

MERGER ANTITRUST LAW

LAW 1469
Georgetown University Law Center
Fall 2025

Tuesdays and Thursdays, 3:30 pm – 5:30 pm
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CLASS 26 WRITTEN ASSIGNMENT

Instructions

Submit by email by 3:30 pm on Tuesday, November 25

Send to wdc30@georgetown.edu

Subject line: Merger Antitrust Law: Assignment for Class 26

Assignment: Calls for an outline

For our last homework assignment, prepare an exam-style issue outline for last year's final exam hypothetical. Using the hypothetical as your only source, identify the questions being asked, list the major issues each question raises, and, for each issue, briefly note the governing legal or economic test, the two to four most important facts to which that test would apply, and a short tentative conclusion—at the level of detail you could realistically produce in roughly 45 minutes of reading and outlining during a five-hour exam.

Before you begin on the hypothetical, I suggest you prepare a form to use in creating your outline. For example, here is a possible set of bullets for market definition (leaving lots of room for your notes):

I. Market definition

- A. Product market definition—[space for tentative conclusion]
 - 1. *Brown Shoe* factors
 - a) Outer boundaries
 - b) Practical indicia
 - 2. Hypothetical monopolist test
 - a) Uniform critical loss test
 - b) One product SSNIP recapture test
- B. Geographic market definition—[space for tentative conclusion]
 - 1. Commercial realities test
 - a) Local market
 - b) Nationwide market
 - c) Regional market
 - 2. Hypothetical monopolist test

When you are actually outlining your answer, cross off the entries in your outline that do not apply and fill in two to four major facts you want to remember for the entries that do apply

In addition to product and geographic market definition, I suggest that you include at least the following major headings (with appropriate subheadings):

II. Horizontal mergers

- A. The *PNB* presumption
- B. Merger to monopoly
- C. Coordinated effects
- D. Unilateral effects
- E. Elimination of a maverick [unless you want to treat this under coordinated effects]
- F. Conclusion on the prima facie case (so that you don't forget it)

Defenses

- G. Entry/expansion/repositioning
- H. Power buyers
- I. Efficiencies
- J. Failing firm
- K. Weakened competitor
- L. Room for other defenses

Conclusion on horizontal liability

III. Potential competition mergers

- A. Actual potential competition
- B. Perceived potential competition

IV. Vertical mergers

- A. Input foreclosure/RRC
- B. Output foreclosure/RRC
- C. Anticompetitive information conduits
- D. Coordinated effects

V. Settlement possibilities

- A. Divestiture remedies for horizontal mergers
- B. Divestiture remedies for actual potential competition mergers
- C. None for perceived potential competition mergers
- D. Access contracts for vertical foreclosure/RRC mergers
- E. Firewalls for vertical anticompetitive information conduits

VI. "Litigate the fix"

VII. Injunction standards

- A. Clayton Act § 15 for DOJ actions
- B. FTC Act 13(b) for FTC preliminary injunction proceedings

These are only suggestions. You should create an outline form that works best for you. But all of these issues are fair game in the exam.

Finally, you should have boilerplate paragraphs for the law or economic tests for each second-level entry in your outline.

If you have any questions, send me an email. See you in class.

Mattress Merger

This hypothetical presents a simplified version of the mattress industry. In this world, mattresses are only sold to individuals for personal use at home. There are no commercial sales to hotels, furnished apartment buildings, dormitories, or similar establishments. All mattresses are innerspring, with no foam, latex, or hybrid mattresses. While all mattresses use springs, they vary in features, quality, and price.

Note: Market shares tables are on the last page

You are an associate at Gambini & Galloway LLP, working with partner Mona Lisa Gambini on a potential acquisition. Your client, ComfortPlus Bedding, Inc., the nation's largest manufacturer of mattresses, is negotiating to acquire Bedding Warehouse, Inc., the nation's largest retail mattress chain, for approximately \$4 billion in cash and stock. Due diligence is ongoing, and no merger agreement has been signed. Bedding Warehousing was not on the market, but the \$4 billion offer price was too attractive not to pursue.

ComfortPlus has requested a preliminary antitrust risk assessment of the transaction. Ms. Gambini has advised ComfortPlus that the Federal Trade Commission (FTC) would likely conduct any antitrust review. She has tasked you with drafting a memorandum for ComfortPlus that addresses the following: (1) the likelihood of an FTC investigation; (2) the theories of anticompetitive harm the FTC would likely explore, the defenses the merging parties might raise, and the conclusions the FTC is likely to draw; (3) the prospects of resolving any investigation, whether without conditions or through a mutually acceptable consent order; (4) the FTC's likely enforcement actions and ComfortPlus' options if precomplaint resolution efforts fail; (5) any steps ComfortPlus could take before or during the investigation to improve its chances of ultimately closing the deal; and (6) the overall likelihood of successfully closing the deal, whether before or after litigation, based on what you know so far.

ComfortPlus has provided some preliminary information and documents in response to your initial request, although key details remain to be learned. You have also extensively researched publicly available materials concerning the industry and its participants. This is what you have learned.

The parties

ComfortPlus. ComfortPlus Bedding, Inc., headquartered in Hickory, North Carolina, is a publicly traded Delaware company and the world's largest mattress manufacturer and supplier. Formed in 2010 through the merger of SleepLux International and Restwell Corp., ComfortPlus now operates in over 30 countries, with more than 20 manufacturing facilities worldwide and a workforce exceeding 10,000 employees. In 2023, the company generated nearly \$6 billion in revenue globally, with over \$4.3 billion from U.S. sales alone. Its primary mattress brands in the U.S. include ComfortPlus, the company's flagship premium product; Restwell, the top mattress brand in the U.S. by sales; and CloudNest, the third-highest-selling mattress brand. Pursuing growth through acquisitions, ComfortPlus has acquired four mattress manufacturing companies since 2018.

In 2020, ComfortPlus began vertically integrating into retail by acquiring Dreamland Mattress Corporation, a U.S. mattress retailer with 50 stores in Pennsylvania, Maryland, and Virginia. ComfortPlus retained Dreamland's management and operates the company as a fully functional independent subsidiary. Dreamland has its own headquarters in Pittsburgh, Pennsylvania, and

maintains independent back office operations, including finance, human resources, merchandising, real estate, IT systems, distribution, and logistics. Approximately 75 employees support these corporate functions.

To maintain Dreamland's competitive position in the retail market, ComfortPlus operates Dreamland independently of its manufacturing division. This independence enables Dreamland to continue to market and sell mattresses from other manufacturers alongside ComfortPlus-branded products. All Dreamland stores, for example, carry both of DreamHaven's national brands. Consistent with this arms-length relationship, ComfortPlus has designated both its mattress wholesale division and its Dreamland retail subsidiary as separate profit centers, with the compensation of each division's senior executives based primarily on their own division's operating profits. Accordingly, the ComfortPlus mattress manufacturing division and Dreamland have to negotiate the price at which ComfortPlus will sell mattresses to Dreamland, just as they did before Dreamland was acquired. As a result, the prices ComfortPlus charges Dreamland for mattresses have not changed materially since the acquisition, except for inflation.

ComfortPlus also has established an information firewall between its manufacturing division and Dreamland's operations. Mattress manufacturers routinely share confidential business information with retailers to support effective product marketing, including wholesale pricing, product development plans, launch schedules, marketing calendars, promotional strategies, and category-specific growth initiatives. ComfortPlus' firewall aims to prevent this competitively sensitive information from flowing from Dreamland to ComfortPlus's manufacturing division.

Under its independent management, Dreamland has opened an additional 25 stores and expanded its retail operations into New York and North Carolina. As of the end of 2023, approximately 99% of ComfortPlus-branded mattress sales in the U.S. come through third-party retailers, while less than 1% come through Dreamland stores. ComfortPlus estimates that Dreamland's going concern value as a company is between \$120 and \$160 million.

In August 2024, ComfortPlus announced plans to allocate \$100 million to Dreamland to fund an aggressive retail expansion that would open 40 to 50 new stores in the next three years. The plan is to open 10 to 12 stores in 2025, 20 stores in 2026, and the remaining stores in 2027. Eight sites have already been identified—State College, Pennsylvania; Frederick, Maryland; Charlottesville, Virginia; Ithaca, New York; Wilmington, North Carolina; Harrisonburg, Virginia; Binghamton, New York; and York, Pennsylvania—and Dreamland is in negotiations with landlords to obtain long-term leases on suitable space in each location. Dreamland's management team, which does not know about the possibility of ComfortPlus acquiring Bedding Warehouse, is actively working on locations for the remaining stores. If the acquisition of Bedding Warehouse goes forward, ComfortPlus will immediately withdraw Dreamland's funding and cancel all of Dreamland's expansion efforts.

Bedding Warehouse. Bedding Warehouse, Inc., a privately held mattress specialty retail chain, is the largest mattress retailer in the United States in revenue. Headquartered in Dallas, Texas, the company has expanded significantly through a series of acquisitions, growing from under 600 stores in 2010 to its current size of 2,200 stores nationwide, including 130 locations across Pennsylvania, Maryland, and Virginia. It offers a wide range of mattress brands from various suppliers, including ComfortPlus, DreamRest, PlushSleep, CloudNest, Restful Haven, GentleSlumber, and SoftSpring. In addition to these brands, Bedding Warehouse sells two private-label brands, SnoozeMate and DreamEase. The company employs over 9,000 people

across its extensive network of brick-and-mortar retail locations and, in 2023, generated \$6.3 billion in revenue from its mattress sales.

Bedding Warehouse has also invested heavily in its digital presence, developing a robust e-commerce platform that provides consumers with a seamless online shopping experience, detailed product descriptions, and personalized recommendations. Their website also features an innovative sleep education hub with articles, videos, and interactive tools designed to help customers understand mattress options, sleep health, and product care. However, the company does not offer online sales.

The deal

The parties are discussing an acquisition of Bedding Warehouse for a total purchase price of \$4.0 billion, consisting of \$2.7 billion in cash and \$1.3 billion in stock, representing a deal premium of approximately 25% over Bedding Warehouse's recent market valuation. Following the transaction, ComfortPlus shareholders will own 85% of the combined entity, while Bedding Warehouse shareholders will hold a 15% stake. Upon closing, ComfortPlus will expand its board of directors to include two designated members from Bedding Warehouse. After that, the combined company's shareholders will elect all board members in the ordinary course.

Following the acquisition, ComfortPlus will merge Dreamland into Bedding Warehouse, which will operate as an independent subsidiary under the same arrangements as it did Dreamland premerger. ComfortPlus will retain Bedding Warehouse's current management team to lead the combined retail operations to maintain BW's brand identity and operational focus while leveraging ComfortPlus' broader infrastructure and resources. Given Bedding Warehouse's existing capabilities and infrastructure, substantially all of Dreamland's corporate, administrative, sales, and operational personnel will be redundant postmerger and their positions eliminated. Dreamland's headquarters facility and warehouses, as well as retail locations that compete with Bedding Warehouse, will be divested to buyers not engaged in the mattress business.

The deal rationale

Bedding Warehouse and ComfortPlus already have substantial business ties. Every Bedding Warehouse store carries all three ComfortPlus brands (ComfortPlus, Restwell, and CloudNest), which account for 50% of BW's revenue. (Bedding Warehouse also carries both DreamHaven national brands—DreamRest and GentleSlumber—which accounts for 30% of Bedding Warehouse's revenues nationally, with all other brands accounting for 20% of its revenues nationally.)

Building on this existing relationship, ComfortPlus anticipates three strategic benefits from acquiring Bedding Warehouse.

First, the combined company will significantly increase its customer reach, enabling it to respond more effectively to keep pace with evolving consumer preferences, drive brand awareness, and broaden avenues for developing lifetime relationships with consumers.

Second, the acquisition would expand and diversify ComfortPlus' retail operations by combining Bedding Warehouse's 2,200 stores, well-known website, and sleep education resources with ComfortPlus' own stores. Currently, ComfortPlus earns 99% of its revenue from wholesale sales and less than 1% through its Dreamland retail stores. While ComfortPlus has been devoting effort and resources to building a more substantial retail capability, acquiring Bedding Warehouse—

already the leader in retail mattress sales—offers a much more attractive route to achieve this growth. With Bedding Warehouse’s strong retail operations, the combined company is expected to shift its revenue balance to around 42% from wholesale and 58% from retail channels.

ComfortPlus believes the market will react favorably to this diversification and its stock price will significantly increase postacquisition.

Third, ComfortPlus anticipates significant opportunities for product innovation by collaborating closely with Bedding Warehouse’s experienced sales associates, who interact daily with customers and understand their needs firsthand. This partnership will provide valuable consumer insights that ComfortPlus’s product development team can use to create more tailored and innovative sleep solutions. Key areas of innovation will include addressing common sleep issues, such as developing features to reduce snoring, enhance temperature regulation, and provide optimal support. ComfortPlus also plans to incorporate advanced sleep-tracking technology and introduce new materials and designs to elevate overall comfort, ensuring products meet a wide range of customer preferences for a better night’s sleep.

The acquisition is expected to be accretive to earnings per share in the first year after closing, primarily due to the elimination of duplicative corporate overhead costs from Dreamland’s operations and the increased operational scale of the combined company. The company expects to use the improved earnings to fund investments in Bedding Warehouse’s retail operations and increase dividend payments to shareholders.

Mattresses

A mattress is a layered sleep surface consisting of three main components: a support core of steel coils providing foundational alignment and motion isolation; a comfort layer of foam, fiber, or cotton batting for cushioning and pressure relief; and a quilted top layer of breathable fabrics for comfort and airflow. Consumers consider mattresses essential items. Mattresses are purchased by over 95% of households across all income levels. Most consumers replace them every seven to ten years.

Mattress pricing is distinctive, characterized by high retail margins, frequent promotional pricing, and significant price discrimination between models despite similar production costs. A mattress is a significant purchase for most consumers. Surveys show that many consumers like to comparison shop at two or more stores and are willing to travel up to 20 miles if necessary before making their final selection.

