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Complaint

IN THE MATTER OF

THE COCA-COLA COMPANY

FINAL ORDER, OPINION, ETC., IN REGARD TO ALLEGED VIOLATION OF
SEC. 7 OF THE CLAYTON ACT AND SEC. 5 OF THE
FEDERAL TRADE COMMISSION ACT*Docket 9207. Complaint, July 15, 1986--Final Order, June 13, 1994*

This final order requires Coca-Cola, for ten years, to obtain Commission approval before acquiring any part of the stock or interest in any company that manufactures or sells branded concentrate, syrup, or carbonated soft drinks in the United States.

Apearances

For the Commission: *Joseph S. Brownman, Ronald Rowe, Mary Lou Steptoe and Steven J. Rurka.*

For the respondent: *Gordon Spivack and Wendy Addiss, Coudert Brothers, New York, N.Y.*

OPINION OF THE COMMISSION

BY OWEN, *Commissioner:*

I. INTRODUCTION

This case involves a prospective combination of The Coca-Cola Company (“Coca-Cola”) and the Dr Pepper Company (“Dr Pepper”), which was enjoined before consummation.¹ Both companies make soft drink concentrates and syrups that are used by bottlers to produce carbonated soft drinks for sale to consumers.² In 1986, when Coca-Cola had the largest market share among soft drink concentrate producers, and Dr Pepper was the fourth largest producer, IDFF paragraph 226, Coca-Cola entered into an agreement whereby Coca-Cola was to acquire all of the stock in DP Holdings, Inc.³ (“DP Holdings”), which owned 100% of the stock of Dr Pepper, for a total consideration of approximately \$470 million. IDFF paragraph 9.

The Commission filed an administrative complaint pursuant to Section 5(b) of the Federal Trade Commission Act (“FTC Act”), 15 U.S.C. 45(b), and Section 11 of the Clayton Act, 15 U.S.C. 21, alleging that Coca-Cola’s acquisition of Dr Pepper would, if consummated, violate Section 7 of the Clayton Act, 15 U.S.C. 18, and Section 5 of the FTC Act, 15 U.S.C. 45. The complaint further alleged that the agreement itself constituted a separate violation of Section 5 of the FTC Act.

¹ The following abbreviations are used in this opinion:

ID	Initial Decision (page no.)
IDFF	Initial Decision Findings of Fact. (Paragraph no.)
AD	Brief of Counsel Supporting the Complaint in Support of Appeal from Initial Decision
ABC	Answering Brief of Appellee and Cross-Appellant The Coca-Cola Company
ATr.	Transcript of Oral Argument before the Federal Trade Commission (June 6, 1991)
RBCA	Reply Brief of Appellee and Cross-Appellant The Coca-Cola Company
RBCC	Reply Brief of Counsel Supporting the Complaint

² Concentrate is sold by producers, such as Coca-Cola and PepsiCo, to bottlers, which combine the concentrate with carbonated water and sweetener, and package the resulting soft drinks in cans or bottles for sale to consumers. (Some concentrate, such as for “diet” drinks, is sold premixed with sweeteners.) Neither Coca-Cola nor Dr Pepper is a bottler, although Coca-Cola has ownership interests in bottlers. IDFF paragraph 203. Syrup, which is made by adding water and sweetener to concentrate, is sold to fountain wholesalers. The wholesalers distribute the syrup to retail outlets, which combine it with carbonated water to produce soft drinks for soda fountains or certain types of vending equipment.

³ DP Holdings, Inc., a Delaware corporation, was a holding company created as a vehicle for an earlier leveraged buy out of Dr Pepper. IDFF paragraph 5.

The administrative law judge ("ALJ") who tried the case concluded that the proposed acquisition was likely to substantially lessen competition in the national markets for branded soft drink concentrate and for all soft drink concentrate. However, he declined to issue an order against Coca-Cola on the ground that an order was not in the public interest. Commission complaint counsel appealed, and Coca-Cola cross-appealed the findings of violations of the FTC and Clayton Acts. Having considered the parties' briefs and arguments, and the record as a whole, we affirm the finding of violations of the FTC and Clayton Acts, and reverse the conclusion that a prior approval order should not be entered against Coca-Cola.⁴

II. HISTORY OF THE PROCEEDING

Coca-Cola's efforts to acquire Dr Pepper occurred at the same time that PepsiCo, Inc. sought to acquire the Seven-Up Company (another concentrate manufacturer) from Philip Morris, Inc.⁵ The Commission investigated both transactions simultaneously, and on June 20, 1986, authorized its staff to seek injunctive relief against both on June 23, Philip Morris announced that it was terminating its acquisition agreement with PepsiCo. On June 24, the Commission filed suit in federal district court, seeking a preliminary injunction against Coca-Cola's impending acquisition pursuant to Section 13(b) of the FTC Act, 15 U.S.C. 53(b).⁶ On July 15, 1986, while the district court action was pending, the Commission issued an administrative complaint against Coca-Cola.⁷ See IDFF paragraphs 7-11, 372-75.

In the injunction proceeding, the district court found that the Commission had made a sufficient preliminary showing that the acquisition was likely to substantially lessen competition in the market for carbonated soft drink concentrates. Accordingly, on July

⁴ We adopt the findings of fact in the ALJ's Initial Decision to the extent that they are not inconsistent with this opinion.

⁵ Coca-Cola has stated that its proposed acquisition of Dr Pepper was a "defensive" maneuver spurred by PepsiCo's plan to acquire Seven-Up. ATr. at 61. See IDFF paragraph 10.

⁶ In lieu of a temporary restraining order, the parties agreed to defer implementing their acquisition agreement pending a ruling on the Commission's application for a preliminary injunction. See *FTC v. Coca-Cola Co.*, 641 F. Supp. 1128, 1129 n.2 (D.D.C. 1986), vacated as moot, 829 F.2d 191 (D.C. Cir. 1987) (per curiam).

⁷ The Commission did not file an injunctive action or administrative complaint against PepsiCo because of the earlier abandonment of PepsiCo's acquisition (see *infra* Part III.B.).

31, 1986, the district court issued a preliminary injunction against the transaction.⁸

On August 5, 1986, the shareholders of DP Holdings announced their desire to terminate the purchase agreement, and later sold Dr Pepper to an investment group headed by Hicks & Haas.⁹ Coca-Cola then moved to dismiss the Commission's pending administrative complaint, asserting that the costs of litigation outweighed the likely benefits of any remedial order that might result. The Commission denied the motion on the ground that if the Commission ultimately found that the proposed acquisition violated the law, its cancellation by DP Holdings did not eliminate the need for prospective relief. *See Order Denying Respondent's Motion for Dismissal of the Complaint* (Aug. 9, 1988); IDFF paragraph 12.

The administrative case was tried in 1990 before Administrative Law Judge Lewis F. Parker. On November 30, 1990, ALJ Parker issued his opinion, finding that branded concentrate used to produce branded carbonated soft drinks was the most appropriate relevant market in which to assess the effects of the acquisition (ID 99), and that all concentrate and syrup used to produce carbonated soft drinks also constituted a relevant market (ID 107).¹⁰ He found that the relevant geographic market was the nation as a whole (ID 99); that there were substantial barriers or impediments to entry into branded soft drink concentrate (ID 105), making entry difficult, risky and time-consuming (ID 108); and that expansion by fringe firms was extremely unlikely (ID 105-106, 108). The ALJ found that the relevant markets were highly concentrated, and that the proposed acquisition would substantially increase that concentration (ID 102).

The ALJ found that the acquisition would:

- (1) Eliminate Dr Pepper as a substantial, independent competitive force in the relevant markets;
- (2) Increase the likelihood of or facilitate collusion;
- (3) Increase the difficulty of entry; and
- (4) Raise the costs and reduce the competitiveness of other firms in the relevant markets.

⁸ 641 F. Supp. at 1141.

⁹ After this action, Coca-Cola withdrew its pending appeal of the preliminary injunction and successfully petitioned the court of appeals to vacate the district court's order on grounds of mootness. *FTC v. Coca-Cola Co.*, 829 F.2d 191.

¹⁰ The ALJ rejected Coca-Cola's assertion that the relevant market consisted of all beverages. *See* IDFF paragraphs 49-66, 160; ID 93-94.

ID 108. These factors, according to the ALJ, all “increase the likelihood that firms will increase prices and restrict the output of carbonated soft drinks both in the near future and in the longer run.” *Id.*

The ALJ concluded that the effect of the acquisition, if consummated, may be substantially to lessen competition in the relevant markets, in violation of Section 7 of the Clayton Act and Section 5 of the FTC Act. He further found that the acquisition agreement between Coca-Cola and DP Holdings violated Section 5 of the FTC Act. *Id.* Despite these conclusions, the ALJ declined to issue an order against Coca-Cola, reasoning that an order requiring respondent to obtain the prior approval from the Commission before acquiring any other concentrate or bottling company would not be in the public interest. ID 107. This conclusion was based on the ALJ’s evaluation of the record, and on the Bureau of Competition’s earlier concurrence with Coca-Cola’s 1986 motion to dismiss the complaint on public interest grounds. ID 106.

For the reasons set forth below, we affirm ALJ Parker’s finding of law violations, and reverse his decision against entry of an order; however, we decline to enter, in its entirety, the order sought by complaint counsel.

III. THE COMMISSION’S AUTHORITY TO PROSECUTE THIS ACTION

Coca-Cola contends that the ALJ erred by rejecting four challenges to the Commission’s authority to prosecute this action. First, Coca-Cola argues that the ALJ should have dismissed paragraphs 11 and 13 of the complaint (alleging that the proposed acquisition would violate the Clayton and FTC Acts) on the ground that the acquisition was never consummated. ABCA at 86-89. Second, respondent asserts that the ALJ erred in finding that the purchase agreement violated Section 5 of the FTC Act. ABCA at 92-96. Third, Coca-Cola argues that the ALJ should have dismissed the entire complaint as moot. ABCA at 91 n.44. Finally, respondent contends that the ALJ should have dismissed the complaint on the ground that prosecution of the administrative action was vindictive, arbitrary and capricious, and therefore violated the Due Process Clause of the Fifth Amendment to the United States Constitution. ABCA at 96-102. We find Coca-Cola’s arguments to be without merit.

*A. The Commission's Authority to Conduct
Administrative Proceedings Concerning an
Acquisition Enjoined Prior to Consummation*

1. The Commission's statutory jurisdiction over acts alleged
in paragraphs 11 and 13 of the complaint

Paragraph 11 of the complaint alleged that “[t]he proposed acquisition of the stock of DP Holdings by Coca-Cola would, if consummated, violate Section 7 of the Clayton Act, as amended, 15 U.S.C. 18.” Paragraph 13 of the complaint similarly alleged that the proposed acquisition “would, if consummated, violate Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. 45.” Coca-Cola contends that these paragraphs articulate only “threatened” violations of the Clayton and FTC Acts. ABCA at 89. The Commission’s suit for a preliminary injunction under Section 13(b) of the FTC Act prevented the parties from consummating the acquisition before the Commission issued its administrative complaint. Coca-Cola argues that because the acquisition was not fully consummated, it did not violate Section 5 or Section 7 (ABCA at 88-89). Coca-Cola further argues that the Commission lacked jurisdiction to adjudicate the lawfulness of the enjoined acquisition because its jurisdiction allegedly does not reach prospective law violations (ABCA at 87-89, 91-92). Finally, it argues that, even if the Commission initially had jurisdiction, that jurisdiction lapsed when the parties announced their intention to abandon the transaction (after the district court issued a preliminary injunction against it) (RBCA at 51 n.36).

The ALJ rejected these arguments and refused to dismiss the charges in paragraphs 11 and 13. *See Order Denying Respondent’s Motion to Dismiss the Complaint* (Mar. 13, 1990). For the reasons below, we agree with the ALJ that complaint paragraphs 11 and 13 stated charges that were within the Commission’s jurisdiction.

It is important to identify the nature of the conduct at issue here and the consequences of respondent’s arguments. Coca-Cola challenges the Commission’s jurisdiction over “possible future violations” of the Clayton Act (ABCA at 87-89, 91-92), as if the acquisition of Dr Pepper were some remote hypothetical. In fact, Coca-Cola and DP Holdings had agreed on all details of the acquisition; had filed statutorily required notices of their transaction; had contractually committed themselves to going forward unless the

government obtained an injunction (and, even then, they were bound to use “their best efforts to have any such . . . injunction lifted” (*see infra* p. 15, note 26)); and persisted in their transaction after the Commission notified them of its objections and of its intention to seek an injunction if forced to do so. In other words, a federal court injunction was the only barrier to full consummation. Far from being a “possible future violation,” the acquisition was certain, absent government intervention.¹¹

Moreover, the consequence of Coca-Cola’s argument is that once the Commission obtained a preliminary injunction under Section 13(b) of the FTC Act, it would lose jurisdiction to conduct administrative adjudications of the lawfulness of unconsummated acquisitions or other impending violations of law.¹² The preliminary injunction would then have to be dissolved, both because Section 13(b) limits a preliminary injunction to a maximum of 20 days unless the Commission issues an administrative complaint within that period,¹³ and because the Commission, lacking jurisdiction, presumably could no longer show any prospect of success on the ultimate merits. The parties would then be free to revive their transaction, forcing the Commission to go to court once again. Such a wasteful duplication of agency efforts and drain on judicial resources could hardly be what Congress envisioned for the Commission’s enforcement practices.

We have previously rejected an argument virtually identical to Coca-Cola’s:

¹¹ Coca-Cola’s argument that only fully consummated transactions violate Section 7 of the Clayton Act ignores the courts’ flexible construction of “acquire” in Section 7 to reach transactions that fall short of being consummated acquisitions. *See, e.g., McTamney v. Stolt Tankers & Terminals (Holdings), S.A.*, 678 F. Supp. 118, 120 (E.D. Pa. 1987); *United States v. Columbia Pictures Corp.*, 189 F. Supp. 153, 181-83 (S.D.N.Y. 1109-0). It also ignores the probabilistic focus of Section 7, which was intended to “arrest the creation of trusts, conspiracies, and monopolies in their incipiency and before consummation.” S. Rep. No. 698, 63rd Cong., 2d Sess. 1 (1914); *see also Hospital Corp. of Am. v. FTC*, 807 F.2d 1381, 1389 (7th Cir. 1986), *cert. denied*, 481 U.S. 1038 (1987) (“HCA”).

¹² The consequences of respondent’s argument are not limited to acquisitions; the same result would occur if the Commission sought to preliminarily enjoin other unlawful conduct that is imminent but not yet implemented. While respondent suggests that the Commission might retain the ability to challenge unconsummated mergers by attacking the legality of some acquisition agreements (but not the Coca-Cola/Dr Pepper agreement, *see infra* Part III.A.2.) such an alternative may be unavailable in other contexts, *e.g.*, when a person is about to engage in a deceptive practice.

¹³ An administrative complaint may be dispensed with only where the Commission seeks a permanent court injunction under the last proviso of Section 13(b). (Coca-Cola’s argument that the Commission could abandon administrative adjudications in favor of federal court litigation to obtain a permanent injunction is discussed *infra*.)

The Commission's subject-matter jurisdiction depends on the nature of the alleged illegal conduct, and not on whether it is ongoing at any particular point during the trial. To hold otherwise would mean that a Commission law enforcement action could be brought to a halt at any time . . . by an abandonment, even a temporary one, of the challenged conduct. [V]oluntary cessation of unlawful activity is not a basis for halting a law enforcement action.

Warner Communications, Inc., 105 FTC 342 (1985).¹⁴ The Commission's adjudicative jurisdiction is thus similar to a federal district court's jurisdiction to judge the legality of, and enjoin, a challenged practice; such jurisdiction does not evaporate simply because a defendant has abandoned the practice. *See, e.g., R.C. Bigelow, Inc. v. Unilever, N.V.*, 867 F.2d 102, 106 (2d Cir.) (suit to enjoin merger not mooted by abandonment of transaction), *cert. denied*, 493 U.S. 815 (1989); *see also City of Mesquite v. Aladdin's Castle, Inc.*, 455 U.S. 283, 289 (1982); *United States v. W.T. Grant Co.*, 345 U.S. 629, 632 (1953); *United States v. Realty Multi-List, Inc.*, 629 F.2d 1351, 1387 (5th Cir. 1980); *United States v. Aluminum Co. of Am.*, 148 F.2d 416, 448 (2d Cir. 1945).¹⁵

In addition to creating an untenable situation for law enforcement, Coca-Cola's argument that the Commission lacks jurisdiction over unconsummated acquisitions (or over any other imminent violation of a law enforced by the Commission) is legally defective. Respondent's argument is based on the particular tenses used in Section 11(b) of the Clayton Act, 15 U.S.C. 21(b), and Section 5(b) of the FTC Act, 15 U.S.C. 45(b). Section 11(b) authorizes the Commission to issue an administrative complaint when it has reason to believe that a person "is violating or has violated" certain sections of the Clayton Act (including Section 7). Section 5(b) authorizes an administrative complaint when the Commission has reason to believe that a person "has been or is using any unfair method of competition" Coca-Cola reads this language as permitting actions only against past or ongoing law violations, and not against imminent violations (ABCA at 87-89, 91-92).

¹⁴ After the Commission obtained a preliminary injunction against a proposed merger between Warner Communications and Polygram Records (*FTC v. Warner Communications, Inc.*, 742 F.2d 1156 (9th Cir. 1984)), the parties abandoned the transaction, and moved to dismiss the Commission's pending administrative complaint. The Commission denied the motion.

¹⁵ A case may, of course, be moot if there is no reasonable likelihood of recurrence. *W.T. Grant Co.*, 345 U.S. at 633. Respondent's mootness argument is discussed *infra* Part III.A.3.

Coca-Cola's focus on these sections is misplaced. Section 11(b) and Section 5(b) are "purely procedural." Adventist Health Sys./West, FTC Dkt. No. 9234, slip op. at 13 n.26 (Aug. 2, 1991). In contrast, the Commission's subject matter jurisdiction over this case is conferred by Section 5(a)(2) of the FTC Act and Section 11(a) of the Clayton Act. These sections respectively empower the Commission "to prevent" persons from using unfair methods of competition, and grant it "authority to enforce compliance" with the Clayton Act.¹⁶ They are forward-looking provisions that focus on preventing future illegal conduct rather than on punishing past wrongdoing. *See, e.g., FTC v. Ruberoid Co.*, 343 U.S. 470, 473 (1952); *FTC v. Cement Inst.*, 333 U.S. 683, 706 (1948).¹⁷ The Commission's action against an almost consummated acquisition is consistent with Congress' enactment of the FTC and Clayton Acts in order to halt potentially anticompetitive practices and mergers in their incipiency. *See, e.g., FTC v. Brown Shoe Co.*, 384 U.S. 316, 322 (1966); *United States v. E.I. du Pont de Nemours & Co.*, 353 U.S. 586, 597 (1957); *Grand Union Co. v. FTC*, 300 F.2d 92, 98-99 (2d Cir. 1962) (FTC Act "intended to be prophylactic: to stop in their incipiency acts which when full blown would lead to monopoly or undue hindrance of competition"); and *see also supra* p. 6, note 11.

Seemingly oblivious to this broad statutory scheme, Coca-Cola's argument for an incapacitating limitation on the Commission's jurisdiction singles out two isolated phrases ("is violating or has violated" in Section 11(b) and "has been or is using" in Section 5(b)). Coca-Cola has not pointed to any legislative history indicating that the use of the present and past tenses in these procedural sections was intended to set a limit on the Commission's broad jurisdiction. Rather, at the time that the FTC and Clayton Acts were enacted, the Commission was less likely to have advance notice of planned, but unexecuted activities, and lacked any express powers to obtain preliminary relief. Accordingly, the language cited by Coca-Cola

¹⁶ Specifically, Section 5(a)(2) empowers and directs the Commission "to prevent persons, partnerships, or corporations... from using unfair methods of competition in or affecting commerce and unfair or deceptive acts or practices in or affecting commerce." (Emphasis supplied.) Section 11(a) vests the Commission with "authority to enforce compliance" with Sections 2, 3, 7, and 8 of the Clayton Act.

