IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

FEDERAL TRADE COMMISSION, Plaintiff,	)
v.	) Case No. 1:00CV01688 (JR)
H.J. HEINZ COMPANY and MILNOT HOLDING CORPORATION, Defendants.	)

FILED
OCT 19 2000
NANCY MAYER WHITTINGTON, CLERK
U.S. DISTRICT COURT

DEFENDANTS' POST TRIAL REPLY MEMORANDUM

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Dated: September 20, 2000

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Defendants H.J. Heinz Company ("Heinz") and Milnot Holding Corporation ("Milnot") respectfully submit this reply memorandum in support of their post trial brief, conclusions of law and findings of fact.

I. INTRODUCTION

The FTC has briefed the case it wished it had presented at trial, but never did. Consequently, the agency's Post Trial Memorandum is not based on record evidence or market facts, but instead self-assertions without underlying support. Its legal arguments are similarly a study in avoidance of current legal standards and current legal precedent, highlighting, instead, outdated case law and antitrust theory from decades in the past. Most importantly, its analysis of the ultimate issue this Court must address — this merger's probable effect on competition and consumers — is both shallow and incomplete.

From the outset of this case, all sides have agreed that Heinz and Beech-Nut compete to get on the shelf next to Gerber. But competition to get on the shelf is not an indicator of the competitive process this Court must assess. Instead, it is competition to "get-off-the-shelf" — the competition in the store for consumer purchases — that counts. In the end, the key question is whether it is reasonably probable that this merger will substantially lessen this competition. And it is this question that the FTC declines to answer, because the clear answer, based on evidence rather than unfounded conjecture, defeats the agency's case.

Representative of the agency's attempt to evade this issue is its pretense that Gerber Products Company ("Gerber") is irrelevant to the Court's analysis. This case is not an attack on Gerber, nor is it a case about Gerber. But the plain fact is that Gerber is integral to assessing competition to "get-off-the-shelf," because whether the competitor is Heinz or Beech-Nut or both, Gerber alone is the brand both Heinz and Beech-Nut compete with for consumer sales in the stores. Accordingly, it is this merger's reasonably probable effect on competition with Gerber that matters, because it is competition with Gerber that directly affects the price consumers pay for baby food.

The FTC does not want to confront this central issue. It prefers, instead, to argue that the concentration levels in this market give rise to a presumption that the merger will substantially lessen competition — its prima facie case — and then clings to this legal presumption as if the standard were irrebuttable. While grudgingly yielding that the ultimate burden of persuasion is on the agency, it seeks to insulate itself from ever having to confront that burden by setting for the defendants the unrealistically high interim standard of having to rebut the prima facie case by a "clear showing" with "clear and convincing evidence," citing excerpts from Professor Areeda, rather than case law.

Defendants understand they have a burden. As the United States Court of Appeals for the D.C. Circuit explained quite clearly in *United States v. Baker Hughes Inc.*, 908 F.2d 981 (D.C. Circuit), once the FTC establishes a prima facie case, the defendants must come forward with evidence that the merger will not substantially lessen competition. 908 F.2d at 982. There should be no debate, however, about the level of proof that this burden-of-production requires. Affirming the district court's holding that defendants satisfy this burden of production with "sufficient evidence," the D.C. Circuit rejected the FTC's argument here that a "clear showing" or "clear and convincing evidence" is required, noting that so heavy a burden would improperly shift the ultimate burden of persuasion to defendants. *Id.* at 983.

The evidentiary showing required of defendants, therefore, is that which is "sufficient" to overcome the structural presumption. In evaluating whether that showing has been made, this Court must go beyond the market structure and examine the transaction in light of the history of competition within that structural mold, the current competitive environment, and probable effects on competition in the future if the merger is or is not approved. *See United States v. General Dynamics Corp.*, 415 U.S. 486, 498 (1974) (citing *Brown Shoe v. United States*, 370 U.S. 294, 322 n.38) ("only a further examination of the particular market — its structure, history, and probable future — can provide the appropriate setting for judging probable anticompetitive effect of the merger").

Defendants submit that they have easily carried their burden of production. They have come forward with more than sufficient evidence showing that:

- This concentrated market has been dominated for decades by a single firm, Gerber. (DFF 7-27).[1]

- As a consequence of that domination, the only other players in the market, Heinz and Beech-Nut, have been unable to have any discernible impact on the price at which baby food is sold to consumers — instead, the retail price has undeniably been set by Gerber and steadily increased. (DFF 18-19; DX 128).

- Heinz and Beech-Nut have been relegated to "also ran" players, each with market shares hovering around 14-15%, who compete, if at all, to be selected as the second brand baby food on the shelf. (DFF 42, 65, 191-92).

- This competition to get-on-the-shelf has had no discernible impact on the competition to get-off-the-shelf (*i.e.*, sales to the consumer), which is virtually everywhere carried on between Gerber (the No. 1 brand) and the second brand stocked by the retail store (*i.e.*, Heinz or Beech-Nut). (DFF 92-96; DX 130, 132; 128).

- Every strategy to defeat the Gerber stranglehold on the market — from internal pricing strategies (*i.e.*, value pricing) (DFF 48-50), to efforts by Beech-Nut to compete with the Gerber Baby on the basis of brand equity (DFF 71-73), to the unsuccessful entry into the market of substantial outside investors intent on growing market share of the smaller brand (DFF 63-66), Heinz's substantial investment in plant modernization to lower costs (DFF 55), to innovation initiatives that have met with little success because the second brand innovators were no match against the substantial resources and national stature of Gerber (DFF 36-40, 268-75) — has been unavailing.