Alternative sleep surfaces such as futons, waterbeds, hammocks, and floor mattresses typically serve as secondary or specialized options rather than primary beds. These products differ from mattresses in key ways: they lack dedicated retail channels and industry trade associations, sell at lower price points (under \$300 versus around \$1,000 for mattresses), have shorter lifespans, and exhibit more elastic demand as they are more discretionary purchases than necessities. These alternatives also lack specialized manufacturing facilities, and production costs are usually significantly lower due to simpler construction and less expensive materials. While some consumers choose alternatives for philosophical or cultural reasons, market data shows no measurable substitution between mattresses and these products for general use due to a relative increase in the price of mattresses.

Industry data indicates mattress demand is relatively price inelastic, with an aggregate short-run demand elasticity averaging -0.2 for all mattress products. This is likely because consumers view mattresses as necessity purchases that significantly impact their quality of life and are infrequent enough that price rarely determines replacement timing. For a 5% price increase, sales in the

short run are expected to decrease by only 1%, but the lost customers do not substitute with alternative bedding products. Instead, they delay their purchase of a mattress. While customers may switch between mattress brands based on relative quality and price, those in the market for a mattress are ultimately committed to purchasing a mattress rather than a non-mattress substitute.

Mattress manufacturing

The mattress manufacturing process is a highly specialized operation designed to ensure durability, comfort, and adherence to rigorous quality standards. It begins with selecting materials based on the mattress's intended firmness, comfort, and longevity. Key raw materials include steel coils, cotton or polyester batting, fabric covers, and adhesives, which are carefully cut and shaped to precise specifications. Facilities dedicated to mattress manufacturing are uniquely tailored to integrate these materials with precision, ensuring that every product meets both regulatory and customer expectations. Unlike simpler production lines for alternative sleep surfaces such as futons or hammocks, these facilities are designed exclusively for mattress production.

The assembly process starts with constructing the support core, where steel coils are arranged as either interconnected units or individually wrapped components to provide foundational alignment and motion isolation. Above this core, the comfort layer—cotton or fiber batting—is added to enhance cushioning and pressure relief. Finally, a quilted top layer of breathable fabrics is attached to improve airflow and overall comfort. Once the core and comfort layers are assembled, the quilted cover is sewn, with additional padding incorporated for extra softness. This cover is securely attached to the mattress, and reinforced edge supports are added to prevent sagging along the perimeter.

All mattresses sold in the United States must comply with strict federal flammability standards designed to reduce the risk of fire-related injuries. These regulations require mattresses to meet specific resistance criteria to open-flame ignition, ensuring consumer safety. Manufacturers must also adhere to labeling guidelines and maintain detailed records to demonstrate compliance, as enforced by the Consumer Product Safety Commission (CPSC).

Recent innovations in innerspring mattress design have further advanced functionality and consumer appeal. Enhanced coil arrangements and advanced breathable covers have significantly improved temperature regulation. Dual-comfort designs allow for different firmness levels on each side of the mattress to accommodate varying preferences. Reinforced perimeter coils now offer better edge stability and an expanded usable surface area. In response to the growing demand for sustainability, manufacturers are incorporating eco-friendly materials, such as organic cotton covers and recycled steel in coil production. These advancements highlight the industry's ongoing commitment to enhancing traditional innerspring technology while maintaining its core benefits.

Mattress manufacturers sell to specialty mattress stores and other mattress retailers rather than directly to consumers. The U.S. mattress manufacturing industry is highly concentrated and dominated by three major players: ComfortPlus Bedding, DreamHaven Industries, and SleepSmart Corporation. Together, these firms account for 75% of all U.S. mattress manufacturing revenue. While the past decade has seen the emergence of innovative startups like SlumberBox and CozyRest, these newer entrants have struggled to gain significant market share.

Despite introducing fresh approaches to mattress design and marketing, these companies each command less than 2% of nationwide sales. See Table 1 for sales and share of national sales. The two largest manufacturers produce and promote several well-known national brands. ComfortPlus Bedding's portfolio includes the ComfortPlus, Restwell, and CloudNest brands, while DreamHaven Industries produces the DreamRest and GentleSlumber brands. These national brands require substantial ongoing investment in advertising and promotion to maintain consumer awareness and preference. Many manufacturers, including ComfortPlus and DreamHaven, also operate as contract manufacturers, producing private-label or in-house brands for retail chains. This dual approach—maintaining national brands while serving as contract manufacturers—allows manufacturers to achieve higher capacity utilization in their production facilities and lower their overall production costs. SleepSmart, SlumberBox, CozyRest, and SnoozeNest are exceptions and produce only their own brands, which they sell exclusively through their own retail stores.

Mattress manufacturers ship nationwide at uniform wholesale prices throughout the United States despite varying transportation costs. Trucking remains the primary mode of transport, although rail transport is a cost-effective alternative for bulk shipments across longer distances, particularly when moving large quantities between major population centers. While some manufacturers may utilize regional distribution centers to streamline delivery further, the ability to ship across state lines has become a standard industry.

ComfortPlus and other mattress manufacturers charge retailers around \$600 per mattress, earning roughly 50% margins, with some variation based on product features and brand strength. ComfortPlus' analysis shows that a 10% price increase to all retailers in a market would reduce its unit sales by 20%, as retailers raise prices to maintain their 40% margins. Similarly, if other manufacturers raised prices by 10%, they each would lose 20% of sales. The analysis also indicates that if a manufacturer increases its price on one product to all but one retailer in a market, at least 60% of lost unit sales would shift to the same product at the lower-priced store as customers engage in comparison shopping (with the remaining 40% would purchase a different mattress at the original store). ComfortPlus defines a store's market as a 20-mile radius around the store, and includes as market participants all mattress stores within a 40-mile radius (so that their draw areas overlap).

Almost all participants in the mattress industry belong to the American Sleep Products Association (ASPA). The ASPA has separate committees for mattress manufacturers, suppliers, and related businesses. Working with its members, the ASPA collects and distributes market intelligence, provides research and educational resources, fosters collaboration and networking within the industry, and organizes events and initiatives that connect businesses and promote innovation. Furthermore, the APSA, directly and with its members, lobbies federal and state governments on behalf of the industry on issues such as flammability standards, environmental regulations, and trade policies. The internet shows that there are also third-party market research reports specifically on mattress manufacturing, although ComfortPlus has yet to provide any copies.

Mattress retailing

In 2023, U.S. retail sales of mattresses to end-user customers totaled \$18 billion. Most sales occur through local brick-and-mortar stores, where customers can “test drive” various brands, models, and firmness levels before making a purchase. This hands-on experience is critical, as

most consumers insist on assessing a mattress in person due to the wide range of comfort levels, materials, and features available.

Mattress retailers purchase their inventory directly from manufacturers at wholesale and maintain ownership until sale, with no consignment arrangements. Over the course of a year, retailers charge an average of \$1000 per mattress and earn an average percentage gross margin of around 40%. However, prices and margins can vary due to differences in mattress features, quality, and brand and store reputation. Prices can be as low as \$700 and as high as \$1300, and margins can be as low as 30% and as high as 50%. Net income as a percentage of revenues is typically around 25% due to high fixed costs such as rent, utilities, inventory carrying costs, and staff salaries, combined with relatively low inventory turnover. A typical mattress retail store sells fewer than ten mattresses per day.

The U.S. mattress retail market includes national and regional chains, specialty stores, and department stores like Baxter and Fulton. While some retailers, such as SleepSmart and SlumberBox, sell exclusively in-house brands, most offer a mix of products from multiple manufacturers. These include major brands like ComfortPlus and DreamHaven, private-label options from contract manufacturers, and additional offerings across a range of price points and customer needs.

Retailers differentiate themselves through product variety, pricing strategies, customer service, and in-store experiences. For example, some prioritize everyday low pricing, while others rely on frequent promotions. Customer service features, such as personalized consultations, trial periods, and no-hassle return policies, build trust and loyalty. Many stores enhance the shopping experience with luxury showrooms or interactive sleep assessment tools. Despite these differences, all mattress products sold at retail, regardless of brand, features, or price, are subject to similar market forces.

All mattress stores, regardless of their business model, carry a range of mattress products that vary significantly in features, quality, and price. Even stores that sell only in-house brands, such as SleepSmart or SlumberBox, offer product lines spanning different features, quality, and price points. The variety within each store ensures that consumers can compare and select mattresses based on their specific preferences. Given the popularity of ComfortPlus brands, essentially all multibrand mattress stores carry the ComfortPlus line of products and consider them essential for a successful mattress store business.

Each store (in coordination with the home office if in a chain) selects the mix of products it will carry and sets the price for each product. Products sell at the prices posted in the store, which can be changed quickly. Mattress stores frequently advertise on television, newspapers, and other media, especially when products are “on sale.”

The largest players in the U.S. mattress market include Bedding Warehouse, MattressDepot, and SleepSmart. Bedding Warehouse leads as the largest specialty retailer, with approximately 35% of national mattress sales revenue across its 2,200 stores, offering a mix of brands and private-label options. MattressDepot holds 20% of the market and distinguishes itself within the furniture retail sector with a selection of in-house and third-party brands. While neither Bedding Warehouse nor MattressDepot operates its own manufacturing facilities, both contract with third-party manufacturers to produce private label products. SleepSmart accounts for about 10% of the mattress market, selling its own manufactured brand exclusively through its 723 retail stores.

Together, these three firms control 65% of mattress sales nationally. See Table 2 for sales and share of national sales.

Most mattresses are sold through brick-and-mortar stores, as consumers traditionally prefer to test mattresses in person. While some retailers offer online sales through their websites, they have achieved only negligible sales in this channel.

Mattress retail stores are strategically located to maximize visibility and accessibility for consumers. They are commonly found in high-traffic suburban retail corridors, often near other furniture stores, home improvement centers, or major shopping malls. Freestanding stores and showrooms are particularly prevalent for larger chains or specialty mattress retailers. Increasingly, mattress retailers are establishing a presence within mixed-use developments and lifestyle centers, capitalizing on the growing trend of combining shopping with residential and entertainment options.

Most large retail chains employ sophisticated methods for selecting store locations. Their planning departments analyze demographics, competition, traffic patterns, and lease terms to identify optimal locations for new stores, ensuring profitability and market reach. Bedding Warehouse, for example, has achieved dominant positions in many local markets identified by its large planning department. For internal purposes, Bedding Warehouse defines its local draw area as 20 miles around each store (the maximum distance a shopper is willing to travel to shop at multiple stores). Of its 2,200 stores nationwide, 675 stores (about 30% of its network) face limited competition:

- 150 BW stores have no mattress retail competitor that competes in the BW store's draw area (i.e., the nearest competitor is at least 40 miles away so that the draw areas do not overlap)
- 225 BW stores have just one competitor that competes in the BW store's draw area
- 300 BW stores have two competitors that compete in the BW store's draw area

Moreover, Bedding Warehouse does not locate stores within 40 miles of each other to avoid intracompany competition. This ensures each location serves a distinct customer base and avoids cannibalizing sales. For every store it operates, Bedding Warehouse seeks at least a 60% market share by revenue in that store's draw area. In each of the last four years, Bedding Warehouse has achieved this goal in over 90% of its stores.

However, some chains have adopted simpler strategies. Dreamland, for example, locates its retail stores primarily by identifying the most successful Bedding Warehouse retail stores in areas with sufficient population to support another retailer. To maintain profitability, Dreamland, like Bedding Warehouse, avoids locating its stores within 40 miles of another company store to prevent intracompany competition. Of Dreamland's 75 stores, 50 are located within a two-mile radius of a Bedding Warehouse store with no other mattress retailers within 40 miles, while 15 are near Bedding Warehouse locations that have one other competitor within that radius. The remaining ten Dreamland stores are in areas where they are the only mattress retailer within 40 miles. This focused strategy of targeting Bedding Warehouse locations has proven successful, and ComfortPlus has authorized and funded Dreamland to open 40 to 50 new stores using the same approach.

Dreamland's preference for entering markets with fewer competitors aligns with observed pricing trends. Market research shows that average mattress prices decrease as the number of competing stores increases, which further incentivizes it to focus on underserved markets where

Bedding Warehouse is the sole existing retailer. See Table 3.

Table 3
Competitors and Prices

	Average Price
Area 1 (1 store)	\$1,144
Area 2 (2 stores)	\$1,052
Area 3 (3 stores)	\$989
Area 4 (4 stores)	\$947

Dreamland also has observed that prices converge in areas where multibrand mattress retail stores compete. This is because consumers typically visit multiple stores to compare options before purchasing, creating pressure for retailers to track and match competitors' prices. In particular, ComfortPlus confirms this has been the case where Dreamland competes with Bedding Warehouse.

The typical multibrand mattress retail store requires substantial space and capital investment. Each store occupies 4,000 to 5,000 square feet of showroom space. Opening a new location involves significant costs, whether purchasing land and constructing a new building or leasing an existing space. Building a new showroom from scratch can cost between \$2,000,000 and \$4,000,000. Leasing and renovating an existing space of the same size can cost between \$800,000 and \$1,800,000 or more (plus ongoing lease expenses ranging from \$12,500 to \$17,500 per month). In addition to the building, these upfront costs include store fixtures and equipment, initial inventory, pre-opening costs like permits and marketing, and working capital to cover operating expenses until profitability. The choice between purchasing land and constructing a new building or leasing an existing space depends on factors like location, market conditions, and the retailer's long-term business strategy. Beyond high startup costs, several operational barriers to entry confront a new multibrand mattress retail store. These include competition from established local retailers, the need to secure agreements with multiple mattress manufacturers, and the challenge of differentiating the store from other brands.

Dreamland is unaware of any competitor planning to enter any of the markets in which it competes with Bedding Warehouse. Moreover, if a new store decided to enter, it would take at least two years to begin operation due to the time required to complete a market assessment, locate suitable retail space, obtain the necessary permits and manufacturer supply agreements, and complete renovations or construction.

