IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF WISCONSIN
MILWAUKEE DIVISION

UNITED STATES OF AMERICA, STATE of WISCONSIN, STATE of ILLINOIS, and STATE of MICHIGAN, *Plaintiffs*, v. DEAN FOODS COMPANY, *Defendant.*	Civil Action No. 2:10-cv-00059 (JPS)

DEFENDANT'S REPLY IN SUPPORT OF PARTIAL MOTION TO DISMISS OR, IN THE ALTERNATIVE, FOR A MORE DEFINITE STATEMENT

In their Response, Plaintiffs start out by contending they do not even need to plead a relevant geographic market for their fluid milk claim. That contention fails, however, because section 7 of the Clayton Act expressly requires proof that competition will be substantially lessened in a relevant "section of the country," and the Supreme Court has held that a properly alleged "geographic market" is therefore a "necessary predicate" to a section 7 claim. From that false start, Plaintiffs go on to make arguments that are inconsistent with the case law, ignore the terms of the U.S. Department of Justice's own Merger Guidelines, and depend on factual allegations not found in the Complaint. Yet they still fail to plead facts establishing a relevant geographic market.

Plaintiffs argue that "Wisconsin, the UP, and northeastern Illinois" comprise the relevant geographic market for fluid milk sales because "price discrimination" is possible

for *some* unidentified fluid milk customers at *some* unspecified locations *somewhere* within that area. *See* Response at 6-9, 14. They say it is enough to allege that "the customers that are potentially affected by the acquisition are located [somewhere] in Wisconsin, the UP, and northeastern Illinois." *Id.* at 15. No authority supports this novel position, which renders market definition a nullity. By this logic, it would be equally valid to insert "the United States" in place of "Wisconsin, the UP, and northeastern Illinois" in Plaintiffs' formulation. Absent factual allegations establishing the particular locations of customers subject to price discrimination and the reasons why those locations comprise a relevant geographic market, Plaintiffs' approach is legally deficient and economically meaningless.

Despite more than nine months of pre-complaint investigation (with the benefit of civil subpoena authority, the production of more than a million pages of documents, and numerous fact depositions), Plaintiffs still have not, and Dean Foods believes cannot, state the basic facts required to support a properly pleaded geographic market. In light of Plaintiffs' evident inability to cure the fundamental defects in their Complaint, Dean Foods respectfully suggests that the fluid milk claim should be dismissed with prejudice.

ARGUMENT

I. COUNT 2 OF THE COMPLAINT (THE FLUID MILK CLAIM) SHOULD BE DISMISSED FOR FAILURE ADEQUATELY TO PLEAD A RELEVANT GEOGRAPHIC MARKET

A. Geographic Market Definition Is Required in Section 7 Cases

It is black letter law that a properly defined geographic market is a "necessary predicate" to a claim under section 7 of the Clayton Act, 15 U.S.C. § 18. *United States v. Marine Bancorp., Inc.*, 418 U.S. 602, 618 (1974). This essential element is found in the language of section 7 itself, which requires proof that the challenged transaction will

substantially lessen competition in a particular "section of the country," a term the Supreme Court "[w]ithout exception . . . has treated" as "identical" to "relevant geographic market." *Id.* at 620.

Plaintiffs therefore are plainly wrong when they contend that geographic market definition "is not a jurisdictional prerequisite" to their section 7 claim "or an issue having its own significance under the statute" but "is merely an aid for determining whether [market] power exists." Response at 4 (quoting *Gen. Indus. Corp. v. Hartz Mountain Corp.*, 810 F.2d 795, 805 (8th Cir. 1987) (internal quotations omitted)). They support this contention by citing cases *that arose under a different statute*. The *Hartz Mountain* case had *nothing* to do with assessing "the likely competitive effects of an acquisition." Response at 4. *Hartz Mountain* was a dealer termination case arising under sections 1 and 2 of the *Sherman Act*, 15 U.S.C. §§ 1, 2; it was *not* a section 7 merger case. The only other case Plaintiffs cite for their contention, *Ball Mem. Hosp., Inc. v. Mut. Hosp. Ins., Inc.*, 784 F.2d 1325 (7th Cir. 1986), *cited in* Response at 4, was also a Sherman Act case. The Sherman Act, which condemns contracts in restraint of trade and actual or attempted monopolization, focuses on the creation or abuse of market power. Unlike Clayton Act section 7, the Sherman Act *does not include* the key phrase "section of the country."[1]

Accordingly, Plaintiffs' effort to avoid pleading the "necessary predicate" of a relevant geographic market must fail.