¹⁷ Given the prophylactic nature of Commission orders to cease and desist, it is less important to show that an activity has crossed the line from impending to actualized than it might be in the context of a proceeding designed to punish wrongdoing. Cf. e.g., *W.T. Grant Co.*, 345 U.S. at 633 (an injunction against future law violations can be granted "even without a showing of past wrongs"); *United States v. Oregon State Medical Society*, 343 U.S. 326, 333 (1952) ("All it takes to make the cause of action for relief by injunction is a real threat of future violation....")

may simply have reflected the assumption that the Commission ordinarily would be acting after the fact, rather than a deliberate restriction of the Commission's broad prophylactic powers.¹⁸

Subsequently, Section 13 of the FTC Act, 15 U.S.C. 53, added in 1938 (52 Stat. 115), and amended in 1973 (87 Stat. 592), and the Hart-Scott-Rodino Antitrust Improvements Act of 1976, 90 Stat. 1383, 1390 (1976) ("the HSR Act") confirmed that the tenses in Sections 5(b) and 11(b) do not limit the Commission's jurisdiction. Section 13(a) authorizes the Commission to seek a preliminary injunction whenever a person "is engaged in, or is about to engage in" [emphasis added] false advertising of foods, drugs, devices, or cosmetics. Section 13(b) broadly empowers the Commission to seek a preliminary injunction against anyone who "is violating, or is about to violate" [emphasis added] any provision of law enforced by the Commission. Significantly, both parts of Section 13 assume that the Commission will issue and adjudicate an administrative complaint after a preliminary injunction is granted (*see supra* p. 7), and they make no distinction between impending and ongoing violations. These two sections -- enacted more than forty years apart -- consistently reinforce the Commission's jurisdiction to adjudicate the lawfulness of imminent, as well as past or present, violations of the laws that it enforces.¹⁹ *See Warner Communications, Inc.*, 105 FTC

¹⁸ Properly applied, the "plain meaning" doctrine supports the Commission's exercise of jurisdiction in the present case. In ascertaining the "plain meaning" of a statute, consideration cannot be limited merely "to the particular statutory language at issue, [but must also take into account] the language and design of the statute as a whole." *K Mart Corp. v. Cartier Inc.*, 486 U.S. 281, 291 (1988); accord, *United States Nat'l Bank of Oregon v. Independent Ins. Agents of Am., Inc.*, 113 S. Ct. 2173, 2182 (1993). Nevertheless, by isolating a few words and urging a literal interpretation, Coca-Cola appears to suggest that the Commission must limit its search for the plain meaning to these isolated phrases alone. Where a statute is clear and consistent on its face, and in its entirety, this approach might be sufficient. But where, as here, the "plain meaning" of isolated parts of a statute may be at variance with the entire statutory scheme and with Congress' ultimate intent, the "plain meaning" of such phrases must give way to an interpretation that comports with the overall statutory mandate. As the Supreme Court has noted:

Over and over we have stressed that "[i]n expounding a statute, we must not be guided by a single sentence or member of a sentence, but look to the provisions of the whole law and to its object and policy."

United States Nat'l Bank of Oregon, 113 S. Ct. at 2182 (quoting *United States v. Heirs of Boisdore*, 49 U.S. (8 How.) 113, 122 (1849)). *See also United States v. Ron Pair Enterprises, Inc.* 489 U.S. 235, 242 (1989) ("The plain meaning of legislation should be conclusive, except in the 'rare case [in which] the literal application of the statute will produce a result demonstrably at odds with the intentions of its drafters.' *Griffin v. Oceanic Contractors, Inc.*, 458 U.S. 564, 571 (1982). In such cases, the intention of the drafters, rather than the strict language, controls.").

¹⁹ Coca-Cola points to two letters commenting on legislation that led to enactment of Section 13(b), which express the Commission's desire for statutory authority to prevent the "continuance" or "continuation" of unlawful conduct. RBCA at 51 n.36 (citing 6 Kintner, *Legislative History of the*

at 342 (Section 13(b) “expressly contemplates adjudication of the merits of the legality of unconsummated mergers”).

Furthermore, Coca-Cola’s interpretation of the FTC and Clayton Acts is at odds with the statutory system that Congress has created for dealing with potentially anticompetitive mergers of a certain size. After giving the Commission the express power to seek preliminary injunctions against mergers and other anticompetitive practices, Congress later made that power (and the corresponding power of the Department of Justice under Section 15 of the Clayton Act) more effective by enacting the HSR Act, *supra*. The HSR Act added Section 7A of the Clayton Act, 15 U.S.C. 18a, which prohibits persons from making acquisitions over a certain size prior to giving detailed notice to the Commission and the Justice Department, and waiting for specified periods of time. The purpose of Section 7A was to facilitate the government’s ability to obtain preliminary injunctions prior to consummation, in recognition of how difficult it is to “unscramble” a completed combination, and to undo all of the adverse effects on competition once a business or its assets have changed hands. *See* S. Rep. No. 94-803, 94th Cong., 2d Sess. 61, 65 (1976).

We are not aware of anything in the HSR Act’s legislative history suggesting that Congress intended to authorize premerger injunctions only at the cost of eliminating administrative adjudications of their lawfulness. To the contrary, the HSR Act demonstrates that Congress intended for the Commission to exercise its jurisdiction over unconsummated but imminent acquisitions. Indeed, Section 7A(f) of the Clayton Act (part of the HSR Act) states: “If a proceeding is instituted or an action is filed by the Federal Trade Commission, alleging that a proposed acquisition violates [the FTC or Clayton Acts], or an action is filed by the United States [alleging a violation of the Clayton or Sherman Acts] . . .” [emphasis added], the agency’s motion for a preliminary injunction shall be promptly assigned to a district court judge. The reference to a “proceeding” by the Commission (as opposed to an “action” by the Commission or the Justice Department) can only be to an administrative proceeding. Section 7A(f) thus implicitly recognizes that the Commission is empowered to commence an administrative proceeding challenging a “proposed

Federal Antitrust Laws and Related Statutes 4962, 4982-83 (1983)). These letters are limited in the issues that they address and do not reach the question of whether the Commission’s powers are being limited to past or present law violations. In any event, they cannot override Section 13(b)’s clear authorization to proceed against persons who are “about to” violate laws enforced by the Commission.

acquisition," *i.e.*, before a merger is consummated, and to continue the proceeding after the acquisition has been preliminarily enjoined. This tacit recognition also exists in Section 7A(h), a confidentiality provision, which permits disclosure of premerger notification materials in administrative proceedings - presumably proceedings concerning the merger described in the HSR notice.

Coca-Cola suggests that the Commission has an alternative, *i.e.*, forgoing administrative proceedings in favor of preliminary and permanent injunctive relief in federal court under the last proviso in Section 13(b) (ABCA at 89 n.41).²⁰ This suggestion ignores the fact that the Commission was established for the express purpose of applying its expertise to mergers and unfair competitive practices. Congress "thought the assistance of an administrative body would be helpful in resolving such questions and indeed expected the FTC to take the leading role in enforcing the Clayton Act. . ." *HCA*, 807 F.2d at 1386.²¹ Although the Commission does seek permanent injunctions in appropriate cases, Coca-Cola's suggestion that the Commission routinely seek such injunctions instead of conducting administrative adjudication would be in derogation of the Commission's statutory responsibilities to explicate the FTC and Clayton Acts as they apply to mergers, and to fashion appropriate remedies for unlawful acquisitions.

In sum, Coca-Cola's argument depends on an excruciatingly literal reading of procedural portions of the FTC and Clayton Acts that squarely conflicts with more substantive sections and with Congress, broad remedial intent.²² It would also neuter the effective system established by Congress to give the Commission advance notice of impending acquisitions, so that it may seek a preliminary injunction against those that may be anticompetitive, and subsequently adjudicate their lawfulness. We reject respondent's argu-

²⁰ As an exception to the requirement that the Commission issue an administrative complaint after obtaining preliminary injunctive relief, Section 13(b) states: "Provided further, That in appropriate cases the Commission may seek, and after proper proof, the court may issue, a permanent injunction."

²¹ See also, e.g., *FTC v. Sperry & Hutchinson Co.*, 405 U.S. 233, 239-40 (1972); *Cement Inst.*, 333 U.S. at 692-93; *Grand Union Co.*, 300 F.2d at 99 (Commission established "as an expert body to apply the imprecise standards of Section 5"); S. Rep. No. 597, 63d Cong., 2d Sess. 8-9 (1914).

²² The Supreme Court has rejected other overly literal readings of the FTC and Clayton Acts. For example, the Court has upheld broad fencing-in orders even though Section 5(b), if read literally, authorizes only orders against the specific violation charged in the Commission's complaint. *Rubberoid Co.*, 343 U.S. 473-74; *FTC v. Morton Salt Co.*, 334 U.S. 37, 51-52 (1948). In *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 335-49 (1963), the Court held that Section 7 of the Clayton Act applied to a merger between two banks, even though the express statutory language appeared literally to cover only a unilateral acquisition of stock.

ments and find that the Commission has jurisdiction to adjudicate the lawfulness of Coca-Cola's proposed acquisition of Dr Pepper.

**2. The purchase agreement as a violation of Section 5
of the Federal Trade Commission Act**

Even assuming *arguendo* that the Commission lacked jurisdiction over an unconsummated acquisition under paragraphs 11 and 13 of the complaint, the Commission has jurisdiction under complaint paragraph 12, which alleged that the acquisition agreement between Coca-Cola and DP Holdings violated Section 5 of the FTC Act. The ALJ upheld this count (ID 108). Coca-Cola contends, however, that this complaint allegation should have been dismissed because a "failsafe," provision in the parties' contract allegedly eliminated the possibility of an anticompetitive purpose or anticompetitive effect (ABCA at 92-96).²³ We reject this argument and affirm the ALJ's finding.

It is well established that certain practices that do not violate the Sherman and Clayton Acts (15 U.S.C. 1, 12, *et seq.*) may nonetheless be "unfair methods of competition" that violate Section 5 of the FTC Act. *See, e.g., FTC v. Brown Shoe Co.*, 384 U.S. at 321-22. This principle flows from the Commission's power to prevent practices which, although not violations of those antitrust laws, contravene the public policies behind them. *See, e.g., Sperry & Hutchinson Co.*, 405 U.S. at 239-44; *Atlantic-Refining Co. v. FTC*, 381 U.S. 357, 369 (1965). The Commission has applied this principle to mergers, holding that where an acquisition violates Section 7 of the Clayton Act, the company that agreed to sell the stock or assets has violated Section 5 of the FTC Act even though, as a selling company, it is not subject to Section 7. *Dean Foods Co.*, 70 FTC 1146, 1290-92 (1966). The Commission reasoned:

Since mergers which have the requisite effect upon competition are in violation of Section 7, it necessarily follows that an agreement to effect such a merger must conflict with the basic policies of the Clayton Act and therefore is in violation of Section 5 of the Federal Trade Commission Act. *Id.* at 1291 (emphasis added). *See also, e.g., Rhinechem Corp.*, 93 FTC 233 (1979); *Beatrice Foods Co.*, 67 FTC 473, 726 (1965). This principle applies with equal force to an acquiring party's agreement to make an anticompetitive acquisition. Accordingly, the ALJ correctly held that Coca-Cola's contractual agreement to purchase Dr Pepper -- an acquisition

²³ Although respondent did not characterize this as a jurisdictional attack, we discuss it here inasmuch as it relates to the Commission's jurisdiction over unconsummated mergers.

that had the tendency to substantially lessen competition -- violated Section 5, independent of any violation of the Clayton Act.²⁴

Coca-Cola does not dispute this underlying principle. *See* ABCA at 89 n.42. However, it asserts that if the acquisition in itself did not violate the Clayton or Sherman Acts because it was not consummated, the purchase agreement could not violate Section 5 of the FTC Act unless it "was undertaken with anticompetitive purposes" or "had anticompetitive effects." ABCA at 93. Although we disagree with respondent's legal premise, we need not address it at length because Coca-Cola has failed to establish the factual predicate for its argument.²⁵

The agreement between Coca-Cola and DP Holdings manifested, at a minimum, an intention to eliminate competition between them by eliminating Dr Pepper as an independent competing manufacturer of soft drink concentrate. The only alleged support for Coca-Cola's contention that the acquisition agreement was not anticompetitive is a "fail-safe" provision in the agreement that required, as a condition precedent to the closing, that there be no outstanding injunction that would make consummation of the transaction illegal.²⁶ Coca-Cola

²⁴ The remainder of this discussion assumes (as we find below) that the acquisition, if consummated, would have lessened competition in violation of Section 7 of the Clayton Act.

²⁵ Respondent's argument ignores established precedent holding that a showing of an actual anticompetitive effect is unnecessary to prove a violation of Section 5 because that section was designed to stop their incipency acts and practices that could lead to violations of the Sherman or Clayton Acts. *See supra* pp. 8-9; *see also Sperry & Hutchinson Co.*, 405 U.S. at 244 ("unfair competitive practices [are] not limited to those likely to have anticompetitive consequences after the manner of the antitrust laws"); *Dean Foods Co.*, 70 FTC at 1289-90 (rejecting claim that the acquired company was not liable under Section 5 absent proof of "an actual adverse effect on competition of the magnitude required by the Sherman Act").

Coca-Cola (ABCA at 93) cites cases supposedly requiring a showing of an anticompetitive purpose or effect to find a violation of Section 5 where there is no violation of the Clayton or Sherman Acts: *E.I. du Pont de Nemours & Co. v. FTC*, 729 F.2d 128 (2d Cir. 1984); *Boise Cascade Corp. v. FTC*, 637 F.2d 573 (9th Cir. 1980); and *Official Airline Guides, Inc. v. FTC*, 630 F.2d 920 (2d Cir. 1980), cert. denied, 450 U.S. 917 (1981). These cases are inapposite for several reasons, but the most salient distinction is that each involved independent conduct rather than agreements between competitors (as here) or other agreements.

²⁶ The relevant portion of Section 10.01 of the purchase agreement reads:
This agreement may be terminated at any time prior to the Closing:

(v) By either Sellers or Buyer in writing, without liability, if there shall be any order, writ, injunction or decree of any court or governmental or regulatory agency binding on Buyer and/or Sellers, which prohibits or restrains Buyer and/or Sellers from consummating the transactions contemplated hereby, provided that, Buyer and Sellers shall have used their best efforts to have any such order, writ, injunction or decree lifted and the same shall not have been lifted within sixty days after entry, by any such court or governmental or regulatory agency.

contends that this proviso belies any anticompetitive purpose in, or effect from, the acquisition agreement because the parties did not intend to complete the acquisition in the face of a court finding that the acquisition was illegal. ABCA at 94.

Coca-Cola's characterization of the nature of the "fail-safe" provision is flawed. It did not prevent an illegal acquisition, only one that had been enjoined by a court. The district court could have denied a preliminary injunction either because it thought the Commission lacked a sufficient likelihood of success on the merits, or because it thought the equities weighed against an injunction. Neither determination would constitute a finding that the acquisition was legal.²⁷ Under the "fail-safe" provision, had the district court ruled against the Commission, the parties could have completed (and presumably would have been contractually obligated to complete) the transaction, even if it were, in fact, illegal. Thus, the "fail-safe" provision is better characterized as a "stop-loss" provision, which would have allowed the parties to go their separate ways, without investing more time and money in the proposed acquisition, had a court enjoined the transaction. The "fail-safe" provision does not prove that there was no intent to proceed with an illegal transaction; if anything, it indicates that Coca-Cola and Dr Pepper were willing to proceed with the transaction without regard to its eventual legality if they could convince a court not to enjoin it.²⁸ Parties who attempt an acquisition that would substantially lessen competition, and force the Commission to litigate in federal district court to enjoin the transaction, cannot escape liability under Section 5, after their transaction is enjoined, by agreeing among themselves that they should have no further liability.

3. The parties' abandonment of the acquisition did not moot the administrative proceedings

²⁷ A federal district court does not conclusively determine the legality of an acquisition in a preliminary injunction proceeding. Thus, even if the court had denied a preliminary injunction on the merits, that would not have made the acquisition "legal," and the Commission ultimately could have found that the acquisition violated the FTC and Clayton Acts. *See, e.g., Simeon Management Corp. v. FTC*, 579 F.2d 1137, 1142 (9th Cir. 1978) (affirming final Commission order despite court's earlier denial of preliminary injunction based on its assessment that the Commission was not likely to succeed on the merits).

²⁸ Indeed, the agreement obligated the parties to use their "best efforts" to have any injunction lifted before they could cancel the acquisition (*see supra* note 26).

Coca-Cola alternately contends that when the parties abandoned the acquisition, the administrative case became moot and should have been dismissed. ABCA at 90-91; *cf. also* RBCA at 51 n. 36. The Commission and the ALJ previously rejected similar claims by respondent. *See Order Denying Respondent's Motion for Dismissal of the Complaint* (Aug. 9, 1988); *Order Denying Respondent's Motion for Dismissal of the Complaint* (March 16, 1990). Coca-Cola has not demonstrated that those decisions should be altered; and indeed, the very argument that Coca-Cola makes here has been squarely rejected by the United States Court of Appeals for the Second Circuit. *R.C. Bigelow*, 867 F.2d at 106 (suit to enjoin merger not mooted by abandonment of transaction).

It was established long ago that voluntary cessation of illegal activities, even if accomplished before the Commission issues a complaint, is not a defense. *See, e.g., Carter Prods. Co. v. FTC*, 323 F.2d 523, 531 (5th Cir. 1963); *C. Howard Hunt Pen Co. v. FTC*, 197 F.2d 273 (3d Cir. 1952); *FTC v. Wallace*, 75 F.2d 733, 738 (8th Cir. 1935). Similarly, abandonment of an acquisition does not moot the Commission's case, unless it is absolutely clear that the identical or "functionally-equivalent" merger cannot reasonably be expected to recur. *Warner Communications, Inc.*, 105 FTC at 343 (citing *United States v. Concentrated Phosphate Export Ass'n*, 393 U.S. 199 (1968), and *W.T. Grant Co.*; *accord, e.g., Midcon Corp.*, FTC Dkt. No. 9198, *Order Denying Motion to Dismiss* (Nov. 16, 1987); *Rhinechem Corp.* *See also supra* pp. 7-8. Demonstrating that a proceeding is moot because past conduct will not be repeated is the respondent's burden, and it is a heavy one. *W.T. Grant Co.*, 345 U.S. at 633; *Rubbermaid, Inc. v. FTC*, 575 F.2d 1169, 1173 (6th Cir. 1978).

Coca-Cola asserts that Warner Communications is distinguishable because the motion to dismiss preceded the trial there, and the Commission found that questions of fact remained as to the likelihood that violations could recur. Respondent asserts that in the instant proceeding, the ALJ found, after trial, that the sale of Dr Pepper to Hicks & Haas "eliminated any reasonable possibility" that Coca-Cola would acquire Dr Pepper. ABCA at 90 (quoting IDFF paragraph 375).²⁹

²⁹ The ALJ did not, however, retract his previous ruling that the case was not moot. Moreover, his ruling that a prior approval order was unnecessary did not mandate a conclusion that the case was moot, because mootness and the need for permanent relief are distinct concepts with different burdens of proof. *See TRW, Inc. v. FTC*, 647 F.2d 942, 954 (9th Cir. 1981).

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We reject the ALJ's finding as unsupported by the record. In as much as DP Holdings no longer owns Dr Pepper, it would be correct to say that Coca-Cola could not again make the identical acquisition from the same owner. However, neither the ALJ nor Coca-Cola has pointed to any basis in the record for concluding that Hicks & Haas would not sell Dr Pepper, or that Coca-Cola would not try to buy it (or another competing concentrate maker) later.³⁰ To the contrary, the ALJ cited testimony by Brian Dyson, a Coca-Cola executive, "that Coca-Cola needs to be free to make acquisitions of interests in concentrate companies to protect the integrity of its bottling system in the United States." IDFF paragraph 369; *see also id.* at paragraph 204.³¹ At oral argument, after noting that the Dr Pepper acquisition was a defensive move against PepsiCo,³² Coca-Cola's counsel said that respondent may need to make defensive purchases in the future. ATr. 61-62. When asked at oral argument whether Coca-Cola had made a commitment not to acquire Dr Pepper, the answer was non-responsive, and certainly not a clear negative.³³

³⁰ For this reason, the court of appeals' vacation of the preliminary injunction on the ground of mootness in *FTC v. The Coca-Cola Co.*, No. 86-1764 (D.C. Cir. Mar. 24, 1987) (cited in ABCA at 90 n.43), is not dispositive here. The court's statement that the "original merger" would not be revived says nothing about the possibility of other acquisitions, including any new attempt by Coca-Cola to acquire Dr Pepper. That question was not before the district or appellate courts because their only responsibility was to consider the need for preliminary injunctive relief against the acquisition at hand.

³¹ Because Dr Pepper had few assets other than its trademark (IDFF paragraph 9), presumably its current owners could easily resell it. Coca-Cola's assertion (RBCA at 53 n.39) that it had no "history of making concentration acquisitions" is beside the point. The important question is whether Coca-Cola would seek to make future concentrate acquisitions. Coca-Cola does not disavow any interest in future acquisitions, implicitly admitting, when arguing against the imposition of an order requiring prior Commission approval for concentrate acquisitions, that it may want to make such acquisitions in the future. ABCA at 137.

³² The ALJ concluded that: "The Coca-Cola-Dr Pepper proposal was a defensive move to effect a blockage of the PepsiCo-Seven Up transaction, or if that transaction were allowed, to acquire Dr Pepper." IDFF paragraph 10 (citations omitted).

