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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

BRIEF OF THIRTY-SIX AMICI CURIAE IN SUPPORT OF THE FEDERAL TRADE COMMISSION

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(A) **Parties and Amici.** Except for the following Amici, all parties, intervenors and amici who have appeared before the District Court and in this Court are listed in the Brief for Appellant Federal Trade Commission: Alaska, Arizona, Arkansas, California, Colorado, Connecticut, District of Columbia, Florida, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Louisiana, Maryland, Michigan, Minnesota , Mississippi, Nevada, New Hampshire, New York, North Carolina, Northern Mariana Islands, Ohio, Oklahoma, Puerto Rico, South Dakota, Texas, Utah, Vermont, Virginia, Washington, West Virginia, Wisconsin and Wyoming.

(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.

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INTEREST OF THE AMICI

Amici Curiae, the States of Alaska, Arizona, Arkansas, California, Colorado, Connecticut, District of Columbia, Florida, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Louisiana, Maryland, Michigan, Minnesota, Mississippi, Nevada, New Hampshire, New York, North Carolina, Northern Mariana Islands, Ohio, Oklahoma, Puerto Rico, South Dakota, Texas, Utah, Vermont, Virginia, Washington, West Virginia, Wisconsin and Wyoming. ("Amici States"), by and through their Attorneys General, respectfully submit this brief in support of the appeal filed by the Federal Trade Commission ("FTC") in the above-captioned matter. The Attorneys General, as enforcers of both state and federal antitrust laws, have a substantial interest in ensuring that the federal antitrust laws are interpreted in harmony with sound antitrust policy and relevant judicial precedent. In their capacities as *parens patriae*, they are empowered to protect the consumers of their respective states from violations of the antitrust laws.[1]

INTRODUCTION

In light of their significant interest in protecting consumers, the Attorneys General of the Amici States find the decision of the Trial Court particularly troubling. The Trial Court has dispensed with established precedent and has justified an otherwise illegal merger to duopoly on the grounds of claimed efficiencies. Its decision is unique, contrary to relevant precedent, and detrimental to the interests of consumers.

While the Trial Court's analysis errs in many respects, the Amici States respectfully direct this Court's attention to two points. First, the Trial Court's opinion represents an extraordinary and unjustified divergence from existing precedent and scholarly analysis on the subject of

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[1] 15 U.S.C. §15c. *See Georgia v. Pennsylvania R.R. Co.*, 324 U.S. 439 (1945) (common law *parens patriae*).

efficiencies. Its acceptance of efficiencies as a defense to an otherwise illegal merger to duopoly is unprecedented. Second, the Trial Court failed to require a showing that the predicted efficiencies would be passed on to consumers. In fact, in the underlying market, even if the merger will lead to substantial and realizable efficiencies, consumer prices will likely *increase*, rather than decrease.

STATEMENT OF THE CASE

Amici States adopt the Statement of the Case set forth by the FTC in its brief.

ARGUMENT

A. THE TRIAL COURT ERRED IN JUSTIFYING AN UNLAWFUL MERGER TO DUOPOLY WITH CLAIMED EFFICIENCIES

Whether an efficiencies defense should be available to save an otherwise unlawful merger is a question of first impression for this Circuit. Amici States acknowledge the growing debate over what role, if any, projected efficiencies should play in merger analysis. This Court, however, need not decide whether efficiencies should ever be considered in evaluating mergers. Rather, this Court need only decide that efficiencies are not a defense where, as in the instant case, the merger creates a duopoly by eliminating one out of three competitors.

1. Reliance on Efficiencies in Cases of Severe Market Concentration Ignores Well-Established Precedent

In order to appreciate fully the magnitude by which the lower court's opinion diverges from established precedent, it is important to understand the caution with which efficiency arguments have been treated by the courts in situations far less extreme than mergers to duopoly. The Supreme Court has historically treated efficiency arguments in merger enforcement, at best,

