UNITED STATES DISTRICT COURT
DISTRICT OF COLUMBIA

FEDERAL TRADE COMMISSION,	)	
	)	
Plaintiff,	)	
v.	)	Civ. No. 1:04CV00534 (JDB)
	)	
ARCH COAL, INC., *et al.*,	)	
	)	**REDACTED (PUBLIC VERSION)**
	)	
Defendants.	)	

MEMORANDUM IN SUPPORT OF PLAINTIFF'S MOTION FOR PRELIMINARY INJUNCTION

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Introduction

The Federal Trade Commission ("FTC" or "Commission") seeks a preliminary injunction pursuant to section 13(b) of the Federal Trade Commission Act, 15 U.S.C. § 53(b), to prevent the acquisition by Arch Coal, Inc. ("Arch") of Triton Coal Company, LLC ("Triton") until the completion of an administrative proceeding, initiated by the FTC upon unanimous vote on April 6, 2004, challenging the transaction as unlawful under section 7 of the Clayton Act, 15 U.S.C. § 18. Contrary to defendants' claim that this merger is procompetitive, the electric utilities who are the parties' principal customers have expressed substantial concern that it will result in less competition and higher prices. The merger raises serious antitrust concerns by enhancing the ability and incentive for anticompetitive coordinated interaction among the leading coal companies in Wyoming's Southern Powder River Basin ("SPRB"). It challenges the fundamental tenets of section 7 of the Clayton Act and of modern merger analysis, as set forth in the federal government's Horizontal Merger Guidelines and in myriad decisions by this and other courts.

If the proposed merger is allowed to proceed, three firms – Arch, Peabody, and Kennecott – will be in a position to increase prices through coordinated interaction. These three firms will control 85.8% of all SPRB production, including 100% of the production of 8800 Btu coal, the highest valued coal in the region. Within the industry, Arch has been the most vocal public proponent of greater "producer discipline" in order to achieve higher sustained prices. Prior to this transaction, however, Arch was the smallest of the three major SPRB producers, and not well placed to exercise market leadership. This merger would change that dynamic, not only by putting Arch at parity with Peabody and Kennecott, but by placing in Arch's hands all 8800 Btu capacity not currently within the control of these three firms. By also taking this capacity (Triton's North Rochelle mine) out of the hands of a competitor, the acquisition would, as Arch's Vice President of market research observed when Arch contemplated acquiring Triton in 2001, provide " " for Arch against the possibility of " " SPRB production. PX0165 at 002.

The means by which Arch and either Peabody or Kennecott (or all three firms) could engage in coordinated interaction in the SPRB is straightforward. For example, two or all three of the firms might simply limit expansion of their 8800 Btu mines, particularly as demand for 8800 Btu coal continues to increase. In other words, they would expand supply less than, or less quickly than, would occur in a competitive market. (Alternatively, they might restrict output or coordinate on price.) As prices rise, customers would have few options. There would be no other sources for 8800 Btu coal, and the options for 8400 Btu coal would be limited to a fringe with insufficient capacity to defeat the 8800 Btu combination.

As one of the parties to this transaction noted succinctly: " " PX0607 at 031.

Coordinated interaction generally cannot be effectively proscribed by restrictions on firms' conduct. *See, e.g., Williamson Oil Co., Inc. v. Philip Morris USA*, 346 F.3d 1287 (11th Cir. 2003). Accordingly, preventing mergers such as this one under section 7 of the Clayton Act may be the only real opportunity to avoid the consumer harm that results from such interdependent behavior.[1] Antitrust law's most fundamental principle is to protect competition for the benefit of consumers. *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 486 n.10 (1977). If this merger were likely to lead to increased supply and lower prices, the sophisticated electric power companies who

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1 As the Supreme Court observed in *Brooke Group, Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 227 (1993), coordinated interaction need not take the form of express collusion, but instead can include more subtle conduct "not in itself unlawful, by which firms in a concentrated market might in effect share monopoly power, setting their prices [or output] at a profit-maximizing, supracompetitive level by recognizing their shared economic interests and their interdependence with respect to price and output decisions." *See*, *e.g.*, U.S. Department of Justice and Federal Trade Commission, *Horizontal Merger Guidelines* § 2.1 (1992) (hereinafter *"Merger Guidelines"*).

are the customers for SPRB coal could be expected to support the transaction. They do not. Rather, they oppose it in overwhelming numbers – evidence that, together with the remainder of the record and evidence to be adduced at the preliminary injunction hearing, show a preliminary injunction under Section 13(b) is warranted pending completion of the FTC's ongoing administrative proceeding challenging the merger under section 7 of the Clayton Act.[2]

Summary of Argument

To obtain preliminary relief, the FTC "is not required to *establish* that the proposed merger would in fact violate Section 7 of the Clayton Act," but only that there are "questions going to the merits so serious, substantial, difficult and doubtful as to make them fair ground" for administrative litigation before the Commission, and that the balance of the equities tips in favor of an injunction. *FTC v. H.J. Heinz, Co.*, 246 F.3d 708, 714-15 (D.C. Cir. 2001) (citations omitted). In this case, there are several strong grounds for believing that this merger could make it possible for coal producers in the SPRB to engage in coordinated interaction more effectively, whether through outright collusion or tacitly, resulting in higher prices for SPRB coal.

First, Arch and Triton are two of only five producers of coal in the SPRB, and, as noted above, two of only four producers of 8800 Btu SPRB coal. The three leading coal producers in the

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2 In an attempt to alleviate the obvious competitive problems raised by the transaction, Arch has proposed to sell one of Triton's mines, the Buckskin facility – an 8400 Btu mine that Arch in 2001 described as " " – to Kiewit. Arch's proposed remedy is wholly executory and not for the Court to consider in this preliminary proceeding. *See infra* section IV. In authorizing staff to seek a preliminary injunction, however, the FTC specifically considered and rejected Arch's settlement offer as inadequate to address the competitive concerns posed by the transaction. Moreover, even if this alternative were proper for consideration – for example, if Triton itself already had sold the 8400 mine to Kiewit – it would not remedy the likely anticompetitive consequences from Arch's acquisition of Triton's 8800 Btu North Rochelle mine. The Buckskin facility faces substantial disadvantages in its location and in the quality of its coal, and – even together with RAG – would not have the ability or incentive to expand production sufficiently to constrain anticompetitive behavior by the larger firms in the market.

region, Arch, Peabody, and Kennecott, would control all production of 8800 Btu coal, as well as nearly of practical capacity (and of excess practical capacity) of 8400 Btu coal. The only remaining competitor of consequence for SPRB coal, RAG American, accounts for percent of SPRB capacity and can produce only lower-grade 8400 Btu coal. The SPRB coal market is highly concentrated and exhibits many of the "plus factors" that make coordination easier, including high barriers to entry, firm and product homogeneity, inelastic demand, tight geographic proximity of the mines, and the ready availability of key competitive information. *See, e.g. Merger Guidelines* §§ 2.1, 2.11, 2.12; *FTC v. Elders Grain, Inc.,* 868 F.2d 901, 905 (7th Cir. 1989) (Posner, J.).

Second, during the past few years, market participants repeatedly have stated their view that, as the number of market players has fallen, the market is trending towards more successful coordinated interaction; market players have undertaken signaling and other efforts to engage in such interaction; and they may intermittently have achieved at least part of their aim. Indeed, each of the firms in the SPRB has expressed the same recognition regarding the profitability, and desirability, of greater firm coordinated interaction. Thus, for example, Arch has recognized that in the "

" PX0656 at 015. Triton believes that prices in the SPRB will increase because "

"[3]

that its long-term marketing strategy should " ." PX at .

that the SPRB is "

[3] PX0644 at 002. In conveying this message to , Triton's CEO stated that "

"

." PX at . has noted that " "[4]

Third, Arch has been the single most vocal proponent in the SPRB of a strategy of producer discipline, and its enthusiasm is well-recognized.[5] In an internal memorandum, Arch's CEO, Steve Leer, concedes that Arch has "

. PX0104 at 002. Prior to this transaction, Arch, as the smallest of the three major SPRB firms, has not been in a strong position to exercise such market leadership. This transaction, however, not only would bring Arch into approximate parity with Kennecott and Peabody, but place in its hands all of the available 8800 Btu coal capacity not currently controlled by the three major firms. Coupled with the fact that Arch already controls the major source of excess available 8400 Btu coal capacity, through its idle Coal Creek mine, Arch will be in a much clearer position to take the lead in implementing market discipline within the SPRB.

Fourth, since Triton opened its North Rochelle mine in 1998, it has provided an important source of destabilizing supply of 8800 Btu SPRB coal. PX 1040. The North Rochelle mine,

, has been a factor impeding the coordinated interaction that all

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[4] PX at . The coal companies are not the only ones that recognize the tendency toward market discipline and higher pricing. Market analysts, consultants, and others have touted producer discipline in recent years. For instance, in 2001 one industry analyst noted that on "

," PX0246 at 001 (Bear Stearns Analyst Michael Dudas' interview with Bloomberg, Jan 3, 2001), while another indicated that it was " "
PX5001 at 002 (Lehman Bros. Research Report Apr. 17, 2001). More recently, consultants such as Hill & Associates have reported that "there has been an increasing concentration of ownership in recent years and some of the large producers have shown a willingness to shut in production when the market was over-supplied." PX0127 at 082 (Hill & Associates & Doyle Trading Assoc., Jan. 2003).

[5] PX0628 at 001 (*Coal & Energy Price Report* article noting that Arch has been "preaching and practicing discipline as fervently as a Baptist minister").

participants in the market recognize would result in higher prices for SPRB coal. In 2001, , an Arch executive characterized Triton as " " Noting that Triton " " observed that " " was " " . PX0165 at 002. Shifting control of this mine from the " " Triton to Arch, which already has a large market share and is the foremost advocate of market discipline, raises a significant likelihood that this merger will have substantial anticompetitive effects in the market for SPRB coal.

Fifth, the likelihood of anticompetitive effects is attested by the strong statements of concern from customers regarding the proposed acquisition. As noted earlier, witnesses from a large number of electric power companies, representing a very substantial proportion of the annual SPRB coal purchases, have expressed grave concern that the merger will reduce competition and result in higher prices. These customers are sophisticated and knowledgeable purchasers with considerable insight and experience into the dynamics of the market. Defendants contend these customers stand to benefit considerably from the transaction. If the merger is anticompetitive, however they would stand to lose tens of millions of dollars. Their strong concerns are a clear signal regarding the risk of anticompetitive effects posed by this transaction.

* * * *

While it is clear that this merger will reduce competition, the Commission need only show that there are serious questions that the merger *may* substantially lessen competition. Moreover, on the basis of the increase in concentration that would result from the merger, the transaction is presumptively illegal under D.C. Circuit precedent, as well as the *Merger Guidelines*. *See*, *e.g.*, *Heinz*, 246 F.3d at 713; *Merger Guidelines* §1.51. In the market for SPRB coal, the Herfindahl-Hirschman Index ("HHI")[6] measure of concentration would increase as a result of the merger from an already highly-concentrated level of 2152 to 2623, an increase of 470 points; even if Arch's executory contract were taken into account, concentration would rise to 2346, an increase of 193.[7]

Such measures alone, however, significantly understate the likely competitive effects of the deal. In a market that is characterized by many factors making coordinated interaction easier, firms are acutely conscious that "[f]ewer producers" provide a "greater potential for discipline," and that "producer discipline will lead to higher sustained pricing" in the region. PX656 at 001; PX5001 at 001. By eliminating the only independent producer of 8800 Btu coal, arming Arch with significant additional capacity, and rendering coordinated interaction among the leading players substantially easier and more profitable to each, the proposed acquisition of Triton will afford Arch and others a greater incentive and ability to coordinate to raise prices.

Accordingly, the Commission requests that this Court preliminarily enjoin Arch's proposed acquisition of Triton, pursuant to Section 13(b) of the Federal Trade Commission Act ("FTC Act"), 15 U.S.C. § 53(b), pending a full administrative trial on the merits before the Federal Trade Commission.[8] Arch has revealed that it intends to consolidate operations at the North Rochelle mine

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6 The HHI index measures market concentration by summing the squares of the market shares of all firms in the relevant market. *Merger Guidelines* § 1.51.

7 PX at . Market shares and HHI numbers are based on each firm's practical capacity, the best available measure of its ability to compete for coal supply contracts in the SPRB. *See infra* p. 9 n.11.

8 Section 13(b) of the FTC Act authorizes the Commission to seek, and empowers this Court to grant, preliminary relief pending the completion of administrative proceedings challenging the proposed acquisition. The Commission has brought an administrative complaint challenging the transaction under Sections 7 and 11 of the Clayton Act, 15 U.S.C. §§ 18, 21, and under Section 5 of the FTC Act, 15 U.S.C. § 45. The Commission has scheduled the evidentiary hearing on the administrative complaint to commence on July 6, 2004. PX 5678 at 016. Defendants have committed not to close the acquisition until two days after the Court rules on

with Arch's adjoining Black Thunder mine. Absent a preliminary injunction, Arch and Triton would be free to consummate the acquisition and "scramble the eggs," preventing any meaningful relief even if the Commission ultimately concludes, following plenary administrative litigation, that this transaction violates Section 7 of the Clayton Act, 15 U.S.C. § 18.[9] Arch could deplete the most valuable reserves at the North Rochelle mine while blocking the mine's access to new reserves by acquiring those reserves for itself.[10] Therefore, preliminary relief is critical to preserve the status quo pending administrative adjudication. *Heinz*, 246 F.3d at 726-27.

<u>Background Facts</u>

SPRB coal accounts for about one-third of the nation's total coal production and is used by electric generators in at least 26 states. SPRB coal is obtained from large, low-cost surface mines in Wyoming. Because of its unique combination of low sulfur content (which renders the coal particularly clean burning and compliant with U.S. environmental regulations) and relatively low price in comparison to coal mined in other regions of the United States, there are no economic substitutes for SPRB coal for the customers who purchase it. Within the SPRB, suppliers have established two distinct price points for coal based on its energy content: 8800 Btu/lb. and 8400 Btu/lb.

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the Commission's motion for a preliminary injunction. PX0285; Defendant's Answers to Complaint ¶11.

9 *See, e.g., FTC v. PPG Industries, Inc.*, 798 F.2d 1500, 1508 (D.C. Cir. 1986); *Elders Grain*, 868 F.2d at 904; *FTC v. Lancaster Colony Corp., Inc.*, 434 F. Supp. 1088, 1096 (S.D.N.Y. 1977) ("at best, divestiture is a slow, cumbersome, difficult, disruptive and complex remedy").

10 New reserves in the SPRB are generally acquired in a lease by application process from the federal government. For new reserves proximate to Triton's mines, Arch and Triton are likely to be among a small number (if not the only) bidders. If Arch is allowed to acquire Triton, Triton can not bid and Arch may acquire leases that otherwise would have been acquired by Triton and are important to Triton's future growth.

The SPRB mines are divided into three producing regions or "Tiers." Within the different tiers, the energy and sulfur content of the coal vary slightly, with greater variances between each tier. The most highly valued SPRB coal is 8800 Btu coal, which is produced in the southern portion of the SPRB, known as "Tier 1." Because of its lower sulfur and ash contents, higher energy content, and access to competing rail transport services, 8800 Btu coal from Tier 1 mines commands a substantial price premium over the 8400 Btu coal mined in Tiers 2 and 3, the adjacent areas to the north in the SPRB. The price differential between 8800 Btu coal and 8400 Btu coal depends upon the respective demand and supply balance for each of the two products. Consequently, supply restrictions by 8800 Btu coal producers, relative to the growing demand for the product, can cause the price of 8800 Btu coal to increase relative to prices for Tier 2 and 3 SPRB coal.

There are four major producers of SPRB coal – Arch, Triton, Kennecott, and Peabody – each with 8800 Btu coal mines. Arch operates the Black Thunder mine, accounting for approximately of the practical capacity[11] in Tier 1; Triton operates North Rochelle, accounting for ; Kennecott produces 8800 Btu coal at its Jacob's Ranch and Antelope mines, accounting for ; and Peabody operates the North Antelope-Rochelle mine, accounting for the remaining . PX5675 at 002. There are no other 8800 Btu mines other than those owned by these four firms.

As shown in the attached Appendix 1, each of the four Tier 1 producers also owns one or more 8400 Btu mines located in Tiers 2 and/or 3. Arch owns the Coal Creek mine in Tier 2, which can produce approximately 18 million tons per year. In 2000, however, Arch suspended production at Coal Creek to address what it regarded as an unfavorable supply/demand balance in the market. PX0255 at 010. Arch has kept the Coal Creek mine idle despite repeated requests by

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[11] Practical capacity is the production capability of a mine based on the equipment in place for coal extraction. It represents a firm's ability to service current and future contracts without undertaking costly expansion, and is how firms judge their ability to sell in the relative near term.

customers to reopen it. PX at . Peabody operates the Caballo mine in Tier 2 and the Rawhide mine in Tier 3. Kennecott owns the Cordero Rojo mine in Tier 2, while Triton operates the Buckskin mine in Tier 3. The only other significant SPRB producer is RAG American. Unlike the four major producers, RAG operates only 8400 Btu mines and has no 8800 Btu mine. RAG operates the Belle Ayr mine in Tier 2 and the Eagle Butte mine in Tier 3. The lower quality coal limits the importance and value of the 8400 Btu mines, particularly those in Tier 3, which are served by only the BNSF railroad.[12] , "

." PX at .

<u>Argument</u>

I. SECTION 13(b) OF THE FEDERAL TRADE COMMISSION ACT ESTABLISHES A PUBLIC INTEREST STANDARD FOR GRANTING INJUNCTIVE RELIEF.

Section 13(b) of the FTC Act, 15 U.S.C. § 53(b), provides that a preliminary injunction may be granted "upon a proper showing that, weighing the equities and considering the FTC's likelihood of ultimate success, such action would be in the public interest."[13]

Under the section 13(b) standard, the Court must grant a preliminary injunction "where such action would be in the public interest – as determined by a weighing of the equities and a consideration of the Commission's likelihood of success on the merits." *Heinz*, 246 F.3d at 714. The

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[12] PX0108 at 016 ("

") *See also* PX0123 at 002-003 (
).

[13] Congress intended the 13(b) standard "to depart from what it regarded as the then-traditional equity standard." *Heinz*, 246 F.3d at 714; *FTC v. Weyerhaeuser Co.*, 665 F.2d 1072, 1081-82 (D.C. Cir. 1981)(quoting H.R. Rep. No. 93-624, at 31 (1971)); *see also FTC v. Libbey, Inc.*, 211 F. Supp. 2d 34, 44 (D.D.C. 2002) ("[t]his standard is broader than the traditional equity standard that is normally applicable to requests for injunctive relief"). In particular, the FTC is not required to show irreparable harm. *Heinz*, 246 F.3d at 714; *Elders Grain*, 868 F.2d at 903; *FTC v. Warner Communications, Inc.*, 742 F.2d 1156, 1159 (9th Cir. 1984).

court's "task is not to make a final determination on whether the proposed [acquisition] violates Section 7, but rather to make only a preliminary assessment of the [acquisition]'s impact on competition."[14] If the Commission is deemed likely to succeed on the merits, a presumption arises in favor of granting the preliminary injunction. *See, e.g., PPG Industries,* 798 F.2d at 1507. Moreover, "[i]n balancing the public and private equities, benefits to the public are entitled to substantially more deference than the benefits to the private defendants." *FTC v. Cardinal Health, Inc.*, 12 F. Supp. 2d 34, 66 (D.D.C. 1998).

II. THE FEDERAL TRADE COMMISSION IS LIKELY TO SUCCEED ON THE MERITS IN ESTABLISHING THAT THE PROPOSED ACQUISITION VIOLATES THE ANTITRUST LAWS.

Section 7 of the Clayton Act prohibits any merger "where in any line of commerce in any section of the country, the effect of such acquisition *may be* substantially to lessen competition or to tend to create a monopoly." 15 U.S.C. § 18 (emphasis added). "All that is necessary is that the merger create an *appreciable danger* of [anticompetitive] consequences in the future. A predictive judgment, necessarily probabilistic and judgmental rather than demonstrable, is called for." *Heinz*, 246 F.3d at 719 (citations omitted) (emphasis added).

