

MERGER ANTITRUST LAW

LAWJ/G-1469-05
Georgetown University Law Center
Fall 2020

Tuesdays and Thursdays, 3:00-5:00 pm
Dale Collins
wdc30@georgetown.edu
www.appliedantitrust.com

GRADED WRITTEN ASSIGNMENT

Instructions

Submit by email by 11:59 pm on Monday, November 16
Send to wdc30@georgetown.edu
Subject line: Merger Antitrust Law: Graded Homework Assignment

Assignment

Calls for a memorandum.

INSTRUCTIONS

This is an untimed *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. You may not talk about the problem with any student or any other person until after class on November 17.

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 that you know that are not relevant to the answer; it will just cost you time and you will not get any credit. Penalties will be levied for excessive length, verbosity, or lack of organization.

The "facts" in the hypothetical should be complete in the sense 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.

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 totally ignored reality whenever it was convenient. The only exceptions are propositions or data that is cited to a source.

This homework assignment is final. Do not expect any clarifications or corrections. If you believe there is an error or inconsistency in the exam, please state your assumptions about the issue within 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 be working on cases that may further illuminate concepts relevant to the homework assignment, I suggest that you wait until shortly before the due time to submit your answer.*

You should assume that all demand and inverse demand curves are linear and that marginal costs are constant. 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 that you do not have to address these elements in your analysis of a possible Section 7 violation.

Beer Bottles Merger

You are an associate in Gambini & Gambini LLP. Mass Glass Corporation (MGC), a client of the firm, is considering making an offer to acquire Bell Bottles, Inc. for \$900 million in cash. MGC and Bell both manufacture glass beer bottles, which they sell to breweries for packaging beer. Although MGC and Bell both have glass plants around the country, they overlap in beer bottle sales only to breweries in the southeastern United States (Florida, Georgia, Alabama, and South Carolina).

Mona Lisa Gambini, a partner with whom you work, has been asked by MGC to provide them with a preliminary antitrust risk assessment of the transaction. Ms. Gambini has told MGC that the acquisition most likely would be reviewed by the Federal Trade Commission. MGC is seeking Gambini's advice on whether the parties can successfully convince the FTC to close the investigation, either cleanly or with some mutually acceptable consent order. MGC also wants Gambini's advice as to what provisions it should anticipate Bell will require in the merger agreement to maximize the probability that the deal will close, whether MGC should accept or resist these provisions, and what, if any, provisions MGC should seek in return. Ms. Gambini has asked you to draft the memorandum to the client to provide this preliminary assessment.

The "loop" within MGC on this possible transaction is very small, and the company has been able to provide you with only a limited amount of information and data. What follows is the information you have been able to obtain from the client as well as from public sources. Ms. Gambini asks that, for the purpose of your memorandum, you accept the estimates of the client as fact but be sure to note this assumption in your memorandum.

The U.S. beer industry

Among those who consume alcoholic drinks, beer is the beverage of choice in the United States. It is preferred by 38% of consumers over wine (30%) and spirits (29%).¹ In 2019, the U.S. beer industry sold 203.1 million barrels of beer—the equivalent of more than 2.8 billion cases of 24-12 ounce containers or 406 million kegs worth of beer²—earning revenues of about \$116.0 billion.³ Based on beer shipment data and U.S. Census population statistics, U.S. consumers 21 years and older consumed an average of 25.9 gallons of beer per person during 2019.⁴ Even so, over the last decades, aggregate beer consumption has been slowly but steadily declining in

¹ National Wholesale Beer Association, Industry Fast Facts, <https://www.nbwa.org/resources/industry-fast-facts> (citing a Gallup Poll).

² *Id.* One barrel of beer contains 330 12-ounce servings. One 1 traditional keg in a bar equals half a barrel. *Id.*

³ Brewers Association, National Beer Sales and Production Data, <https://www.brewersassociation.org/statistics-and-data/national-beer-stats/>.

⁴ National Wholesale Beer Association, Industry Fast Facts, <https://www.nbwa.org/resources/industry-fast-facts>.

the United States, reportedly as concerns about the amount of calories in beer are pushing consumers towards wine and spirits.⁵

Beer production in the United States is dominated by two “mass” brewers, Anheuser-Busch Inbev and MillerCoors, which together account for 62.5% of beer sales in the United States. Constellation (Modelo), Heineken, Boston Beer, and Yuengling are considered “mid-tier” brewers, which collectively account for another 17.9% of beer sales in the United States. The remaining brewers, whether domestic or imports, tend to be very small and are called “craft” brewers. Table 1 gives national market shares for brewers for 2019:

Table 1⁶
Brewer National Market Shares (2019)

	<u>Share</u>
Anheuser-Busch Inbev (ABI)	39.9%
MillerCoors, LLC	22.6%
Constellation (Modelo)	10.6%
Heineken USA	3.3%
Boston Beer (Sam Adams)	2.5%
Yuengling	1.5%
All Other Domestic and Imports	19.5%
Total	100%

Mass beer has been declining in recent years as mid-tier, craft, and imports have grown. In 2019, there were 7,346 operating craft breweries in the United States, including 230 regional breweries, 4,522 microbreweries, and 2,594 brewpubs.⁷ More than 95 percent of all breweries make fewer than 15,000 barrels per year and account for about 3 percent of total volume.⁸

Beer is packaged in glass bottles (30% by volume), aluminum cans (60%), and kegs (10%).⁹ Only aluminum cans substitute for glass beer bottles. Many beer aficionados strongly believe that beer in bottles tastes better, stays cooler longer, and has a longer shelf life than beer packaged in cans.¹⁰ Brewers and retailers like cans because they cost the brewer about 30% less

⁵ See Beverage Dynamics, *U.S. Beer Volume Continues Decline, According to 2019 Beer Handbook*, <https://beveragedynamics.com/2019/10/24/beer-volume-continues-decline-according-to-2019-beer-handbook/>; Craig Giammona & Carmen Reinicke, *Pour One Out for the Fading American Beer Industry*, Bloomberg.com, Mar. 1, 2019, <https://www.bloomberg.com/news/features/2019-03-01/are-beer-sales-declining-carbs-push-drinkers-to-wine-tequila>. Surprisingly, beer consumption, and alcoholic sales generally, are falling during the COVID-19 pandemic. See Leslie Patton *Americans Are Actually Drinking Less During the Pandemic*, Bloomberg.com, June 23, 2020, <https://www.bloomberg.com/news/articles/2020-06-23/are-people-drinking-more-booze-during-coronavirus-apparently-not>.

⁶ National Wholesale Beer Association, Industry Fast Facts, <https://www.nbwa.org/resources/industry-fast-facts>. Yuengling's market share is estimated from press reports.

⁷ Brewers Association, National Beer Sales and Production Data, <https://www.brewersassociation.org/statistics-and-data/national-beer-stats/>.

⁸ National Wholesale Beer Association, Industry Fast Facts, <https://www.nbwa.org/resources/industry-fast-facts>.

⁹ Brewers Association, National Beer Sales and Production Data, <https://www.brewersassociation.org/statistics-and-data/national-beer-stats/>. In our hypothetical world, beer is packaged only in glass bottles, aluminum cans, or kegs. We will ignore other packaging, such as aluminum and plastic bottles, that exists in the real world.

¹⁰ A common criticism of beer packaged in cans tastes “metallic.” This is a subject of intense debate. Since the 1930s, beer can manufacturers have lined their cans with plastic to prevent the beer from coming in contact with the metal. This technology has improved considerably over time. In blind taste tests where the beer is served in a glass, consumers are indifferent to whether the beer was packaged in a bottle or a can. Interestingly, there are not that many complaints when beer is packaged in an aluminum keg. See generally The Alcohol Professor, *Does Beer Taste*

on a delivered basis, are easier and less expensive to transport and store, and sustain less breakage. Moreover, beer degrades with exposure to ultraviolet light and oxygen. Contrary to the belief of many consumers, cans keep beer fresher longer because they block all light and oxygen from reaching the beer. In contrast, all bottles are permeable to some extent to light and oxygen where the cap joins the bottle. As beer can technology has improved, consumers have become increasingly acceptant of cans, even in high-end craft beers. As a result, for more than a decade, aluminum cans have been growing in its share of beer packaging. Over the last ten years, cans have grown from about 47% to 62% of all beer packaging at a relatively steady annual growth rate of about 3.1%—the same as the consumer acceptance rate.¹¹ This has been true even though the relative prices of glass bottles and cans have fluctuated over time. The industry expects this trend to continue at this rate in the foreseeable future. However, given the strength of some consumer preferences, brewers of all types and sizes are reluctant to increase the percentage use of cans in the short run in response to small changes in relative price. MGC estimates that an increase in the average price of glass beer bottles by 5% would result in only a 1% decrease in overall brewer demand for glass bottles.¹²

Beer bottles are a homogeneous product, which is sold almost exclusively on price. Plants that manufacture beer bottles are comprised of a furnace to make the glass from raw materials and bottle-forming manufacturing lines to produce the beer bottles.¹³ Given the unique configuration of a beer bottle, the manufacturing lines, which are very expensive to build, can only manufacture beer bottles. Moreover, it is impossible to convert manufacturing lines for other types of glass bottles to beer bottles. Given the decline in demand for beer bottles over the last twenty or so years as brewers slowly shift to aluminum cans, no new beer bottle plants have been constructed and several plants around the country have been closed. The typical beer bottle manufacturing plant will have two furnaces and multiple beer bottle-forming lines. Short of closing a plant altogether, some manufacturers (including Bell) have mothballed furnaces and/or bottle-forming lines.

Beer bottles are also expensive to ship relative to their purchase price, so they usually ship less than 500 miles from the manufacturing plant. Shipping is by truck, and a 500-mile trip from the plant adds a little less \$0.02 to the cost per bottle. MGC estimates that the marginal cost of production per bottle ranges from \$0.10 to \$0.12 (depending on the manufacturer), so shipping costs for a 500-mile trip can add between 16.6% and 20% to the delivered cost per bottle. Given the relative cost of shipment and the volume of bottles involved, there is no arbitrage in beer bottles—bottles purchased by a brewery are used in that brewery and not resold. The manufacturer sells beer bottles directly to mass and mid-tier breweries. Manufacturers sell to specialized beer bottle distributors for resale to craft breweries.

There are four beer bottle manufacturers in the United States: Owain-Dorning Corporation (OD), MGC, Bell, and Crystal Glass, Inc. Given the locations of their respective plants, MGC and Bell

Better From a Bottle Or a Can?, alcoholprofessor.com, Sept. 5, 2017, <https://www.alcoholprofessor.com/blog-posts/blog/2017/09/05/does-beer-taste-better-from-a-bottle-or-a-can>

¹¹ See National Wholesale Beer Association, Industry Fast Facts, <https://www.nbwa.org/resources/industry-fast-facts> (growth from 47% to 62%).

¹² Since bottles and cans substitute one-for one, a 1% decrease in the demand for bottles results in a 0.5% increase in the demand for cans, since the total quantity of cans demanded is twice the quantity of bottles.

¹³ For get a better free for the production of glass bottles, see New Age Media, Manufacturing process of a glass bottle || Machines and Industry, https://www.youtube.com/watch?v=A_M8WBJMcM0. The bottles being produced are not beer bottles, but the process is the same.

compete in the sale of beer bottles only in the four Southeastern states of Florida, Georgia, Alabama, and South Carolina. MGC has a plant in Jacksonville, FL and Bell has a plant in Macon, GA. OD also has a plant in Montgomery, AL. Crystal Glass, the other U.S. producer, also ships a small number of bottles into the Southeast from its plants in other states. Two importers that manufacture bottles in Mexico can cost-effectively ship beer bottles by boat to ports in Alabama, Florida, and Georgia (shipping bottles by boat is less expensive than shipping by truck). But import quotas that OD, MGC, Bell, and Crystal successfully lobbied to put in place severely limits on the quantities the Mexican producers can export to the United States. Although Mexican producers ship small quantities to the ports in Alabama and Florida, they prefer to fill their quota with shipments to Texas to minimize transportation costs.

