SCHEDULED FOR ORAL ARGUMENT ON FEBRUARY 12, 2001

No. 00-5362

IN THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

FEDERAL TRADE COMMISSION,
Appellant,

v.

THE H.J. HEINZ COMPANY, *ET AL.*,
Appellees,

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLUMBIA, CIVIL ACTION NO. 00-1688 (JR)

BRIEF FOR DEFENDANTS-APPELLEES
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December 29, 2000

CERTIFICATE AS TO PARTIES, RULINGS AND RELATED CASES

A. PARTIES AND AMICI

All parties, intervenors and amici appearing before this Court are:

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Washington, DC 20580

Thirty-Six Amici
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Grocery Manufacturers of America, Inc.
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Citizens For A Sound Economy Foundation
1150 Seventeenth Street, NW
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B. RULINGS UNDER REVIEW

FTC v. H.J. Heinz Co., et al., Civil Action No. 00-1688 (JR) (D.D.C. Oct. 18, 2000) (Robertson, J.) (order denying plaintiff-appellant's motion for preliminary injunction) (App.1414-15).

C. RELATED CASES

This case has not previously been before this Court, and there are no related cases pending in this or any other court.

RULE 26.1 CORPORATE DISCLOSURE STATEMENT

Appellee H.J. Heinz Company and its subsidiaries manufacture and market processed food products throughout the world. H.J. Heinz Company has no parent corporation, and no publicly held company has a 10% or greater share in H.J. Heinz Company.

Appellee Milnot Holding Corporation and its subsidiaries manufacture and market canned chili, canned milk, and processed baby food in the United States. Milnot Holding Corporation has no parent organization. It is privately held, and no publicly held company has a 10% or greater share in Milnot Holding Corporation.

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GLOSSARY

1. "App." means the Joint Appendix filed in this Court.
2. "App. (*Op.*)" means the district court's October 18, 2000, memorandum opinion and order denying preliminary injunctive relief, as provided in the Joint Appendix.
3. "FTC Br." means the Brief for Appellant FTC filed in this Court on November 29, 2000.
4. "AG Amicus Br." means the Brief of Thirty-Six State Attorneys General Amici Curiae in Support of Appellant filed in this Court on December 6, 2000.
5. "PX" means plaintiff's exhibit at trial.
6. "DX" means defendants' exhibit at trial.

STATUTES AND REGULATIONS

All applicable statutes and regulations are contained in the Brief for Appellant.

COUNTER-STATEMENT OF JURISDICTION

This appeal is from a district court order denying a preliminary injunction in an action brought by the Federal Trade Commission pursuant to 15 U.S.C. § 53(b) (1994). The district court had federal question subject matter jurisdiction pursuant to 28 U.S.C. § 1331 (1994). This Court has jurisdiction over the appeal pursuant to 28 U.S.C. §§ 1291 and 1292(a)(1) (1994). The district court's order was a final decision and denied injunctive relief. The notice of appeal was timely filed.

ISSUES PRESENTED

The district court found that the proposed merger of Heinz and Beech-Nut would not substantially lessen competition, and that the merger will actually increase jarred baby food competition in the United States under the standard articulated in *United States v. General Dynamics* and *United States v. Baker Hughes*. The questions presented on appeal are:

1. Whether *Baker Hughes* sets forth the proper analytical framework for determining the likelihood of success under Clayton Act Section 7 in an action for preliminary injunction brought by the Federal Trade Commission.

2. Whether those findings are clearly erroneous under Federal Rule of Civil Procedure 52(a).

STATEMENT OF THE CASE

Almost one year ago, on February 28, 2000, The H.J. Heinz Company ("Heinz") and Milnot Holding Corporation ("Beech-Nut") entered into a merger agreement. App.1421(*Op.*). The parties filed a Premerger Notification and Report the next day, starting the FTC's review process. App.1421-22*(Op.)*. The process culminated on July 7, 2000, when the FTC, in a sharply divided 3-2 vote (with Commissioners Anthony and Swindle dissenting), authorized this action for a preliminary injunction.[1] App.1422(*Op.*).

After conducting a five-and-one-half-day hearing, and reviewing comprehensive post-trial submissions, the district court issued a 28-page opinion denying the FTC's motion for preliminary injunction. App.1416-44(*Op.*). Based on the voluminous evidence adduced in the case, the district court concluded "it [is] more probable than not that consummation of the Heinz/Beech-Nut merger will actually ***increase*** competition in jarred baby food in the United States." App.1440-41(*Op.*) (emphasis added).

The FTC appealed and sought an emergency injunction pending appeal, which the Court of Appeals granted on an expedited basis.

1 The FTC staff lawyers and economists had recommended that the merger be allowed to proceed. *See* App.4362-63 (Commission overrode "recommendations of its staff economists and antitrust lawyers" who thought "this deal should be looked at [not] as diminishing the number of competitors to only two" but "as producing a stronger competitor to Gerber").

STATEMENT OF FACTS AND PROCEEDINGS BELOW

I. THE INDUSTRY STRUCTURE: FOUR DECADES OF GERBER DOMINANCE WITH NO PROSPECT OF CHANGE

A single baby food manufacturer — Gerber — has dominated the jarred baby food market for over 40 years. App.1417(*Op.*). For these four decades, Gerber's share of the jarred baby food market has varied between 65 and 70% (and "even higher when mass merchandiser sales are included"). App.1417,1420 n.3 (*Op.*). Gerber's brand loyalty is greater than any other product sold in the United States, including Coca-Cola or Nike. App.1420(*Op.*).

Gerber has actively maintained its near-monopoly status. Gerber has raised prices continually and stifles innovation. App.1419,1432-33(*Op.*); App.4621; App.5538; App.4514-15 ¶¶5-7. As a result of Gerber's long entrenched dominance, real product innovation has suffered and the baby food industry is declining. App.4504 ¶3;App.4531 ¶3. Despite stable birth rates, grocery baby food sales have declined 15% in the past five years alone. App.1421(*Op.*).

In Gerber's shadow fall two small competitors — Heinz and Beech-Nut — relegated to "also ran" brands. App.3842. The Heinz market share is 17.4%, and Beech-Nut's is approximately 15.4% and those shares have been declining. App.1417(*Op.*). As Gerber itself states, "[i]t's hardly a three-horse race when we have 70% of the market." App.5470. Indeed, post-merger, Gerber's market share will still be ***double*** the combined share of Heinz and Beech-Nut.

Although there are three producers in the baby food market, that fact does not reflect the true competitive reality. Virtually all supermarkets stock only two brands of baby food (and some stock only one). App.1420(*Op.*). Given its market dominance, Gerber is always on the shelf; the "second brand" is either Heinz or Beech-Nut. *Id.* In fact, stores accounting for approximately 10% of all U.S. baby food sales stock only Gerber. App.5222; App.657. In some areas of the country, as many as 80% of the retailers stock only Gerber. App.4582.

While Gerber is sold in virtually every store in the United States, Heinz is sold in stores accounting for only 40% of U.S. baby food sales, and Beech-Nut is sold in stores accounting for only 45%. App.1420-21(*Op.*). Heinz and Beech-Nut also have sharply different regional focuses. Heinz's sales are concentrated in northern New England, the Southeast, the deep South and the Midwest. Beech-Nut's sales, in contrast, are concentrated in the Atlantic region (New York and New Jersey), California and Florida. App.1421(*Op.*).

Neither Heinz nor Beech-Nut have been able to challenge Gerber's market dominance. For the past half century, neither has grown its small share versus Gerber or each other, or been able to expand to become a national player. App.1418-19(*Op.*). Without national distribution, neither has been able to constrain Gerber, either through innovation or product differentiation. *See* App.1432-33(*Op.*).

II. MARKET COMPETITION: HEINZ AND BEECH-NUT TARGET GERBER, NOT EACH OTHER

Driven by the fact that Heinz and Beech-Nut do not appear on the same grocery store shelf, each brand targets Gerber, its only competitor on the shelf. The two brands do not price against each other or even consistently monitor one another's prices. App.1428(*Op.*);App.1062-63.

It is therefore not surprising that supermarkets confirmed that "Heinz and Beech-Nut both currently compete against Gerber not each other in terms of price." App.4535 ¶5;App.4577 ¶4;App.4572 ¶7;App.4527 ¶7. Thus, while retailers regularly price-check Gerber products at competing retailers, they do not generally check the price of Heinz against Beech-Nut, or *vice versa*. App.4567 ¶5; App.4516 ¶13;App.942-43.

For the most part, Heinz and Beech-Nut compete only in those instances in which a supermarket chain asks Heinz and Beech-Nut to submit competing offers to remain on the shelf as the second brand to Gerber. These situations commonly arise from grocery store consolidation, where stores carrying Heinz and Beech-Nut, respectively, merge and wish to carry only one of the two brands on the shelf. App.665;App.916;App.1201-03;App.4299,4306. This competition primarily takes the form of "fixed trade spending," also called "slotting fees" or "pay-to-stay" arrangements, which are lump-sum payments made to the grocery chain to secure shelf placement. App.1430(*Op.*). Notably, because virtually all stores believe they must carry Gerber, they do not require Gerber to make pay-to-stay payments. App.4287;App.2875;App.947.

