Supreme Court of the United States.

OCTOBER TERM, 1971.

No. 71-873.

UNITED STATES OF AMERICA,
Appellant,

v.

FALSTAFF BREWING CORPORATION,
Appellee.

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

BRIEF FOR FALSTAFF BREWING CORPORATION.

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Preliminary Statement.

The statements in the government's brief concerning the travel of the case, jurisdiction, and the statute involved are correct. The government's statement of the question presented is not.

The government insists that the question presented is whether the district court applied an erroneous legal standard in holding that Falstaff's acquisition of Narragansett did not violate Section 7 of the Clayton Act by eliminating the potential competition of the acquiring firm. As appears from the government's brief, the "erroneous legal stand-

ard" is the district court's reliance on statements of Falstaff's management to the exclusion of the other evidence presented. This contention is clearly at variance with the record and the opinion of the court below.

The Question Presented.

The question presented, properly stated, is:

Are the findings of the court below clearly erroneous?

Statement.

The Proceedings Below.

On July 15, 1965, Falstaff acquired the assets and assumed the liabilities of Narragansett. This suit was brought two days earlier, seeking an injunctive order against the acquisition and ultimate relief to enjoin or to undo it. Preliminary relief was denied. On motion of Narragansett the suit was dismissed as to it and judgment was entered accordingly. There was no appeal (App. 1-2).[1]

Trial began October 6, 1970, and concluded October 14, The government offered no live testimony; it relied upon documentary evidence, excerpts of depositions of the principal officers of Falstaff, answers to interrogatories, and stipulations.

The government's brief makes clear its position on this appeal: that the findings of the court below are not supported by the evidence. The government asks this Court to weigh the evidence anew and to reverse.

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[1] "App." references are to the printed appendix in this Court; "GX" references are to government-appellant's exhibits introduced in the district court; "DX" references are to defendant-appellee's exhibits introduced in the district court; "Apx." references are to the appendices to this brief.

The government is wrong: the district court correctly found the government failed to sustain its burden of proof on critical issues; *i.e.*, (1) that Falstaff was a potential entrant into the New England market other than by acquisition of a brewer with a strong distributor organization, and (2) that the acquisition would probably substantially lessen competition.

The evidence offered by the government falls far short of establishing either of these contentions, and the post-acquisition evidence, properly admitted and considered by the district court, establishes that the acquisition did not, in fact, have the anti-competitive effect proscribed by Section 7.

Since the sole question is whether the evidence supports the findings of the district court, it is appropriate that those findings should be adverted to here. The court found, upon review of the evidence:

> "In my considered opinion the plaintiff has failed to establish by a fair preponderance of the evidence that Falstaff was a potential competitor in said New England market at the time it acquired Narragansett. The credible evidence establishes that it was not a potential entrant into said market by any means or way other than by said acquisition. Consequently it cannot be said that its acquisition of Narragansett eliminated it as a potential competitor therein.
>
> "I also find that the Government has failed to establish by a fair preponderance of the evidence that said acquisition by Falstaff will probably result in a substantial lessening of competition in the New England beer market. Section 7 of said Clayton Act is concerned with probabilities, not mere possibilities. Brown Shoe Co., Inc. v. United States, 370 U.S. 294 (1962). It

is my considered opinion that said acquisition by Falstaff will serve to improve the competitive position of the Narragansett brand of beer in the New England beer market which is intensively competitive, and enable it to compete successfully with the brands of large, national breweries which dominate said market.

"Finding, as I do, that it is not probable that said acquisition of Narragansett by the defendant Falstaff may substantially lessen competition in said New England beer market, judgment must be and will be entered in favor of the defendant Falstaff Brewing Corporation." *United States* v. *Falstaff Brewing Corporation,* 332 F. Supp. 970, 972-973.

The New England Beer Market.

The parties agreed upon the relevant market. Geographically, it consists of the New England States (GX 1, App. 18-19, 390).[2] In that market at the time of the acquisition, these facts were true:

The increase in sales of beer during the four years preceding the acquisition was less than the increase in national sales in that period (computed from GX 1, EX N, App. 18-19, 407). The price of beer remained relatively stable in spite of rising costs (App. 374). There was a high degree of instability of market shares of the sellers, and substantial technological innovations (App. 230-231, GX 1, App. 18-19, EX O-Z, App. 408-413). This is significant evidence of intense competition within the market (App. 230) and

[2] The New England States were stipulated to be Maine, New Hampshire, Vermont, Massachusetts, Connecticut and Rhode Island (GX 1, App. 18-19, 390). Care must be taken not to equate the term "New England" with the terms "Northeastern" or "Eastern Coastal." The latter include the New England States as well as Ohio, Pennsylvania, New York, New Jersey and perhaps Maryland and Delaware (GX 10, App. 52, 549).

supports the characterization of competition in the market as "dog-eat-dog" (App. 310-311).

Falstaff, the Acquiring Company.

At the end of 1964, Falstaff sold primarily in the midwest, south and southwestern regions of the United States (*ibid*). It sold its product no closer to the New England market than Toledo, Ohio, on the west and Richmond, Virginia, on the south (App. 302, GX 2, App. 20, 422-425). Its last acquisition, prior to 1965, was in 1956 when it purchased the Mitchell Brewery of El Paso, Texas—capacity of 120,000 barrels per year (GX 2, App. 20, 421).

For some years, Falstaff had expressed publicly its desire to become a national brewer[3] (App. 79-83, GX 13, App. 20, GX 14, App. 80, GX 15, App. 80, GX 16, App. 81, GX 17, App. 81),[4] and while its directors recognized the desirability of entering the *northeast* market, no specific target was established, nor was any program adopted to that end (App. 101-102). Falstaff did not undertake exhaustive investigations looking toward entry into that market (GX 6, App. 25, 459-461).

