MERGER ANTITRUST LAW

LAWJ/G-1469-05	Tuesdays and Thursdays, 3:30-5:30 pm
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CLASS 18 WRITTEN ASSIGNMENT—INSTRUCTOR'S ANSWER

Instructions

Submit by email by 3:30 pm on Tuesday, November 5
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 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. 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 creamier), 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 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 had 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 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 in that it 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 with ensure that the market remain competitive postmerger.

MEMORANDUM OF LAW VERSION

Note: This answer is much longer and more detailed on the explanation that anything I would expect for a graded homework assignment or an exam answer. I prepared this to further explain the law and the reasoning. You be thinking about how to write a more compact memorandum that addresses each element of the prima facie case and each defense.

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.

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.[1] 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 expansion, repositioning, innovation efficiencies, and cost efficiencies defenses advanced by the

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[1] **Note to students**: Since there is such a strong case in premium ice cream, it is not necessary to also plead an all ice cream market. Clare's, however, is arguing that an all ice cream market is the only relevant market and, in that market, there is not likely anticompetitive effect resulting from the merger. There are two ways to test this argument: (1) show that all ice cream is not a relevant market, or (2) even if it is, the merger will have an anticompetitive effect in that market, so somewhere in the memorandum you will have to evaluate whether all ice cream is a relevant market. I chose to evaluate it as part of the prima facie case, but it would have been perfectly OK to evaluate it when assessing the defense.

parties are either 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.

Introduction

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).

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]pond 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).[2] 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.

2 **Note to students**: You do not have to cite cases in the graded homework assignment or the exam. However, you may find it usual to prepare some boilerplate with case quotes and citations to address a legal principle (as the above text illustrates). The instructions to the graded homework assignment and the exam instructions will provide:

> As we discussed in class, you may cut and paste short passages (no more than four sentences) *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.

I suggest that you prepare a document to collect all of these boilerplate passages in one place. For convenience, I informally call this document a "cheat sheet," although, to state the obvious, since it is permitted under the exam instructions it does not involve cheating.

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 of a Section 7 violation, the burden of production then shifts to defendant to adduce evidence sufficient to create a genuine issue of fact on at least one element of the prima facie (including the *PNB* presumption) for the trier of fact to decide.

3. If the defendant discharges its burden of production, 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.

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 strengthen 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

1. The prima facie Section 7 case

The plaintiff must present evidence that permits the trier of fact to find the existence of each of the three essential elements of a Section 7 violation: (1) the relevant product market ("line of commerce"), (2) the relevant geographic market ("section of the country"), and (3) a reasonably probable anticompetitive effect in the relevant market.

a. The relevant product market

We should allege two relevant product markets: premium ice cream and all ice cream. There are two complementary approaches to product market definition: the *Brown Shoe* "outer boundaries" and "practical indicia" criteria and the hypothetical monopolist test.

Under *Brown Shoe*, the "outer boundaries" of the relevant product market "are determined by the reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it." *Brown Shoe Co. v. United States*, 370 U.S. 294, 325 (1962). Moreover, "within this broad market, well-defined submarkets may exist which, in themselves, constitute product markets for antitrust purposes. The boundaries of such a submarket may be determined by examining such practical indicia as industry or public recognition of the submarket as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors." *Id*. (internal citations and footnotes omitted). The original purpose of the *Brown Shoe* "practical indicia" was to enable the finding of relevant (sub)markets within larger markets defined by the "outer boundaries" test. Modern courts, however, do not view submarkets as any different from markets and regard the *Brown Shoe* "practical indicia" as factors qualitative probative of reasonable interchangeability of use and high cross-elasticity of demand.

Second, the "hypothetical monopolist test," which was introduced by the Merger Guidelines in 1982 and now adopted in one form or another by the courts, deems a product grouping ("candidate market") as a relevant market if a hypothetical monopolist of all products in the product group could profitably raise the prices in the product grouping by a small but significant nontransitory price (SSNIP), usually taken to be 5% for a period of one year. The hypothetical monopolist test is a quantitative test. The current 2010 Merger Guidelines have modified the hypothetical monopolist test in two significant ways:

1. Originally, the hypothetical monopolist test only deemed the smallest product grouping that satisfied the test to be a relevant market (the "smallest market principle"). Under the 2010 Merger Guidelines, while the smallest market principle

remains the preferred approach, where appropriate to reflect the economic realities a larger market can be used.[3]

2. Originally, the hypothetical monopolist test required the hypothetical monopolist to increase the prices uniformly of all of the products in the candidate market. Under the 2010 Merger Guidelines, the hypothetical monopolist is now permitted to raise the prices of one or more products selectively while leaving the prices of the other products constant, and the hypothetical monopolist test requires only that the hypothetical monopolist to be able to profitably raise the price of a *single* product in the product group for the product grouping to be a relevant market.

