No. 71-873

In the Supreme Court of the United States

OCTOBER TERM, 1971

UNITED STATES OF AMERICA, APPELLANT

v.

FALSTAFF BREWING CORPORATION AND NARRAGANSETT BREWING COMPANY

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF RHODE ISLAND

BRIEF FOR THE UNITED STATES

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OPINION BELOW

The opinion of the district court (J.S. App. A, pp. 18–23) is reported at 332 F. Supp. 970.

JURISDICTION

The judgment of the district court dismissing the government's complaint (J.S. App. B, p. 24) was entered on October 7, 1971. A notice of appeal to this Court was filed on December 3, 1971 (J.S. App. C, p. 25; App. 585). Probable jurisdiction was noted on February 28, 1972 (405 U.S. 952). The jurisdiction of this Court is conferred by Section 2 of the Expediting Act (15 U.S.C. 29). *United States* v. *Pabst Brewing Co.*, 384 U.S. 546.

QUESTION PRESENTED

Whether the trial court applied an erroneous legal standard in holding that the acquisition by the fourth largest brewer in the United States of the largest brewer in New England did not violate Section 7 of the Clayton Act by eliminating the potential competition of the acquiring firm.

STATUTE INVOLVED

Section 7 of the Clayton Act, 38 Stat. 731, as amended, 64 Stat. 1125, 15 U.S.C. 18, provides in pertinent part:

> No corporation engaged in commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital and no corporation subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of another corporation engaged also in commerce, where in any line of 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.

* * * * *

STATEMENT

The United States instituted this civil antitrust case in the United States District Court for the District of Rhode Island alleging that the acquisition in 1965 of the Narragansett Brewing Company ("Narragansett") by the Falstaff Brewing Corporation ("Falstaff") violated Section 7 of the Clayton Act (15 U.S.C. 18). The theory of the suit was that potential competition in the New England beer market may be substantially lessened by the acquisition. After a trial on the merits, the district court held that the acquisition did not violate Section 7 (J.S. App. A, pp. 18–23).

A. THE NEW ENGLAND BEER MARKET

The product market in this case is beer; the geographic market is the six New England states.[1] During the past decade the beer industry in these states has both grown in sales' volume and increased in concentration.

In the four years preceding Falstaff's 1965 acquisition of Narragansett, beer sales in New England increased approximately 9.5 percent (computed from App. 409-414; computed from GX 1, O–Z),[2] from just under 5.5 million barrels in 1960 to more than 6 million barrels in 1964. During this period the beer market there also became more concentrated. In 1960, the eight largest sellers in New England accounted for approximately 74 percent of all beer sales; by 1964, they accounted for 81.2 percent (App. 167, 575;

[1] The parties stipulated for the purposes of this case that the production and sale of beer was a line of commerce and that New England was a section of the country within the meaning of Section 7 of the Clayton Act (App. 390; GX 1, p. 2). In New England, as elsewhere in the United States, the production of beer is subject to the federal alcohol tax; however, entry into the market is not regulated by the federal or state governments, although the states have varying packaging and labelling requirements. See the Brewer's Almanac, 1965, p. 88–89.

[2] "App." references are to the printed appendix in this Court; "GX" references are to government exhibits introduced in the district court; "DX" references are to defendants-appellees' exhibits in the district court.

GX 30).[3] Approximately 50 percent of the 1960 sales were made by the four largest sellers in New England; by 1964, their share of the product market was 54 percent; and by 1965, the year of acquisition, it was 61.3 percent (App. 168, computed from App. 581–586; computed from DX F).

This steady increase in concentration of beer sales was accompanied by a sharp decrease in the number of brewers operating plants in the region. In 1957, there were eleven breweries in New England; in 1964 there were only six (App. 392; GX 1, p. 4). The three smallest brewers were Hull Brewing Co. in New Haven, Connecticut, Diamond Spring Brewery in Lawrence, Massachusetts, and Dawson's Brewery in New Bedford, Massachusetts (App. 391–392, GX 1, pp. 3–4). Dawson's Brewery had a capacity of 750,000 barrels; Hull and Diamond Spring each had a capacity of 100,000 barrels (*ibid.*). Both Dawson's Brewery, which operated well below capacity, and Diamond Spring were interested in being acquired by a larger brewer and suggested such acquisition to Falstaff (App. 324–325).

Seven of the nation's ten largest brewers sold beer in New England.[4] Falstaff was the largest of the three remaining which did not. The other two were

[3] In 1964, the eight leading sellers in descending order of sales were: Narragansett, Rheingold, Anheuser-Busch, Schaefer, Carling, Ballantine, Schlitz and Pabst (App. 590; DX H). The Rheingold figures from 1964 on include sales by Ruppert, a brewer which Rheingold acquired in 1965 (App. 208–209).

[4] The firms were: Anheuser-Busch, Schlitz, Pabst, Carling, Schaefer, Ballentine and Miller. Not all of them operated plants in the area, however.

Hamm and Coors (App. 406, 589, 590; GX 1, M; DX G and H), both of which were appreciably smaller than Falstaff, ranking eighth and ninth in national sales. These two brewers were located some distance from New England. Hamm's nearest plant was in St. Paul, Minnesota, approximately 1,385 miles from Boston; Coors' only plant was in Golden, Colorado, 2,000 miles from Boston (App. 406, 392; GX 1, M; GX 1, p. 4).

B. NARRAGANSETT, THE ACQUIRED FIRM

Narragansett was the largest seller of beer in New England at the time of its acquisition (J.S. App. A, p. 20), as it had been for each of the five preceding years. Between 1960 and 1965, it had constantly expanded the capacity of its brewery (App. 379), and had itself acquired either the assets or the trademarks of several smaller brewers in and around the New England area.[5]

By 1964, Narragansett was selling 1,275,000 barrels, which was approximately 20 percent of all beer sold in New England (App. 406; GX 1, M; J.S. App. A, p. 20). The same year it ranked twenty-first in national sales, accounting for about 1.4 percent of all beer sales in the United States (computed from App. 406; computed from GX 1, M). Its net sales and net profits,

[5] In 1961, Narragansett acquired the trademarks and trade name of the Krueger Brewing Company of New Jersey (App. 379; GX 5, 17); in 1964 it acquired the assets of the Haffenreffer brewery in Boston (App. 377; GX 5, 17). At the time of the latter acquisition, Narranganactt had already acquired the assets or trademarks of two other New England brewers: Croft in Boston, and Hanley in Rhode Island (App. 379).

which in 1960 were $17.2 million and $417,284, respectively (App. 452–453; GX, p. 10). had increased by 1964 to record levels of $25.2 million and $713,083, respectively (App. 452–453; GX 5, p. 10).

The company operated a modern and efficient plant in Cranston, Rhode Island, with an annual production capacity of 1.5 million barrels (App. 576; DX A, p. 11). It had a good distribution system, built upon contracts with wholesale distributors. As was the general practice in the New England beer business, these contracts were not exclusive, and distributors frequently handled more than one company's beer. Narragansett from time to time changed distributors (J.S. App. A, pp. 20–21; App. 383–384).

C. FALSTAFF, THE ACQUIRING CORPORATION

Falstaff was at the time of the acquisition the fourth largest producer of beer in the United States (App. 588; DX F, p. 8). Its 1964 production was 5.8 million barrels, or 5.9 percent of the nation's production (computed from App. 588; computed from DX F, p. 8).