[1] The two dairy industry cases Plaintiffs cite where district courts in other circuits refused to dismiss antitrust complaints for failure to plead a proper geographic market were also Sherman Act cases, *not* section 7 merger cases. *See* Response at 12 (citing cases). And they were both decided before the Supreme Court's decision in *Ashcroft v. Iqbal*, 129 S. Ct. 1937 (2009), which made clear that plaintiffs in all types of civil cases have an obligation to plead plausible facts to support each element of their claims.

B. Plaintiffs' Arguments Are Contrary to the Case Law

Perhaps recognizing the futility of contending that geographic market definition is not required in a section 7 case, Plaintiffs argue, in the alternative, that the Complaint's conclusory allegation of a geographic market for fluid milk sales is somehow sufficient.

Plaintiffs err by insisting that the area of former competitive overlap is the relevant geographic market. *See* Response at 10 ("Wisconsin, the UP, and northeastern Illinois comprise the region in which Dean and Foremost competed for fluid milk sales prior to the acquisition."). The area in which the two firms historically competed does *not* dictate the relevant geographic market. While the area of overlap may be a starting point for identifying potentially affected customers, "[t]he proper question to be asked . . . is not where the parties to the merger do business or even where they compete, but where . . . the effect of the merger on competition will be direct and immediate." *United States v. Phila. Nat'l Bank*, 374 U.S. 321, 357 (1963).

Section 7 requires a dynamic, forward-looking market definition that encompasses the region where the potentially affected customers could look to purchase fluid milk in the event of a significant price increase. *See FTC v. Elders Grain, Inc.*, 868 F.2d 901, 907 (7th Cir. 1989) (Posner, J.); *see also Lantec, Inc. v. Novell, Inc.*, 306 F.3d 1003, 1027 (10th Cir. 2002) ("The geographic market is not comprised of the region in which the seller attempts to sell its product, but rather is comprised of the area where his customers would look to buy such a product [in case of a price increase].").

The only section 7 authority Plaintiffs cite for their backward-looking, static approach to market definition is the long-outdated opinion in *United States v. Pabst Brewing Co.*, 384 U.S. 546 (1966). *See* Response at 5, 6. But antitrust jurisprudence left

Pabst Brewing behind long ago, beginning with *United States v. General Dynamics Corp.*, 415 U.S. 486, 501-04 (1974), which held that in assessing the probable effects of a merger, courts must focus on the future competitive landscape. *Pabst Brewing* has been overtaken by the Supreme Court's modern emphasis on sound economic concepts and a forward-looking approach to predicting the effects of mergers. *See United States v. Baker Hughes, Inc.*, 908 F.2d 981, 990-91 (D.C. Cir. 1990) (Thomas, J.); *Hospital Corp. of Am. v. FTC*, 807 F.2d 1381, 1385-86 (7th Cir. 1986) (Posner, J.).

Current law requires the pleading of plausible facts showing that customers in the alleged geographic market could not switch to alternative suppliers in response to a significant price increase. *See, e.g.*, *Elders Grain*, 868 F.2d at 907; *see also Ashcroft v. Iqbal*, 129 S. Ct. at 1949 (stating the requirement to plead plausible facts). Plaintiffs' failure to plead such facts means that their geographic market definition must fail as a matter of law.

C. Plaintiffs Have Failed to Follow Their Own Merger Guidelines

Plaintiffs also ignore the terms of the U.S. Department of Justice's Horizontal Merger Guidelines, the federal Plaintiff's own authoritative policy guidance for analyzing merger cases under section 7.

