UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

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

REPLY MEMORANDUM IN SUPPORT
OF PLAINTIFF'S MOTION
FOR PRELIMINARY INJUNCTION


DEBRA A. VALENTINE
General Counsel

RICHARD G. PARKER
Director, Bureau of Competition
Federal Trade Commission
Washington, D.C. 20580

RICHARD DAGEN
DAVID SHONKA

Attorneys
Federal Trade Commission
Washington, D.C. 20580
(202) 326-2628


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## TABLE OF CONTENTS


TABLE OF AUTHORITIES . . . . . . . . . . ii
INTRODUCTION AND SUMMARY . . . . . . . . . . 1
ARGUMENT . . . . . . . . . . 4
I. THE LAW DOES NOT PERMIT STRONG RIVALS TO MERGE IN ORDER TO COMPETE WITH A LARGER FIRM . . . . . . . . . . 4
II. THIS MERGER SIGNIFICANTLY WILL REDUCE COMPETITION IN THE MARKETS FOR PREPARED BABY FOODS . . . . . . . . . . 6
A. Defendants' Attack on Gerber Is Irrelevant . . . . . . . . . . 8
B. Competition for Shelf Space Is A Vital Aspect of Competition . . . . . . . . . . 9
C. Wholesale Competition From Heinz and Beech-Nut Benefits the Market . . . . 11
D. Defendants' "National Distribution" Argument Is A Canard . . . . . . . . . . 13
1. Both Companies Already Sell on a Broad Geographic Scale. . . . . . . . . 13
2. Defendants' "National Advertising" Argument Is Without Merit . . . . . 14
3. Defendants Can Innovate Without This Merger . . . . . . . . . . 15
E. The Merger Is Likely to Result in a Unilateral Price Hike . . . . . . . . . . 16
F. The Merger Increases the Likelihood of Coordinated Interaction . . . . . . . . . . 18
G. Defendants "Power Buyer" Defense Cannot Save This Merger . . . . . . . . . . 18
III. Defendants' Alleged Efficiencies Do Not Reverse The Likelihood of Anticompetitive Effects . . . . . . . . . . 20
A. The Merger Will Result in an Anticompetitive Reduction in Consumer Choice 23
B. Promises of Beneficial New Competition Are Not Merger-Specific . . . . . . . . . 23
C. There Is No Guarantee That Heinz Will Keep Its Prices at Current Levels (Much Less Pass On the Alleged Savings) if the Merger is Consummated . . . . . . . . . . 24
IV. NOTHING LESS THAN A FULL-STOP INJUNCTION WILL PROTECT COMPETITION HERE . . . . 25
CONCLUSION . . . . . . . . . . 27

## TABLE OF AUTHORITIES

**Cases**

*AlliedSignal, Inc. v. B.F. Goodrich Co.*
183 F.3d 568 (7th Cir. 1999) . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 19

*American Hospital Supply Corp. v. Hospital Products Limited*
708 F.2d 589 (7th Cir. 1986) . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 18

*American News Co. v. FTC*
300 F.2d 104 (2d Cir.)
*cert. denied*, 371 U.S. 824 (1962) . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 8

*Brown Shoe Co. v. United States*
370 U.S. 294 (1962) . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 5

*California v. American Stores*
697 F. Supp. 1131 (C.D. Cal. 1988) . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 22

*Community Publishers Inc. v. Donrey Corp.*
892 F. Supp. 1146 (W.D. Ark. 1995)
*aff'd sub nom. Community Publishers, Inc. v. DR Partners*
139 F.3d 1180 (8th Cir. 1998) . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 17

*Eastman Kodak Co. v. Image Technical Serv.*
504 U.S. 451 (1992) . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 18

*FTC v. Alliant Techsystems*
808 F. Supp. 19 (D.D.C. 1992) . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 19, 25

*FTC v. Butterworth Health Corp.*
946 F. Supp.1285 (W.D. Mich. 1996)
*aff'd*, 121 F.3d 708 (6th Cir. 1997) . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 22

*FTC v. Cardinal Health, Inc.*
12 F. Supp.2d 34 (D.D.C. 1998) . . . . . . . . . . . . . . . . . . . . . . 1, 4, 6, 7, 19, 20, 22, 25, 26

*FTC v. Coca-Cola-Co.*
641 F. Supp. 1128 (D.D.C. 1986)
*vacated as moot,* 829 F.2d 191 (D.C. Cir. 1987) . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 6

*FTC v. Imo Industries*
1992-2 Trade Cas. ¶ 69,943 (D.D.C. 1989) . . . . . . . . . . 19

*FTC v. Occidental Petroleum Corp.*
1986-1 Trade Cas. ¶ 67,071 (D.D.C. 1986) . . . . . . . . . . 4

*FTC v. PPG Indus.*
798 F.2d 1500 (D.C. Cir. 1986) . . . . . . . . . . 1, 19, 21, 25

*FTC v. R.R. Donnelley & Sons Co.*
1990-2 Trade Cas. ¶ 69,239 (D.D.C. 1990) . . . . . . . . . . 18

*FTC v. Staples, Inc.*
970 F. Supp. 1066 (D.D.C. 1997) . . . . . . . . . . 1, 4, 6, 7, 14, 20-22, 25

*FTC v. University Health, Inc.*
938 F.2d 1206, 1218 (11th Cir. 1991) . . . . . . . . . . 4, 21, 22, 25

*FTC v. Warner Communications, Inc.*
742 F.2d 1156 (9th Cir. 1984) . . . . . . . . . . 4

*Grumman Corp. v. LTV Corp.*
665 F.2d 10 (2d Cir. 1981) . . . . . . . . . . 19

*In re Baby Food Antitrust Litigation*
166 F.3d 210 (3d Cir. 1999) . . . . . . . . . . 3

*Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, Inc.*
340 U.S. 211 (1951) . . . . . . . . . . 8