with skepticism. In *FTC v. Procter & Gamble*, 386 U.S. 568, 580 (1967), the Court unambiguously concluded that "[p]ossible economies cannot be used as a defense to illegality. Congress was aware that some mergers which lessen competition may also result in economies but it struck the balance in favor of protecting competition. "Several years earlier, in *Brown Shoe Co. v. United States*, 370 U.S. 294, 344 (1962), when faced with the argument that there could be efficiencies in the integration of retail sales and manufacturing operations of a national shoe chain, the Supreme Court stated that "Congress appreciated that occasional higher costs and prices might result from the maintenance of fragmented industries and markets. It resolved these competing considerations in favor of decentralization." Similarly in *United States v. Philadelphia National Bank*, 374 U.S. 321, 371 (1963), the Court emphasized that Congress already had determined that the preservation of competition was its paramount concern and that, accordingly, it would be improper for the Court to engage in some sort of balancing of social or economic debits and credits with respect to efficiency claims.

The Supreme Court has not considered the role of efficiencies in merger analysis since the *Procter & Gamble* decision. However, more recent lower court decisions have followed the Supreme Court's instruction that efficiencies cannot save an otherwise anti-competitive merger. In *California v. American Stores Co.*, the district court rejected defendants' argument that the merger of two large supermarket chains could be justified on the basis of efficiencies. 697 F. Supp. 1125, 1133 (C.D. Cal. 1988), *aff'd in relevant part*, 872 F.2d 837 (9th Cir. 1989), *reversed on other grounds*, 495 U.S. 271 (1990); *see also RSR Corp. v. FTC*, 602 F.2d 1317, 1325 (9th Cir. 1979). Although other courts have indicated that efficiencies may be considered in appropriate circumstances, trial and appellate courts have consistently rejected defendants' claimed

efficiencies where the merger at issue, as here, would create or enhance *severe* market concentration. *See FTC v. Staples*, 970 F. Supp. 1066, 1081 (D.D.C. 1997) (merger of office superstores would increase concentration from two to one in 15 markets and three to two in 27); *United States v. United Tote*, 768 F. Supp. 1064, 1069 (D. Del. 1991) (acquisition reduced number of "meaningful" competitors from three to two); *United States v. Rockford Memorial Corp.*, 717 F. Supp. 1251, 1280 (N.D. Ill. 1989) (merger would "substantially increase the concentration of an already concentrated market"); *cf., United States v. Ivaco, Inc.*, 704 F. Supp. 1409 (W.D. Mich. 1989) (merger to duopoly).[2]

As reflected in the foregoing opinions, the legislative history of the Clayton Act reveals that no real emphasis was placed upon efficiencies in merger analysis by the Act's drafters. Rather, Congress' goal was to foster the consumer benefits that result from minimizing increases in industrial concentration.[3] As Judge Gesell recognized in *FTC v. Coca Cola Co.*:

> Surely Congress had a variety of considerations in mind when it enacted the major public policy enunciated by this Section. There were concerns about size as such, about opportunity for small business, about concentration trends; there was also a belief that a diversified competitive market assures a healthy economy and encourages innovation. To be sure, efficiencies that benefit consumers were recognized as desirable but they were to be developed by

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[2] Amici States are aware of no case in which a merger to duopoly has been permitted where efficiencies were the sole defense to illegality. As one treatise has observed, "in no case ... has a court approved an otherwise anticompetitive merger based on proffered efficiencies." American Bar Association, *Mergers and Acquisitions* 153 (2000). While the court in *FTC v. Butterworth Health Corp.*, 946 F. Supp. 1285 (W.D. Mich. 1996), *aff'd mem.*, 121 F.3d 708 (6th Cir. 1997), accorded the merging defendant hospitals' efficiency claims great weight, that decision should not be read as resting solely on efficiency claims. In that unique case, the court was persuaded that the presumption of illegality was rebutted by evidence presented by the defendants purportedly showing a lack of correlation between high concentration and higher prices for non-profit hospitals. Significantly, *Butterworth* did not involve a merger to duopoly.

[3] Indeed, to the extent that the legislative history refers at all to efficiencies, it appears that Congress believed efficiency would be most effectively promoted through decentralized competition. *See* 95 Cong. Rec. 11,487 (1949) (statement of Rep. Celler, co-author of legislation: "Bigness does not mean efficiency, a better product, or lower prices.")

> dominant concerns using their brains, not their money by buying out troubling competitors. The Court has no authority to move in a direction neither the Congress nor the Supreme Court has accepted.