Between 1960 and 1964, Dawson's (App. 73),[5] Liebmann (App. 134, 300) and Ballantine (App. 142), as well as Narragansett (App. 302-303) initiated negotiations with Falstaff with a view to being acquired by it. Falstaff rejected out of hand Dawson's approach for the reason, among others, that Dawson's lacked an effective distributor organi-

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[3] The national brewers are Anheuser-Busch, Schlitz, Pabst and Miller (App. 39).

[4] We assume that these expressions of intent do not impress the government since they constitute "subjective" evidence.

[5] A number of other small brewers contacted Falstaff. Falstaff was not interested in them because of their lack of effective distributor organizations (App. 325-327).

zation (App. 325). Every potential acquisition was measured by one overriding criterion—the availability of an effective distributor organization (App. 125, 130, 193). Falstaff made no plans to force entry into the market. It was content, if negotiations failed with one or another company, to await developments, since its management believed that entry other than by acquisition was not feasible (App. 189, 190, 193-194, 297).

Falstaff's primary method of distributing beer was, and is, through independent wholesalers (GX 5, App. 23, 454). In 1965, over 80 per cent of its product was distributed by such wholesalers (*ibid*). In the cities of San Diego, Orange, Fresno, and San Francisco, California, it sold through company branches; in cities where it maintained breweries, it maintained branch operations to supply the local market (*ibid*). Its experience had demonstrated that the key to market penetration was the existence of a viable distributor organization (App. 296-298, DX I, DX J, App. 322, 591-594).

Narragansett, the Acquired Company.

At the time of the acquisition, Narragansett was a regional brewer which sold, with the exception of certain minimal sales, only in New England (App. 376). Eighty-five per cent of its common stock was controlled by two families (App. 378). As early as 1956, its management came to the conclusion that without significant growth Narragansett could not survive (App. 372-373). Since so much of the wealth of these families was concentrated in the capital stock of Narragansett, management decided either to expand Narragansett or have Narragansett bought out (*ibid.*). Faced with strong and vigorous competition, it sought without success to acquire other brewers (App. 374-379). Failing in these attempts, it concluded negotiations with Falstaff.

Summary of Argument.

The findings of the trial court will not be set aside unless clearly erroneous. This Court will not substitute its judgment for that of the trial court unless upon review of the entire record it is left with a firm and clear conviction that a mistake has been made.

Classifying evidence as subjective or objective has no significance here. The determination of admissibility turns on the materiality and relevance of the proffered evidence. The weight to be given it is left to the sound discretion of the trier of fact. This is particularly true of evidence of design or intent. Expressions of intent are particularly entitled to credence where, as here, they are supported by consistent prior conduct.

Upon the record below, it is abundantly clear that the government failed to prove that Falstaff was a potential entrant into the New England market by any of the means suggested by the government. While the New England beer market may be characterized at the time of the acquisition as "concentrated," nevertheless the *objective* evidence establishes that competition in that market was intense. But even assuming deviation from a competitive norm, the government offered no evidence that entry *de novo* offered a reasonable expectation of profit to Falstaff. Without such evidence, and in the context of the substantial evidence proving that entry without a distributor organization would have been foolhardy, the government's case fails. Similarly, the claim that Falstaff could have entered the market by a "toe-hold" acquisition is not supported by the record.

Ultimately it was the government's burden to establish that the acquisition would probably lead to a substantial lessening of competition in the New England beer market. It did not establish that the market was of the type which could be benefited by Falstaff's presence at the edge, for the

evidence establishes that Falstaff had no effect on the level or manner of competition. Moreover, the evidence supports the district court's findings that the acquisition did not have an anti-competitive effect. Since the acquisition, Narragansett's share of the market has fallen, its operations have become unprofitable, prices have remained constant in relation to increasing costs and the market shares of the leaders have substantially changed. All of these facts are evidence of intense competition in the market. There being no evidence of any reasonable expectation of a diminution in the level of competition, it must follow that the government failed in its burden on this issue.

Argument.

THE DISTRICT COURT PROPERLY CONCLUDED THAT THE GOVERNMENT FAILED TO PROVE FALSTAFF WAS A POTENTIAL COMPETITOR IN THE NEW ENGLAND BEER MARKET OR THAT THE ACQUISITION OF NARRAGANSETT WOULD *Probably* RESULT IN A SUBSTANTIAL LESSENING OF COMPETITION.

A. *The Trial Court's Findings of Fact may Not be Disturbed unless Clearly Erroneous.*

The government adheres to the position taken in its jurisdictional statement that the district court applied an erroneous legal standard in arriving at its findings. *Compare* Jurisdictional Statement, pp. 9, 11-13, *with* Appellant's Brief, p. 2. We have again sought to determine what standard was erroneously applied and have again concluded that the government's quarrel is with the weight given to certain evidence, which evidence it characterizes as "subjective" (Appellant's Brief, pp. 20-22). It persists in ignoring the plain language of the district court's opinion (see *supra*, pp. 3-4), and the testimony and the voluminous statistical evidence.

The government asserts that Falstaff was a potential competitor by marshaling only a portion of the evidence contained in the record. As to all other evidence, it asks this Court to discount it except where favorable to its case.[6]

This is no more than asking this Court to try the matter *de novo*, which this Court has consistently refused to do. *E.g., United States* v. *Yellow Cab Co.*, 338 U.S. 338, 341-342 (1949); *United States* v. *Oregon State Medical Society*, 343 U.S. 326, 339-340 (1952). The district court's findings will not be set aside unless clearly erroneous. *United States* v. *Yellow Cab Co., supra*, 338 U.S. at 341-342. Its findings are not clearly erroneous unless this Court, upon all the evidence, is "left with the definite and firm conviction that a mistake has been made." *United States* v. *United States Gypsum Co.*, 333 U.S. 364, 395 (1948). Where the evidence supports a conclusion either way, the fact that the trial judge adopts one as opposed to another conclusion impeaches neither his "impartiality nor the propriety of his conclusions." *Chaney* v. *City of Galveston*, 368 F. 2d 774, 776 (5th Cir. 1966); and see *National Labor Relations Board* v. *Pittsburgh Steamship Co.*, 337 U.S. 656, 659-660 (1949).