Expanding an existing mattress retail store presents its own set of challenges. Physical constraints often limit growth within existing locations. The typical store has limited excess capacity, making it difficult to introduce additional brands or product lines without compromising showroom layout or display quality. Physical expansion of a store's footprint is usually impractical due to building and zoning limitations. Relocating to a larger space, while technically feasible, involves costs similar to opening a new store—including renovation, rebranding, and reestablishing the business in a different market area. Such moves also risk disrupting established customer relationships, as customers may not follow the store to a new location, especially if it is less convenient. This need to balance additional inventory capacity against logistical and financial constraints creates significant barriers to expansion, even for successful retailers. Expansions of an existing store are rare in the retail mattress business, and

Dreamland is unaware of any competitor planning to expand or reposition its product line in any of these markets.

Table 1
U.S. Mattress Manufacturers

Manufacturer	Units	Revenues	Revenue Shares
ComfortPlus	7,200,000	\$4,320,000,000	40.00%
DreamHaven Industries	4,500,000	\$2,700,000,000	25.00%
SleepSmart*	1,800,000	\$1,080,000,000	10.00%
RoyalSleep	900,000	\$540,000,000	5.00%
SoftSpring	900,000	\$540,000,000	5.00%
Sleep Haven	900,000	\$540,000,000	5.00%
SlumberBox*	360,000	\$216,000,000	2.00%
CozyRest*	360,000	\$216,000,000	2.00%
SnoozeNest*	360,000	\$216,000,000	2.00%
Others	720,000	\$432,000,000	4.00%
	18,000,000	\$10,800,000,000	100.00%

* Sold exclusively through the manufacturer's retail stores

Table 2
U.S. Mattress Retailers (All)

Retailer	Type	Stores	Units	Revenues	Revenue Share
Bedding Warehouse	Multibrand	2,200	6,300,000	\$6,300,000,000	35.00%
MattressDepot	Multibrand	1,000	3,600,000	\$3,600,000,000	20.00%
SleepSmart	Exclusive*	723	1,800,000	\$1,800,000,000	10.00%
Mattress Warehouse	Multibrand	281	720,000	\$720,000,000	4.00%
Raymour & Flanigan	Multibrand	136	360,000	\$360,000,000	2.00%
SlumberBox	Exclusive*	130	360,000	\$360,000,000	2.00%
CozyRest	Exclusive*	125	360,000	\$360,000,000	2.00%
SnoozeNest	Exclusive*	120	360,000	\$360,000,000	2.00%
Dreamland	Multibrand	75	135,000	\$135,000,000	0.75%
Others**	Multibrand	1,000	4,005,000	\$4,005,000,000	22.25%
		5,765	18,000,000	\$18,000,000,000	100.00%

* Sells only its vertically integrated manufacturer's brand

** Includes smaller chains, specialized single stores, and department stores

Mattress Merger Case Study
(2024 final exam)

Part I: First-Cut Outline

I wrote this outline with the idea that, after reading the hypothetical twice and thinking about your answer, you would come up with something like it (although much shorter and less detailed) before starting to write. A more detailed feedback outline on the liability issues follows.

FIRST READ: SET UP AND TENTATIVE ANSWERS

0. *Role*: Law firm associate making a preliminary case assessment at the beginning of negotiations
 - a. ComfortPlus: Client, buyer, nation's largest mattress manufacturer
 - i. Dreamland—subsidiary, small mattress retailer
 - b. Bedding Warehouse: Target, largest U.S. mattress retailer
1. Questions to be answered/tentative conclusions
 - a. The likelihood of an FTC investigation--ALMOST CERTAIN
 - i. HSR reportable (\$4 billion cash and stock)
 - ii. Visibility in business press
 - iii. Complaints
 - b. The theories of anticompetitive harm the FTC would likely explore, the defenses the merging parties might raise, and the conclusions the FTC is likely to draw—
 - i. Horizontal in mattress retailing
 - ii. Actual potential competition in mattress retailing
 - iii. Vertical input foreclosure of mattresses to rival mattress retailers
 - iv. Vertical output foreclosure of mattress retailer to rival mattress manufacturers
 - v. Vertical anticompetitive conduits
 - c. The prospects of resolving any investigation, whether without conditions or through a mutually acceptable consent order—LOW
 - i. Horizontal can be fixed with divestiture of Dreamland
 - ii. Actual potential competition—Probably cannot be fixed
 - iii. Vertical problems—FTC unlikely to accept behavioral fix
 - iv. NB: The willingness of the agency to accept a “fix” will depend practically (although not legally) on the consumer welfare benefits likely to result from the transaction. Initial impression—VERY FEW BENEFITS
 - d. The FTC's likely enforcement actions and ComfortPlus' options if precomplaint resolution efforts fail
 - i. FTC will litigate Section 13(b) and administrative complaint
 - ii. Options
 1. Litigate a clean deal
 2. “Litigate the fix”
 3. Terminate the merger agreement

- e. Any steps ComfortPlus could take before or during the investigation to improve its chances of ultimately closing the deal
 - i. Find a buyer for Dreamland to fix horizontal problem (preferably with existing Dreamland management)
 - ii. Incentivize Dreamland buyer/management to continue expansion plans
 - iii. Offer access contracts/consent decree to fix vertical foreclosure problems
 - iv. Offer firewall consent decree to fix anticompetitive information conduit
 - f. The overall likelihood of successfully closing the deal, whether before or after litigation, based on what you know so far—NO MORE THAN 50/50
 - i. Depends on the FTC or court accepting a fix in all three problematic areas
-

SECOND READ

1. What is the likelihood of an FTC investigation? ALMOST CERTAIN
 - a. *HSR reportable*: Transaction value (\$4 billion) well above the \$119.5 million threshold for prima facie reportability in 2024
 - b. *Highly visible*: Will be covered by the business press (with likely antitrust problems probably identified)
 - c. *Complaints*: Retail and manufacturing competitors are likely to complain; state AGs may get involved
2. What are the theories of anticompetitive harm the FTC would likely explore and the conclusions it might draw
 - a. HORIZONTAL—ALMOST CERTAIN FTC WILL FIND SECTION 7 VIOLATIONS¹
 - i. Markets:
 1. Product: Mattresses sold at retail (cluster market)
 2. Geographic: Consumer retail → Local (20-mile radius around stores)
 - ii. Theories of anticompetitive harm²
 1. Store overlaps (75 active Dreamland stores)
 - a. 50 stores: 2 → 1 (unilateral effects)
 - b. 15 stores: 3 → 2 (coordinated and unilateral effects)
 - c. [10 remaining stores: Monopolists—no overlap with BW]NB: Only need to find a violation in a single market—so focus on duopoly and triopoly markets where both Bedding Warehouse and Dreamland compete
 - iii. No defenses
 1. *Dreamland divestitures*: Divestitures of Dreamland facilities in competition with Bedding Warehouse stores to buyers that will not operate them as mattress stores still result in significant increases in the postmerger HHIs, unilateral effect in premerger duopoly markets, and coordinated effects in premerger triopoly markets
 2. *Entry/expansion/repositioning*: Barriers too high in local retail markets

¹ “Almost certain” is a lawyer’s diplomatic way of saying it is a slam dunk for the FTC.

² You could also briefly analyze the elimination of a maverick as a possible theory of anticompetitive harm. But since nothing in the hypothetical suggested that this theory might apply, there was no deduction for failing to address it.

3. *Efficiencies*:
 - a. Cost efficiencies
 - i. Some are fixed cost savings and hence not cognizable
 - ii. More generally, management intends to retain all saving from cost efficiencies for reinvestment and dividends and not pass on any savings to customers
 - b. Innovation efficiencies, if they occur at all, are speculative and hence fail on both the verifiability and sufficiency requirements³
- B. ELIMINATION OF ACTUAL POTENTIAL COMPETITION—ALMOST CERTAIN FTC WILL FIND SECTION 7 VIOLATIONS
 - i. Markets: Same as horizontal
 - ii. Theories of anticompetitive harm:
 1. Elimination of actual potential competition
 - a. Merger will stop the planned entry of new Dreamland stores over the next one, two, and three years in some markets where Bedding Warehouse is present in a monopoly, duopoly, or triopoly local retail market
 - b. NB: Cannot tell which specific markets will be harmed, but the FTC certainly will argue that it does not matter as long as we know that *some* markets will be harmed—and the court is very likely to accept the argument
 2. No evidence of elimination of perceived potential competition
- c. VERTICAL—ALMOST CERTAIN FTC WILL FIND SECTION 7 VIOLATIONS UNDER SOME THEORIES
 - i. Markets:
 - ii. Three theories of anticompetitive harm
 1. Input foreclosure/raising rivals' costs in the sale of mattresses to third-party retailers
 - a. *Relevant market*: Local mattress retailing (as before)
 - b. *Theory of harm*: ComfortPlus increases the wholesale price of ComfortPlus mattresses to third-party retailers
 2. Output foreclosure/raising rivals' costs in selling mattresses at retail from third-party manufacturers
 - a. *Relevant market*: National mattress manufacturing (cluster market)
 - b. *Theory of harm*: Likely complete foreclosure/RRC of rival brands by Bedding Warehouse in local retail monopoly markets where BW is the only competitor (150 stores)
 - c. Possible RRC in other local retail markets where BW competes (implemented through BW increasing prices of third-party brands at BW retail stores)
 3. Anticompetitive information conduits in mattress retailing
 - a. Rival manufacturers routinely share with BW:

³ You could also briefly analyze the countervailing buyer power defense and a failing firm defense. But since nothing in the hypothetical suggested that these defenses might apply, there was no deduction for failing to address them.

- i. Wholesale pricing strategies
 - ii. Product development plans and launch schedules
 - iii. Marketing calendars and promotional strategies
 - iv. Category-specific growth initiatives
- b. Competitive harm: ComfortPlus could use rivals' confidential plans to:
 - i. Undercut their pricing strategies
 - ii. Time ComfortPlus product launches to blunt rivals' new products
 - iii. Front-run competitors' promotional campaigns
 - iv. Advantage ComfortPlus brands (which are already 50% of BW revenue)

NB: The competitive concern is that this use of the CSI will reduce the incentives of 3Ps to aggressively compete

- c. Countervailing factors
 - i. BW's business model depends on rival manufacturers
 - ii. Risk of manufacturer retaliation (especially in shifting product to other retail outlet in more competitive markets)
 - iii. Separate profit center structure
 - iv. Proven track record with Dreamland
 - v. Legal and reputational risks
 - vi. Long-term value preservation

iii. No defenses

1. Contractual commitments are unlikely to be acceptable to the FTC, to counterparties, and ultimately to the court to ensure that the transaction will not result in anticompetitive input or output foreclosure harm
 2. Contractual commitments unlikely to be acceptable to the FTC, to counterparties, and ultimately to the court to ensure that competitively sensitive information disclosed by rival mattress manufacturers will not be used by the merged firm to disadvantage these rivals and ultimately harm competition
 3. Elimination of double marginalization—The proposed management structure makes the elimination of double marginalization unlikely
 4. Ease of entry/expansion/repositioning—Barriers too high in both manufacturing and retail markets
 5. Cost efficiencies—fails for the reasons listed above
3. What are the prospects of successfully resolving any investigation, either without conditions or through a mutually acceptable consent order?—VERY LOW
- a. Could fix horizontal and potential competition problems by divesting the entire Dreamland business (including its management and including an escrow fund to finance the planned expansions in the divestiture assets) to an adequate buyer that would continue to operate the existing stores and was incentivized to open new stores as Dreamland currently plans, but the FTC might not be willing to negotiate a consent decree
 - b. The FTC will not take a behavioral consent decree to resolve the vertical concerns—And with over 90% of BW stores achieving a 60% market share, a divestiture solution involving BW stores is not financially viable

4. If resolution at the investigation stage fails, what enforcement action is the FTC likely to take, and what are ComfortPlus' options?
 - a. FTC enforcement action
 - i. FTC will file a complaint in federal district court seeking a preliminary injunction blocking the deal under Section 13(b) of the FTC Act
 1. If the FTC succeeds in showing a likelihood of success on the merits, the court will find the equities weigh in favor of entering a preliminary injunction
 2. Use boilerplate on weighing of equities
 - ii. FTC also will issue an administrative complaint to adjudicate the merits in an FTC adjudicative proceeding
 - b. ComfortPlus options and the likelihood of success in closing the deal:
 - i. Litigate a clean deal—PARTIES ALMOST SURELY WILL LOSE
 - ii. "Litigate the fix"—DEPENDS
 1. *Horizontal problem*: Divest the Dreamland business to a buyer that will operate the divested stores as competitive retail mattress stores
 - a. Find a buyer with retail mattress experience for the Dreamland business that has the incentive and capability of running Dreamland postmerger with the same competitive force that it had premerger
 - b. Either—
 - i. Convince the FTC postcomplaint to accept the "fix" to resolve the horizontal and potential competition concerns or
 - ii. Litigate the fix for the horizontal and actual potential competition claims
 - c. Likelihood of success:
 - i. Depends on the whether the FTC in the first instance or ultimately the court will accept the divestiture as a solution to the horizontal problem
 2. *Potential competition*
 - a. The problem here is to ensure that the divestiture buyer of Dreamland has the incentive and ability to open new stores postmerger as Dreamland would have done in the absence of the merger
 - b. Solution
 - i. Sell Dreamland to a divestiture buyer that is committed to retaining the existing Dreamland management and to opening 40-50 new stores in the next three years
 - ii. Create an additional incentive and enhance the ability of the divestiture buyer to open the new stores by including in the divestiture assets an escrow fund of \$100 million (the amount already authorized by ComfortPlus) to finance new Dreamland stores. The divestiture buyer can draw down funds from the escrow account to finance the opening of new stores for the first three years after the divestiture closing. At the end

of three years, any funds remaining in the escrow fund to revert to ComfortPlus.

