
Clare's/Benny's Ice Cream Merger

CLASS SLIDES

For November 7, 2019

Merger Antitrust Law

Georgetown University Law Center

Dale Collins

Approaching the problem

1. Ask the setup questions
2. Read the problem straight through quickly to spot the major issues
3. Annotate the problem/Outline an answer
4. Start writing

1. Ask the setup questions

1. Who are you/what role are you being asked to play?
2. What is the transaction?
3. What is the form of the work product?
4. What questions are you being asked to address?
5. What law applies?

1. Ask the setup questions

1. Who are you/what role are you being asked to play?

You are an attorney at the FTC and your group is reviewing Clare's pending acquisition of Bennie's, two manufacturers of ice cream. The acquisition is for all cash transaction and Clare's is paying a 40% premium for the Benny's stock. Melissa Brown, your section chief, has asked you to prepare a recommendation as to whether the FTC should seek a preliminary injunction blocking the transaction from a federal district court pending a resolution of an administrative trial. In particular, Ms. Brown is seeking your analysis of how strong the FTC's prima facie case of a Section 7 violation is likely to be and whether the FTC can defeat defenses the merging parties have said that they will advance. Ms. Brown also would like you to address how the court is likely to balance the equities and what the court is likely to decide on the FTC's petition to enter the preliminary injunction.

1. Ask the setup questions

2. What is the transaction?

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1. Ask the setup questions

3. What is the form of the work product?

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You are being asked to write a reasoned memorandum of law

1. Ask the setup questions

4. What questions are you being asked to address?

1
2
3
4
5

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Five questions are presented

BE SURE THAT YOU ADDRESS EACH QUESTION!!

1. Ask the setup questions

5. What law applies?

1

You are an attorney at the FTC and your group is reviewing Clare's pending acquisition of Bennie's, two manufacturers of ice cream. The acquisition is for all cash transaction and Clare's is paying a 40% premium for the Benny's stock. Melissa Brown, your section chief, has asked you to prepare a recommendation as to whether the FTC should seek a **preliminary injunction blocking the transaction from a federal district court pending a resolution of an**

2

administrative trial. In particular, Ms. Brown is seeking your analysis of how strong the FTC's prima facie case of a **Section 7 violation** is likely to be and whether the FTC can defeat defenses the merging parties have said that they will advance. Ms. Brown also would like you to address how the court is likely to balance the equities and what the court is likely to decide on the FTC's petition to enter the preliminary injunction.

- a. FTC Act 13(b) for the standards for entering a preliminary injunction
- b. Clayton Act § 7 for the elements of the substantive violation

2. Quick read to spot the issues

- The problem is likely to have multiple issues
- Some issues will be substantively more important than others
- DO NOT get hung up spending too much time on the small issues at the cost of not adequately addressing the major issues

So what do I need to spot?

Typical structure of a formal merger analysis

- Step 1: The prima facie case
 - Relevant product market
 - *Brown Shoe* “outer boundaries” and “practical indicia”
 - Merger Guidelines hypothetical monopolist test
 - [Price discrimination markets]
 - *Cellophane* fallacy
 - Relevant geographic market
 - “Commercial realities” test
 - Merger Guidelines hypothetical monopolist test
 - [Price discrimination markets]
 - *PNB* presumption
 - Market participants and market shares
 - Application of the *PNB* presumption
 - Other evidence of anticompetitive effect
 - Unilateral effects
 - Coordinated effects
 - Elimination of a maverick
 - [Foreclosure/Raising rivals’ costs]

Effectively to show gross upward pricing pressure or other anticompetitive effect

Typical structure of a formal merger analysis

■ Step 2: Defendants' rebuttal

□ Direct challenges to prima facie case (no upward pressing pressure)¹

□ Traditional defenses (offsetting downward pricing pressure)

- Entry/expansion/repositioning
- Efficiencies
- Countervailing buyer power ("power buyers")
- Failing company/division

Effectively to show sufficient gross downward pricing pressure to create a genuine issue of fact on the merger's net competitive effect

■ Step 3: Balancing (if necessary)

¹ Often addressed in Step 1.