Significantly, these "fixed" payments do not affect retail prices of baby food. App.1430-31(*Op.*);

The only other type of trade spending at the supermarket level is "variable" trade spending, typically consisting of discounts and allowances Heinz and Beech-Nut provide supermarkets to create retail price differentials or programs ***targeted at Gerber***. App.1430-31(*Op.*).

Because the merger enhances rather than eliminates this competition with Gerber, there is no evidence to suggest the merger will adversely affect variable spending. App.1432(*Op.*). Indeed, this variable spending competition against Gerber is currently ***reduced*** by the fixed payments Heinz and Beech-Nut must make to supermarkets simply to stay on the shelves. App.1431-32(*Op.*).

III. THIS MERGER CREATES A NATIONAL COMPETITOR TO GERBER FOR THE FIRST TIME IN AT LEAST FORTY YEARS

Heinz and Beech-Nut have long been unable to compete effectively against Gerber, allowing Gerber to maintain its monopoly, increase prices, and deter innovation. App.1418-19,1432-33(*Op.*). Without national distribution, neither Heinz nor Beech-Nut can advertise nationally. App.989 (Beech-Nut CEO: "any national advertising that we spend money on is, in essence, wasted on the 55 percent of the country [where consumers] can't go to their local store and buy Beech-Nut"). Nor are Beech-Nut and Heinz positioned to introduce new products, which requires higher levels of distribution to ensure that marketing is cost-effective. App.1438-39(*Op.*).

For the first time in nearly half a century, this merger will create a strong, national competitor to Gerber. The combined Heinz and Beech-Nut will bring Heinz's lower prices to Beech-Nut's higher quality recipes, giving Beech-Nut consumers lower prices, and Heinz consumers higher quality products. Heinz will also gain the national distribution platform and brand equity it needs to bring new products Heinz already distributes in Europe into the United States to compete with Gerber. App.1433,1435,1438-39(*Op.*);App.4282-4361;App.685-86.

These benefits — lower prices, increased quality, and expanded output — stem directly from the substantially reduced manufacturing, procurement, and distribution costs, or "efficiencies," that flow from this merger. From an operations standpoint, both the Heinz and Beech-Nut plants operate at substantially less than full capacity; consolidating Beech-Nut's production from its aging plant in Canajoharie, New York (built in 1907) into Heinz's state-of-the-art automated plant in Pittsburgh (completed in 1991) will immediately lower the total cost of producing Beech-Nut baby food by 43%, and decrease the variable cost of

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Gerber's recognition of ***increased*** competition was mirrored in the retail trade's reaction. More than 30 supermarkets, from the largest supermarket in the United States to small "mom and pop" groceries with single stores, all affirmatively stated their support for this merger. They testified that the merger will drive innovation and category growth and finally bring meaningful national competition to Gerber. App.4501-36,4566-85; 4613-14. Indeed, the impact of the merger on retailers — and consequently on Gerber — was well summarized by

IV. THE DISTRICT COURT'S ANALYSIS OF THE PROPOSED MERGER

With the unique, Gerber-dominated baby-food market structure as the backdrop, the district court painstakingly analyzed the likely competitive effects of the proposed merger. The court conducted a five-and-one-half day evidentiary hearing and then issued a detailed opinion summarizing its findings and conclusions. The record before the district court consisted of 1,267 exhibits, including 150 demonstrative exhibits, 32 depositions, and 41 affidavits; 11 trial witnesses, opening statements and closing arguments; and post-trial proposed findings of fact and conclusions of law. Following the testimony and studying the extensive record, the district court concluded that it is "more probable than not that consummation of the Heinz/Beech-Nut merger will actually ***increase*** competition in jarred baby food in the United States." App.1440-41(*Op.*) (emphasis added).

The court conducted its analysis under Section 7 of the Clayton Act, which prohibits a merger between two companies where the effect would be "substantially to lessen competition." In conducting the analysis and reaching his conclusions, Judge Robertson carefully followed the "totality of the circumstances" approach outlined by the Supreme Court in *General Dynamics*, and this Court in *United States v. Baker Hughes, Inc.*, 908 F.2d 981, 984 (D.C. Cir. 1990). As the district court explained, it had to consider (1) whether the FTC had established a prima facie case that the merger would be anticompetitive and (2) whether the defendants had produced evidence to rebut that presumption. The court emphasized that the "ultimate burden of persuasion rests with the Commission throughout." App.1424(*Op.*).

The parties agreed that the product market in this case is jarred baby food. App.1425(*Op.*). The district court weighed the evidence on geographic market and found the relevant market to be jarred baby food in the United States. App.1425-26(*Op.*). Defendants acknowledged — indeed emphasized — that the market is already concentrated due to Gerber's extraordinary market share. Thus, the district court found that the FTC had established its prima facie case. App.1426-27(*Op.*). The defendants also conceded that entry into the market would be difficult, and the district court concluded that entry is therefore not a countervailing factor to the prima facie case. App.1427(*Op.)*.

The FTC's theory below, as explained by the trial court, was "that trade spending competition between Heinz and Beech-Nut benefits consumers and that the merger will eliminate that benefit." App.1430-31(*Op.*); *see* App.86 (FTC Opening Statement: "this case is really ***not*** about the supermarkets. ... It is about consumers") (emphasis added). Accordingly, based on defendants' rebuttal evidence, the district court undertook a detailed analysis of the competitive effects of the merger at both the wholesale and retail levels, and concluded that, despite high concentration and difficult entry, the merger of Heinz and Beech-Nut will not adversely affect consumer prices and, in fact, will enhance competition with Gerber, resulting in immediate consumer benefits. *See* App.1433-38(*Op.*).

A. District Court's Analysis of Current Market

First, the court analyzed consumer competition and concluded that "[i]t is undisputed that Heinz and Beech-Nut are ***virtually never*** found in the same supermarket; Beech-Nut and Heinz ***do not price*** against the other or even consistently monitor one another's prices; and that the cross-elasticity of demand between Heinz and Beech-Nut is ***not statistically significant***." App.1428 (*Op.*)(emphasis added);App.4623;App.1062-66 (emphasis added). Accordingly, because Heinz and Beech-Nut do not constrain each other's prices, the merger will not eliminate any current price constraint in the marketplace. App.1428(*Op.*).

More specifically, the district court found that Heinz and Beech-Nut proved this fact through the economic analysis of Professor Jonathan Baker, formerly the Director of the FTC Bureau of Economics, who "analyzed shelf prices to determine the effects of Heinz's and Beech-Nut's prices on Gerber, and vice-versa, and the effect of Heinz's prices on Beech-Nut's, and vice versa." App.1429(*Op.*). Professor Baker concluded "that 'consumer substitution between Heinz and Beech-Nut is very small and, therefore, the two firms are not constraining each other's pricing at the retail level very much,'" and that there are "no discernible differences in the price of baby food regardless of whether there were two or three competitors" in the market. App.1429(*Op.*). In contrast, the district court noted that the "FTC adduced no evidence of direct price competition between Heinz and Beech-Nut in the same region or SMSA [Standard Metropolitan Statistical Area]." App.1428 (*Op.*). The district court agreed with Professor Baker's conclusion and found that "this merger will not give Heinz any unilateral incentive to increase its price." App.1429(*Op.*).

The court turned next to distribution competition — that is, "competition between Heinz and Beech-Nut to be the second brand on the shelf" by "the payment of negotiated sums of money to retailers or retail chains." App.1430 (*Op.*). The court analyzed both fixed spending and variable spending. The court noted that "Dr. Baker's econometric analysis revealed that trade spending levels had no effect on price, even in markets where all three firms are present." App.1431(*Op.*). The court analyzed each aspect of trade spending separately. The court concluded that the FTC's attempt "to show that fixed trade spending competition between Heinz and Beech-Nut benefits consumers and that the merger will eliminate that benefit . . . failed completely." App.1430-31(*Op.*). As to variable trade spending, the court found a similar dearth of proof by the FTC, since "the record provides no basis for quantifying" the extent to which variable trade spending benefits consumers. App.1431(*Op.*). Indeed, the court stated that the record "leaves substantial doubt that the proposed merger would actually affect variable spending levels," because this spending is directed at Gerber and the merger will not change this competitive posture. App.1431(*Op.*).

The district court then assessed the ability of Heinz and Beech-Nut to compete against Gerber in innovation and product differentiation. Relying on record evidence, the court found that "neither Heinz nor Beech-Nut is strong enough to compete successfully in these areas" without the merger. App.1432 (*Op.*).

