

## Department of Justice Reaches Initial Agreement with Brewers for Merger with Divestiture

*David D. Smith*



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After originally opposing the acquisition of brewer Grupo Modelo (“Modelo”) by Anheuser-Busch InBev (“ABI”), the U.S. Department of Justice (DOJ) has agreed to accept the deal with a divestiture. DOJ and the companies have asked the court to extend the stay in the case to give them time to work out the settlement’s final details. The merged company will be the largest brewer in the world. DOJ’s original decision to oppose the merger is noteworthy because it was based on a “coordinated effects” theory rather than the more common “unilateral effects” model.

Modelo was the largest brewer in Mexico, and the third-largest brewer measured by U.S. sales. Its brands included Corona Extra, America’s best selling import. Modelo accounted for 7 percent of U.S. beer sales. In 2011, ABI had 39 percent of U.S. beer sales. MillerCoors had 26 percent.

The DOJ complaint identified beer as the relevant product market, though it noted the various beer categories, such as sub-premium and high-end. The relevant geographic markets were the United States and 26 metropolitan areas.

The DOJ’s coordinated effects theory was grounded in documentary evidence that Modelo was a “maverick.” ABI operated as a price leader. MillerCoors typically followed the ABI price increases, while Modelo did not. The complaint alleged that Modelo aggressively priced in the United States through its joint venture, Crown Imports, and that ABI responded by targeting Corona. For example, in 2008 ABI launched Bud Light Lime as a competing brand. DOJ alleged that by eliminating the maverick, the merger would make it easier for ABI to raise prices to consumers.

DOJ rejected the parties’ first settlement offer. ABI initially offered to sell Modelo’s 50 percent interest in Crown to its partner in the joint venture, Constellation. ABI would have entered into an exclusive supply agreement to provide Constellation with Modelo beer for import into the United States, but ABI could terminate this agreement after 10 years. ABI would have retained Modelo’s brands and brewing and bottling facilities.

DOJ apparently viewed the competitor created in this way, Constellation, as an inadequate replacement for Modelo. Under the new divestiture agreement, Constellation gets permanent U.S. rights to Corona and Modelo’s other import brands and may purchase Modelo’s Piedras Negras brewery. Although this brewery can provide only 60 percent of Crown’s import needs, Constellation also receives \$400 million to expand the brewery’s capacity.

## *Also In This Issue*

### **DOJ and Publishers Settle in E-Books Case**

Clarissa A. Yeap discusses the Department of Justice’s (DOJ’s) case alleging collusion by Apple and five publishers in the market for e-books. DOJ objected to the contracts that Apple, an e-book retailer, had with each publisher. DOJ contended that these contracts served as coordinating and enforcement mechanisms for a conspiracy that raised the prices consumers paid for e-books. All five publisher defendants have now settled with DOJ and have agreed to terminate any agreements with e-book retailers that restrict discounting or retailers’ discretion over prices. Apple, which objects that these settlements will enhance market power by obstructing its entry to the market, is still scheduled to go to trial.

### **Complaints Against Visa and MasterCard Dismissed**

Allison I. Holt discusses the recent dismissal of antitrust complaints involving Visa and MasterCard’s ATM fees. The complaints targeted contract provisions prohibiting ATM operators from charging higher access fees for transactions on Visa and MasterCard’s networks than the lowest fees charged on other networks. The court found the plaintiffs’ evidence concerning the existence of a conspiracy to be insufficient. The court also rejected each of the plaintiffs’ economic arguments concerning anticompetitive effects. In the view of the court, plaintiffs did not accurately describe how fees and costs are apportioned; they did not properly define a relevant market, and they did not show how the contract provisions would have increased prices for consumers or ATM operators.

# DOJ and Publishers Settle in E-Books Case

*Clarissa A. Yeap*

Macmillan recently reached a settlement with the Department of Justice (DOJ) in a suit alleging a conspiracy to raise e-book prices. DOJ alleged that five of the six largest US publishers, Hachette, HarperCollins, Macmillan, Penguin and Simon & Schuster, had conspired with e-book retailer Apple to raise the prices of e-books and limit competition in an e-books market. The proposed settlement requires that Macmillan immediately terminate agreements with Apple and other e-book retailers that restrict discounting and prohibits Macmillan from entering into new agreements that restrict retailers' discretion over prices. The other four publisher defendants had previously reached similar settlements with DOJ. The case against Apple is scheduled to go to trial in June 2013.

