UNITED STATES DISTRICT COURT
DISTRICT OF COLUMBIA

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

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INTRODUCTION AND SUMMARY

The coal industry in the Southern Powder River Basin ("SPRB") is poised today at a "tipping point." In the 1990s, the industry was characterized by numerous competitors and vigorous price competition. Producers ran at close to full capacity, competing with one another for additional sales by offering coal based on incremental costs. Such competition led to lower pricing. By 1999-2000, however, with the SPRB reduced to just five major firms, producers began to focus increasingly on the benefit that they would derive if they could keep increases in production a step behind increases in demand, in order to raise prices above competitive levels.

Arch Coal, Inc. ("Arch"), among others, recognized that a new industry paradigm – one more favorable to producers – was imperative in order to avoid the effects of competition.[1] Consequently, in 2000, Arch adopted what it euphemistically calls its "market driven" approach, under which Arch seeks to thwart the effects of competition by restricting its production when it believes that, as a result of what it considers to be "oversupply," prices and profits are lower than Arch thinks they could and should be.[2]

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[1] Sellers cannot validly claim that competition could potentially be ruinous. *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 221-222 (1940) (antitrust law "has not permitted the age-old cry of ruinous competition and competitive evils to be a defense").

[2] During the course of this proceeding, there has been much discussion about the use by defendants and other producers of terms like "oversupply" and "production discipline" to describe market events and firms' strategic responses to those events. By repeating defendants' assertions, we do not mean to give them a false credibility as justifications for anticompetitive behavior. In well-functioning competitive markets, there is no such thing as "oversupply." If quantity supplied exceeds quantity demanded at the existing price, then prices will fall to clear the market, and customers will benefit. Firms continue to produce so long as prices meet or exceed the marginal cost of production because doing so contributes to the repayment of fixed costs. ROBERT S. PINDYCK & DANIEL L. RUBINFELD, *MICROECONOMICS* 257 (5TH ED. 2001). By contrast, when firms exercise "production discipline," they withhold production collectively, even when prices are above marginal cost, in order to achieve or maintain supracompetitive prices. *See* DENNIS W. CARLTON & JEFFREY M. PERLOFF, *MODERN INDUSTRIAL*

Arch alone, however, cannot eliminate "oversupply" or insure that increases in production lag increases in demand. By adopting its "market driven" approach, Arch exposed itself to the risk of lost sales and profits in the SPRB if its competitors expanded while Arch was restricting production.

Arch thus embarked upon a campaign to publicize and justify its strategy, obviously in the hope that its SPRB competitors would conclude that adopting a similar strategy would improve profits for all of the major producers. Indeed, each of Arch's major competitors recognized the merits of this strategy and periodically adopted the same approach, although there was occasional "backsliding" as most of the producers (except Arch) succumbed, at various points, to the lure of the increased sales and profits that could be obtained by competing through the sale of incremental coal.

Because of these periodic outbreaks of competition, the paradigm shift in this industry has not firmly taken hold – until now. This acquisition, if not enjoined, will eliminate one of the small number of competitive firms. It will substantially weaken the competitive fringe, and place most of the excess capacity for production of SPRB coal in the hands of the companies most likely to constrain production. As a result, it will make output restriction more profitable for each of the three largest producers, Arch, Peabody, and Kennecott. And it will provide Arch with the scale to lead the industry more readily toward the goal of restricting the rate of expansion of SPRB coal production in order to raise prices. The potential for very substantial competitive harm presented by this acquisition is further confirmed by the unprecedented level of opposition voiced by the overwhelming majority of SPRB coal customers.

ORGANIZATION 123 (3d ed. 2000).

ARGUMENT

The FTC seeks preliminary injunctive relief pursuant to section 13(b) of the Federal Trade Commission Act, 15 U.S.C. § 53(b), to prevent the proposed acquisition by Arch Coal, Inc. ("Arch") of Triton Coal Company, LLC ("Triton"), until the completion of an administrative proceeding, initiated by the FTC on April 6, 2004, challenging the transaction as unlawful under section 7 of the Clayton Act. 15 U.S.C. § 18. The States, having filed suit before this Court to enjoin the proposed transaction under section 7 on April 1, 2004, seek preliminary injunctive relief pursuant to section 16 of the Clayton Act, 15 U.S.C. § 26. The legal standards under which this Court must review the proposed transaction are by now familiar. *See, e.g.*, FTC Pretrial Brief at 10-12; States Pretrial Brief at 5-6.

Although the precise standard for preliminary relief under section 13(b) of the FTC Act is lower than that under section 16 of the Clayton Act, both analyses rest on two general considerations: the Plaintiffs' likelihood of success on the merits (before the Commission or before this Court) and the balance of equitable considerations. Under either standard, preliminary injunctive relief is warranted in this case.

I. PLAINTIFFS HAVE ESTABLISHED A LIKELIHOOD OF SUCCESS ON THE MERITS.

A. The Acquisition Creates a Palpable Risk of Coordinated Interaction

1. Section 7 of the Clayton Act Is Designed to Arrest Potential Anticompetitive Effects in Their Incipiency

Section 7 (including, by implication, any provisional relief sought in furtherance of it) incorporates an "incipiency" standard. It is well settled that Section 7 does not require proof of actual anticompetitive effects or a history of collusion in the relevant market. Courts consistently

have followed Congress' mandate that Section 7 be enforced to arrest potential anticompetitive effects of mergers and acquisitions "in their incipiency," *i.e.*, to prevent mergers and acquisitions that pose a risk of *future* competitive harm.[3]

The "core question" in a Section 7 case is "whether a merger *may* substantially lessen competition . . . ."[4] As stated by the D.C. Circuit in *Heinz*, "'All that is necessary is that the merger create *an appreciable danger* of [coordinated interaction] in the future. A predictive judgment, necessarily probabilistic and judgmental rather than demonstrable, is called for.'" *Heinz*, 246 F.3d at 719 (emphasis added), quoting *Hospital Corp. of America v. FTC*, 807 F.2d 1381, 1389 (7th Cir.1986).

Courts therefore have made it abundantly clear that Section 7 does not require proof of actual anticompetitive effects.[5] In *Warner Communications*, the Ninth Circuit held that "[s]ince Section 7 requires only a showing of reasonable probability of anticompetitive effect and the district court required a showing of collusion, we conclude that the court applied an incorrect legal standard." *Warner Communications*, 742 F.2d at 1160.

The relevant standard to be applied in the Commission's administrative proceeding in this case, therefore, is whether there is a reasonable probability of future anticompetitive effects as a

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[3] *See, e.g., FTC v. Procter & Gamble Co.*, 386 U.S. 568, 577 (1967); *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 362 (1963); *Brown Shoe Co. v. United States*, 370 U.S. 294, 317-18 (1962); *FTC v. Warner Communications Inc.*, 742 F.2d 1156 at 1160 (9th Cir. 1984); *FTC v. Weyerhaeuser Co.*, 665 F.2d 1072, 1094 (D.C. Cir. 1981).

[4] *Procter & Gamble*, 386 U.S. at 577 (emphasis added); *id.* (Section 7 "necessarily requires a prediction of the merger's impact on competition . . . . The section can deal only with probabilities, not with certainties"); *see also Philadelphia Nat'l Bank*, 374 U.S. at 355; *FTC v. H.J. Heinz Co.*, 246 F.3d at 713.

[5] *See, e.g., Procter & Gamble*, 386 U.S. at 577; *Heinz*, 246 F.3d at 719; *Warner Communications*, 742 F.2d at 1160.

result of this acquisition.[6] Whether the acquisition is likely to lessen competition through coordinated interaction depends on whether market conditions "as a whole" are conducive to such behavior. *See* U.S. DEPARTMENT OF JUSTICE AND FEDERAL TRADE COMMISSION, *HORIZONTAL MERGER GUIDELINES* ("*MERGER GUIDELINES*") § 2.1 (1992). A history of cooperative behavior can, of course, be a relevant consideration in assessing the likelihood of future coordinated conduct,[7] but proof of such behavior in the past is not a necessary element of a Section 7 violation.[8] Numerous transactions have been enjoined without any reference to a history of prior anticompetitive conduct.[9] As discussed below, there are numerous factors in this case that point to a likelihood of coordinated conduct in the future.

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[6] *See, e.g., Brown Shoe*, 370 U.S. at 323; *Heinz*, 246 F.3d at 713; *Warner Communications*, 742 F.2d at 1160; *FTC v. Staples, Inc.*, 970 F.Supp. 1066, 1072 (D.D.C. 1997).

[7] *See, e.g., Hospital Corp. of America*, 807 F.2d at 1389; *FTC v. Elders Grain, Inc.*, 868 F.2d 901, 905 (7th Cir. 1989); *FTC v. Cardinal Health, Inc.*, 12 F. Supp. 2d 34, 65 (D.D.C. 1998); *FTC v. Swedish Match*, 131 F. Supp.2d 151 (D.D.C. 2000); *see also United States v. Culbro Corp.*, 436 F. Supp. 746 (S.D.N.Y. 1977); *FTC v. Freeman Hosp.*, 911 F. Supp. 1213 (W.D. Missouri 1995).

[8] While evidence of prior tacit coordination or explicit collusion may suggest that market conditions are conducive to coordinated behavior, *see MERGER GUIDELINES* § 2.1, an absence of prior coordination or collusion clearly does not preclude a likelihood of coordinated behavior in the future, if market conditions are otherwise conducive to such behavior. As discussed *infra*, numerous factors make the SPRB market conducive to coordinated interaction.

[9] *See, e.g., Heinz*, 246 F.3d 708; *FTC v. University Health, Inc.*, 938 F.2d 1206 (11th Cir. 1991); *FTC v. PPG Indus., Inc.*, 798 F.2d 1500 (D.C. Cir. 1986); *United States v. UPM-Kymmene OYJ*, 2003 U.S. Dist. LEXIS 12820, 2003-2 CCH Trade Cas. ¶ 74,101 (N.D. Ill. 2003); *Staples, Inc.*, 970 F. Supp. 1066; *United States v. United Tote, Inc.*, 768 F. Supp. 1064 (D. Del. 1991); *United States v. Ivaco, Inc.*, 704 F.Supp. 1409 (W.D. Mich.1989). *See also Hospital Corp. of America*, 807 F.2d at 1388.

2. There Is a Reasonable Likelihood that this Acquisition Will Increase the Risk of Coordinated Interaction

a. The Evidence Establishes that the Relevant Markets Are Conducive to Coordinated Interaction

As one authoritative treatise has observed, "the most orthodox and probably the most commonly asserted rationale for challenging mergers is that under appropriate circumstances they can facilitate express collusion or oligopoly interaction among the various firms in the postmerger market, including both those that participated in the merger and those that did not." IV PHILLIP E. AREEDA, HERBERT HOVENKAMP & JOHN L. SOLOW, *ANTITRUST LAW* ("*AREEDA'S ANTITRUST LAW*") ¶ 916b at 83 (1998 rev. ed.). In the present case, plaintiffs have focused on the latter effect – coordinated interaction – as the most likely way in which this Acquisition may diminish competition. It is particularly noteworthy in this regard that numerous courts, including this Circuit, have enjoined proposed mergers based upon an increased risk of coordinated interaction.[10]

Coordinated interaction is defined as actions that diminish competition (such as by reducing output) and "that are profitable for each [firm] only as a result of the accommodating reactions of the others." *MERGER GUIDELINES* § 2.1. Coordinated interaction includes tacit coordination (conscious parallelism), which the Supreme Court has defined as a "process, not in itself unlawful, by which firms in a concentrated market might in effect share monopoly power, setting their prices at a profit-maximizing, supracompetitive level by recognizing their shared

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[10] *See, e.g., Heinz Co.*, 246 F.3d at 725; *University Health*, 938 F.2d at 1219; *FTC v. Elders Grain, Inc.*, 868 F.2d 901, 905 (7th Cir. 1989); *PPG.*,798 F.2d at 1503; *UPM-Kymmene Oyj*, 2003-2 Trade Cas. (CCH) ¶ 74,101 at 96,935; *Swedish Match*, 131 F. Supp. 2d at 168 n.13 (D.D.C. 2000); *see also Hospital Corp. of America*, 807 F.2d at 1387 (divestiture ordered to dismantle consummated merger).

economic interests and their interdependence with respect to price and output decisions."[11]

Coordinated interaction is harmful to consumers even if the conduct is lawful tacit coordination that occurs within an oligopolistic market structure.[12] Hence, the fact that tacit coordination is not easily reached under the Sherman Act intensifies the concern of merger policy to prevent mergers that may facilitate such behavior. IV *AREEDA'S ANTITRUST LAW* 916(b)(2) at 86. As this Circuit recently explained, tacit coordination

> is feared by antitrust policy even more than express collusion, for tacit coordination, even when observed, cannot easily be controlled directly by the antitrust laws. It is a central object of merger policy to obstruct the creation or reinforcement by merger of such oligopolistic market structures in which tacit coordination can occur.[13]

Viewed against this legal backdrop, plaintiffs have amply carried the burden of

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[11] *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 227 (1993) (citations omitted); *see also JTC Petroleum Co. v. Piasa Motor Fuels, Inc.*, 190 F.3d 775, 780 (7th Cir. 1999) (Posner, CJ.) (discussing tacit collusion whereby defendants recognize their common interest in acting jointly, but act without any agreement to do so).

[12] *See, e.g., Clamp-All Corp. v. Cast Iron Soil Pipe Institute*, 851 F.2d 478 (1st Cir. 1988) (Breyer, J.) (oligopolistic pricing is not competitively desirable). One reason why tacit collusion or conscious parallelism, by itself, does not violate the antitrust laws is that it would be extremely difficult, if not impossible, to devise an effective remedy since there is no overt conduct that can be enjoined. *See JTC Petroleum, supra,* 190 F.3d at 780 ("The most compelling objection to JTC's theory [of attempted monopolization through tacit collusion] has nothing to do with the language of the Sherman Act but rather is the difficulty of formulating effective relief without transforming the district court into a regulatory agency . . ."); IV *AREEDA'S ANTITRUST LAW* ¶ 927a, at 108-09; *see also Williamson Oil Co., Inc. v. Philip Morris USA*, 346 F.3d 1287 (11th Cir. 2003) (holding that synchronous behavior by oligopolists, absent "plus" factors, was not unlawful); VI *AREEDA'S ANTITRUST LAW* ¶ 1433a at 236 (2d ed. 2003) ("The courts are nearly unanimous in saying that mere interdependent parallelism does not establish the contract, combination, or conspiracy required by Sherman Act § 1.").

