INTRODUCTION

On June 29, 2012, Anheuser-Busch InBev (ABI) agreed to buy the 50% share of Grupo Modelo that it did not already own for an astounding $20.1 billion. They were to pay $9.15 per share, a 30% premium on the market price at the time. These brewers are giants in the industry, well-known for their variety of popular products: ABI produces brands like Budweiser, Bud Light, Busch, Michelob, Beck’s, and Stella Artois; Modelo produces Corona Extra, Corona Light, Modelo Especial, Negra Modelo, Pacifico, and Victoria. At the time, this would be the second-largest beer deal if approved, and it would be one of the largest global takeovers in 2012 as well (Cimilluca and Esterl, 2012). As New York Times journalists Michael J. de la Merced and Mark Scott wrote, this “deal would solidify Anheuser-Busch InBev’s position as the world’s biggest brewer and one of the industry’s most tenacious consolidators” (2012). It would strengthen its position in the fast-growing beer market in Mexico where Modelo controlled a 55% market share (Ascher, 2012). Moreover, it would allow for the accelerated expansion of ABI globally, since Modelo already exported to 170 countries (of which Corona was the leading beer import in 38 of them). It would
be the conclusion of a long relationship between Modelo and Anheuser-Busch, which had purchased a 50% non-controlling stake in the Mexican brewer for $1.6 billion in 1993. For ABI, which had inherited the stake and the strategic relationship with its $52 billion takeover of Anheuser-Busch in 2008, this acquisition was the logical next step. As ABI’s CEO Carlos Brito explained, “together we can do more” (as cited in Cimilluca and Esterl, 2012).

At the time the merger was first proposed, the resulting company was estimated to have a combined annual revenue of $47 billion. It would have operations in 24 countries and manage 150,000 employees (Vaheesan, 2012). Moreover, ABI claimed the merger would provide efficiencies that were expected to generate $600 million in annual cost savings as well as other synergies for the combined brewing powerhouse (de la Merced and Scott, 2012). However, both parties were aware of the potential antitrust concerns such a deal would provoke in the US, and they had a plan to placate dissent.

Most notably, the transaction involved the sale of Grupo Modelo’s 50% stake in Crown Imports, a joint venture with international wine and spirits producer Constellation Brands, which allowed the companies to exclusively import Modelo products into the United States. It is worth noting that Corona Extra was the best-selling imported beer in the US at the time, and that North America represented a major source of growth for Modelo. Constellation agreed to purchase Modelo’s 50% stake for $1.85 billion. Thus, ABI would supply Crown Imports with its Modelo brands, but Constellation would be in charge of sales and distribution in the country. ABI took this step in order to soothe antitrust fears that could result from the transaction. The deal would allegedly keep a lid on ABI’s market share in the US, which was approaching 40% before the merger. Thus, ABI would apparently have no control over the pricing of Modelo products, and Constellation Brands would remain as a separate competitor in the market. This vertical relationship between horizontal competitors appeared unconventional to many, and the Department of Justice (DOJ) certainly opposed it. However, defendants argued that “this kind of relationship is common in this industry,” citing the case of Pabst Blue Ribbon, which was brewed and distributed by MillerCoors in the US. Moreover, they argued that the arrangement would conserve competition (de la Merced and Scott, 2012).

After the announcement was made, ABI and the Justice Department were in active negotiations to resolve their differences with regards to the merger. However, as Bill Baer, Assistant Attorney General in charge of the DOJ’s Antitrust Division, said, the sides were “just too far apart” (as cited in Kendall
and Bauerlein, 2013). Thus, despite ABI’s intended appeasement of antitrust authorities, the Department of Justice filed an official complaint against the merger on January 31, 2013. US authorities claimed they wanted to prevent overcharging of consumers by the global giants that dominate the mass-market brews, and thus they took ABI and Modelo to court. On the one hand, the DOJ portrayed Modelo as an important competitor that put pressure on ABI to maintain low prices. They claimed that this merger would facilitate implicit collusion between ABI and MillerCoors to raise prices. And they argued that the proposed remedy was insufficient for maintaining competition in the market. On the other hand, the defendants argued US consumers would continue to have plenty of choice with the presence of MillerCoors, Heinekein, and the hundreds of regional craft and import brewers who were increasingly becoming popular in the American beer market. They claimed the deal would not enhance ABI’s pricing power in any way, and they argued strong price competition would be maintained because of the presence of so many close substitutes. Finally, the defendants held the consumer would benefit from the efficiencies that would result from the merger. Thus, ABI claimed the government’s suit was “inconsistent with the law, the facts and the reality of the marketplace” (as cited in Kendall and Bauerlein, 2013). Eventually, the court would approve the merger. However, it required ABI and Modelo to adopt stricter structural remedies that would force ABI to sell its US production in addition to its distribution in the country. The court’s ruling on the merger was of great importance, as it would set the stage for further consolidation efforts, and it would define the path for future merger attempts in the industry.