- c. Likelihood of success: Excellent if set up the right way with the right buyer

3. *Vertical problems*

a. Three problems:

- i. Input foreclosure/raising rivals' costs in the sale of mattresses to third-party retailers
- ii. Output foreclosure/raising rivals' costs in selling mattresses at retail from third-party manufacturers
- iii. Anticompetitive information conduits in mattress retailing

To show that the merged firm lacks the ability incentive to engage in each of these anticompetitive behaviors

b. Three types of possible solutions

- i. Convince the court that input foreclosure, output foreclosure, and anticompetitive information conduits are contrary to the profit-maximizing interests of the merged firm and that the merged firm will not pursue any of these anticompetitive actions
- ii. "Fix" the problems through contracts (à la AT&T/Time Warner and Microsoft/Activision)—
 - 1. with third-party retailers to sell them ComfortPlus mattresses at premerger prices (to solve input foreclosure concerns)
 - 2. with third-party manufacturers to carry their brands at BW retail stores (to solve output foreclosure concerns)--, and
 - 3. with third-party manufacturers not to disclose confidential competitive information they provide to BW retail stores to ComfortPlus manufacturing operations (to solve anticompetitive information conduit concerns)
- iii. Divest BW stores in postmerger, monopoly, duopoly, and other sufficiently concentrated local retail markets to eliminate any vertical relationship between ComfortPlus and Bedding Warehouse that could result in anticompetitive input or output foreclosure (à la the DOJ's demands in AT&T/Time Warner)

5. What steps, if any, could ComfortPlus take before or during the investigation to improve its chances of ultimately closing the deal?
 - a. To solve the horizontal concern:
 - i. Find a strong divestiture buyer for the entire Dreamland subsidiary and sign a divestiture agreement contingent on the closing of the main deal. This should solve the horizontal retail problem.⁴
 - b. To solve the actual potential competition concern
 - i. Include in the divestiture assets an escrow fund of \$100 million (the amount already authorized by ComfortPlus) to incentivize and finance new Dreamland stores. At the end of three years from the date of the divestiture sale, any funds remaining in the escrow fund to revert to ComfortPlus. This should solve the actual potential competition problem.
 - ii. To solve the vertical concerns
 1. Solution 1 (not in the profit-maximizing interest of the merged firm to act anticompetitively): Should be extensively explored with the client in the first instance and with the client talking to customers to learn their reactions⁵
 2. Solution 2 (contracts): Should be extensively explored with the client, and model contract forms drafted and vetted with the client; once the forms are in good shape, they should be tested with third-party manufacturers and retailers, and necessary revisions made, and if acceptable to the client, offered to counterparties
 3. Solution 3 (divestiture of BW stores): Should also be explored with the client. If the client is willing (if necessary) to divest BW stores, the next step is to determine which stores would need to be divested to eliminate the input and output foreclosure concerns. Also, if BW stores are being divested, the merged firm may want (and be able) to keep some of the Dreamland stores it would otherwise divest. If the ultimate divestiture list is acceptable to the client (i.e., does not destroy the value

⁴ Some students concluded that the ComfortPlus should divest a large number of Bedding Warehouse stores. All that is necessary to solve the horizontal and actual potential competition problems in the retail market is the divestiture of Dreamland—which ComfortPlus largely was going to do anyway—but to a buyer that would operate them as mattress retail stores with the same competitive force as ComfortPlus did premerger. That should not be too difficult, since Dreamland largely operates as a standalone business unit and the divestiture could (and should) include its existing management. A divestiture solution to the vertical foreclosure problems would have to involve Bedding Warehouse stores, but a behavioral solution would preserve much more of the deal for ComfortPlus. Although the FTC would not accept a behavioral commitment, ComfortPlus could “litigate the fix” by offering 5-year contracts to mattress retailers and manufacturers to solve the input and output foreclosure problems and committing to the court that these contracts would be available even to firms that did not accept them prior to the PI hearing. We have seen courts accept these solutions over the opposition of the FTC.

⁵ Although I would not hold out a great deal of hope that this solution will work given the strong apparent vertical incentives to act anticompetitively, I would not prejudge this conclusion and tell it to the client. If the client says it will not have an incentive to act anticompetitively, then work with the client and the economists to develop the argument and the evidence and see how far you can take it.

of the deal), then a divestiture offer could be made if Solution 2 (contracts) fails⁶

6. What is the likelihood of ultimate success in closing the deal before or after litigation?
- a. Before litigation—CLOSE TO ZERO. Even if the FTC was willing—and it may not be—to accept a Dreamland divestiture to resolve the agency’s horizontal and potential competition concerns, it will not accept a consent decree to resolve the vertical concerns
 - b. In litigation—50/50 at best.
 - i. Horizontal and potential competition divestiture fix:
 1. Depends on finding a divestiture buyer and a divestiture arrangement that satisfies the court that the acquisition of Bedding Warehouse with the fix in place will not lead to a substantial lessening of competition in any local retail market
 2. Should be able to find a suitable divestiture
 - ii. Vertical fix
 1. Solution 1 is unlikely to work because, as noted above, the incentive to act anticompetitively is sufficiently apparent, and the court will not accept the word of the merged firm that it will not behave anticompetitively
 2. Solution 2 will work only if most counterparties are willing to accept the contracts as sufficient to assuage their concerns and the court agrees
 3. Solution 3 will work only if the number of stores that will have to be divested to eliminate the vertical input and output foreclosure incentives are not so large that their divestiture would make the deal unprofitable.
 - iii. *One final thought:* The Dreamland divestiture and vertical contract 'fixes' carry some risk of failing to eliminate the probable anticompetitive harm posed by this transaction. Historically, courts have been willing to accept such risks only when the transaction is shown to deliver significant, highly probable, and transaction-specific consumer benefits—benefits that would not reasonably occur absent the transaction. Here, as the analysis shows, the ComfortPlus/Bedding Warehouse transaction does not appear to generate any material consumer benefits. Without significant consumer benefits, the court is likely to reject these 'fixes' as inadequate to address the Section 7 concerns. Consequently, if ComfortPlus wishes to proceed with the transaction, it should carefully consider how, if at all, the deal could create meaningful consumer benefits.

⁶ I suspect that the ComfortPlus would not be willing to divest enough BW stores to eliminate the concerns of the FTC in the first instance, or ultimately the court, but the client should be informed of the option and the option investigated if the client agrees.

Mattress Merger

Part II: Feedback Outline—Reportability and Liability Issues⁷

Note: As we discussed in class, my exams are written so that it would be difficult to spot and analyze in detail every issue the hypothetical presents. Every exam answer is likely to miss or misanalyze multiple issues.

Questions: Work product—Calls for a reasoned memorandum of law

1. What is the likelihood of an FTC investigation?
2. What are the theories of anticompetitive harm the FTC would likely explore, the defenses the merging parties might raise, and the conclusions the FTC is likely to draw?
3. What are the prospects of successfully resolving any investigation, either without conditions or through a mutually acceptable consent order?
4. If resolution attempts fail, what enforcement action is the FTC likely to take, and what are ComfortPlus' options?
5. What steps, if any, could ComfortPlus take before or during the investigation to improve its chances of ultimately closing the deal?
6. What is the likelihood of ultimate success in closing the deal before or after litigation?

Summary of conclusions: I cannot stress enough the value of writing a summary of your conclusions in the introduction to the memorandum. I do not require a summary for grading purposes, although it is helpful to me to understand where you are going before the detailed analysis begins. However, I submit that failing to write a summary that explicitly lists your conclusions on the major issues is a serious tactical mistake in writing an exam that requires an answer in the form of a reasoned memorandum of law. As a general rule, students who did not include a summary of their conclusions tended to wander in their analysis, missed issues, and often did not make clear their conclusions. Students who wrote a good summary of their conclusions generally wrote clearer, better organized, more concise, and more complete memos and received higher grades. You had five hours for this exam, and spending 45-60 minutes to understand the problem, outline your analysis, and make your conclusions explicit before you start writing can pay enormous dividends.

The FTC investigation—ALMOST CERTAIN

1. **HSR reportability**
 - a. With a \$4 billion purchase price, the transaction is HSR reportable⁸
2. **Visibility**
 - a. A \$4 billion transaction involving the largest mattress manufacturer and the largest mattress retailer will be widely reported in the business press and will not escape the FTC's attention

⁷ See Part I: First-Cut Outline for Issues 3-6.

⁸ Some students used boilerplate with dated HSR thresholds. Be sure you update your HSR boilerplate to give the current applicable thresholds.

- b. A review of the websites of the two companies and other information on the Internet should reveal probable horizontal and vertical issues and perhaps also potential competition issues (depending on what Dreamland has said publicly about its plans to open new stores in the next three years)

3. Complaints

- a. Mattress manufacturers who may be foreclosed from Bedding Warehouse showrooms
- b. Mattress retailers who may be foreclosed from ComfortPlus products
- c. Mattress manufacturers who may be foreclosed from manufacturing Bedding Warehouse's private labels
- d. State AGs in the Mid-Atlantic who may be concerned about the prospect of higher prices in their jurisdictions for mattress consumers and who may want to join the investigation

4. Conclusion: An FTC investigation (including a second request) is almost inevitable⁹

RETAIL HORIZONTAL ANTICOMPETITIVE EFFECTS¹⁰

1. Relevant product market—Sale of mattresses at retail stores¹¹

- a. *Cluster market*: The sale of mattresses at retail is a cluster market.
 - i. Shoppers like to “test drive” a variety of mattresses with different firm levels, features, quality, and price points before making a purchase
 - ii. Most mattress stores carry a variety of mattress products to meet this consumer demand (although there are some stores dedicated exclusively to a single brand)
 - iii. All products in the store are subject to similar market forces (i.e., no need for a Staples/Office Depot carve-out of any product type)
- b. *Brown Shoe* factors
 - i. *Low cross-elasticity with other products*
 - 1. The aggregate elasticity for mattresses by consumers is -0.2—very inelastic

⁹ It is not sufficient to observe, as some students did, that the transaction was HSR reportable. Almost 2000 transactions are reported every year under the HSR Act to the FTC and DOJ. A complete analysis of the inquiry risk requires an examination of other sources of information about the parties and the transaction the reviewing agency is likely to see, the likelihood of complaints by stakeholders (here, third-party mattress manufacturers and retailers), and the possible interest of state AGs in the transaction.

¹⁰ It is important to analyze each applicable major theory of anticompetitive harm (in this hypothetical, horizontal, potential competition, and vertical) separately and at the specific level in the chain of manufacture and distribution where the theory applies. That is why I have titled each of the liability sections with the theory of anticompetitive harm being tested. Moreover, each section starts with market definition since the relevant market where the likely anticompetitive effect is predicted to occur can differ depending on the theory of harm. Some students instead started with an overarching market definition analysis before addressing specific anticompetitive effects. This approach not only makes the memorandum harder to follow but also blurs the focus of the analysis, leading to confusion about what exactly is being evaluated.

¹¹ An all too common problem was the failure to identify explicitly the level at which market definition was being determined. There are two separate product markets here: retail (sales to consumers) and manufacturing (sales to retail stores). Consequently, throughout the memorandum it is essential to make clear what product market you are addressing. To state the obvious, if you conclude that the merger is likely to result in an increase in retail mattress prices, you need to have defined and tested a relevant market at the retail level. Conversely, you need to define and test a relevant market at the manufacturing level if you conclude that the merger will cause an anticompetitive effect at that level.

2. A low aggregate elasticity of demand implies that the cross-elasticities with other products are also very low
 - ii. *Industry or public recognition*: The sale of mattresses at retail is recognized as a separate economic product grouping by—
 1. The industry trade association—The American Sleep Products Association (ASPA)—has a separate committee for mattress firms
 2. Third-party market research reports recognize mattress retailing as a distinct segment
 - iii. *Product's peculiar characteristics and uses*
 1. Mattress, although somewhat differentiated, are broadly homogeneous
 2. Use as the ubiquitous residential sleeping platform
 3. The popularity of major mattress brands like ComfortPlus, Restwell, and DreamRest and the emphasis on brand awareness indicate that consumers recognize and evaluate mattresses as a distinct category of purchase
 - iv. Price and margins (at the retail level):
 1. Retail mattress pricing is relatively standardized across the industry, with price averaging \$1000 per mattress and gross margins averaging around 40%.
 2. Alternative sleep surfaces, such as futons, waterbeds, and hammocks, are not considered substitutes due to their shorter lifespans, lower price points, and discretionary nature
 - v. *Unique production facilities/specialized vendors*
 1. Mattresses are primarily sold through specialized retail stores
 2. Although department stores sell other products, they have a distinct section of the store devoted to mattresses
 3. These stores cater to consumer desires to try mattresses in person due to the range of comfort levels, materials, and features available
 4. Mattress retailers offer personalized consultations, trial periods, and no-hassle return policies, emphasizing the distinct treatment of mattresses as a standalone product
 - vi. *Distinct customers*
 1. End-users seeking to purchase a residential sleeping platform
 2. High willingness to comparison shop, often traveling up to 20 miles to evaluate products at multiple stores
- c. HMT^{12,13}
- i. Critical loss
 1. We can treat each firm in a cluster market as offering a composite product. If these composite products are not significantly differentiated (i.e., prices and margins are close to the mean), we can treat them

¹² I cannot emphasize enough that if your intuitions say a product group is a relevant product market and your HMT is giving you a different answer, *check to make sure you are using the correct formula and are applying it properly*. Although less common, the same principle applies if your *Brown Shoe* analysis is giving you a different answer. Chances are your intuitions are correct.

¹³ In the implementations of the HMT that follow, I used a 5% SSNIP. Many students used a 10% SSNIP. That is fine—and probably even better since satisfying the profitability test at 10% implies that the profit-maximization test is satisfied at 5% (given our assumption of linear demand curves).

roughly as a homogeneous product and apply a critical loss test to assess whether the HMT is satisfied.¹⁴

2. *Critical elasticity*:¹⁵ Here, the aggregate short-run demand elasticity averaged -0.2 for all mattress products. We also know the average price for a mattress is \$1000 and the average margin at retail is 40%. With this data, we can apply a critical elasticity test for a 5% SSNIP:

$$|\epsilon_{cl}| \cong \frac{1}{\delta + m} = \frac{1}{0.05 + 0.40} = 2.22$$

Actual average demand elasticity (in absolute value) is 0.2.

