Merger Antitrust Law
Fall 2019

GRADED HOMEWORK ASSIGNMENT: FROZEN DINNERS MERGER
INSTRUCTOR'S ANSWER

MEMORANDUM OF LAW VERSION

> *Note: This answer is* much *longer and more detailed on the explanation than anything I would expect for a writing assignment, much less a timed exam answer. I prepared this to further explain the law and the reasoning.*

You have asked me to provide a preliminary substantive analysis on a possible acquisition of our client Intelligent Ones (IO) by ConAgra Brands that can be sent to the client. You would like for me to address both the current state of the analysis on the facts we have been given by Alice Long, CEO of Intelligent Ones, as well as to identify the most important pieces of evidence that need to be developed in order to better assess the antitrust risk.

For the reasons explained below, on the current facts I believe that the transaction will be investigated by the FTC but more likely than not the FTC will close the investigation without enforcement action. The strongest case for a challenge is the market for the manufacture and sale of low calorie single serve frozen dinners in the United States. Notwithstanding strong evidence for this market and a strong likelihood that the FTC could establish a prima facie violation of Section 7 of the Clayton Act, this is one of those transactions can be defended. The gross upward pricing pressure resulting from the transaction is limited only to IO and is small in magnitude, which makes the prima facie case weak, and the significant downward pricing pressure resulting from the marginal cost efficiencies, the real prospect of entry by a major competitor, the substantial fixed cost savings, and ConAgra's procompetitive business rationale for the transaction should will be sufficient to dissuade the FTC as a matter of prosecutorial discretion, if not a matter of law, from challenging the transaction.

If the FTC does challenge the transaction, however, it will seek a preliminary injunction under Section 13(b) of the FTC Act blocking closing until the FTC can conduct a full trial on the merits in an administrative trial. Historically, Section 13(b) proceedings have taken no more than 6.5 months from the date of the filing of the complaint to the date of decision. It is difficult to predict whether the court would conclude that the defenses are sufficient to defeat the FTC's motion for a preliminary injunction. Agency practice is not to bring close cases, so there a essentially no modern precedents where the parties have defeated a prima facie Section 7 case. If the court enters a preliminary injunction, companies historically have terminated their transactions rather than continue to litigate through a full administrative trial given the additional time it takes and the likelihood that the Commission—which issued the complaint in the first instance—would conclude on the merits that the transaction violated Section 7. On the other hand, if the court denied the preliminary injunction, the FTC's practice is to terminate the litigation and allow the transaction to close without further enforcement action.

Governing Law and Procedure

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).[1]

To enable the federal antitrust enforcement authorities to review large mergers or acquisitions under Section 7, Congress enacted the Hart-Scott-Rodino Act ("HSR Act"), 15 U.S.C. § 18a. In the case of transactions in the food industry, the FTC will be the reviewing agency. In 2019, transactions resulting the acquiring party holding $90 million or more of stock or assets of the acquired company are subject to the HSR Act, so an acquisition of IO by ConAgra valued at $135 million would be subject to the Act's premerger reporting and waiting period requirements. Prior to closing, the parties will each have to file a prescribed report form with the Antitrust Division of the Department of Justice and with the Federal Trade Commission. The HSR Act then bars the closing of the transaction for an initial waiting period of 30 calendar days to permit the investigating agency to conduct a preliminary antitrust merger review. Moreover, if during the initial waiting period the reviewing agency decides that the transaction warrants a full investigation, the agency will issue a so-called "second request" to the parties for documents and information. These second requests are voluminous, and compliance typically requires several months. Given the highly concentrated business of low calorie single serve frozen foods, the FTC almost certainly will issue a second request in connection with this transaction. The issuance of a second request extends the waiting period for the time it takes the parties to comply plus an additional 30 calendar days. The FTC's practice is to ask the merging parties to enter into a "timing agreement" committing the parties not to close the transaction for an additional 30 to 60 days after the waiting period has expired in order to enable the FTC to complete its investigation and to give the parties the opportunity to present the best possible defense of the transaction. The merging almost find it in their interest to give this commitment.

If, at the end of the investigation, the FTC concludes that the acquisition violates Section 7, in many cases the parties will be able to negate the FTC's concerns by restructuring their transaction pursuant to a consent decree to divestiture problematic lines of business to a third

[1] **Note to students**: Technically, another essential element of a Section 7 violation is the requisite connection to interstate commerce. The instructions to the homework assignment (as well as to the exam) say that you may assume this connection and that you do not need to address it.

party that will continue the competition postmerger. In this case, given the nature of the products, there is nothing to divest that would eliminate any problematic overlap in low calorie single serve frozen foods while still preserving the economic benefits of the transaction. In the absence of a curative consent decree, the parties have the choice of voluntarily terminating their merger agreement or proceeding to litigation with the FTC.