UNDERSTANDING THE BEER INDUSTRY AND ITS RECENT TRENDS

In order to understand why the DOJ opposed the merger and why ABI and Modelo sought to merge in the first place, one must understand how the beer industry works and how the industry has changed in recent decades. Thus, this section will provide an overview of the industry and an analysis of trends.

The Three-Tier System of Beer Distribution

The beer industry is organized into a “three-tier system” of distribution consisting of: (1) suppliers; (2) wholesalers; and (3) retailers (Goldammer, 2008). Suppliers consist of brewers (e.g. ABI, which brews Budweiser in the US) and beer importers (e.g. Crown, which imports Corona in the US). Beer wholesalers purchase beer from brewers and importers and in turn, sell beer to
retailers. Finally, retailers directly sell the beer products to consumers. These are divided into two sub-groups: on-premise retailers are those that sell beverages to be consumed on location (i.e. restaurants, hotels, and bars), and off-premise retailers are those that sell beverages to be consumed off location (i.e. liquor stores, grocery stores, and supermarkets). In general, brewers set the wholesale price at the brewery, and subsequently retailers price according to the wholesale price they are charged. Thus, price competition in the beer industry mostly occurs at the supplier level among rival brewers. In fact, before the proposed merger, brewers ABI and Grupo Modelo (through its stake in Crown Imports) competed for distribution channels at this level. Each group controlled production of their brands and competed in setting wholesale prices. However, the merger as proposed by the defendants with ABI’s sale of Crown, would change the structure of the distribution chain: ABI, which would own Modelo, would compete with Crown, which would be supplied by Modelo. Thus, the DOJ feared this change might reduce competition, since Crown’s supplier would also be its principal competitor. The heart of the disagreement between the DOJ and the defendants was whether price competition would be maintained between these horizontal competitors under the new vertical arrangement.

**The Industry Trends**

Now, in order to understand why ABI and Modelo sought to merge in the first place, one must turn to analyze the recent trends which transformed the beer industry in the last five decades. The structural, policy, and technological changes which have enabled trade, as well as the geographic transformation of beer consumption, have resulted in two predominant trends which have dramatically transformed the beer market:

1. Global consolidation from mergers, acquisitions, and joint ventures between brewers; and
2. The accelerated expansion of the largest firms into emerging regions around the world.

**Consolidation at a Global Scale**

Originally, the beer industry was localized and spread across a large number of small, regional players due to the nature of the product. Beer is relatively simple to make with primary ingredients of water, malted grains, hops, and yeast. The simple process makes it difficult for firms to gain market share through product innovation, and it facilitates quick entry for numerous competitors. Moreover,
due to its high concentration of water, beer is voluminous and heavy. Therefore, it is expensive to store and transport across long distances, making trade very costly. In addition, beer’s durability posed a significant challenge to geographic expansion, as it spoils more easily than other comparable products such as wine (Howard, 2014). However, despite the structural challenges of the industry which favored many localized firms, consolidation and global expansion have become commonplace in this market. And in the last couple of decades, beer has experienced massive concentration at an international scale.

Philip Howard explains the reasons for this trend: “Recent policy and technological changes have eroded many barriers to consolidation… They have enabled the largest firms to exert more political and economic power, and to move closer to the endgame of a global monopoly” (2014, p. 155). He described four main catalysts. First of all, trade agreements have facilitated global expansion and consolidation. For instance, the North American Free Trade Agreement (NAFTA) of 1994 removed tariffs on beer traded between the United States, Mexico, and Canada. This facilitated the merger between Canadian Molson and American Coors to form Molson-Coors in 2005, and it enabled the creation of Crown Imports, the joint venture between Constellation Brands and Grupo Modelo in 2006. Second, the World Trade Organization (WTO) has played an important role in enabling global expansion and consolidation by lifting excessive tariffs on beer imports between member countries, thus opening up their markets to foreign firms. As a result of improving trade conditions, the US beer market has experienced significant entry by a number of important foreign firms. Moreover, the country has seen beer imports skyrocket in the last decades, from around 0.5 billion liters in 1980 to 3.5 billion liters in 2007 (Colen and Swinnen, 2011). Third, the National Beer Wholesalers Association, which was the third largest political action committee in the US in 2012, has helped larger firms lobby and exploit policies to create tax havens for the big players, promoting accelerated growth in the beer industry. Finally, the top firms have been able to grow by exploiting technological advantages that have allowed them to reduce their production costs, giving them an advantage over their smaller rivals: automation technologies have reduced their labor costs, information technologies have reduced their storage costs, and data mining technologies have reduced their marketing costs (Howard, 2014).

In this favorable growth environment, brewers have faced countless incentives to consolidate through the acquisitions of regional players. Some of the reasons are valid; others are not: economies of scale reduce per unit costs;
enhanced negotiating power with distributors and suppliers raises profits; increased ease for cooperation (through signaling) reduces price competition and avoids costly price wars between competitors; and reduced product choice for consumers limits substitutability and decreases elasticity of demand, providing brewers with greater power to unilaterally raise prices. Not surprisingly, the amount spent on acquisitions and joint ventures from 2000 to 2012 between the four brewing powerhouses, AB InBev, SAB Miller, Carlsberg, and Heineken, totaled an astounding $200 billion (Howard, 2014). Moreover, these mergers and acquisitions have strengthened the position of the four main players, and they have resulted in a highly concentrated global beer market. The four main firms controlled roughly 40% of global sales in 2011, and ABI accounted for nearly half of that on its own (Howard, 2014). Operating over 200 brands produced in 125 breweries worldwide, ABI has become the clear dominant world player.

