UNITED STATES DISTRICT COURT
DISTRICT OF COLUMBIA

FEDERAL TRADE COMMISSION, Plaintiff, v. ARCH COAL, INC., *et al.*, Defendants.	Civ. No. 1:04CV00534 (JDB) PUBLIC (REDACTED) VERSION
STATE OF MISSOURI, et al., Plaintiff, v. ARCH COAL, INC., *et al.*, Defendants.	

REPLY MEMORANDUM IN SUPPORT OF PLAINTIFFS' MOTION FOR PRELIMINARY INJUNCTION

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INTRODUCTION AND SUMMARY

Citing no credible evidence and ignoring their own statements and documents, Defendants cobble together a defense based on misdirection that: (1) Arch's acquisition of Triton ("Acquisition") is the best Defendants can do, benefitting Triton and the Buckskin and North Rochelle mines – but not consumers – more than the alternatives; (2) the relevant market is likely broader than all SPRB coal (and 8800 Btu SPRB coal); (3) notwithstanding the Commission's unanimous decision to challenge the Acquisition, the merger is presumptively legal and thus perfect coordination would be impossible; and (4) the views of many highly sophisticated customers should be summarily dismissed.[1] Each of these arguments is undermined by the facts and misses the point.

This case and Section 7 of the Clayton Act are concerned with the potential impact of this Acquisition on competition and customers of SPRB coal. The evidence will show that the Acquisition will tighten the oligopolistic structure of the SPRB coal market, and increase the likelihood of forbearance by the three major producers (i.e., Arch, Kennecott and Peabody) from producing at, or increasing production to, levels that would otherwise exist absent the Acquisition. Moreover, even if Defendants' arguments were supported by credible facts, their arguments miss the point: this case is not about what is best for Defendants or simply whether the North Rochelle or Buckskin mines may operate more profitably or efficiently as a result of the Acquisition. Rather, the only question before the Court is whether the Commission has preliminarily demonstrated, by raising "serious and substantial questions," that the Acquisition

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[1] Defendants suggest that FTC staff and the law firm of Slover & Loftus were somehow improperly involved in marshaling evidence. Putting aside the lack of evidence of improprieties, most of the facts adduced in this case existed before the Acquisition was announced.

reasonably increases the ability of the SPRB coal industry to lower output and raise prices. Because the answer is yes, the Acquisition should be preliminarily enjoined to allow the Commission fully to consider the merits in its pending proceeding.

Plaintiffs recognize that SPRB coal demand will increase over time[2] and do not contend that production will necessarily decrease as a result of the Acquisition. Rather, the question is whether Plaintiffs have shown a reasonable likelihood that the merger will increase the ability of the three major producers to cause the output of SPRB coal to be less than it would be absent the Acquisition. That question can be answered in the affirmative even if all SPRB coal production is likely to increase. The evidence shows that the Acquisition raises a serious question whether interdependent (cooperative) oligopolistic behavior by some or all of the three major producers will result in production lagging demand, keeping the market supply below (and prices above) levels that would be realized absent the Acquisition. The remaining "fringe" producers (i.e., RAG and the owner of Buckskin, assuming it is not Arch) would be less willing and less able without Triton to increase production by a sufficient amount to make output-restricting behavior by the three major producers unprofitable. As a result, this merger would substantially increase the probability that competition and customers will suffer.

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[2] The demand for SPRB coal is projected to grow at a rate of 6% per annum. PX 1002 at 017; PX4203.

ARGUMENT

I. Defendants' Product Market Analysis Is Fundamentally Flawed – the Product Market Is No Broader than All SPRB Coal and May Likely Include a Narrower Market for 8800 Btu SPRB Coal

Plaintiffs assert that the product market is no broader than all SPRB coal, and may likely include narrower markets (particularly 8800 Btu SPRB coal). Defendants assert that the market "is certainly no narrower than all SPRB coal, and quite likely is more appropriately regarded as the entire Powder River Basin, if not even more broadly." Def.'s Pretrial Br. at 20. Both parties reference SPRB coal as a putative product market. Moreover, Defendants' argument that the market is broader than all SPRB coal is flawed and fails to prove that narrower markets within the SPRB coal market do not exist.[3]

A. Defendants Incorrectly Assert that Purchases of Different Products by the Same Consumers Establish a Relevant Product Market

Defendants assert that because "the vast majority of electric generating plants purchasing 8800 Btu coal also have purchased 8400 Btu coal . . . it is both technically feasible and economically justified for utilities to obtain and burn both coals," and thus both are in the same product market. Def.'s Pretrial Br. at 20.[4] Defendants offer no credible evidence to support their

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[3] Even if Defendants properly defined a market broader than SPRB coal, narrower markets comprising all SPRB (or 8800 Btu SPRB) coal can still exist. *See, e.g., FTC v. Staples, Inc.*, 970 F. Supp. 1066, 1075 (D.D.C. 1997) ("within a broad market, 'well defined submarkets may exist which, in themselves, constitute product markets for antitrust purposes'") (citations omitted).