If the matter proceeds to litigation, the Commission will seek injunctive relief to enjoin the closing of the transaction pending the resolution of the Section 7 merits in an administrative proceeding. Section 13(b) of the Federal Trade Commission Act provides that the court may enter a preliminary injunction "[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).[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. That said, federal district court judges in the District of Columbia—by far the most frequent venue for FTC Section 13(b) challenges—recognize that the success of a merger almost always rises or falls on whether a preliminary injunction is entered and so treats these cases more along the lines of a full adjudication on the merits although on a very compressed schedule. For this reason, neither the FTC nor the parties proceed to a full administrative trial following a preliminary injunction decision. If the injunction is entered, the parties historically voluntarily terminate their merger agreement; if the preliminary injunction is denied, except in unusual situations where the FTC believes that the court had made serious reversable error, the FTC will dismiss the administrative complaint and allow the transaction to proceed without further challenge.

Since this transaction is no fixable through a consent decree, whether the FTC will proceed to litigation depends on two factors: (1) whether the FTC concludes at the end of its investigation

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[2] **Note to students**: You do not have to cite cases in the 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. Remember, the exam instructions provide:

> As we discussed in class, you may cut and paste short passages ***from materials you have created*** to introduce a concept, 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 (in proper Blue Book form) as you would in a brief. You are prohibited from copying/cutting and pasting any other prewritten text (written prior to starting your exam) into your take-home exam responses, regardless of who authored the text.

In class, I suggested that you prepare a document to collect all of these passages in one place in I will broad call an outline. Many of the paragraphs explaining the concepts in this memorandum are from my outline, although the application of the concepts to the facts in the question must be written from scratch.

that the transaction violates Section 7, and (2) if so, whether believes, in the exercise of its prosecutorial discretion, that a challenge is in the public interest given the resources the FTC would expend in the litigation, the likelihood of its success in obtaining a preliminary injunction, and any bad precedent that may be created if the FTC does not prevail.

For the reasons explained in the next sections, I believe that the FTC more likely than not will either find that the transaction does not violate Section 7 or will exercise its prosecutorial discretion and not bring a challenge. In evaluating a transaction, the FTC will rely in the first instance on whether the transaction violates the principles set forth in the 2010 Horizontal Merger Guidelines issued by the Commission and the Department of Justice. But because the FTC lacks the power to preliminary enjoin a transaction and must seek a preliminary injunction from a federal district court, it is also attuned to the tests courts apply in Section 7 cases. Since the courts have largely accepted the theories of anticompetitive harm in the Merger Guidelines as supporting a finding of prima facie effect under the *PNB* presumption, I will analyze the substantive risk of 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

> **Note to students**: Most of you added a paragraph on the *Baker Hughes* three-step burden-shifting approach in your introductory section. Technically, this was not necessary since the question of substantive risk could be answered without analyzing whether the required burdens were likely to be satisfied at the various stages of any litigation. and indeed none of you did that analysis. That said, while a *Baker Hughes* paragraph was surplusage, I did not deduct for its inclusion.

Preliminary Substantive Analysis

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

The FTC almost surely will analyze the transaction in a market for the production and sale of low calorie single serve frozen dinners. There are two complementary approaches to product market definition: the *Brown Shoe* "outer boundaries" and "practical indicia" criteria, and the hypothetical monopolist test. Both approaches point to a low calorie single serve frozen dinner product market.

The Brown Shoe *judicial tests*. 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 probative of reasonable interchangeability of use and high cross-elasticity of demand.

Low calorie single serve frozen dinners almost surely satisfy the *Brown Shoe* "outer boundaries" and "practical indicia" criteria. The high cross-elasticity/reasonable interchangeability of use is shown by the high diversion ratios within the market:

IO → Lean Cuisine and Healthy Choice:	50%
Lean Cuisine → Healthy Choice:	90%
Healthy Choice → Lean Cuisine:	90%

Although the zero diversion ratio from Lean Cuisine and Healthy Choice to IO indicates that customers of the former do not view the latter as a substitute, the 50% diversion ratio in the other direction indicates that Lean Cuisine and Healthy Choice are significant price-constraining forces on IO. This should be sufficient for low calorie single serve frozen dinners to satisfy the Brown Shoe "outer boundaries" test.

The "practical indicia" also indicate that low calorie single serve frozen dinners are a relevant precut market. Each product within the market has its most significant competitors within the market (as show by the diversion ratios). The products are recognized by the industry and the public as distinct from other products because of their attributes of being healthy, low calorie, storable (frozen) dinners for individual consumption and being priced higher than non-low calorie single serve frozen dinners ($2.29/$1.86 v. $1.71). Their commercial separateness from non-low calorie single serve frozen dinners is further confirmed by the fact that ConAgra and Nestle brand, price, and sell the low calorie and non-low calorie products differently and that Bellisio, which currently produces only non-low calorie single serve frozen dinners, is actively considering extending its product line and entering with a low calorie single serve frozen dinner line.

