

## LABELSTOCK MERGER

You are an associate at Gambini & Galloway LLP. Tempere Manufacturing Corporation, a firm client, is considering making an offer to acquire Black River Label Stock, Inc. for \$593 million in cash. Tempere and Black River both manufacture and sell pressure sensitive label stock. Mona Lisa Gambini, a partner with whom you work, has been asked by Tempere to provide them with a preliminary antitrust risk assessment of the transaction. Ms. Gambini has told Tempere that the acquisition most likely would be reviewed by the Antitrust Division of the Department of Justice. Tempere is seeking Ms. Gambini’s advice on whether the antitrust enforcement agencies are likely to investigate the transaction and, if so, whether the parties can successfully convince the Division to close the investigation either cleanly or with some mutually acceptable consent order. Tempere also would like to know, if it goes forward with the deal, what, if anything, it can or should do now to improve the chances of success of clearing any investigation without enforcement action.

Ms. Gambini has asked you to draft a memorandum for her to send to Black River to answer their questions. Black River has provided some information, and you have researched materials in the public domain. This is what you have learned:

### Label stock

Pressure sensitive labels are self-adhesive labels peeled off a backing material and applied by pressure to adhere to a bottle, package, or other material. Almost every industry extensively uses these types of labels. They can be applied manually as part of a hand-crafting production process or by using labeling equipment in a high-speed production line.

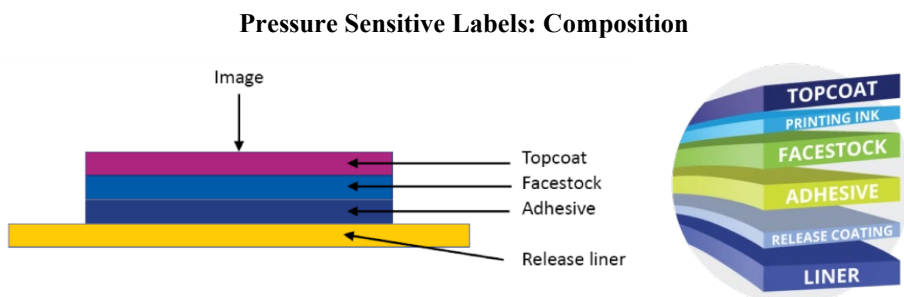
### Pressure Sensitive Labels: Examples



Pressure sensitive labels are made from label stock. Label stock is a multilayer laminate consisting of a face material or “facestock” (the surface of the label on which the text will be printed), an adhesive, a silicon coating (which allows an easy release of the face material from the base material), and the base material or “release liner” (which protects the adhesive).<sup>1</sup>

<sup>1</sup> The facestock in pressure sensitive label stock may be either paper or plastic film. In our hypothetical world, we will assume that there is only one homogeneous type of label stock and it can be used for all purposes. Also, we are going to ignore all demand and supply side disruptions caused by COVID over the last several years and assume that it was business as usual.

Converters make pressure sensitive labels by purchasing label stock in bulk (usually in large rolls) from specialized manufacturers, cutting the rolls to desired sizes and shapes, and adding printed text and images as specified by their customers. After printing, converters can also add a “topcoat” to protect the text and images. There are about 2000 pressure sensitive label converters in the United States. Bulk label stock rolls cost \$1400 per ton to produce and currently sell to converters throughout the country at a wholesale price of \$2,000 per ton.<sup>2</sup>



Specialized manufacturers use high-volume production equipment to produce label stock in bulk rolls. There are seven U.S. label stock manufacturers. There are no imports or exports of label stock into or from the United States, nor would any companies begin importing to the United States if U.S. prices increased by 5%.

**Bulk Label Stock Manufacturing**

Company	Tons (000s)	
	Capacity	Production
Avalee	510	500
Black River	320	200
Tampere	100	100
Madison	60	55
Milwaukee	60	55
Algoma	60	55
Cumberland	32	30
	1142	995

Avalee, headquartered in Chicago, Illinois, is the largest manufacturer and seller of bulk label stock rolls in the United States. Avalee’s plant operates at a rated capacity of 500,000 tons per year. Avalee has no space to increase the capacity of its existing plant. To meet additional demand, Avalee purchases 55,000 tons per year from Tempere under a long-term supply agreement. That agreement expires on December 31, 2023. Avalee is considering building a new plant at a different site but has not finalized its plans, purchased a site, or engaged contractors to design and build the facility. If and when Avalee decides to build a plant, it will take at least two to three years to find a site, obtain the required environmental approvals, construct the facility, and begin commercial production.<sup>3</sup>

<sup>2</sup> Manufacturers sell a variety of different sizes of rolls, many of which are under one ton and are priced proportionally.

