Federal Trade Commission v. Peabody Energy Corporation

492 F.Supp.3d 865 (E.D.Mo. 2020)

Sarah E. Pitlyk, United States District Judge.

Flipping a light switch is the culmination of a long and convoluted process. The electricity needed to turn on that light—indeed, the electricity needed for any purpose, be it residential, commercial, or industrial—is generated at power plants owned by investor- or publicly-owned utilities and cooperatives, independent power producers, or the government. Each power plant consists of one or more electricity generating units ("EGUs"). Each EGU uses one of a wide range of generating technologies to transform the energy in a specific fuel—*e.g.*, uranium, coal, oil, natural gas, sunshine, wind, water—into electricity. The typical user of electrical power is indifferent to the method used to generate that power; to most of us, a megawatt is a megawatt is a megawatt. But to energy companies, utilities, policymakers, regulators, and investors (to name just a few), the process by which certain fuels are selected—or not—for use in electricity generation is a matter of momentous consequence. This case is about that process.

One of the most important fuels for electricity generation is thermal coal. Though it has steadily ceded ground to natural gas and renewables over the past twenty years, coal still provides 20% of our nation's electricity, and it is projected to remain an important fuel source for decades to come. Defendants Peabody Energy Company ("Peabody") and Arch Resources, Inc., ("Arch") are the two largest coal producers in the United States. Peabody and Arch propose to mitigate the effects of the coal industry's overall decline on their employees and investors by combining some of their thermal coal operations in a joint venture (the "JV"). Defendants announced their intention to form the JV on June 19, 2019.

Eight months later, three days before the JV was to be consummated, the Federal Trade Commission ("FTC") filed suit in this Court seeking an immediate injunction under Section 13(b) of the Federal Trade Commission Act to prevent the proposed JV from moving forward until the FTC could conduct an administrative hearing to determine whether it would violate Section 7 of the Clayton Act. . . . The FTC has met its burden under Section 13(b) of the Federal Trade Commission Act for a preliminary injunction; accordingly, its Motion for Preliminary Injunction is granted.

BACKGROUND

I. Factual Background

The case is principally concerned with . . . thermal coal that is mined in . . . the Southern Powder River Basin ("SPRB"), located in northeastern Wyoming, near the town of Gillette. Unlike some mines in other parts of the country, SPRB mines are surface mines, meaning they are not underground. . . .

The commercial circumstances of coal companies have changed significantly in the [21st century]. The three most important changes for this case's purposes are the significantly lower price of natural gas; the substantial increase in renewable generation; and the steep decline in coal generation. The confluence of those trends has led to a significant decrease in coal consumption [in the past two decades].

[For example, in 2004], coal, including but not limited to SPRB coal, comprised almost 50%

of net electricity generation in the United States, while nuclear provided about 20%, natural gas provided about 18%, hydro provided about 7%, and other renewables, including wind and solar, provided about 2%. As a result of the three trends described above, coal's share of net electricity generation in the United States had fallen to about 23%, while natural gas generation had leapt to about 38% of net generation and other renewables had climbed from 2% to about 10%. . . . These trends represent a clear structural shift away from coal to other fuels, and no party has suggested that coal will ever again be the primary fuel used to generate electricity in the United States.

The overall decline in electricity generation from coal is reflected in SPRB coal production. From a peak of 452 million tons of SPRB coal mined in 2008, aggregate SPRB coal production decreased by over 40% to 267 million tons in 2019. Between 2011 and 2019, Peabody's production at its three SPRB mines . . . declined by nearly 30%. Likewise, Arch's production at its two SPRB mines . . . declined by 41%. . . .

As the costs of production have increased and demand has decreased, the price of SPRB coal has declined from $20 per ton in 2006 to approximately $12 per ton in 2020. . . . Higher costs of production combined with lower prices have caused profit margins to fall.

This combination of [these trends] has caused numerous SPRB coal producers to declare bankruptcy over the last ten years. In order to cut costs, mining companies have laid off significant fractions of workforces at all SPRB mines in recent years, including in the last several months. . . .

II. The Proposed Joint Venture

Peabody is a publicly traded mining company headquartered in St. Louis, Missouri. Peabody describes itself as "the leading global pure-play coal company, serving power and steel customers in more than 25 countries on six continents." It is the largest producer and supplier of coal from the SPRB. Peabody operates three mines in the SPRB, [one of which] is the largest coal mine in the world, powering approximately 4.5% of total U.S. electricity generation.