These modifications are increasingly being adopted by the courts. In particular, the modern courts are using the one-product SSNIP test to define markets. *See, e.g.*, *FTC v. Wilh. Wilhelmsen Holding ASA*, 341 F. Supp. 3d 27, 47 (D.D.C. 2018); *United States v. Anthem, Inc.*, 236 F. Supp. 3d 171, 198 (D.D.C. 2017); *United States v. Aetna Inc.*, 240 F. Supp. 3d 1, 20 (D.D.C. 2017); *FTC v. Staples, Inc.*, 190 F. Supp. 3d 100, 121 (D.D.C. 2016); *FTC v. Sysco Corp.*, 113 F. Supp. 3d 1, 33 (D.D.C. 2015); *United States v. H & R Block, Inc.*, 833 F. Supp. 2d 36, 51-52 (D.D.C. 2011).

Premium ice cream. Premium ice cream satisfies the *Brown Shoe* "outer boundaries" and "practical indicia" criteria. Although the investigation did not determine the numerical value of the cross-elasticities between products within premium ice cream, it did reveal that the cross-elasticities between premium ice cream products is high. The investigation showed that if a premium ice cream manufacturer was 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. Conversely, under these circumstances the higher-priced manufacturer would lose little, if any volume to regular ice cream, indicating that the cross-elasticity between premium ice cream and regular ice cream is low. Moreover, premium ice cream satisfies a number of the *Brown Shoe* practical indicia: the industry recognition of premium ice cream as distinct from regular ice cream, premium ice cream has differentiating characteristics (namely, more butterfat content, less overrun, and more calories than regular ice cream), cost more to manufacture ($2.80 v. $2.40 per gallon), and, probably most importantly, a significantly higher price ($4.00 v. $3.00 per gallon at wholesale) and 50% higher percentage margin (30% = 1.20/4.00 v. 20% = $0.60/$3.00)

[3] **Note to students**: As we have discussed, prior to 2010 the agencies on occasion had alleged relevant markets that satisfied the smallest market principle but did not look like any market or product grouping the industry or its customers had ever recognized. Courts tended to hold this departure from the "business realities" against the agency in rejecting the agency's market definition. The 2010 Merger Guidelines rectified this problem by recognizing broader markets that reflect the business realities. The FTC did this, for example, in alleging its market for DDIY tax preparation software in *H&R Block*. The FTC defined the market to include all DDIY tax products, although any two of the three major products satisfied the hypothetical monopolist test and hence the all DDIY tax products market did not satisfy the smallest market principle.

compared to regular ice cream. The judicial precedent, then, strongly supports a premium ice cream market.

Premium ice cream products, however, fail the hypothetical monopolist test under a uniform SSNIP test. We can implement the uniform SSNIP test using percentage critical loss. The percentage critical loss for a product grouping with a uniform SSNIP (δ) of 5% and a uniform margin of 30% is:[4]

$$\%CL = \frac{\delta}{\delta + m} = \frac{5\%}{5\% + 30\%} = 14.3\%$$

The investigation revealed that 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. Since the percentage actual loss is greater than the percentage critical loss, this implementation of the hypothetical fails to establish premium ice cream as a relevant market.

Consistent with the 2010 Merger Guidelines, however, modern courts have held that a product grouping to be a relevant market if a hypothetical monopolist could profitably impose a SSNIP on only *one* of the products in the grouping. We can apply a one-product SSNIP test using the aggregate diversion ratio test. The critical recapture rate R_{cl} has the same numerical value as the percentage critical loss, that is, 14.3%. Under the aggregate diversion ratio test, if the smallest actual recapture rate of each individual product in the candidate relevant market is larger than the critical recapture rate, then the hypothetical monopolist could raise the price of at least one product in the candidate market by a SSNIP and so satisfy the one-product SSNIP test.

The investigation revealed that, for any given brand of premium ice cream, increasing its price will result in close to 100% of its lost sales to other premium ice cream brands. This means that the aggregate diversion ratio (or, more descriptively put, the "aggregate recapture ratio") into premium ice cream is close to 100%. Since this is true for all premium ice cream brands, the smallest of these diversion ratios is larger than the critical recapture rate of 14.3%, which satisfies aggregate diversion ratio test and shows that premium ice cream is a relevant market.

All ice cream. Since the merging parties defend their transaction in part on the grounds that the relevant market is not premium ice cream but rather all ice cream, we also should examine all ice cream as a potential relevant product market.

All ice cream satisfies the *Brown Shoe* "outer boundaries" test. According to the facts revealed by the investigation, although the cross-elasticity between *individual* premium ice cream products and regular ice cream products is relatively low, the cross-elasticity between the two

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[4] **Note to students**: Exam 4 software does not permit you to cut and paste formulas into the exam answer. Before the graded homework assignment is released, I will provide you with a short slide deck with all of the formulas. You can then cite to the formula by equation number.

categories of ice cream products is relatively high. The investigation revealed that a 5% uniform increase in the price across all brands of premium ice cream would result in each premium brand would lose 16% of its unit sales to regular ice cream and none to other brands of premium ice cream. Regular ice cream, then, is a significant constraint as a category on price increases by premium ice cream as a category. Likewise, 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. This too indicates that premium ice cream as a category is a significant constraint on price increases of regular ice cream as a category.[5] Moreover, the aggregate demand for all ice cream is not very elastic: the investigation revealed that a uniform 5% SSNIP across all ice cream products would cause but each brand of premium ice cream to lose 3% of its unit sales all to non-ice cream alternatives and each brand of regular ice cream to lose 5% of its unit sales all to non-ice cream alternatives. This indicates a low cross-elasticity and absence of reasonable interchangeability between ice cream and non-ice cream alternatives. The *Brown Shoe* practical indicia also support a finding of an all ice cream market: the industry and the public recognize ice cream as distinct from other types of foods, ice cream has peculiar characteristics and uses, it is produced using unique production facilities, and it has distinct prices.[6]