DOJ's complaint alleged a conspiracy to switch the contractual relationship between publishers and e-book sellers from the wholesale model, where retailers set the price, to an agency model, where publishers set the price. When the conspiracy began, Amazon was the dominant retailer of e-books and manufacturer of e-book readers. Amazon had an incentive to reduce e-book prices to induce consumers to adopt the new technology of e-books and to buy its e-book reader. The publishers, on the other hand, profited only from selling books, not readers, and preferred higher prices for e-books, which would increase their profit margins and reduce competition for their print books. No single publisher acting independently, however, could force e-book prices above the level set by Amazon. Then, in late 2009 when Apple was preparing to launch its new iPad tablet device and e-book retail website, the publishers saw an opportunity to gain control over e-book prices. Taking advantage of that opportunity required the publishers' collective bargaining power, which was based on their significant share of the market for e-book content, and the cooperation of Apple, a retailer itself. According to DOJ, Apple benefited by eliminating price competition in the e-book retail market that it was about to enter. Also, as the linchpin of the collusive scheme, Apple was able to negotiate larger than usual commissions from the publishers.

DOJ's conspiracy claims depended crucially on the alleged coordination mechanisms provided by the publish-



*EI Senior Economist Clarissa A. Yeap specializes in empirical microeconomic analysis in the assessment of liability and damages in antitrust, intellectual property and class action matters.*

“DOJ's conspiracy claims depended crucially on the alleged coordination mechanisms provided by the publishers' agreements with Apple.”

ers' agreements with Apple. According to DOJ, the Apple Agency Agreements allowed the publishers to adopt identical tiered pricing schedules and other key contract terms. Apple played the central role of assuring the publishers that it offered the same terms to all of them and informing each publisher that the others were willing to accept the agreement. DOJ alleged that Apple shared information with each publisher on its negotiations with the others, which it had little incentive to do except to facilitate coordination. In economic models of collusion, a coordination mechanism plays a key role, providing participants with a method of signaling to each other the price that they are each individually willing to accept.

The Apple Agency Agreements also included a form of most-favored-nation (MFN) status that DOJ argued would help to enforce the collusive agreement. The MFN provision stated that each publisher was required to lower the price of every e-book in Apple's retail website to match the lowest price offered by any other retailer, even if the publisher did

not control that other retailer's price. DOJ claimed that the MFN provision ensured that each publisher had a strong incentive to switch all its retailers to the agency model and adhere to the price tiers defined in the Apple Agency Agreements. A reduction in price by any retailer might lead to a substantial loss for a publisher, who would also have to accept lower prices on its sales through Apple. In the terminology of collusion models, the lost profits act as punishment that is triggered when any participant deviates from the collusive scheme. The threat of punishment helps to sustain the collusive agreement by counteracting each participant's incentive to reap large gains by undercutting the other participants.

According to DOJ, the defendants succeeded in eliminating retail price competition and raising e-book prices. Shortly after signing the Apple Agency Agreements, the publish-

# Complaints Against Visa and MasterCard Dismissed

Allison I. Holt

The United States District Court for the District of Columbia recently dismissed a case alleging that Visa and MasterCard violated Section 1 of the Sherman Antitrust Act when setting ATM access fee pricing requirements for banks and ATM operators. The judge found that there was no factual support for the plaintiffs' claims either of the existence of a conspiracy or of anticompetitive effects.

