UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

FEDERAL TRADE COMMISSION Plaintiff, v. H. J. HEINZ COMPANY and MILNOT HOLDING CORPORATION, Defendants.	Civil Action No. 1:00CV01688 (JR) Judge James Robertson **PUBLIC VERSION**

MILNOT'S POST-TRIAL REPLY BRIEF

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Milnot joins and fully adopts the legal and factual arguments in Defendants' Post-Trial Reply Brief. We respectfully submit this short separate Reply to provide a clear statement of the distinct perspectives of Milnot (and its owner Madison Dearborn Capital Partners ("MDCP")) on why this Court's ruling will be crucial for Milnot, its Beech-Nut baby food business, and most importantly, as a consequence for baby food consumers. The plain fact is that there will be "substantial lessening of competition" ***only*** if this Court enjoins the transaction.

The undeniable reality is that these proceedings have publically exposed Beech-Nut's vulnerability to Gerber's pre-emptive and retaliatory practices. Moreover, any ongoing sale process inherently damages the selling company's reputation with its customers and relationships with its employees. These risks were knowingly accepted by Milnot and MDCP in agreeing to sell to Heinz. That is why Milnot and MDCP went to such lengths to satisfy themselves that Heinz would be an aggressively pro-competitive acquirer of Beech-Nut.

The conviction that Heinz will be such an owner has been confirmed by the evidence at trial. In particular, the testimony of Heinz's CEO, Bill Johnson, whose career has been successfully built on a "value-price" and innovation strategy for ***all*** of Heinz's products and who has personally committed to his Board and Wall Street to make this acquisition a success by taking substantial share away from Gerber, the "Sleeping Giant" that [1] These

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[1] DX 731, *see* facing page; Johnson Tr. 472: ("Q: Mr. Johnson, you've made references to Gerber being asleep or the sleeping Giant. Why is it in your interest to wake up the Giant? A: Well, one, I don't know if we'll wake up him up. The way his history has been, if we do wake him up, two things happen. We either wake him up and he competes with us, at which point we both drive the heck out the category, at which point we drive share against a bigger category, which is good for

Beechnut is trapped in what we call the mushy middle. At the upper end of the market you face a very strong category leader in Gerber. At the bottom you have a price leader in Heinz. This kind of pincer move threatens to reduce your distribution.

It would appear that long-term there is only room in this category for two serious brands. If Beech-Nut is to survive, you must move aggressively to establish your brand as the alternative to Gerber.

No. 2 attacks no. 1.

To become that alternative you will have to attack Gerber the way Papsi attacked Coke, Burger King attacked McDonald's and Scope attacked Listerine.

An attacker is relentless. It's an approach that is continual. Pepsi has been attacking Coke for 50 years. The purpose of these endless attacks is to encourage the market, consumers and trade, to see the category as a two horse race. This type of perception will enable you to initially increase your share at the expense of no. 3, Heinz. (Royal Crown, the no. 3 cola, has a 1.6 share.)

If two brands are to survive, it should be Gerber and Beech-Nut.

The name problem.

One reason that Gerber is a dominant, 70-share brand is the simple fact that they have the only pure name in the category.

Gerber means babies.

Beech-Nut means chewing gum.

Heinz means ketchup.

To deal with this problem, you must either change your name or find a way to attach "babies" to your name. Our recommendation is to talk about "Beech-Nut Babies" in all your communications. (Not Beech-Nut mothers.)

You should change your corporate name to the "Beech-Nut Baby Food Company". It should come down to a battle between Gerber babies and Beech-Nut babies.

The "unfocused" problem.

The next issue to deal with is how do you best attack Gerber. At present, your advertising is somewhat unfocused. You talk about high quality ingredients. You talk about no additives. You talk about "Stages".

imprints on Heinz's corporate mentality assure that growth, not collusion, is the short, long and ***all*** term strategy for Heinz vs. Gerber.[2]

1. Milnot's Perspective on Milnot and Beech-Nut.

The rationale for this deal began in 1990, long before any thought was given to this transaction. Beech-Nut and its advisors recognized then that "long-term there [would] only [be] room in this category for two serious brands." DX 400 (*see* next facing page). Beech-Nut attempted to be that second brand by aggressively attacking Gerber, "the way Pepsi attacked Coke, Burger King attacked McDonald's, and Scope attacked Listerine." *Id.* At that time, Beech-Nut recognized that "[a]n attacker is relentless," that it is "an approach that is continual" and that the "purpose [would be] to encourage the market, consumers and trade, to see the category as a ***two horse race***."[3]

Unfortunately, after 10 years of different strategies, Beech-Nut has failed to become the second serious brand. The market is still "dominated" by Gerber, the "unquestioned ruler" of the baby food aisle. DX 727 (Novartis' current web-site); DX 707 (Forbes Magazine, 1992). In the process, Beech-Nut's profits have plummeted, forcing a change in management that "abandon[ed]"

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everyone. He stimulates, we stimulate innovation. The second thing is he doesn't compete very well, and I shoot to a much higher share, which is not all bad either."); Defendants' Findings of Fact ("DFF") ¶ 16.

[2] Dr. Hilke agreed that the "chairman's views on what are the profit-maximizing incentives for the corporation ... will have a material effect on what the corporation does." DX 1308 (Hilke Dep. Tr. 534).

[3] *Id.* Gerber has acknowledged that "it is hardly a ***three-horse race***." DX 710. Dr. Hilke similarly acknowledged that Gerber viewed the market "currently [as] a ***one-horse race***." Hilke Tr. 335. (All emphasis in this Reply added)

Beech-Nut's role as "innovator" and implemented a broad retrenchment plan based on being "a quick follower to Gerber" and "defending the fort" as a regional, niche player in existing "core" markets. PX 34 (Beech-Nut Integration/Turnaround Plan, written in the summer of 1998).[4]

Today, Beech-Nut is a firm that is unable to ***sustain*** any share or sales gains from Gerber. Meader Tr. 859, 863; PX 34; DX 473 (occasional share gains have been quickly erased, and Beech-Nut has never been able to maintain greater than a 15 percent share of the prepared baby food market). Beech-Nut is a weak and declining regional brand, with declining presence on grocery store shelves, despite retailer consolidation.[5] Beech-Nut's sales volume during this time also declined faster than the overall baby food category.[6]

As one would expect from a weakened, regional player in a market dominated by a national 70+ share player, Beech-Nut does not exert any significant constraining force on market prices. Baker Tr. 968-69, 988, 991 (Beech-Nut cannot lower prices to constrain Gerber's prices because "Beech-Nut has high production costs for making baby food[,]" and its "low ACV" makes

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[4] *Cf. United States v. General Dynamics Corp.*, 415 U.S. 486, 501 (1974) ("Evidence of past production does ***not***, as a matter of logic, necessarily give a proper picture of a company's future ability to compete.")