[4] Defendants also claim that "SPRB customers can and do shift substantial incremental volumes from SPRB suppliers to coal suppliers in other regions," and thus "the relevant geographic market in this case is likely broader than the SPRB." *Id.* at 22. Because a finding that the relevant product market comprises all SPRB coal, or 8800 Btu SPRB coal, would limit the relevant geographic market to the SPRB, we also discuss Defendants' geographic market contentions.

position. Even so, their assertions do not prove that the product market is broader than all SPRB coal. As a matter of law, two products do not necessarily compete in the same market merely because consumers of one product (e.g., cars) also consume another product (e.g., hamburgers).[5]

Defendants agree that "the outer boundaries of a product market" are determined by "the reasonable interchangeability of use or the cross-elasticity of demand between the product itself and the substitutes for it." Def.'s Pretrial Br. at 19 (quoting *Brown Shoe Co. v. United States*, 370 U.S. 294, 325 (1962)). This analysis, refined by the *Merger Guidelines* § 1.11., defines a product market as "a product or group of products such that a hypothetical profit-maximizing firm that was the only present and future seller of those products ('monopolist') likely would impose at least a 'small but significant and nontransitory increase' in price." This "small but significant and nontransitory increase in price" or "SSNIP" test is not simply whether consumers also purchase products outside the group. Rather, it is whether, in response to a small (typically 5%) price increase on all products in the group, enough consumers would substitute a product outside the group for products inside the group to make the price increase unprofitable. *See, e.g., FTC v. Staples, Inc.*, 970 F. Supp. 1066, 1076 & n.8 (D.D.C. 1997). For example, Defendants allege that in response to a huge (300%) price increase in 2001, "customers shifted purchases to

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[5] *See, e.g., New York v. Kraft General Foods, Inc.*, 926 F. Supp. 321, 333 (S.D.N.Y. 1995) ("brand interaction indices" that "measure only the propensity of [consumers] to purchase two products" are "not equivalent to, or proxies for, cross-price elasticities, because they do not purport to measure changes in consumption as a function of changes in price."). *See also Staples, Inc.*, 970 F. Supp. at 1074 (citing *United States v. E.I. Du Pont de Nemours*, 351 U.S. 377, 399 (1956) (court should "not stop after finding [even] a high degree of functional interchangeability between [two products]," but must also measure "the responsiveness of the sales of one product to price changes of the other"); *FTC v. Swedish Match*, 131 F. Supp.2d 151, 164 (D.D.C. 2000) ("dual usage" of moist snuff and loose leaf chewing tobacco by consumers insufficient to establish "that moist snuff induces an adequate level of substitution to constrain loose leaf prices").

other regions." PX0081-040; Def.'s Pretrial Br. at 22. Even if this could be proven, it does not explain whether such shifts would be made *in response to a SSNIP* and thus does not prove a product market broader than all SPRB coal.

Defendants' brief is devoid of empirical (and even anecdotal) evidence that customers would substitute other coals for SPRB coal *in response to a SSNIP*. *Id.* at 20. Properly analyzed, the product market is all SPRB coal and likely includes markets as narrow as 8800 Btu SPRB coal. These markets are supported by customer testimony, Defendants' own documents and executives, competitors, and the expert opinion of Dr. Morris. Customers make purchasing decisions, including whether to switch to another type or grade of coal in response to a SSNIP, based on the economic value of the alternatives.[6] The mere fact that customers have purchased non-SPRB coal does not mean they would switch from SPRB to non-SPRB coal (or from 8800 Btu to 8400 Btu coal) in response to a SSNIP.[7] While Plaintiffs expect to develop even more

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[6] *See generally* PX ; PX0008 (TUCO) ¶¶ 4,6; PX ; PX0011 (Midwest Generation) ¶¶ 12-16; PX

PX6861 (Nebraska Public Power District) ¶¶ 10, 12..

[7] PX PX

; PX

; PX

; PX

; PX , PX

; PX0036 (City Public Service of San Antonio) ¶¶ 10, 11 (CPS purchased other types of coal only because of temporary rail disruptions and would not switch from SPRB coal, even if price were to double); PX;

; PX6861 (NPPD) ¶¶ 3, 4, 5 (NPPD purchases the vast majority of its coal from the SPRB and purchases

evidence for the pending Commission proceeding, Plaintiffs have met their burden at this preliminary stage of demonstrating likely market(s) for all SPRB (and 8800 Btu SPRB) coal.

B. Without Support of Their Own, Defendants Ask the Court to Ignore the Statements of Customers and Producers and the Economic Evidence Supporting Plaintiffs' All SPRB and 8800 Btu SPRB Coal Markets

Customer perceptions, memorialized in numerous declarations, are informed, representative, consistent, and deposition-tested.[8] The customer declarations represent over three-fourths of the total tonnage of SPRB coal produced. These witnesses have extensive experience in the industry and procure tens of millions of dollars of coal each year.[9] Defendants concede these customers provide "realistic" and "informed" details about the market. Def.'s Mem. in Opp'n to Pl.'s Mot. for a Protective Order, at 6. They are sophisticated customers who make detailed assessments, as Triton's Mark Pettibone explains:

> a utility is going to decide what's in their best interest to burn, whether it's eastern coal, whether it's Illinois Basin coal, whether

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minimal amounts of higher Btu coal to keep its burners clean).

[8] Bales Dep. Tr. 249:13-259:13 (affirming declaration PX0011); Dep. Tr. 276:8-15 (declaration, PX , is correct, contains nothing he would change, and he learned nothing during deposition that would lead him to alter any statements); Freund Dep. Tr. 346:22-347:6 (the declarations, PX0013 & PX0023, are accurate and reflect his views); Kelly Dep. Tr. 8:21-9:18 (the basis for the statements in his declarations, PX0008 & PX0039, remain true); Rahm Dep. Tr. 197:9-198:17, 289:2-15, 293:18-295:10, 301:3-22, 304:21-305:21 ((same concern stated in his declaration, PX0007, expressed directly to Arch and the statements in the declaration remain true); Dep. Tr. 91:16-92:1 (have same concerns discussed in his declaration, PX , if Arch-Triton merger were consummated); 171:5-172:15 (information in her declaration, PX , is accurate); Werner Dep. Tr. 46:16-47:13 (declaration, PX0036, reflects the views of CPS).