**Expansion into Emerging Markets**

Moreover, while global consumption of beer has been continuously on the rise for the last 50 years (Figure 1), consumption patterns have changed significantly, pushing players towards new markets, which were previously ignored (Colen and Swinnen, 2011). Per capita consumption has steadily decreased in traditional beer drinking nations, but it has strongly increased in emerging economies, as growth in demand has concentrated in these areas. On the one hand, Belgium reached its maximum consumption per capita in 1974, France in 1976, the UK in 1980, the US in 1981, and Germany in 1983. On the other hand, per capita beer consumption in developing countries has been steadily and consistently on the
rise. In 2003 China overtook the US as the largest beer economy, and in 2005 Russia and Brazil overtook Germany in beer consumption (Figure 2). To explain these trends Liesbeth Colen and Johan Swinnen (2011) conducted an empirical analysis, regressing beer consumption with income across time (using a pooled OLS regression method). In their analysis, they found that the relationship between income and beer consumption has an inverse U-shape. This relationship explains why recent per capita consumption in developed countries has started to decline, while per capita consumption in developing countries is rising steeply.

The changing geographic dynamic has forced the four leading global brewers (three of which have Western European origins and all four of which are headquartered there), to look to expand toward new emerging markets, especially in Asia and Latin America. In 2004 Belgian brewer Interbrew merged with the Brazilian brewer AmBev. The merger was valued at $20 billion. Moreover, the company’s 2008 acquisition of Anheuser-Busch for $52 billion included several Chinese firms and a 50% stake in Grupo Modelo. In 2005, London-based SAB Miller acquired the Colombian Grupo Bavaria for $7.8 billion, allowing the company to gain access to beer markets all across Latin America (and an astounding 98% market share in Colombia). Moreover, in 2011 it acquired a large stake in Turkish brewer Efes, gaining important presence in Russia. In

![Figure 2: Geographic Trends in Beer Consumption (Colen and Swinnen, 2011, p. 32).](image-url)
2010 Dutch brewer Heineken acquired the Mexican firm FEMSA (which makes popular brands such as Tecate, Sol, and Dos Equis) for $7.7 billion. And in 2012 it increased its investments in Asia Pacific Breweries to take a controlling stake in the company. Finally, even Danish brewer Carlsberg, the least global of the top four players, acquired a controlling stake in Baltic Beverages Holding to enter the market in Russia (Howard, 2014). Given this widespread expansion strategy into emerging markets, it makes sense that ABI would look to expand its holdings in Mexico by acquiring the remaining 50% of Grupo Modelo. ABI’s CEO Carlos Brito explained, this was “the natural next step” for them (as cited in Cimilluca and Esterl, 2012).

THE RELEVANT MARKET AND ITS CONCENTRATION

In order to analyze the effects that the merger would have on market concentration and market power, one must keep in mind exactly how the DOJ and the defendants defined the relevant product and geographic antitrust markets. Regarding the relevant product market, the DOJ included all segments of the beer market in its definition, but excluded other alcoholic beverages such as wine and distilled spirits. Defendants generally agreed with this definition. Traditionally, beer products have been categorized according to increasing quality and prices into four segments: sub-premium, premium, premium plus, and high-end crafts. ABI was concentrated in the sub-premium, premium, and premium plus segments. However, the DOJ agreed with the defendants that there was significant competition across all four beer segments, and therefore, that they should all be grouped into one relevant market. They conducted a SSNIP test to measure the demand substitutability of beer among its different segments, as well as the substitutability of beer with wine and distilled spirits. They concluded that in case of a “small but significant and non-transitory increase in prices,” beer was highly substitutable across segments, but that other alcoholic beverages were not sufficiently substitutable to form part of the relevant market (DOJ Complaint, 2013, p. 10).

With regards to the relevant geographic market, the DOJ first identified 26 local markets in the US where ABI and Modelo had greatest dominance. According to the DOJ, “brewers develop pricing and promotional strategies based on an assessment of local demand for their beer, local competitive conditions, and local brand strength” (2013, pp. 10-11). Thus, the DOJ wished to focus the case on the regional markets where ABI would be most likely able to exercise market power post-transaction. However, the defendants argued that even though pricing may vary slightly across regions, most decisions about
brewing, marketing, and brand building occur at a national level. Moreover, competition for distribution among brewers and pricing strategies are national in scope. Therefore, the DOJ presented findings for the broader US market as well, and they argued the merger would result in anticompetitive practices both regionally and nationally.

