ANTITRUST LAW

Unit 11: Horizontal Mergers

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2010 Horizontal Merger Guides
Competitive Effects

Horizontal Merger Guidelines

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6. Unilateral Effects

The elimination of competition between two firms that results from their merger may alone constitute a substantial lessening of competition. Such unilateral effects are most apparent in a merger to monopoly in a relevant market, but are by no means limited to that case. Whether cognizable efficiencies resulting from the merger are likely to reduce or reverse adverse unilateral effects is addressed in Section 10.

Several common types of unilateral effects are discussed in this section. Section 6.1 discusses unilateral price effects in markets with differentiated products. Section 6.2 discusses unilateral effects in markets where sellers negotiate with buyers or prices are determined through auctions. Section 6.3 discusses unilateral effects relating to reductions in output or capacity in markets for relatively homogeneous products. Section 6.4 discusses unilateral effects arising from diminished innovation or reduced product variety. These effects do not exhaust the types of possible unilateral effects; for example, exclusionary unilateral effects also can arise.

A merger may result in different unilateral effects along different dimensions of competition. For example, a merger may increase prices in the short term but not raise longer-term concerns about innovation, either because rivals will provide sufficient innovation competition or because the merger will generate cognizable research and development efficiencies. See Section 10.

6.1 Pricing of Differentiated Products

In differentiated product industries, some products can be very close substitutes and compete strongly with each other, while other products are more distant substitutes and compete less strongly. For example, one high-end product may compete much more directly with another high-end product than with any low-end product.

A merger between firms selling differentiated products may diminish competition by enabling the merged firm to profit by unilaterally raising the price of one or both products above the pre-merger level. Some of the sales lost due to the price rise will merely be diverted to the product of the merger partner and, depending on relative margins, capturing such sales loss through merger may make the price increase profitable even though it would not have been profitable prior to the merger.

The extent of direct competition between the products sold by the merging parties is central to the evaluation of unilateral price effects. Unilateral price effects are greater, the more the buyers of products sold by one merging firm consider products sold by the other merging firm to be their next choice. The Agencies consider any reasonably available and reliable information to evaluate the extent of direct competition between the products sold by the merging firms. This includes documentary and testimonial evidence, win/loss reports and evidence from discount approval processes, customer switching patterns, and customer surveys. The types of evidence relied on often overlap substantially with the types of evidence of customer substitution relevant to the hypothetical monopolist test. See Section 4.1.1.

Substantial unilateral price elevation post-merger for a product formerly sold by one of the merging firms normally requires that a significant fraction of the customers purchasing that product view products formerly sold by the other merging firm as their next-best choice. However, unless pre-merger margins between price and incremental cost are low, that significant fraction need not approach a majority. For this purpose, incremental cost is measured over the change in output that would be caused by the price change considered. A merger may produce significant unilateral effects for a given product even though many more sales are diverted to products sold by non-merging firms than to products previously sold by the merger partner.

> *Example 19:* In Example 5, the merged entity controlling Products A and B would raise prices ten percent, given the product offerings and prices of other firms. In that example, one-third of the sales lost by Product A when its price alone is raised are diverted to Product B. Further analysis is required to account for repositioning, entry, and efficiencies.

In some cases, the Agencies may seek to quantify the extent of direct competition between a product sold by one merging firm and a second product sold by the other merging firm by estimating the diversion ratio from the first product to the second product. The diversion ratio is the fraction of unit sales lost by the first product due to an increase in its price that would be diverted to the second product. Diversion ratios between products sold by one merging firm and products sold by the other merging firm can be very informative for assessing unilateral price effects, with higher diversion ratios indicating a greater likelihood of such effects. Diversion ratios between products sold by merging firms and those sold by non-merging firms have at most secondary predictive value.

Adverse unilateral price effects can arise when the merger gives the merged entity an incentive to raise the price of a product previously sold by one merging firm and thereby divert sales to products previously sold by the other merging firm, boosting the profits on the latter products. Taking as given other prices and product offerings, that boost to profits is equal to the value to the merged firm of the sales diverted to those products. The value of sales diverted to a product is equal to the number of units diverted to that product multiplied by the margin between price and incremental cost on that product. In some cases, where sufficient information is available, the Agencies assess the value of diverted sales, which can serve as an indicator of the upward pricing pressure on the first product resulting from the merger. Diagnosing unilateral price effects based on the value of diverted sales need not rely on market definition or the calculation of market shares and concentration. The Agencies rely much more on the value of diverted sales than on the level of the HHI for diagnosing unilateral price effects in markets with differentiated products. If the value of diverted sales is proportionately small, significant unilateral price effects are unlikely.[11]

Where sufficient data are available, the Agencies may construct economic models designed to quantify the unilateral price effects resulting from the merger. These models often include independent price responses by non-merging firms. They also can incorporate merger-specific efficiencies. These merger simulation methods need not rely on market definition. The Agencies do not treat merger simulation evidence as conclusive in itself, and they place more weight on whether their merger simulations consistently predict substantial price increases than on the precise prediction of any single simulation.

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[11] For this purpose, the value of diverted sales is measured in proportion to the lost revenues attributable to the reduction in unit sales resulting from the price increase. Those lost revenues equal the reduction in the number of units sold of that product multiplied by that product's price.

A merger is unlikely to generate substantial unilateral price increases if non-merging parties offer very close substitutes for the products offered by the merging firms. In some cases, non-merging firms may be able to reposition their products to offer close substitutes for the products offered by the merging firms. Repositioning is a supply-side response that is evaluated much like entry, with consideration given to timeliness, likelihood, and sufficiency. See Section 9. The Agencies consider whether repositioning would be sufficient to deter or counteract what otherwise would be significant anticompetitive unilateral effects from a differentiated products merger.

6.2 Bargaining and Auctions

In many industries, especially those involving intermediate goods and services, buyers and sellers negotiate to determine prices and other terms of trade. In that process, buyers commonly negotiate with more than one seller, and may play sellers off against one another. Some highly structured forms of such competition are known as auctions. Negotiations often combine aspects of an auction with aspects of one-on-one negotiation, although pure auctions are sometimes used in government procurement and elsewhere.

A merger between two competing sellers prevents buyers from playing those sellers off against each other in negotiations. This alone can significantly enhance the ability and incentive of the merged entity to obtain a result more favorable to it, and less favorable to the buyer, than the merging firms would have offered separately absent the merger. The Agencies analyze unilateral effects of this type using similar approaches to those described in Section 6.1.

Anticompetitive unilateral effects in these settings are likely in proportion to the frequency or probability with which, prior to the merger, one of the merging sellers had been the runner-up when the other won the business. These effects also are likely to be greater, the greater advantage the runner-up merging firm has over other suppliers in meeting customers' needs. These effects also tend to be greater, the more profitable were the pre-merger winning bids. All of these factors are likely to be small if there are many equally placed bidders.

The mechanisms of these anticompetitive unilateral effects, and the indicia of their likelihood, differ somewhat according to the bargaining practices used, the auction format, and the sellers' information about one another's costs and about buyers' preferences. For example, when the merging sellers are likely to know which buyers they are best and second best placed to serve, any anticompetitive unilateral effects are apt to be targeted at those buyers; when sellers are less well informed, such effects are more apt to be spread over a broader class of buyers.

6.3 Capacity and Output for Homogeneous Products

In markets involving relatively undifferentiated products, the Agencies may evaluate whether the merged firm will find it profitable unilaterally to suppress output and elevate the market price. A firm may leave capacity idle, refrain from building or obtaining capacity that would have been obtained absent the merger, or eliminate pre-existing production capabilities. A firm may also divert the use of capacity away from one relevant market and into another so as to raise the price in the former market. The competitive analyses of these alternative modes of output suppression may differ.

A unilateral output suppression strategy is more likely to be profitable when (1) the merged firm's market share is relatively high; (2) the share of the merged firm's output already committed for sale at prices unaffected by the output suppression is relatively low; (3) the margin on the suppressed output is relatively low; (4) the supply responses of rivals are relatively small; and (5) the market elasticity of demand is relatively low.

A merger may provide the merged firm a larger base of sales on which to benefit from the resulting price rise, or it may eliminate a competitor that otherwise could have expanded its output in response to the price rise.

> *Example 20:* Firms A and B both produce an industrial commodity and propose to merge. The demand for this commodity is insensitive to price. Firm A is the market leader. Firm B produces substantial output, but its operating margins are low because it operates high-cost plants. The other suppliers are operating very near capacity. The merged firm has an incentive to reduce output at the high-cost plants, perhaps shutting down some of that capacity, thus driving up the price it receives on the remainder of its output. The merger harms customers, notwithstanding that the merged firm shifts some output from high-cost plants to low-cost plants.

In some cases, a merger between a firm with a substantial share of the sales in the market and a firm with significant excess capacity to serve that market can make an output suppression strategy profitable.[12] This can occur even if the firm with the excess capacity has a relatively small share of sales, if that firm's ability to expand, and thus keep price from rising, has been making an output suppression strategy unprofitable for the firm with the larger market share.

6.4 Innovation and Product Variety

Competition often spurs firms to innovate. The Agencies may consider whether a merger is likely to diminish innovation competition by encouraging the merged firm to curtail its innovative efforts below the level that would prevail in the absence of the merger. That curtailment of innovation could take the form of reduced incentive to continue with an existing product-development effort or reduced incentive to initiate development of new products.

The first of these effects is most likely to occur if at least one of the merging firms is engaging in efforts to introduce new products that would capture substantial revenues from the other merging firm. The second, longer-run effect is most likely to occur if at least one of the merging firms has capabilities that are likely to lead it to develop new products in the future that would capture substantial revenues from the other merging firm. The Agencies therefore also consider whether a merger will diminish innovation competition by combining two of a very small number of firms with the strongest capabilities to successfully innovate in a specific direction.

The Agencies evaluate the extent to which successful innovation by one merging firm is likely to take sales from the other, and the extent to which post-merger incentives for future innovation will be lower than those that would prevail in the absence of the merger. The Agencies also consider whether the merger is likely to enable innovation that would not otherwise take place, by bringing together

[12] Such a merger also can cause adverse coordinated effects, especially if the acquired firm with excess capacity was disrupting effective coordination.

complementary capabilities that cannot be otherwise combined or for some other merger-specific reason. See Section 10.

The Agencies also consider whether a merger is likely to give the merged firm an incentive to cease offering one of the relevant products sold by the merging parties. Reductions in variety following a merger may or may not be anticompetitive. Mergers can lead to the efficient consolidation of products when variety offers little in value to customers. In other cases, a merger may increase variety by encouraging the merged firm to reposition its products to be more differentiated from one another.

If the merged firm would withdraw a product that a significant number of customers strongly prefer to those products that would remain available, this can constitute a harm to customers over and above any effects on the price or quality of any given product. If there is evidence of such an effect, the Agencies may inquire whether the reduction in variety is largely due to a loss of competitive incentives attributable to the merger. An anticompetitive incentive to eliminate a product as a result of the merger is greater and more likely, the larger is the share of profits from that product coming at the expense of profits from products sold by the merger partner. Where a merger substantially reduces competition by bringing two close substitute products under common ownership, and one of those products is eliminated, the merger will often also lead to a price increase on the remaining product, but that is not a necessary condition for anticompetitive effect.

> *Example 21:* Firm A sells a high-end product at a premium price. Firm B sells a mid-range product at a lower price, serving customers who are more price sensitive. Several other firms have low-end products. Firms A and B together have a large share of the relevant market. Firm A proposes to acquire Firm B and discontinue Firm B's product. Firm A expects to retain most of Firm B's customers. Firm A may not find it profitable to raise the price of its high-end product after the merger, because doing so would reduce its ability to retain Firm B's more price-sensitive customers. The Agencies may conclude that the withdrawal of Firm B's product results from a loss of competition and materially harms customers.

7. Coordinated Effects

A merger may diminish competition by enabling or encouraging post-merger coordinated interaction among firms in the relevant market that harms customers. Coordinated interaction involves conduct by multiple firms that is profitable for each of them only as a result of the accommodating reactions of the others. These reactions can blunt a firm's incentive to offer customers better deals by undercutting the extent to which such a move would win business away from rivals. They also can enhance a firm's incentive to raise prices, by assuaging the fear that such a move would lose customers to rivals.

Coordinated interaction includes a range of conduct. Coordinated interaction can involve the explicit negotiation of a common understanding of how firms will compete or refrain from competing. Such conduct typically would itself violate the antitrust laws. Coordinated interaction also can involve a similar common understanding that is not explicitly negotiated but would be enforced by the detection and punishment of deviations that would undermine the coordinated interaction. Coordinated interaction alternatively can involve parallel accommodating conduct not pursuant to a prior understanding. Parallel accommodating conduct includes situations in which each rival's response to competitive moves made by others is individually rational, and not motivated by retaliation or deterrence nor intended to sustain an agreed-upon market outcome, but nevertheless emboldens price increases and weakens competitive incentives to reduce prices or offer customers better terms. Coordinated interaction includes conduct not otherwise condemned by the antitrust laws.

The ability of rival firms to engage in coordinated conduct depends on the strength and predictability of rivals' responses to a price change or other competitive initiative. Under some circumstances, a merger can result in market concentration sufficient to strengthen such responses or enable multiple firms in the market to predict them more confidently, thereby affecting the competitive incentives of multiple firms in the market, not just the merged firm.

7.1 Impact of Merger on Coordinated Interaction

The Agencies examine whether a merger is likely to change the manner in which market participants interact, inducing substantially more coordinated interaction. The Agencies seek to identify how a merger might significantly weaken competitive incentives through an increase in the strength, extent, or likelihood of coordinated conduct. There are, however, numerous forms of coordination, and the risk that a merger will induce adverse coordinated effects may not be susceptible to quantification or detailed proof. Therefore, the Agencies evaluate the risk of coordinated effects using measures of market concentration (see Section 5) in conjunction with an assessment of whether a market is vulnerable to coordinated conduct. See Section 7.2. The analysis in Section 7.2 applies to moderately and highly concentrated markets, as unconcentrated markets are unlikely to be vulnerable to coordinated conduct.

Pursuant to the Clayton Act's incipiency standard, the Agencies may challenge mergers that in their judgment pose a real danger of harm through coordinated effects, even without specific evidence showing precisely how the coordination likely would take place. The Agencies are likely to challenge a merger if the following three conditions are all met: (1) the merger would significantly increase concentration and lead to a moderately or highly concentrated market; (2) that market shows signs of vulnerability to coordinated conduct (see Section 7.2); and (3) the Agencies have a credible basis on which to conclude that the merger may enhance that vulnerability. An acquisition eliminating a maverick firm (see Section 2.1.5) in a market vulnerable to coordinated conduct is likely to cause adverse coordinated effects.

7.2 Evidence a Market is Vulnerable to Coordinated Conduct

The Agencies presume that market conditions are conducive to coordinated interaction if firms representing a substantial share in the relevant market appear to have previously engaged in express collusion affecting the relevant market, unless competitive conditions in the market have since changed significantly. Previous express collusion in another geographic market will have the same weight if the salient characteristics of that other market at the time of the collusion are comparable to those in the relevant market. Failed previous attempts at collusion in the relevant market suggest that successful collusion was difficult pre-merger but not so difficult as to deter attempts, and a merger may tend to make success more likely. Previous collusion or attempted collusion in another product market may also be given substantial weight if the salient characteristics of that other market at the time of the collusion are closely comparable to those in the relevant market.

A market typically is more vulnerable to coordinated conduct if each competitively important firm's significant competitive initiatives can be promptly and confidently observed by that firm's rivals. This is more likely to be the case if the terms offered to customers are relatively transparent. Price transparency can be greater for relatively homogeneous products. Even if terms of dealing are not transparent, transparency regarding the identities of the firms serving particular customers can give rise to coordination, e.g., through customer or territorial allocation. Regular monitoring by suppliers of one another's prices or customers can indicate that the terms offered to customers are relatively transparent.

A market typically is more vulnerable to coordinated conduct if a firm's prospective competitive reward from attracting customers away from its rivals will be significantly diminished by likely responses of those rivals. This is more likely to be the case, the stronger and faster are the responses the firm anticipates from its rivals. The firm is more likely to anticipate strong responses if there are few significant competitors, if products in the relevant market are relatively homogeneous, if customers find it relatively easy to switch between suppliers, or if suppliers use meeting-competition clauses.

A firm is more likely to be deterred from making competitive initiatives by whatever responses occur if sales are small and frequent rather than via occasional large and long-term contracts or if relatively few customers will switch to it before rivals are able to respond. A firm is less likely to be deterred by whatever responses occur if the firm has little stake in the status quo. For example, a firm with a small market share that can quickly and dramatically expand, constrained neither by limits on production nor by customer reluctance to switch providers or to entrust business to a historically small provider, is unlikely to be deterred. Firms are also less likely to be deterred by whatever responses occur if competition in the relevant market is marked by leapfrogging technological innovation, so that responses by competitors leave the gains from successful innovation largely intact.

A market is more apt to be vulnerable to coordinated conduct if the firm initiating a price increase will lose relatively few customers after rivals respond to the increase. Similarly, a market is more apt to be vulnerable to coordinated conduct if a firm that first offers a lower price or improved product to customers will retain relatively few customers thus attracted away from its rivals after those rivals respond.

The Agencies regard coordinated interaction as more likely, the more the participants stand to gain from successful coordination. Coordination generally is more profitable, the lower is the market elasticity of demand.

Coordinated conduct can harm customers even if not all firms in the relevant market engage in the coordination, but significant harm normally is likely only if a substantial part of the market is subject to such conduct. The prospect of harm depends on the collective market power, in the relevant market, of firms whose incentives to compete are substantially weakened by coordinated conduct. This collective market power is greater, the lower is the market elasticity of demand. This collective market power is diminished by the presence of other market participants with small market shares and little stake in the outcome resulting from the coordinated conduct, if these firms can rapidly expand their sales in the relevant market.

Buyer characteristics and the nature of the procurement process can affect coordination. For example, sellers may have the incentive to bid aggressively for a large contract even if they expect strong responses by rivals. This is especially the case for sellers with small market shares, if they can realistically win such large contracts. In some cases, a large buyer may be able to strategically undermine coordinated conduct, at least as it pertains to that buyer's needs, by choosing to put up for bid a few large contracts rather than many smaller ones, and by making its procurement decisions opaque to suppliers.

8. Powerful Buyers

Powerful buyers are often able to negotiate favorable terms with their suppliers. Such terms may reflect the lower costs of serving these buyers, but they also can reflect price discrimination in their favor.

The Agencies consider the possibility that powerful buyers may constrain the ability of the merging parties to raise prices. This can occur, for example, if powerful buyers have the ability and incentive to vertically integrate upstream or sponsor entry, or if the conduct or presence of large buyers undermines coordinated effects. However, the Agencies do not presume that the presence of powerful buyers alone forestalls adverse competitive effects flowing from the merger. Even buyers that can negotiate favorable terms may be harmed by an increase in market power. The Agencies examine the choices available to powerful buyers and how those choices likely would change due to the merger. Normally, a merger that eliminates a supplier whose presence contributed significantly to a buyer's negotiating leverage will harm that buyer.

> *Example 22:* Customer C has been able to negotiate lower pre-merger prices than other customers by threatening to shift its large volume of purchases from one merging firm to the other. No other suppliers are as well placed to meet Customer C's needs for volume and reliability. The merger is likely to harm Customer C. In this situation, the Agencies could identify a price discrimination market consisting of Customer C and similarly placed customers. The merger threatens to end previous price discrimination in their favor.

Furthermore, even if some powerful buyers could protect themselves, the Agencies also consider whether market power can be exercised against other buyers.

> *Example 23:* In Example 22, if Customer C instead obtained the lower pre-merger prices based on a credible threat to supply its own needs, or to sponsor new entry, Customer C might not be harmed. However, even in this case, other customers may still be harmed.

9. Entry

The analysis of competitive effects in Sections 6 and 7 focuses on current participants in the relevant market. That analysis may also include some forms of entry. Firms that would rapidly and easily enter the market in response to a SSNIP are market participants and may be assigned market shares. See Sections 5.1 and 5.2. Firms that have, prior to the merger, committed to entering the market also will normally be treated as market participants. See Section 5.1. This section concerns entry or adjustments to pre-existing entry plans that are induced by the merger.

As part of their full assessment of competitive effects, the Agencies consider entry into the relevant market. The prospect of entry into the relevant market will alleviate concerns about adverse competitive effects only if such entry will deter or counteract any competitive effects of concern so the merger will not substantially harm customers.

The Agencies consider the actual history of entry into the relevant market and give substantial weight to this evidence. Lack of successful and effective entry in the face of non-transitory increases in the margins earned on products in the relevant market tends to suggest that successful entry is slow or difficult. Market values of incumbent firms greatly exceeding the replacement costs of their tangible assets may indicate that these firms have valuable intangible assets, which may be difficult or time consuming for an entrant to replicate.

A merger is not likely to enhance market power if entry into the market is so easy that the merged firm and its remaining rivals in the market, either unilaterally or collectively, could not profitably raise price or otherwise reduce competition compared to the level that would prevail in the absence of the merger. Entry is that easy if entry would be timely, likely, and sufficient in its magnitude, character, and scope to deter or counteract the competitive effects of concern.

The Agencies examine the timeliness, likelihood, and sufficiency of the entry efforts an entrant might practically employ. An entry effort is defined by the actions the firm must undertake to produce and sell in the market. Various elements of the entry effort will be considered. These elements can include: planning, design, and management; permitting, licensing, or other approvals; construction, debugging, and operation of production facilities; and promotion (including necessary introductory discounts), marketing, distribution, and satisfaction of customer testing and qualification requirements. Recent examples of entry, whether successful or unsuccessful, generally provide the starting point for identifying the elements of practical entry efforts. They also can be informative regarding the scale necessary for an entrant to be successful, the presence or absence of entry barriers, the factors that influence the timing of entry, the costs and risk associated with entry, and the sales opportunities realistically available to entrants.

If the assets necessary for an effective and profitable entry effort are widely available, the Agencies will not necessarily attempt to identify which firms might enter. Where an identifiable set of firms appears to have necessary assets that others lack, or to have particularly strong incentives to enter, the Agencies focus their entry analysis on those firms. Firms operating in adjacent or complementary markets, or large customers themselves, may be best placed to enter. However, the Agencies will not presume that a powerful firm in an adjacent market or a large customer will enter the relevant market unless there is reliable evidence supporting that conclusion.

In assessing whether entry will be timely, likely, and sufficient, the Agencies recognize that precise and detailed information may be difficult or impossible to obtain. The Agencies consider reasonably available and reliable evidence bearing on whether entry will satisfy the conditions of timeliness, likelihood, and sufficiency.

9.1 Timeliness

In order to deter the competitive effects of concern, entry must be rapid enough to make unprofitable overall the actions causing those effects and thus leading to entry, even though those actions would be profitable until entry takes effect.

Even if the prospect of entry does not deter the competitive effects of concern, post-merger entry may counteract them. This requires that the impact of entrants in the relevant market be rapid enough that customers are not significantly harmed by the merger, despite any anticompetitive harm that occurs prior to the entry.

The Agencies will not presume that an entrant can have a significant impact on prices before that entrant is ready to provide the relevant product to customers unless there is reliable evidence that anticipated future entry would have such an effect on prices.

9.2 Likelihood

Entry is likely if it would be profitable, accounting for the assets, capabilities, and capital needed and the risks involved, including the need for the entrant to incur costs that would not be recovered if the entrant later exits. Profitability depends upon (a) the output level the entrant is likely to obtain, accounting for the obstacles facing new entrants; (b) the price the entrant would likely obtain in the post-merger market, accounting for the impact of that entry itself on prices; and (c) the cost per unit the entrant would likely incur, which may depend upon the scale at which the entrant would operate.

9.3 Sufficiency

Even where timely and likely, entry may not be sufficient to deter or counteract the competitive effects of concern. For example, in a differentiated product industry, entry may be insufficient because the products offered by entrants are not close enough substitutes to the products offered by the merged firm to render a price increase by the merged firm unprofitable. Entry may also be insufficient due to constraints that limit entrants' competitive effectiveness, such as limitations on the capabilities of the firms best placed to enter or reputational barriers to rapid expansion by new entrants. Entry by a single firm that will replicate at least the scale and strength of one of the merging firms is sufficient. Entry by one or more firms operating at a smaller scale may be sufficient if such firms are not at a significant competitive disadvantage.

10. Efficiencies

Competition usually spurs firms to achieve efficiencies internally. Nevertheless, a primary benefit of mergers to the economy is their potential to generate significant efficiencies and thus enhance the merged firm's ability and incentive to compete, which may result in lower prices, improved quality, enhanced service, or new products. For example, merger-generated efficiencies may enhance competition by permitting two ineffective competitors to form a more effective competitor, e.g., by combining complementary assets. In a unilateral effects context, incremental cost reductions may reduce or reverse any increases in the merged firm's incentive to elevate price. Efficiencies also may lead to new or improved products, even if they do not immediately and directly affect price. In a coordinated effects context, incremental cost reductions may make coordination less likely or effective by enhancing the incentive of a maverick to lower price or by creating a new maverick firm. Even when efficiencies generated through a merger enhance a firm's ability to compete, however, a merger may have other effects that may lessen competition and make the merger anticompetitive.

The Agencies credit only those efficiencies likely to be accomplished with the proposed merger and unlikely to be accomplished in the absence of either the proposed merger or another means having comparable anticompetitive effects. These are termed merger-specific efficiencies.[13] Only alternatives that are practical in the business situation faced by the merging firms are considered in making this determination. The Agencies do not insist upon a less restrictive alternative that is merely theoretical.

Efficiencies are difficult to verify and quantify, in part because much of the information relating to efficiencies is uniquely in the possession of the merging firms. Moreover, efficiencies projected reasonably and in good faith by the merging firms may not be realized. Therefore, it is incumbent upon the merging firms to substantiate efficiency claims so that the Agencies can verify by reasonable means the likelihood and magnitude of each asserted efficiency, how and when each would be achieved (and any costs of doing so), how each would enhance the merged firm's ability and incentive to compete, and why each would be merger-specific.

Efficiency claims will not be considered if they are vague, speculative, or otherwise cannot be verified by reasonable means. Projections of efficiencies may be viewed with skepticism, particularly when generated outside of the usual business planning process. By contrast, efficiency claims substantiated by analogous past experience are those most likely to be credited.

Cognizable efficiencies are merger-specific efficiencies that have been verified and do not arise from anticompetitive reductions in output or service. Cognizable efficiencies are assessed net of costs produced by the merger or incurred in achieving those efficiencies.

The Agencies will not challenge a merger if cognizable efficiencies are of a character and magnitude such that the merger is not likely to be anticompetitive in any relevant market.[14] To make the requisite determination, the Agencies consider whether cognizable efficiencies likely would be sufficient to reverse the merger's potential to harm customers in the relevant market, e.g., by preventing price

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13 The Agencies will not deem efficiencies to be merger-specific if they could be attained by practical alternatives that mitigate competitive concerns, such as divestiture or licensing. If a merger affects not whether but only when an efficiency would be achieved, only the timing advantage is a merger-specific efficiency.

14 The Agencies normally assess competition in each relevant market affected by a merger independently and normally will challenge the merger if it is likely to be anticompetitive in any relevant market. In some cases, however, the Agencies in their prosecutorial discretion will consider efficiencies not strictly in the relevant market, but so inextricably linked with it that a partial divestiture or other remedy could not feasibly eliminate the anticompetitive effect in the relevant market without sacrificing the efficiencies in the other market(s). Inextricably linked efficiencies are most likely to make a difference when they are great and the likely anticompetitive effect in the relevant market(s) is small so the merger is likely to benefit customers overall.

increases in that market.[15] In conducting this analysis, the Agencies will not simply compare the magnitude of the cognizable efficiencies with the magnitude of the likely harm to competition absent the efficiencies. The greater the potential adverse competitive effect of a merger, the greater must be the cognizable efficiencies, and the more they must be passed through to customers, for the Agencies to conclude that the merger will not have an anticompetitive effect in the relevant market. When the potential adverse competitive effect of a merger is likely to be particularly substantial, extraordinarily great cognizable efficiencies would be necessary to prevent the merger from being anticompetitive. In adhering to this approach, the Agencies are mindful that the antitrust laws give competition, not internal operational efficiency, primacy in protecting customers.

In the Agencies' experience, efficiencies are most likely to make a difference in merger analysis when the likely adverse competitive effects, absent the efficiencies, are not great. Efficiencies almost never justify a merger to monopoly or near-monopoly. Just as adverse competitive effects can arise along multiple dimensions of conduct, such as pricing and new product development, so too can efficiencies operate along multiple dimensions. Similarly, purported efficiency claims based on lower prices can be undermined if they rest on reductions in product quality or variety that customers value.

The Agencies have found that certain types of efficiencies are more likely to be cognizable and substantial than others. For example, efficiencies resulting from shifting production among facilities formerly owned separately, which enable the merging firms to reduce the incremental cost of production, are more likely to be susceptible to verification and are less likely to result from anticompetitive reductions in output. Other efficiencies, such as those relating to research and development, are potentially substantial but are generally less susceptible to verification and may be the result of anticompetitive output reductions. Yet others, such as those relating to procurement, management, or capital cost, are less likely to be merger-specific or substantial, or may not be cognizable for other reasons.

When evaluating the effects of a merger on innovation, the Agencies consider the ability of the merged firm to conduct research or development more effectively. Such efficiencies may spur innovation but not affect short-term pricing. The Agencies also consider the ability of the merged firm to appropriate a greater fraction of the benefits resulting from its innovations. Licensing and intellectual property conditions may be important to this enquiry, as they affect the ability of a firm to appropriate the benefits of its innovation. Research and development cost savings may be substantial and yet not be cognizable efficiencies because they are difficult to verify or result from anticompetitive reductions in innovative activities.

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[15] The Agencies normally give the most weight to the results of this analysis over the short term. The Agencies also may consider the effects of cognizable efficiencies with no short-term, direct effect on prices in the relevant market. Delayed benefits from efficiencies (due to delay in the achievement of, or the realization of customer benefits from, the efficiencies) will be given less weight because they are less proximate and more difficult to predict. Efficiencies relating to costs that are fixed in the short term are unlikely to benefit customers in the short term, but can benefit customers in the longer run, e.g., if they make new product introduction less expensive.

11. Failure and Exiting Assets

Notwithstanding the analysis above, a merger is not likely to enhance market power if imminent failure, as defined below, of one of the merging firms would cause the assets of that firm to exit the relevant market. This is an extreme instance of the more general circumstance in which the competitive significance of one of the merging firms is declining: the projected market share and significance of the exiting firm is zero. If the relevant assets would otherwise exit the market, customers are not worse off after the merger than they would have been had the merger been enjoined.

The Agencies do not normally credit claims that the assets of the failing firm would exit the relevant market unless all of the following circumstances are met: (1) the allegedly failing firm would be unable to meet its financial obligations in the near future; (2) it would not be able to reorganize successfully under Chapter 11 of the Bankruptcy Act; and (3) it has made unsuccessful good-faith efforts to elicit reasonable alternative offers that would keep its tangible and intangible assets in the relevant market and pose a less severe danger to competition than does the proposed merger.[16]

Similarly, a merger is unlikely to cause competitive harm if the risks to competition arise from the acquisition of a failing division. The Agencies do not normally credit claims that the assets of a division would exit the relevant market in the near future unless both of the following conditions are met: (1) applying cost allocation rules that reflect true economic costs, the division has a persistently negative cash flow on an operating basis, and such negative cash flow is not economically justified for the firm by benefits such as added sales in complementary markets or enhanced customer goodwill;[17] and (2) the owner of the failing division has made unsuccessful good-faith efforts to elicit reasonable alternative offers that would keep its tangible and intangible assets in the relevant market and pose a less severe danger to competition than does the proposed acquisition.

12. Mergers of Competing Buyers

Mergers of competing buyers can enhance market power on the buying side of the market, just as mergers of competing sellers can enhance market power on the selling side of the market. Buyer market power is sometimes called “monopsony power.”

To evaluate whether a merger is likely to enhance market power on the buying side of the market, the Agencies employ essentially the framework described above for evaluating whether a merger is likely to enhance market power on the selling side of the market. In defining relevant markets, the Agencies

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[16] Any offer to purchase the assets of the failing firm for a price above the liquidation value of those assets will be regarded as a reasonable alternative offer. Liquidation value is the highest value the assets could command for use outside the relevant market.

[17] Because the parent firm can allocate costs, revenues, and intra-company transactions among itself and its subsidiaries and divisions, the Agencies require evidence on these two points that is not solely based on management plans that could have been prepared for the purpose of demonstrating negative cash flow or the prospect of exit from the relevant market.

Seminal Cases

THE SEMINAL CASES

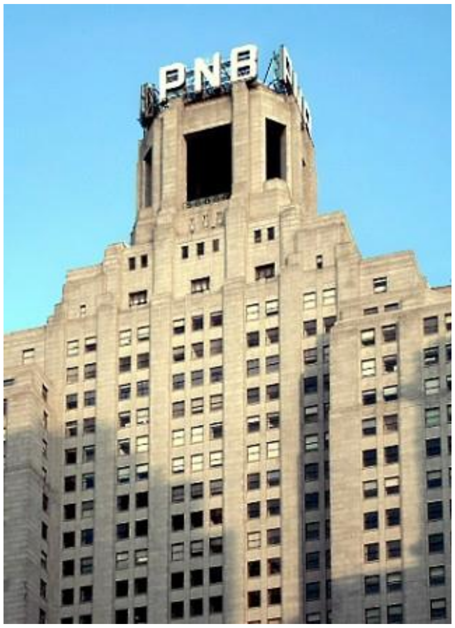
UNITED STATES V. PHILADELPHIA NATIONAL BANK (1963).[1] The Supreme Court provided a solution to one of the most basic questions of merger antitrust law raised by *Brown Shoe* the next year in *Philadelphia National Bank*. There, the Court held that the plaintiff can make a prima facie showing of the requisite anticompetitive effect of a horizontal acquisition through an evidentiary presumption where the combined share of the merging firms, in light of the degree of concentration already present in the market, is sufficiently high:

> [A] merger which produces a firm controlling an undue percentage of the relevant market, and results in a significant increase in the concentration of firms in that market, is so inherently likely to lessen competition substantially that it must be enjoined in the absence of evidence clearly showing that the merger is not likely to have such anticompetitive effects.[2]

The *Philadelphia National Bank* Court did not fix numerical figures for invoking this presumption. In *Philadelphia National Bank* itself, however, the Court found the presumption established when the merging firms combined held over 30% of a relevant market in which the four largest firms held over 75%.[3]

On February 25, 1961, the Department of Justice filed a civil suit to enjoin the proposed merger of The Philadelphia National Bank ("PNB") and Girard Trust Corn Exchange Bank. The complaint charged that the acquisition may tend substantially to lessen competition in commercial bank services in the four-county Philadelphia metropolitan region in violation of Section 1 of the Sherman Act and Section 7 of the Clayton Act. PNB was a national bank with assets in excess of $1 billion and the second largest commercial bank in the four-county region. Girard was a state bank with assets of over $750 million and the third largest commercial bank in the area. PNB and Girard, which were both headquartered in Philadelphia, accounted for approximately 21% and 16%, respectively, of the commercial bank assets in the four-county area. If the merger was consummated, the resulting bank would become the largest in the area, with approximately 36% of the area's total bank assets. As a result of the merger, the two-firm concentration ratio would rise from 44% to 59%, and the four-firm concentration would rise from ___% to 78%.

1. 374 U.S. 321 (1963), *rev'g* 201 F. Supp. 348 (E.D. Pa. 1962).
2. *Id*. at 363.
3. *Id*. at 331.



The government's case at trial was straightforward. The Justice Department relied principally on statistical market share evidence. The Department also introduced testimony by economists and bankers that, notwithstanding the extensive degree of federal and state regulation of the banking industry, there remained substantial areas where product availability, price and quality were determined by competitive forces; that concentration in commercial banking, which the proposed merger would increase, would reduce these competitive forces; that the "area of the country" in which the competitive effect of the merger would be felt primarily would be the area in which the merging parties had their offices and branches, that is, a four-county area around Philadelphia; and that the relevant "line of commerce" was commercial banking. PNB and Girard responded by introducing contrary evidence on these propositions, as well as evidence that the merger was justified because the resulting bank would be better able to compete with out-of-state (particularly New York) banks, would attract new business to Philadelphia, and would generally promote the economic development of the region.

After a trial on the merits, the district court found that commercial banking was a proper relevant product market, but that the four-county metropolitan area was not a relevant geographic market because of competition with other banks for bank business throughout the greater northeastern United States. The district court also found that, even if the four-county region was an appropriate "area of the country" for merger antitrust analysis, there was no reasonable probability that the challenged transaction would substantially lessen competition among commercial banks in that area. Finally, the court found that the merger would benefit the Philadelphia metropolitan area economically. Accordingly, the district court dismissed the complaint.

The government appealed directly to the Supreme Court under the Expediting Act. In six-to-two decision, the Supreme Court reversed,

Girard Trust Corn Exchange Bank
Main office

holding that the merger would violate Section 7 of the Clayton Act, and remanded the case with instructions to the district court to enter judgment enjoining the combination.[4] Justice William J. Brennan, Jr., wrote the opinion for the majority.

Product market definition presented "no difficulty" for the Court. With virtually no analysis, the Court agreed with the district court that "the cluster of products (various kinds of credit) and services (such as checking accounts and trust administration) denoted by the term 'commercial banking' composes a distinct line of commerce."[5] A reading of the opinion suggests as much as anything that the Court believed that the market should be no larger than commercial banking because—at least in the early 1960s—commercial bank products were insulated from competition from other types of institutions either by regulation, as in the case of checking accounts; by a cost advantage over similar products offered by other firms, such as personal finance companies (whose working capital consists substantially of bank loans); or by simple if unexplained consumer preference, most clearly illustrated by savings accounts offered by banks which paid a lower rate of interest than thrift institutions yet remained competitive. More mysterious, and still an analytical problem today, is why the "cluster" of all commercial bank products comprised the relevant product market, as opposed to disaggregating various bank products into distinct lines of commerce for purpose of merger analysis. The Supreme Court offered no explanation, stating summarily only that "commercial banking is a market 'sufficiently inclusive to be meaningful in terms of trade realities.'"[6]

The Supreme Court devoted more attention to the question of geographic market definition. Here, the Court departed from the conclusion of the district court that the northeastern United States was the relevant area of the country. In an oft-quoted passage, the Court observed that "the proper question" to be asked is "not where the parties to the merger do business or even where they compete, but where, within the area of competitive overlap, the effect of the merger on competition will be direct and immediate."[7] This "area of effective competition" is determined as much by where existing purchasers can turn for supplies as by the trade area in which the parties operate.[8] The Court found that convenience of location is essential in banking, and consequently that inconvenience localizes competition in banking the same way that high transportation costs localize competition in other industries.[9] The Court then quickly leaped from the statement of these rules to the conclusion that the relevant geographic market was the four-county metropolitan area, where the "vast

4. The Court reserved the question of whether the combination also violated Section 1 of the Sherman Act.

5. *Id*. at 356.

6. *Id*. at 357 (citing Crown Zellerbach Corp. v. FTC, 296 F.2d 800, 811 (9th Cir. 1961)).

7. *Id*. at 357 (citing BETTY BOCK, MERGERS AND MARKETS 42 (1960)).

8. *Id*. at 359 (citing Tampa Electric Co. v. Nashville Coal Co., 365 U.S. 320, 327 (1961)).

9. *Id*. at 358-59 (citing Crystal Sugar Co. v. Cuban-American Sugar Co., 152 F. Supp. 387, 398 (S.D.N.Y. 1957), *aff'd*, 259 F.2d 524 (2d Cir. 1958)).

bulk" of both PNB's and Girard's business originated. The Court recognized that some business, particularly with large depositors and borrowers, originated outside the four-county area, and that some small customers would find the four-county area much too large for all banks within it to be meaningfully accessible. Accordingly, a compromise was required:

> But that in banking the relevant geographic market is a function of each separate customer's economic scale means simply that a workable compromise must be found: some fair intermediate delineation which avoids the indefensible extremes of drawing the market either so expansively as to make the effect of the merger upon competition seem insignificant, because only the very largest bank customers are taken into account in defining the market, or so narrowly as to place appellees in different markets, because only the smallest customers are considered.[10]

To support its four-county compromise, the Court cited Pennsylvania banking law, which applied equally to both parties and which limited branch banks to counties contiguous to the home county. In the case of banks headquartered in Philadelphia, as were PNB and Girard, Pennsylvania law then permitted branching in the four-county metropolitan area, and both PNB and Girard had branches in each of the four counties.

Having defined the product and geographic dimensions of the relevant market, the Court turned to the merger's expected effect on competition. The Court observed:

> Clearly, this is not the kind of question which is susceptible of a ready and precise answer in most cases. It requires not merely an appraisal of the immediate impact of the merger upon competition, but a prediction of its impact upon competitive conditions in the future; this is what is meant when it is said that the amended § 7 was intended to arrest anticompetitive tendencies in their "incipiency." Such a prediction is sound only if it is based upon a firm understanding of the structure of the relevant market; yet the relevant economic data are both complex and elusive. And unless businessmen can assess the legal consequences of a merger with some confidence, sound business planning is retarded. So also, we must be alert to the danger of subverting congressional intent by permitting a too-broad economic investigation. And so in any case in which it is possible, without doing violence to the congressional objective embodied in § 7, to simply the test of illegality, the courts ought to do so in the interest of sound and practical judicial administration.[11]

Balancing these concerns, the Court concluded "in certain cases . . . elaborate proof of market structure, market behavior, or probable anticompetitive effects" was unnecessary and unwarranted.[12] Instead, given that the dominant theme motivating

10. *Id*. at 361.
11. 374 U.S. at 363 (citations omitted).
12. *Id*..

the Celler-Kefauver Act was an “intense congressional concern” over “a rising tide of economic concentration in the American economy,”[13] the Court held the requisite anticompetitive effect could be presumed from the changes in the market share distribution:

> Specifically, we think that a merger which produces a firm controlling an undue percentage of the relevant market, and results in a significant increase in the concentration of firms in that market, is so inherently likely to lessen competition substantially that it must be enjoined in the absence of evidence clearly showing that the merger is not likely to have such anticompetitive effects.[14]

The Court noted that this presumption is “fully consonant with economic theory”: “That ‘[c]ompetition is likely to be greatest when there are many sellers, none of which has a significant market share,’ is a common ground among most economists, and was undoubtedly a premise of congressional reasoning about the antimerger statute.”[15]

Without establishing a hard and fast threshold, the Court held that PNB’s and Girard’s combined market share of 30% was “undue,” and that an increase in the two-firm concentration ratio from 44% to 59% and the four-firm concentration ratio from ___ to 78% represented a “significant increase” in market concentration, so that the presumptive rule of illegality was triggered. The Court observed in a footnote that Carl Kaysen and Donald Turner recommended in their seminal work that a combined 20% share should be the threshold of prima facie unlawfulness,[16] George Stigler also would employ a 20% threshold,[17] Jesse Markham would use a 25% test,[18] and Derek Bok would look primarily to changes in market concentration of 7% or 8%.[19] The Supreme Court observed that since a 30% combined share presents a “clear” threat to

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13. *Id*.

14. *Id*. (citing United States v. Koppers Co., 202 F. Supp. 437 (W.D. Pa. 1962)).