641 F. Supp. 1128, 1141 (D.D.C. 1986), *vacated as moot,* 829 F.2d 191 (D.C. Cir. 1987).

Historically, many leading scholars asserted that an efficiencies defense should not be used in merger analysis. *See, e.g.,* Robert Bork, *The Antitrust Paradox: A Policy At War With Itself* 127-29 (1978); Richard A. Posner, *Antitrust Law: An Economic Perspective* 112 (1976); Alan Fisher & Robert Lande, *Efficiency Considerations in Merger Enforcement*, 71 Cal. L. Rev. 1582 (Dec. 1983) (hereafter "Fisher & Lande"). More recently, the weight of scholarly opinion appears to have swung in favor of the recognition of some form of efficiencies defense to mergers. *See, e.g.,* IVA Phillip Areeda, Herbert Hovenkamp & John L. Solow, *Antitrust Law: An Analysis of Antitrust Principles and Their Application* § 9E (rev. ed. 1998); Joseph F. Brodley, *The Economic Goals of Antitrust: Efficiency, Consumer Welfare, and Technological Progress*, 62 N.Y.U.L. Rev. 1020 (Nov. 1987). *But see* Eleanor Fox, *Antitrust, Competitiveness and the World Arena: Efficiencies and Failing Firms in Perspective*, 64 Antitrust L. J. 725 (Spring 1996); Testimony of Alan Fisher and Robert Lande before the Federal Trade Commission, published on-line (Nov. 14, 1995) <http:\\www.ftc.gov\opp\global\GC11495.htm>.

However, even scholars who, in the abstract, support an efficiencies defense do not contemplate such a defense being available in a merger to duopoly. For example, FTC Chairman Pitofsky, as an antitrust professor and distinguished antitrust scholar, supported the availability of an efficiencies defense, but proposed a bright-line rule rejecting any efficiencies defense when market concentrations were as high as those at issue in the case at bar. *See* Robert Pitofsky, Proposals for *Revised United States Merger Enforcement in a Global Economy*, 81 Geo. L.J.

195, 213, 218 (1992); *see also* Joseph F. Brodley, *Proof of Efficiencies in Mergers and Joint Ventures*, 64 Antitrust L. J. 575, 587-88 (Spring 1996). Likewise, Professors Areeda, Hovenkamp and Solow, in the leading treatise on antitrust law, would require "[a] showing of 'extraordinary' efficiencies . . . to defend against a merger presenting a strong competitive threat -- namely, where . . . [the] postmerger market's HHI is well above 1800 and the HHI increase is well above 100. In such cases, provable efficiencies must be at least 8 percent across the entire output in the market where competition is believed to be threatened;[4] further, the defendants must show that the merger is unlikely to result in higher consumer prices." IVA Areeda, Hovenkamp & Solow, *supra*, at 94.

Thus, the legislative history of the Clayton Act and the case law interpreting the Act demonstrate that great caution should be exercised generally in considering an efficiencies defense and that such a defense should be rejected in cases where the merger creates a duopoly. Indeed, the rejection of an efficiencies defense in this case is fully consistent with the enforcement view taken by the National Association of Attorneys General ("NAAG") in its Merger Guidelines:

> Even in those rare situations where significant efficiencies can be demonstrated, rather than merely predicted, this showing cannot constitute a defense to an otherwise unlawful merger. Accordingly, efficiencies will only be considered when the merging parties can demonstrate by clear and convincing evidence that the merger will lead to significant efficiencies. Moreover, the merging parties must demonstrate that the efficiencies will ensure that consumer prices will not increase despite any increase in market power due to the merger. In highly concentrated markets, even a merger which produces efficiencies will tend to create or enhance market power and will likely increase consumer prices. In addition, the Attorneys General will reject claims of efficiencies unless the

[4] No savings anywhere close to 8% across the entire market output (Heinz, Beech-Nut *and* Gerber) are predicted here. *See* Slip Op. at 2, 18 (savings of $9.4 to $12 million in $865.1 billion market).

merging parties can demonstrate that equivalent or comparable savings cannot be achieved through other means and that such cost savings will persist over the long run.

NAAG Merger Guidelines, Section 5.3, 4 Trade Reg. Rep. (CCH), ¶13,406, at 21,207 (1993).