B. District Court's Analysis of Merger's Additional Effects

The district court not only found that the merger would cause no upward effect on consumer prices, but also found, based on careful analysis of efficiencies and innovation, that the merger would actually benefit consumers and competition. The district court explained that the "central contention of the defendants is that the merger is the only way to challenge Gerber's dominant market share" — that is, that the merged business will be more efficient, will have "a more attractive and attractively priced product" and will be able to engage in "serious efforts to innovate." App.1433(*Op.*). The district court carefully considered the FTC's structural argument, but found — based not upon "aspirational" testimony, but rather upon "powerful evidence in the record" — that "the Commission's prima facie case inaccurately predicts the merger's probable effect [on] future competition." App.1435(*Op.*).

Specifically, the court credited testimony to the effect that the merger would allow consolidation of production at the automated Pittsburgh plant currently operated by Heinz. This consolidation, the court found, "will achieve substantial cost savings in salaries and operating costs." App.1436(*Op.*). The court quoted the testimony of David Painter, who had primary responsibility for evaluating merger efficiencies for many years as an Assistant Director at the FTC. In this case, Mr. Painter found that the manufacturing cost savings would be "'substantial, significant, … among the largest that I have ever seen certainly in a manufacturing segment.'" App.1436(*Op.*). The district court credited Mr. Painter's evaluation that the savings are "extraordinary." App.1437(*Op.*). The court also noted that the use of Heinz's distribution system could cut costs substantially. App.1437(*Op.*).

Relying on the FTC's own *Horizontal Merger Guidelines*, the court stated that these "are the kinds of efficiencies" properly analyzed in merger analysis.

App.1437(*Op.*). The FTC did "not seriously dispute the proposition that the merger will result in better recipes for former Heinz buyers and value pricing for former Beech-Nut buyers." App.1437-38(*Op.*). The district court continued: "Those consumer benefits will be immediate and virtually automatic." App.1438 (*Op.*).

Judge Robertson then turned to the likelihood of enhanced innovation from the merger. The court credited Professor Baker's testimony that new product launches are practical only when a firm's distribution is "high enough" — *i.e.*, 70% — to ensure meaningful market penetration. App.1439(*Op.*). The court found that the combined entity's post-merger ACV would be about 90%, which would be high enough to support, for example, introduction of Heinz's Oasis program. App.1439(*Op.*). The court thus concluded: "The conditions for increased competition in the form of product innovation and product differentiation will be enhanced by the merger, because the distribution of the combined entities will add Heinz's ACV to Beech-Nut's ACV." App.1438,1420-21(*Op.*).

C. The District Court's Conclusions

Assessing the totality of circumstances, as he was required to do, Judge Robertson concluded that the FTC made its prima facie case, but that the defendants "rebutted that case with proof that the proposed merger will in fact ***increase*** competition." App.1440(*Op.*)(emphasis added). Judge Robertson found, moreover, that the FTC responded "to the rebuttal case essentially with only structural theory" — namely, repetition of the increased market concentration statistics. App.1440(*Op.*). In sum, therefore, Judge Robertson found it "more probable than not that consummation of the Heinz/Beech-Nut merger will actually increase competition in jarred baby food in the United States." App.1440-41(*Op.*).

SUMMARY OF ARGUMENT

The district court correctly concluded that the Heinz-Beech-Nut merger would increase competition in a market historically dominated by a single firm, Gerber. That dominance alone — a 65% plus market share — accounted for the highly concentrated nature of the jarred baby food market. The FTC successfully employed this structural factor to establish a prima facie case below. But that was only phase one of the multi-step process under Section 7 ordained by the Supreme Court and this Circuit's governing precedents. Applying settled Clayton Act principles, Judge Robertson examined the totality of the circumstances and determined that, in light of market realities, the consolidation of two marginal competitors would result in a much-strengthened firm that could bring about genuine competition in a lackluster, declining market. This reinvigorated, competitive market would be characterized by greater product innovation, improved quality, reduced prices and expanded output, all redounding to the immediate benefit of consumers. The record abundantly supports this set of ultimate conclusions, which are firmly buttressed by the deference owed the district court under Rule 52(a).

The FTC now seeks to dramatically alter not only the well-established analytical approach to Section 7 of the Clayton Act, but also the role of the courts in assuring that merger transactions receive a fair and independent review upon a motion for preliminary injunction. It simply cannot be reasonably argued today that the district court committed clear error by considering evidence of the "totality of circumstances," looking at market "structure, history, and probable future" to evaluate the actual competitive impact of the transaction. *United States v. General Dynamics Corp.*, 415 U.S. 486, 498 (1974).

Following the Supreme Court's script from *General Dynamics* and its progeny, this Circuit recognized in *United States v. Baker Hughes*, 908 F.2d 981, 984-85 (D.C. Cir. 1990), the mischief of allowing high concentration numbers, or theoretical barriers to entry alone to shape the analysis, without taking into full account the competitive dynamics and peculiarities of the relevant market and examining how those competitive conditions might affect the outcome. In undertaking the comprehensive market review that *General Dynamics* and *Baker Hughes* demands, the FTC in its own *Merger Guidelines* sets forth for the agency and the courts alike the elements of the expansive inquiry to be undertaken. In this case, such an analysis is particularly compelling, because the district court found it destroys the FTC's premise that its "3-to-2" statistical case accurately reflects either the present competitive conditions of the market or the future impact of this merger.

Here, the FTC argues that *Baker Hughes* need not be followed, because the agency is proceeding under Section 13(b) of the FTC Act — which requires that the FTC go to court to seek a preliminary injunction if it opposes a proposed merger transaction. In short, the FTC argues that once it establishes a prima facie statistical case with barriers to entry, ***no*** further competitive analysis is allowed. No decision by any court supports the FTC's argument. Section 13(b) was enacted to ensure that courts exercise independent judicial review of the potential competitive impact of a merger before issuing a preliminary injunction, not to relegate the courts' role to rubber-stamping agency action. In order to determine whether there is a "reasonable likelihood of success on the merits," as required at the preliminary injunction stage, courts must look "at the merits" of the transaction.

As the district court below properly held, the FTC's prima facie showing does not end the inquiry, but rather marks the starting point, inviting an evidentiary response by the merging companies in rebuttal. Defendants' task is to bring forth evidence showing the market share statistics do not accurately reflect the competitive impact of the proposed transaction (including whatever efficiencies can be shown to be gained from the transaction) and that the merger is unlikely to substantially lessen competition.

Equally unavailing is the FTC's eleventh-hour effort to shift the focus of its case from the impact of the merger on the market for jarred baby food and consumer welfare to the impact on supermarkets. Other than simply pointing to a loss of a competitor, the FTC provides no record support whatsoever for its claim. The district court's findings, supported by Rule 52(a), leave no doubt that the wholesale competition between Heinz and Beech-Nut to gain access to the supermarket shelf has no effect on the prices of jarred baby food. Moreover, the FTC's claim totally ignores the overwhelming record evidence from Gerber and the supermarkets themselves, that far from a loss of competition, the merger will actually compel Gerber to compete at the wholesale level, which the supermarkets overwhelmingly support.

Similarly, the FTC's contention that the district court made ***no*** findings regarding coordinated effects is simply erroneous. The district court's entire opinion rebuts any presumption of collusion flowing from the FTC's prima facie case. And significantly, the district court made a specific finding, citing record testimony and evidence, that structural barriers rebut any possible inference of an increased likelihood of collusion in this case.

The district court did not abuse its discretion in denying a preliminary injunction — its legal analysis is in full accord with the precedents of this and other Circuits. And the district court's findings are not clearly erroneous under Rule 52(a) — its findings have full record support. The district court's decision deserves affirmance by this Court.

STANDARD OF REVIEW

A district court ruling denying a motion for preliminary injunction is reviewed for abuse of discretion. *National Wildlife Federation v. Burford*, 835 F.2d 305, 319 (D.C. Cir. 1987). The district court's findings of fact and conclusions cannot be set aside unless "clearly erroneous." Fed. R. Civ. P. 52(a); *United States v. Marine Bancorporation, Inc.*, 418 U.S. 602, 615 n.13 (1974); *United States v. General Dynamics Corp.*, 415 U.S. 486, 508 (1974); *United States v. Baker Hughes, Inc.*, 908 F.2d 981, 983 (D.C. Cir. 1990). In a merger case the "clearly erroneous" standard "applies to ultimate as well as underlying facts, including economic judgments." *Hospital Corp. of Am. v. FTC*, 807 F.2d 1381, 1385 (7th Cir. 1986).

ARGUMENT

Upon the filing of the FTC's complaint and preliminary injunction motion, the parties met with the Court and set a hearing schedule that afforded both sides some seven weeks for pre-hearing discovery and depositions so that neither side would be denied the opportunity to marshal its best evidence and present its case in an orderly and comprehensive manner to the trial court. This was after the FTC itself had reviewed the merger for four full months. There thus was not in this instance the sort of abbreviated inquiry that often occurs at the preliminary injunction stage. Not once during this process did the FTC contend it needed additional evidence to assess the competitive impact of this merger.[2]

Given the extensive hearing by the district court and breadth of its analysis, the FTC cannot establish that the court applied the wrong law or made clearly erroneous findings. The district court's decision should be affirmed.

