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Thoughts on the DOJ’s Move to Block Further Anheuser-Busch InBev/Grupo Modelo Linkage

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My partner Lee Van Voorhis in Washington drafted some thoughts on this transaction, which I thought would be of interest to the Kluwer readership.

DOJ Sues to Block Further Anheuser-Busch InBev/Grupo Modelo Linkage

On January 31, 2013, the Antitrust Division of the Department of Justice (“DOJ”) announced that it filed a complaint in federal district court seeking to block Anheuser Busch InBev (“ABI”) from acquiring the portion of Grupo Modelo (“Modelo”) it does not already own. The challenge highlights the importance of company documents, the risks of an upfront remedy and other antitrust tips for merging parties.

The Complaint’s allegations

ABI currently has a 43 percent voting interest and a 50.35 percent economic interest in Modelo, and has nine of its nineteen Board seats. Through the proposed acquisition, ABI would acquire control of, and the remaining economic interest in Modelo. The DOJ’s Complaint alleges that the proposed acquisition violates Section 7 of the Clayton Act by diminishing competition in the market for beer in the United States and 26 local markets within the U.S.

As a result of the merger, the Complaint alleges, ABI will have significant pricing power and less incentive to innovate. The Complaint dismisses ABI’s proffered remedy of the sale of Modelo’s equity interest in its United States distributor, as inadequate to alleviate the issues raised by the combination.

The Complaint defines the relevant product market as “Beer.” Although ABI sorts beer into sub-categories – sub-premium, premium (including ABI’s Bud Light), premium plus, and high end (including Modelo’s Corona) – the Complaint alleges that beers compete across categories with Bud Light competing with Corona.

The Complaint alleges that 26 local markets as well as the United States market nationally will be affected by the combination. These markets are already highly concentrated according to the DOJ/FTC Horizontal Merger Guidelines, the complaint states, and are dominated by ABI, MillersCoors, and Modelo. The transaction would combine the first and third largest brewers by market share in the United States.

Nationally, the complaint alleges, ABI has a 39% share, MillerCoors a 26% share, and Modelo is third with a notably small 7% share. However, the Complaint states that this may understate concentration as Modelo has a significantly higher share in many of the local markets involved. As a result of the merger, the Complaint alleges that the Herfindahl-Hirschman-Index (“HHI”), a measure of market concentration, would be increased enough to make the transaction presumptively illegal though it does not say from whence this presumption comes (presumably the Merger Guidelines, which are not necessarily the same as law).

The Complaint also alleges several anticompetitive effects from the merger including increased prices and loss of innovation. The Complaint alleges that higher beer prices will result from the merger both because of an increased likelihood of coordinated pricing between market leaders and unilateral price increases from ABI.

Beer prices in the United States are largely determined by “strategic interactions” between ABI, MillerCoors, and Modelo, it alleges. In practice, ABI announces an annual price increase and MillerCoors follows it soon after. The Complaint alleges, however, that Modelo has disrupted these price increases by declining to match them. As a result, ABI has had to postpone prices increases and also lower prices to keep customers from moving to Modelo products. Post-merger, the Complaint alleges that there will be no strong competitor to restrain ABI’s price increases.

The Complaint also alleges that the loss of head-to-head competition between ABI and Modelo will lead to higher prices on ABI brands. It alleges that without competition from Modelo, ABI will have a strong incentive to raise prices across brands. Any loss of customers on one brand, the Complaint alleges, could be recaptured on a different ABI brand. According to the Complaint the merger will also result in less product innovation and diversity in the market. ABI has in the past responded to Modelo’s competitive threats by adding new beer varieties to its offerings, for example Bud Light Lime.

In structuring the transaction. ABI and Modelo seem to have anticipated DOJ resistance. The proposed transaction includes the sale of Modelo’s 50% interest in its importer, Crown, to the owner of the other 50% and to give the importer an exclusive right to import Modelo beer into the United States for ten years. The Complaint asserts that this is a proposed remedy that will not alleviate the anticompetitive harm of the merger, but will simply create a “façade” of competition. For example, after the ten years are over, ABI may unilaterally terminate the contract and take over all importation and distribution of the Modelo brands.

According to the Complaint, the importer will be unable to replace the lost competition because it will own no brands or facilities of its own and be fully dependent on supplies from its ostensible competitor ABI. The Complaint states that the proposed remedy will transform horizontal competition between Modelo and ABI into a vertical dependency between the importer and ABI. Unlike Modelo, the importer will be reliant on ABI for supply and thus, unable and unwilling to resist ABI’s annual price increases. Indeed, the complaint asserts that it has been Modelo, through its 50% interest, that has kept the importer from behaving this way already.

Moreover, the Complaint alleges that because the import contract may be unilaterally terminated by ABI after ten years the importer will be incentivized to increase prices to please ABI to remain the sole distributor.

