

Class 17 slides

Unit 11: Clare's/Benny's Ice Cream Merger

Merger Antitrust Law

Georgetown University Law Center

Dale Collins

Grading philosophy

■ My approach

1. I read all answers twice and blind grade them each time with a letter grade
2. If the grades for an answer differ significantly between the first and second reads, I read the answer for a third time and reconcile the differences
3. I rank order the exams by letter grade in descending order and apply the prescribed curve for the course
4. UNLESS the quality of the exams do not break significantly at a change in the grading curve, in which case I include the exam in question in the group to which it is most comparable (and fight with the Dean if required)

I do not expect anyone to spot and properly analyze all issues in the hypothetical

Suggestion: How to approaching the problem

1. Ask the setup questions
2. Read the hypothetical straight through quickly to spot the major issues
3. Read the hypothetical again more slowly
Annotate the hypothetical in the margin
Outline an answer
4. Start writing

Another suggestion:

SHOW YOUR WORK!!

Some of you simply asserted that a particular test would or would not be satisfied and got it wrong. Unless you show your work, I will have to assume that this was a conceptual error rather than an arithmetical one.

1. Ask the setup questions

1. Who are you/what role are you being asked to play?
2. What is the transaction?
3. What is the form of the work product?
4. What questions are you being asked to address?
5. What statutes(s) apply?

1. Ask the setup questions

1. Who are you/what role are you being asked to play?
 - From the hypothetical:

You are an attorney at the FTC and your group is reviewing Clare's pending acquisition of Bennie's, two manufacturers of ice cream. The acquisition is for all cash transaction and Clare's is paying a 40% premium for the Benny's stock. Melissa Brown, your section chief, has asked you to prepare a recommendation as to whether the FTC should seek a preliminary injunction blocking the transaction from a federal district court pending a resolution of an administrative trial. In particular, Ms. Brown is seeking your analysis of how strong the FTC's prima facie case of a Section 7 violation is likely to be and whether the FTC can defeat defenses the merging parties have said that they will advance. Ms. Brown also would like you to address how the court is likely to balance the equities and what the court is likely to decide on the FTC's petition to enter the preliminary injunction.

1. Ask the setup questions

2. What is the transaction?

- From the hypothetical:

You are an attorney at the FTC and your group is reviewing **Clare's pending acquisition of Bennie's, two manufacturers of ice cream. The acquisition is for all cash and Clare's is paying a 40% premium for the Benny's stock.** Melissa Brown, your section chief, has asked you to prepare a recommendation as to whether the FTC should seek a preliminary injunction blocking the transaction from a federal district court pending a resolution of an administrative trial. In particular, Ms. Brown is seeking your analysis of how strong the FTC's prima facie case of a Section 7 violation is likely to be and whether the FTC can defeat defenses the merging parties have said that they will advance. Ms. Brown also would like you to address how the court is likely to balance the equities and what the court is likely to decide on the FTC's petition to enter the preliminary injunction.

1. Ask the setup questions

3. What is the form of the work product?

- From the hypothetical:

You are an attorney at the FTC and your group is reviewing Clare's pending acquisition of Bennie's, two manufacturers of ice cream. The acquisition is for all cash transaction and Clare's is paying a 40% premium for the Benny's stock. **Melissa Brown, your section chief, has asked you to prepare a recommendation** as to whether the FTC should seek a preliminary injunction blocking the transaction from a federal district court pending a resolution of an administrative trial. In particular, Ms. Brown is seeking your analysis of how strong the FTC's prima facie case of a Section 7 violation is likely to be and whether the FTC can defeat defenses the merging parties have said that they will advance. Ms. Brown also would like you to address how the court is likely to balance the equities and what the court is likely to decide on the FTC's petition to enter the preliminary injunction.

You are being asked to write a reasoned memorandum of law with a recommendation

1. Ask the setup questions

4. What questions are you being asked to address?

- From the hypothetical:

1
2
3
4
5

You are an attorney at the FTC and your group is reviewing Clare's pending acquisition of Bennie's, two manufacturers of ice cream. The acquisition is for all cash transaction and Clare's is paying a 40% premium for the Benny's stock. Melissa Brown, your section chief, has asked you to prepare a recommendation as to **whether the FTC should seek a preliminary injunction blocking the transaction** from a federal district court pending a resolution of an administrative trial. In particular, Ms. Brown is seeking your analysis of **how strong the FTC's prima facie case of a Section 7 violation is likely to be** and **whether the FTC can defeat defenses the merging parties** have said that they will advance. Ms. Brown also would like you to address **how the court is likely to balance the equities** and **what the court is likely to decide** on the FTC's petition to enter the preliminary injunction.

- Five questions are presented
- BE SURE THAT YOU ADDRESS EACH QUESTION!!

1. Ask the setup questions

5. What law(s) apply?

- From the hypothetical:

1

You are an attorney at the FTC and your group is reviewing Clare's pending acquisition of Bennie's, two manufacturers of ice cream. The acquisition is for all cash transaction and Clare's is paying a 40% premium for the Benny's stock. Melissa Brown, your section chief, has asked you to prepare a recommendation as to whether the FTC should seek a **preliminary injunction blocking the transaction from a federal district court pending a resolution of an administrative trial**. In particular, Ms. Brown is seeking your analysis of how strong the FTC's prima facie case of a **Section 7 violation** is likely to be and whether the FTC can defeat defenses the merging parties have said that they will advance. Ms. Brown also would like you to address how the court is likely to balance the equities and what the court is likely to decide on the FTC's petition to enter the preliminary injunction.

2

- FTC Act 13(b) for the standards for entering a preliminary injunction
- Clayton Act § 7 for the elements of the substantive violation

2. Quick read to spot the issues

- The problem is likely to have multiple issues
- Some issues will be substantively more important than others
- DO NOT get hung up spending too much time on the small issues at the cost of not adequately addressing the major issues

So what do I need to spot?