*Nat'l Soc'y of Prof. Eng'rs v. United States*
435 U.S. 679 (1978) . . . . . . . . . . 17

*NCAA v. Law*
134 F.3d 1010 (10th Cir. 1998) . . . . . . . . . . 22

*Seeburg Corp. v. FTC*
425 F.2d 124 (6th Cir. 1970) . . . . . . . . . . 17

*United States v. Aluminum Co. of America*
377 U.S. 271 (1964) . . . . . . . . . . 5

*United States v. Country Lake Foods*
754 F. Supp. 669 (D. Minn. 1990) . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 18, 22

*United States v. General Dynamics Corp.*
415 U.S. 486 (1974) . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 5, 13

*United States v. Ivaco*
704 F. Supp. 1409 (W.D. Mich. 1989) . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 2, 22, 25

*United States v. Long Island Jewish Medical Center*
983 F. Supp. 121 (E.D.N.Y. 1997) . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 22

*United States v. Mercy Health Services*
902 F. Supp. 968 (N.D. Iowa 1995) . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 22

*United States v. Microsoft Corp.*
87 F. Supp.2d 30 (D.D.C. 2000) . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 8

*United States v. Pabst Brewing Co.*
384 U.S. 546 (1966) . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 6

*United States v. Philadelphia National Bank*
374 U.S. 321 (1962) . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 1, 6

*United States v. Philips Petroleum Co.*
367 F. Supp. 1226 (C.D. Cal. 1973)
*aff'd mem.,* 418 U.S. 906 (1974) . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 14

*United States v. Rockford Mem. Corp.*
717 F. Supp. 1251 (N.D. Ill. 1989)
*aff'd*, 898 F.2d 1278 (7th Cir.)
*cert. denied*, 498 U.S. 920 (1990) . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 21, 22, 25

*United States v. Socony-Vacuum Oil Co.*
310 U.S. 150 (1940) . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 8

*United States v. United Tote, Inc.*
768 F. Supp.1064 (D. Del. 1991) . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 19, 22

*United States v. Western Elec. Co.*
592 F. Supp. 846 (D.D.C. 1984),
*appeal dismissed*, 777 F.2d 23 (D.C. Cir. 1985)à777 F.2d 23 . . . . . . . . . . . . . . . . . . . . 21

*Yamaha Motor Co. v. FTC*
657 F.2d 971 (8th Cir. 1981) . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 13

**Statutes, Regulations, and Agency Guidelines**

Section 2 of the Sherman Act
15 U.S.C. § 2 . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 8

Section 5 of the FTC Act
15 U.S.C. § 45 . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 4

Section 7 of the Clayton Act
15 U.S.C. § 45 . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 4, 13, 17

U.S. Department of Justice and Federal Trade Commission
*Horizontal Merger Guidelines* (April 2, 1992) . . . . . . . . . . . . . . . . . . . . . 4, 7, 16, 17, 20

**Other Authorities**

American Bar Association, Mergers and Acquisitions 137 (2000) . . . . . . . . . . . . . . . . . . . . . 5, 20

Craig W. Conrath and Nicholas A. Widnell, “Efficiency Claims in Merger Analysis: Hostility or Humility?” 7 George Mason L. Rev. 685 (1999) . . . . . . . . . . . . . . . . . . . . . . . . . . . . 21

Joseph Brodley, "Proof of Efficiencies in Mergers and Joint Ventures," 64 Antitrust L.J. 576 (1996) . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 21

Robert Pitofsky, “Efficiencies in Defense of Mergers,” 7 Geo. Mason L. Rev. 485, 486-87 (1999) . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 22

American Bar Association, Mergers and Acquisitions (2000) . . . . . . . . . . . . . . . . . . . . . . . 5, 20

Craig W. Conrath and Nicholas A. Widnell, “Efficiency Claims in Merger Analysis: Hostility or Humility?” 7 George Mason L. Rev. 685 (1999) . . . . . . . . . . . . . . . . . . . . . . . . . . . . 21

Joseph Brodley, "Proof of Efficiencies in Mergers and Joint Ventures," 64 Antitrust L.J. 576 (1996) . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 21

Robert Pitofsky, “Efficiencies in Defense of Mergers,” 7 Geo. Mason L. Rev. 485 (1999) . . . 22

## INTRODUCTION AND SUMMARY

Defendants' Memorandum of Law in Opposition to the Commission's Motion for a Preliminary Injunction (cited herein as "DB" for Defendants' Brief) is a remarkable document, principally for what it concedes. It is agreed that prepared (jarred) baby food is a properly defined relevant product market. Whether the relevant geographic market is national or a series of regional markets, it is undisputed that the merger results in an increase in concentration that the Court of Appeals for this Circuit has found to be "overwhelming." *FTC v. PPG Indus.,* 798 F.2d 1500, 1505-06 (D.C. Cir. 1986).

This means that this merger is, without dispute, presumptively illegal. *United States v. Philadelphia National Bank,* 374 U.S. 321 (1962); *FTC v. Cardinal Health, Inc.,* 12 F. Supp.2d 34 (D.D.C. 1998); *FTC v. Staples, Inc.,* 970 F. Supp. 1066 (D.D.C. 1997). The burden now rests on defendants to show that a merger resulting in a market owned entirely by two competitors is not likely to reduce competition. The traditional route to meeting this heavy burden would be to demonstrate that entry into the market is easy and that the current market shares are misleading. *E.g., Staples,* 970 F. Supp. at 1086. But here again, defendants have conceded away that defense by admitting (as they must) that this industry is characterized by high barriers to entry.