Since actual demand elasticity is several orders of magnitude less than the critical demand elasticity, the test strongly supports the conclusion that all mattresses satisfy the hypothetical monopoly test.¹⁶

ii. One-product SSNIP recapture test

1. We can also apply a one-product SSNIP recapture test for a 5% SSNIP, an average price of \$1000, and an average margin of 40% (the symmetric case):¹⁷

$$R_{Critical}^S = \frac{\delta}{m} = \frac{0.05}{0.40} = 12.5\%.$$

The actual recapture rate is 100% (“While customers may switch between mattress brands based on relative quality and price, those in the market for a mattress are ultimately committed to purchasing a mattress rather than a non-mattress substitute.”)

Since the actual recapture rate is greater than the critical recapture rate, the HMT is satisfied.

¹⁴ This type of treatment is explicitly permitted by the exam instructions.

¹⁵ This is the best and easiest way to perform the HMT for a retail mattress product market.

¹⁶ Some students used the Lerner condition $\epsilon = 1/m$ to calculate the residual elasticity of a retail store to be 2.5 (= 1/0.4) and concluded that the critical elasticity test was not satisfied. But this approach erroneously compared the critical elasticity of aggregate demand to the actual residual demand of a store. The test requires that the critical elasticity of *aggregate* demand (here, 2.22) be compared to the actual elasticity of *aggregate* demand (here, 0.2).

¹⁷ This is not quite technically correct. The margin of 40% works only in the case where the average retail price is \$1000. But Table 3 indicates that the average retail price can differ depending on how many competitors are in the candidate market. These differences create different retail margins since the cost of the inputs remain constant. I did not catch this when I wrote the exam or, for that matter, when I first performed the HMT using a recapture test. I gave full credit if you used 40% as the margin for this formula.

BTW, although the critical recapture rates will differ depending on number of competitors in the market, the differences will not change the result of the HMT: As long as the percentage gross margin is larger than the percentage SSNIP (which it will be), the actual recapture rate of 100% will be greater than the properly-calculated critical recapture rate.

- iii. *One-product SSNIP sufficiency test*: Even more technically, we could use a one-product SSNIP sufficiency test:

$$R_{Sufficient}^1 = \frac{\delta p_1}{\$m_{Min}} \left(= \frac{\$SSNIP_1}{\$m_{Min}} \right),$$

where $\$m_{Min}$ is the smallest dollar margin of all products in the market. The largest sufficient R (and therefore the most conservative test) would use the highest possible $\$SSNIP$ in the numerator and the lowest possible dollar margin in the denominator.

The highest $\$SSNIP$ can be no larger than 5% of the highest price (\$1300) or \$65.

The lowest dollar margin can be no smaller than the lowest possible price (\$700) at the lowest possible percentage margin (30%), or \$210.

$$R_{Sufficient}^1 = \frac{\delta p_1}{\$m_{Min}} = \frac{65}{210} = 30.05\%.$$

Since the recapture rate for all products is 100%, the HMT is satisfied.

- iv. *Brute force calculations*: You could also perform a brute force calculation instead of using any of these formulas.

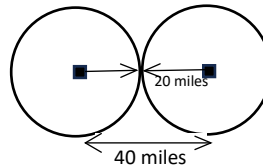
2. The relevant geographic market—Local overlap areas with stores within 40 miles of each Dreamland store¹⁸

a. Judicial factors

- i. Consumers travel up to 20 miles to shop at multiple stores → So stores separated by more than 40 miles do not compete with one another (i.e., have no customer overlaps)

¹⁸ Some students concluded that the geographic market for retail sales was national. Perhaps they were misled by the inclusion of Table 2, which allowed them to calculate HHI in a national retail market. However, the hypothetical was explicit that consumers would travel only up to 20 miles to comparison shop. Moreover, Table 3 shows that retail prices were not uniform throughout the country and that retail stores set their prices depending on local market conditions. Although both merging companies sold nationwide, the sales areas of the parties are not necessarily the same as the relevant geographic market. When end-user consumers travel to the retail store, the relevant geographic markets will be local—typically the union of the draw areas of the competing stores. See *United States v. Philadelphia National Bank*, 374 U.S. 321, 357-58 (1963) (“The proper question to be asked in this case is not where the parties to the merger do business or even where they compete, but where, within the area of competitive overlap, the effect of the merger on competition will be direct and immediate. . . . The factor of inconvenience localizes banking competition as effectively as high transportation costs in other industries. The factor of inconvenience localizes banking competition as effectively as high transportation costs in other industries, the four-county area in which appellees’ offices are located would seem to be the relevant geographical market.”) (internal quotation marks and citations omitted).

BTW, as some students found, a merger assessed in a national retail market probably will not trigger the *PNB* presumption in court (delta of 52.5 and a postmerger HHI of around 1758 (if you assume that each of the “other” retail stores have close to a zero share in the national market) or around 2252 (if you—incorrectly—square the 22.25% of the “other” as if it was one firm). The merger does not even violate the new 30% threshold in the 2023 Merger Guidelines. Although the combined share of the merging firms in a national retail market is 35.75%, the 2023 Guidelines also require that the delta be greater than 100, which it is not in this merger.



This allows us to define the relevant geographic markets as a 40-mile radius around each store that has only zero, one, or two competitors within the 40-mile radius (i.e., the monopoly, duopoly, and triopoly markets).¹⁹

- b. HMT
 - i. The same HMTs work here as they did with product markets since there is 100% recapture by stores within 40 miles of each other²⁰
- c. Notes
 - i. Since this is a horizontal analysis, we can limit the relevant geographic areas to within 40 miles of each Dreamland store.
 - ii. Overstates the relevant geographic markets if we use 75% draw areas (as in Sysco/US Foods), so this is a conservative approach to geographic market definition

3. PNB presumption^{21,22}

- a. Participants: All stores within 40 miles of a Dreamland store
 - i. Focus on Dreamland stores within two miles of a Bedding Warehouse store with limited other competitors in the draw area

¹⁹ Some students concluded that the local retail markets were defined by a radius of 20 miles around each store. This is not quite right since two mattress stores 30 miles apart would still compete with one another in the considerable overlap of their draw areas. Still, since these students recognized the local nature of the retail markets, I gave them full credit on the geographic market issue.

²⁰ Note that this would not be true if the local geographic markets were defined by 20-mile radii.

²¹ As noted in footnote 18, some students made two mistakes in calculating HHIs. First, they used the revenue shares in Table 2 as market shares, which assumed a national retail market. When consumers travel to the retail stores, retail markets are local and the national numbers are irrelevant in the HHI analysis.

Second, when calculating HHIs, a common mistake was to assume that the “others” in the table was a single firm and so calculated the contribution of “others” to the HHI as the square of the “others” market (that is, 22.25% squared for a contribution of 495, which would make “others” the second largest firm in the table). “Others” in market share tables aggregate the shares of multiple firms that are too small to be listed individually in the table. The conventional way of calculating the market share contribution of “others” to the HHI is to assume that no firm in the category is larger than the smallest firm individually identified in the table. Here, the smallest firm was Dreamland, with a revenue share of 0.75%. Accordingly, the largest firm in “others” should have a revenue share of no greater than 0.75%. Dividing the “others” share of 22.25% by 0.75% gives an lower bound to the number of “other” firms of about 30. The actual number is probably much greater. To be conservative, however, you can calculate the maximum market share of each “other” firm dividing the “other” aggregate share number by the minimum number of firms. Here, dividing 22.25% by 30 gives a maximum share for an “other” firm of 0.74%. The contribution of the “other” firms to the HHI is then (0.74%)² times 30, or about 22. In many situations (including here), the contribution of the “other” firm to the HHI will be so small that it can be ignored.

²² While I strongly encourage you to develop a spreadsheet template to calculate the HHIs, it is imperative that (a) you check the template to make sure that it works before the exam, and (b) that you look over the results you obtain during the exam to make sure that they make sense. If, for example, you obtain a total market share in excess of 100% or an HHI in excess of 10,000, you know something has gone seriously wrong.

- ii. Since the Dreamland and Bedding Warehouse stores are only two miles apart, their respective draw areas are essentially the same
 - iii. No Dreamland store is within 40 miles of another Dreamland store—same is true for Bedding Warehouse stores
- b. *PNB* presumption—Triggered in 65 of the 75 markets in which Dreamland operate
- i. HHI's are minimized when the shares of the merging firms are most closely together
 - ii. *Duopoly markets*: 50 of Dreamland's 75 stores are located within a two-mile radius of a Bedding Warehouse store, with no third-party mattress store within 40 miles
 - 1. This is a merger-to-monopoly in the 50 local markets centered on the Dreamland store²³
 - 2. HHI:
 - a. The smallest premerger HHI will be when the firms in the market have market share close to one another. Therefore, to be conservative on the premerger HHI, I assumed that Bedding Warehouse had a 60% share (the minimum share 90% of BW stores have) and Dreamland had the remaining share.
 - b. Calculation:

Merger to monopoly (50 local markets)		
	Share	Min HHI
Bedding Warehouse	60.00%	3600
Dreamland	40.00%	1600
	100.00%	5200

Combined share	100.00%
Premarmerger HHI	5200
Delta	4800
Postmerger HHI	10000

- 3. Triggers the *PNB* presumption under judicial precedent and Merger Guidelines
- iii. *3-to-2 markets*: 15 of Dreamland's 75 stores are located within a two-mile radius of a Bedding Warehouse store, with only one third-party mattress store within 40 miles
- 1. This is a 3-to-2 merger in 15 local markets centered on the Dreamland store
 - 2. HHI:
 - a. Again, to minimize the premerger HHI, I assumed that Bedding Warehouse had a 60% share and the remaining 40% was split equally between the two other firms in the market²⁴

²³ As a merger to monopoly, the transaction also violates Section 2 of the Sherman Act in these markets.

²⁴ Note, however, that this allocation of the remaining market share does not necessary give the smallest delta. The delta would become smaller as the third-party competitor takes more of the remaining 40%. But even if

3-to-2 merger (15 stores)

	Min Share	Min HHI
Bedding Warehouse	60.00%	3600
Dreamland	20.00%	400
3P competitor	20.00%	400
	100.00%	4400

Combined share	80.00%
Premerger HHI	4400
Delta	2400
Postmerger HHI	6800

3. Triggers the *PNB* presumption under judicial precedent and Merger Guidelines

c. *Conclusion*: The acquisition by ComfortPlus of Bedding Warehouse triggers the *PNB* presumption in 65 of the 75 local markets in which Dreamland operates. Support with—

- i. Merger Guidelines and
- ii. Judicial precedent

Should have boilerplate for this

4. Explicit theories of anticompetitive harm

a. Unilateral effects—In the 65 overlap markets

- i. Merger-to-monopoly in 50 markets (a special case of unilateral effects)
 - 1. Indicating an 8.7% increase in average price (from \$1052 to \$1144) (Table 3)
- ii. No unilateral effects in the 15 “3-to-2” markets
 - 1. Postmerger, the merged firm will keep the Bedding Warehouse store and sell the Dreamland store to a third party that will not use it as a retail mattress store. Consequently, any anticompetitive effects will come from coordinated effects.

b. Coordinated effects—In the 15 “3-to-2” relevant markets

- i. Rule
 - 1. Market must be susceptible to coordinated effects premerger
 - 2. The merger must likely increase the probability, effectiveness, or stability of coordinated effects
- ii. Premerger susceptibility
 - 1. Only 3 mattress firms in each relevant market
 - 2. Retail prices are posted and hence transparent
 - 3. Promotions are advertised and hence transparent
 - 4. Competitors track and match prices
 - 5. Retail prices can be changed quickly to respond to any price-cutting by a competitor
 - 6. Individual retail sale transactions are small and frequent in number (i.e., no large, infrequent transactions that can encourage “cheating” on the tacit coordination)

we assume that the third-party competitor has a 35% share and Dreamland a 5% share, the postmerger HHI is 5450 with a delta of 600.

7. High barriers to entry eliminate external interference (see discussion in defenses)
 - iii. Postmerger effectiveness: Eliminates one of a few number of premerger firms—
 1. 3-to-2 merger in 15 markets
 2. Indicating a 6.4% increase in average price (from \$940 to \$1000) (Table 3)
 - iv. *Conclusion*: Strong coordinated effects theory in 15 of the 75 local markets in which Dreamland operates
 - c. Elimination of a maverick²⁵
 - i. There is no evidence that either Bedding Warehouse or Dreamland operates as maverick to disrupt coordinated interaction²⁶
5. Defenses
- a. Zero HHI—Reject as a defense
 - i. ComfortPlus intends to divest “Dreamland’s headquarters facility and warehouses, as well as retail locations that compete with Bedding Warehouse . . . *to buyers not engaged in the mattress business*” (emphasis added)
 - ii. As planned, the effect of these divestitures will be to turn premerger duopoly markets into monopolies and premerger triopolies into duopolies, resulting in price increases indicated by Table 3
 - iii. The FTC, and almost surely the courts, will regard these anticompetitive effects, which will substantially lessen competition in these markets within the meaning of Section 7, to be the proximate result of the merger and hence actionable²⁷
 - b. Entry/expansion/repositioning—Reject as a defense
 - i. Competition requires a physical retail store presence
 - ii. New entry is unlikely in any of the 65 markets in which Dreamland and Bedding Warehouse compete due to barriers to entry
 1. *Initial showroom space requirements* demand 4,000-5,000 square feet, representing a meaningful real estate commitment

²⁵ Unnecessary to address in the memorandum since no facts suggested this would be a defense advanced by the merging parties.