In determining whether the FTC has established a likelihood of success on the merits, the court must measure the probability that, after an administrative hearing on the merits, the Commission will succeed in proving that the proposed merger may substantially lessen competition,

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[14] *FTC v. University Health, Inc.*, 938 F.2d 1206, 1218 (11th Cir. 1991); *Warner Communications,* 742 F.2d at 1162; *see also Heinz*, 246 F.3d at 714; *Libbey,* 211 F. Supp. 2d at 44 (D.D.C. 2002); *FTC v. Swedish Match*, 131 F. Supp. 2d 151, 156 (D.D.C. 2000); *Cardinal Health,* 12 F. Supp. 2d at 45; *Staples,* 970 F. Supp. 1066, 1070-71 (D.D.C. 1997). This Court need not resolve all conflicts of evidence or analyze extensively all antitrust issues; that is the province of the administrative proceeding. *Warner Communications*, 742 F.2d at 1164, citing *FTC v. Lancaster Colony Corp.*, 434 F. Supp. 1088, 1094, 1096 (S.D.N.Y. 1977); *FTC v. Food Town Stores, Inc.* 539 F.2d 1339, 1342 (4th Cir. 1976) ("The district court is not authorized to determine whether the antitrust laws have been or are about to be violated. That adjudicatory function is vested in the FTC in the first instance.").

or tend to create a monopoly. *Heinz,* 246 F.3d at 714. To meet its burden, the FTC need only "raise[] questions going to the merits so serious, substantial, difficult and doubtful as to make them fair ground for thorough investigation, study, deliberation and determination by the FTC in the first instance and ultimately by the Court of Appeals." *Id.* at 714-15 (citations omitted).

By reducing to three – Arch, Peabody, and Kennecott – the firms that control all 8800 SPRB production, and of 8400 SPRB Btu capacity (and of SPRB 8400 excess practical capacity), Arch's proposed acquisition of Triton results in a highly-concentrated SPRB market that is presumptively illegal under controlling case law and the Merger Guidelines.[15] Here, however, as set forth in more detail below, the market shares are likely significantly to *understate* the competitive concerns posed by the merger. The strong concerns expressed by the parties' electric utility customers are mirrored by the view of SPRB producers that increased concentration renders "market discipline" more feasible. Arch is a leading proponent of such discipline as a means of achieving higher prices, and by increasing Arch's share of the market – and of excess production capacity – the acquisition of Triton (or North Rochelle) makes coordinated interaction more likely, while simultaneously reducing the ability of the "competitive fringe" to constrain anticompetitive coordinated interaction by the market leaders.

A. <u>The Relevant Market Is No Broader Than All SPRB Coal, and May Include Narrower Markets Therein</u>

In ascertaining the likely competitive effects of a prospective merger, "defining the relevant market is the starting point for any merger analysis." *Cardinal Health*, 12 F. Supp. 2d at 34. "The

[15] *See, e.g., Heinz*, 246 F.3d at 715-16 ("[i]ncreases in concentration above certain levels are thought to 'raise[] a likelihood of 'interdependent anticompetitive conduct'"; adopting Merger Guidelines' principle that an "HHI increase of more than 100 points, where post-merger HHI exceeds 1800, is 'presumed . . . likely to create or enhance market power or facilitate its exercise'"). *See also United States v. Baker Hughes*, 908 F.2d 981, 982 n.3 (D.C. Cir. 1990); *PPG Industries*, 798 F.2d at 1503.

general rule when determining a relevant product market is that 'the outer boundaries of a product market are determined by the reasonable interchangeability of use [by consumers] or the cross-elasticity of demand between the product itself and substitutes for it.'" *Staples*, 970 F. Supp. at 1074. Invoking these concepts, courts analyze a number of factors and practical indicia in an attempt to delineate relevant markets around "groups of producers which, because of the similarity of their products, have the ability – actual or potential – to take significant amounts of business away from each other." *SmithKline Corp. v. Eli Lilly & Co.*, 575 F.2d 1056, 1063 (3d Cir.), *cert. denied*, 439 U.S. 838 (1978); *Staples*, 970 F. Supp. at 1075.

In defining relevant product markets, courts must be careful to "exclude any other product to which, within reasonable variations in price, only a limited number of buyers will turn . . . ." *Times-Picayune Publishing Co. v. U.S.*, 345 U.S. 594, 612 n.31 (1953). The *Merger Guidelines* define the product market as "a product or group of products such that a hypothetical profit-maximizing firm that was the only present and future seller of those products ('monopolist') likely would impose at least a 'small but significant and nontransitory' increase in price" ("SSNIP").[16] *Merger Guidelines* § 1.11. In the present case, numerous customers have testified that they would not alter their purchases of SPRB coal in response to a SSNIP, a fact supported by the documents of the parties and others in the industry, as well as by the physical properties of the coal and other practical indicia bearing upon product market definition.

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[16] The price increase generally envisioned by the Merger Guidelines and often used by courts in performing this "SSNIP" test is 5 percent. *Merger Guidelines* § 1.11; *Staples*, 970 F. Supp. at 1076 n.8. Thus, in the present case, the relevant inquiry is whether a hypothetical monopolist controlling all SPRB coal (or perhaps controlling certain sub-types of SPRB coal such as 8800 BTU coal) would be able profitably to sustain a price increase of approximately 5 percent at the mine mouth.

1. *Practical Indicia Point to a Relevant Market for SPRB Coal.*

In delineating relevant markets, courts typically rely upon a number of "practical indicia."[17] Not all of these factors need be present before a relevant market can be found. *Staples,* 970 F. Supp. at 1075 (markets can be found "even if only some of these factors are present"). The most important factor is industry and public recognition of the market as distinct. Courts have gone on to clarify that "[t]he delineation of the relevant market in the end is 'a matter of business reality – of how the market is perceived by those who strive to profit in it.'" *Cardinal Health,* 12 F. Supp. at 46 (citations omitted). "Thus, 'industry or public recognition of the [market] as a separate economic unit matters' because we assume that economic actors usually have accurate perceptions of economic realities." *Rothery Storage,* 792 F.2d 210, 219 (D.C. Cir. 1986).

a. Industry and Public Recognition of the Market

Defendants recognize SPRB coal as a distinct product market. The parties repeatedly refer to .[18] They also recognize market phenomena suggesting that SPRB coal is economically distinct. For example, in setting SPRB coal prices, producers do not take into consideration the prices for coal mined in other regions. Arch CEO Steven Leer :

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[17] This Court recently has endorsed these criteria. *Cardinal Health*, 12 F. Supp. 2d at 46; *Staples*, 970 F. Supp. at 1075 (citations omitted).

[18] PX0093 at 002, 025-033 (Arch "); PX0074 at 002 (Arch document showing); PX0601 at 002 (Triton document showing); PX0624 at 002 (Triton document); PX0064 at 052-064; PX0129 at 090-105. . *See e.g.* PX0103 at 002. The Northern PRB, comprising mines in the Montana portion of the PRB, is severely constrained in competing with the SPRB, due primarily to substantially higher taxes imposed by the state of Montana, and the inferior quality of the coal. PX ¶ .

"

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." PX0103 at 001-002.

Similarly, an Arch marketing document states: "

" (italics in original). PX0153 at 001.

Testimony from utility customers that individually purchase tens of millions of dollars worth of coal each year clearly supports SPRB coal as a distinct market. The Tennessee Valley Authority ("TVA") which purchases 6 to 7 million tons of SPRB coal annually, costing about $120 million, including freight, states:

> SPRB coal represents a critical source of plentiful, inexpensive, low-sulfur coal for the U.S. electricity generating industry . . . . Given the large gap in the price between SPRB coal and other low-sulfur coals, and the plentiful supply of SPRB in comparison to other low sulfur coals, a monopolist of SPRB coal could push the price of SPRB coal higher and could also influence contract terms and conditions in a direction not supported by current competitive forces. PX0021 (TVA) ¶¶ 8, 16."

Many other generating companies expressed similar concerns relating to sourcing alternatives to SPRB coal and stated that they would not switch to other coal even in response to a 5%-10% increase in SPRB coal prices.[19]

Testimony and documents of competitors and other third parties also point to the SPRB as a distinct market.[20] Moreover, the D.C. Circuit previously has recognized, in a non-antitrust setting,

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19 ¶ ; PX ¶ ; PX ¶ ; PX ¶¶ ; PX ¶ ; PX ¶ ; PX ¶ ; PX ¶ .

20 PX4200 at 015, 019, 023 (differentiating between the Wyoming mines of the SPRB and the Montana mines of the Northern Powder River Basin ("NPRB") and providing separate production data, etc. for each region); PX at document including

that "there is actually little or no real competition between [PRB and Unita Basin] coal."[21]

There is also evidence of documents and statements of industry participants that may support finding a distinct market within the SPRB for 8800 Btu coal.[22] For example, Arch's CEO has recognized that . PX0214 at 001. Triton's Vice President of Marketing . PX1259 at 012. Many power generating companies recognize 8800 Btu SPRB coal as a distinct product and would not switch from 8800 Btu coal to 8400 Btu coal in response to a 5%-10% increase in the price of 8800 Btu coal.[23]

b. SPRB Coal's Distinct Characteristics and Uses

SPRB coal has a unique set of properties: low sulfur content, low sodium content, low mining costs, low transportation costs - that distinguish it from other types of coal.

Physical Properties. SPRB coal has a unique combination of price and non-price characteristics that distinguish it from other types of coal. It has a very low sulfur content (generally

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production market shares of all SPRB producers and a chart of SPRB demand for 2000-2005 from various sources).

[21] *Western Coal Traffic League v. Surface Transp. Bd.,* 169 F.3d 775, 780 (D.C. Cir. 1999).

[22] In a product market for 8800 Btu coal, the HHI concentration resulting from the merger would be 3382, an increase of 590. PX at . Regardless of whether there is a narrower 8800 market within the market for SPRB coal, the economic analysis of the merger is the same. Post-merger, the three producers of 8800 Btu coal would find it profitable to increase 8800 Btu coal prices, because these three producers also control the majority of 8400 Btu production capacity. Accordingly, they would be able to operate safely in the knowledge that the excess capacity of the "fringe" 8400 Btu coal producers *(i.e.,* RAG, and any new owner of Triton's Buckskin mine) would be insufficient to constrain an 8800 Btu coal price increase. Indeed, an 8800 Btu price increase may well lead to increased demand, and higher prices, for 8400 Btu coal as well.

[23] PX ¶ ; PX ¶ ; PX0038 (TVA) ¶ 4; PX ¶ ; PX ¶ ; PX ¶ .

.8 lbs/MM Btu and below), which makes it compliant with the sulfur emissions provisions of Phase II of the Clean Air Act Amendments (limiting sulfur emissions to no more than 1.2 lbs/MM Btu);[24] it has a heat content of roughly 8300-8800 Btu, and it has relatively low sodium content, which can reduce operational problems caused by slag build-up in power plant boilers.[25]

Within the SPRB, 8800 Btu coal has a 5% higher Btu content, and a lower sulfur content, than 8400 Btu SPRB coal, characteristics many customers find advantageous.[26] Because it takes less 8800 Btu coal than 8400 Btu coal to generate a given heat output, customers find it economical to ship 8800 Btu coal greater distances than 8400 Btu coal. Thus, for customers located significant distances from the SPRB mines, 8800 Btu coal often presents the most economic option. Because some boilers are constrained at the margin in the amount of coal they can process, the use of higher heat-content 8800 Btu coal may enable them to maximize their electrical output, rather than being "derated."[27] For all these reasons, many power generators purchasing 8800 Btu coal are unlikely to substitute 8400 Btu coal in response to a SSNIP.

Low Mining Costs. SPRB coal is found close to the Earth's surface in large, horizontal seams with a typical thickness of 50 to 100 feet. PX0669 at 007;

Consequently, SPRB coal is strip mined in huge, open pit surface mines. PX0669 at 007; PX

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24 42 U.S.C. §7401; PX0098 at 010; PX0021 (TVA) ¶ 8;

25 PX 4200 at 027; PX0021 (TVA) ¶ 10;

26 PX ¶ ; PX ¶ ; PX ¶ .

27 Derate refers to the inability of an electrical generating unit to obtain its full rated design load because it is not possible to move a sufficient volume of a lower energy content coal through the unit. The lower the energy content of the coal, the more coal that must be moved through the unit in order to generate the same amount of electricity.

. This method of mining has a lower cost than traditional deep-shaft, vertical mining techniques that are typically used in other mining regions, such as Appalachia and the Illinois Basin.[28] As a consequence of this low cost and of competition among SPRB producers, the price of SPRB coal is substantially lower at the mine mouth, FOB, than other types of coal.

Low Transportation Costs. Mines in Tier 1 and Tier 2 of the SPRB, including all 8800 Btu mines, have access to two rail lines, the Union Pacific and the Burlington Northern. PX0772 at 036, 066. The railroads have invested significant amounts of capital in rail facilities to handle the huge amounts of coal that are moved out of the SPRB each year. PX0770 at 019. Other producing regions, such as Colorado, are impeded by rail bottlenecks. PX0021 (TVA) ¶ 9. As a consequence of competition between the two rail lines and the infrastructure they have created, customers for SPRB coal enjoy relatively favorable shipping rates. PX0770 at 019; PX ¶ . As a result of low mining costs and favorable shipping rates, SPRB coal is by far the lowest cost available low sulfur coal on delivered cost basis for many U.S. generating companies.[29]

2. *Economic Assessment of Demand Supports a Market for SPRB Coal.*

Demand for SPRB coal is relatively insensitive to changes in price; a monopolist could profitably increase the price of all SPRB coal by 5-10%.[30] In addition to the numerous customer statements and industry documents indicating that the SPRB is a relevant market, modeling by

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28 PX0669 at 007; . For example, while 8800 Btu SPRB coal currently sells for approximately $6.50 per ton FOB and 8400 Btu coal currently sells for approximately $5.25 per ton, Colorado and Utah coal sells for $17 per ton FOB, and low-sulfur Appalachian coal sold in late 2003 for $33 per ton. PX0021 (TVA) ¶ 9; PX5906; PX5639. Recently, premium Appalachian coal has sold for over $55 per ton. **http://www.eia.doe.gov/cneaf/coal/page/coalnews/coalmar.html**

29 PX0770 at 018 (" ."); PX0112 at 002 (SPRB coal is the " ")

30 See *supra* n. 16 and accompanying text.

, shows that a small change in the price of SPRB coal would have little effect on the level of demand.[31]

The price of 8800 Btu SPRB coal moves independently of the price of coal in other regions of the United States.[32] Arch's CEO has conceded that PX1044 at 323. An internal document of , confirms that the demand for SPRB coal is inelastic, or insensitive to price increases, reinforcing the conclusions of the economic studies. PX at .

On the basis of the evidence outlined above, the relevant product market likely is no broader than all SPRB coal, and there may be a narrower market for 8800 Btu SPRB coal. As noted *supra* at n. 22, regardless of whether the latter constitutes a distinct product market, the most direct effect of the acquisition may be felt by purchasers of 8800 Btu SPRB coal.

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[31] . This modeling, , predicts a 5% price increase for SPRB coal would lead to a reduction in quantity demanded of or less and a 10% price increase would lead to a reduction in quantity demanded of or less. PX at At these levels, a hypothetical monopolist of SPRB coal would find a 5-10% price increase profitable.

[32] The spot price for 8800 Btu SPRB coal increased by 80 cents per ton (14%), over the eight-month period July 11, 2003 to March 21, 2004, while Central Appalachian coal increased by $23.70 per ton (71.2%). *Compare* PX5909 at 001-002 and PX5906 at 002-003. SPRB producers are now making their price move. In the week ending April 12, 2004, the spot price of 8800 Btu SPRB coal increased by $1.05 per ton (16.2%) while Central Appalachian coal increased by 25 cents per ton (0.4%). PX5910 at 002-003.

B. A Relevant Geographic Market in which to Analyze the Transaction Is the SPRB.

A relevant geographic market in which to analyze the effects of a proposed acquisition encompasses "the region 'in which the seller operates, and to which the purchaser can practicably turn for supplies.'" *Cardinal Health*, 12 F. Supp. at 49 (citing *Tampa Elec. Co. v. Nashville Coal Co.*, 365 U.S. 320 (1961)); *Merger Guidelines* §1.21. In this instance, the relevant geographic market is the Southern Powder River Basin. Both Arch and Triton operate mines in the SPRB as do Peabody and Kennecott, the other leading producers of SPRB coal.[33] There are no mines located outside the SPRB to which a significant number of SPRB coal customers could and would switch purchases in response to a small increase in price for SPRB coal.

C. This Acquisition Will Increase Concentration Significantly in an Already Highly Concentrated Market.

The ability of firms to coordinate their actions[34] – to pull their competitive punches, with the expectation that their competitors would do the same – depends in substantial part on the number of significant participants in the market.[35] "The fewer competitors there are in a market, the easier it is for them to coordinate their pricing without committing detectable violations of section 1 of the Sherman Act, which forbids price fixing." *Hospital Corp. of Am.*, 807 F.2d at 1387. Courts have found mergers to violate section 7 where the number of competitors post-acquisition was greater than

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[33] ; PX5675 at 001-004; PX4200 at 012-014.

[34] Coordination need not be explicit price fixing, but includes tacit coordination and interdependent behavior. *Elders Grain*, 868 F.2d at 905 (". . . if conditions are ripe, sellers may not have to communicate or otherwise collude overtly in order to coordinate their price and output decisions; at least they may not have to collude in a readily detectable manner."); *Merger Guidelines*, § 2.1.

[35] "The relative lack of competitors eases coordination of actions, explicitly or implicitly, among the remaining few to approximate the performance of a monopolist." *Cardinal Health*, 12 F. Supp. 2d at 45 n.8; *PPG Indus.*, 628 F. Supp. at 885 n.9 (D.D.C.).

the present case, particularly when a market is conducive to coordinated interaction. *See Elders Grain,* 868 F.2d at 902 (reduction from 6 to 5 competitors); *Hospital Corp. of Am.,* 807 F.2d at 1387 (reduction from 11 to 7 competitors); *United States v. UPM-Kymmene OYJ*, 2003-2 Trade Ca. (CCH) ¶74,101 (N.D. Ill. 2003) (reduction from 10 to 9); *FTC v. Bass Brothers Ents., Inc*, 1984-1 Trade Cas. ¶ 66,041, at 68,609-10 (N.D. Ohio 1984)(reduction from 7 to 5); *Warner Communications*, 742 F.2d 1163 (9th Cir. 1984) (reduction from 6 to 5).

In this case, by reducing the number of significant SPRB firms from 5 to 4, and the number of 8800 Btu firms from 4 to 3, the merger increases the likelihood of coordinated interaction. The post-merger market would be dominated by just three firms - Arch, Peabody and Kennecott - who together will have a production market share of 86% in the SPRB. PX at . The resulting post-merger concentration levels are well above the Merger Guidelines' threshold level of 1800 for highly concentrated markets, in which an increase of 100 points or more resulting from a merger is presumed anticompetitive. *Merger Guidelines* § 1.51. In numerous cases, courts have found such concentration levels compelling in enjoining merger transactions, particularly where just a few firms would account for a substantial portion of the relevant market.[36]

Even if Arch determined to follow through with its proposal to sell the Buckskin mine to Kiewit, its acquisition of just the North Rochelle mine

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36 *See, e.g.*, *Hospital Corp. of Am.*, 807 F.2d at 1384 (acquisition found unlawful where increase in market share of acquiring from rose from 14% to 26% and four largest firms post-merger controlled 91% of the market); *Elder's Grain*, 868 F.2d at 905 (injunction warranted against merger that reduced from 6 to 5 the number of firms in the market for industrial dry corn, because merger "will make it easier for leading members of the industry to collude on price and output without committing a detectable violation of section 1 of the Sherman Act"); *United States v. Rockford Mem'l Corp.*, 898 F.2d 1278, 1283 (7th Cir. 1990) ("[t]hree firms having 90 percent of the market can raise prices with relatively little fear that the fringe of competitors will be able to defeat the attempt by expanding their own output to serve customers of the three large firms"); *Cardinal Health*, 12 F. Supp. 2d at 52 (mergers resulting in two firms with 40% and 37% respectively "clearly cross the 30% threshold"); *Coca-Cola*, 641 F. Supp. at 1134, 1139 (combined market share of 42% held presumptively unlawful).

of the capacity in the SPRB coal market, would leave Kiewit as only a minor player less than half the size of RAG, and would increase the HHI by 193 points to 2346, levels which this court and others have deemed presumptively illegal.[37] Given the market structure and concentration levels, there is a presumption of illegality, irrespective of whether Arch ultimately retains both North Rochelle and Buckskin or only North Rochelle.