Starting in 1933 with a 100,000 barrel plant in St. Louis, Missouri, the company grew steadily by acquiring and expanding weak or failing breweries (App. 419–420; GX 2, pp. 6–10; and see App. 324). As of January 1965, Falstaff operated eight plants [6] and sold beer in thirty-two western, mid-western and southern states, sixteen of which it entered after 1950 (App. 426, 423–426; GX 2, p. 11, pp. 6–10). The company did not then sell in the Northeast.

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[6] Subsequent to the filing of this suit, Falstaff closed two of its breweries, and thus at the time of trial it operated six plants, plus the former Narragansett plant (DX C, p. 6).

Falstaff's operations increased in size and profitability during the decade prior to its acquisition of Narragansett. Between 1955 and 1964, its net sales increased from $77 million to $139.5 million, and its net income increased from $4.3 million to $7 million (App. 441; GX 3F, C). A good credit rating through the years enabled it to finance all of its expansion projects. In 1964, the company planned a ten-year, $35 million program to expand its existing plants, apart from any acquisitions it might make (App. 48, 149, 154).

Falstaff markets its beer through two distribution channels: company-owned branches and wholesale distributors. In those cities where it has plants,[7] and in much of California, it distributes its product through company branches (App. 455, GX 5, p. 5). While the branches handled only about 20–25 percent of the company's sales in the early 1960's, their profit-margin per barrel was significantly higher than the profit obtained from distributor sales (App. 45, 551; GX 5, p. 13; GX 10, 65). Nevertheless, most of Falstaff's volume was sold through distributors.[8] The company had built up a strong distributorship system by stimulating public demand for its beer with extensive and effective advertising and by providing distributors with a quality product at a price which allowed a good

[7] Falstaff had two plants at the time of the acquisition in St. Louis, Missouri, and one each in Omaha, Nebraska; New Orleans, Louisiana; San Jose, California; Fort Wayne, Indiana; El Paso, Texas; and Galveston, Texas (App. 425, GX 2, p. 11).

[8] Falstaff in 1965 had 600 distributors; only 150 of these handled Falstaff products exclusively (App. 455; GX 5, p. 13).

markup (App. 437, 440–441; GX 3B, p. 8; GX 3F, pp. 10–12).

D. FALSTAFF'S DECISION TO ENTER THE NORTHEAST

Notwithstanding Falstaff's consistent growth in the decade prior to its acquisition of Narragansett, the company encountered increasingly strong competition during the 1960's from the "national brewers"—*i.e.*, Anheuser-Busch, Schlitz, Pabst, and Miller (App. 444; GX 5, p. 2; and see App. 39, 85, 247–248)—which were selling their products in all of the significant markets in the country (App. 122).[9] National brewers possess important competitive advantages; they are able to advertise on a nation-wide basis, and their beers have greater prestige than regional or local beers (App. 86).[10]

The Falstaff management realized that for the company to compete effectively with the four national brewers it must sell nationally by entering the Northeast (App. 541–542; and see App. 122, 146–147).[11] In

[9] Thus, while total beer sales in the United States increased 10.9 percent between 1960 and 1964, the national firms increased their sales 40.2 percent (computed from App. 588; computed from DX F, p. 8). In 1960, the national firms had 23 percent of beer sales in the United States; by 1964 their share had increased to 29.8 percent (*ibid.*). During the same period Falstaff also grew, but not as rapidly; its sales increased 15.6 percent between 1960 and 1964 (*ibid.*).

[10] National brewers also have the advantages of being less seriously affected by bad weather or labor difficulties in any particular region (App. 87).

[11] Falstaff's president testified that the company had for some time wanted to enter New England as part of its interest in becoming a national brewer (App. 295; see also App. 101–102).

1958, Falstaff had commissioned Arthur D. Little, Inc., a management consultant firm, to study "actions Falstaff should take to maximize its profit in the years to come" (GX 10, transmittal letter). Following a comprehensive review of the company's operations, marketing, growth potential, financing and planning, the Little firm, in its report completed in 1960, recommended, among other things, that Falstaff become a national brewer by entering those significant remaining areas of the country where it did not then market its product, particularly the Northeast (App. 539–541; GX 10, pp. 11, 14).

Specifically, the report recommended that Falstaff enter the East Coast market in 1965 by building a brewery (App. 543–544).[12] The Little report carefully reviewed cost estimates aimed at increasing both the amount of earnings and the ratio of earnings to net worth, and it concluded that the advantages of building a plant exceeded those of buying one (App. 558).[13] The study stated that "[t]here appears to be ample reason * * * for building rather than buying * * * [and] that major new market entrances need not be predicated on the availability of a brewery Falstaff could purchase" (App. 558). The report also pointed out that it would be more profitable for the company

[12] The Little study recommended that Falstaff construct its new plant near Baltimore (App. 554). It also recommended that Falstaff enter the Chicago and Detroit markets within two years (App. 542).

[13] This recommendation to build rather than buy was not categorical; the report noted that there might be exceptional situations where it would be more beneficial to buy than build. It also pointed out that entry by building eliminated worries of adverse antitrust action by the government (App. 558).

to distribute its beer through branch operations rather than by sales through independent distributors (App. 542).

Falstaff thereafter made efforts to enter by acquisition the beer market in the Northeast. Between 1962 and 1964, it tried unsuccessfully to acquire two large brewers located in the New York City area, Liebmann and P. Ballantine & Sons, both of which sold significantly in New England (GX 22, 28, 29).[14] In early 1964, Falstaff sent its special project coordinator to the Massachusetts and New York plants of Piel Brothers, another large brewer, with a view toward possible acquisition of those firms (App. 49, 129). The company also had discussions with executives of Genesee of Rochester, New York, concerning acquisition of that firm (App. 76–77).

During this period, Falstaff also kept on file letters, indexed by state, from distributors and potential distributors in New England who were interested in handling Falstaff beer should the company enter the New England market (App. 470–535; GX 9).

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[14] Liebmann, the brewer of Rheingold beer, was ninth in national sales in 1962 and tenth in 1963 (App. 404, 405); Ballantine was sixth in national sales in 1963 and seventh in 1964 (App. 405, 406). On March 6, 1972, it was announced that Falstaff had agreed to purchase Ballantine's trademarks and tradenames, as well as certain of Ballantine's accounts-receivable and equipment. "Wall Street Journal", p. 9, col. 1–2, March 6, 1972.

E. THE PROCEEDINGS BELOW

On May 26, 1965, Falstaff agreed to acquire Narragansett for approximately $19,500,000.[15] Before the acquisition was accomplished, however, the United States, on July 13, 1965, filed the present suit against Falstaff and Narragansett, alleging that the acquisition would violate Section 7 of the Clayton Act because its effect may be substantially to lessen potential competition in the production and sale of beer in the New England market.[16] The district court denied the government's motion for a temporary restraining order and a preliminary injunction, and, on July 15, 1965, the acquisition was consummated (J.S. App. A, p. 19). On August 16, 1965, Falstaff agreed to operate Narragansett as a separate, wholly-owned subsidiary until otherwise ordered or permitted by the court (App. 11–12), and, on September 22, 1965, the court dismissed the complaint as to the acquired firm, Narragansett (App. 1–2).