3. Annotate/Outline

■ Some facts to note:

- ❑ Clare's is acquiring Benny's
- ❑ There are two types of ice cream: premium and regular
- ❑ The merger is horizontal in premium ice cream; no overlap in regular
- ❑ Premium ice cream is dominated by two firms: Al's and Benny's
- ❑ Two dimensions of competition: Price and innovation
- ❑ Al's has been a price leader
- ❑ Clare's has been a maverick in prices and innovation in premium
- ❑ Everyone else a follower
- ❑ Postmerger, Clare's will consolidate its premium brand into Benny's
- ❑ AND become tied with Al's as the No. 1 premium ice cream (45% share)
- ❑ High cross-elasticity of demand within each of premium with regular
- ❑ Significant product and price differentiation between premium and regular
- ❑ Significant technological supply-side substitutability between premium and regular
- ❑ BUT high reputational barriers
- ❑ Insignificant amount of store brands (which may be local)
- ❑ Little growth in market shares by small premium companies (including Dino's)
- ❑ No (recent) entry into premium by regular ice producers
- ❑ All cost savings are in fixed costs

4. Write

Exam instructions:

Present your analysis in a well-organized, linear, and concise manner. Think about your answers before writing. *Remember Pascal's apology:* "I am sorry that this was such a long letter, but I did not have the time to write you a short one." Clarity of thinking and exposition are much more important than throwing in the kitchen sink. Penalties will be levied for excessive length, verbosity, or lack of organization.

Exam instructions:

As we discussed in class, you may cut and paste short passages from materials you have created to introduce a rule of law, a legal principle, or an economic proposition or formula. You may include quotes from cases in the materials you create for this purpose, but if you do so prepare the quote and cite the case as you would in a brief. Do NOT cut and paste from any other materials.

4. Write: Introduction

- Opening paragraph: “You have asked me”

To: Melissa Brown

From: Dale Collins

Clare’s/Benny’s Ice Cream Merger

You have asked me to assess whether the FTC should be able to obtain a preliminary injunction blocking the pending acquisition by Clare’s of Benny’s, two manufacturers of ice cream, from a federal district court pending a resolution of an FTC challenge in an administrative trial. In particular, you have asked me to assess how strong the FTC’s prima facie case of a Section 7 violation is likely to be and whether the FTC can defeat defenses the merging parties have said that they will advance. You have also asked me to address how the court is likely balance the balance the equities and what the court is likely to decide on the petition to enter the FTC’s preliminary injunction.

4. Write: Introduction

- Short conclusion
 - Succinctly answer the questions asked
 - You can write this last—but if you did a good outline you can (first) draft it now
 - Helpful to you and to me
 - Ensures that you answer all of the questions asked
 - Gives me a roadmap as to how to approach your answer

4. Write: Introduction

- Short conclusion—Instructor's answer

For the reasons explained below, the Commission should prevail in its petition for a preliminary injunction under Section 13(b) of the FTC Act blocking Clare's acquisition of Benny's pending the conclusion of the administrative adjudication of the merits of the Commission's Section 7 claim against the transaction. On the facts found in the investigation, the Commission has a strong likelihood of becoming able to prove to the district court that Clare's proposed acquisition of Benny's would violate Section 7 in the nationwide manufacture and sale of premium ice cream and separately in the nationwide manufacture and sale of all ice cream. The *PNB* presumption is easily satisfied in premium ice cream, and although more borderline in all ice cream, there is additional evidence of consumer harm under resulting from both anticompetitive unilateral and coordinated effects. Consumers are likely to be harmed by both an increase in prices and a reduction in the rate of product innovation as a result of the merger. The various defenses advanced by the parties are either speculative (not verifiable), contradicted by the facts, or fail to show they are sufficient to negate the upward pricing pressures and the reduced incentives to innovate that the merger is likely to create. The equities, especially the public's interest in effective antitrust enforcement and effective relief, weigh heavily in favor of entering a preliminary injunction. The equities weighing against the entry of the injunction are at most only the delay in the receipt of the private monetary benefits of the merger to the merging parties and their shareholders and these benefits will never materialize if the merger is found to be unlawful on the merits. The court should find that the entry of a preliminary injunction is in the public interest.