D. This Merger Is Likely to Harm Competition Substantially.

Beyond the legal presumption based on the reduction in the number of significant SPRB producers, a review of the facts surrounding the proposed merger and the market in which it occurs results in the inevitable conclusion that section 7 of the Clayton Act would be violated. The electric utilities who purchase SPRB coal, and who are knowledgeable and sophisticated buyers, have expressed strong and well-founded concerns regarding the likely effect of the merger in raising SPRB prices. These concerns find confirmation in the statements of SPRB producers and other market participants, who clearly view coordination not only as desirable, but as increasingly feasible with market consolidation. SPRB firms have sought to coordinate their efforts in the recent past – most notably in 2000-2001 – and these efforts demonstrate one way such coordination might be implemented. Moreover, the structure of the SPRB exhibits many of the "plus factors" that make it conducive to coordinated interaction.

There also are strong reasons to believe that this acquisition would render efforts at coordination more successful. Chief among the firms calling for market discipline has been Arch,

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37 *Warner Communications*, 742 F.2d at 1163 (preliminary injunction warranted where merger combined second largest firm with 18.9% market share with sixth largest firm with 7.1% market share, resulting in four-firm concentration ratio of 75%); *FTC v. Bass Bros. Enters. Inc.*, 1984-1 Trade Cas. ¶ 66,041 at 68,609-10 (N.D. Ohio 1984) (acquisition increased market share of second largest firm from 20.9% to 28.5% and the HHI by 318 points, from 1802 to 2120); *UPM-Kymmene OYJ*, 2003-2 Trade Ca. (CCH) ¶74,101 (injunction warranted where merger increased the HHI by 190 points to 2990 in one market; by 290 points in another market; and 3 firm concentration would account for 80% of production).

which post-merger would control the principal source of excess capacity for both 8800 Btu (North Rochelle) and 8400 Btu (Coal Creek) coal. At the same time, the North Rochelle mine, which historically has been the principal disruptive force in the SPRB, no longer would be in the hands of a competitor outside the "big three."

1. *Customer Concerns Raise a Red Flag Regarding this Transaction.*

A fundamental principle of antitrust law, and indeed its *raison d'etre*, is to protect competition for the benefit of customers. *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477 (1977). In measuring the anticompetitive effect of a merger, courts invariably examine its effect on the customers of the merged companies: "'A key factor to consider in analyzing whether the proposed acquisition will violate Section 7 is the impact of the transaction on . . . customers.'" *United States v. IVACO*, 704 F. Supp. 1409, 1427 (W.D. Mich. 1989) (quoting *FTC v. Great Lakes Chemical Corp.*, 528 F. Supp. 84 (N.D. Ill. 1981)). Where customer predictions are supported by the evidence, courts give them significant weight. *Id.* at 1428. If, as Arch claims, the proposed transaction would provide higher output and lower prices for SPRB customers, those customers would have every reason to support the transaction. They do not. Instead, sophisticated customers purchasing hundreds of millions of dollars of SPRB coal predict that competition will be substantially diminished as a result of Arch's acquisition of Triton. These customer concerns are supported by significant evidence and deserve to be given substantial weight. The following are just a few examples of the strong customer concerns.

- a purchaser of about million tons of SPRB coal annually, " " PX ¶ . "

" Id.

Id.

- . He states that " " PX SPRB producers' ability to gain and exchange information about competitors' mining operations: " " Id. ¶ .

- which purchases million tons of SPRB coal annually, states " " PX ¶

- , another significant coal purchaser million tons coming from the SPRB, states that he has " " PX ¶ . " " Id. ¶

- , which purchases million tons of SPRB coal annually, states that it " " PX ¶

Many other generating companies expressed similar concerns relating to sourcing alternatives to SPRB coal and stated that they believe that the acquisition will lead to price increases.[38]

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[38] PX0021 (TVA) ¶¶ 16, 17; PX ¶ ; PX ¶¶ ; ¶ ; PX ¶ ; PX ¶ ; PX ¶ ; PX ¶¶ ; PX

2. *The Merger Will Eliminate a Significant Independent Firm in a Highly Concentrated Market.*

There is substantial evidence that Triton, particularly through its North Rochelle mine has served as a constraining force to coordination in the market.

PX0668 at 14. North Rochelle's production increased by almost percent from million tons in 1999, to million tons in 2000, to million tons in 2001. PX0668 at 14, PX1040. A Triton document confirms . PX0621 at 003. The expansion of North Rochelle in part contributed to the events in the spring of 2000 during which Arch, Peabody, Kennecott and RAG announced production reductions.[39] Triton executives stated that . PX1259 at 400-402; PX4200 at 095-096.

, Andrew Blumenfeld, the VP of market research for Arch Coal Sales, wrote to John Eaves, Arch's Executive VP, Marketing, that

[40] Similarly,

¶¶ ; PX ¶ ; PX ¶ ; PX ¶ ; PX0036 (City Public Service of San Antonio) ¶17.

39 Hill & Associates, a leading industry analyst, confirms this view of the events of 2000: "During the middle of 2000, Arch, Peabody, Kennecott, and RAG all showed restraints in the market. Vulcan, on the other hand, was in a build-up mode at North Rochelle. Thus, it subsequently increased production." [emphasis added.] PX4200 at 095-096.

40 PX0165 at 002 ("

"

, Bob Messey, Arch's Chief Financial Officer, summarized a discussion on, *inter alia*, whether the company should "

" Mr. Messey noted: "

" PX0063 at 001-002.

3. *Fringe Firms Cannot Expand Output Sufficiently to Counteract an Anticompetitive Price Increase.*

A key factor in determining whether a reduction in the number of competitors will increase the likelihood of coordinated interaction is the ability of smaller firms to expand should the major firms reduce their output in order to raise price. *Hospital Corp. of Am.*, 807 F.2d at 1387. Here, post-merger, four firms will control 100% of the market; three firms will control 86% of the market, a situation virtually identical to that in the Rockford hospital market. *Rockford Mem'l.*, 898 F.2d at 1283. Judge Posner explained in *Rockford Mem'l.* that small producers often have higher costs than larger producers, limiting their ability to expand at pre-merger prices. *Id.* at 1283-84.

RAG, currently the number five producer with about 11.7 percent of 2003 SPRB production, has little ability to disrupt coordinated interaction.

").

[41]

Even were RAG to expand, it is unlikely that it would be able to exert much of an effect on pricing. RAG's two mines, which only produce 8400 Btu coal,

. RAG has no 8800 Btu coal.

[42]

For the reasons stated in Section IV, *infra*, Arch's proposed divestiture of one of Triton's two mines – the Buckskin mine, to Kiewit – is not properly before this Court on the pending preliminary injunction. Even if this executory transaction were to be considered, however, the transfer could not constrain anticompetitive price increase by the three major competitors. Buckskin produces only lower priced, lower heat content 8400 Btu coal; it is served by only one rail line; and it has a limited ability to expand production. PX1260 at 114-15, 117-119. As Arch conceded in its

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[41]

[42] PX at . See also PX at ("

") Two other producers in the basin, Wyodak and Western Fuels Association, account for approximately 1 percent each of the total SPRB production.

analyzing the market, "

." PX0108 at 015.

4. *Arch Has been the Leading Proponent of Limiting Coal Production.*

Arch's own statements and conduct clearly reveal its belief that production coordination is feasible in the SPRB. For example, *Coal & Energy Price Report*, July 18, 2002, reports: "Arch Coal, preaching and practicing discipline as fervently as a Baptist preacher, reduced production, and the company's CEO, in a recent Arch earnings report, called such a decision 'the single most significant factor' in its financial performance."[43] A March 18, 2002 PRNewswire-FirstCall news story likewise reported that Arch announced production cuts during a period of increasing prices and even though such cuts would adversely impact Arch's earnings.[44] Indeed, a major SPRB customer states in its declaration that "

" PX ¶ . An internal memo from Arch's CEO Leer acknowledges that Arch has been

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"

43 Complaint ¶ 33(d); PX0628 at 001. See PX1041 at 001.

44 Complaint ¶ 33(c); PX0602 at 001. *See also* Complaint ¶ 33(e); PX5003 at 001 (April 21, 2003 earnings report stating "

")

— " (emphasis added)[45]

By eliminating Triton, Arch will likely have more success in persuading other SPRB competitors to follow its lead in restraining the growth of SPRB coal production. Indeed, Arch has expressly linked successful SPRB coordination to increasing concentration. For example, at a presentation to the Western Coal Transportation Association in Santa Fe, New Mexico, on April 17, 2001, Arch asked " ?" in "Supply/demand balance." PX0656 at 015. In the Southern PRB, it noted "Fewer producers, so greater potential for discipline." PX0656 at 015. In a presentation at a bank meeting, Arch rhetorically asked the following question and gave the following answer:

. PX0154 at 008.

5. *Other Industry Participants and Market Observers also Believe Coordination Is Feasible and Is Facilitated by Increased Concentration.*

Although Arch has been the leading proponent of restraining production, documents from SPRB competitors and other industry participants reveal that they also believe that coordination in the SPRB is feasible, and will be facilitated by increased consolidation. For example, a memorandum from Triton's CEO Jim Hake notes " "[46] A Triton internal memo dated November 3, 2000, reports that "

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45 Complaint ¶ 33(e); PX0104 at 001-002. *See also* PX0105 at 001 (internal report on First Quarter Results stating Arch had taken a " " to support higher prices.)

46 PX0644 at 002. *See also* PX0640 at 068 (February 6, 2001 investment banker presentation on behalf of Triton stating that a joint venture or merger with Triton " "); PX0701 at 002.

" PX0626 at 004-005. It further states that including " " . PX0626 at 005.

Other SPRB competitors likewise have anticipated that consolidation will lead to increased pricing. regarding Powder River Basin Mine Strategy, revealed:

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PX at .

A

"

. . ." PX at

. report on U.S. coal markets, reveals long term market view that "

"[47] document expressed the belief that "

. " PX at . The author of the document,

, further explained that he meant "

"

.

PX at .

Industry analysts and consultants also believe that consolidation and restraint in the growth of

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[47] PX at . *See also* PX at document stating "

" ; PX at .

production will lead to higher prices. For example, a 2003 Hill & Associates Report entitled "The Coal Trading Handbook" states:

> . . . there has been an increasing concentration of ownership in recent years and some of the large producers have shown a willingness to shut in production when the market is over-supplied. This tendency has been reinforced by the fact that more of the coal producers are publicly traded companies. Some of those that have shown restraint recently include: Consol, Peabody, Arch, RAG and Kennecott (RTZ). PX0127 at 082.

Similarly, at a conference stated " " is one of the " "; " " . PX at , . Coal Industry consultants and other industry participants as diverse as have all cited the trend toward consolidation as a factor supporting higher pricing and slower growth in mine production.[48]

Investment analysts following coal stocks have closely followed and applauded consolidation within the industry and coal companies' announcements of output reductions. A report of May 29, 2003, states that with Arch acquiring Triton's two mines, consolidation in the PRB " " PX0088 at 058. An April 2003 research report titled " " notes that:

48 PX0615 at 011 (" ," among other factors, contributes to " "); PX at); see also PX at ; PX0657 at 011; PX at ; PX at ; PX3306 at 003-004; PX at ; PX0081 at 0005; PX0604 at 004; PX0608 at 002, 024; PX0243.

[49]

A Merrill Lynch report on the coal industry of May 12, 2003 states:

> We believe that there exists a positive fundamental case for long term investment in the coal industry. The key, however, remains the uncertain balance of supply and demand . . . . supply could exceed demand without continued producer discipline, especially on the expansion front . . . . We can not express forcefully enough that the current industry consolidation is much needed and long overdue. The consolidation that is occurring is, in our opinion, critical to the long-term profitability of the industry.[50]

6. *SPRB Firms Have Behaved in a Manner Consistent with the Belief that Coordinated Interaction Is Feasible.*

The actions of SPRB competitors are consistent with the belief that coordinated interaction in the SPRB is feasible. For example, SPRB producers regularly have signaled their intent to constrain growth in coal production. A particularly clear example of such public signaling occurred in 2000, when Irl Engelhardt, Chairman and CEO of Peabody Coal stated, in a April 25, 2000, speech to the Western Coal Transportation Association, that coal companies had mined too much coal and

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[49] PX0089 at 004. *See also* PX0160 at 001 (report stating " " are " "); PX0772 at 006, 063 (research report stating " "); PX0125 at 002.

[50] PX5202 at 002. See also PX0124 at 003 (report " "); PX0260 at 006. Documents of other analysts contain similar statements. PX0155 at 013; ; PX0113 at 003, 018 (presentation).

described the steps Peabody had taken to reduce oversupply.[51] A few days after the Engelhardt speech, Kennecott responded by issuing a press release announcing its intent to "temporarily curtail production" at its mines.[52] Shortly following the press release, *Coal Outlook* provided detailed information on Kennecott's plans to curtail production at specific mines.[53]

Arch also followed Peabody's lead. Speaking at the Western Coal Council's Spring Forum, on May 23, 2000, Arch President and CEO Steven Leer noted that overproduction had eroded coal prices and urged coal suppliers to "Produce Less Coal."[54] He stressed to his audience, including representatives of his competitors, that "Arch has been conscientious" in reducing capacity.[55]

Triton documents confirm "

."[56] The document also shows that Triton

.[57]

Triton, however, ultimately decided to expand output at the North Rochelle mine rather than cut back its production.[58]

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[51] Complaint ¶ 34(b); PX0658 at 004.

[52] Complaint ¶ 34(d); PX at .

[53] Complaint ¶ 34(d); PX5600 at 001.

[54] Complaint ¶ 33(a); PX0603 at 012; PX0253 at 013.

[55] Complaint ¶ 33(a); PX0603 at 013; PX0253 at 014.

[56] PX0611 at 001. For further discussion, see Complaint ¶ 34(f).

[57] PX0611 at 001. For further discussion, see Complaint ¶ 34(f).

[58] PX1259 at 371. Following the production cut-backs of 2000, in the spring of 2001, the price of 8800 Btu PRB coal increased by 300 percent from about $4.50 per ton to over $14 per ton. PX0131 at 028. Although prices eventually eroded from the spike levels, they have never returned to pre-spike levels. PX1325 at 19. Rather, they hit a plateau at approximately

The parties' documents reveal that

.[59] Arch documents explicitly

recognized

[60] Competitors acknowledge that they hope their production cut-backs will have an effect on their competitors' production. A document states:

[61] (emphasis added)

7. *The SPRB Market Is Conducive to Coordination.*

In addition to concentration, several other market features are relevant to determining whether coordinated interaction is likely: heterogeneity of the relevant product and producers, elasticity of demand, availability of key market information, characteristics of typical transactions, whether there

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$6.50/ton, which is significantly higher than pre-spike prices. PX5909 at 002. For further discussion, see Complaint ¶ 34(f).

59 PX0109 at 011 (" "; " "); PX0105 at 001 (memo in which Arch CEO Leer notes " ").

60 PX0092 at 033 (in a strategic document relating to Arch's Utah operations, Arch states, " "); *see also* PX0071 at 003 (" ").

61 PX at . For further discussion, see Complaint ¶ 34(f).

is evidence of tacit coordination today in the relevant market, and whether there has been express collusion in any coal market. *Elders Grain,* 868 F.2d at 905; *In Re High Fructose Corn Syrup Antitrust Litig.*, 295 F.3d 651, 656 (7th Cir. 2002); *Merger Guidelines* at § 2.1. The SPRB coal market has several characteristics that make it vulnerable to coordinated interaction.

a. SPRB Coal Is a Homogenous Product

8800 Btu SPRB coal and 8400 SPRB coal are relatively homogenous products.[62] Homogeneity facilitates coordinated interaction, because it is easier for sellers to agree on a common price for standardized products. *Elders Grain,* 868 F.2d at 905; *Hospital Corp. of Am.,* 807 F.2d at 1390. As in the high fructose corn syrup market, there are only two major grades of SPRB coal, differentiated by heat content: 8800 Btu coal and 8400 Btu coal. *In Re High Fructose Corn Syrup Antitrust Litig.*, 295 F.3d at 656-57. Morever, standard adjustments are made in pricing to account for any specific differences that do exist in the coal from different mines. Accordingly, buyers tend to treat coal produced from various mines within each category as a commodity. PX ¶

b. SPRB Producers Are Structurally Homogeneous

Post-merger, the four SPRB coal competitors will be relatively homogeneous in structure, a fact that tends to make it easier to reach terms of coordination. *Merger Guidelines* § 2.11. Different corporate structures among competitors may reduce the incentive to collude, because it may give competitors diverse incentives. *Hospital Corp. of Am.,* 807 F.2d at 1390. None is vertically integrated into power production or sells a complementary product not sold by other competitors. *Merger Guidelines* at § 2.1. While many SPRB coal mines have been owned and operated in the

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62 PX0831 at 001 (" ").

past by generating companies and oil companies, the four SPRB coal producers are traditional mining companies. PX ¶ . Among the major producers today, all but Triton are publicly held. The acquisition will eliminate this heterogeneity. Post merger, each of the three leaders, Arch, Kennecott and Peabody, would control roughly equal shares of the market. Each will control both 8800 Btu and 8400 Btu mines. Accordingly, with strong similarities between the leading firms in the post-merger market, the likelihood of coordinated interaction is enhanced.

c. Key Market Information Is Readily Available

In assessing whether a particular market is susceptible to coordinated interaction, an important consideration is whether the firms that would be engaged in coordination have sufficient information about the market and their rivals' activities to monitor whether rivals are adhering to the terms of coordination, *e.g.*, doing their share to reduce output. *Merger Guidelines* at § 2.11; *see also Hospital Corp. of Am.*, 807 F.2d at 1389 (market in which competitors "routinely exchange intimate information on prices and costs in connection with making joint applications to insurers" favors coordination). In the SPRB coal market, competitive information relating to pricing, production levels, etc. is available from a number of sources. PX0618 at 001-004. As one SPRB competitor observes, pricing is transparent and competitive information freely available. PX ¶ . SPRB producers regularly use trade conferences, the press and coal industry publications to inform the public on market conditions, production costs, coal production cuts, mine productivity and whether the company is gaining an adequate return for its coal.[63]

Timely and relatively reliable production and pricing information is available from a host of daily and weekly trade reports, including *Platts Coal Trade*, *Coal Price and Outlook*, among others.

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63 PX at ; PX1035 at 021, 028; PX at ; PX0097 at 020; PX5614 at 001.

These reports include such information as current and future OTC prices for SPRB coal and regularly report on changes in SPRB coal production levels by producers.[64] All regulated utilities are required to file Form 423 monthly with the Federal Energy Regulatory Commission ("FERC"), stating the quantity and quality of coal purchased and the delivered price for each source.[65]

Industry consultants, such as Hill & Associates and EVA, Inc., publish reports containing detailed competitive information about the SPRB markets. For instance, Hill & Associates publishes an annual study of competition in the market, which includes such important competitive information as total annual production, production capacity, and cost-of-production by mine.[66]

SPRB producers routinely learn competitive information from customers through bidding situations, including the identity of the winning bidder, sales volume availability, and the rank and range of final offer prices for each bid, from customers who convey this market intelligence to SPRB producers.[67] A Triton executive conceded that "

" PX1259 at 412.

right of first refusal, "

" PX0775 at 002.

The geographic isolation and small population of Northeastern Wyoming facilitates the flow of competitive information between coal companies operating in the SPRB. ¶ .

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64 PX ¶ ; PX ¶ .

65 PX ¶ ; PX ¶ .

66 PX4200 at 027, 073; PX ¶ .

67 PX0659 at 001 (Triton document noting and stating "

"); PX0664 at 001; PX0617 at 003; PX0605 at 003; PX at ; PX at ; PX0612 at 001; PX0830 at 003; PX0090 at 002; PX0240 at 001.

Gillette, Wyoming, a town of approximately 20,000 people, PX6500, is the only population center near the SPRB mines. Firm information is available from employees who interact in the same small community and have worked for multiple mines in the area.[68] For example, an e-mail from an Arch employee notes that and told him "

" PX0114 at 001.

PX0618 at 003. A 1999 Triton market report observes:

PX0618 at 003.

Routine meetings occur among mine engineers from the various companies during which substantial comparisons are made of mine operations, equipment used, and tonnages extracted. PX

¶ .

Another source of private information sharing among SPRB producers is merger and joint venture negotiations. For instance,

during those periods in 2001 and 2003 when Triton had been up for sale.[69]

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68 Complaint ¶ 34(e); PX at ; PX1259 at 402-03; PX ¶ .