In *Yellow Cab*, the government attack on the opinion below was that the district judge " '. . . ignored . . . substantially all of the facts which the Government deemed significant.' " And that his opinion " '. . . seems to reflect uncritical acceptance of defendants' evidence and of defendants' views . . . .' " of the law. *United States* v. *Yellow Cab Co., supra*, 338 U.S. at 340. There, this Court found that there was not the slightest justification for these charges.

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[6] The government is perfectly content to rely on "subjective" evidence and post-acquisition evidence when it is favorable to its case. See, for example, Appellant's Brief, p. 8; App. 195.

Here, the government charges that the district judge relied "exclusively upon statements by [Falstaff's] . . . management disavowing any intent to have Falstaff enter the market other than by the acquisition of Narragansett . . . ." (Appellant's Brief, p. 14).

As in *Yellow Cab,* there is not the slightest justification here for a charge as critical and extravagant as this. Rather, examination of the record brings to mind the comment of the late Justice Harlan in his brief but pungent dissent in *United States* v. *Penn-Olin Chemical Co.,* 378 U.S. 158, 183 (1964):

> "I can see no purpose to be served by this remand except to give the Government an opportunity to retrieve an antitrust case which it has lost, and properly so. Believing that this Court should not lend itself to such a course, I would affirm the judgment of the District Court."

B. *In Arriving at its Findings, the Trial Court was Required to Receive and Weigh All Material Evidence.*

It is impossible to pass to the merits of this appeal without commenting on the propriety of the district court's consideration of certain evidence. Without explicitly saying so, the government in effect argues for exclusion of what it terms "subjective evidence" in Section 7 cases (Appellant's Brief, pp. 21-26). It argues that objective evidence is the only reliable evidence.[7]

Section 7 by its very terms requires inquiry into probabilities. *Brown Shoe Co., Inc.* v. *United States,* 370 U.S. 294, 323 (1962). By and large, the existence or nonexistence of

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[7] Limiting the district court to consideration of objective evidence goes hand and glove with the government's so-called objective test. The government asserts that an objective test is necessary to insure predictability. While predictability in the law is de-

a violation of Section 7 is not "susceptible of a ready and precise answer." *United States* v. *Philadelphia National Bank*, 374 U.S. 321, 362 (1963). To ascertain whether Section 7 has been violated, the trial judge should receive and consider all relevant evidence which bears on the issue.

To support its claim that subjective evidence should be excluded, the government distorts the meaning of an excerpted portion of this Court's opinion in *United States* v. *Penn-Olin Chemical Co., supra*, 378 U.S. at 175 (Appellant's Brief, p. 21). Neither in that excerpt nor elsewhere in the opinion does this Court say that it is impermissible for the district court to receive and weigh such evidence. All the Court held in that portion of the opinion was that the record provided *prima facie* evidence that both joint venturers might have entered the market and that the government was not required to prove that management actually intended to enter said market in order to make out a *prima facie* case. In so doing, the Court noted that each participant

> "had the know-how and the capacity to enter that market and could have done so individually at a reasonable profit. Moreover, each company had compelling reasons for entering the southeast market." 378 U.S. at 175.

The government argued that probability of independent entry should be presumed from a showing of capability and interest. *See* pp. 30, 31, 35, 38 and 39 in government's brief in *Penn-Olin*. That suggestion was rejected. Both of the joint venturers were concededly potential competitors, each with capability and interest, and the government argued that it was sufficient to show that either "could" have

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sirable, it cannot be used to subvert the plain language of the statute. Moreover, this objective test does not provide any increased ability to predict the outcome in Section 7 cases. See *infra*, n. 21.

entered. *United States* v. *Penn-Olin Chemical Co.*, *supra*, 378 U.S. 172-173. In remanding that case for findings on the issue of probability, this Court necessarily rejected that argument.

Statements of design and intent are entitled to credence where consistent with prior conduct. See *Nasser* v. *United States*, 257 F. Supp. 443, 447-448 (N.D. Cal. 1966); cf. *Flynn* v. *Crume*, 101 F. 2d 661, 664 (7th Cir. 1939). The record demonstrates that Falstaff's conduct prior to the merger was consistent in all respects with management's view that entry into the New England market, either *de novo* or by "toe-hold" acquisition, would not be a rational economic undertaking. Accordingly, the district court properly relied on management's statements of intent.[8]

C. *The Evidence Conclusively Establishes that Falstaff was Not a Potential Competitor in the New England Beer Market Other than by the Acquisition of Narragansett.*

It was the government's burden to prove that the *probable* result of the acquisition would be to substantially lessen competition in New England in the production and sale of beer. It chose to meet that burden in part by claiming that the acquisition eliminated potential future competition between Falstaff and the other sellers in the market. To accomplish this end, it was incumbent upon the government to demonstrate that Falstaff would probably have entered the market by the means it suggests, for Section 7 is con-

[8] The government also faults the district court for relying "principally" on post-acquisition evidence (Appellant's Brief, n. 30, at p. 32) which must have been difficult if the court relied solely on "subjective" evidence. The court did receive such evidence and properly so. *United States* v. *Pabst Brewing Co.*, 384 U.S. 546, at 550-551 (1966); see also *Federal Trade Commission* v. *Consolidated Foods Corp.*, 380 U.S. 592 (1965).

cerned with probabilities and not with "ephemeral possibilities." See *Brown Shoe Co., Inc.* v. *United States, supra,* 370 U.S. at 323.