²⁶ Some students characterized Dreamland as a “maverick” because when one of its stores enters a new market, the retail prices of the incumbent mattress stores decrease. This is not a correct characterization. “Mavericks” are incumbent firms with idiosyncratic business models that disrupt tacit coordination among the other incumbent firms. The elimination of a future entrant is analyzed under the actual potential competition doctrine. However, I can see the reasoning here, and I credited exams characterizing future Dreamland entrants as “mavericks” with spotting the elimination of actual potential competition as a theory of anticompetitive harm applicable to the ComfortPlus/Bedding Warehouse merger.

²⁷ Some students used the *2ab* shortcut to calculate the delta, reasoned that the right market share to use for Dreamland was zero since all competing Dreamland stores would be divested, calculated that the delta was zero, and concluded that the deal did not violate the Merger Guidelines thresholds and hence did not pose a horizontal antitrust problem. The *2ab* shortcut, however, looks to the shares of the firms premerger in the ordinary course of business. That gives Dreamland a positive share and the merger a positive delta.

But leaving the *2ab* formula aside, it should be obvious that when some stores exit the market as they would here, the premerger and postmerger HHIs will differ and that the delta will be positive. The situation is most obvious in the premerger duopoly markets where the only competing firms are Bedding Warehouse and Dreamland. In calculating the HHIs for a duopoly earlier, we saw that the premerger HHI was 5200, the postmerger HHI w 10,000, so that the delta was 4800.

2. *New construction costs* range from \$2-4 million for a new building, while leasing and renovation expenses on an existing building can run \$800,000-\$1.8 million plus monthly lease payments of \$12,500-\$17,500
 3. *Substantial upfront capital* needed for store fixtures, equipment, initial inventory, permits, marketing, and working capital until reaching profitability
 4. The new retail entrant must *secure multiple manufacturer agreements*, complicated by any exclusive arrangements with incumbent firms and any manufacturer's minimum order requirements
 5. The new entrant must confront *competition from established retailers*, which benefit from existing brand recognition, loyal customer bases, and economies of scale
 6. *Timing constraints*: "Dreamland is unaware of any competitor planning to enter any of the markets in which it competes with Bedding Warehouse. Moreover, if a new store decided to enter, it would *take at least two years* to begin operation due to the time required to complete a market assessment, locate suitable retail space, obtain the necessary permits and manufacturer supply agreements, and complete renovations or construction." (p. 13)
- iii. Expansion or repositioning is unlikely in any of the 15 retail overlap markets in which there is a third competitor due to barriers:
1. Physical space limitations within existing stores prevent adding new brands/products without compromising display quality and store layout
 2. Building and zoning restrictions typically make it impractical to expand existing store footprints
 3. Relocation to larger spaces incurs costs comparable to new store openings, including renovation, rebranding, and market reestablishment expenses
 4. Customer relationships may be disrupted when stores relocate, as consumers may not follow to less convenient locations
 5. Need to balance inventory expansion against logistical/financial constraints creates operational challenges for retailers
 6. "Expansions of an existing store are rare in the retail mattress business, and Dreamland is unaware of any competitor planning to expand or reposition its product line in any of these markets." (p. 13)
- c. Countervailing power buyers—No facts to support²⁸
- i. Mattress retailers charge rack prices to all customers for all products
 - ii. All customers are small, with presumably no buyer power
- d. Efficiencies—No facts to support any cognizable efficiencies
- i. Rule
 1. Merger specificity
 2. Verifiability
 3. Sufficiency (counts only benefits passed on to customers)

²⁸ Unnecessary to address in the memorandum since no facts suggested this would be a defense advanced by the merging parties.

4. Not anticompetitive
- ii. The acquisition is essentially a “trade-up” deal to replace a smaller retail operation with a much larger one. ComfortPlus has identified three synergies from the transaction, none of which constitutes a cognizable efficiency—
 1. Increased customer reach
 - a. *Not merger specific*:
 - i. Could be achieved by opening new stores
 - ii. ComfortPlus has already allocated \$100 million to expand Dreamland by opening 40-50 new stores in the next three years. Eight sites have already been identified, demonstrating that ComfortPlus has the means to achieve increased customer reach independently of the merger.
 - b. *Not sufficient*: What are the specific benefits to consumers that would result from the merger that customers would not obtain if the absence of the merger?
 - c. *Not verifiable*: If there are any efficiencies resulting from increased customer reach, they lack specificity and hence are speculative and not verifiable
 2. Cost savings and improved operation benefits
 - a. *Not sufficient*
 - i. The only identified cost savings come from the elimination of Dreamland facilities and personnel—these are not marginal cost savings and hence not cognizable efficiencies
 - ii. Finally, ComfortPlus intends for any benefits from the deal to go to shareholders, not consumers:
“The company expects to use the improved earnings to fund investments in Bedding Warehouse’s retail operations and increase dividend payments to shareholders.” (p. 8)
 - b. *Result from an anticompetitive aspect of the transaction*
 - i. Perhaps more importantly, these cost reductions result from an anticompetitive aspect of the transaction
 3. Product innovation
 - a. *Not merger specific*:
 - i. ComfortPlus argues that the acquisition will enable closer collaboration between its product development team and Bedding Warehouse’s sales associates to create innovative products
 - ii. But ComfortPlus already maintains relationships with multiple retailers, including Bedding Warehouse, and could engage in joint product development initiatives or gather consumer insights without acquiring the retailer. This suggests that the innovation efficiencies are not merger-specific

- b. Not verifiable:
 - i. ComfortPlus's proposed innovations (e.g., sleep-tracking technology, dual-comfort designs, advanced materials) are uncertain as to if and when they will occur and as to the consumer benefits associated with such innovations if they do occur
 - ii. Hence, they are speculative and not verifiable
- c. Not sufficient:
 - i. There facts indicating the magnitude of the consumer benefits if the merger were to produce any cognizable efficiencies in product innovation would be sufficient to offset the diminution in consumer welfare due to higher prices and the other likely anticompetitive effects resulting from the acquisition
 - ii. Even if innovations are introduced resulting from the merger, some or all of them may be limited to high-end product lines, restricting access to a subset of consumers
- e. Failing company—No facts to support²⁹
 - i. *Rule:* The allegedly failing firm—
 - 1. would be unable to meet its financial obligations in the near future
 - 2. would not be able to reorganize successfully under Chapter 11 of the Bankruptcy Act, and
 - 3. has made unsuccessful good-faith efforts to elicit reasonable alternative offers that would keep its tangible and intangible assets in the relevant market and pose a less severe danger to competition than the proposed merger
 - ii. *Failing:* No facts indicate that any company or division involved in the acquisition is failing
 - iii. *Chapter 11:* No facts indicate that any company needs reorganization
 - iv. *Alternative buyers:* No shopping was done for alternative, less anticompetitive buyers
 - 1. "Bedding Warehousing was not on the market, but the \$4 billion offer price was too attractive not to pursue." (p.1)
- f. *Conclusion:* There are no defenses the merging parties could credibly raise to negate the likely anticompetitive horizontal retail effects of the acquisition in the relevant retail markets.

6. **Bottom line:** On the facts as we know them so far, the FTC will investigate and challenge the transaction the elimination of horizontal competition in 65 local retail mattress markets

²⁹ Unnecessary to address in the memorandum since no facts suggested this would be a defense advanced by the merging parties.

ELIMINATION OF ACTUAL POTENTIAL COMPETITION³⁰

1. Requirements

- a. *Relevant market*: The relevant market in which the putative entry is likely to occur
- b. *Noncompetitiveness*: The relevant market is operating noncompetitively
- c. *Uniqueness*: The actual potential entrant is relatively unique in its ability to enter the relevant market or would enter the market substantially before any other firm
- d. *Ability*: The actual potential entrant must have an “available, feasible means” of procompetitive entry
- e. *Incentive/likelihood of entry*: In the absence of the acquisition, the actual potential entrant would likely enter the relevant market “in the near future”
- f. *Procompetitive effect*: If the actual potential entrant entered the market, it would enter at a scale that would materially improve the competitive performance of the market

2. Relevant markets

- a. Market definition
 - i. Local mattress retail markets defined around retail stores as described in the horizontal analysis section
- b. Application: Focus on—
 - ii. *Monopoly markets*: 150 local markets in which Bedding Warehouse is the only competitor
 - iii. *Duopoly markets*: 175 local markets in which Bedding Warehouse is one of only two competitors (not including Dreamland)
 - iv. Among these markets, focus more narrowly on markets in or around the Mid-Atlantic region (where Dreamland currently has stores and can most easily supply new stores)

Recall: A Section 7 violation in any one market is enough to enjoin the deal, so we can keep the focus narrow to the markets most likely to be problematic

3. Uniqueness

- a. High barriers to entry—see analysis in horizontal section
- b. Presumably, the FTC will use its precomplaint subpoena authority to determine if there are other, similarly situated firms that are likely to enter into the same markets in which Dreamland might enter (and find that there are few, if any, such firms)

4. Noncompetitiveness

- a. Bedding Warehouse is a monopolist in each of the 150 local monopoly markets
- b. Bedding Warehouse is one of two firms in each of the 175 local duopoly markets

³⁰ Some students analyzed Bedding Warehouse’s plans to add 40-50 new stores in the next three years under the “potential expander” theory. This theory posits that mergers involving a company with a small share in the market premerger but with the likelihood of a significant growth in its small in the relatively near future should be evaluated assuming that the small company has already achieved its projected growth. This contrasts with the actual potential competition theory that addresses the likely entry of one of the merging parties into a new market in the near future. The hypothetical states that Bedding Warehouse plans on opening stores in new markets, not expanding the stores in markets that it already serves. Consequently, the proper analysis here is under actual potential competition doctrine, not the potential expander theory.

- c. Each of these markets is highly concentrated, with premerger HHIs ranging from 5000 to 10000 → The *PNB* presumption supports the conclusion that markets with this level of concentration are operatively noncompetitively
- d. Market research shows that the markets are noncompetitive since adding one store decreases prices
 - i. Prices in the monopoly markets would decrease from an average of \$1144 to an average of \$1052 (an 8% decrease) (Table 3)
 - ii. Prices in the duopoly markets would decrease from an average of \$1052 to an average of \$989 (a 6% decrease) (Table 3)

5. Ability

- a. ComfortPlus has the ability, through Dreamland, to enter any of these markets and has committed funding to open between 40 and 50 stores in the next three years absent the merger
- b. Since ComfortPlus acquired Dreamland in 2000, Dreamland has opened 25 new stores in the Mid-Atlantic region

6. Incentive/likelihood of entry

- b. In August 2024, ComfortPlus announced plans to allocate \$100 million to Dreamland to fund an aggressive three-year retail expansion that would open 40 to 50 new stores
- c. Dreamland has identified eight sites already—State College, Pennsylvania; Frederick, Maryland; Charlottesville, Virginia; Ithaca, New York; Wilmington, North Carolina; Harrisonburg, Virginia; Binghamton, New York; and York, Pennsylvania—and is in negotiations with landlords to obtain long-term leases on suitable space in each location.
- d. Dreamland's plan is to open another 2 to 4 stores in 2025, 20 stores in 2026, and the remaining stores in 2027, although the sites have not been definitely identified.
- e. The new sites, like the ones already identified, will be in areas where Bedding Warehouse is either the only store within 40 miles or one of two stores within that radius
 - i. "Dreamland, for example, locates its retail stores primarily by identifying the most successful Bedding Warehouse retail stores in areas with sufficient population to support another store and then establishing locations near them, but only in areas with no second mattress store within 40 miles. . . . Of Dreamland's 75 stores, 50 are located within a two-mile radius of a Bedding Warehouse store with no other mattress retailers within 40 miles, while 15 are near Bedding Warehouse locations that have one other competitor within that radius. . . . This focused strategy of targeting Bedding Warehouse locations has proven successful, and ComfortPlus has authorized and funded Dreamland to open 40 to 50 new stores using the same approach."(p. 12)
- f. Bottom line:
 - i. In the absence of the transaction, Dreamland will open at least eight new stores in areas where Bedding Warehouse is the only competitor
 - ii. In the absence of the transaction, Dreamland is likely to open another 2 to 4 stores in 2025, 20 stores in 2026, and another 10 to 20 stores in 2027 where Bedding Warehouse is the only competitor or perhaps one of two competitors
 - iii. If the transaction goes forward, none of these stores will open

7. Procompetitive effect of entry

- a. Given Dreamland's premerger strategy of locating its stores in premerger monopoly or duopoly local markets where Bedding Warehouse competes, it is reasonably probable that some, if not all, of Dreamland's planned new stores will open in one of these markets
- b. As noted above, entry of a new store into an existing monopoly or duopoly market will decrease prices by 6% to 8%.

8. Conclusion—ALMOST CERTAIN SECTION 7 VIOLATION

- a. If the transaction does not go forward, it is reasonably probable that some, if not all, of the 40-50 Dreamland stores that are likely to open in the next three years will be in highly concentrated markets in which Bedding Warehouse currently operates and Dreamland does not
 - b. If the transaction goes forward, none of these stores will enter any of these markets
 - c. As a result, additional competition that would have existed in the future will not occur
-

VERTICAL ANTICOMPETITIVE EFFECTS

1. Theories of vertical harm

- a. Input foreclosure/raising rivals' costs in mattress manufacturing
- b. Output foreclosure/raising rivals' costs in mattress manufacturing
- c. Anticompetitive information conduits in mattress retailing³¹

2. Input foreclosure/raising rivals' costs in mattress retailing

- a. *Key points to keep in mind:*
 - i. Premerger, ComfortPlus, which is charging the profit-maximizing wholesale price for its mattresses, would lose profits if it increased the price of ComfortPlus mattresses to retailers.
 - ii. Premerger, ComfortPlus earns only the manufacturer's margin on the mattresses it sells
 - iii. Postmerger, the merged firm will earn the manufacturer's margin on the ComfortPlus mattresses it sells to third-party retailers, but it will earn the manufacturer's margin plus the retail margin on the ComfortPlus mattresses sold by Bedding Warehouse.
 - iv. *Key question:* If the merged firm increases the price of ComfortPlus mattresses to third-party retailers, will the incremental profit gain on the sales diverted to the ComfortPlus brand sold by Bedding Warehouse be greater than the incremental profit loss from the third-party retailers?