Arch is also a publicly traded mining company headquartered in St. Louis, Missouri. Arch operates two thermal coal mines in the SPRB, [one of which] is the second most productive mine in the United States. In addition to Peabody and Arch, five other companies produce coal in the SPRB from seven mines. . . .

Defendants announced the proposed joint venture on June 19, 2019. If consummated, the JV would combine [some of] Peabody and Arch's mining assets. The JV would be 66.5% owned by Peabody and 33.5% owned by Arch, and Peabody would serve as the JV operator and handle coal marketing for the JV. The JV would control approximately 65-70% of all SPRB coal produced, and would operate five of the top ten most productive mines in the United States.

Defendants contend that the JV will combine their . . . mining assets in a "highly synergistic joint venture aimed at strengthening coal's competitiveness against natural gas and renewables, while creating substantial value for customers and shareholders." . . .

III. The FTC's Challenge and Procedural History

On February 25, 2020, the FTC initiated an administrative proceeding challenging the JV under Section 7 of the Clayton Act and Section 5 of the FTC Act. The following day, the FTC initiated this litigation, filing a complaint seeking a temporary restraining order ("TRO") and preliminary injunction blocking the JV pursuant to Section 13(b) of the FTC Act. . . .

LEGAL STANDARD

Section 7 of the Clayton Act prohibits mergers or acquisitions "the effect of [which] may be substantially to lessen competition, or to tend to create a monopoly" in "any line of commerce or in any activity affecting commerce in any section of the country." 15 U.S.C. § 18. When the FTC has "reason to believe that a corporation is violating, or is about to violate, Section 7 of the Clayton Act," it may seek a preliminary injunction under Section 13(b) of the FTC Act to "prevent a merger pending the Commission's administrative adjudication of the merger's legality." *FTC v. Staples, Inc.*, 970 F. Supp. 1066, 1070 (D.D.C. 1997).

The standard for a preliminary injunction described in Section 13(b) of the FTC Act differs from the more familiar preliminary injunction standard applied in other contexts. . . . A preliminary injunction may be granted in an antitrust case if the FTC shows that weighing the equities and considering the Commission's likelihood of ultimate success. In order to demonstrate such a likelihood of ultimate success, the FTC must raise questions going to the merits so serious, substantial, difficult and doubtful as to make them fair ground for thorough investigation, study, deliberation and determination by the FTC in the first instance and ultimately by the Court of Appeals. A showing of a fair or tenable chance of success on the merits will not suffice for injunctive relief.

In *United States v. Baker Hughes, Inc.*, 908 F.2d 981, 982–83 (D.C. Cir. 1990), the D.C. Circuit established a burden-shifting framework for evaluating the FTC's likelihood of success on the merits. [Under this framework], the [FTC] must first present a prima facie case that the merger will result in an undue market concentration for a particular product or service in a particular geographic area. That showing creates a presumption that the merger will substantially lessen competition. The burden of production then shifts to the defendant[s] to rebut the presumption, and, on a sufficient showing, back to the [FTC] to present additional evidence of anticompetitive effects. The ultimate burden of persuasion remains at all times with the [FTC]. *FTC v. Sanford Health*, 926 F.3d 959, 962-63 (8th Cir. 2019). . . .

DISCUSSION

I. Market Definition

The FTC's initial burden, then, is to demonstrate that there is a relevant market in which the proposed JV is likely to harm competition relative to the "but-for" world in which there is no JV. . . .

This initial step is mission-critical for all FTC merger challenges. *United States v. Marine Bancorp.*, 418 U.S. 602, 618 (1974) (Market definition is "'a necessary predicate' to deciding whether a merger contravenes the Clayton Act."). . . .

A relevant market consists of two separate components: a product market and a geographic market. . . . In this case, the principal question in the market definition phase is the relevant product market. If the FTC succeeds in defining the product market as SPRB coal, the geographic market follows rather uncontroversially from that conclusion. Therefore, the Court will focus first on the parties' positions on the relevant product market.

A. Relevant product market

A product market is defined by the reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it. . . . In other words, a properly defined product market includes the functionally similar products to which customers could turn if the JV attempted to impose a post-closing price increase. . . .