The traditional hypothetical monopolist test with a uniform price increase shows that all ice cream is a relevant product market under a 5% SSNIP.[7] We can test this under a percentage critical loss analysis. The formula for percentage critical loss %CL is:

$$\%CL = \frac{\delta}{\delta + m},$$

where δ is the SSNIP (here, 5%) and m is the percentage gross margin. Here, premium ice cream and regular ice cream have different margins, so that we do not have a single margin to apply to an all ice cream market. However, since when all lost sales go to non-ice cream alternatives when the prices of both premium ice cream and regular ice cream is increased by 5% (i.e., there is no recapture by any ice cream product), if premium ice cream and regular ice each separately

[5] **Note to students**. You could convert the data provided in the problem into cross-elasticities or diversion ratios between the two categories of products, but since we do not have numerical tests for what is "high" cross-elasticity this would not be an effective use of your time. Rather, consider this a judgment call, so just state your judgment. There are a lot of judgment calls in antitrust practice. Ms. Brown may disagree with your judgment, but she will recognize the judgment call if it is reasonably supported by the facts. I will use the same standard in grading the answer.

[6] **Note to students**: Not necessarily explicit in the hypothetical, but good, common sense points to make in the memorandum. Since the points were not explicit in the hypothetical, however, I would not hold a failure to make the points to be a deficiency in the memorandum.

[7] **Note to students**: The next paragraphs are superfluous to the answer. If premium ice cream is a relevant market, then a hypothetical monopolist of any larger group of products containing all premium ice cream could raise the price of at least one product in the market—namely, the price of at least one premium ice cream product—profitably by a SSNIP and so satisfy the one-product SSNIP test. That is all that needs to be said to answer whether all ice cream is a relevant market. But if you concluded that premium ice cream alone was not a relevant market, you would need to run one of the tests below to determine if all ice cream was a relevant market.

satisfy their respective critical loss tests, then a hypothetical monopolist will be able to raise prices by 5% across all products. The percentage critical losses for premium ice cream and regular ice cream are:

$$\%CL_{\text{premium}} = \frac{5\%}{5\% + 30\%} = 14.3\%$$
$$\%CL_{\text{regular}} = \frac{5\%}{5\% + 20\%} = 20.0\%,$$

Since the actual loss for premium ice cream is 3% and the actual loss for regular ice cream is 5%, both are significantly less than their respective critical losses. Consequently, a hypothetical monopolist could profitably raise prices by 5% across all ice cream products, satisfying the hypothetical monopolist test for an all ice cream market.

Although premium ice cream is the relevant product market under the smallest market principle, we should allege both premium ice cream and all ice cream as relevant product markets. While, as shown below, the FTC's case in a premium ice cream market is very strong, by alleging a relevant market of all ice cream products and then showing anticompetitive effects in that market as well, as a litigation tactic we can preempt Clare's argument that the merger is not problematic in an all ice cream market.

b. The relevant geographic market

The relevant geographic market is the United States.

The second essential element of a prima facie Section 7 case is the relevant geographic market. In *Philadelphia National Bank*, the Supreme Court has defined the relevant geographic market to be "the area of effective competition . . . in which the seller operates, and to which the purchaser can practically turn for supplies." *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 359 (1963) (emphasis removed). The relevant geographic market also may be assessed using the hypothetical monopolist test.

Brand name ice cream is sold nationwide. There are no store brands of premium ice cream and store brands account for only 6.7% of revenues in regular ice cream. Manufacturers of premium ice cream and regular ice cream (taken separately) each sell at the same price across brands throughout the country. Courts have held that where the companies in the relevant product market sell their products nationwide at uniform prices, the United States is a relevant geographic market. The Merger Guidelines recognize this principle as well. Moreover, using the hypothetical monopolist test, we know that a hypothetical monopolist could profitably raise prices by 5% across all products across the country. (The math is the same here as in the relevant product market analysis above.) This confirms that the relevant geographic market is the United States.

This is sufficient to establish the national market as the relevant geographic market. While there may be smaller geographic markets within the nationwide market, the facts stated in the investigation record do not allow us to analyze this. Moreover, since, as will be shown below, the merger violates Section 7 in both a nationwide premium ice cream and an all ice cream market, it is unnecessary to examine the competitive effects in any smaller markets in order to obtain a preliminary injunction.