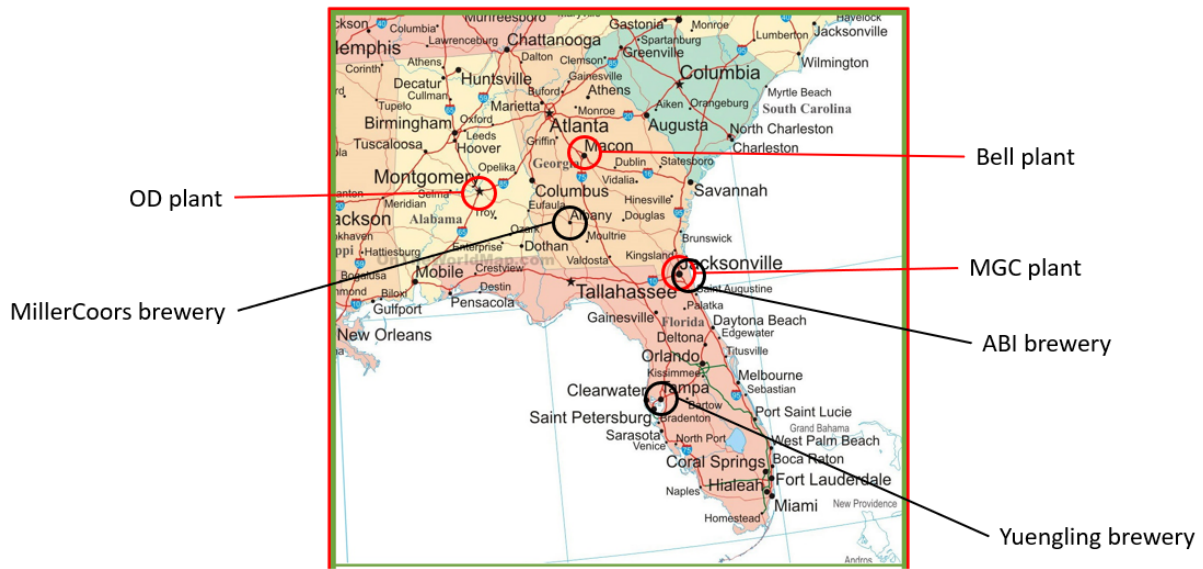


Table 2 gives the supply requirements of glass bottles and aluminum cans for the packaging of beer by breweries in the Southeast in 2019:

Table 2
Major Southeastern Breweries
 (units in millions)

	Location	Bottles	Cans
ABI	Jacksonville, FL	742.5	1901
MillerCoors	Albany, GA	772	1871
Yuengling	Tampa, FL	183.15	257
Total mass beer		1698	4029

Southeastern Craft Breweries

	Number	Bottles	Cans
Florida	329	277	185
Georgia	111	101	67
Alabama	51	16	11
South Carolina	88	20	13
Total craft beer	579	414	276
TOTAL BEER		2112	4305

The mass and mid-tier brewers, including ABI, MillerCoors, and Yuengling, purchase beer bottles through three-year exclusive contracts for which they solicit bids from beer bottle manufacturers through Requests for Proposals (RFPs). ABI and Yuengling contract separately for each of their respective breweries. MillerCoors has one contract covering all seven of its breweries, including the one in Albany, GA. In each case, the major brewers will award the supply contract to the one beer bottle manufacturer that bids the lowest price for bottles delivered to the brewery (inclusive of shipping). All contracts expire on December 31 of the same year. The next contract expiration date is December 31, 2021. Prebidding negotiations between the bottle manufacturers and the brewers will begin roughly in January of next year.

Beer bottles for craft and other smaller breweries are sold through independent distributors that purchase on a “spot” basis at the beer bottle plant.¹⁴ Wholesale prices paid by distributors are uniform are the same throughout a region across manufacturers. The margins on beer bottles sold to craft brewers permit a distributor to ship throughout the four-state southeastern region regardless of the manufacturing plant where that distributor obtains its beer bottles.

Table 3 shows the unit sales of beer bottles to the various breweries and craft beer bottle distributors in the southeastern United States by manufacturer:

Table 3
Beer Bottles Shipments into the Southeast
(millions of bottles)

	All Breweries		Major Breweries		Craft Breweries	
	Units	Share	Units	Share	Units	Share
OD	798	37.8%	772	45.5%	26	6.2%
MGC	970	45.9%	926	54.5%	44	10.6%
Bell Bottles	321	15.2%	0	0.0%	321	77.6%
Crystal Glass	18	0.8%	0	0.0%	18	4.3%
Importers (2)	6	0.3%	0	0.0%	6	1.5%
TOTAL	2,113	100.0%	1,698	100.0%	415	100.0%

In the Southeast, MSC and Bell compete to sell beer bottles to ABI’s brewery in Jacksonville, FL and to Yuengling’s brewery in Tampa, FL. MSC and Bell also submit bids for MillerCoors’ national contract for all of its breweries, including its brewery in Albany, GA, but OD’s locational advantages has made it the winning bidder for MillerCoors’ national contract for decades. Except for Yuengling, the other mid-tier brewers—Constellation, Heineken, and Boston Beer—all have their breweries outside of the southeast, and MGC and Bell do not compete for beer bottle sales to these companies. MSC and Bell also compete to sell to beer bottle distributors, which in turn sell to 580 small craft breweries in the Southeast.

The award of supply contracts by ABI and Yuengling for their respective Southeast breweries and MillerCoors for its national supply contract has been stable for the last 20 or so years. MGC believes that this stability is due to two factors: the winning bidder’s locational advantages to the brewery to be supplied and differences in the production efficiency of the three Southeastern bottle plants.

¹⁴ “Spot” purchasing occurs when the purchase is made, literally, “on the spot.” These purchases are made outside of any contract and usually made up of small orders, and often paid for immediately.

The bottling plants are roughly similar in their production capacities, which enables any plant to serve one mass beer brewery (ABI or MillerCoors, but not both simultaneously) plus Yuengling, with any residual production going to craft breweries. See Table 6 below.

MGC, which has the closest plant to ABI’s Jacksonville brewery and to Yuengling’s Tampa brewery, consistently wins those contracts. Although OD is more distant than Bell to MillerCoors’ Albany brewery, OD locational advantages generally throughout the country to MillerCoors’ breweries has enabled it to win the MillerCoors’ national supply contract. Although it always bids, Bell has not won any contracts to supply a major Southeast brewery since an old ABI brewery in Macon, GA closed in 1995 after the ABI Jacksonville plant was modernized and expanded. Bell built its Macon, GA bottle plant to service the ABI Macon brewery. When the ABI Macon plant closed, Bell mothballed half of its capacity (one glass furnace and two bottling lines) and used the remainder of its capacity to service smaller breweries in the rapidly emerging craft beer segment. However, Bell can quickly reopen its mothballed capacity if it wins a supply agreement with a major brewery. See Table 4.

Table 4
Winning Bids to Major Breweries
Bottle
Requirements

Brewery	Location	(millions)	Producer	Distances (miles)	Bids	
ABI	Jacksonville, FL	742.5	MGC	Jax to Jax	0	\$0.120
			Bell	Macon to Jax	182	\$0.135
			OD	Montgomery to Jax	268	\$0.150
MillerCoors	Albany, GA	772.2	MGC	Jax to Albany, GA	148	\$0.150
			Bell	Macon to Albany	80	\$0.125
			OD	Montgomery to Albany	120	\$0.120
Yuengling	Tampa, FL	183.15	MGC	Jax to Tampa	149	\$0.120
			Bell	Macon to Tampa	300	\$0.140
			OD	Montgomery to Tampa	332	\$0.130

Note: All three bottle plants have enough capacity to serve one mass Southeast brewery plus Yuengling, with the residual production going to craft breweries

The three Southeast bottle plants also differ in their efficiency. MGC believes that the OD Montgomery plant, which has an annual production capacity of 1.1 billion bottles, operates at the industry average marginal production cost of \$0.11 per bottle. Bell’s older Macon plant, which has an annual production capacity of 1.15 billion bottles (including the mothballed lines), is one of the least efficient plants in the industry, with a marginal production cost of \$0.12 per bottle. Although Bell has attempted to increase its efficiency and lower its marginal costs on numerous occasions, it has been largely unsuccessful. The MGC Jacksonville plant, with an annual capacity of 1.1 billion bottles, is very efficient, with a marginal production cost of \$0.10 per bottle. The differences in efficiency among the plants depend on unpatented know-how trade secrets used to reduce raw material costs, reduce energy consumption, and increase “pack-to-

melt.”¹⁵ With a relatively minor investment, MGC believes that it can use its know-how and reduce the Bell Macon plant’s marginal costs by a little over 8% to the industry standard of \$0.11 per bottle, if not lower.

Tables 5-8 provide MGC’s estimates on delivered costs, bidding, excess capacity, and various measures of financial performance.

Table 5
Manufacturing and Shipping Costs

	OD				MGC				Bell			
	Manufacturing Cost	Miles	Shipping	Delivered Cost	Manufacturing Cost	Miles	Shipping	Delivered Cost	Manufacturing Cost	Miles	Shipping	Delivered Cost
ABI(Jacksonville)	\$0.1100	268	\$0.0096	\$0.1196	\$0.1000	0	\$0.0000	\$0.1000	\$0.1200	182	\$0.0066	\$0.1266
MC (Albany)	\$0.1100	120	\$0.0043	\$0.1143	\$0.1000	148	\$0.0053	\$0.1053	\$0.1200	80	\$0.0029	\$0.1229
Yuengling (Tampa)	\$0.1100	332	\$0.0120	\$0.1220	\$0.1000	149	\$0.0054	\$0.1054	\$0.1200	300	\$0.0108	\$0.1308

Table 6
Excess Capacity
(millions of bottles)

	Capacity	ABI	MC	Yuengling	Craft	Excess Capacity
OD	1100		772.2		26	301.8
MGC	1150	742.5		183.15	44	180.35
Bell	1100				321	779

Table 7
Financial Performance

	OD		MGC			Bell		Others	
	MillerCoors	Craft	ABI	Yuengling	Craft	Major	Craft	Major	Craft
Price	\$0.1200	\$0.1500	\$0.1200	\$0.1200	\$0.1500	\$0.1200	\$0.1500	\$0.1200	\$0.1500
Margin	8.3%	26.7%	16.7%	16.7%	33.3%	0.0%	20.0%		26.7%
Cost	\$0.1100	\$0.1100	\$0.1000	\$0.1000	\$0.1000	\$0.1200	\$0.1200		\$0.1100
Shipments (from Table 3)	772	26	743	183.15	44	0	321	0	24
Revenues	\$92,640,000	\$3,900,000	\$89,100,000	\$21,978,000	\$6,600,000	\$0	\$48,150,000	\$0	\$3,600,000
\$margin	\$7,720,000	\$1,040,000	\$14,850,000	\$3,663,000	\$2,200,000	\$0	\$9,630,000	\$0	\$960,000
Revenue share (large)	45.5%		43.7%	10.8%		0.0%		0.0%	
Revenue share (craft)		6.3%			10.6%		77.3%		5.8%
Revenue share (all)		36.3%			44.2%		18.1%		1.4%

Table 8
Industry Averages

Average price (large)	\$0.1200
Average price (craft)	\$0.1500
Average price (all)	\$0.1255
Average margin (large)	12.5%
Average margin (craft)	22.2%
Average margin (all)	14.6%

¹⁵ “Pack-to-melt” is a measure of a plant’s efficiency that compares the amount of glass melted in the plant’s furnaces to the amount actually packed for shipment to customers (in tons).

MGC says that the transaction is motivated by two factors: (1) manufacturing efficiencies that Bell can achieve using MGC's know-how, and (2) an ability to bid competitively for MillerCoors national supply contract, which both MGC and Bell currently lack.

First, as noted above, MGC has the most efficient beer bottle manufacturing operation in the country. With a company-wide average marginal cost of \$0.10 per bottle, its marginal costs are 9% lower than the industry average of \$0.11 per bottle. On the other hand, Bell's eight plants have the least efficient beer bottle manufacturing operation in the country, with an average marginal cost of \$0.12 per bottle. The physical equipment—the glass-making furnace and the beer bottle forming lines—are essentially the same in all beer bottle plants. Differences in operating efficiencies result from differences in the unpatented trade secret know-how used to reduce raw material costs, reduce energy consumption, and increase “pack-to-melt.” With a small investment to add some additional monitoring and testing equipment to Bell's plants, MGC believes that it can use its existing know-how and reduce the Bell average marginal cost to about \$0.105 per bottle or about less than 5% below the industry average. Bell is confident that it can make the technology transfer work. In a recent acquisition of a beer bottle manufacturing business in Europe with plants similar in structure, age, and operating efficiency to those of Bell, MGC successfully reduced the marginal costs of the four acquired plants from \$0.12 per bottle to \$0.105 per bottle. With Bell's eight plants and nationwide annual production of 6 billion bottles, successfully making this technology transfer will yield annual cost savings of between \$60 million and \$90 million per year on the current level of Bell's sales.

Second, neither MGC nor Bell individually has the plant capacity or the plant locations to bid competitively for MillerCoors national supply agreement, which leaves the business to OD.¹⁶ MGC plants are largely located east of the Mississippi River, and Bell's plants are located mostly west of the Mississippi River. Together, the combined company would have plants competitively located with those of OD to supply each of MillerCoors' breweries. Moreover, with some reallocation of production among the combined plants, the merged company could free up the capacity necessary to satisfy the MillerCoors' requirements while continuing to supply the ABI, Yuengling, and craft beer distributors the two companies now supply premerger. Finally, after MGC's operational efficiency improvements have been put in place in the Bell's eight plants, MGC believes that it will have a material cost advantage over OD in bidding for the MillerCoors business. MillerCoors' national supply requirement is for 3.9 billion bottles. If the merged company could earn a dollar margin of \$.005 per bottle on sales to MillerCoors—which should allow it to underprice OD's manufacturing margin cost, that would earn the company an additional \$19.7 million annually.

For this reason, MGC believes that MillerCoors will support the deal. MGC also believes that Yuengling will be neutral since OD postmerger could continue to be the second lowest-cost supplier and so constrain MGC's prices. MGC is more wary about ABI. ABI is known to be an aggressive complainer to the FTC about deals it believes have any prospect of anticompetitively affecting it. The merger will eliminate Bell as the second lowest cost supplier to ABI in

¹⁶ While MGC and Bell both bid for the MillerCoors supply agreement, their respective bids except certain MillerCoors' plants that each firm lacks the capacity to serve. Both are consistently outbid by OD, which has the plants, locations, and capacity to supply all of the MillerCoors breweries.