Three separate complaints were brought against Visa and MasterCard. *Stoumbos v. Visa* and *Mackmin v. Visa* were brought by consumers who paid access fees for using ATMs. *The National ATM Council v. Visa* was brought by the National ATM Council (NAC), a trade association, and a group of owners and operators of independent ATMs, ATMs not owned by banks. All three complaints targeted Visa and MasterCard contract provisions that prohibited ATM operators from charging higher fees for transactions on Visa and MasterCard's networks than the lowest access fees charged on other networks. That is, independent ATMs could not charge consumers using Visa and MasterCard branded bank cards higher transaction fees than they charged consumers using cards from other ATM networks. The complaints argued that these provisions limited competition and prevented ATM operators from offering discounts. Visa and MasterCard claimed that these provisions prevented fees from rising too high.

For there to be a violation of Section 1 of the Sherman Act, there must be both an agreement and a restraint of trade. The three plaintiff groups all alleged an agreement between Visa, MasterCard, and several banks. That allegation was based on statements that prior to Visa and MasterCard's becoming publicly held entities, they were operated by their member banks, and that the rules being objected to originated when bankcard associations, made up of the same banks, governed the ATM networks. The court found that the contention "that banks used to belong to the bankcard associations does not provide factual support for the conclusion that banks are engaged in a horizontal conspiracy to restrain trade."

In addition, the court found fault with each of the plaintiffs' economic arguments concerning anticompetitive effects. The court found three problems with plaintiffs' arguments:



Allison I. Holt is a Senior Economist at EI. She has extensive experience working on price fixing matters and estimating damages resulting from collusive agreements.

plaintiffs did not accurately describe how fees and costs are apportioned among consumers, ATM operators, and networks; they did not coherently and consistently define a relevant market that was experiencing anticompetitive effects; and they did not show how Visa and MasterCard's pricing requirements would have increased prices for consumers [*Stoumbos and Mackmin*] or ATM operators [*National ATM Council*].

In the view of the court, none of the three complaints provided any data or analysis concerning the costs faced by ATM operators. ATM operators incur no direct costs for using the various networks. Each time a customer uses an ATM,

the ATM network receives a fee from the bank that issues the ATM card. The network deducts a portion of that fee and then passes the remainder along to the ATM operator. Plaintiffs argued that but for the provisions in operators' contracts with Visa and MasterCard, operators could encourage consumers to use lower cost networks by offering

“...the court found fault with each of the plaintiffs' economic arguments concerning anticompetitive effects.”

discounts or other inducements to consumers. Those inducements would act to pass some of the cost savings on to ATM users. The court did not find a sufficient basis for the plaintiffs' argument that "the rules create an arrangement, 'that prohibits discounting, directing consumers to less expensive competitor networks, and other pricing behavior characteristic of a free and competitive market.'" Plaintiffs did not provide any information about the cost of using the Visa or MasterCard network relative to other independent networks. If costs were the same, then there would be no savings to switching to a lower cost network. If Visa and MasterCard networks had higher costs, there was no evidence that any cost savings from switching to a lower cost network would be passed along to consumers.

In addition, the court found that because the *Stoumbos* and the *Mackmin* complaints wrongly argued that these agreements increased costs to ATM operators, rather than reduced their revenue, the plaintiffs did not show how con-

## DOJ and Publishers Settle

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ers switched all major e-book retailers, including Amazon, to the agency model and prohibited discounting and other price promotions by the retailers. Consumers suffered because e-book prices rose to \$12.99 or \$14.99 from a pre-conspiracy price of \$9.99. The price increases affected a sizeable market: consumers spent \$300 million for the publisher defendants' e-books in 2010. In a related lawsuit, a settlement for \$69 million was reached between three publishers, Hachette, HarperCollins and Simon & Schuster, and 49 states. The states' cases against Apple and the other publishers as well as class actions that include claims for monetary damages remain pending.

The defendants have denied DOJ's allegations. They contended that Apple negotiated agreements with each publisher individually, and there was no collusion. Apple has strongly objected to the proposed publisher settlements as they would effectively dismantle its contracts before

a trial had taken place. Apple argued that DOJ's lawsuit would bolster Amazon's market power by disadvantaging a new entrant, rather than increase competition. Barnes & Noble and several authors groups have also objected to the proposed settlements for the same reason. They alleged that Amazon's low prices hurt traditional bookstores and authors and thus are not in the public interest. DOJ countered that the antitrust laws are meant to protect competition, not competitors, and that high prices due to collusion harm, rather than benefit, the public.

