MERGER ANTITRUST LAW

LAWJ/G-1469-05
Georgetown University Law Center
Fall 2024

Tuesdays and Thursdays, 3:30 pm – 5:30 pm
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CLASS 18 WRITTEN ASSIGNMENT

Instructions

Submit by email by 5:00 pm on Monday, October 28
NOTE THAT THE RETURN DATE IS THE DAY BEFORE CLASS[1]
Send to wdc30@georgetown.edu
Subject line: Merger Antitrust Law: Assignment for Class 18

Assignment

Calls for a memorandum of law.

INSTRUCTIONS[2]

This is an untimed *not-graded* homework assignment. You may consult any written source, including, without limitation, the class notes, cases, outlines (commercial or otherwise), books, treatises, the Internet, Westlaw, and Lexis-Nexis. If this were an exam question, you would have to do your own work and not talk about the problem with any student or other person until after the return date. But since this is a only practice exam question, feel free to discuss the problem with others in the class. The idea here is to learn how to write an answer to this type of hypothetical, so do whatever works best for you.

Present your analysis in a well-organized, linear, and concise manner. Think about your answer 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. Do not, for example, tell me things you know are not relevant to the answer; it will just cost you time, and you will not get any credit for extraneous material. Penalties will be levied for excessive length, verbosity, or lack of organization.

The "facts" in the hypothetical should be complete in that they present what is known at the time the analysis is requested. As in life, some information you would like to have may simply not be available. Analyze the facts as they are presented in the question.

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1 I will distribute the instructor's answer/feedback memorandum on Monday night.

2 With two exceptions—namely, this homework assignment is not graded and you may work with others in preparing your own answer—these instructions are identical to the one you will receive for the graded homework assignment. My expectation, which is subject to discussion and change, is that I will give out the graded homework assignment on Friday, November 8, and it will be due on *Wednesday, November 20, at 8:00 pm*. Note that this is the day *before* Class 24. I would like to review your answers before we discuss the problem in Class 24.

It should go without saying that, outside of this assignment, you should not believe anything in the statement of any hypothetical fact situation. I have taken considerable liberties in fashioning the problems and have ignored reality whenever it was convenient.

This homework assignment is final. Do not expect any clarifications or corrections. If you believe there is an error or inconsistency in the problem, please state your assumptions about the issue in your discussion of that issue. You may email me if you wish, but I will either not respond or respond to the class as a whole. *For this reason, and more importantly, because we will continue working on cases that may further illuminate concepts relevant to the homework assignment, I suggest you wait until shortly before the due time to submit your answer.*

You should assume that all demand, inverse demand, and residual demand curves are linear, that marginal costs are constant, and that all firms maximize their profits given their residual demand curves and marginal costs. You also should assume that the requisite effect on interstate commerce is present and that the transaction involves the acquisition of stock or assets, so you do not have to address these elements in your analysis of a possible Section 7 violation.

Ice Cream Merger

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 Benny's stock. Melissa Brown, your section chief, has asked you to prepare a memorandum recommending whether the FTC should seek a preliminary injunction blocking the transaction from a federal district court pending a resolution of the merits in 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 the defenses the merging parties advanced during the investigation. 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 ultimate question whether to enter the FTC's requested preliminary injunction. The transaction's success will turn on the outcome of the Section 13(b) proceeding because Clare's and Benny's have told the staff that they will terminate their transaction if the district court enters a preliminary injunction and will not litigate the merits in an adjudicative proceeding.

The FTC's investigation has revealed the following facts.

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.

Notwithstanding this ease of switching on the production equipment, Clare's, which entered into the manufacture of premium ice cream three years ago, is the only regular ice cream manufacturer that has begun new production of premium ice cream over the last ten years. A second firm, Dino's, entered into the manufacture of premium ice cream four years ago, but Dino's did not produce regular ice cream and entered the market de novo.

Ice cream products are differentiated by content and brand. While prices can and have varied among brands within 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.[3] The following chart gives sales for ice cream manufacturers:

Ice Cream												
	Premium Ice Cream				Regular Ice Cream				All Ice Cream		
Manufacturer	Gallons	Revenues	Profits	Revenue Share	Gallons	Revenues	Profits	Revenue Share	Total Revenues	Revenue Share	Total Profits
Clare's	43.8	$175	$53	5.0%	1,608.3	$4,825	$965	31.7%	$5,000	26.7%	$1,018
Breyers	8.8	$35	$11	1.0%	1,588.3	$4,765	$953	31.3%	$4,800	25.6%	$964
Al's	393.8	$1,575	$473	45.0%	808.3	$2,425	$485	15.9%	$4,000	21.4%	$958
Benny's	350.0	$1,400	$420	40.0%	0.0	$0	$0	0.0%	$1,400	7.5%	$420
Turkey Hill	0.0	0	$0	0.0%	300.0	$900	$180	5.9%	$900	4.8%	$180
Blue Bell	8.8	$35	$11	1.0%	205.0	$615	$123	4.0%	$650	3.5%	$134
Izzy's	8.8	$35	$11	1.0%	138.3	$415	$83	2.7%	$450	2.4%	$94
Wells	8.8	$35	$11	1.0%	88.3	$265	$53	1.7%	$300	1.6%	$64
Dino's	43.8	$175	$53	5.0%	0.0	$0	$0	0.0%	$175	0.9%	$53
Eddy's	8.8	$35	$11	1.0%	0.0	$0	$0	0.0%	$35	0.2%	$11
Store brands (10)	0.0	0	$0	0.0%	338.3	$1,015	$203	6.7%	$1,015	5.4%	$203
	875.0	$3,500	$1,050	100.0%	5,075.0	$15,225	$3,045	100.0%	$18,725	100.0%	$4,095