<sup>3</sup> Two to three years is the fastest a minimum efficient scale label stock plant can be constructed. Expansions of existing plants typically take around two years.

Black River, the target company, is headquartered in Dayton, Ohio, and is the second largest manufacturer and seller of bulk label stock in the United States. In 2018, Black River management decided to significantly expand and modernize its bulk label stock plant, increasing its capacity from 220,000 annual tons to 320,000 tons per year. Black River completed the expansion in late 2021. Expenses associated with the expansion are causing the company to run a significant negative cash flow into the foreseeable future. In early 2022, the management was replaced, and the new management decided to put Black River up for sale in September 2022.

Tampere, the acquiring company and the firm's client, is a Finnish company headquartered in Helsinki. It is the third largest bulk label stock manufacturer in the United States. Tampere entered the United States in 2015 by exporting label stock from its production plants in Finland. Having gained product acceptance and sales experience in the United States, in late 2017, Tampere completed a large production plant in the United States with the capacity to produce 100,000 tons of label stock annually. At the time it built the plant, Tampere was selling only 20,000 tons annually in the United States.

Until recently, Avalee was the price leader in the United States. The other companies selling in the United States (including Tampere) matched Avalee's pricing. This ended in early 2022 when Black River began discounting label stock to gain more sales and more fully utilize its expanded plant capacity. Since label stock is a homogeneous product, the other companies matched Black River's wholesale price to protect their market share, stabilizing the market wholesale price at \$2000 per ton.

The demand for label stock is relatively inelastic, with an aggregate own-elasticity of  $-0.1$ . The demand for label stock is ultimately driven by the demand for pressure sensitive labels, which typically account for a small portion of the cost of goods sold. There are no reasonable substitutes since non-adhesive labels are often not technically suited for the labeled product. Even if they are technically suitable, using non-adhesive labels requires the manufacturer of the labeled goods to change its production process and increases the manufacturer's total production costs.

### **Tempere's history and business plans**

In the early 2010s, Tempere saw the United States as a prime market to enter. Not only was the United States one of the world's largest markets for bulk label stock, but it was also dominated by two firms—Avalee and Black River, which collectively had a share of over 80%—and exhibited high wholesale prices. Avalee had successfully increased prices at rates higher than the company's cost increases for years, which Black River and the smaller firms followed.

Tempere entered the U.S. market in 2015 through exports from Finland. It priced its label stock aggressively to gain market acceptance and market share. However, Tempere's aggressive pricing was largely irrelevant to U.S. market prices because Tempere had little ability to sell significant volume in the United States. After Tempere's entry into the United States, Avalee continued to lead whole price increases for the industry.

Tempere grew relatively slowly and, by late 2017, was selling only 20,000 tons of label stock annually in the United States. Nonetheless, Tempere was confident it could grow in the United States. In late 2018, Tempere opened a 100,000-ton per year production facility in the United States. To help offset the costs of building the plant and increase its capacity utilization, Tampere entered into a five-year agreement to supply Avalee 55,000 tons per year beginning in January

2019 at a discount of 20% off Tampere’s wholesale price. (As noted above, this contract is up for renewal at the end of 2023.) With 20,000 tons in existing annual sales and 55,000 tons committed to Avalee, Tempere had excess capacity of only 25,000 tons at the time the plant opened. As a result, Tempere cut back on its aggressive pricing, began to follow Avalee’s price lead, and relied on good customer service and market growth to further load its plant and reduce excess capacity.

Currently, Tempere’s sales to converters have grown to 45,000 tons annually. With its supply commitment to Avalee of 55,000 tons, Tempere is operating at full capacity and needs additional capacity if it is to continue to grow. Tempere has aggressive plans to grow its U.S. sales by 25% for five years once it has the capacity to cover the increased sales.

To meet its projected future production needs, Tempere developed the following strategy. Avalee would expand its U.S. plant to double its capacity from 100,000 tons to 200,000 tons annually by the end of 2024. Once the expansion is online, Tempere will again have significant excess capacity. As it did with its original plant, Tempere ideally would like to reduce the excess capacity by entering into a new supply agreement with Avalee for 55,000 tons annually from 2025 to 2029. Since Avalee would balk at not having a supply agreement for 2024, Tempere would delay its growth plans until 2025 and renew the existing supply agreement for five years starting at the beginning of January 2024. Whether Tempere would be willing to continue to supply Avalee after 2028 would depend on how well Tempere was doing at the time. The following table summarizes Tempere’s business plans without the Black River acquisition. Tempere has not yet started discussions with Avalee on a renewed supply agreement but plans to do so early next year.