There are two tests for defining a relevant geographic market in the Merger Guidelines.[2] The first, described in section 1.21, focuses on the available sources of supply, and it would require the relevant market to include all locations of production that a hypothetical monopolist would have to control to be able profitably to impose a general significant price increase. Merger Guidelines § 1.21.

[2] The pertinent sections of the Horizontal Merger Guidelines are appended to Dean Foods' opening brief at Tab A.

The second test, described in section 1.22, focuses more narrowly on "particular locations" where customers can profitably be targeted for "price discrimination" (defined as charging certain customers a significantly higher price net of costs, including "net of transportation costs"). *Id.* § 1.22. Under this second test, Plaintiffs must (1) identify the "particular locations" of the targeted customers, (2) establish that the customers located in those particular areas (*i.e.*, the targeted customers) cannot defeat a significant price increase by substituting to more distant fluid milk suppliers, and (3) show that non-targeted customers (*i.e.*, customers located outside the targeted areas) could not resell to targeted customers to defeat the price increase through arbitrage. *Id.* § 1.22.

In their Response brief, Plaintiffs now make it clear that their Complaint relies *only* on the price discrimination test set forth in section 1.22 of the Guidelines and *not* on the supplier-focused test of section 1.21. Response at 7-9.

By forswearing section 1.21, Plaintiffs concede that even a hypothetical monopolist that owned all the milk processing plants in Wisconsin, the UP, and northeastern Illinois could *not* raise prices across the board for all fluid milk customers in this proposed area without inducing enough customers to buy milk from competing processors outside the area to defeat the general price increase. *See id.* at 11 (acknowledging that the supplier-focused test in section 1.21 would not support their proposed market definition). Instead, Plaintiffs are claiming that prices could only be increased for certain (unidentified) customers in certain (unspecified) locations *somewhere within the boundaries* of Wisconsin, the UP, and northeastern Illinois. *See id.* at 9-10 (asserting that the only question is whether a targeted price increase could be imposed on "*a set of purchasers in* [the proposed] geographic market") (emphasis added);

id. at 14 ("The issue is whether customers can engage in arbitrage to offset the impact of a price increase *to certain targeted customers*.") (emphasis added).

Plaintiffs' approach fails to satisfy any of the three requirements for defining a relevant geographic market in section 1.22 of their own Merger Guidelines:

First, the Complaint fails to identify the "particular locations" of customers that Plaintiffs claim could be targeted for price discrimination. Only those "particular locations" may constitute relevant markets under section 1.22.

Second, the Complaint fails to allege that customers located in those targeted areas could not defeat a significant price increase by purchasing from "more distant sellers." The Complaint alleges only that most customers "in Wisconsin and the UP" currently choose to purchase fluid milk sourced from plants within 150 miles *at today's prices*, Compl. ¶¶ 15, 41, but there is no allegation that these same customers (let alone customers in northeastern Illinois) would not buy from more distant plants in the event of a significant price increase in the future, as the Guidelines require. *See* Merger Guidelines § 1.22 (stating that a relevant market may be defined on the basis of price discrimination only "if a hypothetical monopolist can identify and price differently to buyers in certain areas ('targeted buyers') ***who would not defeat the targeted price increase by substituting to more distant sellers in response to a 'small but significant and nontransitory' price increase for the relevant product***") (emphasis added).

Plaintiffs assert it is "irrelevant" whether the targeted customers can switch to competing suppliers and that the only issue is "the possibility of arbitrage." Response at 11. That is wrong. As quoted above, section 1.22 of Plaintiffs' own Guidelines expressly requires a showing that the targeted customers cannot substitute "to more

distant sellers."[3] It is implausible, for example, that retailers in Chicago or Milwaukee could be targeted for significant price increases without causing them to seek fluid milk bids from alternative suppliers.[4]

