at any time in the future to take full advantage of the cozy market structure this merger will produce. *See* Tr. 1165-66 (Hilke); App. 1277-78. Defendants' conclusory statements regarding "cartel problems" cannot support the claim that diminished competition is unlikely in a stable, two-firm market, particularly at this stage of the proceedings.

IV. THE DISTRICT COURT COMMITTED LEGAL ERROR IN IGNORING COMPETITIVE EFFECTS AT THE WHOLESALE LEVEL.

The district court committed a basic legal error in concluding that a reduction of competition in the wholesale market is irrelevant unless the Commission can meet the unprecedented burden of showing a quantifiable effect on retail prices. Op. 15-17; App. 1430-32; *see* FTC Br. 27-31. Defendants' attempts to finesse this independent ground for reversal fail; they ignore the factual record on this point and misstate the pertinent legal principles. Def. Br. 32-35.

As demonstrated in our opening brief (FTC Br. 11-14, 27-31), competition between Heinz and Beech-Nut at the wholesale level is robust and benefits wholesale customers. Contrary to Heinz's argument (Def. Br. 6), such competition is not

¹² That the lower court found that the wholesale market was the primary focus of the Commission's case (Op. 12, 14-15; App. 1427, 1429-30) belies defendants'

¹³ There also is no evidentiary basis for defendants' argument that retailers approve of the transaction. Def. Br. 34. The lower court struck all but a few select passages (none of which evinces support for the transaction) from defendants' proffered affidavits from several grocers, because the affidavits were not based on personal knowledge and were riddled with hearsay and inadmissible opinion. Tr. 928-29, 1054-58; App. 1039-40, 1166-70. Even stronger customer support, from sophisticated railroads, was found unpersuasive in *Ivaco, supra*, principally because

prices is “famously difficult,” and would impose a burden that would “normally prove insurmountable.” *See In re Brand Name Prescription Drugs Antitrust Litigation*, 123 F.3d 599, 605 (7th Cir. 1997); *Hanover Shoe, Inc. v. United Shoe Machinery Corp.*, 392 U.S. 482, 492-93 (1968). Yet, if the retail market itself is functioning efficiently and competitively – and there is no reason in this case to suppose that the retail grocery market is not – cost reductions enjoyed by retailers are likely ultimately to benefit consumers, whether by lower baby food prices, display improvements, or capital expenditures that will make shopping more pleasant or convenient. *See* Tr. 255-56, 265-73 (Hilke), Tr. 163-64 (Long), Tr. 622-24 (Quinn), Tr. 843-46 (Davidson); App. 290-91, 300-08, 197-98, 704-06, 954-57. The district court’s supposition that the demonstrable loss of head-to-head competition between Heinz and Beech-Nut for sales to retailers is relevant *only* if the Commission can show a quantifiable impact on retail prices is contrary to bedrock principles of antitrust law, and typifies the serious legal errors embodied in the lower court’s denial of a preliminary injunction.

CONCLUSION

The decision of the lower court should be reversed and the matter remanded with instructions to enter a preliminary injunction pending final resolution of the pending administrative proceeding.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE PURSUANT TO
FED. R. APP. P. 32(A)(7)(c) AS TO WORD COUNT

I certify that pursuant to Fed. R. App. P. 32(a)(7)(C) the Reply Brief of Appellant, Federal Trade Commission, is proportionally spaced, has a typeface of 14 points, and contains 6,990 words.

David C. Shonka

IN THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

FEDERAL TRADE COMMISSION,)	
)	
Plaintiff-Appellant,)	
)	
v.)	No. 00-5362
)	
H.J. HEINZ COMPANY)	
)	
and)	
)	
MILNOT HOLDING CORPORATION,)	
)	
Defendants-Appellees.)	

CERTIFICATE OF SERVICE

I hereby certify that I have this 10th day of January, 2001, served the Reply Brief of Plaintiff-Appellant Federal Trade Commission by hand delivering two copies to each counsel for defendants-appellees:

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