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The American Antitrust Institute

Antitrust Analysis of Whirlpool's Proposed Acquisition of Maytag

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Introduction

The American Antitrust Institute (AAI) has conducted an independent review of the proposed acquisition of Maytag by Whirlpool, two significant competitors in the manufacture of cooking, refrigeration and freezing, dishwashing, and laundry appliances. Our review has been informed by discussions with industry personnel and a review of publicly available data and information. We believe this background provides an adequate understanding of the specifics to frame the core antitrust issues and concerns raised by the proposed transaction. The AAI has not had access to confidential company information or documents produced in discovery and our analysis and recommendations are limited accordingly.

The proposed merger would consolidate either the two largest, or two of the largest home appliance manufacturers in the U.S. Based on the available information, the AAI believes that a Whirlpool/Maytag combination raises significant competitive issues in the U.S. market for laundry appliances, particularly the market for top-loading washers. Depending on the treatment of the Sears Kenmore brand, market shares for the merged company would range from almost 50% to 75% of relevant top-loading washer, front-loading washer, and dryer markets. Merger-induced increases in concentration would span more than 1,000 to over 2,000 HHI, to produce post-merger concentration of over 3,000 HHI to close to 6,000 HHI.

Under the Department of Justice/Federal Trade Commission 1992 *Horizontal Merger Guidelines* ("*Guidelines*"), concentration induced by the proposed merger in laundry markets is far in excess of the thresholds that would trigger competitive concerns. A

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[1] Vice President and Senior Research Fellow, American Antitrust Institute (AAI). The American Antitrust Institute is an independent Washington-based non-profit education, research, and advocacy organization. Our mission is to increase the role of competition, assure that competition works in the interests of consumers, and challenge abuses of concentrated economic power in the American and world economy. For more information, please see www.antitrustinstitute.org. Among the AAI's more than one hundred contributors is at least one organization whose clients include an opponent of the Whirlpool/Maytag merger. This working paper has been reviewed by the AAI Policy Committee and other individuals inside and outside the AAI. It has also been approved by the AAI Board of Directors.

change in HHI due to the merger of more than 50 points in a highly concentrated post-merger market (i.e., above 1,800 HHI) potentially raises significant competitive concerns. Moreover, when post-merger concentration exceeds 1,800 HHI and the merger-induced increase in concentration is more than 100 HHI points, it is presumed that the merger is likely to "create or enhance market power or facilitate its exercise." [2]

In light of the foregoing, the proposed merger of Whirlpool and Maytag is therefore likely to substantially lessen competition by impairing the ability of rivals to compete effectively and to harm consumers through higher prices, reduced choice, and less innovation. The AAI strongly urges the Department of Justice Antitrust Division to block the proposed transaction or, in the absence of a challenge, require the merging companies to divest a suitable number of laundry assets to a viable buyer(s) in order to negate the proposed merger's harmful effects.

Background

On July 17, 2005, the Whirlpool Corporation ("Whirlpool") announced a proposal to acquire Maytag Corporation ("Maytag") for $17 per Maytag share (henceforth, "the proposed merger"). Over the course of the next month, Whirlpool raised its offer for Maytag by almost 25%, signing a definitive agreement on August 22, 2005 for $21 per share.[3] On October 7, 2005, the U. S. Department of Justice (DOJ) Antitrust Division issued a second request for information. On December 1, 2005, Whirlpool announced "substantial compliance" with the second request, noting that the merging parties had reached an agreement with DOJ not to close the transaction before February 27, 2005.[4]

In acquiring Maytag through a series of consecutively higher bids, Whirlpool ousted competing bidder Ripplewood-controlled Triton Acquisition Holdings. Moreover, analyst reports indicate that competitor Haier could well make alternative offers should the Whirlpool deal fall through.[5] The history of this transaction indicates that in buying Maytag—despite a high cost structure and management issues--Whirlpool is acquiring a viable competitor with one of the strongest and best-known brand names in appliances worldwide.

Summary of Findings

If the AAI's understanding of the facts is correct, the merger should not be allowed to go forward, at least in its current form, for the following reasons:

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[2] Department of Justice/Federal Trade Commission, 1992 *Horizontal Merger Guidelines*, Section 1.51.
[3] See Whirlpool press releases dated July 17, 2005, July 22, 2005 and August 8, 2005, August 10, 2005, and August 22, 2005. Online. Available http://www.whirlpoolcorp.com/news/.
[4] Whirlpool Press Release. October 7, 2005. "Justice Department Request Additional Information on Whirlpool/Maytag Merger." Online. Available http://www.whirlpoolcorp.com/news/release.asp?rid=307 and Whirlpool. Press Release. December 1, 2005. "Whirlpool, Maytag Certify Substantial Compliance With Second Request; Enter Into Timing Agreement with Antitrust Division." Online. Available http://www.whirlpoolcorp.com/news/release.asp?rid=313.
[5] See, for example, Prudential Equity Group, LLC. November 7, 2005. "MYG: Company Closes Underutilized Plant. This Could be the Tip of the Iceberg, Lowering our 1Q06 & 2006 Estimates."

- The merger will *increase concentration far beyond acceptable levels* in highly concentrated U. S. markets for dryers, front-loading washers, and top-loading washers. The effect of the merger on the market for top-loading washers will be particularly severe, raising prices and reducing choice for middle- and lower-income consumers who cannot afford high-end, front-loading appliances.