c. Market shares, concentration, and the *PNB* presumption

In *Philadelphia National Bank*, the Supreme Court held that "a merger which produces a firm controlling an undue percentage of the relevant market, and results in a significant increase in the concentration of firms in that market, is so inherently likely to lessen competition substantially that it is must be enjoined in the absence of evidence clearly showing that the merger is not likely to have such anticompetitive effects." *United States v. Philadelphia National Bank*, 374 U.S. 321, 363 (1963). Specifically, the Court held that a combined firm with at least 30% share and in increase in the 2-firm concentration ratio from 44% to 59% was sufficient to constitute "undue market share" and cause a "significant increase in concentration" to predicate the *PNB* presumption. The 2010 Guidelines provide that mergers in markets with a post-merger HHI above 2500 and a delta of 200 or more "will be presumed to be likely to enhance market power" and be sufficient to predicate the *PNB* presumption. Although the Guidelines are not binding on courts, modern courts frequently cite the Guidelines as supporting authority when finding that mergers that increase the HHI by 200 or more points and result in a postmerger HHI of 2500 or more as authority in finding that the merger satisfies the predicates for the *PNB* presumption. *See, e.g.*, *United States v. Anthem, Inc.*, 855 F.3d 345, 349 (D.C. Cir. 2017); *FTC v. Penn State Hershey Med. Ctr.*, 838 F.3d 327, 347 (3d Cir. 2016); *Saint Alphonsus Med. Ctr.-Nampa Inc. v. St. Luke's Health Sys., Ltd.*, 778 F.3d 775, 786 (9th Cir. 2015); *ProMedica Health Sys., Inc. v. FTC*, 749 F.3d 559, 568 (6th Cir. 2014); *FTC v. Staples, Inc.*, 190 F. Supp. 3d 100, 128 (D.D.C. 2016) ("Staples' proposed acquisition of Office Depot is therefore presumptively illegal because the HHI increases more than 200 points and the post-merger HHI is greater than 2,500."). The Guidelines also provide that in moderately concentrated markets (that is, markets with an HHI between 1500 and 2500), transaction that increase the HHI by more than 100 points "potentially raise significant competitive concerns and often warrant scrutiny."

Premium ice cream. In premium ice cream, the transaction combines Benny's, the number 2 with a 40% share, with Clare's, a firm tied for number 3 with a 5% share, giving the combined firm a 45% share. The transaction would increase the HHI by 400 point to 4080:[8]

[8] **Note to students**: Unless this has changed, Exam4 software will not allow you to cut and paste an Excel table into the exam answer (at least not with the proper formatting). If you can practice with the software, you may wish to experiment as to the best way to import HHI tables that require only minor reformatting. Alternatively, you can just explain what you did to create the table and then just give me the required numerical results. If you go this route, you might want to create some boilerplate text that you can import into the answer with your numerical results.

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

The resulting combined market share (45%), market concentration, HHIs and deltas would exceed what the courts have required in the past to predicate the *PNB* presumption. The combined firm's share of 45% significantly exceeds the 30% threshold set in *Philadelphia National Bank*, and transaction result in a significant increase in concentration by eliminating one of the four top firms and increasing the 2-firm concentration ratio from 85% to 90%. Measured by the 2-firm concentration ratio, while in *Philadelphia National Bank* the market concentration increased 15 percentage points while here the increase is only 5 points, the *PNB* market was much less concentrated both premerger (44%) and postmerger (59%), while here the market premerger was already extremely contracted (85%). Given the extremely high level of premerger market concentration, the 5-percentage point increase to 90% should be seen as a merger to duopoly and sufficient to indicate as much if not more of a competitive problem than in *PNB* itself.[9]

The transaction also violates the Merger Guidelines, which the courts regard as informative although not binding. The market postmerger is "highly concentrated" with a postmerger HHI of 4080 (above the 2500-point threshold) and the transaction increases the HHI by 400 points (above the 200-point threshold), making the merger presumptively anticompetitive.

[9] **Note to students**. I have absolutely no authority for this. But this is memorandum to the section chief, and I am entitled—if not expected—to make an argument of this type. Ms. Brown may reject it, but on the other hand she may think it is both creative and compelling. I would buy it.

All ice cream. In an all ice cream market, the transaction combines Clare's, the number 1 firm with a 26.7% share, with Benny's, the number 4 with a 7.5% share, giving the combined firm a 34.2% share. The transaction would increase the HHI by 399 points to 2329:

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

Although the FTC has not recently challenged a transaction in this range, the combined share of 34.2% and an increase in the 2-firm concentration ratio from 53.2% to 59.8% arguably could satisfy the *PNB* presumption under the facts of *Philadelphia National Bank*.[10] Moreover, the change in the HHI of 399 and the resulting postmerger HHI of 2329, although not presumptively unlawful, is be high enough to raise significant competitive concerns under the Merger Guidelines. While most modern complaints filed by the FTC and DOJ have larger HHI statistics, especially in postmerger concentration, there is judicial precedent for finding a Section 7 violation with shares and concentration in the same range as we have here. *See, e.g.*, *United States v. UOM-Kymmene OYJ*, No. 03 C 2528, 2003 WL 21781902 (N.D. Ill. July 25, 2003) (complaint alleging combined market share of 20%, delta of 190, and postmerger HHI of 2990); *see also In re Evanston Northwestern Healthcare Corp.*, No. 9315, 2007 WL 2286195, at *4

[10] **Note to students**: This is much more of a stretch than the last argument. The postmerger HHI is essentially the same as in *PNB*, but the change here is only 5 percentage points as opposed to the 15 in *PNB*. If I were Ms. Brown, I probably would not find this argument especially compelling, but I would give your credit for taking the shot. Same for the grading.