Once the relevant market was defined and agreed upon by both sides, the DOJ had to consider the concentration pre-transaction and analyze exactly how the merger would affect this concentration post-transaction. In 2012 ABI, MillerCoors, Modelo, and Heineken controlled nearly 80% of the US beer market (Figure 3). With its 12 breweries in the US, ABI accounted for 39% as the market leader, and Modelo controlled an additional 7%. Thus, the proposed merger would result in a combined market share of approximately 46%. Moreover, both companies controlled powerful branding empires, and thus the combined powerhouse would own the number one brand in the country (Bud Light) and the number one import (Corona). Using the Herfindahl-Hirschman Index (HHI) to measure market concentration (which sums the squared market shares of all players in a relevant market), the merger would result in an increase in the HHI of 566 points, raising the post-transaction HHI of the national market to 2,800. This would be significantly above the 2,500 threshold value beyond which the DOJ considers a market “highly concentrated” (2013, p. 12). Furthermore, these values were even more dramatic in many of the local markets. In one such
market (Oklahoma City), the HHI would increase 1000 points due to the merger, resulting in an astonishing concentration value of 4,886 (DOJ Complaint, 2013).

Thus, considering ABI’s dominance both in the 26 regional markets and at the national level, the DOJ became tremendously worried about the merger with Modelo. The proposed transaction would effectively unite the number one and number three players, and it would result in a highly concentrated environment. Moreover, this concentration would be aggravated by the significant barriers to entry which were identified in the beer industry: the huge advertisement and marketing costs required to build brand reputation, the substantial costs needed to develop a network of distributors and delivery routes, the difficulty of getting shelf-space from retailers, and the huge fixed costs associated with building an efficient brewery capable of competing with the mega incumbents. According to the DOJ, these barriers prevented new entrants from engaging the market and naturally reducing the concentration. Thus, the DOJ argued that since entry would be unlikely to happen on its own, further consolidation of the market should be avoided. The ensuing trial would be of utmost importance as it would set the leading precedent for future consolidation efforts in the country. The US court would have the power to change the momentous trends of the industry or open way for continued concentration.

WHY ABI PROPOSED THE MERGER AND HOW THEY ARGUED CONSUMERS WOULD BENEFIT

ABI and Grupo Modelo argued that the increase in market concentration would not be significant enough to enhance market power, and that the merger would result in pro-competitive efficiencies that would overcompensate for any negative effects. The mid-1970s saw the beginnings of a radical shift in anti-merger politics. As the Chicago School of economics gained ground, with its emphasis on economic rigor in legal reasoning, antitrust law began to shift focus towards consumer welfare. Thus as Kenneth Elzinga and Anthony Swisher explain, “market concentration still mattered, but only in the service of consumer welfare protection” (2005, p. 255). The new DOJ-FTC Horizontal Merger Guidelines assert: “mergers should not be permitted to create or enhance market power (defined as a firm’s ability to profitably maintain prices above marginal cost for an extended period of time) or to facilitate its exercise,” but should be allowed when they result in “cognizable efficiencies that are of a character and magnitude such that the merger is not likely to be anticompetitive in any relevant market” (Elzinga and Swisher, 2005, p. 258). Thus ABI and Grupo Modelo had to demonstrate that despite the increased concentration, the merger would not
provide them with market power, that price competition would be conserved, and that efficiencies would be created that would benefit consumers. In fact, the defendants offered three main arguments to argue these same points.

**Enable ABI to Compete in the Face of Shifting Demand**

First, ABI and Grupo Modelo argued the merger would better allow the company to compete in an increasingly divided US market where specialty brewers were growing in popularity and increasing market share. Demand for beer has been transforming such that consumers increasingly demand variety in the beer industry. As Victor and Carol Horton Tremblay explain, this “consumer demand for variety drives… brand proliferation” (2007, p. 56). Interestingly, on the one hand, this change in demand has been a source of concentration among the largest brewers. Mergers are attractive strategies for them because they provide the fastest and easiest way to broaden product offerings. However, on the other hand, the new demand for variety has naturally shifted market away from the large brewers and towards craft and import brewers instead. These have been increasingly able to enter the market creating special niches. Thus, even though the industry has witnessed overall concentration, the specialty beer industry has experienced dramatic segmentation coupled with explosive growth.

Defendants claimed the merger would not enhance ABI’s market power in the US due to the growing number of craft and import beer brands which provided a vast number of close substitutes to the local mega-brands. In 2014 import beer volume grew 7% compared to the mere 0.5% growth in the total US beer market. And craft beer volume rose an astounding 18% resulting in an increase to 11% total market share (Kell, 2014). Moreover, as craft brewers have become more popular, there has been increased entry into the market. According to the *Brewers Association*, there were 3,464 breweries in operation in 2014, an increase of nearly 20% compared to 2013. Not surprisingly, a majority of these were craft brewers (producing less than 6 million annual barrels and independent of the large beer conglomerates). As John Kell explains, “American craft brewers now produce one out of every 10 beers sold in the United States” (2014). Thus, the defendants argued competition has remained extremely high despite industry concentration, and they claimed it is bound to remain high due to the recent change in demand for variety which has shifted market towards craft.