The government recognizes that the determination of the possibility of potential entry by Falstaff involves three factors: (1) the growth and structure of market; (2) expectation of a reasonable profit;[9] and (3) financial capability and incentive to enter (Appellant's Brief, p. 26). As to all of these factors, the burden was on the government to prove their existence. Falstaff concedes that given an acceptable level of profit it had the financial capability and the interest to enter the New England beer market.[10] But the existence of an acceptable level of profit can only be determined by ascertaining the potential profit which Falstaff might have

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[9] The government speaks in terms of "reasonable prospects for making . . . entry successful." We conclude in light of the citation that the term is equivalent to an expectation of a reasonable profit. See Appellant's Brief, p. 25, and n. 25, at p. 25. The probability of entry can only be judged in terms of Falstaff's rational economic interests. Davidow, "Conglomerate Concentration and Section Seven: The Limitations of the Anti-Merger Act," 68 Column. L. Rev. 1231, 1244 (1968).

[10] Without assurance of an acceptable level of sales, there could be no expectation of an acceptable level of profit. And without that expectation, it is unlikely that Falstaff could have borrowed the money to build a brewery. As its president testified:

> "In the first place, we had no sales in New England, and for us to have attempted to finance the brewery of the size of which we believe necessary above a million barrels, there was no way that we could estimate to any degree of certainty what kind of sales we would generate after we built the brewery, and therefore, it would have been a difficult thing for us in my opinion to borrow the money. Certainly we never could have justified it to our stockholders, because we did find it very difficult to open in major metropolitan markets where entrenched rulers were already doing business without a decent distributor system. That is, the reason why we did acquire, it was the distributorship purely and simply." (App. 296.)

earned by entering through the means the government suggests as compared with other markets within which Falstaff was operating, or which it might have entered. The government failed to produce this evidence.

The government proved only that Falstaff had the desire to be a national brewer and that such a desire entailed expansion into the Northeastern market. From these facts, however, it does not follow that, for purposes of Section 7 of the Clayton Act, Falstaff was a potential entrant into the New England market.

The government made no attempt to prove at what time Falstaff's aspiration to national status would result in penetration of the New England market. Showing that this acquisition violated Section 7 by eliminating potential competition, requires at least proof that the potential would have been realized within the period during which the characteristics of the market remained essentially the same as they were at the time of the acquisition. It is only with respect to this period of time, the *foreseeable future*, that a reasonably accurate prediction can be made as to whether a merger may result in a substantial lessening of competition. Merely showing that a firm not selling in one part of the country desires eventual sales in a national market is not sufficient.

The government points to the New England beer market and concludes that entry was attractive for the sole reason that sales of all brands increased by almost 10 percent in a four-year period (Appellant's Brief, p. 27). The government points to Narragansett and asserts that Narragansett's experience was typical. One may ask, "Typical of what?" There is no evidence in the record that Narragansett's sales or profit experience was necessarily typical of that of its competitors. Nor was there evidence suggesting that the New England market was growing more rapidly or was

more attractive than other markets.[11] In fact, the testimony of Carl Haffenreffer that Narragansett had been in a price squeeze for several years strongly points the other way. He said:

> "Well, it was competitive. There were those who were cutting prices, but the major force was the fact that they were not—that the larger breweries were not raising their prices as costs increased, labor and material costs increased, with the result there was a price squeeze on our brewery." (App. 374.)

Beyond this, there was substantial unrebutted evidence that competition in the market was intense (App. 310, 374, 230). At the time of the acquisition, the substantial growth in the market shares of the national brewers was just beginning to occur. *Compare* GX 1, EX O-Z, App. 18-19, 408-413 *with* DX H, App. 208, 590, Apx. A. This evidence of the actual conditions in the market is more persuasive than evidence of concentration which in and of itself merely gives rise to a suspicion that competition may no longer be the dominant force.[12]

Assuming that evidence of concentration was sufficient to establish a noncompetitive market structure, it remained for

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[11] It is unnecessary to comment at any length on the assertion by the government that the New England beer market had the capacity and size to sustain new entrants. There is no evidence to support such a conclusion and the district court did not so find.

[12] There is no necessary correlation between the level of competition and market concentration (App. 226-227).

> "Q. What I want you to tell me now, Mr. Horowitz, is the relationship of concentration, whoever uses the term, to competition.
>
> . . . . . .
>
> "A. As far as we know there is none. (App. 226.)

the government to prove that entry by the means it suggests would have offered Falstaff an acceptable level of profit. *United States* v. *Penn-Olin Chemical Co., supra,* 378 U.S. at 175; see also Pitofsky, "Joint Ventures under Antitrust Laws: Some Reflections on the Significance of Penn-Olin," 82 H.L.R. 1007, 1028 (1969). The government did not carry this burden.

Its sole evidence on *de novo* entry is the A. D. Little study which recommended construction of a brewery near Baltimore, Maryland (GX 10, App. 81, 543). The government offered no evidence to establish the trustworthiness of any of the conclusions of this report or the assumptions on which those conclusions were founded. The government was content to introduce the report in evidence, select certain portions favorable to its position and reject those which did not support its contentions. The district court was fully warranted in its refusal to accept the judgments expressed in this study. Falstaff did not accept many of the Little findings (App. 298, 331-332), and the ones which it did accept proved to be wrong (App. 296-297).[13]

Moreover, these recommendations can only be viewed in the context of the assumptions upon which they were based, and there is no evidence, apart from the report itself, that these assumptions were valid. There is, in fact, evidence that they were not. The technology upon which Little based

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[13] The Little study recommended among other things that Falstaff build a brewery in Southern California and that Falstaff enter the Chicago and Detroit markets (App. 545-547). Falstaff went so far as to buy land in Southern California which it later sold when it became apparent that demand for its beer could not justify the construction of a brewery (App. 298). In addition, Falstaff attempted to enter the Detroit and Chicago markets with disastrous consequences (App. 296-297; see also DX I & J, App. 322, 591-594).

its estimate of construction costs could not be implemented[14] (App. 323). And the recommendations for construction of a brewery had as their purpose the penetration of the New York and Philadelphia markets (GK 10, App. 81, 549).[15] The Little report did not recommend construction of a brewery in New England for the purpose of penetrating that market and as a result has no relevance in this proceeding.