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2 In fact, it is notable that the five full days of trial for the preliminary injunction in this case were the same number of trial days afforded the parties for the full merits trial in *Baker Hughes*.

I. THE DISTRICT COURT'S BAKER HUGHES COMPETITIVE EFFECTS ANALYSIS WAS LEGALLY CORRECT AND CERTAINLY NOT CLEARLY ERRONEOUS

Clayton Act Section 7 prohibits mergers where "the effect of such acquisition may be substantially to lessen competition, or tend to create a monopoly." 15 U.S.C. § 18 (1994). "The statutory test is whether the effect of the merger may be substantially to lessen competition in any line of commerce in any section of the country." *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 355 (1963). "The core question is whether a merger may substantially lessen competition, and necessarily requires a prediction of the merger's impact on competition." *FTC v. Procter & Gamble Co.*, 386 U.S. 568, 577 (1967). As Judge Posner has aptly noted, "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." *Hospital Corp. of Am. v. FTC*, 807 F.2d 1381, 1386 (7th Cir. 1986).

"[I]t is to be remembered that § 7 deals in 'probabilities,' not 'ephemeral possibilities.'" *Marine Bancorporation*, 418 U.S. at 622-23 (citing *Brown Shoe Co. v. United States*, 370 U.S. 294, 323 (1962)). "[A]ssumption is no substitute for reasonable probability as a measure of illegality under § 7," and "[t]he need for substantiality cannot be ignored." *Procter & Gamble*, 386 U.S. at 584 (Harlan, J., concurring). As the Supreme Court has pointed out, the FTC itself defines the level of "substantial" impact required by the statute: "significant and real, and discernible not merely to theorists or scholars but to practical, hard-headed businessman." *Id.* at 599.

In its earliest cases interpreting Section 7 of the Clayton Act, the Supreme Court took the view that market shares were almost entirely determinative of the validity of a merger. In *United States v. General Dynamics Corp.*, 415 U.S. 486

(1974), however, the Supreme Court "usher[ed] in a new era of Clayton Act §7 merger analysis." *Kaiser Aluminum & Chem. Corp. v. FTC*, 652 F.2d 1324, 1335 (7th Cir. 1981). The question directly presented in *General Dynamics* was whether the district court properly considered pertinent industry factors in a case where the government had established a prima facie presumption from market share statistics showing high industry concentration. 415 U.S. at 498. Cautioning "that statistics concerning market share and concentration, while of great significance, were not conclusive indicators of anticompetitive effects," the Court admonished that "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." *Id.* at 498 (quoting *Brown Shoe*, 370 U.S. at 322 n.38).[3]

As this Court explained in *Baker Hughes*, "*General Dynamics* began a line of decisions differing markedly in emphasis from the Court's antitrust cases of the 1960's. Instead of accepting a firm's market share as virtually conclusive proof of its market power, the Court carefully analyzed defendants' rebuttal evidence." 908 F.2d at 990; *see also Kaiser Aluminum*, 652 F.2d at 1335 (same). Of particular importance to this case, the *Baker Hughes* court held:

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3 In the same term, the Supreme Court decided *Marine Bancorporation*, confirming that a "challenged merger must be judged by its effects on the relevant product and geographic markets." 418 U.S. at 630. The Court reiterated "that by introducing evidence of concentration ratios ... the Government [can] establish[ ] a prima facie case." *Id.* at 631. But, as the Court continued, this showing merely shifts the burden to defendants "to show that the concentration ratios, which can be unreliable indicators of actual market behavior, did not accurately depict the economic characteristics of the ... market." *Id.; see also United States v. Citizens & So. Nat'l Bank*, 422 U.S. 86, 120 (1975) ("the Government plainly made out a prima facie case of a violation of § 7 under several decisions of this Court. It was thus incumbent upon [defendant] to show that the market share statistics gave an inaccurate account of the acquisitions' probable effects on competition") (citations omitted).

> The Supreme Court has adopted a totality-of-the-circumstances approach to the statute, weighing a 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.

Baker Hughes, 908 F.2d at 984; *see also* Robert Pitofsky (FTC Chairman), Statement of the Federal Trade Commission on Mergers and Corporate Consolidation in the New Economy, Hearing Before Senate Comm. on the Judiciary (June 16, 1998) ("Merger analysis has moved from strict reliance on structure-based presumptions that focused largely on market share data to a sophisticated analysis that takes account of the dynamic nature of competition in the real world . . . . It also is important to recognize and give proper weight to the potential efficiency effects of mergers.").

The district court here strictly followed the framework for determining whether a merger will substantially lessen competition set forth by this Court in *Baker Hughes*:

> 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, the government establishes a presumption that the transaction will substantially lessen competition. The burden of producing evidence to rebut this presumption then shifts to the defendant. 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.

908 F.2d at 982-83 (citations omitted).

Having found a prima facie case based on market concentration, the district court shifted the burden of production to defendants. "*General Dynamics* does not require the defendant to present a defense upon which he bears the burden of proof in the sense of ultimately persuading the trier of fact that he is entitled to relief." *Kaiser Aluminum*, 652 F.2d at 1340; *see Baker Hughes*, 908 F.2d at 992. Rather, "[i]n 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." *Baker Hughes*, 908 F.2d at 991. That is precisely the review the district court undertook in this case, and on the record compiled below its findings are unassailable.

As noted above, the district court first examined the market statistics, and explained that those statistics do not reflect the competitive market dynamic — namely, the ability of Heinz and Beech-Nut to compete against Gerber, or how, and the extent to which, Heinz and Beech-Nut compete against each other. The district court then considered defendants' rebuttal evidence that the merger will not harm price competition or increase prices at the wholesale or consumer levels. Finally, the district court considered evidence produced by defendants showing that the merger will actually increase competition in the jarred baby food market by creating a meaningful national competitor to Gerber, the only real player in the market for the past forty years.

The district court concluded that, despite high concentration and difficult entry, the merger of Heinz and Beech-Nut will not adversely affect consumer prices, and in fact, will enhance competition with Gerber resulting in immediate consumer benefits. *See* App.1437-38(*Op.*). These findings were based on, supported in and corroborated by an overwhelming record, consisting of tens of thousands of defendants' own internal records, expert econometric analyses of the merger's effects on pricing, expert reports on efficiencies from the merger, records from Gerber, and affidavits from the customers themselves – the retail supermarkets.[4]

Given the overwhelming record made by defendants, it was incumbent upon the FTC to produce additional evidence beyond its statistical case, yet it failed completely to do so. *Baker Hughes*, 908 F.2d at 983; *see also Kaiser Aluminum*, 652 F.2d at 1340 ("[t]he government continues to bear the burden of persuasion even after it has made out a prima facie case through statistical evidence"). Instead, the FTC came back with nothing, other than the same structural theory it asserted in the district court and now asserts again on appeal. App.1440(*Op.*).

As this Court has explained, that showing is clearly not sufficient. "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." *Baker Hughes*, 908 F.2d at 992.

Indeed, the FTC's reliance on a statistical case alone here stands in stark contrast to its proof in *FTC v. Staples, Inc.*, 970 F. Supp. 1066 (D.D.C. 1997), a case involving a 3-to-2 merger of the two largest office products "superstores." In that case, the FTC "pointed to internal ... documents which present[ed] price comparisons between [defendants'] prices," but the FTC produced no such evidence here. *Id.* at 1076. Defendants in this case, on the other hand, affirmatively showed that their internal documents track and target Gerber, not each other. Similarly, in *Staples*, the FTC introduced price comparison studies and

4 The FTC's reference to a few isolated instances of short-term couponing (*see* FTC Br. at 15-16) does not call into question these findings. Heinz consumer spending efforts — including couponing — are aimed at ***Gerber*** and do not vary based on the presence of Beech-Nut in a market. *See* App.2123; App.476-77; App.657-62. In addition, Professor Baker specifically reviewed coupon data and testified that couponing did not affect his econometric analysis. App.1299-1334.

econometric analyses showing that prices were lower in markets where both merging parties were present. *Id.* at 1076-77. The FTC offered no such evidence here. And defendants in this case adduced econometrics and expert testimony showing just the opposite — that there was no difference in price regardless of whether the other brand was present in the marketplace. App.4991-96;App.1069-73. And in *Staples*, the FTC offered expert efficiencies testimony from David Painter, together with an efficiencies expert report. *Staples*, 970 F. Supp. at 1090. The FTC offered no such evidence here. Defendants did.