The hypothetical monopolist test. The "hypothetical monopolist test," which was introduced by the Merger Guidelines in 1982 and now adopted in one form or another by the courts, deemed 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 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 of all of the products in the candidate market. Under the 2010 Merger Guidelines, where the hypothetical monopolist could raise the prices of one or more products selectively while leaving the prices of the other products constant, 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). A important practical implication of these two modifications is that any

[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.

product groupings containing a relevant market is itself a relevant market, since the hypothetical monopolist could simply profitably raise the prices for the products that create the original relevant market and leave unchanged the prices of all of the other products in the larger product grouping.

Low calorie single serve frozen dinners 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% (as we have here) is:

$$\%CL = \frac{\delta}{\delta + m} = \frac{0.05}{0.05 + 0.30} = 14.3\%$$

The percentage actual loss from the product grouping resulting from a 5% SSNIP is 16.6%. Since percentage actual loss is greater than the percentage critical loss, the hypothetical monopolist test fails for a uniform price increase.

Modern courts, however, 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. The aggregate diversion ratio test holds that if the actual diversion ratios from each product in the product grouping into the all other products in the product group (holding the prices of all of the other products constant) is greater than the critical recapture rate, the product grouping allows the price of at least one of product in the product grouping to be profitably increased by a SSNIP. Here, the actual diversion ratios into the market are:

IO:	50% (to Lean Cuisine and Healthy Choice)
All other products:	90% (to low calorie single serve frozen dinners other than IO)

The critical recapture rate is:

$$R_{CL} = \frac{\delta}{\delta + m} = \frac{0.05}{0.05 + 0.30} = 14.3\%$$

Since the diversion ratios of each product individually in low calorie single serve frozen dinners is greater than the critical recapture rate, the hypothetical monopolist test is satisfied under the aggregate diversion ratio test.

Notes to students:

Comment 1. Note the structure of this section: (1) some "boilerplate" from the outline on the relevant concepts, and (2) the application of the concept to the facts in the hypothetical to reach a conclusion.

Comment 2. As I mentioned in case, whenever you have doubts about the applicability or application of a particular hypothetical monopolist test, you can always use a brute force calculation. Below is a brute force calculation showing that a hypothetical monopolist could increase the price of IO by a 5% SSNIP profitably:

DATA			**CALCULATION**	IO	
%SSNIP	5.0%		$SSNIP (Δp)	$0.1145	SSNIP * price
Price	$2.29	Table 2	Retained units	18,209,607	(1-16.6%)*units
Total sales	$50,000,000	Table 1, 4	Gross gain	$2,085,000	
Total units	21,834,061	Calculated			
%Actual loss	16.6%	Table 3	Lost units	-3,624,454	16.6% * units
%Recapture	50.0%	Table 3	$margin (m)	$0.69	
			Gross loss	-$2,485,340	
$margin (IO)	$0.69	Table 2			
$margin (other LC)	$0.56	Table 2	Recapture rate	50%	
			Margin on recap	$0.56	
			Recapture sales	1,812,227	50% * lost units
			Recapture gain	$1,014,847	
			TOTAL GAIN	$614,507	
				PASSES	

Comment 3. Some students thought that the fact that the diversion ratio from other low calorie products to IO was zero eliminated IO from the market. This is incorrect in two respects. First, the aggregate diversion ratio test looks at diversion into all of the other products in the market in the aggregate (hence the source of the name of the test), so that fact that there is no diversion from some products to another is irrelevant as along as the aggregate diversion is high enough. Second, the 90% diversion ratios were enough to make all low calorie single serve frozen dinners *except* IO a relevant market. But given that the hypothetical monopolist can selectively increase prices in a product grouping, any group of products containing a relevant market is also a relevant market. So, if all low calorie single serve frozen dinners except IO is a market, then low calorie single serve frozen dinners including IO is a relevant market as well.

Comment 4. The high diversion ratio of 50% from IO to Lean Cuisine and Healthy Choice should have indicated that Lean Cuisine and Healthy Choice premerger impose material pricing pressure on IO and therefore IO should be in the same market as Lean Cuisine and Healthy

Choice when considering a combination between IO and Healthy Choice. Remember, you need to find the market appropriate for evaluating the competitive effects of the transaction in issue.

Comment 5. Some students though that IO could be a relevant market by itself under the *Cellophane* fallacy. That is very likely true, but it does not help here in light of Comments 1 and 2.

Comment 6. Everyone who failed to identify all low calorie single serve frozen dinners as a relevant market identified all single serve frozen dinners as a relevant market under a uniform SSSNIP test using a percentage critical loss implementation.

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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.

Low calorie single serve frozen dinners are sold nationwide and each sell at the same price across brands throughout the country.[4] Advertising is also nationwide.[5] 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 the country for at least one product in the market. (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 a nationwide low calorie single serve frozen dinner market, it is unnecessary to examine the competitive effects in any smaller markets.