15. *Id*. (internal citations and footnote omitted). To support the basic economic proposition, the Court cited JOE S. BAIN, BARRIERS TO NEW COMPETITION 27 (1956); CARL KAYSEN & DONALD TURNER, ANTITRUST POLICY 133 (1959); FRITZ MACHLUP, THE ECONOMICS OF SELLERS’ COMPETITION 84-93, 333-36 (1956); Derek Bok, *Section 7 of the Clayton Act and the Merging of Law and Economics*, 74 HARV. L. REV. 226, 308-16, 328 (1960); Jesse M. Markham, *Merger Policy under the New Section 7: A Six-Year Appraisal*, 43 VA. L. REV. 489, 521-22 (1957); Edward S. Mason, *Market Power and Business Conduct: Some Comments*, 46 AM. ECON. REV. 471 (1956); George Stigler, *Mergers and Preventive Antitrust Policy*, 104 U. PA. L. REV. 176, 182 (1955).

16. CARL KAYSEN & DONALD TURNER, ANTITRUST POLICY ___ (1959).

17. George Stigler, *Mergers and Preventive Antitrust Policy*, 104 U. PA. L. REV. 176, 182 (1955).

18. Jesse M. Markham, *Merger Policy under the New Section 7: A Six-Year Appraisal*, 43 VA. L. REV. 489, 522 (1957).

19. Derek Bok, *Section 7 of the Clayton Act and the Merging of Law and Economics*, 74 HARV. L. REV. 226, 328-29 (1960). Actually, in his published article Bok recommended 5% as a threshold. *Id*.

competition it was unnecessary to specify a minimum threshold, and emphasized that the fact that a merger results in a firm with less than 30% does not raise an inference that the combination does not violate Section 7.[20]

After finding a prima facie violation, the Court turned to whether there was anything in the record by way of a negative defense to rebut the inference of anticompetitive effect derived from the market share distribution. First, the Court rejected as inadequate testimony of bank officers that competition in the Philadelphia area was vigorous and would continue to be so after the merger, especially since the witnesses could not give concrete reasons for their conclusions. In addition, while testimony from representatives of the parties suffered from its inherently self-serving nature, the fact that other testimony was from bank officers representing small competitor banks did not substantially enhance its probative value, since in an oligopolistic market small companies may be content to follow the anticompetitive lead of the larger firms.[21] Second, the Court found irrelevant the fact that multiple banks would continue serving the Philadelphia area, and so afford any customers dissatisfied with the services of the merged firm with ready alternatives. Section 7, the Court repeated, was intended to arrest the trend toward concentration in its incipiency, before the customers' alternatives disappeared. The Court intimated that ease of entry of new competitors might ensure the continued competition and the availability of consumer alternatives, but given the fact that entry into banking was regulated the Court did not explore this possibility.[22] Finally, the Court rejected the argument that the extensive degree of regulation made the banking industry immune from the anticompetitive effects of concentration. The Court found that competition among banks existed along a variety of dimensions—price, variety of credit arrangements, convenience of location, attractiveness of physical surroundings, credit information, investment advice, personal accommodations, advertising, and special services—and, at least by implication, suggested that a threatened diminution of competition along any of these dimensions was within the purview of Section 7.

Finally, the Court considered and rejected each of the three affirmative defenses offered by the banks. First, as a matter of fact, contrary to the banks' contentions, mergers were not the only means of following their customers to the suburbs; banks could open de novo branches rather than acquiring existing ones. In this connection, the Court noted that "one premise of an antimerger statute such as § 7 is that corporate growth by internal expansion is socially preferable to growth by acquisition."[23] The Court left unaddressed the question of the legal significance of being able to "follow" one's customers, assuming for whatever reason that de novo entry was not feasible. Second, the Court found irrelevant the fact that the merger would enable the resulting bank better to compete with large out-of-state banks,

20. *Philadelphia Nat'l Bank*, 374 U.S. at 364-65 & n.41.

21. *Id*. at 367 n.43.

22. *Id*. at 367 & n.44.

23. *Id*. at 370.

particularly New York banks, for large loans, although it did not reject categorically a defense of "countervailing power":

> We reject this application of "countervailing power." If anticompetitive effects in one market could be justified by procompetitive consequences in another, the logical upshot would be that every firm in an industry could, without violating § 7, embark on a series of mergers that would make it as large as the industry leader. For if all the commercial banks in the Philadelphia area merged into one, it would be smaller than the largest bank in New York City. This is not a case, plainly, where two small firms in a market propose to merge in order to be able to compete more successfully with the leading firms in that market.[24]

Finally, the Supreme Court held that the district court's finding that the merger would bring business to the Philadelphia area was without legal significance:

> [A] merger the effect of which "may be substantially to lessen competition" is not saved because, on some ultimate reckoning of social or economic debits and credits, it may be deemed beneficial. A value choice of such magnitude is beyond the ordinary limits of judicial competence, and in any event has been made for us already, by Congress when it enacted the amended § 7. Congress determined to preserve our traditionally competitive economy. It therefore proscribed anticompetitive mergers, the benign and the malignant alike, fully aware, we must assume, that some price might have to be paid.[25]

Although the Court may have been carried away by its rhetoric in speaking of "benign" anticompetitive mergers (one charitable possibility is an anticompetitive merger that does not precipitate other mergers or acquisitions in the market), the Court's instruction was clear: legality under Section 7 turned on the threat of an anticompetitive effect—still not precisely defined but clearly related to the notion of concentration—in some relevant market. As long as the requisite threat to competition existed, other putatively beneficial consequences in the market offered no defense to a Section 7 violation.

Although the *Philadelphia National Bank* Court stressed that a presumption of anticompetitive effect based on market shares was rebuttable, with the acquiescence if not encouragement of the Supreme Court, the lower courts rapidly transformed that rather mechanical presumption into a conclusive evidentiary inference. As a result, for years market definition—from which the market shares and market concentrations would be derived—was the battleground on which antitrust challenges were fought, making *Philadelphia National Bank* the critical case for results, if not theory.

24. *Id*. at 370-71.
25. *Id*. at 371.

NOTES

1. Richard Posner, Brennan's law clerk during the 1962-63 term, reports that he wrote Brennan's opinion for the majority in *Philadelphia National Bank*.[26] Posner said that Brennan "wasn't very interested in the details of legal analysis, so we law clerks wrote the opinions and he would go over them."[27] While on the Harvard Law Review, Posner had been assigned to cite check a portion of path-breaking article by Derek Bok entitled *Section 7 and the Merging of Law and Economics* in which Bok had argued for a simplified approach to Section 7 cases.[28] In *Philadelphia National Bank*, Posner incorporated the idea of a simple prima facie showing of anticompetitive effect in what is now known as the *PNB* presumption.

After clerking for Justice Brennan, Posner served from 1963 to 1965 as an attorney-advisor to FTC Commissioner Philip Elman. For the next two years, Posner was an assistant to Solicitor General Thurgood Marshall. Posner joined the faculty of the Stanford Law School in 1968 as an associate professor and moved to the University of Chicago Law School as a professor in 1969. In 1981, Posner was nominated by President Ronald Reagan to be a judge on the Court of Appeals for the Seventh Circuit, where he served as chief judge from 1993 to 2000.

UNITED STATES V. ALUMINUM CO. OF AMERICA (ROME CABLE) (1964).[29] On April 1, 1960, the Department of Justice filed a civil complaint charging that the acquisition by the Aluminum Company of America (Alcoa) of Rome Corporation violated Section 7 of the Clayton Act. Alcoa was a fully integrated aluminum producer. It was the nation's largest refiner of aluminum ore into primary aluminum, accounting for about 38% of total U.S. primary aluminum production capacity. It also manufactured a wide variety of intermediate and final aluminum products, including aluminum wire and cable. Alcoa made no copper products. Rome was primarily engaged in the manufacture of copper wire and cable products, although in 1952 it began making aluminum rod from aluminum ingot purchased from primary producers. Still, at the time of the acquisition, over 90% of Rome's production was of insulated copper products. Alcoa acquired Rome on March 31, 1959, in a stock exchange valued at the time at about $32

26, *See* Interview with Richard Posner, Securities and Exchange Commission Historical Society Oral History Project 2 (Jan. 25 2011).

27. Id. at 2.

28. *See* Derek C. Bok, *Section 7 and the Merging of Law and Economics*, 74 HARV. L. REV. 226 (1960).

29. 377 U.S. 271 (1964), *rev'g* 214 F. Supp. 501 (N.D.N.Y. 1963) (Blue Book No. 1512).

million.[30] The complaint alleged that the acquisition would substantially lessen actual and potential competition in "various wire and cable products" generally and between Alcoa and Rome in particular, and sought an order of divestiture and an injunction against further acquisitions of any company engaged in the production or sale of wire or cable products, conduit, or cable accessories.

After a four-week trial on the merits, the district court held that the acquisition did not violate Section 7 and dismissed the complaint. Product market definition was the central issue. The district court found that aluminum wire and cable were used almost exclusively by electric utilities for electric power transmission. Copper wire was also used for this purpose. In overhead lines, bar or lightly insulated aluminum conductor had virtually displaced copper conductor in new installations. Underground, however, where the conductor has to be heavily insulated, copper was by far the dominant conductor. The district court found that bare aluminum conductor was a separate line of commerce, but that insulated aluminum conductor had to be included in the same relevant market with insulated copper conductor. The court rejected an all aluminum conductor product market on the grounds that insulated cooper conductor had to be included in any market containing insulated aluminum conductor.[31] Within the two relevant markets found by the court—bare aluminum conductor and insulated aluminum plus copper conductor—the shares of the merging companies and the change in concentration resulting from the merger were not sufficiently high to warrant antitrust concern.

Alcoa/Rome Shares in Various Proposed Product Markets

Proposed	Alcoa		Rome		Combined		
lines of commerce	Share	Rank	Share	Rank	Share	Rank	D.C. Result
Bare aluminum conductor	32.5%		0.3%		32.8%		No violation
Insulated aluminum conductor	11.6%	3	4.7%	8	16.3%		No market
Insulated aluminum and copper conductor	0.3%		1.3%		1.6%		No violation
Aluminum conductor (bare and insulated)	27.8%	1	1.3%	9	29.1%	1	No market
All conductor	1.8%		1.4%		3.2%		No violation

Note: Blank cells indicate that the data was not contained in the court's opinion

30. *See Court in Antitrust Case Clears Alcoa Purchase of Rome Cable*, N.Y. TIMES, Jan. 30, 1963, at 12.

31. *Alcoa*, 214 F. Supp. at 510.

The district court made three other findings that supported its dismissal of the complaint. First, the court found that Alcoa's purpose in acquiring Rome was to gain expertise in the manufacture of more sophisticated types of insulated aluminum conductor and not to eliminate a competitor. Indeed, the court found that Alcoa and Rome competed in only four products and that Rome's production in the overlapping products was not significant.[32] Second, although the government argued that concentration in the aluminum *industry* was increasing, the court found that concentration in aluminum *conductors* was decreasing. Moreover, prior to the Rome acquisition, Alcoa had not acquired any companies involved in the manufacture or sale of aluminum conductor. Third, the court found that there was ease of entry into the manufacture and sale of aluminum conductor and that in the preceding ten years the number of insulated aluminum conductor manufacturers grew from four to twenty-nine (most of which, like Rome, were originally insulated copper conductor manufacturers). The court noted that several manufacturers had exited the business for failure to make a profit, indicating that the business was operating competitively.

On a direct appeal under the Expediting Act, the Supreme Court reversed in a six-to-three decision. Justice William O. Douglas wrote the majority opinion. Douglas focused immediately on the district court's rejection of an all aluminum conductor market. Douglas agreed that there is competition generally between insulated aluminum conductor and insulated copper conductor. But in overhead distribution, Douglas found, insulated aluminum conductor has "decisive advantages" over insulated copper conductor—including its costs being 50% to 65% of the cost of insulated copper conductor—and that its share of total installations increased from 6.5% in 1950 to 77.2% in 1959.[33] Douglas found that these facts justified making insulated aluminum conductor its own "submarket." Without further analysis, Douglas also held that it was "proper" to combine bare and insulated aluminum conductor into a single "all aluminum conductor" market, presumably on the view that it is permissible to combine two lines of commerce into a new single market.[34]

Douglas found that the Alcoa/Rome transaction violated Section 7 in an all aluminum conductor market. Douglas observed that the all aluminum conductor market was highly concentrated, with Alcoa as the largest producer, Alcoa and Kaiser Aluminum & Chemical Corporation controlling 50% of the market, and the largest five firms controlling more than 76% of the market. Quoting *Philadelphia National Bank*, Douglas noted that "if concentration is already great, the importance of preventing even slight increases in concentration and so preserving the possibility of eventual deconcentration is correspondingly great."[35] Douglas concluded:

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32. *Id*. at 512.

33. *Alcoa*, 377 U.S. at 276.

34. *Id*. at 276-77.

35. *Id*. at 279 (quoting United States v. Philadelphia Nat'l Bank, 374 U.S. 321, 365 n.42 (1963)).

> The acquisition of Rome added, it is said, only 1.3% to Alcoa's control of the aluminum conductor market. But in this setting that seems to us reasonably likely to produce a substantial lessening of competition within the meaning of § 7. It is the basic premise of that law that competition will be most vital "when there are many sellers, none of which has any significant market share." *United States v. Philadelphia National Bank*, 374 U. S., at 363. It would seem that the situation in the aluminum industry may be oligopolistic. As that condition develops, the greater is the likelihood that parallel policies of mutual advantage, not competition, will emerge. That tendency may well be thwarted by the presence of small but significant competitors. Though percentagewise Rome may have seemed small in the year prior to the merger, it ranked ninth among all companies and fourth among independents in the aluminum conductor market; and in the insulated aluminum field it ranked eighth and fourth respectively. Furthermore, in the aluminum conductor market, no more than a dozen companies could account for as much as 1% of industry production in any one of the five years (1955-1959) for which statistics appear in the record. Rome's competition was therefore substantial. The record shows indeed that Rome was an aggressive competitor. It was a pioneer in aluminum insulation and developed one of the most widely used insulated conductors. Rome had a broad line of high-quality copper wire and cable products in addition to its aluminum conductor business, a special aptitude and skill in insulation, and an active and efficient research and sales organization. The effectiveness of its marketing organization is shown by the fact that after the merger Alcoa made Rome the distributor of its entire conductor line. Preservation of Rome, rather than its absorption by one of the giants, will keep it "as an important competitive factor," to use the words of S. Rep. No. 1775, [81st Cong., 2d Sess.] p. 3 [1950]. Rome seems to us the prototype of the small independent that Congress aimed to preserve by § 7.[36]

The Court reversed the judgment of the district court and remanded with instructions to fashion an appropriate divestiture decree.

Justice Potter Stewart, joined by Justices John M. Harlan and Arthur J. Goldberg, dissented. First, Stewart argued that the district court's "practical judgment," based on a pragmatic application of the *Brown Shoe* factors, that insulated aluminum conductors were not a relevant line of commerce should be sustained.[37] Second, even if insulated aluminum conductors were a relevant line of commerce, Stewart argued, the evidence showed that bare aluminum conductor and insulated aluminum conductor did not compete with one another and that it was improper to include them in the same relevant market. [38]

36. *Id.* at 280-81.
37. *Id*. at 284 (Stewart, J., dissenting).
38. *Id*. at 286.

UNITED STATES V. VON'S GROCERY CO. (1966).[39] On January 25, 1960, Von's and Shopping Bag Food Stores agreed to merge effective March 28, 1960. Von's operated 28 supermarkets in the Los Angeles area with total annual sales of approximately $85 million, yielding an average of approximately $3 million in sales per store. Shopping Bag operated 36 supermarkets in the area with total annual sales of approximately $79 million for an average of approximately $2.1 million in sales per store. In 1958, Von's ranked third and Shopping Bag Food Stores fifth in terms of total sales by grocery stores in the Los Angeles metropolitan area; Von's had approximately a 4.7% share and Shopping Bag approximately a 4.2% share. After the merger, the combined company would be the largest retail grocery chain in the Los Angeles area with a share of 8.9%.[40]

On March 25, 1960, three days before the effective date of the merger, the Department of Justice filed a civil complaint charging that the proposed merger violated Section 7 of the Clayton Act. The complaint alleged that the acquisition would substantially lessen competition in the purchase, distribution, and sale of groceries and related products in the Los Angeles area. The complaint also alleged that Von's competitive advantage over smaller sellers of groceries might be enhanced by the merger and that independent retailers might be deprived of a fair opportunity to compete with the combined firm. The government sought a preliminary injunction to block the closing pending an adjudication of the merits and a permanent injunction to block the transaction altogether.

The Department did not fare well in the district court. On March 28, the court denied the Department's application for a temporary restraining order (TRO) and allowed the merger to proceed. On June 3, 1960, the court denied the government's application for a preliminary injunction to require Von's and Shopping Bag to be operated as separate entities pending trial of the action. On December 15, the court denied the Department's motion for summary judgment, and on September 14, 1964, following a trial on the merits largely on a stipulated record, the court found for the defendants and dismissed the complaint.

Since the parties agreed both that the retail sale of groceries and related products was the relevant product market and that the Los Angeles metropolitan area was the

39. 384 U.S. 270 (1966), *rev'g* 233 F. Supp. 976 (S.D. Cal. 1964) (Blue Book No. 1510).

40. *Von's*, 233 F. Supp. at 980. The Supreme Court found the combined share to be 7.5% and the combined firm to be the second largest grocery retailer in the Los Angeles area. *See Von's*, 384 U.S. at 272.

relevant geographic market,[41] the only question for the court was the merger's probable effect on competition. The district court found that the market was characterized by ease of entry and was very competitive:

> In 1960, the approximately 4,800 stores in the area were operated by 4,000 separate concerns. During 1960, 128 new "single outlet" stores opened. The leading 20 chains opened 67 new stores in 1960 against 171 by smaller chains and single store operators. While the 10 leading chains accounted for 43.6%, the remainder, including 3,818 single store operators, accounted for 56.4% of the sales in the area in 1960. Another indication of the competitive situation is the fact that Shopping Bag's gross increased while its profits decreased. The witness, Hayden, president of the company, testified that this was occasioned by competition as well as the need for experienced executives.[42]

The court also noted the role of cooperatives, which allowed smaller stores to achieve the same volume purchasing discounts as the larger chains and which had open membership. Overall, the court found that the average shopper had from two to ten competing stores within convenient distance to shop and that competition, even after the merger, had driven prices down "about as far as possible."[43] The court concluded that the acquisition would have no likely adverse effect on competition:

> The government argues that over-all competition has been substantially reduced by the merger, but the proof falls short of establishing such to be the case. In fact, the figures relied upon by the government tend to establish to the contrary. Again it is repeated that in 1960 the approximately 4,800 stores in the area were operated by 4,000 separate concerns. The merger here did not materially change that situation. It did not increase or decrease competition store for store with any grocer, single store, or chain, since the acquired stores continued as before. As between stores, only a few of those of Von's and Shopping Bag were in direct competition since generally each company's stores were in different localities of the area. A few did compete directly. Apparently the reason for the failure of the evidence to pinpoint a decrease in competition was because there was actually no decrease.[44]

The government appealed directly to the Supreme Court under the Expediting Act. In a six-to-two decision, the Supreme Court reversed and remanded with instructions to the district court to enter a divestiture order. In an opinion by Justice Hugo L. Black, the Court quickly summarized the facts supporting its conclusion. Von's and Shopping Bag were respectively the third and sixth largest retail grocery stores in the Los Angeles area. Together, they became the second largest retail grocery retailer in the Los Angeles area, with a share of 7.5%. Prior to the merger,

41. *Id*. at 979.
42. *Id*. at 982.
43. *Id*. at 985.
44. *Id*. at 983-84.

both were "rapidly growing" and "highly successful."[45] At the same time, the number of owners operating single stores in the market had decreased from 5,365 in 1950 to 3,818 in 1961, and finally to 3,590 in 1963. Many of the single stores were being acquired by chains. Between 1949 and 1958, nine of the top twenty chains acquired 126 stores from their smaller competitors. Overall, the number of chains with two or more stores increased from 96 in 1953 to 150 in 1962. Although not part of the record, Black noted a table prepared by the FTC and included in the government's reply brief that mergers and acquisitions had "continued at a rapid rate since the merger."[46] Black concluded: "These facts alone are enough to cause us to conclude contrary to the District Court that the Von's-Shopping Bag merger did violate § 7. Accordingly, we reverse."[47]

Black's opinion makes clear that the majority read the purpose of the Clayton Act following the Celler-Kefauver amendments was to arrest the "'rising tide' toward concentration into too few hands and to halt the gradual demise of the small businessman."[48] Although Black mentioned in passing that the combined company accounted for 7.5% of the grocery sales in the Los Angeles area, he never used this figure in his analysis. Nor did Black mention any concentration ratios in his opinion or make reference to, much less employ, the *PNB* presumption. To the majority, the key fact was that the number of single store operators was declining. While some single operators may have exited the market altogether because of inefficiency or mismanagement, others were acquired by larger chains.[49] Black concluded:

> It is enough for us that Congress feared that a market marked at the same time by both a continuous decline in the number of small businesses and a large number of mergers would slowly but inevitably gravitate from a market of many small competitors to one dominated by one or a few giants, and competition would thereby be destroyed. Congress passed the Celler-Kefauver Act to prevent such a destruction of competition.[50]

Justice Potter Stewart, joined by Justice John M. Harlan, issued a vigorous dissent. Stewart noted that *Brown Shoe* had established two fundamental principles in

45. *Von's*, 384 U.S. at 272.

46. *Id*. at 274. The table, reprinted as Appendix 2 to the majority opinion, show that 134 stores had been acquired by twelve companies between 1961 and 1964. *See id.* at 280.

47. *Id*.

48. *Id*. at 276; *see id.* at 275 ("[T]he basic purpose of the 1950 Celler-Kefauver Act was to prevent economic concentration in the American economy by keeping a large number of small competitors in business.") (footnote omitted).

49. Using the numbers supplied in the Court's opinion, there were 547 fewer single store operators in the market in 1961 than there were in 1950. During roughly the same time period (1949 to 1948), nine of the top twenty chains acquired 126 stores from their smaller competitors. Assuming that these nine companies accounted for most of the acquisitions and assuming no entry into the market (certainly not correct), in the neighborhood of 75% of the single store operators shut down their stores rather than sold them to an acquirer.

50. *Id*. at 278.

applying Section 7: acquisitions were to be judged light of economic context of their industry and contemporary economic theory, and the purpose of Section 7 is to protect competition, not competitors. But, Stewart observed, the majority performed no analysis of the competitive effects of the acquisition and instead applied Section 7. Expanding upon the district court's analysis, Stewart concluded that any competitive analysis of Los Angeles retail grocery sales would reveal vigorous competition, an unconcentrated market, no trend forward concentration, considerable new entry, and substantial movement over time in the identities of many of the larger chains. Moreover, Stewart noted that, for the most part, Von's stores were located in the southern and western areas of Los Angeles and that Shopping Bag stores were located in the northern and eastern areas. Where Von's and Shopping Bag stores did compete directly, the record showed that there were also other chain stores and several smaller stores competing for the patronage of the same customers.[51] With respect to small grocers, Stewart concluded that they were in need of no protection. Stewart observed that they were thriving in Los Angeles, cooperative purchasing groups ensured that they could purchase at prices competitive with the large chains, and the most aggressive competitors were frequently single store operators. Stewart also observed that there are no substantial barriers to entry into the Los Angeles retail grocery market and that numerous new small firms had entered. Stewart pointedly noted that the majority did not and could not invoke the *PNB* presumption: "[T]he circumstances of the present merger fall far outside the simplified test established by that case for precisely the sort of merger here involved."[52] Stewart would have sustained the dismissal of the case by the district court.

NOTES

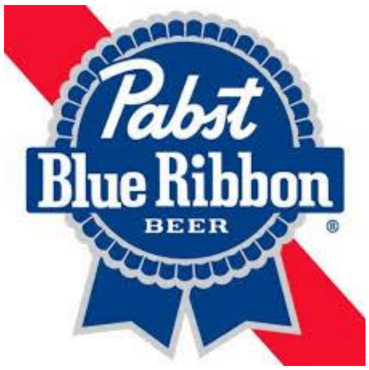
1. *Von's* is considered by most to be the poster child for aggressive antitrust restrictions on low market share horizontal transactions in unconcentrated markets. Interestingly, the argument in the Supreme Court for this aggressive position was made by Richard A. Posner.

UNITED STATES v. PABST BREWING CO. (1966).[53] On July 30, 1958, Pabst Brewing Company acquired the assets and business of Blatz Brewing Company from Schenley Industries, Inc. in a deal valued at about $14.5 million.[54] At the time of the acquisition, Pabst ranked tenth in sales of beer in the United States with 3.02% of the nationwide beer sales and operated four breweries: Milwaukee, Wisconsin, Peoria Heights, Illinois, Newark, New Jersey, and Los Angeles, California. Blatz ranked

51. *Id*. at 295-96 (Stewart, J., dissenting).
52. *Id*. at 302 (footnote omitted).
53. 384 U.S. 546 (1966), *rev'g* 233 F. Supp. 475 (E.D. Wis. 1964) (Blue Book No. 1479).
54. *Pabst Brewing Acquires Blatz From Schenley for 14.5 Million*, N.Y. TIMES, July 31, 1958, at 33.

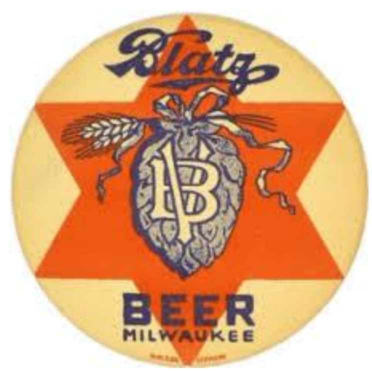
eighteenth with 1.47% of nationwide bee sales and operated one brewery in Milwaukee, Wisconsin. Following the acquisition, the Blatz brewery was closed and Blatz brand beer was brewed in the four Pabst plants.

A little over a year later, on October 1, 1959, the Department of Justice filed a civil complaint charging that the acquisition violated Section 7 of the Clayton Act.



The complaint alleged that the effect of the acquisition may be substantially to lessen competition or to tend to create a monopoly in the production and sale of beer in the United States, the State of Wisconsin, and the three state area of Wisconsin, Illinois and Michigan and sought a permanent injunction ordering Pabst to divest Blatz. Before trial, the parties stipulated that the relevant product market was the production, sale and distribution of beer and that the continental United States was a relevant geographic market. The issues for trial were whether the State of Wisconsin and the three state area of Wisconsin, Illinois and Michigan were also relevant geographic markets and whether the acquisition entailed a reasonable probability of a substantial lessening of competition in any properly defined relevant market.

The trial began on January 27, 1964. At 3:45 pm the next day, after offering 260 exhibits and reading portions of deposition testimony, the government rested.[55] Pabst then moved to dismiss under Rule 41(b) of the Federal Rules of Civil Procedure for failure to prove a prima facie case. After a full briefing and a hearing, the district court granted the motion and dismissed the complaint.



First, the district court held that the government failed to prove that either Wisconsin or the three state area of Wisconsin, Illinois and Michigan constituted a proper relevant market in which to analyze the competitive effects of the transaction. The government had argued that Wisconsin was a relevant market because (1) prior to the acquisition, the most intense competition between Pabst and Blatz existed in Wisconsin, and therefore the impact of the acquisition would be most severe in that state, (2) Wisconsin's standing in the beer industry made it an appreciable segment of the

55. The district court was clearly perturbed by this development, since the government had told the court repeatedly that it intended to call 71 live witnesses at trial, resulting in several reschedulings to accommodate a long trial. Two days before the trial was to start, the government changed its position and told the court that it would take no more than two trial days to present its case and that it would offer no witnesses. *See Pabst Brewing*, 233 F. Supp. at 478-80.

market, (3) each state was a separate relevant market, since each state has its own regulations affecting the beer industry, (4) Blatz prices were higher in Wisconsin than in any other state, and (5) Wisconsin's high per capita consumption of beer, high consumption of draught beer and large number of small, locally owned breweries made it a unique market. The government made analogous arguments for a Wisconsin-Illinois-Michigan relevant geographic market. The court, after a detailed analysis distinguishing the precedent cited by the government, rejected the two proposed markets because they did not reflect the "commercial realities" of the beer industry. Pabst and Blatz competed throughout most of the continental United States and nothing makes Wisconsin or the three state area distinct from the national beer market.

Second, the district court held that the government failed to prove a prima facie case of likely anticompetitive effects in the continental United States beer market, the only geographic market remaining in the case. The court held that the national market share of the combined company—4.79% in 1959 and 5.83% in 1961—was not by itself sufficient to predicate an "undue percentage of the relevant market" under the *PNB* presumption.[56] Moreover, the court found that the government failed to prove any trend toward concentration that Section 7 was intended to prevent. Significantly, after reviewing the precedent, the court held that only a trend toward concentration for Section 7 purposes was not merely a reduction in the number of competitors, but a reduction due to a history of acquisitions.[57] While the court acknowledged that the number of breweries had declined in the United States from 750 in 1934, to 264 in 1957, and finally to 229 in 1961, "[s]o far as the record discloses, not a single merger or acquisition in the beer industry preceded the acquisition of Blatz by Pabst and the decrease in the number of breweries resulted from the play of natural economic forces."[58] In light of the government's failure to prove a prima facie case of anticompetitive effect, the district court dismissed the complaint.

The government appealed directly to the Supreme Court under the Expediting Act. Although all nine justices voted to reverse, three of justice concurred only in the result.

Justice Black, the author of the majority opinion in *Von's*, again wrote the majority decision. First, Black held that the district court erred in failing to find that the government did prove a prima facie case that Wisconsin and Wisconsin-Michigan-Illinois were relevant geographic markets in which to assess the competitive effects of the transaction. Black gave short shrift to the question of geographic market definition. To Black, Section 7's requirement that the plaintiff prove a reasonable probable anticompetitive effect "in any section of the country"

56. *Id*. at 491.
57. *Id*. at 492.
58. *Id*. at 493.

did not mean that the plaintiff had to prove an economically meaningful geographic market:

> The language of this section requires merely that the Government prove the merger may have a substantial anticompetitive effect somewhere in the United States "in *any* section" of the United States. This phrase does not call for the delineation of a "section of the country" by metes and bounds as a surveyor would lay off a plot of ground. The Government may introduce evidence which shows that as a result of a merger competition may be substantially lessened throughout the country, or on the other hand it may prove that competition may be substantially lessened only in one or more sections of the country. In either event a violation of § 7 would be proved. Certainly the failure of the Government to prove by an army of expert witnesses what constitutes a relevant "economic" or "geographic" market is not an adequate ground on which to dismiss a § 7 case. Congress did not seem to be troubled about the exact spot where competition might be lessened; it simply intended to outlaw mergers which threatened competition in any or all parts of the country. Proof of the section of the country where the anticompetitive effect exists is entirely subsidiary to the crucial question in this and every § 7 case which is whether a merger may substantially lessen competition anywhere in the United States.[59]

Without further analysis, Black sustained the government's proof of Wisconsin and Wisconsin-Michigan-Illinois as relevant "sections of the country" in which to analyze the competitive effects of the transaction.

Turning to competitive effects, Black reported the figures in the following two tables.

Pabst/Blatz

	Pabst		Blatz		Combined	
Section of the country	Share	Rank	Share	Rank	Share	Rank
Continental U.S. (1958)		10		18	4.49%	5
Continental U.S. (1961)					5.83%	3
Wis.-Mich.-Ill.	5.48%	7	5.84%	6	11.32%	
Wisconsin (1958)		4		1	23.95%	1
Wisconsin (1961)					27.41%	

59. *Pabst Brewing*, 384 U.S. at 549-50 (emphasis in original; internal citation and footnote omitted).

Trend toward Concentration

	United States		Wis.-Mich.-Ill.		Wisconsin	
	Breweries	10-FCR	Breweries	8-FCR	Breweries	4-FCR
1934	714					
1955					77	
1957		45.06%	104	58.93%		47.74%
1961	229	52.60%	86	67.65%	54	58.62%

Black concluded:

> These facts show a very marked thirty-year decline in the number of brewers and a sharp rise in recent years in the percentage share of the market controlled by the leading brewers. If not stopped, this decline in the number of separate competitors and this rise in the share of the market controlled by the larger beer manufacturers are bound to lead to greater and greater concentration of the beer industry into fewer and fewer hands. . . . In accord with our prior cases, we hold that the evidence as to the probable effect of the merger on competition in Wisconsin, in the three state area, and in the entire country was sufficient to show a violation of § 7 in each and all of these three areas.[60]

In reaching this result, Black rejected the district court's view that Section 7 was only concerned about a trend toward concentration due to mergers:

> Congress, in passing § 7 and in amending it with the Celler-Kefauver Anti-Merger amendment, was concerned with arresting concentration in the American economy, whatever its cause, in its incipiency. To put a halt to what it considered to be a "rising tide" of concentration in American business, Congress, with full power to do so, decided "to clamp down with vigor on mergers." . . . We hold that a trend toward concentration in an industry, whatever its causes, is a highly relevant factor in deciding how substantial the anti competitive effect of a merger may be.[61]

Justice Harlan, joined by Justice Stewart, concurred in the result.[62] While Harlan agreed that the government had made out a prima facie case that Wisconsin and Wisconsin-Michigan-Illinois are proper "sections of the country" in which to analyse the Pabst/Blatz merger, they disagreed with Black that a "section of the country" within Section 7 could be something other than a meaningful economic market. Here, Harlan believed that the government had satisfied its burden of proof by presenting evidence that that "significant barriers exist to prevent outside brewers from entering

60. *Id*. at 551-52 (footnote omitted).
61. *Id*. at 552-53 (citation omitted).
62. Recall that Justice Stewart, joined by Justice Harlan, dissented in *Von's*.

the Wisconsin market as effective competitors to those brewers already marketing beer there."[63] Contrary to the majority, Harlan and Stewart would have sustained the district court's finding that failed to prove a prima facie case of the requisite anticompetitive effect in the continental United States market.

Justice Abe Fortas also concurred in result, agreeing with Harlan and Stewart that proof of an economically meaningful relevant geographic market is an essential element of a Section 7 case: "Unless both the product and the geographical market are carefully defined, neither analysis nor result in antitrust is likely to be of acceptable quality."[64]

UNITED STATES V. GENERAL DYNAMICS CORP. (1974).[65] In the ten or so years since *Philadelphia National Bank*, the *PNB* presumption had become conclusive. Moreover, given the flexibility of the courts in defining markets coupled with a strong tendency to accept the government's alleged markets, the *PNB* presumption could be triggered in almost every government case. As a practical matter, horizontal acquisitions by large companies even of small competitors became per se unlawful.

In 1974, the Supreme Court dramatically changed the course of horizontal merger analysis with its decision in *General Dynamics*. Not only did the Court return the *PNB* presumption to its rebuttable roots, the Court also brought a new emphasis to the importance of non-market share factors probative of the competitive consequences of horizontal acquisitions. Notwithstanding market shares of 15.1% and 8.1% in the relevant market and a rapidly declining number of industry participants—more than enough to invoke the rule of presumptive illegality under *Von's* and the other post-*Philadelphia National Bank* cases—the Court permitted one coal producer to acquire a controlling interest in another coal producer. The Court found that the acquired company's coal reserves were already committed by long-term contracts to electric utilities at predetermined prices. Lacking a supply of uncommitted coal that could be sold in the future at terms and conditions of the acquired firm's choosing, the Court found that acquired firm no longer was a significant independent competitive force which could affect prices and output in the marketplace. Accordingly, not only was the presumption of likely anticompetitive effect unreliable in this case, on the evidence before it the Court found no likelihood that the acquisition would substantially lessen competition in the future.

In 1954, Material Service Corporation acquired 10 percent of the stock of United Electric Coal Companies, a coal strip and open-pit miner in Illinois and Kentucky. Material was a large midwest building materials producer and supplier of building materials, concrete and limestone. Through its wholly-owned mining subsidiary Freeman Coal Mining Corporation, Material operated four deep coal mines in

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63. *Pabst Brewing*, 384 U.S. at 558 (Harlan, J., concurring in result).
64. *Id*.at 562 (Fortas, J., concurring in result).
65. 415 U.S. 486 (1974), *aff'g* 341 F. Supp. 534 (N.D. Ill. 1972) (Blue Book No. 1861).

southern and central Illinois. Material had never operated a strip mine and lacked the experience and experience to do so. During the next several years, Material increased its stock ownership in United Electric and by 1959 Material had acquired more than 34 percent of United Electric's outstanding stock. This stock interest provided Material with effective control of United Electric and from 1959 forward Freeman and United Electric were operated under common control.

Several months after the 1959 management reorganization, Material was acquired by General Dynamics Corporation. At the time, General Dynamics was a large diversified company with the bulk of its revenues coming from sales of aircraft, communications and marine products to various government defense agencies. General Dynamics acquired a majority interest in Material as part of a diversification program to enter non-defense commercial businesses. In the early 1960s General Dynamics continued to increase its holding in United Electric, and in 1966 obtained the remaining outstanding stock through a tender offer and squeeze-out merger.

Although all of these developments had been publicly disclosed—indeed, the Justice Department had been furnished information about Material's stock interests in United Electric in 1960—it was not until 1967 that the Antitrust Division commenced its Section 7 action against the Material's acquisition of effective control and against General Dynamics solidification of that control. The action sought permanent relief in the form of an order requiring General Dynamics to divest its interest in United Electric.

The government approached the case as a straightforward horizontal merger. Both Material and United Electric sold coal in Wisconsin, Illinois, Kentucky, Iowa, and Missouri. Indeed, about half of the coal sold by each company was shipped to common customers, virtually all of which were electric utilities. The complaint alleged that the relevant product market was coal, and that the relevant geographic market was the State of Illinois, or alternatively, the Eastern Interior Coal Province Sales Area (which included Illinois and Indiana, as well as parts of Kentucky, Tennessee, Iowa, Minnesota, Wisconsin, and Missouri), one of four major coal producing regions in the United States.

The government sought to prove that the acquisitions posed the requisite threat to competition for a Section 7 violation through the *PNB Bank* presumption. In 1959, Material accounted for 15.1% of Illinois coal production and 7.6% of the coal production in the Eastern Interior Coal Province, and was the second largest coal producer in each of these areas. United Electric's share was 8.1% in Illinois and 4.8% in the Eastern Province. By the time of trial in 1967, Material's coal production had dropped in Illinois to 12.9% and in the Eastern Province to 6.5%. Meanwhile, United Electric's share had increased slightly in Illinois to 8.9% and decreased slightly in the Eastern Province to 4.4%. The combination of Material and United Electric became the coal producer in Illinois in 1959 and the second largest in the Eastern Province.

General Dynamics-Material/United Electric

Market	General Dynamics Share Rank	United Electric Share Rank	Combined Firm Share Rank	n-CR	Change Pts Δ%	Conc. Trend
			1959			
Illinois	15.1% 2	8.1% 5	23.2% 1	2: 37.8% 4: 54.5 10: 84.0	7.7 22.4%	Yes
Eastern Interior Coal Province	7.6% 2	4.8% 6	12.4% 2	2: 29.6% 4: 43.0 10: 65.5	4.8 14.5%	Yes
			1967			
Illinois	12.9% 2	8.9% 6	21.8% 2	2: 37.8% 4: 54.5 10: 84.0	7.7 22.4%	Yes
Eastern Interior Coal Province	6.5% 5	4.4% 9	10.9% 2	2: 29.6% 4: 43.0 10: 65.5	4.8 14.5%	Yes

Rank: Market rank
Pts: Point change in the n-CR
Conc. Trend: Trend toward concentration
n-CR: N-firm concentration ratio
Δ%: Percentage change in the n-CR

At trial, the primary issues emerged: (1) the propriety of "coal" as the relevant product market; (2) the propriety of Illinois and the Eastern Interior Coal Sales Areas as the relevant product markets; and (3) the probability of any lessening of competition in the alleged relevant markets as a result of the acquisition of control over United Electric.

The district court rejected the government's proposed product market definition. It held, after an extensive discussion of the evidence, that interfuel competition between coal, oil, natural gas, and nuclear energy for electric utility supply contracts required that the relevant line of commerce for testing the competitive effect of the transaction to be the "energy market." The court also rejected the government's contention that coal was a relevant submarket, holding that such a submarket ignores what the buyers (almost exclusively electric utilities) actually do, that is, compare various forms of energy in making their purchasing decisions. The district court reasoned that if the competition between glass and metal containers was sufficient to include them both in the same relevant market, as the Supreme Court did in

Continental Can over the opposition of the defendants, then coal and other forms of energy sources should also be included in the same relevant market.[66]

The district court also rejected the government's proposed geographic market definitions. The court observed that the government's proposed markets were based on production patterns, not consumption patterns, and that no customer of either Material or United Electric purchased, or that any producer sold, coal throughout either of the government's proposed markets. Instead, the court found that the cost of transporting coal may approach 30% to 40% of its delivered price and is therefore a critical factor influencing the choice of coal suppliers that can realistically compete for a given utility's business. The evidence showed that mines located in Illinois, Indiana and western Kentucky long had been grouped into Freight Rate Districts designated by the Interstate Commerce Commission and that different rate districts serve a different and distinct geographic area.[67] Consequently, the court held that the relevant geographic markets in this case were eight Freight Rate Districts. The court also identified two individual customers to be relevant geographic markets. Commonwealth Edison, which has multiple facilities throughout the region, annually consumed a quantity of coal equal to the combined production of several freight rate districts and in fact purchases throughout multiple districts. Commonwealth Edison also had the most extensive commitment to the use of nuclear energy and had embarked on an air pollution reduction program that called for increasing use of nuclear energy, gas and oil. Similarly, the Metropolitan Chicago Intestate Air Quality Control Region had adopted air pollution control regulations that prohibited the burning of coal with high levels of sulfur content.

Although the district court found that the government's case was fatally deficient for failure to establish its alleged relevant markets, the district court further found that even if the government's proposed markets had been adopted the challenge would fail because of "the Government's failure to show that a substantial lessening of competition resulted from the United Electric-Freeman combination" in any product or geographic market.[68] This determination rested on three findings:

1. The decline in the number of coal producers in Illinois and in the Eastern Interior Coal Province occurred, not because of acquisitions by others, but as the inevitable result of the declining demand for coal as an energy source. This reduction in demand also was reflected in the fact that the combined company produced less coal in 1967 than it did in 1959. Accordingly, the court observed, the instant case is distinguishable from trend toward concentration resulting from mergers and acquisitions

66. *General Dynamics*, 341 F. Supp. at 555-56 (*citing as authority* United States v. Continental Can Co., 378 U.S. 441 (1964)).

67. The history and functions of the Freight Rate Districts in issue are discussed in Ayrshire Collieries Corp. v. United States,335 U.S. 573, 576 (1949).

68. *General Dynamics*, 341 F. Supp. at 557.

found in *Philadelphia National Bank* and *Von's* which justified preventing even slight increases in concentration.

2. Material and United Electric were "predominantly complementary in nature." United Electric was a strip mining company with no experience in deep mining nor any likelihood in acquiring it, while Material was a deep mining company with no experience or expertise in strip mining. Moreover, the mine and coal reserves of Material and United Electric were located in different freight rate districts. Finally, United Electric does not and cannot produce coal that meets the sulphur limits of the Metropolitan Chicago Intestate Air Quality Control Region. The only common sales in 1965-1967—the period chosen by the government for analysis—where to Commonwealth Edison.

