UNITED STATES DISTRICT COURT
DISTRICT OF COLUMBIA

FEDERAL TRADE COMMISSION,
Plaintiff,
v.
ARCH COAL, INC., *et al.*,
Defendants.

STATE OF MISSOURI, et al.,
Plaintiff,
v.
ARCH COAL, INC., *et al.*,
Defendants.

Civ. No. 1:04CV00534 (JDB)

REDACTED PUBLIC VERSION

PLAINTIFFS' POST-HEARING REPLY BRIEF

WILLIAM E. KOVACIC
General Counsel

SUSAN A. CREIGHTON
Director

MELVIN H. ORLANS
Senior Counsel
Bureau of Competition

Federal Trade Commission
600 Pennsylvania Avenue, N.W.
Washington, D.C. 20580

July 16, 2004

MICHAEL H. KNIGHT
MORRIS A. BLOOM
RHETT R. KRULLA
JOHN MARTIN
SCOTT REITER
NEIL AVERITT

Attorneys
Federal Trade Commission
601 New Jersey Avenue, N.W.
Washington, D.C. 20001
(202) 326-2608

ANNE E. SCHNEIDER
Assistant Attorney General
Missouri Attorney General's Office
ON BEHALF OF PLAINTIFF STATES

TABLE OF CONTENTS

TABLE OF AUTHORITIES

CASES

STATUTES

OTHER AUTHORITIES

I. THE PROPER LEGAL STANDARD

Under the section 13(b) standard, this Court must grant a preliminary injunction "where such action would be in the public interest – as determined by a weighing of the equities and a consideration of the Commission's likelihood of success on the merits." *FTC v. H.J. Heinz Co.*, 246 F.3d 708, 714 (D.C. Cir. 2001). The Court's "task is not to make a final determination on whether the proposed [acquisition] violates Section 7 [of the Clayton Act], but rather to make only a preliminary assessment of the [acquisition]'s impact on competition."[1] The Commission establishes a likelihood of success on the merits if it has raised "serious [and] substantial" questions that require determination by the Commission and ultimately, the court of appeals. *Heinz*, 246 F.3d at 714-15. Thus, the Commission need not prove by a preponderance of the evidence that section 7 has been violated, because that question is left to the Commission after a full administrative hearing. Rather, the Commission "need only show that there is a 'reasonable probability'" that the Acquisition may substantially lessen competition. *FTC v. Staples, Inc.*, 970 F. Supp. 1066, 1072 (D.D.C. 1997); 15 U.S.C . § 18. Hence, although this burden is not insubstantial, neither is it overwhelming. We submit that defendants repeated efforts to characterize the burden as a particularly "heavy" one (Defs. Post-Trial Br. at 6) somewhat overstate the case.

---

1 *FTC v. University Health, Inc.*, 938 F.2d 1206, 1218 (11th Cir. 1991); *FTC v. Warner Communications Inc.*, 742 F.2d 1156, 1162 (9th Cir. 1984); *see also Heinz*, 246 F.3d at 714; *FTC v. Libbey, Inc.* 211 F. Supp. 2d 34, 44 (D.D.C. 2002); *FTC v. Swedish Match*, 131 F. Supp. 2d 151, 156 (D.D.C. 2000); *FTC v. Cardinal Health, Inc.*, 12 F. Supp.2d 34, 45 (D.D.C. 1998); *Staples*, 970 F. Supp. at 1070-71. This Court need not resolve all conflicts of evidence or analyze extensively all antitrust issues; that is the province of the administrative proceeding. *Warner Communications*, 742 F.2d at 1164, citing *FTC v. Lancaster Colony Corp.*, 434 F. Supp. 1088, 1094, 1096 (S.D.N.Y. 1977); *FTC v. Food Town Stores, Inc.* 539 F.2d 1339, 1342 (4th Cir. 1976) ("The district court is not authorized to determine whether the antitrust laws have been or are about to be violated. That adjudicatory function is vested in the FTC in the first instance.").

II. PLAINTIFFS HAVE SUCCESSFULLY SHOWN A REASONABLE PROBABILITY THAT THE ACQUISITION MAY SUBSTANTIALLY LESSEN COMPETITION

Defendants' post-trial filings are truly remarkable, not only for what they say (and we take issue with much of that), but for what they do not say. This acquisition threatens to generate (or strengthen) industry-wide "production discipline" – producers' efforts to solve the "problem" created when "oversupply" leads to "depressed" (*i.e.*, competitive) prices. Despite the fact that the record is replete with evidence showing the SPRB producers' attempts to adopt these anticompetitive practices on an industry-wide basis to reduce competition, and this acquisition's threat to make these attempts more successful, defendants' filings make no mention whatsoever of "production discipline" or "oversupply." Instead, defendants posit a theoretical world where coordination cannot occur unless SPRB producers have perfect information regarding all aspects of one another's production and other facets of competition.[2]

Simply put, under defendants' standards, coordinated interaction could never occur in any industry – even though Arch has repeatedly and publicly proclaimed the need for such behavior. PPF 326-37, 350-59. Moreover, defendants' theoretical obstacles to coordination are belied by the real world, that is, the actual state of competition in the SPRB, which demonstrates that coordinated interaction is not only likely, but may well have occurred. Not surprisingly, then, defendants mischaracterize the current state of the market and ignore the industry's "charge" (led by Arch) toward "production discipline." In making their arguments, defendants rely primarily upon the self-serving trial testimony of their fact witnesses and the flawed testimony of their

---

[2] It strains credulity to believe that all of the speeches, press releases, and internal documents could be characterized as hypothetical "venting" or stupidity, rather than real efforts to obtain a result.

economic expert, while ignoring (as did Ms. Guerin-Calvert) the most probative evidence, namely, the contemporaneous business documents. Similarly, defendants ignore the untenable explanations and evasions offered by Mr. Leer when he was confronted with Arch's adoption of, and proselytizing about production discipline.