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4 **Note to students**: The hypothetical was explicit on this with respect to IO but implicit with respect to the other brands. I have assumed these facts as the facts most consistent with the hypothetical.

5 **Note to students**: The hypothetical was not explicit on this. I have assumed these facts as the facts most consistent with the hypothetical.

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 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); *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."

In low calorie single serve frozen dinners, the transaction combines ConAgra, the number 2 firm with a 22.1% share, with IO, the number 3 firm with a 19.2% share, giving the combined firm a 41.3 share. The transaction would increase the HHI by 849 points to 4708:

Low-Calorie Single-Serve Frozen Dinners

	Sales	Share	HHI contribution
Nestlé (Lean Cuisine)	142.45	54.8%	3000
ConAgra Foods (Healthy Choice)	57.41	22.1%	487
Intelligent Ones	50.00	19.2%	370
Others/Private label (6)	10.22	3.9%	3
	260.08	100.0%	3859
Combined share		41.3%	
Premerger HHI			3859
Delta			849
Postmerger HHI			4708

2-firm CR:	
Premerger	76.8%
Postmerger	96.1%
Change	19.2%

The resulting combined market share, market concentration, postmerger HHI, and delta would exceed what the modern courts have found sufficient to predicate the *PNB* presumption. The combined firm's share of 41.3% significantly exceeds the 30% threshold set in *Philadelphia National Bank.* The transaction results in a significant increase in concentration by eliminating one of the three significant firms in the market and increasing the 2-firm concentration ratio from 76.8% to 96.1%, significantly in excess of the 44% to 59% change in the 2-firm concentration ratio the *PNB* Court found sufficient.

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. The statistics here fall well within the range of most modern complaints filed by the FTC and DOJ that have been successful in court, and significantly higher than some challenges. *See, e.g.*, *FTC v. H.J. Heinz Co*., 246 F.3d 708 (D.C. Cir. 2001) (complaint alleging combined market share of 33%, delta of 510, and postmerger HHI of 5285); *United States v. Anthem, Inc.*, 236 F.Supp.3d 171 (D.D.C.) (combined share of 47%, delta of 537, and postmerger HHI of 3000), *aff'd*, 855F.3d 345 (D.C. Cir. 2017); *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); *United States v. H&R Block, Inc.*, 833 F. Supp. 2d 36, 72 (D.D.C. 2011) (combined market share of 35%, delta of 400, and postmerger HHI of 4691); *see also In re Evanston Northwestern Healthcare Corp.*, No. 9315, 2007 WL 2286195, at *4 (FTC Aug. 6, 2007) (combined market share of 35%, delta of 384, and postmerger HHI of 2739).

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 low calorie single serve frozen foods. In particular, the acquisition is likely to result in unilateral gross upward pricing pressure on the price of Intelligent Ones. It is hard to see, however, how the transaction would increase the likelihood or effectiveness of coordination interaction on either price or grocery store shelf space. Finally, there is no indication on the facts we have that the acquisition will eliminate a maverick.

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 (emphasis added). 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 only one firm firms need to be close competitor to the other (and not necessarily the closest) and eliminated the 35% combined share requirement.

On its face, it is sufficient under the 2010 revisions for the unilateral effects theory to apply that Healthy Choice is a significant competitor of IO (as shown by the 50% diversion ratio from IO to Healthy Choice and Lean Cuisine), even though IO is not a significant competitor to Healthy Choice (as shown by the 0% diversion ration from Healthy Choice to IO).

We can test this in the first instance by calculating the upward pricing pressure on IO (UPP_{IO}) that would be created by the merger:

$$UPP_{IO} = D_{IO \to HC} \$m_{HC}$$

We can estimate the diversion ratio from IO to Healthy Choice through the proportional shares method:

$$D_{IO \to HC} = \left(1 - D_{OO}\right)\frac{s_{HC}}{1 - s_{IO}} = \left(1 - 0.5\right)\frac{0.221}{1 - 0.192} = 13.7\%$$

The dollar margin for Healthy Choice is \$0.56. This yields an UPP_{IO} of \$0.077.[6]

[6] **Note to students**: You could also have calculated the GUPPI here to the same qualitative effect.

By itself, this is not too meaningful, but we can do a brute force calculation with recapture to test how high we can unilaterally profitably increase the price of IO due to recapture of some sales by Healthy Choice:

Brute Force: Profitability of IO price increase	
%SSNIP for IO	3.40000%
$SSNIP (Δp)	$0.0777
%Actual loss to everything/1%	3.32%
Diversion to other LC	50.00%
%Actual loss to other LC/1%	1.66%
% Diversion of lost sales to HC	13.7%
%Actual loss	11.29%
Retained sales	19,405,750
Gross gain	$1,508,104
Lost unit sales	-2,469,250
$margin (m)	$0.69
Gross loss	-$1,693,200
Margin on recap	$0.56
Recapture sales	338,287
Recapture gain	$188,474
TOTAL GAIN	$3,378

By trial and error, I found that recapture by Healthy Choice would make a price increase of at much as 3.4% profitable. Since any price increase as a result of a merger that is not offset by a consumer benefit is anticompetitive, the 3.4% price increase, although small, is still positive and hence technically anticompetitive.