[5] Beech-Nut's ACV fell more than 10% between December 1998 and December 1999. PX 11-4555. Its current ACV stands at just ***45%***. *See* DX 444-2226. Beech-Nut still sells baby food primarily in Albany and Buffalo, NY; Miami, FL; Hartford, CT; Syracuse, NY; New Jersey; Richmond, VA; Cincinnati, OH; South Carolina; Tampa, FL; Southern California; Harrisburg, PA; and Northern New England. *See* DX 435-0032; DX 129; DX 612.

[6] *See* Meader Tr. 832; DX 444-2180. In fiscal year 1996, close to 14 million cases of Beech-Nut baby food were sold in the continental U.S.; in fiscal year 2000 fewer than 12 million were sold in the continental U.S., and fewer cases are projected to be sold in 2001, and still fewer in 2002. DX 1098; DX 427-2032; DX 463.

it difficult to expand sales enough to justify a lower price; "Beech-Nut is not constraining Heinz pricing at retail."); DX 402 (Beech-Nut is ; DFF ¶ 464.[7] As "the leading antitrust treatise" – according to the FTC (Post-Trial Br. 21) – explains, "[m]arginally profitable small firms, living at the ***sufferance*** of more efficient large rivals, exert only a modest downward pressure on prices." Areeda & Hovenkamp, *Antitrust Law*, Vol. IV, at ¶ 927.

In *FTC v. Proctor & Gamble Co.*, 386 U.S. 568 (1967), the Supreme Court blocked P&G's acquisition of Clorox because it would create a "dominant" firm, like Gerber.[8] The Court explained that such a firm can "discourage active competition from the firms already in the industry due to fear of retaliation by Proctor," the dominant firm. *Id.*[9]

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[7] Significantly, Mr. Meader testified that "[m]ost of the competition with Heinz takes place in the form of fixed spending. It does not reduce list price or net price. In fact, often times in order to fund higher levels of fixed spending, we automatically decrease variable spending and the net price to retailers goes up." Meader Tr. 867; *see also* DX 718 on facing page (internal Gerber report that); DFF ¶ 255 (*citing* DX 132 and Baker Tr. 977-79) ("prices for Heinz are actually higher after bidding competition than in retail markets where there was no bidding; [thus,] "'there is no evidence that bidding competition lowers the price of baby food at retail.'").

[8] As retailers themselves explain, Gerber – like Proctor & Gamble – is dominant and controls the market. DX 56 at ¶ 7 (Cashen Decl.) ("Gerber is powerful in baby food in the way that Proctor & Gamble is powerful in the detergent market."); *see also* Meader Dep. 27 (DX 624) ("Gerber is kind of like Proctor and Gamble in a way where they have got such brand power that they can impose their brand on a retailer.")

[9] The government's position has consistently been that structural remedies are the best remedy for monopolistic pricing and practices. *See United States v. Microsoft Corp.*, 97 F. Supp.2d 59 (D.D.C. 2000) (adopting the government's "proposed final judgment . . . that would mandate both conduct modification and structural reorganization [into ***two*** separate organizations], and noting that well-established Supreme Court precedents dating from the beginning of the last century [establish] that a mandated divestiture was a possibility, if not a probability). This merger achieves that same result – turning an anticompetitive monopoly into a "major league" competitive "two horse race" –

Given the effectiveness of Gerber's efforts, it is understandable that Gerber opposes this transaction, viewing the as the DX 703-0182 (*see* next facing page). But the is bad for Milnot, bad for retailers, and worse for consumers as best evidenced by Gerber's history of *supra*-competitive prices. DX 128.[10]

The FTC argues that, even if Beech-Nut cannot effectively compete against Gerber, it still has options other than a sale to Heinz, including: private label, plant modernization, an alternative buyer, a joint venture with Heinz, or a management or employee leveraged buyout. FTC Post-Trial Br. 29-30, 39-40, 43. None of these is a viable option.

- **Private Label.** Beech-Nut has "never seriously considered private label baby food," has not been asked to make private label jarred baby food by retailers or consumers, and does not "have any plans" to do so. Meader Tr. 872.[11] The FTC's only evidence

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and is the only realistic possibility for ensuring active and effective competition in the baby food market.

[10] Retailers are "interested in [baby food] category growth." Dean Dep. Tr. 20. But "[b]aby food has been a stagnant category" for years. DX 30 at ¶ 4 (Holmes Decl.); *see also* DX 56 at ¶ 10 (Cashen Decl.) ("Baby food has been a flat category."). "Gerber has not used its [dominant] position to advance the baby food category." DX 29 at ¶ 3 (Gatta Decl.) "Gerber [–]the price leader [–] generally has the highest prices and is the first to raise its prices in the baby food market." (DX 62 at ¶ 4 (Young Decl.) And, "Gerber has not been an innovative supplier." DX 30 at ¶ 7 (Holmes Decl.) "The fact that the category has been down . . . 14 percent over the last 10 years reflects . . . the fact that the customer is not getting what they want in the category . . . ." Davidson Tr. 838. Thus, "competition and innovation in the baby food category will benefit retailers . . . and . . . consumers." DX 30 at ¶ 8 (Holmes Decl.).

[11] Making private label baby food "is just not practical for Beech-Nut. Private label would require a lot of small runs, small quantities of highly seasonal items. It would be very expensive to

is Dr. Hilke's testimony, and an ambiguous ***Heinz*** document.[12] The FTC cited no ***Beech-Nut*** document or witness to show that Beech-Nut would market private-label baby food.[13]

- **Plant Modernization.** Beech-Nut has no plans to modernize its plant, and could not cost-justify any meaningful improvement. Meader Tr. 890 ("[W]e will always be higher cost. We couldn't afford 10 million for a hydrostatic sterilizer even if our building would allow it."); DX 641 at ¶ 73; DX 159 (Canajoharie Plant Video); DX 641-0011.

- **Alternative Buyer.** Despite an intense three-month effort by Chase to sell Milnot, any price. Dr. Hilke's post-trial, written testimony in PX 821 (for which there was no *opportunity* for cross-examination, as it arrived on Friday, September 15th), asserts that Chase's search for an alternative buyer was ' That "opinion" is unsubstantiated