2. Experience Shows that Projected Efficiencies Often Fail to Materialize.

This Court should be wary of recognizing an efficiencies defense for another reason. Experience shows that merging parties' forecasted efficiencies often fail to materialize. When, as in this case, the proposed merger will result in a duopoly, such speculative efficiency claims are even more suspect.

Many studies have concluded that predicted merger-related efficiencies, in fact, do not occur. The Union Pacific/Southern Pacific railroad merger, approved in 1996 largely on the basis of the merged railroads' projected efficiencies provides a strong example of the perils involved in predicting efficiencies. Over the objections of the Department of Justice, the Department of Agriculture, various states and numerous shippers, the Surface Transportation Board allowed the Union Pacific and the Southern Pacific Railroads to merge. *Union Pac. Corp., No. 32760*, 1996 WL 467636, at *202 (Surface Transp. Bd. Aug. 6, 1996). As did the Trial Court in the instant case, the Board accepted the merging firms' predictions of breathtaking efficiencies directly tied to the merger. *Id.* at *93. A post-merger case study, however, found that the predicted streamlining, improved service and improved equipment uses never materialized. Craig W. Conrath & Nicholas A. Widnell, *Efficiency Claims in Merger Analysis: Hostility or Humility?*, 7 Geo. Mason. L. Rev. 685, 697-702 (1999). Instead, the merger was estimated to have cost rail shippers at least $2 billion. *Id.* at 698 n. 51 (*citing* Tim Minihan, *Persistent Service Problems Put UP-SP Union on the Ropes*, Purchasing, Mar. 12, 1998, at 71).

Other surveys of case studies have shown that past efforts to predict efficiencies have met with failure at least as often as they have met with success. *See generally* Joseph F. Brodley, *Perspectives on Efficiencies and Failing Firms in Merger Analysis: Proof of Efficiencies in Mergers and Joint Ventures*, 64 Antitrust L.J. 575, 576 (1996) (*citing* Raymond S. Hartman, *The Efficiency Effects of Electric Utility Mergers: Lessons from Statistical Cost Analysis*, 17 Energy L.J. 401, 413-15 (1996)). Such studies have found that despite near unanimous predictions of future profit due to efficiencies, 60 to 80 percent of the mergers were unsuccessful in realizing this result. *Id.; see also* Fisher & Lande, *supra*, at 1619-24.

In view of the frequency with which efficiency predictions fail to be realized, courts have looked with great skepticism upon efficiencies claims supported solely by promises or aspirational testimony of the merging parties' executives. In *United States v. Ivaco*, for example, the district court acknowledged the "good faith" intentions of the merging parties to use projected cost savings to fund post-merger innovation. The court, however, found good faith intentions inadequate to overcome the government's showing of illegality in this merger to duopoly, pointing out that there was "no assurance" that defendants' representations regarding efficiencies would actually come to fruition. 704 F. Supp. at 1426-27. In the case at bar, Heinz and Beech-Nut's claims of post-merger efficiencies are equally unsupported by anything more than promises and optimistic predictions.

In sum, relevant precedent, legislative history, the scholarly literature and the empirical evidence *all* reject the availability of an efficiency merger defense for a merger to duopoly. Given that the merger under consideration will result in a duopoly, Amici States respectfully suggest that this case does not present the appropriate vehicle through which this Circuit should

enter the efficiencies debate. Rather, this Court should simply hold that, under the factual circumstances presented here, a merger cannot be justified by efficiencies defense.

B. THE TRIAL COURT ERRED BY FAILING TO REQUIRE THE MERGING PARTIES TO DEMONSTRATE THAT PROJECTED EFFICIENCIES WOULD BE PASSED ON TO CONSUMERS

The Trial Court places great emphasis on the merging firms' projections of efficiencies. It accepts as axiomatic the unsupported proposition that the merger "will result in better recipes for former Heinz buyers and value pricing for former Beech-Nut buyers," slip op. at 20, while apparently ignoring the loss of consumer choice posed by the merger. However, the Court admits that it "remains to be seen" whether the merged entity will use merger-related cost savings to compete more vigorously with market leader Gerber; thereby failing to make any finding as to whether cost savings would reach consumers. Amici States believe that this failure to make any findings that post-merger savings would be passed on to consumers is contrary to law and constitutes clear error.