[9] They have held positions in coal mining, sales, mine and utility handling, facility construction, as well as board and officer positions for coal industry organizations. *See generally* PX0004 (Western Farmers Electric Cooperative) ¶ 1; PX007 (Wester Energy) ¶ ¶ 1,2; PX ; PX0011 (Midwest Generation) ¶¶ 1,2; PX ; PX ; PX0022 (Kansas City Power & Light) p. 1; PX ; PX .

> it's western coal, whether it's lignite, and they are going to make decisions and plan accordingly. Those are long-term, global issues. When it comes to me competing for somebody's business that has determined they can burn Powder River Basin coal, either in part or in whole, what – I'm competing with [is] the Powder River basin at that point . . . presumably they're going to be lower than anything in the east anyway.

Pettibone Dep. Tr. 80:23-81:19.

These customers' views should be given substantial weight and certainly should not be brushed aside summarily before trial. Each buys substantial amounts of SPRB coal and their unique position in the market enables them to provide "accurate perceptions of economic realities." *Rothery Storage & Van Co.*, 792 F.2d 210, 219 n.4. Moreover, their views are supported by numerous documents,[10] the testimony of Defendants' executives and others in the industry,[11] and Dr. Morris' expert report, all of which recognize that SPRB coal and 8800 Btu SPRB coal are distinct product markets.

Dr. Morris tested whether SPRB coal constitutes a relevant market by simulating a small (5%) price increase by a hypothetical monopolist controlling all SPRB coal production. Using a weighted average price and conservative estimates of demand elasticity and costs, Dr. Morris

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[10] *See* Mem. in Supp. of Pl.'s Mot. for Prelim. Inj., at 14 - 16. *See, e.g.*, Letter from Arch CEO Steven Leer to Herbert Denton stating:

> One of the fundamental errors of the PRB producers, as their coal has moved further eastward, has been to base their pricing strategies off of their production costs as opposed to the substitution value of competitive eastern coals . . . . Put another way, the value gap between the western and eastern coals has been much too wide. PX0103 at 001-002.

[11] For example, Mr. Pettibone of Triton states: "I'm competing with the other people that produce coal in the Southern Powder River Basin, . . . which will probably be the cheapest alternative." Pettibone Dep. Tr. 82:19-22. Mr. of indicates: "
." Dep. Tr. 246:21-247:01.

concludes: "The calculations [in the report] indicate that a price increase [by a monopolist of all SPRB coal] would be profitable. The gain from a 5 percent higher price would be about $101 million per year and the loss from losing sales would be only about $11 million per year, giving an increase of about $90 million per year." PX4300 (Morris Expert Report) ¶ 29. Regarding an all SPRB coal market, Dr. Morris concludes: "This is not a close call and should not be a controversial issue." *Id.* at ¶ 30. Dr. Morris also reports that "[i]nformation suggests that narrower product markets may be relevant to assess the competitive effects of the acquisition. The narrowest such relevant market is 8800 Btu coal." *Id.* at ¶ 31.

Because "the determination of the relevant market in the end is 'a matter of business reality –[] of how the market is perceived by those who strive for profit in it," it is "imperative that the Court, in determining the relevant market, take into account the economic and commercial realities of the . . . industry." *FTC v. Cardinal Health, Inc.*, 12 F. Supp. 2d 34, 46 (D.D.C. 1998) (citations omitted). "[I]ndustry or public recognition of [a market] as a separate economic unit matters because we assume that economic actors usually have accurate perceptions of economic realities." *Id.* (citations omitted.) As here, where the statements of sophisticated buyers are supported by other credible evidence, courts have found them persuasive.[12]

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[12] *See, e.g., Swedish Match*, 131 F. Supp. 2d at 162 (finding "persuasive" statements by loose leaf tobacco distributors that they do not believe consumers would meaningfully increase moist snuff purchases in response to a 5-10% price increase); *Cardinal Health*, 12 F. Supp. 2d 34, 48-49 (D.D.C. 1998) (finding market for wholesale distribution of prescription drugs where, *inter alia*, "[n]umerous customers testified at trial that they would not increase their direct purchases from manufacturers or consider self-distribution in the event of anti-competitive practices [by prescription drug wholesalers]"); *FTC v. PPG Industries, Inc.*, 798 F.2d 1500, 1505 (D.C. Cir. 1986) ("the evidence that PPG and Swedlow are competitors . . . is overwhelming. It is recognized as a fact in the internal documents of the two companies and in the testimony of their customers.").

II. The Proposed Acquisition Will Substantially Increase the Likelihood of Coordinated (Cooperative) Interaction

Defendants' arguments regarding the likelihood of coordination seriously misstate the law and the facts. Defendants correctly cite the Merger Guidelines: "Whether a merger is likely to diminish competition by enabling firms more likely, more successfully or more completely to engage in coordinated interaction depends upon whether market conditions, on the whole, are conducive to reaching terms of coordination . . . ." Def.'s Pretrial Br., at 28 (quoting *Merger Guidelines* § 2.1). However, Defendants then incorrectly assert that "an essential axiom of coordinated interaction theory is that coordination can succeed only if market participants (1) can reach terms of agreement . . . ." *Id.* This misapprehends coordinated interaction theory and the law. Whether Defendants' self-described unilateral/independent acts prove the absence of or inability to agree is a red herring.