(FTC Aug. 6, 2007) (combined market share of 35%, delta of 384, and postmerger HHI of 2739).[11]

But even if the court was not willing to find that the Commission had established the predicates of the *PNB* presumption in an all ice cream market on these structural numbers alone, when the court considers the additional evidence discussed below, it should find that the Commission has established a prima facie case of anticompetitive effect in the all ice cream market.

d. Additional evidence supporting the prima facie case

Modern courts and the Merger Guidelines recognize that mergers are anticompetitive under Section 7 when they have a reasonable probability of increasing prices, reducing market output, reducing product or service quality, or reducing rate of technological innovation or product improvement in the market compared to what would have happened in the market on a going-forward basis in the absence of the transaction.

Here, the Commission can provide additional evidence that the transaction is reasonably likely to increase prices and reduce innovation in the sale of premium ice cream. In particular, the acquisition is likely to increase the likelihood and success of coordinated interaction in the sale of premium ice cream between Al's and the combined firm generally and through the elimination of Clare's as a maverick in particular. Although, for the reasons explained below, this is not a good case in which to advance a price unilateral effects theory, although an innovation unilateral effects should be successful in court.

Coordinated effects theory. The coordinated effects theory asks whether the merger is likely to increase the ability and incentives of a sufficient number of firms in the market to engage in successful tacit collusion. There are two conditions for the coordinated effects theory to apply: (1) the market must be susceptible to tacit coordination, and (2) the merger must make tacit collusion either more likely or more successful.

Here, the premium ice cream market is susceptible to tacit coordination premerger. The premium ice cream market is characterized by two dominant firms (Al's and Benny's) that collectively account for 85% of premium ice cream sales premerger. There is evidence of attempts of firms in the premium ice cream market to tacitly coordinate their behavior: Al's had led price increases in the market that were followed by all other firms (including Benny's) prior to Clare's entry, while after Clare's entry Al's continue to led price increases and other firms followed, although Clare's mitigated the magnitude of the price increases. The fact that a uniform SSNIP hypothetical monopolist test fails (see above) further suggests that the premerger tacit coordination has been

[11] **Note to students**: The *Northwestern Evanston* statistics are great, but they are from an FTC administrative decision and not strictly precedent in a federal district court proceeding, which is why I put them behind a "see also" signal.

largely successful since the prevailing premerger price is within 5% of the hypothetical monopolist's profit-maximizing price.

Moreover, Clare's acquisition of Benny's is likely to increase the probability and effectiveness of tacit coordination postmerger in premium ice cream. Clare's, which entered the premium ice cream market only three years ago and is a much smaller firm, is a maverick that had disrupted the ability of Al's and Benny's to raise prices. If Clare's acquires Benny's, however, Clare's will become of the two dominant firms in premium ice cream, each with a market share of 45%. Clare's premerger refusal to follow Al's price leadership, as well as its innovative efforts in developing new types of premium ice cream, were designed to increase Clare's market share and enable it to become a larger, more profitable player in the premium ice cream market.

After Clare's acquires Benny's, it will have achieved that goal, obtaining a 45% market share and becoming tied for the number 1 position in premium ice cream sales. Antitrust law is predicated on firms acting in their profit-maximizing interests. Here, the question for the court is whether Clare's postmerger is likely to maximize its profits by seeking to increase its market share by continuing to hold the line on prices and developing new products, or change strategies and tacitly coordinate with Al's to raise premium ice cream prices. Given Clare's postmerger market share, if Clare's is to grow its market share, it must take new customers primarily from Al's. Clare's is likely to recognize that Al's will meet Clare's competition, and the result likely will be steady prices, if not a price war, and no increase in profits. Tacitly coordinating with Al's in increasing prices, however, is likely to significantly increase Clare's profits. This indicates that Clare's most likely will cease being an aggressive price competitor postmerger in premium ice cream.

Moreover, for the same reason Clare's profit-maximizing incentive postmerger is likely to stop innovating new products. Again, innovation would be designed to attract customers away from Al's. Al's could respond either with innovative efforts on its own or lower prices, both of which would be good for consumers but bad for Clare's. As a result, Clare's is likely to cease be innovative, which also has the advantage of increasing profits by reducing innovation and related marketing costs.

Unilateral effects. Both the courts and the Merger Guidelines recognize the theory of unilateral effects. Unilateral effects is a theory of anticompetitive harm that goes to the elimination of significant "local" competition between the merging firms, so that the merged firm can raise prices independently of how other incumbent firms react. The 2010 Merger Guidelines explain:

> A merger between firms selling differentiated products may diminish competition by enabling the merged firm to profit by unilaterally raising the price of one or both products above the pre-merger level. Some of the sales lost due to the price rise will merely be diverted to the product of the merger partner and, depending on relative margins, capturing such sales loss through merger may make the price

> increase profitable even though it would not have been profitable prior to the merger. 2010 DOJ/FTC Horizontal Merger Guidelines § 6.1.