In fact, studies have shown that even though concentration has increased in the beer market, profits have remained low and market power has remained insignificant. Boone’s index of relative profit differences, which compares variable profits between firms across different regimes of competition, showed
that even though concentration increased from 1990 to 2008, market power did not, implying that competition remained high (Gokhale and Tremblay, 2012). It is clear that despite the increased consolidation among the brewing powerhouses, the “major beer brands… continue to face a steep challenge in the US” (Kell, 2014). Thus, ABI argued the Modelo merger would result in no competitive harm to consumers, and would allow the company to broaden its brands to better compete with the emerging specialty brewers that were quickly growing in importance.

**Remedy to Preserve Competition**

Second, ABI and Grupo Modelo claimed their proposed remedy would help preserve an equal level of competition as that seen pre-merger. They were to sell their 50% stake in Crown Imports to Constellation Brands, thus relinquishing control of sales and distribution of Modelo products in the US. Moreover, they would sign a 10-year contract with Constellation granting them exclusive control of their brands for that period. Thus, as *Wall Street Journal* writers Brent Kendall and Valerie Bauerlein describe, ABI argued that “the price of a Corona Extra in the US would be decided separately from the price of a Bud Light” (2013). According to the defendants, the remedy would conserve a separate competitor from ABI in the market. Namely, Constellation Brands would take the place of Grupo Modelo. Constellation would have full control over Crown Imports in terms of brand marketing, product distribution, and most importantly pricing strategies. Thus ABI and Constellation would allegedly compete in the same way that Modelo previously competed with ABI in the beer market, and price competition would supposedly remain unchanged.

**Pro-Competitive Efficiencies to Benefit Consumers**

Finally, the third argument set forth by ABI and Grupo Modelo was that the proposed merger would result in significant efficiencies, which would be passed on to consumers in the form of lower prices. ABI claimed the merger would generate approximately $600 million in annual cost savings for the combined brewing powerhouse due to captured economies of scale and synergies.

The tremendous technological changes and innovations during the last five decades “generated multiplant scale economies” in the brewing industry (Tremblay and Tremblay, 1988, p. 26). These tremendous economies of scale have been continuously growing since the 1970’s giving large-scale brewers a natural cost advantage over small regional players. In fact, Tremblay and Tremblay’s industry studies showed that the minimum efficient scale (MES)
at the firm level required to minimize long-run average costs for brewers has continuously grown in the last half century (2007). The researchers recorded the MES rising from 1 million barrels in 1960 to 8 million barrels in 1970, to 16 million barrels in 1980, to 23 million barrels in 2001, and they argued that the MES is still increasing. Tremblay and Tremblay concluded that more than 90% of firms were inefficiently small around 1980 (1988). And as Figure 4 shows, there continues to be a considerable difference between the actual number of brewers and the efficient number of brewers (i.e. the number of brewers that would exist if each firm produced at MES). As Tremblay and Tremblay explained, the rapid growth in MES put a great deal of pressure on brewers to grow in size, and the trend incentivized consolidation from an efficiency standpoint (2007).

During the last several decades, the rising minimum efficient scale was the main driver of mergers in the brewing industry. This is because the most effective way to achieve consolidation in the market and capture the associated “multiplant economies of scale” discussed above, was through acquisitions of brewers. Tremblay and Tremblay’s logit regression model, which historically analyzed the factors that influenced horizontal merger activity in brewing, gave credence to “Dewey’s hypothesis” that acquisitions have been primarily a way to “transfer assets from failing firms to rising firms” (as cited in Tremblay and Tremblay, 1988, p. 26). Thus, they argued “mergers in brewing have been due

![Figure 4: Minimum Efficient Scale](image)

Figure 4: Minimum Efficient Scale (Tremblay and Tremblay, 2007, p. 56).
primarily to efficiency” claims “rather than market power” (Tremblay and Tremblay, 1988, p. 34).

As proof in support of its claims, ABI was able to directly point to the incredible efficiencies it achieved and to the scale economies it captured in its previous acquisition of Anheuser-Busch. While the company originally predicted synergies of $1.5 billion, it would eventually achieve an astounding $2.25 billion (Espinoza, 2009). The first year alone the company captured cost-savings of $250 million by implementing InBev’s strict corporate policies in frugality (they fired 1,400 unneeded employees) and optimizing production processes in their new AB plants (they cut brewing process waste in half within four years). Moreover, CEO Carlos Brito managed to increase the company’s margins from 31% to 39% in just a few years (compared to rival SABMiller’s stagnant 23% margin) (Roberts, 2013). Fortune writer, Daniel Roberts described Brito saying that his “prowess at cost cutting is unrivaled” (2013). And Harry Schuhmacher, editor of the Beer Business Daily, described ABI as follows: “They are a profit and margin-generating machine. Nobody can touch them” (as cited in Roberts, 2013). Thus, ABI argued they would capture huge synergies and scale economies through their Modelo merger. They claimed these efficiencies would result in lower production costs for the company and consequently more competitive prices for consumers.