Unable to escape the district court's well-supported findings under the correct legal analysis, the FTC conjures on appeal the remarkable assertion that the district court "failed to make ***any*** factual determinations ***at all***" with respect to coordinated interaction, and effects of the merger at the wholesale and local market level. *See* FTC Br. at 23 (emphasis added). The FTC then invites this Court to conduct a plenary review of the record, generally resurrecting its competing evidentiary views without citing the countervailing evidence introduced by the defendants, and, in most instances, without referring to the district court's expressly contrary findings.[5] The FTC's assertion in the first place is flatly incorrect and conspicuously at odds with the findings in the district court's 28-page opinion. Those findings are not clearly erroneous, and the FTC's argument for plenary review is without merit.

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5 For example, while the FTC asserts in its opening brief that Heinz and Beech-Nut compete on price, it cites advertising, couponing and other consumer loyalty programs, which show nothing more than Heinz and Beech-Nut competing with Gerber, not each other, as the district court found and as the record amply demonstrated. In fact, even a reference to the district court's express finding on this very point is conspicuously absent from the FTC's assertion in this regard. Similarly, again without referencing the district court's finding on the point, the FTC contends Heinz and Beech-Nut monitor each other's prices; suffice it to say that the district court's finding to the contrary is well supported. *Compare* App.5556-5615; App.1062-63; App.974; App.655-57 *with* FTC Br. at 9.

"Where there are two permissible views of the evidence, the factfinder's choice between them cannot be clearly erroneous." *Anderson v. Bessemer City*, 470 U.S. 564, 574 (1985); *see also Fasolino Foods Co. v. Banca Nazionale Del Lavoro*, 961 F.2d 1052, 1058 (2d Cir. 1992) ("The district court clearly fulfilled [its] obligation in nineteen pages of lucid factual findings and another ten pages of well-supported legal conclusions. All that is required by Rule 52(a) is that the trial court provide findings that are adequate to allow a clear understanding of its ruling.").

II. THE FTC'S ARGUMENTS ON APPEAL ARE NOT AVAILING

Faced with inescapable findings and conclusions supported in the record establishing that this merger will increase quality, increase output and lower prices, the FTC has been forced to take extreme legal and factual positions on this appeal pushing beyond the bounds of settled antitrust doctrine. To avoid the Section 7 competitive effects analysis the district court undertook in this case, the FTC now claims, remarkably, that *Baker Hughes* and the Supreme Court framework for analysis it sets forth are not applicable to the FTC at the preliminary injunction stage. The argument has no merit.

A. The "Totality of the Circumstances" Standard Under Section 7 Is No Different For the FTC in a Preliminary Injunction Case

The FTC is boldly asking this Court to depart from *General Dynamics* and *Baker Hughes* in this case. It is the FTC's contention that the *General Dynamics-Baker Hughes* analysis is reserved for the ***permanent*** injunction hearing, but has no application at the ***preliminary*** injunction stage. FTC Br. at 25-26. Where the transaction in question is a "merger to duopoly," in an admittedly highly concentrated market, with entry unlikely, the FTC maintains that it has "clearly satisfied all the criteria for securing a preliminary injunction" in this Circuit. *Id.* at 19. Defendants' rebuttal evidence regarding the actual competitive effects, including efficiencies from the merger, is not to be considered at this "stage of the proceeding" according to the FTC. *Id.* at 21, 49.

There is no authority for the FTC's position. Section 13(b) of the FTC Act requires that, to enjoin a merger under Section 7 of the Clayton Act, the FTC proceed in federal court. 15 U.S.C. § 53(b)(2) (1994). Under Section 13(b), "a district court must (1) determine the likelihood that the FTC will ultimately succeed on the merits and (2) balance the equities." *FTC v. University Health, Inc.*, 938 F.2d 1206, 1217 (11th Cir. 1991). "It is not enough for the FTC to show merely that it has a 'fair and tenable chance' of ultimate success on the merits as has been argued and rejected in other cases." *FTC v. Staples, Inc.*, 970 F. Supp. 1066, 1072 (D.D.C. 1997). "[S]uch a standard would run contrary to Congressional intent and reduce the judicial function to a mere 'rubber stamp' of the FTC's decisions." *Id.*

Nothing in Section 13(b) of the FTC Act suggests that courts are to engage in a more circumscribed inquiry when considering the FTC's motion for a preliminary injunction. Indeed, contrary to the notion of a degree of judicial deference to the FTC's prima facie showing of high concentration and entry barriers, the Section's legislative history recognizes that it is "the duty of the courts to exercise independent judgment on the propriety of issuance of a ... preliminary injunction." Trans-Alaska Pipeline Authorization Act, Pub. L. No. 93-153, 87 Stat. 576, Conf. Rep. No. 93-924, 1973 U.S.C.C.A.N. 2523, 2533.

Such has been the understanding of federal courts in this and every other Circuit. Thus, in *University Health* — a Section 13(b) case — the Eleventh Circuit followed the Section 7 analysis outlined in *Baker Hughes* to determine the FTC's likelihood of success on the merits. The FTC's prima facie case thus did not end the inquiry. *Id.* at 1218. Indeed, the Eleventh Circuit held the defendant could "rebut this presumption" with evidence showing "that the market-share statistics give an inaccurate account of the acquisition's probable effect on competition in the relevant market." *Id.* (citations omitted). In language derived from the reasoning in *General Dynamics*, the appellate court specifically observed that "the defendant may demonstrate unique economic circumstances that undermine the predictive value of the government's statistics." *Id.* Moreover, citing *Baker Hughes*, "[i]f the defendant successfully rebuts the presumption of illegality," the Eleventh Circuit held, "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." *Id.* at 1218-19 (quoting *Baker Hughes*, 908 F.2d at 983); *see also FTC v. Elders Grain, Inc.*, 868 F.2d 901, 904 (7th Cir. 1989) (Posner, J.) ("in a section 13(b) proceeding ... [t]he merits depend to a great extent on the economic effects of the challenged acquisition").

This Court's decision in *FTC v. PPG Industries*, 798 F.2d 1500 (D.C. Cir. 1986), does not command a different result. The FTC relies heavily on an out-of-context quotation from that case. *PPG*, however, did not address whether the standard for a preliminary injunction in a merger case differs from the standards for success outlined by the Supreme Court and articulated in *Baker Hughes*. Rather, *PPG* focused on the threshold issue of product market definition. The district court there found that, if the merging companies competed in the same product market, the district court's full competitive analysis that "the effects to be anticipated from [the] merger include a decline in vigorous inter-material research and development, an increase in the price of both glass and acrylic, and an erosion of quality service." *FTC v. PPG Indus.*, 628 F. Supp. 881, 885 (D.D.C. 1986). The Court of Appeals affirmed that conclusion without discussion.

The FTC's isolation and distortion of a single sentence from *PPG* is insufficient to support its radical and truly novel preliminary injunction theory. Indeed, *PPG* expressly recognizes that resolution of the likely competitive effects of a merger is appropriately assessed under Section 13(b) just as the district court did here, pursuant to the *General Dynamics* totality-of-the-circumstances approach. 798 F.2d at 1504.

Nor are we aware of any case in this Circuit that has undertaken to narrow the judicial inquiry under Section 13(b). Rather, in every recent Section 13(b) case, the analysis has uniformly followed the burden-shifting methodology for Section 7 challenges articulated in *Baker Hughes*. *See Staples, Inc.*, 970 F. Supp. at 1082; *FTC v. Cardinal Health, Inc.*, 12 F. Supp. 2d 34, 54 (D.D.C. 1998); *FTC v. Swedish Match*, No. 00-1501 (TFH) (D.D.C. Dec. 14, 2000). To hold otherwise and adopt the new standard the FTC urges on this Court would in effect foreclose meaningful independent judicial review of a merger at the preliminary injunction stage altogether. In fact, it is noteworthy that the FTC's proposed standard would no doubt have resulted in issuance of a preliminary injunction in *General Dynamics, Marine Bancorporation, Citizen & Southern* and *Baker Hughes*, effectively killing mergers which ultimately were found lawful.

Similarly, the FTC's reliance on entry barriers in this case does not dispose of the need for the full "totality of the circumstances" inquiry. In *Baker Hughes*, the government, like here, sought "to imbue[] the entry factor with talismanic significance." 908 F.2d at 985. This Court's response was that "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." *Id.* Rather, the rebuttal evidence is to be uninhibited and can include non-entry evidence such as "the tendency of the market toward even stronger levels of competition," "significance of market shares and concentration," "likelihood of express collusion or tacit coordination, and prospect of efficiencies from merger," "industry structure," "inter-industry cross elasticities of demand and supply" and "product differentiation." *Id.*

Collectively, this case law uniformly stands for the simple proposition that, because every merger is unique, every merger must be analyzed on its own facts. No doubt all merger cases present varied facts to the courts, some analogous and some not to the instant case. But that is the point of Section 7 analysis, and it is precisely why defendants must be able to present — and the court must appropriately be able to consider — rebuttal evidence in any case. There is simply no "cookie-cutter" approach to merger review.