Finally, there was no evidence that construction of a brewery would offer Falstaff an acceptable level of profit. The evidence was to the contrary. Falstaff, unlike the government,[16] called as a witness an economist, Dr. Ira Horowitz, who was equipped with impressive credentials and the benefit of extensive studies of the brewing industry. He concluded that it was "unthinkable" that Falstaff would have committed the error of building a brewery in New England in 1964 or 1965 (App. 237-240, 254-255).

The government declines to accept the conclusion of Dr. Horowitz because it disagrees with his assumptions, which, in his words, were "extraordinarily optimistic" (App. 286). It suggests that Falstaff could have earned a higher rate of profit per barrel because such a higher rate was being earned by Anheuser-Busch and Pabst (Appellant's Brief, p. 30). It fails to note that both those companies were at the time experiencing their greatest increase in sales (DX 6, App. 208, 489).

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[14] The government claims that these technological assumptions were implemented and points to GX 17, pp. 7-8. Falstaff's director of research states that outdoor fermentation tanks were under construction, not in use. Apparently these tanks were not satisfactory (App. 323).

[15] This illustrates why Falstaff cautions that the terms "East Coast" and "New England" are not co-extensive. See n. 2, *supra*.

[16] On two occasions, the government requested and was granted permission to have its staff economists sit with counsel (App. 196, 315). These economists did not testify.

The government is unable to effectively dispute the most significant assumption made by this witness, *i.e.*, that Falstaff would have to sell 850,000 barrels of beer during the first ten years and 1,000,000 barrels per year thereafter in order to achieve a 6.7 per cent rate of return (App. 238). The government correctly asserts that Dr. Horowitz's calculations do not take into account the fact that a portion of this productive capacity could be distributed to other Falstaff markets. Dr. Horowitz was unable to determine with any degree of certainty what that potential was (App. 287). As his statement on that point is the only evidence of record, we think that to impute a value to that factor is so speculative as to be unworthy of credence.

A comparison between the 6.7 percent rate of return projected by Dr. Horowitz and the first year rate of return of 3.7 percent on Falstaff's investment in Narragansett should give no solace to the government (Appellant's Brief, p. 30). The comparison underscores the optimistic nature of Dr. Horowitz's assumption. Is it to be concluded that management would forego a 6.7 percent return in exchange for 3.7 percent if it thought the former were reasonably available?

Post-acquisition evidence settles the matter. In the period 1965 to 1969, Narragansett barrel sales dropped by almost 200,000 (DX H, App. 208, 590, App. B). If, as the government asserts, Narragansett was a dominant force in the market, how likely is it that Falstaff could have achieved a market penetration of 13 per cent (computed on the basis of the figures contained in DX F, App. 199, 581-585) when at the same time Narragansett was losing sales and losing money (App. 299)? If the combined power of Falstaff and Narrangansett was insufficient to halt a decline in Narragansett sales, could a new entrant to the market be expected to sell 850,000 barrels of beer?

The likelihood of successful entry cannot be judged by looking merely at productive capacity. It does no good to produce beer if one cannot sell it. On the basis of thirty letters [17] received by Falstaff during the period of 1960 to 1965, the government asserts that a distributor organization was available through which Falstaff could have sold its product (Appellant's Brief, pp. 40-41). There is no showing that any of these distributors had the experience or the capacity to market a new product. Indeed, the evidence is that such an organization was not available.[18]

Nor is there any showing that Falstaff would have undertaken to enter the market by building a brewery without securing a market for the distribution of the product. Management was consistent in its view that a distributor organization was the primary ingredient to entry into the market (App. 189, 190, 193-194). It is inconceivable that a publicly held company such as Falstaff, which had never in its history built a new brewery, would invest $20,000,000 in a new facility without being assured that there was a market for its product. Such an assertion completely disregards the economic realities of the situation, and could hardly be considered credible evidence. *See* n. 10, *supra*.

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[17] Little is known of the "potential" distributors other than what is stated in their letters. Of those letters, fourteen appear to have come from persons or organizations already distributing beer. Of those fourteen, seven were from Massachusetts, three from Connecticut, one from Vermont and three from Maine (GX 9, App. 16, 485-535). As of January 1965, Narragansett had 68 distributors (GX 2, App. 20, 427).

[18] The only substantive evidence on the question of the acquisition of a distributor organization was by Carl Haffenreffer. He said:

> "It would have been very difficult if not impossible. If they tried to create one of existing wholesale distributors I don't believe it would have been possible." (App. 375.)

Falstaff's history of growth is one of expansion to contiguous markets (GX 2, App. 20, 418-422). It fully realized the substantial undertaking that would be necessary to enter a new market without first having the distributor organization. Its earlier attempts to penetrate the Detroit, Chicago and southern California markets resulted in substantial financial reverses for the reason that the distributor organization was never strong enough to withstand the competition[19] (App. 296-299). In light of these experiences, statements of management that it would not enter the New England market by construction of a brewery without first having an effective distributor organization are supported by what must be considered, even in the government's view, "objective evidence" (App. 189, 190, 318).

Failing in its proof on *de novo* entry, the government asserts that Falstaff could have entered the market by "toe-hold" acquisition (Appellant's Brief, pp. 36-38). See *The Bendix Corp.* (FTC), 3 Trade Reg. Rep. ¶ 19,288, vacated and remanded on other grounds, *Bendix Corp. v. Federal Trade Commission,* 450 F. 2d 534 (6th Cir. 1971). We do not concede the legitimacy of the "toe-hold" theory in a Section 7 case.[20] Nevertheless, accepting it *arguendo,*

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[19] The government asserts that where Falstaff was willing to spend sufficient amounts on advertising it was able to establish and maintain adequate distribution and sales (Appellant's Brief, n. 41, p. 40). A comparison of the Detroit and Chicago markets proves how erroneous that assertion is. In spite of increasing advertising expenditures in Chicago, Falstaff consistently lost money (DX J, App. 322, 593). Advertising expenditures were reduced in the Detroit market only after the distributors were lost (App. 356).