3. The bulk of United Electric's existing reserves were either depleted or committed under long-term supply contracts and the prospect of obtaining new reserves was remote. Material had to use coal from one of its mines to discharge United Electric's obligations to Illinois Power Company when United Electric found its reserves inadequate. Several of United Electric's other long-term contracts were backed up by Material's reserves and could not have been obtained without this support. Nor could United Electric find new reserves. Evidence at trial, including testimony by government experts, showed that economically minable strip mine reserves were not presently available. Consequently, United Electric's ability to be a competitive force and affect the market price of coal was severely limited and steadily diminishing.

The district court concluded that, under these circumstances, the combination's continuation would not adversely affect competition nor would divestiture benefit competition. The court dismissed the government's complaint.

The government appealed directly to the Supreme Court under the Expediting Act. It sought to revive coal as a relevant line of commerce for antitrust analysis through a largely mechanical application of the *Brown Shoe* submarket indicia. Coal, the government argued, is recognized by the industry, governmental authorities, and the public as a separate economic entity. It is physically different from other forms of energy sources, its heat producing qualities are unique, as are its mining and production techniques. Coal is also sold at a delivered price per BTU significantly lower than other fuels, which makes it the fuel of choice for consumers—especially stream-driven electric utilities—for which fuel is the principal cost of production even in the face of small or temporary reductions in the price of other fuels such as oil or gas. Accordingly, while energy may have been a relevant product market in the instant case, coal by itself was also a relevant submarket.

The district court's error in rejecting the government's proposed geographic markets, the government argued, was the reverse of its error in rejecting the government's proposed product market. In choosing energy as the exclusive line of commerce, the trial court ignored the existence of narrower, relevant submarkets; in adopting the narrower Freight Rate Districts as geographic markets, the court ignored the existence of broader geographic markets which also constituted relevant "sections of the country" in which to analyze the effect of the combination.

Finally, the government maintained that its proof at trial made out a *prima facie* case against the combination. The government noted that the Court had found mergers *prima facie* unlawful in cases involving smaller market shares that those of Material and United Electric in either the government's proposed relevant markets, at least where, as here, concentration had been rapidly increasing. Moreover, the district court's finding that United Electric's coal reserves were inadequate to make it an effective competitor in the future was flawed, the government argued, because it rested on the same economic premise as the "failing firm" defense and must be tested against the same standard. This includes a showing that the there was no alternative to the challenged acquisition to prolonging United Electric's life, including a sale to a less anticompetitive purchaser. Here, there was no finding that United Electric's reserves were so depleted that it was about to go out of business either in 1959 or 1967 but for the acquisitions in issue, that United Electric could not have acquired additional strip reserves after 1959 or 1967, that it could not have acquired deep-mining expertise and deep mining reserves if it had not become affiliated with Material, or that Material was the only available purchaser with access to additional coal reserves.

Interestingly, although the government devoted the bulk of its brief to the market definition questions and the application of the *PNB* presumption, the defendants largely ignored these issues and focused instead on the ultimate question of whether the evidence as a whole, especially United Electric's low reserves, supported the district court's conclusion that the combination did not threaten to harm competition. In a well-placed footnote, the defendants also observed that the trial judge, Chief Judge Edwin A. Robson of the Northern District of Illinois was a distinguished antitrust jurist, having served as the coordinating judge in the civil electrical equipment cases, and was one of the principal authors of the Manual for Complex and Multidistrict Litigation.[69] The defendants also pointed out that, despite a presumably diligent search, the government was unable to find a single customer to present at trial that thought the combination had led, or was likely to lead in the future, to a substantial lessening of competition in any market.

In a five-to-four decision, the Supreme Court affirmed the dismissal of the case. Justice Potter Stewart, the author of the dissents in *Alcoa (Rome Cable)* and *Von's* who also joined Harlan's special concurrence in *Pabst*, wrote the majority opinion. Consistent with his arguments for the need of careful economic analysis to predict the competitive effect of a merger, Stewart focused on how the *PNB* presumption

69. Brief for Appellees at 5 n.3, United States v. General Dynamics Corp., 415 U.S. 486 (1974).

was both triggered *and* rebutted in the case. To this end, despite the attention paid in the government's brief to the issues of market definition, Stewart did not dwell on the question but merely accepted arguendo the government's proposed product and geographic markets and market share statistics. Stewart also readily accepted the government's view that, within these markets, the *PNB* predicates of "undue percentage share" and "a significant increase in concentration" were satisfied, thus triggering the PNB presumption of anticompetitive effect.[70]

But recalling *Brown Shoe's* caution that statistical evidence of market share and concentration, while of great significance, were not conclusive, Stewart held that it was necessary to assess the evidence of the "structure, history and probable future" of the coal industry in order to determine the applicability of the presumption and ultimately the likelihood of an anticompetitive effect from the acquisition. After embarking on a lengthy summary of the district court's findings, Stewart observed that the *PNB* presumption implicitly assumed that "a company that has maintained a certain market share in the recent past will be in a position to do so in the immediate future":[71]

> Thus, companies that have controlled sufficiently large shares of a concentrated market are barred from merger by § 7, not because of their past acts, but because their past performances imply an ability to continue to dominate with at least equal vigor. In markets involving groceries or beer, as in *Von's* and *Pabst*, statistics involving annual sales naturally indicate the power of each company to compete in the future. Evidence of the amount of annual sales is relevant as a prediction of future competitive strength, since in most markets distribution systems and brand recognition are such significant factors that one may reasonably suppose that a company which has attracted a given number of sales will retain that competitive strength.[72]

Applied to the coal industry, Stewart concluded that a company's past ability to produce, as measured by its share of industry sales, is of "limited significance" in assessing its future ability to compete. For the most past, market shares based upon sales are locked in place at any point in time, representing not contemporaneous competition on the merits but rather the obligation to fulfill previously negotiated supply contracts. Therefore, the government's reliance on market shares based on historical sales to raise an inference of likely anticompetitive effect was unjustified.

Rather, since competition manifested itself more in rivalry for new long-term contracts, which in turn necessitated an uncommitted source of coal supply, Stewart observed that a better indicator of a firm's future competitive effectiveness is its share of uncommitted reserves of recoverable coal. The record revealed that United Electric's reserve position was very weak: while it ranked fifth among Illinois

70. *General Dynamics*, 415 U.S. at 494-95 nn.6-7.
71. *Id*. at 501.
72. *Id*.

producers in terms of annual production, it ranked tenth in reserve holdings with less than one percent of the reserves held by coal producers in Illinois, Indiana, and western Kentucky, having already depleted and closed many of its mines. Moreover, only about 8 percent of United Electric's reserves, representing roughly one-tenth of a percent of the three-state area industry reserves, were uncommitted. Given the weakness of United Electric as reflected in its uncommitted reserves, Stewart concluded that the district court was correct in finding that United Electric's acquisition and elimination as an independent participant in the marketplace would not substantially lessen competition.

Significantly, Stewart rejected the government's efforts to frame the analysis in terms of the "failing company" defense as the government had urged. Stewart noted that the failing company defense assumes that the challenged acquisition will lessen competition in the marketplace, but takes a "lesser of two evils" approach in permitting the transaction to go forward when the only available alternative is the failure of the company and its exit from the market. Accordingly, if the company will not imminently fail or if other alternatives to failure are available—especially the sale of the failing firm to a less anticompetitive purchaser—the defense cannot be sustained. Stewart observed that in this case, however, the defendants did not seek to justify an anticompetitive merger, but rather sought to show that the government's statistical showing of prima facie illegality was insufficient because it did not account for the inability of United Electric to compete effectively for long-term electric utility supply contracts in the future either with its own reserves or with reserves it could obtain in the absence of the challenged combination.

Justice Douglas, joined by Justices Brennan, White and Marshall, dissented. The dissent focused on the questions of product and geographic market definition, essentially adopting the government's analysis. Since the majority predicated its *PNB* analysis on the government's proposed markets, the dissent's conclusion that the government had proved its proposed markets served to establish the prima facie case. To the dissent, then, it only remained whether the defendants had succeeded in rebutting the *prima facie* case. Douglas would have found that they did not. Douglas would have treated the rebuttal in the nature of a failing firm defense as the government had urged. The viability of a failing firm defense is judged at the time of the acquisition. But the findings of the district court as to the weakened state of United Electric's coal reserves were as of the time of trial. Although no findings were made on the state of United Electric Reserves as of 1959, the time Material first gained effective control, 21 million tons of United Electric's 52 million tons of strip reserves existing at the time of time were committed in 1968, nine years after the challenged acquisition. Likewise, the finding that there were no economically available new strip reserves was made as of the time of trial; there was no finding that new strip reserves were not available in 1959 and the record demonstrated that several other companies made new acquisitions of strip reserves in the 1960s. Finally, Douglas questioned whether United Electric could have developed, contrary to the district court's finding, expertise in deep mining to be able to tap the 27 million tons of deep mining reserves it possessed in 1959. In any event, the existence of these deep reserves may have made United Electric (or at least these deep reserves) an attractive acquisition prospect to a company with which a combination posed less of a threat to competition. Since the requisite findings to make out a failing company defense were not made, the rebuttal of the government's *prima facie* case should have failed, at least on the record so far. Douglas would have remanded the case to the district court to assess the impact of the Material-United Electric combination on the Illinois and Province markets as of 1959.

NOTES

1. General Dynamics reflects a significant generational shift in the composition of the Court. Of the five members of the majority, not a single one other than Stewart was on the Court for any of the prior antitrust merger cases. On the other hand, with the exception of Marshall—who as the Solicitor General argued vigorously to block or dissolve the mergers in *Von's* and *Pabst*—all of the dissenting justices were present for all of the Court's merger antitrust decisions in the 1960s.

United States v. General Dynamics Corp. (1974)

	President	**Sworn In**	**Replaced**
Majority			
Potter Stewart (author)	Eisenhower	Oct. 14, 1958	Harold Burton
Warren E. Burger (C.J.)	Nixon	June 23, 1969	Earl Warren
Harry Blackmun	Nixon	June 9, 1970	Abe Fortas
Lewis F. Powell	Nixon	Jan. 7, 1972	Hugo Black
William Rehnquist	Nixon	Jan. 7, 1972	John M. Harlan
Minority			
William O. Douglas (author)	Roosevelt	Apr. 17, 1939	Louis Brandeis
William J. Brennan, Jr.	Eisenhower	Oct. 16, 1956	Sherman Minton
Byron White	Kennedy	Apr. 16, 1962	Charles E. Whittaker
Thurgood Marshall	Johnson	Oct. 2, 1967	Tom C. Clark

The following chart summarizes the votes from *Philadelphia National Bank* to *General Dynamics*.

PNB* to *General Dynamics

	***PNB* (6-2)**	***Alcoa* (6-3)**		***Von's* (6-2)**	***Pabst* (9-0)**		***GD* (5-4)**
Warren	m	m		m	m	Burger	m
Black	m	m		M	M	Powell	m
Douglas	m	M		m	c		D
Clark	m	m		m	m	Marshall	d
Harlan	D	d		d	sc	Rehnquist	m
Brennan	M	m		m	m		d
Stewart	d	D		D	sc		M
White	--	m		c	sc		D
Goldberg	sc	d	Fortas	--	sc	Blackmun	m

M Majority opinion author
m Joined majority opinion
c Regular concurrence
sc Special concurrence
D Dissent author
d Joined dissent

Given their positions in *PNB*, *Alcoa*, and *Von's*, Stewart and Harlan would have been predictable votes for finding no violation in *General Dynamics*, and Rehnquist's replacement of Harlan did not affect the vote of that seat. The Burger and Powell replacements of Warren and Douglas, respectively, were critical to the Court's change of attitude toward mergers, since the votes of those seats changed. Blackmun, who replaced Fortas, provided the fifth vote. It is not clear how Fortas would have voted if he remained on the Court.

2. Since *General Dynamics* lower courts increasingly have employed more detailed and flexible qualitative analysis (albeit with varying degrees of theoretical guidance) of the likely competitive effects of proposed horizontal mergers and acquisitions. While concentration statistics continue to be the primary basis on which to predict the future competitive effects of an acquisition, plaintiffs today bear more of a burden of demonstrating the probative value of these statistics. Courts have considered a wide variety of factors in assessing the ability of the simple market structure model to predict the likelihood that the acquisition in question will be anticompetitive, including the degree of concentration and the level of sophistication among buyers; volatility in the market share distribution (particularly any trend towards deconcentration); changing demand patterns; the degree of product heterogeneity within the relevant market; the extent of excess industry capacity; the existence of vigorous competition from smaller, but strong and growing, competitors; the ease of entry into the relevant market; volatility in supplier or new customer relationships; a history of innovation from different companies in the market; the financial health of either or both of the parties, the likelihood that the acquired firm will exit the market in the absence of an acquisition; any preacquisition

anticompetitive conduct by the parties; and postacquisition continuation of price competition in the market.

UNITED STATES v. BAKER HUGHES, INC.,
908 F.2d 981 (D.C. Cir. 1990)

Before RUTH B. GINSBURG, SENTELLE, and THOMAS, Circuit Judges.

CLARENCE THOMAS, Circuit Judge:

Appellee Oy Tampella AB, a Finnish corporation, through its subsidiary Tamrock AG, manufactures and sells hardrock hydraulic underground drilling rigs (HHUDRs) in the United States and throughout the world. Appellee Baker Hughes Inc., a corporation based in Houston, Texas, owned a French subsidiary, Eimco Secoma, S.A. (Secoma), that was similarly involved in the HHUDR industry. In 1989, Tamrock proposed to acquire Secoma.

The United States challenged the proposed acquisition, charging that it would substantially lessen competition in the United States HHUDR market in violation of section 7 of the Clayton Act, 15 U.S.C. § 18.[1] In December 1989, the government sought and obtained a temporary restraining order blocking the transaction. *See* Temporary Restraining Order, *United States v. Baker Hughes Inc.*, No. 89-03333 (D.D.C. Dec. 15, 1989). In February 1990, the district court held a bench trial and issued a decision rejecting the government's request for a permanent injunction and dismissing the section 7 claim. *See United States v. Baker Hughes Inc.*, 731 F. Supp. 3 (D.D.C. 1990). The government immediately appealed to this court, requesting expedited proceedings and an injunction pending appeal. We granted the motion for expedited briefing and argument, but denied the motion for an injunction pending appeal. The appellees consummated the acquisition shortly thereafter.

The basic outline of a section 7 horizontal acquisition case is familiar. By showing that a transaction will lead to undue concentration in the market for a particular product in a particular geographic area,[2] the government establishes a

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1. Section 7 prohibits mergers and acquisitions the effect of which "may be substantially to lessen competition, or to tend to create a monopoly." 15 U.S.C. § 18.

2. The parties in this case do not seriously contest the district court's definition of the relevant markets. The court defined the geographic market as the entire United States, *see* 731 F. Supp. at 5 6, and the relevant product as three types of HHUDRs: face drills ("jumbos"), long hole drills, and roof bolting drills, as well as associated spare parts, components, and accessories, and used drills. *See id.* at 4, 6 8.

Although the appellees quibble with the court's product market definition, they conclude that "the [district] court's product market definition presages its finding that the extent of present competition and ease of entry preclude finding a violation of Section 7." Brief for Appellees at 10 (emphasis added). If the appellees believe that the court's product market definition contributed to their victory, we see no reason to address their halfhearted and contradictory challenges to that definition.

presumption that the transaction will substantially lessen competition. *See United States v. Citizens & Southern Nat'l Bank,* 422 U.S. 86, 120-22, 95 S. Ct. 2099, 2118-19, 45 L.Ed.2d 41 (1975); *United States v. Philadelphia Nat'l Bank,* 374 U.S. 321, 363, 83 S. Ct. 1715, 1741, 10 L.Ed.2d 915 (1963). The burden of producing evidence to rebut this presumption then shifts to the defendant. *See, e.g., United States v. Marine Bancorporation,* 418 U.S. 602, 631, 94 S. Ct. 2856, 2874-75, 41 L.Ed.2d 978 (1974); *United States v. General Dynamics Corp.,* 415 U.S. 486, 496-504, 94 S. Ct. 1186, 1193-97, 39 L.Ed.2d 530 (1974); *Philadelphia Bank,* 374 U.S. at 363, 83 S. Ct. at 1741. If the defendant successfully rebuts the presumption, the burden of producing additional evidence of anticompetitive effect shifts to the government, and merges with the ultimate burden of persuasion, which remains with the government at all times. *See Kaiser Aluminum & Chem. Corp. v. FTC,* 652 F.2d 1324, 1340 & n.12 (7th Cir. 1981).

By presenting statistics showing that combining the market shares of Tamrock and Secoma would significantly increase concentration in the already highly concentrated United States HHUDR market, the government established a prima facie case of anticompetitive effect.[3] The district court, however, found sufficient evidence that the merger would not substantially lessen competition to conclude that the defendants had rebutted this prima facie case. The government did not produce any additional evidence showing a probability of substantially lessened competition, and thus failed to carry its ultimate burden of persuasion.

In this appeal, the government assails the court's conclusion that the defendants rebutted the prima facie case. Doubtless aware that this court will set aside the district court's findings of fact only if they are clearly erroneous, *see* Fed. R. Civ. P. 52(a), the government frames the issue as a pure question of law, which we review de novo. The government's key contention is that the district court, which did not expressly state the legal standard that it applied in its analysis of rebuttal evidence, failed to apply a sufficiently stringent standard. The government argues that, as a matter of law, section 7 defendants can rebut a prima facie case *only by a clear showing that entry into the market by competitors would be quick and effective.* Because the district court failed to apply this standard, the government submits, the

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3. From 1986 through 1988, Tamrock had an average 40.8% share of the United States HHUDR market, while Secoma's share averaged 17.5%. 731 F. Supp. at 6. In 1988 alone, the two firms enjoyed a combined share of 76% of the market. (The district court inaccurately calculated this figure as 66%. *See id.* at 10; Brief for Appellant at 10 n. 10; Brief for Appellees app. A.) The acquisition thus has brought about a dramatic increase in the Herfindahl-Hirschman Index (HHI)—a yardstick of concentration—for this market. The Department of Justice's Merger Guidelines characterize as "highly concentrated" any market in which the HHI exceeds 1800. *See* United States Dep't of Justice, Merger Guidelines § 3.1 (June 14, 1984), *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,103, at 20,561-64 (1988). This acquisition has increased the HHI in this market from 2878 to 4303. Brief for Appellant at 5 n. 3, 12 (calculated from 1986-1988 figures; *see* 731 F. Supp. at 6).

court erred in concluding that the proposed acquisition would not substantially lessen future competition in the United States HHUDR market.

We find no merit in the legal standard propounded by the government. It is devoid of support in the statute, in the case law, and in the government's own Merger Guidelines. Moreover, it is flawed on its merits in three fundamental respects. First, it assumes that ease of entry by competitors is the *only* consideration relevant to a section 7 defendant's rebuttal. Second, it requires that a defendant who seeks to show ease of entry bear the onerous burden of proving that entry will be "quick and effective." Finally, by stating that the defendant can rebut a prima facie case only by a *clear* showing, the standard in effect shifts the government's ultimate burden of persuasion to the defendant. Although the district court in this case did not expressly set forth a legal standard when it evaluated the defendants' rebuttal, we have carefully reviewed the court's thorough analysis of competitive conditions in the United States HHUDR market, and we are satisfied that the court effectively applied a standard faithful to section 7.[4] Concluding that the court applied this legal standard to factual findings that are not clearly erroneous, we affirm the court's denial of a permanent injunction and its dismissal of the government's section 7 claim.

I.

It is a foundation of section 7 doctrine, disputed by no authority cited by the government, that evidence on a variety of factors can rebut a prima facie case. These factors include, but are not limited to, the absence of significant entry barriers in the relevant market. In this appeal, however, the government inexplicably imbues the entry factor with talismanic significance. If, to successfully rebut a prima facie case, a defendant *must* show that entry by competitors will be quick and effective, then other factors bearing on future competitiveness are all but irrelevant. The district court in this case considered at least two factors in addition to entry: the misleading nature of the statistics underlying the government's prima facie case and the sophistication of HHUDR consumers. These non-entry factors provide compelling support for the court's holding that Tamrock's acquisition of Secoma was not likely to lessen competition substantially. We have concluded that the court's consideration of these factors was crucial, and that the government's fixation on ease of entry is misplaced.

Section 7 involves *probabilities,* not certainties or possibilities.[5] The Supreme Court has adopted a totality-of-the-circumstances approach to the statute, weighing a

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4. Even if we found more impressive the argument that the district court did not clearly articulate the legal standard applicable to a section 7 rebuttal, it would remain open to us to affirm that court's judgment. *Cf. Nelson v. United States,* 838 F.2d 1280, 1285 (D.C. Cir. 1988) ("[W]e may affirm a trial court's decision on a basis not relied on by the district court where that ground finds support in the record.") (citation omitted).

5. *See Brown Shoe Co. v. United States,* 370 U.S. 294, 323, 82 S. Ct. 1502, 1522-23, 8 L.Ed.2d 510 (1962) ("Congress used the words '*may be* substantially to lessen competition' (emphasis supplied), to indicate that its concern was with probabilities, not certainties. Statutes

variety of factors to determine the effects of particular transactions on competition. That the government can establish a prima facie case through evidence on only one factor, market concentration, does not negate the breadth of this analysis. Evidence of market concentration simply provides a convenient starting point for a broader inquiry into future competitiveness; the Supreme Court has never indicated that a defendant seeking to rebut a prima facie case is restricted to producing evidence of ease of entry. Indeed, in numerous cases, defendants have relied entirely on non-entry factors in successfully rebutting a prima facie case.

In *United States v. General Dynamics Corp.*, 415 U.S. 486, 94 S. Ct. 1186, 39 L.Ed.2d 530 (1974), for instance, the Supreme Court rejected the government's argument that a merger between two leading coal producers would violate section 7. Although the transaction would result in the two largest firms controlling about half of all sales in an industry that was already highly concentrated because of a rapid decline in the number of competitors, the defendants produced considerable evidence that the merger would not substantially lessen competition. One of the parties to the merger owned only minimal reserves of coal, an irreplaceable raw material, and had already committed these reserves through long-term contracts. This evidence led the Court to conclude that the government's statistics regarding concentration in the wake of the merger inaccurately portrayed the post-merger company's weak competitive stature, and that the defendants had therefore rebutted the prima facie case. *Id.* at 503-04, 94 S. Ct. at 1196-97. Nowhere did the Court consider barriers to entry.

Indeed, the Court in *General Dynamics* emphasized the comprehensive nature of a section 7 inquiry, quoting at length from its decision a decade earlier in *Brown Shoe Co. v. United States*, 370 U.S. 294, 82 S. Ct. 1502, 8 L.Ed.2d 510 (1962). *See General Dynamics,* 415 U.S. at 498, 94 S. Ct. at 1194. In *Brown Shoe,* the Court applied section 7 stringently, holding that a merger that created a company with a 5% share of a highly fragmented market violated the statute. In arriving at this result, however, the Court stressed that a transaction must

> be functionally viewed, in the context of its particular industry. That is, whether the consolidation was to take place in an industry that was fragmented rather than concentrated, that had seen a recent trend toward domination by a few leaders or had remained fairly consistent in its distribution of market shares among the participating companies, that had experienced easy access to markets by suppliers and easy access to suppliers by buyers or had witnessed foreclosure of business, that had witnessed the ready entry of new competition or the erection of barriers to prospective entrants, all were aspects, varying in importance with the merger under consideration, which would properly be taken into account.

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existed for dealing with clear-cut menaces to competition; no statute was sought for dealing with ephemeral possibilities. Mergers with a *probable* anticompetitive effect were to be proscribed by this Act.") (footnote omitted) (emphasis added).

370 U.S. at 321-22, 82 S. Ct. at 1521-22 (footnote omitted).[6] All these factors are relevant in determining whether a transaction is likely to lessen competition substantially, but none is invariably dispositive. *See* Note, *Horizontal Mergers After* United States v. General Dynamics Corp., 92 Harv. L. Rev. 491, 500 (1978).

In the wake of *General Dynamics,* the Supreme Court and lower courts have found section 7 defendants to have successfully rebutted the government's prima facie case by presenting evidence on a variety of factors other than ease of entry. *See, e.g., Citizens & Southern,* 422 U.S. at 121-23, 95 S. Ct. at 2119-20 (no lessening of competition, and thus no violation of section 7, where acquired banks were already associated with acquiring bank; no discussion of ease of entry); *Lektro-Vend Corp. v. Vendo Co.,* 660 F.2d 255, 276 (7th Cir. 1981) (acquired company's deteriorating market position both before and after acquisition rebutted prima facie case), *cert. denied,* 455 U.S. 921, 102 S. Ct. 1277, 71 L.Ed.2d 461 (1982); *FTC v. National Tea Co.,* 603 F.2d 694, 699-700 (8th Cir. 1979) (weak market position of acquiring company made substantial lessening of competition unlikely); *United States v. International Harvester Co.,* 564 F.2d 769, 773-79 (7th Cir. 1977) (company successfully rebutted prima facie case by showing, among other things, financial weakness of acquired company, de facto independence of acquired company from acquiring company, strong level of competition in relevant market, and tendency of the market toward even stronger levels of competition).

Indeed, that a variety of factors other than ease of entry can rebut a prima facie case has become hornbook law. *See, e.g.,* P. Areeda & H. Hovenkamp, *Antitrust Law* ¶¶ 919, 920.1, 921, 925, 934, 935, 939, at 813-23 (Supp. 1989) (other factors include significance of market shares and concentration, likelihood of express collusion or tacit coordination, and prospect of efficiencies from merger); H. Hovenkamp, *Economics and Federal Antitrust Law* § 11.6, at 307-11 (1985) (other factors include supply of irreplaceable raw materials, excess capacity, degree of product homogeneity, marketing and sales methods, and absence of a trend toward concentration); L. Sullivan, *Handbook of the Law of Antitrust* § 204, at 622-25 (1977) (other factors include industry structure, weakness of data underlying prima facie case, elasticity of industry demand, inter-industry cross-elasticities of demand and supply, product differentiation, and efficiency). *See generally* Antitrust Section, ABA, *Horizontal Mergers: Law and Policy* 162-75, 201-04, 219-63 (Monograph No. 12, 1986).

It is not surprising, then, that the Department of Justice's own Merger Guidelines contain a detailed discussion of non-entry factors that can overcome a presumption of illegality established by market share statistics. *See* United States Dep't of Justice,

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6. *See also id.* at 322 n. 38, 82 S. Ct. at 1522 n.38 ("Statistics reflecting the shares of the market controlled by the industry leaders and the parties to the merger are, of course, the primary index of market power; but only a further examination of the particular market—its structure, history and probable future—can provide the appropriate setting for judging the probable anticompetitive effect of the merger.").

Merger Guidelines (June 14, 1984) [hereinafter Guidelines], *reprinted in* 4 Trade Reg.Rep. (CCH) ¶ 13,103, at 20,561-64 (1988). According to the Guidelines, these factors include changing market ***986 **227** conditions (§ 3.21), the financial condition of firms in the relevant market (§ 3.22), special factors affecting foreign firms (§ 3.23), the nature of the product and the terms of sale (§ 3.41), information about specific transactions and buyer market characteristics (§ 3.42), the conduct of firms in the market (§ 3.44), market performance (§ 3.45), and efficiencies (§ 3.5).

Given this acknowledged multiplicity of relevant factors, we are at a loss to understand on what basis the government has decided that "[t]o rebut the government's prima facie case, the defendants were *required* to show that *entry* would be both quick and effective in preventing supracompetitive prices." Brief for Appellants at 11-12 (emphasis added). If the district court in this case had focused exclusively on entry, it might be understandable that the government would mirror that focus in attacking the court's conclusion. The district court, however, canvassed a number of non-entry factors that contributed to its conclusion that the defendants had rebutted the prima facie case. By ignoring these factors, the government's arguments against that conclusion fall wide of the mark.

The district court's analysis of this case is fully consonant with precedent and logic. The court reviewed the evidence proffered by the defendants as part of its overall assessment of future competitiveness in the United States HHUDR market. As noted above, the court gave particular weight to two non-entry factors: the flawed underpinnings of the government's prima facie case and the sophistication of HHUDR consumers. The court's consideration of these factors was not only appropriate, but imperative, because in this case these factors significantly affected the probability that the acquisition would have anticompetitive effects.

With respect to the first factor, the statistical basis of the prima facie case, the court accepted the defendants' argument that the government's statistics were misleading. Because the United States HHUDR market is minuscule, market share statistics are "volatile and shifting," 731 F. Supp. at 11, and easily skewed. In 1986, for instance, only 22 HHUDRs were sold in the United States. In 1987, the number rose to 43, and in 1988 it fell to 38. Every HHUDR sold during this period, thus, increased the seller's market share by two to five percent. A contract to provide multiple HHUDRs could catapult a firm from last to first place. The district court found that, in this unusual market, "at any given point in time an individual seller's future competitive strength may not be accurately reflected." *Id.* at 9. While acknowledging that the HHUDR market would be highly concentrated after Tamrock acquired Secoma, the court found that such concentration in and of itself would not doom competition. High concentration has long been the norm in this market. For example, only four firms sold HHUDRs in the United States between 1986 and 1989.

Id. at 5-6.[7] [FN7] Nor is concentration surprising where, as here, a product is esoteric and its market small. Indeed, the trial judge found that "[c]oncentration has existed for some time [in the United States HHUDR market] but there is no proof of overpricing, excessive profit or any decline in quality, service or diminishing innovation." *Id.* at 12.

The second non-entry factor that the district court considered was the sophistication of HHUDR consumers. HHUDRs currently cost hundreds of thousands of dollars, and orders can exceed $1 million. *Id.* at 8. These products are hardly trinkets sold to small consumers who may possess imperfect information and limited bargaining power. HHUDR buyers closely examine available options and typically insist on receiving multiple, confidential bids for each order. *Id.* This sophistication, the court found, was likely to promote competition even in a highly concentrated market. *Id.* at 11.

The government has not provided us with any reason to suppose that these findings of fact are unsupported in the record or clearly erroneous, *see* Fed. R. Civ. P. 52(a). We thus accept them as correct. These findings provide considerable support for the district court's conclusion that the defendants successfully rebutted the government's prima facie case. Because the defendants also provided compelling evidence on ease of entry into this market, we need not decide whether these findings, without more, are sufficient to rebut the government's prima facie case. The foregoing analysis of non-entry factors is intended merely to underscore that, contrary to the government's assumption, these factors are relevant, and can even be dispositive, in a section 7 rebuttal analysis.

II.

The existence and significance of barriers to entry are frequently, of course, crucial considerations in a rebuttal analysis. In the absence of significant barriers, a company probably cannot maintain supracompetitive pricing for any length of time. *See, e.g., United States v. Falstaff Brewing Corp.,* 410 U.S. 526, 532-33, 93 S. Ct. 1096, 1100-01, 35 L.Ed.2d 475 (1973); *United States v. Syufy Enters.,* 903 F.2d 659, 664 (9th Cir. 1990); *California v. American Stores Co.,* 872 F.2d 837, 842 (9th Cir. 1989), *rev'd on other grounds,* 495 U.S. 271, 110 S. Ct. 1853, 109 L.Ed.2d 240 (1990); *Ball Memorial Hosp., Inc. v. Mutual Hosp. Ins.,* 784 F.2d 1325, 1335-36 (7th Cir. 1986). The district court in this case reviewed the prospects for future entry into the United States HHUDR market and concluded that, overall, entry was likely, particularly if Tamrock's acquisition of Secoma were to lead to supracompetitive pricing. The government attacks this conclusion, asserting that, as a matter of law, the court should have required the defendants to show clearly that entry would be "quick and effective." We reject this novel and unduly onerous standard. The district court's factual findings amply support its determination that future entry into the

7. *See also supra* note 3 (HHI of United States HHUDR market before merger was 2878; Department of Justice regards any market in which HHI exceeds 1800 as "highly concentrated").

United States HHUDR market is likely. This determination, in turn, supports the court's conclusion that the defendants successfully rebutted the government's prima facie case.

As authority for its "quick and effective" entry test, the government relies primarily on *United States v. Waste Management, Inc.*, 743 F.2d 976, 981-84 (2d Cir. 1984). This reliance is misplaced. Neither *Waste Management* nor any other case purports to establish a categorical "quick and effective" entry requirement. The Second Circuit in *Waste Management* simply noted that the defendant had successfully rebutted the government's prima facie case by showing that entry into the Dallas/Fort Worth trash collection market was "easy." *Id.* at 983. That a defendant *may* successfully rebut a prima facie case by showing quick and effective entry does not mean that successful rebuttal *requires* such a showing. We are at a loss to understand how the government derived from *Waste Management* (where, lest the irony be missed, the government lost) the proposition that "a defendant arguing supposed ease of entry can rebut the government's prima facie case *only* by clearly showing that entry will be both quick and effective at preventing supracompetitive pricing." Brief for Appellant at 14 (emphasis added).

That the "quick and effective" standard lacks support in precedent is not surprising, for it would require of defendants a degree of clairvoyance alien to section 7, which, as noted above, deals with probabilities, not certainties. Although the government disclaims any attempt to impose upon defendants the burden of proving that entry actually will occur, *see* Reply Brief for Appellant at 13 n. 13, we believe that an inflexible "quick and effective" entry requirement would tend to impose precisely such a burden. A defendant cannot realistically be expected to prove that new competitors will "quickly" or "effectively" enter unless it produces evidence regarding specific competitors and their plans. Such evidence is rarely available; potential competitors have a strong interest in downplaying the likelihood that they will enter a given market. When the government sarcastically "wonders how slow and ineffective entry rebuts a prima facie case," *id.* at 12, it misses a crucial point. If the totality of a defendant's evidence suggests that entry will be slow and ineffective, then the district court is unlikely to find the prima facie case rebutted. This is a far cry, however, from insisting that the defendant must *invariably* show that new competitors will enter quickly and effectively.

Furthermore, the supposed "quick and effective" entry requirement overlooks the point that a firm that *never* enters a given market can nevertheless exert competitive pressure on that market. If barriers to entry are insignificant, the *threat* of entry can stimulate competition in a concentrated market, regardless of whether entry ever occurs. *See Falstaff Brewing,* 410 U.S. at 532-33, 93 S. Ct. at 1100-01 (potential for defendant Falstaff to enter the market might induce brewers in the Northeast to maintain competitive prices); *FTC v. Procter & Gamble Co.,* 386 U.S. 568, 581, 87 S. Ct. 1224, 1231-32, 18 L.Ed.2d 303 (1967) ("It is clear that the existence of Procter at the edge of the industry exerted considerable influence on the market . . . . [The] industry was influenced by each firm's predictions of the market behavior of its competitors, actual *and potential.*") (emphasis added); *cf. Byars v. Bluff City News Co.*, 609 F.2d 843, 851 n. 19 (6th Cir. 1979) ("If entry barriers are low, the threat of potential competition operates as a significant check on monopoly power since competitors will quickly enter the market if prices are raised significantly."). If a firm that *never* enters a market can keep that market competitive, a defendant seeking to rebut a prima facie case certainly need not show that any firm *will* enter the relevant market.

The final flaw in the proposed "quick and effective" standard is its manipulability. The adjectives "quick" and "effective" are not self-defining, and have not traditionally been used in the section 7 context. The government's Merger Guidelines do not use the words when discussing entry, noting only that

> [i]f entry into a market is so easy that existing competitors could not succeed in raising price for any significant period of time, the Department is unlikely to challenge mergers in that market.... In assessing the ease of entry into a market, the Department will consider the likelihood and probable magnitude of entry in response to a "small but significant and nontransitory" increase in price.

Guidelines § 3.3, *reprinted in* 4 Trade Reg. Rep. (CCH) at 20,562. In its brief, moreover, the government fails to state its own standard consistently, insisting at one point that a defendant show that entry will be "sure, swift, and substantial." Brief for Appellant at 16. Our uncertainty over the meaning and implications of "quick and effective" entry makes us all the more resistant to the imposition of such a requirement. Nor has the government shown that current section 7 law is so confused as to warrant the invention of a new standard.

The government's insistence on a "quick and effective" entry standard only reaffirms our doubts, raised in section I of this opinion, about the government's approach to section 7 analysis. Predicting future competitive conditions in a given market, as the statute and precedents require, calls for a comprehensive inquiry. The government's standard would improperly narrow the section 7 inquiry, channelling what should be an overall analysis of competitiveness into a determination of whether a defendant has shown particular facts.

Having rejected the "quick and effective" entry standard itself, we turn briefly to the government's more general argument that the district court's findings regarding ease of entry failed to support its conclusion that the defendants had rebutted the prima facie case. The district court in this case discussed a number of considerations that led it to conclude that entry barriers to the United States HHUDR market were not high enough to impede future entry should Tamrock's acquisition of Secoma lead to supracompetitive pricing. First, the court noted that at least two companies, Cannon and Ingersoll-Rand, had entered the United States HHUDR market in 1989, and were poised for future expansion.[8] 731 F. Supp. at 9, 10, 11. Second, the court stressed that a number of firms competing in Canada and other countries had not penetrated the United States market, but could be expected to do so if Tamrock's acquisition of Secoma led to higher prices. *Id.* at 10-11.[9] Because the market is small, "[i]t is inexpensive to develop a separate sales and service network in the United States." *Id.* at 8. Third, these firms would exert competitive pressure on the United States HHUDR market even if they never actually entered the market. *Id.* at 10-11. Finally, the court noted that there had been tremendous turnover in the United States HHUDR market in the 1980s. Secoma, for example, did not sell a single HHUDR in the United States in 1983 or 1984, but then lowered its price and improved its service, becoming market leader by 1989. *Id.* at 9, 10. Secoma's growth suggests that competitors not only can, but probably will, enter or expand if this acquisition leads to higher prices. The district court, to be sure, also found some facts suggesting difficulty of entry,[10] but these findings do not negate its ultimate finding to the contrary.

In sum, we see no error—legal or factual—in the district court's determination that entry into the United States HHUDR market would likely avert anticompetitive effects from Tamrock's acquisition of Secoma. The court's determination on entry, considered along with the findings discussed in section I of this opinion, suffices to rebut the government's prima facie case.

III.

Finally, we consider the strength of the showing that a section 7 defendant must make to rebut a prima facie case. The district court simply reviewed the evidence that the defendants presented and concluded that the acquisition was not likely to substantially lessen competition. The government argues that the court erred by

8. As the Guidelines note, " 'Entry' may occur as firms outside the market enter for the first time *or as fringe firms currently in the market greatly expand their current capacity.*" Guidelines § 3.3, *reprinted in* 4 Trade Reg. Rep. (CCH) at 20,562 n. 20 (emphasis added).

9. Some of these firms have already tried, but failed, to penetrate the United States HHUDR market. As the district court correctly noted, however, failed entry in the past does not necessarily imply failed entry in the future: if prices reach supracompetitive levels, a company that has failed to enter in the past could become competitive. *See* 731 F. Supp. at 11; *cf. Cargill, Inc. v. Monfort of Colo., Inc.,* 479 U.S. 104, 119 n. 15, 107 S. Ct. 484, 494 n. 15, 93 L.Ed.2d 427 (1986) ("In evaluating entry barriers . . . a court should focus on whether significant entry barriers would exist *after* the merged firm had eliminated some of its rivals, because at that point the remaining firms would begin to charge supracompetitive prices, and the barriers that existed during competitive conditions might well prove insignificant.").

10. The court, for instance, noted that HHUDRs are custom-made, and thus are not readily interchangeable or replaceable. Buyers, therefore, tend to return to sellers from whom they have purchased in the past. 731 F. Supp. at 8. The court also found that HHUDR customers typically place great importance on assurances of product quality and reliable future service—considerations that may handicap new entrants. *Id.* It also noted the significant economies of scale involved in manufacturing HHUDRs. *Id.*

failing to require the defendants to make a "clear" showing. *See* Brief for Appellant at 13. The relevant precedents, however, suggest that this formulation overstates the defendants' burden. We conclude that a "clear" showing is unnecessary, and we are satisfied that the district court required the defendants to produce sufficient evidence.

The government's "clear showing" language is by no means unsupported in the case law. In the mid-1960s, the Supreme Court construed section 7 to prohibit virtually any horizontal merger or acquisition. At the time, the Court envisioned an ideal market as one composed of many small competitors, each enjoying only a small market share; the more closely a given market approximated this ideal, the more competitive it was presumed to be. *See United States v. Aluminum Co. of Am.,* 377 U.S. 271, 280, 84 S. Ct. 1283, 1289, 12 L.Ed.2d 314 (1964) ("It is the basic premise of [section 7] that competition will be most vital 'when there are many sellers, none of which has any significant market share.' ") (quoting *United States v. Philadelphia Nat'l Bank,* 374 U.S. 321, 363, 83 S. Ct. 1715, 1741, 10 L.Ed.2d 915 (1963)).

This perspective animated a series of decisions in which the Court stated that a section 7 defendant's market share measures its market power, that statistics alone establish a prima facie case, and that a defendant carries a heavy burden in seeking to rebut the presumption established by such a prima facie case. The Court most clearly articulated this approach in *Philadelphia Bank:*

> Th[e] intense congressional concern with the trend toward concentration [underlying section 7] warrants dispensing, in certain cases, with elaborate proof of market structure, market behavior, or probable anticompetitive effects. Specifically, we think that a merger which produces a firm controlling an undue percentage share of the relevant market, and results in a significant increase in the concentration of firms in that market, is so inherently likely to lessen competition substantially that it must be enjoined in the absence of evidence *clearly showing* that the merger is not likely to have such anticompetitive effects.

374 U.S. at 363, 83 S. Ct. at 1741 (emphasis added). *Philadelphia Bank* involved a proposed merger that would have created a bank commanding over 30% of a highly concentrated market. While acknowledging that the banks could in principle rebut the government's prima facie case, the Court found unpersuasive the banks' evidence challenging the alleged anticompetitive effect of the merger. *See id.* at 366-72, 83 S. Ct. at 1743-46.

In *United States v. Von's Grocery Co.,* 384 U.S. 270, 86 S. Ct. 1478, 16 L.Ed.2d 555 (1966), the Court further emphasized the weight of a defendant's burden. Despite evidence that a post-merger company had only a 7.5% share of the Los Angeles retail grocery market, the Court, citing anticompetitive "trends" in that market, ordered the merger undone. The Court summarily dismissed the defendants' contention that the post-merger market was highly competitive. *Id.* at 277-78, 86 S.

Ct. at 1482.[11] [FN11] Noting that the market was "marked at the same time by both a continuous decline in the number of small businesses and a large number of mergers," the *Von's Grocery* Court predicted that, if the merger were not undone, the market "would slowly but inevitably gravitate from a market of many small competitors to one dominated by one or a few giants, and competition would thereby be destroyed." *Id.* at 278, 86 S. Ct. at 1482; *see also United States v. Pabst Brewing Co.*, 384 U.S. 546, 550-52, 86 S. Ct. 1665, 1668-69, 16 L.Ed.2d 765 (1966) (acquisition producing brewer accounting for 4.49% of nationwide beer sales violates section 7; brewer's rebuttal evidence virtually ignored).