Jacksonville (the only brewery for which MGC and Bell compete). OD both lacks the capacity to supply both MillerCoors Albany and ABI Jacksonville and faces a significantly locational disadvantage (and therefore higher shipping costs) to Jacksonville compared to Bell. In an attempt to assuage any ABI concerns, MGC is in negotiations with ABI to extend the current supply agreement, which will expire on December 31, 2021, at current terms for another six years to December 31, 2027. Finally, MGC believes that craft beer bottle distributors and craft breweries in the Southeast will oppose the transaction, seeing it simply as eliminating one of three significant beer bottle manufacturers that can now supply them and leaving them with only two realistic suppliers.

Merger Antitrust Law
Fall 2020

GRADED HOMEWORK ASSIGNMENT: BEER BOTTLE MERGER
INSTRUCTOR'S ANSWER

MEMORANDUM OF LAW VERSION

Note: This answer is much longer and more detailed on the explanation than anything I would expect for a writing assignment, much less a timed exam answer. I prepared this as a teaching tool to explain the law and the reasoning in detail rather than a model exam answer.

You have asked me to provide a preliminary risk assessment of a possible acquisition of our client Mass Glass Corporation (MGC) of Bell Bottles, Inc. for \$900 million in cash.¹ In particular, you have asked me to assess whether the parties can successfully convince the FTC to close the investigation, either cleanly or with some mutually acceptable consent order, and not proceed to litigation. You have also asked me to address what provisions MGC should anticipate Bell will require in the merger agreement to maximize the probability that the deal will close, whether MGC should accept or resist these provisions, and what, if any, provisions MGC should seek in return.

I have based this preliminary risk assessment on some initial limited information provided by MGC as well as information gleaned from public sources. As we learn more, this risk assessment may change.

For the reasons explained below, the FTC almost certainly will open a preliminary investigation and then issue a second request to the parties for an in-depth investigation. Since the transaction value is \$900 million, the transaction will be subject to the Hart-Scott-Rodino Act's reporting and waiting period requirements. It will be readily apparent from the HSR filings and even a cursory review of the websites of the companies, and possibly from complaints from customers, that MGC and Bell are two of the four companies that manufacture and sell glass beer bottles in the United States. The preliminary investigation should also reveal that, although MGC and Bell both have glass plants around the country, they overlap in beer bottle sales only to breweries in the southeastern United States (Florida, Georgia, Alabama, and South Carolina). That should focus the merger review on the manufacture and sale of glass beer bottles in the Southeast.

¹ **Note to students:** Some of you created code names for the companies. Good for you! You remembered my admonition that memoranda of this type should never use actual company names. I must confess that in writing this answer I obviously forgot my own rule. Since I did not follow my own rule, I can hardly dun others who failed to follow it. The instructions for the exam, however, will dispense with the desirability of using code names.

At the end of the merger review, the FTC almost certainly will challenge the acquisition in the manufacture and sale of glass beer bottles in the Southeastern United States in two distinct targeted customer markets: (1) beer bottles sold directly to large breweries (the “large brewery market”), and (2) beer bottles sold to distributors for resale to craft breweries (the “craft brewery market”). In the large brewery market, there are three large breweries in the Southeast. The FTC could elect either to allege a relevant market consisting of all three breweries or to allege separate bidding markets for each of the three breweries. Regardless of how the large brewery markets are defined, the transaction is a 3-to-2 merger that will easily predicate the *Philadelphia National Bank* presumption. Moreover, there is strong additional evidence that the transaction will anticompetitively increase prices due to a second cost auction unilateral effect at ABI’s Jacksonville brewery as well as the likelihood of increased tacit coordination in the large brewery market as a whole. In the craft brewery market, the concentration statistics will predicate the *PNB* presumption, which will be supported by a strong coordinated effects theory of anticompetitive harm. On the facts available, there are no defenses to the FTC’s *prima facie* case. An entry/expansion/repositioning defense, a power buyers defense, and an efficiencies defense all are contradicted by the facts as we understand them.

If challenged, the FTC should accept a consent decree requiring the divestiture of only the Bell Macon plant. Given the high likelihood of a challenge, Bell almost certainly will demand that MGC accept a contractual obligation in the purchase agreement to propose a consent decree to the FTC requiring the divestiture of the Macon plant if necessary to resolve the FTC’s objections and permit the deal to close without litigation. Given the almost certainty that the transaction will be enjoined absent a divestiture of the Macon plant, MGC should accept such a divestiture commitment in order to obtain the very large synergies available from the acquisition of the remaining seven Bell plants around the country. In return, MGC should require provisions in the purchase agreement that (1) require the parties to file their HSR forms and comply with any second request within a set time period; (2) preserve the option to litigate the merits by providing for an extension of the drop-dead date; (3) obligate Bell to use its reasonable best efforts to cooperate with MGC in the defense of the transaction in the investigation and in any litigation; and (4) give MGC control overall strategy and timing decisions related to the defense of the transaction. MGC should not negotiate these litigation-related provisions with the idea that MGC would litigate in an attempt to defeat the FTC and close the deal without any divestiture—Bell will not accede to that—but rather to preserve a litigation option in the event that the FTC does not accept a Macon divestiture. In that case, MGC would have the option of finding a buyer for the Macon plant, entering into a divestiture agreement contingent on the closing of the Bell acquisition, and litigating the fix. If MGC gives Bell its requested divestiture provision, Bell should be willing to accept all of MGC’s requested provisions. There should be no need for MGC to accede to an antitrust reverse termination fee.

Inquiry Risk²

The FTC almost certainly will open a preliminary investigation and then issue a second request to the parties for an in-depth investigation.

To enable the federal antitrust enforcement authorities to review large mergers or acquisitions under Section 7, Congress enacted the Hart-Scott-Rodino Act (“HSR Act”), 15 U.S.C. § 18a. The FTC will be the reviewing agency if the transaction is reviewed. In 2020, transactions resulting in the acquiring party holding \$94 million or more of stock or assets of the acquired company are subject to the HSR Act, so an acquisition by MGC of Bell valued at \$900 million would be subject to the Act’s premerger reporting and waiting period requirements.

Under the HSR Act, prior to closing, the parties will each have to file a prescribed report form with the Antitrust Division of the Department of Justice and with the Federal Trade Commission. The HSR Act then bars the transaction’s closing for an initial waiting period of 30 calendar days to permit the investigating agency to conduct a preliminary antitrust merger review. It will be readily apparent from the HSR filings and even a cursory review of the websites of the companies that MGC and Bell are two of the four companies that manufacture and sell glass beer bottles in the United States, which will cause the FTC to open an initial investigation. During this investigation, the FTC will invite the parties to make a presentation on their transaction, ask the parties to submit various documents, data, and information about their operations and the markets in which they operate, review the websites of the companies and other information available from public sources and interview customers and competitors. Indeed, it is also possible that some brewers will complain about the transaction to the FTC in these interviews, if not reach out to the FTC affirmatively. In particular, MGC acknowledges that ABI is known to be an aggressive complainer to the FTC about deals it believes have any prospect of anticompetitively affecting it.

As a result of this initial investigation, the FTC will learn that, although MGC and Bell both have glass plants around the country, they overlap in beer bottle sales only to breweries in the southeastern United States (Florida, Georgia, Alabama, and South Carolina). Indeed, a major goal of the initial presentation to the FTC by the merging parties should be to convince the FTC to narrow its investigation to the manufacture and sale of beer bottles in the Southeast. Customers in their interviews by the FTC staff in the initial 30-day HSR waiting period should also confirm this. As a result, the remainder of the merger review should focus on the Southeast.

The FTC then almost certainly will issue a second request and conduct an in-depth review of the transaction. The issuance of a second request extends the waiting period for the time it takes the

² **Note to students:** The hypothetical stated that Ms. Gambini told MGC that “the acquisition most likely would be reviewed by the Federal Trade Commission.” While my intent was to say that, if investigated, the review would be allocated to the FTC in the clearance process and leave open the question of whether the transaction would be reviewed. But my articulation was sloppy and those of you who assumed that Ms. Gambini essentially said that the inquiry risk was 100% and therefore did not need to be addressed in the memorandum were perfectly within your rights.

parties to comply plus an additional 30 calendar days. The FTC's practice is to ask the merging parties to enter into a "timing agreement" committing the parties not to close the transaction for an additional 30 to 60 days after the waiting period has expired to enable the FTC to complete its investigation and to allow the parties to present the best possible defense of the transaction. The merging parties almost find it in their interest to give this commitment, since otherwise the FTC is likely to cease talking to the parties after the parties submit their second request materials and instead devote 100% of its efforts to preparing for litigation. While this may be only a negotiating tactic, it is very effective in incentivizing the merging parties to enter into a timing agreement.

At the conclusion of the investigation, the FTC will decide whether to close its investigation without taking any enforcement action or to challenge the transaction as a violation of Section 7 of the Clayton Act. If the FTC decides to challenge the transaction, the parties have three options: (1) settle the investigation with a consent decree acceptable to the FTC, (2) litigate the merits of the FTC's challenge, or (3) voluntarily terminate the purchase agreement.

Substantive Risk

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).³

For the reasons explained in the following sections, I believe that the FTC almost certainly will conclude that the transaction violates Section 7. In evaluating the transaction, the FTC will rely in the first instance on whether the transaction violates the principles set forth in the 2010 Horizontal Merger Guidelines issued by the Commission and the Department of Justice. U.S. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines (rev. Apr. 19, 2010) ("2010 Horizontal Merger Guidelines"). But because the FTC lacks the power to preliminarily enjoin a transaction and must seek a preliminary injunction from a federal district court, it will also be attuned to the tests courts apply in Section 7 cases. Since the courts have largely accepted the theories of anticompetitive harm in the Merger Guidelines as supporting a finding of *prima facie* effect under the *Philadelphia National Bank* presumption, I will analyze the substantive risk of the transaction under the usual judicial framework:

³ **Note to students:** Technically, another essential element of a Section 7 violation is the requisite connection to interstate commerce. The instructions to the homework assignment (as well as to the exam) say that you may assume this connection and that you do not need to address it.

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 legality⁴

1. The *prima facie* Section 7 case

The plaintiff must present evidence that permits the trier of fact to find the existence of each of the three essential elements of a Section 7 violation: (1) the relevant product market (“line of commerce”), (2) the relevant geographic market (“section of the country”), and (3) a reasonably probable anticompetitive effect in the relevant market.

a. The relevant product market

The FTC almost surely will analyze the transaction in a market for the manufacture and sale of glass beer bottles and so exclude aluminum beer cans from the relevant market. Furthermore, the FTC almost certainly will disaggregate the sale of beer bottles into two distinct targeted customer markets: (1) beer bottles sold directly to large breweries, and (2) beer bottles sold to distributors for resale to craft breweries. I first will analyze the exclusion of aluminum cans from the market and then develop the two targeted customer markets.⁵

i. Glass beer bottles and the exclusion of aluminum cans

There are two complementary approaches to product market definition: (1) the *Brown Shoe* “outer boundaries” and “practical indicia” criteria, and (2) the hypothetical monopolist test. Both

⁴ **Note to students:** Some of you added a paragraph on the *Baker Hughes* three-step burden-shifting approach in your introduction to this section. This was unnecessary since the question of substantive risk could be answered without analyzing whether the required burdens were likely to be satisfied at the various stages of any litigation. That said, while a *Baker Hughes* paragraph was surplusage, I did not deduct for its inclusion.

⁵ **Note to students:** Some of you analyzed an all beer bottle market. That is technically correct, since any product grouping containing a relevant market is also a relevant market under the Merger Guidelines. I did not analyze an all beer bottle market because there is nothing in the facts that indicates that there is any cross-elasticity between the two targeted customer markets, the arguments for separate large brewery and craft brewery markets were compelling, and an analysis of an all beer market in addition to the two targeted customer markets added nothing to the analysis. Given the strength of the argument for the two targeted customer markets and that the task was to anticipate what the FTC would do in its analysis, it would have been a mistake not to identify them and to analyze only the all beer bottle market. That said, if you identified the relevant markets as a targeted customer market for larger breweries (collectively or individually) and an all beer bottle market, or even only an all beer bottle market, you could have found all of the anticompetitive effects in your analysis of the additional evidence of harm following the *PNB* presumption. If you did that, the failure to identify one or both targeted customer markets would have been largely harmless in predicting the outcome of the investigation.

approaches point to a relevant product market containing only glass beer bottles and excluding aluminum beer cans.⁶

The Brown Shoe judicial tests. Under *Brown Shoe*, the “outer boundaries” of the relevant product market “are determined by the reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it.” *Brown Shoe Co. v. United States*, 370 U.S. 294, 325 (1962). Moreover, “within this broad market, well-defined submarkets may exist, which, in themselves, constitute relevant product markets for antitrust purposes. The boundaries of such a submarket may be determined by examining such practical indicia as industry or public recognition of the submarket as a separate economic entity, the product’s peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors.” *Id.* (internal citations and footnotes omitted). The original purpose of the *Brown Shoe* “practical indicia” was to enable the finding of relevant (sub)markets within larger markets defined by the “outer boundaries” test. Modern courts, however, do not view submarkets as any different from markets and regard the *Brown Shoe* “practical indicia” as factors probative of reasonable interchangeability of use and high cross-elasticity of demand in market definition generally.