The FTC brought this case because it has reason to believe that a post-merger industry may result in substantially less competition – precisely what section 7 prohibits. This, in turn, will raise the price of coal and harm consumers. If those behaviors do arise, the evidence shows that they will include the elements of output coordination and a restriction of supply. When supply is limited, prices will go up, and thus defendants can achieve the desired effects on price even if they never agree or even coordinate on specific price terms.[3]

The defendants have tried to head off this conclusion by asserting that the information available to the coal producers is neither wholly certain nor wholly complete, and thus that it is insufficient to operate this scheme of coordination. We agree that the information is imperfect. But information does not need to be perfect in order to move prices measurably above competitive levels. U.S. Department of Justice and Federal Trade Commission, *Horizontal Merger Guidelines* (*Merger Guidelines)* § 2.11 (1992); *Areeda's Antitrust Law* § 1431 at 215-16. Within the relevant product markets, the coal from each mine may differ slightly in its characteristics, but these differences are not an obstacle to coordination. Standard adjustments are made in pricing to account for any specific differences that may exist. PPF 407-09. Production increases may become apparent only some months after a contract has been signed, but they will show up eventually, and the firm that contemplates "cheating" would be

---

[3] *See* PX 8611-006 at ¶ 17 (tacit coordinated interaction merely requires that producers adopt strategies that are consistent with competing less aggressively).

well aware of this. *See* PPF 422-23. Moreover, if a firm were to deviate from coordinated interaction and expand output significantly, other SPRB producers would quickly notice and have a chance to respond. PPF 422-24.

The Supreme Court in *Eastman Kodak Co. v. Image Technical Services*, 504 U.S. 451, 466-67 (1992), stated that theory cannot "trump" the facts, and emphasized that antitrust cases should be resolved on the record evidence. And contrary to defendants' theoretical and hypothetical assertions that coordinated interaction is impossible here, the facts show not only that coordinated interaction is increasingly possible (and rendered more likely by this transaction), but that it may already have occurred during recent years. This can be seen by comparing the situation in the SPRB today with the SPRB as it existed in the 1990s.

In the 1990s, SPRB market was genuinely competitive, as antitrust law defines competition.[4] Producers made changes in their mines to reduce their costs. Competition drove prices down toward marginal cost, as producers sold incremental production at the best price they could get above marginal cost. PPF 291-93.

Today, however, the market is significantly different. As defendants are forced to concede in their post-trial brief (p. 2), "all producers in the SPRB are today pricing above their incremental costs, seeking to recover a rate-of-return to permit future capital investments, the funding of long-term indebtedness, and some margin of return for their investors." We expect that *some* firms in a market may succeed in these ways, but when *most or all* do so, it is properly

---

[4] Antitrust law and economic theory both define a competitive market as one where prices are driven down to approximate marginal cost. *See, e.g., FTC v. Indiana Fed'n of Dentists*, 476 U.S. 447, 459 (1986); *Environmental Action, Inc. v. FERC*, 939 F.2d 1057 (D.C. Cir. 1991); *Ball Memorial Hosp., Inc. v. Mutual Hospital Ins., Inc.*, 784 F.2d 1325, 1344 (7th Cir. 1986).

seen as a marker of diminished competition.[5] And the cause of that diminution in competition can certainly be attributed to the conduct most explicitly intended to bring it about – repeated exhortations from the major producers, particularly Arch, for more "output discipline," coupled with increasing adherence to this strategy by some, if not all, of the Big Three.

Indeed, contemporaneous documentary evidence shows that all of the , along with , either "flirted with" or adopted the concept of constraining output in order to move away from selling coal at incremental prices.

Moreover, Mr. Lien of RAG acknowledged the inherently interdependent nature of the strategy, stating that could not have moved away from incremental pricing if the other producers had continued to engage in it.[6] PPF 295. In short, we know that coordinated interaction is possible because the industry is moving in that direction in

---

[5] Defendants attempt to avoid this obvious conclusion by suggesting that plaintiffs seek to measure defendants' conduct against the inappropriate benchmark of "perfect competition." *See* Defs. Post-Trial Br. 2-3. There are two responses to this argument. First, as demonstrated above (*see* n.4, *supra*), plaintiffs' definition of a "competitive market" is the one accepted by antitrust courts. Second, in any event, defendants' conduct may certainly be measured against the state of competition that existed in the SPRB prior to the advent of "production discipline" and "market driven" strategies. Accordingly, issues of "perfect competition" aside, it is clear that the market has become less competitive in recent years.

Furthermore, contrary to defendants' assertions (Defs. Post-Trial Br. 2), plaintiffs' case is not premised upon a prediction that post-merger prices would be higher, or output lower, than would be the case in a perfectly competitive market. Rather, plaintiffs have established that, as a result of coordination (or more successful coordination), post-merger prices are likely to be substantially higher (and output lower) than they would be without the merger.

[6] Mr. Leer similarly conceded that Arch's strategy of constraining production could be adversely affected if its competitors were to expand while Arch was constraining production, thus taking market share and profits away from Arch (Day 6 a.m. Tr. 63 (Leer); PX 1000 at 280:6-14; PX 105).

comparison to a baseline from the recent past.[7]

It is not incumbent upon plaintiffs to predict the exact manner in which coordination will likely take place. Nonetheless, in view of defendants' largely theoretical (and inaccurate) arguments about the impossibility of coordination, we note that there is ample evidence in the record showing how post-merger coordination on restricting output[8] may occur.