³¹ Some students minimized concerns about anticompetitive vertical effects because ComfortPlus stated it would operate Bedding Warehouse independently, as it does now with Dreamland. However, this ignores a fundamental antitrust principle: courts and the FTC evaluate mergers based on the merged firm's profit-maximizing incentives, not its stated intentions. Without evidence that independent operation serves the firm's financial interests, such promises carry little weight—a point Judge Leon made in AT&T/Time Warner. The analysis must focus on economic incentives, not unenforceable commitments (unless the commitments can be made enforceable through an injunction or contracts the agency or the court finds adequate to protect firms against harms that likely would otherwise occur).

- b. Relevant markets
 - i. *Product market*: Mattress sales to third-party retailers
 - ii. *Geographic market*: National
 - 1. Does not depend on local market conditions
 - 2. Allows the merged firm to maintain a uniform nationwide price to third-party retailers
- c. ComfortPlus mattresses are essential to third-party mattress retailers
 - i. ComfortPlus accounts for 40% of the mattresses sold in the United States (by units or revenues)
 - ii. ComfortPlus' brands include "ComfortPlus, the company's flagship premium product; Restwell, the top mattress brand in the U.S. by sales; and CloudNest, the third highest-selling mattress brand." (p. 5)
 - iii. "Given the popularity of ComfortPlus brands, essentially all multibrand retail mattress stores carry the ComfortPlus line of products and consider them essential for a successful mattress store business." (p. 11)
- b. Input foreclosure/RCC—increasing the wholesale price of ComfortPlus mattresses to third-party retailers—is likely to be profitable³²
 - i. Shifting ComfortPlus sales from third-party mattress retailers would cause the merged firm to lose the manufacturer's margin on lost sales but gain the manufacturer's margin plus the retailer's margin for customers that shift from the rival store to Bedding Warehouse
 - ii. *Approach 1*: A conservative "back-of-the-envelope" calculation (no formulas)
 - 1. Say premerger a third-party retailer sells 10 ComfortPlus mattresses, earning ComfortPlus \$3000 in profits (= \$300 margin times 10 customers)
 - 2. Postmerger, suppose the merged firm increases the ComfortPlus mattress to a third-party retailer and that all 10 customers now will not buy a ComfortPlus from the retailer (i.e., all customers are marginal, so

³² **IMPORTANT:** The analysis in the outline is not quite right. It implicitly assumes that Bedding Warehouse competes in all markets. The hypothetical is deficiently silent on this market fact and the assumption is probably incorrect. In markets where Bedding Warehouse is not present, the merged firm has no incentive to change prices to third-party retailers.

If the merged firm can discriminate in pricing between stores, the analysis still applies in those markets in which Bedding Warehouse competes. But in the more likely case where Bedding Warehouse cannot price discriminate—especially among retail stores in a nationwide chain—the analysis must account for the fact that in local markets where Bedding Warehouse does not compete the diversion ratio will be zero and an increase in prices to third-party stores above the already profit-maximizing premerger price will reduce the merged firm profits earned in those local markets.

The upshot is that the aggregate "nationwide" diversion ratio should be reduced to reflect the zero diversion ratios of third-party stores that do not compete with Bedding Warehouse. The greater the proportion of ComfortPlus sales from these stores, the more the "nationwide" diversion ratio needs to be reduced. If Bedding Warehouse competes in the majority of local markets, this adjustment would not materially change the antitrust conclusion. Conversely, if the majority of ComfortPlus sales come from stores that do not compete with Bedding Warehouse, the antitrust conclusion could differ.

I must admit that I did not identify this complication while drafting the exam, originally preparing this outline, or grading the papers. I only recognized the problem in my last review of this outline. Consequently, when I was grading the papers, I gave full credit to answers that performed the analysis in the outline. I did not change this after I recognized the problem.

we ignore any profits the merged firm would have earned from inframarginal customers that would have purchased the mattress at the higher price)

3. Given the diversion ratio of 60%, 6 of these customers will divert to Bedding Warehouse and purchase a ComfortPlus mattress at the premerger price of \$1000. On these diverted sales, the merged firm makes \$4200 (= \$700 merged firm margin times 6 diverted customers)
4. Consequently, RRC is profitable: The merged firm's postmerger profit of \$4200 on diverted sales is greater than the \$3000 loss on the third-party retailer.³³

iii. *Approach 2: vGUPPI/2 merger simulation*

1. Formula:

$$vGUPPI_{M2} = D_{M2 \rightarrow M1} \% m_{MF} \frac{p_{M1}}{p_{M2}} = \frac{D_{M2 \rightarrow M1} \$m_{MF}}{p_{M2}},$$

where M2 are ComfortPlus mattresses sold to third-party retailers, and M1 are ComfortPlus mattresses "sold" postmerger to Bedding Warehouse

2. Variables

- a. D = 60% (diversion of mattress sales at the manufacturer level mirrors the diversion ratio of mattress sales at the retail level)
- b. CP \$margin = \$600 wholesale price (p_M) * 50% gross margin = \$300
- c. BW \$margin = \$1000 wholesale price * 40% gross margin = \$400
- d. $\$m_{MF} = \$300 + \$400 = \700

3. Applied

$$vGUPPI_{M2} = \frac{D_{M2 \rightarrow M1} \$m_{MF}}{p_{M2}} = \frac{(0.6)(700)}{600} = 70.0\%$$

$$\frac{vGUPPI_{M2}}{2} = \frac{70.0\%}{2} = 35.0\%$$

4. The vGUPPI/2 merger simulation indicates that the profit-maximizing increase in the price at which the merged firm sells ComfortPlus mattresses to third-party retailers would be 35%. This implies an average price increase of \$210, or a change in ComfortPlus' average price from \$600 to \$810.

iv. *Coordinated effects*

1. If ComfortPlus increases the wholesale price of its mattresses to retailers, this may incentivize other manufacturers to increase their prices as well.
2. Premerger susceptibility
 - a. High market concentration
 - i. In the national mattress manufacturing market, the top three firms have a market share of 75%. Table 1. This

³³ This argument also makes the case that total foreclosure of third-party retailers is profitable. It does not answer two important questions: (1) Which is more profitable—complete foreclosure or RCC at the right price? (2) If RRC is more profitable, what is the right price? Still, I gave full credit for this analysis and conclusion.

- alone probably makes out a prima facie case of premerger susceptibility.
- b. Very low aggregate demand price elasticity
 - i. Aggregate demand elasticity at the retail level is -0.2.
 - ii. This translates to very inelastic aggregate demand at the manufacturing level
 - c. Price transparency
 - i. In addition, wholesale prices are likely to be transparent since mattress retailers dealing with manufacturers are likely to reveal information about the prices they pay other manufacturers³⁴
 - d. Trade association activity
 - i. Mattress manufacturers have their own committee in the American Sleep Products Association. The FTC and the courts accept lawful trade association membership as probative of both (a) the willingness of competitors to engage in coordinated activity, and (b) a forum for them to facilitate tacit (or explicit) coordination
 - ii. Moreover, the ASPA “collects and distributes market intelligence” (p. 10), which presumably increases the transparency of the market
 - e. The hypothetical suggests there are high barriers to entry into manufacturing
 - i. *Specialized facilities*: Mattress production requires presumably expensive dedicated manufacturing facilities tailored to integrate steel coils, batting, fabric covers, and adhesives with precision, ensuring compliance with durability, comfort, and regulatory standards
 - ii. *Economies of scale*: Needs high capacity utilization to achieve the lower production costs of incumbent manufacturers
 - iii. *Brand recognition and marketing*: Major manufacturers make substantial ongoing investments in advertising and promotion to maintain consumer awareness and preference
 - iv. *Bottom line*: “While the past decade has seen the emergence of innovative startups like SlumberBox and CozyRest, these newer entrants have struggled to gain significant market share. Despite introducing fresh approaches to mattress design and marketing, these companies each command less than 2% of nationwide sales.” (pp. 9-10)

³⁴ Getting information from customers is a ubiquitous means for manufacturers to find out about their competitors’ prices.

3. Postmerger effectiveness

- a. An increase in market concentration is not a factor since Bedding Warehouse has no manufacturing operations
- b. However, the profit-maximizing unilateral incentive for the merged firm to increase the wholesale prices of ComfortPlus mattresses it sells to third-party retailers is likely to increase incentives of other mattress manufacturers to increase their prices as well.
- c. In addition, as explained below under anticompetitive information conduits, Bedding Warehouse can act as a clearinghouse for information about the wholesale prices it is charged, which also is a factor in increasing the likelihood, effectiveness, or stability of anticompetitive coordinated interaction postmerger.

3. Output foreclosure/RCC

- a. Key points:
 - i. Output foreclosure/RCC occurs when the downstream merged entity (here, Bedding Warehouse)—
 1. *Complete foreclosure*: Refuses to purchase mattresses from third-party mattress manufacturers to resell at its Bedding Warehouse retail stores, or
 2. *RRC*: Competitively disadvantages third-party mattress manufacturers by increasing the price at which BW sells rival mattresses at BW retail stores
 - ii. *Case 1*. Output foreclosure in postmerger monopoly retail markets where Bedding Warehouse is the only competitor (i.e., Bedding Warehouse postmerger local monopoly retail markets)
 - i. Postmerger, Bedding Warehouse will be a monopolist in 200 local retail markets
 1. In 150 local markets, BW faces no competitors premerger
 2. In 50 additional markets, Bedding Warehouse and Dreamland are the only competitors premerger; postmerger, Bedding Warehouse will be the only competitor
 - ii. In these 200 postmerger monopoly markets, the merged firm will have the ability and incentive to completely foreclose third-party mattress manufacturers
 1. *Ability*: Postmerger, Bedding Warehouse, which buys its mattress inventory as a principal, can refuse to sell rival third-party brands at its stores (complete foreclosure) or, alternatively, increase the price at which it sells those brands over premerger levels (RRC)
 2. *Incentive (qualitative³⁵)*:
 - a. Where Bedding Warehouse is a monopolist, mattress customers can only obtain a mattress if they purchase from BW
 - b. To focus on complete foreclosure as the theory of harm (and not conflate it with higher downstream prices), assume that the merged firm maintains the retail price of ComfortPlus mattress at the premerger level.

³⁵ Not the most rigorous analysis of output foreclosure, but I gave full credit for this type of analysis.

- c. While Bedding Warehouse would lose the retail margin of \$400 from the sale of a third-party brand, the merged firm would earn \$700 (= \$400 retail margin + \$300 manufacturer's margin) on every customer that switched and purchased a ComfortPlus mattress, for an incremental profit gain of \$300
- d. Accordingly, as long as 57.14% of the marginal customers for the third-party brand switch with complete foreclosure to a ComfortPlus mattress, complete foreclosure will be profitable.
 - i. Breakeven condition:

$$\$400 \times 100 = \$700 \times x \Rightarrow x = 57.14$$

- e. If Bedding Warehouse refused to sell any competing brands (complete foreclosure), given the highly inelastic aggregate demand curve ($\varepsilon = -0.2$), it is highly likely that at least 57.14% of customers who would have purchased a third-party brand at Bedding Warehouse would purchase a ComfortPlus brand rather than go without a new mattress
 - f. *Bottom line*: While complete foreclosure may or may not be as profitable as RCC, it is still profitable, and the adverse effect on consumer welfare would be substantial. If RCC would be more profitable, it would extract even greater profits than complete foreclosure and further harm consumer welfare.
3. *Incentive (quantitative)*:
- a. *Strategy*: Use a vGUPPI/2 merger simulation to estimate the profit-maximizing price increase in the third-party brand holding the retail price of ComfortPlus mattress at their premerger levels
 - b. vGUPPI (at the Bedding Warehouse retail level):

$$vGUPPI_{R2} = D_{R2 \rightarrow R1} \%m_{MF} \frac{p_{R1}}{p_{R2}},$$

where product R2 are the rival brands (viewed as a composite commodity) sold by Bedding Warehouse and R1 are the ComfortPlus brands sold at Bedding Warehouse (also viewed as a composite commodity).

Since $p_{R1} = p_{R2}$ premerger, the vGUPPI formula reduces to:

$$vGUPPI_{R2} = D_{R2 \rightarrow R1} \%m_{MF}.$$

- c. Since we are dealing only with local markets in which Bedding Warehouse is a monopolist, we need to calculate the $\$m_{MF}$ using the average retail price for a monopolist given in Table 3, that is, \$1144.³⁶ The marginal cost at the manufacturing level is \$300 and \$0 at the retail level, so $\$m_{MF} = \$1144 - \$300 = \844 and $\%m_{MF} = \$844 / \$1144 = 73.8\%$. So

³⁶ This is a detail. I gave full credit if you used \$1000 as the price.

$$vGUPPI_{R2} = D_{R2 \rightarrow R1} \times 0.738.$$

- d. How should we estimate D ?
- i. Consider a local market where Bedding Warehouse is a monopolist. The aggregate demand elasticity for mattresses is -0.2, while the residual demand elasticity of the rival's product is -2.5 (= $1/0.40$ by the Lerner condition).
 - ii. A low aggregate demand elasticity means that if the prices of all products increase by a uniform percentage, very few units in the aggregate will be lost.
 - iii. A high residual demand elasticity for rival products indicates that the rival brands will lose a large number of units with a uniform percentage price increase.
 - iv. To balance the low unit loss in the aggregate and the relatively high unit loss of rival products, a large percentage of the lost rival units must divert to ComfortPlus units. We don't know what the diversion ratio is, but it is likely close to 100%.
- e. If we use, say, 90% as a conservative estimate of the diversion ratio, we obtain:

$$vGUPPI_{R2} = 0.90 \times 0.738 = 66.4\%$$

$$\frac{vGUPPI_{R2}}{2} = \frac{66.4\%}{2} = 33.2\%.$$

A 33.2% price increase on a retail price of \$1144 is \$380, increasing the average rival retail price sold at Bedding Warehouse to \$1524.³⁷

- f. We can look at the problem another way. Antitrust law regards a substantial price increase due to a merger as a Section 7 violation. A 10% price increase is substantial. To find what diversion ratio would be necessary to make a postmerger unilateral price increase in rival products sold at Bedding Warehouse profitable, we can solve the following equation for D :

$$10\% = \frac{vGUPPI_{R2}}{2} = \frac{D_{R2 \rightarrow R1} \times 0.738}{2}$$

Solving, we find $D = 27.1\%$. Whatever the actual diversion ratio is, it almost certainly must be greater than 27.1% in order to limit aggregate unit loss as required by the very inelastic aggregate demand. Hence, a unilateral increase of at least 10%

³⁷ You may ask why the price is also much higher than the \$1144 price that Table 3 shows a monopolist retailer would charge. But Table 3 averaged mostly retail stores that were independent of manufacturers. Here, the higher price is the consequence of the significant diversion of mattresses at the rival level from third-party mattresses to higher-margin mattresses produced by the merged firm.

in the price Bedding Warehouse charges for rival brands would be profitable.