³³ The transcript contains the following exchange:

MR. SPIVACK [counsel for Coca-Cola]: . . . There is no evidence in this record that we [Coca-Cola] are still interested in buying Dr. Pepper. Our President was on the stand, why didn't you ask him? There is no evidence that we are still interested.

CHAIRMAN STEIGER: Is there any evidence that you have a commitment not to buy Dr Pepper?

MR. SPIVACK: We walked away. The deal has been abandoned. We walked away from it voluntarily. Let me make it very clear. You filed a Preliminary Injunction proceeding. The Judge issued a Preliminary Injunction on July 31st. On August 5th, we walked away from this deal.

Now, the contract is in the record. You can look at the contract. The contract gave Dr Pepper the right to walk away August 29th. The only way Dr Pepper could walk away prior to August 29th is with our permission. So, we agreed to abandon this acquisition. So, there is no evidence we are interested.

The transaction at issue was challenged because Coca-Cola attempted to acquire Dr Pepper, not because Coca-Cola attempted to acquire it from a particular seller. The record above shows that it is still quite possible for Coca-Cola to attempt to acquire Dr Pepper or another competing concentrate manufacturer; indeed, Coca-Cola emphatically refuses to rule it out.³⁴ Because the Commission cannot conclude that "there is no reasonable expectation that the wrong will be repeated,"³⁵ the proceedings against Coca-Cola were not mooted by the abandonment of the instant transaction and the sale of Dr Pepper to a third party.³⁶

*B. Coca-Cola's Assertion that Prosecution of the
Administrative Action was Vindictive, Arbitrary and
Capricious, Depriving Respondent of Due Process*

Coca-Cola concedes (ABCA at 99) that the Commission may properly proceed against one company engaged in an unlawful practice without necessarily pursuing competitors engaged in similar practices.³⁷ Nevertheless, Coca-Cola argues that by proceeding

And let me tell you something else. We offered this Commission in 1987, I came in and I said, "I'll give you a consent decree that says any company over one percent, we'll give you a decree so that if we buy a company over one percent, you can order us to divest it at any time within the next four months. We'll buy it first. We will hold it separate. You can order us to divest in four months."

We have got to be free to make the acquisition because they may have -- Pepsi Cola may go out and make a tender offer to somebody and the only way we can effectively deal with a tender offer is to buy it. Or somebody may try to buy one of our bottlers and it is going to kill our bottler system, we have to go in and buy it.

Then we'll come in and we'll take the risk. We could persuade you not to make us divest.

ATr. at 61-62 (emphasis added).

Coca-Cola later filed a motion to "correct" the transcript of the oral argument, requesting that the Commission change not respondent's answer, but Chairman Steiger's question. The Commission rejected the motion, finding that "review of the overall transcript of the hearing does not substantiate Counsel's claim that the context [of the question and answer] supports this change." Decision and Order Denying Respondent Coca-Cola's Motion to Correct the Transcript of Oral Argument (Oct. 17, 1991).

³⁴ In assessing mootness, the Commission may properly consider the need to prevent other future anticompetitive acquisitions. *See, e.g., TRW, Inc. v. FTC*, 647 F.2d at 953 ("the concern is with repeated violations of the same law, and not merely with repetition of the same offensive conduct"). This is not the same as assuming that any future acquisitions by respondent will be anticompetitive (RBCA at 53 n.39).

³⁵ *W.T. Grant Co.*, 345 U.S. at 633.

³⁶ *Cf. R.C. Bigelow*, 867 F.2d at 106 ("narrowly drawn affidavits containing disclaimers only of present intention to resume allegedly unlawful" merger insufficient to meet defendants' "heavy burden in order to render the case moot.").

³⁷ *See, e.g., FTC v. Universal-Rundle Corp.*, 387 U.S. 244 (1967); *Moog Indus., Inc. v. FTC*, 355 U.S. 411 (1958).

against Coca-Cola, but not against PepsiCo, even though both companies' proposed acquisitions would have had similar effects on competition, the Commission arbitrarily and capriciously placed Coca-Cola in a worse position than its competitor (ABCA at 98-100). Moreover, it contends that the Commission's actions in filing and prosecuting an administrative complaint were motivated by a vindictive, and therefore unconstitutional, desire to "penalize" respondent "because Coca-Cola exercised its statutory right to judicial review of the Commission's opposition to Coca-Cola's proposed acquisition of Dr Pepper" (ABCA at 96, 100-02).

Coca-Cola challenges the Commission's selective prosecution policy, an area where the courts traditionally have given the government "broad discretion." *Wayte v. United States*, 470 U.S. 598, 607 (1985) (quoting *United States v. Goodwin*, 457 U.S. 368, 380 n.11 (1982)). Acknowledging that the decision to prosecute is "particularly ill-suited to judicial review," the Supreme Court has noted among the types of factors that the government is best-suited to analyze are: "the prosecution's general deterrence value, the Government's enforcement priorities, and the case's relationship to the Government's overall enforcement plan . . ." *Id.* The government's prosecutorial discretion is "not 'unfettered'" and may not be "'deliberately based upon an unjustifiable standard. . . .' including the exercise of protected statutory and constitutional rights . . ." *Id.* at 608 (citations omitted). The burden on the complaining party is to show both that the complained of policy "had a discriminatory effect" and was "motivated by a discriminatory purpose." *Id.* Coca-Cola has failed to meet this burden.

In the first instance, Coca-Cola's discriminatory enforcement claim depends on its erroneous assertion that "no material fact" distinguished its proposed acquisition from the PepsiCo merger (ABCA at 99). On June 20, 1986, the Commission determined that it had reason to believe that the combination of Coca-Cola and Dr Pepper might violate the Clayton Act and the FTC Act, and authorized its staff to seek a preliminary injunction pending the issuance and resolution of an adjudicative complaint against the transaction.³⁸

³⁸ Coca-Cola asserts that, on this date, the Commission also authorized the Bureau of Competition to "file" an administrative complaint against both transactions (ABCA at 97, citing IDFF paragraph 374). Coca-Cola and the ALJ are mistaken. The Commission issued its administrative complaint against Coca-Cola on July 15, 1986, ID at 2, three weeks after PepsiCo abandoned its proposed acquisition of Seven-Up. IDFF paragraphs 11, 375.

On the same day, the Commission took the identical action against PepsiCo's proposed acquisition of Seven-Up. Pursuant to standard Commission practice, Commission staff informed Coca-Cola and PepsiCo that the Commission had authorized staff to seek a preliminary injunction, if the parties still intended to proceed with the transactions. *Cf.* IDFF paragraph 374, ABCA at 99, n.47. Thus, up to that point, the Commission treated both Coca-Cola and PepsiCo identically, and both received the same "last clear chance" to abandon their respective transactions without Commission action.

On June 23, 1986, the parties announced the abandonment of PepsiCo's acquisition of Seven-Up. IDFF paragraph 374. In contrast, Coca-Cola indicated that it intended to proceed with its acquisition of Dr Pepper, unless the Commission obtained an injunction against it; indeed, the parties were contractually committed to going forward unless the Commission obtained an injunction.³⁹ Therefore, even assuming that PepsiCo's proposed acquisition was just as likely as Coca-Cola's to violate the FTC and Clayton Acts, the two companies behaved in materially different ways after the Commission informed them of its reason to believe that their actions were unlawful. The question, then, is whether the Commission's determination to treat differently companies behaving in disparate manners is arbitrary and capricious.

As Coca-Cola has documented (ABCA at 100-01; IDFF paragraph 376), the Commission's recent practice generally has been to forgo taking further action against companies that -- like PepsiCo -- abandon their acquisitions after the Commission informs them of its reason to believe that the acquisition would violate the FTC or Clayton Acts, but before a hearing on a preliminary injunction. By giving companies an incentive to terminate anticompetitive acquisitions promptly, thereby avoiding district court litigation to enjoin such mergers, this practice facilitates Commission enforcement by conserving its scarce human and financial resources.⁴⁰ Conversely,

³⁹ In addition to Section 10.01, as previously noted, Section 4.02 of the purchase agreement between Dr Pepper and Coca-Cola obligated Coca-Cola to use its best efforts to obtain government approval of the transaction. CX3V. Coca-Cola could not unilaterally abandon the transaction until August 29, 1986, CX3Z-14, or until 60 days after a court issued an injunction precluding consummation of the transaction. *See supra* p. 15, note 26. When the Commission first announced its intention to challenge the acquisition, neither of these conditions had been met.

⁴⁰ *Cf. United States v. Saade*, 652 F.2d 1126, 1136 (1st Cir. 1981) (pointing to Government's "effort to husband its limited prosecutorial resources" as legitimate rationale for selective prosecution). In *Bordenkircher v. Hayes*, 434 U.S. 357 (1978), the Court emphasized the right of the prosecution to proceed in the most aggressive fashion, without offering the wrongdoer a less onerous alternative. In

by proceeding against companies that -- like Coca-Cola -- persevere in their acquisition efforts until enjoined, the Commission may deter other companies from persisting after they have received a warning.⁴¹ The practice also permits the Commission to concentrate its resources on the most determined violators. Moreover, once the Commission has invested substantial time and effort to obtain a preliminary injunction, continuing with an administrative proceeding, even if the parties subsequently abandon the merger, serves a useful purpose. If the complaint allegations are proven, and the Commission issues an order requiring respondent to obtain the Commission's approval before making a similar acquisition, the Commission can avoid the need to relitigate the same issues with the law violator concerning a future acquisition. These rationales - deterrence of unlawful conduct and conservation of prosecutorial resources - are legitimate reasons for maintaining enforcement proceedings against Coca-Cola and similarly situated companies.⁴²

The discussion above shows that the Commission issued an administrative complaint against Coca-Cola not to punish it, but pursuant to a policy designed to maximize the Commission's enforcement resources and deter unlawful conduct.⁴³ The cases on which Coca-Cola relies for its "punitive prosecution" argument, such as *North Carolina v. Pearce*, 395 U.S. 711, 723-26 (1969), and *Blackledge v. Perry*, 417 U.S. 21, 25-29 (1974), are therefore inapposite. Those cases involved criminal defendants who successfully appealed their sentences, only to receive harsher sentences upon

the instant case, the Commission could have chosen to proceed with its preliminary injunction suit and adjudicative proceedings without offering Coca-Cola a warning and opportunity to abandon its plans without liability.

⁴¹ See, e.g., *Wayte*, 470 U.S. at 613; *Saade*, 652 F.2d at 1136. The alternative - discontinuing enforcement proceedings if a transaction is abandoned, no matter how late in the game - would reduce this deterrent effect. The other alternative proceeding against all companies - would unduly burden the Commission's resources. Coca-Cola's situation is unusual in that two competitors proposed similar acquisitions almost simultaneously, and PepsiCo's withdrawal meant that only Coca-Cola was subject to an administrative proceeding and resulting order. However, had the Commission deviated from its standard practice by proceeding against PepsiCo, this might have resulted in accusations that the Commission was treating PepsiCo arbitrarily.

⁴² See, e.g., *Wayte*, 470 U.S. at 612-13; *United States v. Taylor*, 693 F.2d 919, 923 (9th Cir. 1982); *Saade*, 652 F.2d at 1136 & n.14. Cf. also *Bordenkircher v. Hayes*, 434 U.S. at 364-65 (prosecutor's desire to induce a guilty plea is permissible basis for indictment on more serious charges than were proposed in exchange for guilty plea).

⁴³ Contrary to Coca-Cola's assertion, the ALJ has not affirmatively "found" that Coca-Cola was being penalized, and he did not characterize Coca-Cola's conduct as "electing to exercise its statutory right to judicial review" (ABCA at 99, 100). See ID 106.

retrial, under circumstances suggesting that the defendants were being vindictively punished for seeking judicial review. Central to those decisions was the fact that the defendants were penalized for doing "what the law plainly allows [them] to do," *i.e.*, exercising their appeal rights.⁴⁴

Coca-Cola can hardly be said to have been exercising its right to appeal or to other forms of "judicial review," for which it allegedly received discriminatory treatment. Coca-Cola did not seek judicial "review" of any governmental activity. Rather, it was the Commission, not Coca-Cola, which had to seek relief from a court. Coca-Cola persisted in attempting to consummate an acquisition after it was put on notice that the Commission had determined that there was reason to believe that the acquisition was unlawful. Thus, a more appropriate comparison is to the draft resister in *Wayte*, who persevered in his refusal to register for the draft even after the government advised him that he was violating the law, and gave him the opportunity to abandon his unlawful conduct before prosecuting him. The Supreme Court held that the government's prosecution did not impermissibly single him out or punish him for exercising his constitutional rights. *Id.* at 609-14.⁴⁵

Therefore, for the reasons above, we reject Coca-Cola's arguments.

IV. MERGER ANALYSIS

Section 7 of the Clayton Act prohibits mergers or acquisitions that may substantially lessen competition in any line of commerce in any section of the country. 15 U.S.C. 18. In merger law, the ultimate issue is whether the challenged acquisition will likely hurt consumers

⁴⁴ In *Pearce*, the Court noted that the state had offered no reason or justification for an increased sentence "beyond the naked power to impose it", quoting the trial judge who had observed that the state's silence as to its motives led to an inescapable conclusion that the petitioner was being punished for exercising post-conviction appeal rights. 395 U.S. at 726. In the instant case, the Commission's policy is justified by factors that the *Wayte* court observed are legitimately within the government's expertise to evaluate - enforcement priorities and policies, and deterrence of illegal behavior.

⁴⁵ Furthermore, Pearce and similar cases involved defendants who were sentenced to longer prison terms than had been deemed appropriate for their crimes. In contrast, Coca-Cola was subjected only to an administrative complaint and trial, during which it had full opportunity to pursue its defense and perhaps be vindicated. Moreover, as Coca-Cola acknowledges (*see ABCA* at 101 and RX 574-A), the Commission ordinarily issues a ten-year prior approval order against respondents that agree to consent orders, as well as against respondents that litigate against the Commission. *Compare, e.g., Monsanto Corp.*, FTC Dkt. No. C-3458 (Sept. 1, 1993), with *Olin Corp.*, 113 FTC 400 (1990), aff'd, 986 F.2d 1295 (9th Cir. 1993), *cert. denied*, 114 S.Ct. 1051 (1994).

either through unilateral anticompetitive effects or “by making it easier for the firms in the market to collude, expressly or tacitly, and thereby force prices above, or farther above the competitive level [T]he worry is that [the acquisition] may enable the acquiring firm to cooperate (or cooperate better) with other leading competitors on reducing or limiting output, thereby pushing up the market price.” *HCA*, 807 F.2d at 1386.

To make this determination, the Commission must undertake its Section 7 analysis first by defining the relevant line(s) of commerce or product market(s) that may be affected by the acquisition, and second, by defining the relevant section(s) of the country or geographic market(s) in which any effects may be realized. The inquiry concludes with an assessment of the acquisition’s likely impact upon competition in the identified market(s) and with a consideration of any defenses or justifications for the acquisition that may be advanced by the parties.

A. *The Relevant Product Market*

1. Introduction

As already noted, the first step in merger analysis is to determine the relevant product market(s). *See, e.g., E.I. du Pont de Nemours & Co.*, 353 U.S. at 593. Because the ultimate issue is whether competition may be lessened, a relevant market must be economically meaningful, *i.e.*, one in which market power may be exercised. Such markets have been described as “any grouping of sales whose sellers, if unified by a hypothetical cartel or merger, could raise prices significantly above the competitive level.” *H.J., Inc. v. International Tel. & Tel. Corp.*, 867 F.2d 1531, 1537 (8th Cir. 1989) (quoting P. Areeda & H. Hovenkamp, Antitrust Law paragraph 518.1 (1987 Supp.)); *see also* Owens-Illinois, Inc., FTC Dkt. No. 9212, slip op. at 4 (Feb. 26, 1992); U.S. Department of Justice and Federal Trade Commission Horizontal Merger Guidelines, reprinted in 4 Trade Reg. Rep. (CCH) paragraph 13,104 (Apr. 2, 1992) (“Merger Guidelines”), Section 0.1.

The issue before us is whether concentrate⁴⁶ used to make the major national and regional premium brands of carbonated soft drinks - the market urged by complaint counsel (*see infra* note 79)

⁴⁶ *See supra* p. 1, note 2, for definitions of concentrate and syrup. This opinion will generally use “concentrate” as a shorthand reference to both concentrate and syrup.

and found by the ALJ (ID 99) (hereinafter "branded concentrate") - is a relevant product market in which to assess the effects of the acquisition.⁴⁷ Coca-Cola argues that the ALJ made two fundamental errors in defining the product market: (1) he misapplied or unduly relied upon a "5% test" to determine the relevant market (ABCA at 29); and (2) he ignored "overwhelming" evidence of competition between branded and other carbonated soft drinks (ABCA at 37). For the reasons below, we reject these contentions and affirm the ALJ's findings.

2. The methodology for defining relevant product markets

Product markets may be defined either by "the reasonable interchangeability of use or the cross-elasticity of demand." *Brown Shoe Co. v. United States*, 370 U.S. 294, 325 (1962).⁴⁸ These two approaches are different techniques that attempt to answer the same question: which products do consumers treat as sufficiently good substitutes for one another that the products should be considered for merger analysis purposes as being in the same market?

Consistent with Commission practice, and relevant decisional law,⁴⁹ the ALJ (ID 94 -96) sought to delineate relevant, economically meaningful markets by applying the methodology of the version of the merger guidelines that was generally used by both enforcement agencies at the time of his decision. *United States Department of Justice Merger Guidelines, reprinted in 4 Trade Reg. Rep. (CCH)* paragraph 13, 103 (June 14, 1984) ("1984 Guidelines"), Section

⁴⁷ The ALJ found that all concentrate and syrup used to make carbonated soft drinks is also a relevant product market (IDFF paragraph 67, ID 107). Because our holding concerning the market for branded concentrate is dispositive of this case, it is not necessary for us to review the finding of an "all concentrate" market or to consider the acquisition's effects in such a market.

Coca-Cola, while arguing that the relevant product market includes at least all carbonated soft drinks, appears to have abandoned its claim before the ALJ that the relevant product market consists of all beverages. In any event, based on the record before us, we affirm the ALJ's conclusion that "the all potables market is not one which can be looked to with any confidence in an analysis of the probable competitive consequences of the proposed acquisition." ID 94; See IDFF 50-66, 112-129; ID 93-94.

⁴⁸ Cross-elasticity of demand is defined as the percentage change in the quantity sold of product B, associated with a one percent change in the price of product A, holding product B's price constant. A high value indicates that the products are good substitutes, and presumably in the same market, although there may be interpretation difficulties, particularly when prices may already reflect the exercise of market power. See F.M. Scherer & D. Ross, *Industrial Market Structure and Economic Performance* ("hereinafter Scherer & Ross") 75-76 (3d ed. 1990).

⁴⁹ See, e.g., *Olin Corp.*, 113 FTC at 595.

2.11. The result is the same under the new 1992 Merger Guidelines, Section 1.11, which use the same basic methodology.⁵⁰

This approach begins with the goods or services in question (which constitute a provisional market), and then asks what would happen if a hypothetical monopolist that was the sole producer imposed a “small but significant and nontransitory” price increase in the provisional market.⁵¹ If, “in response to the price increase, the reduction in sales of the product would be large enough that a hypothetical monopolist would not find it profitable to impose such an increase in price,” Merger Guidelines, Section 1.11, then the provisional market is too small (*i.e.*, it is not an economically meaningful market), and the analysis is repeated by adding the next best substitute product. This continues until the point is reached at which the hypothetical monopolist could profitably increase prices. *Accord*, 1984 Guidelines, Section 2.11. This test is often referred to as the “5% test” because a “small but significant and nontransitory” price increase is generally taken, in the first instance, to be five percent. Merger Guidelines, Section 1.11; 1984 Guidelines, Section 2.11.⁵²

In defining product markets, the Merger Guidelines’ 5% test does not reduce the range of evidence that may be considered or preclude evaluation of other data regarding cross-elasticity of demand. Thus, the 5% test merely provides an analytical framework that attempts to organize and quantify evidence of consumer substitution patterns. The Commission has recognized that “direct evidence of the consequences of an hypothesized future price increase will rarely be available” and that “all relevant evidence” should be considered.

⁵⁰ The Merger Guidelines “update the Merger Guidelines issued by the U.S. Department of Justice in 1984 and the Statement of Federal Trade Commission Concerning Horizontal Mergers issued in 1982.” Merger Guidelines, Section 0. n.4. The 1992 Merger Guidelines preserve the “sound frameworks for antitrust analysis of mergers” contained in earlier guidelines and statements, make “improvements . . . to reflect advances in legal and economic thinking . . . and also clarify certain aspects of the Merger Guidelines that proved to be ambiguous or were interpreted by observers in ways that were inconsistent with the actual policy of the agencies.” Statement Accompanying Release of *Revised Merger Guidelines*, reprinted in 4 Trade Reg. Rep. (CCH) paragraph 13,104 (Apr. 2, 1992).