69 PX609 at 002; PX0660 at 004; PX0633 at 001; PX0118 at 001; .

[70]

d. Collusion in the Coal Industry

The coal industry includes a history of collusion, which provides evidence that a market is vulnerable to coordinated interaction. *Elders Grain,* 868 F.2d at 905; *Merger Guidelines* at § 2.1. Collusion cases in the coal industry include *In re Anthracite Coal Antitrust Litig.*, 79 F.R.D. 707 (M.D. Penn. Sept. 29, 1979); *United States v. Tedesco,* 441 F. Supp. 1336 (M.D. Penn. 1977); *South-East Coal Company v. Consolidation Coal Co.*, 434 F.2d 767 (6th Cir. 1970); *see In re Grand Jury Criminal Indictments*, 469 F. Supp. 666 (M.D. Pa. 1978).

8. *Entry Will Not Defeat the Acquisition's Anticompetitive Effects.*

For entry to rebut the presumption of anticompetitive effect, the evidence must show not merely that a firm might enter, but that "entry into . . . . the market would likely avert anticompetitive effects from [the] acquisition."[71] Entry must be "timely, likely, and sufficient in its magnitude, character and scope to deter or counteract the competitive effects" of a proposed transaction.[72] For new entry to be likely, the sales opportunities available to a new entrant must be sufficient to enable the entering firm to operate at a large enough scale to make entry profitable. *Merger Guidelines*

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[70] PX1044 at 478-79; PX0101 at 001-002 (an Arch document containing "
")."

[71] *Staples*, 970 F. Supp. at 1086, *quoting Baker Hughes*, 908 F.2d at 989; *accord Swedish Match*, 131 F. Supp. 2d at 170; *Cardinal Health*, 12 F. Supp. 2d at 55. In order for entry to be sufficient to restore competition, it must be entry that replaces the competition that existed prior to the acquisition. *Cardinal Health,* 12 F.Supp 2d at 58; *see also United States v. United Tote,* 768 F. Supp. 1064, 1082 (D. Del. 1991) (rejecting entry defense when "entry . . . would not constrain anticompetitive price increases by incumbents").

[72] *Merger Guidelines* § 3.0; *see Cardinal Health*, 12 F. Supp. 2d at 55-58 (adopting "timely, likely, and sufficient" test).

§ 3.3.

In merger analysis, slow entry is not effective, constraining entry. *Elders Grain,* 868 F.2d at 905 ("three to nine years" means entry is "slow" such that "colluding sellers need not fear that any attempt to restrict output in order to drive up price will be promptly nullified by new production"). Entry must be *timely, i.e.*, normally within two years. *Merger Guidelines* § 3.2; *see United Tote*, 768 F. Supp. at 1080 ("a two year time frame is an appropriate measure of the time period in which significant anticompetitive harm can occur in the absence of entry"); *Ivaco, Inc.*, 704 F. Supp. at 1420 (three years is too long to "pose a significant restraint to price increases"); *Bass Bros. Enters., Inc*, 1984-1 Trade Cas. ¶ 66,041 (N.D. Ohio 1984).

The process that a new entrant in the SPRB would need to undertake would include acquiring a lease for the rights to mine the land; planning and designing the coal mine, including receiving environmental permits; and constructing the coal mine. While some of these steps could be pursued simultaneously, the total time for entry would likely take at least five years. Obtaining mineral rights in the SPRB, which are typically acquired from the federal government in a lease by application process, takes approximately three years. PX0668 at 28. Mine design and permit acquisition, including federal and state environmental permits, takes approximately 5 years. PX0668 at 29. Triton concedes that

. PX0668 at 30. Arch estimates that

. PX0132 at 035.

While there has been significant consolidation and change in ownership, there has been no new entry into the SPRB coal market since 1993.

III. THE EQUITIES WEIGH IN FAVOR OF PRELIMINARY INJUNCTIVE RELIEF.

Where, as here, the Commission has demonstrated a likelihood of success on the merits, defendants face a difficult task of "justifying anything less than a full stop injunction." *PPG*, 798 F.2d at 1506; *see Heinz*, 246 F.3d at 726; *Staples*, 970 F. Supp. at 1091. The strong presumption in favor of a preliminary injunction can be overcome only if: (1) significant equities compel that the transaction be permitted; (2) a less drastic remedy would preserve the Commission's ability to obtain complete relief at the conclusion of administrative litigation; and (3) a less drastic remedy would check interim competitive harm. *PPG*, 798 F.2d at 1506-07. *Weyerhaeuser*, 665 F.2d at 1085.

None of these three conditions are met in this case. *First*, in balancing the equities, the principal public equity is the effective enforcement of the antitrust laws. *Heinz*, 246 F.3d at 726. Without a preliminary injunction, the government often cannot restore competition via divestiture, to the public's detriment. *Id.*; *Weyerhaeuser*, 665 F.2d at 1086 n.31. "Section 13(b) itself embodies congressional recognition of the fact that divestiture is an inadequate and unsatisfactory remedy in a merger case . . . ."[73] Arch can offer little more than the private gains to be had from its ownership of the Triton mines. Its efficiency claims are largely speculative and cannot be verified. Moreover, there is no indication that they will inure to the benefit of consumers, and the consumers themselves do not believe that they will benefit from the merger.

Second, absent a preliminary injunction, Arch will take steps that will fundamentally alter the acquired assets, making it impossible to restore competition to pre-acquisition levels should the Commission ultimately prevail in the administrative litigation it has initiated. Arch may sell one of Triton's two coal mines to a third party, which will be impossible to recover. It also will merge

[73] *Heinz,* 246 F.3d at 726 (citing legislative history); *PPG*, 798 F.2d at 1508; *FTC v. Rhinechem Corp.*, 459 F. Supp. 785, 787, 790 (N.D. Ill. 1978); *Lancaster Colony*, 434 F. Supp. at 1096 ("At best, divestiture is a slow, cumbersome, difficult, disruptive and complex remedy").

Triton's North Rochelle mine with its Black Thunder mine, rationalize personnel and equipment, and make operational changes, such as reconfiguring mining pits, which may be impossible to reverse. Moreover, Arch may mine coal from the mines acquired from Triton rather than its own mines, depleting their reserves and preventing effective relief.

Third, the interim harm to Triton's mines may be substantial. Any remedy short of a preliminary injunction will not adequately check the interim harm; nor can Arch present any significant equities that override the principal public equity of effective enforcement of the Clayton Act. The private equities of allowing Triton to escape its troubled financial condition and allowing the holders of its debt to enjoy the benefits of the acquisition do not outweigh the Commission's showing of likelihood of success on the merits, and thus the court must enter a full stop injunction under § 13(b). *PPG*, 798 F.2d at 1506; *Weyerhaueser,* 665. F.2d at 1082-83.

IV. ARCH'S PROPOSAL TO SELL BUCKSKIN TO KIEWIT IS NOT PROPERLY BEFORE THE COURT

As plaintiff will argue more fully in plaintiff's forthcoming motion *in limine*, Arch's proposal to sell the Buckskin mine to Kiewit is not properly before this court under section 13(b) of the FTC Act. First, the proposed sale of Buckskin is clearly offered as a "self-help" attempt to remedy the competitive problems created by Arch's proposed acquisition of Triton. Answer ¶¶ 8, 9. As such, it is for the Commission in the first instance, subject to review by the Court of Appeals, rather than for the district court, to consider.[74] Second, the contract is wholly executory, and entirely contingent

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[74] *See* 15 U.S.C. §§ 21(a)-(d) (FTC authorized to enforce Clayton Act via administrative proceedings with review by court of appeals); 15 U.S.C. §§ 45(a)-(d) (FTC authorized to enforce FTC Act via administrative proceedings with review by the court of appeals); *accord Hospital Corp. of Am.* 807 F.2d at 1386 (J. Posner):

> One of the main reasons for creating the Federal Trade Commission and giving it concurrent jurisdiction to enforce the Clayton Act was that Congress distrusted

upon Arch acquiring Triton. Accordingly, if this court declines to issue a preliminary injunction, Arch will be free to acquire Triton and then may renegotiate, modify, amend or even rescind its agreement to sell the Buckskin mine.

Unlike in *Libbey*, defendants here have not restructured Arch's proposed acquisition of Triton, and defendants concede that pursuant to defendants' May 29, 2003 purchase agreement, Arch will acquire all the assets of Triton.[75] Moreover, the court would maintain no continuing jurisdiction under § 13(b) to oversee the Buckskin sale. The public would be denied the benefit of interim relief, and the Commission may be unable to craft meaningful and effective permanent relief following a full administrative adjudication on the merits.[76]

Section 13(b) limits the role of the district court to a determination of whether the public interest warrants preliminary relief during the pendency of administrative litigation. *Heinz*, 246 F.3d at 714-15. Under the statutory scheme set out by Congress, in cases such as this, where the

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judicial determination of antitrust questions. It thought the assistance of an administrative body would be helpful in resolving such questions and indeed expected the FTC to take the leading role in enforcing the Clayton Act, which was passed at the same time as the statute creating the Commission.

[75] Defendants' Answers to Complaint ¶ 8. *See FTC v. Libbey, Inc.*, 211 F. Supp. 2d 34 (D.D.C. 2002).

[76] *Warner Communications,* 742 F.2d at 1165 (a preliminary injunction should be granted if denial "would preclude effective relief if the Commission ultimately prevails'); *Swedish Match,* 131 F. Supp. 2d at 173 ("The absence of an injunction will also make it impossible to accomplish full relief should the Commission subsequently determine after a full administrative hearing that this acquisition does violation (sic) Section 7 of the Clayton Act."); *PPG Industries,* 798 F.2d at 1506-07 (Once the FTC establishes a likelihood of success on the merits, there is a strong presumption that a full-stop preliminary injunction should issue in order to serve these goals.)

Commission has issued an administrative complaint,[77] the questions of ultimate liability, and consequently remedy, are for the Commission in the first instance, and ultimately for the Court of Appeals. *See FTC v. Food Town Stores, Inc.*, 539 F.2d at 1342 ("The district court is not authorized to determine whether the antitrust laws have been or are about to be violated. *That adjudicatory function is vested in the FTC in the first instance.*") (emphasis added); *accord Heinz*, 246 F.3d at 714. Thus, under § 13(b), the court should not consider Arch's inadequate proposal to remedy competitive harm from this transaction by selling off the Buckskin mine.

As noted above, the D.C. Circuit long has held that once the district court determines that the FTC has established a likelihood of success on the merits, it "face[s] a difficult task in justifying anything less than a full stop injunction." *PPG*, 798 F.2d at 1506. The evidence here supports no less.

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[77] In issuing its administrative complaint, the Commission has determined to exercise its prosecutorial discretion and authority to develop the record in this case through administrative litigation. This will enable the agency to apply its administrative expertise in exploring the issues, and to articulate its views on the conduct alleged in the administrative complaint, thereby clarifying the laws it enforces.

Conclusion

For the foregoing reasons, the Court should grant the Commission's motion for a preliminary injunction against the proposed acquisition.

Respectfully submitted,

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APPENDIX I

PX 5675

2003 SPRB CAPACITY AND PRODUCTION AND CONCENTRATION ANALYSIS

APPENDIX II

LIST OF DECLARANTS
AND
DEPONENTS

APPENDIX III

U.S. Department of Justice and Federal Trade Commission, *Horizontal Merger Guidelines* (1992, rev'd 1997)

1992 HORIZONTAL MERGER GUIDELINES
[WITH APRIL 8, 1997, REVISIONS TO SECTION 4 ON EFFICIENCIES]

The U.S. Department of Justice ("Department") and Federal Trade Commission ("Commission") today jointly issued Horizontal Merger Guidelines revising the Department's 1984 Merger Guidelines and the Commission's 1982 Statement Concerning Horizontal Merger Guidelines. The release marks the first time that the two federal agencies that share antitrust enforcement jurisdiction have issued joint guidelines.

Central to the 1992 Department of Justice and Federal Trade Commission Horizontal Merger Guidelines is a recognition that sound merger enforcement is an essential component of our free enterprise system benefitting the competitiveness of American firms and the welfare of American consumers. Sound merger enforcement must prevent anticompetitive mergers yet avoid deterring the larger universe of procompetitive or competitively neutral mergers. The 1992 Horizontal Merger Guidelines implement this objective by describing the analytical foundations of merger enforcement and providing guidance enabling the business community to avoid antitrust problems when planning mergers. The Department first released Merger Guidelines in 1968 in order to inform the business community of the analysis applied by the Department to mergers under the federal antitrust laws. The 1968 Merger Guidelines eventually fell into disuse, both internally and externally, as they were eclipsed by developments in legal and economic thinking about mergers.

In 1982, the Department released revised Merger Guidelines which, reflecting those developments, departed dramatically from the 1968 version. Relative to the Department;s actual practice, however, the 1982 Merger Guidelines represented an evolutionary not revolutionary change. On the same date, the Commission released its Statement Concerning Horizontal Mergers highlighting the principal considerations guiding the Commission's horizontal merger enforcement and noting the "considerable weight" given by the Commission to the Department's 1982 Merger Guidelines.

The Department's current Merger Guidelines, released in 1984, refined and clarified the analytical framework of the 1982 Merger Guidelines. Although the agencies' experience with the 1982 Merger Guidelines reaffirmed the soundness of its underlying principles, the Department concluded that there remained room for improvement.

The revisions embodied in the 1992 Horizontal Merger Guidelines reflect the next logical step in the development of the agencies' analysis of mergers. They reflect the Department's experience in applying the 1982 and 1984 Merger Guidelines as well as the Commission's experience in applying those guidelines and the Commission's 1982 Statement. Both the Department and the Commission believed that their respective Guidelines and Statement presented sound frameworks for antitrust analysis of mergers, but that improvements could be made to reflect advances in legal and economic thinking. The 1992 Horizontal Merger Guidelines accomplish this objective and also clarify certain aspects of the Merger Guidelines that proved to be ambiguous or were interpreted by observers in ways that were inconsistent with the actual policy of the agencies.

The 1992 Horizontal Merger Guidelines do not include a discussion of horizontal effects from non-horizontal mergers (e.g., elimination of specific potential entrants and competitive problems from vertical mergers). Neither agency has changed its policy with respect to non-horizontal mergers. Specific guidance on non-horizontal mergers is provided in Section 4 of the Department's 1984 Merger Guidelines, read in the context of today's revisions to the treatment of horizontal mergers.

A number of today's revisions are largely technical or stylistic. One major objective of the revisions is to strengthen the document as an analytical road map for the evaluation of mergers. The language, therefore, is intended to be burden-neutral, without altering the burdens of proof or burdens of coming forward as those standards have been established by the courts. In addition, the revisions principally address two areas.

The most significant revision to the Merger Guidelines is to explain more clearly how mergers may lead to adverse competitive effects and how particular market factors relate to the analysis of those effects. These revisions are found in Section 2 of the Horizonal Merger Guidelines. The second principal revision is to sharpen the distinction between the treatment of various types of supply responses and to articulate the framework for analyzing the timeliness, likelihood and sufficiency of entry. These revisions are found in Sections 1.3 and 3.

The new Horizontal Merger Guidelines observe, as did the 1984 Guidelines, that because the specific standards they set out must be applied in widely varied factual circumstances, mechanical application of those standards could produce misleading results. Thus, the Guidelines state that the agencies will apply those standards reasonably and flexibly to the particular facts and circumstances of each proposed merger.

0. PURPOSE, UNDERLYING POLICY ASSUMPTIONS AND OVERVIEW

These Guidelines outline the present enforcement policy of the Department of Justice and the Federal Trade Commission (the "Agency") concerning horizontal acquisitions and mergers ("mergers") subject to section 7 of the Clayton Act,(1)

to section 1 of the Sherman Act,(2)

or to section 5 of the FTC Act.(3) They describe the analytical framework and specific standards normally used by the Agency in analyzing mergers.(4) By stating its policy as simply and clearly as possible, the Agency hopes to reduce the uncertainty associated with enforcement of the antitrust laws in this area.

Although the Guidelines should improve the predictability of the Agency's merger enforcement policy, it is not possible to remove the exercise of judgment from the evaluation of mergers under the antitrust laws. Because the specific standards set forth in the Guidelines must be applied to a broad range of possible factual circumstances, mechanical application of those standards may provide misleading answers to the economic questions raised under the antitrust laws. Moreover, information is often incomplete and the picture of competitive conditions that develops from historical evidence may provide an incomplete answer to the forward-looking inquiry of the Guidelines. Therefore, the Agency will apply the standards of the Guidelines reasonably and flexibly to the particular facts and circumstances of each proposed merger.

0.1 Purpose and Underlying Policy Assumptions of the Guidelines

The Guidelines are designed primarily to articulate the analytical framework the Agency applies in determining whether a merger is likely substantially to lessen competition, not to describe how the Agency will conduct the litigation of cases that it decides to bring. Although relevant in the latter context, the factors contemplated in the Guidelines neither dictate nor exhaust the range of evidence that the Agency must or may introduce in litigation. Consistent with their objective, the Guidelines do not attempt to assign the burden of proof, or the burden of coming forward with evidence, on any particular issue. Nor do the Guidelines attempt to adjust or reapportion burdens of proof or burdens of coming forward as those standards have been established by the courts.(5) Instead, the Guidelines set forth a methodology for analyzing issues once the necessary facts are available. The necessary facts may be derived from the documents and statements of both the merging firms and other sources.

Throughout the Guidelines, the analysis is focused on whether consumers or producers "likely would" take certain actions, that is, whether the action is in the actor's economic interest. References to the profitability of certain actions focus on economic profits rather than accounting profits. Economic profits may be defined as the excess of revenues over costs where costs include the opportunity cost of invested capital.

Mergers are motivated by the prospect of financial gains. The possible sources of the financial gains from mergers are many, and the Guidelines do not attempt to identify all possible sources of gain in every merger. Instead, the Guidelines focus on the one potential source of gain that is of concern under the antitrust laws: market power.

The unifying theme of the Guidelines is that mergers should not be permitted to create or enhance market power or to facilitate its exercise. Market power to a seller is the ability profitably to maintain prices above competitive levels for a significant period of time.(6) In some circumstances, a sole seller (a "monopolist") of a product with no good substitutes can maintain a selling price that is above the level that would prevail if the market were competitive. Similarly, in some circumstances, where only a few firms account for most of the sales of a product, those firms can exercise market power, perhaps even approximating the performance of a monopolist, by either explicitly or implicitly coordinating their actions. Circumstances also may permit a single firm, not a monopolist, to exercise market power through unilateral or non-coordinated conduct--conduct the success of which does not rely on the concurrence of other firms in the market or on coordinated responses by those firms. In any case, the result of the exercise of market power is a transfer of wealth from buyers to sellers or a misallocation of resources.

Market power also encompasses the ability of a single buyer (a "monopsonist"), a coordinating group of buyers, or a single buyer, not a monopsonist, to depress the price paid for a product to a level that is below the competitive price and thereby depress output. The exercise of market power by buyers ("monopsony power") has adverse effects comparable to those associated with the exercise of market power by sellers. In order to assess potential monopsony concerns, the Agency will apply an analytical framework analogous to the framework of these Guidelines.

While challenging competitively harmful mergers, the Agency seeks to avoid unnecessary interference with the larger universe of mergers that are either competitively beneficial or neutral. In implementing this objective, however, the Guidelines reflect the congressional intent that merger enforcement should interdict competitive problems in their incipiency.

0.2 Overview

The Guidelines describe the analytical process that the Agency will employ in determining whether to challenge a horizontal merger. First, the Agency assesses whether the merger would significantly increase concentration and result in a concentrated market, properly defined and measured. Second, the Agency assesses whether the merger, in light of market concentration and other factors that characterize the market, raises concern about potential adverse competitive effects. Third, the Agency assesses whether entry would be timely, likely and sufficient either to deter or to counteract the competitive effects of concern. Fourth, the Agency assesses any efficiency gains that reasonably cannot be achieved by the parties through other means. Finally the Agency assesses whether, but for the merger, either party to the transaction would be likely to fail, causing its assets to exit the market. The process of assessing market concentration, potential adverse competitive effects, entry, efficiency and failure is a tool that allows the Agency to answer the ultimate inquiry in merger analysis: whether the merger is likely to create or enhance market power or to facilitate its exercise.

1. MARKET DEFINITION, MEASUREMENT AND CONCENTRATION

1.0 Overview

A merger is unlikely to create or enhance market power or to facilitate its exercise unless it significantly increases concentration and results in a concentrated market, properly defined and measured. Mergers that either do not significantly increase concentration or do not result in a concentrated market ordinarily require no further analysis.

