MERGER ANTITRUST LAW

LAWJ/G-1469-05
Georgetown University Law Center
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Tuesdays and Thursdays, 3:30-5:30 pm
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CLASS 18 WRITTEN ASSIGNMENT

Instructions

Submit by email by 3:30 pm on Thursday, November 7 (one week)
Send to dale.collins@shearman.com
Subject line: Merger Antitrust Law: Assignment for Class 18

Assignment

Calls for a memorandum.

INSTRUCTIONS[1]

This is an untimed *not graded* homework assignment. You may consult any written source, including without limitation the class notes, cases, outlines (commercial or otherwise), books, treatises, the Internet, Westlaw, and Lexis-Nexis. Of course, you must do your own work and not talk about the problem with any student or any other person until after class on November 20.

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. Do not, for example, tell me things that you know that are not relevant to the answer; it will just cost you time and you will not get any credit. Penalties will be levied for excessive length, verbosity, or lack of organization.

The "facts" in the hypothetical should be complete in the sense that they present what is known at the time the analysis is requested. As in life, some information you would like to have may simply not be available. Analyze the facts as they are presented in the question.

It should go without saying that, outside of this examination, you should not believe everything (or anything) in the statement of any hypothetical fact situation. I have taken considerable liberties in fashioning the problems and have totally ignored reality whenever it was convenient.

This homework assignment is final. Do not expect any clarifications or corrections. If you believe there is an error or inconsistency in the exam, please state your assumptions about the issue within your discussion of that issue. You may email me if you wish, but I will either not respond or respond to the class as a whole. *For this reason, and more importantly because we*

[1] With one exception—namely, this homework assignment is not graded—these instructions are identical to the ones you will receive for the graded homework assignment. My expectation, which is subject to discussion and change, is that I will give out the graded homework assignment on Wednesday, November 15, and it will be due before Class 24 on Tuesday, November 26. I do not want you working on this over the Thanksgiving break.

will be continuing to work on cases that may further illuminate concepts that are relevant to the homework assignment, I suggest that you wait until shortly before the due time to submit your answer.[2]

You should assume that all demand and inverse demand curves are linear and that marginal costs are constant. You also should assume that the requisite effect on interstate commerce is present, so that you do not have to address this element of a Section 7 violation in your memorandum.

Ice Cream Merger

You are an attorney at the FTC and your group is reviewing Clare's pending acquisition of Benny'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. The success of the transaction will turn on the outcome of the Section 13(b) proceeding, since Clare's and Benny's have told the staff that they will terminate their transaction if the district court enters a preliminary injunction and not litigate the merits in an adjudicative proceeding.

The FTC's investigation has revealed the following facts:

The industry recognizes two types of ice cream: premium ice cream and regular ice cream. Premium ice cream has more butterfat content, less overrun (that is, less air, which makes it more creamy) and more calories than regular ice cream. Premium and regular ice cream are made on the same machines. Switching is gallon-for-gallon and involves negligible switching costs. The marginal costs of producing premium and regular ice cream, however, differ because of the difference in the cost of ingredients. The marginal cost of producing premium ice cream is \$2.80 per gallon, while the cost of producing regular ice cream is \$2.40 per gallon. Marginal costs, which are constant, have not changed in recent years and are not expected to change in the future.

While prices can and have varied among brands with in both premium and regular ice cream, actual prices charged by manufacturers during the investigation have converged—with no sign of collusion—throughout the country to \$4.00 per gallon for premium ice cream and \$3.00 per gallon for regular ice cream. The following charts give sales for ice cream manufacturers:

[2] This is not applicable to this assignment, but it will be relevant to the graded homework assignment. My suggestion is that you not submit the graded homework assignment until the weekend after Class 23.

	Ice Cream										
	Gallons	Premium Revenues	Profits	Revenue Share	Gallons	Regular Revenues	Profits	Revenue Share	Total Revenues	Revenue Share	Total Profits
Clare's	43.8	$175	$53	5.0%	1,608.3	$4,825	$965	31.7%	$5,000	26.7%	$1,018
Breyers	8.8	$35	$11	1.0%	1,588.3	$4,765	$953	31.3%	$4,800	25.6%	$964
Al's	393.8	$1,575	$473	45.0%	808.3	$2,425	$485	15.9%	$4,000	21.4%	$958
Benny's	350.0	$1,400	$420	40.0%	0.0	$0	$0	0.0%	$1,400	7.5%	$420
Turkey Hill	0.0	0	$0	0.0%	300.0	$900	$180	5.9%	$900	4.8%	$180
Blue Bell	8.8	$35	$11	1.0%	205.0	$615	$123	4.0%	$650	3.5%	$134
Izzy's	8.8	$35	$11	1.0%	138.3	$415	$83	2.7%	$450	2.4%	$94
Wells	8.8	$35	$11	1.0%	88.3	$265	$53	1.7%	$300	1.6%	$64
Dino's	43.8	$175	$53	5.0%	0.0	$0	$0	0.0%	$175	0.9%	$53
Eddy's	8.8	$35	$11	1.0%	0.0	$0	$0	0.0%	$35	0.2%	$11
Store brands (10)	0.0	0	$0	0.0%	338.3	$1,015	$203	6.7%	$1,015	5.4%	$203
	875.0	$3,500	$1,050	100.0%	5,075.0	$15,225	$3,045	100.0%	$18,725	100.0%	$4,095