- The undeniable fact is that this is a closed market where Gerber stands virtually unopposed, with no constraints on its pricing policies to reverse the steady increase in retail prices (DX 128), nor any competitive force capable of energizing the market with new innovations for the benefit of consumers (DFF 28-47, 87, 137, 276).

Defendants have further shown that the present merger provides the last and only clear chance to introduce real competition into this market environment:

- By combining Heinz and Beech-Nut, new, improved products will be offered nationally for the first time at value prices that will be at least 15-20% below the retail prices charged by Gerber. (DFF 132, 282-93).

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[1] Defendants' Proposed Findings of Fact are referred to herein as "DFF," Plaintiff's Findings of Fact as "PFF," and Plaintiff's Post Trial Memorandum in Support of Federal Trade Commission's Motion for a Preliminary Injunction is referred to as "FTC Br."

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- The state-of-art Pittsburgh plant that is now operating at capacity (DFF 57) will, REDACTED be operating at substantially increased capacity, and the synergies from the merger of these two second-brand companies will produce significant cost savings that will provide the resources needed to go head-to-head with Gerber nationally and out-compete the market leader on price, quality, and new product innovations (DFF 260-385).

- This is not the evidence introduced by the two merging companies alone; it is in fact the very conclusion that Gerber itself came to when it first heard of the merger, and immediately moved to install (DFF 445-60). REDACTED

Defendants' showing undeniably rebuts the FTC's prima facie case. It demonstrates that consumers will be far better off with the merger than without it; that the stagnant market of today and the past four decades, gripped in the steady annual price increases of Gerber, will give way tomorrow, with the merger, to a more open, competitive environment, far more hospitable to product innovation and exceedingly more vulnerable to reductions in prices at the retail level, with the quality of baby food improving rather than remaining constant.

It is not enough, on the strength of this rebuttal evidence, for the FTC to stand firm on its structural case and insist that a preliminary injunction should issue. That is an argument effectively urging that the merger be defeated for all time. *FTC v. Exxon Corp.*, 636 F.2d 1336, 1343 (D.C. Cir. 1980). To obtain that result, the law demands that the FTC "produce additional evidence of anticompetitive effects" of the merger on competition. *Baker-Hughes*, 908 F.2d at 982. In a word, the FTC has "the ultimate burden of persuasion," and must come forward with evidence that shows, on "a totality-of-the-circumstances approach" that this transaction will not merely lessen competition (a showing it has not and cannot make), but will ***substantially*** lessen competition. *Id.* at 984; *General Dynamics*, 415 U.S. at 498. That ultimate burden has plainly not been met.

Rather, faced with an overwhelming record showing that this merger will intensify competition with Gerber, the FTC has countered with essentially its own prognostications, record cites to itself and, not infrequently, proposed findings having no record cites at all. By way of important example, the FTC addresses the ability of Heinz to raise prices post-merger in a passing sentence, gratuitously asserting:

> "by acquiring the brand that, by reputation, can price just behind Gerber, and does, Heinz will have positioned itself to move its new product line into Beech-Nut's pricing point. There would be significantly reduced incentive for either of the two firms to compete aggressively against one another or cheat on any tacit understanding they may reach."

FTC Br. 33-34. For this not insignificant proposition, the agency cites its Proposed Findings of Fact 364 (PFF 364). But PFF 364 is nothing more than a paragraph saying the same thing, without citation to the record or to any other supporting authority. In contrast, the ***record*** in this case shows:

- Tracy Quinn, the Heinz Managing Director of Infant Feeding, hired Booz-Allen to conduct an independent review of the acquisition and its likely market impact. (DFF 284; Quinn Tr. 567-68; Demos Dep. 143 (PX755)).

- Based on its independent review, Booz-Allen prepared a "Growth Strategy," which concluded that Heinz could grow its volume **REDACTED** ***lowering*** Beech-Nut's price to the Heinz value price levels. (DFF 287; Quinn Tr. 570-71; DX 1 at 38).

- That same independent study concluded Heinz stands to gain close to **REDACTED** more by pricing at its value price model than pricing at Beech-Nut levels. (DX 1 at 80).

- Mr. Johnson, the Heinz President and CEO, reviewed and approved the Growth Strategy, and on this basis, recommended this merger to the company's Board of Directors, which approved the merger based primarily on these critical findings. (DFF 289-91; Johnson Tr. 452, 454, 456 and 459-61).

- This growth strategy is consistent with the company's actual record and past successes, reducing costs and prices of ketchup, pet foods and tuna businesses. DFF 293; Johnson Tr. 463-64.

- This strategy also matches shareholder expectations for volume growth. *See* DFF 282; Mehring Dep. 14-19 (DX 1320) (the "primary" factor investors are looking for is "what's known as real growth, which is known as volume growth, profitable growth").

As the following pages make clear, this example is not exhaustive of the FTC's approach in its Post-Trial Memorandum. But this example does illustrate how the agency has addressed

(3) innovation competition. It has not presented evidence to support its case on any count. Nor can it support its argument that its own Guidelines do not apply to this case.