Although the Supreme Court has not overruled these section 7 precedents, it has cut them back sharply. In *General Dynamics*, 415 U.S. at 498-504, 94 S. Ct. at 1194-97, the Court affirmed a district court determination that, by presenting evidence that undermined the government's statistics, section 7 defendants had successfully rebutted a prima facie case. In so holding, the Court did not expressly reaffirm or disavow *Philadelphia Bank's* statement that a company must "clearly" show that a transaction is not likely to have substantial anticompetitive effects. The Court simply held that the district court was justified, based on all the evidence, in finding that "no substantial lessening of competition occurred or was threatened by the acquisition." *General Dynamics*, 415 U.S. at 498, 94 S. Ct. at 1194.

General Dynamics began a line of decisions differing markedly in emphasis from the Court's antitrust cases of the 1960s. Instead of accepting a firm's market share as virtually conclusive proof of its market power, the Court carefully analyzed defendants' rebuttal evidence.[12] These cases discarded *Philadelphia Bank's* insistence that a defendant "clearly" disprove anticompetitive effect, and instead described the rebuttal burden simply in terms of a "showing." *See, e.g., United States v. Marine Bancorporation*, 418 U.S. 602, 631, 94 S. Ct. 2856, 2874-75, 41 L.Ed.2d 978 (1974) (after government established prima facie case, "the burden was then

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11. Justice Stewart, in dissent, emphasized the considerable amount of evidence in the record indicating the market's competitiveness. 384 U.S. at 290-301, 86 S. Ct. at 1489-95 (Stewart, J., dissenting).

12. Judge Posner has elucidated this point:

> The most important developments that cast doubt on the continued vitality of such cases as *Brown Shoe* and *Von's* are found in other cases, where the Supreme Court, echoed by the lower courts, has said repeatedly that the economic concept of competition, rather than any desire to preserve rivals as such, is the lodestar that shall guide the contemporary application of the antitrust laws, not excluding the Clayton Act. . . . Applied to cases brought under Section 7, this principle requires the district court . . . to make a judgment whether the challenged acquisition is likely to hurt consumers, as by making it easier for the firms in the market to collude, expressly or tacitly, and thereby force price above or farther above the competitive level.

Hospital Corp. of Am. v. FTC, 807 F.2d 1381, 1386 (7th Cir. 1986), *cert. denied*, 481 U.S. 1038, 107 S. Ct. 1975, 95 L.Ed.2d 815 (1987).

upon appellees *to show* that the concentration ratios, which can be unreliable indicators of actual market behavior, did not accurately depict the economic characteristics of the [relevant] market") (citation omitted) (emphasis added); *United States v. Citizens & Southern Nat'l Bank,* 422 U.S. 86, 120, 95 S. Ct. 2099, 2118, 45 L.Ed.2d 41 (1975) (after government established prima facie case, "[i]t was . . . incumbent upon [the defendant] *to show* that the market-share statistics gave an inaccurate account of the acquisitions' probable effects on competition") (emphasis added). Without overruling *Philadelphia Bank,* then, the Supreme Court has at the very least lightened the evidentiary burden on a section 7 defendant. *See generally* Note, 92 Harv. L. Rev. at 491 (describing impact of *General Dynamics* on section 7 jurisprudence).

In the aftermath of *General Dynamics* and its progeny, a defendant seeking to rebut a presumption of anticompetitive effect must show that the prima facie case inaccurately predicts the relevant transaction's probable effect on future competition. *See American Stores*, 872 F.2d at 842 (defendant can rebut prima facie case "through evidence *demonstrating* that statistics on market share, market concentration, and market concentration trends portray inaccurately the merger's probable effects on competition") (emphasis added); *cf. Waste Management*, 743 F.2d at 981 (defendant can rebut prima facie case "by *a demonstration* that the merger will not have anticompetitive effects") (emphasis added). The more compelling the prima facie case, the more evidence the defendant must present to rebut it successfully. A defendant can make the required showing by affirmatively showing why a given transaction is unlikely to substantially lessen competition, or by discrediting the data underlying the initial presumption in the government's favor.

By focusing on the future, section 7 gives a court the uncertain task of assessing probabilities. In this setting, allocation of the burdens of proof assumes particular importance. By shifting the burden of producing evidence, present law allows both sides to make competing predictions about a transaction's effects. If the burden of production imposed on a defendant is unduly onerous, the distinction between that burden and the ultimate burden of persuasion—always an elusive distinction in practice—disintegrates completely. A defendant required to produce evidence "clearly" disproving future anticompetitive effects must essentially persuade the trier of fact on the ultimate issue in the case—whether a transaction is likely to lessen competition substantially. Absent express instructions to the contrary, we are loath to depart from settled principles and impose such a heavy burden. *See Kaiser Aluminum & Chem. Corp. v. FTC,* 652 F.2d 1324, 1340 & n. 12 (7th Cir. 1981); *cf. Texas Dep't of Community Affairs v. Burdine,* 450 U.S. 248, 253-56, 101 S. Ct. 1089, 1093-95, 67 L.Ed.2d 207 (1981) (applying similar production-burden-shifting analysis to employment discrimination suits under title VII, and noting that "[t]he ultimate burden of persuading the trier of fact . . . remains at all times with the plaintiff," *id.* at 253, 101 S. Ct. at 1093); 9 J. Wigmore, *Evidence* § 2489, at 300 (J. Chadbourn rev. ed. 1981) (burden of persuasion "never shifts" away from plaintiff).

Imposing a heavy burden of production on a defendant would be particularly anomalous where, as here, it is easy to establish a prima facie case. The government, after all, can carry its initial burden of production simply by presenting market concentration statistics. To allow the government virtually to rest its case at that point, leaving the defendant to prove the core of the dispute, would grossly inflate the role of statistics in actions brought under section 7. The Herfindahl-Hirschman Index cannot guarantee litigation victories.[13] *Cf. Ball Memorial Hosp.*, 784 F.2d at 1336 (explaining that "[m]arket share is just a way of estimating market power, which is the ultimate consideration," and noting that "[w]hen there are better ways to estimate market power, the court should use them"). Requiring a "clear showing" in this setting would move far toward forcing a defendant to rebut a probability with a certainty.

* * *

The appellees in this case presented the district court with considerable evidence regarding the United States HHUDR market. The court credited the evidence concerning the sophistication of HHUDR consumers and the insignificance of entry barriers, as well as the argument that the statistics underlying the government's prima facie case were misleading. This evidence amply justified the court's conclusion that the prima facie case inaccurately depicted the probable anticompetitive effect of Tamrock's acquisition of Secoma. Because the government did not produce sufficient evidence to overcome this successful rebuttal, the district court concluded that "it is not likely that the acquisition will substantially lessen competition in the United States either immediately or long-term." 731 F. Supp. at 12. The government has given us no reason to reverse that conclusion

For the foregoing reasons, the judgment of the district court is

Affirmed.

NOTES

1. *Baker Hughes* is probably the most significant merger antitrust case decided since *General Dynamics*, having set forth the modern judicial paradigm for analysing

13. We refer the government to its own Merger Guidelines, which recognize that "[i]n a variety of situations, market share and market concentration data may either understate or overstate the likely future competitive significance of a firm or firms in the market." Guidelines § 3.2, *reprinted in* 4 Trade Reg. Rep. (CCH) at 20,561. Although the Guidelines disclaim "slavish[ ] adhere[nce]" to such data, *id.*, statement, *reprinted in* 4 Trade Reg. Rep. (CCH) at 20,552, we fear that the Department of Justice has ignored its own admonition. The government does not maximize its scarce resources when it allows statistics alone to trigger its ponderous enforcement machinery. *Cf. Syufy Enters.*, 903 F.2d at 672 ("It is a tribute to the state of competition in America that the Antitrust Division of the Department of Justice has found no worthier target than this paper tiger on which to expend limited taxpayer resources.").

horizontal mergers. No doubt its significance is aided by the fact that two of the three members of the panel—opinion author Clarence Thomas and Ruth B. Ginsburg—are now members of the Supreme Court.

FTC Merger Challenges

FTC SECTION 5

FTC Act § 5. Unfair methods of competition unlawful; prevention by Commission

(a) Declaration of unlawfulness; power to prohibit unfair practices; inapplicability to foreign trade

(1) Unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce, are hereby declared unlawful.

(2) The Commission is hereby empowered and directed to prevent persons, partnerships, or corporations, except [*exceptions omitted*] from using unfair methods of competition in or affecting commerce and unfair or deceptive acts or practices in or affecting commerce.

(3) This subsection shall not apply to unfair methods of competition involving commerce with foreign nations (other than import commerce) unless—

(A) such methods of competition have a direct, substantial, and reasonably foreseeable effect—

(i) on commerce which is not commerce with foreign nations, or on import commerce with foreign nations; or

(ii) on export commerce with foreign nations, of a person engaged in such commerce in the United States; and

(B) such effect gives rise to a claim under the provisions of this subsection, other than this paragraph.

If this subsection applies to such methods of competition only because of the operation of subparagraph (A)(ii), this subsection shall apply to such conduct only for injury to export business in the United States.

(4)

(A) For purposes of subsection (a), the term "unfair or deceptive acts or practices" includes such acts or practices involving foreign commerce that—

(i) cause or are likely to cause reasonably foreseeable injury within the United States; or

(ii) involve material conduct occurring within the United States.

(B) All remedies available to the Commission with respect to unfair and deceptive acts or practices shall be available for acts and practices described in this paragraph, including restitution to domestic or foreign victims.

FTC SECTION 13(B) PRELIMINARY INJUNCTIONS

FTC Act § 13. False advertisements; injunctions and restraining orders

(a) *Power of Commission; jurisdiction of courts* [omitted—deals with false and deceptive advertising]

(b) *Temporary restraining orders; preliminary injunctions*. Whenever the Commission has reason to believe—

> (1) that any person, partnership, or corporation is violating, or is about to violate, any provision of law enforced by the Federal Trade Commission, and
>
> (2) that the enjoining thereof pending the issuance of a complaint by the Commission and until such complaint is dismissed by the Commission or set aside by the court on review, or until the order of the Commission made thereon has become final, would be in the interest of the public—

the Commission by any of its attorneys designated by it for such purpose may bring suit in a district court of the United States to enjoin any such act or practice. Upon a proper showing that, weighing the equities and considering the Commission's likelihood of ultimate success, such action would be in the public interest, and after notice to the defendant, a temporary restraining order or a preliminary injunction may be granted without bond: Provided, however, That if a complaint is not filed within such period (not exceeding 20 days) as may be specified by the court after issuance of the temporary restraining order or preliminary injunction, the order or injunction shall be dissolved by the court and be of no further force and effect: Provided further, That in proper cases the Commission may seek, and after proper proof, the court may issue, a permanent injunction. Any suit may be brought where such person, partnership, or corporation resides or transacts business, or wherever venue is proper under section 1391 of title 28. In addition, the court may, if the court determines that the interests of justice require that any other person, partnership, or corporation should be a party in such suit, cause such other person, partnership, or corporation to be added as a party without regard to whether venue is otherwise proper in the district in which the suit is brought. In any suit under this section, process may be served on any person, partnership, or corporation wherever it may be found. [15 U.S.C. § 53(b)]

(c) *Service of process; proof of service*. Any process of the Commission under this section may be served by any person duly authorized by the Commission—

> (1) by delivering a copy of such process to the person to be served, to a member of the partnership to be served, or to the president, secretary, or other executive officer or a director of the corporation to be served;
>
> (2) by leaving a copy of such process at the residence or the principal office or place of business of such person, partnership, or corporation; or

(3) by mailing a copy of such process by registered mail or certified mail addressed to such person, partnership, or corporation at his, or her, or its residence, principal office, or principal place or business.

The verified return by the person serving such process setting forth the manner of such service shall be proof of the same. [15 U.S.C. § 53(c)]

(d) *Exception of periodical publications* [omitted—deals with false and deceptive advertising]

FTC v. Ardagh Group

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

FEDERAL TRADE COMMISSION,

Plaintiff,

v.

ARDAGH GROUP, S.A.,
COMPAGNIE DE SAINT-GOBAIN, and
SAINT-GOBAIN CONTAINERS, INC.,

Defendants.

Case No. 1:13-CV-01021 (BJR)

PUBLIC VERSION

PLAINTIFF'S MEMORANDUM OF LAW IN SUPPORT OF ITS MOTION FOR PRELIMINARY INJUNCTION

REDACTED VERSION FOR PUBLIC FILING*

*The Federal Trade Commission files this non-confidential redacted version of its Memorandum of Law in Support of its Motion for Preliminary Injunction, filed August 28, 2013. The Protective Order requires all information designated "Confidential" to be redacted from the public version of the pleading filed with the court. Although Defendants designated all information and documents redacted in this Memorandum as "Confidential," most of the information does not appear to be commercial information, the disclosure of which would cause injury to their businesses.

The Federal Trade Commission ("FTC" or the "Commission") has commenced an action in this Court under Section of 13(b) of the FTC Act seeking to enjoin preliminarily Ardagh Group S.A. ("Ardagh") from completing its acquisition of Saint-Gobain Containers, Inc. ("Saint-Gobain" or "Verallia North America") until the resolution of the Commission's pending administrative case to determine the legality of the proposed acquisition. The Commission respectfully submits this memorandum of law in support of its preliminary injunction motion.

INTRODUCTION

The Commission seeks to halt an acquisition that, if consummated, would dramatically concentrate the glass container industry in the hands of two manufacturers and lead to higher prices for glass beer and spirits bottles. For years, three manufacturers have dominated the $5 billion glass container industry in the United States. The second- and third-largest of these manufacturers, Ardagh and Saint-Gobain, now propose to merge in a transaction that would create a durable duopoly. Under well-settled precedent and the Commission's merger guidelines, this merger to duopoly is presumptively unlawful. Indeed, a top Ardagh sales executive stated in June 2013 that Ardagh believes the transaction "may not get approved" since "it is going from 3 to 2 major suppliers."[1]

The Commission has initiated an administrative proceeding to adjudicate the legality of the proposed transaction under the antitrust laws, and the trial in that proceeding begins on December 2, 2013. Thus, the only issue for this Court is whether to grant interim relief by enjoining the Defendants from consummating the proposed acquisition pending the upcoming merits trial. The Court should do so because such interim relief is necessary to prevent consumer harm and to preserve the possibility of an effective remedy.

[1] PX 1574.

Under Section 13(b) of the FTC Act, the Commission is entitled to a preliminary injunction "[u]pon a proper showing that, weighing the equities and considering the Commission's likelihood of ultimate success, such action would be in the public interest." 15 U.S.C. § 53(b). At this stage, the Commission is *not* required to prove whether the acquisition, is, in fact, illegal under the antitrust laws. "That responsibility lies with the FTC" after a full administrative hearing. *FTC v. Whole Foods Market*, *Inc*., 548 F.3d 1028, 1035 (D.C. Cir. 2008) (Brown, J.). The FTC creates a strong "presumption in favor of preliminary injunctive relief" by raising "questions going to the merits so serious, substantial, difficult and doubtful as to make them fair ground for thorough investigation, study, deliberation and determination by the FTC in the first instance and ultimately by the Court of Appeals." *FTC v. H.J. Heinz Co.*, 246 F.3d 708, 714-15 (D.C. Cir. 2001). The Commission undoubtedly has met that standard here.

To counter this strong presumption, coupled with the strong "public interest in effective enforcement of the antitrust laws," defendants must show "particularly strong equities" that favor allowing the acquisition to close before trial. *Id*. at 726-27; *Whole Foods*, 548 F.3d at 1035 (Brown, J.). Defendants cannot do so. At best, Defendants' arguments only underscore the "serious, substantial" questions to be resolved in the administrative trial.

This acquisition will likely cause anticompetitive effects in at least two relevant antitrust product markets: the manufacture and sale of glass containers to (1) beer brewers ("Brewers") and (2) spirits distillers ("Distillers"). Both are relevant antitrust markets for the purposes of assessing the acquisition's competitive impact because other types of containers, such as aluminum cans or plastic bottles, are not economically viable substitutes for glass.

The proper delineation of the relevant market is ultimately "a matter of business reality – a matter of how the market is perceived by those who strive to profit in it." *FTC v. Coca-Cola*

Co., 641 F. Supp. 1128, 1132 (D.D.C. 1986), *vacated as moot*, 829 F.2d 191 (D.C. Cir. 1987). On that question, the evidence leaves little doubt.

- Glass container manufacturers refer to the "three majors" of glass container manufacturing, tell the investment community they operate in a glass container market, and calculate market shares based only on glass container sales.

- Aluminum and plastic container manufacturers have testified that they do not compete directly with glass.

- Glass container manufacturers bid for contracts knowing their customers have already excluded aluminum cans or plastic bottles from consideration.

- Brewers and Distillers who sell products in glass bottles want glass – not cans or plastic – because their customers demand it. As one Brewer explained when asked: "Who determines the mix of packaging? Consumers."[2]

- Brewers and Distillers do not change their brands' packaging based on variations in the relative prices of glass, metal, or plastic containers.

Unless enjoined, Ardagh's planned $1.7 billion acquisition of Saint-Gobain would produce a single firm controlling [redacted] percent of the U.S. glass container industry, according to Ardagh's own assessment. The only other major U.S. manufacturer – Owens-Illinois, Inc. ("O-I") – controls roughly [redacted] percent of the industry. The post-acquisition duopolists would collectively control approximately [redacted] percent of the glass container market for Brewers and [redacted] percent for Distillers, easily exceeding the levels required to establish a presumption that the acquisition violates the antitrust laws. The remaining competitors are fringe importers and small-scale or niche manufacturers.

Today, Ardagh, Saint-Gobain, and O-I – the "three majors," to borrow a term from Ardagh's documents – recognize their mutual incentives to avoid excess capacity that could lead to greater price competition. Indeed, Ardagh's North American President described the glass container industry as having "evolved" to be "very disciplined with 'well-balanced' if not tight

[2] [redacted]

supply demand dynamics."[3] [redacted]

Still, Brewers and Distillers today benefit from competition among the major glass manufacturers by encouraging those manufacturers to bid for their business, and those benefits accrue to consumers. The proposed acquisition would end that competition between Ardagh and Saint-Gobain and lead to higher prices for beer and spirits bottles. It would also dramatically increase the ease and likelihood of coordination between the only two remaining Majors in a "highly concentrated market, with stable market shares, low growth rates and significant barriers to entry" – a situation that provides "few incentives to engage in healthy competition." *FTC v. CCC Holdings, Inc.*, 605 F. Supp. 2d 26, 66 (D.D.C. 2009) (Collyer, J.).

The barriers to entry in this market are extraordinarily high. Glass plants cost hundreds of millions of dollars and take years to build. Not surprisingly, Defendants tout the fact that "new market entrants are faced with meaningful barriers to entry, including significant start-up costs (estimated at $200 million for a new plant)," and other barriers.[6] Where, as here, the market is ripe for coordination and new entry is improbable, "no court has ever approved a merger to duopoly." *Heinz*, 246 F.3d at 717.

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[3] PX 1260-004; Fredlake Dep. at 126-27.

[4] [redacted]

[5] [redacted] *see also* Grewe Dep. at 128 [redacted]

[6] PX 1247-008.

Ed.: Statement of Facts omitted

V. The Commission Challenges Ardagh's Acquisition Of Saint-Gobain.

Ardagh and Compagnie de Saint-Gobain, Saint-Gobain's parent company, entered into a Share Purchase Agreement on January 17, 2013, pursuant to which Ardagh proposes to acquire Saint-Gobain for approximately $1.7 billion on or before January 13, 2014. On June 28, 2013, the Commission voted to file an administrative complaint challenging the acquisition and authorized Commission staff to seek a preliminary injunction enjoining the acquisition pending the resolution of the Commission's administrative trial.

ARGUMENT

The question before this Court is whether it is in the public interest to order Defendants to refrain from closing their transaction until the FTC has concluded its ongoing administrative proceeding. Under controlling law, the answer is plainly yes.

I. THE FTC HAS RAISED "SERIOUS, SUBSTANTIAL" ISSUES APPROPRIATE FOR AN ADMINISTRATIVE TRIAL.

The Commission has determined that it has "reason to believe" that Ardagh's proposed acquisition of Saint-Gobain violates Section 7 of the Clayton Act and Section 5 of the FTC Act.

[55] PX 1379 ¶¶ 1, 10-13 (Complaint, *Anchor Glass Container Corp. v. Owens-Illinois, Inc.*, No. 8:01-cv-1849 (M.D. Fla. Sep. 26, 2001)).

In these circumstances, Section 13(b) of the FTC Act authorizes the Commission to seek a preliminary injunction halting the merger until the Commission "has had an opportunity to adjudicate the merger's legality in an administrative proceeding." *CCC Holdings,* 605 F. Supp. 2d at 35 (citing 15 U.S.C. § 53(b)). The merits trial is scheduled to begin on December 2, 2013 before an administrative law judge, and discovery in that action is nearly complete. Although the acquisition agreement permits Defendants to close in early 2014 (and could presumably be extended), Defendants have threatened to close their acquisition before the completion of the administrative trial. Ardagh intends to litigate the merits trial to conclusion regardless of whether this Court grants the Commission injunctive relief. Ardagh's counsel told the administrative law judge: "[i]f the injunction issues, the parties intend to continue on the administrative proceeding. We will continue to litigate. . . .That is not bluster, Your Honor."[56] Thus, the only issue for this Court is whether the Commission is entitled to a preliminary injunction to preserve its ability to obtain effective relief and to prevent consumer harm.

Section 13(b) of the FTC Act enables the Commission to seek to preserve the status quo in this precise situation. The legislation authorizes the Court to issue a preliminary injunction "where such action would be in the public interest—as determined by a weighing of the equities and a consideration of the Commission's likelihood of success on the merits." *Heinz,* 246 F.3d at 714. The Court must balance these two "public interest" considerations on a sliding scale. *See CCC Holdings*, 605 F. Supp. 2d at 35 (citing *Heinz,* 246 F.3d at 714); *Whole Foods*, 548 F.3d at 1035 (Brown, J.); *FTC v. Elders Grain, Inc.*, 868 F.2d 901, 903 (7th Cir. 1989) (Posner, J.). The greater the FTC's showing of likelihood of success on the merits, the heavier the

[56] PX 0005 (Initial Scheduling Conference Transcript) at 9.

defendants' burden to show "particularly strong equities" in their favor. *Whole Foods*, 548 F.3d at 1035 (Brown, J.); *Elders Grain*, 868 F.2d at 903.

In Section 13(b), Congress demonstrated its concern that "injunctive relief be broadly available to the FTC." *Heinz*, 246 F.3d at 714 (quoting *FTC v. Exxon Corp*., 636 F.2d 1336, 1343 (D.C. Cir. 1980)). Accordingly, Section 13(b) eases the more stringent injunction standard required of private parties. *Id.*; *see also Whole Foods*, 548 F.3d at 1042 (Tatel, J.) ("[T]he FTC – an expert agency acting on the public's behalf – should be able to obtain injunctive relief more readily than private parties."). Thus, at this stage, the FTC is *not* required to prove, nor is this Court required to find, that the proposed acquisition would violate the antitrust laws. *CCC Holdings*, 605 F. Supp. 2d at 35 (citing *Staples,* 970 F. Supp. at 1070). As the D.C. Circuit recognized in *Heinz*, "[t]hat adjudicatory function is vested in the FTC in the first instance." 246 F.3d at 714 (quoting *FTC v. Food Town Stores, Inc.*, 539 F.2d 1339, 1342 (4th Cir. 1976)).

The Commission has met the standard for showing a likelihood of success on the merits because the evidence here raises "serious, substantial questions meriting further investigation." *Whole Foods*, 548 F.3d at 1049 (Tatel, J.); *id.* at 1035 (Brown, J.); *Heinz*, 246 F.3d at 714-15; *see also CCC Holdings*, 605 F. Supp. 2d at 36. Defendants' admissions alone raise serious questions of illegality surrounding this acquisition. Anchor alleged in its 2001 antitrust lawsuit that the "market for the manufacture and sale of glass containers in the United States is highly concentrated" and "the three largest producers . . . account for in excess of 90% of the domestic volume."[57] The glass container industry remains just as concentrated today as it was then.

The proposed acquisition would create a duopoly in markets with high entry barriers and conditions ripe for coordination – an outcome "no court has ever approved." *Heinz*, 246 F.3d at

[57] PX 1379 ¶ 13.

716-17; *see, e.g.*, *CCC Holdings*, 605 F. Supp. 2d 26 (preliminarily enjoining three-to-two merger of insurance software providers); *FTC v. Swedish Match*, 131 F. Supp. 2d 151 (D.D.C. 2000) (preliminarily enjoining merger of loose-leaf tobacco firms where "the top two firms left. . . will have ninety percent of the market."); *FTC v. Staples, Inc.*, 970 F. Supp. 1066 (D.D.C. 1997) (preliminarily enjoining three-to-two merger of office supply superstores); *United States v. H&R Block, Inc.*, 833 F. Supp. 2d 36 (D.D.C. 2011) (permanently enjoining three-to-two merger of tax software firms). There is no reason for this Court to be the first to bless such a merger.

Under the second prong of the Section 13(b) analysis, there is a general presumption in favor of the FTC in the weighing of the equities because "'the public interest in the effective enforcement of the antitrust laws' was Congress's specific 'public equity consideration' in enacting" Section 13(b). *Whole Foods*, 548 F.3d at 1035 (Brown, J.) (quoting *Heinz*, 246 F.3d at 726). No compelling public equities favor allowing this acquisition to close before the trial. Private equity considerations, such as a risk that a transaction will not occur, are given little weight. *Whole Foods*, 548 F.3d at 1034-35 (Brown, J.); *CCC Holdings*, 605 F. Supp. 2d at 75-76. Here, because Defendants confirmed that they will litigate through trial regardless of this Court's ruling, there is nothing to weigh. Preserving the status quo will protect the public interest and will not harm Defendants, who can close their transaction if they succeed in the ongoing administrative proceeding.

[Remainder of brief omitted]

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

FEDERAL TRADE COMMISSION, Plaintiff, v. ARDAGH GROUP, S.A., COMPAGNIE DE SAINT-GOBAIN, and SAINT-GOBAIN CONTAINERS, INC., Defendants.	Case No. 13-CV-1021 (BJR) **PUBLIC (REDACTED)**

DEFENDANTS' MEMORANDUM OF LAW IN OPPOSITION TO THE FEDERAL TRADE COMMISSION'S MOTION FOR A PRELIMINARY INJUNCTION

Wayne D. Collins (D.C. Bar 430266)
Alan S. Goudiss (*pro hac vice*)
Richard F. Schwed (*pro hac vice*)
Heather L. Kafele (D.C. Bar 473584)
SHEARMAN & STERLING LLP
599 Lexington Avenue
New York, New York 10022
Tel: (212) 848-4000
Email: rschwed@shearman.com

Counsel for Defendant Ardagh Group, S.A.

Christine A. Varney
Sandra C. Goldstein (*pro hac vice*)
Yonatan Even (*pro hac vice*)
CRAVATH, SWAINE & MOORE LLP
825 Eighth Avenue
New York, New York 10019
Tel: (212) 474-1000
Email: yeven@cravath.com

Counsel for Defendants Compagnie de Saint-Gobain and Saint-Gobain Containers, Inc.

September 18, 2013

Excerpts--Full version may be found on class web site

Defendants Ardagh Group S.A. ("Ardagh"), Compagnie de Saint-Gobain ("CSG"), and Saint-Gobain Container, Inc. (d/b/a "Verallia" or "VNA") (collectively, "Defendants") respectfully submit this Memorandum of Law in Opposition to the Federal Trade Commission's ("FTC") Motion for a Preliminary Injunction enjoining Ardagh's proposed acquisition of VNA.

PRELIMINARY STATEMENT

The FTC's Motion for a Preliminary Injunction is fundamentally flawed. Ignoring directly on-point precedent, the FTC paints a picture of three powerful glass manufacturers colluding against their stranded customers—beer brewers and liquor distillers—and claims that this Court must act to prevent a merger that will convert an anticompetitive oligopoly to an uncontrollable duopoly. This picture bears no resemblance to reality. The evidence and controlling law make clear that the FTC's motion should be denied.

First, the FTC's alleged relevant product markets—glass containers for beer and for liquor—are legally unsustainable. The FTC's "glass-only" markets ignore the reality that glass container manufacturers are fighting a losing battle against the makers of metal and plastic containers. Glass container manufacturers have struggled in the face of high operating costs, declining demand, and bankruptcies, always one price increase away from losing further volume to alternative packaging. More troubling, the FTC's assertion of "glass-only" product markets ignores controlling legal precedent in which these markets have been explicitly rejected by the Supreme Court, this Court, and the FTC itself. This precedent alone requires rejection of the FTC's market definitions. And developments since the time of this controlling precedent further prove that the relevant markets cannot comprise glass only—today, over 50% of all domestically-packaged beer is packaged in aluminum cans and over 40% of all domestically-packaged spirits is packaged in plastic containers.

Second, the FTC's alleged nationwide geographic market for beer containers ignores the high shipping costs of beer bottles and the testimony of beer customers that distant plants cannot effectively compete for their business. Courts uniformly have held that high transportation costs relative to a product's price typically result in narrow geographic markets. In this case, the geographic market for beer containers is much narrower than the United States.

Third, even if the appropriate relevant markets are glass-only (which they are not), the merger will not have an anticompetitive effect. There is limited competition between Defendants for the sale of beer or spirits containers due to high freight costs, geographically dispersed plants, specialized production lines, and lack of excess capacity, and so there is little meaningful competition that could be impacted by the merger. In addition, both the beer and spirits industries are characterized by a handful of very powerful buyers that are well-equipped to keep glass container prices low. Indeed, [redacted] customers account for almost [redacted]% of Ardagh's beer container revenues, while [redacted] other customers account for over [redacted]% of Ardagh's liquor container revenues. Moreover, these customers are protected by long-term contracts that lock in pricing terms and constrain Ardagh's ability to raise prices after the merger.

Fourth, Ardagh entered into this transaction because it will result in synergies (such as overhead costs savings, reductions in production costs, and manufacturing footprint efficiencies) of at least $95 million annually, which have a present discounted value well in excess of [redacted]. Many of these gains, which will not happen absent this transaction, will be passed on to the customers and others (e.g., lower manufacturing costs) will benefit customers by enabling the combined company to better compete with nonglass packaging, ensuring its long-term survivability.

Fifth, the balance of the equities weighs against the drastic remedy of a preliminary injunction. A preliminary injunction would not simply "preserve the status quo" pending completion of the administrative proceeding; it could effectively doom the merger. While Ardagh is committed to defending the transaction to a final resolution, the merger agreement terminates if the merger is not closed by mid-January, 2014. Thus, if the merger is enjoined, Ardagh may not have the chance to pursue the case to its administrative conclusion.

Finally, Ardagh is restructuring the transaction to further demonstrate that an injunction is not warranted. The restructuring, which is contingent upon the merger closing, has two parts: (1) Ardagh is selling three beer bottle plants and one plant that makes liquor bottles to a capable and well-financed third-party that will be a new and significant competitor, and (2) Ardagh is providing craft beer customers an option to extend their existing supply contracts to 2023, locking in their premerger pricing terms (at the customer's election) for up to ten years. The FTC could not meet its burden to obtain a preliminary injunction against the original transaction and certainly cannot meet its burden against the restructured transaction.

[Background omitted]

APPLICABLE LAW

Section 7 of the Clayton Act bars mergers "'the effect of [which] may be substantially to lessen competition, or to tend to create a monopoly' in 'any line of commerce or in any activity affecting commerce in any section of the country.'" *FTC v. CCC Holdings Inc.*, 605 F. Supp. 2d 26, 35 (D.D.C. 2009) (quoting 15 U.S.C. § 18). The FTC must establish three elements to prove a Section 7 claim: "(1) the relevant product market in which to assess the transaction, (2) the geographic market in which to assess the transaction, and (3) the transaction's probable effect on competition in the relevant product and geographic markets." *FTC v. Arch Coal, Inc.*, 329 F. Supp. 2d 109, 117 (D.D.C. 2004) (citing *United States v. Marine Bancorporation*, 418 U.S. 602, 618-23 (1974)). The FTC has "the burden on every element of their Section 7 challenge, and a failure of proof in any respect will mean the transaction should not be enjoined." *Id*. at 116.

Under 15 U.S.C. § 53(b), "[t]he FTC has the burden of proof in presenting this motion for a preliminary injunction to show a likelihood of success on the merits" of its Section 7 Clayton Act claim. *FTC v. Owens-Illinois, Inc.*, 681 F. Supp. 27, 33-34 (D.D.C. 1988), *vacated as moot*, 850 F.2d 694 (D.C. Cir. 1988) (per curiam). The FTC may establish a presumption in favor of preliminary injunctive relief by raising questions "so serious, substantial, difficult and doubtful as to make them fair ground for thorough investigation." *FTC v. H.J. Heinz Co.*, 246 F.3d 708, 714-15 (D.C. Cir. 2001). But the presumption is *rebuttable*, *id*. at 725, *see FTC v. Whole Foods Mkt, Inc.*, 548 F.3d 1028, 1035 (D.C. Cir. 2008), and courts will deny a preliminary injunction where the FTC fails to demonstrate a likelihood of prevailing on the merits.[18] Although the FTC's burden may be somewhat lower than that of a private litigant seeking interim injunctive relief, "the FTC's burden is not insubstantial." *Arch Coal, Inc.*, 329 F. Supp. 2d at 116. It is certainly not the low bar the FTC wishes for itself in its papers. (*See* FTC Br. at 2, 14). A district court may not "simply rubber-stamp an injunction whenever the FTC provides some threshold evidence; it must 'exercise independent judgment' about the questions § 53(b) commits to it." *Whole Foods*, 548 F.3d at 1035 (quoting *FTC v. Weyerhaeuser Co.*, 665 F.2d 1072, 1082 (D.C. Cir. 1981)). Moreover, "'[a] showing of a fair or tenable chance of success on the merits will not suffice for injunctive relief.'" *Arch Coal*, 329 F. Supp. at 116 (quoting *FTC v. Tenet Health Care Corp.*, 186 F.3d 1045, 1051 (8th Cir. 1999)); *see FTC v. Swedish Match*, 131 F. Supp. 2d 151, 156 (D.D.C. 2000) (same); *FTC v. Staples, Inc.*, 970 F. Supp. 1066, 1072 (D.D.C. 1997) (same).

[18] *See, e.g.*, *FTC v. Lab. Corp. of Am.*, No. SACV 10–1873 AG (MLGx), 2011 WL 3100372 (C.D. Cal. Mar. 11, 2011) (denying preliminary injunction); *FTC v. Lundbeck, Inc.*, Civ. Nos. 08-6379 (JNE/JJG), 08-6381 (JNE/JJG), 2010 WL 3810015 (D. Minn. Aug. 31, 2010) (same), *aff'd*, 650 F.3d 1236 (8th Cir. 2011); *FTC v. Foster*, No. CIV 07-352 JBACT, 2007 WL 1793441 (D.N.M. May 29, 2007) (same); *FTC v. Arch Coal, Inc.*, 329 F. Supp. 2d 109 (D.D.C. 2004) (same); *FTC v. Butterworth Heath Corp.*, 946 F. Supp. 1285 (W.D. Mich. 1996) (same), *aff'd*, 121 F.3d 708 (6th Cir. 1997) (unpublished); *Owens-Illinois*, 681 F. Supp. at 27 (same).

A district court must also "balance the likelihood of the FTC's success against the equities." *Whole Foods*, 548 F.3d at 1035.

[Remainder of brief omitted]

FTC v. CCC Holdings Inc.

CCC Information Services and Mitchell International to Merge

CCC-Mitchell Inc. to Focus on Enhancing Value for Customers Through Increased Innovation and Network Connectivity

April 11, 2008 01:30 PM Eastern Daylight Time

CHICAGO & SAN DIEGO--(BUSINESS WIRE)--CCC Information Services Inc., of Chicago, Ill., and Mitchell International, Inc., of San Diego, Calif., today announced the signing of a definitive agreement under which they will combine in a merger-of-equals transaction valued at $1.4 billion.

CCC and Mitchell are each privately held. The combined enterprise, which will be known as CCC-Mitchell Inc., will be a leading provider of information, workflow management systems and integrated software to insurance companies and collision repair facilities. The company's data, software and services will support the estimating and processing of claims for auto physical damage and bodily injury. At inception, CCC-Mitchell will have annual sales of approximately $460 million and approximately 2,000 employees.

> "CCC-Mitchell will draw from the talent pools of both companies, with a focus on continuing to provide outstanding products, service and support for our customers."

Githesh Ramamurthy, Chairman and Chief Executive Officer of CCC, said: "This transaction will be a transforming event for the insurance claims and collision repair industries. Our customers are under increasing pressure to achieve new levels of efficiency and customer satisfaction, which requires their service providers to offer new and enhanced products, services and solutions. CCC-Mitchell will be positioned to meet these needs as we bring together our two talented teams to create greater value for our customers and business partners through increased innovation and network connectivity."

Alex Sun, President and Chief Executive Officer of Mitchell, said: "We are pleased to have entered into this transaction with CCC, a company that shares our commitment to integrity, innovation and providing outstanding customer service and support. This combination brings together a unique set of products and skills and an increased resource capability that will accelerate innovation, enhance our service levels and over time simplify the lives of our respective customers through greater connectivity and more seamless workflow between the broader portfolio of solutions offered."

Among the customer benefits of the transaction, the combined company will have:

- An expanded communication network to deliver greater connectivity between insurers, repair facilities, and other industry service providers and suppliers;
- Expanded Research & Development resources and a greater ability to enhance current products and services, deliver new technology-based claims solutions, and provide faster time-to-market product delivery;

- An expanded sales and service organization, providing broader and better customer service across North America;
- A larger, more comprehensive data warehouse that will improve the company's ability to deliver industry insights through benchmarking, data analytics and predictive modeling; and
- A broad and widely used portfolio of claims and collision repair solutions from one provider.

Under the agreement, which was unanimously approved by the Boards of Directors of both companies, Mitchell and CCC will merge in a stock-for-stock exchange. Ownership and board seats will be held equally by Aurora Capital Group, the private equity sponsor of Mitchell, and Investcorp, the private equity sponsor of CCC. In addition, CCC-Mitchell management will have a significant stake in the combined enterprise.

Mr. Ramamurthy, currently Chairman and CEO of CCC, will become the CEO of the combined company. Mr. Sun, currently President and CEO of Mitchell, will serve as President of CCC-Mitchell.

"Among its many advantages, the expanded resources of the combined enterprise will enable it to deliver more innovation faster, which will drive increased growth and will, in turn, provide employees with enhanced opportunities for career advancement," Mr. Sun said. "CCC-Mitchell will draw from the talent pools of both companies, with a focus on continuing to provide outstanding products, service and support for our customers."

Mr. Ramamurthy added: "The combined company will be able to expand and update our product portfolio, customer base and geographic coverage more quickly than either company could have individually. Over time, our auto physical damage products and services will evolve to a single, leading platform for each of our applications, allowing us to deliver greater innovation and functionality to both insurers and repairers."

Given the geographic distribution of the companies' respective workforces and customers, as well as the companies' ability to connect through their existing systems, it is anticipated that CCC-Mitchell will operate from multiple locations while maintaining a significant presence in both San Diego and Chicago.

Completion of the transaction is expected to occur immediately following completion of regulatory review and satisfaction of customary closing conditions.

About CCC Information Services Inc.

CCC, founded in 1980, is a leading provider of advanced software, communications systems, and Internet and wireless enabled technology to the automotive claims and collision repair industries. Its client base includes more than 350 insurance companies and thousands of repair facilities. In addition to its products, CCC delivers extensive industry insight to its clients by leveraging the industry's most comprehensive auto claims data warehouse comprising data captured from the millions of transactions processed through its network, complemented by information from more than 30 other data providers. You can find out more about CCC Information Services Inc. by visiting the company's web site at www.cccis.com.

About Mitchell International, Inc.

Mitchell is a leading provider of information, workflow, and performance management solutions to the insurance claims and automotive repair industries. Founded in 1946, Mitchell has developed a rich legacy as the only provider of solutions that address both physical damage and casualty claims needs. In addition, Mitchell is a leading provider of solutions designed to improve the performance of collision repairers through its business systems and customer satisfaction indexing offerings. Mitchell facilitates millions of electronic transactions between thousands of business partners each month to enhance their productivity, profitability, and customer satisfaction levels. On April 2, 2008, Mitchell announced its intention to acquire the Medical Bill Review division of the Fair Isaac Corporation, extending its casualty solutions position to encompass both auto and workers compensation claims. You can find out more about Mitchell International by visiting the company's web site at www.mitchell.com.

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Kekst and Company
Michael Freitag or Roy Winnick, 212-521-4800

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PROTECTING AMERICA'S CONSUMERS

MAIN MENU SEARCH

FTC Launches Suit to Block Merger of CCC and Mitchell

Merger Would Leave Only Two Competitors in the Markets for Estimating and Total Loss Valuation Systems Used by Insurance Adjusters and Auto Body Shops

FOR RELEASE

November 25, 2008

TAGS: Competition

The Federal Trade Commission has filed suit to block the merger of CCC Information Services Inc. and Mitchell International Inc., charging that the merger would hinder competition in the market for electronic systems used to estimate the cost of collision repairs, known as "estimatics," and the market for software systems used to value passenger vehicles that have been totaled, known as total loss valuation (TLV) systems. The FTC's administrative complaint alleges that the merger, which is valued at $1.4 billion, would harm insurers, repair shops and, ultimately, U.S. car owners by reducing from three to two the number of competitors in the two related businesses.

"These estimating and valuation solutions are key tools in the auto insurance and collision repair industries," said Acting Bureau of Competition Director David P. Wales. "There is no doubt that this merger would reduce competition that benefits auto insurers and auto body shops and ultimately would lead to higher prices and less innovation for consumers."

According to the FTC, the merger of CCC and Mitchell would eliminate head-to-head competition between the two companies and leave the combined company with a market share of far more than half of the sales of estimatics, and a market share of far more than half of the sales in the market for TLV systems, creating a likelihood of adverse unilateral effects. The merger also would facilitate coordination among the remaining two competitors, CCC/Mitchell and Audatex, the FTC states in its complaint.

Chicago-based CCC Information Services Inc., a subsidiary of CCC Holdings Inc., was founded in 1980 and has approximately 1,300 employees. The company sells its services to insurance companies, collision repair shops, and independent appraisers. Mitchell International Inc., primarily owned by Aurora Equity Fund III L.P., itself part of the Aurora Capital Group, was founded in 1946 in San Diego and has about 650 employees. The companies announced their planned merger on April 11, 2008. Each of the companies provides both estimatics and TLV systems.

Estimatics consists of a database of parts, parts prices, and repair times, along with software that accesses the database and calculates repair costs based on input information about vehicle damage. These systems allow insurance adjusters and collision repair shops to estimate repair costs faster and more accurately than previously had been possible decades ago when estimates were written manually.

A TLV system also consists of a database and software. But rather than parts and repair cost information, the database contains vehicle information on recent, actual vehicle sales in every locality in the United States. TLV systems allow insurers to quickly obtain valuations for cars totaled in collisions based on recent, actual, local market sales. These valuations allow insurers to present car owners with settlement offers that are accurate and comply with all states' insurance regulations.

The markets for estimatics and TLV systems are already highly concentrated, according to the complaint filed by the FTC. A California-based company called Audatex is the only other significant competitor in both lines of business, the complaint states. CCC, Mitchell, and Audatex have long provided the estimatics market with solutions. Mitchell recently entered the TLV systems market with a new solution that has increased competition in that market, according to the complaint.