Coordinated interaction is characterized by each firm choosing to compete less aggressively because it believes it will be met by others competing less aggressively. PPF 276. Within a few months of one another in 2000, each of the Big Three producers made an announcement reporting the idling of existing production or cancellation of planned capacity expansion. PPF 308 (Peabody), 310 (Kennecott), 326 (Arch), 331 (Arch). Other SPRB competitors understood these announcements as a signal that the announcing company (or companies) would compete less aggressively by constraining output in the face of prices

---

[7] Notwithstanding the foregoing, defendants stridently maintain that the SPRB market is competitive today, citing Ms. Guerin-Calvert and statements from the SPRB producers and from customers. Defs. Post-Trial Br. at 23-24. Customers, however, were not referring to whether they are paying supracompetitive prices. Rather, they used the term "competitive price" to mean simply that they received one or more bids that were consistent with the market price. PPF 592. Day 3 Tr. 96:8-97:2 (Morris). Ms. Guerin-Calvert's definition of "competitive" is inconsistent with both the legal definition of the term and the documents and testimony regarding interaction among SPRB coal producers since 1999. PPF 288. As for the SPRB producers, it is hardly surprising that they stated, in their own self-interest, that the market was competitive. Of course, their contemporaneous business documents tell a far different tale. Finally, as noted in the accompanying text, it is indisputable that the SPRB market is less competitive today than it was in the 1990s.

[8] We again emphasize, as we have previously, that when we speak of restricting output, we mean that output will be less than it would otherwise be without the merger, and not that actual output will necessarily be reduced. *See Staples, Inc.*, 970 F. Supp. at1082 n.14. It is noteworthy, however, that both SPRB output and the output of the Big Three have been virtually flat since 2001. PX 1040. (For this reason, it is misleading for defendants to assert (Defs. Post-Trial Br. 24) that expansion in the SPRB over the past decade has been substantial.)

perceived by producers as unfavorable.

Once such signals have been given, the coordination process entails monitoring one's competitors' market conduct to determine whether those competitors are behaving consistently with the signals they sent, and then deciding whether to continue to behave less aggressively oneself. SPRB producers are able to monitor production cut-backs and expansions to determine if their competitors are maintaining production discipline. PPF 476-86. Such monitoring can be accomplished using the market data available to SPRB producers, including quarterly data on production, observations as to whether competitors have increased capacity, as well as other information that is consistently gathered about competitors' activities. PPF 463-94. Significantly, contrary to defendants' claims, monitoring for this purpose does not require transaction-specific information, such as the prices bid by specific producers to specific customers or the terms of specific contracts. PPF 282. Nor is it necessary to have information on a transaction at the moment it occurs because the output to fulfill that transaction can be monitored directly.

Arch's monitoring efforts were sufficient to enable it to detect (using external information such as customer intelligence and FERC forms) when its competitors were selling incremental coal.[9] *See* PX 90-002 , PX 165-002 , PX 105 . In particular, Arch

---

[9] The evidence shows that any cheating would most likely occur through the sale of coal at incremental prices (which has already occurred). Such cheating could be punished simply by a temporary abandonment of the terms of coordination. *Merger Guidelines* § 2.12. Defendants make the theoretical argument that, if deviation is accomplished by submitting aggressive bids for long-term contracts, no punishment mechanism would be readily available. The facts indicate that this is highly unlikely – the deviating firm would have to find a means to

determined that Peabody was profitably selling incremental coal, contrary to its public statements. This (coupled with continued low prices) led Arch to consider whether it could afford to continue to "lead the charge" to restrict production, or whether it should abandon (at least temporarily) its "market-driven" approach and "ramp" its mines up to full production. PX 105. Arch decided for the moment not to punish Peabody by engaging in more aggressive competition, because this would "cause the [price] rebound to stall" and "ensure[] that pricing for 2003 would not recover to levels that it would otherwise." PX 105.

Because the evidence thus overwhelmingly establishes that coordinated interaction is not only possible and likely, but may actually have occurred, it is particularly important to head off the increased risks that would arise if Arch – a prime instigator – were permitted to acquire the additional resources of Triton. Even if the Buckskin mine were sold separately to Kiewit, Arch's acquisition of the North Rochelle mine would still greatly increase the probability of successful anticompetitive coordinated output restriction. Among other things, Triton's absorption by Arch would make coordinated output restriction by Arch, Kennecott, and Peabody more profitable (and deviation more difficult) for each of these three firms. PPF 516-17. Post-merger, the market would contain only three significant competitors, easing the costs and risks of coordination, while bringing all the productive capacity of the acquired firm within the control of the Big Three. The elimination of Triton would eliminate a significant competitor, replacing it with a competitor (Kiewit) possessing a much smaller market share and far less valuable assets. Furthermore, Arch's acquisition of North Rochelle will make Arch more similar to Peabody and

---

protect its existing business and would have to secure substantial new business through a large number of atypically long contracts before any of the other suppliers recognized what was happening. PPF 423-24.

Kennecott, increasing all three firms' incentives to coordinate. PPF 518. By acquiring North Rochelle, with its super-compliance coal, Arch will obtain the premium product and additional scale that it previously lacked, thus " ." PX 147-002; *see also* PX 152-004. Because Arch has been the leading proponent of constraining production, Arch's increased influence over the industry will undoubtedly increase the likelihood that production discipline will be exercised.[10]

III. COORDINATED INTERACTION WOULD NOT BE DEFEATED BY FRINGE EXPANSION

The *Merger Guidelines* provide that the issue of expansion by firms in the market other than the merging parties should be analyzed using the same methodology as used for entry. *Merger Guidelines* 3.0 n.24. Specifically, where expansion would require significant sunk costs and one year or more to effect, it must be timely, likely and sufficient to counteract any potential for the merger to raise prices, such that its mere threat would prevent a price increase in the first instance. *Id.* at 3.0. The burden of proving timely, likely and sufficient expansion rests with the merging parties. *See, e.g., Heinz*, 246 F.3d 715.