By contrast, the upward pricing pressure on Healthy Choice (UPP_{HC}) is zero, indicating that the combined firm will have no incentive to increase the price of Healthy Choice postmerger:

$$UPP_{HC} = D_{HC \to IO} \$m_{IO} = 0 \times \$0.69 = 0.$$

Coordinated effects theory (price). 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 low calorie single serve frozen dinners market is susceptible to tacit coordination premerger. The market is characterized by two or three significant firms (depending on whether you count IO in or out) with six or seven fringe firms. Since prices are transparent, however you characterize the market it is susceptible to coordinated interaction.

But will the merger make tacit collusion with more likely or more successful? Once ConAgra acquires IO, the remaining significant firms in the low calorie single serve frozen foods market will be Nestle and ConAgra. Normally, a three-to-two merger will make tacit collusion more likely or more successful, and the FTC may very well be expected to argue that here. However, as discussed above, because the diversion ratio from IO to either Lean Cuisine or Healthy Choice is zero, IO premerger exerts no pricing pressure on either product. As a result, IO was not part of the collusive group. Consequently, the pricing pressures on Lean Cuisine on Healthy Choice will be the same postmerger as they were premerger and the number of firms in the collusive group will not decrease. Although the merger will bring ConAgra's market share closer to Nestle's market share, it will not change the alignment of their incentives to tacitly coordinate. A coordinated effects theory should be rejected in this case.

Coordinated effects (shelf space). Nestle and ConAgra are in a battle for grocery store shelf space. Each company is pressuring grocery stores to increase its allocation of shelf space. To the extent that the acquisition brings ConAgra's allocation of shelf space closer to that of Nestle, this arguably could bring somewhat of a truce in the battle. Several facts suggest this is not a meritorious theory of anticompetitive harm.

First, the battle for shelf space is probably more of a function of the shelf space allocations for all single serve frozen dinners, not the shelf space allocations for low calorie single serve frozen dinners alone. In all single serve frozen dinners, the acquisition increases ConAgra's market share by 5% from 23.7% to 28.3%. This probably would not significantly increase ConAgra's relative bargaining power against Nestle in a way that would facilitate coordination on shelf space.

Second, it is not obvious how the battle between Nestle and ConAgra benefits consumers unless it is being fought through more aggressive promotions to consumers. There is no evidence one way or the other on this. If the battle is being fought on the basis or relative bargaining power with the grocery store and not through consumer promotions, a diminution of the battle through more coordination would not harm consumers.

Elimination of a maverick. Antitrust law regards a maverick as a firm that disrupts coordination to a significant degree that would exist in the absence of the maverick. There is nothing in the facts that we know so far that indicates that any firm in low calorie single serve frozen foods (or in all single serve frozen foods) is a maverick.

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 market in which to analyze the transaction is the manufacture and sale of low calorie single serve frozen dinners. A relevant geographic market is the United States. Application of the *PNB* presumption will establish a prima facie case of anticompetitive effect within this market. Moreover, the prima facie case is supported to some extent by the upward pressure the merger will create for the combined firm to increase the price of IO by about 3.5% in the absence of mitigating downward pricing pressures factors. There may also be a possible coordinated effects theory on increased tacit coordination to reduce the battle between Nestle and ConAgra for grocery store shelf space *if* this battle is being waged through consumer promotions. An important, unexplored fact to be investigated is whether the battle is being waged through consumer promotions or though relative bargaining power with the grocery stores. The is no suggestion in the facts that the acquisition will eliminate a maverick.

2. The merging parties' arguments

There are six arguments the merging parties can make in support of the merger: (1) the changes in the market shares and market concentration are only weakly probative of an anticompetitive price effect, since a brute force calculation of the adverse price effect on IO is at most no more than 3.5%; (2) the marginal cost efficiencies resulting from the merger are more than sufficient to offset this gross upward pricing pressure and incentivize the combined firm to lower IO's price postmerger, and (3) the potential entry of Bellisio Foods into low calorie single serve frozen dinners should further diminish any incentive on the part of the combined firm to increase IO's price; (4) any challenge based on an anticompetitive effect on shelf space allocation would be unprecedented and speculative at best; (5) the substantial fixed cost savings resulting from the merger, while not technically cognizable as a defense to offset upward pricing pressure, nonetheless should be considered as a matter of prosecutorial discretion as a factor in favor of no challenging the transaction; and (6) ConAgra's business plans for proceeding postmerger are procompetitive and will enhance consumer value.

