Legal Backgrounder

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DOJ's ABI/MODELO CHALLENGE:
SEEDS OF MORE AGGRESSIVE MERGER REVIEW & ENFORCEMENT

by
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Merger enforcement during President Obama's first term was widely predicted to be relatively aggressive. The Administration did not disappoint, deploying significant investigatory resources resulting in a number of challenges despite a generally moribund mergers and acquisitions marketplace. The agencies went to court repeatedly on cases small and large, ranging from the U.S. Department of Justice's (DOJ) relatively small, chicken processing plant case (Tyson's $3 million plant sale in Virginia), to its blocking AT&T's acquisition of T-Mobile. Nor were the enforcers daunted by resistance from the merging parties. DOJ tried its first successful merger challenge in 9 years, blocking H&R Block's acquisition of TaxACT. The Federal Trade Commission (FTC), meanwhile, tried its first successful federal court challenge to a non-profit hospital merger and took another hospital merger to the U.S. Supreme Court, obtaining a precedential decision.

While these cases are significant in that they reflect resolve to apply the antitrust laws to mergers and acquisitions, none cut particularly new ground doctrinally. Even the FTC's Supreme Court victory reflected more an application of established precedent to a wayward appellate decision than a particularly economic interventionist model. However, during its first term the Administration did announce policy positions in 2010 on merger enforcement standards, and in 2011 on merger remedies, that planted the seeds for something more. Heading into its second term, those policy positions have apparently germinated in the form of the Administration's challenge to the proposed acquisition by Anheuser-Busch/InBev (ABI) of the roughly 50% of Grupo Modelo (Modelo) that ABI did not already own.

An article in the March 4 issue of the *New York Times Magazine* asks, "Are We in Danger of a Beer Monopoly?" But the headline misses the significance of the case. Were the question really whether or not the merger would create a monopoly, we would not view DOJ's challenge as anything more than generally firm antitrust enforcement, similar to the cases brought in the first term. But the real significance of the ABI/Modelo challenge lies in the theories and remedies relied on by DOJ. These signal potentially significant economic policy implications in the form of more doctrinally aggressive merger enforcement for the coming term.

DOJ's ABI/Modelo challenge reflects significant confidence in its ability to intervene productively in merger matters. In order to bring the case, DOJ had to walk a fine doctrinal line to conclude that the challenge was warranted. It also had to accept novel relief and use regulatory tools in order to address the problem it had identified, without potentially overreaching. Put another way, the government did not think the overall transaction was so devoid of legitimacy that it insisted on abandonment of the transaction because of its concerns. At the same time, DOJ was willing to take the risk that its regulatory and novel remedy might distort more than "fix" the market, presumably on the strength of its conclusion that the deal threatened significant economic harm to American beer consumers. But, as discussed further below, the doctrinally tight path walked to reach the

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conclusion of harm suggests at least some question as to the strength of the conclusion. It's that cost-benefit weighing which is revealing about future merger enforcement policy.

The Theoretical Fine Line. At first blush, DOJ's case against ABI/Modelo does not appear factually or theoretically aggressive. It was predicated on ABI's alleged desire to eliminate Modelo from the market as a pricing "maverick," reluctant to follow ABI's lead in instituting price increases. In its complaint, filed on January 31, DOJ alleged that ABI's pricing strategy was to put in place annual price increases, while being as transparent as possible in its actions. ABI's hope was that other firms in the market would follow its lead on price increases. To support its allegations, DOJ cited internal ABI documents:

> ABI's Conduct Plan emphasizes the importance of being 'Transparent – so competitors can clearly see the plan;' "Simple – so competitors can understand the plan;' 'Consistent – so competitors can predict the plan;' and 'Targeted – consider competition's structure." By pursuing these goals, ABI seeks to 'dictate consistent and transparent competitive response.' . . . According to ABI, its Conduct Plan 'increases the probability of [ABI] sustaining a price increase.'

Complaint ¶ 46.

According to DOJ, while MillerCoors was a reliable follower of ABI's published price increases, Modelo was not (despite being nearly half-owned by ABI), which exerted a downward pressure on the price of beer. DOJ's theory was that by removing Modelo from the marketplace, ABI would remove an impediment to its ability to raise prices. DOJ thus alleged a classic "coordinated effects" theory, in which Modelo played the role of the pricing maverick being taken out in the challenged transaction.

As theories go, DOJ's was not unusual economically. Indeed, the previous Administration had endorsed and relied on similar theories.