Plaintiffs need not prove an agreement[13] or that Defendants' conduct is likely to violate the law.

> Coordinated interaction is comprised of actions by a group of firms that are profitable for each of them only as a result of the accommodating reactions of the others. This behavior includes tacit or express collusion, and may or may not be lawful in and of itself.

Merger Guidelines § 2.1. Coordinated interaction "includes" tacit collusion, which courts have described as "interdependent anticompetitive conduct,"[14] "tacit coordination,"[15] "conscious

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[13] *See, e.g., FTC v. Elders Grain, Inc.*, 868 F.2d 901, 905 (7th Cir. 1989) (". . . if conditions are ripe, sellers may not have to communicate or otherwise collude overtly in order to coordinate their price and output decisions . . . .").

[14] *See United States v. General Dynamics Corp.*, 415 U.S. 486, 497 (1974); *see also Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 210 (1993) ("interdependent pricing"); *FTC v. Illinois Cereal Mills, Inc.*, 691 F. Supp. 1131,1137 (N.D. Ill.

parallelism,"[16] and "implicit understanding."[17] The Supreme Court described tacit collusion as a "process, not in itself unlawful, by which firms in a concentrated market might in effect share monopoly power, setting their prices at a profit-maximizing, supracompetitive level by recognizing their shared economic interests and their interdependence with respect to price and output decisions."[18]

A leading treatise describes interdependence in the following manner:

> Whenever rational decision making requires an estimate of the impact of any decision on the remaining firms and an estimate of their response, decisions are said to be "interdependent." *Because of their mutual awareness, oligopolists' decisions may be interdependent although arrived at independently.*

6 Phillip E. Areeda, Herbert Hovenkamp & John L. Solow, Antitrust Law ¶ 1429a, at 207 (2d ed. 2003) (emphasis added). Thus, the absence of an agreement does not prove the absence of interdependent action.

Moreover, coordinated interaction is harmful to consumers even if the conduct is lawful

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1988) ("interdependent, noncompetitive conduct"), *aff'd, FTC v. Elders Grain, Inc.*, 868 F.2d 901, 905 (7th Cir. 1989); *FTC v. Bass Bros Enterprises, Inc.*, 1984-1 Trade Cas. (CCH) ¶ 66,041 (N.D. Ohio 1984) at 68,620 (same).

[15] *See Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 210 (1993); *FTC v. H.J. Heinz Co.*, 246 F.3d 708, 725 (D.C. Cir. 2001); *United States v. Baker Hughes Inc.*, 908 F.2d 981, 985 (D.C. Cir.1990) (citing P. Areeda & H. Hovenkamp, Antitrust Law ¶ ¶ 919', 920.1, 921', 925', 934', 935', 939', at 813-23 (Supp.1989)).

[16] *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 227 (1993).

[17] *See FTC v. PPG Indus., Inc.*, 798 F.2d 1500, 1503 (D.C. Cir.1986).

[18] *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 227 (1993) (citations omitted); *see also JTC Petroleum Co. v. Piasa Motor Fuels, Inc.*, 190 F.3d 775, 780 (7th Cir. 1999) (Posner, CJ.) (discussing tacit collusion whereby defendants recognize their common interest in acting jointly, but act without any agreement to do so).

tacit coordination that occurs within an oligopolistic market structure.[19] A critical goal of Section 7 of the Clayton Act is the avoidance of the creation or fortification by merger of market conditions that are conducive to tacit coordination. As this Circuit recently remarked, tacit coordination

> is feared by antitrust policy even more than express collusion, for tacit coordination, even when observed, cannot easily be controlled directly by the antitrust laws. It is a central object of merger policy to obstruct the creation or reinforcement by merger of such oligopolistic market structures in which tacit coordination can occur.[20]

It is precisely for this reason that this Court's decision whether preliminarily to enjoin the Acquisition is critical.

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[19] *See, e.g., Clamp-All Corp. v. Cast Iron Soil Pipe Institute,* 851 F.2d 478 (1st Cir. 1988) (Breyer, J.) (oligopolistic pricing is not competitively desirable). One reason why tacit collusion or conscious parallelism, by itself, does not violate the antitrust laws is that it would be extremely difficult, if not impossible, to devise an effective remedy since there is no overt conduct that can be enjoined. *See JTC Petroleum, supra,* 190 F.3d at 780 ("The most compelling objection to JTC's theory [of attempted monopolization through tacit collusion] has nothing to do with the language of the Sherman Act but rather is the difficulty of formulating effective relief without transforming the district court into a regulatory agency . . ."); 4 Phillip E. Areeda, Herbert Hovenkamp & John L. Solow, Antitrust Law ¶ 927a, at 108-09 (rev. ed.1998). *See also Williamson Oil Co., Inc. v. Philip Morris USA*, 346 F.3d 1287 (11th Cir. 2003) (holding that synchronous behavior by oligopolists, absent "plus" factors, was not unlawful); 6 Phillip E. Areeda, Herbert Hovenkamp & John L. Solow, Antitrust Law ¶ 1433a, at 236 (2d ed. 2003) ("The courts are nearly unanimous in saying that mere interdependent parallelism does not establish the contract, combination, or conspiracy required by Sherman Act § 1.").