**Tempere Projected Annual Sales with (Delayed) 25% Growth Rate  
without the Black River Acquisition**

Year	Sales (000 tons)			Capacity (000 tons)		Avalee Supply Contract
	Tempere	Avalee	Black River	Total	Excess	
2022	45	55		100	0	Current
2023	45	55		100	0	Current
2024	45	55		100	0	Renewed
2025	56	55		200	89	Renewed
2026	70	55		200	75	Renewed
2027	88	55		200	57	Renewed
2028	110	55		200	35	Renewed
2029	137			200	63	???

Early this year, Tempere’s board of directors approved this strategy and committed the necessary funding for the expansion. By the beginning of this past summer, the company engaged a construction firm to prepare the engineering plans and the plant site for construction to begin in early 2023. Surprisingly, Tempere’s plans to expand its plant have yet to leak into the industry.

Tempere’s plans, however, were put on hold when Black River became available for purchase at the end of the summer. At its current offer price, Tempere estimates it would obtain Black River’s existing 120-ton excess capacity at 70% of the cost per ton of expanding Tempere’s U.S. facility. Tempere finds the financials for buying Black River over expanding Tempere U.S. plant

compelling. While Tempere and Black River are still in negotiations, Tempere understands that there are only two other bidders for Black River—a U.S. private equity company and a Swedish paper company with no label stock operations in the U.S.—but that Tempere’s offer price materially exceeds the bids by the two other companies.

While Black River’s plant has the capacity to absorb Tempere’s current production, Tempere plans to operate both plants and load them with additional sales earned through aggressive pricing. Given all the excess capacity it would have, Tempere would like to continue the Avalee supply agreement to supply 55,000 tons to Avalee annually (if not increase the supply volume) for another four years at the current 20% of the prevailing wholesale price. Tempere has not discussed this with Avalee. But even if Tempere can negotiate a new four-year contract with Avalee, Tempere will still have significant excess capacity in the years following the Black River acquisition and a need to grow the business.

**Tempere Projected Annual Sales with 25% Growth Rate  
with the Black River Acquisition**

Year	Sales (000 tons)			Capacity (000 tons)		Avalee Supply Contract
	Tempere	Avalee	Black River	Total	Excess	
2022	45	55		100	0	Current
2023	56	55	200	420	109	Current
2024	70	55	200	420	95	Renewed
2025	88	55	200	420	77	Renewed
2026	110	55	200	420	55	Renewed
2027	137	55	200	420	28	Renewed
2028	172	0	200	420	48	None
2029	215	0	200	420	5	None

As these tables show, there are two differences between the business plans with and without the Black River acquisition. First, with the Black River acquisition, Tempere would begin its 25% growth plan immediately in 2023 rather than delay it until 2025 as Tempere awaits the completion of its plant expansion. Second, while Tempere would be willing to renew the Avalee supply agreement at current volumes and price terms in both scenarios, the extension would be for four years with the Black River acquisition and five years with the plant expansion.

### **Market reactions**

When asked about the market reaction to the transaction, Tempere executives expect some opposition from converters. Most converters buy from one of the ‘Big Three,’ which collectively account for over 80% of wholesale sales, plus a fringe of small domestic suppliers. They accurately see market competition driven by the three big firms, with the remaining firms as followers. The transaction will reduce the number of major suppliers from three to two, and converters are likely to fear their prices will increase as a result.

Moreover, this fear may be exacerbated by an additional concern that Tempere will close its U.S. plant and consolidate its production into the Black River plant. With 120,000 tons of excess capacity, the Black River plant could readily absorb the Tempere’s plant production. Then, with only 20,000 tons of excess capacity remaining, Tempere would have little incentive to price aggressively to increase production and gain market share. Converters remember that in the last few years, as Tempere’s market share increased and its excess capacity decreased, Tempere cut

back on its aggressive pricing and began to follow Avalee's rice increases. The pace and magnitude of price increases in the market rose as a result.

Tempere is unsure of how Avalee reacts to the transaction. Tempere expects Avalee to have two concerns.

First, Avalee will question the effect of Black River's acquisition on Tempere's willingness to renew the existing supply agreement when it expires at the end of 2023. Avalee sells more label stock today than it can produce. If Tempere buys Black River and continues production of both plants, Tempere will have a significant incentive to renew the current supply agreement (or perhaps even increase the supply volume) to help fill the Black River plant. On the other hand, if Black River is sold to a third-party buyer, Avalee may be able to enter into a good or better supply agreement to replace the Tempere agreement. The new buyer will have a significant incentive to deal with Avalee to reduce the 120,000-ton excess capacity. Tempere expects that, at a minimum, if a third party buys the Black River plant, Avalee will attempt to "play off" Tempere and the new buyer in the bidding for a new five-year supply agreement beginning in 2024 to get even more favorable terms than it has today. But Avalee may think that it is also possible that, if Tempere does not buy Black River, Tempere may seek to reduce its supply commitment or abandon it altogether when the current contract comes up for renewal next year in order to free up production to expand its sales to converters (without the 20% discount).