Defendants have not carried their burden in this instance of showing that the fringe would expand sufficiently to defeat a merger-induced price increase. Rather, in crediting Kiewit with immediate expansion of the Buckskin mine by approximately , and RAG with expansion of its Belle Ayr and Eagle Butte mines by a combined

---

[10] For these reasons and in light of the evidence set forth at PPF 516-18, defendants are flatly incorrect in asserting (Defs. Post-Trial Br. 5) that plaintiffs "failed to make any showing as to a change in the SPRB, post-merger, that would make coordinated interaction in the future any easier, more profitable, or more likely to occur." In fact, Dr. Morris even conducted an empirical analysis demonstrating that the acquisition of North Rochelle alone would increase the gain that Arch would receive from coordination by , and the gain to Kennecott and Peabody each by . PPF 516, 520.

, defendants simply ignore reality as evidenced in

. To expand the loadout capacity at any mine requires significant sunk costs, and is not likely to be undertaken unless some assurance can be had that demand for the additional output will exist into the future. *See generally* PPF 603-27.

. Most importantly, expansion by these 8400 Btu coal fringe firms would not alleviate anticompetitive effects in 8800 Btu coal, and would only partially offset such effects in the SPRB market.

. Rather, it has provided no more than an indication that it would begin the lengthy process of expansion if "the demand is there and . . . there [are] opportunities to go sell this coal." Day 6 p.m. Tr. at 52 (Grewcock). This caveat reveals an important limitation on Kiewit's expansion "plans" – that they are contingent upon an as yet unperformed assessment of the market. (PRF 183-91). In fact, Kiewit isn't even guaranteed to keep Buckskin's current customers, much less identify demand sufficient to justify a lengthy expansion process. As plaintiffs have noted,

.

Moreover, Kiewit admits that to expand Buckskin to would require three years, given the time to acquire equipment, additional permitting, etc. Day 6 p.m. Tr. at 52 (Grewcock) ("[I]n each one of these cases, we ramped these up in year three . . . recognizing the time that you would need to get the permits, acquire the equipment, and, you know, and acquire the coal sales contracts.") PPF 693, 700. This is not the sort of timely "hit and run" entry that would be effective against a merger-induced price increase. The *Merger Guidelines* contemplate as timely "only those committed [expansion] alternatives that can be achieved within two years from initial planning *to significant market impact*." *Merger Guidelines* § 3.2.

Indeed, little detail is even known at this stage about the costs and requirements necessary to ramp up production at the mine. PPF 699-705.

. Kiewit has testified only that it would begin the permitting process, and would begin assessing the demand for additional Buckskin coal once it took title to the mine. Mr. Grewcock, Kiewit's President and Chief Operating Officer, testified that "[i]f this transaction goes through, I've already told our folks to *begin* the permitting process . . . [a]nd then certainly on day one after we acquired Buckskin to *start* making contact with coal customers and finding out what the demand is there and are there opportunities to go sell this coal." Day 6 p.m. Tr. at 52 (Grewcock) (emphasis added).

Even if Kiewit were able to expand in a timely fashion, there is insufficient basis to consider it "likely" that it would do so. As noted above, the company has no current plan in place to expand, and must assess its customer base and market demand before it will put such plans in place. To conclude that such expansion is likely would be wildly inconsistent with Kiewit's contemporaneous business valuation of the asset. Indeed, to assess defendants' and Kiewit's actual expectations regarding the level at which the Buckskin mine will be operated, one need look only to the business valuations made by Kiewit and other prospective purchasers.

At the time it was considering purchasing the Buckskin mine in December 2003, Kiewit ran a series of valuation cases, including a " " ( ), an "optimistic case" (20.9 million tons), and a "high high" case (24 million tons). PPF 691. Other valuation runs performed by Kiewit at this time showed the present value of Buckskin ranging from between to about (at a discount rate of 12%) based on annual production of 18 million to 24 million tons. *Id.* Mr. Grewcock of Kiewit testified that these valuations were performed "for us to do our valuation of how much should we – what the valuation of the mine should be and what we should pay." Day 6 p.m. Tr. at 85 (Grewcock); PPF 691. These were reasonably in line with the - range of values placed on the mine by Arch, Peabody, Kennecott and Kiewit earlier in the year. PPF 690; PX0152 at 002.

Kiewit ultimately offered Triton $95 million for Buckskin in the Spring of 2003, before agreeing to purchase it from Arch in January 2004 for a price of $82 million (plus assumed liabilities). Day 6 p.m. Tr. at 64 (Grewcock); PPF 692. Mr. Grewcock testified that this price represented a $5 million discount off Kiewit's valuation price of $87 million (plus assumed liabilities). Day 6 p.m. 57-58 (Grewcock). The price appears in line with Kiewit's expectations of producing approximately - at the mine. Then, in January or early February 2004, Kiewit was asked to "get involved and explain to the FTC what [its] view of Buckskin was. . . ." Day 6 p.m. Tr. at 49 (Grewcock); PPF 693. At that point, Kiewit ran valuation models at and . PPF 693. The model, labled "FTC Case," shows a stunning net present value of for the Buckskin mine at the level of output. *Id.* It is substantially above all previous assigned values, and above Kiewit's $82 million purchase price. Indeed, it is nearly higher than Kiewit's present purchase price of approximately $75 million. PPF 692. Thus, based on Kiewit's valuation, if the scenario is anywhere near correct, Kiewit's acquisition of Buckskin would be a "steal" of such magnitude that it would be the SPRB equivalent to the Louisiana Purchase.[11] This value and output assumption simply does not comport with any reasonable assumption for the future operation of the mine, nor with Kiewit's actual, real-world, expenditure of its money.