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[15] Falstaff, in exchange for all of Narragansett's property and assets, paid $17,500,000 in cash, $2,000,000 in Falstaff stock, and assumed Narragansett's debts and liabilities (App. 446; GX 5, p. 3). The sale was arranged through the Haffenreffer family who controlled Narragansett and owned 60 percent of its stock (App. 444; GX 5, p. 1). They wished to escape increasing competitive pressure and to provide diversity and security for their personal estates (J.S. App. A, p. 21).

[16] The complaint also charged that the acquisition violated Section 7 by substantially lessening potential competition in the production and sale of beer generally and by increasing industry-wide concentration in the production and sale of beer. After the parties stipulated on December 23, 1969, that the line of commerce was the sale and production of beer and that the relevant section of the country was New England, the United States did not press these additional charges.

Following a trial on the merits, the district court held that the government had failed to prove that Falstaff was a potential entrant into the New England beer market (J.S. App. A, p. 23). Without making any detailed findings, the court rested its conclusion on the subjective intent of Falstaff's management. "[T]he credible evidence establishes beyond a reasonable doubt," the court stated (J.S. App. A, p. 22), "that the executive management of Falstaff had consistently decided not to attempt to enter [the New England] market unless it could acquire a brewery with a strong and viable distribution system such as that possessed by Narragansett." Management "had carefully considered possible alternatives" for entry, the court found (J.S. App. A, p. 22–23), but had determined that none of these would be reasonably profitable.

In addition, the district court held that both before and after the acquisition there had been vigorous competition in the New England beer market (J.S. App. A, p. 21). It pointed to the fact that, since the acquisition, Narragansett's share of the market had declined while the market shares of Anheuser-Busch and Schlitz had increased (J.S. App. A, p. 21). On this basis, the court concluded that it was "not probable" that Falstaff's acquisition of Narragansett may substantially lessen competition in the New England beer market (J.S. App. A, p. 23).[17]

[17] The court added that in any event the acquisition was pro-competitive because it would enable Narragansett to compete more successfully in New England against the national brewers (J.S. App. A, p. 23).

SUMMARY OF ARGUMENT

A. The competitive role played by an established firm on the edge of a concentrated market, with both the economic incentive and the financial capability to enter independently as a substantial competitor, can be significant. Such a firm represents not only a potential source of market deconcentration through future *de novo* entry; it also is in the position, as a significant potential competitor, to be an external influence on the conduct of those firms that are already in the market. Accordingly, the effect of its elimination from the edge of a concentrated market, through its acquisition of a large market share, "may be substantially to lessen competition" in violation of Section 7 of the Clayton Act. Indeed, where the acquiring firm is one of the few remaining potential competitors having the incentive and capability to introduce a new competitive factor into the market, such an acquisition may have no less serious anticompetitive effects than one that eliminates actual competition.

B. It is, therefore, essential to the preservation of a competitive market structure that those firms which are significant potential competitors be accurately and reliably identified. The determination should depend upon a careful analysis of objective economic evidence, directed toward the nature of the particular market, the potential entrant's financial capabilities, its economic incentive for expansion, and the reasonable prospects for making such expansion a successful venture. See p. 25, *infra.*

In the present case, the district court failed to consider such objective criteria. Rather, in assessing the acquiring firm's role as a potential entrant into the New England beer market, it relied exclusively upon statements by that firm's management disavowing any intent to have Falstaff enter the market other than by the acquisition of Narragansett, the leading seller of beer in New England.

Such subjective evidence should not control the appraisal under Section 7 of potential entry. Generally, the motives and intentions of corporate management with respect to business expansion are shaped by a desire to maximize profits; little, if any, consideration is given to Section 7's purpose to preserve the industry structure most conducive to competition. Moreover, once a decision to enter by acquisition is made, corporate officials are committed to defend it. Thus, under a subjective standard, a court is compelled to make a judgment of economic probabilities on what is bound to be self-serving testimony. This introduces a highly uncertain factor into the administration of Section 7. The antitrust consequences of any acquisition would be largely unpredictable both to the businessman and to the Government.

To be sure, reliance on objective, rather than subjective, evidence as a basis for identifying a firm as a potential independent entrant does not achieve absolute certainty. But by basing the potential competition determination under Section 7 on whether, under all the circumstances, future independent entry by the acquiring firm would be a reasonable choice for prudent management, if entry by large acquisition is not available, the "statutory requirement of reasonable probability" (*United States* v. *Penn-Olin Chemical Co.,* 378 U.S. 158, 175) is fully satisfied.

C. Applying that standard in the present case, Falstaff was at the time of the 1965 acquisition a potential entrant into the New England beer market, notwithstanding subjective statements by its management suggesting otherwise. New England had been undergoing significant economic growth, making it attractive to new entry; Falstaff was one of the few breweries outside the area with the ability to enter as a significant competitor in the market; and Falstaff had shown substantial economic incentive to expand into the New England area.

D. The effect of the elimination of Falstaff as a significant potential entrant through the purchase of the largest brewer in the area may be substantially to lessen competition in the New England beer market. That market is highly concentrated. Falstaff's entry into it in a manner that introduced no new competitive factor left New England without any significant competitors on the outside having the potential for meaningful entry. Moreover, it removed the possibility that Falstaff would itself come into New England either independently or by a toehold acquisition. Falstaff had the financial capability to enter by either route. It also had both the economic resources and the experience to establish and maintain an effective system for distributing its beer in the area, either through its own branches or through independent distributors.

ARGUMENT

THE EFFECT OF THE PROPOSED ACQUISITION MAY BE SUBSTANTIALLY TO LESSEN COMPETITION IN THE NEW ENGLAND BEER MARKET BY ELIMINATING THE POTENTIAL COMPETITION THAT THE ACQUIRING FIRM PROVIDED IN THAT AREA

A. AN ACQUISITION THAT ELIMINATES POTENTIAL COMPETITION IN THE BEER INDUSTRY MAY SUBSTANTIALLY LESSEN COMPETITION WITHIN THE MEANING OF SECTION 7 OF THE CLAYTON ACT

Section 7 of the Clayton Act, as amended in 1950, is intended to bar mergers which may further contration or have other anticompetitive effects in the structure of American industries. See *United States* v. *Pabst Brewing Company,* 384 U.S. 546, 552; *United States* v. *Penn-Olin Chemical Co.,* 378 U.S. 158, 170–171; *Brown Shoe Co.* v. *United States,* 370 U.S. 294, 311–322. Industry concentration tends toward an oligopolistic market structure. "As that condition develops, the greater is the likelihood that parallel policies of mutual advantage, not competition, will emerge." *United States* v. *Alcoa,* 377 U.S. 271, 280. See also *Federal Trade Commission* v. *Procter & Gamble Co.,* 386 U.S. 568; *United States* v. *Pabst Brewing Company, supra.*

The structure of a particular industry is determined in part by the total number and size distribution of firms within a particular geographic market—*i.e.,* the actual competitors—which are manufacturing products regarded by consumers as relatively interchangeable. See *e.g.,* Bain, *Industrial Organization,* 7 (2d ed. 1968); Scherer, *Industrial Market Structure and Economic Performance,* 4 (1970 ed.). But the ability of outside firms dealing in the same product lines—*i.e.,* the potential competitors—to enter the relevant market independently also can exert considerable influence on industry structure. See, *e.g.*, Bain, *Industrial Organization,* 8 (2d ed. 1968).[18]

Where a market is highly concentrated—where a few firms account for most or all of the business—there is, as this Court observed in *United States* v. *Philadelphia National Bank,* 374 U.S. 321, 363, a real danger that those firms will find their interests best served by tacitly renouncing vigorous competition, by adopting a policy of "live and let live." And see *United States* v. *Alcoa,* 377 U.S. 271, 280. In such a situation, it is the outside force of potential competition (*i.e.,* the threat of entry by strong firms outside the market either independently or by acquisition of a small firm already in the market) that often provides the most significant limitation on such an exercise of market power by the firms in the concentrated market.[19]

For this reason, the effect of a merger or acquisition which results in the elimination of a significant

[18] Professor Bain classifies the role of potential entrants under the heading of condition of entry into the market, which "determines the relative force of potential competition as an influence or regulator on the conduct and performance of sellers already established *in* a market." Bain, *Industrial Organization*, 8 (2d ed. 1968). See also Turner, *Conglomerate Mergers and Section 7 of the Clayton Act*, 78 Harv. L. Rev. 1313, 1372–1373 (1965); Areeda, *Antitrust Analysis*, 517–518 (1970).