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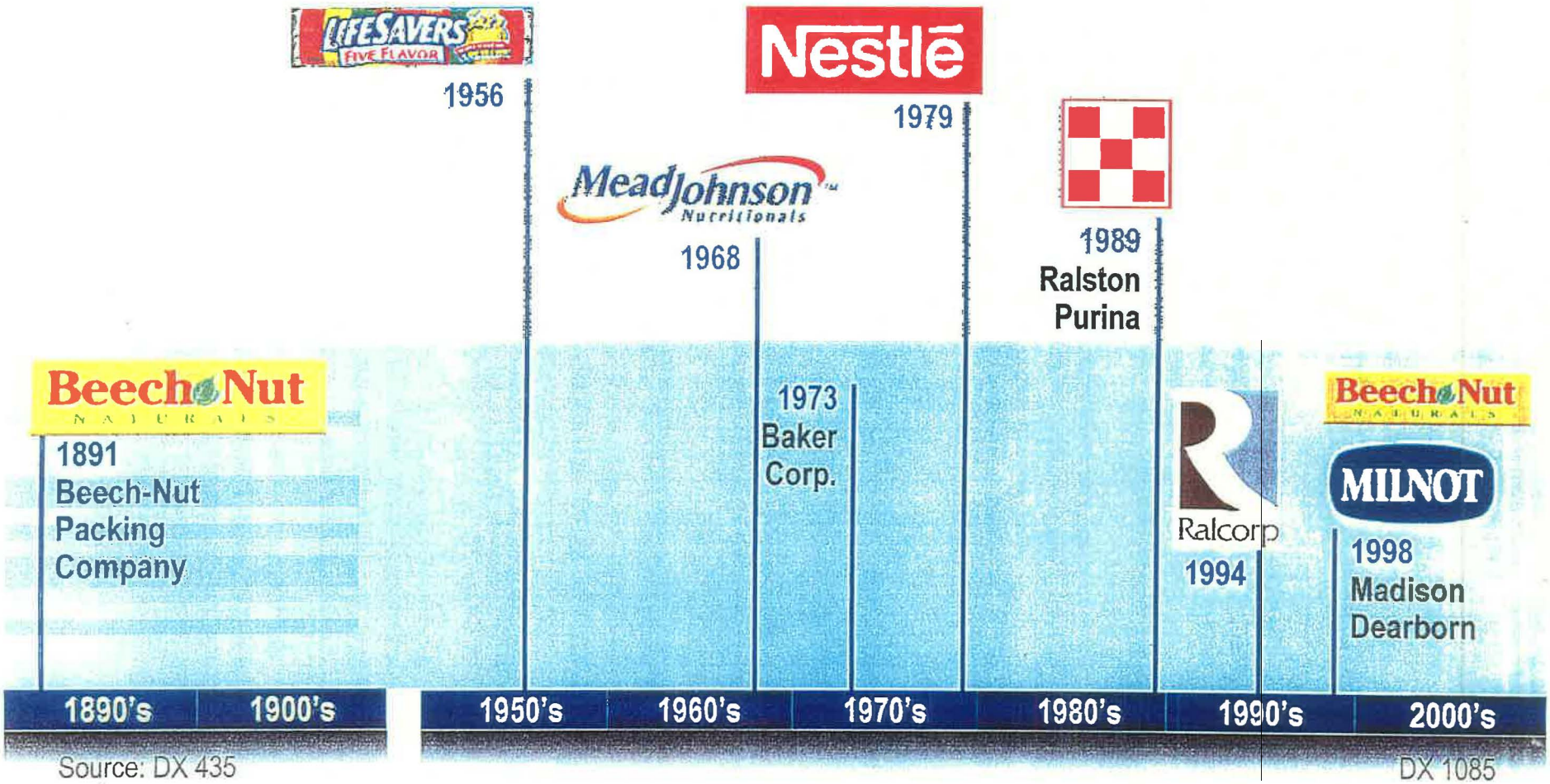
manufacture. In fact, Beech-Nut is least in a position to do private label because [Beech-Nut has] the highest cost structure in the industry." Meader Tr. 872-73; PX 356 (noting that a Beech-Nut produced private label

[12] *See* PX 189. PX 189 speculates that
Id. at 378. It is not true that Beech-Nut seriously considered entering the private label business. Heinz's internal speculation undertakes no analysis of the cost-benefits of private label, nor does it attempt to develop a business case for the prospect. This stands in stark contrast to Gerber's investigation and careful consideration of Heinz/Beech-Nut's profit maximizing strategies.

[13] *See State of New York v. Kraft General Foods, Inc.*, 926 F. Supp. 321, 365 (S.D.N.Y. 1995) (rejecting argument that acquired brand would have, but for the merger, entered into private label because the firm rationally "chose not to undercut its own brand by producing product for private label distribution").

Beech-Nut an "Orphan" Brand

Struggled Under 8 Different Owners



Source: DX 435

DX 1085

by facts or expertise and is wrong.[14]

. Moreover, Beech-Nut has been bought and sold 7 times in the past 27 years. DX 1085 (*see* facing page).

Kelly Tr. 809; DX 1088 (*see* next facing page).

- **Joint Venture.** The FTC speculates that Heinz could co-pack jarred baby food for Beech-Nut by forming a joint venture. But such an arrangement "wouldn't make any sense." Meader Tr. 873. "If [Beech-Nut] were to enter that kind of an agreement with Heinz, [it] would . . . shut down [the] Canajoharie plant, which would be permanent and irreversible." *Id.* At the end of the agreement, Beech-Nut "would have to renegotiate that agreement with Heinz," but would have "no leverage," making the whole concept of a joint venture undesirable for Milnot. *Id.*

- **Management Buy-Out.** The FTC argues that defendants did not consider a management or employee buy-out. But a management buy-out would not solve Beech-Nut's fundamental business problems of no national scale and high-cost production. In any event, the FTC never asked any Beech-Nut employee if increasing his or her ownership stake was feasible or desirable, and there is no evidence it would be. It is not.

2. Milnot's Perspective on Gerber.

Milnot has first-hand experienced with Gerber's admitted dominance. DX 727 (Novartis web-site). And Gerber recognizes that its dominance is unique in that

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[14] Dr. Hilke misread DX 7 when he wrote that

The two events were not linked.

Kelly Tr. 806-07.

DX 731 (*see* page facing page 3, *supra*.).[15]

Gerber's monopoly power is evidenced by its supra-competitive and rising prices. DX 128 (demonstrating that Gerber raises its prices far faster than inflation); DX 62 (Young Decl.) ("Gerber is the price leader . . . it generally has the highest prices and is the first to raise prices in the baby food market."); DX 707 (*Forbes Magazine*: noting that Gerber earns almost 30% return on equity, which "is an impressive showing in ***any*** business.").

Gerber is able to maintain its *supra*-competitive pricing by impeding Beech-Nut's (and Heinz's) efforts to grow share. Every time Beech-Nut has tried to grow share against Gerber, it has been faced with DX 747 (*see* page facing page 6, *supra*.); *see* DX 712 (*see* next facing page) (internal Gerber document identifying markets where ; DX 723

Indeed, most of Gerber's major initiatives in the past have been designed, not to grow share, but to target competitors.[16] For example, Gerber's Tender Harvest knocked Earth's Best out of the race before Heinz could get out of the gate. Johnson Tr. 448-49. Dr. Hilke admitted that

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[15] *See also FTC v. Kaiser Aluminum & Chem. Corp.*, 652 F.2d 1324, 1340 n. 12 (7th Cir. 1981) ("unique economic circumstances" may rebut government's prima facie case).

[16] DX 707 ("When you get above" where Gerber is now, with a 72% market share, increasing that market share "becomes so costly you get no return out of it.").