A relevant product market need not be defined around a single product. . . . Also, the mere fact that a firm may be termed a competitor in the overall marketplace does not necessarily require that it be included in the relevant product market for antitrust purposes. . . Rather, the critical question is whether two products can be used for the same purpose, and if so, whether and to what extent purchasers are willing to substitute one for the other. . . .

Here, the FTC insists that the market for SPRB coal satisfies all applicable criteria for a relevant product market. Defendants counter that the electricity industry is so complex and dynamic that the JV cannot reasonably be evaluated in the context of the market for SPRB coal alone. Instead, they urge this Court to define the relevant product market for evaluation of the JV more broadly, to include not only other kinds of coal but also other fuels that compete with coal in the electricity generation market. . . . Considering all of the evidence, . . . both quantitative and qualitative, the Court finds that SPRB coal is the relevant product market in which to evaluate the competitive effects of the proposed JV.

Crucial to the Court's conclusion is the "narrowest market principle." A broad product market (*e.g.*, American electricity production) may contain smaller markets (*e.g.*, the markets for each of the individual sources of fuel or markets consisting of power producers in a certain region) which themselves constitute relevant product markets for antitrust purposes. . . .

Because competitive harm in any relevant product market is enough to make out a prima facie case for violation of the Clayton Act, and because potential harms to competition will likely be less apparent in a broader, less concentrated market than in a narrower included market, this Court's task is to identify the narrowest market within which the defendant companies compete that qualifies as a relevant product market. See *Times-Picayune Publ'g Co. v. United States*, 345 U.S. 594, 612 n.31 (1953) ("The circle must be drawn narrowly to exclude any other product to which, within reasonable variations in price, only a limited number of buyers will turn."). . . .

The FTC argues that the [hypothetical monopolist test ("HMT"), which is commonly used in antitrust actions to define the relevant market, demonstrates that the relevant product market here is the market for SPRB coal. . . .

The HMT is an analytical method that asks "whether a hypothetical monopolist who has control over the products in an alleged market could profitably raise prices on those products." *FTC v. Staples, Inc.*, 190 F. Supp. 3d 100, 121 (D.D.C. 2016). If a firm with a monopoly over the products in a candidate market could profitably impose a small but significant non-transitory increase in price ("SSNIP"), then that market constitutes a relevant product market for antitrust purposes. Federal agencies, including the FTC, usually use a SSNIP of 5% of prices absent the merger in their analyses of prospective mergers. . . .

Every industry has its idiosyncrasies. Defendants have not persuaded the Court that the energy industry is so different from all other industries that a standard, well-accepted analytical tool like the HMT must be discounted entirely, or that the Court should favor Defendants' less scientific approach to market definition. . . .

The FTC has presented both economic analysis (in the form of the HMT) and practical evidence that the SPRB is a relevant product market under traditional antitrust analytical methods and precedents. . . .

The Court is persuaded that there is meaningful competition between SPRB coal and other sources of fuel used to generate electricity, and that the cost of natural gas influences the price of SPRB coal. Ultimately, though, Defendants' arguments do not cohere into a powerful enough case to persuade the Court to ignore both the narrowest market principle and the standard analytical and economic tools provided by the FTC, which overwhelmingly support the existence of a distinct market for SPRB coal in which consumers likely would be forced to accept a SSNIP. . . .

B. Relevant geographic market

The second half of market definition is to determine the relevant geographic market. The Supreme Court has stated that, for Section 7 of the Clayton Act, the relevant geographic market is "the area in which the goods or services at issue are marketed to a significant degree by the acquired firm." *Marine Bancorp.*, 418 U.S. at 620-21. Stated differently, the proper question to be asked is where, within the area of competitive overlap, the effect of the merger on competition will be direct and immediate. . . . The relevant geographic market is the area to which consumers can practically turn for alternative sources of the product and in which the antitrust defendants face competition. Like the product market, the geographic market must correspond to the commercial realities of the industry and be economically significant.

SPRB coal supplier mines are located exclusively within the Southern Powder River Basin near Gillette, Wyoming. SPRB coal cannot be mined outside the SPRB, and customers cannot purchase SPRB coal from any mines outside of the SPRB. By finding the SPRB coal market to be the relevant product market, then, the Court has effectively also defined the relevant geographic market. Defendants have not argued otherwise. Accordingly, the Court finds that the SPRB is the relevant geographic market.