Glass beer bottles satisfy the *Brown Shoe* “outer boundaries” and “practical indicia” tests. Beer bottles are a homogeneous product, which is sold almost exclusively on price. This results in very high (essentially infinite) cross-elasticities of demand between manufacturers and makes glass beer bottles necessarily reasonably interchangeable in use with one another. Glass beer bottles also have industry recognition as a distinct product, peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors, and so satisfy the *Brown Shoe* “practical indicia” test.

Aluminum beer cans do not pass the “outer boundaries” test to belong in the same market as glass beer bottles. Although both glass bottles and aluminum cans are used by brewers to package beer, they exhibit low cross-elasticity of demand with one another. Many beer consumers strongly believe that beer in bottles tastes better, stays cooler longer, and has a longer shelf life than beer packaged in cans. Moreover, beer degrades with exposure to ultraviolet light and oxygen. Contrary to the belief of many consumers, cans keep beer fresher longer because they block all light and oxygen from reaching the beer. In contrast, all bottles are permeable to some extent to light and oxygen where the cap joins the bottle. As a result, even though brewers

⁶ **Note to students:** Some of you concluded that cans were not in the relevant product market because neither of the merging parties manufacture or sell them. This is incorrect. While it is true that the initial candidate market in the hypothetical monopolist tests begins with the product of a merging firm (perhaps together with “close” substitutes—see Warren-Boulton’s starting point in *H&R Block*, which the court accepted)—in subsequent iterations of the HMT products that have high cross-elasticities/diversion ratios that the merging parties do not produce may be added to the candidate market. For example, Warren-Boulton (and the court) analyzed manual tax preparation methods, which neither of the merging parties produced, for inclusion in the relevant market after the initial candidate market was established although Warren-Boulton and the court ultimately rejected their inclusion for lack of the requisite cross-elasticity.

prefer cans to bottles because they cost the brewer about 30% less on a delivered basis, are easier and less expensive to transport and store, and sustain less breakage, brewers will switch from bottles to cans only to the extent that consumers accept cans. The historical evidence is that over the last ten years, cans have grown from about 47% to 62% of all beer packaging at a relatively steady annual growth rate of about 3.1%—the same as the consumer acceptance rate— notwithstanding fluctuations in the relative prices of glass bottles and cans over this period. This indicates that changes in the demand for glass beer bottles relative to aluminum cans reflect shifts in the demand curve toward cans and not movements up and down the demand curve based on the relative prices of the two containers. In modern antitrust law, “reasonable interchangeability of use” means high cross-elasticity of demand, not mere functional interchangeability.

The hypothetical monopolist test. The “hypothetical monopolist test,” which was introduced by the Merger Guidelines in 1982 and now adopted in one form or another by the courts, deems a product grouping (“candidate market”) as a relevant market if a hypothetical monopolist of all products in the product group could profitably raise the prices in the product grouping by a small but significant nontransitory price (“SSNIP”), usually taken to be 5% for one year. The current 2010 Merger Guidelines have modified the hypothetical monopolist test in two significant ways:

1. Originally, the hypothetical monopolist test only deemed the smallest product grouping that satisfied the test to be a relevant market (the “smallest market principle”). Under the 2010 Merger Guidelines, while the smallest market principle remains the preferred approach, courts and the agencies will use a larger market if appropriate to reflect the economic realities.⁷
2. Originally, the hypothetical monopolist test required the hypothetical monopolist to increase the prices of all of the products in the candidate market. Under the 2010 Merger Guidelines, where the hypothetical monopolist could raise the prices of one or more products selectively while leaving the prices of the other products constant, the hypothetical monopolist test requires only that the hypothetical monopolist to be able to profitably raise the price of a *single* product in the product group for the product grouping to be a relevant market provided that the product is one produced by a merging firm.⁸

⁷ **Note to students:** As we have discussed, prior to 2010 the agencies on occasion had alleged relevant markets that satisfied the smallest market principle but did not look like any market or product grouping the industry or its customers had ever recognized. Courts tended to hold this departure from the “business realities” against the agency in rejecting the agency’s market definition. The 2010 Merger Guidelines rectified this problem by recognizing broader markets that reflect the business realities. The FTC alleged market broader than the smallest markets in *H&R Block*. The FTC defined the market to include all DDIY tax products, although any two of the three major products satisfied the hypothetical monopolist test and hence the all DDIY tax products market did not satisfy the smallest market principle.

⁸ **Note to students:** I could have added a third change—the arguable shift from a profitability interpretation of the HMT to a profit-maximization interpretation. As we discussed in class, however, the agencies in practice continue to use a profitability test in their investigations and in court, the majority of courts have continued to use

The courts have essentially adopted these modifications. In particular, modern courts are using the one-product SSNIP test to define markets. *See, e.g., FTC v. Wilh. Wilhelmsen Holding ASA*, 341 F. Supp. 3d 27, 47 (D.D.C. 2018); *United States v. Anthem, Inc.*, 236 F. Supp. 3d 171, 198 (D.D.C. 2017); *United States v. Aetna Inc.*, 240 F. Supp. 3d 1, 20 (D.D.C. 2017); *FTC v. Staples, Inc.*, 190 F. Supp. 3d 100, 121 (D.D.C. 2016); *FTC v. Sysco Corp.*, 113 F. Supp. 3d 1, 33 (D.D.C. 2015); *United States v. H & R Block, Inc.*, 833 F. Supp. 2d 36, 51-52 (D.D.C. 2011). An important practical implication of these two modifications is that any product grouping containing a relevant market satisfies the hypothetical monopolist test since the hypothetical monopolist could simply profitably raise the prices for the products that create the original relevant market and leave unchanged the prices of all of the other products in the larger product grouping. That said, a court will reject a larger market even though it satisfies the hypothetical monopolist profitability test if the larger market does not conform with the commercial realities of the marketplace.

Beer bottles satisfy the hypothetical monopolist test under a uniform SSNIP test.⁹ We can implement the uniform SSNIP test using percentage critical loss. The idea of the percentage critical loss test is that a hypothetical monopolist can profitably implement a small but significant and nontransitory in price (“SSNIP”) if its percentage actual loss of sales is below its critical loss of sales. The percentage critical loss for a product grouping with a uniform SSNIP (δ) and an average margin m is:

$$\%CL = \frac{\delta}{\delta + m}.$$

The average margins for glass beer bottles depend on the type of brewery that uses the bottles. The average margin for sales to large breweries is 12.5% and craft brewers 22.2%, for a volume-weighted average margin of 14.6%. The minimum critical loss will occur at the highest margin, so that a lower bound for the critical loss for glass bottles is:¹⁰

the profitability test, and the instances in which the two tests diverge will be rare. Accordingly, there is no need to discuss the profit-maximization test, although there would be no harm in dropping a footnote to it.

⁹ **Note to students:** Recall that uniform SSNIP tests are appropriate when the products are homogeneous. One-product SSNIP tests (including implementations that use recapture ratios) only work when the products are differentiated (i.e., support more than one price in the market).

¹⁰ **Note to students:** Some students used 33.3%, which is the percentage margin earned by MGC on sales into the craft brewery market, as the highest margin. This is the highest margin listed in Table 7. In this hypothetical, 33.3% works fine, since the critical loss it produces (13.1%) is still significantly higher than the 1% actual loss reported in the hypothetical. The only time this choice would make a difference is when the actual loss lies between the critical loss calculated at 22.2% and the critical loss calculated at 33.3%. In principle, I believe that 22.2% is the correct number to use. We are using the percentage critical loss implementation of the uniform SSNIP test, and the hypothetical monopolist controls the market as a whole. The revenue-weighted average margin for the craft market is 22.2%, and if diversions occur in proportion to market shares, 22.2% would give an accurate representation of the critical loss for that market.

$$\%CL = \frac{\delta}{\delta + m} = \frac{0.05}{0.05 + 0.222} = 18.4\%$$

According to MGC, an overall increase in the average price of glass beer bottles by 5% would result in only a 1% decrease in overall brewer demand for glass bottles. Although we do not know the percentage actual loss for large and craft breweries separately, the aggregate actual loss of 1% is so much lower than the lowest possible critical loss for any category, we can safely conclude that the hypothetical monopolist test is satisfied for glass beer bottles.¹¹

ii. Targeted customer markets

Although glass beer bottles are homogeneous products, modern antitrust law recognizes that these products may be sold into separate relevant markets defined by customer type. Section 4.1.4 of the Merger Guidelines provides that “[i]f a hypothetical monopolist could profitably target a subset of customers for price increases, the Agencies may identify relevant markets defined around those targeted customers, to whom a hypothetical monopolist would profitably and separately impose at least a SSNIP.” 2010 Horizontal Merger Guidelines § 4.1.4. The concern underlying targeted customer markets (sometimes called “price discrimination markets”) is that certain types of captured or dedicated customers could be targeted for monopolist pricing even if a price increase for all customers would not be profitable. Modern courts have applied this concept in defining product markets. *See, e.g., FTC v. Staples, Inc.*, 190 F. Supp. 3d 100, 117-18 (D.D.C. 2016); *FTC v. Sysco Corp.*, 113 F. Supp. 3d 1, 38-48 (D.D.C. 2015).

Glass beer bottles are purchased from bottle manufacturers by two distinct classes of customers: large breweries and distributors for resale to craft breweries. A defining characteristic of a targeted customer class is the charging of significantly different prices to the targeted class and the remaining customers. Here, large breweries pay \$0.12 per bottle while distributors to craft breweries pay \$0.15, or 25% more, for identical bottles. Moreover, the distribution channels to the two customer classes are different: glass bottles are sold directly by the manufacturer to large breweries on a delivered basis under long-term supply agreements, while distributors to craft breweries purchase at the manufacturing plant on a “spot” basis. Finally, there is no arbitrage in beer bottles: bottles purchased by a brewery are used in that brewery and not resold.

¹¹ **Note to students:** Some students observed correctly that beer bottle manufacturers were operating in the inelastic portion of the demand curve (with an own-elasticity of 1%/5% = -0.2) and then incorrectly concluded that that beer bottles satisfied the HMT. While it is true that when firms operate in the inelastic portion of their demand curves a hypothetical monopolist could profitably increase price by some amount (at least when the buyers are price-takers and do not have market power themselves), we cannot tell from that fact alone by how much the monopolist could increase price. Further analysis—here, by percentage critical loss—is required to determine whether the hypothetical monopolist could profitably increase price by a 5% SSNIP.

For the reasons explained above, both of the targeted customer classes here satisfy the hypothetical monopolist test under a uniform SSNIP using the percentage critical loss implementation.¹²

Indeed, each of the three large breweries in the Southeast can be isolated into their own separate individual markets. Each large brewery obtains its beer bottles through long-term supply contracts that it puts out for bid. Although the prices they pay are all equal today, there is no apparent economic reason why the winning bid prices have to be the same across breweries. Moreover, each of the major breweries constitutes an economically significant dollar volume of beer bottle purchases and a significant share of overall beer bottle sales in the Southeast and so could constitute a “line of commerce” within the meaning of Section 7 in which competition could be substantially lessened:

Large Breweries in the Southeast		
	Purchases	Overall Share
ABI	\$92,640,000	34.8%
MillerCoors	\$89,100,000	33.5%
Yuengling	\$21,978,000	8.3%

The Merger Guidelines indicate that the agencies often define markets for groups of targeted customers rather than individual customers even when the hypothetical monopolist test suggests relevant markets as narrow as individual customers. *See* 2020 Horizontal Merger Guidelines § 4.1.4. But given the significance of the individual large breweries in the market as a whole, the FTC may consider this an exception to the general rule. As explained below, however, the theories of anticompetitive harm are similar, and a *prima facie* case can be established regardless of whether the three large breweries constitute a single market or a collective market.

In sum, the relevant product markets in which to analyze the competitive effects of a MGC/Bell transaction are (1) the manufacture and sales of glass beer bottles to large breweries, and (2) the

¹² **Note to students:** Some of you applied a one-product SSNIP test rather than a uniform SSNIP test. Where the products are physically homogeneous and there is only a single price in the (targeted customer distribution) channel, a one-product SSNIP test is inappropriate. A uniform SSNIP test should have been used. Although you were given only the percentage actual loss for all beer bottles, the loss was so low that it would be reasonable to assume that the percentage actual loss within each channel would also be relatively low and in any event below the critical loss for the channel using the revenue-weighted average margins in Table 8.

manufacture and sale of glass beer bottles to distributors for resale to craft breweries (either collectively or by individual brewery).^{13,14}

b. The relevant geographic market

The second essential element of a *prima facie* Section 7 case is the relevant geographic market. In *Philadelphia National Bank*, the Supreme Court defined the relevant geographic market to be “the area of effective competition . . . in which the seller operates, and to which the purchaser can practically turn for supplies.” *United States v. Philadelphia Nat’l Bank*, 374 U.S. 321, 359 (1963). To the same effect, “[t]he proper question to be asked . . . [is] where, within the area of competitive overlap, the effect of the merger on competition will be direct and immediate.” *Id.* at 357. Congress prescribed a “pragmatic, factual approach to the definition of the relevant market and not a formal, legalistic one.” *Brown Shoe Co. v. United States*, 370 U.S. 294, 336 (1962). “An element of ‘fuzziness would seem inherent in any attempt to delineate the relevant geographical market.” *United States v. Conn. Nat’l Bank*, 418 U.S. 656, 669 (1974) (quoting *Philadelphia Nat’l Bank*, 374 U.S. at n.37). The boundaries of a relevant geographic market “need not . . . be defined with scientific precision,” *id.*, or “by metes and bounds as a surveyor would lay off a plot of ground,” *United States v. Pabst Brewing Co.*, 384 U.S. 546, 549 (1966). Rather, the relevant geographic market should “‘correspond to the commercial realities’ of the industry and be economically significant.” *Brown Shoe*, 370 U.S. at 336-37.