[13] *Heinz Co.*, 246 F.3d at 725; *see also Coca-Cola Bottling Co. of the Southwest*, 118 F.T.C. 452, 600 n.345 (1994), *vacated and remanded on other grounds*, 85 F.3d 1139 (5th Cir. 1996) ("One of the purposes of the Clayton Act § 7 is to prevent markets from becoming oligopolistic and thus susceptible to coordinated interaction, which 'includes tacit or express collusion, and may or may not be lawful in and of itself.'").

establishing a reasonable likelihood that this Acquisition may diminish competition. Although several mechanisms of tacit coordination are possible in the relevant markets, the mechanism that is most strongly supported by the evidence is a form of output restriction in which the major producers would constrain their production so that increases in supply would "lag" increases in demand, thus creating upward pressure on price. As previously noted (*see* Plaintiffs' Pretrial Reply Mem. at 2), this does not mean that total SPRB coal production will necessarily decrease (indeed, it is apt to increase as demand increases), but rather that the output of SPRB coal will likely be less than it would have been absent the Acquisition.

Highly probative evidence (consisting of contemporaneous business documents, the admissions of defendants' executives, and expert testimony) adduced in this proceeding demonstrates that the SPRB coal industry has developed a propensity towards this form of tacit coordination. The facts set forth below persuasively establish this point.

In the 1990s, the coal industry (including the SPRB) was characterized by numerous competitors and vigorous price competition. Producers ran their mines at high capacity, and competed with one another for additional sales by lowering their prices to just above their incremental (marginal) cost of producing the additional tonnage. Day 6 a.m. Tr. 57-58 (Leer); PX1000 at 271:1-10, 211:9-13, 271:1-20; PPF 289-292. As a result of this intense competition, prices in general eroded during this period. Day 6 a.m. Tr. 76-77 (Leer); PX 105-002 ("the 90s proved that incremental production supplied into a weak market was a prescription for disaster").

Dissatisfied with its returns in this competitive environment, Arch in 1999-2000 switched its strategy from selling on an incremental cost basis to the "market-driven" approach it follows today. Day 6 a.m. Tr. 57-58 (Leer); PX1000 at 268. Under its market-driven approach, Arch's strategy is to leave uncommitted tonnage in the ground, rather than sell the coal at a price that

does not provide what Arch considers to be an adequate return. Day 6 a.m. Tr. 61-62 (Leer); PX1000 at 222-23. As a corollary to this approach, Arch will constrain its production if it believes the market price is depressed due to "oversupply." Day 6 a.m. Tr. 62 (Leer).

The success of this market-driven approach necessarily depends on the cooperative behavior of at least some of the other SPRB competitors. For one thing, as Mr. Leer acknowledged, Arch alone cannot affect either "oversupply" or falling prices (Day 6 a.m. Tr. 93, 95, (Leer)). Even more importantly, Arch's strategy can be undermined if its competitors expand while Arch is constraining production, thus taking market share and profits away from Arch (Day 6 a.m. Tr. 63 (Leer); PX1000 at 280:6-14; PX 105), while simultaneously keeping prices low because supply would continue to exceed demand (Day 6 a.m. Tr. 65 (Leer); DX 1069 (PX 253) at 349).[14] This leaves Arch with two obvious courses of action, both of which it has actively pursued since early 2000: (1) attempt to convince its SPRB competitors to follow the same strategy, so that all major competitors would exercise (and benefit from) production "discipline" (*see* PPF 325-327, 447), and/or (2) acquire one or more of its competitors in order to help keep supply limited (PX 63-002; PX 165-002).

Taking each of these points in turn, the record reflects that Arch has repeatedly signaled its SPRB competitors that the industry should constrain production in the face of prices deemed unsatisfactory by producers. Mr. Leer made several presentations to audiences (that included

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[14] Mr. Leer claimed that Arch was unconcerned about its competitors selling additional coal while Arch was restricting production (Day 6 a.m. Tr. 64 (Leer)), but his testimony was contradicted by numerous contemporaneous business documents. *See* Day 6 a.m. Tr. 67-82 (Leer); PX 90-002; PX 165-002; PX 105; PX 104-002 (DX 1091). When pressed, Mr. Leer flatly refused to answer the question whether it would be beneficial for Arch if its competitors followed the same strategy as Arch and restricted production, even though the answer was obvious. *See* Day 6 a.m. Tr. 85 (Leer).

competing SPRB producers and the trade press) in which he advocated industry-wide restraints on production, and was repeatedly quoted in the trade press to this effect.[15] *See* PPF 328-331. Other producers have responded in kind (*see* PPF 338, 343, 345, 431), although not, as yet, with Arch's dedication and commitment. *See, e.g.*, PX 105. Arch has also repeatedly and consistently disclosed its own competitive strategy of restricting production (Day 6 p.m. Tr. 16 (Leer)) – a tactic that would clearly be counterproductive, given the confidential nature of marketing strategies , if Arch were truly concerned that its competitors would take advantage of such knowledge and information, rather than using it as a basis for adopting a similar strategy.

Turning to the second point, the documentary evidence shows that acquiring an SPRB competitor such as Triton is yet another way to keep supply limited (and prices higher than they otherwise would be). For example, prior to its previous attempt to acquire Triton in 2001, one top Arch executive advised others in a planning document that it was: "

." PX 63-002. Similarly, Arch's Vice President for Market Research observed that eliminating Triton, which was the "

," was the "

" PX 165-002.

Ominously for competition, Arch is not alone in its desire to move the SPRB market

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[15] Mr. Leer's unconvincing efforts to "explain away" his public statements were directly inconsistent with the plain meaning of the language that he used, as well as with the trade press' understanding of that language. *See* Day 6 a.m. Tr. 90-100 (Leer).

toward the exercise of production discipline. Although Arch has been the leading advocate of industry-wide production discipline, other SPRB producers have been heading in this direction since 1999-2000. Indeed, with the possible exception of Triton,[16] each of the other SPRB producers has recognized the benefits of a strategy in which production is curtailed so that it lags demand. That is, at various times, the two other major producers (as well as RAG) have recognized the utility of constraining production in order to obtain improved pricing. *See* PPF 338-44; 431; PX 8611 at 022-23. This is perhaps most clearly illustrated by the events in the Spring of 2000 when, within a two-month period, Peabody, Kennecott, and Arch all issued public announcements to the effect that they had curtailed production and/or delayed expansion because current prices did not provide returns that they considered adequate.[17] *See* PX 658-004 (Peabody); PX 1803-002 (Kennecott); PX 214 (Arch); DX 1069 (PX 253) at 349, 353-354 (Arch).

Notwithstanding occasional qualms, Arch has adhered to its market-driven approach, even in the face of financial pressures and occasional "backsliding" by other SPRB producers.

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[16] During Mr. Hake's tenure as Triton's President and CEO, which began in 2001,

[17] Although it cannot be definitively established that these output restrictions caused the price spike of 2001, it is indisputable that, had these output restrictions not taken place, there would have been increased supply available to ameliorate the tight supply and high prices that prevailed during the price spike.

See, e.g., PX 105, DX 1091 (PX 104), PX 90-002. In contrast, as Arch has been able to observe and monitor,[18] most of the other producers have succumbed, at one point or another, to the lure of increased sales and profits that could be obtained through the sale of incremental coal. *See, e.g.*, PX 90-002 ( ), PX 165-002 ( ), PX 105 ( ).[19] Hence, despite Arch's adherence to its strategy of constraining its own production, all three of the major SPRB producers have not yet definitively committed to the same strategy. Should this Acquisition go forward, however, it appears to be only a matter of time before this result would obtain.

In sum, the evidence abundantly demonstrates that the current SPRB coal market (including the narrower 8800 SPRB coal market) is conducive to tacit coordination. As we have shown, SPRB producers already recognize their "shared economic interests and their interdependence with respect to price and output decisions." *Brooke Group Ltd.*, 509 U.S. at 227. Producers today appear poised to enter a new era – one in which they will be able to discard the concept of competing for sales at incremental prices, in favor of a new paradigm in which

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[18] As Dr. Morris testified in his written direct, SPRB producers have significantly more competitive information, particularly regarding current and future production, than do firms in most other industries. Moreover, the evidence shows that SPRB producers monitor the available data and statements made by competitors and consider this information in their business decisions. PX 8611 at 028-31.

[19] Recognizing that "contrary to their public statements, Peabody has not cut back production and . . . [has] been selling incremental tonnage into the market place," Arch considered whether to sell its own incremental tonnage in response. PX 105 at 001-02. In other words, Arch analyzed whether it should, in essence, punish Peabody by resuming competition through the sale of incremental coal, or whether it should instead "stay the course," presumably in the expectation that Peabody would eventually come to its senses. *See* MERGER GUIDELINES § 2.12 ("Credible punishment . . . may not need to be any more complex than temporary abandonment of the terms of coordination by other firms in the market.") Ultimately, because Arch was

Id. at 001.

production would be constrained so that it will lag demand. For the reasons previously explained, each of these producers could profitably take such action "only as a result of the accommodating reactions of the others." *MERGER GUIDELINES* § 2.1. Hence, if the major SPRB producers were to succeed in getting "on the same page" – and this Acquisition substantially increases the risk of that occurring – the result would be a diminution of competition through coordinated interaction.

b. The Evidence Establishes that the Acquisition Likely Increases the Risk of Coordinated Interaction

There are a number of reasons why this Acquisition substantially increases the risk that SPRB producers may engage in coordinated output-constraining behavior (and decreases the likelihood of deviation from such behavior). Dr. Morris' economic analysis demonstrates that the Acquisition would increase the gains from coordination, make it more difficult to profit by deviating from coordination, and more closely align the incentives of the Big Three producers. (PX 8611 at 033-037). In particular, Dr. Morris concluded in his written direct that Arch's "gains from coordination increase from $28.2 million before the acquisition to $79.1 million following the acquisition, an increase of 180 percent . . . [and] Kennecott's and Peabody's gains from coordination increase by 69 percent." PX 8611-034. By substantially increasing the potential gains from coordination, the Acquisition would make coordination more likely. *Id.*

Moreover, the Acquisition will (1) substantially weaken the competitive fringe and eliminate its ability to counteract any output restrictions; (2) place most of the excess capacity in the hands of the firms most likely to restrict actual or planned production; (3) eliminate a significant, independent competitor; and (4) enhance Arch's ability to lead the industry toward an anticompetitive outcome.

To begin with, the Acquisition will substantially weaken the competitive fringe, making it impossible for fringe firms to expand output sufficiently to overcome any output restriction by the three major SPRB producers (*i.e.*, Peabody, Kennecott, and Arch). Here, post-merger (and taking the Kiewit acquisition of Buckskin into account), the three major producers would control about 80% of the SPRB market (and 100% of the 8800 SPRB coal market). PX 5675 at 3. As Judge Posner explained in *United States v. Rockford Memorial Corp.*, 898 F.2d 1278, 1283-84 (7th Cir. 1990), smaller producers often have higher costs than larger producers, limiting their ability to expand at pre-merger prices. *See* PX , PPF 55, 616-625. Faced with concentration figures nearly identical to those in the present case, the district court in *UPM-Kymmene Oyj* last year unequivocally rejected the possibility of fringe expansion as a constraint, persuasively reasoning as follows:

> Indeed, when 80% of current production is in the hands of three companies . . . , they will be able to [act anticompetitively] with little fear that the fringe of other competitors can defeat their attempts at price increases because those fringe competitors will be unable to expand their own output to serve the customers of the giants. For example: to take away 20% of [the giants'] customers, thus reducing their market share from 80% to 64%, the fringe competitors would have to increase their own output by 80% (from 20% to 36% of the market). This would undoubtedly take time and raise their costs, likely so dramatically that their small size would prevent them from surviving such raised costs.

2003 Trade Cas. (CCH) ¶ 74,101 at 96,935.

The largest remaining fringe firm, RAG,

.[20] PX . Moreover, RAG's

[20] Because "[e]ntry that is sufficient to counteract the competitive effects of concern will cause prices to fall to their premerger levels or lower. . . , the profitability of such . . . entry must be determined on the basis of premerger market prices over the long-term." *MERGER GUIDELINES* § 3.0.

. PX

; *see also id.* at 239-40.

It is thus apparent that RAG is

. As for Kiewit/Buckskin, this mine produces only lower-priced, lower-heat 8400 coal, is only served by one rail line, and has a limited ability to expand. PX 108 at 15; PX 1260 at 114-15; PPF 208, 245, 616-625, 627. In addition, for the reasons discussed above, Kiewit's 5% share would not provide a basis for expansion sufficient to constrain a significant output restriction by the three major SPRB producers. *See, e.g., UPM-Kymmene Oyj*, 2003 Trade Cas. (CCH) ¶ 74,101 at 96,935.

The Acquisition would also deprive the fringe of the excess capacity at North Rochelle, and would ensure that most of the excess capacity in the SPRB (Coal Creek and North Rochelle) would be under Arch's control. PPF 533-534, 538-539. This is important because "the existence of excess capacity implies that additional sales can be made at little additional cost, making them disproportionately profitable." *Elders Grain*, 868 F.2d at 906. Hence, sellers who are plagued by excess capacity will be tempted to undermine coordinated interaction by offering additional production at lower prices. *Id.* That risk is minimized, if not entirely eliminated, by the fact that Arch – the strongest proponent of production discipline – would now have most of the excess capacity in the SPRB in its own hands.

Next, the Acquisition would eliminate a significant, independent competitor. PPF 556-570. Triton is aware that other producers (Arch, Peabody, RAG, and sometimes Kennecott) have constrained production from time to time in order to improve the pricing environment (*see* PPF 296, 308, 314- 315, 320, 322, 332, 363-364, 375, 381, 389, 479), and Triton has benefitted from this improved pricing environment. Nonetheless, Triton has, as recently as this year,

offered to sell coal at prices. *See* ; Day 8 a.m. Tr. 29 (Hake). Moreover, Triton's current CEO, Mr. Hake, strongly testified that, during his tenure, Triton has never reduced production in the hope of getting prices to increase. Day 8 a.m. Tr. 28. Indeed, Triton's unwillingness to exercise production discipline was identified by an Arch executive in 2001 as . PX 165-002. There can be no doubt, then, that Triton has been a thorn in Arch's side, and its elimination as an independent competitor would increase the likelihood that Arch and the other major producers will be able successfully to exercise production discipline.