The analytic process described in this section ensures that the Agency evaluates the likely competitive impact of a merger within the context of economically meaningful markets--i.e., markets that could be subject to the exercise of market power. Accordingly, for each product or service (hereafter "product") of each merging firm, the Agency seeks to define a market in which firms could effectively exercise market power if they were able to coordinate their actions.

Market definition focuses solely on demand substitution factors--i.e., possible consumer responses. Supply substitution factors--i.e., possible production responses--are considered elsewhere in the Guidelines in the identification of firms that participate in the relevant market and the analysis of entry. See Sections 1.3 and 3. A market is defined as a product or group of products and a geographic area in which it is produced or sold such that a hypothetical profit-maximizing firm, not subject to price regulation, that was the only present and future producer or seller of those products in that area likely would impose at least a "small but significant and nontransitory" increase in price, assuming the terms of sale of all other products are held constant. A relevant market is a group of products and a geographic area that is no bigger than necessary to satisfy this test. The "small but significant and non-transitory" increase in price is employed solely as a methodological tool for the analysis of mergers: it is not a tolerance level for price increases.

Absent price discrimination, a relevant market is described by a product or group of products and a geographic area. In determining whether a hypothetical monopolist would be in a position to exercise market power, it is necessary to evaluate the likely demand responses of consumers to a price increase. A price increase could be made unprofitable by consumers either switching to other products or switching to the same product produced by firms at other locations. The nature and magnitude of these two types of demand responses respectively determine the scope of the product market and the geographic market.

In contrast, where a hypothetical monopolist likely would discriminate in prices charged to different groups of buyers, distinguished, for example, by their uses or locations, the Agency may delineate different relevant markets corresponding to each such buyer group. Competition for sales to each such group may be affected differently by a particular merger and markets are delineated by evaluating the demand response of each such buyer group. A relevant market of this kind is described by a collection of products for sale to a given group of buyers.

Once defined, a relevant market must be measured in terms of its participants and concentration. Participants include firms currently producing or selling the market's products in the market's geographic area. In addition, participants may include other firms depending on their likely supply responses to a "small but significant and nontransitory" price increase. A firm is viewed as a participant if, in response to a "small but significant and nontransitory" price increase, it likely would enter rapidly into production or sale of a market product in the market's area, without incurring significant sunk costs of entry and exit. Firms likely to make any of these supply responses are considered to be "uncommitted" entrants because their supply response would create new production or sale in the relevant market and because that production or sale could be quickly terminated without significant loss.[(7)]

Uncommitted entrants are capable of making such quick and uncommitted supply responses that they likely influenced the market premerger, would influence it post-merger, and accordingly are considered as market participants at both times. This analysis of market definition and market measurement applies equally to foreign and domestic firms.

If the process of market definition and market measurement identifies one or more relevant markets in which the merging firms are both participants, then the merger is considered to be horizontal. Sections 1.1 through 1.5 describe in greater detail how product and geographic markets will be defined, how market shares will be calculated and how market concentration will be assessed.

1.1 Product Market Definition

The Agency will first define the relevant product market with respect to each of the products of each of the merging firms.[(8)]

1.11 General Standards

Absent price discrimination, the Agency will delineate the product market to be a product or group of products such that a hypothetical profit-maximizing firm that was the only present and future seller of those products ("monopolist") likely would impose at least a "small but significant and nontransitory" increase in price. That is, assuming that buyers likely would respond to an increase in price for a tentatively identified product group only by shifting to other products, what would happen? If the alternatives were, in the aggregate, sufficiently attractive at their existing terms of sale, an attempt to raise prices would result in a reduction of sales large enough that the price increase would not prove profitable, and the tentatively identified product group would prove to be too narrow.

Specifically, the Agency will begin with each product (narrowly defined) produced or sold by each merging firm and ask what would happen if a hypothetical monopolist of that product imposed at least a "small but significant and nontransitory" increase in price, but the terms of sale of all other products remained constant. If, in response to the price increase, the reduction in sales of the product would be large enough that a hypothetical monopolist would not find it profitable to impose such an increase in price, then the Agency will add to the product group the product that is the next-best substitute for the merging firm's product.(9)

In considering the likely reaction of buyers to a price increase, the Agency will take into account all relevant evidence, including, but not limited to, the following:

(1) evidence that buyers have shifted or have considered shifting purchases between products in response to relative changes in price or other competitive variables;

(2) evidence that sellers base business decisions on the prospect of buyer substitution between products in response to relative changes in price or other competitive variables;

(3) the influence of downstream competition faced by buyers in their output markets; and

(4) the timing and costs of switching products.

The price increase question is then asked for a hypothetical monopolist controlling the expanded product group. In performing successive iterations of the price increase test, the hypothetical monopolist will be assumed to pursue maximum profits in deciding whether to raise the prices of any or all of the additional products under its control. This process will continue until a group of products is identified such that a hypothetical monopolist over that group of products would profitably impose at least a "small but significant and nontransitory" increase, including the price of a product of one of the merging firms. The Agency generally will consider the relevant product market to be the smallest group of products that satisfies this test.

In the above analysis, the Agency will use prevailing prices of the products of the merging firms and possible substitutes for such products, unless premerger circumstances are strongly suggestive of coordinated interaction, in which case the Agency will use a price more reflective of the competitive price.(10)

However, the Agency may use likely future prices, absent the merger, when changes in the prevailing prices can be predicted with reasonable reliability. Changes in price may be predicted on the basis of, for example, changes in regulation which affect price either directly or indirectly by affecting costs or demand.

In general, the price for which an increase will be postulated will be whatever is considered to be the price of the product at the stage of the industry being examined.(11) In attempting to determine objectively the effect of a "small but significant and nontransitory" increase in price, the Agency, in most contexts, will use a price increase of five percent lasting for the foreseeable future. However, what constitutes a "small but significant and nontransitory" increase in price will depend on the nature of the industry, and the Agency at times may use a price increase that is larger or smaller than five percent.

1.12 Product Market Definition in the Presence of Price Discrimination

The analysis of product market definition to this point has assumed that price discrimination--charging different buyers different prices for the same product, for example--would not be profitable for a hypothetical monopolist. A different analysis applies where price discrimination would be profitable for a hypothetical monopolist.

Existing buyers sometimes will differ significantly in their likelihood of switching to other products in response to a "small but significant and nontransitory" price increase. If a hypothetical monopolist can identify and price differently to those buyers ("targeted buyers") who would not defeat the targeted price increase by substituting to other products in response to a "small but significant and nontransitory" price increase for the relevant product, and if other buyers likely would not purchase the relevant product and resell to targeted buyers, then a hypothetical monopolist would profitably impose a discriminatory price increase on sales to targeted buyers. This is true regardless of whether a general increase in price would cause such significant substitution that the price increase would not be profitable. The Agency will consider additional relevant product markets consisting of a particular use or uses by groups of buyers of the product for which a hypothetical monopolist would profitably and separately impose at least a "small but significant and nontransitory" increase in price.

1.2 Geographic Market Definition

For each product market in which both merging firms participate, the Agency will determine the geographic market or markets in which the firms produce or sell. A single firm may operate in a number of different geographic markets.

1.21 General Standards

Absent price discrimination, the Agency will delineate the geographic market to be a region such that a hypothetical monopolist that was the only present or future producer of the relevant product at locations in that region would profitably impose at least a "small but significant and nontransitory" increase in price, holding constant the terms of sale for all products produced elsewhere. That is, assuming that buyers likely would respond to a price increase on products produced within the tentatively identified region only by shifting to products produced at locations of production outside the region, what would happen? If those locations of production outside the region were, in the aggregate, sufficiently attractive at their existing terms of sale, an attempt to raise price would result in a reduction in sales large enough that the price increase would not prove profitable, and the tentatively identified geographic area would prove to be too narrow.

In defining the geographic market or markets affected by a merger, the Agency will begin with the location of each merging firm (or each plant of a multiplant firm) and ask what would happen if a hypothetical monopolist of the relevant product at that point imposed at least a "small but significant and nontransitory" increase in price, but the terms of sale at all other locations remained constant. If, in response to the price increase, the reduction in sales of the product at that location would be large enough that a hypothetical monopolist producing or selling the relevant product at the merging firm's location would not find it profitable to impose such an increase in price, then the Agency will add the location from which production is the next-best substitute for production at the merging firm's location.

In considering the likely reaction of buyers to a price increase, the Agency will take into account all relevant evidence, including, but not limited to, the following:

(1) evidence that buyers have shifted or have considered shifting purchases between different geographic locations in response to relative changes in price or other competitive variables;

(2) evidence that sellers base business decisions on the prospect of buyer substitution between geographic locations in response to relative changes in price or other competitive variables;

(3) the influence of downstream competition faced by buyers in their output markets; and

(4) the timing and costs of switching suppliers.

The price increase question is then asked for a hypothetical monopolist controlling the expanded group of locations. In performing successive iterations of the price increase test, the hypothetical monopolist will be assumed to pursue maximum profits in deciding whether to raise the price at any or all of the additional locations under its control. This process will continue until a group of locations is identified such that a hypothetical monopolist over that group of locations would profitably impose at least a "small but significant and nontransitory" increase, including the price charged at a location of one of the merging firms.

The "smallest market" principle will be applied as it is in product market definition. The price for which an increase will be postulated, what constitutes a "small but significant and nontransitory" increase in price, and the substitution decisions of consumers all will be determined in the same way in which they are determined in product market definition.

1.22 Geographic Market Definition in the Presence of Price Discrimination

The analysis of geographic market definition to this point has assumed that geographic price discrimination--charging different prices net of transportation costs for the same product to buyers in different areas, for example--would not be profitable for a hypothetical monopolist. However, if a hypothetical monopolist can identify and price differently to buyers in certain areas ("targeted buyers") who would not defeat the targeted price increase by substituting to more distant sellers in response to a "small but significant and nontransitory" price increase for the relevant product, and if other buyers likely would not purchase the relevant product and resell to targeted buyers,[(12)]

then a hypothetical monopolist would profitably impose a discriminatory price increase. This is true even where a general price increase would cause such significant substitution that the price increase would not be profitable. The Agency will consider additional geographic markets consisting of particular locations of buyers for which a hypothetical monopolist would profitably and separately impose at least a "small but significant and nontransitory" increase in price.

1.3 Identification of Firms that Participate in the Relevant Market

1.31 Current Producers or Sellers

The Agency's identification of firms that participate in the relevant market begins with all firms that currently produce or sell in the relevant market. This includes vertically integrated firms to the extent that such inclusion accurately reflects their competitive significance in the relevant market prior to the merger. To the extent that the analysis under Section 1.1 indicates that used, reconditioned or recycled goods are included in the relevant market, market participants will include firms that produce or sell such goods and that likely would offer those goods in competition with other relevant products.

1.32 Firms That Participate Through Supply Response

In addition, the Agency will identify other firms not currently producing or selling the relevant product in the relevant area as participating in the relevant market if their inclusion would more accurately reflect probable supply responses. These firms are termed "uncommitted entrants." These supply responses must be likely to occur within one year and without the expenditure of significant sunk costs of entry and exit, in response to a "small but significant and nontransitory" price increase. If a firm has the technological capability to achieve such an uncommitted supply response, but likely would not (e.g., because difficulties in achieving product acceptance, distribution, or production would render such a response unprofitable), that firm will not be considered to be a market participant. The competitive significance of supply responses that require more time or that require firms to incur significant sunk costs of entry and exit will be considered in entry analysis. See Section 3.[(13)]

Sunk costs are the acquisition costs of tangible and intangible assets that cannot be recovered through the redeployment of these assets outside the relevant market, i.e., costs uniquely incurred to supply the relevant product and geographic market. Examples of sunk costs may include market-specific investments in production facilities, technologies, marketing (including product acceptance), research and development, regulatory approvals, and testing. A significant sunk cost is one which would not be recouped within one year of the commencement of the supply response, assuming a "small but significant and nontransitory" price increase in the relevant market. In this context, a "small but significant and nontransitory" price increase will be determined in the same way in which it is determined in product market definition, except the price increase will be assumed to last one year. In some instances, it may be difficult to calculate sunk costs with precision. Accordingly, when necessary, the Agency will make an overall assessment of the extent of sunk costs for firms likely to participate through supply responses.

These supply responses may give rise to new production of products in the relevant product market or new sources of supply in the relevant geographic market. Alternatively, where price discrimination is likely so that the relevant market is defined in terms of a targeted group of buyers, these supply responses serve to identify new sellers to the targeted buyers. Uncommitted supply responses may occur in several different ways: by the switching or extension of existing assets to production or sale in the relevant market; or by the construction or acquisition of assets that enable production or sale in the relevant market.

1.321 Production Substitution and Extension: The Switching or Extension of Existing Assets to Production or Sale in the Relevant Market

The productive and distributive assets of a firm sometimes can be used to produce and sell either the relevant products or products that buyers do not regard as good substitutes. Production substitution refers to the shift by a firm in the use of assets from producing and selling one product to producing and selling another. Production extension refers to the use of those assets, for example, existing brand names and reputation, both for their current production and for production of the relevant product. Depending upon the speed of that shift and the extent of sunk costs incurred in the shift or extension, the potential for production substitution or extension may necessitate treating as market participants firms that do not currently produce the relevant product.[(14)]

If a firm has existing assets that likely would be shifted or extended into production and sale of the relevant product within one year, and without incurring significant sunk costs of entry and exit, in response to a "small but significant and nontransitory" increase in price for only the relevant product, the Agency will treat that firm as a market participant. In assessing whether a firm is such a market participant, the Agency will take into account the costs of substitution or extension relative to the profitability of sales at the elevated price, and whether the firm's capacity is elsewhere committed or elsewhere so profitably employed that such capacity likely would not be available to respond to an increase in price in the market.

1.322 Obtaining New Assets for Production or Sale of the Relevant Product

A firm may also be able to enter into production or sale in the relevant market within one year and without the expenditure of significant sunk costs of entry and exit, in response to a "small but significant and nontransitory" increase in price for only the relevant product, even if the firm is newly organized or is an existing firm without products or productive assets closely related to the relevant market. If new firms, or existing firms without closely related products or productive assets, likely would enter into production or sale in the relevant market within one year without the expenditure of significant sunk costs of entry and exit, the Agency will treat those firms as market participants.

1.4 Calculating Market Shares

1.41 General Approach

The Agency normally will calculate market shares for all firms (or plants) identified as market participants in Section 1.3 based on the total sales or capacity currently devoted to the relevant market together with that which likely would be devoted to the relevant market in response to a "small but significant and nontransitory" price increase. Market shares can be expressed either in dollar terms through measurement of sales, shipments, or production, or in physical terms through measurement of sales, shipments, production, capacity, or reserves.

Market shares will be calculated using the best indicator of firms' future competitive significance. Dollar sales or shipments generally will be used if firms are distinguished primarily by differentiation of their products. Unit sales generally will be used if firms are distinguished primarily on the basis of their relative advantages in serving different buyers or groups of buyers. Physical capacity or reserves generally will be used if it is these measures that most effectively distinguish firms.(15) Typically, annual data are used, but where individual sales are large and infrequent so that annual data may be unrepresentative, the Agency may measure market shares over a longer period of time.

In measuring a firm's market share, the Agency will not include its sales or capacity to the extent that the firm's capacity is committed or so profitably employed outside the relevant market that it would not be available to respond to an increase in price in the market.

1.42 Price Discrimination Markets

When markets are defined on the basis of price discrimination (Sections 1.12 and 1.22), the Agency will include only sales likely to be made into, or capacity likely to be used to supply, the relevant market in response to a "small but significant and nontransitory" price increase.

1.43 Special Factors Affecting Foreign Firms

Market shares will be assigned to foreign competitors in the same way in which they are assigned to domestic competitors. However, if exchange rates fluctuate significantly, so that comparable dollar calculations on an annual basis may be unrepresentative, the Agency may measure market shares over a period longer than one year.

If shipments from a particular country to the United States are subject to a quota, the market shares assigned to firms in that country will not exceed the amount of shipments by such firms allowed under the quota.(16)

In the case of restraints that limit imports to some percentage of the total amount of the product sold in the United States (i.e., percentage quotas), a domestic price increase that reduced domestic consumption also would reduce the volume of imports into the United States. Accordingly, actual import sales and capacity data will be reduced for purposes of calculating market shares. Finally, a single market share may be assigned to a country or group of countries if firms in that country or group of countries act in coordination.

1.5 Concentration and Market Shares

Market concentration is a function of the number of firms in a market and their respective market shares. As an aid to the interpretation of market data, the Agency will use the Herfindahl-Hirschman Index ("HHI") of market concentration. The HHI is calculated by summing the squares of the individual market shares of all the participants. (17) Unlike the four-firm concentration ratio, the HHI reflects both the distribution of the market shares of the top four firms and the composition of the market outside the top four firms. It also gives proportionately greater weight to the market shares of the larger firms, in accord with their relative importance in competitive interactions.

The Agency divides the spectrum of market concentration as measured by the HHI into three regions that can be broadly characterized as unconcentrated (HHI below 1000), moderately concentrated (HHI between 1000 and 1800), and highly concentrated (HHI above 1800). Although the resulting regions provide a useful framework for merger analysis, the numerical divisions suggest greater precision than is possible with the available economic tools and information. Other things being equal, cases falling just above and just below a threshold present comparable competitive issues.

1.51 General Standards

In evaluating horizontal mergers, the Agency will consider both the post-merger market concentration and the increase in concentration resulting from the merger.(18)

Market concentration is a useful indicator of the likely potential competitive effect of a merger. The general standards for horizontal mergers are as follows:

a) Post-Merger HHI Below 1000. The Agency regards markets in this region to be unconcentrated. Mergers resulting in unconcentrated markets are unlikely to have adverse competitive effects and ordinarily require no further analysis.

b) Post-Merger HHI Between 1000 and 1800. The Agency regards markets in this region to be moderately concentrated. Mergers producing an increase in the HHI of less than 100 points in moderately concentrated markets post-merger are unlikely to have adverse competitive consequences and ordinarily require no further analysis. Mergers producing an increase in the HHI of more than 100 points in moderately concentrated markets post-merger potentially raise significant competitive concerns depending on the factors set forth in Sections 2-5 of the Guidelines.

c) Post-Merger HHI Above 1800. The Agency regards markets in this region to be highly concentrated. Mergers producing an increase in the HHI of less than 50 points, even in highly concentrated markets post-merger, are unlikely to have adverse competitive consequences and ordinarily require no further analysis. Mergers producing an increase in the HHI of more than 50 points in highly concentrated markets post-merger potentially raise significant competitive concerns, depending on the factors set forth in

Sections 2-5 of the Guidelines. Where the post-merger HHI exceeds 1800, it will be presumed that mergers producing an increase in the HHI of more than 100 points are likely to create or enhance market power or facilitate its exercise. The presumption may be overcome by a showing that factors set forth in Sections 2-5 of the Guidelines make it unlikely that the merger will create or enhance market power or facilitate its exercise, in light of market concentration and market shares.

1.52 Factors Affecting the Significance of Market Shares and Concentration

The post-merger level of market concentration and the change in concentration resulting from a merger affect the degree to which a merger raises competitive concerns. However, in some situations, market share and market concentration data may either understate or overstate the likely future competitive significance of a firm or firms in the market or the impact of a merger. The following are examples of such situations.

1.521 Changing Market Conditions

Market concentration and market share data of necessity are based on historical evidence. However, recent or ongoing changes in the market may indicate that the current market share of a particular firm either understates or overstates the firm's future competitive significance. For example, if a new technology that is important to long-term competitive viability is available to other firms in the market, but is not available to a particular firm, the Agency may conclude that the historical market share of that firm overstates its future competitive significance. The Agency will consider reasonably predictable effects of recent or ongoing changes in market conditions in interpreting market concentration and market share data.

1.522 Degree of Difference Between the Products and Locations in the Market and Substitutes Outside the Market

All else equal, the magnitude of potential competitive harm from a merger is greater if a hypothetical monopolist would raise price within the relevant market by substantially more than a "small but significant and nontransitory" amount. This may occur when the demand substitutes outside the relevant market, as a group, are not close substitutes for the products and locations within the relevant market. There thus may be a wide gap in the chain of demand substitutes at the edge of the product and geographic market. Under such circumstances, more market power is at stake in the relevant market than in a market in which a hypothetical monopolist would raise price by exactly five percent.