A. THE FTC'S "CASE" AGAINST ITS OWN HORIZONTAL MERGER GUIDELINES

The FTC relegates to a footnote ***the acknowledgement*** that Heinz and Beech-Nut will, post-merger, have a combined market share of less than 35% (FTC Br. 26 n.20; DFF 393), and then dismisses defendants' safe-harbor argument (FTC Br. 33) as a "figment of defendant's imagination." The primary author of the *Merger Guidelines*, however, ***disagrees with the FTC***, and agrees with defendants that "to find unilateral effects it is a requirement that the combined market share of a merging firm exceed 35 percent." *60 Minutes with the Honorable James F. Rill, Assistant Attorney General, Antitrust Division, U.S. Department of Justice*, 61 Antitrust L.J. 229, 238. There is and can be no dispute, moreover, that national market shares — where the Heinz and Beech-Nut combined share is less than 35% — are clearly the relevant market shares. (DFF 392). This merger is within the agency's own safe harbor for unilateral effects analysis, plain and simple. The agency must be held to follow its own standards.

B. THE FTC's "CASE" THAT COMPETITION BETWEEN HEINZ AND BEECH-NUT AFFECTS RETAIL PRICE

The FTC argues that the baby food market today experiences competition between the merging companies to get on the shelf, and that this "get-on-the-shelf" or wholesale competition increases trade spending that benefits consumers in the form of lower prices. (FTC Br. 7-8). On a preliminary but significant note, a number of the FTC's "Findings" on this issue (PFF 111, 169, 170, 175, 188, 192, 194, 196, 199) ***offer no record evidence whatsoever.***[3] More importantly, the FTC fails to distinguish between the "fixed" spending that inures directly to the bottom line of the supermarkets receiving these payments, and "variable spending," which affects consumer promotions:

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[3] Paragraphs 169 and 170 of the FTC's Findings of Fact, for example, broadly concluding that consumer benefits from wholesale competition are "substantial," are bereft of any record cites. Likewise, ¶ 175 asserts that trade spending directly benefits consumers, yet ***no*** record cites are provided.

- The agency argues that "fixed and variable [trade spending] is a distinction without a difference" (FTC Br. 8-9), relying on a statement to that effect by its expert Dr. Hilke (Hilke Tr. 1133) that is ***flatly contradicted by the record evidence*** (DFF 222-42).

- It asserts that Heinz and Beech-Nut have been forced to bid "more and more aggressively against one another, bringing consumers better prices, innovation, and increased choice of products" (FTC Br. 7). Here, again, the FTC makes no fixed/variable distinction, and reliance is placed on the self-serving assertions of the FTC in PFF 192, which ***offers no evidentiary backup.***

- Moreover, the FTC mixes indiscriminately those bid situations in response to retail consolidations (PFF 121, 122, 126, 133, 137, 138, 140) – which the evidence of record shows ***had no measurable effect on consumer prices*** (DFF 254-55) — with other so-called "pre-bid" activity by either Heinz or Beech-Nut that is unquestionably and undeniably aimed directly and only at Gerber. *See* PFF 145-157, 173-196; *see also* Quinn Tr. 580; Meader Tr. 887-88.

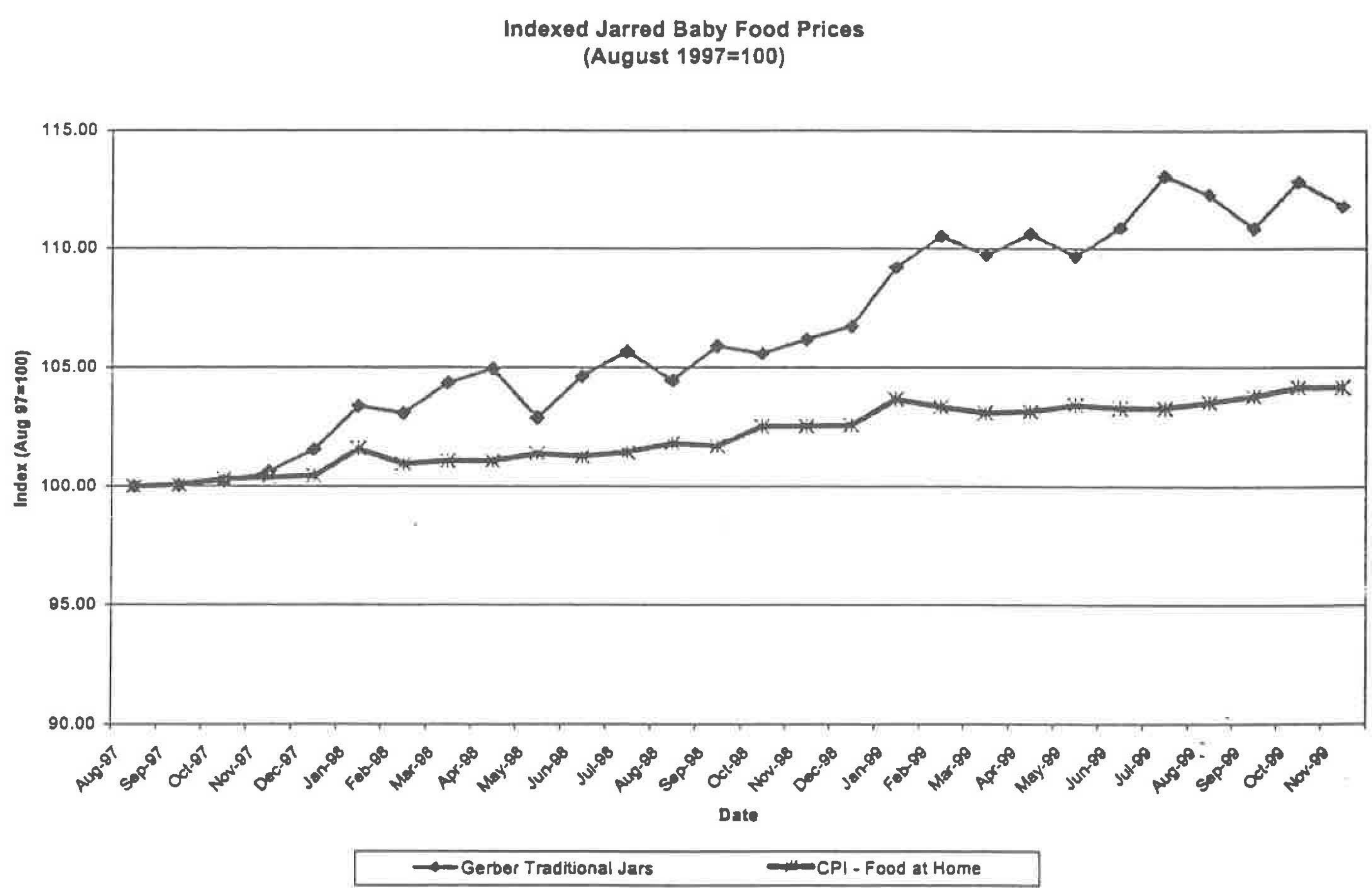
- The FTC further uses the fact that the companies attempt to make up for volume loss (based on distribution losses or otherwise) by implementing incremental spending programs geared to drive volume, to argue that competition for distribution between Heinz and Beech-Nut drives consumer spending. *See* PFF 160-63. The agency's citation for this proposition does not support the assertion — PX 367, the cited evidence, relates to a year-end program to make-up for any lost volume at ***all*** accounts for ***all*** Heinz products, ***not*** any specific lost volume from a Beech-Nut bid. (Quinn Dep. 165). Moreover, Heinz will, of course, have no less incentive to maintain and drive volume post-merger. To the same extent as now, trade spending programs tied to moving volume (*i.e.*, "variable" trade spending) ***compete with Gerber, not Beech-Nut.***