Finally, the Acquisition will provide Arch with both the scale and the product mix to enable it to lead the industry toward the goal of avoiding the "deleterious" effects of competition (*i.e.*, additional supply and incremental pricing). By acquiring North Rochelle, with its super-compliance coal, Arch will obtain the premium product and additional scale that it previously lacked, thus " ." PX 147-002; *see also* PX 152-004. In other words, Arch will gain a stronger "voice," making it more likely that Peabody and Kennecott will follow Arch's lead. Because Arch has been the leading proponent of constraining production, Arch's increased influence over the industry will undoubtedly increase the likelihood that production discipline will be exercised.

As the Supreme Court has observed, a refusal to compete on a parameter such as price, quality, or quantity "impairs the ability of the market to advance social welfare by ensuring the provision of desired goods and services to consumers at a price approximating the marginal cost of providing them." *FTC v. Indiana Federation of Dentists*, 476 U.S. 447, 459 (1986). Similarly, Judge Posner wrote that coordinated interaction can be "effectuated by a purely tacit meeting of the minds, a mutual forbearance to carry production to the point where price equals

marginal cost." RICHARD A. POSNER, *ANTITRUST LAW – AN ECONOMIC PERSPECTIVE* 60 (2001). The evidence demonstrates that the scenario that concerned Judge Posner is precisely the one presented by this Acquisition.

c. The Probative Economic Evidence Points to an Increased Likelihood of Coordinated Interaction

Two experts provided economic testimony concerning the likely effects of the Acquisition – Dr. John Morris on plaintiffs' behalf, and Ms. Margaret Guerin-Calvert on defendants' behalf. *See* PPF 276-289, 295, 300, 388-393, 398-399, 407, 410, 418-430. Not surprisingly, their opinions differed on the key issue of the likelihood of coordinated interaction, with Dr. Morris testifying that the Acquisition posed an increased risk of coordinated interaction and Ms. Guerin-Calvert testifying to the contrary. As shown below, Dr. Morris' opinion is entitled to substantial weight. Dr. Morris considered all of the evidence, particularly including the contemporaneous internal documents created in the ordinary course of business, and his opinions are premised upon, and consistent with, the facts of this case. In contrast, Ms. Guerin-Calvert's opinion on the likelihood of coordinated interaction should be disregarded for numerous reasons, including her failure to consider certain highly probative evidence and the existence of serious inconsistencies between her views and the established facts. *See In re Brand Name Prescription Drugs Antitrust Litigation*, 1999-1 Trade Cas. (CCH) ¶ 72,446 at 84,127-28 (N.D. Ill. 1999) (rejecting expert testimony because, *inter alia*, expert ignored material evidence and rendered essential opinions that were not based on the evidence, but were in fact inconsistent with it).

Dr. Morris rendered the opinion that the SPRB coal industry is prone to coordinated interaction. In reaching this conclusion, Dr. Morris relied upon a number of established facts and

key sources of evidence (*see* PPF 472, 431-470), including the following:

> -The SPRB coal market and the 8800 SPRB coal market are oligopolies, with relatively few producers and high concentration levels.
>
> -During the 1990s, producers competed fairly aggressively, but this began to change after 1999 as Arch adopted its market-driven approach and most producers began to consider the benefits of exercising production discipline in order to raise price above incremental cost.
>
> -Producers recognize their mutual interdependence, and also that it would be in their interest to reduce output in order to raise price – facts clearly established by internal business documents from all of the firms.
>
> -SPRB coal producers have access to a substantial amount of price and output information through customers, the trade press, government reports, and other sources (including the competitors themselves). In fact, significantly more price and output information is available to SPRB producers than is available in most other industries.

In contrast to Dr. Morris' well-founded views, Ms. Guerin-Calvert testified that the SPRB coal market was not susceptible to coordinated interaction. Yet her opinions on this subject are entitled to little, if any, weight. To begin with, Ms. Guerin-Calvert was unable to identify a single market she had ever analyzed that she believed was susceptible to coordinated interaction. PPF 527. In fact, she was able to reach a conclusion that the SPRB market was not amenable to coordinated interaction within a few weeks after being retained and before she had been able to conduct a detailed analysis. PPF 527. *See In re Brand Name Prescription Drugs*, 1999-1 Trade Cas. (CCH) ¶ 72,446 at 84,127 (criticizing expert for "reach[ing] his conclusions within forty hours of his engagement and before he undertook any substantial or detailed study" of the industry).

More significantly, in formulating her opinions, Ms. Guerin-Calvert failed to take into account the contemporaneous internal documents prepared in the ordinary course of business. Ms. Guerin-Calvert failed to address this evidence despite the fact that industrial organization

economics recognizes that such documents are particularly probative in assessing the likelihood of coordinated interaction. Day 3 p.m. Tr. 86 (Morris). Not surprisingly, then, her views in many instances are flatly contradicted by the contemporaneous business documents. For example, Ms. Guerin-Calvert testified that SPRB producers do not take into account the actions of others, a position that is strongly refuted by even a casual review of the documentary evidence. *See, e.g.,* PX 90-002; PX 104 (DX 1091) at 001-02; PX 105; PX 165; PPF 472, 478-486. In fact, the evidence is overwhelming that Arch, Peabody, and other SPRB producers recognize the impact that their output and pricing decisions have on their own profits and on those of their rivals, and that their profits depend on the pricing and output decisions of their rivals. PPF 295, 405, 431-433, 472, 503-504. Moreover, Ms. Guerin-Calvert's opinion on this point is internally inconsistent, since she also conceded that the SPRB market is an oligopoly and that in an oligopoly, each firm recognizes that its output and pricing decisions affect the other market participants' output and pricing decisions, and vice versa.

Ms. Guerin-Calvert also opined that the SPRB market is competitive today. PPF 288. She reluctantly admitted in this regard that competition leads firms to reach the point where price approximates incremental costs, a result that tends to increase consumer welfare. *Id.* Yet unequivocal testimony from Mr. Leer (Day 6 a.m. Tr. 57-58, 78-79 (Leer); PX1000 at 210-12, 268-69) and uncontroverted business documents (PX 104; PX 105; PPF 447) establish that Arch and most of the other producers have no intention whatsoever of selling coal today at incremental prices. In fact, the sale of coal at incremental prices was the competitive situation in the 1990s that led to the advent of production discipline, and producers like Arch have expressed their strong desire to avoid revisiting that earlier era of competition and falling prices. *See, e.g.,* PX 105-002; Day 6 a.m. Tr. 57-58, 78-79 (Leer).

d. Customers Have Expressed Important Concerns Regarding the Potential for Anticompetitive Effects

SPRB coal customers have almost unanimously voiced concern about the likely effects of this Acquisition.[21] (*See* PPF 571-580) In most instances, that concern arises from indications (particularly including statements from Mr. Leer and reports in the trade press) that, led by Arch, the SPRB producers are moving towards a strategy of exercising production discipline. (*See* PPF 309, 590-91) Also fueling customer concern is the belief that increased concentration (and a diminished number of competitors) in the SPRB may further accelerate this trend toward producer discipline. (*See* PPF 572-580).

Although the success of plaintiffs' case does not depend upon customer testimony, such testimony provides a valuable source of information about the likely effects of this Acquisition. It is valuable because: (1) merger cases inevitably involve predictions about future consequences, and customers of the merging firms, being professionally engaged in the marketplace, are well-positioned to make such predictions, and their testimony is routinely considered by courts and the FTC; and (2) the customer testimony here is entitled to special weight because it involves facts

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[21] Only three customers testified in support of the Acquisition, and the position taken by each of them is readily explicable in light of their specific circumstances. Thus, for example, one customer was unconcerned about any price increase that the Acquisition might cause because it was able to pass along any such increase to its customers. Day 10 a.m. Tr. 22-23 (Lapplander). Another of defendants' customer witnesses acknowledged that he had been concerned about the original transaction because he believed that Arch "would further attempt to control supply and demand by idling, closing, reducing the production of Buckskin mine following the acquisition of Triton." Day 10 p.m. Tr. 8-9 (Stuchal). This witness admitted that Arch might constrain production, but believed that his company's particular concern was alleviated by the divestiture of Buckskin because he purchased 8400 coal almost exclusively. *Id.* Defendants' third customer witness, who professed a lack of concern that production would decrease, admitted on cross-examination that he had no way of knowing (and apparently never considered) whether production might be less than it otherwise would have been absent the Acquisition. Day 10 a.m. Tr. 57-58 (Luksan).

particularly within the experience of these witnesses.

1. Customer testimony is generally considered probative – Merger law is inherently predictive, in that it requires an assessment of the likelihood of harm to future competition.[22] The testimony of customers is highly relevant to this kind of prediction. Customers are professionally engaged in watching the marketplace, and are motivated to watch it carefully because they will be the first to feel the effects of any loss of competition. Their testimony has therefore been valued in many different forums. Customer testimony has been influential in the courts. For example, in *Cardinal Health*, 12 F.Supp.2d at 48, the court enjoined a merger in part because "numerous customers" testified they could not shift to alternative sources "in the event of anti-competitive practices."[23] Customer testimony has also been influential at the Federal Trade Commission. The FTC challenged this merger in part on the basis of such testimony, but has also decided in favor of other mergers in part as a result of testimony indicating a lack of concern there.[24] The absence of customer complaints has been commented upon by antitrust courts as a reason to doubt the extent of any problems.[25] The importance of customer testimony has also been emphasized by a variety of enforcement officials and commentators.[26]

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[22] *See Heinz Co.*, 246 F.3d at 719, *quoting Hospital Corp. of America*, 807 F.2d at 1389. *See also Procter & Gamble*, 386 U.S. at 577; *Brown Shoe*, 370 U.S. at 323.

[23] *See also PPG*, 798 F.2d at 1505 (prior competition between the merging firms "is recognized as a fact . . . in the testimony of their customers").

[24] *See, e.g.*, *R.R. Donnelley & Sons*, 120 F.T.C. 36, 197 (1995); *Weyerhaeuser*, 106 F.T.C. 172, 285-86 (1985).

[25] *See, e.g.*, *United States v. Eastman Kodak Co.*, 853 F.Supp. 1454, 1478 (W.D. N.Y. 1994), *aff'd*, 63 F.3d 95 (2nd Cir. 1995); *Ocean State Physicians Health Plan v. Blue Cross*, 692 F.Supp. 52, 68 (D. R.I. 1988), *aff'd*, 883 F.2d 1101 (1st Cir. 1989).

[26] *See* TRANSCRIPT FOR THE FTC/DOJ MERGER WORKSHOP (Feb. 19, 2004) (www.usdoj.gov/atr/public/workshops/docs/40219ftc.wpd), at pp. 215-22; *id.* at 220-21 (remarks

Like any other testimony, customer testimony must be assessed to see what weight it deserves in a particular case. It must be examined for possible bias or insufficient factual underpinnings.[27] But that fact does not count against the weight of such testimony in general; on the contrary, the care with which it is considered reflects its potential importance.

2. Customer testimony here is credible – The customer testimony here can withstand this kind of scrutiny. It is credible precisely because it involves the kinds of issues that the customers were in a position to see clearly, had incentives to study carefully, and are now motivated to report accurately. Some of the customers, for example, were in meetings at which they witnessed speeches by Arch inviting other firms to cut production. *See, e.g.,* Day 2 a.m. Tr. 50 (Kelly). Knowing as they did the individuals involved and the state of the industry, the customers are well able to assess the probable responses and effects of these invitations, and to know how those effects might be magnified if this merger goes forward. Furthermore, these customers make their living analyzing and predicting the future pricing and availability of coal.

In sum, most of the complaining customers are sophisticated companies that are large and experienced coal buyers. These customers are surrogates for competition and the public interest. Their concern about the effects of the merger and their inability to protect themselves demonstrates the potential for severe competitive injury and reinforces the documentary evidence

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of Hugh Pate, Assistant Attorney General for Antitrust) ("customer complaints do matter inside the agencies"); *id.* at 221(remarks of James Rill) ("I don't think there can be any disagreement with the notion that serious, credible customer complaints are certainly revealing as to the possible likely anticompetitive or competitive dynamic of the transaction. I certainly don't disagree with that.")

[27] *See, e.g.*, FTC MERGER GUIDELINES, 4 CCH Trade Reg. Rep. ¶ 13,200 at p.20,905 (1982); *FTC v. R.R. Donnelley & Sons*, 1990-2 Trade Cas. Para. 69,239 at p.64,855 (D. D.C. 1990); TRANSCRIPT FOR FTC/DOJ MERGER WORKSHOP, *supra*, at 221-22 (remarks of James Rill).

and other testimony. In contrast to the majority of defendants' witnesses, the customers have no discernable bias.[28] In fact, because many of these customers were reluctant to run the risk of alienating an important supplier, their decision ultimately to oppose this acquisition speaks volumes about the depth of their concern. Merger injunctions have been decided on the basis of testimony found to be credible and reliable for just these kinds of reasons.[29]

e. Defendants' Arguments that Coordinated Interaction Is Unlikely Are Contravened by the Evidence and the Law

Plaintiffs have established that this Acquisition poses a considerable risk of coordinated interaction. Because of this, defendants have been unable to seize upon a single, definitive argument to the contrary. Instead, defendants have advanced a "grab bag" of arguments, in the apparent hope that one or more might appeal to this Court. The more significant of the arguments defendants have raised at various points are the following: (1) the SPRB market is competitive; (2) SPRB producers are acting independently; (3) market conditions render coordination impossible; (4) contracting practices encourage "cheating;" (5) there is no convenient mechanism for "punishment;" and (6) Triton is not a "maverick." As demonstrated below, all of these arguments are refuted by the facts and/or the law.

First, defendants contend that the SPRB market today is competitive. This argument is

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[28] To the extent that the Court at one point expressed concern about the customers' interests in obtaining low prices, it is the very nature of competitive markets that buyers seek low prices. *Cf., e.g., Socony-Vacuum Oil*, 310 U.S. at 221-222 (antitrust law "has not permitted the age-old cry of ruinous competition and competitive evils to be a defense").