Finally, expansion must be sufficient to counteract the potential anticompetitive effects of the merger. *Merger Guidelines* § 3.4. Moreover, the *Merger Guidelines* recognize that where there is some differentiation among products in a relevant market, "entry, in order to be sufficient, must involve a product so close to the products of the merging firms that the merged firm will be unable to internalize enough of the sales loss due to the price rise, rendering the price increase unprofitable." *Id.* Expansion by Kiewit at Buckskin (or, as discussed below, by RAG at Eagle Butte or Belle Ayr) would be insufficient to counteract a price increase resulting from an output restriction imposed by Arch, Peabody and Kennecott.

Kiewit's own modeling for expansion at Buckskin shows that higher outputs at the mine would have no effect on market pricing. Kiewit used the same pricing assumptions in its modeling, even for the high output projections. Day 6 p.m. Tr. at 67; PPF 703. In other words, Kiewit's valuation model, which serves as defendants' entire basis for claiming that it will operate the Buckskin mine at , assumes there would be no downward effect on prices from an increase in output at Buckskin. This assumption, of course, is in accord with Arch's assessment that Buckskin "is in a very difficult sales position" due to its "disadvantaged quality (8250 BTU)" and "limited market appeal," as well as "the fact that it is served by only the BNSF railroad." PPF 679. It also reflects customer perception that Buckskin coal would not provide a

---

[11] In 1803, the United States purchased the Louisiana territory, including the SPRB, for approximately $15 million, or about 3¢ per acre.

remedy to "

." Day 2 p.m. Tr. at 73 (Holloway); *see*, *e.g.*, PPF 673-75.

It may also reflect that Kiewit has no intention to do anything that would erode pricing in the SPRB. *See* PPF 695-97. In assessing whether to acquire Buckskin, Kiewit recognized that the "[r]isk of lower prices" in the SPRB was "mitigated due to [among other things] Producer consolidation." PX at . Kiewit also noted, in connection with its earlier assessment of Triton's assets, that "PRB producers are exhibiting restraint which has increased prices," and that "

." PX at ; PPF 695. This acquisition, of course, would remedy that problem. Thus, while this recognition by Kiewit may shed light on why "Kiewit has wanted to expand into the Southern Powder River Basin for years," it casts doubt over the role scripted for Kiewit by the defendants as a champion of competition and a "fierce, strong competitor." DPF 183-84.

Nor can RAG be expected to "carry the torch" of expansion. *See generally* PPF 616-27.

. *See Merger Guidelines* § 3.3 (entry is only considered likely "if it would be profitable at premerger prices, and if such prices could be secured by the entrant").

Given the current spot price for 8800 Btu coal of , Day 7 (sealed) at 10 (Hake), and that Belle Ayr and Eagle Butte typically trade at , , would require a sustainable price increase of at least before it would be willing to consider expansion of its mines.

This is supported by the , , who stated: " ." . Moreover, while , he did not disagree with . Indeed he recognized that . Moreover, while indicated that he had " ," he recognized that " ." Thus, the defendants' proof of RAG's likely expansion relies entirely on an

Moreover, while Defendants would have this Court accept as a given that RAG will expand both its mines "full out" by January 1, 2006, they mischaracterize on the issue. In reality, stated that, , " ." . The reason for this , according to , is that "

." ; PRF 155. As plaintiffs' economist Dr. Morris recognized, RAG's incentive is not to rock the boat too much in the SPRB markets, because there are bigger producers with which RAG would have to contend. Day 3 p.m. Tr. at 120 (Morris); PRF 155. Thus, if RAG did expand, it would do so carefully, in a manner that would not impact a merger-induced price increase in the SPRB.

As with Buckskin, RAG's mines also are at a competitive disadvantage to the 8800 Btu mines in the SPRB, making expansion difficult. PPF 616-27. RAG recognized as much in a , in which a company marketing executive indicated: "

."

Expecting R.A.G. and Buckskin to expand belies the recent history in the SPRB. Between 1998 and 2003, buckskin's output has gone from 17.3 to 17.5 million tons per year. PX6104. Similarly, RAG's total output has gone from 40.6 million tons to 42.6 million tons. Id. This occured while prices in the SPRB rose significantly. PX8612. The fact that these neither of these firms expanded output to reduce these prices in the past gives us no reason to believe they would do so in the future.

In sum, neither RAG nor Kiewit are likely to play the role of "coordination spoiler" to the Big Three firms. As with limited fringe players in other markets, they are simply not in a position to take on the dominant players. *United States v. UPM-Kymmene OYJ*, 2003 U.S. Dist. LEXIS 12820 at *24-25, 2003-2 Trade Cas. (CCH) ¶74,101 (N.D. Ill. 2003). Moreover, they have expressed no particular interest in doing so. Even if they were to expand, their products are by all counts disadvantaged vis-a-vis the 8800 Btu coal that will be controlled entirely by Arch, Peabody and Kennecott post-merger. Defendants have not met their burden of proving that expansion by this limited fringe would even be likely to occur, much less that it would be timely or sufficient to constrain post-merger coordination. Accordingly, they have failed to meet the "timely, likely and sufficient" requirements set forth in the *Merger Guidelines*.