2. THE POTENTIAL ADVERSE COMPETITIVE EFFECTS OF MERGERS

2.0 Overview

Other things being equal, market concentration affects the likelihood that one firm, or a small group of firms, could successfully exercise market power. The smaller the percentage of total supply that a firm controls, the more severely it must restrict its own output in order to produce a given price increase, and the less likely it is that an output restriction will be profitable. If collective action is necessary for the exercise of market power, as the number of firms necessary to control a given percentage of total supply decreases, the difficulties and costs of reaching and enforcing an understanding with respect to the control of that supply might be reduced. However, market share and concentration data provide only the starting point for analyzing the competitive impact of a merger. Before determining whether to challenge a merger, the Agency also will assess the other market factors that pertain to competitive effects, as well as entry, efficiencies and failure.

This section considers some of the potential adverse competitive effects of mergers and the factors in addition to market concentration relevant to each. Because an individual merger may threaten to harm competition through more than one of these effects, mergers will be analyzed in terms of as many potential adverse competitive effects as are appropriate. Entry, efficiencies, and failure are treated in Sections 3-5.

2.1 Lessening of Competition Through Coordinated Interaction

A merger may diminish competition by enabling the firms selling in the relevant market more likely, more successfully, or more completely to engage in coordinated interaction that harms consumers. Coordinated interaction is comprised of actions by a group of firms that are profitable for each of them only as a result of the accommodating reactions of the others. This behavior includes tacit or express collusion, and may or may not be lawful in and of itself.

Successful coordinated interaction entails reaching terms of coordination that are profitable to the firms involved and an ability to detect and punish deviations that would undermine the coordinated interaction. Detection and punishment of deviations ensure that coordinating firms will find it more profitable to adhere to the terms of coordination than to pursue short-term profits from deviating, given the costs of reprisal. In this phase of the analysis, the Agency will examine the extent to which post-merger market conditions are conducive to reaching terms of coordination, detecting deviations from those terms, and punishing such deviations. Depending upon the circumstances, the following market factors, among others, may be relevant: the availability of key information concerning market conditions, transactions and individual competitors; the extent of firm and product heterogeneity; pricing or marketing practices typically employed by firms in the market; the characteristics of buyers and sellers; and the characteristics of typical transactions.

Certain market conditions that are conducive to reaching terms of coordination also may be conducive to detecting or punishing deviations from those terms. For example, the extent of information available to firms in the market, or the extent of homogeneity, may be relevant to both the ability to reach terms of coordination and to detect or punish deviations from those terms. The extent to which any specific market condition will be relevant to one or more of the conditions necessary to coordinated interaction will depend on the circumstances of the particular case.

It is likely that market conditions are conducive to coordinated interaction when the firms in the market previously have engaged in express collusion and when the salient characteristics of the market have not changed appreciably since the most recent such incident. Previous express collusion in another geographic market will have the same weight when the salient characteristics of that other market at the time of the collusion are comparable to those in the relevant market.

In analyzing the effect of a particular merger on coordinated interaction, the Agency is mindful of the difficulties of predicting likely future behavior based on the types of incomplete and sometimes contradictory information typically generated in merger investigations. Whether a merger is likely to diminish competition by enabling firms more likely, more successfully or more completely to engage in coordinated interaction depends on whether market conditions, on the whole, are conducive to reaching terms of coordination and detecting and punishing deviations from those terms.

2.11 Conditions Conducive to Reaching Terms of Coordination

Firms coordinating their interactions need not reach complex terms concerning the allocation of the market output across firms or the level of the market prices but may, instead, follow simple terms such as a common price, fixed price differentials, stable market shares, or customer or territorial restrictions. Terms of coordination need not perfectly achieve the monopoly outcome in order to be harmful to consumers. Instead, the terms of coordination may be imperfect and incomplete -- inasmuch as they omit some market participants, omit some dimensions of competition, omit some customers, yield elevated prices short of monopoly levels, or lapse into episodic price wars--and still result in significant competitive harm. At some point, however, imperfections cause the profitability of abiding by the terms of coordination to decrease and, depending on their extent, may make coordinated interaction unlikely in the first instance.

Market conditions may be conducive to or hinder reaching terms of coordination. For example, reaching terms of coordination may be facilitated by product or firm homogeneity and by existing practices among firms, practices not necessarily themselves antitrust violations, such as standardization of pricing or product variables on which firms could compete. Key information about rival firms and the market may also facilitate reaching terms of coordination. Conversely, reaching terms of coordination may be limited or impeded by product heterogeneity or by firms having substantially incomplete information about the conditions and prospects of their rival's businesses, perhaps because of important differences among their current business operations. In addition, reaching terms of coordination may be limited or impeded by firm heterogeneity, for example, differences in vertical integration or the production of another product that tends to be used together with the relevant product.

2.12 Conditions Conducive to Detecting and Punishing Deviations

Where market conditions are conducive to timely detection and punishment of significant deviations, a firm will find it more profitable to abide by the terms of coordination than to deviate from them. Deviation from the terms of coordination will be deterred where the threat of punishment is credible. Credible punishment, however, may not need to be any more complex than temporary abandonment of the terms of coordination by other firms in the market.

Where detection and punishment likely would be rapid, incentives to deviate are diminished and coordination is likely to be successful. The detection and punishment of deviations may be facilitated by existing practices among firms, themselves not necessarily antitrust violations, and by the characteristics of typical transactions. For example, if key information about specific transactions or individual price or output levels is available routinely to competitors, it may be difficult for a firm to deviate secretly. If orders for the relevant product are frequent, regular and small relative to the total output of a firm in a market, it may be difficult for the firm to deviate in a substantial way without the knowledge of rivals and without the opportunity for rivals to react. If demand or cost fluctuations are relatively infrequent and small, deviations may be relatively easy to deter.

By contrast, where detection or punishment is likely to be slow, incentives to deviate are enhanced and coordinated interaction is unlikely to be successful. If demand or cost fluctuations are relatively frequent and large, deviations may be relatively difficult to distinguish from these other sources of market price fluctuations, and, in consequence, deviations may be relatively difficult to deter.

In certain circumstances, buyer characteristics and the nature of the procurement process may affect the incentives to deviate from terms of coordination. Buyer size alone is not the determining characteristic. Where large buyers likely would engage in long-term contracting, so that the sales covered by such contracts can be large relative to the total output of a firm in the market, firms may have the incentive to deviate. However, this only can be accomplished where the duration, volume and profitability of the business covered by such contracts are sufficiently large as to make deviation more profitable in the long term than honoring the terms of coordination, and buyers likely would switch suppliers.

In some circumstances, coordinated interaction can be effectively prevented or limited by maverick firms--firms that have a greater economic incentive to deviate from the terms of coordination than do most of their rivals (e.g., firms that are unusually disruptive and competitive influences in the market). Consequently, acquisition of a maverick firm is one way in which a merger may make coordinated interaction more likely, more successful, or more complete. For example, in a market where capacity constraints are significant for many competitors, a firm is more likely to be a maverick the greater is its excess or divertable capacity in relation to its sales or its total capacity, and the lower are its direct and opportunity costs of expanding sales in the relevant market.[(19)]

This is so because a firm's incentive to deviate from price-elevating and output-limiting terms of coordination is greater the more the firm is able profitably to expand its output as a proportion of the sales it would obtain if it adhered to the terms of coordination and the smaller is the base of sales on which it enjoys elevated profits prior to the price cutting deviation.[(20)] A firm also may be a maverick if it has an unusual ability secretly to expand its sales in relation to the sales it would obtain if it adhered to the terms of coordination. This ability might arise from opportunities to expand captive production for a downstream affiliate.

2.2 Lessening of Competition Through Unilateral Effects

A merger may diminish competition even if it does not lead to increased likelihood of successful coordinated interaction, because merging firms may find it profitable to alter their behavior unilaterally following the acquisition by elevating price and suppressing output. Unilateral competitive effects can arise in a variety of different settings. In each setting, particular other factors describing the relevant market affect the likelihood of unilateral competitive effects. The settings differ by the primary characteristics that distinguish firms and shape the nature of their competition.

2.21 Firms Distinguished Primarily by Differentiated Products

In some markets the products are differentiated, so that products sold by different participants in the market are not perfect substitutes for one another. Moreover, different products in the market may vary in the degree of their substitutability for one another. In this setting, competition may be non-uniform (i.e., localized), so that individual sellers compete more directly with those rivals selling closer substitutes.(21)

A merger between firms in a market for differentiated products may diminish competition by enabling the merged firm to profit by unilaterally raising the price of one or both products above the premerger level. Some of the sales loss due to the price rise merely will be diverted to the product of the merger partner and, depending on relative margins, capturing such sales loss through merger may make the price increase profitable even though it would not have been profitable premerger. Substantial unilateral price elevation in a market for differentiated products requires that there be a significant share of sales in the market accounted for by consumers who regard the products of the merging firms as their first and second choices, and that repositioning of the non-parties' product lines to replace the localized competition lost through the merger be unlikely. The price rise will be greater the closer substitutes are the products of the merging firms, i.e., the more the buyers of one product consider the other product to be their next choice.

2.211 Closeness of the Products of the Merging Firms

The market concentration measures articulated in Section 1 may help assess the extent of the likely competitive effect from a unilateral price elevation by the merged firm notwithstanding the fact that the affected products are differentiated. The market concentration measures provide a measure of this effect if each product's market share is reflective of not only its relative appeal as a first choice to consumers of the merging firms' products but also its relative appeal as a second choice, and hence as a competitive constraint to the first choice(22) where this circumstance holds, market concentration data fall outside the safeharbor regions of Section 1.5, and the merging firms have a combined market share of at least thirty-five percent, the Agency will presume that a significant share of sales in the market are accounted for by consumers who regard the products of the merging firms as their first and second choices.

Purchasers of one of the merging firms, products may be more or less likely to make the other their second choice than market shares alone would indicate. The market shares of the merging firms, products may understate the competitive effect of concern, when, for example, the products of the merging firms are relatively more similar in their various attributes to one another than to other products in the relevant market. On the other hand, the market shares alone may overstate the competitive effects of concern when, for example, the relevant products are less similar in their attributes to one another than to other products in the relevant market.

Where market concentration data fall outside the safeharbor regions of Section 1.5, the merging firms have a combined market share of at least thirty-five percent, and where data on product attributes and relative product appeal show that a significant share of purchasers of one merging firm's product regard the other as their second choice, then market share data may be relied upon to demonstrate that there is a significant share of sales in the market accounted for by consumers who would be adversely affected by the merger.

2.212 Ability of Rival Sellers to Replace Lost Competition

A merger is not likely to lead to unilateral elevation of prices of differentiated products if, in response to such an effect, rival sellers likely would replace any localized competition lost through the merger by repositioning their product lines.[23]

In markets where it is costly for buyers to evaluate product quality, buyers who consider purchasing from both merging parties may limit the total number of sellers they consider. If either of the merging firms would be replaced in such buyers, consideration by an equally competitive seller not formerly considered, then the merger is not likely to lead to a unilateral elevation of prices.

2.22 Firms Distinguished Primarily by Their Capacities

Where products are relatively undifferentiated and capacity primarily distinguishes firms and shapes the nature of their competition, the merged firm may find it profitable unilaterally to raise price and suppress output. The merger provides the merged firm a larger base of sales on which to enjoy the resulting price rise and also eliminates a competitor to which customers otherwise would have diverted their sales. Where the merging firms have a combined market share of at least thirty-five percent, merged firms may find it profitable to raise price and reduce joint output below the sum of their premerger outputs because the lost markups on the foregone sales may be outweighed by the resulting price increase on the merged base of sales.

This unilateral effect is unlikely unless a sufficiently large number of the merged firm's customers would not be able to find economical alternative sources of supply, i.e., competitors of the merged firm likely would not respond to the price increase and output reduction by the merged firm with increases in their own outputs sufficient in the aggregate to make the unilateral action of the merged firm unprofitable. Such non-party expansion is unlikely if those firms face binding capacity constraints that could not be economically relaxed within two years or if existing excess capacity is significantly more costly to operate than capacity currently in use.[24]

3. ENTRY ANALYSIS

3.0 Overview

A merger is not likely to create or enhance market power or to facilitate its exercise, if entry into the market is so easy that market participants, after the merger, either collectively or unilaterally could not profitably maintain a price increase above premerger levels. Such entry likely will deter an anticompetitive merger in its incipiency, or deter or counteract the competitive effects of concern.

Entry is that easy if entry would be timely, likely, and sufficient in its magnitude, character and scope to deter or counteract the competitive effects of concern. In markets where entry is that easy (i.e., where entry passes these tests of timeliness, likelihood, and sufficiency), the merger raises no antitrust concern and ordinarily requires no further analysis.

The committed entry treated in this Section is defined as new competition that requires expenditure of significant sunk costs of entry and exit.[25] The Agency employs a three step methodology to assess whether committed entry would deter or counteract a competitive effect of concern.

The first step assesses whether entry can achieve significant market impact within a timely period. If significant market impact would require a longer period, entry will not deter or counteract the competitive effect of concern.

The second step assesses whether committed entry would be a profitable and, hence, a likely response to a merger having competitive effects of concern. Firms considering entry that requires significant sunk costs must evaluate the profitability of the entry on the basis of long term participation in the market, because the underlying assets will be committed to the market until they are economically depreciated. Entry that is sufficient to counteract the competitive effects of concern will cause prices to fall to their premerger levels or lower. Thus, the profitability of such committed entry-must be determined on the basis of premerger market prices over the long-term.

A merger having anticompetitive effects can attract committed entry, profitable at premerger prices, that would not have occurred premerger at these same prices. But following the merger, the reduction in industry output and increase in prices associated with the competitive effect of concern may allow the same entry to occur without driving market prices below premerger levels. After a merger that results in decreased output and increased prices, the likely sales opportunities available to entrants at premerger prices will be larger than they were premerger, larger by the output reduction caused by the merger. If entry could be profitable at premerger prices without exceeding the likely sales opportunities--opportunities that include pre-existing pertinent factors as well as the merger-induced output reduction--then such entry is likely in response to the merger.

The third step assesses whether timely and likely entry would be sufficient to return market prices to their premerger levels. This end may be accomplished either through multiple entry or individual entry at a sufficient scale. Entry may not be sufficient, even though timely and likely, where the constraints on availability of essential assets, due to incumbent control, make it impossible for entry profitably to achieve the necessary level of sales. Also, the character and scope of entrants' products might not be fully responsive to the localized sales opportunities created by the removal of direct competition among sellers of differentiated products. In assessing whether entry will be timely, likely, and sufficient, the Agency recognizes that precise and detailed information may be difficult or impossible to obtain. In such instances, the Agency will rely on all available evidence bearing on whether entry will satisfy the conditions of timeliness, likelihood, and sufficiency.

3.1 Entry Alternatives

The Agency will examine the timeliness, likelihood, and sufficiency of the means of entry (entry alternatives) a potential entrant might practically employ, without attempting to identify who might be potential entrants. An entry alternative is defined by the actions the firm must take in order to produce and sell in the market. All phases of the entry effort will be considered, including, where relevant, planning, design, and management; permitting, licensing, and other approvals; construction, debugging, and operation of production facilities; and promotion (including necessary introductory discounts), marketing, distribution, and satisfaction of customer testing and qualification requirements.(26)

Recent examples of entry, whether successful or unsuccessful, may provide a useful starting point for identifying the necessary actions, time requirements, and characteristics of possible entry alternatives.

3.2 Timeliness of Entry

In order to deter or counteract the competitive effects of concern, entrants quickly must achieve a significant impact on price in the relevant market. The Agency generally will consider timely only those committed entry alternatives that can be achieved within two years from initial planning to significant market impact.(27) Where the relevant product is a durable good, consumers, in response to a significant commitment to entry, may defer purchases by making additional investments to extend the useful life of previously purchased goods and in this way deter or counteract for a time the competitive effects of concern. In these circumstances, if entry only can occur outside of the two year period, the Agency will consider entry to be timely so long as it would deter or counteract the competitive effects of concern within the two year period and subsequently.

3.3 Likelihood of Entry

An entry alternative is likely if it would be profitable at premerger prices, and if such prices could be secured by the entrant.(28) The committed entrant will be unable to secure prices at premerger levels if its output is too large for the market to absorb without depressing prices further. Thus, entry is unlikely if the minimum viable scale is larger than the likely sales opportunity available to entrants.

Minimum viable scale is the smallest average annual level of sales that the committed entrant must persistently achieve for profitability at premerger prices.(29) Minimum viable scale is a function of expected revenues, based upon premerger prices,(30)

and all categories of costs associated with the entry alternative, including an appropriate rate of return on invested capital given that entry could fail and sunk costs, if any, will be lost.(31)

Sources of sales opportunities available to entrants include:

(a) the output reduction associated with the competitive effect of concern, (32)

(b) entrants' ability to capture a share of reasonably expected growth in market demand,(33)

(c) entrants' ability securely to divert sales from incumbents, for example, through vertical integration or through forward contracting, and (d) any additional anticipated contraction in incumbents' output in response to entry. (34) Factors that reduce the sales opportunities available to entrants include: (a) the prospect that an entrant will share in a reasonably expected decline in market demand, (b) the exclusion of an entrant from a portion of the market over the long term because of vertical integration or forward contracting by incumbents, and (c) any anticipated sales expansion by incumbents in reaction to entry, either generalized or targeted at customers approached by the entrant, that utilizes prior irreversible investments in excess production capacity. Demand growth or decline will be viewed as relevant only if total market demand is projected to experience long-lasting change during at least the two year period following the competitive effect of concern.

3.4 Sufficiency of Entry

Inasmuch as multiple entry generally is possible and individual entrants may flexibly choose their scale, committed entry generally will be sufficient to deter or counteract the competitive effects of concern whenever entry is likely under the analysis of Section 3.3. However, entry, although likely, will not be sufficient if, as a result of incumbent control, the tangible and intangible assets required for entry are not adequately available for entrants to respond fully to their sales opportunities. In addition, where the competitive effect of concern is not uniform across the relevant market, in order for entry to be sufficient, the character and scope of entrants' products must be responsive to the localized sales opportunities that include the output reduction associated with the competitive effect of concern. For example, where the concern is unilateral price elevation as a result of a merger between producers of differentiated products, entry, in order to be sufficient, must involve a product so close to the products of the merging firms that the merged firm will be unable to internalize enough of the sales loss due to the price rise, rendering the price increase unprofitable.

4. Efficiencies

Competition usually spurs firms to achieve efficiencies internally. Nevertheless, mergers have the potential to generate significant efficiencies by permitting a better utilization of existing assets, enabling the combined firm to achieve lower costs in producing a given quantity and quality than either firm could have achieved without the proposed transaction. Indeed, the primary benefit of mergers to the economy is their potential to generate such efficiencies.

Efficiencies generated through merger can enhance the merged firm's ability and incentive to compete, which may result in lower prices, improved quality, enhanced service, or new products. For example, merger-generated efficiencies may enhance competition by permitting two ineffective (e.g., high cost) competitors to become one effective (e.g., lower cost) competitor. In a coordinated interaction context (see Section 2.1), marginal cost reductions may make coordination less likely or effective by enhancing the incentive of a maverick to lower price or by creating a new maverick firm. In a unilateral effects context (see Section 2.2), marginal cost reductions may reduce the merged firm's incentive to elevate price. Efficiencies also may result in benefits in the form of new or improved products, and efficiencies may result in benefits even when price is not immediately and directly affected. Even when efficiencies generated through merger enhance a firm's ability to compete, however, a merger may have other effects that may lessen competition and ultimately may make the merger anticompetitive.

The Agency will consider only those efficiencies likely to be accomplished with the proposed merger and unlikely to be accomplished in the absence of either the proposed merger or another means having comparable anticompetitive effects. These are termed *merger-specific efficiencies*.[(35)] Only alternatives that are practical in the business situation faced by the merging firms will be considered in making this determination; the Agency will not insist upon a less restrictive alternative that is merely theoretical.

Efficiencies are difficult to verify and quantify, in part because much of the information relating to efficiencies is uniquely in the possession of the merging firms. Moreover, efficiencies projected reasonably and in good faith by the merging firms may not be realized. Therefore, the merging firms must substantiate efficiency claims so that the Agency can verify by reasonable means the likelihood and magnitude of each asserted efficiency, how and when each would be achieved (and any costs of doing so), how each would enhance the merged firm's ability and incentive to compete, and why each would be merger-specific. Efficiency claims will not be considered if they are vague or speculative or otherwise cannot be verified by reasonable means.