[29] *See, e.g., Cardinal Health*, 12 F.Supp.2d at 48 (granting injunction when "numerous customers" testified that alternative distribution methods would not work); *FTC v. Great Lakes Chemical Corp.*, 528 F. Supp. 84, 95 (N.D. Ill. 1981) (denying injunction when large buyers, including buyer for duPont, unanimously gave knowledgeable explanations as to why they favored merger that would result in an aggressive supplier with overcapacity).

based upon apparent concessions defendants obtained from many of plaintiffs' customer witnesses to the effect that the prices these customers had received through the bidding process were "competitive," notwithstanding the limited number of bidders. *See, e.g.,* Day 2 Tr. 61 (Kelly); *cf.* Day 2 Tr. 22 (Orme). As Mr. Kelly explained, however, "my definition of competitive is that the prices are all in the relatively same ballpark with each other, and that ballpark is where I thought the market was at that point." Day 2 Tr. 68; *accord*, Day 2 Tr. 22 (Orme). In contrast, as even defendants' economic expert acknowledged (Day 9 Tr. 50-51, 55 (Guerin-Calvert)), a competitive market for antitrust purposes is one where firms price their output at a level that approximates marginal cost.[30]

Moreover, even assuming *arguendo* that the SPRB market today is behaving competitively, the relevant inquiry is not whether current SPRB prices are above competitive levels, but rather whether this Acquisition "create[s] an appreciable danger of such consequences in the future." *Hospital Corp. of America*, 8007 F.2d at 1389. In making this "necessarily probabilistic" prediction (*id.*), the fact that the current market is competitive does not negate the risk that competition will be diminished if the merger goes forward.[31] *See UPM-Kymmene Oyj*, 2003-1 Trade Cas. ¶ 74,101 at 96,932, 96937-38 (enjoining proposed merger despite finding that market was currently competitive).

Next, defendants continue to assert that the SPRB producers are each acting

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[30] *See, e.g., American Tel. & Tel. Co. v. IMR Capital Corp.*, 888 F. Supp. 221, 252 (D. Mass. 1995); I *AREEDA'S ANTITRUST LAW* ¶ 100a; *cf. Verizon Communications, Inc. v. FCC*, 535 U.S. 467, 505 (2001).

[31] For this reason, it is not plaintiffs' burden to establish that the market today is behaving in a noncompetitive manner. We submit, however, that the evidence is suggestive of this conclusion.

independently and have not reached terms of agreement. As we explained at length in our Pretrial Reply Memorandum (at 9-11), this argument misapprehends both coordinated interaction theory and the applicable law. To reiterate briefly, coordinated interaction includes otherwise lawful instances where firms acting unilaterally may nonetheless set prices at supracompetitive levels "by recognizing their shared economic interests and their interdependence with respect to price and output decisions." *Brooke Group*, 509 U.S. at 227. In the present case, there is a substantial risk that the three major producers may decide to practice production discipline to gain improved pricing. This creates an "appreciable danger" of coordinated interaction, even if each of the producers independently arrives at the decision to engage in such behavior.

Another argument pressed by defendants is that market conditions are not conducive to arriving at terms of coordination. Defendants point out, *inter alia*, that specific bids are confidential, and that other allegedly essential information (such as information about winning bids) is either unavailable or available only after a time lag.[32] In making this argument, defendants implicitly suggest that coordination requires complex terms. This ignores the most likely mechanism for coordinated interaction, namely, the simple exercise of production discipline by the major producers. As the *MERGER GUIDELINES* (§ 2.11) explain,

> Firms coordinating their interactions need not reach complex terms concerning the allocation of the market output across firms or the level of the market prices but may, instead, follow simple terms . . . . Terms of coordination need not perfectly achieve the monopoly outcome in order to be harmful to consumers. Instead, the terms of coordination may be imperfect and incomplete – inasmuch as they omit some market participants, omit some dimensions of competition, omit some customers, yield elevated prices short of monopoly levels, or lapse into episodic price wars – and still result in significant competitive harm.

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[32] Notwithstanding defendants' argument, much of this type of information is available to SPRB competitors. Day 10 a.m. Tr. 65 (Stuchal), (*see* PPF 431, 449-458).

This is not a case about overt collusion, such as bid-rigging or price fixing, nor is it a case where firms coordinating their actions need to reach complex terms of agreement. All that is necessary is that the major producers recognize, as most of them already have, the benefit they will all derive if they each individually constrain their production when faced with prices that do not provide returns they consider to be acceptable. Having reached this conclusion, the other producers need only do what Arch has already done – show a commitment to a supply-constraining approach, and then adhere to that approach by constraining production when circumstances so require. Defendants' theoretical arguments about the impossibility of coordination must necessarily fail in the face of evidence that the SPRB producers (particularly including Arch) are inclined to exercise production discipline, are interested in their competitors' willingness to do so, and have been able to monitor whether their competitors are contributing to depressed pricing by selling coal instead of restricting production. *See* PPF 475-486; PX 90-002; PX 105-001; PX 165-002.

Defendants also contend that contracting practices in the SPRB encourage "cheating." According to defendants, a producer could enter into a profitable long-term contract that would entail substantial expansion, but competitors would be unable to detect the scope of such a contract until well after it had been agreed to. This argument, however, is largely based on the type of coal market that existed in 1972 in *United States v. General Dynamics Corp.*, 341 F. Supp. 534 (N.D. Ill. 1972), *aff'd*, 415 U.S. 486 (1974), and not on the SPRB market as it exists today. Whereas *General Dynamics* involved contracts that extended for as much as 15 years or even for the life of the plant, and almost half of the coal was purchased under contracts of 15 years or longer (341 F. Supp. at 543), the situation today in the SPRB is far different. The evidence in this case establishes that SPRB contracts today are typically three years or less in

length, and any longer contracts would contain reopeners. (*See* PPF 267-268 422-426) . Consequently, the limited ability to deviate from a "market-driven" approach by signing up new customers and expanding thereafter would not insulate a competitor from detection for very long. Furthermore, a few such contracts would be unlikely to provide sufficient incentive to deviate, because other competitors could "punish" such deviation by expanding their own production and thus causing prices to erode on the cheater's remaining uncommitted tonnage.

In a related argument, defendants seemingly contend that there is no mechanism available to target and punish a firm that deviates by selling coal when it should be restricting production. This argument misunderstands the nature of punishment, which does not require that the deviating firm be specifically targeted. As the *MERGER GUIDELINES* (§ 2.12) succinctly explain, "Credible punishment . . . may not need to be any more complex than temporary abandonment of the terms of coordination by other firms in the market." Notably, Arch gave serious consideration to doing exactly this – abandoning its "market-driven" approach and instead selling incremental coal – when it detected that Peabody was selling incremental tonnage in spite of its statements that it was cutting back production.[33] *See* PX 105.

Finally, defendants have repeatedly asserted that Triton is not a "maverick," that is, a firm that "ha[s] a greater economic incentive to deviate from the terms of coordination than do most of their rivals." *MERGER GUIDELINES* § 2.12. There are two responses to this argument. First, although the acquisition of a maverick firm is one way in which a merger may increase the likelihood of coordinated interaction, it is not an essential requirement, or precondition, to

[33] Arch ultimately resisted this response because it was concerned that the sale of additional incremental tonnage "would cause the [anticipated price] rebound to stall" and might trigger the sort of price erosion that existed in the 1990s. *See* PX 105-002.

concluding that the likelihood of coordinated interaction is enhanced by this Acquisition. Second, Triton's CEO testified that the company

(Hake). Also, according to Mr. Hake, Triton has never reduced production in an effort to improve prices. Day 8 a.m. Tr. 28 (Hake). Contrary to defendants' assertions, these Triton behaviors do, in fact, make the firm something of a maverick, particularly in comparison to the major producers that have the incentive to exercise production discipline.

In sum, defendants' arguments that coordinated interaction is unlikely must be rejected as ill-conceived and contrary to the evidence adduced in this proceeding.

B. Relevant Product Markets Exist for SPRB Coal, and for 8800 Btu SPRB Coal

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

In defining relevant product markets, courts must be careful to "exclude any other product to which, within reasonable variations in price, only a limited number of buyers will turn . . . ." *Times-Picayune Publishing Co. v. United States*, 345 U.S. 594, 612 n.31 (1953). The *MERGER GUIDELINES* define the product market as "a product or group of products such that a hypothetical

profit-maximizing firm that was the only present and future seller of those products ('monopolist') likely would impose at least a 'small but significant and nontransitory' increase in price" ("SSNIP").[34] *MERGER GUIDELINES* § 1.11.

In the present case, it is barely disputed that SPRB coal is a market. The evidence also establishes that 8800 Btu SPRB coal is a separate product market.

1. A Product Market for SPRB Coal Is Well-Established and Barely Disputed

Economic analysis demonstrates the existence of a market for SPRB coal. Both plaintiffs' and defendants' economic experts agreed that the hypothetical monopolist test of the *MERGER GUIDELINES* is an appropriate method by which to determine whether SPRB coal constitutes a product market.[35] (PPF 63). Plaintiffs' economic expert, Dr. Morris, used two different economic models to determine demand elasticity, (PPF 70, 72), and his most conservative estimate of the demand elasticity for SPRB coal was 0.8.[36] (PPF 73). As a result of this relatively low demand elasticity for SPRB coal, and his estimation of marginal cost, Dr.

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[34] The *MERGER GUIDELINES* generally envision a price increase of at least 5 percent to be "small but significant," and courts often use 5 percent in performing the "SSNIP" test. *MERGER GUIDELINES* § 1.11; *Staples*, 970 F. Supp. at 1076 n.8. The *MERGER GUIDELINES* recognize, however, that "what constitutes a 'small but significant and nontransitory' increase in price will depend on the nature of the industry, and the Agency at times may use a price increase that is larger or smaller than five percent." *MERGER GUIDELINES* § 1.11.

[35] Following the price increase generally envisioned by the *MERGER GUIDELINES*, the relevant inquiry is whether a hypothetical monopolist controlling all SPRB coal would be able profitably to sustain a price increase of approximately 5 percent at the mine mouth.

[36] Demand elasticity measures the percentage by which demand for a product or group of products changes in response to a corresponding change in price. Thus, for instance, a 0.8 demand elasticity implies that a 10 percent increase in the price of a product or group of products will result in an 8 percent decrease in demand. *See, e.g.*, (PPF 72). The range of demand elasticity for SPRB coal is between 0.1 (based on a five percent increase in the price of SPRB coal) and 0.8 (based on a 20 percent increase in the price of SPRB coal). (PPF 71,72).

Morris found that a hypothetical monopolist would generate a net increase in profits of approximately $90 million per year if it were to increase the price of SPRB coal by 5 percent.[37] (PPF 68). Therefore, under the *MERGER GUIDELINES*, SPRB coal is a relevant product market in which to analyze the transaction for antitrust purposes. Although the defendants' economic expert, Ms. Guerin-Calvert, did not calculate the profit that a hypothetical monopolist in the SPRB coal market would generate from a 5 percent increase in the price of SPRB coal, she concluded that hypothetical coordination among SPRB coal producers could be profitable. (PPF 66). This, of course, implies (as Dr. Morris found) that there is a price increase for SPRB coal that would be profitable.

In addition, the evidence demonstrates that there is both industry and public perception that SPRB coal is a product market.[38] Defendants repeatedly refer to a separate SPRB market in their documents, track market shares separately for SPRB coal, and do not take the price of other coal into account when pricing SPRB coal. (PPF 79-83). The defendants' views of SPRB coal are consistent with those of other SPRB coal producers and third parties. For instance, the other SPRB producers, as well as consultants who issue regular reports on coal, also track SPRB coal separately from coal mined in other regions. (PPF 84).

Testimony from customers also supports SPRB coal as a distinct market. SPRB coal

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[37] Out of an abundance of caution, Dr. Morris used the higher elasticity number (implying a greater drop in demand in response to a price increase) with the lower price increase level (5%). Even under these conservative parameters, a 5% price increase generated substantial additional profits. Using the same elasticity figure for higher price increase levels would increase profitability levels.

[38] *See Rothery Storage & Van Co. v. Atlas Van Lines*, 792 F.2d 210, 219 (D.C. Cir. 1986) (recognizing that industry or public recognition of separate economic unit indicates existence of a relevant antitrust market); *Cardinal Health*, 12 F. Supp. at 46 (same).

possesses a unique blend of properties (very low sulfur content, very low price, and low sodium content) that make it particularly desirable to many customers. (PPF 87-88). Customers in need of low sulfur coal testified that it would not be economical for them to switch to burning non-compliant coal even if the price of SPRB coal were to increase, because the cost of alternatives (installing "scrubbers" or purchasing sulfur allowances) would be prohibitive. (PPF 114-115). Other SPRB coal customers testified that there are no other economically competitive coals that combine SPRB coal's low sulfur content with a low sodium content. (PPF 100, 102-106, 108, 110-111, 113, 116-120).[39]

Customers further testified that the delivered cost of SPRB coal is far lower than that of coal from other regions. (PPF 106, 111, 113). The cost of mining SPRB coal is low because the coal is mined in open pits near the surface. (PPF 48, 90). In addition, customers receive favorable shipping rates from the SPRB. (PPF 106). As a result of the prices at which the utility companies are able to procure SPRB coal, utility companies almost uniformly stated that they have not switched – and would not switch – to other coal in response to a 5 percent to 10 percent increase in the price of SPRB coal. (PPF 104, 106, 110, 111, 116-120). In fact, many SPRB coal customers testified that they would not switch to other coal even if the price of SPRB coal were to increase by over 20 percent. (PPF 106, 111, 116-118).

2. The Evidence Also Establishes a Market for 8800 Btu SPRB Coal

Economic analysis also supports the conclusion that 8800 Btu SPRB coal constitutes a relevant market. Other practical indicia, including industry and public recognition of 8800 Btu

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[39] Many customers cannot use NPRB coal due to its high sodium content, and are further limited in using NPRB coal by the cost of transporting it to their plants and by the relatively small volume of coal mined in the NPRB (only 10% of the annual production of PRB coal). (PPF 77, 100, 103).

coal as a distinct economic unit, further support this conclusion. *See Rothery Storage*, 792 F.2d at 219; *Cardinal Health*, 12 F. Supp. at 46.

a. Economic Evidence Supports an 8800 Btu SPRB Coal Market

Dr. Morris testified that 8800 Btu SPRB coal is a relevant product market for antitrust purposes. (PPF 129). Although Dr. Morris recognized that he did not have complete data available to determine with certainty either the demand elasticity of 8800 Btu SPRB coal or the exact incremental cost of producing 8800 Btu coal, he nonetheless found sufficient evidence on which to reach a conclusion. Dr. Morris used the same EVA model employed by Ms. Guerin-Calvert to determine the amount of lost sales that would result from an increase in the price of 8800 Btu SPRB coal. (PPF 132). He then found that a hypothetical monopolist of 8800 Btu SPRB coal would generate a profit by increasing the price of 8800 Btu SPRB coal by 15 percent. (PPF 144-145). Dr. Morris based his conclusion that 8800 Btu SPRB coal is likely a relevant market on the result of the hypothetical monopolist test, and on other market indicia, including historical switching patterns, customer testimony concerning switching patterns and limitations, and other documents. (PPF 153).