Under the 1992 Merger Guidelines, the unilateral effects theory applied whenever: (1) the two merging firms were each other's closet competitors, and (2) their combined market share was greater than 35%. The 2010 Merger Guidelines relaxed these requirements so that the firms only need to be close competitors to each other (although not necessarily the closest) and eliminated the 35% combined share requirement.

A price unilateral effects theory does not apply to Clare's acquisition of Benny's. Premerger, Clare's and Benny's have the same margin and postmerger Clare's will consolidate its premium ice cream products under a single brand. In this case, there is no price unilateral effects story to tell: when margins are the same premerger, a unilateral effects theory depends on diversion to the other brand of the combined firm, and when there is only one brand there can be no diversion. While the merged firm will have two brands—Clare's in regular ice cream and Benny's in premium ice cream—as explained in the market definition section there is little or no cross-elasticity between premium and regular ice cream in either direction for a one-product price increase. Consequently, there will be little diversion from one of the merged firm's brands to the firm's other brand in the event of a single-product price increase. If there is no diversion, there can be no recapture, so the unilateral effects theory does not apply to the transaction.[12]

On the other hand, there is an anticompetitive innovation unilateral effect resulting from this transaction. Clare's has been a strong innovative force in premium ice cream in recent years as it attempted to build its brand and market share, introducing a number of new varieties of premium ice cream. As noted above, continued innovation postmerger is likely to attract a competitive response form Al's either in terms of Al's increased innovation effects or lower prices. While this would be good for consumers, it would be bad for Clare's profits. Recognizing this, Clare's is likely to cease be innovative, which also has the advantage of increasing profits by reducing innovation and related marketing costs, resulting in an anticompetitive innovation unilateral effect.

e. The prima facie case: Summary

Application of the *Brown Shoe* "outer boundary" and "practical indicia" factors, as well as the hypothetical monopolist test, show that a relevant product markets in which to analyze the transaction is premium ice cream and all ice cream. A relevant geographic market is the United States. Application of the *PNB* presumption will establish a prima facie case of anticompetitive effect within this national premium ice cream market and likely in the all ice cream market as well. Moreover, the prima facie case is strengthened because the acquisition will eliminate

[12] **Note to students:** We did not cover this special case in class. Still, you should not apply any theory blindly. That is the reason that we are covering the underpinnings of the theory and not just providing you with a checklist of factors to apply. That said, most students are unlikely to spot this exception and the mandated curve will take this into account.

Clare's premerger incentives to be a maverick in both pricing and innovation in premium ice cream. Clare's acquisition of Benny's will give it a 45% market share and tie it with Al's as the number 1 seller of premium ice cream. Having achieved a dominant position in premium ice cream, it will be in Clare's profit-maximizing incentive to tacitly coordinate with Al's to raise premium ice cream prices and to cease its new product development, all of which will harm consumers of premium ice cream.

2. The defendants' arguments

The defendants make five arguments in defense of the transaction: (1) the only relevant market is all ice cream and in this market the merger is too small to create a competitive problem; (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; (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; (4) Clare's, which will control the merged firm, will continue its philosophy of growing market share through competitive pricing and product innovation in premium ice cream and so benefit consumers; and (5) the merger will produce substantial efficiencies that will offset any possible anticompetitive effect of the transaction. None of these arguments should successfully rebut the presumption that the transaction is anticompetitive.[13]

The evidence shows that the transaction is anticompetitive in an all ice cream. The merging parties argue that they compete in a relevant market of all ice cream. They note the merger would combine the number 1 and a distant number 4 manufacturers of ice cream, reduce the number of leading national brands from nine to eight, and result in a merged firm with only a 34.2% share in a moderately concentrated market.

We need not contest the all ice cream market. All ice cream satisfies the *Brown Shoe* outer boundaries" test and "practical indicia" as well as the uniform-SSNIP hypothetical monopolist test, so our only argument to reject the market is the smallest market principle.[14] We need not make that argument, which could be problematic in court given the 2010 Merger Guidelines' rejection of this requirement, since the transaction is anticompetitive in the all ice cream market for the reasons discussed in analyzing the prima facie case. The transaction is likely to result in

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[13] **Note to students**: I have reorganized the order of these defenses somewhat differently than the order in which they were presented by the hypothetical to put related defenses together. But I suspect that, given the time limits, thinking about a more logical organization is not worth the investment of time, and organizing the section around the arguments in the order they were presented ensures that all of the arguments will be covered.

[14] **Note to students**: You could have argued that the all ice cream market should be rejected as violating the smallest market principle, which has been accepted in some case precedent. The argument is not that strong, however, since the principle has been rejected in the 2010 Merger Guidelines as well as implicitly by some courts (including in H&R Block/TaxACT).

an increase in price to some customers of premium ice cream as well as a reduction in the rate of new premium product development because, as discussed above, Clare's—a maverick premerger—will no longer have the profit-maximizing incentive postmerger to hold the line against premium product price increases or to continue to innovate new premium products.

Repositioning defense. Clare's argues that even if the relevant market is limited to premium ice cream, supply-side substitutability with regular ice cream will ensure that the premium ice cream market remains competitive after the merger. This is a repositioning defense.