The Commission vote to issue the administrative complaint was 3-0, with Commissioner J. Thomas Rosch recused. The Commission also has authorized the staff to file a complaint in federal district court seeking a temporary restraining order and preliminary injunction to preserve the competitive status quo, pending an administrative trial on the merits.

Issuing a complaint is the first step in the administrative trial process. CCC and Mitchell will be offered FTC's "Fast Track" administrative trial procedure. The Commissioners are committed, subject to the bounds of reasonableness and fairness, to a just and expeditious resolution of any potential appeal that may be taken to the full Commission. Should there be an appeal, the Commissioners commit to make every effort to issue an appellate decision no later than 90 days after receiving a notice of appeal if there is no cross-appeal, or 120 days if there is a cross-appeal.

NOTE: The Commission files a complaint when it has "reason to believe" that the law has been or is being violated, and it appears to the Commission that a proceeding is in the public interest. The complaint is not a finding or ruling that the defendant has actually violated the law.

The FTC's Bureau of Competition works with the Bureau of Economics to investigate alleged anticompetitive business practices and, when appropriate, recommends that the Commission take law enforcement action. To inform the Bureau about particular business practices, call 202-326-3300, send an e-mail to antitrust@ftc.gov, or write to the Office of Policy and Coordination, Room 394, Bureau of Competition, Federal Trade Commission, 600 Pennsylvania Ave, N.W., Washington, DC 20580. To learn more about the Bureau of Competition, read "Competition Counts" at http://www.ftc.gov/competitioncounts.

(FTC File No. 081-0155)
(CCC-Mitchell.final.wpd)

CONTACT INFORMATION

MEDIA CONTACT:
Peter Kaplan,
Office of Public Affairs
202-326-2180
STAFF CONTACT:
Casey R. Triggs,
Bureau of Competition
202-326-2804

Related Cases

CCC Holdings Inc., and Aurora Equity Partners III L.P., In the Matter of

Media Resources

Our Media Resources library provides one-stop collections of materials on numerous issues in which the FTC has been actively engaged. These pages are especially useful for members of the media.

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

FEDERAL TRADE COMMISSION, 600 Pennsylvania Avenue, N.W. Washington, D.C. 20580 Plaintiff, v. CCC HOLDINGS INC. 222 Merchandise Mart Plaza, Suite 900 Chicago, IL 60654 and AURORA EQUITY PARTNERS, III L.P., 10877 Wilshire Boulevard, Suite 2100 Los Angeles, CA 90024, Defendants.	)))))))))))))))))	No. _____-CV-________

COMPLAINT FOR TEMPORARY RESTRAINING ORDER
AND PRELIMINARY INJUNCTION PURSUANT TO
SECTION 13(b) OF THE FEDERAL TRADE COMMISSION ACT

Plaintiff, the Federal Trade Commission ("FTC" or "Commission"), by its designated attorneys, petitions the Court, pursuant to Section 13(b) of the Federal Trade Commission Act ("FTC Act"), 15 U.S.C. § 53(b), and Section 16 of the Clayton Act, 15 U.S.C. § 26, for a temporary restraining order and preliminary injunction enjoining defendants CCC Holdings Inc. ("CCC Holdings") and Aurora Equity Partners III L.P. ("Aurora"), including their domestic and foreign agents, divisions, parents, subsidiaries, affiliates, partnerships, or joint ventures, from taking any steps toward combining or acquiring any stock, assets, or other interest of one another, either directly or indirectly; thereby maintaining the status quo during the pendency of an administrative proceeding that has already been initiated by the Commission pursuant to Section 5 of the FTC Act, 15 U.S.C. § 45, and Section 7 of the Clayton Act, 15 U.S.C. § 18.

NATURE OF THE CASE

1. This is an action to stop defendants from consummating or otherwise taking any steps toward an anticompetitive merger-to-duopoly until the completion of an administrative review proceeding begun by the Commission on November 25, 2008. Absent Court action, defendants may merge after December 3, 2008.

2. Defendant CCC Holdings is the parent of CCC Information Services, Inc. ("CCC"). Defendant Aurora is the parent of Mitchell International, Inc. ("Mitchell"). CCC and Mitchell sell, among other things, computer software and data services used by automobile repair shops and similar software and services used by insurance companies to estimate vehicle repair costs and to value "total loss" claims. Insurers must declare a vehicle a total loss when the expected repair costs reach a threshold established by state insurance laws.

3. If defendants' proposed $1.4 billion merger is consummated, the number of significant companies selling these products in the United States would be reduced from three to two, and the merged company will dominate these duopoly markets. The administrative complaint issued by the Commission on November 25, 2008, alleges that this merger-to-duopoly would result in higher prices, reduced product quality, and fewer services. Exh. 1. A hearing on the merits of the merger before an FTC Administrative Law Judge is scheduled to begin on March 31, 2009. *Id.* at 5.

4. Temporary and preliminary injunctive relief is imperative to preserve the status quo and allow the Commission to examine the proposed merger on the merits. Allowing CCC Holdings and Aurora to merge during the administrative proceeding would harm consumers and undermine the Commission's ability to remedy the anticompetitive effects of the transaction.

JURISDICTION AND VENUE

5. This Court's jurisdiction arises under Section 13(b) of the FTC Act, 15 U.S.C. § 53(b), and Section 16 of the Clayton Act, 15 U.S.C. § 26, and under 28 U.S.C. §§ 1331, 1337 and 1345. This is a civil action arising under Acts of Congress protecting trade and commerce against restraints and monopolies, and is brought by an agency of the United States authorized by an Act of Congress to bring this action. CCC Holdings, Aurora, and their relevant operating subsidiaries are, and at all relevant times have been, engaged in activities in or affecting "commerce" as defined in Section 4 of the FTC Act, 15 U.S.C. § 44, and Section 1 of the Clayton Act, 15 U.S.C. § 12.

6 Venue is proper under 15 U.S.C. §§ 22 and 53(b), and 28 U.S.C. § 1391(b) and (c), as both CCC Holdings and Aurora transact business in the District of Columbia.

7. Section 13(b) of the FTC Act, 15 U.S.C. 53(b), provides in pertinent part:

> (b) Whenever the Commission has reason to believe
>
> (1) that any person, partnership, or corporation is violating, or is about to violate, any provision of law enforced by the Federal Trade Commission, and
>
> (2) that the enjoining thereof pending the issuance of a complaint by the Commission and until such complaint is dismissed by the Commission or set aside by the court on review, or until the order of the Commission made thereon has become final, would be in the interest of the public the Commission by any of its attorneys designated by it for such purpose may bring suit in a district court of the United States to enjoin any such act or practice. Upon a proper showing that weighing the equities and considering the Commission's likelihood of ultimate success, such action would be in the public interest, and after notice to the defendant, a temporary restraining order or a preliminary injunction may be granted without bond. . . .

THE PARTIES

8. Plaintiff, the Commission, is an administrative agency of the United States Government established, organized, and existing pursuant to the FTC Act, 15 U.S.C. § 41 *et seq.*,

with its principal offices at 600 Pennsylvania Avenue, N.W., Washington, D.C. 20580. The Commission has the authority and responsibility to enforce, among other things, Section 7 of the Clayton Act and Section 5 of the FTC Act.

9. Defendant CCC Holdings is a for-profit corporation, existing and doing business under and by virtue of the laws of the state of Delaware, with its office and principal place of business located at 222 Merchandise Mart Plaza, Suite 900, Chicago, Illinois 60654. CCC Holdings wholly owns CCC.

10. Defendant Aurora is a limited partnership, existing and doing business at 10877 Wilshire Boulevard, Suite 2100, Los Angeles, California 90025. Aurora wholly owns Mitchell.

THE MERGER

11. A merger agreement executed by CCC Holdings and Aurora on or about April 2, 2008, contemplates a merger of equals. The transaction is valued at $1.4 billion and will create an entity with annual sales exceeding $450 million.

12. Pursuant to the Hart-Scott-Rodino Antitrust Improvements Act, 15 U.S.C. § 18a, and a timing agreement between defendants and the FTC staff, unless restrained or enjoined by this Court, defendants may consummate the merger after December 3, 2008. Defendants have indicated they intend to do so as soon as possible.

13. On November 25, 2008, the Commission authorized commencement of this action under Section 13(b) of the FTC Act, 15 U.S.C. § 53(b), to seek a temporary restraining order and preliminary injunction barring the merger until the resolution of the administrative proceeding that was commenced by the Commission on the same day, pursuant to Section 11(b) of the Clayton Act, 15 U.S.C. § 21(b), and Section 5 of the FTC Act, 15 U.S.C. § 45. The legality of the merger under Section 7 of the Clayton Act, 15 U.S.C. § 18, and Section 5 of the FTC Act, 15

U.S.C. § 45, and the appropriate remedy in the event liability is found, will be determined by the Commission through an administrative proceeding and will be subject to judicial review.

14. In authorizing the filing of this complaint in this Court, the Commission has determined that (1) it has reason to believe this merger would violate the Clayton Act and the FTC Act by substantially reducing competition in one or more lines of commerce, and (2) it will promote the public interest for this Court to enjoin the merger pending the resolution of the Commission's administrative proceedings, and any appeals, so as to minimize the potential harm to customers and preserve the Commission's ability to grant an adequate remedy if it concludes, after the hearing, that the merger is unlawful.

AFFECTED MARKETS

15. The relevant product markets that would be affected by the merger are:

a. partial loss estimating systems ("estimatics") and

b. total loss valuation systems ("TLV systems")

for passenger vehicles sold in the United States. These products could be produced throughout the world.

16. Estimatics are used by repair shops and insurers to estimate vehicle repair costs for passenger vehicles sold in the United States. Estimatics include: (1) a database of parts and labor information for specific vehicle makes, models, and years, and (2) software to access the database and calculate repair costs based on damage information provided by a user.

17. When repair costs reach a certain threshold, which varies from state to state, but is typically between 65 and 75 percent of the vehicle's value, a vehicle must be declared a total loss for insurance purposes. Insurers use TLV systems to determine replacement values of vehicles

sold in the United States. TLV systems include: (1) a database of vehicle sales information from various sources, and hundreds of localities, and (2) software to access and use the database.

18. Both relevant product markets are already highly concentrated, and the proposed merger would further increase concentration levels.

19. There are only three significant providers of estimatics for passenger vehicles sold in the United States: CCC, Mitchell, and Audatex North America, Inc. ("Audatex"). The proposed merger would reduce the number of significant sellers of these products from three to two, with the merged entity having a share of well over half the market.

20. CCC, Mitchell, and Audatex are also the only providers of TLV systems for passenger vehicles sold in the United States. The proposed merger would reduce the number of sellers of these products from three to two, with the merged entity having a share of well over half the market.

ANTICOMPETITIVE EFFECTS

21. The merger of CCC and Mitchell would consolidate two of the three significant providers of estimatics and TLV systems, eliminating substantial head-to-head competition between CCC and Mitchell.

22. Thus, the merger would eliminate both price and nonprice competition between CCC and Mitchell and facilitate the merged entity's unilateral exercise of market power

23. In addition, with a post-acquisition duopoly consisting of CCC-Mitchell and Audatex, and with information relating to competitors' offerings, customers, and prices being available, both of these markets are conducive to the coordinated exercise of market power.

24. The acquisition is of additional concern because, but for the merger, competition between Mitchell, CCC, and Audatex in total loss valuation systems likely would increase in intensity in the coming years, because Mitchell has been gradually gaining market share.

ENTRY BARRIERS

25. Substantial and effective entry into the relevant markets sufficient to deter or counteract the anticompetitive effects of the proposed merger-to-duopoly is unlikely, as the estimatics and TLV systems markets exhibit significant barriers to entry. These include, but are not limited to, the substantial time and expense required to assemble, edit, and maintain estimatics and TLV databases relating to virtually every vehicle driven in the United States, as required by customers, to develop and market a communications software platform, reputation and expertise required by customers to operate these systems, long-term contracts with customers who do not switch easily, and complementary products that are sold as part of bundled packages.

LIKELIHOOD OF SUCCESS ON THE MERITS, BALANCE OF EQUITIES, AND NEED FOR RELIEF

26. In deciding whether to grant relief, the Court must balance the likelihood of the Commission's ultimate success on the merits against the *public* equities, using a sliding scale. Equities affecting only the defendants cannot tip the scale.

27. The Commission's administrative complaint raises questions about the lawfulness of defendants' proposed three-to-two merger under the Clayton Act and the FTC Act that are serious, substantial, difficult, or doubtful enough to make them fair ground for thorough investigation, study, deliberation, and determination by the Commission during the administrative proceeding in the first instance, subject to appellate review.

28. The Commission has reason to believe that the proposed merger would violate Section 7 of the Clayton Act and that the merger agreement violates Section 5 of the FTC Act. In particular, the Complaint Counsel for the Commission is likely ultimately to succeed in demonstrating, among other things, that:

a. The proposed merger-to-duopoly would have anticompetitive effects in both the estimatics and TLV systems markets;

b. Substantial and effective entry into the estimatics and TLV systems markets is difficult, and would not be likely, timely, or sufficient to offset the anticompetitive effects of the merger; and

c. Any efficiencies that defendants may assert will result from the merger are speculative, not merger-specific, and are, in any event, insufficient as a matter of law to justify the merger.

29. Should the Commission rule, after the full administrative trial, that the proposed transaction is unlawful, completely reestablishing the status quo ante of vigorous competition between CCC and Mitchell would be difficult, if not impossible, if the merger has already occurred. Moreover, substantial harm to competition would likely occur in the interim, even if suitable divestiture remedies could be devised.

30. Accordingly, the equitable relief requested here is in the public interest.

WHEREFORE, the Commission respectfully requests that the Court:

1. Temporarily restrain and preliminarily enjoin CCC Holdings and Aurora from taking any further steps to consummate the proposed merger, or any other acquisition of stock, assets, or other interests, either directly or indirectly;

2. Retain jurisdiction and maintain the status quo until the administrative proceeding that the Commission has initiated is concluded; and

3. Award such other and further relief as the Court may determine is appropriate, just, and proper.

November 26, 2008

Respectfully submitted,

By: ______________________

J. ROBERT ROBERTSON
D.C. Bar No. 501873
CASEY R. TRIGGS
ERIC M. SPRAGUE
DONALD R. GORDON
DAVID E. MORRIS
KYLE CHADWICK
VICTORIA L. LIPPINCOTT
SEAN HUGHTO
CECELIA WALDECK
ANGELIKE ANDRINOPOULOS MINA
Attorneys
Federal Trade Commission
Bureau of Competition
600 Pennsylvania Ave., NW
Washington, DC 20580
Telephone: (202) 326-2008

Attorneys for Plaintiff

DAVID P. WALES
Acting Director
NORMAN ARMSTRONG, JR.
Acting Deputy Director
Bureau of Competition

WILLIAM BLUMENTHAL
General Counsel
Federal Trade Commission

CATHARINE M. MOSCATELLI
Assistant Director
ROBERT S. TOVSKY
MORRIS A. BLOOM
Deputy Assistant Directors
Bureau of Competition
Mergers II Division

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on the 26th day of November, 2008, I filed the attached document with the clerk of the court.

I FURTHER CERTIFY that on such date I served the attached on the following counsel by electronic mail (PDF) and U.S. Mail:

John A. Herfort
Gibson, Dunn & Crutcher LLP
200 Park Avenue
New York, NY 10166-0193
JHerfort@gibsondunn.com

Counsel for Defendant CCC Holdings, Inc.

Richard G. Parker
O'Melveny & Myers LLP
1625 Eye Street, NW
Washington, DC 20006
Rparker@omm.com

Counsel for Defendant Aurora Equity Partners III L.P.

J. Robert Robertson
Counsel for Plaintiff
Federal Trade Commission

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

FEDERAL TRADE COMMISSION, **Plaintiff,** **v.** **CCC HOLDINGS INC., *et al.*,** **Defendants.**	)	**Civil Action No. 08-2043 (RMC)**

MEMORANDUM OPINION[1]

American drivers make nearly twenty-five million automobile insurance claims each year and insurers, in turn, spend an estimated $100 billion annually to cover those claims. Most insurers and automotive repair shops use specialized computer software to estimate the cost of repair or the value of replacement in the event of a total loss. These software systems play a critical role in the automotive repair industry. CCC Information Services, Inc. ("CCC") and Mitchell International, Inc. ("Mitchell") are two of the largest companies in these markets. Audatex North America, Inc. ("Audatex"), formerly ADP Claims Services Group, is the one other significant competitor for sales of partial loss estimating and total loss valuation software.[2]

CCC is a wholly owned subsidiary of CCC Holdings Inc. ("CCC Holdings"), a for-profit corporation, existing and doing business under the laws of Delaware, and

[1] This Memorandum Opinion was provided to the parties in final form on March 9, 2009, but public release was delayed to ensure that no confidential business information that had been submitted under seal was being released. Based on input from Defendants and certain interested third parties, some competitively sensitive information has been redacted and other minor adjustments have been made to the opinion. The phrase "[Text redacted]" has been inserted to signify where text has been redacted from the opinion.

[2] Audatex is a subsidiary of Solera Holdings, Inc. ("Solera"), a publicly-traded holding company based in San Diego, California.

headquartered in Chicago, Illinois. CCC Holdings is principally owned by Investcorp, S.A. ("Investcorp"), a private equity firm with more than $15 billion under management, and funded primarily by investors in Saudi Arabia. The majority owner of Mitchell is Aurora Equity Partners III, L.P. ("Aurora"), a private equity firm based in Los Angeles, California, which has approximately $2 billion of assets.

On April 2, 2008, Defendants CCC Holdings and Aurora entered into a Restructuring Agreement ("Restructuring Agreement") which contemplates a $1.4 billion "merger of equals" between CCC and Mitchell to be effected no later than March 31, 2009. PX 786.[3] The Federal Trade Commission ("FTC" or "Commission"), through its Bureau of Competition, seeks to preliminarily enjoin the pending transaction, positing that a 3-to-2 merger in the partial loss and total loss software markets would obviously and substantially harm competition. The Court finds the evidence more complicated and uncertain. Nonetheless, because the FTC has "raised questions going to the merits so serious, substantial, difficult and doubtful as to make them fair ground for thorough investigation, study, deliberation and determination by the FTC in the first instance and ultimately by the Court of Appeals," *FTC v. H.J. Heinz Co.*, 246 F.3d 708, 714-15 (D.C. Cir. 2001) (internal quotations omitted); *see also FTC v. Whole Foods Mkt., Inc.*, 548 F.3d 1028, 1035 (D.C. Cir. 2008) (Brown, J.); *id.* at 1042 (Tatel, J., concurring), the Court will issue the requested injunction.

[3] Technically, Mitchell's holding company would be merged into CCCM Parent (DE), Inc., a Delaware corporation, which, through a series of pass-through entities, would be held primarily by Investcorp and Aurora, as well as by the managing shareholders of CCC Holdings and Mitchell, and a mezzanine fund established by Goldman Sachs. PX786-018-019.

I. PROCEDURAL HISTORY

On November 25, 2008, the FTC found that it had "reason to believe" that the proposed merger would violate the antitrust laws, specifically Section 7 of the Clayton Act, 15 U.S.C. § 18, and issued an administrative complaint challenging the proposed merger. At the same time, the Commission, pursuant to Section 13(b) of the Federal Trade Commission Act ("FTC Act"), 15 U.S.C. § 53(b), and Section 16 of the Clayton Act, 15 U.S.C. § 26, authorized the Bureau of Competition to file the instant Complaint to petition the Court for a temporary restraining order and a preliminary injunction to preserve the status quo pending an administrative adjudication before the FTC; that trial is scheduled to commence no later than March 31, 2009, and the FTC has committed to rendering a final opinion within 90 days of an initial decision by the Administrative Law Judge. *See* FTC Press Release (Nov. 25, 2008). The merging parties suggest they will abandon the merger if an injunction issues, in part because financing would be too difficult to maintain during the administrative process. The Court held a total of nine days of evidentiary hearings and legal argument. The parties submitted approximately 15 boxes of documentary evidence, including documents obtained through discovery and deposition and FTC Investigation Hearing ("IH") transcripts, as well as nearly 300 pages of findings of fact and two rounds of highly refined and informative legal briefing.

II. FACTS

There are millions of accidents each year on roads across the United States. If the drivers in those accidents are insured, they file an insurance claim. This leads to an assessment of the extent of the damage to the automobile and an estimate of the cost of parts and labor needed to effect repairs, or if too expensive, replace the vehicle.

A. The Products

1. Estimatics

Costs for repair of damaged vehicles, or partial loss claims, account for well over $30 billion in insurance claims payments annually. *See* PX 256-003 (CCC).[4] Performing partial loss estimations was once a manual process. The appraiser or claims adjuster would rely on information from published sources and perform the calculations either by hand or with a desk calculator. PX 1020 ¶ 27 (Hayes Prelim. Report). Today, all major automobile insurers and the vast majority of the approximately 45,000 repair facilities subscribe to one or more estimating software products ("Estimatics"). PX 514-013, 015 (Mitchell); PX 531-001 (Mitchell); *see also* PX 6 ¶ 3 (Mello Decl., Anderson Behel Body Shop); PX 10 ¶ 2 (Dorn Decl., Dorn's Body & Paint). These products are much faster than manual calculations, permit analysis of more kinds of information, and are considered more reliable, consistent, and accurate. *See*, *e.g.*, PX 14 ¶ 4 (Brandt Decl., Hartford Fire Ins. Co. ("The Hartford")); PX 13 ¶ 3 (Hall Decl., GMAC); PX 20 ¶¶ 3-4 (Rollins Decl., Safeco Ins. Cos. ("Safeco")); PX 28 ¶ 3 (Wilson Decl., The Hanover Ins. Group, Inc. ("Hanover")); PX 27 ¶ 3 (Danford Decl., Ohio Mutual Ins. Group ("Ohio Mutual")); PX 11 ¶ 3 (Brown Decl., Erie Ins. Group ("Erie")); PX 30 ¶ 4 (Starnes Decl., State Farm Mutual Auto. Ins. Co. ("State Farm")). Estimatics products consist of three main components: (1) a spreadsheet that tracks the line items that are a part of a vehicle repair estimate, (2) the database

[4] Citations to the trial record are in the following form: references to Plaintiff's exhibits—"PX ____ ([Company])"; references to Defendants' exhibits—"DX ____ ([Company])"; references to the preliminary injunction hearing transcript—"[Name], Tr. ([Date]) at [page]:[line] ([Company])"; references to the FTC IH transcripts—"[Name] IH Tr. at [page] ([Company])"; references to deposition designations—"[Name] Dep. at [page] ([Company])"; references to Plaintiff's Findings of Fact—"PFF ¶ [____]"; references to Defendants' Findings of Fact—"DFF ¶ [____]". Citations may deviate from these formats as necessary to protect commercially sensitive information.

from which parts and labor costs are pulled, and (3) the software that calculates the total cost of repair, taking into consideration overlap times (such as the need to remove a bumper only once to perform two repairs behind or to the bumper). PX 1020 ¶ 12 (Hayes Prelim. Report) (citing Ramamurthy IH Tr. (7/22/08) at 198-200).

There are presently five companies in the United States that sell Estimatics: CCC, Mitchell, Audatex, Web-Est LLC ("Web-Est"), and Applied Computer Resources, but the three major competitors in the Estimatics market today are CCC, Audatex and Mitchell, which collectively hold the lion's share of the market — approximately 99%[5] — thus earning the nickname, the "Big Three." *See* PX 1020, Exs. 2-3 (Hayes Prelim. Report); *see also* PX 1028-004 (Web-Est).[6] There are two types of Estimatics products: communicating and non-communicating products. Communicating Estimatics tools are used by insurance companies and repair facilities that are part of a direct repair program ("DRP"), whereas non-communicating estimating tools are used by low-end repair facilities that are not part of a DRP. A DRP is a network of strategic alliances between an insurance company and the repair facilities with which it frequently does business. Communicating products allow insurance companies and DRP repair facilities to instantaneously relay information about the status of partial loss claims through specialized communication links, while non-communicating products do not have this capacity. *See* PX 1020 ¶ 12 (Hayes Prelim. Report); DX 644, App. 2 ¶ 7 (Ordover Coordinated Interaction Report). CCC, Mitchell and Audatex primarily sell communicating Estimatics

[5] Unless otherwise indicated, market shares approximate 2007 data, and are not current.

[6] Audatex also has a substantial global footprint, operating in approximately fifty-one countries across six continents. Including its international operations, Audatex is the largest Estimatics company in the world, and is twice the size of its nearest competitor. *See* PX 89-013 (Audatex).

products. Web-Est and Applied Computer Resources currently sell only non-communicating products.

CCC's core communicating Estimatics offering is called Pathways, but it also offers a low-end, non-communicating tool called Comp-Est which it markets to the independent repair facility segment. PX 86-008, 056 (CCC).[7] To procure the parts and labor data for its Estimatics product, CCC obtained an exclusive license to the Hearst Business Publishing, Inc. "Motor" database in 1998. PX 25 ¶ 22 (Carr Decl., Motor Information Systems ("Motor")). [Text redacted.].

Mitchell's communicating Estimatics product is UltraMate, although it also sells a low-end product called Repairmate. PX 680-004-005 (Aurora). Audatex's Estimatics product is called Audatex Estimating. Unlike CCC, both Audatex and Mitchell have their own proprietary databases, which were developed over many years.

The Estimatics providers generally charge their customers on a per user basis. Currently, the predominant medium for Estimatics software installation is a CD or DVD; monthly software updates must be sent to clients and re-installed on their systems. Web-Est, however, offers a Web-based non-communicating Estimatics product.[8] Seidel, Tr. (1/22 p.m.) at 165:18-22, 167:7-8 (Web-Est). It currently licenses Mitchell's database under restrictive conditions which prohibit it from selling to the top fifty insurance companies, from selling communicating Estimatics products to insurance companies or repair facilities, and from integrating with other third-party service providers, such as parts locators, salvage, and other

[7] CCC acquired Comp-Est in 2003. PX 86-013 (CCC).

[8] Audatex also has begun offering a web-based product. *See* DX 225-33-35 (Audatex).

providers. *See* DX 59 (Mitchell-Web-Est License Agreement); Seidel, Tr. (1/22 p.m.) at 173:24-174:13 (Web-Est). This restrictive license effectively precludes Web-Est from selling to most insurance companies and DRP repair facilities.

2. TLV

Some accidents may prove to be so costly that the insurer will declare the automobile a total loss because the estimated cost of repair approaches or exceeds the vehicle's value. In such situations, the insurance company will calculate the replacement cost of the automobile, as it existed before the accident, based on model, make, upgrades, condition, mileage, etc., and pay the policyholder the vehicle's replacement cost.[9] As with estimating repair costs, the total loss valuation process was once done only by hand. Today there are several different methodologies and tools for insurance companies to calculate total loss. One option is the "book" providers — NADA Appraisal Guides ("NADA"), the Kelley Blue Book, the Red Book, and the Black Book (collectively "the Books") — whose reports are based on local or regional values. Brungger IH Tr. at 121-22 (Mitchell); Linder IH Tr. at 43, 46 (Mitchell); Marushka IH Tr. at 18, 29-30 (CCC). These products are available in hard copy and many are available electronically; the electronic versions are updated more frequently than the printed Books. A number of insurance companies perform some or even most of their total loss valuations in-house using a combination of the Books and market research conducted by internal staff in order to obtain a more accurate and localized valuation than the Books can provide alone. Most insurers, however, use total loss software systems ("TLV") which contain comprehensive databases of vehicle sales information that is regularly compiled from numerous sources and

[9] Insurers will usually replace the damaged vehicle if the cost of repair approaches around 65 to 75% of the vehicles's value. Brungger IH Tr. at 118 (Mitchell).

hundreds of localities. *See* PX 680-007-010 (Aurora); PX 86-008 (CCC). The TLV software products provided by CCC, Mitchell and Audatex account for more than 90% of all total loss valuations. PX 513-016 (Mitchell); PX 548-007 (Mitchell). Other providers of total loss services include AutoBid and Vehicle Valuation Services ("VVS"). VVS is a software product that is used mostly for specialty vehicles such as commercial trucks and classic cars, and for a limited number of non-specialty vehicles as an accommodation to existing clients. *See* PX 401 ¶¶ 3, 5 (Blitstein Decl., VVS).

Until recently, CCC and Audatex were the only providers of TLV. However, Mitchell successfully entered the TLV market in 2005 after two previous failed attempts. CCC's TLV product is called ValueScope Salvage Solutions. PX 256-039, 046 (CCC). Mitchell's TLV product is called WorkCenter Total Loss, and Audatex's product is called Autosource.

B. Marketplace Dynamics

In addition to Estimatics and TLV, CCC, Mitchell and Audatex sell a number of other automotive damage products, including workflow management products, business intelligence products, and repair facility or shop management software. DX 82 (CCC); PX 560-031 (Mitchell).[10] Mitchell also sells an auto injury estimating, or "medical" product; it is the only of the Big Three companies that offers a medical product. *See* PX560-031-032 (Mitchell). Insurance companies often purchase a suite of products from one vendor. These "bundles" usually include a core Estimatics product and several add-on products, such as digital imaging, shop management, aftermarket parts data, workflow, and total loss valuation. Conway, Tr. (1/9) at 92:1-18 (Audatex); *see also* PX 680-007-008, 010 (Mitchell); PX 86-008-009 (CCC); PX 244-

[10] These "add-on" products are sold by a large number of companies in addition to CCC, Mitchell and Audatex, and the merger is not challenged by the FTC based on these products.

062 (CCC); PX 763 (Mitchell). Contracts for DRP repair facilities also often consist of bundles, including the base Estimatics product and a variety of add-ons. Conway, Tr. (1/9) at 111:9-13 (Audatex); DX 47 (Mitchell); DX 98 (CCC). Independent repair facilities tend to purchase only the core estimating product.

The buyers of Estimatics are insurance companies and auto repair facilities, while only insurance companies buy TLV products. Repair facilities account for about 60% of Estimatics revenues, while insurers account for the other 40%. *See* PX 1020, Ex. 2 (Hayes Prelim. Report). Insurers negotiate longer term contracts with Estimatics and TLV systems suppliers – generally two to five years. Sun, Tr. (1/9) at 96:16-20 (Mitchell). In a typical year, approximately 100 insurance company accounts come up for renewal. Brungger IH Tr. at 185-86 (Mitchell). These contracts can cost anywhere from a few thousand dollars per year for a small insurer to several million dollars per year for a large insurer. Conway, Tr. (1/9) at 94:22-95:4 (Audatex); DX 13 ¶ 69 (Hayes Prelim. Report); *see*, *e.g.*, DX 252-4, 53 (five-year, multi-million dollar contract with CCC). Most of these insurance contracts are obtained through a secret bidding process whereby the insurance company submits a request for proposal ("RFP") to the bidders in which it seeks information on the bidder's proposed prices and product bundle options. RFPs are usually accompanied by a non-disclosure agreement, Sun, Tr. (1/9) at 51-52, 46-47 (Mitchell); Brandt, Tr. (1/8 a.m.) at 23 (The Hartford), and therefore are not supposed to be shared with the bidder's competitors. Repair facility contracts are also intended to be confidential. *See*, *e.g.*, Cheskis, Tr. (1/23 a.m.) at 16:5-7, 17:21-23 (Gerber Collision & Glass ("Gerber")); Sun, Tr. (1/9) at 53:24-54:10 (Mitchell); Ramamurthy, Tr. (1/22 a.m.) at 108:19-109:25 (CCC); Conway, Tr. (1/12 a.m.) at 39:8-13 (Audatex).

Despite a highly concentrated supplier base and low growth rates in the industry, PX 543-005 (Mitchell); PX 574-002 (Mitchell), these markets are highly competitive today. Brandt, Tr. (1/8 a.m.) at 17:23-18:2, 18:6-7 (The Hartford); Cheskis, Tr. (1/23 a.m.) at 10:12-23 (Gerber); Aquila Dep. at 15 (Audatex); FTC's Pre-Trial Br. at 3; Ordover, Tr. (1/23 a.m.) at 76:20-77:8. Although insurance company and repair facility contracts are confidential, the Estimatics and TLV vendors expend significant resources in order to obtain "competitive intelligence" about each other's pricing, and compete vigorously for customers. Sun, Tr. (1/8 p.m.) at 53-58, 92-93 (Mitchell). The FTC fears that a merger of CCC and Mitchell will destroy the delicate balance that has sustained healthy competition despite the small number of competitors in these markets; hence this lawsuit.

III. APPLICABLE LAW

Section 7 of the Clayton Act prohibits mergers or acquisitions "the effect of [which] may be substantially to lessen competition, or to tend to create a monopoly" in "any line of commerce or in any activity affecting commerce in any section of the country." 15 U.S.C. § 18. The Supreme Court has explained that Section 7 "deals in probabilities, not certainties." *United States v. Gen. Dynamics Corp.*, 415 U.S. 486, 505 (1974); *see also Brown Shoe Co. v. United States*, 370 U.S. 294, 323 (1962); *United States v. El Paso Natural Gas Co.*, 376 U.S. 651, 658 (1964). Thus, to establish a violation of Section 7, the FTC need not show that the challenged merger or acquisition *will* lessen competition, but only that the loss of competition is a "sufficiently probable and imminent" result of the merger or acquisition. *United States v. Marine Bancorp.*, 418 U.S. 602, 623 n.22 (1974) (quoting *United States v. Continental Can Co.*, 378 U.S. 441, 458 (1964)).

When the FTC has "reason to believe" that the consummation of a merger will violate the antitrust laws, it may seek a preliminary injunction to prevent the merger until the agency has had an opportunity to adjudicate the merger's legality in an administrative proceeding. 15 U.S.C. § 53(b). Section 13(b) of the FTC Act "provides for the grant of a preliminary injunction where such action would be in the public interest." *Heinz* at 714; *see* 15 U.S.C. § 53(b). In enacting Section 13(b), Congress "'demonstrated its concern that injunctive relief be broadly available to the FTC.'" *Heinz*, 246 F.3d at 714 (quoting *FTC v. Exxon Corp.*, 636 F.2d 1336, 1343 (D.C. Cir. 1980)); H.R. Rep. No., 93-624, at 31 (1973), *reprinted in* 1973 U.S.C.C.A.N. 2417, 2533; *see also Whole Foods*, 548 F.3d at 1042 (Brown, J.) ("the FTC – an expert agency acting on the public's behalf – should be able to obtain injunctive relief more readily than private parties."). Thus, the FTC "is not required to prove, nor is the court required to find, that the proposed merger would in fact violate Section 7 of the Clayton Act" in order for a preliminary injunction to be issued. *FTC v. Staples, Inc.*, 970 F. Supp. 1066, 1070 (D.D.C. 1997) (citations omitted). Rather, the FTC "need only show that there is a 'reasonable probability' that the acquisition may substantially lessen competition." *Id.* at 1072.

Section 13(b) authorizes a court to issue a preliminary injunction "[u]pon a proper showing that, weighing the equities and considering the Commission's likelihood of ultimate success, such action would be in the public interest." 15 U.S.C. § 53(b). The Court must balance these considerations on a sliding scale. *Heinz*, 246 F.3d at 714; *FTC v. Elders Grain, Inc.*, 868 F.2d 901, 903 (7th Cir. 1989); *see also Whole Foods*, 548 F.3d at 1035 (Brown, J.). Thus, "[a] greater likelihood of the FTC's success will militate for a preliminary injunction unless particularly strong equities favor the merging parties." *Whole Foods*, 548 F.3d at 1035 (Brown, J.).

The equities will often weigh in favor of the FTC because "'the public interest in effective enforcement of the antitrust laws' was Congress's specific 'public equity consideration' in enacting" Section 13(b). *Id.* (quoting *Heinz*, 246 F.3d at 726). If the FTC meets its burden of showing that it is likely to succeed on the merits, it "creates a presumption in favor of preliminary injunctive relief," *id.*, which the merging parties may rebut by showing that, contrary to traditional antitrust theory, the public equities weigh in favor of the merger. *See Whole Foods*, 548 F.3d at 103 (Brown, J.); *see also FTC v. Arch Coal, Inc.*, 329 F. Supp. 2d 109, 160 (D.D.C. 2004); *cf. Heinz*, 246 F.3d at 727 n.25 (noting that private equities are afforded little weight in Section 13(b) cases). If the merging parties are able to make such a showing, the FTC is required to show a greater likelihood of success on the merits. *Whole Foods*, 548 F.3d at 1035 (Brown, J.) (citing *FTC v. Weyerhaeuser Co.*, 665 F.2d 1072, 1087 (D.C. Cir. 1981)).

IV. ANALYSIS

A. Likelihood of Success on the Merits

The burden of showing likelihood of success on the merits is met if the Commission has "raised questions going to the merits so serious, substantial, difficult and doubtful as to make them fair ground for thorough investigation, study, deliberation and determination by the FTC in the first instance and ultimately by the Court of Appeals." *Heinz*, 246 F.3d at 714-15 (internal citations omitted); *see also Whole Foods*, 548 F.3d at 1035 (Brown, J); *id.* at 1042 (Tatel, J., concurring). At the same time, the Court may not "simply rubber-stamp an injunction whenever the FTC provides some threshold evidence; it must 'exercise independent judgment' about the questions § 53 commits to it." *Whole Foods*, 548 F.3d at 1035 (Brown, J.) (citing *Weyerhaeuser*, 665 F.2d at 1082).[11]

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[11] Defendants take issue with the FTC's interpretation of the "serious, substantial" question standard set forth in *Heinz* and *Whole Foods*, asserting: "[Y]ou can talk about substantial questions, doubtful questions, whatever. . . . [W]hat those cases say [is that] it simply means nothing other than likelihood of success on the merits." Parker, Tr. (2/17 p.m.) at 41:24-42:3 (Mitchell). While

In *United States v. Baker Hughes Inc.*, 908 F.2d 981, 982-83 (D.C. Cir. 1990), the D.C. Circuit adopted an analytical approach to Section 7 cases which has been followed in subsequent Section 13(b) cases. *See*, *e.g.*, *Heinz*, 246 F.3d at 715; *Arch Coal*, 329 F. Supp. 2d at 116. First, to meet its initial burden, the government must show that the proposed merger would lead to "undue concentration in the market for a particular product in a particular geographic area." *Baker Hughes*, 908 F.2d at 982. Such a showing creates a "'presumption' that the merger will substantially lessen competition." *Id.* Upon such a showing, the burden shifts to the defendants to rebut the presumption with evidence that "'shows that the market-share statistics [give] an inaccurate account of the [merger's] probable effects on competition' in the relevant market." *Heinz*, 246 F.3d at 715 (quoting *United States v. Citizens & S. Nat'l Bank*, 422 U.S. 86, 120 (1975)) (alterations in original). If the defendants succeed in rebutting the presumption that the merger will lessen competition, "'the burden of producing additional evidence of anticompetitive effects shifts to the government, and merges with the ultimate burden of persuasion, which remains with the government at all times.'" *Heinz*, 246 F.3d at 715 (quoting *Baker Hughes*, 908 F.2d at 983).

The Supreme Court has cautioned, however, that while "statistics reflecting the shares of the market controlled by the industry leaders and the parties to the merger are . . . the primary index of market power[,] . . . only a further examination of the particular market — its

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Defendants' statement is literally true, precedents irrefutably teach that in this context "likelihood of success on the merits" has a less substantial meaning than in other preliminary injunction cases. *Heinz* not only emphasized this point but *Whole Foods* makes clear that *Heinz* remains good law. The analysis of likelihood of success "measure[s] the probability that, after an administrative hearing on the merits, the Commission will succeed" in proving that the effect of a merger "*may* be to substantially lessen competition or tend to create a monopoly." *Heinz*, 246 F.3d at 714 (emphasis added).

structure, history and probable future — can provide the appropriate setting for judging the probable anticompetitive effect of [a] merger." *Brown Shoe*, 370 U.S. at 322 n.38. In order to adequately address these factors, "the merging parties are entitled to oppose a [Section 13(b)] preliminary injunction with their own evidence, and that evidence may force the FTC to respond with a more substantial showing" of the merger's probable anticompetitive effects. *Whole Foods*, 548 F.3d at 1035 (Brown, J.). In the end, "antitrust theory and speculation cannot trump facts, and even Section 13(b) cases must be resolved on the basis of the record evidence relating to the market and its probable future." *Arch Coal*, 329 F. Supp. 2d at 116-17; *see also Brown Shoe*, 370 U.S. at 322 n.38. Thus, an analysis of the likely competitive effects of a merger requires determinations of (1) the relevant product market, (2) the relevant geographic market, and (3) the transaction's probable effect on competition in those markets. *See Marine Bancorp.*, 418 U.S. at 618-23; *Gen. Dynamics*, 415 U.S. at 510-11; *see also Arch Coal*, 329 F. Supp. 2d at 117.

1. Prima Facie Case

A *prima facie* Section 7 case "rests on defining a market and showing undue concentration in that market." *Whole Foods*, 548 F.3d at 1036 (Brown, J.) (citing *Baker Hughes*, 908 F.2d at 982-83). Courts generally begin their analysis of a Section 7 case by defining the relevant market. *See*, *e.g.*, *Marine Bancorp.*, 418 U.S. at 618-23; *FTC v. Swedish Match*, 131 F. Supp. 2d 151, 156 (D.D.C. 2000). *But see Whole Foods*, 548 F.3d at 1036 (Brown, J.) (noting that "this analytical structure does not exhaust the possible ways to prove a § 7 violation" (citing *El Paso Natural Gas Co.*, 376 U.S. at 660)). A relevant market has two components: (1) the relevant product market and (2) the relevant geographic market. The "relevant product market" identifies the product and services with which the defendants' products compete. The "relevant geographic market" identifies the geographic area in which the defendants compete in marketing their products or services. The FTC bears the burden of proof and persuasion in defining the relevant market. *Arch Coal*, 329 F. Supp. 2d at 119.

Once the relevant market is defined, the court can determine market concentration. The standard measure for market concentration is the Herfindahl-Hirschmann Index ("HHI"). *See Heinz*, 246 F.3d at 716. Under the Federal Trade Commission and U.S. Department of Justice Horizontal Merger Guidelines, a market with a post-merger HHI above 1800 is considered "highly concentrated," and mergers that increase the HHI in such a market by more than 100 points "are presumed . . . likely to create or enhance market power or facilitate its exercise." *Fed. Trade Comm'n & U.S. Dep't of Justice Horizontal Merger Guidelines* (1992), *as revised* (1997) ("Merger Guidelines") § 1.51. Although the Merger Guidelines are not binding on the Court, they provide a "useful illustration of the application of the HHI." *FTC v. PPG Indus., Inc.*, 798 F.2d 1500, 1503 n.4 (D.C. Cir. 1986). Moreover, the D.C. Circuit explained in *Heinz* that a merger to duopoly which increased the premerger HHI of 4,775 by 510 points "create[d], by a wide margin, a presumption that the merger w[ould] lessen competition" in the relevant market. *Heinz*, 246 F.3d at 716.

a. *Relevant Product Markets*

In determining relevant product markets, courts have traditionally considered two factors: "[1] the reasonable interchangeability of use and [2] the cross-elasticity of demand between the product itself and substitutes for it." *Brown Shoe*, 370 U.S. at 325. In other words, the question is "whether two products can be used for the same purpose, and if so, whether and to what extent purchasers are willing to substitute one for the other." *Staples*, 970 F. Supp. at 1074 (internal quotations omitted). Relevant markets will generally include producers who, given product similarity, have the ability to take significant business from each other. *Arch Coal*, 329 F. Supp. 2d at 119.