Courts also test the boundaries of a candidate relevant market using the hypothetical monopolist test. When customers receive goods or services at suppliers’ locations and in the absence of price discrimination based on customer location, the 2020 Horizontal Merger Guidelines normally define geographic markets based on the locations of suppliers. *See* 2020 Horizontal Merger Guidelines § 4.2.1. When the hypothetical monopolist could discriminate based on customer location, the Guidelines define geographic markets based on the locations of targeted customers. *Id.* § 4.2.2. Geographic markets of this type often apply when suppliers deliver their products or services to customers’ locations. Courts are adopting this approach as well. *See, e.g., FTC v.*

¹³ **Note to students:** Some of you rejected a large brewery relevant market because Bell makes no sales into this market. But a firm can be a market participant and be assigned a market share for the purposes of the *PNB* presumption even if it does not make current sales into the market. In the large brewery market, Bell is a market participant because the large brewery market is a bidding market and Bell is a credible bidder. Although Bell has not won any large brewery contracts in recent years, it has the capacity to service a large brewery (and hence could be considered a “rapid entrant”) and, as discussed below, has a price-constraining force on MGC in the bidding for the ABI Jacksonville contract.

¹⁴ **Note to students:** Some of you concluded that the relevant market must be all beer bottles because it is the smallest market that included all of the sales of the merging parties. This is incorrect. Relevant markets are defined by demand-side conditions. The merging parties can participate (and overlap) in multiple disjoint relevant markets (as they did in *Sanford Health*). The smallest market principle addresses the minimal product grouping where the diversion outside of the product grouping is insufficient to prevent a hypothetical monopolist by profitably increasing prices by a SSNIP.

Tronox Ltd., 332 F. Supp. 3d 187, 206 (D.D.C. 2018); *United States v. Bazaarvoice, Inc.*, No. 13-CV-00133-WHO, 2014 WL 203966, at *29-30 (N.D. Cal. Jan. 8, 2014).

The relevant geographic market is dependent on a properly defined product market: a court cannot assess “the area of effective competition” for a product without defining the product itself. Here, there are two relevant product markets and I will assess them separately.

Sales to large breweries. Manufacturers sell glass beer bottles to large breweries under long-term supply agreements for which they were the winning bidder. The contracts for each of the three large breweries in the Southeast provide that the manufacturer must deliver the bottles to the brewery site and include all delivery charges in the purchase price set by the agreement. There is no arbitrage by large breweries, and the brewery must use all of the beer bottles that it purchases and not resell them. Finally, the three glass beer bottle manufacturers each bid for the long-term supply contracts for each of the three large breweries in the Southeast. A hypothetical monopolist controlling the three beer bottle manufacturers could profitably increase the price by 5% or more to each of three large breweries. (The math is the same here as in the relevant product market analysis above.)

Since manufacturers ship beer bottles to large breweries, the relevant geographic market for the manufacture and sale of beer bottles to large breweries will be defined by customer location. Under the facts described above, each of the large breweries satisfies the judicial and hypothetical monopolist tests to be its own individual relevant market. In addition, as provided by the Merger Guidelines, the FTC may elect to aggregate the three breweries into a single relevant geographic market. *See* 2020 Horizontal Merger Guidelines § 4.2.1. The Southeast would be a natural geographic market since it contains the three large southeast breweries and captures the “commercial realities” of the marketplace given the draw areas of each of the beer bottle manufacturing plants.¹⁵

Sales to craft breweries. Rather than selling glass bottles directly to craft breweries as they do to large breweries, manufacturers sell glass beer bottles to independent distributors that in turn resell the bottle to craft breweries. These distributors purchase on a “spot” basis at the beer bottle plant. Wholesale prices paid by distributors are uniform throughout a region across manufacturers. The margins on beer bottles sold to craft brewers permit a distributor to ship throughout the four-state southeastern region regardless of the manufacturing plant where that distributor obtains its beer bottles.

Since manufacturers sell to distributors at the factory, the relevant geographic market for the manufacture and sale of beer bottles to large breweries will be defined by the location of the suppliers. Courts have held that where the companies in the relevant product market sell their

¹⁵ **Note to students:** Several of you who isolated each of the large breweries into their own individual geographic market placed ABI Jacksonville and Yuengling Tampa in a Southeast geographic market but placed MillerCoors Albany into a national market given that MillerCoors procures its beer bottles through a national supply agreement with a single vendor. I should have thought of this! It is a technically better approach than the one I adopted in my answer.

products in the candidate market at uniform prices, the candidate market is a relevant geographic market. The Merger Guidelines recognize this principle as well. Moreover, using the hypothetical monopolist test, we know that a hypothetical monopolist could profitably raise prices by 5% across the country for at least one product in the market. (The math is the same here as in the relevant product market analysis above.) This confirms that the Southeast is the relevant geographic market for the sale of beer bottles to distributors for resale to craft breweries.

c. Market shares, concentration, and the *PNB* presumption

In *Philadelphia National Bank*, the Supreme Court held that “a merger which produces a firm controlling an undue percentage of the relevant market, and results in a significant increase in the concentration of firms in that market, is so inherently likely to lessen competition substantially that it is must be enjoined in the absence of evidence clearly showing that the merger is not likely to have such anticompetitive effects.” *United States v. Philadelphia National Bank*, 374 U.S. 321, 363 (1963). Specifically, the Court held that a combined firm with at least 30% share and an increase in the 2-firm concentration ratio from 44% to 59% was sufficient to constitute “undue market share” and cause a “significant increase in concentration” to predicate the *PNB* presumption. The 2010 Guidelines provide that mergers in markets with a postmerger HHI above 2500 and a delta of 200 or more “will be presumed to be likely to enhance market power” and be sufficient to predicate the *PNB* presumption. Although the Guidelines are not binding on courts, modern courts frequently cite the Guidelines as supporting authority when finding that mergers that increase the HHI by 200 or more points and result in a postmerger HHI of 2500 or more as authority in finding that the merger satisfies the predicates for the *PNB* presumption. See, e.g., *United States v. Anthem, Inc.*, 855 F.3d 345, 349 (D.C. Cir. 2017); *FTC v. Penn State Hershey Med. Ctr.*, 838 F.3d 327, 347 (3d Cir. 2016); *ProMedica Health Sys., Inc. v. FTC*, 749 F.3d 559, 568 (6th Cir. 2014); *FTC v. Staples, Inc.*, 190 F. Supp. 3d 100, 128 (D.D.C. 2016) (“Staples’ proposed acquisition of Office Depot is therefore presumptively illegal because the HHI increases more than 200 points and the post-merger HHI is greater than 2,500.”). The Guidelines also provide that in moderately concentrated markets (that is, markets with an HHI between 1500 and 2500), a transaction that increases the HHI by more than 100 points “potentially raise significant competitive concerns and often warrant scrutiny.”

The Southeastern large brewery market. The sale of beer bottles to large breweries is a bidding market in which the contracts are large, multiyear, and infrequently let out for bid. In this situation, the market participants are those firms that bid for the contracts. Therefore, their respective market shares should be assigned according to the probability of each bidding firm winning the bid. Only three firms bid for these contracts: OD, MGC, and Bell. Neither Crystal Glass nor the Mexican importers have bid for these contracts, presumably because of the transportation cost disadvantages they face (and, in the case of the importers, the import quota restrictions as well). Therefore, these companies should not be considered market participants in this market.

Whether the relevant geographic market is sales to all Southeast breweries collectively or to each brewery individually, the most conservative case from the FTC’s perspective would be to assign each of the three bidding firms an equal share. In this 3-to-2 merger, the transaction would create a firm with 66.6% of the market and increase the HHI by 2222 points from 3333 to 5555:

HHI calculations		
Individual large brewers: 1/n		
OD	33.3%	1111
MCG	33.3%	1111
Bell	33.3%	1111
		3333
Combined share		66.7%
Delta		2222
Post		5555

This easily predicates the *PNB* presumption under both judicial precedent and the Merger Guidelines. A most realistic HHI assessment would take into account that the firms are not equally positioned to win each contract. Indeed, Bell has not won a large brewery contract in the Southeast since the ABI Macon, GA brewery closed in 1995, so it is at least arguable that Bell should be assigned a much-reduced share. But since in the most conservative case, the *PNB* presumption, any more realistic assignment of bidding market shares *a fortiori* would also predicate the *PNB* presumption.¹⁶

The Southeastern craft brewery market. The sale of beer bottles to distributors for resale to craft breweries is a more traditional market. Market participants in this market are those firms that sell into the market. Since beer bottles are a homogeneous product, the market shares of the various market participants are determined by their historical unit volume sales into the market. The transaction would increase the share of the largest firm in the market from 77.6% to 83.8% and increase the HHI by 1637 points from 6185 to 7822:

¹⁶ **Note to students:** Some of you calculated HHIs in an aggregate large brewery market using revenues. Since Bell has no revenues in the large brewery market, this left the HHIs unchanged postmerger and indicates that the presence of Bell has no competitive significance to the price large brewers will pay for bottles postmerger. But this ignores the significance of Bell as a bidder for the long-term supply contracts of bottles. Some of you who used revenue HHIs recognized this and then did market shares using 1/n. If you finally used 1/n (or some variant), I credited you. But in a bidding market with this structure—with infrequent bids for long-term contracts that a large relative to the size of the market—revenues should not have been used at all.

HHI calculations		
Craft Breweries		
OD	6.2%	38
MCG	10.6%	111
Bell	77.6%	6017
Crystal	4.3%	18
Importers (2)	1.5%	1
		6185
Combined share	88.1%	
Delta		1637
Post		7822

This easily predicates the *PNB* presumption under both judicial precedent and the Merger Guidelines.¹⁷

d. Additional evidence supporting the *prima facie* case

Modern courts and the Merger Guidelines recognize that mergers are anticompetitive under Section 7 when they have a reasonable probability of increasing prices, reducing market output, reducing product or service quality, or the reducing rate of technological innovation or product improvement in the market compared to what would have happened in the market on a going-forward basis in the absence of the transaction. The FTC almost surely will be able to prove that this transaction creates significant anticompetitive harm from both unilateral and coordinated effects in the Southeastern large brewery market and an enhancement of anticompetitive coordinated effects in the Southeastern craft brewery market.¹⁸

Unilateral effects in the Southeastern large brewery market. Bidding for large brewery contracts in the Southeast appears to roughly follow a second-cost auction model. A second cost auction model predicts that the winning bid price will be just under the cost of supplying the contract of the second-lowest cost supplier. The relationship need not be exact for the model to be applicable. For example, the winning bidder could bid less than the second-lowest cost supplier due to the winning bidder’s uncertainty about the second-lowest cost or to the bargaining power of the brewery. But even with these adjustments, eliminating the second-lowest cost bidder will

¹⁷ **Note to students:** Some of you used the revenue shares in Table 7 rather than the unit shares in Table 3 to calculate the HHIs. Since the shares are similar enough here, it does not matter to the outcome which metric you used. For the record, however, when the products are homogeneous, unit shares are traditionally used.

¹⁸ **Note to students:** Some of you identified Bell as a “maverick.” There is nothing in the facts that suggests Bell is a “maverick,” that is, a firm that disrupts coordinated interaction among the remaining firms in the market. Compare what made TaxACT a maverick in *H&R Block*.

give the winning buyer additional power in future negotiations and bids and is likely to result in higher bid prices postmerger.¹⁹

Under this model, the transaction is likely to result in a price increase for the ABI Jacksonville supply contract. Consistent with its locational advantage, MGC's Jacksonville plant is the lowest-cost supplier to the Jacksonville brewery and has historically won the Jacksonville supply contract. Bell's Macon plant has sufficient excess capacity to service the ABI Jacksonville demand, is the second closest plant to Jacksonville, and has been the second-lowest bidder for the ABI Jacksonville contract. Still, due to its inefficient production operation, Bell's Macon plant is at a delivered cost disadvantage to OD's Montgomery plant (\$0.1266 vs. \$0.1196, respectively). However, OD's Montgomery plant has the capacity to serve either the MillerCoors Albany plant or the ABI Jacksonville plant but not both. Given its lowered delivered cost to Albany, all other things being equal, OD would make more profit by serving the MillerCoors plant than the Jacksonville plant. This is reflected in the relatively high bid from OD of \$0.150 per bottle for the Jacksonville business in the last contract round. This bidding behavior indicates that, despite its lower delivered cost, OD is unlikely to be a competitive bidder for the ABI Jacksonville contract, leaving only MGC and Bell as realistic competitors for the contract.

