Cereal Merger (Outline)

I. Introduction & Assignment

- **Task:**
  - Advise whether the FTC should seek a § 13(b) PI to block Kiddos' acquisition of GrainWell
  - Assess prima facie case, defenses, equities/public interest
  - Why no Jungle Rings divestiture has been proposed (and what that implies).
- **Short Answer (roadmap):**
  - Narrow product market (children's RTE)
  - U.S. geographic market (United States)
  - Anticompetitive harm
    - Combined share ≈ 57.8%, HHI ≈ 4,366, ΔHHI ≈ 515 → PNB presumption
    - Strong unilateral (recapture)
    - Strong maverick-elimination
    - Supportive coordinated effects
  - Defenses fail
  - Refusal to divest implies anticompetitive value
  - Equities/public interest favor PI.

II. Governing Law & Framework

- **§ 7 Clayton:** Elements—product, geographic, likely anticompetitive effect; "reasonable probability" standard.
- **§ 13(b) FTC Act:** Likelihood of success + equities/public interest; courts treat PIs in mergers as effectively dispositive (*Heinz*, etc.).
- ***Baker Hughes* burden-shifting:** Step 1 (FTC prima facie/PNB), Step 2 (defense rebuttal), Step 3 (FTC ultimate burden); sliding scale.
- **Organization (as written):** Part I (prima facie) → Part II (defenses) → Part III (why no divestiture) → Part IV (likelihood of success) → Part V (equities) → Part VI (recommendation).

III. Prima Facie Case

A. Relevant Product Market — Children's RTE Cereals

1. **Brown Shoe**:
   - **Interchangeability/cross-elasticity:** When one children's brand raises price 5% (others held constant), ~91% of lost units divert to other children's cereals; only ~6% to adult, ~3% to non-cereal. Segment-specific diversion → limited cross-segment substitution.
   - **Practical indicia:** Industry/party recognition; child-targeted branding/uses; distinct customers (parents/kids); price/cost differences; segment-specific marketing/distribution; production considerations.
   - **Bottom line:** Children's RTE satisfies *Brown Shoe* (outer boundaries + indicia).

2. **Hypothetical Monopolist Test (HMT):**
    - Single-product SSNIP/recapture implementation for differentiated goods; framework summarized with case and Guidelines support.
        1. Apply 5% SSNIP to Jungle Rings
        2. Dollar margins for recapturing established children's brands
        3. Critical recapture ≈ 21.25%. Actual recapture ≈ 91%
        4. → SSNIP profitable → market satisfies HMT.
    - **Alternative: Uniform SSNIP critical loss**
        1. *Method 1*: Use segment average in formula
        2. *Method 2*: Use a sufficiency test (use highest margin → lowest critical CL)
        3. *Method 3*: Use revenue-weighted average
            1. *Assumption*: Unit brand losses are proportional to revenue market shares
            2. *Assumption*: All brands lose the same share as the candidate market as a whole (10%)
    - **Commercial realities:** Broader candidate markets could also satisfy HMT, but children's RTE best matches how parties compete and where effects occur.

B. Relevant Geographic Market — United States

- **Commercial realities:**
    - Uniform wholesale pricing
    - National DC distribution
    - National account procurement
    - Scale economies
    - Retailer concentration (~top 5 ≈ 65% of sales)
    - Organization/analysis is national
    - No sustained regional success
- **Supply-side limits:**
    - Foreign/regional suppliers cannot "flood" to defeat a nationwide SSNIP (slotting/brand-building/capacity barriers).
- **HMT confirmation:**
    - *Assumption*: Diversion ratios provided in the hypothetical were for U.S. manufacturers and excluded foreign manufacturers
    - Nationwide SSNIP would be profitable → U.S. is the geographic market.