The Complaint alleges finally that entry and expansion into the beer market is unlikely to be sufficient to remedy the transaction’s competitive effects and that any claimed efficiencies are not merger specific nor likely to be passed onto consumers.

Legal implications for strategic acquirers and practical business conclusions

The ABI/Modelo Complaint has several implications. At the most basic level, it represents another example of the Obama administration's commitment to "vigorously enforce" the antitrust laws. There are several other implications for companies, especially those that engage in strategic acquisitions of competitors:

• Documents remain the most important and most powerful pieces of evidence that the government uses to support its case. The ABI/Modelo Complaint relies heavily upon documentary evidence to support its main allegations, for example:

o Coordinated Effects – The Complaint alleged that ABI played the role of price leader in trying to coordinate pricing, mainly with MillerCoors, the second-largest beer producer in the US. ABI had developed a "Conduct Plan," which emphasized being: "Transparent – so competitors can clearly see the plan…Simple – so competitors can understand the plan…Consistent – so competitors can predict the plan…Targeted – consider competition's structure." Modelo's pricing was so disruptive that "[t]he impact of Crown Imports [Modelo] not increasing price has significant influence on our volume and share. The case could be made that Crown's lack of increases has a bigger influence on our elasticity than MillerCoors does."

o Unilateral Effects – Several ABI documents quoted in the complaint focused on Modelo's role as a market disruptor and constraint on ABI's prices. For example, one ABI executive wrote that "[t]aking market share this way is unsustainable and results in lower total industry profitability which damages all players long-term." ("Emphasis in original.)

The importance of documents in this case cannot be overstated. The transaction involves a broad product market with four potential product submarkets, local and national geographic markets, and complex competitive dynamics. Without contemporaneous documents from ABI, Modelo, and Crown describing their business strategy, motives, and incentives, the DOJ likely could not have constructed a persuasive narrative of competitive harm.

The importance of company documents is reinforced by the FTC's recently released Horizontal Merger Investigation Data Report. The Report shows that of 28 transactions between 1996 and 2012 in which the agency found "hot documents," 25 resulted in an enforcement action. Companies should thus be vigilant in training employees to not create documents –deal documents or otherwise—that may contradict arguments that the company may wish to make to antitrust regulators in future transactions. Good document retention and document creation policies can help smooth regulatory review.

• There are both potential benefits and risks in proceeding with upfront remedies. The government will not automatically accept them, but will vet them carefully to determine whether they alleviate the antitrust harm. The Government will likely put the burden on the parties to show that the remedy alleviates all the competitive issues. As reflected in the 2011 Antitrust Division Policy Guide to Merger Remedies, the agencies take the position that a long-term supply arrangement alone between competitors will rarely be a sufficient remedy in a horizontal merger case.

Here, the DOJ rejected the proposed sale of the 50% interest in the importer coupled with a supply agreement, and then the government essentially alleged that ABI's attempt to provide an upfront remedy was an admission that the transaction is anticompetitive. Note that this is an area where recently-appointed Antitrust Division head Bill Baer showed a strict approach in his prior stint as head of the FTC's Bureau of Competition.

• Even though the agencies typically prefer to define narrow product markets, they may also define broader markets in certain situations. The Complaint alleges a broad "beer" market, instead of four distinct segments as reflected in ABI's documents. Though this approach is consistent with past DOJ practice, as in 2008's InBev/Anheuser-Busch merger and Miller/Coors joint venture, it seems to depart from typical agency practice as well as basic consumer perception. Both the 2010 Horizontal Merger Guidelines and agency practice favor narrow product market definitions, separating out functional substitutes into different markets. For example, in the DOJ's 2011 lawsuit challenging the merger between H&R Block and TaxAct, the DOJ alleged a "digital do-it-yourself tax preparation software market," and in the FTC's 2007 lawsuit against the merger between Whole Foods and Wild Oats, the FTC alleged a "premium and natural organic superstore" market.

In this case, however, the broad market definition may be necessary for DOJ's theory of harm. Most ABI and Modelo brands do not generally compete head-to-head. As the Complaint describes, ABI's most popular brand, Bud Light, is in the premium category whereas Modelo's Corona is in the high-end category. If the Complaint defined the market to be these narrower categories there would have been less competitive overlap and perhaps not enough to challenge the transaction.

• Pay attention to both local markets and a national market. Along with the recent AT&T/T-Mobile lawsuit, the Complaint alleges harm in both local geographic markets and a national market. This signifies that national companies that compete in local markets must not only assess a potential transaction's potential effects in those local markets, but in the national market as well. In the past, companies of this nature might be reasonably confident that, even if they were merging with another large national competitor, the divestiture of assets in certain local geographic markets could remedy the anticompetitive harm. However, with the AT&T and ABI cases, the government has made it clear that it will also assess a transaction's effect on competition from the national level. When such transactions are analyzed at the national level, targeted divestitures may not be sufficient for DOJ.

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