Although MGC's winning bid of \$0.120 for the Jacksonville contract was approximately equal to MGC's estimate of OD's delivered cost of \$0.1196, which might suggest that MGC was pricing against OD rather than Bell, the more likely explanation is that MGC had correctly anticipated that OD would bid high (which it did) and that MGC's bid price was not closer to MGC's estimate of Bell's delivered cost of \$0.1266 was due to uncertainty in its estimate of Bell's delivered cost as well as whatever bargaining power ABI could assert on MGC (perhaps using ABI's contracts for some of its other breweries as leverage). In any event, the elimination of Bell as an independent bidder for the ABI Jacksonville contract should significantly increase MGC's bargaining power and result in higher prices in the future for the ABI Jacksonville contract. ABI, known to be an aggressive complainer to the FTC about deals it believes have any prospect of anticompetitively affecting it, could very well provide support to the FTC for this theory.

This makes out a case of anticompetitive unilateral effects in a single Southeastern large brewery market as well as an anticompetitive unilateral effect (akin to a merger to monopoly) in a standalone Jacksonville ABI market.

A second-cost auction unilateral effect, however, does not appear likely for either the Yuengling Tampa or MillerCoors Albany breweries. In the case of the Yuengling Tampa contract, MGC is the lowest cost and winning bidder. OD, however, has the capacity to serve both the MillerCoors

¹⁹ **Note to students:** Some of you assumed that there must be two products differentiated in prices for a second cost auction unilateral effect to arise. That is not correct. While price-differentiated products are required for a "recapture" theory of unilateral effects, products that are homogeneous (such as beer bottles) can nonetheless create a second cost auction unilateral effect if they are differentiated in some way that affects their respective costs and hence bid prices. Here, the differentiation is spatial, which affects costs through their different transportation charges.

Albany brewery and the Yuengling Tampa brewery and is the second-lowest-cost supplier to the Yuengling brewery. Not surprisingly, OD submitted a relatively aggressive bid for the Yuengling contract in the last round (\$0.130 bid price vs. an MGC-estimated delivered cost of \$0.1220). Since the transaction will not involve both the second-lowest cost supplier/second-lowest bidder for the Yuengling Tampa contract, the transaction should not produce an anticompetitive unilateral effect under a second cost auction theory. The analysis for the MillerCoors Albany brewery is even more straightforward: OD is the lowest cost bidder, so the transaction cannot involve both the lowest or the second-lowest price supplier for the Albany contract. In addition, MillerCoors contracts under a national supply agreement for all of its breweries. Neither MGC nor Bell has the plant locations or the capacity to meet the requirements of the MillerCoors contract, eliminating them as acceptable bidders for the MillerCoors Albany brewery contract.

Coordinated effects in the large brewery market. The FTC is likely to find that the transaction will increase the market postmerger's susceptibility to coordinated effects in the large brewery market. The coordinated effects theory asks whether the merger is likely to increase the ability and incentives of a sufficient number of firms in the market to engage in successful tacit collusion. There are two conditions for the coordinated effects theory to apply: (1) the market must be susceptible to tacit coordination, and (2) the merger must make tacit collusion either more likely or more successful.

Here, the large brewery market is susceptible to coordinated interaction given its structure. There are only three beer bottle manufacturers that bid for large brewery contracts in the market. The three manufacturers (along with Crystal) also have worked together in the past to lobby Congress to impose an import quota on Mexican imports. Moreover, it is at least suggestive of tacit coordination that both OD and MGC bid a high \$0.150 for the other's brewery contracts. Other manufacturers with plants outside of the Southeast, whether because of transportation costs or import quotas (or both), have not bid in the past and are unlikely to bid in the future. Moreover, even if they did bid, their bids—which will be constrained by their delivered costs—are likely to be materially higher than the bids the three Southeast breweries received premerger. That said, although the market is susceptible to tacit coordination premerger, Bell is likely to be a spoiler in any tacit bidding scheme since it has been able to win any large brewery contracts and hence has not been able to share in the supracompetitive profits such a scheme might generate.

Postmerger, however, Bell will be eliminated as an independent bidder for large brewery contracts. The only two realistic bidders, OD and MGC, will no longer be constrained by an independent Bell. We have already seen that this is likely to result in a unilateral price increase to the ABI Jacksonville brewery. But it could also likely result in a tacitly coordinated price increase to the MillerCoors Albany brewery. The merged firm could increase its bid price for the Albany contract, giving OD more of an ability to win the contract at a higher price, in the expectation that OD in turn would increase its bid price for the ABI Jacksonville contract, giving the merged firm even more headroom to win the Jacksonville contract at an increased price. Hence, the elimination of Bell through the merger as an independent bidder would provide both

OD and MGC with the ability and incentive to increase their winning bid prices at the brewery at which each is locationally advantaged by reciprocally increasing their respective bids for the brewery at which they are locationally disadvantaged.²⁰

Coordinated effects in the Southeastern craft brewery market. The FTC is also likely to find that the transaction will increase the market postmerger's susceptibility to coordinated effects in the craft brewery market.

The Southeastern craft brewery market is susceptible to tacit coordination premerger. Premerger, the market was characterized by one dominant firm and a few much smaller firms. Distributors purchase on a "spot" basis off a price list, so prices are transparent. In such a concentrated market, this transparency, by itself, makes the market susceptible to tacit coordination. In addition, the major bottle manufacturers (OD, MGC, Bell, and Crystal) have cooperated in the past to successfully lobby Congress to put in place severe limits on the quantities the Mexican beer bottle producers can export to the United States. Finally, it appears that the market is already exhibiting significant tacit coordination. Beer bottles for craft brewers sell for \$0.150 per bottle, 25% higher than for bottles sold to large breweries, which produces an average gross margin of 22.2%, 78% higher than the average margins earned on the sale of beer bottles to large breweries. Given these differences and the significant excess capacity all three Southeastern beer bottle manufacturers have, it would be surprising in the absence of tacit coordination for the companies to be competing more on price with one another. This is especially surprising for OD and MGC, which only sell 26 million and 44 million beer bottles, respectively, into the market, when their excess capacities are 301.8 million and 180.35 million, respectively. Given the high margins in the market, OD and MGC should be trying to use their excess capacity to capture market share from Bell unless there is ongoing tacit coordination in the market.²¹

²⁰ **Note to students:** Some of you argued against a unilateral effects theory on the grounds that the relatively high bids by OD and MGC for the other's brewery customer were "throw away" bids, since the winning bidder's locational advantages would mean it was unlikely the other would win, and the much more aggressive bidding by OD and MGC for the Yuengling Tampa contract. But at most this only suggests that the large brewery market is not experiencing significant tacit coordination, not that the market is not susceptible to coordinated effects. Moreover, the merger would eliminate a meaningful (albeit unsuccessful) bidder, resulting in only two possible suppliers in the market. Given the 3-to-2 merger, I am convinced that the FTC would allege a coordinated effects theory in the large brewery market notwithstanding the evidence of competition between OD and MGC for one brewery today and that a court would agree. Still, the evidence of competition for the Yuengling brewery was a good spot and I credited the analysis.

²¹ **Note to students:** Some of you added a unilateral effects theory for craft breweries. I cannot say that you are wrong, but the facts do not provide much of a foundation for the theory since prices for sales into the craft brewery channel are uniform at \$0.15 at all three Southeastern beer bottle plants. If a second cost auction unilateral effect could occur, one would expect that the various breweries would be selling bottles into the craft brewery market at different prices already. For a more traditional "recapture" unilateral effects theory, there would have to be some differentiation in prices between the merging firms either before or after the merger (or both). There is no differentiation premerger, and there is nothing in the facts that suggest one way or the other whether price differentiation could occur postmerger. In any event, you would need a good argument to support a finding of a unilateral effect.

The transaction is likely to increase the likelihood or success of coordinated interaction in the Southeastern craft brewery market. The transaction will eliminate the independence of one of the three glass beer bottle plants in the Southeast and make it easier for the two remaining firms to tacitly coordinate with one another. Moreover, outside suppliers, namely Crystal Glass and the Mexican importers, are unlikely to expand their operation in the Southeast to maintain the premerger because of the high transaction costs and, for the Mexican importers, the quota restrictions.^{22,23}

e. The *prima facie* case: Summary

Application of the *Brown Shoe* “outer boundary” and “practical indicia” factors, as well as the hypothetical monopolist test, shows that the relevant markets in which to analyze the transaction are the manufacture and sale of glass beer bottles in the Southeastern United States in two distinct targeted customer markets: (1) beer bottles sold directly to large breweries, and (2) beer bottles sold to distributors for resale to craft breweries. Application of the *PNB* presumption will establish a *prima facie* case of anticompetitive effect within both markets. Moreover, the *prima facie* case will be strongly supported by unilateral and coordinated effects theories of anticompetitive harm in the large brewery market and a coordinated effects theory in the craft brewery market. This makes for a strong *prima facie* case for a Section 7 violation.

2. Possible defense arguments

There are four common defenses to an alleged Section 7 violation that assume *arguendo* that the plaintiff will be successful in establishing a *prima facie* case: (1) entry/expansion/repositioning, (2) power buyer, (3) efficiencies, and (4) failing firm. There is no suggestion in the facts as we

²² **Note to students:** Arguably, the merger may increase the homogeneity of the two remaining incumbent firms and so better align their incentives to tacitly coordinate with each other. I decided to reject this as a factor, however, since premerger the market had two firms similarly situated (both serving a single large brewery) and a disparate firm, while postmerger there would be two disparate firms. At best, the argument that increased firm homogeneity made the market more susceptible to tacit coordination is very weak and strongly dominated by the reduction in the number of firms in the market, so I decided not to include the argument.

²³ **Note to students:** Premerger, the structure of the market might suggest that it could be modeled as a dominant firm with a competitive fringe rather than an oligopoly subject to tacit coordination. This, in turn, might suggest an argument that the acquisition will not change competitive conditions materially. I rejected this approach for two reasons. First, OD and MGC are not acting as competitive firms, since they both are pricing significantly above their marginal costs while operating with significant excess capacity. A competitive firm would expand output until either its marginal cost equals the market price or it reaches its capacity constraint. Second, as a practical matter, even if the market could be modeled as a dominant firm with a competitive fringe, it would be extremely surprising if the FTC would accept the conclusion that an acquisition that eliminated one of the smaller firms and increased the dominant firm’s share from 77.6% to 83.8% and increased the HHI by 1637 points from 6185 to 7822 did not violate Section 7.

currently understand them of a failing firm defense.²⁴ Nor do the facts as we currently understand them support any of the other three defenses.

a. Entry/expansion/repositioning

The FTC and the courts recognize that entry by a new firm, or expansion or repositioning by incumbent firms, may negate the anticompetitive effects that otherwise would likely occur from the merger. For entry to be a defense to a *prima facie* case, the entry must be timely, likely, and of a magnitude sufficient to deter or counteract any likely anticompetitive effects of concern so the merger will not substantially harm customers.

The large brewery market is a bidding market. An entry defense in a bidding market requires the emergence of a new bidder (through new entry or repositioning) to replace the bidder whose independence will be eliminated through the transaction. The new bidder would have situated so that it had the incentives and ability to make bids at prices as least as low as the eliminated bidder likely would have made in the absence of the transaction. Here, there is no prospect for a new bidder to emerge that is similarly or better situated than Bell to make bids for large brewery contracts. Incumbent beer bottle manufacturers with manufacturing plants outside the Southeast would face significant net cost disadvantages to Bell in bidding for supply contracts for any of the three large breweries in the Southeast. Moreover, no firm is likely to build a new beer bottle manufacturing plant in the Southeast given the high capital costs, the declining demand for glass beer bottles by large breweries, and the existing excess beer bottle manufacturing capacity in the Southeast. Nor could new entry overcome the locational advantage of MGC to bid for the ABI Jacksonville supply contract or the need for multiple, properly situated plants to enable it to bid for the MillerCoors national supply contract. Although a new plant could be sited closer to the Yuengling Tampa brewery than any of the incumbent plants, the demand at Yuengling alone is probably insufficient to make the construction of a new beer bottle manufacturing plant financially feasible.

The craft brewing market is a traditional spot market. In this type of market, the FTC and the courts both conceive that a firm raises price by reducing supply, thereby creating an artificial scarcity in the market and causing the inframarginal customers to bid up the price to clear the market. An entry defense in this case depends on third-party suppliers increasing their supply to the market to “fill the hole” in supply created by the anticompetitive effect of the merger.

An entry defense is not supported by the facts as we currently understand them. Consider, for example, a relatively modest 5% increase in the price of beer bottles sold to distributors for resale to craft breweries. We know that the own-elasticity of beer bottles is around -0.2, so that a 5% increase in price requires a 1% decrease in quantity. There are 414 million beer bottles sold annually to craft breweries in the Southeast, so a 1% decrease in quantity would create a “hole”

²⁴ **Note to students:** Some of you read into the hypothetical facts indicating that Bell was financially struggling with the Macon plant. Those facts are not in the hypothetical. If you are going to assume fact, you need to explicitly state so. Here, the better way would be to make you analysis conditional (i.e., if the facts are X, then Y).

of 4.14 million beer bottles. There are only 24 million beer bottles shipped into the Southeast from beer bottle manufacturers outside the region (18 million from Crystal and 6 million from importers), so 4.14 million beer bottles would represent a 17% increase in shipments into the Southeast.