[20] At best, the "toe-hold" theory is amorphous and as yet has not received the approval of this Court. From the statement of the theory by the government we must assume that a firm outside the market may acquire a strong but small competitor in the relevant market even though that market is concentrated. If this is the case, it seems to be an exception clearly outside the ambit of Section 7 of the Clayton Act.

we think the government was required to establish that entry in the market in that manner would have afforded Falstaff a reasonable profit.

The government's case on the "toe-hold" theory consists of the following: (1) Between 1933 and 1958, Falstaff made a number of acquisitions (App. 66-71, GX 2, App. 20, 418-422); (2) that there were three independent brewers with plants in New England, two with a capacity of 100,000 barrels per year, the other with a capacity of 750,000 barrels per year (GX 1, App. 18-19, 391); and (3) that two of these breweries, Dawson's and Diamond Spring, had made overtures to Falstaff (App. 324-325).

The government couples this with Falstaff's financial capability and prior history of developing small breweries into larger ones (Appellant's Brief, pp. 37-38), and concludes that this was an alternative means for Falstaff to enter the market.

This is altogether insufficient. It is unlikely that there is a market in this country where small firms are not extant, and if the government's theory is correct, the acquisition of other than a small[21] firm will always be a violation of Section 7 without further proof.

If the theory of potential competition has any validity, it is only on the basis that rational alternative means of entry exist. See n. 10, *supra*. The record is barren of any evidence which indicates that any of these brewers could

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[21] The word "small" is of some interest in light of the government's pressure for an objective standard to insure predictability. What constitutes small in the context of the New England beer market? It appears that Dawson's with a capacity of 750,000 barrels was a small brewery in the government's view. Or was it a small brewery because it was a failing brewery? Does small depend on the size of the largest producers in the market? Does small depend on the market share? Since the term "small" is undefined it is difficult to perceive how it lends any further predictability in Section 7 cases.

have been purchased for a price which was reasonable or that they possessed a distributor organization which would have made them attractive to an acquiring company.

The burden is not on Falstaff to prove the negative. The government had available to it subpoena powers whereby it could have brought before the court evidence concerning these three brewers whom it says afforded the opportunity for a "toe-hold" acquisition. Without such evidence, it is gross speculation to assume that any could have been bought for a fair and reasonable price, or that by such acquisition Falstaff could have made a meaningful entry into the market place.[22]

This total lack of evidence must be balanced against Falstaff's consistent rejection of these overtures (App. 325-327). Unless one is to assume that the management of Falstaff operates on a totally irrational basis, one must conclude that it would have investigated these overtures with some diligence if it thought they provided any prospect for meaningful entry into the New England beer market. It is the government's burden to prove that entry in this fashion was probable and not merely possible. *Brown Shoe Co., Inc.* v. *United States, supra,* 370 U.S. at 323. It failed to carry that burden.

D. *The Record is Barren of Evidence Tending to Prove that Competition would Probably be Lessened by the Acquisition of Narragansett by Falstaff.*

The ultimate burden on the government here, as in any Section 7 case, is to establish that the acquisition will *prob-*

[22] In order for Falstaff to be truly a potential competitor in the market, the acquisitions which the government suggests should have afforded it a means for meaningful entry in the market. If as a result of those acquisitions, Falstaff was able to sell only a very minor amount of beer, it would hardly be considered as a

ably have a significant adverse impact on competition.[23] Having failed to prove that it was in Falstaff's rational economic interest to enter the market by the means it suggests, it might have made out a case had it been able to demonstrate that Falstaff was "waiting in the wings." *United States* v. *El Paso Natural Gas Co.*, 376 U.S. 651 (1964). Under this theory, it could argue that the merger deprived the market of Falstaff's presence at the edge of the market. But as the late Justice Harlan said, concurring in *Federal Trade Commission* v. *Procter & Gamble Co.*, 386 U.S. 568, at 593-594:

> ". . . [E]conomic theory teaches that potential competition will have no effect on the market behavior of existing firms unless *present market power is sufficient to drive the market price to the point where entry would become a real possibility.* So long as existing competition is sufficient to keep the market price below that point, potential competition is of marginal significance as a market regulator. Thus in a conglomerate or product-extension case, where the effects on market structure which are easiest to discover are generally effects on the 'condition of entry,' an understanding of the workings of the premerger market cannot be ignored, *and, indeed, is critical* to a determination whether the visible effects on 'condition of entry' have any competitive significance." (Emphasis added.) (Footnote omitted.)

There are several reliable and objective criteria by which the level of intensity of competition in a given market can

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competitor by anybody in the market. The government introduced no evidence to demonstrate that these three brewers afforded a possibility for that kind of meaningful entry.

[23] S. Rep. No. 1775, 84 Cong., 1st Sess. 1950, U.S. Code Cong. and Ad. News, vol. 2, p. 4298; *United States* v. *Pabst Brewing Co.*, 384 U.S. 546, at 562 (concurring opinion of Justice Fortas).

be measured. For example, have there been significant price increases? Has there been market share stability?[24] Both these factors were present in the pre-merger market. *See* pp. 4, 14, *supra.*

Furthermore, the government offered no evidence that Falstaff's presence had any effect on the price of beer.[25] Rather, the evidence of record established that Falstaff had no effect on the level of competition in the New England beer market (App. 257), and, further, that its possible competitors did not consider Falstaff a threat (App. 376).[26]

Even assuming that Falstaff was a potential competitor in some fashion, the record contains no evidence to establish the likelihood and substantiality of an adverse competitive effect resulting from the merger except for evidence of market concentration which in the context of the sub-

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[24] Dr. Horowitz testified as follows:

> "It's very hard to measure if not impossible to measure the degree of competition among the firms. All we can do is attempt to see whether the firms in the industry or in the market are, in fact, the havens [*sic*] as with firms in a competitive market, and what we, behaving as we would expect firms in a competitive industry would behave, that is behaving with respect to the quality of their product, pricing behavior, their willingness to innovate and keep up with technilogical [*sic*] changes, and on that presumably, also, perhaps we can look to the stability, I think perhaps it may be useful to look to the stability of their market shares." (App. 230.)