THE DOJ COMPLAINT

However, the DOJ did not agree with the defendants; they believed the merger would result in higher beer prices, which would harm millions of consumers. On January 31, 2013, they officially filed a complaint opposing the merger. In this complaint, the DOJ showed that the merger would significantly enhance the defendants’ market power and enable ABI to raise prices both unilaterally and in coordination with its competitors. They countered the defendant’s pro-competitive efficiency claims and argued that the anti-competitive effects would outweigh these efficiencies (DOJ Complaint, 2013).

According to the DOJ, “the proposed acquisition would eliminate competition by further concentrating the beer industry, enhancing ABI’s market power in the national and regional markets” discussed above, and “facilitating coordinated pricing between ABI and the next largest brewer in the US market, MillerCoors” (2013, p. 2). They argued that the company could not show their alleged efficiencies were acquisition specific, and they claimed these could not be large enough to offset the anticompetitive effects described below. Furthermore, the DOJ claimed that the remedy proposed by ABI and Modelo to
address their anti-competitive concerns was insufficient and largely irrelevant. The DOJ argued the proposed merger was illegal under Section 7 of the Clayton Act, and it submitted three main arguments to make its claims: (1) The merger would eliminate the “head-to-head” competition between ABI and Modelo, increasing the former’s market share and enhancing its ability to exert market power in unilaterally raising prices (2013, p. 20). (2) The merger would facilitate coordination among competitors to avoid price wars and enable coordinated pricing strategies that would increase their profitability at the consumer’s stake. (3) The remedy proposed by ABI and Grupo Modelo was vertical in nature, while the merger created a horizontal problem, and therefore would not protect competition in the market.

**Enhanced Ability to Unilaterally Raise Prices**

The first argument made by the Department of Justice was that the acquisition would increase ABI’s market power and directly reduce competition in the concentrated national and regional markets. The DOJ explained that the acquisition would eliminate the direct head-to-head competition between ABI and Modelo, which had historically been fierce. One ABI executive stated that “Crown Imports… has a significant influence on our volume and share,” and a “bigger influence on our elasticity than MillerCoors” (as cited in DOJ Complaint, 2013, p. 18). Therefore, the DOJ claimed this loss in competition would enhance the ability of ABI to unilaterally raise its brands’ prices. For example, the DOJ explained that if ABI were to raise prices of its Modelo brands, it would stand to “recapture a significant portion of any sales lost due to such a price increase,” because ABI was the market leader in the premium and premium-plus segments where Modelo competed (2013, p. 18).

In fact, ABI’s tendency to raise prices had already been observed in its previous merger with Anheuser-Busch. When InBev took over AB in 2008, the company immediately increased prices on their least-expensive brands in the U.S, and ABI’s CEO, Carlos Brito announced his intention to continue raising prices (Howard, 2014). Despite ABI’s immense captured efficiencies, the company raised prices for consumers. In fact, neither the 2008 AB-InBev merger, nor the 2007 Miller-Coors merger had pro-consumer efficiencies (Vaheesan, 2012). Thus, the DOJ rejected the defendants’ claims that the cost-savings and synergies from the merger would have pro-competitive effects. If history meant anything, consumers would be unlikely to benefit from the companies’ captured synergies.

Moreover, the DOJ presented two additional anti-competitive arguments to their claim of ABI’s enhanced unilateral market power. First, ABI would likely
gain significant negotiating power with respect to distributors (wholesalers), and would be able to pressure them to focus on the AB InBev portfolio (Howard, 2014). Thus, as American Antitrust Institute special counsel Sandeep Vaheesan explained, “if it is permitted to acquire Modelo, AB InBev could have a greater ability and incentive to foreclose craft and regional brewers from distribution channels through exclusive dealings” (2012, p. 2). Second, the DOJ claimed the merger would diminish ABI’s incentive to innovate and develop new brands and products. The direct pressure from Modelo in the premium segment had forced ABI to create new beer brands in order to adequately compete. As one of ABI’s managers described, for years the company looked to create a “Corona killer,” successfully launching its Bud Light Lime brand in 2008 (as cited in DOJ Complaint, 2013, p. 19). Moreover, the DOJ claimed that limits on product innovation were reinforced directly in the merger contract. Its exclusive supplier agreement with Constellation would forbid ABI from launching a “Mexican style beer” in the United States. Thus, according to the DOJ, the merger would not only enhance ABI’s market power to unilaterally raise prices and foreclose on its smaller competitors, it would also suppress development and innovation in the industry.

Enhanced Ability to Coordinate Pricing Strategies

The second argument against the proposed merger was a result of the “interdependent pricing dynamic” between the two largest brewers (DOJ Complaint, 2013, p. 3). The DOJ explained that ABI’s pricing strategy had resulted in implicit coordination between ABI and MillerCoors. This type of coordination was widespread in the industry, and occasionally it had resulted in outright price-fixing schemes between competitors. In the late 1990s, for example, the EU investigated Heineken, Bavaria, Grolsch and InBev for holding secret meetings to divide markets and fix prices in the Netherlands. In 2007, the first three firms were charged a total of $370 million in fines (InBev avoided penalties by providing information about the cartel) (Howard, 2014).