Defendants cannot point to a single case in which a court has allowed a presumptively illegal merger in any market with the high entry barriers present here. This is not surprising because the combination of high concentration and little entry potential is a prescription for consumer injury. Here, document after document confirms the degree to which Heinz and Beech-Nut compete to be carried by supermarkets. The merger totally eliminates that rivalry and provides Heinz with a significant opportunity to raise prices on its own or simply to go along

with Gerber in achieving the same result. Little else is realistically to be expected in a market with only two sellers when nearly all supermarkets want to carry two brands.

Defendants ask the Court to ignore the dictates of law, fact, and common sense in favor of a series of assertions that are particularly weak. The first is that the competition lost by the merger is "trivial," a "sideline," not worth saving. The main problem with that argument is factual – the evidence will show that Heinz and Beech-Nut compete the way firms are supposed to: on the basis of price, quality, and innovation. Another problem is that the assertion is supported principally by untested declarations of supermarkets (not consumers), excerpts of which account for over 11 pages of their 55 page brief. These affiants were not shown defendants' ordinary course of business documents describing the competition between Heinz and Beech-Nut and available to the Court. Rather, recognizing that the merger was "DOA in Washington without customer support" [PX 440], their affiants were shown documents with rosy post-merger projections inconsistent with the ordinary course of business documents and created expressly for purposes of antitrust review. Customer predictions must be rejected unless "supported by the evidence." *United States v. Ivaco,* 704 F. Supp. 1409, 1428 (W.D. Mich. 1989). Here they are not.

Defendants also argue that the market is already hopelessly anticompetitive due to an impregnable monopoly held by Gerber, and that maybe, just maybe, this transaction will make it better. That theory is pure malarkey. Does that mean that all industries in which there is a dominant firm ought to be given an antitrust pass to merge to two firms? Even if Gerber were a monopolist as asserted by defendants, the law holds that monopolies should be broken by competition. Reducing the number of firms to two where entry is not to be expected has long

been recognized to be illegal. No court has permitted a presumptively unlawful merger because a third firm was a monopolist. In fact, no court has permitted a firm to violate the antitrust laws in any way because a rival firm is an alleged monopolist engaged in allegedly anticompetitive conduct, just as no court has permitted firms to engage in price-fixing or group boycotts in response to similar illegal conduct. This Court should not do so. Moreover, the "Gerber is a monopolist" argument fails completely because of the position defendants maintained before the Third Circuit in *In re Baby Food Antitrust Litigation*, 166 F.3d 210 (3d Cir. 1999), when they argued that competition among all the companies, including Gerber, was aggressive and benefitted consumers.

Finally, the defendants promise "extraordinary" efficiencies, but fail to satisfy the burden established by the law and the Merger Guidelines. The alleged efficiencies are not cognizable because they result from a reduction in consumer choice and quality. Their postulated value is dwarfed by the potential anticompetitive effects of the merger. Even assuming that defendants achieve the variable cost savings they assert, and passed through 50 percent of them, and assuming that anticompetitive effects to be expected in a 3-2 merger never materialize, their own econometrics shows that the big projected boon to consumers would be very small.

Most important, there is no guarantee that consumers will ultimately benefit from any of the alleged efficiencies. Defendants' promises that they will do so, however well-intentioned, are not sufficient. The economic history of this country compels the conclusion that competition, not mergers, is the driving force that compels firms to cut costs, and to benefit consumers with lower prices, higher quality and greater innovation. That is the genius of the antitrust laws and the reason why the Merger Guidelines instruct that efficiencies will "almost

never justify a merger to monopoly or near-monopoly." *Merger Guidelines* § 4; *see Staples*; *Cardinal Health*.

In sum, this Court should conclude that a merger of two strong, healthy competitors in a 3-firm market *at least* "raise[s] questions going to the merits so serious, substantial, difficult and doubtful as to make them fair ground for thorough investigation, study, deliberation and determination by the FTC in the first instance and ultimately by the Court of Appeals."[1]

## ARGUMENT

### I. THE LAW DOES NOT PERMIT STRONG RIVALS TO MERGE IN ORDER TO COMPETE WITH A LARGER FIRM

The core of the defendants' claim is the argument that this merger is necessary to combine two weaklings in order to create a single dynamo to take on Gerber's alleged monopoly. (DB at 21) Neither the law nor the facts in this case support that argument. No court has approved a merger simply because it would permit the combined firm to compete more

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[1] *Staples*, 970 F. Supp. at 1071, *quoting FTC v. University Health, Inc.*, 938 F.2d 1206, 1218 (11th Cir. 1991); *accord FTC v. Warner Communications, Inc.*, 742 F.2d 1156, 1162 (9th Cir. 1984). Defendants incorrectly assert that the FTC's burden on this motion is "a heavy one," relying on *FTC v. Occidental Petroleum Corp.*, 1986-1 Trade Cas. ¶ 67,071 (D.D.C. 1986). (DB at 7) That decision, however, was later vacated by the Court of Appeals, No. 86-5254 (D.C. Cir. 1986), and the defendants neither mention the vacatur nor offer any other support for their assertion. In *Occidental,* the Commission ultimately found that the merger violated Section 7 of the Clayton Act and Section 5 of the FTC Act, after the merger had been consummated. *Occidental Petroleum Corp.*, 115 F.T.C. 1010 (1992). Thus, the heavy burden imposed at the preliminary injunction stage denied the Commission – and the public – the benefits of preserving the status quo intended by the statutory scheme. Moreover, this Court's opinion in *Staples* made it clear that "in a suit for a preliminary injunction, the government need only show a 'reasonable probability' that the challenged transaction will substantially impair competition." *Staples*, 970 F. Supp. at 1072.

effectively against a larger rival;[2] on the contrary, lead by the Supreme Court, the courts have almost universally rejected this argument. See Memorandum in Support of Plaintiff's Motion for Preliminary Injunction at 11 n.23 (and cases cited therein). As the Supreme Court has repeatedly stated, the purpose of the Clayton Act is to protect competition rather than competitors. *Brown Shoe*, 370 U.S. at 320 (emphasis in original). Defendants' theory that mergers in markets that are already concentrated are okay because they are already concentrated conflicts with the Supreme Court's admonition in *United States v. General Dynamics Corp*. that "if concentration is already great, the importance of preventing even slight increases in concentration is correspondingly great." 415 U.S. 486, 497 (1974), *quoting United States v. Aluminum Co. of America*, 377 U.S. 271, 279 (1964). For these reasons, courts in many cases have found mergers combining even relatively small market shares – or adding only tiny increments of market share – to be unlawful. In contrast, in this case, the merger would combine significant competitors into an entity that would control more than 33% of the market after the merger. [Baker Rpt. at App. B.]