- The FTC places heavy reliance (PFF 145-157) on PX 205 and PX 195 (which are the same document, although invariably referenced separately by the FTC) to make its same essential "pricing" point. That document contains the exchange of memoranda between Mr. Johnson, Heinz's CEO, and Mr. Keller, the company's then interim Manager of Infant Feeding in the U.S. *See* Johnson Tr. 468, 483. Contrary to the FTC's "spin," that exchange, as Mr. Johnson testified, had ***everything to do with the retail competition between Heinz and Gerber to get-off-the-shelf,*** and nothing to do with the wholesale competition between Heinz and Beech-Nut to get-on-the-shelf (DFF 198; Johnson Tr. 501).

- The FTC's reliance (PFF 158-159) on PX 410 and 431 to support its "retail competition" argument is equally misplaced. Both PX 410 and PX 431 underscore an indisputable fact that the FTC continues to ignore: *i.e.*, Heinz invariably prices ***against Gerber***, not Beech-Nut (PX 410), and the various promotional payments (including in-store coupons, direct-mail coupons) used by Heinz to drive volume (PX 431) are directed not at Beech-Nut, but at the get "off-the-shelf" retail competition ***with Gerber***.

- The same can be said with respect to PFF 173-196, which the FTC uses to argue that it is the competition between Heinz and Beech-Nut which leads to more trade allowances and discounts. The catalogue of "variable" trade spending components contained in those findings are not, as the FTC would have the Court believe, isolated to "bid contest" situations between Heinz and Beech-Nut. The uncontested testimony shows that these "variable" trade spending allowances are paid by both Heinz (Quinn Tr. 574) and Beech-Nut (Meader Tr. 863) ***at all accounts*** to move volume off-the-shelf in the competition at retail ***with Gerber*** (DFF 221, 238; Quinn Tr. 574; Whitney Tr. 551-52).

What is striking — ***and yet is nowhere addressed by the FTC*** — is that this second brand "get-on-the-shelf" competition that supposedly today constrains consumer prices has in fact had ***no constraining effect whatsoever*** on the retail price of baby food. Equally telling, the efforts by Heinz and Beech-Nut to move volume off-the-shelf through "variable" trade spending, have similarly had little impact on retail prices. Rather, as the following chart dramatically reflects, Gerber's market dominance has allowed it to be largely impervious to the second-brands' pricing activity, and it has continued to raise consumer prices annually (while category volume trends downward):



Perhaps more disturbing than the total lack of supporting evidence is the FTC's utter disregard for the record evidence that flatly contradicts its bald assertions. What the record evidence in fact shows is that:

- Heinz and Beech-Nut engage in bid competition against one another infrequently and episodically (DFF 190-93).
- The bid packages submitted regularly include both "fixed" and "variable" spending components (DFF 231-32, 235, 237).
- "Fixed" trade spending is routinely an up-front payment to the retailer for its discretionary use, and rarely, if ever, affects the retail price of baby food (DFF 222-26, 243).
- Retailers confirmed in their sworn testimony that the fixed lump-sum payments they received from the second brand manufacturer were put into store accounts for the retailer's general use and did not get applied directly to the retail price. (Whitney 546-547; DFF 242; Jezowski Dep. 35 (PX 766); DFF 243; Long 160-61; Dean Dep. 69, 112, 119-20 (DX 85); Davidson Tr. 833).
- By contrast, "variable" trade spending is tied to volume sales, and is used largely for promotional and merchandising purposes to incentivize the retailer to sell more product (DFF 217, 251). It is a feature of virtually all of Heinz's and Beech-Nut's accounts in both "core" and "mixed" markets (DFF 220; Quinn Tr. 574; Meader Tr. 863).
- A discernible consequence of the bid process has been over the past several years to increase "fixed" payments at the expense of "variable" payments, with the overall amount that is budgeted for trade spending generally remaining relatively constant (DFF 237-38).
- The fact is that Heinz and Beech-Nut have only actually bid against one another for shelf space on occasion, generally tied to a consolidation of retail stores (Meader Tr. 868; Quinn Tr. 581; DFF 192-93).
- No bid situation involving Heinz and Beech-Nut resulted in a reduction of retail prices to the consumer (DFF 243), and, indeed, prices at retail actually increased following the bid activity at Food Lion (DFF 249, 254-55).
- Professor Baker further studied whether the bidding between Heinz and Beech-Nut for shelf space results in lower consumer prices, and found that the bidding had little such effect and, indeed, may result in higher prices at retail (DFF 254-55).
- No econometric study was offered by Dr. Hilke or the FTC in rebuttal.