⁵¹ The 1984 Guidelines postulated a price increase lasting for one year, which the 1992 Merger Guidelines changed to the “foreseeable future.” The difference is not material in this case.

⁵² The Guidelines make clear that price increases other than 5% can be used in appropriate circumstances, and our shorthand references to a “5% test” are not meant to suggest that such variations are precluded. Merger Guidelines, Section 1.11; 1984 Guidelines, Section 2.11. The ALJ did not confine his discussion to a possible 5% price increase (IDFF paragraphs 150-156).

Merger Guidelines Section 1.11.⁵³ The Commission appreciates both the utility of using cross-elasticity of demand, and the difficulty of calculating such elasticities (*Olin Corp.*, 113 FTC at 595 (citing 1984 Guidelines); *B.A.T. Indus., Ltd.*, 104 FTC 852, 931 (1984); *see also* Merger Guidelines, Section 1.11), and the Commission therefore considers all available relevant evidence in delineating relevant markets. *Olin Corp.*, 113 FTC at 594-95.

This approach is thus consistent with the analytic framework used by the courts. For example, in *Brown Shoe Co. v. United States*, 370 U.S. at 325, the Supreme Court stated that “[t]he 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 substitutes for it.” However, because of the difficulty in calculating and interpreting the actual cross-elasticity of demand, the courts have relied on evidence of reasonable interchangeability of use, including such factors as differences in price or price movements, *United States v. Aluminum Co. of Am.*, 377 U.S. 271, 276-77 (1964); *United States v. Archer-Daniels-Midland Co.*, 866 F.2d 242, 246 (8th Cir. 1988), *cert. denied*, 493 U.S. 809 (1989); quality differences, *FTC v. Warner Communications Inc.*, 742 F.2d 1156, 1163 (9th Cir. 1984) (*per curiam*); *A.G. Spaulding & Bros. v. FTC*, 301 F.2d 585 (3d Cir. 1962); *United States v. Times Mirror Co.*, 274 F. Supp. 606, 617 (C.D. Cal. 1967), *aff'd*, 390 U.S. 712, *reh'g denied*, 391 U.S. 971 (1968); and the existence of separate customer groups for separate products, *United States v. Waste Management, Inc.*, 743 F.2d 976, 980 (2d Cir. 1984); *United States v. Rockford Memorial Corp.*, 717 F. Supp. 1251, 1260 (N.D. Ill. 1989), *aff'd*, 898 F.2d 1278 (7th Cir.), *cert. denied*, 498 U.S. 920 (1990).

Coca-Cola asserts that the ALJ relied too heavily on the 5% test, and that the test yielded misleading results because a 5% increase in the price of concentrate amounts to an insignificant 0.5% increase in the price of soft drinks (because concentrate accounts for only 10%

⁵³ The Merger Guidelines identify some types of evidence that the Commission may take into account (although not exclusively) in analyzing market definitions:

(1) evidence that buyers have shifted or have considered shifting purchases between products in response to relative changes in price or other competitive variables;

(2) evidence that sellers base business decisions on the prospect of buyer substitution between products in response to relative changes in price or other competitive variables;

(3) the influence of downstream competition faced by buyers in their output markets; and

(4) the timing and costs of switching products.

of the cost of a soft drink). ABCA at 31-32; *see* IDFF paragraph 150. We reject these arguments for several reasons.

First, Coca-Cola's argument misperceives the purpose and function of the 5% test. The 5% test is designed, in part, to determine whether purchasers of a relevant product would likely shift to a competing product in the event that sellers of the proposed relevant product attempted to exercise market power. Where the relevant product is a raw material or a semi-finished good, the test looks at the likely reaction of manufacturers or finishers who are acquiring the product as an input into the final finished product, not at the response of ultimate consumers to price changes in the final finished product.⁵⁴ The record here suggests that branded concentrate is an economically meaningful area of competition within which demand responses by buyers would be insufficient to defeat an exercise of market power.

Second, the ALJ plainly did not rely exclusively on the 5% test with respect to the price of concentrate. Even assuming that Coca-Cola's argument is correct and that a test with a larger price increase for concentrate is necessary, an argument that we do not concede, the ALJ found evidence showing that concentrate producers could safely impose even a 100% increase in the price of concentrate. *See, e.g.*, IDFF paragraphs 149, 151-58, ID 95, 97. As Coca-Cola's argument acknowledges, such an increase in concentrate prices, if fully passed on to consumers, would result in a 10% price increase in the finished product, and even a 10% increase in the price of branded carbonated soft drinks would not likely cause sufficient substitution. *Id.* The ALJ's findings are thus based, in adequate part, on an analysis that meets even the test proposed by Coca-Cola.

Third, the ALJ's findings are well grounded in other evidence relevant to product market determinations. Thus, he relied on evidence concerning the varying channels of distribution to consumers and methods of distribution to retailers for carbonated soft drinks, IDFF paragraphs 68-80; industry perceptions of the degrees of competition between different categories of carbonated soft drinks, IDFF paragraphs 109-29; price differences between branded and other carbonated soft drinks, IDFF paragraphs 130-42; differences in consumers' perception of the quality of different categories of

⁵⁴ The 1984 Guidelines advise that "[i]n general, the price for which an increase will be postulated will be whatever is considered to be the price of the product at the stage of the industry being examined." Section 2.11 (footnote omitted). This sentence is repeated in Section 1.11 of the 1992 Merger Guidelines.

carbonated soft drinks, IDFF paragraphs 143-46; historical evidence of price interaction between different categories of carbonated soft drinks, IDFF paragraphs 151-55, 157-59; opinions of market participants about the relationship between prices of different categories of carbonated soft drinks, IDFF paragraph 156; and expert economic testimony, IDFF paragraphs 161-62.

In adopting the ALJ's findings as our own (*see supra* note 4), we thus reject Coca-Cola's argument that his methodology was not consistent with established precedent and was applied erroneously.⁵⁵ However, before turning to a discussion of the ALJ's determination that branded concentrate used to make branded carbonated soft drinks is a relevant market, we highlight some aspects of the ALJ's observation that the concentrate industry and the carbonated soft drink industry "are essentially two different industries which are interrelated." IDFF paragraph 33.

3. The concentrate and carbonated soft drink industries

Concentrate is an intermediate product that has no use, except as an ingredient in carbonated soft drinks. Demand for particular concentrates thus depends on demand for the finished product, the carbonated soft drink, that is made from the concentrate. Thus, manufacturers of concentrate promote the sale of concentrate by promoting the finished product, and not the concentrate itself.

Moreover, all concentrates and carbonated soft drinks are not identical; they are "differentiated products."⁵⁶ While they are differentiated in obvious ways, for example, by the flavor they impart to the finished product (*e.g.*, cola, lemon-lime, orange, etc.), and the manner in which the manufacturer captures that flavor (*e.g.*, the taste of Coca-Cola versus RC Cola), they are also differentiated in more subtle ways. For example, they are differentiated by the image that advertising (or the lack thereof) projects to consumers (*see* IDFF paragraphs 25-28, 143-45, Berry Tr. 691-92), and by the channels of distribution to consumers (*e.g.*, the grocery store or "take-home" channel (cans and bottles to be consumed later), and the "cold drink" channel (chilled soft drinks usually sold for immediate consumption, dispensed by vending machines, convenience stores, and restaurants))

⁵⁵ Coca-Cola's argument that a 5% test would exclude Dr Pepper from the relevant market is discussed *infra* note 77.

⁵⁶ For a general discussion of differentiated products, *see* Scherer & Ross, ch. 16.

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(*see* IDFF paragraph 68). Finally, carbonated soft drinks may also be differentiated by the services that the manufacturer (usually the bottler) provides to retailers. Some bottlers provide retailers with "warehouse delivery," *i.e.*, delivery to the retailer's central warehouse, whereas others provide "direct-store-door delivery" ("DSD"), also called "store-door delivery," in which bottlers' employees deliver soft drinks directly to the store, stock the retailer's shelves, and rotate stock (*see* IDFF paragraphs 74-76, 79).⁵⁷

Against this background, an examination of all of the characteristics of concentrates and finished products shows that they are divided into three distinct categories: major national and regional brands; "warehouse" brands; and private label products.⁵⁸ The major national and regional brands that comprise the first group are characterized by heavy advertising to promote a particular image; wide availability in both the take-home and cold drink channels of distribution; store-door delivery; and services to retailers in the cold drink channel.⁵⁹ IDFF paragraphs 25 29, 77, 81-103, 109, 257. For convenience, we adopt the ALJ's short-hand reference to these as "branded concentrate."⁶⁰ *See* ID 93-99.

The remaining concentrates and their related carbonated soft drinks consist of those that have brand names, but use warehouse distribution ("warehouse brands"), such as Shasta and Faygo (*see* IDFF paragraphs 79-80, 104-06, 161), and private label products,

⁵⁷ Similarly, in the cold drink channel, some bottlers provide dispensing equipment, such as vending machines, fountain equipment, and visi-coolers. Hughes Tr. 760, Connor Tr. 1027-29, Tyler Tr. 1187, Greenberg Tr. 3543-45.

⁵⁸ Dr. Hilke, complaint counsel's expert economist, similarly divided the market into three "tiers," with "tier one" being the major national (but not most regional) brands, "tier two" the warehouse brands, and "tier three" the private label brands. *See* IDFF paragraph 161; Hilke Tr. 2549-52, 2647-48; CX 784A. A Coca-Cola document recognized three analogous segments: national brands, mid-premium brands, and price brands. *See* IDFF paragraph 109.

⁵⁹ These services contribute to the widespread availability of branded soft drinks because they are important to retailers lacking warehouses; they also facilitate retailers' responses to consumer demand and competitive conditions, and provide greater profits to retailers. *See* IDFF paragraphs 258-61; Epstein Tr. 3618-20.

⁶⁰ "Branded concentrates" thus refer to concentrates made by the major national brands - Coca-Cola, PepsiCo, Dr Pepper, Seven-Up, Royal Crown, A&W, and Cadbury Schweppes (*see* IDFF paragraphs 81-102) - and to the regional brands - such as Barq's, Big Red, and Canfields - that, within their area of distribution, are sold to consumers at prices that are comparable to the national brands and that are marked by heavy advertising; wide availability in both the take-home and cold drink channels of distribution; store-door delivery; and services to retailers in the cold drink channel. *See* IDFF paragraph 103; ID 95. The regional brands excluded from this market definition generally lack significant advertising, store-door delivery and broad regional consumer recognition. Such regional brands are more appropriately considered warehouse brands or private label soft drinks.

such as Safeway's Cragmont, that are sold by particular store chains (*see* IDFF paragraph 107). Warehouse brands are available mainly in chain supermarkets; are generally not available in the "cold drink" distribution channel; are less heavily advertised than branded products; and are less expensive than branded soft drinks. *See* IDFF paragraphs 79, 109, 130, 259; Brodkin Tr. 833-34; Cross Tr. 1663; Tyler Tr. 1187. The private label products are also not usually available in the cold drink channel. *See* IDFF paragraphs 79-80, 109, 161. They use little or no advertising and are even less expensive than warehouse brands (IDFF paragraphs 109, 130). For convenience, this opinion will refer to these "warehouse brands" and private label products collectively as "unbranded" or "nonbranded" products (*see* IDFF paragraph 121; ID 97).⁶¹ The general absence of these products from the cold drink channel (which accounted for a substantial share of total carbonated soft drink sales in 1988 (IDFF paragraph 69)) significantly limits the ability of manufacturers of unbranded products to compete with branded products.

4. Branded concentrate as a relevant market

As we have already indicated, branded concentrates comprise the product market alleged by complaint counsel and found by the ALJ, while Coca-Cola argues that the market must be defined broadly enough to include at least the concentrates for all carbonated soft drinks. Of course, the mere recognition that the products, differentiating characteristics (*see supra* Part IV.3.) enable us to classify concentrate into three distinct categories does not in itself answer the question whether branded concentrate constitutes a relevant product market for purposes of Section 7. But for the reasons discussed below, we agree with the ALJ that branded concentrate is the relevant product market in this case.⁶² Our agreement with the ALJ is

⁶¹ We find it unnecessary to determine whether the unbranded concentrates, together or separately, constitute one or more relevant product markets.

⁶² The Commission and the courts do not always divide premium and lower-priced products into separate markets. Such divisions depend upon the facts in each case - the ultimate question always being whether the identified market is one that makes practical economic sense. *See, e.g., Syufy Enters. v. Am. Multicinema, Inc.*, 793 F.2d 990, 994-95 (9th Cir. 1986), *cert. denied*, 479 U.S. 1031, 1034 (1987) (industry-anticipated top-grossing films are separate market from other first-run movies); *Ansell Inc. v. Schmid Labs.*, 757 F.Supp. 467, 475-76 (D.N.J.) (applying Merger Guidelines framework), *aff'd without published opinion*, 941 F.2d 1200 (3d Cir. 1991); *Beatrice Foods Co.*, 101 FTC 733, 801-04 (1983) (chilled, ready-to-serve orange juice is separate market from canned orange juice and frozen concentrate orange juice).

grounded in our determination that branded concentrate is an economically meaningful line of commerce within the meaning of Section 7 and the analytical framework set out in the Merger Guidelines.

a. *Product recognition*

As a threshold matter, we note that a market defined by branded concentrate is consistent with the perceptions of all concentrate manufacturers, soft drink bottlers, and consumers. The record, including Coca-Cola's own documents, shows that manufacturers of concentrate regard branded products as being in a separate product market from unbranded products. *See* IDFF 109-22, 153, ID 97-98. Bottlers of soft drinks similarly recognize a distinction. *See* IDFF paragraphs 122-29. Consumers also believe that branded carbonated soft drinks are superior in quality to nonbranded drinks. Those who buy branded products ordinarily do not buy unbranded products, and vice versa. IDFF paragraphs 143-45. In supermarkets where both branded and nonbranded products are available, the price of branded products is almost always substantially higher than that of the nonbranded products in the same flavor. IDFF paragraphs 30-31. Consumers plainly perceive that branded and unbranded products are in separate markets.⁶³

b. *Product substitution*

Coca-Cola argues, however, that the ALJ simply ignored "overwhelming" evidence of "competition" between branded and unbranded carbonated soft drinks, particularly testimony by industry members that the two competed (ABCA 37, 40-41). However, such testimony reflects competition only in the most literal sense of that word. Most consumers face budgetary constraints that limit all of their purchasing decisions, and, in this sense, all products must "compete" with one another for the consumer's attention and dollars.

⁶³ Coca-Cola argues that the so-called "switching studies" show that all carbonated soft drinks are appropriately placed in the same relevant market. ABCA at 43-45. The switching studies were discussed at some length by the experts for both Coca-Cola and complaint counsel (*see* Lynk Tr. 2742-45, 3028-33; Hilke Tr. 2676-83, 4279-82), but they are of little use to us because they do not isolate and measure consumer switching among soft drinks in response to price changes - a highly relevant issue for our purposes.

Therefore, asserting that two products "compete" with each other is not sufficient to define a relevant market. *See infra* note 66.

Antitrust law is concerned with the ability of a group of firms to exercise market power. The relevant question is whether, in response to anticompetitive price increases, enough customers would switch to alternate products to make a small but significant price increase in the product at issue (here, branded concentrate) unprofitable. *See, e.g., Aluminum Co. of Am.*, 377 U.S. at 275; *Ansell Inc.*, 757 F.Supp. at 475-76.

(1) Substitution by bottlers

Bottlers cannot substitute nonbranded for branded concentrate to make branded soft drinks. No matter how much the price of branded concentrate rises, a Coca-Cola bottler, for example, could not substitute Faygo or Crammont cola concentrate and sell that mixture as Coca-Cola. *See* IDFF paragraph 45.

Coca-Cola notes that concentrate and soft drink producers could engage in supply or production substitution, producing and selling more unbranded soft drinks and fewer branded soft drinks, and thereby increase the market share of unbranded products. ABCA at 48-49. However, this would not be a profitable strategy in response to a small increase in the price of branded carbonated soft drinks, unless sufficient numbers of consumers accept the substitute, *i.e.*, unless the cross-elasticity of demand between branded and unbranded carbonated soft drinks is sufficiently high.

Thus, although the market we are here considering is branded concentrate, an intermediate product, to address Coca-Cola's objections to this market definition, we must consider the possibility of substitution in the downstream market. Because the demand for concentrate depends wholly upon the demand for the finished carbonated soft drink made from the concentrate, a price increase by branded concentrate manufacturers can be made unprofitable to the manufacturers only if a sufficient number of consumers of carbonated soft drinks switch to unbranded soft drinks.

Therefore, in evaluating the readiness with which bottlers will substitute unbranded concentrate for branded concentrate, it is necessary -- and appropriate -- to consider the prices at which consumers will substitute finished products, *i.e.*, unbranded carbonated soft drinks for branded carbonated soft drinks. *See also* IDFF

paragraphs 20 (discussing "derived demand" in the concentrate industry), 149. We now turn to this issue.

(2) Substitution by consumers

For evidence on pricing, we examine the "take-home" channel of distribution (*see infra* p. 49), in which branded, warehouse, and private label soft drinks are all available to consumers. However, we note that because unbranded carbonated soft drinks are generally absent from the cold drink channel, which has a substantial portion of the carbonated soft drink market (*see infra* p. 44), examination of the take-home channel will systematically overstate the competitive strength of unbranded carbonated soft drinks. Thus, if nonbranded carbonated soft drinks are found to have only a small or an insignificant effect on the prices of branded carbonated soft drinks in the take-home distribution channel, they will necessarily have an insignificant effect in the overall market.

There is ample testimony in the record showing that pricing decisions of makers of branded products are seldom affected by the prices of unbranded carbonated soft drinks. IDFF paragraphs 113, 115-21, 124-29, 144; ID 97-98. This evidence indicates that the witnesses and their companies believe that unbranded products are unlikely to take significant business from branded products.⁶⁴

Coca-Cola contends, however, that this conclusion ignores testimony by executives of some concentrate companies, and by some bottlers that they did consider the prices of unbranded soft drinks (ABC at 40-42). To the contrary, as the ALJ found, even when unbranded prices were considered, they were monitored much less frequently, or only in some locations, and the consistent and dominant influence on the pricing of branded products was the price of other branded products. *See, e.g.*, IDFF paragraphs 113, 115, 118, 119, 124, 125, 127.

The ALJ further found that there was little price interaction between branded and unbranded soft drinks. IDFF paragraph 151. His findings were based on, *inter alia*, an elasticity study performed for a Coca-Cola bottler showing that consumers did not switch to unbranded products unless the price spread was quite large, such as

⁶⁴ *See also* IDFF paragraph 110 (Coca-Cola executive stated that his company's introduction of a mid-priced cola brand (Fanta) to compete with Faygo and Shasta would not take business from Coca-Cola except at the fringes); IDFF paragraph 147.

an 80% to 100% differential (IDFF paragraph 154); testimony that a retailer did not encounter switching unless the price differences were similarly large (IDFF paragraph 156); testimony by other bottlers that there was little price interaction between branded and unbranded products (IDFF 156-57); and evidence that in areas where bottlers of branded soft drinks had engaged in illegal price fixing, the artificially elevated prices did not shift consumers to unbranded soft drinks (IDFF paragraphs 47-48, 158).⁶⁵

Coca-Cola also asserts that the ALJ ignored direct evidence of cross-elasticity of demand contained in testimony and documents showing that, in some locations, unbranded carbonated soft drinks increased their share of sales of all carbonated soft drinks when the price spread between unbranded and branded carbonated soft drinks increased. ABCA at 38-39. However, the evidence is insufficient to support Coca-Cola's conclusion. As long as the demand for unbranded soft drinks has some elasticity, a decline in the price of unbranded carbonated soft drinks will lead to an increase in the quantity demanded. This, in turn, will increase the unbranded products' seeming share of the combined sales even if there is no effect on the demand for branded products (*i.e.*, the sales volume of branded carbonated soft drinks remains constant).⁶⁶ Because this evidence does not show that the increased sales of nonbranded carbonated soft drinks resulted in fewer sales of branded soft drinks, it is not probative of the question of whether the cross-elasticity of demand between unbranded and branded carbonated soft drinks,

⁶⁵ Coca-Cola argues that "boutique" soft drinks (*see* IDFF paragraph 108) compete with branded soft drinks through packaging (ABCA at 41 n.19). Even if true, they had an insignificant effect on branded products' prices, a more relevant criterion here. *See* IDFF paragraph 159.