The PNB presumption is weak at best. Although the changes in the market shares and market concentration are sufficient to predicate the *PNB* presumption in the changes in the market shares and market concentration, the probative value of the presumption is weak. The evidence in this case so far isolates any anticompetitive price increase to IO (and not to Healthy Choice or other low calorie products) and shows that the price increase would be no greater than 3.5% even in the absence of any downward pricing pressures created by the merger. Courts, if not the FTC, should be skeptical that such a small price increase can constitute the "substantial lessening of competition" required by a Section 7 violation. This, without more, should act as a significant brake on the enthusiasm of the FTC's enthusiasm to challenge the case. Moreover, even if it is not sufficient standing alone to dissuade the FTC from challenging the deal, it significantly lowers the thresholds for a sufficient defense.

Marginal cost efficiencies. The Horizontal Merger Guidelines recognize an efficiency defense when 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 merger will produce marginal cost reductions. Given its scale, ConAgra has been able to achieve significant savings in procurement of ingredients. Moreover, this efficiency is merger specific: IO lacks, and cannot achieve the scale of ConAgra (which includes its purchases of ingredients for all single serve frozen foods among many other products) to obtain the requite bargaining power to negotiate price reductions with ingredient suppliers that could ever match those negotiated by ConAgra. Moreover, the cost reductions are verifiable: ConAgra's purchase prices can be ascertained from its accounting records and readily compared to those of IO.

The question remains whether the marginal cost reductions are sufficient. Although Ms. Long does not know the numbers with confidence, she suspects that ConAgra can reduce the marginal cost of Intelligent Ones' from the current level of \$1.60 to \$1.50 or even \$1.40 without reducing the quality of the product. A reduction of \$0.10 to \$0.20 would represent a marginal cost reduction downward pricing pressure of 4.4% to 8.7%. Since the gross upward pricing of 3.5% is less than the downward pricing pressure from the marginal cost reductions, the net effect on the combined firm's incentives is to *lower* IO's price, not increase it. Granted, the net pricing pressure is only -0.9% to -5.2%, but it is negative under the facts as we know them. Even if Ms. Long has overestimated the marginal savings and that the actual savings is only \$0.05—half of Ms. Long's lower estimate—the resulting gross downward pricing pressure would still be -2.2%, yielding a net incentive to increase price of only 1.3 % assuming no other downward pricing pressures created by the merger. The FTC should be very hesitant to bring such a challenge because of the precedent it would create if the court were to find this magnitude of a predicted price increase too small to constitute a "substantial lessening of competition" within the meaning of Section 7. I believe that, even in the absence of other downward pricing pressure forces the FTC would exercise its prosecutorial discretion and not challenged the transaction.

Bellisio Foods potential entry. Bellisio Foods is openly considering entering into low calorie single serve frozen dinners. Bellisio is the third largest single serve frozen dinner producer after Nestlé and ConAgra. Its product line is established in grocery stores and it would be a natural and relatively inexpensive extension of its respected Michelina's and Patio brands to add a low calorie single serve frozen dinner product line. In addition to the brand name reputation, Bellisio has the production and distribution facilities and know-how to enter without any significant suck cost expenditure the production and distribution of a low calorie single serve frozen dinner product line. It also has a national advertising program in place that could easily accommodate the new product line. Finally, Bellisio today is three times the size of Intelligent Ones and if Bellisio extended its product line it would be better positioned than IO to defend it grocery store shelf space allocations.

For entry to be a defense to a prima facie case, the entry must be timely, likely, and of a magnitude sufficient to deter or counteract any competitive effects of concern so the merger will not substantially harm customers. Given Bellisio Foods' position, if it so wanted Belisio Foods could entry the manufacture and sale of low calorie single serve frozen dinners quickly and with a significant magnitude. Moreover, any anticompetitive increase in IO's price postmerger could only further encourage Bellisio Foods to enter.

That said, we do not know what Bellisio Foods is planning to do or what it will tell the FTC if asked. The FTC is highly skeptical of entry defenses and rejects them as a matter of course, no modern court has accepted an entry defense to defeat a prima facie case. Even if Bellisio Foods gave evidence most favorable to the merger on timing, likelihood, and magnitude, the FTC could still reject the defense as a technical matter since it would take some time for Belissio Foods to develop its recipes, gear up production, promote its product, during which time the FTC could claim that the combined firm could increase IO's price.

Nonetheless, the FTC should take into account the prospect of Bellisio Foods entering the low calorie single serve frozen dinners in exercising its prosecution discretion in two ways.

First, the prospect of Belliso Foods' entry should mitigate if not negate the incentives of both ConAgra and Nestle to act anticompetitively postmerger. As just noted, any anticompetitive increase in IO's price postmerger could only further encourage Bellisio Foods to enter the space. Entry by the number 3 firm in single serve frozen foods would, at least over the long run, make competition in low calorie single serve frozen dinners more vigorous that it was premerger when IO was the only other significant competitor. To avoid this possibility, ConAgra and Nestle should not act on any of the (small) incentives to act anticompetitively resulting from the merger. This is additional downward pricing pressure that could mitigate against a price increase on IO, even assuming that there was any incentive on the part of the combined firm to increase IO's price postmerger in light of the marginal cost efficiencies.