Gerber's own internal documents suggest that

Hilke

Gerber has also targeted Beech-Nut's efforts to grow share. For example, in 1999 Beech-Nut "produced three terrific spot TV commercials in Spanish directed at the Hispanic market" in California. Meader Tr. 880. The cost was "about $750,000." Shortly thereafter, "Gerber launched a $4 million fully integrated Hispanic program across all media channels." It caused Beech-Nut "to pull[] [its] Hispanic spots." Beech-Nut is continuing "to lose share to Gerber" in the Hispanic market in California. *Id.* This is exactly the type of market pre-emption that Judge Learned Hand found illegal in *Alcoa*.[17]

Similarly, in 1997, when Beech-Nut published an advertisement that stated: "[w]hen it comes to removing unnecessary additives, Gerber's still a little bit behind." DX 417. Gerber began to target Beech-Nut to the point where Beech-Nut's sales dropped by fifteen to twenty percent during the next eighteen months. Meader Tr. 874-76; DX 411 at 0194-95. As Mr. Meader testified,

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[17] *See United States v. Aluminum Co. of America*, 148 F.2d 416, 430 (2d Cir. 1945) ("we can think of no more effective exclusion than progressively to embrace each new opportunity as it opened, and to face every newcomer with new capacity already geared into a great organization, having the advantage of experience, trade connections and the elite of personnel. Only in case we interpret 'exclusion' as limited to maneuvers not honestly industrial, but actuated solely by a desire to prevent competition, can such a course, indefatigably pursued, be deemed not 'exclusionary.' So to limit it would in our judgment emasculate the Act; would permit just such consolidations as it was designed to prevent.")

Beech-Nut no longer engages in this type of competition because they cannot "continue to invite [such] retaliation by Gerber. . . . That would be suicide." Meader Tr. 893.

Gerber has also locked out or substantially reduced Beech-Nut presence on grocery stores' shelves. DX 431 ("If Gerber can convince grocers to carry its organic line . . ., it can claim greater shelf space. . . . Less room for competitors. As [its] line expands, [Gerber has] an even greater capability to push competitors out."); DX 412 (1996 internal Beech-Nut memo) (Gerber "[r]educe[d] competitors' ability to add SKUs," "[p]aid to be exclusive, [and] precluded us from getting in."); DX 413-7022 (Gerber engaged in "incessant . . . assaults on space and slots through new product introduction.").

Gerber has also obtained category captain status to prevent equal access to the shelves. *See* DX 401-7997 ("Gerber being the SCOP partner [*i.e.*, category captain] is attempting to eliminate us as the second brand [a]nd become exclusive."); DX 440 ("Beech-Nut has reduced on-shelf item count . . . vs Gerber . . . . Because of this, Beech-Nut has reduced on-shelf exposure/visability, thus forcing consumers to go to the competition.").

Finally, Gerber has targeted Beech-Nut (and Heinz) using its "under the radar" Catalina coupon program.[18] DX 406. Gerber uses its long-term contract with Catalina, which targets – at the check-out counter – Beech-Nut baby food purchasers with substantial incentives to abandon

[18] Catalina coupons are issued at grocery store check-out counters, typically on the back of cash register receipts, and give consumers savings on future purchases of specific grocery items of a type purchased by that consumer. Meader Tr. 880-81. Catalina coupons are "typically a marketing tool used by smaller brands who are trying to compete with larger brands, trying to gain trial and thereby gain share." Meader Tr. 881.

Beech-Nut. Meader Tr. 880-81; DX 726; DX 446 (describing Gerber's Catalina program as "predatory."). Since Catalina negotiates on a category/nation-wide basis, neither Heinz nor Beech-Nut can effectively compete against this tactic.[19]

This type of one-sided predatory conduct is exactly the type of activity that the Court found illegal in *United States v. Microsoft Corp.*, 87 F. Supp.2d 30, 38 (D.D.C. 2000) ("Predation involves aggression against business rivals through the use of business practices that would not be considered profit maximizing except for the expectation that . . . rivals will be chastened sufficiently to abandon competitive behavior the predator finds threatening to its realization of monopoly profits."). *See also Lepage's Inc. v. 3M*, 1999 WL 346223, 1999-1 Trade Cases ¶ 72,538 (E.D.Pa. May 14, 1999) ("3M set out to protect the dominance in the market of Scotch tape by crippling its competitors and limiting the ability of consumers to buy tape other than Scotch tape. It did this in three ways: (1) by creating 'bundled rebate' programs which discouraged competition on the merits; (2) by offering its customers direct financial incentives for exclusivity; and (3) by stifling the growth of private label and second tier brand sales of transparent tape."); *In re McCormick & Co.*, 2000 WL 521741 (F.T.C. April 27, 2000) (noting that McCormick has "superior brand recognition," which meant that "supermarkets [. . . had . . .] relatively few alternative sources for equivalent products." McCormick used this dominance to negotiate agreements that required "the customer allocate [to McCormick] the large majority of the [shelf] space devoted to spice products." As a majority of the

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[19] Notably, Gerber recognizes that this merger will
DX 703 (*see* facing page)

FTC commissioners stated, this resulted in McCormick taking "Burns-Philp [the only other major competitor] out of the picture as an aggressive competitor.").

3. Milnot's Perspective on Heinz.

Milnot sees Heinz as a regional brand, also with a declining or stagnant business that is victimized by Gerber. Meader Tr. 862; *see also* PX 451 (internal Beech-Nut document recognizing that . Additionally, Milnot recognizes that Gerber has targeted and victimized Heinz in essentially the same ways as Gerber has victimized Beech-Nut. DX 439 (Internal Beech-Nut document noting that Earth's Best is "getting killed on shelf space." and that " Gerber [has been] dealing to get EB to go away," after which it "will seek shelf space."). Moreover, the two brands are largely complimentary, not competitive. Beech-Nut has a brand, Heinz has low-cost production. Beech-Nut has quality recipes, Heinz has a $9 billion organization that sells products in virtually every grocery store in the country. In addition, Heinz's baby food business is regional, and generally non-overlapping with Beech-Nut's business.[20] Meader Tr. 862 ("Beech-Nut and Heinz are sold in almost mutually exclusive geographies.").

[20] Even in the rare markets where both Heinz and Beech-Nut have a presence, Beech-Nut still views its competition as Gerber not Heinz because Heinz and Beech-Nut do not appear on the same store shelf. Meader Tr. 815. Beech-Nut and Heinz "appeal to completely different consumers." *Id.* "Beech-Nut is a premium brand along with Gerber," and it appeals to the quality conscious consumer. *Id.* Whereas Heinz is the value-priced brand appealing to cost-conscious consumers.