Adherence to this totality of the circumstances approach is particularly compelling in this case, where, as in *Baker Hughes* and *General Dynamics*, extraordinarily unique market conditions, as the district court found, clearly show market share statistics have no correlation to the competitive positions of the merging parties. *See Kaiser Aluminum & Chem. Corp. v. FTC*, 652 F.2d 1324, 1341 (7th Cir. 1981) ("[M]arket concentration statistics, however, must be relevant to the focus of competition. The statistics must be an accurate measure of future ability to compete in a relevant market."). Here, of course, industry concentration itself is simply a reflection of Gerber's market share. App.1417(*Op.*).[6]

Nor is this case a "merger-to-monopoly," as the FTC asserts. Heinz and Beech-Nut are not combining to form a market leader, as in *PPG, Elders Grain* or *University Health*, principally cited by the FTC. *See PPG*, 798 F.2d at 1502-03 (world's largest firm in the industry with 30% share acquiring second largest firm

6 The HHI increase here is itself below levels where many mergers have been allowed. *See Baker Hughes Inc.*, 908 F.2d at 983 n.3 (1,425 point HHI increase nearly triple the 510 point increase here); *FTC v. Butterworth Health Corp.*, 946 F. Supp. 1285, 1294 (W.D. Mich. 1996) (1,889 point HHI increase and combined firm market share of 47-65%), *aff'd*, 121 F.3d 708 (6th Cir. 1997).

with 23% share; combined firm would be more than twice the size of next largest competitor); *University Health*, 938 F.2d at 1211 (combined hospital would be largest in market with 43% share); *Elders Grain*, 868 F.2d at 902 (combination of second and fifth firms in market, resulting in largest industrial dry corn producer in the United States).[7]

It is, instead, a merger that will enable the two much smaller companies — what Gerber describes as "also-rans" — to take on and for the first time meaningfully compete with Gerber. That is the very type of transaction the Clayton Act intended to protect, not defeat. *See Brown Shoe*, 370 U.S. at 319 (Clayton Act was not designed to "impede . . . a merger between two small companies to enable the[m] to compete more effectively with larger corporations dominating the relevant market"); *United States v. Country Lake Foods, Inc.*, 754 F. Supp. 669, 680 (D. Minn. 1990) (merger would allow the acquiring firm "to compete directly with the market leader"); *United States v. Consolidated Foods Corp.*, 455 F. Supp. 108, 138 (E.D. Pa. 1978) ("the ... merger will not put a giant in competition with a field of midgets"); *United States v. M.P.M., Inc.*, 397 F. Supp. 78, 93 (D. Colo. 1975) (merger of two of the four largest competitors with

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7 Nor is there is anything inherently unlawful about a 3-to-2 merger, as the FTC appears to suggest. Indeed, the FTC itself in 1997 allowed two of the three existing commercial aircraft manufacturers, McDonnell Douglas and Boeing, to merge —with, in the agency's own words, Boeing acquiring a "non-failing direct competitor in a market in which there is only one other significant rival, Airbus Industries, and extremely high barriers to entry." *See* Federal Trade Comm'n, Statement of Chairman Robert Pitofsky and Commissioners Janet D. Steiger, Roscoe B. Starek III and Christine A. Varney, in the Matter of The Boeing Company/McDonnell Douglas Corporation, File No. 971-0051. There was similar, unrefuted evidence at trial regarding enhanced competition from a 3-to-2 merger allowed to proceed in the greeting card industry. App.962-63.

combined market share over 30% "motivated by a desire to improve the companies' competitive position").[8]

B. The District Court Correctly and Thoroughly Considered the Effects of the Merger at the Wholesale Market Level

The FTC's case in the trial court was captured succinctly in the FTC's Opening Statement:

> As Your Honor recognized at our very first conference in chambers, this case is really not about the supermarkets. . . . It is about consumers. Supermarkets do not stand to bear the risk in this matter if things don't go as promised. . . . Supermarkets, as long as they're treated fairly, if they get a good deal, supermarkets don't really have much at stake.

App.86. The FTC had to take this approach because, in the end, the market at issue is jarred baby food, not some separate market for shelf space in supermarkets.

Thus, the district court's opinion, and the evidence adduced at trial, focus on the FTC's claim that "trade spending competition benefits consumers and that the merger will eliminate that benefit." App.1430-31(*Op.*). The district court concluded that the FTC "failed completely" to support this theory, because there was no evidence to suggest that the wholesale competition between Heinz and Beech-Nut to get on the supermarket shelf in any way affected the consumer price of jarred baby food. *Id.*

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8 The legislative history to the 1950 amendments to the Clayton Act underscores the point: "[o]bviously, those mergers which enable small companies to compete more effectively with giant corporations generally do not reduce competition but rather intensify it. . . . Congress has made it abundantly clear it is not the purpose of this law to prevent mergers of this type." *An Act to Amend an Act Entitled "An Act to Supplement Existing Laws Against Unlawful Restraints and Monopolies, and For Other Purposes," Approved October 15, 1914 (38 Stat. 730), As Amended: Hearing on HR 2734 Before a Subcomm. of the Comm. on the Judiciary*, 81st Cong. 6 (1950) (statement of Senator Herbert R. O'Conor, Chairman).

Consequently, the FTC turns its attention on appeal to new "victims" — the supermarkets — arguing the merger will eliminate Beech-Nut's "shelf payments" at the wholesale level, and that in and of itself is anticompetitive, regardless of the impact on consumers or consumer price. Neither the law nor the facts support this appellate afterthought.

As the Supreme Court pointed out some years ago in *Citizen Publishing Co. v. United States*, 394 U.S. 131 (1969), "[i]n 1950 . . . § 7 was amended to make the measure of anticompetitive acquisitions the extent to which they lessened competition in any line of commerce; rather than the extent to which they lessened competition 'between' the two companies." *Id.* at 137 n.2. Judge Posner underscored the salient point in *Products Liability Insurance Agency, Inc. v. Caum & Forster Insurance Cos.*, 682 F.2d 660 (7th Cir. 1982):

> Now there is a sense in which eliminating even a single competitor reduces competition. But it is not the sense that is relevant in deciding whether the antitrust laws have been violated. Those laws, we have been told by the Supreme Court repeatedly in recent years, are designed to protect the consumer interest in competition.

Id.; *see also Reiter v. Sonotone Corp.*, 442 U.S. 330, 343 (1979) (the antitrust laws were "conceived of primarily ... for the people of United States as individuals, especially consumers"); *United States v. Rockford Mem'l Corp.*, 898 F.2d 1278, 1282 (7th Cir.) ("the current understanding of Section 7 [of the Clayton Act] is that it forbids mergers that are likely to hurt consumer"), *cert. denied*, 498 U.S. 920 (1990). The district court was therefore compelled by the law to follow the agency's theory and analyze the competitive effects of the merger at the consumer level.[9]

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9 The FTC cites "component part" cases (*See* FTC Br. at 28-31), but jarred baby food is not a component part sold to a midstream manufacturer for incorporation into a finished product and, in turn sold to an end user. Baby food is a consumer product, and the effect on competition of a consumer product is measured at the consumer level.

Most significantly, even if the FTC could somehow argue at this stage that the proper inquiry is into the effects of the merger at the ***supermarket*** level, the FTC's claim lacks any record support. First, total trade spending is unaffected by competition to get on the shelf, the existence of which causes trade spending to merely shift from variable to fixed. App.1431-32(*Op.*).

Supermarkets, in fact, perceive the merger as potentially increasing wholesale competition, due to the prospect of finally bringing effective competition to the market leader. It is therefore hardly surprising that the supermarkets — the parties most likely to be injured under the FTC's theory of reduced wholesale competition — overwhelmingly favor this merger. Defendants adduced no fewer than thirty-one affidavits, together with trial testimony, from supermarkets ranging from the largest chain in the country, Kroger, to small single-store "mom and pop" groceries, all supporting this merger on these and other grounds. App.4501-36, 4566-85, 4613-14. That fact alone is dramatic evidence that the FTC's new-found solicitousness for supermarkets is simply no basis for opposing this pro-competitive merger.[10]

10 Notably, the FTC successfully moved to suppress portions of these affidavits regarding the overwhelming supermarket opinions that this merger will enhance competition. App.1166-70. These customer views should be given strong consideration in a merger case. *See United States v. Syufy Enters., Inc.*, 903 F.2d 659, 669 (9th Cir. 1990); *FTC v. Butterworth Health Corp.*, 946

Accordingly, even on an evaluation of this merger that differs markedly from the FTC's consumer-oriented approach below, the elimination of Beech-Nut as a source of shelf space payments to some wholesale customers provides no basis for reversal of the district court. The competition that Gerber will predictably face from the combined companies fully supports the conclusion below that the merger will likely enhance competition, not lessen it. App.1440-41(*Op.*).