On the facts, the premise that these two companies are weaklings is simply false. Both Heinz and Beech-Nut compete effectively and aggressively with Gerber. Heinz is the largest baby food producer in the world and is one of the largest food companies in the U.S. Beech-Nut

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[2] Although the Supreme Court dictum in *Brown Shoe Co. v. United States*, 370 U.S. 294, 346 (1962), and the legislative history of the 1950 Amendments to the Clayton Act, may suggest that the law does not impede the merger of genuinely small companies in order to compete against dominant firms, the total absence of cases finding this suggestion to be dispositive establishes the high thresholds which must be surmounted to support that theory. *See* American Bar Association, Mergers and Acquisitions 137 (2000) ("arguments that increased market share will improve competition in the market are . . . rarely successful or publicly endorsed by courts or the enforcement agencies.").

has a strong reputation for quality and innovation. Both firms are profitable and capable competitors. In short, while Gerber may have the largest share of the baby food market, it confronts substantial and effective competition from Heinz and Beech-Nut along numerous competitive dimensions. The law provides absolutely no justification for eliminating that competition.

## II. THIS MERGER SIGNIFICANTLY WILL REDUCE COMPETITION IN THE MARKETS FOR PREPARED BABY FOODS

Defendants agree that the relevant product market is baby foods[3]

; they agree that retailers compete on a local level[4]

; and they agree that the baby food market is very highly concentrated and only two significant manufacturers – Heinz and Gerber – would remain after this merger [DB at 1-2]. As a result, this transaction is presumptively illegal.[5] *Philadelphia Nat'l Bank*, 374

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[3] Defendants quibble about whether the market is only jarred baby foods or also includes other prepared baby foods. The merger is anticompetitive either way.

[4] Defendants argue that regional or local markets are not appropriate for wholesale competition because the manufacturers compete nationally. Their argument is irrelevant, because the retailers in any particular region or metropolitan area can only turn to the big three manufacturers for baby food. Wholesale markets for consumer goods 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); *FTC v. Coca-Cola-Co.,* 641 F. Supp. 1128, 1140 (D.D.C. 1986) (national and 7-state regional markets, with particular focus on 32 metropolitan areas), *vacated as moot,* 829 F.2d 191 (D.C. Cir. 1987) (transaction abandoned).

[5] The defendants attempt to distinguish *Cardinal Health* and *Staples* on the fact that those mergers involved firms with much larger market shares. (DB at 9) Although the potential dominance of the merged firm may have been a factor in *Staples* (it was not mentioned in *Cardinal Health*), it was not the sole factor addressed by the court in condemning these mergers.

U.S. at 364; *Cardinal Health,* 12 F. Supp.2d 34; *Staples*, 970 F. Supp. 1066; *Merger Guidelines,* § 1.51. That presumption is reinforced by high entry barriers, which defendants concede. [*See* DB at 16-20 (claiming even defendants cannot expand);

] There is no possibility that anticompetitive effects would be lessened by new entry.

With all of the antitrust fundamentals pointing in the FTC's direction, defendants are relegated to asserting a number of rather remarkable propositions:[6] (i) Gerber is a monopolist and the market is not competitive anyway, so this merger cannot do any harm; (ii) the undeniable competition between defendants to get on supermarket shelves is "sporadic" or "trivial" and not worth preserving; (iii) their merger cannot have any unilateral effects, even though Heinz, by acquiring Beech-Nut, will instantaneously eliminate its only competition for the second baby food slot on retailers' shelves, a company long known for innovation and one that forced Heinz to offer lower prices to retailers; and (iv) that there is no possibility of coordinated behavior, even though only two significant firms will remain in the market and even large buyers will have no alternatives but to buy from Heinz and Gerber.

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[6] Defendants' competitive effects story was manufactured for this case.

### A. Defendants' Attack on Gerber Is Irrelevant

Gerber is not on trial here. Even if defendants' allegations about Gerber's conduct had even a shadow of validity, they are irrelevant to this proceeding. Defendants can point to no decisions where a court has approved a merger in order to permit firms to "better" compete with a dominant firm.[7] Moreover, none of the conduct the defendants complain about – new product introductions, exclusivity arrangements, responding to new products and innovations – can be characterized as unlawfully exclusionary conduct, that is, conduct that would not be profitable but for the expectation of driving rivals from the market. *See Microsoft*, 87 F. Supp. 2d at 37. Rather, that conduct simply amounts to competition on the merits.[8]

Defendants' own descriptions of the manner in which Gerber, Heinz, and Beech-Nut compete support this conclusion. Thus, for example, when Gerber responded to Heinz and

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[7] Even if Gerber's market share could be characterized as conferring market power, the courts have uniformly held that exclusionary conduct is necessary to establish the offense of monopolization under Section 2 of the Sherman Act. *See United States v. Microsoft Corp.*, 87 F. Supp.2d 30, 37 (D.D.C. 2000). Moreover, even if Gerber had engaged in exclusionary conduct, that does not justify an anticompetitive merger. The courts have never countenanced a potential antitrust violation as a "cure" for other illegal acts. *See Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, Inc.,* 340 U.S. 211, 214 (1951) ("If petitioner and others were guilty of infractions of the antitrust laws, they could be held responsible in appropriate proceedings brought against them by the Government or by injured private persons."). In *United States v. Socony-Vacuum Oil Co*., 310 U.S. 150, 221-22 (1940), the Supreme Court stated that "genuine or fancied competitive abuses [could not constitute] a legal justification for [particular price-fixing] schemes . . ." *See also American News Co. v. FTC*, 300 F.2d 104, 110 (2d Cir.)("resort to practices outlawed by the antitrust laws cannot be justified by the fact that the practices were a defense to illegal activity."), *cert. denied*, 371 U.S. 824 (1962).