If consumers can substitute the use of one product for another, those products will be deemed "functionally interchangeable." *Id.*; *see also Staples*, 970 F. Supp. at 1074 (finding that office supplies sold by an "office superstore" like Staples are functionally interchangeable with office supplies sold at "mass merchandisers" like Wal-Mart). Courts generally will include functionally interchangeable products in the same product market unless factors other than use indicate that they are not actually part of the same market. *See*, *e.g.*, *United States v. Archer-Daniels-Midland Co.*, 866 F.2d 242, 246 (8th Cir. 1988) (even though beet sugars and high-fructose corn sugars were functionally interchangeable, they did not belong to the same product market because government price support for beet sugars meant that prices for corn sugars could be raised substantially without feeling the competitive impact of beet sugar prices). Cross-elasticity of demand refers to the "'responsiveness of the sales of one product to price changes of the other.'" *Staples*, 970 F. Supp. at 1074 (quoting *United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377, 400 (1956)). However, courts should "exclude any . . . product to which, within reasonable variations in price, only a limited number of buyers will turn." *Times-Picayune Publ'g Co. v. United States*, 345 U.S. 594, 612 (1953).[12]

Courts have relied on several "practical indicia" as aids in identifying the relevant

[12] The Merger Guidelines provide an analytical tool for determining interchangeability and cross-elasticity of demand. The Merger Guidelines define a product market as "a product or group of products such that a hypothetical profit-maximizing firm that was the only present and future seller of those products ('monopolist') likely would impose at least a 'small but significant and nontransitory' increase in price (SSNIP)." Merger Guidelines § 1.11. In most contexts, the Merger Guidelines consider a price increase of 5% to constitute a SSNIP. *Id.*

product market, including: industry or public recognition of a submarket as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors. *Brown Shoe*, 370 U.S. at 325; *see also Arch Coal*, 329 F. Supp. 2d at 120. These indicia can be applied to augment the analyses of interchangeablity and cross-elasticity of demand.

1. *Estimatics Market*

Defendants do not dispute the FTC's contention that Estimatics is so far superior to the paper-based systems that their customers would not return to the old methods even if Estimatics prices increased substantially. *See*, *e.g.*, PX 6 ¶ 2 (Mello Decl.); PX 7 ¶ 4 (Kostakis Decl., Angelo's Auto Body); PX 20 ¶ 4 (Rollins Decl.); PX 27 ¶ 3 (Danford Decl.); PX 11 ¶ 3 (Brown Decl.). Thus, Defendants concede that the core Estimatics software product is a relevant product market. *See* Ordover, Tr. (1/23) at 204:20-25.[13]

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[13] An argument could be made that the Estimatics market should be further subdivided into communicating and non-communicating Estimatics platforms. *Cf.* Ordover, Tr. (1/23 p.m.) at 205:11-14 ("I did not reach an ultimate conclusion of whether these two are in the same market [for repair facilities] although obviously, people can move back and forth between communicating and non-communicating Estimatics systems"). Communication is required to work with the major insurance companies as part of a repair shop network, so all insurance companies and virtually all DRP repair facilities must use communicating products. *See* PX 1020 ¶ 12 (Hayes Prelim. Report); DX 644, App. 2 ¶ 7 (Ordover Coordinate Interaction Report). There also is a considerable cost differential between communicating and non-communicating Estimatics products. *See* PX 760 (Applied Computer Resources has two non-communicating Estimatics products that retail for $99 per month and $135 per month); PX 173 (CCC's "Competitive Comparison Chart"); PX 1407 (CCC). Nonetheless, while communicating Estimatics products may make up a relevant sub-market, that analysis is unnecessary here as it would only further limit the product market definition and minimally enhance the market concentration in the relevant market to a legally insignificant degree. The Court therefore will define the relevant market to include all Estimatics products.

2. *TLV Market*

Although the Defendants do not dispute the FTC's market definition for Estimatics, they disagree with its definition of the total loss valuation market. The FTC defines the relevant total loss valuation market to include only TLV sold in the United States by CCC, Mitchell and Audatex. PX 1020 ¶ 48 (Hayes Prelim. Report); *see also* Hayes, Tr. (1/12 a.m.) at 84:12-22. The Defendants argue that the FTC has not met its initial burden of showing a properly defined product market because it fails to include other sources of total loss valuations that insurance companies currently use or to account for the fact that some insurance companies perform their total loss valuations in-house rather than using TLV products.

Defendants have demonstrated that insurers of auto physical damage currently use a variety of solutions to perform total loss valuations. In addition to the total loss software sold by CCC, Mitchell and Audatex, some insurance companies use the Books to perform some or most of their total loss valuations in-house. Brandt, Tr. (1/8 a.m.) at 47:5-9 (The Hartford); Dibble, Tr. (1/23 a.m.) at 38:23-39:18 (Infinity Ins. Co.). In fact, some of the largest auto insurers in the country rely on the Books for most of their total loss needs. *See* DX 49 (Mitchell); DX 50 (Mitchell). For instance, CCC's CEO, Githesh Ramamurthy, testified that, of the 700,000 total loss claims that [text redacted] processes each year, it calculates roughly 500,000 in-house using NADA. Ramamurthy, Tr. (1/22 a.m.) at 97:4-8 (CCC); *see also* Brandt, Tr. (1/8 a.m.) at 47:5-10 (The Hartford) (Progressive Insurance Company ("Progressive") uses NADA to calculate roughly 75% of its total loss claims).[14] Those insurance companies that

[14] State Farm, Allstate Insurance ("Allstate") and Progressive, three of the largest auto insurers in the country, as well as American Family, Hanover, Cincinnati Insurance, Country Insurance, Kentucky Farm Bureau, Mississippi Farm Bureau, Assurant Specialty Property ("Assurant"), and Infinity Insurance Company use the Books to perform some or most of their total

perform some of their valuations internally may consult other data sources as well, such as Autotrader, or conduct their own research by contacting salvage yards and auto dealerships. *See*, *e.g.*, Dibble, Tr. (1/23 a.m.) at 39:8-13 (Infinity Ins. Co.). Defendants point to these shifts between products as evidence of a single market between Estimatics and the Books. *See* IIB Phillip Areeda *et al*., *Antitrust Law* ¶ 562a, at 371 (3d ed. 2007) ("[A]ctual shifts between two products in response to — or even without — changes in their relative prices indicate a single market.").

This evidence is factually unchallenged by the FTC but the agency contends that it does not have the force Defendants would imply, given that over 90% of all total loss claims are calculated using TLV sold by one of the three major competitors. PX 513-016 (Mitchell); PX 548-007 (Mitchell).[15] According to the FTC, there is sufficient evidence in the record to conclude that the TLV products sold by CCC, Mitchell and Audatex represent a separate product market from other total loss valuation methods.

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loss valuations in-house. Stanton Dep. at 18-19, 23, 26-28, 33, 38-39, 45, 50-51 (NADA); Dibble, Tr. (1/23 a.m.) at 39:8-18 (Infinity Ins. Co.); Licause Dep. at 73 (Assurant); Marushka Dep. at 29, 33-34 (CCC); DX 52 at FTC-PA-000004 (listing approved guide sources in Pennsylvania as Red Book, CCC, NADA, Audatex, Autobid, and Mitchell); Conway, Tr. (1/12 a.m.) at 64:1-9 (Audatex) (American Family uses Books for some of its total loss); Brandt, Tr. (1/8 a.m.) at 47:12-22 (The Hartford uses Book data for some of its total loss needs); Hall, Tr. (1/8 a.m.) at 87:11-14, 99:1-6 (GMAC used Books in North Carolina until it was able to negotiate a flat rate with Mitchell that was less expensive).

[15] Mitchell argued in closing argument that it thinks the nine insurers who do some in-house total loss valuations account for about 20% of the total loss claims market, and that the FTC failed to include those in-house valuations in its HHI calculations. Prior to closing argument, however, there seemed to be a consensus that the Books consumed about 10% of the total loss valuation market. *See* PX 548-007 (Mitchell) (chart showing that "book values" account for 10% of all total loss claims). This figure must include internal calculations performed by insurance companies because only insurance companies (and independent appraisers to some extent) handle total loss claims, with or without TLV software. *See* Hayes, Tr. (1/12 p.m.) at 130:25-131:1.

Dr. John Hayes, an economics expert testifying for the FTC, conducted a critical loss analysis to determine whether a hypothetical monopolist could profitably impose a SSNIP in the TLV market, an approach described in the Merger Guidelines. PX 1020 ¶¶ 26, 42-48 (Hayes Prelim. Report).[16] Through his analysis, Dr. Hayes concluded that TLV software constitutes a relevant product market. *Id.* ¶ 48. Dr. Hayes was aware that some insurance companies use the Books to conduct valuations, but he admitted that he did not know how pervasively internal valuations are used or how insurance companies produce internal valuations. Hayes, Tr. (1/21 p.m.) at 156:24-157:18. Thus, when calculating total loss market shares, Dr. Hayes did not include valuations that were performed internally. *Id.* at 149:22-150:8.

Although Defendants' expert, Dr. Janusz Ordover, did not reach a conclusion as to whether the Books are or are not part of the same market as TLV, Ordover, Tr. (1/23 p.m.) at 205:18-22, a critical failure to support Defendants' challenge to the FTC's market definition for TLV, the Defendants discredit Dr. Hayes's conclusions, arguing that his critical loss analysis is flawed because he incorrectly assumed that insurance companies lack the economies of scale to perform total loss valuations in-house. Hayes, Tr. (1/21 p.m.) at 150:14:151:4, 153:2-154:20, 157:2-158:17. The evidence is clear that CCC lost a large insurance company as a customer when that company decided to do most of its total loss calculations in-house using NADA. DX 86. "[C]ourts have generally recognized that when a customer can replace the services of [an

[16] Critical loss analysis is a standard tool used by economists to study potentially relevant markets. The analysis is based on the assumption that if the price of a product were increased, some customers would not purchase the product, and if enough customers would not purchase the product, the price increase would not be profitable. PX 1020 ¶ 42 (Hayes Prelim. Report). For the purpose of market delineation, Dr. Hayes was interested in whether or not a hypothetical monopolist over all TLV software could profitably impose a SSNIP on one or more of the products included in the candidate market. *Id.* ¶ 44.

external product] with an internally-created [ ] system, this 'captive output' (i.e. the self-production of all or part of the relevant product) should be included in the same market." *United States v. Sungard Data Sys., Inc.*, 172 F. Supp. 2d 172, at 193, 186 (D.D.C. 2001) (quoting *FTC v. Cardinal Health, Inc.*, 12 F. Supp. 2d 34, 48 (D.D.C. 1998)) (alterations in original) (internal quotations omitted); *accord* Merger Guidelines § 1.31 (vertically integrated firms are included in the market "to the extent that such inclusion accurately reflects their competitive significance in the relevant market prior to the merger").

Notwithstanding this gap in Dr. Hayes's analysis, the real-world evidence shows that Books and TLV are not part of the same product market. *See Arch Coal*, 329 F. Supp. 2d at 116 ("[A]nti-trust theory and speculation cannot trump facts."). The Book vendors do not consider themselves to be in competition with CCC, Mitchell, and Audatex. PX 17 ¶¶ 7-13 (Stanton Decl., NADA); PX 19 ¶ 5 (Fournier Decl., Automobile Red Book); PX 29 ¶ 8 (Cross Decl., Nat'l Auto Research). In fact, CCC and Mitchell offer access to NADA as an add-on to their TLV products. PX 241-023 (CCC); PX 643-011 (Mitchell). Most insurance companies do not view the Books as an adequate substitute for TLV products. *See* PX 664-005 (Mitchell); Brown Dep. at 90-90 (Erie); *see also* Hall, Tr. (1/8 a.m.) at 79:15-17, 81:2-4 (GMAC); Danford Dep. at 58 (Ohio Mutual only uses Books for commercial and recreational vehicles that are not in the TLV databases); PX 11 ¶ 7 (Brown Decl.). In fact, the majority of insurers who were contacted by the FTC stated that they would not switch from TLV products to the Books even if facing a price increase of 10% or more. *See*, *e.g.*, Adamson Dep. at 31-32, 40-41 (EMC Ins. Co.); PX 20 ¶ 14 (Rollins Decl.) ("In the event of a 10% price increase in total loss valuation products, Safeco would not be likely to switch to using NADA, Kell[e]y, or other 'book' products for total loss estimates. The book products are only guides, which do not provide a local market evaluation of comparable vehicles.”). Similarly, almost none of the Defendants' internal documents refer to the Books when describing the competitive landscape.[17] To the extent that the Books are mentioned, they are referred to as “ancillary databases.” PX 643-011 (Mitchell document containing a competitive analysis between CCC, Mitchell and Audatex, and referring to NADA and other Books as “ancillary databases”).[18]

The market participants view TLV as separate from the Books for good reason. The evidence reveals that the Books simply are not as accurate, detailed, or up-to-date as TLV. CCC, Mitchell and Audatex use a consistent methodology across all vehicles that includes recent sales of comparable vehicles. PX 1964-009-010 (CCC); PX 1958-034-036 (Mitchell). Their methodology accounts for, among other factors, year, make, model, body style, engine, mileage, upgrades, condition, and includes numerous databases. PX 1964-006, 010 (CCC's TLV product “equates to a vehicle database of approximately 64,00 [sic] unique vehicles, which is substantially more than Red Book and Kelley Blue Book”). CCC's TLV database is “compiled

[17] *See* PX 1412-020 (pie graph showing 2007 market share data for total loss which refers only to Audatex, Mitchell and CCC); PX 99-022 (CCC); PX 107-018 (CCC); PX 204-002 (CCC); PX 214-002 (CCC); PX 515-036 (Mitchell) (noting the holders of the key insurance accounts for estimating, TLV and DRP shops); PX 583-041 (Mitchell); PX 513-012 (Mitchell); PX513-016 (Mitchell document referring only to CCC and Audatex as competitors); PX 643-008 (Mitchell pricing strategy); PX 629-002 (Aurora) (“Mitchell competes primarily against only two other companies, Audatex and CCC Information Services.”). *But see* PX 677 (Mitchell) (Why Use Total Logic Versus NADA); DX 86 (CCC's competitive loss of [text redacted] to NADA); PX 1964-009 (CCC) (“CCC Versus Guidebook Value”).

[18] The Court notes the apt warning that “separate markets are not indicated by documents within A firms that are preoccupied with other A firms. After all, a given producer of A cannot charge more than other A firms and thus may focus entirely on them even though a hypothetical monopolist of product A firms would focus entirely on the price of a close substitute B.” IIB Areeda, *supra*, ¶ 562a, at 372. If the FTC were relying solely on Defendants' documents, that evidence might be insufficient. However, various other industry participants from all sides share the view that TLV and the Books are not interchangeable.

by surveying over 4,400 car dealerships in more than 350 markets twice each month and through 1,800 publications." PX 99-020 (CCC). Mitchell's database contains over [text redacted] million electronic records including the Power Information Network (PIN) data received from JD Power and Associates. PX 643-011 (Mitchell); PX 541-024 (Mitchell). The valuation methodologies used by the Books include subjective data and do not account for all of the vehicle's options, mileage, or condition as precisely as TLV programs. Hall, Tr. (1/8 a.m.) at 79:18-80:8, 80:19-81:8 (GMAC); PX 1964-006, 010 (CCC). For instance, NADA uses wholesale and retail data sets and manipulates that information using analytical modeling and judgment by its editorial staff to estimate vehicle value. PX 17 ¶ 3 (Stanton Decl.); PX 260-001 (CCC); PX1964-016 (CCC Valuescope Methodology & Settlement Tips). Thus, TLV has substantially different valuation methodologies than the Books. *See Brown Shoe*, 370 U.S. at 325 (peculiar characteristics of the product indicate separate product markets).

In addition, TLV provides valuations in local markets, while the Books provide only regional data that are rarely localized. *See* PX 20 ¶ 14 (Rollins Decl.); PX 11 ¶ 7 (Brown Decl.); PX 28 ¶ 11 (Wilson Decl.) (stating that "pricing information in guidebooks . . . does . . . not contain the same level of specificity as local market comparables."); PX 1964-010 (CCC) ("Where NADA will have one region covering seven states, CCC will segment each state into an average of eight local markets."); PX 17 ¶ 9 (Stanton Decl.); PX 256-048 (CCC). Furthermore, TLV systems' calculations are said to comply with applicable state regulations of each state, PX 81-038 (CCC Response to [text redacted] RFP); PX 116-039 (CCC Response to [text redacted] RFP); PX117-044, 051 (CCC Response to [text redacted] RFP), whereas the Books do not.

Nor does CCC, Mitchell, or Audatex price TLV against the Books. TLV costs approximately $ [text redacted] per estimate, PX 548-007, whereas the Books charge about 5-35 cents per use. Stanton Dep. at 101-03 (NADA); PX 19 ¶ 2 (Fournier Decl.). Of course, "products competing against one another in a differentiated product market may have widely different prices." *United States v. Oracle Corp.*, 331 F. Supp. 2d 1098, 1121 (N.D. Cal. 2004).[19] If part of the same product market, the Books and the Defendants' TLV products are undoubtedly differentiated products. The variance in price therefore may not be surprising.[20] However, there is no evidence to suggest that the price of TLV is sensitive in any way to changes in pricing by Book vendors, or vice-versa. *Cf.* PX643-008 (Mitchell) (setting pricing strategy by reference to CCC and Audatex only). In addition, there is scant evidence of any direct competition between TLV and the Books.

In sum, the practical indicia — particularly industry recognition of a separate market; TLV's peculiar characteristics including especially accurate, up-to-date valuations, speed, reliance and defensibility, and ability to interface with estimating products; and sensitivity to price changes only against other TLV products — support the conclusion that TLV software products represent a relevant product market.

Despite this analysis, the fact remains that some of the largest insurance companies in the country perform a significant percentage of their total loss valuations in-house using the Books and that some others use the Books or other valuation methods for a small

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[19] A "differentiated product 'market' is a market in which sellers compete along more dimensions than price." *Oracle*, 331 F. Supp. 2d at 1121.

[20] The Defendants note that Book values are not the final word on total loss valuations; they are simply an input. Insurance companies incur additional costs by employing their own personnel and software to refine the Book valuations with more data points. Stanton Dep. at 26-27 (NADA); Dibble, Tr. (1/23 a.m.) at 38:23-40:4 (Infinity Ins. Co.). Thus, the true "cost" of using the Books is greater than would appear; how much this real cost approaches the pricing of a TLV product is not admitted in the record.

percentage of their total loss claims, rather that TLV. What this demonstrates, at best, is that some of the largest insurance companies in the country have the resources and scale to perform most of their total loss valuations in-house profitably in lieu of using TLV, and that a few middle tier insurance companies use the Books to supplement TLV software, but not that the Books constitute a viable substitute for TLV for the vast majority of insurers.[21] When TLV software is used to calculate 90% of the total loss claims made in this country, and the majority of the remaining 10% includes the largest insurers that do most of their calculations in-house, it is clear that the computer-based TLV products provided by these three suppliers constitute a relevant product market. The Books are, in the main, a complementary product and not a competitive product.

In any event, the FTC is not "required to settle on a market definition at this preliminary stage," *Whole Foods*, 548 F.3d at 1036 (Brown, J.), and inclusion of the Books in the market would have an insignificant effect on the market shares because over 90% of total loss claims are calculated using TLV. PX 513-016 (Mitchell) (chart showing that CCC, Audatex and Mitchell were used to evaluate a combined 90% of all total loss claims made in 2007, while NADA and "other" products were used for approximately 10% of valuations); PX 548-007

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[21] *Cf. United States v. Grinnell Corp.*, 384 U.S. 563, 574 (1966) ("Defendants earnestly urge that despite these differences [between the central station service and substitute alarm systems], they face competition from these other modes of protection. They seem to us seriously to overstate the degree of competition, but we recognize that . . . they 'do not have unfettered power to control the price of their services . . . due to the fringe competition of other alarm or watchmen services.' What defendants overlook is that the high degree of differentiation between central station protection and the other forms means that for many customers, only central station protection will do.") (quoting *United States v. Grinnell Corp.*, 236 F.Supp. 244, 254 (D.R.I. 1964)); *accord Whole Foods*, 548 F.3d at 1038 (Brown, J.). *But see United States v. Engelhard Corp.*, 126 F.3d 1302, 1306 (11th Cir. 1997) ("[I]t is possible for only a few customers who switch to alternatives to make the price increase unprofitable.").

(Mitchell) (table showing that book valuations are used for approximately 10% of all total loss claims while TLV software is used for 90% of claims). Even including the Books and other valuation methods, the combined CCC/Mitchell would still have over a 50% share of the broader total loss valuation product market. *See* PX 513-016 (Mitchell). The corresponding HHIs likewise would still establish a strong *prima facie* case for the FTC. *Cf. Arch Coal*, 329 F. Supp. 2d at 158 (concluding that the HHI increase of 49 to 2,103 was "far from compelling," and thus the *prima facie* case was "fairly weak.").[22]

b. *The Geographic Market*

Unlike some other Section 7 cases, the geographic market is not contested here. The relevant geographic market for both products in this case is the United States. Audatex competes in many foreign countries; CCC and Mitchell currently compete only in the United States. More significantly, although software products can be designed, manufactured and sold almost anywhere, the databases for Estimatics and TLV sold in the United States must contain data that apply to vehicles driven in the U.S., wherever manufactured. Hayes, Tr. (1/12 p.m.) at 131:2-10. Similar auto physical damage products sold outside the United States that rely on a database of foreign vehicles cannot provide partial loss and total loss valuations for most vehicles driven in this country. PX 1020 ¶ 50 (Hayes Prelim. Report).

c. *Market Concentration*

Market share and concentration statistics can establish a presumption of harm and shift the burden of proof to Defendants to demonstrate that the presumption does not accurately reflect a merger's likely effects on competition in the relevant market(s). *Baker Hughes*, 731 F.

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[22] If each of the Book vendors were included in the TLV market as separate suppliers, the merger would still produce an HHI delta well above 100. *See* Merger Guidelines § 1.51(c).

Supp. at 11-12.

1. *Concentration in the Estimatics Market*

There are five competitors in the Estimatics market: CCC, Audatex, Mitchell, Web-Est, which sells the software product WebEst, and Applied Computer Resources, which sells the software product Crash-writeR. Of these, CCC, Mitchell and Audatex dominate the market. Ramamurthy IH Tr. at 157-158 (CCC); PX 1028-004, 017 (Web-Est); Ramamurthy, Tr. (1/22 a.m.) at 40:20-41:7, 74:1-10 (CCC). Defendants' expert, Dr. Ordover, agreed that CCC, Mitchell, and Audatex are the only three competitors for insurance customers in the Estimatics segment and that neither Web-Est nor Applied Computer Resources provides any services to insurers. Ordover, Tr. (1/23 p.m.) at 205:1-7. The Big Three are currently the only competitors for DRP repair facilities as well. PX 4 ¶ 5 (Daly Decl.); PX 27 ¶¶ 4, 7 (Danford Decl.); PX 11 ¶ 4 (Brown Decl.); PX 25 ¶ 15 (Carr Decl.); PX 20 ¶ 5 (Rollins Decl.); Kostakis Dep. at 18 (Angelo's Auto Body Shop). At this point in time, Web-Est and Applied Computer Resources offer only non-communicating Estimatics products to low-end repair facilities that are not part of a DRP. Web-Est and Applied Computer Resources together have a tiny fraction of the Estimatics market — approximately 1% combined[23] — and they currently do not compete to any meaningful extent with CCC, Mitchell and Audatex. Removing Web-Est and Applied Computer Resources from the market share data would have "almost no bearing" on the Estimatics market concentration calculations. Hayes, Tr. (1/12 p.m.) at 124:24-125:5. This is no surprise considering that the contract between Web-Est and Mitchell precludes Web-Est from offering communicating Estimatics to insurance companies or DRP facilities and from selling

[23] Hayes, Tr. (1/12 Tr. p.m.) at 122:4-10; PX 1020, Ex. 2 (Hayes Prelim. Report); *see also* PX 543-011 (Mitchell).

any Estimatics to the top 50 insurance companies. *See* DX 59 (Mitchell-Web-Est License Agreement); Seidel, Tr. (1/22 p.m.) at 173:24-174:13.

In 2007, CCC had approximately a 48% share of the revenue in the Estimatics market, Audatex had a 30% share of the market, and Mitchell had a 21% share. PX 1020-039, Ex. 2 (Hayes Prelim. Report); *see also* Hayes, Tr. (1/12 p.m.) at 120:15-122:10. Thus, the combined CCC/Mitchell would hold almost a 70% market share, and would be more than twice the size of Audatex North America. PX 1020 ¶ 49, Ex. 2 (Hayes Prelim. Report). The merger would increase the HHI in Estimatics from approximately 3,650 to 5,685 — an increase of 2,035 points. *Id.* ¶ 60. The post-merger HHI would therefore be higher than it was in *Heinz*, which "create[d], by a wide margin, a presumption that the merger w[ould] lessen competition." *Heinz*, 246 F.3d at 716; *see also FTC v. H.J. Heinz, Co.*, 116 F. Supp. 2d 190, 195-96 (D.D.C. 2000) (merger would have given the new company approximately 32% of the market and increased HHI by 510 to 5,285).

Because insurance companies and repair facilities operate in different, albeit intertwined sub-markets, it also is useful to break down the numbers between insurance companies and repair facilities. In the repair facility segment, CCC's Estimatics market share as of 2007 was approximately 55.7%, Audatex had a 25.2% share, and Mitchell came in third with an 18.1% share. PX 1020-040, Ex. 3 (Hayes Prelim. Report); *see also* Tr., Hayes (1/12 p.m.) at 136:3-137:9; Ramamurthy, Tr. (1/22 a.m.) at 63:19-25. Web-Est and Applied Computer Resources each had an approximate 0.5% share. If the merger is consummated, the combined CCC/Mitchell would hold approximately a 73.8% share of the Estimatics market for repair facilities. *See* PX1020, Ex. 3 (Hayes Prelim. Report). With respect to the insurance company segment, Audatex led with a 38.5% market share, CCC held a 35.0% market share, and Mitchell came in third at 26.5%. *Id.* Post-merger, CCC/Mitchell would hold a 61.5% share of the insurance segment of the Estimatics market. *See id.*

2. *Concentration in the TLV Market*

The only providers of total loss software systems are CCC, Audatex and Mitchell. *But see* PX 534-005 (Mitchell) (listing three main competitors in total loss valuation segment as CCC, Audatex and Auto-Bid). In 2007, CCC held approximately 60.7% of the TLV market, followed by Audatex with an approximate 34.8% share, and Mitchell at third with only a 4.5% share. PX 1020, Ex. 4 (Hayes Prelim. Report); Hayes, Tr. (1/12 p.m.) at 128:8-23, 129:8-13; *see also* PX 514-019-020 (Mitchell) (pie graph projecting CCC with 51%, Audatex with 42% and Mitchell with 7% of the TLV market in 2008). A combined CCC/Mitchell would hold about a 65% market share. Hayes, Tr. (1/12 p.m.) at 128:13-23 (Dr. Hayes); PX 1020, Ex. 4 (Hayes Prelim. Report); *see also* PX 514-019 (Mitchell). The pre-merger HHI in this market currently exceeds 4,900. The merger would result in an HHI of 5,460, with a 545 delta, Hayes, Tr. (1/12 p.m.) at 128:24-129:7; PX 1020 ¶ 64 (Hayes Prelim. Report), creating the presumption that the merger would lessen competition. *Heinz*, 246 F.3d at 716.

3. *Merger to Duopoly*

The FTC repeatedly proclaimed that this transaction represents a "merger to duopoly," that is, a 3-to-2 merger, as if that settles the question. It asserts that the Estimatics and TLV markets really consist only of the Big Three — CCC, Mitchell, and Audatex. Defendants reject the notion that the descriptive term "duopoly" accurately depicts the post-merger competitive landscape because "Web-Est and a host of other new entrants offer innovative products that can transform the Estimatics market," and [text redacted]. Defs.' Post-Trial Brief at 25. The Court concludes that the accuracy of this descriptor has minimal significance to the analysis here.

The FTC relies heavily on *Heinz* for the proposition that a "merger to duopoly" is destined for a preliminary injunction because "no court has ever approved a merger to duopoly under similar circumstances." 246 F.3d at 717. The FTC overlooks the significance of the phrase "under similar circumstances" in *Heinz*, *id.*, and thus over-reads the case. Instead of making a generalized holding relevant to all 3-to-2 company mergers, the Court of Appeals focused on the nature of the baby food market at issue in *Heinz*, in which high barriers to entry and total transparency in pricing underscored the risk of coordination. While pricing is not completely secret in the instant markets, the characteristics of Estimatics and TLV are worlds apart from baby food. For starters, the software products are complex, the price quotes to insurers are confidential, and the products are usually sold in complex bundles that may include both Estimatics and TLV or just one of these, as well as various other software products. What is clear from this preliminary record is that this situation is not *Heinz*. The question, therefore, is not simply whether this merger would constitute a "merger-to-duopoly," but rather, whether the presumption of anticompetitive effects holds up, for preliminary relief, given the way these markets operate in fact.

As defense counsel admitted at the inception of this case, the HHIs in these markets are "very, very, high." Scheduling Conf. at 10-11. Because of the high market concentrations and HHIs in the pre- and post-merger Estimatics and TLV markets, the FTC has established a strong *prima facie* case that a merger between CCC and Mitchell would violate Section 7 of the Clayton Act. *See Heinz*, 246 F.3d at 716. But that is just the beginning of the inquiry.

2. **Rebuttal Arguments**

Upon the showing of a *prima facie* case, the burden shifts to Defendants to show that traditional economic theories of the competitive effects of market concentration are not an accurate indicator of the merger's probable effect on competition in these markets or that the procompetitive effects of the merger are likely to outweigh any potential anticompetitive effects. The courts have not established a clear standard that the merging parties must meet in order to rebut a *prima facie* case, other than to advise that "[t]he more compelling the prima facie case, the more evidence the defendant must present to rebut [the presumption] successfully," *Baker Hughes*, 908 F.2d at 991.[24] Even in cases where the FTC has made a strong *prima facie* showing:

> [i]mposing a heavy burden of production on a defendant would be particularly anomalous where, as here, it is easy to establish a prima facie case. The government, after all, can carry its initial burden of production simply by presenting market concentration statistics. To allow the government virtually to rest its case at that point, leaving the defendant to prove the core of the dispute, would grossly inflate the role of statistics in actions brought under section 7. The Herfindahl-Hirschman Index cannot guarantee litigation victories.

Id. at 992. With these words of caution in mind, the Court turns to the Defendants' arguments.

a. ***Barriers to Entry***

Defendants' first point of rebuttal is that both the Estimatics and TLV markets will lack significant barriers to entry after the proposed merger, and that existing competitors are "poised for future expansion." *Id.* at 988-89. A variety of factors, including the absence of

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[24] *Baker Hughes* expressly rejected the FTC's theory that "defendants can rebut a prima facie case *only by a clear showing that entry into the market by competitors would be quick and effective*," and instead accepted the district court's conclusion that "the acquisition was not likely to substantially lessen competition." 908 F.2d at 983 (emphasis added).

significant entry barriers in the relevant market, can rebut a *prima facie* case. *Id.* at 984, 987 ("The existence and significance of barriers to entry are frequently, of course, crucial considerations in a rebuttal analysis."); *see also Heinz*, 246 F.3d at 717 n.13 ("Barriers to entry are important in evaluating whether market concentration statistics accurately reflect the pre- and likely post-merger competitive picture."). "Ease of entry is the ability of other firms to respond to collusive pricing practices by entering to compete in the market." *Cardinal Health*, 12 F. Supp. 2d at 54-55. Even in highly concentrated markets, if there is sufficient ease of entry, others might enter to compete and undercut the likely anti-competitive effects of a merger. *Id.* In other words, entry is one way in which post-merger pricing practices can be forced back down to competitive levels. *Id.*; *see also Baker Hughes*, 908 F.2d at 987 ("In the absence of significant barriers, a company probably cannot maintain a supracompetitive pricing for any length of time."); Merger Guidelines, § 3.0 ("A merger is not likely to create or enhance market power or to facilitate its exercise, if entry into the market is so easy that market participants, after the merger, either collectively or unilaterally could not profitably maintain a price increase above premerger levels."). "Determining whether there is ease of entry hinges upon an analysis of barriers to new firms entering the market or existing firms expanding into new regions of the market." *Cardinal Health*, 12 F. Supp. 2d at 55.

According to the Merger Guidelines, entry or expansion must be "timely, likely, and sufficient in its magnitude, character and scope to deter or counteract the competitive effects" that otherwise may be likely to result from a merger that significantly enhances market concentration. Merger Guidelines § 3.0; *see also FTC v. Chi. Bridge & Iron Co.*, 534 F.3d 410, 427-29 (5th Cir. 2008); *United States v. Visa USA, Inc.*, 163 F. Supp. 2d 322, 342 (S.D.N.Y. 2001) (entry must be "timely, likely, and [of a] sufficient scale to deter or counteract any anticompetitive restraints").

1. *History of Entry in the Estimatics and TLV Markets*

"The history of entry into the relevant market is a central factor in assessing the likelihood of entry in the future." *Cardinal Health*, 12 F. Supp. 2d at 56 (citing Merger Guidelines § 3.1); *see also Baker Hughes*, 908 F.2d at 988; *United States v. Waste Mgmt., Inc.*, 743 F.2d 976, 982 (2d Cir. 1984); *United States v. Tote*, 768 F. Supp. 1064, 1076 (D. Del. 1991). The FTC argues that history has proven entry into the Estimatics and TLV markets to be very difficult. The Defendants disagree.

With respect to Estimatics, the FTC contends that Audatex was the last successful entrant with its own database, and that was over thirty years ago. Defendants counter that there have been several recent examples of successful new Estimatics vendors:

- Comp-Est—Founded in 1990 and grew to more than 5,000 customers by the time it was purchased by CCC in 2003 (which still offers the product today to low-end repair shops);
- Focus Write, LLC ("Focus Write")—Started in 2005 by the founder of Comp-Est and quickly grew to 1,500 customers but then floundered due to management issues;
- Web-Est—Founded in March 2008; has already doubled its customer base; and
- Applied Computer Resources—Began offering Crash-writeR in 1993; currently has 600 customers and sells four products to the automotive repair industry.

This evidence of supposed past successes fails to carry much water. Whatever brief success Comp-Est enjoyed, it has disappeared as a competitor through its purchase by CCC in 2003. PX 86-013 (CCC).[25] In 2008, Eric Seidel, a former investor in Focus Write, became the founder and CEO of Web-Est, and purchased the assets of Focus Write in an effort to recoup his investment. Web-Est and Applied Computer Resources are the only two recent entrants who are still in the market, and they held collectively less than a 1% share of the Estimatics market in 2007. For contrast, Crash-writeR is used by fewer than 600 repair facilities whereas CCC's communicating Estimatics product, Pathways, is used by more than 16,000. PX 406; PX 99-018 (CCC). Thus, even a "successful" commercial entry may not be sufficiently successful to affect the analysis here.

The history of successful entrants is additionally clouded by the fact that the companies identified by the Defendants compete(d) only in the "low end market," that is, the small, independent repair facilities that are not part of any DRP and that have traditionally been underserved or ignored by CCC, Mitchell, and Audatex. *See* PX 759 (Applied Computer Resources & Mitchell e-mail correspondence). These independent repair facilities do not require connectivity to insurers or the other add-on features offered by the large vendors and demanded by larger customers. *See id.* This distinction is reflected in the relative prices: Crash-writeR retails for $135 per month, PX 760, while Pathways lists at about [text redacted] per month, PX 1407 (CCC).

Moreover, the last decade has seen a decrease in the number of Estimatics providers. In the 1990s, there were almost a dozen companies offering some form of Estimatics, including Dupont and Sherwin Williams. Carr Dep. at 20-21 (Motor). By the end of the 1990s, the only remaining Estimatics providers were CCC, Mitchell, Audatex, and Comp-Est. *Id.* at 20.

[25] [Text redacted.]

The former competitors have either exited the market or been acquired by CCC, Mitchell, or Audatex. PX 25 ¶ 18 (Carr Decl.).

In the TLV market, Mitchell successfully entered the market in 2005, obtaining over a 4% share of the market by 2008, but that success followed two failed attempts, ten years of effort, and millions of dollars of investment. PX 1020 ¶ 99 (Hayes Prelim. Report). Additionally, Mitchell already had a large share of the Estimatics market. It could capitalize on its strong reputation and relationship with insurance companies, as well as its ability to offer connectivity between its Estimatics product and its new TLV product, in order to gain significant shares of the TLV market. There is no evidence that a firm without an Estimatics product has ever successfully entered the TLV market. This history suggests that barriers to entry in these markets are significant.

2. *Defendants' Reliance on Historic Barriers to Entry*

Defendants have touted the historic barriers to entry into the Estimatics and TLV markets. Mitchell advertised the barriers to entry in countless financing and internal documents over the past few years. For instance, in a 2006 memorandum analyzing whether to purchase Mitchell, Aurora's analysts stated that:

[Text redacted.]

PX 629-001, 004 (Aurora) (emphasis added).[26] Aurora identified a "variety of significant barriers to entry": a proprietary auto physical damage database; a unique auto injury (medical)

[26] Defendants argue that statements such as these are of little value because the industry representatives who made them are not antitrust lawyers and did not mean that there were entry barriers in an "antitrust sense." The Court recognizes the caution but, even discounting the statements as puffery, finds that they are supported by the preliminary record.

database; a large installed customer base; a small, low-growth industry with few primary competitors; and specialized regulatory knowledge of an editorial staff comprising [text redacted] professionals. PX 629-001-002. Separately, Aurora praised the "medium to high" switching costs from one of the Big Three to another and the "stable" competition between Mitchell, Audatex and CCC who have competed against each other for "a number of years." PX 629-004. Mitchell itself has repeatedly cited the "significant barriers to entry" in its financing documents. *See*, *e.g.*, PX 607-014 (Rating Agency Presentation) ("[s]ignificant barriers to entry through unique combination of data, software, communications and relationships"); Sun, Tr. (1/8 p.m.) at 42:12-17 (Mitchell); PX 583-027-028 (Mar. 2007 Confidential Info. Mem. for Senior Secured Credit Facilities) (citing customer network and experience, the Mitchell database, medical database, and high switching costs as significant barriers to entry); PX 560-027 (July 2004 Confidential Info. Memo. for Senior Secured Credit Facilities). Nor was this recitation of barriers saved only for external financiers. In Aurora's 2007 "Annual Meeting Presentation" to its investors after the acquisition of Mitchell, Aurora listed several "Significant Barriers to Entry" in Mitchell's businesses, including its "Customer Network and Experience," "The Mitchell Database," and customers' "High Switching Costs." PX 691-049 (Aurora).

Likewise, CCC and its private equity owner, Investcorp, have repeatedly noted high barriers to entry in these markets. Upon completing the acquisition of CCC, Investcorp issued a press release in which its Chief Operating Officer stated that "[t]his market . . . has high barriers to entry." PX 1401-001. CCC and Investcorp also told rating agencies that there are high barriers to entry in these markets. *See* PX 161-011 (Draft Rating Agency Presentation) ("Key rating considerations [include] [v]ery high barriers to entry with two primary competitors").[27] According to CCC/Investcorp, the "likelihood" of a new entrant into Estimatics is "very low" because of:

- high overall satisfaction with CCC customers, no customer demand for change
- Fragmented market: CCC penetrated in over 20,000 body shops
- Dual network effect with both insurers and body shops
- CCC software involves over a decade of trials and is built on complex algorithms
- Source data on labor for autobody shops difficult to compile.

PX 161-023. CCC/Investcorp described the likelihood of a new entrant into TLV as "low" because:

- CCC Total Loss product is based on bi-monthly surveys of approximately 4,000 dealerships and 2,000 publications
- Differentiated product that is a critical component to insurer decision making
- Generating accurate, up-to-date valuations requires significant resources
- Database built on inspected "steel": unique in the industry
- Some states allow usage of book rates, which eliminates arguments with policyholders/claimants; however, most insurance customers will pay for the most accurate valuation
- Mitchell reportedly building product to compete with CCC and [Audatex], although no evidence that product would be a robust alternative.[28]

[27] CCC's CEO, Mr. Ramamurthy, expressed concern that this draft presentation may not accurately reflect the final version of its rating agency presentation because the document was initially drafted by a number of young financial analysts who are not familiar with the auto physical damage industry. To the extent that CCC failed to provide a final version of the presentation to the FTC in discovery, it was appropriate for the agency to rely on statements in the draft. Furthermore, considering the overwhelming number of references to barriers in other documents, it seems highly unlikely that the final version omitted any reference to "high barriers to entry."

[28] CCC obviously underestimated Mitchell's ability to penetrate the TLV market, although its unique situation would not readily transfer to another new entrant.

PX 161-023. *See also* PX 1420-024 (CCC) ([text redacted]). Audatex documents concur. PX 585-047 (Audatex).

3. *Technical Barriers*

In addition to this historical evidence of Defendants capitalizing on barriers to entry, the very nature of the products in question illustrate why this has been the case. Estimatics products consist of a parts and labor database, and software that interacts with the database to calculate the total cost of repair. PX 1020 ¶ 12 (Hayes Prelim. Report) (citing Ramamurthy IH Tr. (7/22/08) at 198-200). The difficulty and cost of developing and maintaining an entirely new parts and labor database that is accepted by the market would be significant barriers to new entrants. *See*, *e.g.*, PX 691-049 (Aurora); PX 161-023 (CCC). Such a database would need to cover at least 95% of all automobiles in the U.S. market, PX 28 ¶ 5 (Wilson Decl.), and include parts data on all major makes and models of vehicles sold in North America, including "historical information for many years." PX 25 ¶ 12 (Carr Decl.).[29] The database also would need to have comprehensive information on labor times and costs, which would involve an enormous number of expert-supervised time studies. PX 25 ¶ 13 (Carr Decl.). Furthermore, customer feedback on the parts and labor information is developed over a period of years. Linder IH Tr. at 62 (Mitchell); PX 25 ¶¶ 9, 12 (Carr Decl.) ("there likely would be a high error rate . . . because [the entrant's database] would not benefit from corrections . . . accumulated over time based on customer feedback"). Thus, to create a credible database, a new entrant would need to regularly perform "highly resource-intensive tasks" such as "data

[29] For instance, the Motor database contains over 3 million unique parts. PX 25 ¶ 6 (Carr Decl.). Mitchell's database has "over 7.6 million part descriptions, 2.2 million labor times, 128,000 vehicle configurations, 139,000 graphics and detailed parts information for vehicles up to 20 years old." PX 573-009 (Mitchell); *see also* PX 574-001.

revisions and time studies," PX 7 ¶ 6 (Kostakis Decl.), by using parts data from the original equipment manufacturers, and continually update and refine its data. PX ¶ 5 (Brown Decl.).[30]

Mitchell spends over $ [text redacted] million annually, and Audatex $ [text redacted] million annually, just to maintain, update, and refine their databases. Brungger IH Tr. at 93 (Mitchell); PX 516-003 (Mitchell). CCC pays $ [text redacted] million annually for exclusive use of the Motor database. PX 86-234 (CCC). It would take a number of years, untold thousands of man-hours, and millions of dollars of investment to create and maintain a competitive parts and labor database. *See*, *e.g.*, PX 573-009 (Mitchell's database "is unique and would require significant capital and development time to replicate"). *But see* PX 25 ¶¶ 14-15, 20 (Carr Decl.) (total sunk costs for building the Motor database was only about $ [text redacted] million). No firm has done so successfully since the mid-1990s.