[19] "New entry can, of course, quickly alleviate 'undue' concentration. And the possibility of entry can act as a substantial check on the market power of existing competitors." *United States* v. *Phillipsburg National Bank*, 399 U.S. 350, 377 (Mr. Justice Harlan, dissenting).

potential competitor, especially where, as here, there are extremely few firms having the incentive and capability to introduce a significant new competitive factor into the market, "may be substantially to lessen competition," contrary to Section 7 of Clayton Act. *Ford Motor Co.* v. *United States,* No. 70-113, O.T. 1971, slip op. 4–6, decided March 29, 1972; *Federal Trade Commission* v. *Procter & Gamble Co.,* 386 U.S. 568; *United States* v. *Penn-Olin Chemical Co.,* 378 U.S. 158; *United States* v. *Continental Can Co.,* 378 U.S. 441; *United States* v. *El Paso Natural Gas Co.,* 376 U.S. 651. Indeed, such an acquisition may have no less serious anticompetitive effects than one that eliminates actual competition. Cf. *United States* v. *Penn-Olin Chemical Co., supra,* 378 U.S. at 168, 170–174.

In the beer industry, potential competition has particular significance. The market trend toward concentration in that industry has already been noted with some concern by this Court in invalidating a merger between actual competitors. *United States* v. *Pabst Brewing Company, supra,* 384 U.S. at 550–553. That trend alone suggests the importance of a potential entrant to the preservation of a competitive market structure. A brewer on the edge of a concentrated market having both the ability and incentive to enter may offer the only real possibility for deconcentration by future independent entry (see *United States* v. *Philadelphia National Bank, supra,* 374 U.S. at 365 n. 42); it also is an external factor that inhibits anticompetitive practices by those brewers already in the market.[20] See *United States* v. *Jos. Schlitz Brewing Co.*, 253 F. Supp. 129 (N.D. Cal.), affirmed, 385 U.S. 37; *United States* v. *Standard Oil Co. (New Jersey)*, 253 F. Supp. 196 (D. N.J.); *United States* v. *Wilson Sporting Goods Co.*, 288 F. Supp. 543 (N.D. Ill.); and see *Ekco Products Co.* v. *Federal Trade Commission*, 347 F. 2d 745 (C.A. 7); *General Foods Corp.* v. *Federal Trade Commission*, 386 F. 2d 936 (C.A. 3), certiorari denied, 391 U.S. 919.

Moreover, sales in the beer industry depend largely on advertising and on product differentiation unassociated with inherent quality (see *United States* v. *Jos. Schlitz Brewing Co., supra*). The principal barrier to new entry into a particular beer market is, therefore, a financial one associated with promotional costs. When a brewer outside a concentrated market has the resources to enter independently and compete effectively through the media, its elimination as a potential *de novo* entrant, through its acquisition of a large market share, is especially relevant in assessing under Section 7 the effect of such an acquisition upon the competitive structure of the market in question. This Court so recognized in summarily affirming

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[20] As this Court observed in *United States* v. *Penn-Olin Chemical Co., supra*, 378 U.S. at 174: "* * * '[p]otential competition * * * as a substitute for * * * [actual competition] may restrain producers from overcharging those to whom they sell or underpaying those from whom they buy. * * * Potential competition, insofar as the threat survives [as it would have here in the absence of Penn-Olin], may compensate in part for the imperfection characteristic of actual competition in the great majority of competitive markets.' " See also Elzinga, "The Beer Industry," in Adams, *The Structure of American Industry*, 189, 202 (4th ed. 1971).

the district court's decision in *United States* v. *Jos. Schlitz Brewing Co., supra,* which invalidated under Section 7 several proposed acquisitions by Schlitz that would have eliminated significant potential competitors from the edge of the relevant beer market,[21] as well as eliminating actual competition.

B. THE DETERMINATION WHETHER THE ACQUIRING FIRM IS A POTENTIAL COMPETITOR DEPENDS ON THE OBJECTIVE FACTS RELATING TO ITS INDEPENDENT ENTRY INTO THE MARKET AND NOT UPON THE FIRM'S SUBJECTIVE STATEMENTS WITH RESPECT TO THE LIKELIHOOD OF SUCH ENTRY

In determining whether Falstaff was a potential competitor, the district court relied solely on statements by Falstaff's management that the acquiring firm had no intention of entering the New England market other than by a merger with a leading local brewer in the area. It pointed only to testimony of company executives that "possible alternatives" to the present acquisition had been "carefully considered" and rejected on the ground that they would not have

[21] Schlitz, the nation's second largest brewer, whose premium beer accounted for only a small percentage of the California market, attempted to acquire Burgermeister, a leading California popular-priced beer. The acquisition was invalidated under Section 7 on the ground that it would eliminate Schlitz as a potential entrant into the California market with its own popular-priced "Old Milwaukee" beer (253 F. Supp. 142). In the same case, the acquisition by Schlitz of a controlling interest in a large Canadian brewer, Labatt, and its United States subsidiary, General Brewing Co., both of which were significant potential competitors in California and in the western United States, was held to have anticompetitive effects in violation of Section 7 of the Clayton Act (253 F. Supp. at 138).

afforded "a reasonable probability of a profitable entry" into New England (J.S. App., p. 22). "[T]he executive management of Falstaff had consistently decided not to attempt to enter said market," the court found (*ibid.*), "unless it could acquire a brewery with a strong and viable distribution system such as that possessed by Narragansett."

The subjective motives and intentions of corporate management as to alternatives they might or might not have pursued with respect to a given market have never been accepted by this Court as a basis for concluding that a firm is not a potential entrant. Indeed, in *United States* v. *Penn-Olin Chemical Co., supra,* the Court, following a full review of objective evidence showing the capability and incentive of joint venturers to enter a market independently, held (378 U.S. at 175): "Unless we are going to require subjective evidence, this array of probability certainly reaches the prima facie stage. As we have indicated, to require more would be to read the statutory requirement of reasonable probability into a requirement of certainty. This we will not do." See also *Federal Trade Commission* v. *Procter & Gamble Co.,* 386 U.S. 568, 580–581.

For the concept of potential competition to be meaningful under Section 7, there must be some reliable and accurate means for ascertaining which firms are significant potential competitors. Reliance on management's stated preference as the determinative test is both unreliable and inaccurate.