[8] There is nothing anticompetitive about Gerber's introduction of its "Tender Harvest" label after Heinz's introduction of its "Earth's Best" label. The fact that "Gerber can copy quickly" (DB at 15-16) simply suggests that Gerber is an effective competitor. Indeed, consumers are likely to benefit substantially from the fact that Gerber can in effect double the number of choices of a given product available to them so quickly.

Beech-Nut efforts to expand sales by offering "financial incentives" to retailers and by lowering prices (*see* DB at 18), there was nothing anticompetitive about those actions; indeed, consumers were likely to benefit from the consequently lower retail prices. Similarly, when Beech-Nut used comparative advertising to highlight its "all-natural" recipes, Gerber had to respond by "dramatically [raising] its consumer promotion spending in Beech-Nut's core regions." (DB at 18.) Responding to an advertising campaign by dramatically lowering prices is not an exclusionary practice; rather, it is precisely what should happen in a competitive environment.

**B. Competition for Shelf Space Is A Vital Aspect of Competition**

Defendants cannot deny that there is competition for shelf space between Heinz and Beech-Nut, so they belittle it by calling it "a sideline," or "trivial." They miss the mark. To reach consumers, manufacturers must first compete to be accepted by retailers. It is that competition that, in part, sets the stage for downstream competition for consumer sales. Manufacturers affect retail pricing only through wholesale pricing, consumer promotions, and other marketing strategies.[9]

Thus, competition at the wholesale level does matter.

Defendants contend, nevertheless, that they price against Gerber, and do not take each other's prices into account. (DB at 42.) It is true that both firms look at Gerber's prices, because

[9]

they compete against Gerber. But the evidence is clear that wholesale pricing is also a major element of competition between Heinz and Beech-Nut to get on a grocer's shelves. *E.g.*,

PX 482 (Meader) at 13:

PX 529 (Weis Markets) at ¶ 9:

> *See also* PX 531 (Wegmans Food Markets) at ¶ 13; PX 478 (The Vons Companies) at ¶ 5; PX 479 (Safeway, Inc., Northern California division) at ¶¶ 7-8; PX 480 (Farmer Jack Supermarkets) at ¶¶ 3,5; PX 369 at 524; PX 689 (Johnson at 244).

This is price competition, pure and simple. While it is at the wholesale level, simple economics teaches that wholesale cost ultimately will affect retail price. Indeed, as defendants concede, even Gerber responds to competition from Heinz and Beech-Nut when its market position is threatened, by offering greater financial incentives and consumer promotions. (DB at 18.)

Defendants ask the Court to rest assured that shelf space spending competition between Heinz and Beech-Nut will be replaced after the merger with strong competition from Gerber (DB at 47-48) to stay on supermarket shelves. That makes no sense, because there will be only two available suppliers for two available slots. As Beech-Nut's CEO states:

The likely result of this merger is one that defendants struggle to ignore: instead of the hypothesized increase in trade spending in competition with Gerber, the two remaining firms would realize that they would be better off by not competing aggressively against the other. After all, they no longer have a third firm to worry about.

**C. Wholesale Competition From Heinz and Beech-Nut Benefits the Market**

Defendants mischaracterize the evidence when they argue that they have no effect on Gerber's behavior because it is a monopolist. Gerber defends against perceived threats to its market position by aggressively granting financial incentives and consumer promotions. (DB at18.) *E.g.*:

PX 531 (Wegmans Food Markets) at ¶ 11:

PX 482 (Beech-Nut) at 39:

*See also* PX 482 at Ex. 3; PX 483 at 987, 988; PX 490

It is clear that wholesale competition between Heinz and Beech-Nut benefits consumers, as several supermarkets have testified. *E.g.*,

PX 529 (Weis Markets) at ¶ 10

PX 531 (Wegmans Food Markets) at ¶ 9-10

PX 481 (Hannaford Brothers) at ¶ 8

*See also* PX 478 (The Vons Companies) at ¶¶ 6; PX 479 (Safeway, Inc., Northern California division) at ¶ 6; PX 493; PX 42 at 905; PX 289 at 982; PX 284 at 564.

The positive effect of the competition for shelf space has been addressed throughout our initial memorandum. That this competition is always on the minds of Heinz and Beech-Nut is reflected throughout the companies' business documents. A Beech-Nut document complains that

A Heinz document similarly laments:

Novartis Corporation, Gerber's parent, similarly concluded that this merger would

Defendants' flawed econometric studies notwithstanding, price wars, bidding wars, and promotion wars invariably benefit consumers, and are at the heart of what the antitrust laws are meant to preserve.