[20] *FTC v. H.J. Heinz Co.*, 246 F.3d 708, 725 (D.C. Cir. 2001). Professors Areeda *et al.* state that the difficulty of reaching tacit coordination under the Sherman Act "intensifies the concern of merger policy to prevent mergers that will facilitate tacit coordination," and that "[t]he fact that the oligopoly itself is not reachable under the Sherman Act tends to heighten rather than diminish the Clayton Act concern." 4 Phillip E. Areeda et al., Antitrust Law ¶ 916b2 (rev. ed. 2002). *See also Coca-Cola Bottling Co. of the Southwest*, FTC Docket No. 9215, 118 F.T.C. 452, 600 n.345 (1994), *vacated and remanded on other grounds*, 85 F.3d 1139 (5th Cir. 1996) ("One of the purposes of the Clayton Act § 7 is to prevent markets from becoming oligopolistic and thus susceptible to coordinated interaction, which 'includes tacit or express collusion, and may or may not be lawful in and of itself.'").

Defendants argue that market dynamics make coordination impossible and that Triton is not a maverick. Two examples illustrate the futility of Defendants' arguments. First, Defendants' arguments focus on the likelihood of coordination on a bid-by-bid, contract-by-contract, basis.[21] Although we do not discount the risk of such behavior as a result of the Acquisition, Plaintiffs' case recognizes that if supply of a product lags demand, it creates upward pressure on price.[22] For example, the three major producers may mutually recognize that by expanding production slower than demand, supply will tighen and prices will be higher than they might be otherwise. "[C]ollusion [can be] effectuated by a purely tacit meeting of the minds, a mutual forbearance to carry production to the point where price equals marginal cost." RICHARD A. POSNER, ANTITRUST LAW – AN ECONOMIC PERSPECTIVE 60 (2001). It makes no difference whether the reduced supply results from an agreement or tacit coordination – the effect is the same. And the coordination need not be perfect to do harm. *Merger Guidelines* § 2.11. This Acquisition will substantially increase the likelihood of tacit coordination of supply.

As Plaintiffs have explained,[23] SPRB producers recognize their "shared economic interests and their interdependence with respect to price and output decisions." *Brooke Group,* 509 U.S. at 227. Even if (as Defendants allege) SPRB producers have acted unilaterally, it does not prove a lack of interdependence. Defendants' own documents and statements advocate "production discipline," "pricing discipline," "market discipline," and "restraint." Indeed, Arch has been among the most outspoken, repeatedly urging the industry to constrain expansion and

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21 *See* Def.'s Pretrial Br., at 34-36.

22 For example, OPEC producers agree on production quotas that limit supply causing price to approach a price target.

23 *See* Mem. in Supp. of Pl.'s Mot. for Prelim. Inj., at 4-6, 28-32.

production. *See* Mem. in Supp. of Pl.'s Mot. for Prelim. Inj., 28-29. This Acquisition surely will increase the likelihood of such coordinated interaction and the consumer harm that results.

III. Using Practical Annual Capacity, the Most Appropriate Measure of Market Concentration, or any Other Reasonable Measure (Except Total Reserves, an Inappropriate Measure), the Acquisition Is Not Presumptively Lawful (as Defendants suggest)

Defendants take issue with Plaintiffs' use of practical capacity[24] to measure market shares and concentration, arguing that this Court instead should rigidly rely on reserves by virtue of a case decided 30 years ago in a different market under different circumstances. *See United States v. General Dynamics Corp.*, 415 U.S. 486 (1974). The Commission was well aware of *General Dynamics* (the parties argued vigorously that it controlled) when it decided to challenge this Acquisition. While the case involved a coal merger, the facts and circumstances at issue are different from those before this Court. Indeed, the Supreme Court's reasoning in *General Dynamics* supports Plaintiff's use of practical capacity. *General Dynamics* states that market shares and concentration should provide a "proper picture of a company's future ability to compete," *id.* at 501, and that the probable effects of a merger must be based on an "examination of the particular market." *Id.* at 498. The measurement should accurately reflect the "focus of competition in a given time frame." *Id.* at 501.

Most of the coal at issue in *General Dynamics* was sold under long-term (15-plus year) supply contracts and competition tended to be a "one time thing." *United States v. General Dynamics*, 341 F. Supp. 534, 543 (N.D. Ill. 1972). Once the initial coal contract for an electric utility was executed, "competition to satisfy the coal requirements of a particular plant [was]

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[24] Practical annual capacity is the production capability of a mine based on the equipment currently in place for coal extraction. It reflects a firm's ability to service current and future contracts without undertaking costly expansion.

effectively precluded for an extended period of time amounting to as much as 15 years or even the full life of the plant."[25] Combined with the fact that 92% of the acquired firm's reserves were already committed under long-term contracts, 341 F. Supp. at 538, the Supreme Court held that, "[i]n a market where the availability and price of coal are set by long-term contracts rather than immediate or short-term purchases and sales, reserves rather than past production are the best measure of a company's ability to compete."[26]

The appropriate market share measure in this case is practical capacity. In contrast to *General Dynamics*, the SPRB market is currently characterized by regular sales for contracts of much shorter duration (three years and less).[27] Practical capacity provides a more accurate

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[25] *Id.* Customers purchased 76% of their coal under contracts of five years or longer, and 43% of their coal under contracts of 15 years or longer. *Id. See also* Report to the Federal Trade Commission on the Structure of the Nation's Coal Industry, 1964-1974 at 85 n. 46 (noting that an estimated 80% of all coal purchases were made under long-term contracts, and a "significant percentage of coal supply contracts run from 5 to 30 years").