Second, Avalee also recognizes that if Tempere buys the Black River plant, Tempere will have an incentive to engage in aggressive pricing to build market share and reduce excess capacity. That will reduce the price increases Avalee would like to see in the future. If Tempere does not acquire Black River and continues to supply Avalee with 55,000 tons per year, Tempere will not have excess capacity to reduce and hence will not return to aggressive pricing. Of course, Avalee will recognize that Tempere may decide to expand its plant and aggressively price to fill the new capacity once online, but that additional capacity is at least two or three years away at the earliest.

## LABELSTOCK MERGER Outline<sup>1</sup>

*This outline summarizes the analysis of the hypothetical. The issues presented range from easy to spot and analyze to quite complicated. In the time available, no answer could spot, much less analyze, all of the issues. The exams were ranked ordered based on their completeness and analytical persuasiveness. I then applied the law school's curve to assign grades.*

- 0. Questions**—Calls for a reasoned memorandum of law on a preliminary antitrust analysis
- a. Are the antitrust enforcement agencies likely to investigate the transaction?
  - b. If so, can the parties successfully convince the Division to close the investigation either cleanly or with some mutually acceptable consent order?
  - c. What, if anything, can or should Tempere do now to improve the chances of success of clearing any investigation without enforcement action?

### **1. Inquiry risk**

- a. Antitrust Division
  - i. *HSR reportable*: Purchase price \$593 million > \$101 million threshold. No exemptions<sup>2</sup>
  - ii. The Division will learn of the horizontal overlap from the HSR filings
  - iii. The overlap will lead the Division to learn about other competitors, which it could do through an Internet, literature, and newspaper search
  - iv. Moreover, there a possible, if not likely, complaints from Avalee and/or larger converters that would inform the Division further about the structure of the industry
  - v. The Division's search of publicly available information plus any information it learns from complainants will reveal that this is a 3 → 2 horizontal merger with four (low capacity) fringe firms
  - vi. The preliminary investigation will result in the companies producing basic documents (e.g., strategic plans, any internal or external market research reports) and in interviews with customers

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<sup>1</sup> There was a typo on Page 7 of the exam. “*Avalee* would expand its U.S. plant to double its capacity . . . .” should read “*Tempere* would expand its U.S. plant to double its capacity . . . .” This should have been obvious from the context. In any event, it does not appear that anyone was tripped up by the typo.

<sup>2</sup> A surprising number of students cited the HSR thresholds for 2020 or 2021 rather than for 2022. I suspect that this resulted from the use of old boilerplate, but there is no excuse for not using the current thresholds. If you did this in a memorandum to a partner or an agency section chief, you would not be treated kindly.

More generally, you must be careful to make sure that your boilerplate fits the problem. I not infrequently find references to ice cream, orange juice, and other irrelevant products in students' answers. My suggestion is that when you are preparing your boilerplate, highlight in **bold** anything that may need to be changed or updated to conform to the issues you are addressing.

- vii. The preliminary investigation will reveal that an indepth second request investigation is warranted
- viii. CONCLUSION: Tempere should anticipate a preliminary and second request investigation

b. State AGs

- i. Could be an interest by the state AG in which the Tempere plant is located if there is a possibility that plant would close<sup>3</sup>
- ii. If interested in the transaction, the state AG almost surely would join in the Antitrust Division's investigation and not open a separate investigation

**2. Substantive risk**

a. Relevant product market: Manufacture and sale of pressure sensitive label stock

i. *Brown Shoe* factors

- 1. Homogeneous product → high cross-elasticities of demand between producers
- 2. No reasonable substitutes → very inelastic own-demand (-0.1) and low cross-elasticities with other types of labelling products
- 3. Industry recognition
- 4. Peculiar uses and characteristics (lower cost to use than non-adhesive labels)
- 5. Unique production processes and facilities (that take two to three years to build)
- 6. Distinct customers (converters)

ii. Hypothetical monopolist test: use critical elasticity test  
(NB: Demand-based)

- 1. Price: \$2000 per ton
- 2. Cost: \$1400 person
- 3. Margin:  $(2000 - 1400)/2000 = 30\%$
- 4. %SSNIP: 5%
- 5. Critical elasticity test

$$|\varepsilon_c| \cong \frac{1}{\delta + m} = \frac{1}{0.05 + 0.30} = 2.86$$

- 6. |Actual elasticity|:  $0.1 < 2.86 \rightarrow$  HMT satisfied for a 5% SSNIP