Merging Complementary Strengths

		Beech-Nut Naturals	Heinz	Beech-Nut Nature's Goodness by Heinz
Strong Brand Equity	✓	✓		✓
Low Cost Plant	✓		✓	✓
Strong Financial Backing	✓		✓	✓
Premium Recipes	✓	✓		✓
Stable Ownership	✓		✓	✓
Ability to Innovate	✓		✓	✓
National Distribution Network	✓		✓	✓
National Critical Mass	✓			✓

Source: DX 419

4. Milnot's Perspectives on the Deal

This transaction is the last chance – at least for the foreseeable future – to create meaningful competition in the baby food category. This deal will allow Beech-Nut baby food to be sold in a way that it cannot be sold today, and has not been sold before. This merger combines two complementary businesses to make a substantially stronger and more effective competitor to Gerber. DX 1087 (*see* facing page).

5. Milnot's Perspective on the Law.

The FTC argues – and this Court has questioned – whether "classic antitrust" suggests that Heinz and Beech-Nut are "going to want to expand market share . . . up to a point, and then they'll find a nice equilibrium and they'll all get along together." Court Tr. at 1014. But classic antitrust does not suggest anything of the kind when the pre-merger market is controlled by a monopolist, like Gerber. As a "leading antitrust treatise explains," "efficiency-creating mergers [among weaker rivals] would create additional firms capable of lowering price and expanding out profitably and thus increase the likelihood of ***departures*** from oligopoly pricing." Areeda & Hovenkamp, *Antitrust Law*, Vol. IV, ¶ 927. As Dr. Hilke admitted, "a duopoly is a more pro-competitive market [structure] than a monopoly." Hilke Tr. at 1185.[21]

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[21] As George Stigler, noted economist and Nobel Laureate, explains, even in a well-functioning oligopoly, the low-cost producer will, unless it has the highest share, be a maverick and have incentives to grow. THE THEORY OF PRICE, p. 230 (1987); *1992 Merger Guidelines*, § 2.12 ("coordinated interaction can be effectively prevented or limited by maverick firms – firms that have a greater economic incentive to deviate from the terms of coordination than do most of their rivals."). That is because if the lower cost firm (Heinz/Beech-Nut) does not have the largest market share, "profits of the [oligopoly] are not being maximized at any price." *Id.* As a result, it is extremely

For this reason, the courts often permit or recognize the pro-competitive potential of mergers that, like this one, create to a dominant firm, like Gerber:[22]

- *State of New York v. Kraft General Foods, Inc.*, 926 F. Supp. 321, 351 (S.D.N.Y. 1995) (permitting merger where "retailers. . . indicated that the acquisition [of Nabisco's cereal business was] likely to strengthen, not weaken, competition . . . because it makes Post a stronger competitor to Kellogg and General Mills, more able to challenge them effectively");

- *United States v. Country Lake Foods, Inc.*, 754 F. Supp. 669, 680 (D. Minn. 1990) (finding that evidence that merger would allow the acquiring firm "to compete directly with the market leader" relevant "as further evidence that the proposed acquisition will enhance competition");

- *Kaiser Aluminum & Chem. Corp. v. FTC*, 652 F.2d 1324, 1341 (7th Cir. 1981) ("Among the factors to be considered might be . . . the continuation of active price

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unlikely, given Gerber's 70+% share, that any "cozy collusive" arrangement could be reached, enforced, or maintained. *1992 Merger Guidelines*, § 2.1 ("Successful coordinated interaction entails reaching terms of coordination . . . and an ability to detect and punish deviations that would undermine the coordinated interaction.")

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competition. In some cases unique economic circumstances might make other factors significant," such as "the merger of two small firms to survive competitively in a market, or the demand of a market for large producers");

- *United States v. M.P.M., Inc.*, 397 F. Supp. 78, 93 (D. Colo. 1975) (merger of two of four largest competitors with combined market share over 30% "motivated by a desire to improve the companies' competitive position" and which resulted in "combination [to offer service that] was superior to that offered by either of the previously independent companies alone");

- *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 370-71 (1963) ("two small firms" may merge "to compete more successfully with the leading firms in that market");

- *Brown Shoe Co. v. United States*, 370 U.S. 294, 319 (1962) (the Clayton Act was not designed to "impede . . . a merger between two small companies to enable the[m] . . . ***to compete more effectively*** with larger corporations ***dominating*** the relevant market").

The FTC has no answer except the assertion that all so-called "three-to-two" mergers are "presum[ed]" to violate Section 7 *per se* unless the "evidence clearly show[s] that the merger [will] not likely have . . . anticompetitive effects." FTC Post-Trial Br. at 1.[23] But this is incorrect.

First, the D.C. Circuit expressly rejected a "clear evidence" standard and the burden-of-persuasion switching approach. *United States v. Baker Hughes*, 908 F.2d 981 (D.C. Cir. 1990). There now-Justice Thomas explained that "[t]o allow the government virtually to rest its case [after 'presenting market concentration statistics'], leaving the defendant to prove the core of the dispute, would grossly inflate the role of statistics in actions brought under Section 7." *Id.* at 992. Thus, the

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[23] The standard now urged by the FTC is based on a ***1962*** Supreme Court case, *Philadelphia National Bank*, which later Supreme Court cases cut back sharply. *See* Defendants' Post-Trial Brief at 7 & n. 8.

court concluded that "the ultimate burden of persuasion . . . remains with the government at all times." *Id.* at 983; *see also Kaiser Aluminum & Chem. Corp.*, 652 F.2d at 1340 ("The government continues to bear the burden of persuasion even after it has made out a prima facie case through statistical evidence.")

With regard to the "clear evidence" standard, the D.C. Circuit was "loath to depart from settled principles and impose such a heavy burden." *Baker Hughes*, 908 F.2d at 991. To do so, would "essentially [force a defendant to] persuade the trier of fact on the ultimate issue in the case." Imposing such a "heavy burden of production on a defendant would be particularly anomalous," since "[r]equiring a 'clear showing' . . . would move far toward forcing a defendant to rebut a probability with a certainty." *Id.* at 992. For this reason, the D.C. Circuit held that it was sufficient for defendants to "***produc[e]*** evidence" that shows that concentration statistics "inaccurately predict[s] the relevant transaction's probable effect on ***future*** competition." *Id.* at 991.

Second, the absence of ***any*** precedent directly on point (*i.e.,* a merger between two "wanna-bees," where the market is controlled by a "dominant" firm, which Gerber itself admits is the case here, DX 727), is attributable to the ***uniqueness*** of this market. As the FTC's own declarants – *e.g.*, Mr. DiCesare of Wegman's – confirmed, Gerber is "as close as it comes" in terms of "manufacturers that are dominate in their categories." DiCesare Dep. at 81. Gerber also agrees that DX 731 (Gerber document discussing the reasons why

While no court has addressed the question whether two weak regional players can combine to combat a dominant monopolist, the FTC has cleared such transactions.[24] Moreover, grocery retailers have seen factually analogous acquisitions ***enhance*** competition. As Roger Davidson from Ahold testified in response to the Court's own questioning, the merger between American Greetings and Gibson's created a stronger competitor to Hallmark. Where "one was dominant before [and] wasn't doing so much bidding, now . . . [y]ou have two strong players bidding," which has "drive[n]" "consumer prices" "down." Davidson Tr. 852.