Typical structure of a formal merger analysis

- Step 1: The prima facie case
 - Relevant product market
 - *Brown Shoe* “outer boundaries” and “practical indicia” for product market
 - Merger Guidelines hypothetical monopolist test
 - [Price discrimination/targeted customers markets]
 - *Cellophane* fallacy
 - Relevant geographic market
 - “Commercial realities” test
 - Merger Guidelines hypothetical monopolist test
 - [Price discrimination markets]
 - *PNB* presumption
 - Market participants and market shares
 - Application of the *PNB* presumption
 - Other evidence of anticompetitive effect
 - Unilateral effects
 - Coordinated effects
 - Elimination of a maverick
 - [Foreclosure/raising rivals’ costs]

Effectively to show gross upward pricing pressure or other anticompetitive effect

Typical structure of a formal merger analysis

- Step 2: Defendants' rebuttal
 - Direct challenges to prima facie case (no upward pressing pressure)¹
 - Traditional defenses (offsetting downward pricing pressure)
 - Entry/expansion/repositioning
 - Efficiencies
 - Countervailing buyer power ("power buyers")
 - Failing company/division
- Step 3: Balancing (if necessary)
- *A/so*, need to address standards for the entry of a Section 13(b) preliminary injunction
 - Likelihood of success on the merits (addressed about)
 - Weighing the equities/public interest

Effectively to show sufficient gross downward pricing pressure to create a genuine issue of fact on the merger's net competitive effect

Do not forget this!

¹ Often addressed in Step 1.

3. Annotate/Outline

■ Some facts to note:

- Clare's is acquiring Benny's
- There are two types of ice cream: premium and regular
 - Although prices within each segment have converged, they have varied in the past → differentiated products → look out for one-product SSNIP tests/unilateral effects
- The merger is horizontal in premium ice cream; no overlap in regular
- Premium ice cream is dominated by two firms: Al's and Benny's
- Two dimensions of competition: Price and innovation
- Al's has been a price leader
 - Clare's has been a maverick in prices and innovation in premium
 - Everyone else a follower
- Postmerger, Clare's will consolidate its premium brand into Benny's → eliminates differentiation
- AND become tied with Al's as the No. 1 premium ice cream manufacturer (45% share)
- High cross-elasticity of demand within each of premium and regular
- Significant product and price differentiation between premium and regular
- Significant technological supply-side substitutability between premium and regular
 - BUT high reputational barriers
- Insignificant amount of store brands (which may be local)
- Little growth in market shares by small premium companies (including Dino's)
- No (recent) entry into premium by regular ice producers
- All cost savings are in fixed costs

3. Annotate/Outline

- Note some numbers:

The industry recognizes two types of ice cream: premium ice cream and regular ice cream. Premium ice cream has more butterfat content, less overrun (that is, less air, which makes it more creamy), and more calories than regular ice cream. Premium and regular ice cream are made on the same machines. Switching is gallon-for-gallon and involves negligible switching costs. The marginal costs of producing premium and regular ice cream, however, differ because of the difference in the cost of ingredients. The marginal cost of producing premium ice cream is \$2.80 per gallon, while the cost of producing regular ice cream is \$2.40 per gallon. Marginal costs, which are constant, have not changed in recent years and are not expected to change in the future.

$$\begin{aligned} MC_P &= \$2.80 \\ MC_R &= \$2.40 \end{aligned}$$

While prices can and have varied among brands with in both premium and regular ice cream, actual prices charged by manufacturers during the investigation have converged—with no sign of collusion—throughout the country to \$4.00 per gallon for premium ice cream and \$3.00 per gallon for regular ice cream. The following chart give sales for ice cream manufacturers:

$$\begin{aligned} P_P &= \$4.00 \\ P_R &= \$3.00 \end{aligned}$$

$$\$M_P = \$1.20$$

$$\$M_R = \$0.60$$

$$\%M_P = \frac{1.20}{4.00} = 30\%$$

$$\%M_R = \frac{0.60}{3.00} = 20\%$$

October 18, 2020

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3. Annotate/Outline

- Note some numbers:

There are high cross-elasticities of demand between brands within each of the two ice cream segments and low cross-elasticities between individual products in different segments. So, for example, if a premium ice cream manufacturer were to increase its price while the other premium ice cream manufacturers held their prices constant, the higher-priced manufacturer would lose a significant amount of volume to its premium brand rivals and little, if any volume to regular ice cream. The same is true for regular ice cream brands.

$$R_i = 100\%$$

For a 5% uniform increase in the price across all brands of premium ice cream, however, each premium brand would lose 16% of its unit sales to regular ice cream and none to other brands of premium ice cream or non-ice cream products. For a 5% uniform increase in the price of all brands of regular ice cream, each regular brand would lose 7.5% of its unit sales to premium ice cream and none to other brands of regular ice cream or non-ice cream products. When the price of all brands of ice cream (premium and regular) is increased by 5%, there would be no switching between premium and regular brands of ice cream, but each brand of premium ice cream would lose 3% of its unit sales to non-ice cream alternatives, while each brand of regular ice cream would lose 5% of its unit sales to non-ice cream alternatives.

~~Cross-Sales~~
 $L_P = 16\%$
TO REG

$$L_R = 7.5\%$$

TO PREM.

$L_{ALL}:$
 $L_P = 3\%$
 $L_R = 5\%$

Clare's (the buyer) is the largest manufacturer of regular ice cream and the third largest manufacturer of premium ice cream. Benny's (the target) is the second largest manufacturer of premium ice cream but manufactures no regular ice cream. In its meeting the staff, Clare's made the following arguments in defense of the transaction:

4. Write

- Be organized:

Exam instructions:

Present your analysis in a well-organized, linear, and concise manner. Think about your answers before writing. *Remember Pascal's apology:* "I am sorry that this was such a long letter, but I did not have the time to write you a short one." Clarity of thinking and exposition are much more important than throwing in the kitchen sink. Penalties will be levied for excessive length, verbosity, or lack of organization.