[25] The government did not introduce evidence as it did in *United States* v. *El Paso Natural Gas Co., supra,* 376 U.S. at 655, to demonstrate that Falstaff's actions had some effect on the price of beer or the level of competition in the New England beer market.

[26] Carl Haffenreffer, former executive vice-president and director of marketing, testified as to Narragansett's view of Falstaff as a competitor prior to the merger. He said:

> "They were no threat. We certainly didn't consider them any threat to us. We had much greater threats to concern ourselves with." (App. 376.)

stantial evidence as to the existence of intense competition has little or no probative value. *See* p. 15, *supra*. The post-acquisition evidence[27] establishes that the merger neither led to increased concentration in the market, or increased market power, *i.e.*, control over prices of the acquired firm.[28] Since the merger, beer prices have remained constant relative to cost (App. 235). Narragansett's share of the market has fallen (DX H, App. 208, 590; Apx. B) and its profits have declined (App. 257-258, 200, DX H, App. 288, 590; Apx. B). Competition in the New England beer market has remained intense and, if anything, has become more pronounced (App. 245-246, 299, 312).

It is significant that the government has chosen to ignore all of the post-acquisition evidence. Neither in its case below nor in its brief in this Court did it mention what took place in the New England beer market between 1965 and

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[27] Dr. Horowitz felt that the post-acquisition evidence was extremely relevant in ascertaining whether the merger had any anticompetitive effects. He testified as follows:

> "If I have, as I have here, five years of postacquisition [457] data, I am quite impressed with that . . . .
>
> . . . . . .
>
> "Here I have five years and I think that is an impressive set of observations.
>
> Q. . . . Do you have an opinion as to whether the effect of the acquisition of Narragansett by Falstaff had any effect in lessening competition in this industry in New England?
>
> "A. Yes.
>
> "Q. What is that opinion?
>
> "A. I don't think it had that effect." (App. 263.)

[28] These alternative tests have been suggested as measures against which to judge the effect of "geographic extension mergers" on competition in a market. *United States* v. *First National Bank of Jackson*, 301 F. Supp. 1161, 1189-1190 (S.D. Miss. 1969). The instant merger is a "geographic extension merger" in that it involved two firms producing a similar product in separate geographic markets in which they were not direct rivals. *Id.* at 1190.

the date of trial. This post-acquisition evidence is fatal to the government's case. Accordingly, it claims that consideration of such evidence is improper. However, it had little difficulty in accepting the validity and relevance of such evidence in the *Pabst* case. *See United States* v. *Pabst Brewing Company, supra,* 384 U.S. at 550-551.

Certainly, the court was entitled to consider this objective evidence in arriving at the conclusion that the acquisition did not have an anti-competitive effect. With these facts in hand and the lack of any countervailing evidence, the district court had no alternative but to find that the merger did not result in the lessening (substantial or otherwise) of the highly intense competition that characterizes the New England beer market.

Conclusion.

The findings of the court below were not clearly erroneous. They are fully justified by the record, and the judgment below should be affirmed.

Dated July 10, 1972.

Respectfully submitted,

MATTHEW W. GORING,

JAMES S. McCLELLAN.

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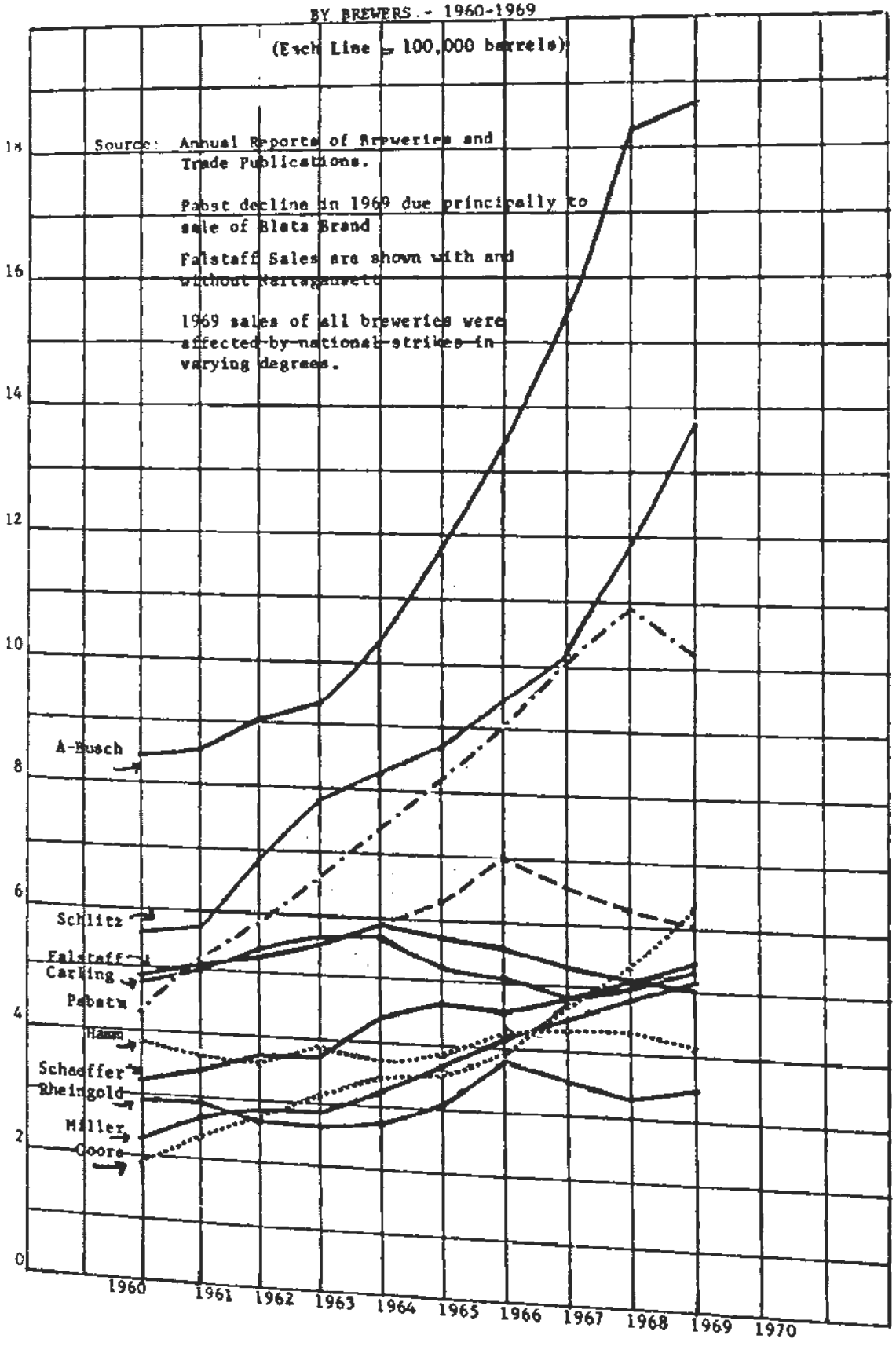
STEPHEN J. CARLOTTI.