Other retailers have seen similar situations. DX 42 ("In the mass-marketed cookie and snack category a similar creation of effective competition resulted from Keebler's acquisition of Sunshine and President's, allowing them to compete more effectively with Nabisco (increasing promotions and programs), resulting in . . . better consumer prices."). Indeed, this Court

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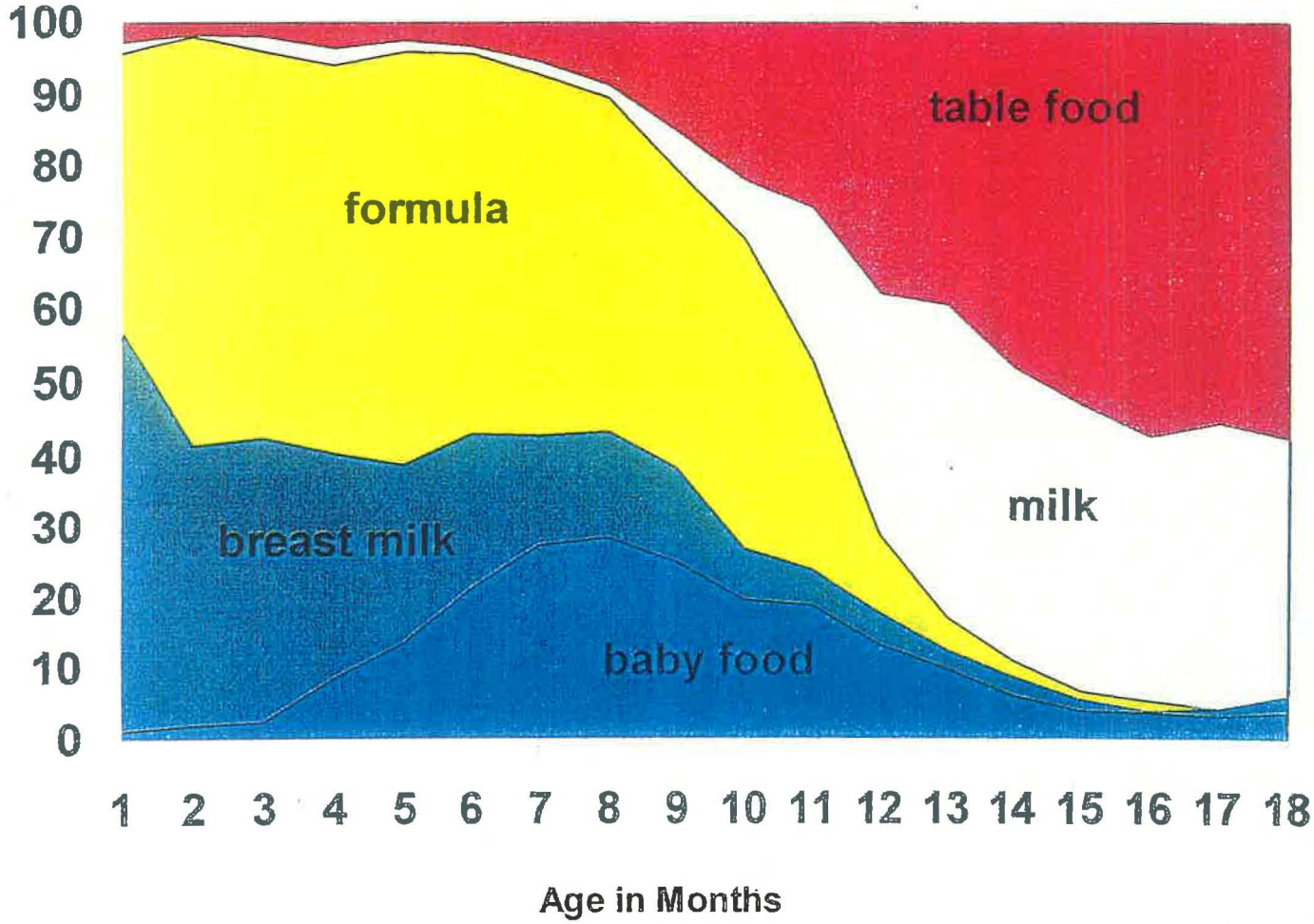
[24] Significantly, the FTC did not challenge a 4 to 2 merger. In 1995, Litton Industries, a developer and manufacturer of advanced night vision technology, acquired two competitors, Intevac Industries' Electro-Optical Sensors division and Imo Industries' night vision and laser equipment business. *See Briefly . . . Litton Indus.*, 174 Aerospace Daily 52 (June 14, 1995). Although the "FTC issued a Second Request on March 24 in Litton Systems' proposed acquisition of Imo," both deals ultimately closed. *Merger Briefs, FTC:Watch* (Mar. 27, 1995); Vago Muradian, *For the Right Price*, 195 Defense Daily 2 (Apr. 2, 1997).

Similarly, efficiencies do justify "mergers to monopoly." In 1997, American Pacific purchased Kerr-McGee's ammonium perchlorate business to become "the only ammonium perchlorate producer in the U.S." *American Pacific Buys Kerr-McGee's Ammonium Perchlorate*, 159 Chem. Week 40 (Oct. 22, 1997). "Ammonium Perchlorate is used mainly as fuel for solid rocket engines on space vehicles and weapons systems." *Id.* American Pacific's CEO justified the merger saying "this agreement will lead to greater efficiencies . . . to the solid rocket motor industry." *Kerr-McGee Ammonium Perchlorate Being Acquired by American Pacific*, Chem. Market Reporter (Oct. 20, 1997).

Share of Stomach



Source: INS Study

appropriately noted the intense competition that occurs when "Coke and Pepsi go at each other head-to-head." Court Tr. 288.[25]

The FTC argues that, notwithstanding increased competition between Heinz/Beech-Nut and Gerber post-merger – at some ***unspecified*** point – an "equilibrium" will be reached which will result in higher prices. In response, this Court asked Dr. Hilke "how far ahead do you look" in determining the competitive effects of a merger. Court. Tr. 1165.

Given the immediate and definite pro-competitive impact of the merger, the question the Court must pose – as it did – is "when [will a 'nice equilibrium' occur], ***if*** it ever happens." Court Tr. 1164-65. The FTC's failure to identify when – and if – that "nice equilibrium" will occur, quantify its effect, or explain how such a collusive equilibrium could be reached, means that the FTC

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[25] Dr. Hilke tried to explain away Coke vs. Pepsi by arguing that there are "other" soft drinks involved. But in baby food there are also "other" products involved. Coke and Pepsi compete against each other mainly because they want to steal share from each other, *not* because Dr. Pepper or 7-Up may be on the fringe. Hilke Tr. 1139. Here too, there are many alternative infant foods that compete with jarred and prepared baby food markets. Gerber sees numerous products as substitutes for jarred baby food at different stages in an infant's development, including breast milk, formula, and table food. DX 714 (*see* facing page); *see also* DX 15; DX 743; DX 1.