- Prepare in advance

Exam instructions:

As we discussed in class, you may cut and paste short passages from materials you have created to introduce a rule of law, a legal principle, or an economic proposition or formula. You may include quotes from cases in the materials you create for this purpose, but if you do so prepare the quote and cite the case as you would in a brief. Do NOT cut and paste from any other materials.

4. Write: Introduction

- Opening paragraph to a memorandum: “You have asked me”

To: Melissa Brown

From: Dale Collins

Clare’s/Benny’s Ice Cream Merger

You have asked me to assess whether the FTC should be able to obtain a preliminary injunction blocking the pending acquisition by Clare’s of Benny’s, two manufacturers of ice cream, from a federal district court pending a resolution of an FTC challenge in an administrative trial. In particular, you have asked me to assess how strong the FTC’s prima facie case of a Section 7 violation is likely to be and whether the FTC can defeat defenses the merging parties have said that they will advance. You have also asked me to address how the court is likely balance the balance the equities and what the court is likely to decide on the petition to enter the FTC’s preliminary injunction.

You should be able to copy most of this from the exam pdf

4. Write: Introduction

- Short conclusion
 - Succinctly answer the questions asked
 - You can write this last—but if you did a good outline you can do a first draft it now
 - Helpful to you and to me
 - Ensures that you answer all of the questions asked
 - Gives me a roadmap as to how to approach your answer

4. Write: Introduction

- Short conclusion—Instructor's answer

1

For the reasons explained below, the Commission should prevail in its petition for a preliminary injunction under Section 13(b) of the FTC Act blocking Clare's acquisition of Benny's pending the conclusion of the administrative adjudication of the merits of the Commission's Section 7 claim against the transaction. On the facts found in the investigation, the Commission has a strong likelihood of becoming able to prove to the district court that Clare's proposed acquisition of Benny's would violate Section 7 in the nationwide manufacture and sale of premium ice cream and separately in the nationwide manufacture and sale of all ice cream. The *PNB* presumption is easily satisfied in premium ice cream, and although more borderline in all ice cream, there is additional evidence of consumer harm under resulting from both anticompetitive unilateral and coordinated effects. Consumers are likely to be harmed by both an increase in prices and a reduction in the rate of product innovation as a result of the merger. The various defenses advanced by the parties are either speculative (not verifiable), contradicted by the facts, or fail to show they are sufficient to negate the upward pricing pressures and the reduced incentives to innovate that the merger is likely to create. The equities, especially the public's interest in effective antitrust enforcement and effective relief, weigh heavily in favor of entering a preliminary injunction. The equities weighing against the entry of the injunction are at most only the delay in the receipt of the private monetary benefits of the merger to the merging parties and their shareholders and these benefits will never materialize if the merger is found to be unlawful on the merits. The court should find that the entry of a preliminary injunction is in the public interest.

4. Write: Introduction

- Short conclusion—Instructor's answer

2

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4. Write: Introduction

- Short conclusion—Instructor's answer

3

For the reasons explained below, the Commission should prevail in its petition for a preliminary injunction under Section 13(b) of the FTC Act blocking Clare's acquisition of Benny's pending the conclusion of the administrative adjudication of the merits of the Commission's Section 7 claim against the transaction. On the facts found in the investigation, the Commission has a strong likelihood of becoming able to prove to the district court that Clare's proposed acquisition of Benny's would violate Section 7 in the nationwide manufacture and sale of premium ice cream and separately in the nationwide manufacture and sale of all ice cream. **The PNB presumption is easily satisfied in premium ice cream, and although more borderline in all ice cream, there is additional evidence of consumer harm under resulting from both anticompetitive unilateral and coordinated effects. Consumers are likely to be harmed by both an increase in prices and a reduction in the rate of product innovation as a result of the merger in both markets.** The various defenses advanced by the parties are either speculative (not verifiable), contradicted by the facts, or fail to show they are sufficient to negate the upward pricing pressures and the reduced incentives to innovate that the merger is likely to create. The equities, especially the public's interest in effective antitrust enforcement and effective relief, weigh heavily in favor of entering a preliminary injunction. The equities weighing against the entry of the injunction are at most only the delay in the receipt of the private monetary benefits of the merger to the merging parties and their shareholders and these benefits will never materialize if the merger is found to be unlawful on the merits. The court should find that the entry of a preliminary injunction is in the public interest.

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- Short conclusion—Instructor's answer

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4

4. Write: Introduction

- Short conclusion—Instructor's answer

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5

4. Write: Introduction

- Short conclusion—Instructor's answer

For the reasons explained below, the Commission should prevail in its petition for a preliminary injunction under Section 13(b) of the FTC Act blocking Clare's acquisition of Benny's pending the conclusion of the administrative adjudication of the merits of the Commission's Section 7 claim against the transaction. On the facts found in the investigation, the Commission has a strong likelihood of becoming able to prove to the district court that Clare's proposed acquisition of Benny's would violate Section 7 in the nationwide manufacture and sale of premium ice cream and separately in the nationwide manufacture and sale of all ice cream. The *PNB* presumption is easily satisfied in premium ice cream, and although more borderline in all ice cream, there is additional evidence of consumer harm under resulting from both anticompetitive unilateral and coordinated effects. Consumers are likely to be harmed by both an increase in prices and a reduction in the rate of product innovation as a result of the merger. The various defenses advanced by the parties are either speculative (not verifiable), contradicted by the facts, or fail to show they are sufficient to negate the upward pricing pressures and the reduced incentives to innovate that the merger is likely to create. The equities, especially the public's interest in effective antitrust enforcement and effective relief, weigh heavily in favor of entering a preliminary injunction. **The equities weighing against the entry of the injunction are at most only the delay in the receipt of the private monetary benefits of the merger to the merging parties and their shareholders and these benefits will never materialize if the merger is found to be unlawful on the merits.** The court should find that the entry of a preliminary injunction is in the public interest.