Note: Gallons and revenues are in millions

There are high cross-elasticities of demand between brands within each of the two ice cream segments and low cross-elasticities between individual products in different segments. So, for example, if a premium ice cream manufacturer were to increase its price while the other premium ice cream manufacturers held their prices constant, the higher-priced manufacturer would lose a significant amount of volume to its premium brand rivals and little, if any, volume to regular ice cream. The same is true for regular ice cream brands.

For a 5% uniform increase in the price across all brands of premium ice cream, however, each premium brand would lose 16% of its unit sales to regular ice cream and none to other brands of premium ice cream. For a 5% uniform increase in the price of all brands of regular ice cream, each regular brand would lose 7.5% of its unit sales to premium ice cream and none to other brands of regular ice cream. When the price of all brands of ice cream (premium and regular) is increased by 5%, there would be no switching between premium and regular brands of ice cream, but each brand of premium ice cream would lose 3% of its unit sales to non-ice cream alternatives while each brand of regular ice cream would lose 5% of its unit sales to non-ice cream alternatives.

Clare’s (the buyer) is the largest manufacturer of regular ice cream and the third largest manufacturer of premium ice cream. Benny’s (the target) is the second largest manufacturer of premium ice cream but manufactures no regular ice cream. In its meeting with the staff, Clare’s made the following arguments in defense of the transaction:

Clare’s deal rationale:

1. Clare’s is buying Benny’s as a means of becoming a bigger player in premium ice cream. Clare’s entered the manufacture and sale of premium ice cream only three years ago. While Clare’s has invested almost all of its premium ice cream profits in advertising its premium ice cream brands, it has only been able to achieve a market share of 5%. This is too slow a rate of growth for Clare’s management. Clare’s

believes that its inability to gain market share more quickly is due in large part to its reputation as a regular ice cream manufacturer, where Clare's is known as a large but undistinguished producer with little of the "flair" associated with premium ice cream brands. Clare's plans on dropping the Clare's premium brand name and consolidating all of its premium operations into the Benny's brand, which is one of the best in the premium ice cream business.

2. Clare's plan for the merged company, as presented to the staff, is to invest its savings from the merger in the premium ice cream business, aggressively take on Al's, the premium ice cream market leader, and grow the merged firm's volume and market share.

3. Since entering the premium ice cream space, Clare's has introduced a large number of new premium ice cream flavors, some of which have become quite popular. Prior to Clare's entry, the other premium ice manufacturers only rarely introduced a new flavor. After Clare's entry, Al's and Benny's have been introducing new flavors to match the Clare's flavors that have become popular. Clare's says that it will bring its spirit of innovation to the management of Benny's.

4. The merged firm can save $60 million in annually recurring overhead costs by consolidating management, back office, and sales operations and eliminating almost all of Benny's corresponding operations. The staff does not dispute these numbers.

5. The merged firm can save another $30 million in operating costs by consolidating production. Clare's smallest plant is old and makes 200 million gallons of regular ice cream (and currently no premium ice cream), and the merged firm can close this plant and move the production into Benny's single plant, which is new and currently has 350 million gallons of excess capacity. The staff does not dispute these numbers.

Clare's antitrust arguments:

1. The relevant market in which to analyze the transaction is the all ice cream market, and within this market the transaction does not trigger the *PNB* presumption under either the Merger Guidelines or judicial precedent.

2. Even if the market is technically defined as premium ice cream, the HHIs based on actual sales are not all that high. Moreover, given the fact that the same machines are used for both premium ice cream and regular ice cream (although the ingredients differ), the ability of producers to increase their production of premium ice cream with negligible switching costs if prices were to increase protects premium ice cream customers from any anticompetitive price increase.

3. In addition to its innovation in new flavors, Clare's has achieved success in building premium ice cream market share by holding the line on price increases when other manufacturers were attempting to institute price increases. Clare's says will bring the same philosophy in holding the line on price increases to the management of the merged firm. The staff confirmed that on a number of occasions, including before Clare's entry, Al's has sought to lead a price increase for premium ice cream. All of the other premium ice cream manufacturers followed Al's lead. When Clare's entered, however, Clare's resisted following Al's lead in raising prices. Al's continued to raise prices periodically, but at a much lower magnitude than before

Clare's entered the premium ice cream business, and all of the other premium except Clare's followed.

4. Dino's, which entered four years ago and today has the same share as Clare's in premium ice cream, has also been trying to grow in premium ice cream (primarily by investing in advertising). The staff has confirmed this. Moreover, in its interview with the staff, Dino's said that it would continue to aggressively invest in its brand name reputation whether or not Clare's and Benny's merged. Clare's argues that Dino's efforts to grow will ensure that the market remains competitive postmerger.