Application of the "maverick" story to the ABI/Modelo transaction, however, pushes into new areas when considered in light of other facts normally considered economically relevant to a DOJ merger review. In the first place, DOJ's complaint is one of the first to apply, in a noteworthy manner, the revised Horizontal Merger Guidelines (Merger Guidelines) issued by DOJ and FTC in 2010. The revised Merger Guidelines placed greater emphasis on direct evidence of competitive effects, rather than on market shares and market structure as did previous versions. 2010 Merger Guidelines § 2. In its press release accompanying the 2010 Merger Guidelines, DOJ noted that "market definition is not an end itself or a necessary starting point of merger analysis," but rather is but one tool to be used in service of a determination of a "merger's likely competitive effects." Press Release, Aug. 19, 2010, *Department of Justice and Federal Trade Commission Issue Revised Horizontal Merger Guidelines*, http://www.justice.gov/atr/public/press_releases/2010/261642.htm.

The change in the guidelines reflected an analytical movement away from wooden presumptions against mergers based on market share, towards analysis of the facts of how a market was actually likely to perform. The ABI/Modelo challenge appears to take this trend to the extreme in the opposite direction. Modelo was only one of a number of other competitors, including at least one significant global brewer, and according to DOJ's complaint had a nationwide market share of only 7% – hardly a presence that one would expect would allow Modelo to disrupt oligopolistic market behavior of ABI and MillerCoors. Rather than focusing on these facts as "one tool" in the analysis, DOJ appears to have waived away these structural facts, stating that the parties' "combined national share actually *understates* the effect that eliminating Modelo would have on competition in the beer industry." Complaint ¶ 3 (emphasis in original). While DOJ's statement may be explicable by the advocacy context in which it was made, the fact remains that Modelo's small share should be viewed as a real, economic indicator weakening the certainty of the conclusion that the transaction was likely anticompetitive, or, at least, calling into question the magnitude of the potential anticompetitive effect.

Similarly, ABI's ownership of roughly 50% of the alleged "maverick" Modelo weakens the likelihood of any or significant harm because it should reduce the likelihood or degree of disruptive behavior from Modelo. The 2010 Merger Guidelines essentially make the point that a partially owned competitor is more likely to follow rather than break from the herd, observing that even a "minority" investor might be able to exert control over the pricing and competitive decisions of the firm in which it holds a stake. The Guidelines explain that a minority investment might provide an incentive for the firm to blunt its own competitive actions, secure in the knowledge that it will receive a portion of the profits from sales lost to the competing firm. Moreover, the overlapping ownership might facilitate the flow of competitively sensitive information between the firms. 2010 Merger Guidelines § 13. Indeed, the prior administration had brought cases under just such a partial-ownership theory. DOJ's successful challenge to Dairy Farmers of America's (DFA) acquisition of a 50% interest in Southern Belle Dairy was predicated on a theory that DFA would have less incentive to compete aggressively against Southern Belle, knowing that it would receive 50% of Southern Belle's profits. *See United States v. Dairy Farmers of America, et al.*, Competitive Impact Statement (E.D. Ky. Oct. 2, 2006), *available at* http://www.justice.gov/atr/cases/f221700/221713.htm. Particularly given the market conditions DOJ alleged – i.e., a market prone toward oligopolistic behavior – ABI's ownership in Modelo should have muted any disruptive influence from Modelo and suggests a reduced potential for anticompetitive effects if Modelo's independence were completely eliminated.

The point here is not that it was impossible for Modelo to have been somewhat disruptive. It may well have made some independent decisions that made the coordination DOJ alleged between ABI and MillerCoors less than perfect. But, the magnitude of the potential anticompetitive harm was surely open to question given these circumstances. Indeed, suppose that Modelo had been completely independent of ABI and ABI proposed to acquire 50% of Modelo. DOJ would undoubtedly have suspected – as its guidelines suggested and its prior enforcement decisions reflected – that the 50% acquisition would have been tantamount to eliminating Modelo as a competitor. In short, doctrinally, DOJ had to walk a fine line to bring this case.

Implications of the Remedy. Rather than fight to a judicial decision, ABI and DOJ chose to settle their disagreement. ABI chose to make a divestiture and agree to other remedies to fix DOJ's concerns; and DOJ chose to allow the merger to proceed rather than insist on the status quo ante. In one aspect, the remedy looks a bit like a traditional merger remedy, calling for divestiture of assets in the relevant market – brewing capacity and the control over the Modelo brands in the United States in perpetuity. But on further examination it is not, as DOJ stated in explaining the remedy, merely "a clean, structural remedy that eliminates the likely anticompetitive effects of the acquisition." Competitive Impact Statement at 9. Rather, the characterization of the remedy as a clean, structural remedy frays in the light of the novel and regulatory aspects of the relief.

First, DOJ's structural relief was admittedly inadequate. DOJ did not require divestiture of the productive assets necessary to serve the market. Rather, the divested brewing assets are inadequate to support the current and future demand predicted for the divested brands. Accordingly, DOJ is requiring that a buyer of the assets increase their capacity – a compelled expansion of output – even going so far as to take the additional, apparently unprecedented, step of adding the divestiture buyer as a defendant in the case to ensure compliance. The Department somewhat blandly acknowledges this extraordinary relief: "Requiring the buyer of divested assets to improve those assets for the purposes of competing against the seller is an exceptional remedy that the United States found appropriate under the specific set of facts presented here." Competitive Impact Statement at 11.