The court should reject this argument. Although, as the staff found during the investigation, the same machines are used for both premium ice cream and regular ice cream and there are negligible costs to switch from the production of regular ice cream to premium ice cream (apart from the cost differences in ingredients), very substantial reputational barriers to entry and expansion exist that will prevent supply-side substitutability from ensuring that the transaction will not reduce competition. Despite Clare's and Dino's aggressive efforts to grow in premium ice cream, neither was able to obtain more than a 5% market within three years of entry. Indeed. The investigation revealed that Clare's purchased Benny's because it did not believe it could grow its market share significantly in the coming years on its own. The significant price differential ($4.00 v. $3.00) and especially the margin differential (30% v. 20%) between premium ice cream and regular ice cream, in light of the technical ease of supply-side substitution, also strongly indicate that reputation is a significant barrier to entry or expansion into premium ice cream that makes supply-side substitutability from regular ice cream to premium ice cream is insufficient to constrain anticompetitive pricing.

Expansion defense. Clare's argues that Dino, another relatively new entrant, is similarly positioned to Clare's in premium ice cream and will protect the market (whether premium ice cream or all ice cream) from any anticompetitive effect resulting from the merger. This is an expansion defense. An expansion defense has the same elements as an entry defense: the expansion must be sufficiently timely, likely, and sufficient to "deter or counteract any competitive effects of concern so the merger will not substantially harm customers." The burden of making a prima facie defense of an expansion defense is on the merging parties. Here, the parties have not made their prima facie showing and the investigation record strongly suggests that they will not be able to do so.

First, Clare's bears the burden of showing that Dino's expansion will be sufficient to offset whatever anticompetitive tendencies the merger may create. This requires a showing that the upward pricing pressure caused by the merger will be offset by the downward pricing pressure resulting from Dino's expansion. But Clare's has only *asserted* that the downward pressure exerted by Dino's expansion will offset the upward pricing pressure of the merger. Clare's has not shown, for example, how much expansion is required by Dino's to offset the upward pricing pressure of the merger, much less than Dino's will expand by the required amount. After four years, Dino's has achieved a market share of only 5%—the same market share that Clare's achieved after three years. Even if Dino's continues to grow its market rate at its historical rate—about 50% per year—in another two years Dino's will have a market share of only a little over 11%.

Second, as a growing incumbent firm in the market, the court show only look at the *incremental* growth Dino's would achieve beyond what it would have grown in the absence of the merger. To the extent that Dino's would have exerted downward pressure in the market in the absence of the merger, that downward pressure could not count as part of the defense. Only the incremental growth should count, and neither Clare's nor Dino's has offered any evidence as to what this incremental growth would be.

Third, even if Dino's is successful in eventually replacing the downward pricing pressure that Clare's would be exerted in the absence of the merger, it will take some time for Dino's to achieve the requisite growth. During this time, the merged firm will be able to raise prices and harm consumers.

Finally, even if this was sufficient to replace the downward pricing pressure that Clare's exerted premerger in a timely fashion, an increase in prices is not the only anticompetitive effect likely to result for the merger. Clare's was also an aggressive innovator of new premium ice cream products, many of which achieved consumer acceptance and became popular. There is no evidence in the record that Dino's is an innovator of new premium ice cream products.

Clare's will continue postmerger to price and innovate aggressively. Clare's argues that its 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. As noted above, however, Clare's premerger incentives to price and innovate aggressively were designed to increase its market share and become a larger, more profitable firm. After the merger, it will have achieved its goal of becoming a larger firm. Moreover, Al's and the combined firm will account for 90% of all premium ice cream sales. Under these conditions, it will be in the combined firm's profit-maximizing interest to follow Al's lead increasing prices—or even to lead price increases itself—since the opportunity costs of *not* doing so will be so high. Given this profit incentive, Clare's claim that it will continue to price and innovate aggressively after the merger just as it did before the merger should not be credited.

Cost efficiencies defense. The Horizontal Merger Guidelines recognize an efficiency defense when (similarly to entry) the efficiencies will negate the anticompetitive effect shown in the proof of the prima facie case. Courts have been more cautious in recognizing the validity of the principle of an efficiencies defense because of statements in earlier Supreme Court cases (*Brown Shoe* and *Procter & Gamble*) that efficiencies will not save an anticompetitive merger. However, most courts have been willing to assume at least for the purposes of analysis that the efficiencies defense described in the Horizontal Merger Guidelines is a cognizable defense, although no court has yet to find on the facts that the elements of an efficiency defense were satisfied. As with the entry defense, an efficiency defense is a *negative* defense: the efficiencies must negate the anticompetitive effect the merger otherwise would have. Moreover, to be cognizable, courts and the merger guidelines require the efficiencies to be merger specific and verifiable in addition to being sufficient to overcome the otherwise anticompetitive effect of the merger.

When, as here, the anticompetitive concern is higher prices postmerger, to be a defense the efficiencies must generate sufficient downward pressure on prices to offset the upward pressure resulting from the merger's reduction of competition. Because a profit-maximizing firm will set prices and output so that its marginal revenue will equal its marginal cost, only changes in marginal costs resulting from the merger will affect the merged firm's prices. Here, the efficiencies of the transaction—eliminating duplicative administrative and sales overhead, streamlining their combined sales force, and taking advantage of some excess capacity to consolidate production and reduce the number of the merged firm's operating plants—are all fixed costs that will not affect marginal cost. Accordingly, even assuming that the efficiencies are merger specific and verifiable, they cannot be expected to be passed on to customers and hence will generate no downward pricing pressure. Under these circumstances, an efficiencies defense will be rejected on the facts.