Second, depending on the entry evidence and the relatively weak prima facie case (for the reasons discussed above), it is possible that the court could be convinced to accept the defense that the potential entry of Bellisio Foods to defeat the prima facie case. This would be the first modern judicial precedent of a successful entry defense and a precedent that the FTC undoubtedly does not want to set, which would further encourage the FTC not to challenge the transaction.

Fixed cost savings. In addition to the marginal cost savings, ConAgra has sufficient excess capacity in its production, distribution, marketing, and back office systems to accommodate Intelligent Ones, with plenty of room left for growth, which will permit ConAgra to shut down Intelligent Ones' duplicative operations and eliminate about $6 million per year in annual recurring fixed costs. Moreover, because ConAgra already has a massive nationwide advertising program, it almost surely can increase the overall advertising of Intelligent Ones (perhaps by cutting back on some other products with lower margins) while saving some of the $4 million in advertising Intelligent Ones is currently spending.

Although fixed cost savings resulting from a merger generate no downward pricing pressure and hence are not a cognizable efficiencies defense under the Merger Guidelines, the agencies have declined in the exercise of their prosecutorial discretion to bring close cases where the fixed cost savings from the merger would be significant. Here, the annually recurring fixed cost savings will be at least $6 million per year, which is more than IO's current earnings of $5 million per year. Moreover, valued for ten years at an 8% discount rate, the present value of the fixed cost savings is over $40 million. Given the incentive of the combined firm to increase prices by at most a very small amount, if it has an incentive to increase prices at all in light of the various downward pricing pressures created by the merger, the large fixed cost savings from the merger should counsel the FTC not to challenge the deal.

ConAgra's business plans. Ms. Long believes that ConAgra's interest in Intelligent Ones is motivated in part by ConAgra's product diversity/growth strategy. Intelligent Ones offers a recognized higher-quality product than ConAgra's Healthy Choice line. ConAgra has told Ms. Long that, once it acquires Intelligent Ones, ConAgra plans on accelerating the introduction of new Intelligent Ones products and increasing advertising to attract additional customers to the product line. The large marginal cost reductions that ConAgra is likely to obtain from the deal would also incentivize it to lower IO's price. Both expanding IO's product diversify and lowering IO's price are significant procompetitive benefits.

Moreover, ConAgra told Long that it is not concerned about cannibalizing Healthy Choice customers by increasing the demand for Intelligent Ones. IO has a $0.13 gross margin advantage over Healthy Choice, so has long as the IO price decrease resulting from the merger's marginal cost reductions are no more than \$0.13, it would still be more profitably for ConAgra to sell a unit of IO rather than a unit of Healthy Choice. This makes the transaction a win-win for consumers and ConAgra.

Note to students: Some of you addressed the possibility of a power buyers and a failing firm defense. No evidence probative of a power buyers defense was presented in the hypothetical and the failing firm was negated because (1) the financials in Table 1 showed the IO was able to cover all of its costs and it make a profit, and (2) there is no suggestion that IO was shopping the company for “less anticompetitive” offers. Accordingly, it was unnecessary to include a discussion of either defense. That said, here is how I would have addressed them.

Power buyers. The 2010 Horizontal Merger Guidelines recognize the possibility that powerful buyers may constrain the ability of the merging parties to raise prices. The Guidelines, however, do not presume that the mere presence of powerful buyers prevents a merger from having anticompetitive effects. Even buyers with considerable bargaining leverage may have to accept higher prices in the wake of an increase in market power on the sell side of the market. Moreover, the merger may have anticompetitive effects, such as a reduction in product or service quality or in the rate of technological innovation or product improvement, that a buyer with sufficient bargaining power can avoid a nominal price increase cannot protect itself. Finally, even if the powerful buyers can protect themselves from a price increase from an anticompetitive merger, the market power created or enhanced by the merger can be used to harm less powerful buyers in the relevant market.

As a result, to be effective, the defense requires the showing of (1) a mechanism by which the putative powerful will be able to protect themselves from the anticompetitive effects of the merger, and (2) that there are no other buyers in the market that will likely be harmed as a result of the merger.

In the ConAgra/IO transaction, there is no evidence of the existence of any powerful buyers, although perhaps some of the large supermarket chains may be able to protect themselves against any price increases attempted by the combined firm in the wake of the acquisition. In addition to no particular firms being identified as power buyers, there is no suggestion of a mechanism by which the putative power buyers could protect themselves. Finally, even if some large supermarket chains could protect themselves from the anticompetitive effect of the transaction, there are many small supermarket and grocery store operations that almost surely could not protect themselves.