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■ Conclusion

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4. Write: Introduction

- Applicable law
 - Clayton Act § 7
 - FTC Act § 13(b)
 - *Baker Hughes* three-step burden shifting approach

4. Write: Introduction

- Applicable law
 - Clayton Act § 7

Section 7 of the Clayton Act prohibits mergers and acquisitions “where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly.” 15 U.S.C. § 18. By its terms, a Section 7 violation contains three essential elements: (1) a relevant product market (“line of commerce”), (2) a relevant geographic market (“section of the country”), and (3) a reasonably probable anticompetitive effect in the relevant market (that is, the combination of the relevant product market and the relevant geographic market).

4. Write: Introduction

- Applicable law
 - FTC Act § 13(b)

The Commission may seek injunctive relief to enjoin a transaction pending the resolution of the Section 7 merits in an administrative proceeding under Section 13(b) of the Federal Trade Commission Act “[u]pon a proper showing that, weighing the equities and considering the Commission’s likelihood of ultimate success, such action would be in the public interest.” 15 U.S.C. § 53(b). The public interest standard requires courts to “measure the probability that, after an administrative hearing on the merits, the Commission will succeed in proving that the effect of the [proposed transaction] may be substantially to lessen competition” in violation of the Clayton Act. *FTC v. Sysco Corp.*, 113 F. Supp. 3d 1, 22 (D.D.C. 2015). The Commission meets this standard if it “has raised 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.” *Id.* at 23.

4. Write: Introduction

- Applicable law
 - *Baker Hughes* three-step burden shifting approach

Clare's acquisition of Benny's is a horizontal acquisition since it involves competitors in the production and sale of ice cream generally and premium ice cream in particular. In horizontal cases, courts have adopted a three-step burden-shifting procedure:

1. The plaintiff bears burden of proof in market definition and in market shares and market concentration within the relevant market sufficient to trigger the *PNB* presumption (explained below).
2. Once the plaintiff has made a prima facie showing, the burden of production then shifts to defendant to adduce evidence sufficient to put the *PNB* presumption in issue.
3. If the defendant discharges its burden, the burden of persuasion returns to plaintiff to prove in light of all of the evidence in the record that the merger is reasonably probable to have an anticompetitive effect in the relevant market.

See *United States v. Baker Hughes, Inc.*, 908 F.2d 981, 982-83 (D.C. Cir. 1990). Although not required, the plaintiff may strengthen its prima facie case by presenting additional evidence supporting a finding that the transaction is anticompetitive. Courts apply a "sliding scale" approach to the defendant's burden in Step 2 above, so that the stronger the plaintiff's prima facie case, the higher the defendant's showing must be to discharge its burden of production for putting the plaintiff's prima facie case in issue. *Id.* at 983.

4. Write: Introduction

■ The roadmap

The DOJ/FTC 2010 Horizontal Merger Guidelines focus more on competitive effects and do not strictly require a showing of a relevant market. To obtain a preliminary injunction, however, the Commission will have to petition a federal district court, which will require the showing of a relevant market under prevailing case law precedent. As to the showing of anticompetitive effects, the courts continue to employ the *Philadelphia National Bank* presumption in assessing a prima facie case and also have largely accepted the theories of anticompetitive harm in the Merger Guidelines to further support the prima facie case. Accordingly, I will analyze the transaction under the usual judicial framework:

1. The prima facie Section 7 case
 - a. The relevant product market
 - b. The relevant geographic market
 - c. Market shares, concentration, and the *PNB* presumption
 - d. Additional evidence supporting the prima facie case
2. The defendants' arguments
3. Conclusion on Section 7 legality
4. Weighing of the equities
5. Conclusion