IV. DEFENDANTS FAILED TO CONDUCT A PROPER RELEVANT MARKET ANALYSIS TO REFUTE THE CONCLUSION THAT SPRB COAL AND 8800 BTU SPRB COAL ARE RELEVANT PRODUCT MARKETS

"The general rule when determining a relevant product market is that 'the outer boundaries of a product market are determined by the reasonable interchangeability of use [by consumers] or the cross-elasticity of demand between the product itself and substitutes for it.'" *Staples*, 970 F. Supp. at 1074. Defendants direct the Court to a two-pronged test used to determine cross-elasticity. First, one must evaluate the "availability of products that are similar in character or use to the product in question." Next, one must evaluate "the degree to which buyers are willing to substitute those similar products for the [test] product." Def.'s Post-Trial Br. at 9. Despite having posited this test, defendants failed properly to apply it because they completely ignore the second (and key) prong of the cross-elasticity test – the degree to which buyers are willing to substitute other coals for SPRB coal and 8800 Btu SPRB coal. Instead, they have focused only on the first prong of the test – looking at the functional interchangeability of other coals to SPRB coal and 8800 Btu SPRB coal.[12]

A. Defendants Have Failed to Refute the Conclusion that SPRB Coal Is a Relevant Product Market

Defining SPRB coal as a relevant market is hardly contested. Plaintiffs' Post-Hearing Br. at 29-30. Indeed, defendants essentially concede that SPRB coal is a relevant market, stating that "the relevant market is certainly no narrower than all SPRB coal." Defs Post-Trial Br. at 1). Dr. Morris concluded that SPRB coal is a relevant product market for anti-trust purposes. PPF 65. Although Ms. Guerin-Calvert offered her opinion with respect to the 8800 Btu SPRB coal market, she never refuted that SPRB coal is a relevant market. *See* PPF 66. In fact, she testified that if SPRB coal producers could coordinate output of SPRB coal, they could profitably raise the price. *Id.* Because Ms. Guerin-Calvert thus acknowledged that a hypothetical monopolist could profitably raise the price of SPRB coal, this satisfies the *Merger Guidelines* test (§ 1.11) showing that it is a relevant market.

As set forth in more detail in Plaintiffs' Post-Hearing Brief (at 30-31), there are multiple reasons why SPRB coal is a relevant product market. In particular, SPRB coal's unique properties (very low sulfur content, very low price, and low sodium content) make it desirable to many

---

[12] As a matter of law, two products do not necessarily compete in the same market merely because they "are similar in use." For instance, even though bicycles and cars can be used for transportation (the first prong of the cross-elasticity test), in order to determine cross-elasticity of bicycles and cars, one would also need to determine the degree to which consumers would purchase bicycles if the price of cars were to increase significantly. (Plaintiff's Reply Mem. in Support of Prelim. Inj. at 4; Day 9 Tr. 86:16-22; *see, e.g., New York v. Kraft General Foods, Inc.*, 926 F. Supp. 321, 333 (S.D.N.Y. 1995); *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); *Swedish Match*, 131 F. Supp.2d at 164).

customers. Plaintiffs' Post-Hearing Brief at 31. In addition, the delivered cost of SPRB coal is far lower than that of coal from other regions. (*Id.*).

Defendants erroneously base their argument that an SPRB coal market is "artificially narrow" on the fact that some companies burn both SPRB coal and coal from other regions. Yet defendants completely failed to satisfy the second prong of the cross-elasticity test because they were unable to present even any colorable evidence suggesting that such customers would replace their SPRB coal with coal from other regions if the price of SPRB coal were to increase by a small but significant amount (*Merger Guidelines* § 1.11). They did not present such evidence because it does not exist – customers repeatedly testified that they would not purchase other coals if the price of SPRB coal were to increase significantly. PPF 104, 106, 110, 111, 116-120. The only switching that has taken place among coal regions is one-way switching *toward* SPRB coal. That is, SPRB coal has replaced coal from other regions. PRF 62. There is simply no evidence that utilities are switching their coal purchases *away from* SPRB coal based on economics. Therefore, although there is some functional interchangeability between SPRB coal and coal from other regions, SPRB coal is a product market because of the low cross-elasticity of demand.

B. Defendants Erroneously Rely on the Ability of Customers to Burn both 8400 Btu SPRB Coal and 8800 Coal to Conclude that 8800 Btu SPRB Coal Is Not a Relevant Product Market

In contending that 8800 Btu SPRB coal is not a product market, defendants ignore the results of the hypothetical monopolist test. (*See generally* Plts Post-Hearing Br. at 32). As was explained in our earlier filing (*id.* at 32-33), Dr. Morris concluded that a hypothetical monopolist could generate a profit by raising the price of 8800 Btu SPRB coal (PPF 132, 144-145), and Ms.

Guerin-Calvert was ultimately forced to concede this point (PPF 146-149).[13] The fact that the hypothetical monopolist test is satisfied by 8800 coal demonstrates that it is a relevant product market.

Defendants implicitly concede that there are some customers who can only purchase either 8800 Btu SPRB coal or 8400 Btu SPRB coal, regardless of the economics. DFF 39; *see also* PPF 186-188. For the remaining SPRB customers, it is undisputed that purchasing decisions are based on economics. PPF 160; DFF 39. Despite that, defendants draw their conclusions about the 8800 Btu SPRB coal market without evaluating the economic decisions that face customers. Instead, they rely on the mere fact that some customers can and/or do purchase (or have purchased) both 8800 Btu SPRB coal and 8400 Btu SPRB coal. Defs Post-Trial Br. at 11-12. By doing so, defendants not only ignore the degree to which buyers are willing to substitute 8400 Btu SPRB coal for 8800 Btu SPRB coal (the second prong of the cross-elasticity test offered by defendants (Defs Post-Trial Br. at 9)), but they also fail to consider the extent of the price increase that would be necessary before significant substitution would occur. Consequently, defendants reach an essentially meaningless conclusion that does not consider the economics of the decisions facing these customers, which defendants themselves concede is the basis for purchasing decisions. *See* DFF 39.

---

[13] Ms. Guerin-Calvert's conclusion that 8800 Btu SPRB coal is not a product market therefore directly contradicts the results of her own analysis demonstrating that a hypothetical monopolist of 8800 Btu SPRB coal could profit from a significant increase in the price of 8800 Btu SPRB coal. Further, her conclusion seemingly ignores live customer testimony that utilities would not even consider switching from 8800 Btu SPRB coal in the face of a significant price increase of 8800 Btu SPRB coal. *See* PPF 154.