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<sup>3</sup> Unfortunately, I failed to identify in the hypothetical the state in which the Tempere plant was located, but that should not have stopped you from identifying that AG's possible interest



- b. Relevant geographic market: The United States<sup>4</sup>
  - i. Commercial realities
    - 1. All manufacturers sell nationwide
    - 2. Uniform price throughout the U.S. of \$2000 per ton
    - 3. No exports or imports
  - ii. HMT: Same as for relevant product market
- c. Market participants and market shares
  - i. All seven current sellers; no nonseller market participants<sup>5</sup>
  - ii. Market shares:
    - 1. Domestic producers at current sales
    - 2. QUERY: What to do with Tempere's sales to Avalee? Does it matter? A BIT (see below)

d. *PNB* presumption

NOTE: All unit sales by manufacturers is the preferred calculation, but dollar sales by all manufacturers also works and gives essentially the same *PNB* presumption result. Sales to converters distorts Tempere's significance and should not be used.

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<sup>4</sup> At least one student simply asserted that it was “clear” that the relevant geographic market was the United States. I agree with the conclusion, but the assertion is not a reasoned analysis. In writing formal memoranda, you should strike words like “clear” and “obvious” from your vocabulary.

Separately, some students relied solely on the fact that there are no imports or exports into or out of the United States and that no imports would start even if the U.S. price increased by 5%. This is sufficient to show that the relevant geographic market is no larger than the United States, but it is not sufficient to show that the relevant geographic market is the United States. Regional or local geographic markets are consistent with the absence of imports or exports. To establish that the United States is the relevant geographic market, you also need to cite that bulk label stock manufacturers sell nationwide and that the wholesale price is a uniform \$2000/ton.

Lastly, some students added a paragraph at the end of the geographic market analysis to the effect that “[w]hile there may be smaller geographic markets within the nationwide market, the facts stated in the investigation record do not allow us to analyze this.” This is not correct. Under the facts as given—all producers identified, all sell nationwide, and all sell at a uniform price of \$2000/ton—there is only a national market. The paragraph was part of the boilerplate and illustrates that you need to make sure that the boilerplate you use fits the problem.

<sup>5</sup> Some students identified the market participants as only the Big Three and performed the HHI calculation on just the top three firms. This is incorrect. While in coordinated effects a subgroup of firms can be a collusive group, for the purpose of market definition *all* current sellers must be included in the market (with the exception that any firm that is nearly certain to cease production and exit the market in the near future can be excluded). The “commercial realities” judicial test requires as much. *H&R Block* is a good illustration of the DOJ's recognition of this principle.

I should also note that some students looked at—and performed HHI calculations for—both a “Big Three” market and an all seven-manufacturer market. This was a waste of valuable exam time. Only the seven-firm market was relevant to the analysis.

Company	Bulk Label Stock Manufacturing Tons (000s)		HHI calculations			
	Capacity	Production	Capacity Share	HHI	Production Share	HHI
Avalee	510	500	44.66%	1994	50.25%	2525
Black River	320	200	28.02%	785	20.10%	404
Tampere	100	100	8.76%	77	10.05%	101
Madison	60	55	5.25%	28	5.53%	31
Milwaukee	60	55	5.25%	28	5.53%	31
Algoma	60	55	5.25%	28	5.53%	31
Cumberland	32	30	2.80%	8	3.02%	9
	1142	995	100.00%	2947	100.00%	3131
		Combined	36.78%		30.15%	
		Pre HHI		2947		3131
		Delta		491		404
		Post HHI		3438		3535
		2FCR				
		Premerger		72.68%		70.35%
		Postmerger		81.44%		80.40%
		Difference		8.76%		10.05%

- i. Merger Guidelines: Triggers presumption under the Guidelines, but not that deep into the “red zone” (i.e., not a strong presumption):
  1. Post > 2500;  $\Delta > 200$
  2. Guidelines: “will be presumed to be likely to enhance market power”
- ii. *PNB* itself: Good support (but needs to be argued and not just asserted)
  1. Combined firm’s share right at or slightly above *PNB*’s threshold of 30%
  2. Combined postmerger 2FCR:
    - Capacity:  $\approx 81\%$ ; increase: 8.76% points
    - Revenues:  $\approx 80\%$ ; increase: 10/05% points
 Low compared to *PNB* point change, but much higher starting concentrations → should be enough to support presumption
- iii. Judicial support: Reasonably strong<sup>6</sup>
  1. *FTC v. H.J. Heinz Co.*, 246 F.3d 708, 716 (D.C. Cir. 2001) (merger of second and third largest firms with a delta of 510 and a postmerger HHI of 5285 created a presumption of anticompetitive effects by a “wide margin”)
  2. *United States v. H&R Block, Inc.*, 833 F. Supp. 2d 36, 72 (D.D.C. 2011) (merger of second and third largest firms triggering