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

The Agency will not challenge a merger if cognizable efficiencies are of a character and magnitude such that the merger is not likely to be anticompetitive in any relevant market.[(36)] To make the requisite determination, the Agency considers whether cognizable efficiencies likely would be sufficient to reverse the merger's potential to harm consumers in the relevant market, e.g., by preventing price increases in that market. In conducting this analysis,[(37)] the Agency will not simply compare the magnitude of the cognizable efficiencies with the magnitude of the likely harm to competition absent the efficiencies. The greater the potential adverse competitive effect of a merger--as indicated by the increase in the HHI and post-merger HHI from Section 1, the analysis of potential adverse competitive effects from Section 2, and the timeliness, likelihood, and sufficiency of entry from Section 3--the greater must be cognizable efficiencies in order for the Agency to conclude that the merger will not have an anticompetitive effect in the relevant market. When the potential adverse competitive effect of a merger is likely to be particularly large, extraordinarily great cognizable efficiencies would be necessary to prevent the merger from being anticompetitive.

In the Agency's experience, efficiencies are most likely to make a difference in merger analysis when the likely adverse competitive effects, absent the efficiencies, are not great. Efficiencies almost never justify a merger to monopoly or near-monopoly.

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

5. FAILURE AND EXITING ASSETS

5.0 Overview

Notwithstanding the analysis of Sections 1-4 of the Guidelines, a merger is not likely to create or enhance market power or to facilitate its exercise, if imminent failure, as defined below, of one of the merging firms would cause the assets of that firm to exit the relevant market. In such circumstances, post-merger performance in the relevant market may be no worse than market performance had the merger been blocked and the assets left the market.

5.1 Failing Firm

A merger is not likely to create or enhance market power or facilitate its exercise if the following circumstances are met: 1) the allegedly failing firm would be unable to meet its financial obligations in the near future; 2) it would not be able to reorganize successfully under Chapter 11 of the Bankruptcy Act;[(38)] 3) it has made unsuccessful good-faith efforts to elicit reasonable alternative offers of acquisition of the assets of the failing firm[(39)]

that would both keep its tangible and intangible assets in the relevant market and pose a less severe danger to competition than does the proposed merger; and 4) absent the acquisition, the assets of the failing firm would exit the relevant market.

5.2 Failing Division

A similar argument can be made for "failing" divisions as for failing firms. First, upon applying appropriate cost allocation rules, the division must have a negative cash flow on an operating basis. Second, absent the acquisition, it must be that the assets of the division would exit the relevant market in the near future if not sold. Due to the ability of the parent firm to allocate costs, revenues, and intracompany transactions among itself and its subsidiaries and divisions, the Agency will require evidence, not based solely on management plans that could be prepared solely for the purpose of demonstrating negative cash flow or the prospect of exit from the relevant market. Third, the owner of the failing division also must have complied with the competitively-preferable purchaser requirement of Section 5.1.

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1. 15 U.S.C. Section 18 (1988). Mergers subject to section 7 are prohibited if their effect "may be substantially to lessen competition, or to tend to create a monopoly."

2. 15 U.S.C. Section 1 (1988). Mergers subject to section 1 are prohibited if they constitute a "contract, combination or conspiracy in restraint of trade."

3. 15 U.S.C. Section 45 (1988). Mergers subject to section 5 are prohibited if they constitute an "unfair method of competition."

4. These Guidelines update the Merger Guidelines issued by the U.S. Department of Justice in 1984 and the Statement of Federal Trade Commission Concerning Horizontal Mergers issued in 1982. The Merger Guidelines may be revised from time to time as necessary to reflect any significant changes in enforcement policy or to clarify aspects of existing policy.

5. For example, the burden with respect to efficiency and failure continues to reside with the proponents of the merger.

6. Sellers with market power also may lessen competition on dimensions other than price, such as product quality, service, or innovation.

7. Probable supply responses that require the entrant to incur significant sunk costs of entry and exit are not part of market measurement, but are included in the analysis of the significance of entry. See Section 3. Entrants that must commit substantial sunk costs are regarded as "committed" entrants because those sunk costs make entry irreversible in the short term without foregoing that investment; thus the likelihood of their entry must be evaluated with regard to their long-term profitability.

8. Although discussed separately, product market definition and geographic market definition are interrelated. In particular, the extent to which buyers of a particular product would shift to other products in the event of a "small but significant and nontransitory" increase in price must be evaluated in the context of the relevant geographic market.

9. Throughout the Guidelines, the term "next best substitute" refers to the alternative which, if available in unlimited quantities at constant prices, would account for the greatest value of diversion of demand in response to a "small but significant and nontransitory" price increase.

10. The terms of sale of all other products are held constant in order to focus market definition on the behavior of consumers. Movements in the terms of sale for other products, as may result from the behavior of producers of those products, are accounted for in the analysis of competitive effects and entry. See Sections 2 and 3.

11. For example, in a merger between retailers, the relevant price would be the retail price of a product to consumers. In the case of a merger among oil pipelines, the relevant price would be the tariff--the price of the transportation service.

12. This arbitrage is inherently impossible for many services and is particularly difficult where the product is sold on a delivered basis and where transportation costs are a significant percentage of the final cost.

13. If uncommitted entrants likely would also remain in the market and would meet the entry tests of timeliness, likelihood and sufficiency, and thus would likely deter anticompetitive mergers or deter or counteract the competitive effects of concern (see Section 3, infra), the Agency will consider the impact of those firms in the entry analysis.

14. Under other analytical approaches, production substitution sometimes has been reflected in the description of the product market. For example, the product market for stamped metal products such as automobile hub caps might be described as "light metal stamping," a production process rather than a product. The Agency believes that the approach described in the text provides a more clearly focused method of incorporating this factor in merger analysis. If production substitution among a group of products is nearly universal among the firms selling one or more of those products, however, the Agency may use an aggregate description of those markets as a matter of convenience.

15. Where all firms have, on a forward-looking basis, an equal likelihood of securing sales, the Agency will assign firms equal shares.

16. The constraining effect of the quota on the importer's ability to expand sales is relevant to the evaluation of potential adverse competitive effects. See Section 2.

17. For example, a market consisting of four firms with market shares of 30 percent, 30 percent, 20 percent and 20 percent has an HHI of 2600 ($30^2 + 30^2 + 20^2 + 20^2 = 2600$). The HHI ranges from 10,000 (in the case of a pure monopoly) to a number approaching zero (in the case of an atomistic market). Although it is desirable to include all firms in the calculation, lack of information about small firms is not critical because such firms do not affect the HHI significantly.

18. The increase in concentration as measured by the HHI can be calculated independently of the overall market concentration by doubling the product of the market shares of the merging firms. For example, the merger of firms with shares of 5 percent and 10 percent of the market would increase the HHI by 100 ($5 \times 10 \times 2 = 100$). The explanation for this technique is as follows: In calculating the HHI before the merger, the market shares of the merging firms are squared individually:

$(a)^2 + (b)^2$. After the merger, the sum of those shares would be squared: $(a + b)^2$, which equals $a^2 + 2ab + b^2$. The increase in the HHI therefore is represented by 2ab.

19. But excess capacity in the hands of non-maverick firms may be a potent weapon with which to punish deviations from the terms of coordination.

20. Similarly, in a market where product design or quality is significant, a firm is more likely to be an effective maverick the greater is the sales potential of its products among customers of its rivals, in relation to the sales it would obtain if it adhered to the terms of coordination. The likelihood of expansion responses by a maverick will be analyzed in the same fashion as uncommitted entry or committed entry (see Sections 1.3 and 3) depending on the significance of the sunk costs entailed in expansion.

21. Similarly, in some markets sellers are primarily distinguished by their relative advantages in serving different buyers or groups of buyers, and buyers negotiate individually with sellers. Here, for example, sellers may formally bid against one another for the business of a buyer, or each buyer may elicit individual price quotes from multiple sellers. A seller may find it relatively inexpensive to meet the demands of particular buyers or types of buyers, and relatively expensive to meet others' demands. Competition, again, may be localized: sellers compete more directly with those rivals having similar relative advantages in serving particular buyers or groups of buyers. For example, in open outcry auctions, price is determined by the cost of the second lowest-cost seller. A merger involving the first and second lowest-cost sellers could cause prices to rise to the constraining level of the next lowest-cost seller.

22. Information about consumers' actual first and second product choices may be provided by marketing surveys, information from bidding structures, or normal course of business documents from industry participants.

23. The timeliness and likelihood of repositioning responses will be analyzed using the same methodology as used in analyzing uncommitted entry or committed entry (see Sections 1.3 and 3), depending on the significance of the sunk costs entailed in repositioning.

24. The timeliness and likelihood of non-party expansion will be analyzed using the same methodology as used in analyzing uncommitted or committed entry (see Sections 1.3 and 3) depending on the significance of the sunk costs entailed in expansion.

25. Supply responses that require less than one year and insignificant sunk costs to effectuate are analyzed as uncommitted entry in Section 1.3.

26. Many of these phases may be undertaken simultaneously.

27. Firms which have committed to entering the market prior to the merger generally will be included in the measurement of the market. Only committed entry or adjustments to pre-existing entry plans that are induced by the merger will be considered as possibly deterring or counteracting the competitive effects of

concern.

28. Where conditions indicate that entry may be profitable at prices below premerger levels, the Agency will assess the likelihood of entry at the lowest price at which such entry would be profitable.

29. The concept of minimum viable scale ("MVS") differs from the concept of minimum efficient scale ("MES"). While MES is the smallest scale at which average costs are minimized, MVS is the smallest scale at which average costs equal the premerger price.

30. The expected path of future prices, absent the merger, may be used if future price changes can be predicted with reasonable reliability.

31. The minimum viable scale of an entry alternative will be relatively large when the fixed costs of entry are large, when the fixed costs of entry are largely sunk, when the marginal costs of production are high at low levels of output, and when a plant is underutilized for a long time because of delays in achieving market acceptance.

32. Five percent of total market sales typically is used because where a monopolist profitably would raise price by five percent or more across the entire relevant market, it is likely that the accompanying reduction in sales would be no less than five percent.

33. Entrants' anticipated share of growth in demand depends on incumbents' capacity constraints and irreversible investments in capacity expansion, as well as on the relative appeal, acceptability and reputation of incumbents' and entrants' products to the new demand.

34. For example, in a bidding market where all bidders are on equal footing, the market share of incumbents will contract as a result of entry.

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

36. Section 7 of the Clayton Act prohibits mergers that may substantially lessen competition "in any line of commerce . . . in any section of the country." Accordingly, the Agency normally assesses competition in each relevant market affected by a merger independently and normally will challenge the merger if it is likely to be anticompetitive in any relevant market. In some cases, however, the Agency in its prosecutorial discretion will consider efficiencies not strictly in the relevant market, but so inextricably linked with it that a partial divestiture or other remedy could not feasibly eliminate the anticompetitive effect in the relevant market without sacrificing the efficiencies in the other market(s). Inextricably linked efficiencies rarely are a significant factor in the Agency's determination not to challenge a merger. They are most likely to make a difference when they are great and the likely anticompetitive effect in the relevant market(s) is small.

37. The result of this analysis over the short term will determine the Agency's enforcement decision in most cases. The Agency also will consider the effects of cognizable efficiencies with no short-term, direct effect on prices in the relevant market. Delayed benefits from efficiencies (due to delay in the achievement of, or the realization of consumer benefits from, the efficiencies) will be given less weight because they are less proximate and more difficult to predict.

38. 11 U.S.C. Sections 1101-1174 (1988).

39. Any offer to purchase the assets of the failing firm for a price above the liquidation value of those assets--the highest valued use outside the relevant market or equivalent offer to purchase the stock of the failing firm--will be regarded as a reasonable alternative offer.

APPENDIX IV

PX 5678

Federal Trade Commission Administrative Complaint, *In the Matter of Arch Coal, Inc., et al.*, Docket No. D09316, issued April 6, 2004

IN CAMERA

UNITED STATES OF AMERICA

BEFORE

FEDERAL TRADE COMMISSION

DOCKET NO.

D09316

IN THE MATTER OF:

ARCH COAL, INC., ET AL

COMPLAINT

m 347A (11/89)

IN CAMERA

IN CAMERA

031-0191

UNITED STATES OF AMERICA
BEFORE FEDERAL TRADE COMMISSION

In the Matter of ARCH COAL, INC., a corporation, NEW VULCAN COAL HOLDINGS, LLC, a limited liability company, and TRITON COAL COMPANY, LLC, a limited liability company.	)	Docket No. 9316

COMPLAINT

The Federal Trade Commission ("Commission"), having reason to believe that respondents Arch Coal, Inc. ("Arch"), a corporation, and New Vulcan Coal Holdings, LLC ("New Vulcan"), a limited liability company, entered into an agreement, in violation of Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45, for the acquisition by Arch of Triton Coal Company, LLC ("Triton") from New Vulcan, which acquisition, if consummated, would violate Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18, and Section 5 of the Federal Trade Commission Act, and that a proceeding in respect thereof would be in the public interest, hereby issues its complaint, stating its charges as follows:

RESPONDENT ARCH

1. Respondent Arch is a corporation organized and existing under the laws of the State of Delaware, with its principal place of business at One CityPlace Drive, Suite 300, St. Louis, Missouri 63141.

2. Respondent Arch is the second largest coal producer in the United States, operates approximately 30 coal mines in the United States, and had $1.4 billion in revenues in 2003. Arch is one of five significant producers of coal in the Southern Powder River Basin in Wyoming ("SPRB") and is one of only four producers of 8800 Btu SPRB coal.

IN CAMERA

RESPONDENTS NEW VULCAN AND TRITON

3. Respondent New Vulcan is a limited liability company, wholly owned by Vulcan Partners, an investment partnership. New Vulcan is organized and exists under the laws of the State of Delaware, with its principal place of business at 141 Market Place Drive, Suite 100, Fairview Heights, Illinois 62208.

4. Respondent Triton is a limited liability company, wholly owned by New Vulcan and organized and existing under the laws of the State of Delaware, with its principal place of business at 113 South Gillette Ave, Suite 203, Gillette, Wyoming 82716.

5. Respondent Triton is one of five significant producers of coal in the SPRB and is one of only four producers of 8800 Btu SPRB coal.

JURISDICTION

6. Arch is, and at all times relevant herein has been, engaged in commerce as "commerce" is defined in Section 1 of the Clayton Act, as amended, 15 U.S.C. § 12, and is a corporation whose business is in or affects commerce as "commerce" is defined in Section 4 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 44.

7. New Vulcan and Triton are, and at all times relevant herein have been, engaged in commerce as "commerce" is defined in Section 1 of the Clayton Act, as amended, 15 U.S.C. § 12, and are limited liability companies whose businesses are in or affect commerce as "commerce" is defined in Section 4 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 44.

THE ACQUISITION AND THE PROPOSED SALE OF BUCKSKIN

8. Pursuant to a Merger and Purchase Agreement ("Agreement") dated May 29, 2003, Arch proposes to acquire all the assets of Triton, including principally Triton's North Rochelle mine, from New Vulcan for approximately $364 million in cash (the "Acquisition").

9. Arch also has entered into an executory contract, in or about January 2004, to transfer another mine that it is acquiring from Triton, Triton's Tier 3 Buckskin mine assets (valued at approximately $80 million, or approximately 22% of the value of the Acquisition), to Peter Kiewit Sons', Inc. ("Kiewit"), a competing initial bidder for Triton and a competing final bidder for Triton's Buckskin mine assets. This executory contract does not materially change the Acquisition or its likely effect on competition.

10. Arch's acquisition of Triton, both as originally agreed among respondents and as further agreed between Arch and Kiewit, is an acquisition of "the whole or any part of the stock"

and "the whole or any part of the assets" of Triton, within the meaning of Section 7 of the Clayton Act.

11. On March 30, 2004, the Commission authorized the commencement of an action under Section 13(b) of the FTC Act to seek a preliminary injunction barring the Acquisition during the pendency of administrative proceedings.

RELEVANT MARKET

12. The relevant product markets in which the competitive effects of the proposed Acquisition may be assessed are SPRB coal and any narrower markets therein.

13. The price differential between 8800 Btu SPRB coal and 8400 Btu SPRB coal depends on the demand and supply balance for each of the two products. Consequently, supply restrictions by producers of 8800 Btu SPRB coal, relative to the growing demand for the product, can cause the price of 8800 Btu SPRB coal to increase relative to the price of 8400 Btu SPRB coal.

GEOGRAPHIC MARKET

14. The relevant geographic market within which to assess the competitive effects of the proposed Acquisition is the SPRB (and any narrower markets therein). The SPRB is the only area with mines to which customers can turn for supply of SPRB coal, and Tier 1 of the SPRB is the only area with mines to which customers can turn for supply of 8800 Btu SPRB coal. The Acquisition will adversely affect electricity customers in areas throughout the United States.

COAL FROM THE SPRB

15. Coal is a leading energy source in the United States. Coal-fired generating plants account for about 92% of all coal consumption and about 50% of all electric power produced in the United States. Of the approximately 1.1 billion tons of coal produced annually in the United States, about one-third is produced in the SPRB, which is located in Wyoming. SPRB coal is burned by electric generators in at least 26 states, including generators extending from Oregon to Arizona in the west, to Lake Michigan, Georgia, and Alabama in the east. Electric generators account for virtually all consumption of SPRB coal. In 2003, mines in the SPRB produced about 363 million tons of coal with an approximate value in excess of $2 billion.

16. The SPRB is a source of low sulfur coal that has an energy content of between approximately 8300 and 8800 British Thermal Units ("Btus") per pound. SPRB coal is lower in sulfur than most coals mined in the United States and is one of the few coals that comply with the current sulfur emission limits imposed on coal-fired generators by the 1990 Clean Air Act. SPRB coal is also low in ash and sodium content. These properties, combined with

exceptionally low mining costs, give SPRB coal a strong economic advantage in supplying many electric generators compared to coal produced in other regions of the United States.

THE THREE TIERS IN THE SPRB

17. SPRB coal suppliers and customers have established two distinct price points for SPRB coal based on the heat content of the coal – 8800 Btu and 8400 Btu. Coal contracts specify sulfur content and the Btu range of the coal and provide price adjustment for actual sulfur content and Btu content of the coal transferred from the mine.

18. The most highly valued SPRB coal is 8800 Btu coal, which is produced in the [illegible] energy content, and easy access to competing rail transport service.

19. The mines that produce 8400 Btu coal are divided between Tiers 2 and 3. Tier 2 mines are located just south of Gillette, Wyoming. These mines typically produce coal that has not only a lower heat content but also generally a higher sulfur content than coal from Tier 1. Tier 3 mines include those mines located immediately north and east of Gillette, Wyoming. These mines also produce coal with approximately 8400 Btu/lb., but with higher sulfur content than the Tier 2 mines to the south.

20. Coal mines in Tier 1 and Tier 2 of the SPRB have a transportation advantage because they have access to the joint line of the Burlington Northern Santa Fe ("BNSF") and Union Pacific ("UP") railroads. Consequently, shippers of coal from mines in Tier 1 and Tier 2 of the SPRB are able to contract with either BNSF or UP to transport the coal to the customer's generating plant. Tier 3 mines have access only to the BNSF railroad. Tier 3 producers are competitively disadvantaged relative to producers in Tiers 1 and 2 of the SPRB, because they produce a lower Btu coal with a higher sulfur content than mines in other regions of the SPRB, and have access to only the BNSF railroad.

21. Four significant producers in the SPRB – Arch, Peabody, Kennecott, and Triton – all operate mines in the Tier 1 Region. Arch's Black Thunder mine and Triton's North Rochelle mine are located in the Tier 1 region and produce 8800 Btu coal. Each of these producers also conducts one or more coal mining operations in Tiers 2 and 3 of the SPRB. Arch's Coal Creek mine, which Arch has kept idle since 2000, is located in the Tier 2 region. Triton's Buckskin mine is located in the Tier 3 region. Another SPRB producer, R.A.G., is a significant producer of 8400 Btu SPRB coal, but produces coal only in Tiers 2 and 3.

USE OF SPRB COAL

22. Coal-fired generating plants are optimized to use coal from a certain source, or a specific mixture of coals. Switching to, or away from, SPRB coal often entails significant costs. Most generating plants burning SPRB coal that were brought on line in the last 20 years are designed specifically to burn SPRB coal and cannot economically burn other coal. Prior to the development of the SPRB coal mines, coal-fired generating plants were designed to burn the highest Btu coal, generally bituminous coal with a heat content up to 12,000 Btu/lb., from the closest mines to the plants without regard to sulfur content. Following passage of the Clean Air Act of 1990, many of these older plants converted their facilities to burn SPRB coal in order to comply with stricter sulfur emissions limitations. Converting a coal-fired electric generating facility from high-Btu bituminous coal to SPRB coal is costly, in the tens of millions of dollars, and takes a significant amount of time. Plant modifications to burn SPRB coal include upgrading the coal conveying and handling systems to deliver the higher volume of SPRB coal needed by the electric generating units at the plant, and modifying the plants' boiler and heat absorption and cleaning systems. Many older plants that currently burn SPRB coal would require installation of scrubbers to reduce emission of sulfur compounds before they could switch to non-SPRB (*e.g.*, Appalachian) coal in any significant volume. Installing a scrubber is an expensive procedure, which can cost hundreds of millions of dollars and take several years.