Courts, in considering an efficiencies defense, have made quite clear that merging parties must demonstrate that projected efficiencies will be passed on to consumers. In *FTC v. Staples*, for example, the court performed a detailed analysis of the evidence relating to potential pass-through of cost savings with a view to identifying as precisely as possible the portion of such savings that would ultimately reach consumers. The court concluded that the merging parties' claims of two-thirds pass-through to be unrealistic in light of a historic rate of fifteen to seventeen percent. 970 F. Supp. at 1090. Here, the Trial Court made no attempt to analyze pass-through rates in anything but the most general and speculative terms.

Especially instructive in this regard is *United States v. United Tote*, a case in which the

court was asked to consider a three-to-two merger, just as in the instant case. 768 F. Supp. 1064. In *United Tote,* the merging firms came forward with testimony from numerous industry participants who opined that the combined firms would experience enhanced research and development capabilities, increased abilities to meet large network service demands and a wider range of product offerings. *Id.* at 1084. The court was unpersuaded. It held that "while it appears that the merger may have some pro-competitive aspects, those aspects are simply insufficient to counter the Government's strong case of anti-competitive effect particularly since *there is no guarantee that these benefits will be passed along* to the small to medium track segments of the market." *Id.* at 1085 (emphasis added); *see also Rockford Memorial*, 717 F. Supp. at 1289 (merging parties must show by "clear and convincing evidence that the efficiencies provided by the merger produce a significant economic benefit to consumers").

The critical mechanism for insuring that a merger's cost-savings get passed on to consumers is competition. Without competition, it is unlikely that efficiencies will reach consumers, while the risk of price increases remains substantial. As the court noted in *Rockford Memorial*:

> [E]ven if all the defendants' savings were verifiable and could only be achieved through merger, the amount saved pales in comparison to the likely amount of revenues generated by defendants in the same five year period.. . .Moreover, monopoly rents could far outweigh the savings presented, particularly in light of the fact that much of the savings cited by the defendants were not clearly and convincingly generated by the merger.

Id. at 1291. Likewise, the Court of Appeals in *FTC v. University Health, Inc.*, counseled that "[A] defendant who seeks to overcome a presumption that a proposed acquisition would substantially lessen competition must demonstrate that the intended acquisition would result in

significant economies and that these economies ultimately would benefit competition and, hence, consumers." 938 F.2d 1206, 1211, 1222-23 (11th Cir. 1991); *see also Staples*, 970 F. Supp. at 1089-90 (defendants must show that efficiencies evidence rebuts presumption that merger may substantially lessen competition).

In the case at bar, following the merger, the structure of the baby food market would be significantly less competitive than it is now. With no realistic prospect of new entry, the merger would create a permanent duopoly where the two firms are each present in at least 90 percent of the stores. The court found that, even in a three-firm market, Heinz and Beech-Nut have tended to act as price followers with respect to Gerber as a consequence of Gerber's market share as well as its "unparalleled brand recognition and . . . loyalty." Slip Op. at 4. This problem will not be corrected by the merger to duopoly.

Further, the Court wholly discounted current competition in the market and accepted the merging firms' projections that, more probably than not, the merger will lead to more competition rather than less. Established principles of economic analysis indicate, however, that a duopoly would give Heinz even more of an incentive to engage in coordinated behavior than before. *E.g.*, XII Herbert Hovenkamp, *Antitrust Law: An Analysis of Antitrust Principles and Their Application* §2002f, at 22 (1999). Although it is impossible to predict with certainty what business strategy the merged firm would adopt, it would appear to be much more likely that a firm participating in a duopolistic market where supermarkets generally carry two brands would

take advantage of the marketing benefits from the premium brand, while securing the production costs benefits of the value brand.[5]

Price benefits are not the only value that consumers stand to gain or lose when firms merge. The inherent value of having three firms, as opposed to two, from which to choose should not be underestimated. The Supreme Court in *Philadelphia National Bank* points out that: "[a] fundamental purpose of amending [Clayton Act] § 7 was to arrest the trend toward concentration, the tendency to monopoly, before the consumer's alternatives disappeared through merger." 374 U.S. at 367. The opinion goes on to express great concern over some of the many non-price benefits of competition jeopardized by large increases in concentration, including: "variety of credit arrangements, convenience of location, attractiveness of physical surroundings, credit information, investment advice, service charges, personal accommodations, advertising, miscellaneous special and extra services." *Id.* at 368.