Defendants argue, however, that this is a phantom barrier because new entrants will not be required to develop a new database after the merger. CCC has agreed that, upon consummation of the merger, it will relinquish its exclusive rights to license Hearst's Motor database, allowing any competitor or entrant the opportunity to obtain immediate access to a comprehensive, fully updated database of parts and services. Ramamurthy, Tr. (1/22 a.m.) at 90-91, 91-92:8; DX 218 (CCC Letter to Motor). Defendants argue that the renewed open access to the Motor database is likely to generate additional new entry. The use of "existing" or "idle facilities" can facilitate entry into a market. *FTC v. Occidental Petroleum Corp.*, No. 86-900, 1986 U.S. Dist. LEXIS 26138, at *21 (D.D.C. Apr. 29, 1986) (reasoning that the presence of idle

[30] Mitchell, Motor, and Audatex each use labor times developed from their own propietary time studies. PX 578-025 (Mitchell); PX 25 ¶ 8 (Carr Decl.); PX 1000-006 (Audatex) ("Forty years of experience, backed by time and labor studies"); PX 585-017 (Audatex).

factories for the production of polyvinyl chloride resin — a thermoplastic resin derived from the chemicals ethylene and chlorine — could reduce barriers to entry because "[f]irms can enter the market through means other than *de novo* plant construction in considerably less time than it would take to build an entirely new facility"). Here, access to the Motor database certainly could make the Estimatics market more appealing to potential entrants.

However, economic realities may prevent a new entrant from pursuing a license to use the Motor database. CCC currently pays $ [text redacted] million per year for its exclusive license of the Motor database. PX 86-234 (CCC). While a new entrant might be expected to pay significantly less for a non-exclusive license, that negotiated price remains unknown and unknowable. A price that approached the $ [text redacted] million range that Mitchell and Audatex spend annually to maintain their databases may be prohibitively expensive for new entrants who also must offer lower prices to attract customers. Because this is a low-growth industry with few new customers, *see* PX 574-002 (Mitchell), new entrants would have to win business from incumbents to generate sufficient revenues to remain a going concern for any length of time. It is unclear whether they could do so profitably, or if the projected profits would be sufficient to entice new entrants, given the market power that would be held by CCC/Mitchell and Audatex. *See* Merger Guidelines § 3.3 (entry considered "likely" if it would be profitable at pre-merger prices, and if such prices could be secured by the entrant). Notably, no potential new entrant has contacted Motor about the availability of its database since the merger was announced in April 2008. PX 25 ¶ 20 (Carr Decl.).
[Text redacted.]. *Id.* ¶ 22 (Carr Decl.).[31]

Despite these hurdles, it cannot be gainsaid that the release of the Motor database

[31] [Text redacted.]

would significantly reduce the most critical barrier to entry in Estimatics. However, access to a complete and respected Estimatics database appears to be only one of many related barriers to entry.

As with Estimatics, a database for TLV also requires the compilation and integration of millions of data points collected from thousands of sources. For example, Audatex's database draws on "approximately 110 million vehicle records" per year, and contains data from over 11,000 dealerships and over 3,500 other local market resources. PX 534-019; *see also* PX 1943-007, 009; PX 688-075. CCC has a "vehicle database of approximately 64,00 [sic] unique vehicles." PX 1964-010 (CCC). Both CCC's and Mitchell's TLV products include vehicle history reports by Vehicle Identification Number (VIN) to verify the condition of the vehicle. PX 81-032-036 (CCC Response to [text redacted] RFP); PX 116-035-038 (CCC Response to [text redacted] RFP); PX 643-011 (Mitchell). Thus, development of a TLV database poses similar challenges to those relating to creation of an Estimatics database.

Besides the database, the second main component of Estimatics and TLV products is the software that computes repair estimates or, in the case of TLV, vehicle valuations. With respect to Estimatics, development of complex, customizable, and integrated software is another significant barrier to entry. Firms must design custom interfaces that support specific communication protocols. *See* PX 25 ¶ 18 (Carr Decl.); *see also* Carr Dep. at 23 (Motor) (features and functionalities of Estimatics software are important to customers). CCC's Estimatics software "involves over a decade of trials and is built on complex algorithms." PX 204-006. It can communicate via the Internet or a private network, PX 81-006 ([text redacted] RFP), and offers a patented "Compare" feature that automatically alerts users when alternative parts are available. PX 81-019 (CCC). CCC began developing its Pathways product in 1993-94, but did not roll it out until 1996 even though it did not have to create its own database. Dickens IH Tr. at 115-117 (CCC). Despite advances in computer technology, it is projected that developing new Estimatics software would take one to two years. Lindner IH Tr. at 147:12-14 (Mitchell); *accord* PX 680-093-094 (Aurora); Lukens Dep. at 95-97 (APU Solutions, Inc. ("APU")) (Mitchell executive told an APU executive that the combined Mitchell-CCC platform would take 3-5 years to complete).[32] Focus Write developed a software interface over a period of about 18 months, PX 610-001, but its software "logic" was considerably improved once Focus Write was given access to Mitchell's software. PX 545-003 (2006 Focus Write Letter).

Similarly, TLV software is also powered by complex algorithms that interact with the database and drive the TLV system. Sun IH Tr. at 59-60 (Mitchell); Sun, Tr. (1/8 p.m.) at 47:199-48:19 (Mitchell) (to penetrate the TLV market, Mitchell partnered with J.D. Power, its source for the core database and development of algorithms for the software). In a combined effort, VVS and CCC spent eighteen to nineteen months developing a TLV software product for commercial trucks alone. Blitstein Dep. at 18-19 (VVS). CCC financed and provided the computer programs for the project. *Id.* at 17-18.

Although small repair facilities can use and perhaps may even prefer a basic Estimatics tool without all of the add-on programs, insurance companies and DRP repair facilities, which constitute the overwhelming majority of the market, require communicating products that offer connectivity between the insurance company and the repair facility. For these customers, the Estimatics product must be able to communicate the status of partial loss claims through the Internet or other specialized communication links. *See* PX 1020 ¶ 12 (Hayes Prelim.

[32] APU is a technology provider for the alternative parts-supply industry that recently entered into a strategic relationship with Audatex.

Report); *see also* PX 81-006 (CCC's Estimatics product can communicate via the Internet or a private network). In addition, because many customers, particularly insurance companies, prefer to purchase their auto physical damage and TLV products in bundles from one vendor,[33] successful vendors must be able to offer a full portfolio of products. *See* PX 25 ¶ 18 (Carr Decl.).[34] This point is demonstrated by the business practices of the three major competitors: In addition to the core estimating products, the bundles offered by CCC, Mitchell and Audatex may include digital imaging, shop management, aftermarket parts data, workflow, audit tools, and total loss valuation, among others; they also may offer free or cut-rate training on the use of the products as well as variable pricing based on frequency of use or contract duration. Conway, Tr. (1/9) at 92:1-18 (Audatex); PX 680-007-008, 010 (Mitchell); PX 86-008-009 (CCC); PX 244-062 (CCC's Response to [text redacted] RFP). Without a full suite of products to offer, a new firm would face enormous difficulties in challenging the established companies for business from insurance companies and DRPs.

Indeed, partially as a result of product integration and connectivity between repair facilities and insurance companies, CCC has achieved "[d]eep integration with customers [that] supports a 95% retention rate." PX 99-011 (CCC). This "stickiness" affects both insurance

[33] *See* PX 11 ¶ 4 (Brown Decl.) ([text redacted]); PX 27 ¶ 5 (Danforth Decl.) ([text redacted]); *see also* PX 686-013 (Ohio Casualty Ins. Co. ("Ohio Casualty") RFP); Brandt, Tr. (1/8 a.m.) at 20:18-21:3 ([text redacted]).

[34] *See*, *e.g.*, Burklin Dep. at 80-81 ([text redacted]); Brungger IH Tr. at 161-162, 158-159 ([text redacted]); PX 535-022 (Mitchell's TLV product was regarded as a "Killer Product [that] Closes [a] Big Portfolio Gap"); Hayes, Tr. (1/12 p.m.) at 134:14-135:10; PX 401 ¶ 12 (Blitstein Decl.) ("[T]he inclusion of an automobile partial loss estimating system is widely regarded among customers as a necessary feature when considering the purchase of an automobile total loss valuation product."); PX 534-005 (Mitchell) (Kelley Blue Book and NADA cannot enter TLV market segment because they "do not have the base estimatics business to leverage (as does CCC, [Audatex] and Mitchell)"); PX 71-004 (CCC's total loss functionality will not be optimized unless it is paired with CCC's Estimatics).

companies and repair facilities because if an insurance company is unwilling to switch, the repair shops that are part of its DRP typically will not switch either. This is because insurance companies either "mandate" that members of its DRP use the same Estimatics product used in-house or recommend (issue a "soft mandate") that they use the same product. PX 531-002 ("Insurance DRP Mandates continue to drive market."); PX554-036 (Mitchell). Thus, relationships with large insurance carriers are an important dynamic in the industry because such relationships are:

> the leading driver of revenue as carriers are not only the estimatics vendors' largest customers in terms of direct revenue, but also generate secondary revenue streams through repair shops that are affiliated with the insurance carriers' DRP programs. These insurance carrier relationships are generally longstanding and difficult to break once established as the switching costs associated with retooling internal systems and forcing system turnover at the repair shop level are steep. In addition, the service provided by estimatics vendors are critical to the operation of insurance carriers' claims resolution process and any disruption would have negative ramifications for the carrier's operations.

PX 585-047 (Audatex).[35]

Additionally, "integrated services, technological infrastructure in place, and long-term customer contracts all contribute to prohibitively high switching costs," PX 583-028 (Mitchell), thus making it difficult for a new entrant to gain market share from an incumbent vendor. *See* PX 543-016 (Mitchell). Furthermore, "[s]witching vendors is a long, difficult process, often taking as much as 12 to 18 months to fully transition to a new provider." PX 585-029 (Audatex); PX 574-003, 016 (Mitchell) (A customer switching vendors "would be forced to

[35] The current state of the marketplace for Estimatics products is as described. However, there is evidence that the insurance industry is moving towards open standards, by which the insurer would no longer mandate what software its DRP repair facilities use (potentially opening up the repair shop market considerably). *See* Ramamurthy, Tr. (1/22 a.m.) at 94:19-24 (CCC).

retrain its employees, which can take as long as 3-4 days per employee for an insurance carrier, and make a significant capital expenditure to switch out [the] embedded technological infrastructure"). These disincentives to switching have resulted in an incumbent winning percentage of close to 90%. PX 574-003 (Mitchell); PX 629-003 (Mitchell); Conway, Tr. (1/9) at 121:4-5 (Audatex); Ramamurthy Dep. at 47 (CCC); Hayes, Tr. (1/12 p.m.) at 161:25-162:11. *See also* PX 668-021 (Mitchell) ("Particularly among Top 25, Core Vendors are entrenched – switching rare").

Furthermore, on this preliminary record, it appears that reputation, scale, and relationships also serve as lesser barriers to entry. The significance of reputational barriers to entry in antitrust analysis is a somewhat unsettled question. *See Tote*, 768 F. Supp. at 1075. Reputation can be a considerable barrier to entry where customers and suppliers emphasize the importance of reputation and expertise. *See Chi. Bridge*, 534 F.3d at 437-38 & n.17 (while "general reputation" alone is not an effective barrier to entry, reputation for "industry-specific traits" of expertise and experience was considered significant in the storage tank-building industry); *Cardinal Health*, 12 F. Supp. 2d at 57 (reasoning that the strength of reputation of the merging companies over smaller companies in the pharmaceutical wholesale market served as barriers to growth of smaller competitors); *Tote*, 768 F. Supp. at 1075 (stating that the lack of a record of demonstrated performance served as a significant barrier to entry in the totalisator market, an industry that creates systems that support a common form of wagering at racetracks). *But see Waste Mgmt.*, 743 F.2d at 984 ("[W]e fail to see how the existence of good will achieved through effective service is an impediment to, rather than the natural result of, competition."); *United States v. Consol. Foods Corp.*, 455 F. Supp. 108, 119 (E.D. Pa. 1978) ("Particularly in selling to institutional customers brand names are not significant.").

The record illustrates that reputation for experience and scale are legitimate barriers to entry in the Estimatics and TLV markets. As a precondition to bidding, most insurance companies require multiple years of audited financial statements showing financial stability, and multiple references from other Estimatics customers. PX 94-016 (CCC Response to [text redacted] RFP); PX 95 at 5 (CCC Response to [text redacted] RFP); PX 687-07, 026, 027 ([text redacted] RFP); PX 118-065-066, 067 (CCC Response to [text redacted] RFP); PX 116-008 (CCC Response to [text redacted] RFP); PX 117-004, 005, 028 (CCC Response to [text redacted] RFP); PX 686-006 ([text redacted] RFP). Insurance customers demand a "strong [s]hop footprint . . .[,] a proven management team that is dedicated to customer service . . .[, and] a proven Estimatics product with a clear roadmap for future enhancement and options." PX204-007 (Audatex). Scale is important in this industry, in part, because a vendor has to be large enough to afford the continuous research and development necessary to be competitive in Estimatics and TLV. Sun Dep. at 101 (Mitchell); *see also* Daly Dep. at 76-77 (Allstate) ("I would suspect that some of these smaller companies simply didn't have the track record or resources to the extent that we felt comfortable partnering with them on such a . . . significant initiative and product."). In addition, insurance customers place great importance on extensive customer support capabilities and may require Estimatics suppliers to affirm that they have a single point of contact available 24 hours a day, seven days a week. *See*, *e.g.*, PX 118-009 (CCC Response to [text redacted] RFP).

On these factors, the Big Three have an enormous advantage. CCC, Mitchell, and Audatex are enormous companies in comparison to their remaining competitors, much less a new entrant. Mitchell has over 1,400 employees, Sun Dep. at 17 (Mitchell), of which [text redacted] to [text redacted] are dedicated to insurance customer support, Sun, Tr. (1/9) at 75:4-8

(Mitchell). It has [text redacted] to [text redacted] people across the country in its collision sales department, Sun Dep. at 39, and an editorial staff of [text redacted] to maintain its database, PX 572-026 (Mitchell). Mitchell has a technical assistance center staffed from 5 a.m. to 5 p.m. and offers the option of emergency technical assistance 24 hours a day, seven days a week. PX 1958-043 (Mitchell's Response to [text redacted] RFP); *see also* PX 681-003 ([text redacted]). CCC has over 834 full-time employees, including 225 product development personnel, and 36 client consultants who are scattered throughout the country and are responsible for training, customer service, and technical support. *See* PX 94-012, 019 (CCC Response to [text redacted] RFP). CCC also has over 120 field employees able to service insurance customers, PX 95-022 (CCC Response to [text redacted] RFP), 65 account managers and field support personnel covering all 50 states in its Insurance Services Division, and 60 representatives in its Automotive Services Group. PX 116-004 (CCC Response to [text redacted] RFP).

In terms of experience, Mitchell's Executive Vice President for Auto Physical Damage, Marc Brungger, has been with the Company for 20 years. PX 691-046 (Aurora). "Mitchell also has an editorial staff with an average of over 17 years of industry experience." PX 573-009 (Mitchell). CCC's management team has an "[a]verage of 10+ years of industry and company experience." PX 99-011 (CCC Lenders' Presentation). In addition, given the number of individuals who have defected to a competitor and the relative dearth of novices in this industry, *see*, *e.g.*, Conway, Tr. (1/9 a.m.) at 91:21-92:24 (Conway worked at Mitchell before moving to Audatex); PX562-33 (Tony Aquila was employed by Mitchell before leaving for Audatex); DX 30-8 (Eric Seidel was a former investor in Focus Write), the evidence suggests that there are a limited number of people who have significant experience on the seller side of this industry.

Relationships also play a significant role in insurance companies' and repair facilities' choice of vendor. CCC, Audatex and Mitchell have a large head start over the recent and potential new entrants in establishing customer relationships. Through its 60 year history of providing estimating solutions, Mitchell has established an extensive network of thousands of insurance staff and collision repair facility users that would be difficult to replicate. *See* PX 573-009 ("Mitchell has a long-standing and deep relationship with over [text redacted] insurance companies and over [text redacted] collision body shops through its 60 year history."). Likewise, "CCC has a highly diversified, stable customer base" and "strong, long-term customer relationships with a 95% customer retention rate." PX 99-011, 007 (CCC).

Finally, the return on investment in the Estimatics and TLV markets may make entry of new firms unlikely. The cost of creating the software (and potentially a database) are up-front sunk costs. The ability of new entrants to recoup those costs may be limited by factors that define these markets: (1) Estimatics and TLV markets are "**very** mature with not a lot of room for growth," PX 543-005 (Mitchell) (emphasis in original); (2) customers do not frequently switch firms, PX 618-027 (Mitchell); PX 161-007, 011 (CCC); PX 543-016 (Mitchell); PX 574-003 (Mitchell); PX 583-026 (Mitchell); and (3) insurance companies enter long-term contracts for Estimatics and TLV, so only about a third of insurers are even available for bid in a given year, PX 583-026 (Mitchell). These factors led Mitchell to conclude that the "small revenue opportunity" in Estimatics "should deter any potential new competitor from making the considerable capital investment it would require to develop the database and communications infrastructure necessary to compete in this space." PX 629-002 (Mitchell). Further consolidation of these markets is likely to make potential new entrants even more wary.

4. *Web-Est: The "Fix" To Barriers to Entry?*

Defendants rely heavily on the potential future of Web-Est to counter the FTC's case on barriers to entry. Web-Est was formed in March 2008 with Mitchell's financial backing around the same time CCC and Mitchell announced the merger; Mitchell holds a [text redacted] % interest in Web-Est. Seidel, Tr. (1/22 p.m.) at 173:11-15 (Web-Est). Web-Est now offers a Web-based non-communicating estimating product to low-end repair facilities. Seidel, Tr. (1/22 p.m.) at 165:18-22, 167:7-8 (Web-Est).[36] It does not currently participate in the TLV market. Web-Est's Estimatics system is based, in part, on a license permitting it to use Mitchell's parts database, but the license agreement contains a restrictive covenant that prohibits Web-Est from selling to the top fifty insurance companies, from selling communicating Estimatics products to insurance companies or repair facilities, and from integrating with other third-party service providers, such as parts locators, salvage, and other providers. *See* DX 59; Seidel, Tr. (1/22 p.m.) at 173:24-174:13 (Web-Est).

Facing FTC resistence to the merger, Mitchell followed suit to CCC's release of its exclusive hold on the Motor database. Mitchell and Web-Est have entered into a new licensing agreement which will become effective as soon as the merger closes. Seidel, Tr. (1/22 p.m.) at 175:20-23, 177:12-19 (Web-Est); DX 423 (Mitchell). Pursuant to the new agreement, Mitchell will remove virtually all of the restrictions on Web-Est's rights to sell to insurance companies and repair facilities. Seidel, Tr. (1/22 p.m.) at 175:20-25 (Web-Est); DX 423 (Mitchell).

[Text redacted.]

The new license agreement also resets the clock on Web-Est's initial five year license to the

[36] [Text redacted.]

Mitchell database, and gives Web-Est an option to renew for an additional five years. Seidel, Tr. (1/22 p.m.) at 175:9-14 (Web-Est); DX 423 (Mitchell). Web-Est also will be permitted to use other databases if it wishes, and can integrate with other vendors' products. *Id.* Furthermore, if the merger closes, Mitchell will relinquish its equity in Web-Est as well as its purchase option for Web-Est. *Id.*; Sun Tr. (1/9 p.m.) at 65:11-25 (Mitchell).

[Text redacted.]

The ability and willingness of current competitors to expand their foothold in the market and/or reposition greatly reduces the anticompetitive effects of a merger, and is essentially equivalent to new entry. *See Arch Coal*, 329 F. Supp. 2d at 148 ("Defendants have shown that the post-merger fringe capacity in the [market] would be more than sufficient to absorb any increase in demand caused by any production lag coordinated by the 'big three' producers . . . ."). Defendants argue that the release of these restrictions will shatter the only major barrier to entry, will enable Web-Est to expand its business to new heights, and will usher in a new era of dynamic competition in these markets. They offer numerous points of evidence in support of their conclusion.

Defendants contend that Web-Est's web-based product will make it a "game changer" in the industry. Seidel, Tr. (1/22 p.m.) at 193:11-21 (Web-Est). They argue that Audatex's experiences in the U.S. market confirm that the concept of web-based products is gaining ground in the auto physical damages industry. Cheskis, Tr. (1/23 a.m.) at 11:3-23 (Gerber uses Audatex's web-based product in sixteen facilities in the United States); DX 225-33-35 (Audatex [text redacted]). Additionally, Web-Est already has a communicating Estimatics product embedded in its non-communicating product which it can turn on almost immediately, Seidel, Tr. (1/22 p.m.) at 176:1-3, 186:19-187:3 (Web-Est); is in the process of developing [text redacted], *id.* at 188:10-189:12, thus eliminating the barrier of product portfolio in Estimatics and TLV.

Defendants suggest that these plans have already begun to reap significant rewards. Since its formation last spring, Web-Est has more than doubled its initial customer base; it now sells Estimatics to about 11% of its addressable market. *Id.* at 165:23-25, 174:14-21.[37] Looking forward, Eric Seidel plans an aggressive price-cutting strategy and forecasts sales to DRPs and insurers within the first year and annual revenues of $14.6 million within five years. DX 30 at 6-7, 50 (Web-Est Oct. 2008 Business Plan). Mr. Seidel expects to add 5,000 customers within five years, including three insurance carriers within the next year. *Id.* at 5, 28. [Text redacted.]

Although Defendants acknowledge that Web-Est is not nearly as large as Audatex, CCC or Mitchell, they assert that Web-Est does not plan "to go out and try to replicate a CCC, a Mitchell, Audatex," because they are "brick and mortar" Estimatics firms. *Id.* at 193:11-21. Defendants argue that Web-Est believes it will become the Estimatics industry's version of Netflix which upended Blockbuster and revolutionized the movie rental business. *Id.* at 193:22-194:19.

Mr. Seidel, who testified at the preliminary injunction hearing, is an impressive man and the Court has no doubt that he has the entrepreneurship, experience, and drive that bode well for Web-Est's future. Then again, of course, Mr. Seidel is whole-heartedly behind the proposed merger because it would free his hands to compete as he wishes. Nonetheless, the

[37] Due to the current restrictions of the Mitchell license, Web-Est currently is limited to pursuing a market of approximately [text redacted] small shops. Seidel, Tr. (1/22 p.m.) at 174:14-17 (Web-Est).

Court cannot ignore that Web-Est is a ten to twelve person company with current projected annual revenues of $ [text redacted] million (assuming the merger is effected). *Id.* at 218:14-19; PX 1003-006-007, 033 (Web-Est). It will be an ant to an elephant, compared to a post-merger CCC/Mitchell, at $450 million in revenues and over 2,000 employees. *See* PX 529-006 (transaction valued at approximately $1.4 billion and CCC/Mitchell expects to earn $460 million in annual sales at inception); *see also* Seidel, Tr. (1/22 p.m.) at 205:3-6 ([text redacted]). Assuming that web-based products will succeed (society is increasingly using the web, including the courts for electronic case filing), insurance companies will still demand customer support services and suppliers still will need large sales forces to woo them. The growth curve to take Web-Est from where it is now to where it would need to be to compete with CCC/Mitchell seriously enough to cause price competition is extraordinarily steep and inevitably long. That journey is made more difficult by the fact that Mitchell will no longer lend its expertise to Web-Est, nor will it hire out its staff to Web-Est. Sun, Tr. (1/8 p.m.) at 13:5-9 (Mitchell).

Moreover, CCC, Mitchell and Audatex have been refining their Estimatics software for over a decade. *See* PX 204-006 (CCC). In discussing whether entry is "sufficient," the Merger Guidelines suggest that:

> where the concern is unilateral price elevation as a result of a merger between producers of differentiated products, entry, in order to be sufficient, must involve a product so close to the products of the merging firms that the merged firm will be unable to internalize enough of the sales loss due to the price rise, rendering the price increase unprofitable.

Merger Guidelines § 3.4. From this record, it is simply unknown how many insurance companies and DRP repair facilities will find Web-Est's communicating Estimatics product to be up to par, or at what pace.

And, Web-Est cannot be considered a truly independent actor because Mitchell will continue to be so involved in its business. In order to be accepted, "curative divestitures" must be made to a new competitor that is "in fact . . . a willing, *independent* competitor capable of effective production in the . . . market." *White Consol. Indus. v. Whirlpool Corp.*, 781 F.2d 1224, 1228 (6th Cir. 1986) (emphasis added). Mitchell's counsel has similarly observed that it is a "problem" to allow "continuing relationships between the seller and buyer of divested assets after divestiture, such as a supply arrangement or technical assistance requirement, which may increase the buyer's vulnerability to the seller's behavior." Richard G. Parker & David A. Balto, Evolving Approach to Merger Remedies, Antitrust Report (May 2000), *available at* http://www.ftc.gov/speeches/other/remedies.shtm (citing FTC, *A Study of the Comm'n's Divestiture Process* (1999), *available at* http://www.ftc.gov/os/1999/08/divestiture.pdf). Although Mitchell will relinquish its financial interests in Web-Est upon consummation of the merger, Web-Est will continue to license Mitchell's database for at least five years, with a continuing option for five more.

[Text redacted.]

At its rosiest, Web-Est's most optimistic financial projection predicts annual revenues of approximately $ [text redacted] million by 2013 (of which $ [text redacted] million would come from insurance companies). PX 1003-033 (Web-Est); Seidel, Tr. (1/22 p.m.) at 198:19-23, 202:25-205:2 (Web-Est). This is admirable growth. By contrast, however, in 2007, Mitchell had $ [text redacted] million in total revenue and an EBITDA[38] of $ [text redacted] million. PX 530-004 (Mitchell). CCC had $ [text redacted] million in total revenue and an

[38] Earnings Before Interest, Taxes, Depreciation and Amortization.

EBITDA of $ [text redacted] million. *Id.*; PX 86-034 (CCC) (also estimating Solera's global revenues in 2007 at $ [text redacted] million). A merged CCC/Mitchell would be even bigger. According to the Merger Guidelines, entry is "timely" if it can be achieved "within two years from initial planning to significant market impact." Merger Guidelines § 3.2. ("significant market impact" means "significant impact on price in the relevant market"). While two years may be a short time frame by which to judge successful entry in this industry, even within five years, Web-Est hopes to make hardly a splash compared to Mitchell's current market share. Whatever Web-Est's plans and aspirations for the future may be, it is very unlikely to be able to compete effectively, *i.e.*, affect pricing, within five years or even soon thereafter. *See In re Chi. Bridge & Iron Co.*, 138 F.T.C. 1024, 1071 (2005) ("the mere fact that new entrants and fringe firms have an intent to compete does not necessarily mean that those firms are significant competitors capable of replacing lost competition").

5. *Predictive Analytics*

Predictive analytics, an internal method of calculating future estimates based on an insurance company's own empirical data, Marushka Dep. at 14-15 (CCC), may supplant the Estimatics software sold by CCC, Mitchell and Audatex one day, and the Defendants hint that it may be sooner rather than later when they suggest that the merger of two outdated platforms cannot hurt anyone. It is acknowledged by CCC, however, that there is "nothing in production . . . that we've actually seen" that might replace today's Estimatics. Ramamurthy IH Tr. at 203:13-19 (CCC). CCC's General Manager, Insurance Services Group, stated that no insurance company currently uses predictive analytics to calculate partial loss estimates and he does not know whether predictive analytics are allowed under insurance regulations. Marushka Dep. at 15 (CCC). In other words, while "there has been talk about . . . it," Ramamurthy IH Tr. at 203

(CCC), no insurance companies have implemented it. *See* Marushka Dep. at 15. The Court finds this evidence of new entry too speculative to rely upon.[39]

b. *Coordinated Effects*

Merger law "rests upon the theory that, where rivals are few, firms will be able to coordinate their behavior, either by overt collusion or implicit understanding in order to restrict output and achieve profits above competitive levels." *Heinz*, 246 F.3d at 715 (citing *PPG Indus.*, 798 F.2d at 1503). The theory follows that, absent extraordinary circumstances, a merger that results in an increase in concentration above certain levels "raise[s] a likelihood of 'interdependent anticompetitive conduct.'" *PPG Indus.*, 798 F.2d at 1503 (quoting *Gen. Dynamics*, 415 U.S. at 497); *see also FTC v. Univ. Health, Inc.*, 938 F.2d 1206, 1218 n.24 (11th Cir. 1991) (high concentration makes it "easier for firms in the market to collude, expressly or tacitly, and thereby force price above or farther above the competitive level"); *Elders Grain*, 868 F.2d at 905. Successful coordinated interaction entails "[1] reaching terms of coordination [2] that are profitable to the firms involved and [3] an ability to detect and punish deviations that would undermine the coordinated interaction." Merger Guidelines § 2.1. Whether a merger will make coordinated interaction more likely depends "on whether market conditions, on the whole, are conducive to reaching terms of coordination and detecting and punishing deviations from those terms." *Id.* Because the FTC has established a *prima facie* case, the burden is on the Defendants to demonstrate "structural barriers," unique to this industry, that are sufficient to defeat the "ordinary presumption of collusion" that attaches to a merger in a highly concentrated market. *Heinz*, 246 F.3d at 725.

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[39] With the movement towards web-based platforms well underway, *see* DX 225-33-35 (Audatex), and the potential emergence of predictive analytics in the not too distant future, the FTC may be chasing yesterday's technology, when all is said and done.

"The combination of a concentrated market and barriers to entry is a recipe for price coordination." *Id.* at 724. Yet, despite the high HHI numbers currently displayed in these markets, by all accounts, Estimatics and TLV are highly competitive markets today and there is no evidence of past coordination. Danford Dep. at 120 (Ohio Mutual); Brandt, Tr. (1/8 a.m.) at 17:23-18:7 (The Hartford); Cheskis, Tr. (1/23 a.m.) at 10:12-23 (Gerber); Aquila Dep. at 15 (Audatex); Conway, Tr. (1/9) at 169:10-21 (Audatex). *Compare with Edlers Grain*, 868 F.2d at 905 ("there is a history of efforts to fix prices in the industry"); *Hosp. Corp. of Am. v. FTC*, 807 F.2d 1381, 1388 (7th Cir. 1986) ("there is a tradition . . . of cooperation between competing hospitals in Chattanooga"). "While proof of prior cooperative behavior is relevant, it is not a necessary element of likely future coordination in violation of Section 7." *Arch Coal*, 329 F. Supp. 2d at 116. But Defendants do not rest there. Rather, they argue that these markets provide a perfect example of the HHI's failure to measure anticompetitive effects because, despite their high concentration, "[t]he undisputed market realities here present a perfect storm of factors that impede coordination." Defs.' Post-Trial Brief at 16. According to Defendants, those factors include: (1) product heterogeneity; (2) lack of price transparency; (3) complexity and lack of standardization with respect to pricing and products; (4) firm heterogeneity; (5) large, infrequent contracts; (6) high fixed costs relative to variable costs; and (7) the presence of sophisticated buyers. *See* Ordover, Tr. (1/23 a.m.) at 90:1-92:5.

1. *Characteristics of the Products and Competitors*

"[R]eaching terms of coordination may be limited or impeded by product heterogeneity." Merger Guidelines § 2.11; *see also*, *e.g.*, *Hosp. Corp. of Am.*, 807 F.2d at 1390. "Estimatics software is differentiated along a number of important dimensions," including "accuracy and coverage of the underlying data for parts and estimated labor times, perceived differences in the ease of use of the competing products, and the quality and timeliness of technical support services." PX 1020 ¶ 71 (Hayes Prelim. Report). Dr. Ordover opined that on a scale of zero to ten, these products are closer to a ten in terms of heterogeneity. Ordover, Tr. (1/23 a.m.) at 85:2-11. Insurance companies demand customized Estimatics and TLV products tailored to fit their individual needs. Ramamurthy, Tr. (1/22 a.m.) at 99:8-100:2 (CCC). Some insurers even require that bidders commit to spending $500,000 to $600,000 per year to develop software unique to that customer. *Id.*

In addition to product heterogeneity, coordination may be impeded by a lack of "standardization of pricing or product variables on which firms could compete." Merger Guidelines § 2.11. The base Estimatics product is often sold in highly customized bundles that include other auto physical repair products and various add-on products to suit the particular requirements of the customer, thus resulting in significant product variability. Ramamurthy, Tr. (1/22 a.m.) at 88:3-7 (CCC); Conway, Tr. (1/9) at 93:24-95:5 (Audatex) ("With the number of products that [Audatex] offer[s] [to insurers], you could come up with thousands of different combinations of those products."); *id.* at 111:9-13 ("On the [repair] shop side with the number of different add on products," Audatex could offer "hundreds" of different bundles). Along with the base estimating product, the bundles can be comprised of any number or combination of other products and add-ons, as well as varying levels of installation support, customer service, training and integration. Rollins Dep. at 17 (Safeco); Kostakis Dep. 36, 37-39 (Angelo's Auto Body Shop); *see also* DX 98 (CCC Price Sheet); DX 47 (Mitchell's August 2007 price list for repair facilities is thirty-one pages long, consisting of almost 400 product and pricing options). These customized bundles have highly complex and varying pricing metrics including flat fees for the entire bundle, individual product pricing, and almost everything in between. *See*, *e.g.*, DX 243-10-21 (CCC Pathways Services Agreement).

Defendants also assert that the likelihood of coordination in these markets is further diminished by the heterogeneity exhibited among the firms in these markets. "[R]eaching terms of coordination may be limited or impeded by firm heterogeneity, for example, . . . the production of another product that tends to be used together with the relevant product." Merger Guidelines § 2.11. Defendants argue that because the sale of add-ons and other products in conjunction with Estimatics and TLV is an increasingly important area of focus and source of revenue growth, "the merged firm's unique interest in enhancing sales of such related offerings further impedes any interest in coordinated interaction." Defs.' Post-Trial Brief at 20. They point to Mitchell's unique medical bill-review services as an example. *See* PX 583-027-028 (Mitchell); PX560-031-032 (Mitchell).

While Defendants' arguments do have force, particularly with regard to the insurance industry, their points are weakened by their own admissions that there is a "minimum differentiation in offerings," PX 1420-007 (CCC); *see also* PX 253-010 (CCC). "Generally speaking there are . . . three or four [bundles] that are purchased consistently from one insurance company to the next in most all of the bids." Conway, Tr. (1/9) at 94:9-11 (Audatex). The "standard package" includes the basic estimating system, the imaging systems, an aftermarket products tool and communication. *Id.* at 94:12-18. While it is true that Mitchell is the only one of the Big Three firms that offers a medical bill-review product, with limited other exceptions, CCC, Mitchell and Audatex have essentially the same suite of product offerings and add-ons, and are therefore unable to separate themselves from the pack on a consistent basis through unique sets of products. *See* PX 1420-007 (CCC document showing the different add-ons in Estimatics) ([text redacted]); PX 253-010 (CCC) (noting that [text redacted]). *But see* PX 550-

022 (Mitchell) ("Continue to look for points of differentiation"); *see also* Carr Dep. at 23 (Motor).

2. *Dynamics of the Marketplace*

In addition to product and firm heterogeneity and variability, Defendants argue that the unique marketplace dynamics make coordination unlikely. First, Defendants assert that the lack of pricing transparency for Estimatics and TLV is a significant impediment to coordination. "Reaching terms of coordination may be limited or impeded . . . by firms having substantially incomplete information about the conditions and prospects of their rivals' businesses," Merger Guidelines § 2.11, and the ability to detect deviations from the terms of coordination is limited "if key information about specific transactions or individual price or output levels is [not] available routinely to competitors." *Id.* § 2.12. *See also Oracle*, 331 F. Supp. 2d at 1166 ("Without homogeneity [of product offerings] or transparency [in pricing], the market conditions are not conducive to coordinated effects, either tacit or express."). The bidding process for insurance companies is conducted on a confidential basis, and bids are usually accompanied by a non-disclosure agreement. Sun, Tr. (1/9) at 46:22-47:4 (Mitchell); Brandt, Tr. (1/8 a.m.) at 23:19-22 (The Hartford). Though these competitors go to great lengths to obtain "intelligence" about each other's pricing, Sun, Tr. (1/8 p.m.) at 55:13-58:21 (Mitchell); Sun, Tr. (1/9) at 75:20-77:5 (Mitchell), and the record contains instances where one vendor has obtained partial bids, price lists, or other pricing information about their competitors, *e.g.*, PX 85-059 (CCC); PX 506 (Mitchell on Audatex pricing); PX 623 (Mitchell), PX 696 (Mitchell); PX 713 (Mitchell on Audatex pricing); PX 714 (Mitchell on Audatex pricing); PX 715 (Mitchell on CCC pricing); PX 716 (Mitchell on CCC pricing), pricing for insurance company contracts is not "routinely available."[40] Furthermore, many times when CCC, Audatex or Mitchell obtain so-called competitive information on pricing, the information is either misleading or simply false (presumably to force a lower bid). *See*, *e.g.*, DX 425-1 ([text redacted]); Conway, Tr. (1/12 a.m.) at 28:14-19 (Audatex "expect[s]" that customers have provided inaccurate information on occasion with the hopes of driving down Audatex's prices).

The FTC contends that CCC, Mitchell and Audatex obtain a substantial amount of information after a bidding process, which they can use to set future prices. *See* Sun, Tr. (1/8 p.m.) at 55:6-9 (Mitchell); *see also* PX 172-002 (CCC e-mail); PX 598-001 (Mitchell [text redacted]); PX 179-003 (CCC). Given the degree of product variability in the industry, past pricing information may be suggestive but not necessarily helpful for the next bid, particularly a bid for the same insurer because contracts with insurance companies can last from two to five years, during which time prices have been shown to alter significantly. *See Arch Coal*, 329 F. Supp. 2d at 141 ("It is true that industry publications make some market information available among producers. However, the information published in those sources is limited, imperfect, and largely unreliable and untimely.").

Pricing is not as obscure in the repair facility segment. Like insurance company bids, repair facility contracts are confidential. *See*, *e.g.*, Sun, Tr. (1/9) at 53:19-54:10 (Mitchell); Ramamurthy, Tr. (1/22 a.m.) at 108:23-25 (CCC); Conway, Tr. (1/12 a.m.) at 39:8-17 (Audatex). Repair facility contracts also often consist of bundled products, including the base Estimatics product and a variety of add-ons. Conway, Tr. (1/9) at 111:9-113:2 (Audatex). However, despite confidential repair facility contracts and product bundling, Estimatics pricing for the

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[40] One source of competitive intelligence is former employees of one of the Big Three competitors who migrate to another one. Sun Dep. at 10-12 (Mitchell); PX 624-001.
[Text redacted.]

repair shop segment is "transparent." Seidel, Tr. (1/22 p.m.) at 227:9-14, 226:2-24 (Web-Est) (stating that it is possible to get the price points of the Big Three's Estimatics products by calling up shops and asking what they are paying); *see also*, *e.g.*, PX 179-003 (CCC); PX 173 (CCC [text redacted]); PX 742-008 (Mitchell began a matching program in December of 2008 in which it offered to match CCC and Audatex on the condition that Mitchell had the "competitive quote faxed in").

Likewise, TLV prices are more transparent than Estimatics prices for insurance companies. Because TLV is sold on a per valuation basis, there is only one price to track. *See* PX 172-002 (CCC e-mail) ("Mitchell is already in [the] door with estimating and is offering total loss @ $ [text redacted]"); PX 722 (Mitchell e-mail) (Mitchell agreed on $ [text redacted] per valuation for a certain insurer "in part because CCC came in at $ [text redacted]."). However, TLV prices are becoming less transparent as vendors turn increasingly toward the "one throat to choke concept," *i.e.*, bundling, whereby they purchase Estimatics, TLV and add-ons from a single source. *See* PX 543-019-020 (Mitchell); PX 550-025 (Mitchell); PX 1432-003 (CCC); PX 1402 (CCC web-page promoting the CCC One total repair platform). Even when TLV is sold separately, these three companies still have differing price metrics based on a variety of factors including, *inter alia*, the relationship with the customer and the size of the order. *See* DX 186-26 (CCC contract with [text redacted]) (per valuation price, plus surcharge for certain methods of ordering, as well as additional fees for different vehicles); DX 187-10 (CCC contract with [text redacted]) (per valuation price for cars, additional for trucks, with separate minimum purchase requirements for both).

On balance, as Dr. Ordover suggests, the pricing information in these markets is best described as "shrouded," Ordover, Tr. (1/23 a.m.) at 88:8-22, *i.e.*, neither as transparent as the FTC would wish nor as secret as the Defendants would now prefer.

Defendants also contend that long-term, high-value Estimatics and TLV contracts in the insurance industry lower the incentives to coordinate and increase the incentives for cheating. *See id.* at 85:15-23. Insurance contracts typically range from two to five years, and can be priced anywhere from a few thousand dollars a year for a small insurer to several million dollars a year for a large insurer. Conway, Tr. (1/9) at 96:16-20, 94:22-95:4 (Audatex); *see*, *e.g.*, DX 252-4, 53 (five-year contract with CCC). Defendants and their expert assert that the insurance contracts, particularly for Tier One insurers, are just too valuable for any one of the three competitors to agree to forego, whether implicitly or explicitly. The Merger Guidelines provide that "[w]here large buyers likely would engage in long-term contracting, so that the sale covered by such contracts can be large relative to the total output of a firm in the market, firms may have the incentive to deviate" from the terms of coordination. Merger Guidelines § 2.12; *see also United States v. Archer-Daniels-Midland Co.*, 781 F. Supp. 1400, 1416, 1423 (S.D. Iowa) (finding coordination unlikely where transactions in the market were "relatively large" and "infrequent"). And, although individual repair facility contracts are not particularly large, Defendants argue that because CCC, Audatex and Mitchell earn large portions of their revenues from the sale of non-Estimatics products, they have an incentive to deviate from any potential terms of coordination in order to sell additional products.

In a similar vein, Defendants argue that the bargaining power and sophistication of their insurance company customers further impede coordination. A sophisticated customer base makes price coordination more difficult, *see Baker Hughes*, 908 F.2d at 986 (sophisticated "buyers closely examine available options and typically insist on receiving multiple, confidential bids for each order"), but buyer power is greater when there are few buyers in the market. *See*

Edlers Grain, 868 F.2d at 908 ("A concentrated and knowledgeable buying side makes collusion by sellers more difficult."). Although the top fifty insurance companies account for approximately 80% of the total revenues in physical damage claims market, PX 543-019, the insurance market as a whole is not concentrated. The HHI for the nineteen largest insurers (*i.e.*, the only insurers with a greater than 1% market share), who together represent 76% of the entire insurance market, is only 631 — not very concentrated. *See* PX 515-028; *see also* PFF ¶ 197. However, it is true that the larger automobile insurance companies have enough buying power to demand customized products and to use their leverage regularly to keep Estimatics prices low for repair facilities in their DRP networks. *See* Cheskis, Tr. (1/23 a.m.) at 13:16-14:13 (Gerber); *see also* Hall, Tr. (1/8 a.m.) at 94:15-24 (GMAC); Ramamurthy, Tr. (1/22 a.m.) at 110:15-111:6 (CCC). Collectively, the heterogeneity of the base products and customized bundling, the largely confidential pricing, and the high-value insurance contracts tend to make tacit coordination less likely than the huge HHIs might predict.