[26] 415 U.S. at 502. The Supreme Court noted that a company with relatively large uncommitted reserves would be in a better position to negotiate for long term contracts than a firm with small reserves, even though the latter may presently produce a greater tonnage of coal. *Id.* Arch's claim that committed and uncommitted reserves is the proper measure of market share is twice misplaced. Arch would count committed reserves, even though these by definition cannot affect market pricing. *General Dynamics* made clear that under then prevailing market conditions, uncommitted reserves were the proper measure of concentration: "A more significant indicator of a company's power to effectively compete with other companies lies in the state of a company's uncommitted reserves of recoverable coal." *Id.*

[27] PX4611 at 021 ("An increasingly large proportion of contracts and sales in the SPRB and at Arch are shorter term . . . ."). Of Arch's 2003 contracts, were for less than a year. PX4611 at 024. Of the million tons of coal Arch contracted for in 2002, approximately million were pursuant to contracts shorter than three years in duration, and contracts were for greater than six years. PX4611 at 023; *see also* PX1021 at 041 (less than percent of Arch's contracts are for greater than five years); PX0098 at 069-070 (of Triton's contracts, only were for longer than five years, were for less than one year); PX
(
); PX (

measure than reserves of a firm's ability to compete for contracts of shorter duration because firms are limited by a mine's practical capacity in the near term. For example, Buckskin has of reserves. Its mine manager, however, conceded that planning production above would "be an exercise in futility."[28] Expanding mine capacity is not cheap, easy, or quick. To expand Arch's Black Thunder mine by million tons would cost and take two years. Other mines face similar costs and periods for expansion.[29] Expansion may also require winning several substantial contracts, in contrast to *General Dynamics* where competition was for very long-term and large requirements contracts (all the needs of the plant). Practical capacity is a real and binding constraint. Producers have stopped bidding for new contracts in a particular year after they have sold out their practical capacity. Dep. Tr. 43:16-24 (stating that mine received requests for proposals for deliveries but did not respond because had no uncommitted capacity).

Using practical capacity to measure concentration, the Acquisition would increase the Herfindahl-Hirschman Index ("HHI") from an already highly-concentrated level of 2152 to 2623, an increase of 470 points, and give three firms control of 86% of the market.[30] Defendants argue

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[28] PX1260 at 032; PX0687 at 003. Indeed, Buckskin currently is permitted for a maximum of only 27 million tons. PX1260 at 032; *See also* Dep. Tr. 183:11-17.

[29] PX . To expand the capacity of beyond its current maximum would require the addition of , and the installation of , and would cost approximately and take up to two years to complete . *See, e.g.*, Dep. Tr. at 204:9-205:21. *See also* PX (large capacity expansions can take longer than 1 year and require approval by senior management and state regulatory agencies).

[30] Even if Arch determined to follow through with its proposal to sell the Buckskin mine to Kiewit, its acquisition of North Rochelle would increase the HHI by 193 points to 2346 and give three firms control of 81% of the market.

that the Acquisition is presumptively legal, but these are concentration levels from which this Court and others have found just the opposite.[31] Moreover, the same conclusion results using other reasonable measures of concentration.[32]

IV. Defendants' Proffered Efficiencies Do Not Save the Acquisition

Defendants' arguments, including that the Acquisition will facilitate greater output and cost savings at Triton's mines, fail to save an unlawful Acquisition. "[A] defendant who seeks to overcome a presumption that a proposed acquisition would substantially lessen competition must demonstrate that the intended acquisition would result in significant economies and that these economies ultimately would benefit competition and, hence, consumers."[33] The *Merger*

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[31] *FTC v. Warner Communications, Inc.*, 742 F.2d 1156, 1163 (9th Cir. 1984) (preliminary injunction warranted where merger combined second largest firm with 18.9% market share with sixth largest firm with 7.1% market share, resulting in four-firm concentration ratio of 75%); *FTC v. Bass Bros. Enters. Inc.*, 1984-1 Trade Cas. ¶ 66,041 at 68,609-10 (acquisition increased market share of second largest firm from 20.9% to 28.5% and the HHI by 318 points, from 1802 to 2120); *United States v. UPM-Kymmene OYJ*, 2003-2 Trade Ca. (CCH) ¶74,101 (N.D. Ill. 2003) (injunction warranted where merger increased the HHI by 190 points to 2990 in one market; by 290 points in another market; and 3 firm concentration would account for 80% of production).

[32] Using permitted capacity (*i.e.*, the maximum amount of tonnage each mine is authorized to produce according to its air quality permit), the HHI increases by 395 points, from 2065 to 2460; and even excluding Buckskin, still increases by 167 points, to 2232. Using loadout capacity (*i.e.*, the amount of tonnage that can be physically transported from the mine given existing plant and rail infrastructure), the HHI increases by 512 points, from 2068 to 2579; and excluding Buckskin, increases by 224 points to 2292. PX5675 at 003. Indeed, even using reserves (and including Buckskin), the HHI still increases by 298 points, from 2054 to 2353. *Id.* Only by using reserves as the measure and excluding the Buckskin transaction can Defendants limit the HHI increase to 49 points, which is infinitesimally below the level (anything above 50 points) that would raise significant competitive concerns in a concentrated market such as this. *See* Merger Guidelines § 1.51(c).

[33] *H.J. Heinz Co.*, 246 F.3d at 720 (*quoting University Health*, 938 F.2d 1206, 1223 (11th Cir. 1991)). *See also Cardinal Health*, 12 F. Supp. 2d at 63 ("the critical question . . . is whether the projected savings from the mergers are enough to overcome the evidence that tends to show that possibly greater benefits can be achieved by the public through existing, continued competition.").