Defendants' response to the overwhelming evidence of competition between the firms is to suggest that much of their trade spending is of the "fixed" variety and does not reduce retail

price. (DB at 47-48) Retailers state otherwise.[10] *E.g.*, PX 693 (WinCO) at 39

Moreover, the vast majority of payments are variable.[11]

## D. Defendants' "National Distribution" Argument Is A Canard

### 1. Both Companies Already Sell on a Broad Geographic Scale.

Both Heinz and Beech-Nut sell to retailers operating in states spanning the country from the East Coast to the West. Defendants' assertion that they are stuck in their core territories not only is belied by the facts, it is inconsistent with their own admonition that the Court should look at this market from a dynamic, rather than static perspective. (DB at 2, citing *United States v. General Dynamics Corp.,* 415 U.S. 486 (1974).) Unlike the situation in *General Dynamics,* where the acquired firm had little or no upside sales potential, both Heinz and Beech-Nut have expanded into each other's territories, in part, due to consolidation of supermarkets. In addition, they 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 certain areas of the

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[10] The "fixed" portion of trade spending includes slotting fees, pay-to-stay fees, and resets/conversion/transition fees. Fixed payments for resets and conversion routinely are required for existing accounts when the manufacturer changes its product mix on the retailer's shelf by adding or removing certain SKUs. Fixed spending for "transition" is involved when an account is switched over from a competitor. "Variable" trade spending includes off-invoice discounts, accruals, merchandising, marketing, advertising, displays, and promotions. Beech-Nut concedes that all variable spending "tend to result in price reductions at store shelf."

[11]

country, geographic expansion will come about as retailers merge and consolidate across regions into chains of greater national scope and select one company for their second baby food line chain-wide.[12] Heinz and Beech-Nut inevitably will have a geographical reach at least as broad as those chains. Both companies have recognized this changing dynamic.[13]

### 2. Defendants' "National Advertising" Argument Is Without Merit

Both companies, and particularly Beech-Nut, already have established strong brand identities in their core regions. Advertising can be targeted regionally, and magazine advertising can even be targeted to individual consumers.

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[12] 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.

[13] Defendants concede that "***wholesale*** competition for shelf space is ***not*** localized. . . . Succinctly, grocery chains that purchase baby food are national and regional competitors which compete and operate in multiple geographic locations." DB at 41 n.20 (emphasis in original). Heinz and Beech-Nut inevitably will expand along with the chains.

Thus, the geographic scope of advertising clearly can expand along with geographic expansion of sales.

### 3. Defendants Can Innovate Without This Merger

Both companies have successfully innovated on their current scale in the United States , and on an even smaller scale in other countries.[14] Before seizing upon this merger, Heinz's plans for the future included the U.S. introduction of products already produced in Canada – a country with a much smaller population than the U.S.

Similarly, defendants tout the success of Heinz's "Oasis" project in Italy, a country with a much smaller population than the U.S.[15]

Heinz USA can also piggyback on Heinz innovations in other markets and thus spread development costs over a larger sales base, as illustrated by Heinz's plans to import some

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[14] Moreover, they have spurred innovation by Gerber.

Gerber has not, as defendants claim, "blacked out" innovation.

[15] Defendants' claims for the Oasis project in any event are widely exaggerated.

products from its Canadian baby food operation and its global infant feeding strategy.[16]

[17]

**E. The Merger Is Likely to Result in a Unilateral Price Hike**

The merger will eliminate fierce price competition between Heinz and Beech-Nut for access to retailers' shelves. Whether Heinz and Beech-Nut have a combined market share somewhat over or under 35 percent in any geographic region is irrelevant, for it is clear that Heinz and Beech-Nut are the ***only*** available substitutes for the second baby food slot on retailers' shelves.[18] Post-merger, only Heinz will be "bidding" for the second slot. Heinz will not have to bid as hard, and the price of Heinz baby food to retailers will increase. That Heinz and Beech-Nut do not compete on the shelves of two-baby food retailers is not germane to this analysis. They compete to get on the shelves, and retailers attest (*see* statements *supra* at pp. 10-

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[16]

[17]

[18] Defendants claim that the Merger Guidelines contain a 35% "safe harbor" for unilateral effects. (DB at 41.) Not only do they cite no authority for that proposition, it is contrary to the clear language of the section that speaks in terms of a presumption that is triggered: when the merging parties have a combined market share of at least 35%, the "agency will presume that a significant share of sales in the market are accounted for by consumers who regard the products of the merging firms as their first and second choices." *Merger Guidelines,* § 2.211.

12) that this competition has important procompetitive effects and benefits consumers. Heinz admits that

The merger also will eliminate Beech-Nut's innovation and will reduce consumer choice of baby food brands.[19] Consumer choice is ignored by defendants, but it is matter of great importance.

Indeed, consumer choice ultimately is what competition is all about. *Seeburg Corp. v. FTC,* 425 F.2d 124, 128 (6th Cir. 1970) ("[i]t is the purpose of Section 7 to preserve buyers the choice arising out of such competition.").

As to private label baby foods, defendants claim that there is no loss from this merger because we cannot show that Heinz would enter. That is not our burden. This merger harms

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[19] Defendants incorrectly suggest that Section 7 is only concerned about mergers that enable firms to raise price above competitive levels. (*See* DB at 38-39.) As stated by the Supreme Court in *Nat'l Soc'y of Prof. Eng'rs v. United States,* 435 U.S. 679, 695 (1978), competition protects "all elements of a bargain – quality, service, safety, and durability – and not just the immediate cost." *See Community Publishers Inc. v. Donrey Corp.*, 892 F. Supp. 1146, 1153 n.8 (W.D. Ark. 1995), *aff'd sub nom. Community Publishers, Inc. v. DR Partners,* 139 F.3d 1180 (8th Cir. 1998); *Merger Guidelines*, § 0.1, n. 6 ("Sellers with market power also may lessen competition on dimensions other than price, such as product quality, service, or innovation."); *Id.* § 1.11 (agency will consider buyer and seller "response to relative changes in price or other competitive variables").

competition because it eliminates the beneficial effect occurring today due to the possibility, perceived by Heinz,

By acquiring Beech-Nut, Heinz would eliminate a perceived constraint on its pricing and reduce the likelihood that Heinz itself would enter with a private label of its own to preempt Beech-Nut, as Heinz was contemplating.