The following examples, cited by defendants as proof that 8800 Btu SPRB coal is not a product market, illustrate how misleading it is for defendants to conclude, based upon a customer's ability to purchase both 8400 and 8800 Btu SPRB coal, that it would be economical for the customer to do so if the price of 8800 Btu SPRB coal were to increase significantly:

Tuco: Defendants assert that, because Tuco solicited bids for, and burned, both 8400 Btu SPRB coal and 8800 Btu SPRB coal, this illustrates that 8800 Btu SPRB coal is not a product market. (DFF 37, 44). However, Tuco's policy of soliciting bids from all SPRB producers is solely as a result of governmental requirements imposed on Southwestern Public Service Company ("SPS"), a publicly regulated utility for which Tuco purchases coal. In fact, Tuco has not purchased 8400 Btu SPRB coal for two of SPS' stations because 8800 Btu SPRB coal allows SPS to run its boilers more efficiently from a logistical standpoint. Tuco's Vice President responsible for coal procurement testified that he does not think that Tuco would switch from 8800 Btu SPRB coal even if the price of 8800 Btu SPRB coal were to increase significantly. PRF 37; PRF 44.

Westar: Defendants similarly cite to Westar for the proposition that the decision to buy 8800 Btu SPRB coal or 8400 Btu SPRB coal is based on economics. DFF 39. Had defendants fully examined the economics of Westar's purchasing decisions, however, they would have learned that (1) 8400 Btu SPRB coal does not burn efficiently in Westar's boilers, (2) as a result of this inefficiency, Westar does not find it economical to burn 8400 SPRB coal at its plants, and (3) if the price of 8800 Btu SPRB coal were to increase significantly there would be no economic alternatives for Westar. PRF 39.

By focusing solely on the ability of customers to purchase both 8800 Btu SPRB coal and 8400 Btu SPRB coal, not only do the defendants ignore the test necessary to determine a relevant product market, but they also ignore the economics of each customer's SPRB coal purchasing decisions. Arch's CEO, Mr. Leer, has explicitly stated that there are distinct demands for 8800 Btu SPRB coal and 8400 Btu SPRB coal. (PPF 182). This fact is particularly significant because Mr. Leer testified that Arch "will be responsive to [its] customers and responsive to demand in the market." Day 6 a.m. Tr. at 8:20-22 (Leer). It logically follows that Arch responds to the demand for 8800 Btu SPRB coal without regard to the separate demand for 8400 Btu SPRB coal (and vice versa). Triton's Senior Vice-President of Sales similarly acknowledged that there are economic realities that limit customers' abilities to switch between SPRB coals. (PPF 190).

Because defendants improperly conducted the market delineation test, their arguments regarding product market are meritless.

V. TRITON CANNOT INVOKE A "WEAKENED FIRM" OR "FLAILING FIRM" DEFENSE

Another reason defendants urge that this merger should be permitted is because Triton is allegedly such a weakened firm that its loss would have only a limited competitive significance. Even if Triton is not bankrupt or technically failing, they say, it is at least locked in a downward spiral of difficulties. This is sometimes referred to as the "flailing firm" defense.

The flailing firm defense is not logically impossible, but it has always been met with well-deserved skepticism in the courts. After all, it is very easy for the managers of a firm to paint a gloomy picture of its prospects, particularly when they know that this is the path to getting approval for a transaction that they desire. And it is equally easy for accountants to present technically accurate numbers in a form that calls attention to unfavorable features, and distracts attention from favorable ones. Moreover, the weakened company defense is in some senses contrary to other goals of the antitrust laws, since it encourages the assets and customers of such companies to pass to their strongest competitors, reallocating resources in the market in the ways that are most likely to accelerate concentration. For this and other reasons the courts have noted that financial weakness, "while perhaps relevant in some cases, is probably the weakest ground of all for justifying a merger." *Kaiser Aluminum & Chemical Corp. v. FTC*, 652 F.2d 1324, 1339 (7th Cir. 1981); *cf. United States v. General Dynamics*, 415 U.S. 486, 506 (1974) (failing company doctrine has strict limits).

Quite apart from this general skepticism, Triton is precluded from asserting a flailing firm defense here on four specific grounds: (1) It is not in fact in serious financial difficulties; (2) Any difficulties that it might have are minor in comparison with the difficulties involved in the few cases where the defense has been recognized; (3) Defendants have been internally inconsistent in their claims regarding ; and (4) Defendants have not fully considered the range of practical alternatives that would be available for financing improvements at Triton.

First of all, Triton is not in fact in serious financial difficulties. Therefore, it simply cannot be a flailing firm. We discussed these issues at length in our Post-Trial Brief, and will not repeat those arguments here, except to emphasize one point that seems of particular importance. Triton is in fact profitable, and its basic profitability has just been obscured by

Triton posted earnings before interest, taxes, depreciation, depletion and amortization ("EBITDA") of The main reason that the firm might appear unprofitable in some accounting presentations is . That debt is arranged in an unusual way, however. By agreement with the lenders,

. After that time, however, the apparent profitability of the company will rise sharply

Triton has urged that depletion must also be taken into account, and that this requires a further, more lasting, more "real" adjustment to the EBITDA earnings. Such an adjustment is probably legitimate, but its significance is grossly overstated. By Triton's own figures the proper adjustment for depletion is no more than per ton of coal (PX 882 at 003) – . That is hardly enough to move EBITDA figures from approximately all the way into the flailing company range.