⁶⁶ The same results could be obtained by arbitrarily including any other grocery product (or even non-grocery product) in a "market" with branded carbonated soft drinks, and calculating their relative "market shares." As long as there is some elasticity of demand for the other product, when its price falls, its sales will increase, and its relative share of the total will increase. For example, if, during a given day, a store sells 90 pounds of oranges and 10 pounds of garlic, oranges have 90% of the total (90 divided by 100). If a temporary price reduction for garlic increases garlic sales to 20 pounds the next day, while orange sales remain constant, oranges' share of the total decreases to 82% (90 divided by 110), even though their actual sales were not affected by the garlic sale. Yet, we suspect that garlic and oranges compete with each other only in the sense that both must be purchased from money allocated for a household's food budget. Similarly, the mere fact that an increase in the price of branded carbonated soft drinks results in a decrease in their share of sales of all carbonated soft drinks is insufficient to support the conclusion that branded and unbranded carbonated soft drinks belong in the same market.

based on the record evidence here, is high enough to prevent branded products from constituting a relevant market.⁶⁷

Coca-Cola's argument that the ALJ disregarded other evidence that lowering the price of unbranded products affected sales of branded products (ABCA 39, 45-46) is equally flawed. The ALJ considered and rejected Coca-Cola's evidence, essentially because it involved price reductions that were substantially larger than the "small but significant" price differentials contemplated by the Merger Guidelines. *See* IDFF paragraphs 136-38, 140; ID 98. For example, Coca-Cola cited a period in Cincinnati in which the Kroger chain put 2-liter bottles of its private label Big K brand on sale for \$.39 a bottle, which increased Big K's share of carbonated soft drink sales. ABCA at 46, Gross Tr. 3225, 3229. However, that sale price was 40-50% below the typical promotional price of \$.69-.79 per 2-liter bottle for private label carbonated soft drinks. Kalil Tr. 924, Berry Tr. 694, Frank Tr. 3356, Connor Tr. 1021.⁶⁸ In the same vein, Coca-Cola cites testimony that sales of nonbranded carbonated soft drinks would increase if the makers of branded concentrate and soft drinks stopped promoting their products. ABCA at 40, 45-46. However, as complaint counsel point out, cessation of promotional activity translates directly into a price increase of 30-100% in the take-home channel.⁶⁹ RBCC at 41-42. Since concentrate manufacturers make payments to bottlers to advertise and promote the bottlers' products, if concentrate manufacturers ceased making these advertising and promotion payments, with no change in the price of concentrate, the

⁶⁷ Coca-Cola also claims that the prices of unbranded and branded soft drinks have trended together over time, and that this fact "confirms that branded soft drinks compete in the same relevant product market as private label and other warehousedelivered soft drinks," ABCA at 38 (citing in part Olin Corp.). Common price trends may reflect nothing more than changes in the costs of common ingredients. Moreover, the issue here is not whether unbranded and branded carbonated soft drinks together constitute a relevant product (a determination that is unnecessary to the disposition of this case, *see supra* note 47); the issue is whether branded carbonated soft drinks can also make up a separate product market. The possibility that branded carbonated soft drinks might constrain the price of unbranded carbonated soft drinks -- contributing to related price trends would not necessarily imply that unbranded carbonated soft drinks constrain the price of branded carbonated soft drinks. *See* Olin Corp., 113 FTC at 595-600, 602 (conclusion that two products form relevant product market does not preclude finding that one of them also constitutes a relevant market in its own right).

⁶⁸ Another example involved giving away private label carbonated soft drinks (IDFF paragraph 138, Koch Tr. 638-39) - hardly a realistic indication of cross-elasticity of demand.

⁶⁹ This range is based on testimony about the promotional prices of branded carbonated soft drinks compared to their regular shelf prices. Trebilcock Tr. 1165, Tyler Tr. 1189, Sutton Tr. 1263, Knowles Tr. 2504-05, Ippolito Tr. 3150-51. The vast majority of carbonated soft drinks in the take-home channel are sold at promotional prices (IDFF paragraph 213, Brodkin Tr. 880, Kalil Tr. 915, Connor Tr. 1065), making the promotional prices the most relevant market prices for purposes of antitrust analysis.

real price of concentrate to the bottler would be increased. *See* IDFF paragraphs 25-28. Cessation of all promotional activity would be in part a direct price increase to bottlers who buy the concentrate, and in part an indirect price increase, because the advertising support that the concentrate manufacturer provided to bottlers would be lower even though the price of the concentrate remained the same.

Evidence of this nature merely goes to the point that some sort of large price increase would induce consumers to switch to less costly products, regardless of how close or distant they may be on the chain of substitutes.⁷⁰ However, the market response to these large price changes is not probative of whether producers could profitably increase prices by smaller amounts; in defining markets for antitrust purposes, it is the market response to a small but significant price increase that is relevant. Moreover, there is no evidence in the record that, when faced with deep price discounting by unbranded carbonated soft drinks, bottlers of branded carbonated soft drinks were forced to significantly lower their prices in order to maintain their sales volume. For example, there is testimony that Coca-Cola's sales were not affected by an 80-100% price spread between its products and Kroger's Big K. IDFF paragraphs 154, 155.⁷¹

In contrast to respondent's evidence involving soft drink price increases or decreases of 30 to 100%, complaint counsel asked a number of witnesses whether it would be profitable for all of the bottlers of branded carbonated soft drinks to simultaneously raise the

⁷⁰ *See, e.g., United States v. Aluminum Co. of Am.*, 148 F.2d 4161 426 (2d Cir. 1945); *The Cellophane Fallacy and the Justice Department's Guidelines for Horizontal Mergers*, 94 Yale L.J. 670, 676 (1985); Baker and Blumenthal, *The 1982 Guidelines and Preexisting Law*, 71 Calif. L. Rev. 311, 322 n.54, (1983).

⁷¹ Coca-Cola also contends that the ALJ ignored evidence that lowering the price of branded carbonated soft drinks took sales away from their unbranded counterparts (ABC at: 38, 41, RBCA at 21-23). For example, Coca-Cola cited testimony by Mr. Skinner, Vice President of Shasta Beverages (a warehouse brand), that Shasta's marketing was affected as the prices of Coca-Cola and Pepsi-Cola approached Shasta's, and that Shasta responds to the marketing of those branded products. Skinner Tr. 3174-75, 3177-78.

Coca-Cola's factual predicate is questionable: in many areas, the record showed no clear correlation between the magnitude of the branded/private-label price differential and the private-label soft drinks' market share. *See* Complaint Counsel's Reply to Respondent's Proposed Finding 130 (derived from CX 263 I-0, S-Y). More fundamentally, Coca-Cola's evidence is not inconsistent with defining the relevant market as branded concentrate. The critical point is that manufacturers of branded carbonated soft drinks can raise their prices without regard to the response of Shasta or other unbranded products. For example, Mr. Skinner testified that Coca-Cola and PepsiCo do not generally respond to Shasta's pricing decisions. *See* IDFF paragraph 152; Skinner Tr. 3201; *see also* IDFF 11 154-55. This suggests that at the prices evidenced in the record, branded carbonated soft drinks are not constrained by warehouse brands and are a relevant product market.

price of branded carbonated soft drinks by 10%, everything else remaining constant.⁷² The uniform answer to this question was affirmative.⁷³ The fact that this increase is insufficient to shift demand to unbranded products indicates that branded carbonated soft drinks (and by extension, branded concentrate) constitute a relevant economic market.

Coca-Cola also argues that complaint counsel's question invited witnesses to assume that "everything else remaining constant" meant that "nothing would happen in response" to the price increase (RBCA at 25). In other words, respondent charges complaint counsel with "beg[ging] the question" by asking witnesses whether increasing prices of branded products would be profitable if it did not cause them to lose sales. RBCA at 25. There is no indication that the witnesses interpreted complaint counsel's question in the meaningless sense that Coca-Cola suggests.⁷⁴ Complaint counsel asked this same question of at least eight witnesses; the fact that respondent's counsel did not object or seek clarification of the witnesses' statements through cross-examination suggests that all present understood that the witnesses were being asked to assume that the prices (but not the volumes) of unbranded carbonated soft drinks would remain constant while branded prices increased.⁷⁵ Furthermore, when complaint counsel phrased the question differently, the answer was still the same.⁷⁶ Accordingly, we find this line of questioning to be

⁷² Such concerted action is equivalent to action by the Merger Guidelines' hypothetical monopolist. A 10% increase in the price of soft drinks is equivalent to a 100% increase in the price of concentrate. *See supra* p. 29.

⁷³ See IDFF paragraph 156, Berry Tr. 708, Hughes Tr. 759, Brodkin Tr. 860, Kalil Tr. 927, Connor Tr. 1025, Trebilcock Tr. 1107-08, Turner Tr. 1318, and Westerman Tr. 1802-03. Some bottlers also testified that branded soft drink prices could increase by 20% or 30% before enough consumers would switch to unbranded soft drinks to make the increase unprofitable. *See* Connor Tr. 1071-72; Westerman Tr. 1803-04.

⁷⁴ Complaint counsel first established that in setting prices for branded carbonated soft drinks, bottlers do not consider or react competitively to the pricing of nonbranded carbonated soft drinks (*see* Berry Tr. 704-05; Hughes Tr. 758-59; Brodkin Tr. 856-57; Kalil Tr. 924-26; Connor Tr. 1022-24; Trebilcock Tr. 1103-06; Turner Tr. 1311-14; Westerman Tr. 1797-99), then asked about the profitability of a 10% price increase in branded carbonated soft drinks.

⁷⁵ Indeed, the appropriate time for challenging the question was while the record was still open. Now, it is simply too late and the questions and answers must stand.

⁷⁶ Mr. Shanks (Tr. 98-99) was asked:

Q. Let me ask you the same question with respect to branded carbonated soft drink products and private label products, and that question is, do you have an opinion as to whether a fully passed on 10 percent price increase of concentrate, producing a 1 percent increase in the price of carbonated soft drinks, would be constrained by private label products if private label prices did not change?
A. I do not think they would constrain the prices.

probative of the degree of price elasticity between branded and nonbranded carbonated soft drinks, and that it is credible evidence that there is a separate market for branded carbonated soft drinks.

c. *Other factors*

Respondent's arguments on product market incorrectly assume that the ALJ relied primarily on the 5% test to define the relevant product market (*see supra* pp. 28-30). Based on that erroneous assumption, respondent further argues that consistent application of a 5% test would place Coca-Cola and Dr Pepper in different product markets.⁷⁷ However, as we have found, the ALJ relied on other evidence as well, including perceptions and business decisions of

Q. What about a 100 percent price increase of concentrate producing a fully passed on price increase of the carbonated soft drink level of 10 percent, do you have an opinion as to whether non-carbonated soft drink products would constrain such a price increase?

A. I don't think there would be a significant constraining effect.

Q. What about private label products at that 100 percent and 10 percent increase, do you have an opinion as to whether private label products would constrain the 10 percent price increase in the carbonated soft drink market?

A. I do not think that they would.

Mr. Tyler (Tr. 1190) was asked:

Q. Assuming that the private label brands, that their retail prices remained the same, and that Coke and Pepsi increased their retail prices, would it be profitable for you to increase your retail prices?

A. . . . I don't understand the question.

Q. Well, would you be able to, would private label brands constrain the major brands from an increase in price?

A. No, I don't think the private labels pricing has that much to do with the major brand products price.

⁷⁷ Coca-Cola claims that a 5% test cannot be used to exclude private label and other warehouse-delivered soft drinks from the relevant product market without necessarily excluding Dr Pepper as well. In support of this proposition, respondent cites a period when Dr Pepper's prices were higher than Coca-Cola's or PepsiCo's prices, and Dr Pepper increased its prices "by amounts greater than 5 percent more than the concentrate price increases by Coca-Cola and PepsiCo - without a loss of sales." ABCA at 35-36 (citing IDFF paragraph 188); Knowles Tr. 2455-56, 2495-96. However, at the same time that Dr Pepper increased its concentrate prices, it also increased its promotional allowances to bottlers, Knowles Tr. 2455-56; RX 150-D, suggesting that multiple factors influenced Dr Pepper's volume of sales. Furthermore, the document cited by Coca-Cola is contradicted by other evidence. Dr Pepper/Seven-Up's chief operating officer testified that the difference or range between the shelf price and promoted price of Coca-Cola or Pepsi, on one hand, versus Dr Pepper, on the other, would be "basically the same" where the two are handled by the same bottler. Knowles Tr. 2505. One Dr Pepper bottler stated that Dr Pepper must be offered at the same promoted prices as his other brands, and another said that Dr Pepper is competitively priced at or below Coke and Pepsi prices in his area. IDFF 190, citing Trebilcock Tr. 1166; Turner Tr. 1310-11. Moreover, the record shows that during some periods, Coca-Cola's concentrate prices increased by more than 5% over those for Pepsi-Cola (RX 150-N) - but respondent does not even suggest that those two products are in different markets. Finally, even though Dr Pepper's concentrate price was higher than Coca-Cola's, the total ingredient cost (concentrate plus sweetener) was approximately the same for the two brands because Dr Pepper required less sweetener (Gross Tr. 3247-48, 3255).

makers of concentrate and soft drinks, and evidence that price interaction between branded and unbranded soft drinks was limited. The ALJ relied on a similarly broad range of evidence to support his conclusion that Dr Pepper is in the same market as other branded soft drinks. For example, he found that Coca-Cola and Dr Pepper, and their respective bottlers, regarded the two products as significant competitors. IDFF paragraphs 192-97, 199, 202. Coca-Cola and PepsiCo took the price for Dr Pepper into consideration when setting their prices, and Dr Pepper similarly priced its products against Coca-Cola, Pepsi-Cola, and other branded carbonated soft drinks. IDFF paragraphs 113, 116, 117, 133, 192, 194, 195, 202. The weight of the evidence shows that the retail prices of Dr Pepper's soft drinks were comparable to those of Coca-Cola and Pepsi-Cola (*see* IDFF paragraph 190). Therefore, other evidence suggesting interchangeability of use (in addition to the 5% test) also undermines Coca-Cola's argument that Dr Pepper's and Coca-Cola's branded soft drinks were not in the same market.

For the reasons above, we find that the concentrate used to produce national and regional branded carbonated soft drinks that are store-delivered and widely available (and fully serviced) in the cold drink channel is the relevant product market in which to assess the effects of Coca-Cola's proposed acquisition of Dr Pepper. *See supra* notes 47, 61.

B. *The Relevant Geographic Market*

As with the relevant product market, determination of the relevant geographic market is a "necessary predicate" for analyzing an acquisition's effect on competition. *United States v. Marine Bancorporation*, 418 U.S. 602, 618 (1974); *Brown Shoe Co. v. United States*, 370 U.S. at 324; *United States v. E.I. du Pont de Nemours & Co.*, 353 U.S. at 593. Complaint counsel and Coca-Cola agree, and the ALJ found, that the United States is a relevant geographic market. IDFF paragraph 163. We agree that the record amply supports the existence of a nation-wide relevant geographic market.

However, complaint counsel appeal the ALJ's ruling (ID 99-100) that there are no local markets for concentrate within the national market. AB at 40. Complaint counsel argue that it is possible for producers of branded concentrate to price discriminate in local areas,

i.e., to charge higher prices for branded concentrate in certain geographic areas where there is less intensive competition, AB at 14, and that such local areas are separate relevant geographic markets. Merger Guidelines, Section 1.22. We do not reach the merits of complaint counsel's argument because the record lacks sufficient area-specific evidence to determine whether in particular local markets the effect of the acquisition may be to substantially lessen competition or to tend to create a monopoly.

C. Effects of the Proposed Acquisition

The policy that underlies Section 7 and the Merger Guidelines concerns mergers or acquisitions that might enable the resulting entity to collude with other firms in the market, or to engage in anticompetitive conduct on its own. *FTC v. PPG Industries, Inc.*, 798 F.2d 100, 1503 (D.C. Cir. 1986). See also *Cargill v. Monfort of Colorado*, 479 U.S. 104 (1986); *R.C. Bigelow; HCA*, 807 F.2d at 1386, 1387. As Judge Posner reasoned in HCA regarding coordinated conduct: “the worry is that it [the merger] may enable the acquiring firm to cooperate (or cooperate better) with other leading competitors on reducing or limiting output, thereby pushing up the market price.” *Id.* at 1386. Similarly, the Merger Guidelines declare that the “unifying theme” of merger analysis is that “mergers should not be permitted to create or enhance market power or to facilitate its exercise.” Section 0.1.⁷⁸

Having defined the relevant product and geographic markets, we now consider whether Coca-Cola’s acquisition of Dr Pepper would increase concentration in the relevant product and geographic market sufficiently that the effect “may be substantially to lessen competition, or to tend to create a monopoly.” 15 U.S.C. 18.

1. Market concentration

As the ALJ found, and as Coca-Cola has conceded, there is no dispute that the carbonated soft drink industry is highly concentrated. ID 101-103; RBCA at 4. The ALJ used the now standard Herfindahl-

⁷⁸ Market power is “the ability profitably to maintain prices above competitive levels for a significant period of time,” or to “lessen competition on dimensions other than price, such as product quality, service, or innovation.” Merger Guidelines at n.6; Owens-Illinois, slip op. at 4-5 (quoting 1984 Guidelines).

Hirschmann Index ("HHI") to measure the levels of concentration prior to the proposed acquisition, and afterwards, assuming Coca-Cola had completed its acquisition of Dr Pepper. As noted by Judge Bork:

Market power or the lack of it is often measured by the HHI. The FTC and the Department of Justice, as well as most economists, consider the measure superior to such cruder measures as the four- or eight-firm concentration ratios which merely sum up the market shares of the largest four or eight firms. The HHI, by contrast, is calculated by squaring the individual market shares of all firms in the market and adding up the squares. This method, unlike the four- and eight-firm concentration ratios, shows higher market power as the disparity in size between firms increases and as the number of firms outside the first four or eight decreases.

PPG Industries, Inc., 798 F.2d at 1503. Thus, the HHI ranges from 10,000 in a pure monopoly to a number approaching zero in an atomistic market.

The following table shows the respective concentration levels for complaint counsel's proposed market of Tier I concentrate firms in 1986:

1986 Concentration Levels of Tier I Firms

Pre-acquisition HHI	3,128.5
Post-acquisition HHI	3,572.2
Increase in HHI	443.7

IDFF paragraph 222.

Complaint counsel's proposed market of Tier 1 concentrate firms is equivalent to our market of branded concentrate firms, minus regional DSD brands.⁷⁹ Because the regional branded concentrate firms have such a small share of the national market, their inclusion would reduce concentration levels in Table I only by minor amounts.

Using 1986 data, the combination of Coca-Cola and Dr Pepper would have controlled more than 42% of all branded carbonated soft drink sales, and even higher percentages of sales in the cold drink

⁷⁹ At trial complaint counsel urged a market consisting of branded concentrate, excluding any regional brands. Accordingly, complaint counsel's expert excluded regional branded soft drinks in calculating the HHI. *See CX 784A*. However, the ALJ defined the relevant market to include certain regional branded soft drinks, and as already discussed, we agree with the ALJ's market definition. While complaint counsel have urged us to affirm the ALJ's determination, complaint counsel have continued to cite their expert's numbers calculated without the regionals as the level of concentration. *See AB at 9; RBCC at 23; IDFF paragraph 222.*

channel, which consists primarily of branded soft drinks. *See* IDFF paragraphs 226-27, 232-37, and *supra* p. 34.

The ALJ found that the proposed acquisition's increase in already-high concentration levels created a presumption that the acquisition would have harmed competition (ID 101-03). We agree. The post-merger HHI substantially exceeds 1800, and the increase is well above the 100-point level that Section 1.51(c) of the Merger Guidelines regards as presumptively presenting potential significant competitive concern. Indeed, the post-acquisition levels of concentration in this market are far above those that the courts have held to establish a legal presumption of illegality.⁸⁰ *See, e.g., United States v. General Dynamics Corp.*, 415 U.S. 486, 496-97 (1974). We likewise have held that comparable increases in concentration raise serious competitive concerns. *See, e.g., Owens-Illinois*, slip op. at 27; *Olin Corp.*, 113 FTC at 610-11; *HCA*, 106 FTC at 487-88, 807 F.2d at 1386⁸¹

2. The likelihood that the proposed acquisition
would have resulted in collusion and
other adverse effects on competition

⁸⁰ In this regard, we note that in PPG, a preliminary injunction case involving comparable concentration figures (a merger of firms with 30% and 23% market share resulting in an HHI increase from 1943 to 3295), the district court found "a virtual certainty that the acquisition will be held unlawful," and the Court of Appeals (per Judge Bork) opined that there "is no doubt that the pre- and post-acquisition HHI's and market shares found in this case entitle the Commission to some preliminary relief." *PPG*, 798 F.2d at 1503.

⁸¹ Even if all branded and nonbranded concentrate sales are included in calculating the level of market concentration, the concentration level in that broader market, and the change that would have been caused by Coca-Cola's acquisition of Dr Pepper, would still have been well above the level that the courts have held to be presumptively illegal and above the thresholds in the Merger Guidelines at which the enforcement agencies presume "that mergers . . . are likely to create or enhance market power or facilitate its exercise." Merger Guidelines Section 1.51(c).