Guidelines § 4.0 state that efficiencies must:

(1) be tested and verified by "a rigorous analysis . . . in order to ensure that those 'efficiencies' represent more than mere speculation and promises about post-merger behavior." *Heinz*, 246 F.3d at 721; *University Health*, 938 F.2d at 1223; *United States v. Mercy Health Services*, 902 F. Supp. 968, 987-88 (N.D. Iowa 1995);

(2) be "merger-specific," *i.e.*, not achievable without the merger, otherwise the asserted benefits could be achieved without the loss of a competitor, *Heinz*, 246 F.3d at 721-22; and

(3) outweigh the anticompetitive effects of the acquisition and result in a more competitive market. *University Health*, 938 F.2d at 1223.

Defendants' alleged efficiencies, totaling $134.4 million over five years, are not merger-specific or verifiable, and will probably be substantially less than what Defendants hope. PX4501at 10-31, (Painter Expert Report). Nor is there evidence that customers will benefit or that the savings outweigh the substantial anticompetitive effects likely to result.

A. Many of Arch's Alleged Cost Savings Are Not Merger Specific and Cannot Be Verified

Plaintiffs critique Arch's efficiency claims in detail in Mr. Painter's expert report. PX4501 (Painter Expert Report). Two examples highlight some of the deficiencies from which Arch's claims suffer. Arch alleges that it can recover of M1 seam coal that Triton had failed to recover from North Rochelle, for a five year savings of . Lang Expert Report, Attachment No. 6. North Rochelle's mine manager, however, stated that

Deppe Dep. Tr. 115:3-117:6. Such savings are not merger specific and must be disregarded. *Heinz*, 246 F.3d at 721-22. Arch also alleges it will save over five years because less mining equipment is needed than would be required had North Rochelle remained with Triton. Paul Lang (Defendants' efficiencies expert and the President of Thunder Basin Coal

Company, which operates Black Thunder) conceded that he estimated equipment needs based on his subjective opinion. PX1009 at 034. Yet, Arch's own mine plan, a sophisticated computerized program that calculates the number of coal haul trucks that would be required by a combined operation, produces different answers. PX1009 at 034. Lang did not use these numbers in his analysis. PX1009 at 034-35. No documents support Lang's estimates. PX1009 at 037, 042. Because these claimed savings cannot be verified and are inherently speculative, they too must be disregarded. *Heinz*, 246 F.3d at 721.

B. A Small Anticompetitive Price Increase Would Swamp Any Cost Savings

The SPRB coal market is huge, with over $2 billion in annual sales. A small price increase would be extremely costly to electric customers.[34] Conservatively, if a 50 cent-per-ton price increase (less than 10%) were limited to the three major producers, customers would pay an additional $155 million a year, or $775 million over five years. Even if all of Defendants' alleged $134 million in savings were verified, merger-specific, and certain to benefit customers dollar for dollar, they are swamped by even a small price increase.

V. Triton Is an Important Competitor and Is Not Flailing

Defendants' claims that Triton is

While Defendants urge that Triton cannot because it must maintain sufficient reserves to service the duration of long-term supply contracts and , they fail to mention that contracts are currently being renegotiated

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[34] Arch's own budget analyses project higher coal prices and do not show any price reductions that flow from savings. Lang Expert Report, Attachment No. 6; Lang Dep. Tr. 162-64. Arch's current five-year plan does not forecast any expansion in capacity, nor has Arch completed any capacity expansion studies. Lang Dep. Tr. 125-27.

pursuant to reopener provisions under which the contracts will terminate on , if Triton and the customers fail to agree on price and Triton declines to match the price offered by a competing producer. Pettibone Tr. 50-68. Moreover, Defendants presume that Triton's future is limited to its current reserve base, and thus that the mine will run dry within the next years. Yet, current reserves at each of the 8800 Btu SPRB mines, with the exception of Jacobs Ranch, fall within a narrow range of (North Rochelle) to 14.1 years (NARC). PX1040 at 001; PX5801. Thus, by Defendants' logic, all of those mines will be closed by 2018. Indeed, at budgeted production of 70 million tons per year, Arch's Black Thunder mine has only 18 months more reserves than Triton's North Rochelle mine. PX1044 at 015; PX1040 at 001.

Further, Triton's financial condition is not dire.[35] Triton has been extremely profitable, earning dollars[36] and has paid down its debt.[37]

PX . In addition, while Defendants threaten that Triton will not invest in reserves or capital improvements, Triton has

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[35] Triton states it does not seek to argue a "failing firm" defense. Rather, the thrust of its argument is that its investors made a bad investment through a highly leveraged transaction. However, it is the investors, not the customers, who should bear this cost.

[36] In 2002, Triton had EBITDA (earnings before interest, taxes, depreciation, depletion, and amortization) of and profits from operations of . PX0881 at 004. In 2003, its EBITDA was and profits from operations . *Id.* PX0902 at 010; PX .

[37] . PX . Its bank debt has been reduced from over to approximately and will be paid off by . Hake Dep. Tr. 15:15-16:4. It has made its principal payments on the debt. *Id.*

. PX .

[38] and is to do so.[39]

Hake Dep. Tr. 11:2-8.[40]

Hake Dep. Tr. 7:2-7; 81:10-82:13.[41]

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[38] Triton West Roundup reserves contiguous to North Rochelle and the West Hay Creek reserves contiguous to Buckskin,

A recent letter from Triton CEO Hake to Triton investors notes that

[39]

[40]

PX . According to Mr. Hake,

. Hake Dep. Tr. 11:2-21.