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4. Write: Introduction

- Short conclusion—Instructor's answer

For the reasons explained below, the Commission should prevail in its petition for a preliminary injunction under Section 13(b) of the FTC Act blocking Clare's acquisition of Benny's pending the conclusion of the administrative adjudication of the merits of the Commission's Section 7 claim against the transaction. On the facts found in the investigation, the Commission has a strong likelihood of becoming able to prove to the district court that Clare's proposed acquisition of Benny's would violate Section 7 in the nationwide manufacture and sale of premium ice cream and separately in the nationwide manufacture and sale of all ice cream. The *PNB* presumption is easily satisfied in premium ice cream, and although more borderline in all ice cream, there is additional evidence of consumer harm under resulting from both anticompetitive unilateral and coordinated effects. Consumers are likely to be harmed by both an increase in prices and a reduction in the rate of product innovation as a result of the merger. The various defenses advanced by the parties are either speculative (not verifiable), contradicted by the facts, or fail to show they are sufficient to negate the upward pricing pressures and the reduced incentives to innovate that the merger is likely to create. The equities, especially the public's interest in effective antitrust enforcement and effective relief, weigh heavily in favor of entering a preliminary injunction. The equities weighing against the entry of the injunction are at most only the delay in the receipt of the private monetary benefits of the merger to the merging parties and their shareholders and these benefits will never materialize if the merger is found to be unlawful on the merits. **The court should find that the entry of a preliminary injunction is in the public interest.**

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4. Write: Introduction

- Applicable law
 - Clayton Act § 7
 - FTC Act § 13(b)
 - *Baker Hughes* three-step burden shifting approach

4. Write: Introduction

- Applicable law
 - Clayton Act § 7
 - Instructor's answer (prepared in advance):

Section 7 of the Clayton Act prohibits mergers and acquisitions “where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly.” 15 U.S.C. § 18. By its terms, a Section 7 violation contains three essential elements: (1) a relevant product market (“line of commerce”), (2) a relevant geographic market (“section of the country”), and (3) a reasonably probable anticompetitive effect in the relevant market (that is, the combination of the relevant product market and the relevant geographic market).

4. Write: Introduction

- Applicable law
 - FTC Act § 13(b)
 - Instructor's answer (prepared in advance):

The Commission may seek injunctive relief to enjoin a transaction pending the resolution of the Section 7 merits in an administrative proceeding under Section 13(b) of the Federal Trade Commission Act “[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.” 15 U.S.C. § 53(b). The public interest standard requires courts to “measure the probability that, after an administrative hearing on the merits, the Commission will succeed in proving that the effect of the [proposed transaction] may be substantially to lessen competition” in violation of the Clayton Act. *FTC v. Sysco Corp.*, 113 F. Supp. 3d 1, 22 (D.D.C. 2015). The Commission meets this standard if it “has raised questions going to the merits so serious, substantial, difficult and doubtful as to make them fair ground for thorough investigation, study, deliberation and determination by the FTC in the first instance and ultimately by the Court of Appeals.” *Id.* at 23.

4. Write: Introduction

- Applicable law
 - *Baker Hughes* three-step burden shifting approach
 - Instructor's answer (form prepared in advance):

Clare's acquisition of Benny's is a horizontal acquisition since it involves competitors in the production and sale of ice cream generally and premium ice cream in particular. In horizontal cases, courts have adopted a three-step burden-shifting procedure:

1. The plaintiff bears burden of proof in market definition and in market shares and market concentration within the relevant market sufficient to trigger the *PNB* presumption (explained below).
2. Once the plaintiff has made a prima facie showing, the burden of production then shifts to defendant to adduce evidence sufficient to put the *PNB* presumption in issue.
3. If the defendant discharges its burden, the burden of persuasion returns to plaintiff to prove in light of all of the evidence in the record that the merger is reasonably probable to have an anticompetitive effect in the relevant market.

See *United States v. Baker Hughes, Inc.*, 908 F.2d 981, 982-83 (D.C. Cir. 1990). Although not required, the plaintiff may strengthen its prima facie case by presenting additional evidence supporting a finding that the transaction is anticompetitive. Courts apply a "sliding scale" approach to the defendant's burden in Step 2 above, so that the stronger the plaintiff's prima facie case, the higher the defendant's showing must be to discharge its burden of production for putting the plaintiff's prima facie case in issue. *Id.* at 983.

4. Write: Introduction

■ The roadmap

□ Instructor's answer (form prepared in advance):

The DOJ/FTC 2010 Horizontal Merger Guidelines focus more on competitive effects and do not strictly require a showing of a relevant market. To obtain a preliminary injunction, however, the Commission will have to petition a federal district court, which will require the showing of a relevant market under prevailing case law precedent. As to the showing of anticompetitive effects, the courts continue to employ the *Philadelphia National Bank* presumption in assessing a prima facie case and also have largely accepted the theories of anticompetitive harm in the Merger Guidelines to further support the prima facie case. Accordingly, I will analyze the transaction under the usual judicial framework:

1. The prima facie Section 7 case
 - a. The relevant product market
 - b. The relevant geographic market
 - c. Market shares, concentration, and the *PNB* presumption
 - d. Additional evidence supporting the prima facie case
2. The defendants' arguments
3. Conclusion on Section 7 legality
4. Weighing of the equities
5. Conclusion

4. Write: The prima facie case

■ The relevant product market

1. Premium ice cream only

- *Brown Shoe* “outer boundaries” and “practical indicia” (test and application)
- Hypothetical monopolist test (test and application through percentage critical loss)

2. All ice cream

- *Brown Shoe* “outer boundaries” and “practical indicia”
- Hypothetical monopolist test (test and application through percentage critical loss)

Do not get lost in the details. Think about what your intuitions tell you are the correct relevant markets. When you do the details (especially the HMT), if you are getting an answer different from your intuitions, double check your work!