3. Conclusion on likelihood of success on the Section 7 merits

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 premium ice cream and a nationwide all ice cream and defeat the expansion, pricing and innovation efficiencies, cost efficiencies, and price reduction defenses of the merging parties. This proves a likelihood of success on the merits of proving a Section 7 violation in both markets.

4. Weighing the equities

In addition to assessing the Commission's likelihood of success of the merits of its Section 7 claim in a full administrative adjudication, Section 13(b) of the FTC Act also requires the court to weigh the equities to determine whether this relief would be in the public interest. 15 U.S.C. § 53(b). The Court must consider the interests of the public of either in having the merger close during the pendency of the merits litigation or preventing it until the end of that proceeding, as well as the private equities, which include the corporate interests of the merging parties. *FTC v. Swedish Match*, 131 F. Supp. 2d 151, 172 (D.D.C. 2000). Here, as in every other case where the court has found the requisite likelihood of success on the merits, the balance of the equities weighs in favor of granting the injunction.

The public equities. Where the FTC can show a likelihood that the proposed transaction will substantially lessen competition, the public interest in effective enforcement of the antitrust law weighs in heavily in favor of granting an injunction. *See FTC v. H.J. Heinz Co.*, 246 F.3d 708, 726 (D.C. Cir. 2001); *Swedish Match*, 131 F. Supp. 2d at 173. In addition, where the FTC can show a likelihood that the proposed transaction will substantially lessen competition there is a strong public interest ensuring that the FTC has the ability to order effective relief if it succeeds on the merits at trial. *FTC v. Sysco Corp.*, 113 F. Supp. 3d 1, 86 (D.D.C. 2015). Courts have long held that the only way to ensure that effective relief—often a blocking permanent injunction—can be ordered after trial to prevent the companies from merging during the pendency of the litigation and that relief is unlikely to be fully effective if the parties are permitted to consummate their transaction, even subject to a hold separate order, and the court must unwind the transaction after the conclusion of the merits trial. *See FTC v. PPG Indus., Inc.*, 798 F.2d 1500, 1506-09 (D.C. Cir. 1986). "Section 13(b) [of the FTC Act] itself embodies congressional recognition of the fact that divestiture is an inadequate and unsatisfactory remedy in a merger case." *Heinz*, 246 F.3d at 726.The public equities weighing in favor of a preliminary injunction here are especially strong since Clare's had announced that it will discontinue its premium brand and sell premium ice cream only under the Benny's brand as well as close one of its production facilities once the merger closes.

The merging parties claim that the appellees claim that entry of a blocking preliminary injunction would deny consumers the procompetitive advantages of the merger and that this public equity weighs against the entry of a preliminary injunction. But the parties do not argue that the merger would result in *reduced* prices to consumers. The most they argue is that the public will be deprived of the increased innovation in premium ice cream products that Clare's say it will bring to the combined company. But as demonstrated above, regardless of what Clare's says today, it is likely to be in Clare's profit-maximizing interest to adopt Benny's premerger business philosophy of raising prices and not innovating. Moreover, an administrative proceeding on the merits is likely to last no more than another year or so, so if a preliminary injunction is entered and the merging parties ultimately prevail and consummate their merger, any benefits will only be temporarily delayed.

The private equities. The private equities are the additional profits Clare's believes it will earn from the merger and the premium Benny's shareholders will earn from the premium price Clare's is willing to pay for their shares. At most, these benefits will only be delayed by a year or so by the entry of a preliminary injunction. Moreover, if the Commission ultimately concludes on the merits that the transaction would violate Section 7, the transaction will not be consummated and the claimed benefits never received.

Even if the parties, as they have represented, will terminate the transaction if the district court enters a preliminary injunction and not litigate the merits in an adjudicative proceeding, that is not a private equity that the court should credit. Courts almost universally are unmoved by this representation, reasoning that the control of whether to litigate the merits in an FTC proceeding is completely in the control of the merging parties. If they do not wish to litigate the merits in an administrative proceeding, it must be because either the private benefits on the merger are not that greats or that the probability of their success on the merits is low. In either case, the private equities here are weak at best.

The weight of the equities. The public interest in effective antitrust enforcement and the ability to order effective relief strongly outweigh any potential public or private benefits in allowing the merger to be consummated during the pendency of the merits trial, benefits that at worst would only be delayed by a year or so.[15]

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.

[15] **Note to students**: I should have included in the facts the typical representation by the parties that they will terminate their transaction if the district court enters a preliminary injunction and not litigate the merits in an adjudicative proceeding. Courts almost universally are unmoved by this representation, reasoning that the control of whether to litigate the merits in an FTC proceeding is completely in the control of the merging parties. If they do not wish to litigate the merits in an administrative proceeding, it must be because either the private benefits on the merger are not that greats or that the probability of their success on the merits is low. In either case, the equities continue to strongly weigh in favor of entering the preliminary injunction.