<sup>6</sup> I continue to be surprised by the number of students who failed to provide support from the modern merger antitrust case law for the applicability of the *PNB* presumption. As I stressed a number of times in class, modern case law support—that is, case citations with supporting parentheticals—is more important in court than *PNB* itself or the Merger Guidelines (which to a court are only advisory).

presumption with a combined share of 28%, a delta of 400, and postmerger HHI of 4691)

3. *United States v. UPM-Kymmene Oyj*, No. 03 C 2528, 2003 WL 21781902 (N.D. Ill. July 25, 2003) (triggering presumption with a combined share of 20%, a delta of 190, and a postmerger HHI of 2990)
  4. *See In re Evanston Northwestern Healthcare Corp.*, 144 F.T.C. 1, 380 (2007) (Commission opinion) (triggering presumption with a combined share of 35%, a delta of 384, and a postmerger HHI of 2739)
- iv. CONCLUSION: Reasonably strong PNB presumption given PNB and judicial support

**3. Unilateral effects—Not applicable**

- a. Homogeneous products: Classical recapture unilateral effects not applicable
- b. Uniform pricing nationwide: So an auction unilateral effects theory does not apply<sup>7</sup>

**4. Coordinated effects--Applicable**

- a. Premerger susceptibility: YES
  - i. Homogeneous product
  - ii. Three firms with a 4-firm fringe with limited capacity

	Capacity		Excess	
	tons	%	tons	%
Top 3	930	81.4%	130	88.4%
Fringe 4	212	18.6%	17	11.6%
	1142	100.0%	147	100.0%

Largest 3 firms have 81.4% of the domestic manufacturing capacity and 88.4% of the excess manufacturing capacity → this is a collusive group

- iii. Small firms operating close to capacity → little incentive to cut prices to increase share → should play follow the leader
- iv. In fact, prior to Black River’s disruptive conduct in the wake of its capacity expansion, all firms (including importers except Tempere) did follow Avalee’s price lead

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<sup>7</sup> There is an arguable unilateral effect if Tempere is likely to discontinue its sales to Avalee as a result of the merger. But this is contrary to what Tempere says are its postmerger business plans, which is to renew the Avalee contract. There is also a separate question of whether failing to renew the supply agreement, even if a result of the merger, is an actionable anticompetitive effect. I would have credited an argument either way, but no one spotted this issue.

1. Tempere's aggressive pricing when it entered the market in 2015 was largely irrelevant since it had little ability to sell significant volume in the United States
  - v. Also, the long-term agreement whereby Tempere supplies Avalee with 55K tons annually is evidence of a willingness of the two firms to cooperate with another (much like the evidence that the firms in *H&R Block* cooperated in lobbying the IRS). While a supply agreement between competitors is lawful absent evidence it was used to facilitate price-fixing, on the facts given Tempere's purpose to enter into the agreement was to increase the load on its new plant, which otherwise would have started running with a very low-capacity utilization. The evidence is significant, however, because Tempere and Avalee will be the only two major manufacturers remaining is Tempere's acquires Black River.
- b. Postmerger increase in likelihood and effective: DEPENDS
- i. In favor of YES
    1. 3 → 2 in the collusive group
    2. If postmerger Tempere consolidates production into the Black River plant and closes its own plant, then excess capacity in the industry would almost disappear, eliminating any incentives to cut prices and increasing increases to increase prices. Although Tempere does not plan to do this, there is nothing at this point to stop it from changing its mind
    3. On a going forward basis, without the merger Tempere is likely to expand its own plant, significantly increasing the total amount of excess capacity in the industry. Tempere's expansion and its resulting excess capacity is likely to lead Tempere to aggressively price its product in order to gain share and further load its plant. If Black River (now on its own, although perhaps under new management) continues to price aggressively, then two of the three major firms in the industry will be competing vigorously. If the acquisition goes forward, Tempere will not expand its plant and this competition will be lost.
  - ii. In favor of NO
    1. If Tempere keeps both its plant and the Black River plant open, it would have significant excess capacity and face the same incentives as Black River does premerger to cut prices in an effort to further load the plant.

For the memorandum to be complete, these issues need to be spotted and argued one way or the other. I credited a reasoned argument either way.