4. Write: The prima facie case

- The relevant product market
 - Premium ice cream only
 - Brown Shoe “outer boundaries” and “practical indicia” (test and application)
 - Hypothetical monopolist test (test and application through percentage critical loss)
 - All ice cream
 - Brown Shoe “outer boundaries” and “practical indicia”
 - Hypothetical monopolist test (test and application through percentage critical loss)
- The relevant geographic market
 - The United States
 - The “area of effective competition” test (test and application)
 - Nationwide sales by majors
 - Uniform nationwide pricing by majors
 - Insignificant amount of store brands (which may be local)
 - Hypothetical monopolist test—performed above

4. Write: The prima facie case

- Market shares, concentration, and the *PNB* presumption
 - *PNB* presumption (boilerplate for judicial presumption and Merger Guidelines)
 - Use revenues for market shares (no nonseller participants)
 - Premium ice cream HHI chart
 - 45%, $\Delta = 400$, postmerger HHI = 4080
 - Strong HHI and judicial precedent case (including surpassing thresholds in *PNB*)
 - All ice cream HHI chart
 - 34.2%, $\Delta = 399$, postmerger HHI = 2329
 - Relatively weak HHI and judicial precedent case (surpasses 30% *PNB* threshold and maybe 4CFR)
 - Strengthened by supporting theories of anticompetitive harm (below)

4. Write: The prima facie case

- Market shares, concentration, and the *PNB* presumption

Premium Ice Cream

	Revenues (\$millions)	Share	HHI
Al's	\$1,575	45.00%	2025
Benny's	\$1,400	40.00%	1600
Clare's	\$175	5.00%	25
Dino's	\$175	5.00%	25
Eddy's	\$35	1.00%	1
Breyers	\$35	1.00%	1
Blue Bell	\$35	1.00%	1
Izzy's	\$35	1.00%	1
Wells	\$35	1.00%	1
	\$3,500	100.0%	3680
Combined share		45.0%	
Delta			400
Postmerger HHI			4080

All Ice Cream

	Revenues (\$millions)	Share	HHI
Clare's	\$5,000	26.7%	713
Breyers	\$4,800	25.6%	657
Al's	\$4,000	21.4%	456
Benny's	\$1,400	7.5%	56
Turkey Hill	\$900	4.8%	23
Blue Bell	\$650	3.5%	12
Izzy's	\$450	2.4%	6
Wells	\$300	1.6%	3
Dino's	\$175	0.9%	1
Eddy's	\$35	0.2%	0
Store brands (10)	\$1,015	5.4%	3
	\$18,725	100.0%	1,930
Combined share		34.2%	
Premerger HHI			1,930
Delta			399
Postmerger HHI			2329

4. Write: The prima facie case

- Additional evidence supporting the prima facie case
 - Coordinated effects—applies
 - Test
 - Market susceptible to tacit coordination
 1. Selection problem
 - Will the firms be able to “agree” to the price or other terms on which they will tacitly coordinate?
 2. Incentive compatibility problem
 - Will the (short-run) incentive to pursue a more competitively aggressive strategy, which all profit-maximizing firms have, undermine an any tacit coordination?
 3. External interference problem
 - Apart from the firms in the market, will other entities disrupt any tacit coordination?
 - Merger will increase the probability and effectiveness of tacit coordination

4. Write: The prima facie case

- Additional evidence supporting the prima facie case
 - Maverick—applies (Clare's is a maverick)
 - Small firm premerger
 - Disrupted the ability of Al's and Benny's to raise prices
 - Innovative
 - Large firm with single brand postmerger (45% share; tied for No. 1 with Al's)

4. Write: The prima facie case

- Additional evidence supporting the prima facie case
 - Unilateral effects—does not apply
 - Test
 1. The products must be differentiated
 2. The products of the merging parties must be close substitutes for one another
 - That is, they have high cross-elasticities of demand with one another
 3. The products of (most) other firms must be much more distant substitutes
 - That is, they have low cross-elasticities of demand with the products of the merging firms
 4. Repositioning into the products of the merging firms must be difficult
 - That is, other incumbent firms and new entrants in the market cannot easily change their product's attributes or introduce a new product that would be a close substitute to the products of the merging firm
 - But same price premerger and one brand postmerger