II. FTC's Prima Facie Case for Likelihood of Anticompetitive Effects

Having found that the FTC has carried its burden of establishing a relevant market for SPRB coal, the Court turns next to the likely effects of the proposed [merger or JV] on competition within that market. . . . [The FTC presented evidence showing] that SPRB coal customers would not be able to protect themselves from a price increase; and an argument that just such a price increase is likely from the proposed JV. . . .

Currently, Defendants are both pursuing business strategies that focus explicitly on reducing output from their SPRB mines. . . . Defendants argue that . . . the JV will have anticompetitive effects. . . . According to Defendants, they have presented evidence showing that it would be self-defeating for the JV to raise prices, while the FTC has produced no evidence that Defendants intend to raise prices. [This argument is inconsistent with the Defendants' business strategies]. . . .

Ultimately, this Court need not decisively sift through various models and theories. . . . The Court's task is to determine whether the FTC has raised questions going to the merits so serious, substantial, difficult and doubtful as to make them fair ground for thorough investigation, study, deliberation and determination by the FTC in the first instance and ultimately by the Court of Appeals. The FTC has cleared that bar.

III. Defendants' Case Against Likelihood of Anticompetitive Effects

The presumption that the JV will substantially lessen competition is rebuttable. Defendants can either discredit the data underlying the initial presumption in the government's favor or affirmatively show why the JV is unlikely to substantially lessen competition. . . .

The proposed JV involves the two biggest producers of the relevant product in an already concentrated market, and it would create a single entity with 68% market share. That share far exceeds what the Supreme Court has held to be a concerning level of concentration. . . .

None of Defendants' arguments can defeat the presumption of anticompetitive effects created by the FTC's showing.

IV. Defendants' Claimed Efficiencies

Defendants' other response to the FTC's prima facie case is that the JV will achieve significant efficiencies that are likely to enhance competition, rather than hinder it. . . . Where, as in this case, a court finds high market concentration levels, defendants must present proof of extraordinary efficiencies to rebut the government's prima facie case. . . .

The Court is not aware of any case, and Defendants have cited none, where the merging parties have successfully rebutted the government's prima facie case on the strength of the efficiencies.

Defendants claim that the JV will generate significant efficiencies by optimizing production across mines that are currently operated separately, thereby reducing the cost of operations and increasing the output of coal. . . . Further, the JV will better position Defendants to compete in today's energy marketplace, ensuring that their mines will continue to operate and providing customers "access to a stable and reliable supply of SPRB coal in the future." . . .

The Court is, of course, concerned about the fundamental unverifiability of efficiencies that are grounded in the business judgments of Defendants' employees. Also, . . . some portion of Defendants' projected efficiencies are unrealistic or oversimplified. . . .

> Even if the savings are neither as great as defendants have claimed nor capable of precise quantification based on the evidence presented by defendants, the Court is convinced that combining the adjacent . . . mines will inevitably allow the JV to achieve some measure of lower costs and higher productivity. . . .

That said, even granting Defendants every dollar of their claimed efficiencies (which, based on the foregoing, is not wholly justified) and making the implausible assumption that they would pass every penny of those efficiencies on to their customers, Defendants' claimed efficiencies still would not offset the likely competitive harm to those same customers . . . Therefore, the Defendants' claimed efficiencies add little to the Defendants' effort to rebut the FTC's case that the proposed JV would likely have anticompetitive effects in the SPRB coal market. . . .

CONCLUSION

Having considered all of the evidence presented in this case, the Court [finds that] there can be little doubt that the acquisition of the second largest firm in the market by the largest firm in the market will tend to harm competition in that market. . . . The FTC has satisfied its burden of showing a "reasonable probability" that a JV between the two largest SPRB coal suppliers would harm competition in the SPRB coal market. The JV is likely to cause unduly high market concentration in the market for SPRB coal, which, despite the headwinds facing the coal industry, is projected to continue supplying a significant portion of the fuel for electricity generation in the United States for decades to come. The evidence offered by Defendants to rebut the FTC's prima facie case makes clear that there is meaningful competition between SPRB coal and other fuels, but it does not rebut the FTC's central claim that there is meaningful coal-on-coal competition that would be lost if the parties were allowed to consummate the JV. The equities also favor granting a preliminary injunction.

Accordingly, the Court grants the FTC's Motion for Preliminary Injunction.