### F. The Merger Increases the Likelihood of Coordinated Interaction

"[I]t is easier for two firms to collude without being detected than for three to do so." *American Hospital Supply Corp. v. Hospital Products Limited*, 708 F.2d 589, 602 (7th Cir. 1986). That undeniable proposition is one from which defendants cannot hide. Even assuming there are large buyers in the market as defendants claim, power buyers are buyers with alternative sources. [See discussion *infra.*] Now, large retailers can "swing volume to leverage price" (DB at 52) because they have a choice of either Heinz or Beech-Nut for the second slot. Post-merger, retailers would not have alternative sources.

### G. Defendants "Power Buyer" Defense Cannot Save This Merger

In a case such as this one, where there are scores of supermarket purchasers, the power buyer defense does not apply. Unlike the situation in *Country Lake Foods,*[20] where three buyers purchased ninety percent of the fluid milk sales in the relevant market, the buyers here are far less significant.[21] Although supermarket

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[20] *United States v. Country Lake Foods,* 754 F. Supp. 669, 674 (D. Minn. 1990).

[21] *FTC v. R.R. Donnelley & Sons Co.*, 1990-2 Trade Cas. ¶ 69,239, at 64,854-55 (D.D.C. 1990), cited by defendants, also is different. There, a few large buyers purchased most of the "catalogs, magazines and advertising inserts" printing services offered by the merging defendants.

mergers have created larger buyers, these are relatively few in number. Moreover, the Supreme Court has recognized that a few power buyers cannot be expected to protect *other* buyers. *Eastman Kodak Co. v. Image Technical Serv.,* 504 U.S. 451, 475-76 (1992). The fact that *some* buyers may be large does not immunize from challenge a merger that affects both large, sophisticated buyers and small, less sophisticated ones. For example, in *United Tote*, the court rejected the power buyer defense where the market had a large number of small buyers. 768 F. Supp. at 1085. Indeed the case law recognizes that a merger may properly be enjoined even if the product has only *one* customer.[22]

Moreover, where the power buyer is an intermediate purchaser, they may not necessarily act to protect the market, but may simply pass on the price increase. *See, e.g., AlliedSignal, Inc. v. B.F. Goodrich Co.*, 183 F.3d 568, 575 (7th Cir. 1999). The most recent case of this Court that evaluated this defense, *Cardinal Health*, is also instructive. In that case, the large buyers, pharmacy chains and group purchasing arrangements, were especially powerful since they could self-warehouse, had a "significant amount of leverage in contract negotiations . . . monitor[ed] prices very closely and [were] aware of the wholesalers' individual cost-structures." 12 F. Supp. 2d at 60. But because there were many buyers including independent hospitals and independent pharmacies that could not exercise similar leverage, the buyer power argument failed. Here, the defense also fails, because supermarkets lack the alternatives and sophistication of the large buyers in *Cardinal Health*, and in any case there is no evidence that the actions of these buyers

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[22] *E.g., PPG Indus.*, 798 F.2d 1500; *Grumman Corp. v. LTV Corp.,* 665 F.2d 10 (2d Cir. 1981); *FTC v. Alliant Techsystems*, 808 F. Supp. 19 (D.D.C. 1992); *FTC v. Imo Industries*, 1992-2 Trade Cas. ¶ 69,943 (D.D.C. 1989). All of these cases involved products that were purchased solely by the Pentagon, yet the Court of Appeals and this Court found that the mergers would increase market power and enjoined them.

would protect the interests of smaller buyers or the ultimate consumer. In fact, defendants maintain that these large buyers are already helpless against Gerber.

## III. DEFENDANTS' ALLEGED EFFICIENCIES DO NOT REVERSE THE LIKELIHOOD OF ANTICOMPETITIVE EFFECTS

As a leading treatise has observed "[i]n no case . . . has a court approved an otherwise anticompetitive merger based on proffered efficiencies."[23] In *Staples* and in *Cardinal Health*, this Court evaluated efficiencies far more substantial than those suggested by these defendants 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. Defendants' efficiency story suffers from a number of defects:

- First, it is difficult to know what they are claiming, because it keeps changing – their efficiency estimates have steadily increased since the merger came under scrutiny by the Commission, and now are much higher than those presented to senior Heinz management.

- Second, while defendants concede that only variable cost savings are relevant to the analysis of the competitive effects of the merger [*see* DB at 25-26; ], defendants' brief asserts an efficiencies estimate ($ million) that is considerably higher than the variable cost savings estimate of Ken Campbell, defendants' fact witness ($ million). [Compare DB at 25 with DX 205. ] And defendants' efficiency expert opined in deposition that only $ million represent variable cost. [PX 762 (Painter) at 70]

- Third, while defendants apparently agree that production variable cost savings are the most relevant [*see* DB at 26, quoting *Merger Guidelines* § 4], they neglect to mention that Messrs. Campbell and Painter estimated production variable cost savings to be only $ million. [DX 205; PX 762 (Painter) at 72]

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[23] Mergers and Acquisitions, *supra* note 2 at 153.

- ! Fourth, defendants' efficiencies assume no change in quality – in contrast to their argument that baby foods are heterogeneous products, with Beech-Nut having superior quality. Since Beech-Nut will no longer be produced, defendants present an apples-to-oranges comparison. Although moving production from Beech-Nut's plant to Heinz may lower production costs, consumers who prefer Beech-Nut's recipes or quality may be worse off.[24]

- ! Fifth, the efficiencies are clearly dwarfed by the potential price increases that may result from the merger.[25]

- ! Sixth, defendants present no credible evidence that sufficient savings will be passed on to consumers to offset the likely price increase in the absence of competitive rivalry.

Competition is the force that drives efficiency[26] and that allows consumers to receive the benefits that the market can produce. Efficiency claims are easier to assert than to achieve,[27] 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

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[24]

[25] Baby food is a $800 million market in the United States. Just a 2 percent increase in price would amount to $16 million.

[26] 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").

[27] 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).