The following table shows the market concentration in 1986 if all branded and nonbranded concentrate were included in the market, what that level of concentration would have been had Coca-Cola acquired Dr Pepper, and the increase in the level of concentration that would have been caused by that acquisition:

1986 Concentration Levels of all Producers of Concentrate

Pre-acquisition HHI	2,565.6
Post-acquisition HHI	2,929.2
Increase in HHI	363.6

While the level of, and increase in, concentration in this case is sufficient to create a presumption that the acquisition is illegal, *Philadelphia Nat'l. Bank*, 374 U.S. at 363, we do not rely solely on that statistical showing.⁸² Following the approach of Section 2 of the Merger Guidelines, we examine the acquisition in light of the other market factors to assess its potential adverse competitive effects. After this assessment, we examine whether entry is sufficiently easy that there need be no concern with potential adverse competitive effects.

The ALJ identified four ways in which the acquisition could have substantially lessened competition in the relevant market:

- (a) Eliminating Dr Pepper Company as a substantial, independent competitive force in the relevant market;
- (b) Increasing the likelihood of, or facilitating, collusion;
- (c) Increasing the difficulty of entry; and
- (d) Increasing the costs and reducing the competitiveness of other firms in the relevant market.

ID 101-04, 108. From this, the ALJ concluded that the acquisition would increase the likelihood that firms would increase prices and restrict output in the future. ID 108. For the reasons below, we agree.

a. *Eliminating Dr Pepper Company as a substantial, independent competitive force in the relevant market*

The ALJ found that the acquisition would eliminate Dr Pepper as a substantial independent competitor to Coca-Cola (IDFF paragraph

⁸² Coca-Cola notes that courts have found that high market shares do not always indicate that an acquisition would violate the Clayton Act (ABCAt 10), and this proposition is certainly correct. However, the results in each case cited depended on the particular facts and market in question. Six of the cases cited turned on the absence of barriers or impediments to entry: *Echlin Mfg. Co.*, 105 FTC 410, 491-92 (1985); *Waste Management, Inc.*, 743 F.2d at 983; *Syufy Enters.*, 903 F.2d at 664-65 (9th Cir. 1990); *United States v. Calmar, Inc.*, 612 F.Supp. 1298, 1306 (D.N.J. 1985); *United States v. Baker Hughes, Inc.*, 908 F.2d 981, 989 (D.C. Cir. 1990); *FTC v. Promodes S.A.*, 1989-2 Trade Cas. (CCH) paragraph 68, 688 at 61, 626 (N.D. Ga. Apr. 14, 1989). *United States v. Citizens & Southern Nat'l Bank*, 422 U.S. 86 (1974), involved the acquisition by Citizens & Southern National Bank ("Citizens") of banks in which it already held a 5% share, and which had always been operated as *de facto* branches of Citizens. *Id.* at 100. Therefore there was no effective competition between the acquired banks and Citizens, nor was any likely to develop. *Id.* at 121. In *United States v. Crowell, Collier, & Macmillan, Inc.*, 361 F.Supp. 983, 995 (S.D.N.Y. 1973), the .6% market share of the acquired firm was held to be *de minimis* given the structure of the market in question.

326). Respondent attacks this finding frontally, arguing that Dr Pepper is a “niche” product and a “marginal competitor,” “not a direct competitor” of Coca-Cola. ABCA at 16-17. This assertion is not supported by the record. Dr Pepper competes directly against Coca-Cola’s Mr. Pibb spicy pepper flavor. IDFF 3. More generally, Coca-Cola’s own documents show that respondent viewed, Dr Pepper as a significant competitor, a view that was consistent with testimony by bottlers and other industry members. For example, Coca-Cola’s 1985 annual business plan identified five competitors, one of which was Dr Pepper, CX 16-Z-22; Coca-Cola’s 1988 operational business plan identified only six competitors, one of which was Dr Pepper; bottlers Turner, Tr. 1308-11, Ippolito, Tr. 3111-12, and Tyler, Tr. 1193, all testified that Dr Pepper competed with Coca-Cola. *See* IDFF paragraphs 111, 191-202, and *supra* p. 41.⁸³

b. *Increasing the likelihood of, or facilitating, collusion*

In a market with a small number of competitors, decreasing the number of competitors is likely to reduce the difficulties and costs inherent in reaching and enforcing a collusive agreement to raise price or restrict output. Merger Guidelines, Section 2.0; HCA, 807 F.2d at 1387. Accordingly, eliminating Dr Pepper as a substantial independent competitor against Coca-Cola (and other branded concentrate companies) increases the likelihood of collusion.⁸⁴ Such collusion could manifest itself as a diminution in competition in the national market for branded concentrate, leading to higher nationwide prices for branded concentrate. *See* ID 103.

⁸³ In 1986, Dr Pepper was the fourth largest branded concentrate company, with approximately 4.6% of all carbonated sales. IDFF paragraph 226. Coca-Cola attempts to downplay the significance of that market share with statistics showing that “by 1987 sales of 129 new soft drink brands introduced since 1970 collectively accounted for 38.7 percent of all carbonated soft drink sales” ABCA at 51. Many of those “new soft drink brands” are accounted for by products brought out by Coca-Cola, PepsiCo, and the other major branded concentrate producers as they diversified their brand line by the addition of diet and caffeine-free combinations. IDFF paragraph 214-16. The share of total sales accounted for by the largest concentrate producers rose steadily from 1970 through 1988. IDFF paragraph 241. By 1988, Dr Pepper had become the third largest branded concentrate company. IDFF paragraph 226. In contrast, a firm such as Original New York Seltzer, cited by Coca-Cola as an actual new entrant (ABCA at 64), began business in 1982, Miller Tr. 3438-39, and had sales of approximately 8.5 million cases, accounting for approximately 0.1% of all carbonated soft drink sales in 1986. CX. 784A. In 1989, New York Seltzer still had sales of approximately 8.5 million cases. Miller Tr. 3460.

⁸⁴ Given the strong market position of PepsiCo, the second largest seller of branded concentrate in the relevant geographic market, we do not believe that the acquisition of Dr Pepper would have significantly increased Coca-Cola’s ability to unilaterally exercise market power, *i.e.* to elevate price and suppress output. *See* Merger Guidelines, Section 2.2.

Furthermore, there is a history of price fixing of branded soft drinks at the bottler level (IDFF paragraph 47). Although we are here concerned with the possibility of collusion in the market for branded concentrate, the history of price fixing by bottlers suggests that there are local or regional soft drink markets that are conducive to collusion. It evinces the bottlers' perception that the number of competitive dimensions involved posed no insuperable obstacle to collusion.⁸⁵ This price fixing suggests that if a cartel of concentrate producers raised concentrate prices nationally, bottlers could successfully pass on the price increase in the form of higher soft drink prices.

Coca-Cola contends that monitoring a collusive agreement would be "virtually impossible" and that cheating on the collusive agreement would be easy, making participation by all bottlers necessary, but unlikely. ABCA at 79-81. Of course, with respect to bottlers owned by the concentrate companies, an increasing phenomenon, the argument is inapposite.⁸⁶ As long as bottlers lack an incentive to undermine an attempt to raise the price of branded soft drink concentrate -- either because the bottler is owned by a concentrate company, or because the bottler can successfully pass on any price increase -- there is no reason why concentrate companies could not be as successful in raising prices in the national market as the local bottlers were in the bottler price-fixing cases.

Coca-Cola additionally contends that differing degrees of vertical integration by concentrate firms create disincentives to collude, citing *B.F. Goodrich*, 110 FTC 207, 329-32 (1988). ABCA at 82-84. While we agree that varying degrees of vertical integration may create disincentives to collude, the results "will depend upon whether any given integrated firm on balance will benefit from or be harmed by collusion." *B.F. Goodrich*, 110 FTC at 330. Given their large market shares (*see* CX 784 and IDFF paragraph 226), the two largest branded concentrate companies Coca-Cola and PepsiCo - must participate in any collusive price agreement in order for it to succeed,

⁸⁵ "[T]erms of coordination may be imperfect and incomplete -- inasmuch as they omit some market participants, omit some dimensions of competition, omit some customers, yield elevated prices short of monopoly levels, or lapse into episodic price wars -- and still result in significant competitive harm." Merger Guidelines, Section 2.11

⁸⁶ IDFF paragraphs 2, 83, 353.

and have an obvious economic incentive to do so.⁸⁷ Each has ownership interests in bottlers that distribute approximately one-half of their carbonated soft drink sales, IDFF paragraphs 83, 353, and they are the only branded concentrate companies to have substantial ownership interests in bottlers. IDFF paragraphs 2, 83. Even though PepsiCo owns its bottlers outright, whereas Coca-Cola holds the bulk of its bottler investments as 49% ownership interests, the differences in vertical integration between the two may be less significant than the similarities and are not great enough to inhibit establishing a collusive price. Thus, Coca-Cola has not demonstrated how any such difference would affect firms' incentives to cooperate, or would interfere with their ability to detect and retaliate against cheating on a collusive scheme.

c. Increasing the difficulty of entry and increasing the costs and reducing the competitiveness of other firms in the relevant market.

The ALJ found that the proposed acquisition would have made entry into the market for branded concentrate more difficult, and that it would have increased the costs and reduced the competitiveness of other firms in the relevant market. ID 104-105, 109. We concur. Because both of these anticompetitive effects stem from the impact that the acquisition would have had on brand name soft drink bottlers, we discuss them together, and discuss entry more fully below.

For either a new or existing branded concentrate manufacturer to compete effectively, it needs soft drink bottlers that offer store-door delivery and have a minimum efficient scale of 8% to 15% of their local market. Koerner Tr. 430, Connor Tr. 1016, Cross Tr. 1678, Westerman Tr. 1791. As of 1985 (the last full year before the complaint was issued in this case), only two families of brands, Coca-Cola and Pepsi-Cola, had market shares of that size throughout the country; other branded concentrate makers had to use bottlers that also distributed other brands. *See infra* Part IV.C.3.

⁸⁷ ID 103. Indeed, the ALJ found that both desired to raise the price of concentrate and that they had engaged in price signalling. *Id*; IDFF paragraphs 328-34.

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In 1985, Dr Pepper had the fourth largest share of branded carbonated soft drink sales. IDFF paragraphs 241-43.⁸⁸ In some soft drink markets, Dr Pepper's sales were substantially above its national average, Slaughter Tr. 2160, allowing it to virtually support a local bottler by itself (*see also infra* p. 57, note 102). Dr Pepper's size thus made it an attractive brand for third bottlers that compete with Coke and Pepsi bottlers. While the Seven-Up and RC Cola families of brands had similar national market shares, Dr Pepper had a unique flavor, which made it especially attractive to third bottlers because it meant that they could carry Dr Pepper without concern that flavor restrictions would prevent them from distributing other brands of carbonated soft drinks.⁸⁹ IDFF paragraphs 269, 316-20.

Because Dr Pepper has the right to disapprove any transfer of a Dr Pepper franchise,⁹⁰ if Coca-Cola acquired Dr Pepper, Coca-Cola could steer those franchises to Coca-Cola bottlers that did not already bottle Dr Pepper.⁹¹ Such transfers would have been consistent with Coca-Cola's long-standing practice of not selling concentrate to more than one bottler in the same territory. Dyson Tr. 2367-68; *see also* IDFF 359. The ALJ found that this would weaken third bottlers that depend upon Dr Pepper for a significant share of their volume if those bottlers could not achieve minimum efficient scale for distribution without Dr Pepper. IDFF paragraph 360, ID 103-04. This would potentially raise the costs for those rivals of Coca-Cola and PepsiCo that lack their own bottler networks, as well as potentially raising the costs for and difficulty of entry by new producers of concentrate seeking store-door distribution to compete with established firms.

⁸⁸ In 1986, Dr Pepper ranked fifth in market share according to the Nielsen data, behind Coke, Pepsi, Seven-Up, and RC. IDFF paragraph 241. The Nielsen data understated Dr Pepper's actual share (IDFF paragraph 242), but even using those data, Dr Pepper's share exceeded RC's in 1985, 1987, and 1988. IDFF paragraph 241.

⁸⁹ A flavor restriction is a provision in the contract between a concentrate maker and its bottler that prohibits the bottler from producing another brand's version of the same flavors. IDFF paragraph 267. The effect of flavor restrictions is discussed in more detail *infra* pp. 57-60.

⁹⁰ Slaughter Tr. 2202-03; IDFF paragraph 355. Dr Peppers approval rights are triggered by changes of ownership involving as little as 10% of a bottling company. IDFF 355.

⁹¹ Coca-Cola argues that it would not risk injury to its relationship with Dr Pepper bottlers by transferring Dr Pepper franchises from third bottlers to Coca-Cola bottlers. ABCA at 22-24. This argument borders on frivolous. About 40% of Dr Pepper products are already distributed by Coca-Cola bottlers, and these bottlers, of course, would not care about attempts to move Dr Pepper franchises to other Coca-Cola bottlers. As to the remaining 60%, as long as there is a Coca-Cola bottler to which the Dr Pepper franchise can be transferred, Coca-Cola has no reason to be concerned about its relations with the existing Dr Pepper franchise holder.

This effect on competition would be limited to the Dr Pepper franchises that are held by third bottlers (20% at the time of trial), IDFF paragraph 354, or that move to third bottlers in the future. Moreover, Dr Pepper sought to place its franchises with the strongest possible bottler in each market (*id.*), which meant that, even absent the acquisition, some franchises that became available might have been awarded to the local Coke or Pepsi bottler in preference to a third bottler. However, in the five years preceding the initial decision, 20 Dr Pepper franchises were awarded to third bottlers, ID paragraph 358, demonstrating that Dr Pepper franchises are still an important source of potential soft drink volume to third bottlers. Loss of this volume by third bottlers would have made it more difficult for those bottlers to attain efficient scale of operations and to be efficient distributors for new or existing competitors of Coca-Cola and Pepsi-Cola in branded concentrate.

d. *Coca-Cola's argument that increased concentration has not decreased competition in the market*

Coca-Cola asserts that over the decades, competition between Coca-Cola and PepsiCo has been vigorous, and that historical data show that price competition has remained vigorous even as concentration in the carbonated soft drink industry increased. ABCA at 77-79.

Looking at the historical data, several facts are indisputable. Over an extended period prior to the attempted acquisition, national concentration among carbonated soft drink concentrate firms increased. IDFF paragraph 241. Over this same period, carbonated soft drink consumption increased, IDFF paragraph 34; per-case operating profit from the sale of concentrate fell, IDFF paragraph 24; carbonated soft drink production costs fell, IDFF paragraphs 35-36; and packaged carbonated soft drink prices, adjusted for inflation, fell, IDFF paragraph 211. Coca-Cola attempts to use data on changes in output, prices, and profit margins, as well as other market factors reflective of competition, to disprove any causal relationship between increasing concentration and decreasing competition. ABCA at 12-16.

However, there are two problems with Coca-Cola's argument. First, the concern of Section 7 of the Clayton Act is with probable future performance of an industry after a merger, and while historical

performance can be important in predicting that probable future performance, the lack of previous anticompetitive effects does not rule out future anticompetitive effects after the merger in question is completed.⁹² Second, as complaint counsel point out, RBCC at 26-27, the data cited by Coca-Cola do not show what happened to economic profits,⁹³ or even total accounting profits, of major concentrate producers during the period when industry concentration increased.

There is little evidence in the record relevant to economic profits of branded concentrate producers. In the years prior to the attempted acquisition of Dr Pepper, Coca-Cola (as well as PepsiCo and Dr Pepper) reported increasing profits as industry concentration increased.⁹⁴ Dyson Tr. 2415, Weatherup Tr. 1448, Knowles Tr. 2455-56. However, increased accounting profits do not necessarily mean increased economic profits. There is simply no basis in the record in this case to determine whether or not the producers of branded concentrate were pricing competitively prior to the acquisition attempt in question.

We recognize that in many respects, in many parts of the country, the market for carbonated soft drinks was highly competitive through the time when the record closed in this case; we recognize further that there was a history of intense rivalry between Coca-Cola and PepsiCo (IDFF paragraph 209).⁹⁵ However, we cannot accept Coca-

⁹² We note that the period of increasing industry concentration is also the period when numerous bottlers of branded carbonated soft drinks engaged in price fixing. IDFF paragraph 47. This suggests that the entire industry may not be behaving competitively.

⁹³ For purposes of antitrust analysis, "economic profit," rather than "accounting profit," is the appropriate measure of firm performance. Economic profit accounts for the opportunity costs of all the assets that a firm uses in its business, while accounting profit reflects a firm's explicit historical expenditures. See W. Baumol & A. Blinder, *Economics: Principles and Policy*, 424-25 (2d ed. 1982); P.R. Gregory and R.J. Ruffin, *Essentials of Economics*, 96-100, 120 (1986); J. Hirshleifer, *Price Theory and Applications*, 176-79 (3d ed. 1984); D. Carlton & J Perloff, *Modern Industrial Organization*, 361-68 (1990).

⁹⁴ Contrary to Coca-Cola's assertion (ABCA at 12 n.6), the price of concentrate increased faster than the rate of inflation over the years immediately preceding the administrative trial. See ID at 104. For example, between 1980 and 1986, the bottle/can price of Coke and Diet Coke concentrate increased by around 53%, while inflation as measured by the Consumer Price Index increased by around 32% (see RX 60A). Coca-Cola's reliance on RX 62 to argue that prices did not escalate is misplaced, because RX 62 relates to revenues to Coca-Cola, net of Coca-Cola's advertising and promotion expenses. (We do not, however, take the fact that Coca-Cola's prices were increasing faster than the rate of inflation during this period to mean that Coca-Cola was necessarily exercising market power.)

⁹⁵ See, e.g., IDFF paragraph 208; Shanks Tr. 111; Carew Tr. 246; Schmid Tr. 293-94; Currie Tr. 387-88. We would not, however, characterize as competitive those carbonated soft drink markets in which bottlers, including some Coca-Cola and Pepsi-Cola bottlers, engaged in price fixing.

Cola's contention that this competition would necessarily continue in the future regardless of the level of concentration.

In the past, Coca-Cola and PepsiCo were never required to take market share from each other; rather, they gained market share at the expense of other brands. IDFF paragraph 241; Kalil Tr. 947-48. However, as Coca-Cola and PepsiCo grow larger, it becomes more difficult to take market share from other brands, simply because the other brands have less market share to lose. Moreover, as those other concentrate companies market shares shrink, they have greater difficulty in obtaining efficient bottler, store-door distribution, because it is more difficult for their bottlers to reach the minimum efficient scale (*see infra* pp. 57ff.).

Thus, the incentives for Coca-Cola and PepsiCo change as their combined market share increases. It becomes harder for either of them to enlarge their market share without taking the share from the other, and their competitors become less able to mount a strong competitive challenge as their distribution systems become smaller and relatively less efficient. If the antitrust laws allowed Coca-Cola, and, by implication, PepsiCo, to increase market share by purchasing their major competitors, rather than competing for it, we have no assurance that they would continue to compete aggressively in the future -- particularly in an industry with a history of price fixing at one level. Furthermore, the ALJ's finding that both companies have signalled their desire to raise concentrate prices, possibly forgoing competition for market share (IDFF paragraphs 328-34; ID 103), underscores our conclusion that past price competition between Coca-Cola and PepsiCo would not necessarily have continued after the acquisition. Thus, respondent's arguments do not undermine the ALJ's findings that the proposed acquisition may have substantially lessened competition in violation of Section 7.

3. Ease of entry and other mitigating factors

In *United States v. Waste Management, Inc.*, 743 F.2d at 982, the Second Circuit observed that the Supreme Court:

has held that appraisal of the impact of a proposed merger upon competition must take into account potential competition from firms not presently active in the relevant product and geographic markets. *United States v. Falstaff Brewing Corp.*, 410 U.S. 526, 93 S.Ct. 1096, 35 L.Ed. 2d 475 (1973); *Federal Trade Commission v. Proctor & Gamble Co.*, 386 U.S. 568, 87 S.Ct. 1224, 18 L.Ed.2d 303 (1967);

United States v. Penn-Olin Chemical Co., 378 U.S. 158, 84 S.Ct. 1710, 12 L.Ed.2d 775 (1964).

We have likewise held that a “primary consideration in evaluating the likely competitive effects of a merger or acquisition is the ease or difficulty with which new competitors might enter the market in response to supracompetitive pricing.” Owens-Illinois, slip op. at 27-28.