□ Note:

- It was unnecessary to analyze a regular ice cream market
 - There is no overlap in regular ice cream—and we have only looked at theories of harm in horizontal mergers
 - Incidentally, there is no nonhorizontal theory of harm that applies to a regular ice cream market either

4. Write: The prima facie case

- The relevant product market
 - Premium ice cream only—*Brown Shoe*
 - “Outer boundaries” test
 - Very high cross-elasticities/diversion ratios/recapture ratios within the candidate market
 - Little diversion to outside the candidate market for one-product price increases
 - Practical indicia
 - Industry recognition of premium ice cream as distinct from regular ice cream
 - Premium ice cream has differentiating characteristics (namely, more butterfat content, less overrun, and more calories than regular ice cream)
 - Premium ice cream costs more to manufacture (\$2.80 v. \$2.40 per gallon)
 - Probably most importantly, premium ice cream has
 - a significantly higher price (\$4.00 v. \$3.00 per gallon at wholesale), and
 - a 50% higher percentage margin (30% = 1.20/4.00 v. 20% = \$0.60/\$3.00)

4. Write: The prima facie case

- The relevant product market
 - Premium ice cream only—Hypothetical monopolist test

1. Use percentage critical loss to test the profitability of a uniform SSNIP:

$$\%CL = \frac{\delta}{\delta + m} = \frac{5\%}{5\% + 30\%} = 14.3\%$$

But actual loss is 16%. Therefore, the test fails.

Make sure you get the inequalities right! Actual loss greater than critical loss means that the hypothetical monopolist loses too many customers to make the SSNIP profitable

2. One-product SSNIP test with aggregate diversion ratio:

$$R_{cl} = \frac{\delta}{m} = \frac{5\%}{30\%} = 16.7\%$$

Here, $R_{Clare's}$ and $R_{Benny's}$ are close to 100% (need at least one of the products of a merging firm), so one-product aggregate diversion ratio test is satisfied and premium ice cream is a market

Again, make sure you understand the inequalities! Actual recapture greater than critical recapture means that the hypothetical monopolist is recapturing enough customers to make the SSNIP profitable

4. Write: The prima facie case

- The relevant product market
 - All ice cream—*Brown Shoe*
 - “Outer boundaries” test
 - The cross-elasticity between the two *categories* of ice cream products is relatively high
 - Premium ice cream as a category diverts almost 100% diversion to regular ice cream
 - Regular ice cream as a category diverts almost 100% diversion to premium ice cream
 - Practical indicia
 - Industry and the public recognition of ice cream as distinct from other types of foods
 - Ice cream has peculiar characteristics and uses
 - Ice cream is produced using unique production facilities
 - Ice cream has distinct prices

4. Write: The prima facie case

- The relevant product market
 - All ice cream—Hypothetical monopolist test
 - Percentage critical loss for a uniform SSNIP:

$$\%CL_{\text{premium}} = \frac{5\%}{5\% + 30\%} = 14.3\%$$

$$\%CL_{\text{regular}} = \frac{5\%}{5\% + 20\%} = 20.0\%,$$

Actual loss for premium ice cream and regular ice cream is 3% and 5%, respectively.

- That is, with a 5% SSNIP—
 - The hypothetical monopolist would make money on premium ice cream (sufficient recapture), and
 - The hypothetical monopolist would make money on regular ice cream (sufficient recapture)

Therefore, the hypothetical monopolist could profitably raise prices by a 5% SSNIP and so all ice cream is a relevant product market

4. Write: The prima facie case

- The relevant geographic market
 - The United States
 - The “area of effective competition” test (test and application)
 - Nationwide sales by majors
 - Uniform nationwide pricing by majors
 - Insignificant amount of store brands (which may be local)
 - Hypothetical monopolist test—performed above

4. Write: The prima facie case

- Market shares, concentration, and the *PNB* presumption
 - *PNB* presumption (boilerplate for judicial presumption and Merger Guidelines)
 - Use revenues for market shares
 - If you are going to be testing for an all ice cream market, products are differentiated in prices
 - No nonsellers in premium ice cream
 - Although technologically easy and inexpensive to switch, significant reputational barriers
 - Despite Clare's and Dino's aggressive efforts to grow in premium ice cream, neither was able to obtain more than a 5% market within three years of entry
 - Significant price differential (\$4.00 v. \$3.00) and especially the margin differential (30% v. 20%) between premium ice cream and regular ice cream not competed away by supply-died switching
 - Clare's purchasing Benny's because it did not believe it could grow its market share significantly in the coming years on its own → high reputational barriers

4. Write: The prima facie case

- Market shares, concentration, and the *PNB* presumption
 - Applying the *PNB* presumption:

Premium Ice Cream

| | Revenues | | |
|----------------|----------------|---------------|-------------|
| | (\$millions) | Share | HHI |
| Al's | \$1,575 | 45.00% | 2025 |
| Benny's | \$1,400 | 40.00% | 1600 |
| Clare's | \$175 | 5.00% | 25 |
| Dino's | \$175 | 5.00% | 25 |
| Eddy's | \$35 | 1.00% | 1 |
| Breyers | \$35 | 1.00% | 1 |
| Blue Bell | \$35 | 1.00% | 1 |
| Izzy's | \$35 | 1.00% | 1 |
| Wells | \$35 | 1.00% | 1 |
| | \$3,500 | 100.0% | 3680 |
| Combined share | | 45.0% | |
| Delta | | | 400 |
| Postmerger HHI | | | 4080 |

45%, $\Delta = 400$, postmerger HHI = 4080
 Strong HHI and judicial precedent case (including surpassing thresholds in *PNB*)