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);

(2) 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*;

(3) 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 (1998);[28]

(4) will be passed on, and produce a significant economic benefit to consumers, *Cardinal Health*, 12 F. Supp.2d at 62; *Staples*, 970 F. Supp. at 1089-91; *United Tote*, 768 F. Supp. at 1084-85 (efficiencies rejected because "there are no guarantees that these savings will be passed on to the consuming public"); *California v. American Stores*, 697 F. Supp. 1131, 1133 (C.D. Cal. 1988) (rejecting claim of over $50 million in efficiencies since savings will not "invariably" be passed on to consumers); and

(5) will outweigh the anticompetitive effects of the acquisition and result in a more competitive market. *Cardinal Health*, 12 F. Supp.2d at 64; *Staples*, 970 F. Supp. at 1089-91; *University Health*, 938 F.2d at 1222-23 ("significant economies and that these economies ultimately would benefit competition, and hence, consumers"); *Ivaco*, 704 F. Supp. at 1427; *United Tote*, 768 F. Supp. at 1085.

Defendants' efficiency claims fall far short of meeting these requirements.[29]

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[28] *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.").

[29] Defendants legal support for their efficiency defense (DB at 27) is clearly distinguishable. In *United States v. Long Island Jewish Medical Center*, 983 F. Supp. 121 (E.D.N.Y. 1997) and *FTC v. Butterworth Health Corp.*, 946 F. Supp.1285 (W.D. Mich. 1996), *aff'd*, 121 F.3d 708 (6th Cir. 1997), the courts relied on the non-profit nature of the merging hospitals and regulatory relief (in *Butterworth*). In *Country Lake Foods*, efficiencies were likely the least important of several factors, including low entry barriers, a total absence of brand

**A. The Merger Will Result in an Anticompetitive Reduction in Consumer Choice**

The centerpiece of the defendant's efficiency claims is the planned move of Beech-Nut's production to Heinz's plant in Pittsburgh. Those efficiencies are not cognizable in this case because they result from an anticompetitive reduction in consumer choice. Defendants plan to discard __ percent of Heinz recipes and __ percent of Beech-Nut recipes as a result of the merger. While it is a normal occurrence for products to be weeded out through ordinary supply/demand interactions in the marketplace, it is a far different matter when consumer "choice" is imposed by merger. For those consumers who prefer the recipe that is not selected or prefer Beech-Nut's quality (Heinz has a greater rate of product recalls), the merger will result in a significant reduction in choice and quality.

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

Defendants' promises could be achieved in a less anticompetitive means. Both firms are successful and profitable and have been able to innovate. Some of the "new" products defendants are promising already are available, and others would be available without the merger.

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Thus, the promised new competition is not merger specific.

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

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differentiation, and a buying market dominated by 3 firms. None of those factors is present in this case.

- 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." [PX 440] William Johnson, Heinz's CEO, characterizes the work thus far as "preliminary research" [PX 689 (Johnson) at 132] and states that "aseptic right now is an unproven and eventually – it's a small proposition right now." [*Id.* at 142-43]

- Heinz's promise of "revolutionary quality control" (DB at 49) adds nothing to the market. Beech-Nut already has unsurpassed quality control.

### C. There Is No Guarantee That Heinz Will Keep Its Prices at Current Levels (Much Less Pass On the Alleged Savings) if the Merger is Consummated

The defendants have indicated that Heinz intends to consolidate all its baby food production under a single brand – "Beech-Nut Nature's Goodness" –

Within the current market structure, Heinz baby food is sold at wholesale prices lower than the prices for Gerber baby food, and lower than the prices for Beech-Nut baby food (DB at 28), and is perceived to be of somewhat lower quality than Gerber and Beech-Nut baby food. By contrast, Beech-Nut baby food is sold at approximately the same prices as Gerber baby food, and is perceived to be of approximately the same or higher quality. Heinz represents that after the merger, it will "offer [] a higher quality product at value pricing." *Id*. at 28. It has not, however, specified precisely what its value prices will be. Moreover, after the merger, the competitive constraints imposed by Beech-Nut as an independent firm will no longer exist. As a result, the prices at which Heinz will be able to maximize profits may in fact be considerably higher than its current prices, and its volume levels may be 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.

Most critical is the question of whether the projected savings are enough to overcome the potential competitive harm from the merger. In this case, the potential cost savings, certainly less than $ million a year, pale in comparison to the potential competitive harm from a price increase as low as 2 percent in this $800 million market. *Cf. Rockford*, 717 F. Supp. at 1291.

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).

## IV. NOTHING LESS THAN A FULL-STOP INJUNCTION WILL PROTECT COMPETITION HERE

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.

Defendants are strangely silent on the question of public equities, suggesting only that absent the merger "who will compete with Gerber?" (DB at 56.)[30] 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 benefits consumers. Both Heinz and Beech-Nut are profitable and robust and will continue to offer significant competition absent this merger.

[30] The defendants are appropriately silent on the question of private equities, since "[o]nce the FTC has established likelihood of success on the merits, the Defendants' showing of private equities alone is insufficient to deny the preliminary injunction." *Cardinal Health*, 12 F. Supp. 2d at 66.

## CONCLUSION

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

Respectfully submitted,

DEBRA A. VALENTINE
General Counsel

RICHARD G. PARKER
Director
Bureau of Competition
Federal Trade Commission
600 Pennsylvania Avenue, N.W.
Washington, D.C. 20580

RICHARD DAGEN
DAVID SHONKA

Attorneys
Federal Trade Commission
600 Pennsylvania Avenue, N.W.
Washington, D.C. 20580

By:

RICHARD DAGEN
DC Bar No. 388115
DAVID SHONKA
DC Bar No. 224576
DAVID BALTO
Attorneys for Plaintiff
Federal Trade Commission
600 Pennsylvania Avenue, N.W.
Washington, D.C. 20580

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(202) 326-2628