Dr. Hilke provided no explanation for the FTC's argument that these products do not "constrain" prices in exactly the same way that Cadbury-Schweppes, Dr. Pepper, and Seven-Up "constrain" Coke's and Pepsi's prices. Indeed, Dr. Hilke baldly asserted that "prepared baby food . . . is more convenient than breast feeding," Hilke Report at ¶ 10, based solely on his "common sense observation," ***not*** any economic analysis of what "reasonably interchangeable substitutes" influence prices or the competitive interactions of baby food producers, as required to properly define a market. *See United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377, 395 (1956) ("In considering what is the relevant market for determining the control of price and competition, no more definite rule can be declared than that commodities reasonably interchangeable by consumers for the same purposes make up that 'part of the trade or commerce'").

has failed to support its speculations with hard evidence and has failed to turn this "ephemeral possibility" into a "reasonably probable" event. *United States v. Citizens & Southern Nat'l Bank*, 422 U.S. 86 (1975) ("The Clayton Act is concerned with 'probable' effects on competition, not with 'ephemeral possibilities.'").

A collusive equilibrium can occur ***only*** if it is possible to reach an agreement and enforce that agreement through detection and punishment. *1992 Merger Guidelines*, § 2.12 ("Where detection or punishment is likely to be slow, incentives to deviate are enhanced and coordinated interaction is unlikely to be successful."). Here a collusive equilibrium is less likely to occur post-merger than pre-merger, since it becomes significantly more difficult for Gerber to punish deviations. As Gerber appropriately recognizes, the merger will allow Heinz/Beech-Nut to

and to

DX 747. Thus, the Court's question of how far into the future should it look cannot be answered because the FTC failed to establish that an anticompetitive equilibrium – unlike a fully competitive Coke/Pepsi equilibrium – will occur at any point in the future.

6. Milnot's Perspective on the Equities.

The FTC ignores altogether the "weighing of the equities" requirement of the FTC Act Section 13(b).[26] Under Section 13(b), the FTC is not entitled to a preliminary injunction unless

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[26]Section 13(b) of the FTC Act states that "[u]pon a proper showing that, ***weighing the equities*** and considering the Commission's ***likelihood of ultimate success***, such action would be in the public interest, . . . a preliminary injunction may be granted." 15 U.S.C. § 53(b).

"the harm to the parties and to the public that would flow from a preliminary injunction is outweighed by the harm to competition." *FTC v. Great Lakes Chem. Corp.*, 528 F. Supp. 84, 86 (N.D. Ill. 1981). Here, a balancing of the speculative harm against the strong public and private interests in allowing the deal to close tilts decidedly in favor of allowing the parties to close.

a. Public Equities Favor And Outweigh any Harm From An Immediate Closing.

If the Court grants the FTC's request for a preliminary injunction, there may be an appeal but there will be no administrative proceeding, because the deal will be dead. *FTC v. Exxon Corp.*, 636 F.2d 1336, 1343 (D.C. Cir. 1980) ("the issuance of a preliminary injunction blocking an acquisition or merger [will] prevent the transaction from ever being consummated."); *FTC v. Staples, Inc.*, 970 F. Supp. 1066, 1093 (D.D.C. 1997) (preliminary injunction "will most likely kill the merger").[27] Therefore, in deciding whether a preliminary injunction is in the "public interest" under the language of Section 13(b) the Court must choose between allowing the deal to close (with possible post-administrative remedies, if necessary) and no deal at all, ever. For this reason, the courts have required the FTC to meet a "heavy burden" prior to granting a merger-blocking injunction. *See F.T.C. v. Occidental Petroleum Corp.*, 1986 WL 952, 1986-1 Trade Cases P 67,071 (D.D.C. April 29, 1986) ("The Commission's burden on a preliminary injunction motion is properly a heavy one, since, as this Circuit has recognized, the granting of preliminary injunctive relief is 'an extraordinary and drastic remedy, "particularly in the merger and acquisition context.'")

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[27] As discussed in the Defendants' Reply, this case is decidedly ***not*** *Staples*.

Even if the Court were to adopt the FTC's view that all that is at issue here is "preliminary" relief, it then becomes even more difficult to argue there will be any "harm to the . . . public" during the "period between the denial of the preliminary injunction and the final adjudication of the merits" of an FTC administrative hearing. In fact, all of the evidence points to consumer ***benefit*** during this interim period, for several reasons.

- ***First***, Heinz could never as a practical matter increase prices of Heinz (or Heinz/Beech-Nut) baby food during the pendency of an administrative proceeding, because to do so would mean losing the case. *See, e.g., General Dynamics*, 415 U.S. at 505 n. 13 ("post-merger evidence showing a lessening of competition may constitute an 'incipiency' [of anticompetitive effects] on which to base a divestiture suit").

- ***Second***, a delayed closing will, by definition mean a delay in Heinz's ability to realize distribution and manufacturing efficiencies and plans for innovation, thereby depriving consumers of the clear ***pro***-competitive benefits involved.

- ***Third***, a delay in closing will also mean a continuation of the significant downward trends in Beech-Nut's ability to compete. *See, supra.* at pp. 3-6.

The other side of the public equities coin is balancing these demonstrable benefits against the "harms" likely to flow from an immediate closing. The FTC devotes three lines to this point, claiming that "because Heinz intends

making "an effective post-merger remedy after an administrative trial is likely to be futile." FTC Post-Trial Brief at 44. The FTC cites no support or even argument for why this is true. It is not.

Beech-Nut's strengths are its brand and its recipes. That is why Heinz is buying Beech-Nut. PX 149 (Heinz's purchase is .

Those strengths will still exist at the end of an administrative trial. Indeed, Beech-Nut will indisputably be strengthened, as Heinz invests in the brand and implements a national roll-out of Beech-Nut immediately post-closing. The FTC has never claimed Heinz would do otherwise (its arguments go principally to how Beech-Nut will be priced post-merger). Therefore, any divestiture required after an administrative trial would be of a much stronger, much more appealing, ***nationally*** distributed Beech-Nut. A divestiture effort at that stage would be much more likely to yield an interested buyer for the brand and the recipes than the Chase sales process with the current, weak regional Beech-Nut. And to the extent that there ***is*** demand for a third brand, as the FTC claims (FTC Post-Trial Br. at 4), then Heinz can reintroduce its Heinz brand after divestiture. Heinz will be able to do this because it will always have the Heinz name and it ***already*** sells Ketchup and many other products to almost every store in the country.

Thus, given the certainty of immediate pro-consumer benefits, and the actual better ability to achieve divestiture after the end of an administrative hearing, a preliminary injunction is clearly contrary to the public interest.

b. Private Equities Favor Immediate Closing.