4. Write: Defendants' rebuttal arguments

1. The only relevant market is all ice cream and in this market the merger is too small to create a competitive problem;
 - a. Premium ice cream is also a market (see above) in which the merger is anticompetitive
 - b. Need not contest all ice cream is also a market, BUT
 - i. Shares alone are (weakly) predictive the PNB presumption
 - ii. Eliminates Clare's as a maverick and creates an anticompetitive unilateral effect in innovation

Note: There is no anticompetitive coordinated effect in pricing because the premerger margins of Clare's and Benny's products are the same and Clare's is consolidating the merged firm's premium ice cream products into one brand (so that there can be no diversion postmerger). Of course, you could argue that although Clare's says that it will consolidate the brands postmerger, it is under no obligation to do so and if it maintains two brands postmerger there would likely be an anticompetitive coordinated effect in pricing.

4. Write: Defendants' rebuttal arguments

2. Even if premium ice cream is the relevant market, the HHIs based on actual sales, which are not that high, should be further downgraded in their probative value of anticompetitive effect given the supply-side substitutability between regular ice cream and premium ice cream;
 - a. HHIs high in actual sales (violate judicial precedent and Merger Guidelines)
 - b. Production switching costs are low, but reputational barriers are high
 - c. Premium ice cream is also a market (see above) in which the merger is anticompetitive
 - i. Dino's unsuccessful
 - ii. No recent supply-side entry from established regular ice cream manufacturers despite higher margins in premium ice cream

4. Write: Defendants' rebuttal arguments

3. Dino's, which entered four years ago and today as the same share in premium ice cream as Clare's, will continue to grow its business aggressively and its efforts will ensure that the premium ice cream market remains competitive postmerger;
 - a. Expansion defense (test)
 - b. Dino's only reached 4% market share after four years
 - c. Even if Dino's grows at its historical rate—about 50% per year—in another two years it would only have a market share of a little over 11%
 - d. Should only look at *incremental* growth resulting from the merger—parties presented no evidence
 - e. Even if Dino's is successful in creating enough downward pricing pressure to offset the merger's anticompetitive effect, will take some time during which the merger violates Section 7
 - f. Even enough downward pricing pressure would not offset anticompetitive effect of reduced innovation

4. Write: Defendants' rebuttal arguments

4. The merger will produce substantial efficiencies that will offset any possible anticompetitive effect of the transaction; and
 - a. Test
 - b. Fixed cost efficiencies are not cognizable
 - i. Eliminating duplicative administrative and sales overhead
 - ii. Streamlining the combined sales force
 - iii. Taking advantage of some excess capacity to consolidate production
 - iv. Reducing the number of the merged firm's operating plants
 - c. No claim of other, cognizable efficiencies

4. Write: Conclusion on likelihood of success

3. Conclusion on Section 7 legality

Under the standards used in the Horizontal Merger Guidelines and by the courts, the FTC should be able to establish its prima facie case that the merger violates Section 7 in both a nationwide gourmet pizza market and a nationwide all pizza market and defeat the entry, efficiencies, and price reduction defenses of the merging parties. This proves a Section 7 violation in both markets.

4. Write: Weighing the equities

- Role of equities in applying Section 13(b) (boilerplate)
- The equities
 - The public equities (boilerplate)
 - The private equities (largely boilerplate)
 - Deal will crater
 - Lost of premium to Benny's shareholders
- Weighing the equities (boilerplate)

5. Write: Conclusion

5. Conclusion

For the reasons stated above, the Commission should prevail in its petition for a preliminary injunction under Section 13(b) of the FTC Act blocking Clare's acquisition of Benny's pending the conclusion of the administrative adjudication of the merits of the Commission's Section 7 claim against the transaction.