Second, rather than rely on a structural divestiture, DOJ intervened in ABI's relationship with its owned and independent distributors. It disrupted established contractual rights of the owned distributors to distribution of the Modelo brands and imposed a three-year regulation on ABI's discretion in managing its relationships with independent distributors. The purpose of these interventions is to protect Constellation Brands' ability to reach consumers.

Did the Perceive Harm Justify the Intervention? We ask the balancing question not to answer it but to illustrate DOJ's willingness to rely on its conclusions in this complicated setting to challenge a merger. Considered together, the theory and remedy call further into question the strength of the conclusion that Modelo was much of a "maverick." For example, if ABI's control over distribution is so disruptive of Constellation

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Brands' ability to compete, one has to inquire why this control did not corral the allegedly maverick Modelo. And, in explaining the overall remedy, DOJ comes relatively close to admitting Modelo was not much of a maverick by observing that a benefit of the remedy is elimination of ABI's ownership interest in Modelo: "Furthermore, the proposed Final Judgment puts an end to the existing entanglements between ABI and Modelo with respect to the United States beer market." Competitive Impact Statement at 10. But why is it much of a benefit to eliminate that entanglement if Modelo was such a maverick that its acquisition was significantly anticompetitive?

Not addressed in DOJ's explanation, but revealing as to its future enforcement intent, are the potential market distortions that could flow from the type of relief it was willing to accept. Forced capacity expansion by judicial decree would seem likely to distort a market. Nothing in the decree requires that the additional capacity be brought to bear narrowly to disrupt coordination between ABI and MillerCoors, the theory on which the case was brought. Indeed, the facility to be expanded is not even located in the United States, but rather, Mexico. Perhaps Constellation Brands will choose to use the capacity to introduce new products elsewhere, or subcontract out its brewing capacity for other purposes. Or, Constellation Brands may choose to target U.S. competitors other than the two dominant, coordinating players. One could theorize that Constellation may not be incentivized to compete as aggressively going forward as was Modelo. Modelo could have been more comfortable flaunting its parent, protected from the full punishment ABI might normally mete out to a maverick because of ABI's ownership interest in Modelo. Constellation Brands, on the other hand, might be more cautious than Modelo and target its new capacity on smaller players in the U.S. rather than taunt the leaders of the herd. ABI will have no reason not to react fully if Constellation Brands attacks its share aggressively. And, how will ABI/Modelo react to the new capacity? Who is to say that the new capacity will not cause ABI/Modelo to redirect output from another plant now flowing into the U.S. into Mexico or some other country? By putting itself in the role of master planner – mandating an increase in market capacity – the DOJ has set in motion a series of unknowable events that, history teaches, will almost certainly lead to at least some unintended consequences.

The doctrinal aggressiveness reflected in the ABI/Modelo challenge was presaged during the first term of the Administration when DOJ issued its Merger Remedies Guide. In that Guide, DOJ backed off earlier statements that suggested it would not normally intervene in the vertical aspects of a merger under a theory that depended on a party acting anticompetitively in the future. In essence, DOJ even then suggested it would discount the potential distortive effects of its merger relief in order to support stronger merger intervention.[1] In the ABI-Modelo remedy, DOJ follows through on this pronouncement, regulating ABI not for anything it had done with its distributors (otherwise Modelo could not have roamed as a maverick), but for what it might do.

Conclusion. The point of this LEGAL BACKGROUNDER is not to suggest that DOJ erred in its conclusion that it had real evidence that the acquisition of Modelo was potentially anticompetitive or that the divestiture to Constellation Brands, induced capacity expansion, and distribution regulation might make the market more competitive than it would have been absent the challenge. Rather, the point is that the predictive judgments made in merger enforcement are inherently uncertain, and are particularly uncertain in the ABI/Modelo matter where the theories are complicated and rely on counterintuitive interpretations of the structural facts and the relief is novel and regulatory. If the ABI-Modelo challenge is a signal of things to come, then the willingness of the DOJ to bring this case may mark the beginning of a doctrinally, aggressive period of merger enforcement during the second term of the Obama Administration.

[1] A 2011 Washington Legal Foundation Legal Backgrounder (Vol. 26 No. 18) predicted the more interventionist enforcement from these remedy guidelines was predicted: "[T]he Division's increased acceptance of conduct remedies seems to demonstrate that the updated guide is actually a guide to "additional" merger remedies, i.e., that the willingness to pursue conduct remedies implies a willingness to challenge mergers where in the past the Division may have decided not to intervene in the market." *See* http://www.wlf.org/Upload/legalstudies/legalbackgrounder/08-05-11Botti_LegalBackgrounder.pdf.