Ms. Guerin-Calvert also conducted the hypothetical monopolist test using the EVA model. (PPF 132). In her live testimony, Ms. Guerin-Calvert conceded that, based on her numbers, a hypothetical monopolist could generate a profit by raising the price of 8800 Btu SPRB coal by 25 percent. (PPF 146-149).[40]

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[40] Ms. Guerin-Calvert made this concession based on an estimated contribution margin of 50 percent. (PPF 152). This contribution margin is overstated, however, because she understated incremental costs. (PPF 152, 177-180). Dr. Morris estimated that the contribution margin is closer to 18 percent. (PPF 140). To the extent that the actual contribution margin realized by the producers of 8800 Btu SPRB coal is less than the 50 percent estimated by Ms. Guerin-Calvert, the profitability of a given price increase in 8800 Btu SPRB coal by a

Both economic experts thus agreed that a hypothetical monopolist of 8800 coal could profitably impose a significant price increase, although they disagreed as to the magnitude of that increase.[41] The fact that a hypothetical monopolist could profitably impose such an increase, however, demonstrates that 8800 Btu coal is a relevant product market.[42]

b. Customer Testimony Supports an 8800 Btu SPRB Coal Market

Testimony from utility customers that individually purchase tens of millions of dollars worth of 8800 Btu SPRB coal each year supports 8800 Btu SPRB coal as a product market. Some of those customers are unable to switch their purchases from 8800 Btu SPRB coal to the lower heat content 8400 Btu SPRB coal. (PPF 186-187). These companies testified that it would be uneconomical for them to switch to any lower Btu SPRB coal because doing so would result in a boiler "derate." (PPF186-187).[43]

For many other customers, including some whose boilers physically could handle an

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hypothetical monopolist would be greater. Thus, even smaller increases in price would be profitable. (PPF 150).

[41] Ms. Guerin-Calvert contended that a 15% price increase would be unprofitable, while Dr. Morris found that it would increase profits. Ms. Guerin-Calvert nonetheless acknowledged at trial that a 25% price increase would be profitable.

[42] If a hypothetical monopolist selling a group of products can profitably impose a significant price increase, that group of products comprises a relevant antitrust market. The Merger Guidelines recognize, as did Ms. Guerin-Calvert, that the size of the price increase may exceed the traditional 5-10 percent level, depending on the industry. *Merger Guidelines* § 1.11. Indeed, a hypothetical monopolist that found a 5, 10, or 15 percent price increase to be unprofitable, but a 25 percent price increase to be profitable, would be expected to raise prices by 25 percent.

[43] Derating occurs when a boiler does not have the capacity to burn the greater amount of lower Btu coal that would be necessary to achieve the same heat output as a lesser amount of higher Btu coal. Customers have testified that their derate differential is even greater when pushing SPRB coal through boilers that were originally designed to burn higher Btu coal. (PPF 187).

increased volume of 8400 Btu SPRB coal, it would still be uneconomical to switch away from 8800 Btu SPRB coal even if the price were to increase significantly. These customers evaluate the economics of their SPRB coal procurement on a cents per million Btu basis. (PPF 95). The largest component of that evaluation is the delivered cost, which includes the price of the coal FOB mine and the cost to transport the coal to their generating facilities. (PPF 189, 190). Many of these customers testified that the transportation cost accounts for such a large percentage of their delivered costs that an increase in the price of 8800 Btu SPRB coal FOB mine would be too insignificant to affect the economics of their delivered costs and, hence, their coal purchasing pattern. (PPF 189).

Customers also testified that the high Btu and low sulfur content of 8800 SPRB coal has other economic advantages compared to the lower Btu, higher sulfur 8400 SPRB coal. Burning a lower volume of 8800 SPRB coal allows some utility companies to run their boilers more efficiently from a logistical standpoint. This advantage would be lost if they burned a greater volume of 8400 Btu SPRB coal. (PPF 192, 193). Further, other customers have testified that they need to purchase the 8800 Btu SPRB coal because its lower sulfur content allows them to economically comply with the Clean Air Act. (PPF 188).

Testimony from many customers that they would not switch from 8800 Btu SPRB coal if the price were to increase significantly supports an 8800 SPRB coal product market for antitrust purposes. The fact that a relatively small number of 8800 coal customers could switch to purchasing 8400 SPRB coal if the price of 8800 coal were to increase significantly does *not* refute the conclusion that 8800 SPRB coal is a product market for antitrust purposes, because such a price increase would still be profitable. *See Times-Picayune Publishing,*, 345 U.S. at 612 n.31.

c. Documents and Other Evidence Support an 8800 Btu SPRB Coal Market

The evidence demonstrates that there is widespread industry recognition that 8800 coal is a separate economic unit, and thus a relevant market. *See Rothery Storage & Van*, 792 F.2d at 219; *Cardinal Health*, 12 F. Supp. at 46. For example, Arch's CEO explicitly stated that there are distinct demands for 8800 Btu SPRB coal and 8400 Btu SPRB coal. (PPF 182). Further, Triton's Senior Vice-President of Sales acknowledged the economic reality testified to by customers that the distance of a utility customer's facilities from the SPRB impacts its ability to switch between SPRB coals.[44] (PPF 190). Similarly,

indicated that, based on his many years experience in the SPRB, a producer controlling all the supply of 8800 Btu SPRB coal would be able to profitably increase prices. (PPF 183).

Other industry sources also recognize that 8800 Btu SPRB coal is a distinct product market. An SPRB competitor recognized that if his company were a hypothetical monopolist of 8800 Btu SPRB coal, it could raise the price and generate a profit. (PPF 183). In addition, 8400 Btu SPRB coal and 8800 Btu SPRB coal are tracked separately by financial markets because of their distinct values to customers. (PPF 198).

On the basis of the evidence outlined above, the relevant product markets in which to assess the antitrust effects of the acquisition are SPRB coal and 8800 Btu SPRB coal.

C. The Relevant Geographic Market Is the SPRB

A relevant geographic market in which to analyze the effects of a proposed acquisition encompasses "the region 'in which the seller operates, and to which the purchaser can practicably

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[44] *Supra* at I.B.2.6.

turn for supplies.'" *Cardinal Health*, 12 F. Supp. at 49 (citing *Tampa Elec. Co. v. Nashville Coal Co.*, 365 U.S. 320 (1961)); *MERGER GUIDELINES* §1.21. In this instance, the relevant geographic market is the Southern Powder River Basin. Both Arch and Triton operate mines in the SPRB, as do Peabody and Kennecott, the other leading producers of SPRB coal. (PPF 205). Because the relevant product market is defined as SPRB coal, which is produced entirely in the SPRB, the product market and geographic market analyses are inextricably intertwined. (PPF 204a).

D. The Merger Increases Market Shares Significantly in an Already Highly Concentrated Market

The ability of firms to coordinate their actions – to pull their competitive punches, with the expectation that their competitors would do the same – depends in substantial part on the number of significant participants in the market.[45] "The fewer competitors there are in a market, the easier it is for them to coordinate their pricing without committing detectable violations of section 1 of the Sherman Act, which forbids price fixing." *Hospital Corp. of America*, 807 F.2d at 1387. Courts have found mergers to violate section 7 where the number of competitors post-acquisition was greater than the present case, particularly when a market is conducive to coordinated interaction.[46]

In this case, by reducing the number of 8800 Btu producers from 4 to 3, and by increasing the share of the SPRB market controlled by the three largest firms, the merger increases the

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[45] "The relative lack of competitors eases coordination of actions, explicitly or implicitly, among the remaining few to approximate the performance of a monopolist." *Cardinal Health*, 12 F. Supp. 2d at 45 n.8; *FTC v. PPG Indus.*, 628 F. Supp. 881, 885 n.9 (D.D.C. 1986).

[46] *See Elders Grain*, 868 F.2d at 902 (reduction from 6 to 5); *Hospital Corp. of America*, 807 F.2d at 1387 (reduction from 11 to 7); *UPM-Kymmene OYJ*, 2003-2 Trade Ca. (CCH) ¶74,101 (reduction from 10 to 9); *FTC v. Bass Brothers Ents., Inc*, 1984-1 Trade Cas. ¶ 66,041, at 68,609-10 (N.D. Ohio 1984)(reduction from 7 to 5); *Warner Communications*, 742 F.2d 1163 (reduction from 6 to 5).

likelihood of coordinated interaction. The post-merger market would be dominated by just three firms - Arch, Peabody and Kennecott - who together will have a market share of over 80% of SPRB coal, and 100% of 8800 SPRB coal. PX5675 at 002, 003.

1. Market Shares Are Properly Measured by Capacity or Production, Not by Reserves

Market shares and concentration should provide a "proper picture of a company's future ability to compete[,]" *General Dynamics*, 415 U.S. at 501, and the measurement should accurately reflect the "focus of competition in a given time frame." *Id.* Similarly, the *MERGER GUIDELINES* indicate that market shares should be calculated "using the best indicator of firms' future competitive significance." *MERGER GUIDELINES*, § 1.41. To do so, the market shares must be based on the products – and in this case, the contracts – that customers want.

Using the approach counseled by the Supreme Court and the *MERGER GUIDELINES*, the appropriate measure of market shares to assess this merger is capacity, whether measured as loadout capacity or practical capacity.[47] First, capacity measures the amount that producers can realistically offer to sell within a year or two because it is expensive and time consuming to expand. Meanwhile, the vast majority of current contracts for SPRB coal are for relatively short duration (ranging from immediate "spot market" purchases to supply contracts lasting a few years), so that supplying them from long-term reserves is not practical. (PPF 266-272). Thus, loadout or practical capacity provide the proper measure of the coal producers' ability to compete for sales and contracts.

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[47] Loadout capacity refers to the capacity of the facilities that load coal into train cars. PX8611 at 15. (PPF 243) Practical capacity refers to the capacity available given the current physical equipment at the mines and the expected overburdens in mine plans. PX8611 at 15. (PPF 242)

The record shows that changes to capacity can be difficult, costly and take a significant period of time. For instance, to expand Arch's Black Thunder mine by tons would cost $ and take years; similarly to expand RAG's Eagle Butte mine beyond its current million ton capacity would cost approximately $ to and take up to years. (PPF 246). Buckskin's mine manager testified that planning production over the mine's permit capacity of would "be an exercise in futility." (PPF 245, 295) When the price for SPRB coal increased in 2001, the increase was, in part, the result of insufficient capacity to get coal out of the pits and load it onto the trains. (PPF 50, 253) Typically, to expand loadout capacity significantly, new air quality permits would be required and after the permit is acquired, the facility must be installed. Day 3 p.m. Tr.72 (Morris). These investments to expand capacity exceed the typical response to a "small but significant and nontransitory price increase.[48] Yet, under the *MERGER GUIDELINES*, market shares are normally calculated "based on the total sales or capacity currently devoted to the relevant market together with that which likely would be devoted to the relevant market in response to a 'small but significant and nontransitory' price increase." *MERGER GUIDELINES* § 1.41.

While it is expensive and time consuming to expand reserves, current contracts for SPRB coal are for relatively short duration, with most contracts running three years or less.[49] Thus,

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[48] Interestingly, when defendants' economic expert testified that loadout capacity was too static a measure of a firm's ability to compete presently for future contracts, she said that pricing is "much more dependent on what reserves are able to be deployed in, say, 2005 or 2006 than" past production levels. Day 8 p.m. at 88-89 (Guerin-Calvert). A measure of "what reserves are able to be deployed in 2005 or 2006" is an annual product or capacity figure, not the total uncommitted reserves available for the life of a mine.

[49] Of Arch's 2003 contracts, were for less than a year. PX4605 at 024. Of the million tons of coal Arch contracted for in 2002, approximately million (%) were pursuant to contracts shorter than three years in duration, and no contracts were for greater than

what limits a SPRB coal producer's ability to compete for contracts is its short-term production capabilities for the duration of the contract (i.e., capacity), not the long-term uncommitted reserves for a mine that would have been important for long term contracts. *Compare* PPF at 242 (customers consider practical production capacity to be the measurement regarding a mine's ability to supply it with coal) *with General Dynamics*, 415 U.S. at 499-500, 502 (because nearly all coal transferred to utilities was under long-term requirements contracts "for all or at least a major portion of the total fuel requirements for the life of the plant[,]" in a market "where availability and price of coal are set by long-term contracts rather than immediate or short-term purchases and sales, reserves rather than past production are the best measure of a company's ability to compete"). Moreover, reserves do not affect current competition or prices. Day 3 p.m. at 74 (Morris); Day 9 full day at 87 (Guerin-Calvert) (changes in reserves may or may not affect price levels). (PPF 259)

2. HHIs Calculated for the Merger Exceed the Level that Signals Potential Competitive Concerns

Under any measure for market shares, the markets for SPRB coal and 8800 Btu SPRB coal are highly concentrated.[50] (PPF 228) Day 3 p.m. Tr. 44 (Morris); PX8611 at 13. Moreover, using any measure of market shares, and even allowing for the sale of the Buckskin mine to Kiewit, the merger raises competitive concerns.[51] Even if the sale of the Buckskin mine to

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six years. PX4605 at 023; *see also* PX1021 at 155-156 (
). PPF 270.

[50] The *MERGER GUIDELINES* regard markets with an HHI that exceeds 1800 as highly concentrated. *MERGER GUIDELINES* § 1.51(c).

[51] Under the *MERGER GUIDELINES*, as Ms. Guerin-Calvert conceded on cross-examination, "it will be presumed that mergers producing an increase in the HHI of more than 100 points are likely to create or enhance market power or facilitate its exercise. *MERGER GUIDELINES* § 1.51(c).

Kiewit occurs, post-merger Peabody, Kennecott, and Arch would account for 79.9% of loadout capacity for SPRB coal, PX5675 at 003, and the post-merger HHI for SPRB coal based on loadout capacity is 2292, which is an increase of 224 points from the current market concentration level.[52] (PPF 232) Similar results obtain when other measures of market shares are used.[53]

Even if market shares are calculated on recoverable reserves and the sale of the Buckskin mine to Kiewit takes place, the level of concentration suggests that merger will potentially raise significant competitive concerns. The post-merger HHI based on reserves is 2103, which is an increase in the HHI of 49 points. As Defendants' expert, Ms. Guerin-Calvert, admitted on cross-examination, the *MERGER GUIDELINES* state that "[m]ergers producing an increase in the HHI of more than 50 points in highly concentrated markets post-merger potentially raise significant competitive concerns[.]" *MERGER GUIDELINES* § 1.51(c); Day 9 full day at 40-42 (Guerin-Calvert). After all, "cases falling just above and just below a threshold present comparable competitive issues." *MERGER GUIDELINES* § 1.5 (numerical divisions, such as a change in the HHI of 50 points, suggests greater precision than is possible); Day 9 full day at 42-43 (Guerin-Calvert).