Business decisions are necessarily and properly motivated by a purpose, fundamental to our free enterprise system, to maximize profits. The determination to expand into new markets is made with a view toward immediate profit advantage; it does not depend on preserving the industry structure that is most conductive to competition. Given this, a voiced preference for entry by means of a substantial acquisition is not surprising. Almost always it is easier to enter a market by purchasing a large existing market share than by engaging in the hard competition that confronts a firm entering independently or through what is commonly referred to as a "toehold" acquisition.[22]

But, merely because expansion by a large acquisition may be more profitable to the acquiring firm does not mean that the firm lacks the capability to enter a particular market independently. See *United States* v. *Standard Oil Co. (New Jersey)*, 253 F. Supp. 196, 220-223, 227 (D. N.J.). Management's subjective preference to maximize profits is thus not an accurate reflection of the competitive status of a potential entrant. If deemed controlling in the present context, it would effectively undermine the fundamental concept of Section 7, which is to insure that the profit motivation in our free enterprise system is directed into procompetitive channels. See, *e.g., United States* v. *Pabst Brewing Company, supra.*

Moreover, the weight to be accorded such subjective evidence would depend essentially on the trial court's

[22] "Toehold entry" means entry into a market by a new competitor through the acquisition of a small competitor already operating there. See *The Bendix Corp.* (FTC), 3 Trade Reg. Rep. ¶ 19,288, vacated and remanded on other grounds, *Bendix Corporation* v. *Federal Trade Commission*, 450 F. 2d 534 (C.A. 6); *The Stanley Works* (order of the Federal Trade Commission dated May 17, 1971), 3 Trade Reg. Rep. ¶ 19,646.

evaluation of the sincerity of officials committed to defend their management's decision. This introduces a highly uncertain factor into the administration of Section 7. Management officials, who naturally attempt to justify their corporate decision to enter a market by acquisition, are often unable to give disinterested, retrospective testimony about what their corporation would have done if it had not been able to consummate the acquisition.[23] Not infrequently, an acquiring firm which has been barred by antitrust proceedings from making a particular acquisition may turn to the more competitive method of market entry that it originally had declined to pursue.[24]

[23] In another Section 7 case, for example, officials of Bethlehem Steel strongly insisted that unless Bethlehem were allowed to acquire Youngstown Steel, the company would never enter the midwest steel market. The district court ruled against the merger. *United States* v. *Bethlehem Steel Corp.*, 168 F. Supp. 576 (S.D.N.Y.). Bethlehem then entered the market independently. See Moody's *Industrial Manual*, 1966, p. 2861.

[24] For example, in 1960 the United States challenged the acquisition by Anheuser-Busch Co. of a large brewing facility in Miami, Florida, contending that the acquisition would eliminate actual and potential competition. Anheuser-Busch agreed to a consent decree providing for divestiture. *United States* v. *Anheuser-Busch, Inc.*, 1960 Trade Cases, ¶69,599. Following the divestiture, Anheuser-Busch is reported to have "forgone any policy of acquiring rival brewers and has since undertaken an extensive program of building new plants in Florida and other locations." Elzinga, op. cit. *supra*, note 20, at p. 203.

Similarly, in 1961, Schlitz attempted abruptly to expand its small share of the beer market on the West Coast by merging with Burgermeister, rather than introducing its own popular-priced beer, see n. 21, *supra*. While the merger was being challenged in the courts, however, Schlitz developed other facil-

Subjective testimony as to corporate intentions and economic preferences is thus a particularly unreliable basis for decision under Section 7. If it were determinative, the outcome of each potential competition case would turn upon the vagaries of managerial attitudes and policies, without regard to economic probabilities. Businessmen would be unable to "assess the legal consequences of a merger with some confidence" (*United States* v. *Philadelphia National Bank, supra,* 374 U.S. at 362). The antitrust consequences of an acquisition would lose that necessary element of predictability that this Court has recognized is so important in merger transactions which may involve many millions of dollars, the livelihood of large numbers of employees and even whole communities, and the public interest in the structure of a concentrated industry. See, *e.g., United States* v. *Topco Associates,* No. 70–82, O.T., 1971, decided March 29, 1972, slip op., p. 13, n. 10.

It is therefore essential, both to the purpose of Section 7 and to its efficient administration, that the role of a potential entrant on the edge of a concentrated market be assessed on the basis of a careful analysis of objective economic evidence, uninfluenced by what management might later subjectively claim to have "considered" or "decided" (J.S. App., p. 22). The situation "must be viewed functionally in the con-

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ities and today operates its own large brewery and warehouse in Los Angeles, California, 1971 Moody's *Industrial Manual*, p. 1174.

See also Brief for the United States in *United States* v. *First National Bancorporation, Inc. and First National Bank of Greeley*, No. 71–703, this Term, at pp. 32–34.

text of the particular market involved, its structure, history and probable future" (*United States* v. *Continental Can Co., supra,* 378 U.S. at 458). Whether, in that context, the outside firm may be a significant potential competitor should turn on objective factors: whether, considering the structure of the market, the putative entrant's financial capability to enter independently, its economic incentive to do so, and the reasonable prospects for making such an entry successful, there exists a basis for entry which would be reasonably acceptable to prudent management, if entry by acquisition of a large market share were not an available option.[25]

To be sure that standard does not reduce the potential competition determination under Section 7 to litmus test certainty. But the statute does not demand that it do so (see *United States* v. *Penn-Olin Chemical Co,. supra,* 378 U.S. at 175); Section 7 requires only a determination of reasonable probabilities, not certainties. See, *e.g., Ford Motor Co.* v. *United States, supra,* slip op. at pp. 3–4, n. 4; *United States* v. *Philadelphia National Bank, supra,* 374 U.S. at 362–363; *Brown Shoe Co.* v. *United States, supra,* 370 U.S. at 323. Its purpose is to prohibit all acquisitions the effect of which "may be substantially to lessen competition."

Viewed in this light, reliance on objective criteria provides a predictable basis for assessing an outside firm's capabilities of independent entry. Moreover, such a standard affords a more accurate reflection of

[25] See Pitofsky, *Joint Ventures Under the Antitrust Laws: Some Reflections on the Significance of Penn-Olin,* 82 Harv. L. Rev. 1007, 1024–1030 (1969).

the potential entrant's influence on the conduct of those firms already in the market. See, *e.g.*, *Ford Motor Co.* v. *United States, supra; United States* v. *Penn-Olin Chemical Co., supra.* Ordinarily, firms in the market will evaluate the competition of an established firm on the edge of the market on the basis of objective factors indicating the outsider's financial capacity and economic incentive to enter; rarely will they be aware of management's subjective preferences motivated by a desire to maximize profits.

Accordingly, we submit that the fundamental determination in potential competition cases must be based on an objective appraisal of the factors bearing on whether independent entry is preferable to no entry at all for a firm with the potential entrant's capabilities and incentives. The basic question is whether, considering all the circumstances, independent entry in the future is a reasonable choice for prudent management, if entry by large acquisition is not available. Where a concentrated market is growing, and profit expectations in it are good, an outside firm with the legal, technological and financial capabilities to enter must be viewed as a potential entrant if it would be reasonable for it to enter independently or by a toehold acquisition. Such a firm serves both as a future source of deconcentration and as a restraining influence on existing competitors.

C. FALSTAFF IS A POTENTIAL ENTRANT INTO THE NEW ENGLAND BEER MARKET

Under the objective criteria we have outlined—as distinguished from the stated preference of Falstaff's management to enter the New England beer market by acquisition of a local market leader upon which the district court relied—Falstaff was a potential entrant into the area. The objective evidence shows that (1) the New England beer market has been undergoing significant economic growth, making it attractive to new entry; (2) Falstaff was one of the few breweries outside the area with the ability to enter as a significant competitor in the market; and (3) Falstaff had substantial economic incentive to expand into the New England area.