In balancing theoretical harms against the benefits of this merger, the Court can, and should, take account of the substantial harms to Milnot and MDCP of denying or delaying a closing. As the D.C. Circuit has explained, "it is permissible for the court to weigh among the equities the potential benefits, public ***and*** private, that may be lost by a merger blocking preliminary injunction." *FTC v. Weyerhauser Co.*, 665 F.2d 1072, 1083 (D.C. Cir. 1981).

The harm to MDCP of delaying a closing are readily apparent.

Meader Tr. 812-13; DX 1, 435.

Respecting and facilitating this type of "ease of exit" is a recognized antitrust benefit. *See Great Lakes*, 528 F. Supp. at 98 ("[T]he proposed acquisition will encourage entry . . . by preserving reasonable opportunities to exit."); *In re Pillsbury Co.*, 93 F.T.C. 966, 1041 n.43 (1979) (Commissioner Pitofsky) ("Long-term competitive considerations require preservation of . . . ease of entry, and opportunity for businessmen to take entrepreneurial risks. The other side of that coin is a largely unarticulated policy, a clear corollary to the first, which would preserve exit opportunities.").

The harms to Milnot and the Beech-Nut brand itself from a delay in closing are also readily apparent. Under Madison Dearborn's ownership, Beech-Nut is resource-constrained. *See, e.g.*, Meader Tr. 822 ("We are not part of a $10 billion organization like Heinz or Novartis, and ***we have to manage our cash flow very carefully***."); DX 446 ("We need to be as efficient and as effective as possible with our ***limited dollars***.").[28] As discussed, Beech-Nut's business has already

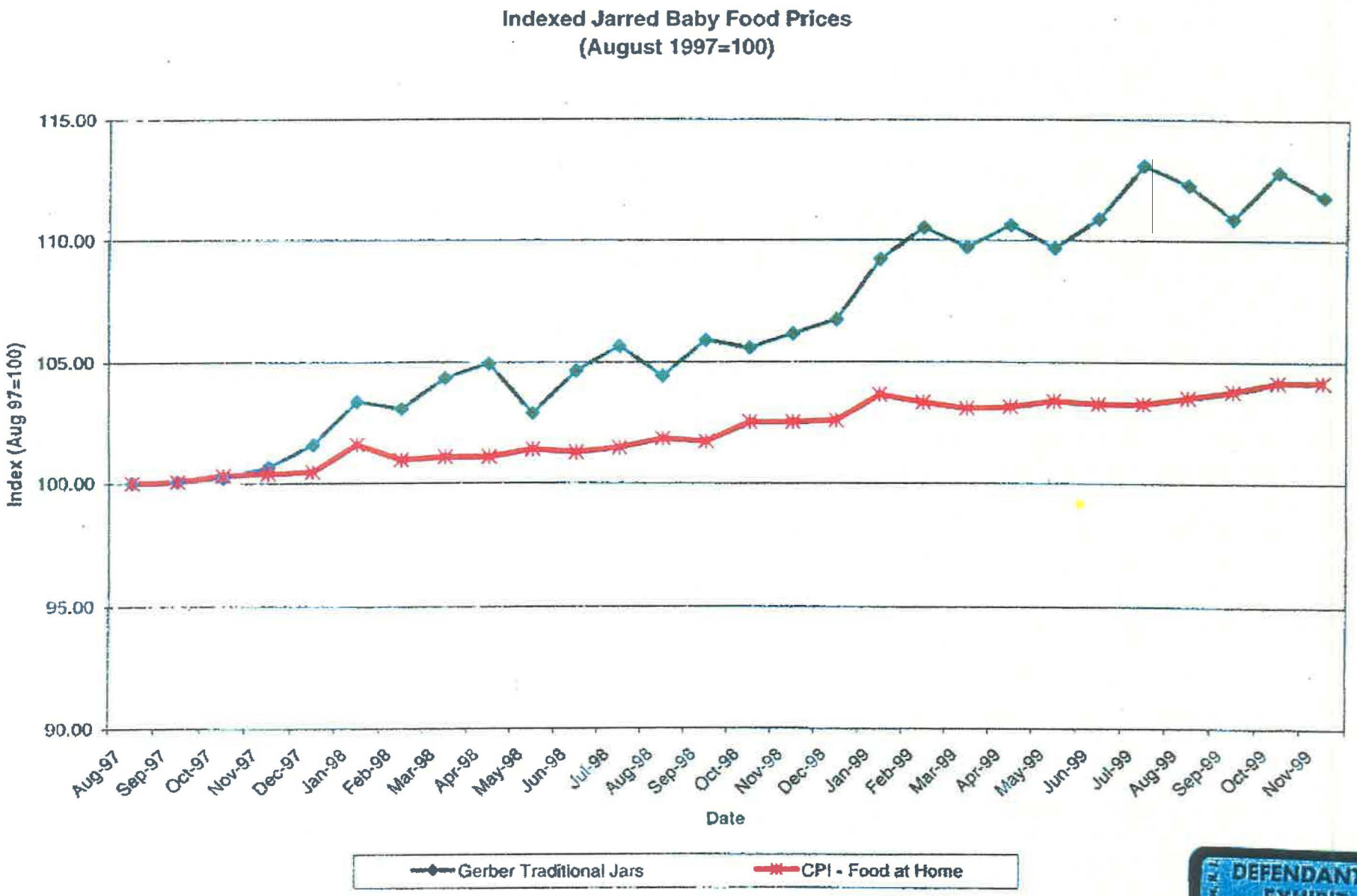
[28] *See also* DX 404 (12/17/99 Memorandum from Milnot Chief Financial Officer to senior staff:

suffered since the contract with Heinz was signed in February, 2000. Beyond questioning customers and further Gerber inroads at Beech-Nut accounts, Beech-Nut's brokers and employees face an uncertain future. *See, e.g.*, PX 568 in trade spending); PX 569

; *see also* PX 313.

Given its numerous owners over the past 110 years (DX 1085, page facing page 8, *supra*.), the presence of monopolist Gerber, and Milnot's financial constraints, it is not surprising – ***and it remains unrebutted*** – that Beech-Nut as a brand is in steady decline.

For these reasons as well, the equities weigh strongly in favor or clearance.



DEFENDANT'S EXHIBIT 128

FTC V. HEINZ

A preliminary injunction would serve only Gerber, whose dominance of the baby food market will continue to injure consumers, without Heinz ever being able to launch a frontal challenge to Gerber's supra-competitive pricing. *See* DX 128 (on facing page). But "[i]t is axiomatic that the antitrust laws were passed for 'the protection of competition, not competitors.'" *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 224 (1993) (*citing Brown Shoe Co. v. United States*, 370 U.S. 294, 320 (1962)).

Dated: September 20, 2000

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I, Colin R. Kass, hereby certify that on this 27th day of October, 2000, I caused a copy of the foregoing Public Version of Milnot's Post-Trial Reply Brief to be served via facsimile:

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