Moreover, the DOJ argued that since its entry into the US market with its purchase of Anheuser-Busch, ABI had led annual price increases transparently in many of its regional markets with the expectation that other competitors would follow suit. The DOJ described ABI’s “Conduct Plan” as a strategic pricing plan in the US “that reads like a how-to manual for successful price coordination” (2013, p. 13). The DOJ quoted the plan itself, whose stated goal was to improve “competitor conduct over the long term,” and yield “the highest level of followership in the short-term” so as to “dictate consistent and
transparent competitive responses” (as cited in DOJ Complaint, 2013, p. 14). Moreover, according to the DOJ, MillerCoors had never deviated from ABI’s coordinated leadership in raising prices. Colluding in this concentrated market was more profitable than fighting for market share by engaging in aggressive competition. Thus, through price signaling, ABI demonstrated its ability and desire to establish a regime of tacit collusion with competitors.

Nevertheless, Modelo had historically resisted these “ABI-led price hikes” (DOJ Complaint, 2013, p. 3). The Mexican brewer’s pricing strategy, which was called “The Momentum Plan,” sought to narrow the price gap between Modelo beers and its competitors in the premium segment (low to medium priced lager beers). Modelo wanted to take market share from ABI’s Bud and Bud Light brands as well as the Miller and Coors lines of products. In fact, Nathan Miller and Matthew Weinberg conducted a difference-in-difference regression model that contrasted price changes for ABI and MillerCoors with Modelo and Heineken both before and after the joint venture of MillerCoors was first formed (2015). The regression coefficients indicate that ABI and MillerCoors prices increased by 9% relative to Corona after the merger. As the authors explain, the “empirical results indicate the presence of tacit collusion between MillerCoors and its closest rival, Anheuser-Busch InBev” during the post-merger periods; however, no such collusion was found between ABI and Grupo Modelo (2015, p. 27).

Interestingly, this intense competition remained even though ABI was a major shareholder in Modelo and had the right to appoint nine out of the nineteen company board members. Indeed, this was because “firewalls” had been created so that the ABI members of Modelo’s board would not become privy to pricing information, and would have no say in the day-to-day business operations of the company. They were walled off from strategic discussions about pricing, and they were unable to prevent Modelo’s aggressive tactics established in its “Momentum Plan.” Thus, Modelo’s refusal to coordinate with its competitors placed limits on the harmful coordination practices between ABI and MillerCoors. In September of 2010, ABI rescinded a planned price increase in California because of the share growth in the Corona brand. Moreover, in 2012, ABI’s concern about the growing market share of Modelo in California resulted in an outright price war in which ABI implemented aggressive price reductions meant to discipline Corona. These “trigger strategies,” which sought to punish noncooperation, had been frequently used by Anheuser-Busch in the past even before its merger with InBev (Tremblay and Tremblay, 2007, p. 65). The price wars of 1954, 1988, and 1995 were
all initiated by AB to promote cooperation in the beer market (Tremblay and Tremblay, 2007).

Thus, according to the DOJ, if ABI were allowed to acquire the remainder of Modelo, these competitive constraints on ABI and MillerCoor’s ability to raise prices would be eliminated. With Modelo out of the picture, ABI would be free to increase prices of its brands across all beer segments, knowing its other competitors would follow suit. The DOJ provided ABI’s internal documents as proof to show that Modelo was an integral competitor for ABI that prevented the company from raising prices in the premium segment. These documents said that “while the relative price to MC has remained stable, the lack of price increase in Corona is increasing pressure in premium,” and that ABI would have to restrain price hikes to “limit the impact of price compression on our premiums as a result of the Corona deeper discount” (as cited in DOJ Complaint, 2013, p. 17). Thus, according to the DOJ, the merger would facilitate price coordination led by ABI, and this would directly result in reduced competition and higher prices for consumers.

**Ineffective Remedy**

Finally, the DOJ’s third argument was meant to discredit the proposed remedy of ABI and Modelo as insufficient and largely irrelevant in protecting competition. Well aware of the anti-competitive concerns the merger would undoubtedly raise, ABI agreed to sell Modelo’s existing 50% interest in Crown Imports. The remedy also included a proposed “Amended and Restated Importer Agreement,” which gave Constellation the exclusive 10-year right to import and sell Modelo products (DOJ Complaint, 2013, p. 4). The problem, according to the DOJ, was that the agreement did not include the sale of the actual Modelo brands or the brewing and bottling facilities that made the products. It would depend entirely on ABI for its supply, facilitating coordination between the two supposed competitors.

Under the remedy, ABI would enter into a vertical supplier relationship with Constellation, which would also be a horizontal competitor of ABI. Thus, Modelo would have the power and incentive to foreclose on Constellation (perhaps not directly with higher prices, which would likely be prevented by their 10-year supplier agreement, but with delayed supply and delivery, among other things). Moreover, the remedy would only be short term. At the end of the 10-year period, ABI would be free to terminate the agreement with Constellation, giving ABI full control of all aspects of the importation, sale, and distribution of the Modelo brands in the United States, and ABI would
be free to renegotiate the supply agreement at any point in time during the 10-year period.