Note: Gallons and revenues are in millions

There are high cross-elasticities of demand between brands within each ice cream segment and low cross-elasticities between individual products across these two segments. So, for example, if one 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 20% of its volume to its premium brand rivals and no volume to regular ice cream. The converse is true for regular ice cream brands.

For a 5% uniform increase in the price across all brands of premium ice cream, however, each premium brand would lose 16.67% 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

[3] I appreciate that this is a very counterfactual assumption. I could make the problem more realistic by introducing different prices for different products, but then you would have to deal with some arithmetical complications in applying the hypothetical monopolist test that I am sure you would rather avoid.

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.

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 meetings with the staff, Clare's discussed its deal rationale and made five arguments in defense of the transaction:

Clare's deal rationale:

1. Clare's is buying Benny's to become a more significant player in premium ice cream. Clare's began manufacturing and selling premium ice cream only three years ago. While Clare's has invested almost all of its premium ice cream profits in advertising its premium brands, it has only achieved a market share of 5%. This rate of growth is too slow for Clare's management. Clare's believes its inability to gain market share more quickly is primarily due to its reputation as a regular ice cream manufacturer, where Clare's is known as a large but undistinguished producer with little of the "flair" associated with premium ice cream brands. Following the merger, Clare plans to drop Clare's premium brand name and consolidate all its premium operations into Benny's brand, one of the best brands in the premium ice cream business.
2. Clare's plans to invest its savings from the acquisition in the premium ice cream business, aggressively take on Al's, the premium ice cream market leader, and grow the merged firm's volume and market share.
3. Since entering the premium ice cream space, Clare's has introduced many new premium ice cream flavors, some of which have become quite popular. Before Clare's entry, the other premium ice manufacturers only rarely introduced a new flavor. After Clare's entry, Al's and Benny's have been introducing new flavors to match the Clare's flavors that have become popular. Clare's says that it will bring its spirit of innovation to the management of Benny's.
4. The merged firm can save $60 million in annually recurring overhead costs by consolidating management, back office, and sales operations and eliminating almost all of Benny's corresponding operations. The staff does not dispute these numbers.
5. The merged firm can save another $30 million in operating costs by consolidating production. Clare's smallest plant makes 200 million gallons of regular ice cream and currently makes no premium ice cream. The merged firm can close this plant and move the production into Benny's single plant, which is new and currently has 350 million gallons of excess capacity. The staff does not dispute these numbers.

Clare's antitrust arguments:

1. The relevant market in which to analyze the transaction is the manufacture and sale of all ice cream in the United States.[4] The characteristics, interchangeability of use, and supply-side substitutability are sufficient under judicial precedent to make all ice cream the relevant market. This market also satisfies the hypothetical monopolist test

[4] The staff agrees that the relevant geographic market is the Unitd States.

under the Merger Guidelines. Within this relevant market, the merger is too small to create a competitive problem.

2. Even if the market is technically defined as premium ice cream, the HHIs based on actual sales are not all that high. The shares are even lower when, under the Merger Guidelines, regular ice manufacturers are considered participants in the market even if they do not currently make premium ice cream. When the participation of these manufacturers is properly attributed with market shares of premium ice cream due to the ease of supply-side switching, the transaction does not trigger the *PNB* presumption under either judicial precedent or the Merger Guidelines.

3. Dino's, which entered four years ago and today has the same share as Clare's in premium ice cream, has also been trying to grow in premium ice cream (primarily by investing in advertising). The staff has confirmed this. Moreover, in an interview with the staff, Dino's said it would continue to aggressively invest in its brand name reputation whether or not Clare's and Benny's merge. Clare's submits that Dino's continuing efforts to grow will ensure that the market remains competitive postmerger.

4. In addition to its innovation in new flavors, Clare's has successfully built its premium ice cream market share by holding the line on price increases when other manufacturers were attempting to institute price increases. Clare's says that it will bring the same philosophy of holding the line on price increases and innovating to the management of the merged firm. The staff confirmed that Al's has sought to lead a price increase for premium ice cream on many occasions, including before Clare's entry. All of the other premium ice cream manufacturers followed Al's lead. When Clare's entered, however, Clare's resisted following Al's lead in raising prices. Al's continued to raise prices periodically, but at a much lower magnitude than before Clare's entered into the premium ice cream business, and all of the other premium ice cream manufacturers except Clare's followed Al's price increase. It is also undisputed that Clare's is a leader in creating new flavors of premium ice cream and that Al's and Benny's both responded to Clare's successful innovations with matching innovations of their own.

5. The merger will produce substantial efficiencies that will offset any possible anticompetitive effect of the transaction.