All Ice Cream

| | Revenues | | |
|-------------------|-----------------|---------------|--------------|
| | (\$millions) | Share | HHI |
| Clare's | \$5,000 | 26.7% | 713 |
| Breyers | \$4,800 | 25.6% | 657 |
| Al's | \$4,000 | 21.4% | 456 |
| Benny's | \$1,400 | 7.5% | 56 |
| Turkey Hill | \$900 | 4.8% | 23 |
| Blue Bell | \$650 | 3.5% | 12 |
| Izzy's | \$450 | 2.4% | 6 |
| Wells | \$300 | 1.6% | 3 |
| Dino's | \$175 | 0.9% | 1 |
| Eddy's | \$35 | 0.2% | 0 |
| Store brands (10) | \$1,015 | 5.4% | 3 |
| | \$18,725 | 100.0% | 1,930 |
| Combined share | | 34.2% | |
| Premerger HHI | | | 1,930 |
| Delta | | | 399 |
| Postmerger HHI | | | 2329 |

34.2%, $\Delta = 399$, postmerger HHI = 2329
 Relatively weak HHI and judicial precedent case (surpasses 30% *PNB* threshold and maybe 4CFR)
 Strengthened by supporting theories of anticompetitive harm (below)

4. Write: The prima facie case

- Market shares, concentration, and the *PNB* presumption
 - Instructor's answer (form prepared in advance):
 - First, look at *Philadelphia National Bank* (if applicable):

Although the FTC has not recently challenged a transaction in this range, the combined share of 34.2% and an increase in the 2-firm concentration ratio from 53.2% to 59.8% arguably could satisfy the *PNB* presumption under the facts of *Philadelphia National Bank*. Moreover, the change in the HHI of 399 and the resulting postmerger HHI of 2329, although not presumptively unlawful, is be high enough to raise significant competitive concerns under the Merger Guidelines. While most modern complaints filed by the FTC and DOJ have larger HHI statistics, especially in postmerger concentration, there is judicial precedent for finding a Section 7 violation with shares and concentration in the same range as we have here. See, e.g., *United States v. UOM-Kymmene OYJ*, No. 03 C 2528, 2003 WL 21781902 (N.D. Ill. July 25, 2003) (complaint alleging combined market share of 20%, delta of 190, and postmerger HHI of 2990); see also *In re Evanston Northwestern Healthcare Corp.*, No. 9315, 2007 WL 2286195, at *4 (FTC Aug. 6, 2007) (combined market share of 35%, delta of 384, and postmerger HHI of 2739).

4. Write: The prima facie case

- Market shares, concentration, and the *PNB* presumption
 - Instructor's answer (form prepared in advance):
 - Second, look at the Merger Guidelines thresholds:

Although the FTC has not recently challenged a transaction in this range, the combined share of 34.2% and an increase in the 2-firm concentration ratio from 53.2% to 59.8% arguably could satisfy the *PNB* presumption under the facts of *Philadelphia National Bank*. **Moreover, the change in the HHI of 399 and the resulting postmerger HHI of 2329, although not presumptively unlawful, is be high enough to raise significant competitive concerns under the Merger Guidelines.** While most modern complaints filed by the FTC and DOJ have larger HHI statistics, especially in postmerger concentration, there is judicial precedent for finding a Section 7 violation with shares and concentration in the same range as we have here. See, e.g., *United States v. UOM-Kymmene OYJ*, No. 03 C 2528, 2003 WL 21781902 (N.D. Ill. July 25, 2003) (complaint alleging combined market share of 20%, delta of 190, and postmerger HHI of 2990); see also *In re Evanston Northwestern Healthcare Corp.*, No. 9315, 2007 WL 2286195, at *4 (FTC Aug. 6, 2007) (combined market share of 35%, delta of 384, and postmerger HHI of 2739).

4. Write: The prima facie case

- Market shares, concentration, and the *PNB* presumption
 - Instructor's answer (form prepared in advance):
 - Third, look at the case law:

Although the FTC has not recently challenged a transaction in this range, the combined share of 34.2% and an increase in the 2-firm concentration ratio from 53.2% to 59.8% arguably could satisfy the *PNB* presumption under the facts of *Philadelphia National Bank*. Moreover, the change in the HHI of 399 and the resulting postmerger HHI of 2329, although not presumptively unlawful, is high enough to raise significant competitive concerns under the Merger Guidelines.

While most modern complaints filed by the FTC and DOJ have larger HHI statistics, especially in postmerger concentration, there is judicial precedent for finding a Section 7 violation with shares and concentration in the same range as we have here. See, e.g., *United States v. UOM-Kymmene OYJ*, No. 03 C 2528, 2003 WL 21781902 (N.D. Ill. July 25, 2003) (complaint alleging combined market share of 20%, delta of 190, and postmerger HHI of 2990); see also *In re Evanston Northwestern Healthcare Corp.*, No. 9315, 2007 WL 2286195, at *4 (FTC Aug. 6, 2007) (combined market share of 35%, delta of 384, and postmerger HHI of 2739).

Note: Not the strongest case authority, but use what you can. If the HHIs were somewhat higher, you could add other cases.