Failing firm. Ms. Long reported that IO has been “struggling somewhat in recent years,” which raises the prospect of a failing firm defense. The “failing firm” defense has existed as a defense to a Section 7 action since the Supreme Court’s decision in *International Shoe Co. v. FTC*, 280 U.S. 291, 299-303 (1930). The idea behind the defense is that it is better to permit an “anticompetitive” acquisition than to allow the failing firms assets—and therefore productive capacity—to exit the market. Under *International Shoe*, it is a complete defense to a Section 7 claim that the acquired entity is "a corporation with resources so depleted and the prospect of rehabilitation so remote that it faced the grave probability of a business failure." *Id*. at 777. The 2010 Horizontal Merger Guidelines have refined the elements of the defense to require:

(1) the allegedly failing firm would be unable to meet its financial obligations in the near future;

(2) it would not be able to reorganize successfully under Chapter 11 of the Bankruptcy Act; and

(3) it has made unsuccessful good-faith efforts to elicit reasonable alternative offers that would keep its tangible and intangible assets in the relevant market and pose a less severe danger to competition than does the proposed merger.

U.S. Dep't of Justice & Fed. Trade Comm., Horizontal Merger Guidelines § 11 (rev. 2010). Moreover, the Guidelines provides that, for the purpose of the third requirement, "[a]ny offer to purchase the assets of the failing firm for a price above the liquidation value of those assets will be regarded as a reasonable alternative offer." *Id*. § 11 n.16.

Here, IO, although perhaps "struggling," is not failing within the meaning of the defense either under judicial precedent or the guidelines. In its most recent fiscal year, IO was able to cover all of its fixed and variable costs and still make profits of $5 million. Moreover, IO did not solicit the ConAgra offer and there is no suggestion that ConAgra has made any efforts to solicit other offers, much less ones that might be less anticompetitive than ConAgra.

<u>Conclusion on Section 7 legality</u>

I believe that the transaction will be investigated by the FTC but more likely than not the FTC will close the investigation without enforcement action. The strongest case for a challenge is the market for the manufacture and sale of low calorie single serve frozen dinners in the United States. Notwithstanding strong evidence for this market and a strong likelihood that the FTC could establish a prima facie violation of Section 7 of the Clayton Act, this is one of those transactions can be defended. The gross upward pricing pressure resulting from the transaction is limited only to IO and is small in magnitude, which makes the prima facie case weak, and the significant downward pricing pressure resulting from the marginal cost efficiencies, the real prospect of entry by a major competitor, the substantial fixed cost savings, and ConAgra's procompetitive business rationale for the transaction should will be sufficient to dissuade the FTC as a matter of prosecutorial discretion, if not a matter of law, from challenging the transaction.

Need for Evidence

The results of this analysis, of course, depend on being able to prove the critical elements as well as ensuring that we are not missing anything that could change the analysis. The lists below identify the most important pieces of evidence that we should collect.

Evidence to support the above analysis

1. Diversion ratios (may require an econometric analysis of point-of-sale scanner data)
2. Prices and gross margins (from accounting data)
3. Market shares (from regular course of business documents and third-party market research reports)
4. Confirmation of marginal and fixed cost savings (may require the use of a third-party expert accountant or management consultant to be persuasive to the FTC)
5. Interviews and documents from ConAgra on the above plus its postmerger plans for the combined firm (especially as it relates to the product line expansion and pricing of IO)
6. Interviews and documents from ConAgra on the battle with Nestle for grocery store shelf space
7. Whatever additional information that can be found on Bellisio Foods' potential entry

More general evidence—From both IO and ConAgra (under an "outside counsel only" joint defense agreement)

1. A list of the top ten customers of the company for low calories single serve frozen dinner and the company's assessment of how these customers would respond to an FTC inquiry about how they likely would be affected, if at all, by the transaction
2. Interview with knowledgeable business people about:
    a. The likely reaction of major grocery store customers to the transaction
    b. What, if anything, the merging parties can tell grocery store customers to "sell" them on the benefits of the transaction to the stores and their customers
3. Any strategic plans or marketing plans prepared over the last three years for single serve frozen dinners generally and low calories single serve frozen dinners in particular
4. Any marketing or advertising plans prepared over the last three years for single serve frozen dinners generally and low calories single serve frozen dinners in particular
5. Any long-range strategic plan prepared over the last three years for single serve frozen dinners generally and low calories single serve frozen dinners in particular

6. Any other company document that identifies competitors for low calorie single serve frozen dinners
7. Any internally or externally prepared market research report prepared over the last three years for single serve frozen dinners generally and low calories single serve frozen dinners in particular
8. Any third-party reports or trade magazine articles that analyze the likely future of the IO
9. Any third-party reports or trade magazine articles that analyze the potential entry of Bellisio Foods into low calorie single serve frozen dinners
10. Any internal analyses or studies regarding the transaction, especially:
    a. any possible "4(c)" documents
    b. any possible "4(d)" documents
    c. any documents that address the rationale for the transaction
    d. any documents that address likely present or future changes in any product line as a result of the transaction