23. Montana coals from the Northern Powder River Basin ("NPRB") are not competitive with Wyoming coals from the SPRB. NPRB coals have high sodium content, which can lead to operational problems at the generating plant. The high sodium content associated with NPRB coals tends to create excessive slagging in the boilers that adversely affects the boilers' efficiency. In addition, Montana imposes a significantly higher severance tax on its coal than does Wyoming. The higher tax puts Montana NPRB coal at a competitive disadvantage to Wyoming's SPRB coal. Transportation from the NPRB mines is also limited to one rail line. NPRB coal production is small relative to that in the SPRB, and shipments of NPRB coal have declined in recent years.

24. Even if coal from outside the SPRB possessed physical characteristics that would allow its use in lieu of SPRB coal, coals from other regions are too costly on a delivered cost basis to be an economic substitute for SPRB coal for most generators that use SPRB coal. For many generators that burn SPRB coal, Colorado and Uinta Basin coals are much more expensive, on a delivered cost per Btu, sulfur-adjusted basis, than SPRB coals. Appalachian coal is significantly more expensive on a delivered cost per Btu basis than SPRB coal, and moreover most Appalachian coal has high sulfur content.

25. SPRB coal is sold exclusively at the mine-mouth in the SPRB. Customers ship the coal on one of the two rail lines serving the SPRB and negotiate a freight rate with the railroad.

26. 8800 Btu SPRB coal produced in Tier 1 of the SPRB is functionally and economically distinct from the 8400 Btu SPRB coal produced in Tier 2 and Tier 3 of the SPRB. More 8400 Btu coal must be transported and burned in order to generate the same heat output as would be generated from a given quantity of 8800 Btu coal. Because more 8400 Btu coal is required to generate the same heat value as a given amount of 8800 Btu coal, in general the greater the distance from the SPRB to a customer's generating facility, the more uneconomical it is for a customer with a given type of generator that is burning 8800 Btu SPRB coal to switch to 8400 Btu SPRB coal in response to an increase in the mine price of 8800 Btu SPRB coal.

27. Performance problems associated with burning 8400 Btu SPRB coal make use of this coal uneconomic for some 8800 Btu SPRB coal customers. When low-Btu coal is used to fuel a boiler designed to burn higher Btu coal, more coal must be moved through the boiler to generate the same quantity of heat. It is often not possible, however, to move a sufficient volume of coal through the boiler unit to achieve the boiler's full rated steam output level, causing the rated maximum electric generating capacity of the generating facility to be reduced, a consequence referred to in the electricity industry as a "derate." For some 8800 Btu coal customers, use of 8400 Btu coal causes a derate. Growth in demand for electricity has increased, and is likely to continue to increase, the demand for 8800 Btu SPRB coal relative to the demand for 8400 Btu SPRB coal.

MARKET STRUCTURE

28. The relevant markets are highly concentrated.

29. Arch is one of five significant producers of SPRB coal and is one of only four producers of 8800 Btu SPRB coal.

30. Triton is one of five significant producers of SPRB coal and is one of only four producers of 8800 Btu SPRB coal.

31. Arch idled its 8400 Btu SPRB coal mining operations at Coal Creek in or about July 2000 because of what Arch regarded as unfavorable conditions existing in the market environment.

32. Arch has much of the infrastructure in place to support coal production of 18 million tons per year at its Coal Creek mine. Through its idle Coal Creek mine, Arch controls the principal excess capacity for production of 8400 Btu SPRB coal.

33. Through its North Rochelle mine, Triton controls the principal excess capacity for production of 8800 Btu SPRB coal.

34. Arch and Triton are direct and actual competitors in each of the relevant markets. They compete with each other on price and on reliability of supply, among other things.

THE SPRB COAL MARKET IS SUSCEPTIBLE TO COORDINATION

35. The SPRB coal market (and any narrower market therein) possesses several tructural features that make coordination more likely, including a small number of competitors, igh barriers to entry, homogeneity of the relevant product, relatively inelastic demand, vailability of substantial market and competitor information, and close geographic proximity of ompetitors.

36. Respondents and others, including Kiewit, recognized that consolidation in the SPRB has led and will lead to producer restraint and higher SPRB prices.

37. Detailed information regarding SPRB coal market and competitor output, sales, rices, capacity, forecasts, and plans is readily available to mine owners through the trade press nd through other public and private sources of information.

38. Behavior by the major SPRB producers facilitates coordination. The major SPRB roducers regularly signal their intent with respect to coal production, and competitors keenly ollow these signals and ascertain whether production announcements are actually implemented. This signaling includes open communications by coal companies and coal company executives at nvestor conferences and trade association meetings and through press releases and statements in he trade press.

39. Arch has been a leading proponent of limiting SPRB coal production. With the cquisition of Triton, Arch will have greater incentive and ability to limit supply of SPRB coal rom the mines it already owns and those it would acquire. Arch has publicly encouraged SPRB competitors to restrict output to stabilize or increase prices for SPRB coal. Arch's output estriction and signals concerning output and prices facilitate coordination by reducing ncertainty among Arch's SPRB competitors. For example:

a. On May 18, 2000, Arch announced its plans to reduce production at Coal Creek in a press release in which Arch President and CEO Steven Leer stated; "We are committed to earning an adequate return for our shareholders, and we will not resume higher levels of production at Coal Creek until such a return is possible." Speaking at the Western Coal Council's Spring Forum on May 23, 2000, before an audience that included Arch's competitors, Mr. Leer noted that overproduction had eroded coal prices. Mr. Leer urged coal suppliers to "Produce Less Coal" in response to the problem of oversupply. Advocating cutbacks in coal production, Mr. Leer said that coal companies would benefit from matching supply and demand and that Arch, Kennecott, and Peabody were all moving to reduce production. He stressed to his audience that "Arch has been conscientious" in reducing capacity, including idling Coal Creek (removing 10 million tons per year of output and idling 18 million tons per year of capacity) and limiting expansion at Black Thunder to about 60 million tons per year (the original plan had called for about 80 million tons per year).

b. At an April 17, 2001, Western Coal Transportation Association meeting, Mr. Leer delivered the keynote address to the group, which included his competitors and customers. In that speech, Mr. Leer explained that the reason for the price increase in the SPRB was the "supply/demand balance," due, in part, to the fact that in the "Southern PRB, [there were] fewer producers, so greater potential for discipline." Even though coal prices had more than doubled from the previous year, Mr. Leer defended his and his competitors' decisions to constrain supply – "We've had offers to open up Coal Creek Mine for one year at extremely attractive pricing. And the answer is no. I think other producers are in the same boat." Arch's message got through to Triton, and indeed was discussed within a few days internally among Triton's management.

c. On March 18, 2002, PRNewswire-FirstCall reported that Arch announced production cuts during a period of increasing prices and even though such cuts would adversely impact Arch's earnings. Quoting Mr. Leer, the report stated:

> "While we are seeing the initial signs of an economic recovery, and forward pricing for 2003 has begun to increase, we believe that the best course for Arch is to act aggressively to bring production in line with demand.
>
> * * *
>
> "We are committed to being a market-driven producer," Leer said. "We believe it would be a mistake to sell coal into an oversupplied market, at prices that will not provide an adequate return.
>
> "We have not taken these steps lightly," he added. "The reductions will have an adverse impact on earnings, particularly in the first and second quarters, given the relatively fixed nature of our cost structure in the near term."

According to Mr. Leer, being "market driven" means exercising production discipline, *i.e.*, when demand is less than supply at Arch's desired price, Arch reduces its output rather than its price. Mr. Leer's statements were not merely posturing for public consumption. Privately Mr. Leer urged that Arch should continue to restrict output even in light of rising prices, because output increases would cause the price rebound to stall.

d. Four months after Arch announced its decision to restrict production, the July 18, 2002, edition of Coal & Energy reported that Arch had, in fact, reduced its coal shipments. The article further reported Arch's most recent pricing for SPRB coal. The report quoted Mr. Leer:

> "Although we are continuing to restrict production, we are seeing

signs that the market is progressing towards a healthier balance between supply and demand. . . . In the West, we have committed in recent weeks approximately 3 million tons of Powder River Basin coal for delivery in 2003 or 2004, at an average price of approximately $7 per ton. . . . We are very comfortable with our position and feel no sense of urgency to sign contracts at current pricing levels. . . . We continue to believe that the current market has far more upside potential than downside."

e. Throughout 2002 and into 2003, Mr. Leer continued to tout the benefits of restricting production. On April 21, 2003, one month before Arch announced it was acquiring Triton, Mr. Leer stated in a release announcing Arch's First Quarter 2003 results that "we continue to believe that our strategic decision to leave uncommitted tons in the ground, rather than sell them at a price that does not provide an adequate return, is sound." At the same time, Mr. Leer reaffirmed privately that Arch had been doing the right thing by restricting production and cautioned that Arch's ability to continue to lead the charge would depend on gaining market support. However, Mr. Leer warned that if prices did not improve soon, Arch would ramp up the mines to full production. Such a ramp-up would send Arch's competitors a strong signal that Arch was prepared to punish other producers if they failed to support Arch's output curtailment initiative.

40. Arch's SPRB competitors also understand the importance of limiting production to tighten the supply/demand balance in the market and have signaled their own production intentions. For example:

a. Privately, an executive of a major SPRB producer observed, in May 2000, that while the company could not enter into express or implied understandings with its competitors as to market matters influencing or affecting price, it could set a rational, independent example for the PRB industry. The company examined the message it would send to the PRB industry by curtailing expansion and expressed hope that competitors would consider these factors in their own market behavior, in light of preclusion, under antitrust law, of express or implied understandings or communications on these topics.

b. Irl Engelhardt, Chairman and CEO of Peabody Coal, made the following statement in his April 25, 2000, speech to the Western Coal Transportation Association:

"The growing demand for Powder River Basin coals should point to robust market conditions. The opposite is true; conditions are soft at present. Why? Our 'firm' believes that too many producers relied upon those optimistic market projections discussed earlier, and some made investments that resulted in oversupply situations."

Mr. Engelhardt then described the steps Peabody had taken to reduce "oversupply," including:

- In early 1999, Peabody suspended the 10-million-ton-per-year Rawhide Mine, "one of the most productive mines in the United States;"
- Also in 1999, Peabody delayed a 30-million-ton-per-year capacity expansion at North Antelope/Rochelle "until margins will generate the proper returns;" and
- In April 2000, Peabody idled a truck/shovel fleet at Caballo, reducing output by 8 million tons per year, "until market conditions improve."

c. In an internal evaluation of its own SPRB coal supply strategy, another major SPRB producer noted with interest Mr. Engelhardt's speech, including his statements regarding the damage oversupply had wrought and Peabody's output reductions until market conditions improve.

d. On May 8, 2000, a few days after the Engelhardt speech, Kennecott issued a press release announcing its intent to "temporarily curtail production" at its mines. A week later, on May 15, 2000, Coal Outlook reported that "these reductions would come from the Cordero Rojo complex, 5.5 million tons; Jacobs Ranch, 2 million tons; and Colowyo, 500,000 tons." The article quotes Kennecott's president Gary Goldberg as stating that Kennecott elected to curtail output "rather than accept prices that do not provide a return on its investment."

e. Communications among the major SPRB producers are not limited to speeches, but include direct conversations concerning expansion plans and mine operations. Competitors also discuss with one another supply contracts with individual customers. In considering how to respond to a customer's expressed interest in purchasing coal, a major SPRB producer drew on its discussions with Arch personnel regarding the customer's future purchase commitments with Arch. Discussions between competitors also involve SPRB price projections and the SPRB supply and demand balance.

f. Triton, well aware of the cutbacks by the three largest of the five SPRB producers, ordered the development of plans for the public announcement – at a May 15, 2000, speech to a Coaltrans conference – of its own plan to reduce production at North Rochelle until pricing improved. But Triton ultimately decided to expand output at the North Rochelle mine rather than cut back its production. Triton continued to operate the North Rochelle mine at close to full practical capacity until after entering into the acquisition agreement with Arch, entering into a joint defense agreement with Arch, and engaging in due diligence discussions with Arch. More recently, Triton also has indicated that it has plans to reduce production at the North Rochelle mine.

PRIOR TO THE PROPOSED ACQUISITION, TRITON'S NORTH ROCHELLE MINE HAS BEEN THE PRINCIPAL SOURCE OF OUTPUT EXPANSION IN THE SPRB DURING THE PRECEDING FIVE YEARS

41. Shipments of SPRB coal increased by 70 million tons over the period 1998 through 2003. While other SPRB producers exercised production discipline, Triton rapidly expanded production at its North Rochelle mine, the newest mine in the SPRB. Triton's North Rochelle mine has been the largest source of increased supply of SPRB coal over the period 1998 through 2003. The increase in coal shipments from the North Rochelle mine accounted for 34.1% of the total increase in coal shipments from the SPRB over that period. The expansion at North Rochelle has been the largest expansion of supply of SPRB coal over that period.

42. Output expansion has been profitable for Triton. Triton's EBITDA was over $50 million in 2002, and Triton has continued to have a strong operating income and EBITDA. The vast majority of Triton's operating income and EBITDA in 2002 and 2003 came from Triton's North Rochelle mine.

43. Arch Coal management recognized that an acquisition of Triton will provide an "insurance policy" for Arch in the SPRB, by eliminating an "undisciplined" producer and enabling Arch more effectively to control production to match demand.

ANTICOMPETITIVE EFFECTS OF THE ACQUISITION

44. The Acquisition would combine two of only four producers of 8800 Btu SPRB coal and would combine two of the leading producers of SPRB coal.

45. The Acquisition would combine the two firms that hold the principal sources of excess capacity in the SPRB and would bring under Arch's control the principal source of excess capacity for production of 8800 Btu SPRB coal.

46. The transfer by Arch of Triton's Tier 3 Buckskin mine to Kiewit does not remedy the potential anticompetitive effects of the Acquisition in the SPRB or in 8800 Btu coal. Buckskin and R.A.G. would be unable to constrain a coordinated price increase in the SPRB.

47. The Acquisition may substantially lessen competition in the following ways, among others:

a. It would combine two of the leading producers of SPRB coal, would substantially increase concentration in the SPRB market and result in a highly concentrated SPRB market, would eliminate the existing substantial competition between Arch and Triton, and would substantially reduce competition in the SPRB market.

b. It would combine the two firms that hold the principal sources of excess capacity in the SPRB and would bring under Arch's control the principal source of excess capacity for production of 8800 Btu SPRB coal.

c. It would combine two among only four producers in Tier 1 of the SPRB, would substantially increase concentration in 8800 Btu SPRB coal and result in high concentration among 8800 Btu coal producers, would eliminate the existing substantial competition between Arch and Triton, and would substantially reduce competition in 8800 Btu SPRB coal.

d. It would increase the likelihood of coordination in the market for SPRB coal (and narrower markets therein), a market that is already susceptible to coordination. Following the Acquisition, Arch could more easily coordinate profitably with either or both of the other two remaining major producers to restrict output, limit capacity expansion, or raise price as demand for SPRB coal continues to grow. The Acquisition would make coordination among SPRB producers, and among producers of 8800 Btu SPRB coal, easier, more likely, more successful, and more durable.

ENTRY CONDITIONS

48. Entry into the relevant markets would not be timely, likely, or sufficient in its magnitude, character, and scope to deter or counteract the anticompetitive effects of the Acquisition.

VIOLATIONS CHARGED

COUNT I -- ILLEGAL ACQUISITION

49. The allegations contained in Paragraphs 1-48 are repeated and realleged as though fully set forth here.

50. The effect of the Acquisition may be substantially to lessen competition or tend to create a monopoly in violation of Section 7 of the Clayton Act, 15 U.S.C. § 18, and Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45.

COUNT II -- ILLEGAL ACQUISITION AGREEMENT

51. The allegations contained in Paragraphs 1-48 are repeated and realleged as though fully set forth here.

52. Arch and Triton, through the Agreement described in Paragraph 8, have engaged in unfair methods of competition in or affecting commerce in violation of Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45.

NOTICE

Proceedings on the charges asserted against you in this complaint will be held before an Administrative Law Judge (ALJ) of the Federal Trade Commission, under Part 3 of the Commission's Rules of Practice, 16 C.F.R. Part 3. A copy of Part 3 of the Rules is enclosed with this complaint.

This complaint will be made public on the 6th day following its issuance, unless one or more respondents object thereto before the expiration of said period. A respondent objecting to the Commission's making the complaint public shall file a statement of the basis for its objection(s) with the ALJ, who shall consider such objection(s) and complaint counsel's response thereto and shall issue an order prescribing what portions of the complaint, if any, shall be redacted before it is made public.

You may file an answer to this complaint. Any such answer must be filed within 20 days after service of the complaint on you. If you contest the complaint's allegations of fact, your answer must concisely state the facts constituting each ground of defense, and must specifically admit, deny, explain, or disclaim knowledge of each fact alleged in the complaint. You will be deemed to have admitted any allegations of the complaint that you do not so answer.

If you elect not to contest the allegations of fact set forth in the complaint, your answer shall state that you admit all of the material allegations to be true. Such an answer will constitute a waiver of hearings as to the facts alleged in the complaint and, together with the complaint, will provide a record basis on which the ALJ will file an initial decision containing appropriate findings and conclusions and an appropriate order disposing of the proceeding. Such an answer may, however, reserve the right to submit proposed findings and conclusions and the right to appeal the initial decision to the Commission under Section 3.52 of the Commission's Rules of Practice.

If you do not answer within the specified time, you waive your right to appear and contest the allegations of the complaint. The ALJ is then authorized, without further notice to you, to find that the facts are as alleged in the complaint and to enter an initial decision and a cease and desist order.

The ALJ will schedule an initial prehearing scheduling conference to be held not later than 7 days after the last answer is filed by any party named as a respondent in the complaint. Unless otherwise directed by the ALJ, the scheduling conference and further proceedings will take place at the Federal Trade Commission, 600 Pennsylvania Avenue, N.W., Washington, D.C. 20580. Rule 3.21(a) requires a meeting of the parties' counsel as early as practicable before the prehearing scheduling conference, and Rule 3.31(b) obligates counsel for each party, within 5 days of receiving a respondent's answer, to make certain initial disclosures without awaiting a formal discovery request.

A hearing on the complaint will begin on the sixth day of July, 2004, at 10:00 A.M. in Room 532, or such other date as determined by the ALJ. At the hearing, you will have the right to contest the allegations of the complaint and to show cause why a cease and desist order should not be entered against you.

NOTICE OF CONTEMPLATED RELIEF

Should the Commission conclude from the record developed in any adjudicative proceedings in this matter that the Merger and Purchase Agreement described in Paragraph 8 violates Section 5 of the Federal Trade Commission Act, as amended, or that the proposed acquisition challenged in this proceeding would, if consummated, violate Section 7 of the Clayton Act, as amended, or Section 5 of the Federal Trade Commission Act, as amended, the Commission may order such relief against respondents as is supported by the record and is necessary and appropriate, including, but not limited to:

1. An order to cease and desist from any action to effect the acquisition by Arch of any assets or securities of Triton.

2. Rescission of the Merger and Purchase Agreement between respondents.

3. Divestiture of an ongoing, operating business, including all assets, tangible and intangible, including, but not limited to, all intellectual property, knowhow, trademarks, trade names, research and development, and customer contracts.

4. Such other or additional relief as is necessary to ensure the creation of one or more viable, competitive, independent entities to compete against Arch in the relevant markets.

5. A requirement, for a ten (10) year period, that Arch and Triton provide the Commission with notice in advance of acquiring the assets or securities of, or any other combination with, any person engaged in the mining and sale of SPRB coal.

IN WITNESS WHEREOF, the Federal Trade Commission has caused this complaint to be signed by its Secretary and its official seal to be hereto affixed, at Washington, D.C. this sixth day of April, 2004.

By the Commission.

C. Landis Plummer

C. Landis Plummer
Acting Secretary

SEAL:

PX5678-018

APPENDIX V

LIST OF EXHIBITS TO MEMORANDUM IN SUPPORT OF PLAINTIFF'S MOTION FOR PRELIMINARY INJUNCTION