The DOJ called this a “façade of competition between ABI and its importer,” explaining that the proposed remedy “eliminates from the market Modelo – a particularly aggressive competitor – and replaces it with an entity wholly dependent on ABI” (2013, p. 4). Vaheesan of the American Antitrust Institute explained that the proposed remedy was “creating a competitor that replaces Modelo in name only” (2012, p. 2). In the complaint, the DOJ quoted Crown’s own CEO who allegedly wrote to his employees: “our #1 competitor will now be our supplier… it will not, going forward be ‘business as usual’” (as cited in DOJ Complaint, 2013, p. 4). The DOJ further explained that the “remedy transforms horizontal competition into vertical dependency” (2013, p. 5). Unlike Modelo, Constellation would have no incentive to deviate from coordination with its supplier. In fact, the company would be incentivized to preserve a strong relationship with ABI, in order to maintain its importation agreement after the 10-year period. Moreover, since Constellation would not be producing the Modelo products under the proposed agreement, they would not have the same interests as Modelo to grow the brand. According to the DOJ, Modelo had the additional incentive to increase volume in order to “cover manufacturing costs” (2013, p. 21).

Furthermore, Constellation had already shown that it did not share Modelo’s incentive to thwart ABI’s price leadership in its joint venture with Modelo. In fact, according to the DOJ, Constellation had consistently urged Crown to follow ABI’s price leadership, much like MillerCoors at the time. To support their claims, the DOJ quoted Constellation’s Managing Director, who purportedly wrote to Crown’s CEO in August 2011, urging him to follow ABI in its announced price hike: “ABI’s announcement gives you the opportunity to increase profitability without having to sacrifice significant volume” (as cited in DOJ Complaint, 2013, p. 21). Crown’s own CEO was concerned with the proposed remedy that would give Constellation full control over the joint venture. He wrote, “the Crown team is extremely anxious about this change in ownership,” and “this is in no small part the result of Constellation’s actions over the term of the joint venture to limit investment in the business” (as cited in DOJ Complaint, 2013, p. 22). In fact, Modelo itself had sued Constellation in 2010 for breaching its fiduciary duty for refusing to invest in marketing the Modelo brands.

Thus, according to the DOJ, if the acquisition were approved with the proposed remedy, Constellation would be free to coordinate with ABI post-transaction and
follow the leader in its price-hikes. The DOJ argued that ABI and Constellation would likely negotiate mutually profitable pricing strategies because “unlike ABI and Modelo, which are horizontal competitors, Constellation would be a mere participant in ABI’s supply chain under the proposed arrangement” (2013, p. 23).

THE COURT’S DECISION AND FUTURE IMPLICATIONS OF THE ABI-MODELO RULING

Ultimately, the court ruled in favor of a settlement between the DOJ and the defendants, which allowed the merger to go forward but imposed much stricter structural remedies. It required the companies to divest Modelo’s entire US business, including: perpetual and exclusive licenses for all of Modelo’s brands in the US, Modelo’s 50% interest in Crown Imports, and complete ownership in the company’s Piedras Negras brewery (the new Modelo plant which was to be the largest and most technologically advanced brewery in the world after its completion in 2013). Moreover, the settlement included an agreement by Constellation to expand the Piedras Negras plant in order to ensure that Constellation could independently meet current and future demand for the Modelo brands in the US. ABI was to sell these and all other assets for its US operations of Modelo to Constellation Brands in order to ensure the maintenance of an independent competitor in the market. The DOJ agreed to this, claiming the “settlement will maintain competition in the beer industry nationwide, benefitting consumers” (Department of Justice Office of Public Affairs, 2013). Thus, the settlement would give Constellation complete control of brewing, bottling, and distributing in the US. This way, the company would no longer depend on ABI for its supply, and it would maintain an equal competitor in the market. Bill Baer, Assistant Attorney General in charge of the DOJ’s Antitrust Division, said that the “settlement announced today will create an independent, fully integrated and economically viable competitor to ABI” (Department of Justice Office of Public Affairs, 2013). Thus, against some odds, the merger was approved, but the structural reforms imposed by the DOJ would set an important precedent for future mergers. The 2008 AB-InBev and 2007 Miller-Coors mergers were approved without significant structural remedies. However, any such mega-mergers would clearly face much more resistance in the future.

This ruling will be particularly significant for a merger which had been rumored for a long time: ABI and SAB Miller. Bernard Ascher of the American Antitrust Institute explained that the purchase of Grupo Modelo by ABI would be seen as a “test case for assessing how antitrust authorities in various countries
might react to a mega-merger of AB InBev and SABMiller” (2012, p. vii). In fact, just eight weeks ago on October 13, 2015, ABI announced its agreement to acquire its closest rival for $104 billion (Bray and de la Merced, 2015). It is uncertain exactly how antitrust authorities will react to the merger, but it is quite certain the transaction will garner extensive regulatory scrutiny. Moreover, as was made clear in ABI-Modelo, if the deal is approved, ABI and SABMiller are sure to face extensive structural reform.

REFERENCES