Nor can the FTC maintain an argument that the merger removes any constraint on retail price, because the overwhelming evidence is that Heinz and Beech-Nut do not compete at the retail level. As set forth in Defendants' Findings of Fact and Defendants' Conclusion of Law, the following six forms of evidence demonstrated there was no appreciable competition between Heinz and Beech-Nut to get off the shelf (no retail competition):

- In most regions of the country, consumers had a choice between Heinz and Beech-Nut but not both (Defendant's Conclusions of Law 39; DFF 116-118; 155-156).
- Even when Heinz and Beech-Nut are in the same region of the country, they are never on the same store shelf and there is no evidence that an appreciable number of consumers would switch grocery stores based on relative differences between the Heinz and Beech-Nut price (Defendant's Conclusions of Law 40; DFF 109-115).
- Heinz and Beech-Nut are differentiated products with different market positioning (Defendant's Conclusions of Law 41; DFF 119-123).
- Heinz and Beech-Nut do not monitor the other's price or change their price based on the other's price (Defendant's Conclusions of Law 42-47; DFF 124-146).
- The cross elasticity between Heinz and Beech-Nut is extremely low, in some cases not statistically significant at all, demonstrating that consumers do not respond to a price increase of Heinz or Beech-Nut by buying the other brand (Defendant's Conclusions of Law 48; DFF 147, 167-177).
- Retail prices are not lower in "mixed" markets than in "core" markets as would be expected if retail competition between Heinz and Beech-Nut mattered (Defendant's Conclusions of Law 49; DFF 148-154). The FTC has offered no evidence to the contrary.[4]

Thus, the FTC has no credible evidence supporting a unilateral pricing effect. The evidence establishes that Beech-Nut competition does ***not now*** constrain Heinz from raising

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4 The FTC maintains that consumer prices are lower in "mixed" markets than they are in "core" markets. But its record reference to PFF 92 cites Hilke's testimony and documents that are ***not even on the point.*** The Hilke testimony (Hilke Tr. 1140-41, 1144-46, 247-48) makes no effort to compare consumer prices in "core" and "mixed" markets. DX 14-0020 does not even properly assign cities to "core" or "mixed" areas (Hilke Tr. 247-48; PX-20-0757 and PX-0681) (two copies of the same document) states the contrary proposition:

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Dr. Hilke conceded he was not relying on these documents for the truth of the matter therein. (Hilke Tr. 1179-81). And as to DX 14 in particular, Dr. Hilke conceded that the analysis was entirely unreliable, because the same cities were listed in both core and mixed markets. (Hilke Tr. 1181).

price. Accordingly, the merger cannot properly be regarded as eliminating Beech-Nut as a price constraint on Heinz. A restraining force imagined (by the FTC) but never present is but a strawman that, under record testimony, evaporates altogether. And with it disappears as well the FTC's claim of unilteral pricing effects. *See* Defendant's Conclusions of Law 49; *Butterworth Health Corp.*, 946 F. Supp. at 1295 (concluding that, where defendants show "high market concentration . . . does not correlate positively with higher prices," they have "demonstrated good reason to question the applicability of the traditional presumption that a significant increase in market concentration will lead to higher prices in connection with the merger . . ..")

C. THE FTC'S "CASE" AGAINST INNOVATION

The FTC argues that Heinz and Beech-Nut can bring innovation to the market separately without the merger, and that the acquisition will eliminate innovation competition. The evidence of record is, however, ***all to the contrary***:

- In fact, the baby food market in the U.S. has experienced little innovation in the past decade. DFF 87. This has been an unwelcome trend to retailers, who expressed uniform frustration with the lack of innovation. (DFF 88-90).

- Indeed, Heinz has had no successful product innovation because of its limited distribution. DFF 294. And Beech-Nut also has abandoned its risk as an innovator and decided simply to follow Gerber. DX 403 at 2380.
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- The FTC touts Beech-Nut's effort to develop nutraceuticals, but the only nutraceuticals it can find in jarred baby foods are in bananas and carrots. (PFF 285). And then, digging even deeper into the past, it hypes Beech-Nut's introduction of glass jars a lifetime ago. (FTC Br. 28).

- Finally, the FTC notes recent ideas that Heinz has tested in other countries (PFF 287), without a shred of evidence that these have any prospect of being funded for the U.S.

- Specifically, the FTC asserts that the planned innovations, REDACTED can and likely will be introduced by Heinz independently if there is no merger. Yet, its Findings on this point (PFF 456-66) ***mischaracterize the testimony*** of Mr. Johnson (Tr. 470-72) to the effect that, without the synergies and national distribution capabilities offered by the merger, neither REDACTED will be fully introduced in the U.S. (DFF 266, 277, 280, 296, 302).