But this conclusion is not the end of the analysis. Defendants ignore a number of other factors present in these markets that would tend to confirm the HHI's predictions regarding the likelihood of coordination. Estimatics and TLV are "stable" markets in which the same three companies have been competing against each other for over a decade, making the market participants very familiar with each other. PX 583-024 (Mitchell); Sun, Tr. (1/8 p.m.) at 20:11-22 (Mitchell); *see also* PX 574-002 (Aurora); PX 554-054, 055 (Mitchell) ("the industry will not dramatically change over the next 5-10 years"); PX 1970-027 (CCC-Mitchell) ("The $40 billion auto damage claims industry is large and stable . . . ."). Defendants point to a lack of price transparency as the "[k]ey information" that is not "available routinely." *See* Merger Guidelines §§ 2.11 & 2.12. But pricing is not the only "key information" that is contemplated by the

Guidelines. Indeed, the Guidelines state that if "key information about specific transactions *or* individual price or output levels is available routinely to competitors, it may be difficult for a firm to deviate secretly." *Id.* § 2.12 (emphasis added). These three firms know what products each offers, what insurance accounts each has won, and, often, the identities of the final two bidders for an insurance company contract. *See, e.g.*, Balbirer IH Tr. at 73 (CCC) ("Obviously we know what their products are, they know what our products are, and we're in the marketplace. They know who we sell to and we know who they sell to."). In particular, each of these three companies knows which one of them sells to which of the top twenty-five insurance companies. PX 543-011-012 (Mitchell) (identifying top twenty-five insurers, who won the contract, and claims volume). CCC, Audatex and Mitchell have sought to "gather as much competitive information [about each other] as possible" for a number of years, Sun, Tr. (1/8 p.m.) at 57:17-58:1 (Mitchell), and have largely succeeded in their efforts.

These competitive markets are stable in part because they are very mature and have little room for growth. PX 543-005 (Mitchell); *see also* PX 1970-033 (CCC-Mitchell).[41] Estimatics is "90%+ saturated," making it a "game [of] market share take-away." PX 630-017. But market shares have also remained stable over the last several years. *See* PX 583-024 (Mitchell); PX 543-020 (Mitchell) ("not a lot of switching going on"). "Taking [m]arket [s]hare is [d]ifficult" in this industry, largely because of the high switching costs and the time associated with switching products. PX 543-016 (Mitchell); *see also* PX 634-002 (Mitchell e-mail) (cost of switching generally is $ [text redacted] per user); PX 585-029 (Audatex); PX 574-003, 016 (Mitchell). Because of the difficulty of gaining market share, CCC, Audatex and Mitchell have all shifted their focus toward selling more products to their existing customers rather than

[41] [Text redacted.]

engaging in price wars over each other's customers. *See* PX 543-019, 020; PX 550-024-025, 030; *see also* [text redacted]; PX 632-034. This can lead to even greater stabilization of market share and greater segmentation of the market, thus increasing the incentives and lowering the impediments to tacit coordination. *See* Merger Guidelines § 2.11 ("Firms coordinating their interactions need not reach complex terms concerning the allocation of the market output across firms or the level of the market prices but may, instead, follow simple terms such as . . . stable market shares, or customer or territorial restrictions.").

Nor are high switching costs the only characteristics that make these markets conducive to tacit coordination in the form of market stabilization or customer allocation. Product heterogeneity, which in some ways can reduce the likelihood of coordination, can also lead to greater segmentation of the market and more entrenched market shares.[42] Decreasing the number of firms who can service the larger contracts from three to two is likely to accelerate the trend of market stability, as gaining market share will be marginalized, and increased customization and integration of products will become the primary goal.

Finally, the argument that high fixed costs relative to variable costs creates an incentive to seek volume, while broadly appealing, is not as applicable to the Estimatics and TLV markets as it might be to other software markets. When fixed costs are high relative to variable costs, there is a "strong economic incentive[] to produce at close to full capacity" that "works against the likelihood of any collusive price raising scheme which would require output

[42] "Although homogeneity of products may make the creation and enforcement of a traditional cartel easier, tacit collusion may be easier when products are differentiated. When products are highly differentiated, direct competition between them is limited, in effect creating a smaller number of critical points for tacit interaction. . . . The result may be that highly segmented markets . . . can sustain high profits more effectively than homogeneous markets." Lawrence A. Sullivan & Warren S. Grimes, *The Law of Antitrust: An Integrated Handbook* § 11.2e1, at 635 (2d ed. 2006).

restrictions." *Archer-Daniels*, 781 F. Supp. at 1423. As Dr. Ordover noted, industries with high fixed costs relative to variable costs are likely to have no barriers to expansion, and no capacity constraints on production. Ordover, Tr. (1/23 a.m.) at 91:16-92:1. Here, while the Big Three firms have no capacity constraints, the Estimatics and TLV markets are already "very mature" and offer little room for growth. PX 543-005 (Mitchell). Capacity is limited by customer demand, not vendor cost, and the volume of claims has been growing at a slow rate over the last several years. *See id.* Moreover, because of the time and high costs associated with switching products, it is very difficult to gain market share. Accordingly, Dr. Hayes calculated that "it's not in [the merged firm's] interests to reduce prices; in fact, it's in their interest to raise prices." *See* Hayes, Tr. (1/21 a.m.) at 69:11-72:1.

The Defendants point to a Solera financial document to support their contention that Audatex sees the merger as a potential opportunity to increase its competition for CCC's and Mitchell's existing customers. In that document, Solera stated:

> We view potential industry consolidation as a positive for Solera [because]: [1] It provides an opportunity for Solera to gain share in North America as its two competitors will be distracted; [and] [2] it likely creates a *more rational North American market*, as the newly combined competitors would be highly levered and capital constrained.

DX 41-AUD0000229 (Audatex) (emphasis added). As indicated by an internal company e-mail from [text redacted], which the FTC championed as a "smoking gun" of sorts, to a profit maximizing business operating under these market conditions, "rational" means avoiding price wars with competitors. PX 552.[43]

In a highly concentrated market, with stable market shares, low growth rates and

[43] [Text redacted.]

significant barriers to entry, there are few incentives to engage in healthy competition. Although the FTC has exaggerated the legal significance of the "merger-to-duopoly" inquiry, it is clear that CCC/Mitchell and Audatex will likely be the only major players in these markets for the foreseeable future. "[I]t is easier for two firms to collude without being detected than for three to do so," *Am. Hosp. Supply Corp. v. Hosp. Prods. Ltd.*, 780 F.2d 589, 602 (7th Cir. 1985), but price fixing is only one concern of the antitrust laws. A more common concern is "the creation or reinforcement by merger of . . . oligopolistic market structures in which tacit coordination can occur." *Heinz*, 246 F.3d at 725. With only two dominant firms left in the market, the incentives to preserve market shares would be even greater, and the costs of price cutting riskier, as an attempt by either firm to undercut the other may result in a debilitating race to the bottom.

Nevertheless, Defendants have made a strong argument that despite these characteristics, the market dynamics create a number of incentives to compete, and indeed, have maintained a competitive marketplace to this day. *See* Mitchell, Tr. (2/17 p.m.) at 43:14-44:15 ("Concentrated though they are everybody agrees that [these markets] are competitive. . . . We know that this market does not operate the way the presumption indicates. Why? Because it's highly concentrated, [yet] it's [still] competitive, that's the first clue."). Although Defendants present several arguments why coordination is not likely to occur despite their merger, the FTC has responded with substantial evidence of significant barriers to entry as well as credible evidence that coordination is possible, and even likely, in these markets. Whether the Defendants' argument that the unique combination of factors in these markets negates the probability that the merger may tend to lessen competition substantially, or whether the FTC is correct that the market dynamics confirm the presumptions that follow its *prima facie* case, is ultimately not for this Court to decide. As Judge Tatel confirmed in *Whole Foods*, "[c]ritically, the district court's task is not 'to determine whether the antitrust laws have been or are about to be violated. That adjudicatory function is vested in the FTC in the first instance.'" 548 F.3d at 1042 (Tatel, J., concurring) (quoting *Heinz*, 246 F.3d at 714-15). The Defendants' arguments may ultimately win the day when a more robust collection of economic data is lain before the FTC. On this preliminary record, however, the Court must conclude that the FTC has raised questions that are so "serious, substantial, difficult and doubtful" that they are "fair ground for thorough investigation, study, deliberation and determination by the FTC." *Heinz*, 246 F.3d at 714-15.

c. *Unilateral Effects*

The FTC's sufficient response to the Defendants' rebuttal arguments on coordinated effects alone could suffice, but because the parties focused on unilateral effects throughout the evidentiary hearing, a brief analysis on this issue is in order. There are two basic analytical frameworks for analyzing the competitive effects of a merger: coordinated and unilateral effects. Though the distinction between these two frameworks has more significance in law than it does in economics, s*ee* Hayes, Tr. (1/12 p.m.) at 138:5-8, 10-11 (describing the distinction between coordinated and unilateral effects as "artificial"), the basic premise underlying the distinction is that the unilateral effects theory surmises that firms do not recognize their shared interest in elevating price, whereas the coordinated effects theory assumes that they do. *Id.* at 138:15-19. Thus, under unilateral effects theory, economists assume that firms behave independently. *Id.* at 138:18-19.

There are two main theories that predict unilateral effects: (1) the "dominant firm" theory and (2) the differentiated products theory. Both experts agreed that the "dominant firm" theory, also known as the "network effects" or "tipping point" theory, does not apply here, so the Court turns to the differentiated products theory. *See* Hayes, Tr. (1/21 p.m.) at 209:18-210:7 ("I do not credit the strength of the network effects being sufficient to undermine Audatex. I [do not give] that argument a lot of weight."); Ordover, Tr. (1/23 p.m.) at 148:5-18.

The differentiated products theory applies to markets where the products sold by different suppliers are not perfect substitutes for one another. Unilateral effects in a differentiated product market are likely to be profitable under the following conditions: (1) the products must be differentiated; (2) the products controlled by the *merging* firms must be close substitutes, *i.e.*, "a substantial number of the customers of one firm would turn to the other in response to a price increase"; (3) other products must be sufficiently different from the products offered by the merging firms that a merger would make a small but significant and non-transitory price increase profitable for the merging firm; and (4) repositioning must be unlikely. *Oracle*, 331 F. Supp. 2d at 118. As Dr. Ordover observed, the Estimatics and TLV products sold by CCC, Mitchell and Audatex are significantly heterogeneous. *See* Ordover, Tr. (1/23 a.m.) at 85:2-11. As to the second, third and fourth conditions, the Merger Guidelines advise that:

> [s]ubstantial unilateral price elevation in a market for differentiated products requires that there be a significant share of sales in the market accounted for by consumers who regard the products of the merging firms as their first and second choices, and that repositioning of the non-parties' product lines to replace the localized competition lost through the merger be unlikely.

Merger Guidelines § 2.21. Thus, the key point in contention is whether a significant percentage of consumers view CCC and Mitchell as their first and second choice, and Audatex as a "more distant third." *See* PX 1020 ¶ 79 (Hayes Prelim. Report).

Economists employ a separate category of models to predict unilateral behavior, that is, to predict whether a hypothetical profit maximizing firm would find it profitable to raise prices on its own. Hayes, Tr. (1/12 p.m.) at 138:11-15. Dr. Hayes prepared three different models to predict the likelihood of unilateral effects in these markets: (1) a Bertrand simulation of price effects for repair facilities, (2) a bidding model for the sale of Estimatics to insurance companies and (3) a separate bidding model for the sale of TLV to insurance companies.

Dr. Hayes's Bertrand model, which incorporates data on market shares, diversion ratios, and production costs, predicts a post-merger average price increase of about 30% for Estimatics for repair facilities. Hayes, Tr. (1/12 p.m.) at 153:17-55:15; *see also* PX 1059 ¶¶ 6-10, 17, Ex. S-2 (Hayes Suppl. Report). Accounting for the cost savings and cross-selling opportunities that would be facilitated by the merger, the model still predicts an average price increase of approximately 19%. PX 1059, Ex. S-2.[44] Dr. Ordover challenges the accuracy of the diversion ratios that Dr. Hayes employs in his model, but even using Dr. Ordover's suggested diversion ratios, the model still predicts substantial price increases for repair facilities. Hayes, Tr. (1/21 p.m.) at 213:24-214:14.

Because CCC, Mitchell and Audatex bid on Estimatics contracts with insurance companies, Dr. Hayes employed a derivation of an auction model to predict the merger's effect on prices for the insurance segment of the Estimatics market. PX 1020 ¶ 78 (Hayes Prelim.

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[44] Defendants argue that Dr. Hayes's opinions are not based in reality because the combined CCC/Mitchell could not "conceivably get away with the sort of price increase that" his Bertrand model predicts. CCC, Tr. (1/21 p.m.) at 179:22-25. But Dr. Hayes admits that he puts "less weight on the precise numbers than the general directional indications that come out of the analyses. . . . [W]hether it's going to be 40 percent or 20 percent at each particular supplier, I wouldn't stake my reputation on that." Hayes, Tr. (1/21 p.m.) at 161:24, 177:10-12; *see also* Hayes, Tr. (1/21 p.m.) at 164:11-12 ("The world is complex[;] we can't capture everything in a model that we might like to."). Thus, it is not particularly troublesome that the extraordinary price increases predicted in the model may not accord with "economic realities." *See* Ordover, Tr. (1/23 p.m.) at 151:20-25.

Report).[45] This model assumes that in a procurement auction, which these bids resemble, though the winner is the supplier that is able to make the most attractive offer to the customer, the winning price is actually determined by the supplier with the second-most attractive offer. *Id.* Thus, the most attractive offer determines the winner and the second-most attractive offer determines the price. *Id.* Critically, the model predicts that the merger will cause prices to increase "*if* the merging suppliers would have been the most attractive and second-most attractive suppliers had they remained separate, and the third-most attractive supplier is viewed as a more distant choice." *Id.* ¶ 79 (emphasis added).[46] Therefore, the model attempts to mirror the economic theory. Through a series of calculations, which include data on market shares, profit margin earned on incremental sales, and incumbent winning percentage, *see* PX 1059 ¶¶ 24, 26, 27 (Hayes Suppl. Report), Dr. Hayes's model predicts that insurance companies are likely to receive a price increase of approximately 7% for Estimatics products. *Id.*, Ex. S-7.[47]

[45] Specifically, Dr. Hayes analyzed the price effects on sales of Estimatics to insurers using "an independent private values English auction with no reserve price. The key role of the 'independent private values' assumption is to acknowledge that while bidders may know something about their rivals' costs, they do not know more about those costs than their rivals know. The absence of a reserve price (i.e., a maximum acceptable bid set by the insurer) is justified by the fact that there are no good substitutes for estimatics software . . . ." PX 1020 ¶ 78 n. 123 (Hayes Prelim. Report).

[46] In addition to inferring from the price increase that the non-merging firm is a more distant third choice, the model also assumes a more distant third. This is because the auction model always predicts some unilateral price increase, which, under economic theory, can occur only where the non-merging firm is a more distant third choice; and because the model was calibrated to generate the 80% price-cost margin exhibited in these markets, which, in combination with the high incumbent winning percentage and market share data, produces a significant price increase. *See* DX 644 ¶ 24 (Ordover Report) (lowering the economic margin in the model makes "the gap between the challeng[ing bidders] . . . small[er]," which, in Dr. Ordover's view, is an "assumption [that] more accurately reflects the business realities").

[47] Notably, Dr. Hayes's auction model predicts that Audatex will have to reduce prices for Estimatics by approximately 15% when it is the incumbent bidder, *i.e.*, when it has a nearly 90% chance of winning, even though the combined CCC/Mitchell will be able to raise prices. PX 1059,

Thus, "[w]hat the model is telling us is that there [is a] reasonably large fraction of customers that think that . . . Audatex is a more distant third." Hayes, Tr. (1/21 a.m.) at 42:16-18. If the Defendants' asserted cost-savings are included in the calculations, the average price increase is a more modest 1%. PX 1059, Ex. S-7 (Hayes Suppl. Report).

Finally, Dr. Hayes prepared a similar auction simulation to determine whether there would be price effects for the TLV market. Using similar inputs as the auction model for Estimatics, the TLV simulation predicted, without accounting for cost savings, an increase in price to insurance companies of 15.8%. *Id.*, S-12; *see also* Hayes, Tr. (1/12 p.m.) at 166:15-167:17. With cost savings, the model still finds an average price increase of 6% in TLV. PX 1059, S-12 (Hayes Suppl. Report); *see also* Hayes, Tr. (1/12 p.m.) at 167:18-168:9.

The main problem with Dr. Hayes's models is that the data and predictions cannot reasonably be confirmed by the evidence on this record. The FTC argues that there is a presumption that a "significant share" of customers prefer the merging parties' products as their first and second choices if the merged firm has a market share of at least 35%. FTC's Post-Trial Brief at 47 (citing Merger Guidelines § 2.211). However, this presumption is warranted only if: "each product's market share is reflective of not only its relative appeal as a first choice to consumers of the merging firms['] products but also its relative appeal as a second choice, and hence as a competitive constraint to the first choice." Merger Guidelines § 2.211.

As part of his investigation, Dr. Hayes reviewed a sample of eighteen bidding contests for Estimatics between 2003 and 2007. PX 1020 ¶ 80 (Hayes Prelim. Report). In seventeen of those contests, CCC was the victor, while Mitchell was one of the finalists in nine

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Ex. S-7 (Hayes Suppl. Report). Defendants make much of the fact that Audatex has aggressively attempted to impede this merger, arguing that Audatex's opposition to the merger is evidence in itself of the merger's likely competitive effects. *See*, *e.g.*, Defs.' Post-Trial Brief at 1.

and Audatex was the runner-up in eight. *Id.* Mitchell and Audatex were the finalists in the one remaining instance. *Id.* ¶ 80 n. 126. But, approximately one hundred insurance contracts are up for renewal each year, Brungger IH Tr. at 186:1-22 (Mitchell), meaning that Dr. Hayes reviewed a total of eighteen bidding contests out of approximately 400 that occurred during that time span. This fraction of auctions is not large enough to rely on as a representative sample of the entire insurance market. *See Oracle*, 331 F. Supp. 2d at 1167 ("Drawing generalized conclusions about an extremely heterogeneous customer market based upon testimony from a small sample is not only unreliable, it is nearly impossible."); *see also SunGard*, 172 F. Supp. 2d at 182-83. On the TLV side, Dr. Hayes reviewed data from a larger set of recent bid events, but only four of them identified who the two finalists were. *See* PX 1020 ¶ 88 (Hayes Prelim. Report). CCC and Mitchell were one of the finalists in all of these instances; CCC and Audatex were the two finalists in no instances. *Id.* Again, this sample is too small to rely on to make broad conclusions about a highly fragmented market.

With respect to repair facilities, the diversion ratios are the best indicators of whether a significant share of the market views CCC and Mitchell as their first and second choices, and Audatex a more distant third. Dr. Hayes's diversion ratios are derived from a two-year old survey of thirty-one former CCC customers which notes that the results "cannot be projected to the population as a whole due to the limited number of completes." PX 1423-005 (CCC); Hayes, Tr. (1/21 p.m.) at 175:6-13. The warning that the diversion ratios cannot be projected to CCC's entire customer portfolio is evidence of its unreliability. Moreover, the twenty-nine responses that Dr. Hayes used to calculate his diversion ratios account for less than 0.2% of all of CCC's repair facility customers. Ramamurthy, Tr. (1/22 a.m.) at 62:7-8 (CCC has approximately 22,000 repair facility customers). This data is even more unreliable than the data relating to insurance company choices, especially considering that Bertrand models typically rely on large volumes of data to estimate diversion ratios. Ordover, Tr. (1/23 p.m.) at 153:20-154:5; *see also id.* at 154:12-155:7 (the Bertrand model is most reliable in markets where there are tens of thousands of data points, such as a consumer products market); *see also* Hayes, Tr. (1/21 p.m.) at 176:6-8 ("Certainly 31 customers is not a terribly large number. More customer information would be useful."). Moreover, Dr. Hayes had no data from Mitchell or Audatex regarding their diversion ratios. Instead, he used CCC's diversion ratios to predict Mitchell and Audatex's diversion ratios based on their respective market shares.[48]

Alternatively, the Merger Guidelines state that a combined market share of at least 35% may be sufficient to presume that the merger will result in unilateral effects if "data on product attributes and relative product appeal show that a significant share of purchasers of one merging firm's product regard the other as their second choice." Merger Guidelines § 2.211. Evidence of this sort is sorely lacking in each segment of these markets. Dr. Hayes could not identify any characteristics of Estimatics or TLV products that might make Audatex a more distant third choice for certain insurers. Nor could he identify any characteristics of a particular class of insurers that might cause them to view Audatex as a more distant third — with the possible exception of lack of familiarity. Furthermore, Dr. Hayes relied on statements of only six out of approximately 300 insurance companies for his conclusion that Audatex's Estimatics

[48] The Court does not conclude that the predictions of Dr. Hayes's Bertrand model are necessarily wrong or that the diversion ratios he used are necessarily incorrect. The Court merely concludes that it cannot rely upon such a limited amount of data. Dr. Ordover concluded that "the diversion ratios that [Dr. Hayes] is putting into his model are not robust, I don't think they're sound, I don't understand them, and I don't believe that they *necessarily* match up with the economic realities of the repair facilities in the marketplace." Ordover, Tr. (1/23) at 151:20-25 (emphasis added).

product is a "more distant third" choice for a significant share of insurance companies. Of those six insurance companies, none of them actually stated that they viewed Audatex as a more distant third choice, nor could they identify any characteristics of Audatex's product that would make it a more distant third choice for them. *See* Hall, Tr. (1/8 a.m.) at 89:8-21 (GMAC did not "know anything about Audatex"); Brandt, Tr. (1/8 a.m.) at 20:3-6, 41:8-18 (The Hartford was "impressed" with all three of the firms' offerings and a director within its auto and liability practice department opined that CCC, Audatex and Mitchell all had a relatively similar look, touch and feel); *id.* at 41:4-5 ("Q. You're not suggesting [Audatex offers] an inferior product are you? A. Oh, no.").

The evidence is similarly lacking for TLV. Dr. Hayes could not identify any insurers — let alone any group or class of insurers — that view Audatex's TLV product as a "more distant third" choice. The only evidence that Dr. Hayes found that might suggest that Audatex's product is less desirable in some respect was one reference about higher valuations. Hayes, Tr. (1/21 a.m.) at 98:15-21. All the same, he continued the faulty assumption that some insurers view Audatex as a more distant third for Estimatics to assume that those same insurers view it as a more distant third in TLV. *See* Hayes, Tr. (1/21) at 96:12-23.

Evidence relating to repair facilities is also notably absent. The vast majority of repair facilities who testified or were contacted by the parties ranked Audatex as first or second in Estimatics. *See*, *e.g.*, Kostakis Dep. at 40 (Angelo's Auto Body Shop); DX 25 ¶ 8 (Benjamin Decl., ABRA Auto Body & Glass). In fact, a 2006 *Collision Week* survey ranked Audatex as the "Best Overall Estimating System Provider in 2006," finding Audatex superior to CCC and Mitchell in 8 of 8 categories for Estimatics. DX 43; *see also* DX 33 at 00064042, 0064044 (survey showing that shops using two estimating systems most frequently use Audatex and

CCC). The evidence showing that Audatex is at least comparable to CCC and Mitchell does not necessarily mean that Audatex is not viewed as a more distant third choice by some share of the market. Even so, the absence of any evidence of identifiable characteristics of these firms' products or their customers that might make Audatex a more distant third option makes it impossible to reach the conclusion that Audatex is a more distant third choice.[49]

Without credible evidence that Audatex is a more distant third choice for a significant share of the market to support the predictions of Dr. Hayes's models, the Court cannot conclude that the merger is likely to result in unilateral price elevations.

d. *Efficiencies*

Finally, Defendants argue that the efficiencies that will result from the merger will offset any potential anticompetitive effects of the merger. The Merger Guidelines recognize that "mergers have the potential to generate significant efficiencies by permitting a better utilization of existing assets, enabling the combined firm to achieve lower costs in producing a given quantity and quality than either firm could have achieved without the proposed transaction." Merger Guidelines § 4. Although the Supreme Court has not sanctioned the efficiencies defense in Section 7 cases, "the trend among lower courts is to recognize the defense." *Heinz*, 246 F.3d at 720. "The courts have recognized that 'in certain circumstances, a defendant may rebut the government's *prima facie* case with evidence showing that the intended

[49] Even if Audatex were a distant third for some percentage of the market, a unilateral price increase would be profitable for the merged firm only if it were unlikely that Audatex could reposition itself to replace CCC or Mitchell should they raise prices to supracompetitive levels. *See* Merger Guidelines § 2.21. Because the only evidence in the record regarding customer preference is that a few insurance companies lack familiarity with Audatex's products, there is no reason to believe that Audatex would not be a suitable replacement for CCC or Mitchell. *See* Hall, Tr. (1/8 a.m.) at 89:11-21 (GMAC does not "know anything about Audatex," but it "plan[s] to learn something about [it]" if the merger is consummated).

merger would create significant efficiencies in the relevant market.'" *United States v. Long Island Jewish Med. Ctr.*, 983 F. Supp. 121, 146-47 (E.D.N.Y. 1997) (quoting *Univ. Health*, 938 F.2d at 1222); *see also Arch Coal, Inc.*, 329 F. Supp. 2d at 150. However, courts have rarely, if ever, denied a preliminary injunction solely based on the likely efficiencies. *See Heinz*, 246 F.3d at 720; *FTC v. Swedish Match N. Am.*, 131 F. Supp. 2d 151, 171-72 (D.D.C. 2000); *Tote*, 768 F. Supp. at 1084-85. And in a highly concentrated market characterized by high barriers to entry, the parties opposing a preliminary injunction must provide "proof of extraordinary efficiencies" in order to rebut the presumption of anticompetitive effects. *Heinz*, 246 F.3d at 720; *see also* Phillip E. Areeda, *et al.*, IVA *Antitrust Law* ¶ 971f, at 47 (2d ed. 2006) (requiring "a showing of 'extraordinary'" efficiencies where the "post-merger market's HHI is well above 1800 and the HHI increase is well above 100"). Moreover, in such circumstances, "the court must undertake a rigorous analysis of the kinds of efficiencies being urged by the parties in order to ensure that those 'efficiencies' represent more than mere speculation and promises about post-merger behavior." *Heinz*, 246 F.3d at 721. The Defendants have not demonstrated here that their efficiencies are verifiable, *see Staples*, 970 F. Supp. at 1089, or that the cost savings achieved through efficiencies are likely to be greater than the transaction's likely anticompetitive effects, *see Cardinal Health*, 12 F. Supp. 2d at 62-63.

1. *Cost Savings*

Efficiencies enabled by a merger "can create incentives to reduce prices, and if these efficiencies are sufficiently large, they may fully offset any price elevation that might otherwise flow from the merger." PX 1020 ¶ 75 (Hayes Prelim. Report). Defendants assert that the efficiencies achieved through the merger will produce cost savings of at least $48 to $55 million per year resulting from the elimination of redundant or overlapping functions and the consolidation of product lines. DX 27 at 6-21 (PriceWaterhouseCoopers ("PWC") Synergy Analysis); DX 28 at 4-13 (CCC/Mitchell Confidential Synergy Review); Balbirer IH Tr. at 26-27, 50-51 (CCC); PX 746-006, 007 (Mitchell). These projected potential cost savings exceed 20% of the companies' combined cost base. DX 28 at 6 (CCC/Mitchell Confidential Synergy Review).

The projected cost savings would indeed be substantial and such cost savings were fundamental to the parties' decision to merge. *See*, *e.g.*, Sun, Tr. (1/9) at 9:8-15 (Mitchell). However, the vast majority of these cost savings will be realized only if, and when, Defendants consolidate to a single software platform. DX 27 at 6-21 (PWC Synergy Analysis); Sun, Tr. (1/9) at 19:20-22:1 (Mitchell); Balbirer IH Tr. at 68 (CCC); DX 28 at 4-13 (CCC/Mitchell Confidential Synergy Review). CCC and Mitchell estimate that it will take two to three years to combine their operations and eliminate redundant software systems, DX 115-48 (CCC/Mitchell Confidential Offering Mem.), but they acknowledge that it might take as long as ten years to complete the integration, and the nature of the ultimate software product is uncertain, *see* PX 755 ([text redacted]); *see also* Sun, Tr. (1/8 p.m.) at 77:9-12 (Mitchell); PX 756 (Mitchell [text redacted]).

The Merger Guidelines advise that "[d]elayed benefits from efficiencies (due to delay in the achievement of, or the realization of customer benefits from, the efficiencies) will be given less weight because they are less proximate and more difficult to predict." Merger Guidelines § 4 n. 37. Thus, while the Court does not doubt that Defendants intend to consolidate the two firms' software into one platform, it cannot place great weight on the predicted cost savings resulting from that consolidation because there is no telling when those savings might begin to accrue or whether they will actually materialize and not be absorbed in the consolidation effort.

Defendants admit that the merger will result in one-time costs of approximately $27.5 million over the first three years, thus lessening their projected cost savings to approximately $20-27 million per year during that time period. DX 27 at 2, 7 (PWC Synergy Analysis). Even these numbers are speculative and are supported by little more than lawyer argument. Mitchell hired two financial consultants to analyze and confirm that the merger makes financial sense. *See* Sun, Tr. (1/9) at 18:14-18 (Mitchell). In their final estimates, both Bain & Co. ("Bain") and PWC predicted that the merger would result in a net loss (in terms of costs versus synergies) at the end of three years. PX 1823 (Bain); *see also* Sun, Tr. (1/9) at 37:9-19 (Mitchell). *But see* DX 115-48 (CCC/Mitchell Confidential Offering Memorandum predicting net synergies of $11.2 million in year one); DX 27 at 7 (PWC Synergy Analysis). Defendants argue, however, that Bain's final projections do not accurately portray the likely synergies because its analysis (a) treats as "costs" certain expenditures, such as investment in research and development, without allowing such expenditures to show efficiency gains, Sun, Tr. (1/9) at 24:22-25:4 (Mitchell), and (b) lists integration expenses without attempting to quantify the benefits that will arise from non-overlapping business units, *id.* at 25:10-26:2 (Mitchell). But Bain and PWC are Defendants' financial consultants, not the FTC's, and Mr. Sun admitted that he did not "have any reason to believe that these guys . . . did a bad job." *Id.* at 37:17-20. Thus, without overanalyzing the accuracy of their predictions based on incomplete information, it is enough to conclude that the record is far from clear what the net savings would be; hence, Defendants have not demonstrated that the cost savings are likely to counteract the potential anticompetitive effects.

Even assuming *arguendo* that the Defendants will achieve significant cost savings in a timely manner, there is no evidence to suggest that a sufficient percentage of those savings will accrue to the benefit of the consumers to offset the potential for increased prices. *See Univ. Health*, 938 F.2d at 1223 (defendant asserting efficiency defense "must demonstrate that the intended acquisition would result in significant economies and that these economies ultimately would benefit competition and, hence, consumers"). First, platform consolidation would create significant one-time switching costs for a large number of repair facilities. At least a quarter of all repair facilities — 11,000 or more — use only one software platform. PX 635-018 (Mitchell). Those repair facilities currently using the platform that ultimately is not chosen for consolidation will incur one-time costs related to switching to the surviving platform. Rollins Dep. at 84 (Safeco); *see also* PX 1020 ¶ 11 (Hayes Prelim. Report). Meanwhile, as of the end of 2007, only 1,500 use both CCC and Mitchell. *See* Ramamurthy Dep. at 72-73 (CCC); Balbirer IH Tr. at 189-190 (CCC); PX 632-033 (Mitchell); PX 516-006 (Mitchell). Thus, fewer than one in thirty repair facilities — those that currently use both CCC and Mitchell — will realize any costs savings by licensing one fewer product. *See* PX 516-006 (Mitchell). Furthermore, a substantial number of insurance companies would likewise incur switching costs.

Second, while reducing the costs of doing business provides several advantages for the merged firm, these advantages could show up in higher profits instead of benefitting customers or competition. *See* Hayes, Tr. (1/21 a.m.) at 87:7-88:14. Mr. Ramamurthy admits that CCC will give its shareholders much of any savings. Ramamurthy IH Tr. at 74-75 (CCC). CCC's CFO, Andrew Balbirer, similarly stated that the synergies from the deal would either be invested in new products or go to company profits. Balbirer IH Tr. at 50-51 (CCC). Likewise, Mr. Sun of Mitchell stated that the cost savings are likely to go to "building value added products" rather than lowering consumer costs. Sun IH Tr. at 49-50 (Mitchell).

2. *Innovations*

Defendants also assert that the merger will lead to innovations. Innovation claims are "often a speculative proposition," *see Heinz*, 246 F.3d at 722, and such claims are often looked upon with skepticism for good reason:

> [W]hen the two firms are already among the largest in the market, there is no empirical basis for thinking that even larger firms would produce more R&D. We would therefore limit the defense to instances in which the two merging firms can show that their size forces them to accept higher per-unit costs for research and development than larger firms in their market must pay, and that the merger will enable them to achieve some figure closer to parity.

IVA Areeda, *et al*., *supra*, ¶ 975g, at 94. Defendants assert that as a result of the cost savings generated by the merger, the merged entity will spend considerably more on new product research and development than the two companies spend individually. *See* DX 28 at 2-3 (CCC/Mitchell Confidential Synergy Review); Ramamurthy IH Tr. at 50-51 (CCC), 82-83; *see also* Ramamurthy, Tr. (1/22 a.m.) at 111:16-112:11 (CCC) (stating that the merger would "allow us to throw more resources" at development of [text redacted]). The CEOs for both Mitchell and CCC testified that the merged firm will spend approximately 50% more on new product research and development than the combined amount the two companies currently spend as separate companies. Sun, Tr. (1/9 a.m.) at 39:24-40:23 (Mitchell); Ramamurthy, Tr. (1/22 p.m.) at 148:20-25 (CCC) (stating that the combined firm will deploy $10-15 million more towards innovation). But there is no telling whether these aspirations of greatly enhanced investment in R&D will become a reality as the combined firm is saddled with the burden of paying off its combined debt. Furthermore, there is little evidence that these promises of increased R&D spending are merger-specific. Mr. Balbirer testified, for instance, that CCC could already afford to increase R&D funding on its own if its "shareholders were willing to trade off their return." Balbirer IH Tr. at 198 (CCC). This is a standard conflict between investors and management. There is no reason to believe that the merger will eliminate this pervasive problem.

In sum, although the merger may produce substantial efficiencies in the future, such efficiencies are too far afield and too speculative to overcome the strong presumption of anticompetitive effects created by the large HHIs and the high barriers to entry in the Estimatics and TLV markets.

B. Equities

When the FTC shows a likelihood of success on the merits, it will usually be able to obtain a preliminary injunction because the public equities often converge with the "success on the merits" analysis because "'the public interest in effective enforcement of the antitrust laws' was Congress's specific 'public equity consideration' in enacting" Section 13(b). *Whole Foods*, 548 F.3d at 1035 (Brown, J.) (quoting *Heinz*, 246 F.3d at 726). However, the "likelihood of success" analysis and the "public equities" analysis are legally different points and the latter should be analyzed separately, no matter how strong the agency's case on the former.[50] But since, as discussed above, the FTC has demonstrated a likelihood of success on the merits as a preliminary matter, the Defendants must now show that, despite the likely anticompetitive effects of their proposed merger, the merger would nonetheless benefit their customers. Only "public equities" that benefit consumers can override the FTC's showing of serious questions on

[50] If the two factors always merged, then there would be no need for a public equities analysis when the FTC shows a likelihood of success on the merits. The D.C. Circuit's plurality decision in *Whole Foods* indicated that a separate equities analysis is necessary. *Whole Foods*, 548 F.3d at 1035 (Brown, J.) ("The district court did not apply the sliding scale, instead declining to consider the equities. . . . If, and only if, the district court's certainty [that the FTC would not succeed on the merits] was justified, it was appropriate for the court not to balance the likelihood of the FTC's success against the equities.").

the merits. *Whole Foods*, 548 F.3d at 1041 (Brown, J.). For instance, if potential merger partners can present credible evidence that the merged company will lower consumer prices because of extraordinary efficiencies (even when the same efficiencies might not suffice to overcome the presumption in favor of the FTC's *prima facie* case on the merits), and those efficiencies and lowered prices will be lost forever if the merger is preliminarily enjoined, the public equities in favor of the merger might outweigh the FTC's likelihood of success on the merits. However, it is clear that a "'risk that the transaction will not occur at all,' by itself, is a private consideration that cannot alone defeat the preliminary injunction." *Id.* (citing *Heinz*, 246 F.3d at 726; *Weyerhaeuser*, 665 F.2d at 1082-83).

The Defendants predict that the merger will produce cost savings of 20%. This would be an extraordinary degree of efficiencies. However, the evidence fails to induce confidence that such cost savings will in fact occur, much less when they might be realized. In addition, the evidence leaves uncertainty as to whether cost savings will be enjoyed by customers or by shareholders.

Contrary to this conclusion, Defendants urge the Court to recognize that "[t]he combined company will be able to offer an integrated product that incorporates the best features of each company's stand-alone product portfolio." DFF ¶ 374. The Court accepts and agrees that the evidence supports this statement. "The merging parties envision using the combined resources of the two companies and spending more on new product research and development than they spend individually to improve existing and create new products and reduce costs" for customers. *Id.* ¶ 375. The Court accepts and agrees that the Defendants envision such a future. "[C]ustomers and consumers [will] benefit from more innovative products." *Id.* ¶ 380. The Court agrees and accepts this statement as well.

Both timing and free choice undercut Defendants' predictions of the public value of the potential merger. That is, the parties predict that it will be at least three to five years before their separate software platforms might be merged, and perhaps as much as ten years before it makes sense to do that. During that lengthy waiting period, the serious questions raised by the FTC might ripen into fact and produce a coordinated marketplace through regional or customer allocation or other coordinated terms. During that lengthy waiting period, the evidentiary base for Dr. Hayes's predictions of unilateral effects might mature.

While the merging parties "envision" using their combined resources to increase research and development of new products, once a merger is effected, their choices would be wide open and they might reasonably decide to use profits to reduce debt instead of increase research, given the debt structure of the newly-merged company and its share of the markets for Estimatics and TLV. The Court does not doubt their intentions, but cannot bank on them for purposes of this preliminary analysis of the equities here.

The only "hard" equity point made by Defendants is that their customers will benefit from more innovative products. Even though such a result is uncertain, this benefit must be weighed against the public benefit. In that weighing, the Court uses a sliding scale. The uncertainty of the public benefit of innovative products is too long in coming and too uncertain in result to hold much weight against the FTC's interest in enforcing the antitrust laws. The equities favor granting a preliminary injunction.

V. CONCLUSION

For the foregoing reasons, the FTC's Motion for Preliminary Injunction [Dkt. # 4] will be granted. A memorializing order accompanies this Memorandum Opinion.

DATE: March 18, 2009

/s/
ROSEMARY M. COLLYER
United States District Judge

mitchell

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CCC-Mitchell Mutually Agree to Terminate Merger

CHICAGO and SAN DIEGO, March 11, 2009—CCC Information Services Inc., of Chicago, and Mitchell International, Inc., of San Diego, announced today that they will no longer pursue the merger of the two companies.

"In light of the court's decision, we have jointly decided to terminate the merger. A year ago when we announced the transaction, our stated objective was to deliver greater innovation to our customers and partners. This theme has remained a constant and will continue to be at the forefront of our efforts," stated Githesh Ramamurthy, Chairman and CEO of CCC.

"Serving our customers has always been our primary focus. We have reached the point in the regulatory process in which our customers, employees and shareholders are best served by continuing as independent companies," stated Alex Sun, President and CEO of Mitchell International.

About Mitchell International, Inc. Mitchell International (www.mitchell.com) is a leading provider of information and workflow solutions to the Property & Casualty claims and Automotive Collision Repair industries. The company's comprehensive solution portfolio streamlines the entire auto physical damage, bodily injury and workers' compensation claims processes. Mitchell enables millions of electronic transactions between more than 30,000 business partners each month to enhance partner productivity, profitability, and customer satisfaction.

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Order to Show Cause, FTC v. CCC Holdings Inc., No. 1:08-2043 (RMC) (D.D.C. Mar. 27, 2009)

In light of the Defendants' public announcement indicating that they will not proceed with the merger, it is hereby ORDERED that the Federal Trade Commission shall show cause in writing, no later than April 9, 2009, why the Court should not close this case administratively. Signed by Judge Rosemary M. Collyer on 3/27/09. (lcrmc1) (Entered: 03/27/2009)

IN UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

FEDERAL TRADE COMMISSION, Plaintiff,	)	
v.	)	Civil Action No. 08-2043 (RMC)
CCC HOLDINGS, INC. and AURORA EQUITY PARTNERS III L.P. Defendants.	)	

<u>RESPONSE TO ORDER TO SHOW CAUSE</u>

Because a judge's decision is a final decision in a § 13(b) matter, and because the defendants have abandoned the deal, we see no reason why this court should not close this matter administratively. As stated in *FTC v. Food Town Stores, Inc.*:

> It is at once obvious that in a proceeding under § 13, the granting or denial of a temporary restraining order or a preliminary injunction is an end unto itself. The district court is not authorized to determine whether the antitrust laws have been or are about to be violated. That adjudicatory function is vested in F.T.C. in the first instance. The only purpose of a proceeding under § 13 is to preserve the *status quo* until F.T.C. can perform its function.
>
> Viewed in this light, the conclusion follows that the district court's denial of a T.R.O. effectively terminated the litigation and constituted a final order which is appealable under 28 U.S.C. § 1291.

539 F.2d 1339, 1342 (4th Cir. 1976); *see also Commonwealth v. Tenneco, Inc.*, 538 F.2d 1026

(4th Cir. 1976) (Order for TRO was a final order when that was all that was sought).

Thus, we have no objection to this court closing this case administratively.

By: */s/ J. Robert Robertson*

J. ROBERT ROBERTSON
D.C. Bar No. 501873
Federal Trade Commission
Bureau of Competition
600 Pennsylvania Ave., NW
Washington, DC 20580
Telephone: (202) 326-2008
Fax: (202) 326-2884

Attorney for
FEDERAL TRADE COMMISSION

April 8, 2009

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on the 8th day of April, 2009, I served the foregoing Response on the following counsel via electronic mail.

John A. Herfort
Gibson, Dunn & Crutcher LLP
200 Park Avenue
New York, NY 10166-0193
Jherfort@gibsondunn.com

Counsel for Defendant CCC Holdings, Inc.

Richard G. Parker
O'Melveny & Myers LLP
1625 Eye Street, NW
Washington, DC 20006
Rparker@omm.com

Counsel for Defendant Aurora Equity Partners III L.P.

/s/ J. Robert Robertson
J. Robert Robertson
Counsel for Plaintiff
Federal Trade Commission

Minute Order, FTC v. CCC Holdings Inc., No. 1:08-2043 (RMC) (D.D.C. Oct. 5, 2009)

MINUTE ORDER discharging the Court's March 27, 2009 Order to Show Cause. This case is hereby CLOSED. Signed by Judge Rosemary M. Collyer on 10/5/09. (lcrmc1) (Entered: 10/05/2009)