1. *The New England beer market is attractive to new entry.*—In the early 1960's, the beer market in New England had undergone considerable economic growth. Barrel sales in the area increased from 1960 to 1964 almost ten percent (computed from App. 409–414; computed from GX1, O–Z). The experience of Narragansett, the acquired firm, during this period was typical. Its New England beer sales had grown markedly between 1960 and 1964 (App. 402–403; GX, I-L), and, according to its executive vice-president (App. 379), at the time of the acquisition the company was still growing. Its net sales and net income had increased progressively in the preceding four years, registering record figures in 1964 in both categories (App. 452–453; GX 5, p. 10).

The New England market was, therefore, attractive to outside brewers. It had, moreover, both the size and the capacity to sustain new entrants. Falstaff does not contend, nor did the district court find, otherwise.

2. *Falstaff was one of the few breweries that had the ability to enter the New England market in a*

meaningful way.—At the time of the acquisition, Falstaff was the fourth largest brewer in the country; it sold in all the major sections of the United States except the Northeast. Moreover, it, too, was growing. In the decade prior to its acquisition of Narragansett, the acquiring firm's net sales increased from $77 million to $139.5 million; its net income rose from $4.3 million to $7 million during the same period (App. 442; GX 3F, C).

Of the nation's ten largest brewers in 1964 (see pp. 4–5, *supra*), there were only two brewers, Hamm and Coors, besides Falstaff that did not sell in New England. Falstaff was the largest; its 1964 sales exceeded Hamm's by more than two million barrels and exceeded Coors' by almost two and a half million barrels (App. 588). That it had the financial resources to enter the New England market *de novo* or by a "toehold" acquisition is not seriously questioned (Motion to Affirm, p. 8). The company's financial position was strong and its credit rating was good (see Statement, *supra,* pp. 6–7). It had obtained financing for all its ventures in the past (App. 48), and, in 1964, Falstaff had planned a ten-year, $35 million program to expand its existing plants, apart from any acquisition it might make (App. 149, 154).

Falstaff argues that *de novo* entry would have been ill-advised because the return on its investment would have been unreasonably low (Motion to Affirm, p. 9). The contention is based on a calculated 6.7 percent return suggested by its expert witness, Dr. Horowitz, which he characterized as "inordinately low" and as "a very, very poor investment indeed" (App. 239).[26] But, it does not follow from the fact that expansion could be accomplished by more profitable means that Falstaff lacked the ability to enter the New England market independently as a significant competitor. See *United States* v. *Standard Oil Co.* (*New Jersey*), *supra*, 253 F. Supp. at 220–223, 227.

Moreover, the 6.7 percent figure is suspect. Even Dr. Horowitz recognized that the construction of a new plant in New England would make Falstaff a national brewer, and thus provide the company with system-wide incremental earnings which, when added to its New England earnings, would raise the plant's return above 6.7 percent (App. 287–288).[27] Furthermore, Dr. Horowitz' calculations are based upon an estimated profit figure of $1.16 per barrel, which was then the average profit being made by Falstaff at its older breweries (see n. 26 *supra*). It is not unlikely

[26] Dr. Horowitz's calculation was made on the basis of an estimated $20 million cost to Falstaff to construct a conventional million-barrel brewery in New England. He hypothesized a cost figure of $20.00 per barrel, and a profit per barrel of $1.16—which was Falstaff's average profit per barrel between 1960 and 1964 (App. 239)—on sales of 850,000 barrels per year for the first ten years, and of 1,000,000 barrels per year for the forty years thereafter (App. 238). Falstaff's contention (Motion to Affirm, p. 9) that a projected sales volume of 850,000 barrels per year would have required the company to obtain "13% of the New England beer market" is not well taken. Falstaff could have used the beer produced by this plant for sales anywhere in the Northeast area, both inside and outside of New England.

[27] Dr. Horowitz stated that he was unable to calculate the specific additional financial benefit that the New England plant would provide by making Falstaff a national brewer (App. 287–288).

however, that a newly constructed plant would yield a higher return. Both Anheuser-Busch and Pabst, for example, earned returns of better than \$2.50 per barrel from their new plants in New England (App. 239-240).

At all events, the 6.7 percent estimated return from an entry *de novo* compares favorably with the projected return on investment under the Narragansett acquisition. Falstaff spent \$19 million to acquire Narragansett, and Dr. Horowitz acknowledged that if the earnings of the acquired firm were to continue at their record 1964 level (\$713,000), this would represent a return to Falstaff on its investment of only 3.7 percent (App. 288–289).

3. *Falstaff had substantial economic incentive to expand into the New England market.*—Faced in the late 1950's with stiff competition from national brewers (see Statement, *supra,* p. 8), Falstaff's management recognized that the firm's economic interests required expansion into the few remaining areas of the country where it was not then doing business. As early as 1960, the management consultant firm of Arthur D. Little, Inc., in a comprehensive study commissioned by Falstaff, recommended that the company enter the populous Northeast within five years (App. 541–542; GX 10, p. 14; and see App. 122, 146-147). In response, the company, as its president testi-

fied (*supra,* n. 11), began to explore possibilities for enterin gthe Northeast beer market.[28]

In 1962 and 1963, it made extensive efforts to acquire Liebmann, a New York City brewery with substantial sales in New England (App. 561–563; GX 22). When that proved unsuccessful, it attempted to purchase Ballentine of Newark, New Jersey, which was in 1964 the sixth largest seller of beer in New England (App. 589; DXG).[29] Failing there, Falstaff turned to the Massachusetts and New York breweries of Piel Bros. (App. 129), although again to no avail. In addition, the company maintained throughout this period files of letters, indexed by state, from distributors and potential distributors in New England who wished to handle Falstaff beer should it enter the New England market (App. 470–535; GX 9).

D. THE EFFECT OF THE ACQUISITION MAY BE SUBSTANTIALLY TO LESSEN COMPETITION IN NEW ENGLAND

This objective evidence, we submit, shows that Falstaff was a potential entrant into the New England market. Its elimination as such through its purchase of the largest brewer in the area may have the

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[28] Appellee asserts that the United States "wrongly equates" New England with the Northeast (Motion to Affirm, p. 5 n. 5). No effort has been made, however, to analyze the anticompetitive effects of the present acquisition in terms of any broader geographic market than the one stipulated by the parties, *i.e.*, the six New England states (App. 390; GX 1, p. 2). To the extent that entry into that geographic market satisfies Falstaff's economic need to do business in the Northeast, there is no reason to distinguish between New England and the Northeast.