Who could supply these bottles? For the same reasons just discussed, no company is going to build a new beer bottle manufacturing facility in the Southeast, so an entry defense in the craft brewery market would have to rely on existing beer bottle plants outside of the Southeast shipping more bottles into the Southeast. Importers, which are subject to import quota restrictions, prefer to fill their quota with shipments to Texas to minimize transportation costs, so they are unlikely to significantly increase their imports into Florida in the wake of a 5% price increase. This means that most of the supply to “fill the hole” would have to come from Crystal. Crystal, however, faces a significant competitive disadvantage because of the cost of shipping into the Southeast from its plants in other regions. MGC estimates that a 500-mile trip from the plant adds a little less \$0.02 to the cost per bottle or about \$.004 per bottle per 100 miles. Assuming that distributors, who would purchase at the beer bottle plant, have the same shipping costs as beer bottle manufacturers, a 5% increase in the \$15 price for craft brewer bottles—which is equal to \$0.75—would offset the transportation costs of sending bottle only an additional 187.5 miles into the region. It is unlikely that distributors would be willing to increase their shipments into the Southeast by 17% under these circumstances. Moreover, and perhaps most importantly, the FTC will demand evidence from distributors showing that they would increase their shipments by the required amounts in order to accept the defense, and it is improbable that the merging parties can find sufficient distributors who would give this testimony to the FTC.

b. Power buyers

The FTC and the courts recognize the buyers may be sufficiently large and powerful to be able to protect themselves against an anticompetitive price increase resulting from a merger. For a power buyer defense to be cognizable, the merging parties must (1) demonstrate the mechanism by which the putative power buyers will protect themselves and (2) demonstrate that all buyers in the market can protect themselves.

The usual protective mechanism is that a buyer that purchases a substantial share of the relevant product can discipline the combined firm from increasing prices by threatening to shift a sufficiently large amount of its purchases from the combined firm to one or more alternative third-party suppliers and thereby defeat the profitability of the price increase to it. The idea is that if the buyer has a large amount of product demand to shift relative to the total market size and can induce alternative suppliers to bid for the right to supply it at premerger prices, the buyer can protect itself.

We can determine the amount that needs to be shifted from a critical loss analysis. Say, for example, the ABI Jacksonville brewery was threatened with a 5% price increase. Margins on MGC sales to ABI Jacksonville are 16.7%, so the critical loss would be:

$$\%CL = \frac{\delta}{\delta + m} = \frac{0.05}{0.05 + 0.167} = 23.0\%.$$

So, for ABI to discipline a 5% price increase postmerger from MGC, it would have to shift at least 23% of its demand—or 170.9 million bottles (= 23% of 743 million)—to a third-party supplier. Although Bell would not be available due to the acquisition, OD, which currently has an excess capacity of 301.8 million bottles, could supply that demand. But OD’s delivered cost to ABI Jacksonville is \$0.196 per bottle, or just about the same as MGC’s winning bid price of \$1.20. Since OD surely will demand some markup over cost to sell to ABI, ABI cannot obtain replacement supply for a disciplining critical loss at its premerger price of \$0.12. As a result, MGC could raise its price at least to the matching price of OD, resulting in some anticompetitive price increase postmerger to ABI Jacksonville. Thus, the power buyer defense fails with respect to ABI Jacksonville.

A similar analysis applies to Yuengling Tampa. Yuengling Tampa has an annual requirement of 183.15 million bottles. OD has sufficient excess capacity to supply the entire amount. However, OD’s delivered cost to Tampa is \$0.1220 per bottle, higher than the \$0.120 that MGC charges Yuengling premerger. As a result, Yuengling cannot obtain replacement supply for a disciplining critical loss at its premerger price of \$0.12. Consequently, MGC could increase the price it charges Yuengling by at least a small amount postmerger and Yuengling would not be able to protect itself. The power buyer defense fails with respect to Yuengling Tampa.

Finally, although this requires confirmation, at least some if not all of the distributors to Southeast craft brewers are unlikely to have the requisite demand to be able to induce a bidding for the replacement of some or all of their demand at premerger prices and hence will not be able to protect themselves. Thus, the power buyer defense fails here as well.

c. Efficiencies

The Horizontal Merger Guidelines recognize an efficiency defense when the efficiencies will negate the anticompetitive effect shown in the proof of the *prima facie* case. Courts have been more cautious in recognizing the validity of the principle of an efficiencies defense because of statements in earlier Supreme Court cases (*Brown Shoe* and *Procter & Gamble*) that efficiencies will not save an anticompetitive merger. However, most modern courts have been willing to assume at least for the purposes of analysis that the efficiencies defense described in the Horizontal Merger Guidelines is a cognizable defense, although no court has yet to find on the facts that the elements of an efficiency defense were satisfied. As with the entry defense, an efficiency defense is a *negative* defense: the efficiencies must negate the anticompetitive effect the merger otherwise would have. Moreover, in addition to being sufficient to overcome the otherwise anticompetitive effect of the merger, courts and the merger guidelines require the efficiencies to be merger specific, verifiable, and not result from an anticompetitive effect of the transaction.

When, as here, the anticompetitive concern is higher prices postmerger, to be a defense the efficiencies must generate sufficient downward pressure on prices to offset the upward pressure resulting from the merger's reduction of competition. Because a profit-maximizing firm will set prices and output so that its marginal revenue will equal its marginal cost, only changes in marginal costs resulting from the merger will affect the merged firm's prices.

Here, MGC believes that the merger will produce significant marginal cost reductions. MGC has the most efficient beer bottle manufacturing operation in the country. With a company-wide average marginal cost of \$0.10 per bottle, its marginal costs are 9% lower than the industry average of \$0.11 per bottle. Bell's eight plants, on the other hand, have the least efficient beer bottle manufacturing operation in the country, with an average marginal cost of \$0.12 per bottle. The physical equipment—the glass-making furnace and the beer bottle forming lines—are essentially the same in all beer bottle plants, and differences in operating efficiencies result from differences in the unpatented trade secret know-how used to reduce raw material costs, reduce energy consumption, and increase “pack-to-melt.” With a small investment to add some additional monitoring and testing equipment to Bell's plants, MGC believes that it can use its existing know-how and reduce the Bell average marginal cost to about \$0.105 per bottle or about less than 5% below the industry average. Bell is confident that it can make the technology transfer work. In a recent acquisition of a beer bottle manufacturing business in Europe with plants similar in structure, age, and operating efficiency to those of Bell, MGC successfully reduced the marginal costs of the four acquired plants from \$0.12 per bottle to \$0.105 per bottle. With Bell's eight plants and nationwide annual production of 6 billion bottles, successfully making this technology transfer will yield annual cost savings of between \$60 million and \$90 million per year on the current level of Bell's sales.

Notwithstanding the evidence of these facts, the FTC is unlikely to accept the defense. As a general matter, the FTC (as well as the Antitrust Division) have been historically very hostile to the efficiencies defense. If the FTC acts as it typically has in the past, the FTC will reject the defense for failure to be (1) merger specific, (2) verifiable, and (3) sufficient to negate the transaction's likely anticompetitive effect.

The FTC historically has taken the view that efficiencies are not merger specific if the efficiencies, in theory, could be achieved in the absence of the transaction. Here, the transaction efficiencies will result from applying unpatented trade secret know-how regarding production operations developed by MGC to Bell. Where the source of the efficiencies is knowledge developed from experience and testing that is not protected by some intellectual property right, the FTC's position is that the company to be benefitted could, with the investment of sufficient time and resources, create this knowledge on its own. The FTC considers it irrelevant that the company to be benefitted may have tried and failed multiple times in the past to develop this knowledge. While if an otherwise convincing case were presented to a court, the court may conclude that the FTC's test is wrong and that the proper test—more consistent with the language of the Horizontal Merger Guidelines—is whether the company to be benefitted is likely

to create the efficiency within some time frame in the absence of the transaction, which would require litigating the merits (which MGC does not want to do here).²⁵

The FTC historically has also taken the view that an efficiency is not verifiable unless the likelihood, cost, magnitude, and efficacy of the asserted efficiency can be ascertained with a high degree of confidence by a third party acceptable to the FTC. In practice, the FTC rejects evidence developed in-house by the merging parties as sufficient to establish the verifiability of an asserted efficiency. The FTC has rejected evidence of the asserted efficiencies being achieved in prior transactions on the grounds that the company to be benefitted in the instant transaction may differ in unknown ways from companies that have achieved the efficiencies in the prior transactions. Even when the merging parties have retained a third-party engineering firm or other experts to verify the efficiencies, the FTC has found ways to criticize the study and has not accepted it.²⁶

Finally, and most significantly, even apart from challenges to merger specificity and verifiability, the FTC would almost surely reject the claimed efficiencies as sufficient to negate the anticompetitive effect that otherwise is likely to result from the transaction. There are three separate problems here, even assuming that the FTC accepted that the transaction would enable the combined company to reduce the marginal costs of the four acquired Bell plants from \$0.12 per bottle to \$0.105 per bottle.

- *First*, the combined firm must have an incentive to “pass on” some or all of the savings from the marginal cost reductions to consumers to create the downward pricing pressure necessary to offset the upward pricing pressure resulting from the acquisition. Here, however, it is not apparent that the combined firm has any incentive to pass on any cost savings to customers. The incentive to pass on savings to customers comes from the additional profits the firm would earn through increased sales by lowering price. Given the inelastic demand for beer bottles, any increased sales would have to come from shifting share from another beer bottle manufacturer. But the other manufacturer is likely to respond to any such attempt by lowering its own prices to maintain share, in which

²⁵ **Note to students:** Some of you wrote the efficiencies were not merger specific because MGC could sell the requisite know-how to Bell. This would be extreme, even for the FTC. The problem is that there is nothing in the hypothetical that indicates that MGC would be willing to sell the know-how to Bell at any price Bell would be willing to offer or even that the know-how can be packaged up to be sold. An argument that the efficiencies lack merger specificity usually depends on facts showing that there is something the merging party could do on its own (including acquiring assets, goods, or services available in the marketplace making investments in physical plant or R&D) that does not depend on another party acting contrary to its own individual self-interest.

²⁶ **Note to students:** While we talked about the high hurdles parties face, it was reasonable for those of you who thought that MGC’s successful experience in Europe in transferring efficiencies to plants similarly situated to Bell’s Macon plant would make the efficiencies verifiable here. I credited this conclusion. I suppose my skepticism come from an historical episode with the FTC where my client was in an analytically identical situation and the FTC rejected a very successful efficiency-enhancing transfer of know-how in Europe as probative of the verifiability of the same efficiency in the United States.

case the merged firm would only reduce prices without gaining sales. Knowing this, the merged firm is unlikely to pass on any of the marginal cost savings.

- *Second*, even if the combined firm has an incentive to pass on some or all of the marginal cost savings, the “passed on” savings must be sufficient to keep the prices at premerger levels notwithstanding the gross upward pricing pressure produced by the merger. This requires quantification of both the downward pricing pressure produced by the “passed on” marginal cost reductions and the upward pricing pressure produced by the merger. These methods of quantification are always subject to challenge, and the FTC’s position will be that it is the parties’ burden to prove the offset to the FTC’s satisfaction.
- *Third*, even if the “passed on” savings are sufficient to offset the upward pricing pressure resulting from the elimination of Bell as an independent competitive force in the market, it will take some time for the merged firm to achieve the efficiencies. During this time, the merged firm will have the ability to increase prices at least in the craft brewery market, and hence the transaction will be anticompetitive for at least some period of time.²⁷

In sum, although the marginal cost efficiencies may be a good one in court if adequately supported, the likelihood that the FTC will accept it and close the investigation without enforcement action is remote.

Finally, to the extent that the merger might increase competition for the MillerCoors national supply contract, that efficiency would largely occur outside the Southeast brewery and craft brewery markets. Even if the merger did increase competition for the MillerCoors contract—and the facts as developed so far do not permit us to assess this—out-of-market efficiencies are not legally cognizable to offset in-market anticompetitive effects. Moreover, in light of the strength of the *prima facie* case in the southeast markets, it is unlikely that the FTC would decline to challenge the transaction because of any out-of-market efficiencies as a matter of prosecutorial discretion.

3. Conclusion on substantive risk

Under the standards used in the Horizontal Merger Guidelines and by the courts, the Division should be able to establish its *prima facie* case that the merger violates Section 7 in both the large brewery and craft brewery markets and defeat any entry, power buyers, or efficiencies defense. This proves a Section 7 violation in both markets.

²⁷ **Note to students:** Some of you posited that the transfer could happen very quickly after the closing. There is nothing in the facts that suggest this, but then again, there is nothing in the facts that says that the transfer could not happen quickly. If you are going to assume a fact not in the hypothetical, you need to identify as such. Here, the better approach would be to say *if* the transfer would happen quickly, then the timeliness requirement of an efficiencies defense would be satisfied, but otherwise it would not. I made the opposite mistake: I assumed that the transfer would not happen quickly. While this is consistent with almost every deal I have every seen, it was still an assumption and I should have stated it conditionally.

Relief Risk

If, as almost surely will be the case, the FTC concludes that the acquisition will violate Section 7 in both the large brewery and craft brewery markets, it will commence litigation and seek a blocking preliminary injunction under Section 13(b) of the FTC Act pending a full adjudication of the merits in an FTC administrative proceeding unless the FTC and the merging parties can reach a consent decree settlement or the merging parties voluntarily terminate the transaction.