If entry is “so easy that market participants, after the merger, could not profitably maintain a price increase above premerger levels,” then the merger is unlikely to lead to the exercise of market power. Merger Guidelines, Section 3.0. The reason is that absence of barriers or impediments to entry “makes it highly unlikely that a merger or acquisition will have anticompetitive effects, because any effort to extract supracompetitive prices and profits will induce new entry, which will reduce prices to competitive levels.” *B.F. Goodrich*, 110 FTC at 295-96. When a merger results in a firm with market power, “if prompt, effective entry is unlikely, customers may be exposed to sustained periods of anticompetitive harm.” Owens-Illinois, slip op. at 28. See *United States v. Baker Hughes, Inc.*, 908 F.2d 981 (D.C. Cir. 1990).

In this case, Coca-Cola argues that there are two sources for expansion of output to defeat any collusive pricing by branded concentrate producers: entry by new firms, and expansion by existing producers of nonbranded soft drinks.⁹⁶ ABCA at 84. Because the basic issues are the same for entry by firms not presently producing any concentrate and for entry by firms currently producing unbranded concentrate, we treat both sources of potential entry together.⁹⁷

The Commission traditionally has assessed ease of entry by looking for identifiable barriers or impediments that could foreclose entry or prevent expansion by existing smaller firms sufficient to

⁹⁶ Coca-Cola’s position on entry may not be consistent with its reasons for seeking to buy Dr Pepper. Coca-Cola asserts that there are absolutely no barriers to entry. However, Coca-Cola has described its attempt to acquire Dr Pepper as a “defensive acquisition” because PepsiCo was seeking to acquire Seven-Up. ATr. 61; IDFF paragraph 10. If there are absolutely no barriers to entry, as Coca-Cola claims, one might ask why it could not have simply introduced new brands of carbonated soft drinks in response to PepsiCo, instead of offering to pay \$470 million for what was essentially the Dr Pepper trademark. IDFF paragraph 9.

⁹⁷ Under Section 1.32 of the Merger Guidelines, certain firms that participate in the market through supply-side response are included as participants in the market, and are therefore treated separately from other firms that may enter the market. In this case, following the Merger Guidelines’ approach would result in the same conclusion.

forestall anticompetitive conduct within the relevant market. Impediments that could prevent entry include "any condition that necessarily delays entry into a market for a significant period of time and thus allows market power to be exercised in the interim." *Echlin Mfg. Co.*, 105 FTC 410, 486 (1985). Barriers to entry are "additional long-run costs that must be incurred by an entrant relative to the long-run costs faced by incumbent firms." *Id.* at 485 (citing G. Stigler, *The Organization of Industry* 67 (1968)); *accord, e.g., HCA*, 106 FTC at 491. Barriers or impediments need not be absolute; rather, they are assessed "in terms of the amount of time required for a motivated outsider to effect entry." *Olin Corp.*, 113 FTC at 612; *Owens-Illinois*, slip op. at 28.

The Merger Guidelines use a comparable analytical approach, defining "easy entry" as entry that is "timely, likely, and sufficient in its magnitude, character and scope to deter or counteract the competitive effects of concern." Section 3.0. To be "timely," entry must take no more than two years to go from initial planning to a significant market impact. *Id.*, Section 3.2. To be "likely," entry must be profitable at premerger prices, and a prospective new entrant must be able to obtain those premerger prices. To be "sufficient," entry must be able to restore competitive pricing -- *i.e.*, it must be effective in offsetting any loss of competition due to the business combination in question.⁹⁸

A would-be entrant into the market for branded carbonated soft drink concentrate can create a flavor and obtain a supply of concentrate. IDFF paragraphs 244-48. However, the entrant must then find means to convert the concentrate into packaged soft drinks or fountain syrup, arrange to have its products distributed to stores, restaurants, and vending locations, and stimulate sufficient consumer demand to make producing the concentrate profitable. See IDFF paragraph 266. The ALJ found that barriers and impediments at the distribution stage prevented easy entry into the market for branded concentrate, so that new entry was not likely to constrain collusive price increases among the existing firms in the market. ID 105. As one witness stated: "It is easy to get one's product produced, but it is very difficult to get it distributed." IDFF paragraph 266.

Coca-Cola asserts that entry is easy, and that there has been virtually continuous new entry into the relevant markets (ABCAs at

⁹⁸ While there is no predetermined market share that the new entrants must meet, they must obtain a sufficient share to offset any output restriction that follows the acquisition.

51). Respondent contends that "by 1987 the sales of 129 new soft drink brands introduced since 1970 collectively accounted for 38.7 percent of all carbonated soft drink sales." ABCA at 51, citing IDFF paragraph 322.⁹⁹ However, many of these new "brands" are products developed by existing major concentrate companies, such as Coca-Cola's Diet Coke, New Coke, and Cherry Coca-Cola, as well as caffeine-free variations of existing Coca-Cola products. *See* IDFF paragraphs 321-22; *cf. also id.*, paragraphs 214-16.

That Coca-Cola and PepsiCo can introduce new products does not show that new firms can thereby prevent anticompetitive price increases. Coca-Cola and PepsiCo already have established distribution arrangements with their bottler networks through which to market new products. Thus, they do not face the barriers and impediments to obtaining distribution that a new entrant would encounter. For example, Coca-Cola and PepsiCo do not face flavor restrictions which would prevent them from introducing a new diet or caffeine-free cola-flavored soft drink to their existing bottler network. A new entrant would have to find bottlers that do not currently handle a competing product with a flavor restriction that prevents handling the new product. As we discuss below, the record indicates that barriers and impediments to obtaining an effective bottling and distribution system prevent entry into the branded concentrate market from being timely, likely, or sufficient.

The most effective way to distribute branded carbonated soft drinks is through a network of soft drink bottlers that provides store-door delivery. IDFF paragraphs 258-61. Store-door delivery enables bottlers (and the retailers using them) to respond rapidly to competitors' in-store price promotions and to consumer demand. IDFF paragraphs 258, 260. It also gives concentrate manufacturers and bottlers access to the cold drink and vending channels, and to retail outlets that lack their own warehouses. IDFF paragraphs 257-60. Warehouse delivery lacks these advantages. Moreover, concentrate manufacturers that rely on warehouse delivery have difficulty selling a full product line and adequately promoting their soft drinks. IDFF paragraphs 260, 261.

Coca-Cola asserts (ABCA at 68-70) that the ALJ's product market definition caused him to ignore the advantages that warehouse delivery offers a new entrant, such as being able to sell its products

⁹⁹ Of those brands, the record evidence indicates that only one had achieved a market share as large as Dr Pepper's; the rest had market shares averaging 0.3% each. IDFF paragraph 322.

at a lower price. Respondent, however, misses the point: warehouse-delivered soft drinks were excluded from the relevant product market because they cannot constrain the price of branded products. Thus, although a new entrant using warehouse delivery arguably could successfully sell a lower-priced carbonated soft drink, such brands have not been able to take market share away from, and constrain the prices of, branded products like Coca-Cola. *See supra* Part IV.A. As a bottler witness who provides store-door delivery stated, “Probably the two [methods of delivery] shouldn’t even be considered in the same discussion.” IDFF paragraph 258. Concentrate firms that used both methods stated that warehouse delivery was inadequate. IDFF paragraph 261; *see also* IDFF paragraphs 296-98, 317.¹⁰⁰

In addition to providing store-door delivery, to be fully effective, a bottler must be large enough to take advantage of various scale economies relating to the production, distribution, and marketing of carbonated soft drinks.¹⁰¹ A bottler needs at least 8% to 15% of the local market for carbonated soft drinks to achieve minimum efficient scale. Koerner Tr. 430; Connor Tr. 1016; Cross Tr. 1678; Westerman Tr. 1791. Only two concentrate firms have national market shares at that level or above: Coca-Cola and PepsiCo.¹⁰² IDFF paragraphs 227-28, 241. To obtain an efficient-sized bottler, every other concentrate manufacturer must use bottlers that also distribute other brands of carbonated soft drinks.

Most local markets for carbonated soft drinks have a Coca-Cola bottler, a Pepsi-Cola bottler, and a so-called “third bottler,” which carries various brands of soft drinks other than Coca-Cola or Pepsi-

¹⁰⁰ Dr Pepper’s experience demonstrates this. The company initially had to use warehouse distribution because it was considered a cola, and thus subject to flavor restrictions that prevented it from using Coca-Cola or Pepsi-Cola bottlers. Warehouse distribution was not effective, and Dr Pepper’s sales did not improve until Dr Pepper successfully challenged its designation as a cola and obtained access to those bottlers. *See* IDFF paragraphs 316-19. Additionally, Procter & Gamble, which already possessed expertise in warehouse distribution of food, did poorly when it attempted to distribute Crush and Hires Root Beer through warehouses. IDFF paragraphs 296-98.

¹⁰¹ For example, a bottler realizes economies by producing a larger volume of soft drinks in a given bottling plant, which spreads the fixed production costs over a larger output. Carew Tr. 192-93; Weatherup Tr. 1486-87. By increasing the volume of soft drinks delivered to each store during a single stop, the bottler lowers the average per-unit delivery cost of the stop. Brodkin Tr. 848-49. When a grocery store requires payment of a fixed amount from soft drink bottlers to participate in a store promotion, increasing the volume of soft drinks sold to that store reduces the average cost of the promotion per bottle or can sold. Berry Tr. 697. Cf. also IDFF paragraphs 278, 282.

¹⁰² Because soft drink market shares vary greatly from city to city, some brands of carbonated soft drinks other than Coke or Pepsi have more than 8-15% of a given local market. For example, in a few of its strongest markets, Dr Pepper has more than 15% of carbonated soft drink sales. AB Appendix B. However, the record contains few such instances.

Cola brands. IDFF paragraphs 37-40. Coke, Pepsi, and “third” bottlers, however, are frequently not available to new entrants into the market for concentrate because franchise agreements between bottlers and existing concentrate makers usually contain a so-called “flavor restriction,” which prohibits the bottler from handling another brand of the same flavor of soft drink as the concentrate manufacturer’s. IDFF paragraph 267. This means, for example, that a company seeking to market a branded cola-flavored concentrate could not use a Coca-Cola or Pepsi-Cola bottler, and could not use the third bottler if it already carries another branded cola.¹⁰³ See, e.g., IDFF paragraphs 267-69. These flavor restrictions pose a significant impediment¹⁰⁴ to a new entrant seeking to use existing bottlers to achieve minimum efficient scale.¹⁰⁵

Coca-Cola, however, characterizes flavor restrictions “as increasing competition in this market,” contending that flavor restrictions force a new entrant to compete with an existing concentrate manufacturer to obtain a contract with a bottler. ATr. at 35. We disagree. Without flavor restrictions, a new entrant must merely convince a prospective bottler that the new entrant’s flavor/brand will create incremental profits, increasing the bottler’s sales revenues more than the incremental costs associated with the new flavor/brand, while the bottler may continue selling all of its existing brands. Because flavor restrictions force the bottler to abandon an established flavor/brand that conflicts with the new entrant’s flavor/brand, the new entrant, when facing flavor restrictions, must convince a bottler that it can completely and profitably replace the sales of the existing flavor/brand, as well as providing the bottler with incremental new sales.

For concentrate manufacturers other than Coca-Cola or Pepsi, this may be an insurmountable obstacle to obtaining distribution, as

¹⁰³ Coca-Cola notes that the flavor restrictions do not apply to sales of cola fountain syrup. ABCA at 58. In fact, there are few opportunities for new entrants in the fountain segment of the market. Fountain equipment generally has only four different “spigots,” dispensing four different soft drink brands or flavors, and they are typically filled with Coca-Cola and Diet Coke (or Pepsi-Cola and Diet Pepsi), a lemon-lime flavor, and one other flavor. Koerner Tr. 473-74. The equipment is often loaned to the user by a bottler or concentrate company that then controls which brands can be placed in that equipment. Connor Tr. 1027-29, Tyler Tr. 1187-88.

¹⁰⁴ As noted *infra* pp. 59-60, a finding that flavor restrictions are an impediment to new entry does not constitute a finding that they are anticompetitive.

¹⁰⁵ These flavor restrictions suggest that the initial step in entry, *i.e.*, developing a flavor, may not be as easy as it first appears, inasmuch as a new entrant may need to create a flavor that does not duplicate existing brands (and therefore avoids flavor restrictions), yet still has strong consumer appeal.

Philip Morris found out when it attempted to market Like Cola, the first decaffeinated cola-flavored carbonated soft drink. Although neither Coca-Cola nor PepsiCo offered a decaffeinated cola at that time, flavor restrictions prevented their bottlers from handling Like because it was a cola-flavored product.¹⁰⁶ Cf. IDFF paragraph 271. Moreover, if a new entrant successfully displaces another concentrate maker (other than Coca-Cola or Pepsi, of course), this merely results in substituting one brand of carbonated soft drink for another, without increasing the number of carbonated soft drinks available in the market.¹⁰⁷

Coca-Cola's second argument is that flavor restrictions increase competition by forcing the bottler to give its undivided loyalty to marketing one brand of each flavor. ATr. 35; ABCA at 60. This proposition is irrelevant because it only bears on whether flavor restrictions are an unreasonable restraint of trade, which is not at issue. It does not address whether these restrictions, given the economies of scale in the production and distribution of carbonated soft drinks, are a barrier or impediment to entry.¹⁰⁸ In any case, the decided weight of this record reflects the exclusionary effects of flavor restrictions vis-a-vis new entrants; Coca-Cola's arguments about procompetitive effects are largely theoretical and inadequately demonstrated.

¹⁰⁶ Coca-Cola argues that flavor restrictions are not onerous because Coca-Cola's apply only to cola-flavored soft drinks. ABCA at 58. However, that precludes new entrants, such as Philip Morris, from using Coca-Cola bottlers to compete with a new cola-flavored soft drink, which is the most popular flavor category (see IDFF paragraphs 31, 267). Moreover, if the Coca-Cola bottler also bottles another flavor, for instance root beer, for a different company that also has a flavor restriction, that restriction will preclude a new entrant from introducing a new root beer through that bottler, even though Coca-Cola has no flavor restriction on root beer.

¹⁰⁷ Coca-Cola argues that flavor restrictions do not prevent a bottler from distributing one brand of carbonated soft drink in one geographic area, and another brand in another geographic area. ABCA at 59. That is possible if the bottler serves an area wider than the franchise areas that it has been granted by particular concentrate manufacturers. However, new entrants nonetheless are foreclosed from part of the market; entry is impeded by the flavor restriction, even if it is not absolutely blocked.

¹⁰⁸ Coca-Cola cites A&W as an example of a firm that successfully entered the market despite flavor restrictions. ABCA at 59. A&W started in the restaurant business over 70 years ago; its root beer formula was developed in 1919. Lowenkron Tr. 2057-58. It entered the take-home channel in 1971. *Id.* at 2058. A&W has successfully expanded its product line from its root beer base and added new flavors. A&W's ability to obtain bottlers for the new products depended in large part on the fact that it marketed relatively unusual flavors, such as cream soda, grapefruit (Squirt), and Vernors (a uniquely flavored ginger ale), but no cola or lemon-lime. See Lowenkron Tr. 2071-73. Those flavors did not encounter flavor restrictions because bottlers handled no other product with the same flavor. Moreover, according to the record evidence, A&W has obtained only a relatively small market share. See IDFF paragraph 97, Lowenkron Tr. 2065-66.

According to Coca-Cola, there are some alternatives to using existing (but unavailable) bottlers. To avoid the obstacles created by flavor restrictions, a new entrant could create its own bottlers. However, such bottlers would need to achieve at least an 8-15% market share to realize the needed economies of scale. Creating a bottling network is not realistic. IDFF paragraph 273.

Alternately, Coca-Cola asserts that beer distributors have been successfully used by some companies, including major carbonated soft drink concentrate producers. ABCA at 64-67. The ALJ found that these companies do not rely on beer distributors for most of their distribution. IDFF paragraphs 264-65. The "successes" cited by Coca-Cola during the period covered by this record are limited to firms selling "niche" or "boutique products," such as American Natural Beverage Co. ("Soho" brand), Unadulterated Food Products, Inc. ("Snapple" brand), and Original New York Seltzer. During this period, these companies sold small quantities of premium-priced products that could not constrain the price of branded carbonated soft drinks. *See* IDFF paragraphs 108, 159.¹⁰⁹ Moreover, witnesses from two of the companies stated that beer distributors were not very satisfactory.¹¹⁰ For most companies, using beer trucks to carry their soft drinks did not enable them to successfully compete with branded carbonated soft drinks.¹¹¹ *See* IDFF paragraphs 262-64. Indeed,

¹⁰⁹ These companies' sodas were sold at average retail prices ranging from \$2.19 to \$2.79 for a pack of four single-serving bottles, with promotional prices of \$1.99 for two of the brands. *See* Collier Tr. 4112, Greenberg Tr. 3554, Miller Tr. 3443. These prices are significantly higher than branded products' average of \$1.57 for a pack of six cans, and \$1.39 to \$1.49 on sale. IDFF paragraphs 131, 133. In 1988, after 11 years in business, American Natural Beverage had sales of \$20,000,000. Collier Tr. 4067. In 1990, after eight years in business, Snapple sold some 1.1 million cases of soft drinks, and it was distributed in only three regions, with 70-75% of its sales in the New York metropolitan area. Greenberg Tr. 3529, 3558. Original New York Seltzer sold 18,000,000 cases in 1987 and only 8,500,000 in 1989. Miller Tr. 3455, 3460. In contrast, more than 2.6 billion cases of Coca-Cola were sold in 1986. IDFF paragraph 27.

¹¹⁰ One witness testified that most beer distributors do not perform well for Snapple, and that Snapple would prefer to use soft drink bottlers as distributors, but cannot because of flavor restrictions. Greenberg Tr. 3555-56. A witness from Original New York Seltzer stated that the economics of the beer distributors that it uses limits their effectiveness as carbonated soft drink distributors. IDFF paragraph 264; Miller Tr. 3453-54.

¹¹¹ There are a number of reasons for the failure of "piggybacking" carbonated soft drinks on beer trucks. First, beer trucks do not stop at all locations where soft drinks are sold, limiting market penetration. Miller Tr. 3453-54. Second, beer distributors have restrictions on their credit-practices that are incompatible with the credit practices of carbonated soft drink bottlers. IDFF paragraph 262. Third, beer distributors see beer as their main profit source and are less willing to invest in the success of soft drink distribution. *Id.*

Although a beer distributor arguably could own a carbonated soft drink bottling facility and offer store-door distribution of carbonated soft drinks on a stand-alone basis, like any other bottler, it would have to obtain an 8-15% market share to achieve minimum efficient scale.

Anheuser-Busch, which has obvious expertise in beer distribution, attempted to introduce ZeltzerSeltzer, a flavored soda, through its beer distributors. These distributors were not successful, and Anheuser-Busch failed in its entry attempt. IDFF paragraphs 309-11.

In addition to substantial entry barriers, we find that several other related factors specific to this product market compound the difficulties confronting new entrants. As the ALJ found, these include new product introductions by Coca-Cola and Pepsi-Cola (IDFF paragraphs 284-95), and competition for retail promotional activity (IDFF paragraphs 274-83). Coca-Cola argues that these are merely signs of vigorous competition, and cannot be considered barriers to entry. ABCA at 53, 56. We do not find that new product introductions or competition for retail promotional activity are barriers to entry. Nonetheless, each of these factors is an aspect of competition that helps put the entry barriers into context.

In the case of new product introductions, the record shows that when new entrants develop and introduce new branded products, existing companies can overwhelm them by developing their own imitative products, which they can widely and rapidly distribute through their established bottler networks (IDFF paragraphs 284-88). For example, as previously noted, in 1982, Philip Morris introduced Like Cola, a caffeine-free cola, and had some initial success distributing it through Seven-Up bottlers. However, soon afterwards, Coca-Cola and Pepsi-Cola introduced their own caffeine-free colas. Like Cola failed. IDFF paragraphs 286-88, 291-95. The experience of Philip Morris demonstrates that, while a new entrant struggles to obtain effective distribution, Coca-Cola and PepsiCo have time to develop competing products before the new entrant can establish its brand. This makes the barrier of obtaining effective distribution that much more formidable to new entrants.

Competition for retail promotional activity in the take-home channel is an important aspect of competition for producers of branded concentrate and of branded carbonated soft drinks. In order to participate to a significant degree in retail promotions -- which make up a substantial part of branded soft drink sales -- a branded carbonated soft drink needs a local bottler with store-door distribution and large sales volume. IDFF paragraphs 274-83. This reinforces the need to obtain local bottler distribution, which is exactly the barrier to entry that the new entrant must overcome.