## 5. Elimination of a maverick

- a. Black River is currently a maverick: It has reduced its wholesale price (to capture additional market share and further load its plant) and disrupted Avalee's price leadership
  - i. BUT does it matter that Black River is likely to be sold to someone even if Tempere is blocked from acquiring it? Perhaps not, since it appears that Black River's incentive to cut prices comes from its structural excess capacity and its desire to increase its share to load its plant, not from an idiosyncratic management decision. I credited an argument made either way
- b. Arguably, Tempere is a maverick but for the acquisition. Prior to negotiations with Black River, the Tempere board had approved an expansion to double capacity by 2024. Tempere business plan with its internal expansion was to return to aggressive pricing in order to gain share and further load the plant. The acquisition of Black River would stop Tempere's internal expansion.<sup>8</sup>
- c. ALSO, is it likely that Tempere will return to aggressive pricing if it acquires Black River and gains all of Black River's excess capacity (thus replacing Black River as a maverick)?

For the memorandum to be complete, these issues need to be spotted and argued one way or the other. I credited a reasoned argument either way.

## DOWNWARD-PRICING PRESSURE DEFENSES

### 6. Entry/expansion/repositioning defense—Not applicable

- a. No evidence of any new firm entering the market<sup>9</sup>
- b. Avalee's plans are too uncertain, and it would take too long for Avalee to build capacity if and when it chose to do so

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<sup>8</sup> Alternatively, Tempere's planned expansion but for the Black River merger could have been analyzed under a "potential expander" rubric akin to the elimination of actual potential competition. The labels here are less important than spotting the issue and making an argument.

<sup>9</sup> Some students styled their answers as "the merging firms will argue" that there exist firms that are likely to rapidly enter the production or sale of label stock in the relevant market without incurring significant sunk costs of entry and exit, and that this entry and expansion would be sufficient to prevent any anticompetitive effect from the merger from occurring. They then proceeded to develop the argument why this defense will be rejected. (This was not the only analysis of a defense that was styled this way.) While I did not deduct for this formulation, I could have. Remember, your firm is representing the buyer, so you have influence over what the parties will argue. You and your client only lose credibility with the agency—and with the court if you are litigation—of making arguments that have no support. If a defense is not supportable on the facts, just say so without putting words in your client's mouth.

- c. No evidence that any other firm (except for Tempere prior to entering negotiations with Black River) had an interested in expanding its plant
- d. In any event, plant expansions or new construction is likely to take too long to come online (two to three years) to avoid an otherwise short-term anticompetitive effect
- e. BUT with the merger, Tempere's business plan is to begin aggressive pricing to expand sales and further load the plant immediately. This is a form of expansion defense since it negates Tempere's interest in reducing production in or to increase prices. Whether this will be accepted by the Antitrust Division in the investigation or the court in litigation depends on how persuasive Tempere is that expansion rather than contradiction of production is in its profit-maximizing interest.<sup>10</sup>

#### **7. Efficiencies defense—Not applicable**

- a. Tempere's reduction in the cost of capacity is not a cognizable efficiency since it only reallocates existing capacity and does not increase it.
  - i. Indeed, market capacity in the future is likely to be less with the acquisition that without it, since if Tempere cannot acquire Black River it is likely to significantly expand its own plant.
  - ii. No indication of any marginal cost savings, product improvements, or other customer benefit flowing from the transaction (apart from any incentives for Tempere to more aggressively price given its postmerger excess capacity, but this is probably better analyzed as an incentive to expand production (see above))

#### **8. Power buyers defense—Not applicable**

- a. Uniform converter price of \$2000/ton indicates that no converter is exercising buyer power
- b. In any event, with 2000 converters, at least some converters will be too small to have any buyer power and be able to resist anticompetitive price increases<sup>11</sup>

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<sup>10</sup> Some students argued that the four fringe firms would defeat an anticompetitive price increase by expanding their production. There are two hurdles to overcome to make this argument. First, the four fringe firms are operating close to capacity and collectively could expand their production by only 17K tons annually. An argument is necessary to say that an expansion of 17K tons would "fill the hole" created by any effort by Avalee and Tempere to tacitly coordinate to increase prices. Given the very inelastic demand for bulk label stock, there is an argument to be made here. But the much bigger problem is that these firms were willing to "follow the leader" when Avalee increased price historically and there is no reason to believe that they would not do the same in a postmerger world.