- The FTC also discounts the merger's importance to achieving national distribution, referring in PFF 408 to retailer consolidations as opening doors to national distribution. There is, however, ***no evidence of record*** regarding the future likelihood of retail consolidations, ***nor any testimony*** to support that either Heinz or Beech-Nut can, or will, likely gain national distribution as a result of such activity. For the past forty years, they have not.

- In fact — and without any contradiction whatsoever — the testimony and evidence at trial established that, with all commodity volume ("ACV") below 50%, neither Heinz nor Beech-Nut can successfully innovate. (DFF 51, 74, 266-267, 296-309).

After the acquisition, Heinz would have the ACV needed to launch innovations in the U.S. (DFF 266-267, 281, 309), because there is a true correlation between ACV and product success. (DFF 296-99). Thus, while **REDACTED** are today innovation concepts that cannot come to full fruition in the U.S., they will become viable projects post-merger. (DFF 296, 301-08). Insofar as the FTC argues otherwise in PFF 440, 446 and 458, it mischaracterizes the testimony of both Mr. Johnson (Tr. 526-27) and Ms. Quinn (Tr. 636, 645).

D. THE FTC'S "CASE" AGAINST QUALITY

The FTC further attacks the merger by arguing that, if approved, it will have another unilateral anticompetitive effect by eliminating the quality now offered by the Beech-Nut brand. Here too:

- The assertion that the Heinz Pittsburgh plant cannot be counted upon to maintain the Beech-Nut brand and quality levels after the acquisition ignores both the Campbell testimony regarding differences between the Pittsburgh and the Canajohorie plants (DFF 329-41), and the clear evidence of Heinz's product safety record over the years (DFF 336-38, 340, 343). The FTC reference to PFF 315 and PX 149 state nothing to the contrary. Nor does the FTC's reference to "recalls" distinguish Heinz from Beech-Nut or Gerber, which have both had their own product recalls. *See* DX 343-49 (Gerber); DX 334-35, 337, 339-42 (Beech-Nut).

- To the extent the FTC is suggesting that the merger might deprive some consumers of today's Heinz brand, since the product rationalization may produce a different taste and quality (Hilke Tr. 1160; 297-98), such speculation hardly suggests unilateral anticompetitive effects — particularly since the evidence supports the more likely assumption that it is Heinz value price, not its quality, that attracts most consumers.

(DFF ¶¶ 48-50; PX 171 at 126; PX 273 at 569; PX 284 at 567; PX 216 at 470; PX 341 at 006).[5]

III. THE FTC'S CHALLENGE TO DEFENDANTS' EFFICIENCIES

The FTC's attack on the Defendants' showing of cost savings resulting from the merger — made without the benefit of any expert testimony — is similarly "off the cuff" and lacks record support. It conveniently ignores the important, uncontradicted testimony of Mr. Campbell and Mr. Painter. Thus:

- The FTC only "credits" REDACTED variable manufacturing costs to the merger (FTC Br. at 37). But, it does so by confusing variable ***conversion*** cost savings with variable ***production*** cost savings. (*Id.*). Correcting for this confusion more than doubles the properly credited variable manufacturing costs REDACTED
- The FTC further misreads the testimony as to the total variable cost savings realizable by the acquisition (FTC Br. 36). If the FTC had properly included not only the variable ***manufacturing*** cost savings of REDACTED (DFF 367, 379), but the REDACTED broker's fees and reclamation costs; (DX 1-0031; DFF 367, 379, DX 124) — which the FTC nowhere contested — then it would know, as the unrebutted record evidence shows, the total variable cost savings are between REDACTED.[6]

In all other respects, the FTC's criticism of the efficiencies' analysis of Mr. Campbell, as verified by Mr. Painter, is refuted by the record:

- The FTC takes Mr. Campbell to task for removal of a REDACTED "plug" in conversion savings (FTC Br. 411-12), ***without reference to*** Mr. Campbell's explanation that he removed the "plug" when actual, verifiable costs were known. (Campbell Tr. 712-3).

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[5] The FTC also argues "any possibility" of future competition for private label business without the merger is a "credible enough" to prevent the acquisition. As the FTC must concede, and does concede elsewhere in its brief, however, its burden is not "possibility" but "probability." (FTC Br. 12). Equally significant, there is ***no*** record evidence that either Heinz or Beech-Nut intend to (or could) enter private label. Again as the FTC concedes, parent concerns for baby food present "a large obstacle" to products without brand names. (PFF 324; Hilke Tr. 406).

[6] The FTC assigns REDACTED error to the variable conversion cost savings because they were based on *budget* data used by Mr. Campbell and verified by Mr. Painter, but not on Beech-Nut *actual* costs for FY00. (FTC Br. 36-37; PFF 424, 497). But, there is no record support for the proposition that use of actual Beech-Nut costs for FY 00 would have reduced cost savings by any amount. Moreover, if *actual* Beech-Nut costs are to be used, the FTC comparison should be as well to *actual* Heinz costs for FY00. The FTC had no efficiencies expert in this case and made no such comparison. By contrast, both Mr. Campbell and Mr. Painter compared Beech-Nut *budgeted* costs to Heinz *budgeted* costs in arriving at their savings. (Campbell Tr. 720-21, 726-730; Painter Tr. 791). Nothing offered by the FTC provides a basis to question their approach or conclusions.