4. Write: The prima facie case

- Additional evidence supporting the prima facie case
 - Coordinated effects—applies
 - State the test (prepared in advance)
 - Apply the test—on price
 - Market susceptible to tacit coordination
 1. Selection problem
 - Will the firms be able to “agree” to the price or other terms on which they will tacitly coordinate?
 2. Incentive compatibility problem
 - Will the (short-run) incentive to pursue a more competitively aggressive strategy, which all profit-maximizing firms have, undermine any tacit coordination?
 3. External interference problem
 - Apart from the firms in the market, will other entities disrupt any tacit coordination?
 - Merger will increase the probability and effectiveness of tacit coordination
 - Note
 - Works in both the premium ice cream market and the all ice cream market

4. Write: The prima facie case

- Additional evidence supporting the prima facie case
 - Maverick—applies (Clare’s is a maverick in pricing and innovation)
 - State the test (prepared in advance)
 - Apply the test
 - Small firm premerger
 - Disrupted the ability of Al’s and Benny’s to raise prices premerger
 - Innovative—forced Al’s and Benny’s to follow
 - Large firm with single brand postmerger (45% share; tied for No. 1 with Al’s)—reduces maverick incentives on both price and innovation
 - Bottom line:
 - Will enable more accommodating conduct on higher premium prices
 - Will enable more accommodating conduct on lower rates of premium innovation
 - Note
 - Works in both the premium ice cream market and the all ice cream market

4. Write: The prima facie case

- Additional evidence supporting the prima facie case
 - Unilateral effects on price—does not apply
 - Test (prepared in advance)
 1. The products in question must be differentiated
 2. The products of the merging parties must be close substitutes for one another
 - That is, they have high cross-elasticities of demand or diversion ratios with one another
 3. The products of (most) other firms must be much more distant substitutes
 - That is, they have low cross-elasticities of demand or low diversion ratios with the products of the merging firms
 4. Repositioning into the products of the merging firms must be difficult
 - That is, other incumbent firms and new entrants in the market cannot easily change their product's attributes or introduce a new product that would be a close substitute to the products of the merging firm
 - Apply the test
 - Premerger, the Clare's and Benny's premium ice cream products were sold at the same price
 - Postmerger,
 - Clare's will consolidate the premium brands, so there will only brand, so there will be no differentiated premium products on which to increase the price of one product and divert sales to a second product
 - Little diversion from premium products to regular products (and vice versa), so no opportunity for unilateral effects by raising the price in one category and recapturing diverted sales in the other category

4. Write: The prima facie case

- Additional evidence supporting the prima facie case
 - Unilateral effects on innovation—at least arguable
 - Apply the test
 - Premerger, the Clare's was uniquely innovative in premium ice cream
 - Largely in a effort to increase market share
 - Postmerger,
 - Combined firm will have a large market share in premium ice cream
 - 45%--Tied for #1 with AI's
 - Given the large share, no longer has the same incentives to innovate
 - So rate of innovation in premium ice cream would decrease even if all other firms continued to maintain their premerger innovation rates
 - Note
 - Works in both the premium ice cream market and the all ice cream market
 - Although this theory is sound, the reduction in innovation works better as a coordinated effect theory

4. Write: The prima facie case

- Additional evidence supporting the prima facie case
 - One more thing—GUPPIs
 - Think carefully whether you need to discuss GUPPIs
 - These are used in models to predict postmerger price increases
 - GUPPIs themselves are only indices—Standing alone they do not tell you very much
 - There are no thresholds for when a GUPPI is “too high” and suggests an actionable anticompetitive price increase
 - The only models we have examined that simulate prices with GUPPIs are ones with *complete symmetry* between the merging firms
 - If you do not see complete symmetry in the model, chances are that there is little to say about GUPPIs

Remember, you will get no credit for discussing things that are not useful in answering the question presented!!

4. Write: Defendants' rebuttal arguments

- First, make sure you know what defenses need to be addressed:
 1. *Broad markets/ low HHIs*: The only relevant market is all ice cream and in this market the merger is too small to create a competitive problem
 2. *Rapid entrants/entry*: Even if premium ice cream is the relevant market, the HHIs based on actual sales, which are not that high, should be further downgraded in their probative value of anticompetitive effect given the supply-side substitutability between regular ice cream and premium ice cream
 3. *Expansion defense*: Dino's, which entered four years ago and today as the same share in premium ice cream as Clare's, will continue to grow its business aggressively and its efforts will ensure that the premium ice cream market remains competitive postmerger
 4. *Continued maverickness*: Clare's, which will control the merged firm, will continue its philosophy of growing market share through competitive pricing and product innovation in premium ice cream and so benefit consumers given its larger sales base
 5. *Efficiencies*: The merger will produce substantial efficiencies that will offset any possible anticompetitive effect of the transaction. None of these arguments should successfully rebut the presumption that the transaction is anticompetitive

This is taken verbatim from the hypothetical. But you cannot always expect that the hypothetical will be so clear in mapping the defense arguments to the legal defenses.

Also, you may find it helpful to name the defenses

4. Write: Defendants' rebuttal arguments

1. *Broad market*: The only relevant market is all ice cream and in this market the merger is too small to create a competitive problem
 - a. *Key 1*: Premium ice cream is also a market (see above) in which the merger is anticompetitive
 - Sufficient that the merger be found likely to be anticompetitive in only one relevant market to be enjoined
 - b. Could argue that all ice cream violates the “smallest market” principle
 - Still cited by some courts but rejected as a strict requirement in the 2010 Merger Guidelines—not a winning argument
 - c. *Key 2*: The transaction is anticompetitive is an all ice cream market
 - i. Shares alone (weakly) predicate the *PNB* presumption
 - ii. Merger eliminates Clare's as a maverick and creates an anticompetitive unilateral effect in pricing and innovation
 - d. Note on merging-firms unilateral effects in all ice cream
 - i. There is no anticompetitive merging-firms unilateral effect in pricing because—
 - a. the premerger margins of Clare's and Benny's products are the same, *and*
 - b. Clare's is consolidating the merged firm's premium ice cream products into one brand → no opportunity for diversion postmerger
 - ii. Of course, you could argue that although Clare's says that it will consolidate the brands postmerger, it is under no obligation to do so and if it maintains two brands postmerger there would likely be an anticompetitive unilateral effect in pricing