If 8800 Btu SPRB coal is found to be a relevant market, the merger raises competitive concerns in a highly concentrated market. Based on loadout capacity, the post-merger HHI is

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[52] If the sale of Buckskin from Arch to Kiewit does not occur, the post-merger HHI based on loadout capacity is 2579, which is an increase of 512 points. PX8611 at 15.

[53] The post-merger HHI for SPRB coal based on practical capacity is 2346 after the sale of the Buckskin mine to Kiewit, which is an increase of 193 points from the current market concentration level. (PPF at 232)

3418, which is 726 points higher than the pre-merger level.[54]

To be sure, Plaintiffs do not complain solely of the effect of the merger on concentration levels. Rather, we submit that – given the very large increase in concentration in an already highly concentrated industry, with markets clearly defined and clearly protected by significant entry barriers[55], and given the opportunities this Acquisition would afford to Arch to exercise leadership in encouraging SPRB output restrictions – the Commission has shown that the risk of post-merger coordinated output-constraining behavior is quite substantial, that the danger is more than "appreciable," and so the Commission is entitled to an injunction to preserve the status quo pending full resolution of all parties' contentions.

II. THE DEFENSES OFFERED BY THE PARTIES ARE INSUFFICIENT

In addition to their argument that the market is not conducive to coordination, Defendants offer three principal defenses in an attempt to rebut the Plaintiffs' evidence that the proposed merger is likely to lessen competition: a) Triton is a weakened company, and thus Arch and Kiewit will be stronger owners of the North Rochelle and Buckskin mines; b) the merger will result in substantial efficiencies; and c) the divestiture of Buckskin to Kiewit resolves the competitive concerns raised by the transaction. These arguments, whether considered

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[54] Similar conclusions result for other measures of market share. If market shares are measured by practical capacity, the post-merger HHI is 3382 and the change in the HHI is 590 points. The HHI is 3378 based on 2003 production levels for 8800 Btu SPRB coal, which is an increase of 557 points from the pre-merger HHI. Based on reserves, the post-merger HHI for 8800 Btu SPRB coal is 3349 and the change is 369 points. (PPF 237).

[55] That Defendants have not seriously advanced entry arguments in this matter is not surprising, given that it would take at least 5 years and cost tens of millions of dollars to enter the SPRB market. (FTC Pretrial Brief at 39-40).

individually or collectively, provide insufficient evidence to deny the injunction requested in order that the Commission can fully evaluate these claims.

A. Triton's Financial Condition Does Not Justify an Anticompetitive Merger

While admitting that Triton is not a "failing firm" under the antitrust laws, defendants nonetheless seek to downplay Triton's future competitive significance, asserting essentially that the company is "flailing." Def. Pretrial Brief at 14. The so-called "flailing firm" or "weakened company" defense derives from the Supreme Court's decision in *General Dynamics*, 415 U.S. 486, by which a presumption of illegality based on market concentration alone can be rebutted if defendants can prove that the acquired firm's current market shares overstate its future competitive significance due to its weak financial condition.[56]

The evidence in this case, however, does not support such a defense. First, as just demonstrated this case does not rest on market concentration alone. Second, as we now demonstrate, the record in this proceeding leaves no doubt that Triton is neither "failing" nor "flailing."

Even if the transaction with Arch is not consummated, the Triton mines are in a

[56] This defense also has been termed the "*General Dynamics*" defense. It bears note how far afield from *General Dynamics* the present case lies. In *General Dynamics*, the acquired firm had "no uncommitted reserves." In this case,

and has nominated a lease tract containing an additional 173 million tons of recoverable reserves, which at current production rates will provide an additional of reserves for the mine. DX 1024-0024673

position to maintain or expand their current output. Moreover, Triton management has indicated that, should this transaction be enjoined, it will

Accordingly, there is no basis on which to conclude that Triton's current competitive position somehow overstates its future competitive significance.

1. The "Flailing Firm" or "Weakened Company" Defense

As the Eleventh Circuit noted in reversing the district court's denial of a preliminary injunction in *University Health, Inc.*, 938 F.2d 1206 (11th Cir. 1991):

> [W]e view *General Dynamics* as standing for the unremarkable proposition that a defendant may rebut the government's prima facie case by showing that the government's market share statistics overstate the acquired firm's ability to compete in the future and that, discounting the acquired firm's market share to take this into account, the merger would not substantially lessen competition. *The weakness of the acquired firm is only relevant if the defendant demonstrates that this weakness undermines the predictive value of the government's market share statistics.*

Id. at 1221 (citations omitted) (emphasis added); *see also Warner Communications*, 742 F.2d at 1164; *Rockford Memorial Corp.*, 717 F. Supp. at 1289; *UPM-Kymmene OYJ*, 2003 U.S. Dist. LEXIS 12820, 2003-2 Trade Cas. (CCH) ¶ 74,101. Indeed, "[f]inancial weakness, while perhaps relevant in some cases, is probably the weakest ground of all for justifying a merger," and "certainly cannot be the primary justification" for permitting one. *Kaiser Aluminum & Chemical Corp. v. FTC*, 652 F.2d 1324, 1339, 1341 (7th Cir. 1981). Nor does the weakened-company defense vitiate the standards for the failing-firm or failing-division defense.

Thus, financial difficulties "are relevant only where they indicate that market shares would decline in the future and by enough to bring the merger below the threshold of

presumptive illegality." *AREEDA'S ANTITRUST LAW* ¶ 963(a)(3), at 13. "While a merger is a relatively 'permanent' arrangement having long-lasting competitive effects, financial difficulties not raising a significant threat of failure are typically remedied in a moderate length of time." *Id.* at 14. The record shows that Triton is not "weakened" or "flailing," such that its future competitiveness would be overstated by its current capacity.

2. Triton is Profitable

Triton's mines currently are profitable. In 2002, Triton posted earnings before interest, taxes, depreciation, depletion and amortization ("EBITDA") of $, and operating income of $. (PPF 712). In 2003, its EBITDA was $, and its operating income $. *Id.* Through the First Quarter of 2004, Triton's mines posted a consolidated EBITDA of $, and operating income of $. *Id.* Although defendants argue that profitability must be measured solely on the basis of net income, to do so would ignore both logic and business reality, particularly when assessing the competitive ability of Triton's assets going forward. Indeed, Triton itself has touted EBITDA as an important measure of asset performance. (PPF 711, 712, 715).

Moreover, although Triton lists its cash costs at $ per ton,

These include, for example, equipment leases, some repair expenses, most labor costs, property and other taxes, insurance, and some overhead costs. Because only a portion of the cash cost figure includes costs that would actually be incurred by producing the incremental ton, it is not surprising that the sale of incremental tons at below $ contributes to EBITDA and net income. Mr. Hake recognized that Triton could contribute approximately $ to its EBITDA at North Rochelle, and over $ to its operating

income, by selling roughly additional tons of coal at a price of $ per ton in 2004. ((Hake); DX-0485-0012855.)

Even considering net income, Triton is profitable. Although according to the defendants, Triton posted a net loss of over $ in 2003, the company's Statement of Income provided to its bank on February 16, 2004 shows

for the year. (PPF 713; PX0881 at 003). In 2002, the company recorded a net income of over $. *Id.* To get from the EBITDA numbers set forth above to

net income figures, deductions are made for asset depreciation, reserve depletion, interest expense, loan amortization, and other fees paid by Triton to its lender, (PPF 710, 711). Depreciation, depletion, and amortization expenses do not constitute cash outlays by the incurring firm. Interest expense and most banking fees are cash outlays but are expended pursuant to financing choices made by management and owners.[57] Deducting non-cash and financing expenses, while appropriate for firm financial reporting under basic accounting principles, understates the actual performance and value of the underlying productive assets, which, for Triton, are its two mines. Indeed, the record shows that Triton and others recognize that EBITDA (and operating income) are appropriate measures of profitability in assessing the performance of these assets. (PPF 715).

3. Triton's Assets Are Viable and Will Remain So In the Reasonable Future

Triton's mines are viable in the market today, and are projected to remain so over the next

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[57] Standard finance theory holds that the value of a productive asset is not dependent on the sources of the asset's financing. , it would not incur interest expenses and most banking fees.

several years. The Buckskin mine currently is sold out for 2004 (at tons). (PPF at 717). The North Rochelle mine, having sold out at tons in both 2002 and 2003, has sold tons thus far in 2004 and continues to sell coal for the second half of the year. *Id.* Based on these sales figures,

. *Id.* Indeed, Triton has budgeted operating profit and net income in each of the next

. *Id.*

To the extent that North Rochelle

. (PPF 717, 719, 721). As Triton's CEO, Jim Hake, testified at trial,

. (PPF 719).

. In any event, Triton budgets indicate that in the absence of the transaction,

. (PPF at 718).

Triton's North Rochelle mine already commands a significant price premium over many other 8800 Btu mines, because it produces coal that is lower in sulfur, allowing its customers to maintain sulfur credits under the Environmental Protection Agency's Acid Rain Program. (PPF 722-724). This sulfur adjustment premium varies with the value of sulfur credits, and is currently in the range of $ per ton. (PPF 724). Moreover,

(PPF 728, 729).

The mine's strip ratio (an important element of mining costs) decreases over that time from to , before rising slightly through . (PPF 728; PX0072). Arch has estimated that North Rochelle's stand alone costs will decrease over the next few years (PPF 729), a time during

which producer costs in the SPRB generally are expected to rise. *Id.*

The North Rochelle mine is competitive at today's prices, and will continue to be so in the future. (PPF 724, 729). The mine's average realization per ton currently is approximately $ (PPF 724; PX902), and it recently has made contract sales of coal at $ for 2005 and $ for 2006. These prices do not reflect the sulfur adjustment premium added to the price. (PPF 722). Mr. Hake testified on deposition that North Rochelle can cover its fully allocated costs at prices of approximately $. (PPF 723). Indeed, as noted above, even at prices as low as $, North Rochelle is able to contribute substantially to EBITDA and operating income. (PPF 725).

Triton's Buckskin mine also is profitable and will remain so. Buckskin is acknowledged as the lowest cost producer of 8400 Btu coal in the SRPB. Buckskin is capable of being operated quite profitably under current market conditions as well as future expected market conditions. (PPF 730). Moreover, far from allowing Buckskin to dwindle,

(PPF 699).

Neither Triton's existing contracts with , nor its current reserves base, are barriers to future competitiveness. Both the contracts, which currently run through and account for a total of million tons of output per year, are undergoing (or recently have been through the process of) contract re-openers under which Triton has the option of matching a market price obtained by the customer or refusing to do so and releasing the customer from the remainder of the contract. (PPF 739). Thus, Triton has the option of "clearing" additional capacity (accounting for approximately its annual output) if Triton decides it is in its best interest to do so.

North Rochelle and Buckskin will be profitable over the next several years. (PPF 728-

730).

. (PPF 718). In short, there is no reason to believe that the current competitive position of the mines, as reflected in the plaintiffs' concentration analysis, somehow overstates their competitive significance, or to conclude that these assets will not be competitive over the next several years.

4. Triton (or a Subsequent Acquirer) Will Continue to Be Competitive

Although defendants assert that

, and that there are no other buyers for the North Rochelle property, Triton's ordinary course of business documents and actions show otherwise. Triton executives admit that, in the absence of the proposed transaction, they will seek to , and will seek to

. (PPF 731, 734-736). In addition,

Triton has spent resources consistent with bidding on both the West Roundup and West Hay Creek reserves tracts, and has informed its bank and its investors that it is preparing to bid. (PPF at 732-734).

Triton's calendar 2004 budget, prepared in good faith for and approved by Triton's Board of Managers, includes proposed capital contributions of million for the two reserve tracts. (PPF 732, 737). Moreover,

. (PPF 734).

Id. While Triton may face competition from Arch and/or Peabody in bidding on the West Roundup lease, that is the nature of the bid process.[58] Moreover, under the federal regulations controlling that process the Department of Justice Antitrust Division has an obligation to review proposed lease awards and to intervene against any award that would create "a situation inconsistent with the antitrust laws." 43 C.F.R. § 3422.3-4 (2003) (PX6108)

In addition,

. (PPF 735). Although

Triton testified that it was

Indeed,

Id.

Moreover,

. (PPF 737).

(PPF 738).

other owners such as Arch and Kiewit would be expected to make such necessary investments if

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they owned the assets, the flailing firm argument fails. *UPM-Kymmene OYJ*, 2003 U.S. Dist. LEXIS 12820 at *30 (finding that it would be "bad policy" to allow the weakened competitor defense to justify an anticompetitive merger where the acquired firm "is viable, and it is non-competitive simply because its parent has decided not to compete.") If economic opportunities exist to exploit the Triton assets, Triton's owners, a new owner, other equity investors, or lenders would have an incentive to provide the capital to exploit them.

Finally, although defendants claim there are no alternative purchasers for the Triton assets, and particularly for the North Rochelle mine, they have not since 2003 undertaken to make such a determination.[59] During the 2003 sale process, Kiewit expressed initial interest in all of Triton, dropping back to bid only for Buckskin when it determined, of its own accord, that it would be unlikely to be able to compete in bidding with Arch and Peabody for North Rochelle. (PPF 708). Kiewit testified at trial that it would continue to be interested in purchasing all of Triton at the right price, albeit at a lower price than currently is being offered by Arch. *Id.* In addition, has expressed a desire to acquire an 8800 Btu mine, and is another potential bidder. *Id.* Others, including foreign investors, also may step forward to acquire mines in the SPRB. Indeed, RAG recently was sold to buyers from outside the SPRB. *Id.*

In short, Triton's management admits that if the transaction with Arch is not consummated, it will

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. (PPF 741) While defendants claim that Triton cannot sell Buckskin alone and maintain ownership of North Rochelle, doing so could well prove to be a profitable strategy. Triton may be able to sell Buckskin, pay off all of its debt, and continue to operate North Rochelle profitably for the foreseeable future. (PPF 741).

Triton's assets are competitive and viable today, and they will continue to be so in the future. Indeed, the financial picture surrounding these assets may well improve. Nothing in the record supports the conclusion that Triton's current market position overstates its future competitive significance, or that its financial condition transforms the acquisition from anticompetitive to procompetitive. Accordingly, it is not entitled to the protections of either the weakened competitor or failing firm defenses.