- The FTC faults Mr. Campbell's REDACTED purchasing savings (PFF 415, 440) because they were based on ***percentage*** discounts from vendors rather than "specific amounts." However, both Mr. Campbell and Mr. Painter explained that the percentage discounts when read in context with existing contracts allow calculation of post-merger prices. Campbell Tr. 739-40; *see also* Painter Tr. 773-78. And while the FTC suggests these percentage discounts are not "really" going to be available (PFF 440), Mr. Campbell testified that they are not only real but represent the vendors "opening position as you go into negotiating a contract." (Campbell Tr. 740).

- In hypothesizing that the Heinz production line for REDACTED will be built in the Pittsburgh plant and thus adversely affect Mr. Campbell's cost savings calculations (PFF 433), the FTC ***again ignores*** Mr. Campbell's testimony that (i) no decision has yet been made where to locate the REDACTED but (ii) if located in Pittsburgh, that would have no affect on the cost savings associated with moving the Beech-Nut jarred production into Pittsburgh. (Campbell Tr. 734-35).

- The FTC's assertion that the Campbell cost study is based on the assumption that Heinz "will be able to retain 100% of the customers of the separate companies after the Merger" ***is simply wrong*** (PFF 436).The assumption, instead, is that Heinz will sell 100% of the ***budgeted volumes*** of both companies. Painter Dep. 145; *see also* DX 641-0008 to 09. That assumption is not only sound, but it also understates the likely volumes since there will inevitably be other sales to Gerber customers and new customers to the category (DFF 286-88).

- The FTC suggests that savings based on calculations by Booz, Allen & Hamilton are "unverified" by Mr. Painter. (FTC Br. 38; PFF 428.) However, the record shows that Mr. Painter "replicated" all of the calculations done by Booz, Allen, spoke directly with Booz, Allen personnel to understand the basis of all of the calculations performed, and, relied on the expertise of others at his firm as well as third parties, just as he had done at the FTC for many years. (Painter Tr. 769-71; DX 641-0003; 0023.)

- To the extent that the FTC complains that the cost savings — which increased by about 10%, between February and August — are "now much higher," Mr. Campbell explained that the differences had to do with substituting updated "actuals" for "plugs" for procurement and co-pack (Campbell Tr. 689-690),[7] a substitution that the FTC was alerted to in advance (Campbell Tr. 694-95).[8]

- The Commission claims fixed cost savings are irrelevant. (FTC Br. 37). They are not and here there are substantial savings — REDACTED in manufacturing, (DX 645) and

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[7] Campbell Tr. 689:24. The official transcript incorrectly reads "half billion" but should correctly read "half million."

[8] The FTC similarly criticizes Mr. Campbell's cost-savings' estimate on the ground a lower "firm" figure REDACTED was calculated by Mr. Campbell earlier in the year. Mr. Campbell explained that the "firm" figure had reference to likely savings in the first-year budget immediately after the merger with the savings to be fully realized thereafter. (Campbell Tr. 714-15; *see also* Painter Report, DX 641-0007).

REDACTED in non-manufacturing (DX 1 at 31). *See* Painter Tr. at 766; Painter Report DX 641-0005 to 06.[9]

When the FTC's arguments are reviewed in light of the whole record, it is clear there are significant cost savings that will reduce consumer prices. These savings can be summarized as follows:

Total annual cost savings	REDACTED
Total annual manufacturing and distribution cost savings	
Total annual variable manufacturing cost savings	

By any standard, these savings are extraordinary.[13] They are, moreover, merger-specific, and, as the record shows with abundant clarity, cannot be realized separately by the companies without the merger (DFF 378-381, 385). Thus:

- Contrary to the FTC's supposition that volume expansion can be achieved independently by Heinz or Beech-Nut in the present market conditions (PFF 469-74), the uncontested fact is that category has been in decline over the past years (DFF 83-91) and, notwithstanding that each company has picked up accounts due to retail

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9 Non-manufacturing fixed cost savings arise from trade spend efficiencies REDACTED and elimination of corporate overhead REDACTED. (DX 1 at IV-2F). The FTC does not address the non-manufacturing fixed cost savings at all. As to fixed manufacturing costs savings, it makes a half-hearted attack. *See* PFF 430, 432. First, the FTC claims Mr. Campbell did not include enough fixed cost depreciation in his cost study. (PFF 430). In fact, Mr. Campbell properly reflected the capital investment that Heinz will make as well as the transfer of assets from Canajoharie and characterized the incremental depreciation expense as "a very conservative assumption." (Campbell Tr. at 721-22). Second, the FTC engages in rampant speculation by suggesting that there will be increased insurance expenses REDACTED (PFF 432). In fact, Mr. Campbell consulted with the Heinz insurance department and was advised that there would be no additional insurance expense charged to baby food after the merger. (Campbell Tr. 724-25).

10 DFF 351; DX 1; DX 645; DX 127.

11 DFF 351; DX 645; DX 122.

12 DFF 367; DX 645; DX 124.

13 The FTC seeks to dismiss what the experts in this case all recognize as significant savings by comparing the conversion cost savings (erroneously estimated REDACTED with the size of the ***retail*** market for jarred baby food (FTC Br. 40). This is the wrong comparison. Rather, the proper comparison is to look at how the cost reductions impact on the overall cost of producing baby food. Here, conversion costs REDACTED (DFF 380), and cognizable variable costs are reduced REDACTED (DFF 407), leading to reduction in retail prices of REDACTED (DFF 412).

consolidations, each has also lost accounts as well (DFF 194, 197). On net, both Heinz and Beech-Nut have lost ACV over the last several years, and see no prospect of reversing that trend (DFF 54, 70, 74, 77-78, 198).