[41]

. PX .

VI. Defendants' Proposed Divestiture of Buckskin Does Not Resolve the Antitrust Issues Raised by the Acquisition

In the event that the Court concludes the Acquisition is anticompetitive, Arch argues that its proposed sale of the Buckskin mine to Kiewit fixes this problem. If this Court entertains such evidence, which Plaintiffs have moved to exclude, it would not remedy the anticompetitive effects of the Acquisition.[42]

A. Buckskin Is an Inferior Mine

Contrary to Triton's own , Defendants allege that Buckskin is the more valuable of Triton's mines.[43]

. PX
, Triton will consider additional refinancing alternatives. Hake Dep. Tr. 82:2-13.

[42] Before Arch submitted its bid, Triton was negotiating to sell Buckskin (and perhaps all of Triton) to Kiewit. Initially, Kiewit was interested in acquiring all of Triton. PX1325 at 005; PX3631. On March 4, 2003, Kiewit submitted a non-binding offer of $325 million. PX1325 at 005; PX3618. Kiewit ultimately offered $95 million for Buckskin. When Triton grew impatient with the pace of negotiations, it accepted Arch's bid for both mines. PX1258 at 004.

[43] Various firms evaluated an acquisition of Triton. All agreed that the bulk of the value resided in North Rochelle. *See, e.g.*, PX ("We felt like the lion's share of the would be associated with North Rochelle. . . . because that – they have a larger

Thus, putting Buckskin in Kiewit's hands would not be sufficient to allow the fringe successfully to constrain an anticompetitive price increase by the three major producers. Buckskin suffers from several disadvantages, including coal with lower heat content, higher sulfur content, and the mine's location on the single rail line.

Arch also views Buckskin as an inferior mine and never intended to keep it. Arch stated in its 2003-2007 Strategic Plan, dated November 2002, "Buckskin, Vulcan's Tier 3 mine, is in a very difficult sales position with the low BTU content of its coal (8250 BTU), and the fact that it is served by only the BNSF railroad." PX0108 at 015. The Strategic Plan also contemplated a potential Triton acquisition and possible divestiture of Buckskin, which Arch did not consider attractive: "The acquisition of Vulcan by Arch could include the possible divestiture of Buckskin mine. As indicated earlier, this Tier 3 operation has disadvantaged quality (8250 BTU) with limited market appeal."[44] PX0108 at 016. Arch and its representatives have recognized that even Arch's dormant Coal Creek mine is a superior property to Buckskin.[45]

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margin, and they were producing more tons, a greater margin."); *see also* PX0152 at 002 Arch Board Presentation seeking approval for proposed transaction: ("

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[44] See also PX0102 at 002 ("Buckskin is more of a stand-alone operation and is not strategic in nature. While it would be a good addition at an appropriate price, it is not key to the overall strategy. Buckskin also has more pricing and transportation risks.").

. PX ; Dep. Tr. at 21:4-7.

[45] PX0123 at 002-03 ("[Coal Creek] would be a superior property for Arch due to the reserve characteristics and access to the Union Pacific Railroad the railroad that serves many of Arch's customers for western coal.").

B. Defendant's Argument that Kiewit Would Expand Buckskin Production to 36 Million Tons Lacks Factual Support

Defendants allege that Buckskin has the potential to be incredibly profitable, that Kiewit intends to expand Buckskin, and that Kiewit can increase production to . Def.'s Pretrial Br. at 12. Defendants overstate Kiewit's current intentions, and understate those of Triton. Moreover, as Kiewit . Dep. Tr. 132:6-133:18. Defendants' argument that Kiewit would expand Buckskin to was developed in the context of this litigation and not in the ordinary course of business.[46] In considering the purchase of the Buckskin mine, Kiewit modeled various production scenarios to evaluate the purchase price it would pay for the Buckskin mine, Dep. Tr. 122:16-122:25, none of which contemplated production beyond tons per year. PX7944, PX7945. However, in the context of its attempt to protect its acquisition of Buckskin from Arch, Kiewit modeled both a ton-a-year scenario. Dep. Tr. 123:1-13.

In addition, even if Kiewit truly contemplates expanding production beyond tons, it represents, at best, a modest increase. Triton is already engineering a plan that will take the mine up to million tons per year and it expects to have the final engineered plan completed within the next . Dep. Tr. at 170:20-24.[47] That is consistent with Buckskin's current air quality permit. There is no reliable

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46 . Dep. Tr. at 123:21-124:13.

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evidence of what would be required to expand to tons nor whether

Even if in Kiewit's hands, Buckskin could expand output beyond what Triton plans, it would be insufficient to keep pace with demand growth.[48] Morever, Defendants' claimed expansion would be exceeded if production by the three major producers lags even slightly behind what it would be absent the Acquisition. In the face of the serious questions raised by Plaintiffs, even Defendants' rosiest and unsupported expansion scenarios do not save an unlawful Acquisition.

157:4-15.

Dep.Tr. at 158:1-7; 164:3-11; 174:22-175:16.

[48] The demand for SPRB coal is expected to increase by 19 million tons in 2004 and 18 million tons in 2005, and is expected to increase each year between 2003 and 2013. PX4203. Demand is expected to continue to grow throughout the Hill & Associates forecasting period of 2003 - 2013.

Respectfully submitted,

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