<sup>11</sup> Some students also said that there was no obvious mechanism for a converter to exercise market power. But given the extent of excess capacity in the industry post the Black River expansion there is an obvious mechanism for a large enough firm: threaten to shift enough of the firm's bulk label stock requirement to Black River to make it worthwhile for the incumbent supplier to reduce prices. But with a uniform price of \$2000/ton across the country we

### **9. Failing firm defense—Not applicable**

- a. No indication that Black River is cannot service its debts
- b. No indication that even if Black River cannot service its debts, it could not be reorganized in bankruptcy
- c. Two other bidders for Black River plant who are not actual or potential competitors (and therefore would present no antitrust concerns if either acquired Black River)

### **RELIEF RISK**

### **10. At the DOJ**

- a. If there is a merger review, it is likely to be done by the Antitrust Division. During the Biden administration, AAG Jonathan Kanter has refused to enter into any consent decree settlement. Tempere should be advised that the likelihood of a consent decree settlement with the Division is low to nonexistent.
- b. A “fix it first” trade up solution
  - i. Kanter has been willing to allow the merging parties to “fix it first,” that is, divest the overlapping business of one of the parties to a third party to whom the Division does not object prior to the closing of the main deal. If it were willing, Tempere could do a “trade up” fix by selling its own (smaller) plant to a third-party divestiture buyer. Assuming a qualified buyer, there is a good to excellent chance that the Division would accept this as a “fix it first.”<sup>12</sup>
  - ii. If the DOJ would not accept a trade up divestiture as a “fix it first,” the margining parties could “litigate the fix” by entering into a definitive agreement with a qualified divestiture buyer. Here, it would not be necessary for the merging parties to close the divestiture deal unless and until the court permitted it.

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do not see this. The absence of price variation suggests either that no converter is large enough to matter to a bulk label stock supplier or that the prices in the market have already been (uniformly) negotiated down to as low a level as they will go (perhaps because of tacit collusion).

<sup>12</sup> Some students suggested that Tempere could sell a “portion” of its excess capacity to a third-party divestiture buyer. Three problems here. First, how does one divest a “portion” of the excess capacity of a plant? I am not saying that it cannot be done—in fact, some chemical plants have multiple owners that spit the output according to their equity shares—but you need an explanation of how to do it. Second, how much capacity do you need to sell to negate the antitrust concerns? You need an argument as to how much to sell and why this should resolve the antitrust concerns. Finally, the Antitrust Division would be the agency to investigate the transaction, and Kanter has yet to accept a straightforward consent decree for the sale of an entire business, much less a complicated consent decree involving the splitting of a plant, which is likely to require continuous monitoring. That leaves the parties with a “litigate the fix” option, which brings us back to the first and second problems. The “trade up” option of selling the Tempere plant is much more straightforward, especially if it is necessary to “litigate the fix.”

- c. On an entirely separately track, the antitrust harms arise from a postmerger situation where Tempere closes its plants and consolidates its production in the Black River plant. This essentially eliminates the excessive capacity in the industry and with it the incentive to price aggressively. Tempere could try to settle the investigation with a commitment to keep both plants operating consistent with its current business plan.
  - i. The problem again is that the Antitrust Division under AAG Kanter has yet to accept a divestiture consent decree, much less a behavioral consent decree, in any merger. It is most unlikely that a consent decree to keep both plants open would be accepted by the Antitrust Division.
  - ii. Failing a consent decree solution with the Division, the parties could litigate. They could try to convince the judge that their business plans to keep both plants open were in their profit-maximizing interests, so that no judicial order was required (much like AT&T in AT&T/Time Warner with respect to distributing Time Warner content) or, failing that, to accept an order that ensured that keep both plants would continue to operate (similar to what UnitedHealth did in UnitedHealth/Change, although there it was with respect to a divestiture and not a behavioral requirement).

## **WHAT CAN TEMPERE DO NOW TO IMPROVE THE CHANCES OF CLEARING ANY INVESTIGATION WITHOUT ENFORCEMENT ACTION?**

### **11. Contract with Avalee**

- a. Tempere should open negotiations with Avalee to renew the contract *contingent* on Tempere's acquisition of Black River. Providing Avalee assurance of supply (especially at current terms) should eliminate much of Avalee's concerns about the transaction. Moreover, making the commitment contingent on the success of the Black River acquisition should realign Avalee's interests not to complain about the deal. Finally, it ensures that Avalee will not be strapped for bulk label paper and will be able to continue to supply its customers, which should also mitigate some if not all of their concerns.

### **12. Possible state AG consent decree**

- a. If Tempere wants to pursue a consent decree to keep both plant open (or even a trade up option) and the Antitrust Division will not settle, another possibility is a separate settlement with the state AG in the state where Tempere has its plant. State AGs have shown more willingness to enter into consent decrees (especially behavioral decrees) than the Division, and a state decree would impose a legal obligation on Tempere just as much as a federal decree. Tempere may be able to use an appropriate state decree to avoid federal litigation altogether or, if the Division commences suit anyway, the state decree will be part of the competitive landscape in which the court will assess the likely effects of the transaction.