- Nor does the FTC offer support for its claim that, absent the merger, Beech-Nut's costs could be reduced through modernization. Its reliance on PFF 470 is typically misplaced and misguided, having nothing whatsoever to do with the point asserted. What is on point is Beech-Nut's affirmation that there are no plans to make (DFF 82, 328). REDACTED

- Finally, the record makes abundantly clear that there simply REDACTED (DFF 121-22; Kelley Tr. 802-09). While Dr. Hilke offers — without study or analysis — nor even any conversation or discussion with the principals involved — that the Chase search for investors was insufficient (PX 821; PFF 475-76), it is hard to imagine how Chase could have been any more diligent in seeking out prospective purchasers other than Heinz. (Kelley Tr. 803-09).

The fact remains the REDACTED (Kelley Tr. 804). Heinz interest was, as Mr. Johnson testified, driven by its desire to compete head-to-head with the market leader, Gerber (Johnson Tr. 452-53). By combining the Heinz value price strategy with Beech-Nut's strong brand equity (Johnson Tr. 459, 452, 463-64; DFF 287-88), Heinz sees the opportunity to energize a stagnant market (DFF 84-85), to introduce product innovations calculated to recapture lost consumers and grow the category as it is being grown overseas (DFF 308). That is a procompetitive merger in every sense of the word (DFF 402-03, 414).[14] It has no prospect of substantially lessening competition in the baby food category, as Gerber itself recognized upon learning of the acquisition (DFF 444-60).

IV. THE MERGER WILL NOT LEAD TO TACIT COLLUSION

The FTC raises the "bogeyman" of tacit collusion as further reason to disapprove the merger. Its "tacit collusion" argument at the end is very much like its prima facie structural argument. The FTC relies essentially on the duopoly market structure with little chance of new

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[14] The efficiencies, moreover, are fully cognizable. Dr. Hilke's novel theory that they cannot be considered because of the combination of two sets of SKUs into one best-quality, value-priced line cannot stand factually (DFF 415-420, 421) or conceptually. The merger will bring about ***a substantial expansion***, ***not a reduction*** in output. (DFF 296-88, 453; (growth plan forecasts increased output); DFF 297-301 (new products)).

entry to force into place a self-serving prediction that, post-merger, Heinz and Gerber will coordinate on prices. Once again, the legal assertions may get the FTC on the playing field, but the agency does not move the ball. The record in this case removes all concerns of possible tacit coordination:

- Again, the two-brand dynamic of the marketplace today will be no different post-merger. Just as now, only one other brand will be on the shelf next to Gerber after the acquisition. There is no evidence to suggest collusion occurs in two-brand markets now. (DFF 424-43). And the FTC has failed to show why there would be any increased likelihood to collude post-merger.

- While the FTC sees removal of Beech-Nut as eliminating the principal constraint on Heinz to collude with Gerber on retail price, there is overwhelming evidence ***that contradicts*** the FTC's essential premise: *i.e.*, that today Beech-Nut constrains Heinz's "better instincts" to raise prices. *See supra* Section II(B).

- If anything, as Professor Baker explained at trial, Heinz incentives post-merger make the prospect of tacit coordination with Gerber less likely, because Heinz is a "maverick" firm that has no reason to lock into market share or otherwise reduce its presence and value in the marketplace, in the eyes of its Board, or investors. Baker Tr. 1012-13; DX 617 ¶ 8.

- The FTC seeks to counter these incentives by implying that Heinz might coordinate with Gerber because it is REDACTED citing PX 423. This statement, standing alone, is taken out of context and completely ignores the testimony regarding this document at trial by Heinz CEO Bill Johnson. As Mr. Johnson stated at trial, the portion of the cited page that the FTC fails to include in its quote is: "although our ***value positioning will continue to be the cornerstone of our business strategy***, price alone puts us in a very vulnerable position." (PX 423-2508) (emphasis added). At trial, Mr. Johnson confirmed that the Heinz value positioning "will continue to be the cornerstone of [its] business strategy. ... [The] value pricing strategy is the culture of this business in the United States and it seems to be the best way for us to go to market." Johnson Tr. 510.

- While the FTC dismisses the influence of retailers as "power buyers" capable of disciplining collusive price increases, there is evidence of record supporting such "power buyer" discipline, with threats of downsizing shelf space, undesirable placement decisions, or eliminating one of the other brands altogether. (DFF 430-32).[15]

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[15] The FTC also contends that the power buyer defense does not apply, because the baby food manufacturers sell to small buyers as well as large buyers. Notably, the FTC does not take into account the degree of sales to small buyers versus large buyers. REDACTED (DFF 426; DX 20).

- In addition, the FTC makes no mention of the pricing complexities that would certainly disrupt, and defeat, an effort to coordinate. It is in fact the case that those complexities imbue the retail pricing of baby food, which is determined by retail stores, not manufacturers. (DFF 108; 433-34).

- The ability to discipline any coordinated conduct is, moreover, seen by Gerber itself as not readily available if the merger is approved. It thus appropriately recognized that the merger will allow Heinz/Beech-Nut to

REDACTED

(DX 747 at 231).

In short, there is nothing to support the FTC's tacit coordination argument, which is no more than that, argument.

V. CONCLUSION

For the foregoing reasons, the FTC's Motion for Preliminary Injunction should be denied.

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing Defendants' Post-Trial Reply Memorandum was served by hand delivery this 20th day of September, 2000, upon:

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