4. Conclusions

- a. These substantial increases in the price of rival products sold by Bedding Warehouse in monopoly markets would substantially lessen competition in violation of Section 7 in those markets
 - b. The vGUPPI/2 merger simulation gives the profit-maximizing unilateral price increase in the third-party brands, given that the merged firm will hold the price of the ComfortPlus brands constant at premerger levels. If we remove this constraint, the profit-maximizing strategy for the merged firm likely would be to increase the ComfortPlus brand's price above the premerger level and reduce the third-party brand's price increase below the unilateral profit-maximizing price increase. While we cannot tell what the profit-maximizing joint price increases would be, we do know that they must yield profits at least as large as the unilateral price increase on the rival and have as damaging, if not more damaging, effect on consumer welfare
- iii. Output foreclosure outside of Bedding Warehouse local monopoly markets³⁸
1. The presence postmerger of retail competitors selling rival brands at premerger prices in competition with Bedding Warehouse will significantly diminish the merged firm's incentives to increase the price of rival products unilaterally
 2. The reduced incentive occurs because of a reduction in the diversion ratio from rival products sold by Bedding Warehouse to ComfortPlus products sold at Bedding Warehouse.
- iv. If Bedding Warehouse increases the price of all non-ComfortPlus brands while competing retailers continue offering these same brands at their premerger prices, most customers who prefer non-ComfortPlus brands would likely switch to competing stores to purchase their preferred brand at the lower price. However, the customers who remain at Bedding Warehouse despite the price increase would be those who:
1. Consider ComfortPlus a close second-choice substitute for their preferred brand, and
 2. Do not find it worth the effort to comparison shop at competing stores to buy their preferred brand at the premerger price.
- v. This is likely to be a small percentage of the Bedding Warehouse shoppers who prefer a nonComfortPlus mattress, probably less than 10%.³⁹
- vi. We can simulate a unilateral price increase by Bedding Warehouse in nonComfortPlus brands using the vGUPPI using the nationwide averages:

³⁸ Since we have identified a significant prima facie output foreclosure/RRC effect in 200 BW local monopoly retail markets, it is not as important to examine whether there is a significant output foreclosure/RRC in other markets. Student who only identified the effect in the BW local monopoly markets received full credit on this theory of harm.

³⁹ The hypothetical is silent on this diversion ratio.

$$\begin{aligned} vGUPPI_{R2} &= D_{R2 \rightarrow R1} \%m_{MF} \\ &= 0.10 \times 0.70 = 7.0\% \end{aligned}$$

$$\frac{vGUPPI_{R2}}{2} = \frac{7.0\%}{2} = 3.5\%,$$

where $D = 10\%$ and $\%MF = 70\%$ ($= \$700/\1000).

vii. Conclusions

1. Under these assumptions and keeping in mind that the rival products are available from competing merchants at premerger prices, it is unlikely that the FTC or the court would view a 3.5% price increase ($= \$35$), it is unlikely that the FTC or the court would find this unilateral price increase at one store to amount to a substantial lessening of competition.
2. Perhaps further investigation would identify some markets— most likely postmerger duopoly or triopoly markets where Bedding Warehouse was one of the retail stores—where a unilateral price increase by BW in the price of nonComfortPlus brands would be substantial, but at this point, it is unnecessary to explore this possibility. We already know there are 200 local markets in which input foreclosure would be substantial, and that is enough to make out a substantial Section 7 output foreclosure/RRC case

viii. Coordinated effects outside of postmerger local monopoly markets

1. If BW increases the prices of non-ComfortPlus products, would this incentivize rival retailers to increase the prices of those products themselves?
2. *Conclusion:* Probably not (except perhaps in postmerger duopoly markets).
 - a. By keeping prices constant, rival retailers could earn the gross margin of \$400 on every diverted customer they captured. If they increase their prices to match BW's price, no customers would switch to them and all they would earn is the \$SSNIP on the retail price for each customer they retain.
 - b. While we might see some coordinated effects in postmerger duopoly markets, we will less likely see them in local retail markets with three or more competitors. In these markets, the third-party stores face a prisoner's dilemma. If one store increases its price to accommodate BW's price increase and the other rival store does not, the store that increases its price will gain no customers from BW and lose 60% of its marginal customers to the lower-priced store. This dynamic probably creates a strong incentive not to accommodate BW's price increase.
 - c. However, the FTC is likely to consider this as a theory of anticompetitive harm to explore

4. Anticompetitive information conduits

- a. *Third-party information flow*: Bedding Warehouse, as a major retailer, will receive sensitive and confidential business information from third-party mattress manufacturers whose products it sells, including wholesale pricing, product development plans, promotional strategies, and marketing initiatives.
- b. *Post-acquisition risk of disclosure*: Despite any stated independence between ComfortPlus' manufacturing division and Bedding Warehouse, the acquisition creates a structural link that could facilitate the transfer of competitively sensitive information to ComfortPlus' manufacturing operations
- c. *Financial incentive for information sharing*: The merger introduces a strong financial incentive for the merged firm to share third-party manufacturer confidential information with ComfortPlus' manufacturing division and to use it to disadvantage these competitors and benefit the sale of ComfortPlus mattresses. With access to third-party manufacturers' pricing, product strategies, and other sensitive details via Bedding Warehouse, ComfortPlus could:
 - i. Preemptively undercut competitors' pricing in specific markets.
 - ii. Tailor product development or marketing efforts to undermine rival manufacturers' new product launches.
 - iii. Exploit promotional schedules to align ComfortPlus' competing promotions more effectively with the promotions of rival manufacturers.
- d. *Adverse effect on competition*: The sharing and use of competitively sensitive information of rival mattress manufacturers is likely to harm competition:
 - i. *Reduced incentives to compete from matching*: The mere act of ComfortPlus leveraging Bedding Warehouse's insights to match rival manufacturers' pricing, marketing campaigns, or product innovations could diminish competitors' incentives to invest in these competitive efforts, knowing they may not gain a meaningful advantage.
 - ii. *Further reduced incentives from aggressive undercutting*: If Bedding Warehouse, under ComfortPlus' direction, engages in more aggressive undercutting of rivals' pricing or promotional efforts, competitors could be further deterred from competing vigorously, fearing that any aggressive move will be met with an even stronger response.
 - iii. *Facilitation of collusion through reciprocal information exchange*: Bedding Warehouse could also share some of ComfortPlus' plans with rival manufacturers under the guise of maintaining retail relationships. This sharing of sensitive information could reduce uncertainty among manufacturers, facilitating explicit or tacit collusion at the manufacturer level by aligning their strategies.

Bedding Warehouse's position as the largest mattress retailer and ComfortPlus' position as the largest mattress manufacturer are likely to amplify the risk of substantial competitive harm in local retail and national manufacturing markets.
- e. *Limits of contractual confidentiality restrictions*: Even with confidentiality restrictions or nondisclosure agreements in place, the financial incentive to share and use the information, coupled with the inherent challenges of monitoring and enforcing such agreements, makes them unlikely to effectively prevent anticompetitive harm.

5. Defenses

a. Insufficiency of a “contractual commitment” fix:

- i. *Input foreclosure*: The FTC and rival retail stores unlikely to find a commitment by the merged firm to continue to supply ComfortPlus-brand mattresses to retail competitors of Bedding Warehouse stores. Even with a contract in place, the merged firm would have both the ability and incentive to disadvantage rivals through numerous mechanisms that are difficult to specify, monitor, and enforce through contractual provisions, including:
 1. Price discrimination
 - a. Supply contracts could not control all of the various ways ComfortPlus could supply mattresses to Bedding Warehouse at transfer prices significantly lower than the prices ComfortPlus offers to rival retailers
 2. Promotion discrimination
 - a. ComfortPlus could support promotions at Bedding Warehouse in ways that it would not be obligated to offer rival retailers
 3. Non-price discrimination in product quality or service levels
 - a. ComfortPlus could prioritize Bedding Warehouse in terms of product quality, timely deliveries, or access to newer product lines, while subtly degrading these factors for rival retailers
 4. Monitoring and enforcement:
 - a. Monitoring and proving discriminatory promotional practices across varying market contexts would be practically impossible.
 5. Information Asymmetries and Competitive Intelligence:
 - a. Despite firewalls, ComfortPlus might leverage insights from Bedding Warehouse’s retail operations to adjust its wholesale pricing strategies in ways that harm rival retailers.
- ii. *Output foreclosure*: The FTC—and rival mattress manufacturers—almost surely will find long-term purchase agreements and contractual commitments to maintain fair dealing at Bedding Warehouse retail stores insufficient to allay their competitive concerns. While contracts could mandate continued business relationships, they cannot effectively prevent significant discrimination or ensure truly competitive treatment. The merged firm would have both the ability and incentive to disadvantage rivals through numerous mechanisms that are difficult to specify, monitor, and enforce through contractual provisions, including:
 1. Commercial terms:
 - a. Wholesale pricing guarantees and adjustment mechanisms
 - b. Minimum purchase commitments across product lines
 - c. Required inventory levels by store location
 - d. Protection for full product line representation
 - e. Guaranteed prime showroom space allocation (by rival in order to prevent BW from playing rival manufacturers against each other if only the total showroom for all rivals is guaranteed)
 - f. Equal access to promotions and marketing support
 - g. Competitive retail pricing relative to ComfortPlus products (since BW purchases inventory as a principal and can set its own prices)

2. Sales practices:
 - a. Balanced commission structures across brands
 - b. Equal sales staff training and support
 - c. Prevention of customer steering
 - d. Equal access to financing programs
 3. Operational Safeguards:
 - a. Equal delivery times and service levels
 - b. Standardized inventory management
 - c. Equal product placement and display maintenance
 - d. Protection against selective stockoutsInformation protection
 - e. Firewalls preventing data flow to ComfortPlus
 - f. Protection of pricing and promotion plans
 - g. Safeguards for product development information
 - h. Equal access to customer feedback data
 4. Monitoring and enforcement:
 - a. Clear compliance metrics
 - b. Regular auditing rights
 - c. Swift dispute resolution
 - d. Meaningful penalties
 - e. Third-party oversight
- iii. *Confidentiality agreements with Bedding Warehouse.*
1. Confidentiality commitments are notoriously difficult to monitor and enforce. The FTC will not accept a behavioral consent decree with confidentiality obligations as sufficient to prevent harm arising from vertical anticompetitive information conduit and would oppose any analogous “fix” in court
 2. Mattress manufacturers are also likely to oppose a confidentiality commitment as sufficient to protect their competitively sensitive information
 3. If the FTC and mattress manufacturers vigorously oppose the sufficiency of a confidentiality commitment, the court is unlikely to accept the fix
- iv. If these objections are presented to the court, the court is likely to reject contractual commitments as sufficient to negate the competitive harms from input or output foreclosure
- b. Elimination of double marginalization
- i. The merging parties would likely argue that in a vertical merger, the profit-maximizing strategy of the merged firm is to eliminate the double marginalization. This, they would argue, has two implications for the analysis:
 1. They will *decrease* the price of ComfortPlus mattresses sold at Bedding Warehouse stores, not increase it
 2. Even if they increase the price of ComfortPlus mattresses to third-party retailers (RRC), the welfare gains from the decrease in price at Bedding Warehouse stores will more than offset the welfare losses from an increase in the price of ComfortPlus mattresses at third-party stores
 - ii. A quantitative analysis here would be very complex, given that this is not a pure vertical merger (unlike the situation in *AT&T/Time Warner*). The complexity itself

suggests that the merging parties may not be able to satisfy their burden of production at Step 2 of Baker Hughes.

- iii. But there is a simpler refutation: ComfortPlus says that it will operate Bedding Warehouse postmerger separately from its mattress manufacturing operations and, in particular, will compensate the executives of each division based on their profitability (including profitability on internal sales) just as it does Dreamland today:

“ComfortPlus has designated both its mattress wholesale division and its Dreamland retail subsidiary as separate profit centers, with the compensation of each division’s senior executives based primarily on their own division’s operating profits. Accordingly, the ComfortPlus mattress manufacturing division and Dreamland have to negotiate the price at which ComfortPlus will sell mattresses to Dreamland, just as they did before Dreamland was acquired. As a result, the prices ComfortPlus charges Dreamland for mattresses have not changed materially since the acquisition, except for inflation.”

This plan indicates that the merged firm will not eliminate double marginalization since the manufacturing and retail divisions will negotiate the internal transfer price of mattresses and will not set the margin at the manufacturing level at zero as EDM requires.⁴⁰

⁴⁰ This analysis also illustrates a fundamental asymmetry in the antitrust treatment of subjective evidence: If the merging parties say they will not pursue profitable anticompetitive actions postmerger, the agencies and the courts will essentially reject this evidence as not credible. On the other hand, if the merging parties say that will not pursue profitable procompetitive actions postmerger, regulators almost always accept these statements at face value. In both cases, the companies are claiming they will act against their profit-maximizing interest, but regulators only credit such statements when they reduce the merger's claimed procompetitive benefits.