C. The District Court's Consideration of Efficiencies and Innovation Was Well Within Its Legal Province and In Accordance With the FTC's Own Horizontal Merger Guidelines

The defendants successfully rebutted the prima facie case by showing that there will be no anticompetitive effect on price or reduction in retail or wholesale competition, and needed to go no further. Nevertheless, defendants produced additional evidence, beyond any showing required by Section 7, to establish that the merger will in fact enhance competition.

This showing was made primarily through the merger's manufacturing and distribution efficiencies and the corresponding consumer benefits, which the district court discussed at length. The district court found the efficiencies to be "extraordinary," resulting in consumer benefits that would be "immediate and virtually automatic." App.1436-38(*Op.*). The district court's findings, moreover, did "not rest upon aspirational testimony, but instead credit[ed] powerful evidence in the record about the efficiencies realized from the merger, and about the enhanced prospects of the merged entity to introduce innovative products to compete with Gerber." App.1435(*Op.*) On appeal, with no real challenge to

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F. Supp. 1285, 1299 (W.D. Mich. 1996), *aff'd*, 121 F.3d 708 (6th Cir. 1997); *FTC v. Great Lakes Chem. Corp.*, 528 F. Supp. 84, 95 (N.D. Ill. 1981).

mount against these findings, the FTC contends it was error to consider this evidence at all.

Section 7 analysis would be irrational without consideration of the pro-competitive effects of a merger. As Justice Harlan cogently explained in *Procter & Gamble*: "economic efficiencies produced by the merger must be weighed against anticompetitive consequences in the final determination whether the net effect on competition is substantially adverse." 386 U.S. at 597 (Harlan, J., concurring). "Economies achieved by one firm may stimulate matching innovation by others, the very essence of competition. They always allow the total output to be delivered to the consumer with an expenditure of fewer resources." *Id.* at 598. In fact, in that case, the FTC itself acknowledged "a merger that results in increased efficiency of production, distribution or marketing may, in certain cases, increase the vigor of competition in the relevant market." *Id.* at 603.

To the extent efficiencies remained an open question in 1966, the question is now closed, and the answer well-established. In *University Health*, 938 F.2d at 1212, the FTC raised the precise contention it has raised on appeal here, arguing efficiencies could not be considered by the district court. The Eleventh Circuit flatly rejected that argument, holding: "[i]t is clear that whether an acquisition would yield significant efficiencies in the relevant market is an important consideration in predicting whether the acquisition would substantially lessen competition." *Id.* at 1222.

University Health is not an outlier. "The majority of courts have considered efficiencies as a means to rebut the government's prima facie case that a merger will lead to restricted output and increased prices." ABA Antitrust Section, *Mergers And Acquisitions: Understanding The Antitrust Issues* 152, 180 (2000); *see FTC v. Tenet Health Care Corp.*, 186 F.3d 1045, 1054 (8th Cir. 1999); *United*

States v. Long Island Jewish Med. Ctr., 983 F. Supp. 121, 149 (E.D.N.Y. 1997); *Marathon Oil Co. v. Mobil Corp.*, 669 F.2d 378, 380 (6th Cir. 1981).

This Circuit has similarly acknowledged the important role that efficiencies play in the "competitive effects" analysis under Section 7 of the Clayton Act, recognizing that the "prospect of efficiencies from merger" is a factor that rebuts the FTC's prima facie case. *Baker Hughes,* 908 F.2d at 985. Similarly, in *FTC v. Cardinal Health*, the district court, following *Baker Hughes*, held "a defendant may rebut the government's prima facie case with evidence showing that the merger would create significant efficiencies in the relevant market." 12 F. Supp. 2d at 61 (citation omitted). And *Staples* likewise held "whether an acquisition would yield significant efficiencies in the relevant market is an important consideration in predicting whether the acquisition would substantially lessen competition." 970 F. Supp. at 1088.

The district court's consideration of defendants' efficiencies evidence here as part of its overall analysis of the merger's effect on competition was therefore dictated by — not contrary to — established precedent. As stated in the FTC Staff Report, *Anticipating the 21st Century: Competition Policy in the New High-Tech, Global Marketplace* (May 1996):

> Section 7 asks whether a transaction's effect may be substantially to lessen competition. Credible efficiencies likely to be achieved through a transaction may contribute to the overall competitive effect of the merger. For this reason the merging parties should be able to put forward likely pro-competitive efficiencies at the agency review stage, in administrative litigation, and in court. ***Because both courts and agencies have jurisdiction over mergers, there is little basis for suggesting that a court ignore what an agency may consider.*** Moreover, the introduction of competitively relevant efficiency evidence in court better aligns merger policy with other areas of competition law.

Id. at 24 (emphasis added); *see also* 4A Areeda, *et al.*, *Antitrust Law* ¶ 970c, at 25-26 (1998) ("[n]either the language nor the legislative history of § 7 forecloses an economies defense").11

Here, the district court found "[i]n the context of this particular case, th[e] efficiencies will enable Heinz to provide the best of the two companies' recipes under the new Heinz/Beech-Nut (or Beech-Nut/Heinz) label, and to apply its value pricing strategy to the entire combined production volume." App.1437(*Op.*). These manufacturing efficiencies are precisely the type of efficiencies the *Guidelines* contemplate, and the commentators support. *See Horizontal Merger Guidelines* § 4 (1997) ("efficiencies resulting from shifting production among facilities formerly owned separately, which enable the merging firms to reduce the marginal cost of production, are more likely to be susceptible to verification, merger-specific, and substantial, and are less likely to result from anticompetitive reductions in output"); 4A Areeda, *et al.*, *Antitrust Law* ¶ 970c, at 28-29 (1998) ("the strongest case for an efficiencies defense is the one in which two inefficiently small firms attain efficiencies enabling them to compete more vigorously with larger rivals that have already attained lower costs").

On appeal, the FTC now objects to the efficiencies analysis, and argues that the district court committed legal error by taking notice of these particular efficiencies, even if efficiencies can be considered, because this merger will eliminate a brand in the marketplace. The FTC also contends that there is no

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11 The consensus for consideration of efficiencies is indisputable, and the FTC's assertions otherwise are unexplainable. *See* Robert Pitofsky (FTC Chairman), Efficiencies in Defense of Mergers: 18 Months After, Remarks at George Mason Law Review Antitrust Symposium: The Changing Face of Efficiency (Oct. 16, 1998) ("The most significant aspect of the 1997 revisions is that they ***tied efficiencies directly into competitive effects analysis***. The revisions recognized that ***cost reductions may reduce the likelihood of coordinated interaction or the incentive to raise price unilaterally***. In these and other market situations, efficiencies are likely to lead to benefits to consumers.") (emphasis added).

support for the assumption that the efficiency savings in this case will be "passed through" to consumers. None of these arguments has merit.

The FTC's objections to the validity of the efficiencies analysis hardly warrant discussion. The district court adopted the testimony of defense expert David Painter, who, through 1997, evaluated merger efficiencies at the FTC and testified in merger cases for the FTC for 30 years, most recently as an Assistant Director in the FTC Bureau of Competition. App.828-30; App.5299-5301 ¶¶ 1-6. Mr. Painter, in fact, was the FTC's expert on efficiencies in the 1997 case *FTC v. Staples, Inc.* App.832. Here, Mr. Painter looked at cost savings from the standpoint of what he would have done at the FTC to apply the standards stated in the FTC *Horizontal Merger Guidelines*. App.833. He reviewed the Heinz cost savings estimates, tracked the information back to their source in ordinary course-of-business documents, identified the methodology, verified the calculations, and replicated the analysis. App.833;App.5304 ¶17;App.5301-02 ¶¶ 8-11. He then evaluated whether he had enough information to determine that the savings were merger-specific in the sense that, as a practical realistic matter, they would be achieved only with this merger. App.833;App.5302 ¶13; App.5303n.3. The FTC did not seriously challenge Mr. Painter's credentials or his analysis of the efficiencies in the district court.

Next, the FTC contends, categorically, that efficiencies in this case are not "cognizable." In other words, because the merger will consolidate the Heinz and Beech-Nut brands, the FTC argues that consumer choice will be reduced, and efficiencies that reduce this choice should not be considered. Put more directly, even if output increases, prices decline, and quality improves, the FTC says none of that is "cognizable" because some consumers will lose their choice for the quality of the Heinz brand. There is simply no precedent or support for this contention, and the agency has never before adopted such an extreme argument.

Professor Baker explained at the hearing that to throw out the efficiencies here would be tantamount to saying that whenever two brands merge, quality improvements and price reductions will not be recognized, no matter how large. App.1120-21. Equally important, from a factual standpoint, the FTC is also on weak ground. Dr. Hilke's entire analysis of a loss of consumer choice was based on a document that he later conceded he had misinterpreted. App.498-99.[12] Thus, the FTC is without record evidence to support the proposition that consumers will be disappointed by the new and improved brand, with Beech-Nut quality at a Heinz value price. Moreover, the concept that consumers would lose a choice implies that consumers ***have*** a choice. There are only two brands on a supermarket shelf before and two brands after the acquisition. App.1118-19. The merger actually promises to give consumers additional choices in the form of new products. App.1435(*Op.*)

[13] The district court, of course, rejected this challenge at trial, finding that the consumer savings will be "immediate and virtually automatic." App.1437-38(*Op.*). The district court's finding is firmly grounded in the record.[14]

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[12] This of course is consistent with other record evidence showing that Heinz consumers buy Heinz because of price, not quality. App.1119-20;App.497;App.1062.