4. Write: Defendants' rebuttal arguments

2. *Rapid entrants*: Even if premium ice cream is the relevant market, the HHIs are not that high and should be further downgraded given the supply-side substitutability between regular and premium ice cream
 - a. *Reject HHI premise*: HHIs high enough in actual sales to predicate the *PNB* presumption under judicial precedent and the Merger Guidelines
 - b. State test for rapid entrants defense
 - i. Firms that likely to rapidly into production or sale of a product in the relevant market, without incurring significant sunk costs of entry and exit, would be sufficient to prevent any anticompetitive effect from the merger
 - c. Apply tests: Reputational barriers are too high—
 - i. Despite Clare's and Dino's aggressive efforts to grow in premium ice cream, neither was able to obtain more than a 5% market within three years of entry
 - ii. Clare's purchasing Benny's because it did not believe it could grow its market share significantly in the coming years on its own
 - iii. Significant price differential (\$4.00 v. \$3.00) and especially the margin differential (30% v. 20%) between premium ice cream and regular ice cream did not induce regular ice cream producers other than Clare's to materially shift or expand production into premium ice cream

4. Write: Defendants' rebuttal arguments

2. *Rapid entrants (con't)*:

d. Bottom line:

- i. High reputational barriers prevent timely and sufficient entry to constrain pricing
- ii. No argument that entry (rapid or otherwise) would protect the market from an anticompetitive decrease in the innovation of new premium ice cream products

4. Write: Defendants' rebuttal arguments

3. *Expansion*: Dino's, which entered four years ago and today as the same share in premium ice cream as Clare's, will continue to grow its business aggressively and its efforts will ensure that the premium ice cream market remains competitive postmerger
 - a. State test (expansion defense—prepared in advance)
 - i. Timely
 - ii. Likely
 - iii. Sufficient
 - b. Apply the test—not timely or sufficient
 - i. Dino's only reached 5% market share after four years
 - ii. Even if Dino's grows at its historical rate—about 50% per year—in another two years it would only have a market share of a little over 11%
 - iii. Should only look at *incremental* growth resulting from the merger—parties presented no evidence
 - iv. Even if Dino's is successful in creating enough downward pricing pressure to offset the merger's anticompetitive effect, will take some time during which period the merger would be anticompetitive and violate Section 7
 - v. Even enough downward pricing pressure would not offset anticompetitive effect of reduced innovation

4. Write: Defendants' rebuttal arguments

4. *Continued maverickness*: Clare's, which will control the merged firm, will continue its philosophy of growing market share through competitive pricing and product innovation in premium ice cream and so benefit consumers
 - a. Clare's premerger incentives to price and innovate aggressively were designed to increase its market share and become a larger, more profitable firm. After the merger, Clare's will have achieved its goal of becoming a larger firm.
 - b. Moreover, Al's and the combined firm will account for 90% of all premium ice cream sales → strong incentive to follow the leader (coordinated effects)
 - Under these conditions, it will be in the combined firm's profit-maximizing interest to follow Al's lead increasing prices—or even to lead price increases itself—since the opportunity costs of *not* doing so will be so high
 - c. Given this profit incentive, Clare's claim that it will continue to price and innovate aggressively after the merger just as it did before the merger should not be credited

4. Write: Defendants' rebuttal arguments

5. *Efficiencies*: The merger will produce substantial efficiencies that will offset any possible anticompetitive effect of the transaction; and
 - a. Test (prepared in advance)
 - i. Merger specific
 - ii. Verifiable
 - iii. Sufficient to overcome otherwise anticompetitive effect of the merge
 - iv. Not resulting from an anticompetitive effect of the merger
 - b. Fixed cost efficiencies are not cognizable (fails sufficiency element—not passed on to customers)
 - i. Eliminating duplicative administrative and sales overhead
 - ii. Streamlining the combined sales force
 - iii. Taking advantage of some excess capacity to consolidate production
 - iv. Reducing the number of the merged firm's operating plants
 - c. No claim of other, cognizable efficiencies

4. Write: Conclusion on likelihood of success

- Instructor's answer

3. Conclusion on likelihood of success on the Section 7 merits

Under the standards used in the Horizontal Merger Guidelines and by the courts, the FTC should be able to establish its prima facie case that the merger violates Section 7 by likely increasing prices and reducing product innovation in both a nationwide premium ice cream and a nationwide all ice cream and defeat the expansion, pricing and innovation efficiencies, cost efficiencies, and price reduction defenses of the merging parties. This proves a likelihood of success on the merits of proving a Section 7 violation in both markets.

- No need to be elaborate here—details in conclusion in the introduction
 - State the dimensions of the relevant product and geographic market
 - State the nature of the anticompetitive effect
 - State what defenses were rejected
 - Conclude on likelihood of success on the merits

You can use some boilerplate here—but be sure to customize it to the problem!

4. Write: Weighing the equities

- Role of equities in applying Section 13(b) (prepared in advance)
- The equities
 - The public equities (prepared in advance)
 - The private equities (largely prepared in advance)
 - Deal will crater
 - Lost of premium to Benny's shareholders
- Weighing the equities (prepared in advance)

5. Write: Conclusion

- Instructor's answer

5. Conclusion

For the reasons stated above, the Commission should prevail in its petition for a preliminary injunction under Section 13(b) of the FTC Act blocking Clare's acquisition of Benny's pending the conclusion of the administrative adjudication of the merits of the Commission's Section 7 claim against the transaction.

- Again, no need to be elaborate if the conclusion paragraph in the introduction answers the specific questions asked

Final thoughts

- Graded homework problem
 - Posted on November 4 after review session; due on November 16 (11:59 pm)
 - Counts as one of the three exam questions
 - Same level of detail and difficulty as the ice cream merger
 - No homework and little preparation required for classes during the homework period → Spend your time on the homework problem
 - No time limit
- Review session
 - Wednesday, November 4, 12:30 pm – 2:30 pm (use the special Zoom link)
- Don't hesitate to reach out to me with questions before the graded homework assignment

This is the time to nail down the rubric, the boilerplate, and your exam strategy

It will pay large dividends during the timed exam.