NATIONAL BARREL SALES APPENDIX A (DX G)
BY BREWERS - 1960-1969

(Each Line = 100,000 barrels)

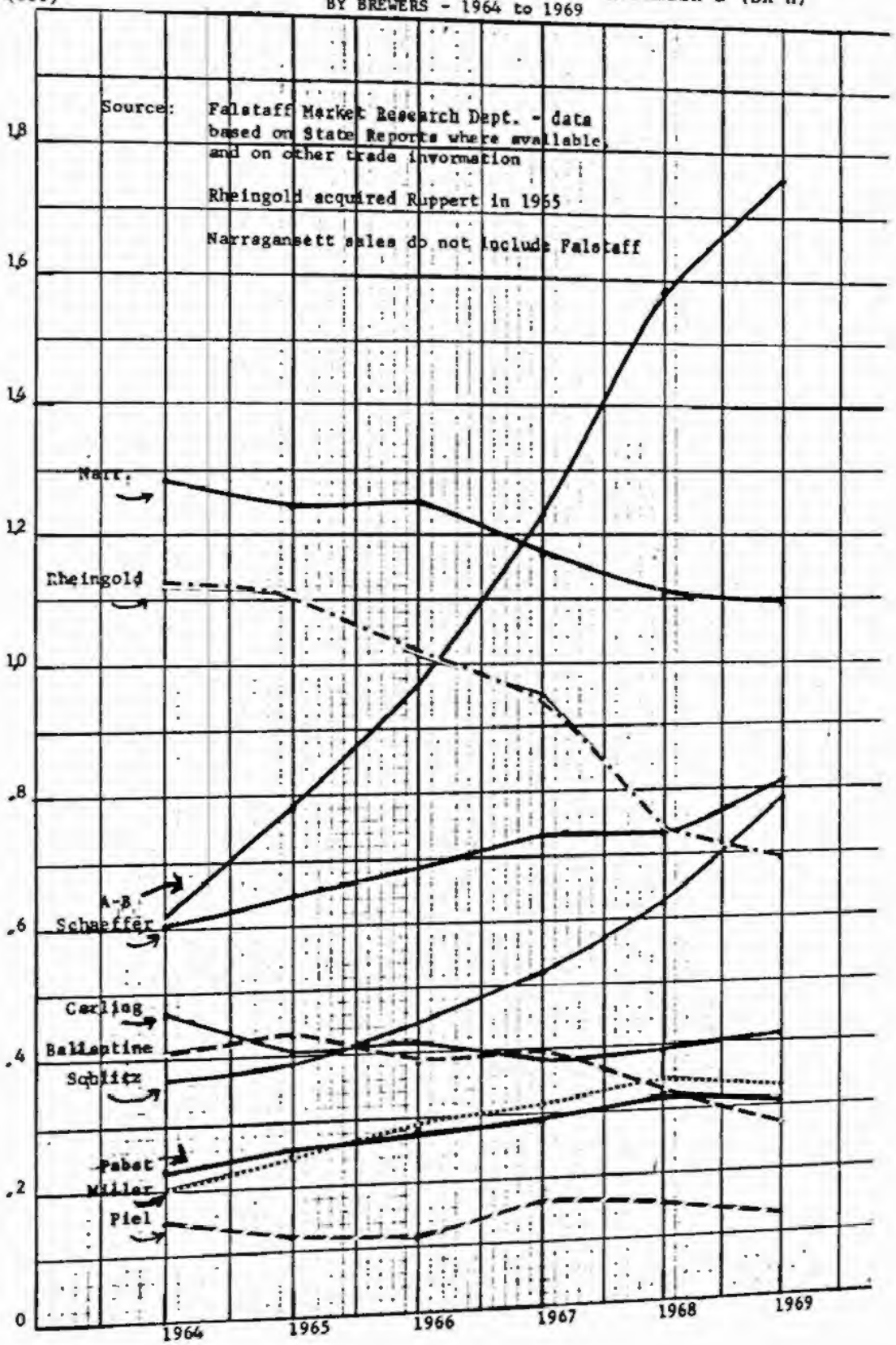


Millions

Bbls.
~~(000)~~

NEW ENGLAND BARREL SALES
BY BREWERS - 1964 to 1969

APPENDIX B (DX H)



Source: Falstaff Market Research Dept. - data based on State Reports where available, and on other trade information

Rheingold acquired Ruppert in 1965

Narragansett sales do not include Falstaff