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Even if an entrant can obtain satisfactory distribution, its entry would not likely be timely, as that term is used in the Merger Guidelines. The entry attempts by American Natural Beverage, Unadulterated Food Products, and Original New York Seltzer show that it takes longer than two years from the beginning of entry until there is any significant market impact (*see supra* p. 60, note 109). The creation of a viable distribution network for soft drinks is expensive and time consuming. *See discussion supra*; IDFF paragraphs 289, 294, 312-13, 324. Nor are difficulties in entering the market for branded concentrate limited to start-up companies. Major firms, including Philip Morris, Procter & Gamble, R.J. Reynolds, and Anheuser-Busch, have attempted to enter the market for branded concentrate and branded carbonated soft drinks, with little or no success. IDFF paragraphs 291-302, 309-11. Their difficulties were largely attributable to their inability to gain access within a reasonable period to a network of bottlers with minimum efficient scale. IDFF paragraphs 291-315; *see also id.*, paragraphs 316-20.¹¹²

In order to constrain a price increase by existing producers, we note that it is not sufficient that a new entrant be "successful" in the sense of being profitable. If new entrants cannot sufficiently expand output to prevent existing producers from raising prices, their entry will not be sufficient to prevent a cartel from raising prices. Industry conditions indicate that this is a likely scenario. If a new entrant is distributed through bottlers owned or controlled by Coca-Cola or PepsiCo, those bottlers will not likely permit the new entrant to undermine a cartel that includes Coca-Cola and PepsiCo. It is thus likely that even the small market shares that new entrants have obtained in the past overstate the actual competitive significance of any new entry.

Finally, the history of price fixing by bottlers suggests that at that level, the industry has not always been protected by competitive market forces. Consequently, analysis of conduct in the industry merits particular care.

¹¹² Even a regional firm with strong consumer acceptance within its geographic area faces the same difficulties in expanding into other geographic markets because of obstacles to obtaining efficient distribution in areas where it has not previously had consumer acceptance. For example, when the current owners of Barq's acquired the company in 1976, its root beer enjoyed a strong area of consumer preference in southern Louisiana and southern Mississippi. Koerner Tr. 416-19. Barq's expected that it could obtain national distribution within ten years, but by 1988, Barq's reached only 60-65% of the nation. Koerner Tr. 424

For the reasons above, we affirm the ALJ's finding that entry into the market for branded carbonated soft drink concentrate is difficult, and unlikely to overcome the proposed acquisition's adverse effects on competition in the market for branded concentrate.¹¹³ We find that the acquisition of Dr Pepper would have substantially lessened competition among producers of branded concentrate within the United States, in violation of Section 7 of the Clayton Act and Section 5 of the FTC Act.

Additionally, for the reasons set out in this Part and *supra* Part III.A.2, we find that Coca-Cola's agreement with DP Holdings to acquire Dr Pepper was a separate violation of Section 5 of the FTC Act.

V. APPROPRIATE RELIEF

Complaint counsel sought an order requiring Coca-Cola to obtain prior Commission approval before respondent could acquire: (1) another firm that manufactured branded concentrate or syrup; or (2) another firm that bottled and distributed carbonated soft drinks and had the exclusive rights to distribute a branded carbonated soft drink that competes with Coca-Cola (IDFF paragraph 361). Although the ALJ found that the acquisition would probably have lessened competition substantially, he declined to issue an order against Coca-Cola (ID 106-07). We disagree with the ALJ on the need for an order, but we do not discern a need for an order as broad as that proposed by complaint counsel. Accordingly, our order does not apply to acquisitions of bottlers, unless they also market branded concentrate.

A. *The Appropriateness of Issuing Any Order*

1. The standards for issuing a prior approval order

The Commission has "wide discretion in its choice of a remedy," and "the courts will not interfere except where the remedy selected has no reasonable relation to the unlawful practices found to exist." *Jacob Siegel Co. v. FTC*, 327 U.S. 608, 611, 613 (1946). *See also* *FTC v. Ruberoid Co.*, 343 U.S. 470, 473 (1952). The Commission has the authority to impose prior approval requirements in merger

¹¹³ The issues of efficiencies and firm failure were not raised and are therefore not before us.

cases. *Abex Corp. v. FTC*, 420 F.2d 928 (6th Cir. 1970), *cert. denied*, 400 U.S. 865 (1970).

Both complaint counsel (AB at 21) and Coca-Cola (ABC at 130) agree that the appropriateness of a prior approval order should be determined under the holding in *American Medical International, Inc.*, 104 FTC 1, 224 (1984) ("AMI"), that:

[I]t is industry market structure and market conditions, not whether a 'knowing and deliberate violation' or a 'likelihood of repeated unlawful conduct' has been shown . . . that determines the appropriateness of imposing a prior approval requirement in a particular case.

However, they disagree on what market conditions would justify a prior approval order. Complaint counsel argue that prior approval is appropriate when "future acquisitions may be competitively problematic." AB at 21 (citing *AMI*, 104 FTC at 224, and *HCA*, 106 FTC 361, 514). Coca-Cola contends that the standard is "whether acquisitions to be governed by a contemplated prior approval order would 'be so manifestly anticompetitive as to warrant a prior approval remedy.'" ABC at 130-31, n.68 (citing *HCA* at 515).

In the past, we have determined the appropriateness of prior approval requirements by considering industry structure and market conditions, and we thus agree with complaint counsel that the language from *HCA* urged by Coca-Cola is inapt. That language pertained to the standard for requiring prior approval for acquisitions of hospitals throughout the United States, *i.e.*, outside the local geographic market at issue. The scant evidence in the record indicated that competitive conditions varied greatly in other local geographic markets. Accordingly, there was insufficient evidence with respect to those other markets to determine whether industry structure and market conditions warranted a prior approval requirement.

Following *AMI*, *HCA*, and *B.F. Goodrich*, we look at industry structure and market conditions to determine whether a prior approval provision is warranted.¹¹⁴

¹¹⁴ If an acquisition would be objectionable under the antitrust laws, it is not a valid argument against requiring prior approval to say that it would make the acquisition less likely and thus diminish competition for the assets in question.

2. The ALJ's rejection of any order

At the conclusion of the trial, the ALJ determined that it would not be in the public interest to issue an order in this case, based on his analysis of the record and "the Bureau's own position before trial was held ('recent developments in the soft drink and concentrate industries, render prior approval an unnecessary remedy') . . ." ID 107. While highlighting complaint counsels previous position as his primary reason, ID 106, the ALJ also stated that "complaint counsel assume, contrary to the evidence, that all acquisitions in the concentrate and bottling industry would be anticompetitive . . ." and expressed his belief that a prior approval order would unfairly disadvantage Coca-Cola vis-a-vis its competitors. ID 107. We reverse.

After the Commission obtained a preliminary injunction against the proposed acquisition, Dr Pepper's shareholders terminated their agreement with Coca-Cola and sold Dr Pepper to an investment group led by Hicks & Haas. Coca-Cola then moved to dismiss the administrative complaint on the ground that further proceedings were not in the public interest. *See supra* p. 3. The Bureau of Competition joined in the motion, asserting that a prior approval order was not necessary because premerger notification under Section 7A of the Clayton Act, 15 U.S.C. 18a, would provide the Commission with "adequate notice of most potentially anticompetitive acquisitions" by Coca-Cola, and because of "recent developments in the soft drink and concentrate industries." Memorandum in Support of Complaint Counsel's Response to Respondent's Motion to Dismiss (Apr. 21, 1987), quoted in IDFF paragraph 362.¹¹⁵

The Commission, however, disagreed with complaint counsel and refused to dismiss, stating, *inter alia*, that:

The abandonment of a merger does not automatically moot prospective relief . . . In this proceeding, the Notice of Contemplated Relief includes, *inter alia*, a ten-year ban on Coca-Cola's acquisitions of the stock or assets of any entity engaged in the manufacture or sale of carbonated soft drinks or concentrate of carbonated soft drinks, except as may be approved by the Commission. We are not

¹¹⁵ The Bureau of Competition also contended that a requirement of prior approval before making vertical acquisitions (*i.e.*, of bottlers) was not in the public interest because it would deter acquisitions that enhanced efficiency. *Id.* Because we conclude, for other reasons (*see infra*), that an order covering acquisitions of bottlers is unnecessary, we do not address this contention. Nor do we reach or adopt the ALJ's findings concerning the presence and effects of efficiencies from bottler consolidations, *e.g.*, IDFF paragraphs 35 and 36.

persuaded that subsequent events have eliminated the need for some form of prior approval relief if a violation of law is established. Notwithstanding respondent's arguments to the contrary, continuation of this proceeding is therefore in the public interest.

Order Denying Respondent's Motion for Dismissal of the Complaint (Aug. 9, 1988) at 3.

Our August 1988 ruling rejected the parties' contention that the sale of Dr Pepper to another buyer automatically obviated the need for a prior approval order. It was therefore erroneous for the ALJ to reject an order based primarily on a position taken by the Bureau of Competition prior to our ruling. Moreover, other than alluding to the Bureau's April 1987 assertion that industry conditions had changed since the administrative complaint was filed in July 1986, the ALJ did not make any findings as to what those changes were, why they made a prior approval order unnecessary, or why he concluded that most acquisitions by Coca-Cola would not pose potential problems for competition. *See ID 107.* To the extent that his decision was based on his conclusion that Coca-Cola would not again attempt to acquire Dr Pepper, we have determined that he erred (*see supra* pp. 17-20).

Accordingly, under the applicable standards, we consider complaint counsel's argument that we impose a prior approval order on Coca-Cola in two different markets: (1) acquisitions of makers of branded concentrate and syrup; and (2) acquisitions of local bottlers of branded carbonated soft drinks.

B. *The Need for the Order Proposed by Complaint Counsel*

We find that complaint counsel have only satisfied us as to the need for the issuance of a prior approval order concerning acquisitions of manufacturers of branded concentrate and syrup.¹¹⁶ We do not further discuss complaint counsel's request for a prior approval order concerning acquisitions of local bottlers in the downstream market for branded carbonated soft drinks, in light of our inability, on

¹¹⁶ "Branded concentrate" has the same meaning as our definition of the relevant product market, *i.e.*, brand name concentrate used to make national and regional brand name carbonated soft drinks and syrup that are heavily promoted, widely available in the take-home and cold drink channels, and distributed by bottlers that provide store-door service or services to retailers in the cold drink channel.

this record, to reach determinations based on local geographic markets.¹¹⁷ *See supra* Part IV.B.¹¹⁸

Given, during the period covered by the record in this proceeding, the very high levels of concentration, the large market share held by Coca-Cola (*see supra* Part IV.C.1, and IDFF paragraphs 81, 222, 226),¹¹⁹ the likelihood of anticompetitive effects in this industry, and the barriers and impediments blocking entry, into this market, we are convinced that future acquisitions by respondent of branded concentrate firms whose market share in the United States is above a *de minimis* amount would likely raise competitive concerns. Our conviction is bolstered by the increase in industry concentration levels over time (*see, e.g.*, IDFF paragraphs 226, 241); the need for, and difficulty of, obtaining efficient local distribution of carbonated soft drinks; and the history of price fixing in the local distribution of branded carbonated soft drinks (*see supra* Part IV.C.2). Accordingly, both industry structure and market conditions evidenced in the record indicate that there is a significant likelihood that a future acquisition by Coca-Cola of a branded concentrate firm whose market share in the United States is above a *de minimis* amount would raise competitive concerns, and thus warrant imposition of a prior approval order.¹²⁰ Furthermore, this likelihood appears so great that the mere possibility that some acquisitions of branded concentrate firms by respondent might have a procompetitive effect does not outweigh the need for a prior approval order. In the event that such procompetitive effects outweigh the anticompetitive effects for any given transaction, the Commission can grant approval on a case-by-case basis.

We reject the argument that statutory premerger notification is an adequate substitute for a prior approval requirement. First, a prior approval obligation would give the Commission notice of acquisitions that may be competitively problematic even though they do not meet the HSR reporting threshold. *See HCA*, 106 FTC at 514-17; *cf.*

¹¹⁷ The fact that our order is limited to manufacturers of branded concentrate obviates many of the injuries feared by Coca-Cola (ABCA at 153-54), such as inability to make "defensive" acquisitions of most bottlers, or of major customers (such as restaurant chains) that also market their own private label fountain drinks.

¹¹⁸ Of course, the acquisition of a bottler that also produced branded concentrate would be covered by the prior approval requirements of our order.

¹¹⁹ The cited findings by the ALJ calculate respondent's share of the all-concentrate market, and therefore underestimate Coca-Cola's share of the branded concentrate market.

¹²⁰ Moreover, as we have found, we cannot rule out the prospect that respondent might seek to acquire Dr Pepper or another branded concentrate firm in the foreseeable future.

Louisiana-Pacific Corp., 112 FTC 547, 566 (1989). Second, prior approval shifts to Coca-Cola the burden of justifying a covered acquisition, which is appropriate given that respondent attempted to make an unlawful anticompetitive acquisition.¹²¹

Coca-Cola has urged, and complaint counsel have objected to, a provision in the order exempting from the prior approval requirements “acquisitions of companies with less than 1 percent of the national market for carbonated soft drink concentrate.” ABCA at 154-56; AB at 39-40. Coca-Cola argues that a *de minimis* provision would “minimize the need to seek prior approval in time sensitive acquisitions which do not raise antitrust concerns.” ABCA 155.

The Commission’s directive on the inclusion of prior approval clauses in Section 7 orders permits the inclusion of a *de minimis* exception, so long as prior notification is required for any excepted transaction that would not be reported pursuant to HSR rules. FTC Staff Bull. 88-01 (cited in RX 574A). To the extent that the Commission’s competitive concerns are otherwise met, the Commission in the past has made exceptions from prior approval provisions for certain *de minimis* acquisitions. See, e.g., *HCA*, 106 FTC at 524; *Central Soya Co., Inc.*, 113 FTC 786, 790 (1990).

Under the Merger Guidelines, where, as here, the market is highly concentrated, a merger producing an increase in the HHI of less than 50 points is “unlikely to have adverse competitive consequences and ordinarily require[s] no further analysis.” Section 1.51(c). In the present case, we have concluded that with respect to such a transaction, prior notification, either through an HSR filing or pursuant to an order, should be sufficient to protect the Commission’s interests. This would enable the Commission to examine the rare merger where the anticompetitive effects of the acquisition were not sufficiently reflected in the HHI increase of less than 50. The order therefore provides for a *de minimis* exception to prior approval with respect to any concern which has sales of less than 50 million, 192-ounce case equivalents¹²² in each of the three years preceding the acquisition.

¹²¹ See, e.g., *HCA*, 807 F.2d at 1393 (citing *FTC v. National Lead Co.*, 352 U.S. 419, 431 (1957) (“But ‘respondents must remember that those caught violating the Act must expect some fencing in.’”)).

¹²² The record suggests that the 192-ounce case equivalent is a standard industry measure of sales. See, e.g., CX 781B (*in camera*).

Based on sales data in the record, this would be roughly equivalent to an HHI increase of 50.¹²³

FINAL ORDER

This matter has been heard by the Commission upon the appeals of complaint counsel and respondent The Coca-Cola Company from the Initial Decision, and upon briefs and oral argument in support of, and in opposition to, the appeals. For the reasons stated in the accompanying Opinion, the Commission has determined to affirm in part, and to reverse in part, the Initial Decision. Accordingly, the Commission enters the following order.

I. DEFINITIONS

It is ordered, That for purposes of this order, the following definitions shall apply:

A. "*Coca-Cola*" means The Coca-Cola Company, a corporation organized under the laws of Delaware, with its headquarters located at One Coca-Cola Plaza, N.W., Atlanta, Georgia, and its directors, officers, agents, employees, and representatives, and its subsidiaries, divisions, affiliates, successors, and assigns. For purposes of this order, Coca-Cola Enterprises Inc. is a subsidiary or affiliate of Coca-Cola.

B. "*Concentrate*" means the base element, flavors, or essences mixed according to a formula which, when added to carbonated water and nutritive or non-nutritive sweetener, is a carbonated soft drink.

C. "*Syrup*" means the concentrate and nutritive or non-nutritive sweetener which, when added to carbonated water, is a carbonated soft drink.

D. "*Branded concentrate*" or "*branded syrup*" means concentrate or syrup used to produce carbonated soft drinks that are identified with any nationally or regionally recognized label, name, or trademark and that, in general, are heavily advertised, widely available in the take-home and cold drink channels, and distributed by bottlers

¹²³ The translation of an HHI increase of roughly 50 points--below which the Merger Guidelines indicate we are unlikely to have competitive concerns--into 192-ounce case equivalents is accomplished as follows. Coca-Cola had a 38.5% share of an all-concentrate market. IDFF 226. Using the 38.5% figure, an HHI increase of 50 points would be generated if Coca-Cola acquired a firm with a .65% market share. (Mathematically, the change in HHI is equal to $2 \times 38.5 \times .65 = 50.05$.) The record reflects a 1988 all-concentrate market of 7,538.8 million 192-ounce case equivalents, CX 781B (*in camera*), so that a .65% market share equals roughly 50 million 192-ounce case equivalents.

that provide store-door service or services to retailers in the cold drink channel. This definition does not include a label, name, or trademark associated solely with a single grocery or restaurant retailer, or with a generic flavor.

E. "*Branded carbonated soft drink*" means a drink made by combining carbonated water with branded syrup or with nutritive sweetener or non-nutritive sweetener and branded concentrate.

II.

It is ordered, That Coca-Cola, for a period of ten (10) years from the date this order becomes final, shall not acquire, directly or indirectly, without the prior approval of the Federal Trade Commission:

A. The whole or any part of the stock, share capital or equity interest of any company or firm:

1. Engaged in the manufacture and sale in the United States of branded concentrate or branded syrup; or
2. Engaged in the franchising or licensing of any brand, name, or trademark used in the Untied States in connection with the production, marketing, or sale of branded concentrate, branded syrup, or branded carbonated soft drinks;

B. Any brand, name or trademark associated with the production, sale or distribution of branded concentrate, branded syrup, or branded carbonated soft drinks in the United States.

Provided however, that this prior approval requirement shall not apply to any acquisition by Coca-Cola of only physical assets involved in the production, sale or distribution of concentrate, syrup, or carbonated soft drinks, or from acquiring a bottler of carbonated soft drinks, so long as the bottler is not engaged in the manufacture and sale of branded concentrate or branded syrup, or in the franchising or licensing of any brand, name, or trademark of any branded carbonated soft drinks.

Provided further, that so long as Coca-Cola provides advance notification to the Federal Trade Commission as required under this proviso, the prior approval requirement contained in this Section shall not apply to any acquisition by Coca-Cola of:

(1) Any company or firm where such company or firm has sales of less than 50 million, 192-ounce case equivalents in each of the three years preceding such acquisition; or

(2) Any brand, name, or trademark acquired from any person (as that term is defined in 16 CFR 801.1 (a)(1)) where (i) the sales of soft drinks bearing such brand, name or trademark, and (ii) the sales of soft drinks bearing any other brand, name, or trademark acquired from such person during the preceding twelve-month period, total less than 50 million, 192-ounce case equivalents in each of the three years preceding the most recent acquisition.

Advance notification shall be provided to the Federal Trade Commission under this proviso when Coca-Cola's Board of Directors or any individual or entity that is authorized to act on Coca-Cola's behalf in such acquisitions, authorizes issuance of a letter of intent or enters into an agreement to make an acquisition covered by this proviso, whichever is earlier.

The notification required by this proviso shall be the Notification and Report Form set forth in the Appendix to Part 803 of Title 16 of the Code of Federal Regulations, as amended, and shall be prepared and transmitted in accordance with the requirements of that part. The notification required by this proviso shall apply to Coca-Cola and shall not apply to any party that Coca-Cola seeks to acquire. Coca-Cola shall comply with reasonable requests by the Commission staff for additional information within fifteen (15) days of service of such requests.

The notification required of Coca-Cola by this proviso shall not require additional notification by Coca-Cola to the Federal Trade Commission of any acquisition for which notification is required to be made, and has been made, pursuant to Section 7A of the Clayton Act, 15 U.S.C. 18a, or for which prior approval by the Federal Trade Commission is required, and has been requested, pursuant to Section II of this order.

III.

It is further ordered, That, for the purposes of determining or securing compliance with this order, and subject to any legally recognized privilege, upon written request and on reasonable notice

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to Coca-Cola made to its principal office, Coca-Cola shall permit any duly authorized representatives of the Federal Trade Commission:

- A. During office hours and in the presence of counsel, to have access to, inspect and copy all books, ledgers, accounts, correspondence, memoranda and other records and documents in the possession or under the control of Coca-Cola relating to any matters contained in this order; and
- B. Upon five days notice to Coca-Cola and without restraint or interference from Coca-Cola, to interview officers or employees of Coca-Cola, who may have counsel present, regarding such matters.

IV.

It is further ordered, That Coca-Cola shall notify the Federal Trade Commission at least thirty (30) days prior to any proposed change in the corporation such as dissolution, assignment or sale resulting in the emergence of a successor corporation; the creation, dissolution or sale of subsidiaries; or any other change that may affect compliance obligations arising out of this order.

Commissioner Azcuenaga and Commissioner Starek recused.