DOJ believes that the Macmillan settlement and settlements with other publishers will quickly restore competitive retail prices for e-books and prevent the recurrence of collusive behavior. Competition in the e-book market will also increase because of entry by new competitors, such as Google and Microsoft. Increased price competition will benefit consumers by lowering prices in the short run and potentially by promoting innovation in the variety and quality of e-books and e-book readers in the long run.

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## Complaints Dismissed

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sumers might have chosen to use a lower cost network or show that the ATM operators would have passed any savings from using lower cost networks on to consumers. All three plaintiffs claim that the phrase "lower cost networks" actually meant "networks that pay the operators higher fees," but the court stated that "nothing in the complaints would alert the reader to the fact that plaintiffs are relying upon this novel and unsustainable definition of the term 'cost.'" The court faulted both consumer plaintiff complaints for not discussing what costs the ATM operators faced and how the alleged agreement prevented ATM operators from offering discounts.

The court also criticized both the Stoumbos and the Mackmin complaints for failing to define the relevant market. The complaints might have alleged that the anticompetitive effects would have taken place in one of two vertically related markets: a market for network services provided to ATM operators or a market for ATM services provided to consumers. That aspect of the allegation, however, was never clarified. Thus, the court found the plaintiffs did not clearly specify whether the competition allegedly prevented by the agreement would be competition between networks or competition between individual ATMs.

Finally, the court faulted the Mackmin plaintiffs for claiming to have been charged an ATM fee at some time, without specifically addressing whether multiple networks were available, whether the ATM cards that the plaintiffs used could be used in multiple networks, or whether those networks were all accessible through the ATM they used. Similarly, in the Stoumbos case, the plaintiff did not demonstrate that she had an ATM card that could have accessed multiple different networks.

The court found a similar lack of factual support for the claims of the third plaintiff group, the NAC and Independent ATM operators. Those plaintiffs failed to address the issue that the allegedly inflated fees were paid by consumers and not independent ATM operators. The court ruling stated, "If ATM operators are required to charge consumers more for ATM transactions than they might absent the access fee rules, the rules tend to benefit operators by increasing their revenue." Since the NAC complaint provided no information about the costs faced by ATM operators, it was not clear to the court how higher fees charged customers would constitute an antitrust injury to ATM operators. In the view of the court, just as the consumer plaintiffs failed to show an effect on consumers, the operator plaintiffs failed to show an effect on operators.

## *EI News and Notes*

### **Toyota Industries Acquires Cascade**

Toyota Industries Corporation acquired Cascade Corporation after the Department of Justice (DOJ) decided not to challenge the transaction. The DOJ decision followed an extensive investigation that included the use of simulation models to address possible vertical competitive issues. EI economists Barry C. Harris, Matthew B. Wright, Michael B. Baumann and Su Sun worked with attorneys from White & Case and K&L Gates on the antitrust defense of the acquisition.

### **Merger in Solid Waste Industry**

Advanced Disposal merged with Veolia ES Solid Waste Inc. after agreeing on a limited divestiture with the Department of Justice. The merger involved a number of local markets in solid waste collection and disposal. EI economists Henry B. McFarland and David D. Smith, worked with attorneys from Crowell & Moring and Winston & Strawn on the antitrust defense of the acquisition.

### **Value of Lost Services**

EI economist Gloria J. Hurdle testified in Federal District Court concerning damages in *Beatrice Girdler, et al. v. United States of America* on behalf of the defendant. Dr. Hurdle estimated the value of household services lost due to a fall on government property. The Court concluded that the plaintiffs had failed to sustain their burden of proof and judgment was entered for the defendant.

### **China Institute of International Antitrust and Investment's Symposium**

EI economist Su Sun gave a presentation on market definition issues at the China Institute of International Antitrust and Investment's First Annual Symposium – "The First Five Years of AML: Present and Perspective." The conference in Beijing was attended by top officials from all three Chinese agencies responsible for enforcing China's Antimonopoly Law: the Ministry of Commerce, the National Development and Reform Commission, and the State Administration of Industry and Commerce.

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