Third, the Complaint fails to allege that non-targeted customers cannot resell fluid milk to the supposedly targeted customers and thus defeat the alleged price discrimination through arbitrage. (In contrast, the Complaint includes just such an allegation in pleading that individual school districts are the relevant geographic markets for school milk sales. Compl. ¶ 34.) Plaintiffs vainly try to cover up this glaring hole in their fluid milk claim by stressing the Complaint's allegation that "*[r]etailers* in Wisconsin, the UP, and northeastern Illinois do not resell fluid milk to other retailers or institutions in any substantial quantity." Compl. ¶ 13 (emphasis added). *See* Response at 10, 14. But they ignore the allegation in their own Complaint that distributors and food service companies can and do resell fluid milk to other customers. Compl. ¶ 13 ("Distributors and food service companies *resell the milk that they purchase from processors* to small retailers, restaurants, and institutions.") (emphasis added). Moreover, the Complaint acknowledges that distributors and other customers "obtain rebates, discounts, or other forms of price relief," *id.* ¶ 14, which would obviously help the distributors realize a profit from resale and thereby help to enable arbitrage in response to

[3] *See also In re Brand Name Prescription Drugs Antitrust Litig.*, 288 F.3d 1028, 1030-31 (7th Cir. 2002) (Posner, J.) (observing that substitutability and arbitrage are two independent responses that targeted customers can use to defeat price discrimination).

[4] Plaintiffs allege that fluid milk is "costly to transport" and that the prices charged to different customers vary based in part on the processor's transportation costs, as well as its production and other costs. *See* Compl. ¶¶ 14-15; Response at 8, 9, 10. But variations in price based on differences in transportation costs (or any other costs) are not "price discrimination." Merger Guidelines § 1.22; *see United States v. Eastman Kodak Co.*, 63 F.3d 95, 106-07 (2d Cir. 1995).

price discrimination targeted at certain retailers. Thus, the Complaint contains allegations inconsistent with an assertion that arbitrage is not possible in fluid milk sales.[5]

II. IN THE ALTERNATIVE, PLAINTIFFS SHOULD BE REQUIRED TO PROVIDE A MORE DEFINITE STATEMENT

In the alternative, Dean Foods asks the Court to require Plaintiffs to provide a more definite statement of the alleged geographic market, including:

- The identities and particular locations of fluid milk customers that Plaintiffs believe Dean Foods can profitably target for price discrimination;
- The factual basis, if any, for concluding that these targeted customers cannot substitute to more distant fluid milk suppliers in response to a significant price increase; and
- The factual basis, if any, for concluding that other customers will not be able to engage in resale of fluid milk to the targeted customers to defeat the targeted price increase through arbitrage.

Plaintiffs make the astounding suggestion that Dean Foods is best positioned to identify the fluid milk customers in the relevant market. Response at 15. Perhaps Plaintiffs forget that they have the burden of proof, including on the fundamental issue of which customers they allege will be harmed by the transaction and which will not be. *See United States v. Connecticut Nat'l Bank*, 418 U.S. 656, 669 (1974); *FTC v. H.J. Heinz Co.*, 246 F.3d 708, 715 (D.C. Cir. 2001). Requiring Plaintiffs to make the

[5] The Response brief includes improper factual assertions about the likelihood and supposed efficacy of arbitrage by distributors—allegations found nowhere in the Complaint. *See* Response at 14. Plaintiffs also go well beyond the Complaint in asserting that milk processors "can charge more" where "customers have few nearby processors to choose from" and can price discriminate "based on factors in addition to the proximity of customers." *Id.* at 8 & n.5. "[I]t is axiomatic that the complaint may not be amended by the briefs in opposition to a motion to dismiss. . . . [C]onsideration of a motion to dismiss is limited to the pleadings." *Car Carriers v. Ford Motor Co.*, 745 F.2d 1101, 1107 (7th Cir. 1984).

necessary factual allegations will sharpen the issues in the case and enable Dean Foods to take more efficient and focused discovery.

CONCLUSION

Plaintiffs' fluid milk claim should be dismissed with prejudice. In the alternative, Plaintiffs should be required to provide a more definite statement of the facts necessary to support a properly defined geographic market. Dean Foods respectfully suggests that oral argument may help to illuminate the issues raised by this motion.

Respectfully submitted,

Dated this 25th day of March, 2010.

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