[29] Falstaff was willing to pay $35.5 million for Ballentine (App. 573; GX 29, p. 1). In 1972, it acquired certain valuable Ballentine assets (see n. 14 *supra*).

effect of substantially lessening competition in the New England beer market.[30]

1. *The New England market was highly concentrated.*—At the same time that the beer market in New England was enjoying economic growth (*supra*, p. 3), it was becoming more concentrated. Between 1960 and 1964, the eight largest brewers operating in the area increased their market share from 74 percent to 81.2 percent (App. 167; GX 30). The four largest New England brewers had 54 percent of sales in 1960, and by 1965, their market share had grown to 61.3 percent (computed from App. 581–588; computed

[30] The district court's conclusion to the contrary was improperly based on post-acquisition evidence indicating that "since Falstaff's acquisition of Narragansett on July 15, 1965, there has been no diminution of the intensity and vigor of said competition" (J.S. App., p. 21). Such evidence, however, has never been considered conclusive in determining anticompetitive consequences of a merger or acquisition. As this Court stated in *Federal Trade Commission* v. *Consolidated Foods Corp.*, 380 U.S. 592, 598, "the force of § 7 is still in probabilities, not in what later transpired." It is, therefore, not particularly relevant to the Section 7 determination in this case that Narragansett's share of the beer market declined after the acquisition (J.S. App., p. 21). Compare *Federal Trade Commission* v. *Procter & Gamble Co.*, 386 U.S. 568, 576–577. The sole question under the antitrust statute is whether, in assessing probabilities at the time of the acquisition in 1965, the structural changes in the New England beer market caused by the elimination of the acquiring firm as a potential entrant and by the removal of the acquired firm as an independent competitor were such as to warrant a conclusion that competition there *may* be substantially lessened. That question should not be answered, as the district court did here, principally on the basis of post-acquisition developments. See *United States* v. *Continental Can Co.*, *supra*, 378 U.S. at 463.

from DXF). Thus, at the time of the acquisition, the level of concentration in the New England market was even higher than the 58.62 percent market share of the four leading beer sellers in Wisconsin that concerned this Court in *United States* v. *Pabst Brewing Co., supra,* 384 U.S. at 551.[31] Compare also *United States* v. *Jos. Schlitz Brewing Co., supra,* 253 F. Supp. at 134, 159, 179.

In addition, during approximately the same period, the number of brewers which operated plants in the region had been cut almost in half. Of the eleven brewers in this category in 1957, there remained only six by 1964 (App. 392; GX 1, p. 4); and three of these were sufficiently small to be permissible toehold acquisition for a potential entrant (see p. 4 *supra*).

2. *The acquisition of Narragansett by Falstaff may substantially lessen competition by eliminating Falstaff as a potential competitor in the New England market.*—Given this high degree of concentration, Falstaff's acquisition of the leading beer distributor in the area, Narragansett, created a "reasonable likelihood" (*United States* v. *Penn-Olin Chemical Co., supra,* 378 U.S. at 171), or a "reasonable probability" (*id.* at 175; *United States* v. *Von's Grocery Co., supra,* 384 U.S. at 285 (Mr. Justice Stewart, dissenting)), that competition in the New England beer market would be substantially lessened. Section 7 "look[s] not merely to the actual present effect of a merger but instead to its

[31] Moreover, in *Pabst*, the eight leading beer sellers in the three-state market had 67.65 percent of sales, as compared with the 81.2 percent figure here.

effect upon future competition" (*United States* v. *Von's Grocery Co., supra,* 384 U.S. at 277).

As we pointed out earlier, when an established brewer outside a concentrated market enters that market by acquiring one of its local leaders, it eliminates itself as a significant factor that inhibits firm within the market from adopting "parallel policies of mutual advantage" (*United States* v. *Alcoa, supra,* 377 U.S. at 280) in disregard of local competitive conditions. Falstaff's acquisition of Narragansett left the New England beer market, which was fast becoming oligopolistic, without any significant competitors on the outside having the potential for meaningful entry (see *supra*, pp. 4–5). Since, moreover, the acquisition merely changed ownership of the leading firm in the area, no new competitive factor was introduced into the market.[32] Thus, the anticompetitive impact resulting from the elimination of Falstaff as a potential competitor was even more serious here than when two potential entrants combine to enter a market through a joint venture. In the latter instance, the loss of potential competition is counterbalanced by the creation of a new firm that actually enters the market. Compare *United States* v. *Penn-Olin Chemical Co., supra,* 378 U.S. at 170, 172–174.

[32] The district court's statement, made without any findings, that the acquisition would have a procompetitive effect because it would enable Narragansett to compete more successfully with national brewers, finds little support in the record. That consideration is, in any event, not a basis for validating the acquisition. See *Ford Motor Co.* v. *United States, supra,* slip op. at 6–7; *United States* v. *Philadelphia National Bank, supra,* 374 U.S. at 370–371.

In addition, the acquisition eliminated the possibility for future deconcentration of the market that would result if Falstaff entered either independently or through a toehold acquisition of one of the small New England brewers. In view of the concentration in the beer industry and the increasing barriers to entry by new firms, "[t]he most promising source of new competition is that of the established brewer moving into a new geographic market." [33] The potential for such a move existed in this case, since, as we have shown, Falstaff had both the economic incentive to expand its operations into New England and the financial capability to do so by opening a new plant in the area or by acquiring a small existing plant and expanding it.

The company was financially capable of entering *de novo* by building a conventional million-barrel brewery in New England for roughly $20 million (App. 48, 154, 159).[34] Furthermore, it could have built a new brewery of less conventional design for even less than $20 million. Arthur D. Little estimated the cost of constructing such a plant, with a million-barrel

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[33] Elzinga, "The Beer Industry," in Adams, *The Structure of American Industry*, 189, 202 (4th ed. 1971). The barriers to entry are principally the high-scale costs of production and the heavy promotional costs associated with introducing a new beer. *Id.* at 201–202.

[34] Falstaff's economic expert, Dr. Horowitz, testified that a cost of $20 per barrel was reasonable (App. 239), and indicated that a lower cost per barrel might be possible if a larger brewery were built (App. 238–239). The 1960 Arthur D. Little report estimated the cost of a conventional million-barrel brewery at $19,321,000 ($19.32 per barrel) (App. 556; GX 10, 14, 16; and see App. 239). The brewery could have been built in two or three years (*ibid.*).

capacity, to be $16 million ($15.93 per barrel) (App. 556; GX 10, p. 98).[35]

Nor was Falstaff limited to entering the New England market independently if it did not acquire Narragansett. It also might have made a "toehold" acquisition, *i.e.,* the purchase of a small brewery which is then expanded (see n. 22 *supra*). There were several breweries in the area, which could have provided such a base for operations. Both Hull Brewing Co. in New Haven, Connecticut, and Diamond Spring Brewery in Lawrence, Massachusetts, were sufficiently small to provide a toehold in the market; each had a capacity of approximately 100,000 barrels annually (App. 391–392; GX 1, pp. 3–4). Dawson's Brewery, in New Bedford, Massachusetts, which consistently operated well below its capacity of 750,000 barrels per year (*ibid.*), was another likely candidate. Indeed, both Diamond Spring and Dawson's had made overtures to Falstaff inviting acquisition (App. 324–325); and it is undisputed that Falstaff could have obtained the necessary financing for acquisition and expansion of any of these brewers (App. 48, 149).

[35] Falstaff seeks to discount this evidence on the basis of a claim by its president (App. 323) that the company could not find satisfactory designs for two of the processes recommended in the Little report—outdoor fermentation and outdoor storage. But in 1964, Falstaff's chief of research and development reported that the company had succeeded in the engineering of outdoor storage tanks and praised their economic advantage (GX 17, pp. 7–8). Falstaff's Annual Report for the same year contained a prominent picture of six of these tanks under construction at one of its plants in St. Louis (GX 3F, p. 5). Moreover, the Little report recommended various alternative processes for constructing a less expensive plant; the company apparently either failed to test these or found them satisfactory.