In the case at bar, Heinz is a value-priced brand, while Beech-Nut competes as a premium brand, giving consumers two different options and a basis on which the firms could compete. In this regard, Professors Areeda, Hovenkamp and Solow note that there may be a social loss if mergers reduce the number of products available by reducing the presence of minimally advertised lower priced brands. Areeda, Hovenkamp & Solow, IVA Antitrust Law, *supra*, at 79. In markets with differentiated consumer products, such as this one, a vital goal of antitrust policy is to preserve and enhance consumer choice. *See Seeburg Corp. v. FTC*, 425 F.2d 124, 128 (6th Cir. 1970) ("It is the purpose of Section 7 to preserve buyers the choice

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[5] This Court should hold, at a minimum, that even if the merging firms are not required to establish that post-merger prices will *fall*, they must at least be required to prove that they will not *increase*. Heinz and Beech-Nut were apparently unable or unwilling to do either in the proceedings below.

arising out of such competition."). The Trial Court's opinion disregards the harm to consumers that inevitably will result from the elimination of one of the three firms in this market when their choices of firms and products are diminished. Alternatives are, in themselves, an important consumer benefit that the Trial Court has overlooked.

In sum, the Trial Court erred in not requiring a showing that any benefits resulting from efficiencies would be passed on to consumers. The facts provide no basis for concluding that consumer welfare will be at all enhanced if the proposed merger is allowed to proceed. On the contrary, well-settled principles of economic analysis support Amici States' position that consumers will be harmed if the merger goes forward, and that consumers will benefit if the merger is blocked.

CONCLUSION

For the reasons set forth above, the decision of the Trial Court should be reversed and the proposed merger enjoined.

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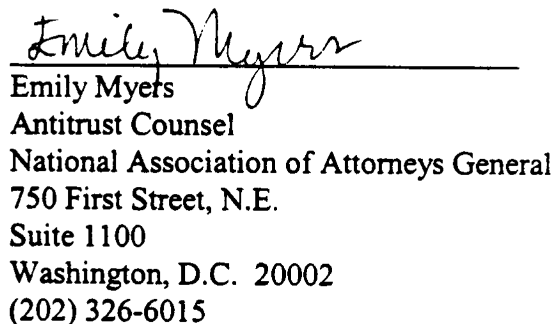

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SCHEDULED FOR ORAL ARGUMENT FEBRUARY 12, 2001

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.

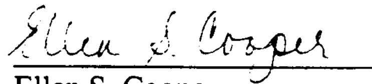
ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

NOTICE OF INTENT TO FILE AN AMICUS BRIEF

Amici Curiae, the States of Alaska, Arizona, Arkansas, California, Colorado, Connecticut, Florida, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Louisiana, Maryland, Michigan, Minnesota, Mississippi, Nevada, New Hampshire, New York, North Carolina, Ohio, Oklahoma, South Dakota, Texas, Utah, Vermont, Virginia, Washington, West Virginia, Wisconsin and Wyoming, together with the District of Columbia, the Commonwealth of Puerto Rico and the Territory of the Northern Mariana Islands, by and through their Attorneys General,

respectfully submit this Notice of Intent to File an Amicus Brief in support of the appeal filed by the Federal Trade Commission in the above-captioned matter.

Respectfully submitted,



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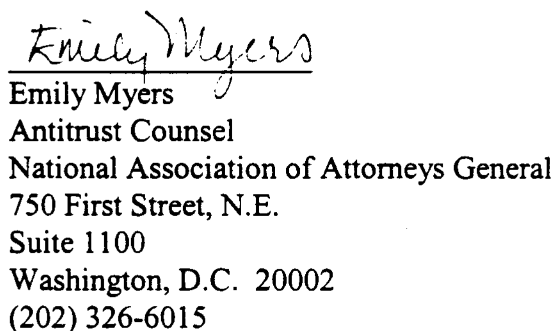

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