The second reason why Triton is not entitled to the weakened company defense is that its financial difficulties pale in comparison with those faced by firms for whom the defense has actually been recognized. The "principal authority for the existence of a weak company defense," according to the Seventh Circuit, is *United States v. International Harvester*, 564 F.2d 769 (7th Cir. 1977).[14] That case involved Harvester's acquisition of Steiger Tractors, a manufacturer of specialty four-wheel-drive farm tractors. Steiger had truly serious financial difficulties. In 1970 it lost $525,971, had only $82,755 of working capital and only $4,914 to meet current liabilities of $1,111,841, resulting in its suppliers refusing to ship it parts and components. 564 F.2d at 775. In 1971 Steiger lost $825,922; its current liabilities of $4,338,613 exceeded its current assets of $3,881,971; and its working capital had been reduced to a negative $456,642. *Id.* In 1972 its working capital was negative $752,000. *Id.* By 1972, Steiger's banks were unwilling to extend further credit. *Id.* By 1973, Steiger concluded, and the court agreed, that "the only practicable

---

[14] *Kaiser Aluminum & Chemical Corp. v. FTC*, 652 F.2d 1324, 1338 (7th Cir. 1981), *citing United States v. International Harvester*, 564 F.2d 769 (7th Cir. 1977).

source of sufficient amounts of equity financing to solve its pressing needs" was to interest International Harvester in an investment. *Id.* at 776, 779. Other cases recognizing the defense have posed similarly extreme facts.[15] Triton, by contrast, stands on a far more sound financial footing.

A third reason why Triton is not entitled to a flailing firm defense is that it has not been entirely consistent – and thus not entirely persuasive – in describing some of the circumstances that are alleged to be the sources of the firm's weakness. For example, we are told that Triton's

. In particular,

. Defs Post-Trial Br. at 43. At the same time, however, we are told that this same mine is a source of dazzling opportunity for Kiewit, a place where production can be expanded by percent on "very, very attractive" financial terms. Defs Post-Trial Br. at 37. It is hard to reconcile these two very different prognoses. The defendants attempt to do so by positing that the beneficial expansion .

But if the expansion makes business sense for Kiewit, it would also make business sense for Triton (and Triton's financial backers), and so the argument is really little more than an assertion that the nation's capital markets do not work rationally, something that is difficult to accept as an *a priori* statement.

---

[15] *See FTC v. National Tea Co.*, 603 F.2d 694, 699 (8th Cir. 1979) (firm lost money in each of the preceding five years; its stores were smaller than its competitors; and it was unable to find and develop new sites). *See also Lektro-Vend Corp. v. Vendo Co.*, 660 F.2d 255, 276 (7th Cir. 1981) ("Between 1959 and 1969, Vendo's share of the candy vending machine manufacturing market dropped from 31% to 16%, and by 1972, Vendo was completely eliminated from the candy and cigarette vending machine business").

Finally, a fourth reason why Triton is not a flailing firm is that it has not yet seriously explored all the alternative routes to either obtaining more capital or else selling the firm to a less-anticompetitive buyer. We are told that

. This statement defies common sense if there are investment opportunities as close and tangible as defendants claim for the Buckskin mine.[16] Incremental investment should be judged by its incremental return, and we are told that the return there would be very good

, then this Court should follow the principles of *UPM-Kymmene OYJ*, 2003-2 CCH Trade Cas. ¶ 74,101 at 96,936 (N.D. Ill. 2003), which found the weakened company defense inapplicable to a firm that "is non-competitive simply because its parent has decided not to compete." It similarly appears that Triton has not searched recently for other possible buyers, and so cannot really assert with confidence that there are none available.[17]

For all these reasons, Triton is not properly considered as a weakened or "flailing" firm. It may have challenges and financial issues to confront, but all firms have those. Triton is not so fundamentally different in its situation or marginal in its impacts that it should be exempt from the normal standards of the antitrust laws.

---

[16] Or, as alternatives to investing more capital in the mine itself, the investors might put money into leases of adjacent ground, or into a corporate restructuring under which Buckskin is sold and corporate operations concentrated on North Rochelle.

[17] As we discussed in our Post-Hearing Brief (at 50), Triton has not made such a search since 2003.

VI. DEFENDANTS HAVE NOT CARRIED THEIR BURDEN OF ESTABLISHING AN EFFICIENCIES DEFENSE

Defendants appear to acknowledge that their much-touted efficiencies defense simply did not pan out at trial. Defendants started out with high hopes, submitting a lengthy and detailed description of the alleged efficiencies to the Commission (PX 1024), and opening the argument section of their pretrial brief (at 10-12) with a discussion of alleged efficiencies. They proceeded to lead off their defense case with the testimony of their first mining expert, Mr. Lang, followed shortly thereafter by their second mining expert, Mr. Kostic. But after their efficiencies case was called into serious doubt at trial, defendants have now "buried" their efficiencies discussion and have all but abandoned the argument. The half-hearted nature of defendants' discussion speaks for itself.

VII. CONCLUSION

For the reasons stated here, in our opening Post-Hearing Brief, and in our pre-trial memoranda, plaintiffs have raised serious and substantial questions sufficient to warrant injunctive relief during the pendency of an administrative proceeding to assess the antitrust merits of the proposed acquisition. The present motion should therefore be granted in its entirety.

Respectfully submitted,

WILLIAM E. KOVACIC
General Counsel

SUSAN A. CREIGHTON
Director

BERNARD A. NIGRO JR.
Deputy Director

MELVIN H. ORLANS
Senior Counsel
Bureau of Competition

RHETT R. KRULLA (D.C. Bar No. 279505)
MICHAEL H. KNIGHT (D.C. Bar No. 441161)
MORRIS A. BLOOM
JOHN MARTIN
SCOTT REITER
Attorneys
Federal Trade Commission
601 New Jersey Avenue, N.W.
Washington, D.C. 20001
202-326-2608

JEREMIAH W. (JAY) NIXON
Attorney General

ANNE E. SCHNEIDER
Assistant Attorney General
Missouri Attorney General's Office
Missouri Bar No. 35479
(573) 751-8455
ON BEHALF OF PLAINTIFF STATES