Falstaff argues that because of the size of these smaller brewers, a toehold acquisition was not economically attractive (Motion to Affirm, p. 11). The point is not well taken, however. To be sure, none of the three plants mentioned above had a million-barrel capacity, which may be necessary in New England for efficient operation (App. 375; compare App. 557; DX 10, p. 99). But Falstaff could have altered that situation through expansion of whichever brewer it acquired.

Indeed, Falstaff had substantial experience with the enlargement and modernization of small and ailing breweries. ~~Indeed,~~ Its president testified that Narragansett was the first brewery acquired by Falstaff which at the time of acquisition was not "dying or dead" (App. 324). Falstaff's New Orleans plant, for example, with a current annual capacity of 1.1 million barrels, had a capacity of only 140,000 when Falstaff acquired it (App. 420–421; GX 2, p. 4); and its Omaha plant produced at the time of acquisition only 150,000 barrels per year, but now has a capacity of 750,000 barrels (App. 420; GX 2, pp. 2–3).[36]

In view of this objective evidence—*i.e.,* the presence of several small brewers in the New England market amenable to acquisition by a potential entrant, Falstaff's financial capability to acquire and expand them, and its past experience in improving the capac-

[36] Similarly, Falstaff expanded the capacity of its Fort Wayne, Indiana, plant from 400,000 to 1,000,000 barrels per year; the capacity of its Galveston, Texas, plant was increased from 400,000 barrels to 1.2 million barrels annually (App. 420–421; GX 2, pp. 4–5).

ity of failing beer plants—a "toehold entry" into New England was a rational business alternative.

Furthermore, the record indicates that, had Falstaff entered this market by constructing a new brewery or by acquiring a small plant and expanding it, the company, despite its assertions to the contrary (Motion to Affirm, pp. 7–8, 10–11), could have developed an effective distribution system in the area.[37] There are, as we have noted, two methods by which a brewer can distribute its beer: company-owned branches and independent wholesale distributors. Falstaff had used both in other areas of the country (App. 455; GX 5, p. 5), and neither method was foreclosed to it in New England.

In its 1960 report, Arthur D. Little noted that Falstaff's branches, although then responsible for distribution of only 25 percent of the company's beer, accounted for half of the company's after-tax profits (App. 552; GX 10, p. 66).[38] The report demonstrated that branch distributions netted Falstaff a profit of approximately $2.00 per barrel over what could be made on sales by independent distributors (App. 551; GX 10, p. 65). The company thus had a strong financial incentive to distribute in New England through branches. As we have shown (*supra,* pp. 27–30), it had the economic resources to establish and maintain a branch distribution system there, and, from its own

[37] On this point, as on virtually all the others discussed in this brief, the district court failed to make any detailed findings as required by Rule 52(a), F.R.Civ.P. Cf. *United States* v. *El Paso Natural Gas Co., supra.*

[38] This part of the Little report was based on Falstaff's sales and earnings for 1958.

operations in other markets, it had the experience and knowledge to run such a system effectively.

Alternatively, Falstaff could have established an effective distribution system through wholesale distributors. In 1964, roughly eighty percent of its sales were made in this manner (App. 455; GX 5, p. 13). As the company had acquired weak or failing breweries and expanded them over the years, it had built up an effective corps of 600 distributors (App. 455; App. 440; GX 5, p. 13; GX 3F, p. 11).

To achieve an effective wholesale distribution system in New England, Falstaff's president stated that a new entrant would need to offer potential distributors three things: a company marketing plan under which the brewer spent adequate sums of money to promote the product to the buying public (*i.e.,* advertising); a wholesale price permitting a profitable mark-up; and a product with a good reputation (App. 41). Falstaff could provide all three elements.

The reputation of its beer was first rate (GX 10, p. 1). It had for years provided a profit mark-up to its distributors adequate to build what it considered an excellent distributor network (App. 440). The company was innovative and aggressive in its marketing.[39] Moreover, as Falstaff's president testified (App. 359), a distributor expects the brewer to spend substantial

[39] The company was a leader in the development of certain practices conducive to the establishment and maintenance of sound distributorship: it promulgated the company-distributor "Code of Cooperation," and it created a Distributor Advisory Council (App. 440; GX 3F, p. 10; and see App. 359).

sums on advertising, and Falstaff stressed continuously that its advertising, conducted in print and electronic media,[40] was extensive and effective (App. 437–441; GX 3B, p. 8; GX 36, pp. 5–6; GX 3D, pp. 6–7; GX 3E, pp. 1, 12–13; GX 3F, pp. 11–12).[41]

Finally, the evidence shows that there were beer distributors in New England interested in marketing Falstaff's product. Between 1960 and 1965, the company had received thirty unsolicited inquiries from firms and individuals in the area offering to handle Falstaff beer should the company enter the market (App. 470–535; GX 9). Nineteen of the thirty were already established independent distributors (Motion to Affirm p. 10 n. 9).[42] Moreover, there were a great many more

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[40] Television advertising time was available in New England (App. 382–383).

[41] Where the company was unwilling to spend a sufficient amount on advertising, it was unable to establish or maintain adequate distribution or sales. Thus, Falstaff's entry into the Detroit area was unsuccessful. It did not advertise sufficiently to hold its first distributors. When these distributors failed, the company lost sales and cut back further on advertising, which made it impossible to attract or hold new distributors and make sales (App. 296–297, 355–358). By contrast, in Chicago, where Falstaff made heavy advertising expenditures, the company buoyed its distributors and had good sales and profits (App. 593–594; DX J; and see App. 356).

[42] Thus, Falstaff's claim that there was "no evidence of the capacity of any of these [thirty] individuals or firms to provide effective distribution" (Motion to Affirm, p. 10) is unfounded. Several of the letters explicitly show that the distributor had both the ability and capacity to be effective (see *e.g.*, App. 483–520; GX 9, no. 1 1017, no. 1 1042). Moreover, the thirty inquiries referred to came to Falstaff unsolicited; they were merely representative of a much larger group of distributors who were potentially available should the company attempt to recruit them.

beer distributors potentially available to Falstaff upon entry. In New England, distributors do not have exclusive distributorship contracts (App. 383); they could, and frequently did, handle more than one brand (App. 507, 483; GX 9, no. 1 1061, no. 1 1017); and both brewers and distributors could switch their affiliations (App. 383).

In sum, the detailed objective evidence in this case—which the district court disregarded in favor of management's stated subjective preferences and intentions—shows, we submit, that Falstaff was a significant potential entrant into the New England beer market. Nor were there any significant obstacles to its entry *de novo* or by a small "toehold" acquisition; it had the capability, the interest and the incentive to come into the market by either course and compete vigorously to obtain a significant market share. By acquiring Narragansett with its 20 percent share of the New England market, Falstaff eliminated the substantial competitive effects of its role as a potential competitor. It removed perhaps the last real possibility for deconcentration of the highly concentrated New England beer market, the effect of which "may be substantially to lessen competition" in the area, contrary to the fundamental purpose of Section 7 of the Clayton Act. See *United States* v. *Philadelphia National Bank, supra,* 374 U.S. at 362–363; *United States* v. *Penn-Olin Chemical Co., supra,* 378 U.S. at 170–171; *Brown Shoe Co.* v. *United States, supra,* 370 U.S. at 331–332.

CONCLUSION

The judgment of the district court should be reversed and the case remanded for the entry of an appropriate decree.

Respectfully submitted.

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JUNE 1972.

U.S. GOVERNMENT PRINTING OFFICE: 1972