5. Defendants' Flailing Firm Defense Is No More Than a Recast Efficiencies Claim

Defendants' argument that the court must weigh the "but for" world of Triton's allegedly weak ownership of the North Rochelle and Buckskin mines against Arch's and Kiewit's ownership of the mines (Def. Pretrial Brief at 14) really is no more than a recast efficiencies claim. The assertion that Arch and Kiewit will be stronger owners of North Rochelle and Buckskin than Triton is not unlike the argument made in *Heinz*, 246 F.3d at 720, that a merger between two manufacturers of baby food would render the postmerger firm a more effective competitor than either of the merging parties would be individually. *See Heinz*, 246 F.3d at 720. The D.C. Circuit treated this argument in *Heinz* as an efficiency defense subject to the normal limitations on that defense. Namely, when a merger takes place in a highly concentrated industry, as in this case, the defendants must prove "extraordinary efficiencies." *Id.* at 720. The court must also "undertake a rigorous analysis" of the alleged efficiencies "to ensure" that they are "more than mere speculation and promises about post-merger behavior." *Id.* at 721. And the efficiencies must be unlikely to be accomplished in the absence of either the proposed merger or another means having comparable anticompetitive effects. *MERGER GUIDELINES* § 4. Otherwise the benefits "can be achieved without the concomitant loss of a competitor." *Heinz*, 246 F.3d at

722. As discussed in more detail in the next section, the defendants here cannot establish efficiencies under these standards that are sufficient to outweigh the potential anticompetitive effects of the proposed transaction, and thus their efficiencies defense, and their weakened company defense, must fail.

B. The Parties Have Not Adequately Established Efficiencies Sufficient to Overcome an Anticompetitive Merger

To provide a valid defense, Defendants' claimed efficiencies, when balanced against the potential anticompetitive harm, must "create a net economic benefit for the . . . consumer." *Rockford Memorial Corp.*, 717 F. Supp. at 1251. Where the "monoply rents could far outweigh the savings presented," the efficiencies defense will be rejected. *Id. See also Cardinal Health*, 12 F.Supp.2d at 63 (rejecting efficiencies claim and noting that "critical question raised by the efficiencies defense is whether the projected savings from the merger[ ] are enough to overcome the evidence that tends to show that possibly greater benefits can be achieved by the public through existing, continued competition"). As a general rule, "extraordinary efficiencies" will be required "where the HHI is well above 1800 and the HHI increase is well above 100." *Heinz*, 246 F.3d at 720 (quoting IVA *AREEDA'S ANTITRUST LAW*, ¶ 971f at 44).[60] Moreover, efficiencies claims must be subjected to "rigorous analysis" by the Court. *Heinz*, 246 F.3d at 720. This is because even "efficiencies projected reasonably and in good faith by the merging firms may not be realized." *Merger Guidelines*, § 4. Moreover, because "information relating to the efficiencies is uniquely in the possession of the merging firms," the merging firms carry the burden of proof on efficiencies and:

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[60] As noted above, assuming an SPRB market and consummation of the Buckskin transaction, the HHI index would increase by 193 points to 2346.

> must substantiate efficiency claims so that the Agency can verify by reasonable means the likelihood and magnitude of each asserted efficiency, how and when each would be achieved . . . how each would enhance the merging firm's ability and incentive to compete, and why each would be merger specific.

MERGER GUIDELINES, § 4. Defendants here fall woefully short of the rigorous standard required to establish an efficiencies defense.

1. Even the Full (and Implausible) Efficiencies Figure Proffered by Defendants Pales in Comparison Both to the Likely Price Increase and Other Relevant Measures

In the supplemental report of Mr. Lang, Arch claims that, as a result of the acquisition, it will realize $134.8 million in savings over the 2004-2008 time period. DX 1111 at 0025758.[61] Of this amount, $27.4 million are general and administrative expenses, which Mr. Lang himself acknowledges could be achieved by "another coal company" without an adjacent mine. (PPF 628). This leaves $107.4 million in "North Rochelle specific" savings. PPF 628. As discussed more fully below, a significant portion of these remaining savings are at best speculative.

Even the full $134.8 million claim, however, would be swamped by the likely anticompetitive harm. As illustrated by the table below, if the merger leads to even a 5% price increase by the three major SPRB producers (Arch, Kennecott and Peabody), customers would pay on the order of $441 million over the 5 year period during which efficiencies are claimed. A 20% price increase would cost consumers approximately $1.7 billion.

[61] The claim totaled in Mr. Lang's initial report, but his supplemental report noted "variances" of positive [over $12 million] and negative [variance of approximately the same amount], or total variances of . The net amount, however, was [about $900,000], resulting in the revised estimate of $134.8 million. Mr. Lang later increased the claim by about in his written direct testimony.

% price increase	Cost of increase to customers
5%	$441.3 M
10%	$882.6 M
20%	$1,765 M

Thus, even giving the Defendants the full benefit of their claims, the efficiencies would be insufficient to counter an otherwise anticompetitive merger.

2. Arch's Savings Figures are Vastly Overstated

In addition to being overstated, Defendants efficiency claims are implausible.

a. Many of Defendants' Efficiency Claims Are Without Merit

At least three categories of Defendants' efficiency claims are either wholly without merit or indisputably overstated: 1) procurement savings, 2) the upper seam coal, and 3) insurance.

Procurement savings. Few matters of proof in this trial could have been disposed of as easily as a legitimate procurement savings claim. With exclusive possession of the relevant data, all Defendants would have had to do was provide some supplier affidavits, or maybe a few invoices, showing the specific items at issue and the likely amount prices would decline post-merger.

Instead, they decreed, through Mr. Lang, that they would obtain a 3% reduction on all procured items. Lang Report, DX 770 at 0019768. Unable to document this figure with their own data (a striking contrast to the reams of spreadsheets purporting to back up other aspects of Mr. Lang's report, DX 770), Defendants attempted to rely on Mr. Kostic. But Mr. Kostic testified that he was "not able to independently verify" the 3% figure because there was no "apples to apples" comparison to be made. (June 25, a.m. at 59-60.) Indeed, on cross examination, Mr. Kostic admitted that his only data on the subject were oral discussions with a Mr. May, from which he set the savings factor, for one item (ammonium nitrate) in one expense

category (explosives), at %. (June 25, p.m.(Kostic) at 102, 105-06). No mention was made by either Mr. Kostic or Mr. Lang of the contemporaneous business planning document assuming a % savings. PX 4655 at 2.

Defendants proceeded on to apply this one (unsupported) % figure for a single explosives item across the board to six entire procurement categories. DX 770 at 0019768. Mr. Lang continued to advocate this methodology in his supplemental report, despite being advised, through Mr. Painter's report, that this very Court had rejected such an approach (on the strength of Mr. Painter's testimony) seven years ago. (PPF 650), Staples, 970 F.Supp. at 1090 (rejecting the across the board extrapolation from a group of savings categories – instead of just one item – to all procurement costs).

Defendants' stubborn adherence to this untenable claim – tallied at about $9 million -- speaks volumes about their approach to efficiencies in this matter.

The Upper Seam. In the past, prior to North Rochelle's move into the North Roundup lease area, its upper seam coal had been of lower quality than the rest of its reserves. (July 7, afternoon (Painter) at 28; PX 7875 . As it has moved into North Roundup, however, it has seen the quality of that coal increase substantially. *Id.*

Seizing on this no longer relevant historical quality issue, Arch claims that it will realize $15.2 million in merger savings because its allegedly greater ability to mix and sell lower quality coal allows it to recover this upper seam coal, whereas the standalone Triton would toss it aside as overburden. But Arch admits that the $15.2 million savings claim "should be zero" if in fact Triton intended to recover the coal on its own. (June 25, morning (Lang) at 63).

And the only reliable evidence demonstrates that recovery of the coal is exactly what Triton would do. Even Mr. Kostic admits that Triton is now in fact mining this very coal, (June

25, afternoon (Kostic) at 82).

In support of their contention, Defendants rely on the hearsay testimony of Mr. Deppe's replacement, current mine manager Brad Clark, as told to Mr. Kostic. (PPF 640-642; Day 5 p.m. Tr. 80-82, 96-97 (Kostic)) Yet Mr. Kostic, who regularly does consulting work for Arch, performed his entire "analysis" between the Sunday morning after his daughter's wedding and the Tuesday his report was due. He has done no independent analysis on this issue, and is simply not a useful source of information on this topic. (PPF 641; Day 5 p.m. Tr. 89-93 (Kostic)) (timing of report and bias), 96 (lack of analysis).

Sworn testimony contrary to the financial incentives of an unpaid and independent witness easily outweighs the unsworn (and even unwritten) hearsay testimony of an interested witness (Mr. Clark), proffered through a paid expert (Mr. Kostic), particularly where it would have been so easy for Defendants to introduce direct evidence.

Insurance. The only way the combined mine can realize the claimed $7.7 million insurance premium savings is by accepting less coverage – higher deductibles and a longer "shutdown" period before business interruption coverage kicks in. PX 4656 (Painter written direct) at 6. North Rochelle could make this choice on its own, and any actuarial difference in the risk spread across the larger combined mine versus the smaller North Rochelle mine is accounted for by the differences in the premium – zero for the combined mine versus about $1 million over the five year period for the combined mine. *Id.* Thus, the real "savings" figure is

therefore this $1 million, not the $7.7 million claimed. The exact same claim was presented to, and rejected by, another Federal District Court in *Rockwood Memorial.* 717 F.Supp. at 1290 ("after the merger the merged entity could increase its deductible in order to receive a lower premium. Just as easily [the acquiree] could increase its deductible [on its own] to reduce its insurance premiums"). It should be accorded no better treatment here.

In the accompanying findings, Plaintiffs discuss in more detail other similarly inflated claims, such as:

- the dragline efficiency (clearly a timing efficiency at best, worth only a fraction of the amount claimed) (PX 4656 at 4-5), and
- inventory savings (worth, not the value of the inventory (which merely gets converted to cash), but rather the carrying cost value of 10%) (PX 4656 at 6-7).

In sum, many of the claims made by Defendants lack merit.

b. Defendants' Equipment Claims Are Overstated and Undocumented

While there are likely to be some merger specific equipment savings, defendants have failed to carry their burden of documenting that those savings will in fact reach the grossly inflated attributed to them. DX 1111 at 0025758. At least of that figure (the amount of operating savings attributable to the drill, loader and tractor) is simply contrary to the evidence of record. (PPF 656) And an additional , the total amount attributable to the claimed three truck reduction, is both contrary to some of the inconsistent evidence submitted by defendants, as well as insufficiently verified. PX 4502 at 13. Although Defendants control of all the relevant information, they simply have failed to carry their burden of quantifying the alleged savings, so that they may be verified through "reasonable means." *See generally* July 7, afternoon (Painter) at 39-44.

Improper operating savings. The rationale for much of the equipment savings (drills, loaders and tractors) claimed is merely that the two mines have "excess [equipment] capacity," (June 25, morning (Lang) at 28), and can engage in "sharing of that equipment between" the two mines. *Id.* at 30. This is fundamentally different from the rationale for other equipment savings (trucks and graders), which is that there will be less need for the function they perform. But Mr. Lang wrongly applied the same cost savings methodology to both groups.

Once Mr. Lang determined that a piece of equipment would be eliminated, he calculated both ownership cost savings (appropriate in both cases) and operating cost savings (not appropriate for drills, tractors and loaders). In other words, there are no operating cost savings from the elimination of, say, a drill, if both companies have drills that are only used 50% of the time. The same drilling will still need to be performed, and drills will still be running the same amount of time, with one drill running 100% of the time versus two drills running 50% of the time. While there will be legitimate savings from owning only one drill, the operating costs will not change. *See* Day 10 p.m. Tr. 50 (Painter); PX 4502 at 3-5 (explaining problematic methodology); DX 1111 at 0025758 (claiming operating cost savings for this equipment in the "hourly labor expense reduction," maintenance and repair expense," "diesel fuel savings," and "lubricant savings" line items).

Overstatement of haul truck savings. Defendants claim a constant reduction of three haul trucks over each year of the period 2004-08, which they value at about $18 million, or $6 million per truck. DX 770 at 0019766; PX 4502 at 13. Mr. Lang conceded that he estimated equipment needs based on his subjective opinion. Day 5 a.m. tr. at 75 (Lang); PX1009 at 034 Lang I.H.). But this subjective opinion is so inconsistent with the objective facts of record, many of which come from contemporaneous business documents prepared by Mr. Lang or other

Arch personnel, that it cannot satisfy the D.C. Circuit's "rigorous analysis" standard. *Heinz*, 246 F.3d at 720. These inconsistencies are detailed at PPF 660-662a. Most fundamentally, PX 4654, a contemporaneous business document assuming , predicts more trucks for the combined mine than Mr. Lang's savings analysis, which prediction is entirely consistent with the . *See* Day 10 Tr. 41-42 (Painter); PX 4656 (Painter written direct) at 009.[62]

Moreover, it is clear that the principal driver for the claimed haul truck reduction, reduced overburden haul distances, is not merger specific in significant respects. Mr. Painter testified, and Mr. Lang agreed, that in 2007 and/or 2008, North Rochelle could reduce its overburden hauling distances on its own (*i.e.*, without the acquisition). July 7, afternoon (Painter) at 47-48. As the North Rochelle pits move westward, space is freed for overburden dumping. *Id.* And the parties are free at any time, without the acquisition, to reach a mutually profitable agreement that would permit Triton to dump overburden on the adjacent, and already mined, land where the overburden would allegedly be dumped in the event of the acquisition. *Id.* Thus, part of the savings claimed can be achieved without the acquisition and for antitrust purposes is improperly claimed as merger-specific savings. PX4501 ¶29b (Painter Expert Report).[63]

In short, both the contemporaneous business documents, as well as the underlying

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[62] The document used to back up Mr. Lang's savings calculation did not contain a similar haul truck detail, DX 1123; July 7 afternoon at 44 (Painter), even though such detail is customary (June 25, afternoon (Lang) at 4). No explanation has ever been provided why pushing the closing date back three months could so vastly change the savings calculation.

[63]

rationale, are wholly at odds with Mr. Lang's "judgment" predicting a constant three truck reduction for the entire five-year period. While there may be some legitimate truck savings, it is not up to this Court, or the Commission, to speculate as to the amount.

Defendants control the relevant efficiencies information, and having produced several inconsistent documents and analyses, which provide more questions than answers, their claim cannot survive the "rigorous analysis" this Court is required to conduct. *Heinz*, 246 F.3d at 720.