Since all of the competitive problems resulting from the acquisition stem from the acquisition of the Bell Macon beer bottle plant and not the other Bell plants, the FTC should accept a consent decree requiring the divestiture of the Bell Macon plant.^{28,29,30,31,32,33} The FTC will require the

²⁸ In addition, although the FTC would never admit that there are likely to be significant marginal cost efficiencies resulting from the merger, the fact that the combined company will be able to try to implement these marginal cost efficiencies in the seven Bell plants MGC would be able to acquire with a Macon plant divestiture consent decree is another factor that weighs in favor of the FTC accepting the consent decree.

²⁹ **Note to students:** Some of you thought that a divestiture consent decree would not be in MGC's interest because it would destroy the value of the deal. Keep in mind, however, that Macon was not the only plant MGC would acquire. There were plenty of synergies remaining in the deal for MGC in making the remaining seven Bell plants more efficient even if MGC had to divest the Bell Macon plant. MGC estimated that synergies of \$60-\$90 million annually from decreasing Bell's marginal cost in producing six billion bottles in all eight Bell plants from the current \$0.12 per bottle to \$0.11 or \$0.105 per bottle. Macon only produced 321 million bottles, so the annually recurring synergies from that plant would be \$3.2-\$4.8 million. With a Macon divestiture, the synergies would be reduced to \$56.8-\$85.2 million. The present discount value of this cashflow evaluated as a perpetual annuity at an 8% discount rate is \$710-\$1065 million. Evaluated over ten years at the same discount rate is \$381.1-\$571.6 million. This would more than make a purchase of the seven Bell plants even with no price reduction financially worthwhile. Similarly, even if Jacksonville had to be sold, the deal would remain in MGC's interest.

³⁰ **Note to students:** Some of you wrote that the FTC would not be willing to accept a consent decree if it had an excellent chance of prevailing in court. This is not correct. While the FTC and the Antitrust Division today will not compromise on the relief they require to fix a perceived anticompetitive problem in order to avoid litigation (as they arguably once did), they will accept a consent decree if it provides all of the relief they believe necessary to ensure that the transaction will not be anticompetitive.

³¹ **Note to students:** Some of you thought that Jacksonville was the plant to divest. As a general rule, all that the agencies require is that the business of one or the other merging parties divest its business in the problematic market. So either MGC Jacksonville or Bell Macon should be an acceptable fix. Macon is less profitable than Jacksonville and buyers tend to like to divest the seller's facilities, so Macon would appear the better candidate for divestiture. But you are correct that Jacksonville would work as well as Macon, and there may be reasons—not addressed in the hypothetical—that would make Jacksonville the better plant to sell.

³² **Note to students:** Some of you concluded that a divestiture of the Macon plant would not be acceptable because it would reduce the number of firms participating in the Southeast. First, that would not be true if a nonparticipant—say, a private equity firm—acquired Macon. Second, an incumbent firm operating in the Southeast could acquire Macon if that acquisition itself did not present its own antitrust problem. So, for example, while the FTC would not accept OD as the divestiture buyer, it very likely would accept Crystal.

³³ **Note to students:** Some of you thought that a partial divestiture of the Bell Macon plant might be sufficient. There are four problems with this. First, and most important, the practice of the agencies is to demand the divest of the *entirety* of the business of one party or the other in the problematic market. Second, there is nothing in the hypothetical to suggest the Macon plant could be subdivided and a part of it sold, that the divestiture portion could be financially viable in the market (or that the remaining portion would be financially viable) or that a buyer of the divestiture portion would emerge. Third, there is nothing in the hypothetical that a portion of the Macon plant (such as the mothballed furnace or lines), if divested, would relace the competitive force Bell had premerger in the Southeast, especially since Bell needed its existing operations for financial viability and its mothballed operations to

consent decree to provide that the FTC must approve the divestiture buyer as well as the manner of divestiture. The FTC will approve the buyer only if the FTC is convinced that the buyer has the incentive and ability to continue to operate in the two problematic Southeastern markets with the same competitive force as Bell had premerger.

To ensure that an acceptable buyer exists—especially given the locational disadvantages and extreme excess capacity conditions of the Bell Macon plant—the FTC almost certainly will require a “buyer up-front.” That will require the merging parties to find a divestiture buyer for the Macon plant, enter into a divestiture agreement with that buyer contingent on the closing of the main deal, and then obtain the prior approval of the FTC of that buyer and the divestiture agreement before the FTC will accept the consent decree and permit the main transaction to close.

Assuming that a buyer acceptable to the FTC can be found, MGC should have a high degree of confidence that the FTC will permit the MGC/Bell transaction to close without litigation, although the timing of the closing will depend on how quickly an acceptable buyer can be found and then vetted by the FTC. Given the high inquiry and substantive risk in this transaction, MGC may wish to begin a search for a buyer at an early stage. Indeed, proposing to divest the Bell Macon plant early in the review may eliminate—or at least truncate—the second request investigation.³⁴

Finally, MGC’s willingness to extend the ABI Jacksonville supply, which will expire on December 31, 2021, at current terms for another six years to December 31, 2027, will not mitigate either the substantive risk or the relief risk. First, the agencies have consistently demanded divestitures to resolve horizontal mergers concerns and have not accepted behavioral relief. Second, with the declining demand for beer bottles, it is at least possible that ABI Jacksonville would be able to negotiate an even lower price on the contract beginning January 1, 2022, than it has in the current contract and an extension of the current contract at current terms would not provide for a lower price. Third, once the extended contract expired, all of the concerns about the anticompetitive effect of the merger concerning ABI Jacksonville would reemerge, especially since there is nothing in the likely trajectory of the beer bottle industry

provide the excess capacity necessary to bid for the ABI Jacksonville brewery. Fourth, although more appropriate for the next section on the contract provisions, Bell, recognizing that if the divestiture of a portion of the Macon plant was not acceptable to the FTC, a HOHW provision that only required a partial divestiture effectively would convert the purchase agreement into a purchase option for MGC, would never accept it. Unless MGC acceded to a complete divestiture of the Macon plant, we should expect Bell to terminate the negotiations and walk away.

³⁴ **Note to students:** Some of you questioned whether the Macon plant was saleable or whether there was a buyer that would be acceptable to the FTC. On saleability, there is no indication in the facts that Macon is a failing plant. To the extent that the plants is not be as profitable as some other plants, the purchase price will adjust so that there is a sufficient expected return on investment for buyers to emerge, especially since any consent decree divestiture obligation on MGC will be absolute and not subject to any reservation price. As far as acceptable buyers are concerned, since Crystal has only a minimal presence in the Southeast, it should be acceptable to the FTC as a divestiture buyer. And if the purchase price is low enough, Crystal no doubt, would be an interested buyer.

(such as the construction of a new beer bottle plant in the Southeast) that would materially change the competitive dynamics six years hence from where they are today.

Purchase Agreement Considerations

MGC should expect Bell to perform an antitrust risk assessment of the transaction and come to the same conclusions as we have in this memorandum. Bell's shareholders receive their money if and only if the transaction closes, so MGC should expect Bell to condition its acceptance of the offer on MGC's contractual commitment to ensure to the maximum possible extent that the transaction will close.

Bell's initial demand is likely to be an unqualified "hell or high water" provision, that is, a contractual commitment that MGC divest whatever is necessary to settle the investigation. Bell's analysis should show that it will be enough to commit to divest only the Bell Macon plant. MGC should stand firm that this is all it is willing to commit to divest. If necessary, we can present the antitrust analysis to Bell to show the sufficiency of a Macon plant divestiture under the "common interest" privilege. The FTC recognizes that the common interest privilege shields from discovery in the investigation or any litigation communications between MGC and Bell (and their respective attorneys) in connection with their joint efforts to analyze and then defend the transaction from discovery by the FTC.^{35,36,37}

Bell may also request an antitrust reverse termination fee. Bell should resist this. An antitrust reverse termination fee would be payable by MGC to Bell if the deal did not close because of the failure of one or more of the antitrust closing conditions to be satisfied by the termination date. A failure of the closing conditions would occur only if the FTC rejected the divestiture of the Macon plant as a consent decree remedy and MGC either did not litigate or litigated and lost the preliminary injunction. Since the rejection of a Macon plant divestiture consent decree is such a low probability event, if MGC stands firm and refuses to give Bell a reverse termination fee in

³⁵ **Note to students:** Some of you advised MGC that Bell would require some sort of HOHW provision but did not identify what Bell was likely to demand and, if unqualified (which it almost certainly would be initially), whether the demand could be negotiated down to something more limited. Given the facts in the hypothetical, it was incumbent to identify Bell Macon plant (or the MGC Jacksonville plant, depending on your analysis) as a divestiture that was suitably limited and would resolve the FTC's concerns if an acceptable buyer could be found.

³⁶ **Note to students:** Some of you advised MGC to reject any type of HOHW provision. The problem with this is, given near certainty the FTC will challenge the transaction, Bell will not do a deal without at least MGC's commitment to accept a consent decree requiring the sale of the Bell Macon or the MGC Jacksonville plant. As explained above, if MGC wants to do the deal—and it certainly should given the synergies available from the other seven Bell plants (see *supra* note 29)—MGC is going to have to accept a qualified HOHW to divest one or the other plant and should be so advised.

³⁷ **Note to students:** It is worth noting that a HOHW provision only requires the buyer to propose and be willing to accept a consent decree within the bounds of the provision. It is not a guarantee that the deal will close. The FTC has complete discretion whether to accept a consent decree proposal and it can reject a proposal for even an arbitrary reason. If the buyer has made the maximum consent decree proposal required by the HOHW provision and the FTC rejects it, the buyer has satisfied its contractual obligation.

addition to a Macon plant divestiture commitment, Bell will almost surely cave on the reverse termination fee.

In return for committing to divest the Macon plant if necessary, MGC should require a provision that gives it decision-making authority as to how to defend the transaction (although MGC should accept in return an obligation to consult with Bell).

Although a consent decree commitment to divest the Bell Macon plant should be enough to settle the investigation, at this early stage MGC should not give up a credible option to litigate. To this end, in return for a Macon plant divestiture commitment, MGC should also require an extension of the termination date in the acquisition agreement to give MGC enough time to fully litigate a Section 13(b) preliminary injunction action with the FTC. Courts in the District of Columbia, where any case against the transaction is likely to be brought, have decided almost all recent Section 13(b) litigations within six months or so of the filing of the complaint. A six-month extension of the standard one-year termination date in the event of litigation is common in merger agreements that are likely to present antitrust concerns. If MGC stands firm on a six-month extension to litigate, Bell should accede to it.

A litigation option is important in the unlikely event that the FTC rejects a Macon divestiture as sufficient to preserve the option—and the leverage it gives over the FTC—to “litigate the fix.” That is, if the FTC refuses to accept a Macon divestiture consent decree, MGC can proceed to find a divestiture buyer and sign a contingent sale and purchase agreement. Then, in litigation, the court will take into account the “fix” in assessing the competitive effects of the restructured transaction. In this connection, MGC also should require the purchase agreement to include a provision requiring Bell to work with MGC in defending any litigation.

The option to litigate should be exercisable solely in MGC’s discretion but subject to consultation with Bell. Bell may want an unconditional obligation to litigate, but, again, given the low probability that the FTC will reject a Macon divestiture consent decree that would make litigation necessary, Bell is likely to cave on this demand if MGC stands firm in resisting it.

To further ensure that MGC can control the timing of when, if at all, to commence litigation, MGC may also want to require the filings of the parties’ respective HSR forms within ten days of the signing of the acquisition agreement and a reciprocal obligation that the parties respond to any second request within five months of receipt. A provision requiring the filing of the parties’ HSR forms within ten days of signing is almost universal in merger agreements. A requirement that the parties comply with their respective second requests within five months of receipt is less common, but it will give MGC much more control over the timing. With these obligations, the initial waiting period would end and the second requests issue about 1.5 months after signing. Under a five-month second request compliance obligation, the parties would submit their respective responses 6.5 months after signing, and the final HSR 30-day waiting period would end 7.5 months after signing. As noted above in the inquiry risk analysis, the FTC typically asks

the parties to enter into a timing agreement not to close their transaction for 30 or 60 days after the expiration of the HSR Act waiting period. If the parties agree, then even a 60-day commitment would expire 9.5 months after the signing. If consent decree negotiations are proceeding satisfactorily, MGC can voluntarily commit not to close for as many as three additional months to permit the negotiations to conclude and not jeopardize its litigation option. On the other hand, in the unlikely event that at some point the negotiations appear that they will not conclude with a Macon plant divestiture consent decree, MGC can refuse to further extend its commitment not to close, force the FTC into court for a preliminary injunction, and then have sufficient time to litigate the fix.³⁸

³⁸ **Note to students:** Some of you engaged in a long discussion (perhaps boilerplate) on a whole variety of different contract provisions that one or the other party may demand including, for example, the general efforts clause. This was unnecessary. All that was required was a discussion of the provisions that would help ensure that the closing would occur at some point. While some of these provisions might make the defense more efficient and seamless or give one or the other party the moral high ground to argue for certain defensive tactics, unless they materially affected the probability of closing it was not necessary to address them given the nature of the assignment and just made the memorandum unnecessarily lengthy.