C. Shares/HHI and PNB Presumption

- **Numbers:** Combined ≈ 57.8% share; HHI ≈ 4,366; Δ ≈ 515 → highly concentrated and large delta.
- **Support**
    - Judicial
    - Merger guidelines
    - *PNB*

D. Theories of Competitive Harm

1. **Unilateral Effects (recapture):**
    1. Elements
        a. Differentiated products
        b. Kiddos is closest substitute
        c. Others are more distant
        d. Entry/expansion/repositioning not timely/likely/sufficient (TLS)
    2. Kiddos is Jungle Rings' closest rival: ~55.6% of JR's lost sales divert to Kiddos
    3. Recapture test shows 5% JR price rise profitable (actual 55.6% ≫ critical 21.25%)
2. **Maverick elimination:**
    1. Elements
        a. Market conducive to more coordination
        b. JR's conduct materially disrupts it
        c. Merger likely ends that disruptive conduct
        d. Merger results in higher coordination risk
    2. Kiddos documents tout "discipline"/reduced "promotional chaos" → JR's disruptive pricing/promo constraint would be softened/eliminated post-merger.
3. **Coordinated effects (supportive):**
    1. Elements
        a. Premerger, the market is susceptible to tacit coordination
        b. Postmerger, the merger increases the likelihood/effectiveness/stability of coordination
    2. Facts
        a. High concentration
        b. Transparent category resets
        c. Fewer independent decision-makers
        d. Theory is weaker than unilateral/maverick but adds weight

---

IV. Defenses & Rebuttals (as applied)

- **Broader market(s):** Legally irrelevant once harm shown in any proper line of commerce; narrow market most probative here.
- **"Remaining rivals constrain"**
    - CerealCorp and store brands don't restore the lost localized constraint/incentive (recapture economics)
    - Non-cereal breakfasts are weak substitutes.
- **"JR is too small/unsustainable"**
    - Size ≠ significance
    - Record and internal docs show outsized disciplinary role
- **Exit story**
    - Contradicted by recent performance and GrainWell investment plans.
- **Entry/expansion/repositioning (TLS):**
    - Not timely/likely/sufficient given barriers (brand equity, shelf/slotting, promotions, ad spend, scale).

- **Efficiencies:**
  - Fixed cost efficiencies do not count
  - Other claimed efficiencies not merger-specific or not verified
  - Even if some, they don't outweigh predicted harm.
- **Failing-firm/weakened-competitor:**
  - Strict failing-firm elements not met (assuming defense applies to a brand)
    - JR has a positive contribution margin → not failing
    - No effort to shop brand to a less anticompetitive purchaser
  - JR not "weakened"
    - JR has a positive contribution margin → not failing
    - GrainWell's current plan is to continue brand—investment under evaluation, but no decision made to discontinue brand

---

V. Why No Divestiture of Jungle Rings?

- **Observation:** Properly structured JR divestiture could resolve concerns, yet Kiddos hasn't proposed one.
- **Economics of refusal:**
  - Claimed synergies fall $130.5M short of covering price/premium + transaction costs
    - Claimed operational efficiencies: $922 million
    - Minus transaction-related costs: $152.5 million
    - Minus deal premium: $900 million
    - = $130.5 million loss if deal closed with no divestiture
  - Kiddos' internal "discipline/chaos" language implies the missing value is anticompetitive (suppressing JR constraint).
- **Implication:** Deal likely profitable only with reduced competition → strengthens inference of harm; predicts no settlement or "litigate-the-fix."

VI. Likelihood of Success on the Merits

- Strong prima facie case (market definition + *PNB* + explicit theories) + defenses lack evidentiary support → high likelihood FTC prevails at PI.

VII. Equities & Public Interest

- Public equities
  - Irreversibility— PI preserves competition during adjudication; post-closing harm cannot be effectively remedied
  - Inadequacy of divestiture ex post
  - Need to preserve effective relief.
- Private equities
  - *Buyer*: Lost merger synergies during the PI delay
  - *Seller*: Loss of the time value of money during the PI delay
    - Private parties lose only if the ultimate finding on the merits is for the merging parties—if a blocking injunction is entered, merging parties suffer no loss

- **Balance:** When the government shows a likelihood of success on the merits, the public interest in the public equities always outweighs the private equities of merging parties

---

VIII. Recommendation

- **File for a § 13(b) PI**
  - Given likely injunction, Kiddos likely abandons rather than litigates merits.