[13] The FTC compares production dollar savings with total annualized baby food sales to create the illusion that the efficiencies from the merger are small. This comparison is meaningless — it compares costs at the manufacturing level with sales at the retail level. The proper comparison, instead, is to look at how the manufacturing cost reductions impact the overall cost of producing baby food.

[14] Given the district court's findings, the assertion by the Attorneys General amici that the district court "fail[ed] to make any findings that post-merger savings would be passed on to consumers" is puzzling, to say the least. *See* AG Amicus Br. at 9.

As Professor Baker explained, these cost savings must be passed through to consumers, not by reason of any altruistic behavior on the part of Heinz, but instead, because of hard, factual market conditions that demonstrate low pricing to be the only profit-maximizing position Heinz can assume: "if those costs of producing and distributing fall, additional units that would not have been profitable to sell before become profitable now. Even if the revenue from those units goes down a little bit, the costs have fallen a lot so more units become profitable to make and sell than before. As a result, any firm that experiences a variable cost decline will have an incentive to lower prices after that cost reduction ... lowering prices means that the firm will sell more. So it will be able to expand output as a result." App.1108-09. This impact is even more pronounced here, as Professor Baker explained in his economic analysis, concluding Heinz will be driven to pass through at least 50% and likely 100% of its production savings. App.1109-11.[15]

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[15] The FTC takes a quote from the district court's opinion out of context to suggest doubt as to whether Heinz will take Gerber on. The very next sentence of the opinion, however, lays to rest any doubt concerning the district court's finding: "[w]hen the efficiencies from the merger are combined with a new platform for product innovation, however, it appears more likely than not that Gerber's own predictions of more intense competition will come true." App.1438(*Op.*).

In sum, there is no basis in law or fact for faulting the district court's consideration of defendants' efficiencies evidence as an integral part of its competitive effects analysis. The FTC's objections on appeal that the efficiencies are deficient ignore the district court's express findings to the contrary, and are particularly ill-founded from an agency that offered no competing efficiencies analysis, or competing efficiencies expert, at trial.[16]

D. The District Court Correctly Found There Is No Increased Likelihood of Post-Merger Collusion

The clearly erroneous standard "applies to ultimate as well as underlying facts, including economic judgments," such as the likelihood of collusion post-merger in a Section 7 case. *Hospital Corp.*, 807 F.2d at 1385. To avoid this standard and invite plenary review, the FTC argues in the extreme that the district court "failed to make any factual determinations ***at all***" with respect to "coordinated effects." FTC Br. at 23 (emphasis added). The FTC's assertion is far off the mark.

First, "[w]hen an economic approach is taken in a section 7 case, the ultimate issue is whether the challenged acquisition is likely to facilitate collusion." 807 F.2d at 1386. In other words, the entire rationale underlying the prima facie presumption afforded the FTC in a merger case is the economic assumption that increases in concentration can render prospects of collusion among the remaining firms in the market more likely. Thus, critically and dispositively,

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16 The FTC also speculates on appeal whether Heinz will introduce its aseptic and Oasis innovations. Not only is this conjecture unrelated to efficiencies analysis, it is not grounded in record evidence, which is to the contrary. App.1438-39(*Op.*);App.686;App.4379;App.4311; App.4359-60;App.5467.

the district court's entire opinion and findings that defendants rebutted the prima facie case also serve as explicit findings rebutting any presumption that there is an increased likelihood of post-merger collusion.

This point is evident from the only plausible collusion theory the FTC can postulate in the first instance. Specifically, to show there is any more likelihood of collusion post-merger, the FTC must argue, as it has on appeal, that Beech-Nut is a constraint on the price of Heinz baby food. FTC Br. at 39. In other words, the FTC must be able to show that but for the presence of Beech-Nut in the marketplace, Heinz would be more likely to collude with Gerber on price. But the district court's findings completely vitiate this theory, because those findings unequivocally show that Heinz and Beech-Nut are currently not constraining each other's prices in the marketplace. App.1428-29(*Op.*). Put another way, Heinz will have no more and no less of an ability to collude post-merger than it has now.

These powerful and unrefuted findings completely undercut any collusion theory in this case, and serve as the backdrop for the district court's more specific finding that "[t]he Commission's argument that further concentration in the baby food industry will increase the likelihood of collusion was effectively rebutted by Professor Baker's testimony regarding the structural market barriers to collusion in the market. *See* Tr. 1010-1023." App.1435n.7(*Op.*). The FTC claims this finding is not valid because it appears in a footnote, citing *Knapp Shoes, Inc. v. Sylvania Shoe Manufacturing Corp.*, 15 F.3d 1222 (1st Cir. 1994). The *Knapp* footnote, however, was faulted for its failure to reference record evidence to adequately explain the single-sentence finding. *Id.* at 1228.

Here, by contrast, the district court's finding directly incorporates Professor Baker's testimony (fourteen pages from the trial transcript) regarding the structural barriers to collusion in the market. App.1435 n.7(*Op.*); App.1121-34. That testimony is telling, and more than suffices "to apprise the appellate court of the

There is an additional point weighing heavily against collusion. Post-merger, as Professor Baker explained, Heinz will have a very different cost structure, forcing it into the role of a "maverick" bent on growing share in order to fully utilize its capacity and maximize its distribution. App.1123-24;App.1127,1053. Accordingly, Heinz and Gerber will have very different perspectives on where prices should be post-merger, and it would be difficult to conceive that they could ever reach agreement. "Coordination will not be possible when any significant firm chooses, for any reason, to go it alone," and one reason to go it alone is an "objective . . . to capture a significant amount of volume in order to [improve] sales position." *Brooke Group, Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 239-40 (1993) (citation omitted); *see Horizontal Merger Guidelines* §§ 2.12, 4.

The FTC's only response to Professor Baker was the unvarnished opinion of its expert Dr. Hilke, who offered gratuitously that collusion is a forgone conclusion with increased concentration. *But see* 6 Areeda, *Antitrust Law* ¶ 1429b (1986) ("in markets inhabited by a few firms . . . [i]t does not mean that consumers will be injured, for oligopoly prices may be lower in the long run if they reflect increase innovations and if the oligopolists are more progressive than more numerous firms would be"); Malcolm B. Coate & A.E. Rodriques, *The Economic Analysis of Mergers* 44 n.42 (1997) ("It is possible a Herfindahl of 2000 in one industry will raise competitive concerns while a Herfindahl of 5000 in another industry will imply continued competition. Thus, no real sliding scale exists. Overall, while high concentration raises concerns, these concerns may disappear once other factors are evaluated. Since collusion analysis takes place on a case by case basis, no real generalizations are possible."). The FTC's argument amounts to nothing more than the now-discredited theory by both the courts and the antitrust agencies that numbers alone can dictate outcome.

III. THE DISTRICT COURT PROPERLY BALANCED THE EQUITIES IN THE CASE

Section 13(b) also requires that the FTC show, weighing the equities, that enjoining a merger would be in the public interest. 15 U.S.C. § 53(b) (1994); *FTC v. Weyerhauser Co.*, 665 F.2d 1087 (D.C. Cir. 1981). In balancing the equities, "[i]t is always better to avoid relying on vague concepts and instead to ask concretely who would be helped and who hurt by a proposed action: here, who would be helped and who would be hurt by allowing — and who by forbidding — a challenged acquisition to go through before what are often protracted administrative proceedings." *Elders Grain*, 868 F.2d at 904. Undeniably, as Judge Posner noted, "[a]n acquisition that is pro-competitive or that is likely to lead to lower prices via expansion or output through economies of scale or other efficiencies will benefit consumers, suppliers, and other economic players, and the benefit will be reduced (perhaps to zero) if the acquisition is enjoined or rescinded." *Id.*

Here the district court found the merger will improve quality for Heinz buyers, lower prices for Beech-Nut buyers, bring new products to market, enhance competition against the market leader, and that the consumer benefits from this merger will be immediate.

CONCLUSION

For the foregoing reasons, defendants respectfully request that the district court's decision be affirmed.

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CERTIFICATE OF COMPLIANCE PURSUANT TO FED. R. APP. P. 32(A)(7)(c) AS TO WORD COUNT

I certify that pursuant to Fed. R. App. P. 32(a)(7)(C) the Brief for Defendants-Appellees is proportionally spaced, has a typeface of 14 points, and contains 13,642 words.

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CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing Brief for Appellees were served by hand delivery, this 29th day of December, 2000, upon:

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