C. The Divestiture of the Buckskin Mine Does Not Remedy the Competitive Problems Created by the Acquisition

While much has been made by both sides over the extent to which the Court should consider the defendants' proposed fix at this preliminary stage, the fact remains that the divestiture of the Buckskin mine to Peter Kiewit Sons ("Kiewit") is not adequate to allay the competitive harm arising from the transaction. If the underlying acquisition would violate section 7, the proposed divestiture remedy must *fully* restore competition in the affected market to render the transaction lawful. *See, e.g., Ford Motor Company v. United States*, 405 U.S. 562, 573 (1972); *United States v. Du Pont & Co.*, 353 U.S. 586, 607 (1957).[64] Moreover, where the plaintiffs have established a reasonable probability that a transaction may tend to lessen competition substantially, the burden of proving that a divestiture cures the competitive problems

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[64] The FTC also has recognized this principle in assessing the curative nature of divestiture proposals. *See* FTC, A STUDY OF THE DIVESTITURE PROCESS 37 (1999) (noting that a merger divestiture proposal "should be evaluated in terms of whether the divestiture will restore competition in the complaint market."); TIMOTHY J. MURIS, CHAIRMAN, FEDERAL TRADE COMMISSION, *ANTITRUST ENFORCEMENT AT THE FEDERAL TRADE COMMISSION: IN A WORD – CONTINUITY*, prepared remarks before the American Bar Association (August 7, 2001) ("We will require a divestiture that will likely create a viable business entity (rather than a creation of lawyers) *to resolve the competitive problems posed by the merger* . . . . [T]he issue is highly fact specific.") (emphasis added).

properly rests with the defendants.[65] Defendants have not borne that burden.

Further, even if the burden is placed on the plaintiffs, the evidence establishes that the divestiture of Buckskin to Kiewit is insufficient to resolve the competitive concerns created by the transaction. Arch's acquisition of North Rochelle alone increases concentration significantly in markets that are already highly concentrated and conducive to coordination. (PPF 232-233). For the reasons discussed above, that acquisition makes anticompetitive coordination among the major producers more profitable and easier, and thus more likely. This is particularly true in the market for 8800 Btu SPRB coal, where the merger will reduce the number of competitors from four to three. Moreover, because those producers also control the majority of 8400 Btu coal, a price increase in 8800 Btu coal will be profitable even if some significant portion of 8800 Btu SPRB coal purchasers were to switch to the 8400 Btu product. (PPF 531).

Divesting Buckskin to Kiewit does little to solve the problem.[66] To the extent that defendants claim that Kiewit is a stronger owner of Buckskin than Triton would have been, they make an efficiencies argument that is neither cognizable nor merger specific. Kiewit provides no special operational synergies or abilities as an owner of Buckskin that could not be achieved either by a capital-infused Triton, or by another purchaser. Moreover, Kiewit offers no guarantee

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[65] *See, e.g., White Consolidated Industries, Inc. v. Whirlpool Corp.*, 612 F. Supp. 1009, 1032 (N.D. Ohio), *injunction vacated on further proceedings*, 619 F. Supp. 1022 (N.D. Ohio 1985), *aff'd*, 781 F.2d 1224 (6th Cir. 1986); *see also, United States v. Franklin Electric Co.*, 130 F. Supp.2d 1025, 1033-34 (W.D. Wisc. 2000).

[66] As an initial matter, it is important to note that Triton already was deep into negotiations with Kiewit for the sale of Buckskin at the time it signed the deal to sell both mines to Arch. (PPF 668). Thus, the "but for" world, had Arch not stepped in to acquire Buckskin, very likely would have included Kiewit owning Buckskin. Indeed, Triton's sale of Buckskin to Kiewit prior to its sale of North Rochelle to Arch would actually have had a deconcentrating effect on the market since it would have reduced Triton's current market share. (PPF 664). To that end, the defendants should not be permitted to claim "credit" for the divestiture as an antitrust fix.

that it will operate Buckskin at a level of output higher than Triton, and has no firm plans to do so. (PPF 698-705).

A Buckskin divestiture does nothing to address the likely competitive harm in the market for 8800 Btu SPRB coal, and only partially addresses concerns in an all SPRB market. The Big Three producers (Arch, Kennecott and Peabody) will control 100% of 8800 Btu SPRB coal production and over 80% of 8400 SPRB production. Thus, even if a price increase in 8800 SPRB coal drove some consumers to 8400 coal, the Big Three would capture the lion's share of that business, increasing the profitability of the price increase. (PPF 531). While it is better for Kiewit to own Buckskin than for Arch to own it, it is insufficient to alleviate the competitive concerns arising from Arch's acquisition of the North Rochelle mine.

Customer testimony demonstrates the inadequacy of the Buckskin divestiture. All of plaintiffs' customer witnesses (including those testifying live at trial and those testifying by declaration) were aware of the proposed divestiture of Buckskin to Kiewit, and all remained concerned about the transaction. (PPF 673-675). Indeed, only one customer (defendants' witness Mr. Stuchal – who purchases 8400 Btu coal almost exclusively) testified that the proposed divestiture alleviated his concerns about the transaction. (Day 7 a.m. Tr. at 79 (Stuchal)). Similarly, plaintiffs' expert, Dr. Morris testified that the divestiture is inadequate to alleviate the competitive concerns arising from the acquisition. (PPF 663).

The Buckskin mine is disadvantaged due to its relative size, location, and the inferior quality of its coal. As indicated by customers and industry participants alike, Buckskin's lower thermal content and higher sulfur levels reduce the value of its coal vis-a-vis that of many other SPRB mines. (PPF 676-680). Moreover, the mine's location on the single rail line at the northernmost portion of the SPRB limits its market reach and results in a pricing disadvantage.

(PPF 681-688). Finally, Buckskin accounts for only 4.8% of SPRB production, and is unlikely to be able to influence pricing trends. RAG, with two 8400 Btu mines that are as large or larger than Buckskin, has little impact on SPRB pricing. (PPF 677-678). There is no reason to believe that Buckskin standing alone will be any different.

Defendants' evidence on the sufficiency of the divestiture is limited to the testimony of one customer (Stuchal), and of their economic expert, who testified that neither Arch's acquisition of all of Triton, nor its acquisition of North Rochelle alone, created competitive concern. While Mr. Grewcock of Kiewit testified that he expects to operate the mine efficiently and effectively, he could not provide any guaranty that he will produce more coal than Triton. Indeed, Triton

. (PPF 699). Moreover, Kiewit itself has recognized the potential for pricing discipline to lead to higher prices in the SPRB in

related to its review of the Buckskin assets. (PPF 695-697).

Thus, there is no credible evidence that the potential anticompetitive effects arising from the acquisition are sufficiently alleviated by the divestiture of Buckskin to Kiewit.

III. THE EQUITIES FAVOR ENTRY OF PRELIMINARY RELIEF

The last phase of the analysis under section 13(b) requires the Court to balance the equities. In a public antitrust action this task is much simpler than it might be in a private matter. An injunction is the ordinary and preferred remedy. "Where, as in this case, the Court finds that the Commission has established a likelihood of success on the merits, a presumption in favor of a preliminary injunction arises." *Staples*, 970 F. Supp. at 1091.

A. The Public Equities Call for an Injunction

The equity standards of section 13(b) were specifically designed to give special weight to protecting the public interest in competition.[67] For this reason, the courts have uniformly held that once the government has carried its burden of showing likely success on the merits, then an injunction should presumptively be issued.[68] The courts have reasoned that the public interest is the primary value here, and the principal public equity lies in seeing effective enforcement of the antitrust laws.[69]

A preliminary injunction protects the public from antitrust injury in two very tangible ways. First, an injunction ensures that an effective remedy is possible at the end of the case. It prevents scrambling of the eggs, transfer of trade secrets, degradation of the acquired firm's capabilities, or any other actions that might make the merger difficult to undo. The D.C. Circuit emphasized this point in *Heinz*, noting that section 13(b) "embodies congressional recognition of the fact that divestiture is an inadequate and unsatisfactory remedy in a merger case . . . ."[70] Second, an injunction protects the public against the exercise of market power by the combined firms in the interim, until the case is finally decided.[71]

The facts in this case give ample reason to fear that both these consequences will come to pass in the absence of an injunction. First, the assets of the two firms are likely to be scrambled

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[67] Conference Report at 31, U.S. Code Cong. & Admin. News 1973, p.2533.

[68] *See, e.g.*, *PPG*, 798 F.2d at 1507; *Weyerhaeuser*, 665 F.2d at 1085; *Cardinal Health*, 12 F. Supp.2d at 66; *Staples*, 970 F. Supp. at 1091.

[69] *See Heinz*, 246 F.3d at 726; *FTC v. University Health*, 938 F.2d at 1225.

[70] *Heinz*, 246 F.3d at 726. *See also FTC v. Rhinechem Corp.*, 459 F. Supp. 785, 787, 790 (N.D. Ill. 1978); *FTC v. Lancaster Colony*, 434 F. Supp. 1088, 1096 (SDNY 1977).

[71] *See Staples*, 970 F. Supp. at 1091.

or degraded beyond later recall. Absent injunctive relief, Arch Coal will sell Triton's Buckskin mine and will consolidate Triton's North Rochelle mine with its own Black Thunder mine, rationalizing personnel and equipment and making operational changes in the configuration of mining pits. Arch may also follow a strategy of short-term exploitation that emphasizes removal of coal from the mines acquired from Triton, thus depleting Triton's reserves and making future divestiture more difficult.

At the same time, consumers will likely be forced to pay higher prices in a non-competitive market, due to an increase in the price of SPRB coal or 8800 Btu SPRB coal. Utility companies pass on changes in fuel input costs to their customers, consumers of electricity. (PPF at 742-750). As a result, if the utility companies are forced to pay higher prices for SPRB coal or 8800 Btu SPRB coal, they will pass those cost increases on to consumers. *Id.*

B. Only other Public Equities Can Preclude an Injunction

Since section 13(b) is focused on protecting the public interest, public equities calling for an injunction can be trumped only by other public equities. In other words, Arch must demonstrate why it is affirmatively in the *public* interest for the transaction to go forward. It must also show why the two public harms ordinarily associated with anticompetitive mergers – interim injury and eventual difficulties of divestiture – will not be present in this case. The D.C.

Circuit has described the full analysis of these points as a test of "three countervailing features."[72] That test is very stringent,[73] and it cannot be satisfied here.

The chief public benefit usually claimed for a merger is its efficiency. That benefit cannot be claimed here, however. We have already shown that any efficiencies from this transaction are small, speculative, non-merger-specific, and any event certain to be swamped by the much larger anticompetitive overcharges that the Acquisition will make possible. As a result, there will be no cost-savings for the utility companies to pass on to consumers and consumers would not benefit from any cost-savings realized by Arch.[74]

Nor can Arch establish that the active harms ordinarily associated with anticompetitive mergers are not of concern here. To the contrary, we have demonstrated that there is a risk of interim consumer harm in the form of elevated prices for SPRB coal, and also that there is a risk to the feasibility of eventual divestiture, as a result of Arch Coal's planned changes and rearrangements of the acquired assets.[75]

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[72] *Weyerhaeuser*, 665 F.2d at 1085, *quoted in PPG*, 798 F.2d at 1506. The three features are (1) significant equities that favor the transaction; (2) reason to expect that eventual relief remains practical; and (3) reason to expect that interim anticompetitive harm will be checked. These factors were first articulated to determine when the alternative of a hold-separate order could be used. However, they would seem equally applicable to considering the greater change involved in dispensing with an injunction altogether. *See Staples*, 970 F. Supp. at 1091.

[73] The D.C. Circuit in *PPG* noted that "the district court did not sufficiently recognize that *Weyerhaeuser* kept intact the presumption in favor of a preliminary injunction . . . ." 798 F.2d at 1506-07.

[74] Even if Arch were to achieve cost-savings as a result of this transaction, those cost-savings will not be passed on to Arch's customers. (PPF 632-638, 754-755). As a result, there will be no cost-savings for the utility companies to pass on to consumers and consumers would not benefit from any cost-savings realized by Arch.

[75] Anticipated post-acquisition restructurings were found to preclude effective relief in several cases, thus justifying injunctive relief. *See, e.g.*, *Heinz*, 246 F.3d at 726; *Staples*, 970 F. Supp. at 1091.

C. Private Equities Are Distinctly Secondary

Defendants may have private equities at stake in this matter as well. The corporations may wish to have access expanded business relationships and new sources of capital, and the individual shareholders of Triton clearly would prefer to realize cash on their investment. These factors are not irrelevant, but they have only secondary importance.[76] Such private equities cannot, by themselves, overcome public equities supporting an injunction. The courts have repeated on many occasions that "a countershowing of private equities alone would not suffice to justify denial of a preliminary injunction barring the merger."[77]

CONCLUSION

We have shown in this proceeding, through witnesses and through indisputable documentary evidence, that: (a) Arch has attempted to lead output reduction by the leading SPRB coal mines; (b) SPRB coal is a market susceptible to tacit coordination because leading mines would be able to reach a mutually profitable understanding regarding output restrictions, to detect deviations from those reductions, and to punish firms that fail to restrict their output; and (c) Arch's acquisition of Triton (or the North Rochelle mine) will significantly increase the likelihood of successful anticompetitive coordination among the leading mines. With respect to the latter point, Triton's absorption by Arch would make coordinated output restriction by Arch, Kennecott, and Peabody more profitable for each of these three firms. Post-merger, the market would contain only three significant competitors, easing the costs and risks of coordination, while bringing all the productive capacity of the acquired firm within the control of the Big

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[76] *See Weyerhaeuser*, 665 F.2d at 1083; *see also Heinz*, 246 F.3d at 708 n.25; *University Health*, 938 F.2d at 1225.

[77] *Weyerhaeuser*, 665 F.2d at 1083. *See also PPG*, 798 F.2d at 1506-07; *Cardinal Health*, 12 F. Supp.2d at 66; *Staples*, 970 F. Supp. at 1091; *Rhinechem*, 459 F. Supp. at 791.

Three. In short, we have shown that the Acquisition would substantially increase the risk of anticompetitive tacit coordination. This conclusion is further confirmed by the fact that customers overwhelmingly oppose the merger because of their expectations that it would reduce competition and lead to higher prices.

Under these circumstances, we submit that the Commission has raised "serious and substantial questions" as to whether this Acquisition may substantially lessen competition, and that the plaintiff states have carried their burden as well. Consequently, plaintiffs are entitled to a preliminary injunction preventing consummation until the issues can be fully determined before the FTC, subject to appellate review.

Respectfully submitted,

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