- The merger will increase the probability of *lessening competition through unilateral effects and coordinated interaction*, creating barriers to entry and stifling the competition that has historically stimulated innovation in laundry appliances.

- The merger *enhances the prospect of strategic behavior* by increasing a merged Whirlpool/Maytag's control of retail floor space and other support and strengthening incentives to use that control to exclude smaller competitors from access to critical distribution channels for laundry appliances.

- The merger will *raise barriers to entry* in laundry by making it more difficult for potential entrants to gain access to distribution outlets and retail visibility.

- The magnitude of potential harm that could result from the transaction and the unlikelihood that any savings would be passed on to consumers of laundry appliances, *make us skeptical that any claimed efficiencies from the merger would be large enough to justify it.*

<u>Market Positions of Appliance Manufacturers</u>

Maytag and Whirlpool produce a wide range of household appliances for both the U.S. and foreign markets. Whirlpool and Maytag both compete in: (1) cooking, (2) refrigeration and freezing, (3) dishwashing, and (4) laundry.[6] Note that manufacturing shares are different from brand shares. For the purposes of illustrating the relative impacts of the proposed merger on non-laundry versus laundry appliance markets, the manufacturer shares shown in Table 1 are adequate.

As discussed later, however, the brand share versus manufacturer share distinction is important for the purposes of analyzing the effects of the proposed merger specifically on laundry markets. For example, the Sears Kenmore brand has been manufactured primarily by Whirlpool for the better part of a century. But Sears' ability (or inability) to control retail pricing, marketing, and promotion for Kenmore products is an important factor to consider in using brand or manufacturer shares. Analysis and conclusions that appear later in the paper are therefore based on market share data that are somewhat different than what is contained in Table 1.

As shown in Table 1, manufacturer share data for 2004 indicates that Whirlpool's share for categories of non-laundry appliances ranges from about 10% to over 30% while

[6] Whirlpool and Maytag competed in freezers beginning in 2005.

Maytag's share ranges from about 10% to almost 20%. Merger-induced increases in concentration range from about 300 HHI to 1,000 HHI, for post-merger concentration ranging from almost 3,000 HHI to almost 4,000 HHI. These statistics are in excess of the *Guidelines* thresholds for triggering competitive concerns. Other sellers in non-laundry markets are General Electric (GE) and Electrolux. Fringe competition accounting for up to 10% of the market is provided by an array of European and Asian firms such as: Bosch-Siemens, Fisher & Paykel, Sub-Zero, Viking, Daewoo, Haier, LG Electronics, Royal Sovereign, Samsung, and Sanyo.

Laundry appliances include electric and gas dryers and top- and front-loading washers.[7] Based on manufacturer shares, Whirlpool's and Maytag's shares in laundry markets are over 50% and around 20%, respectively. Merger-induced increases in concentration range from about 2,000 HHI to almost 3,000 HHI, producing post-merger concentration between about 5,500 HHI to 6,500 HHI. These market concentration statistics far exceed the *Guidelines* thresholds for triggering competitive concerns related to the merger. In front-loading washers and dryers, the field of fringe of competitors accounting for up to 3% of the market is limited to Bosch-Siemens, Fisher & Paykel, and LG Electronics. Based on available information, there are *no* foreign competitors in top-loading washers and no real chance of entry into that market.

Table 1[8]
Manufacturer Market Shares for Major Appliances Produced by Whirlpool and Maytag

Firm	Cooking	Dish-washers	Refrig-erators	Laundry		
				Electric Dryers	Gas Dryers	Washers
	(percent)					
Whirlpool	**9-23**	**33**	**25**	**56**	**55**	**51**
Maytag	**12-18**	**16**	**11**	**19**	**25**	**20**
GE	**36-49**	**29**	**29**	**14**	**11**	**17**
Electrolux	**10-27**	**19**	**25**	**10**	**7**	**9**
Others	**6-10**	**3**	**10**	**1**	**2**	**3**
Combined Share	**27-35**	**49**	**36**	**75**	**80**	**71**
Pre-Merger HHI	**2,530-3,210**	**2,556**	**2,312**	**3,794**	**3,824**	**3,380**
Post-Merger HHI	**2,854-3,762**	**3,612**	**2,862**	**5,922**	**6,574**	**5,420**
Change HHI	**324-552**	**1,056**	**550**	**2,128**	**2,750**	**2,040**

Table 1 highlights the difference in market positions of Whirlpool and Maytag in laundry versus other appliance markets in which there are overlaps. Merger-related changes in concentration in non-laundry appliances are still problematic, but much lower than in laundry appliances. Thus, while the effect of the proposed merger in non-laundry markets raises concerns under the *Guidelines* that bear looking into, the AAI's analysis and recommendations will focus on laundry markets, which will be the most adversely affected.

[7] Separate shares for top-loading and front-loading were not available to AAI.
[8] *Appliance*, "Share of the Market Picture for 2004.

Relevant Markets for Laundry

Background

In defining relevant product markets, Section 1.1 of the *Guidelines* asks whether consumers would switch to competing products in response to a hypothetical price increase. In other words, would a small but significant (e.g., 5-10%) and nontransitory price increase in the product over competitive levels by all firms in the proposed market be enough to induce consumers to switch to an alternative product? For example, if enough customers would switch to a front-loading washing machine in response to a price increase for top-loaders so that the increase was unprofitable, then the relevant market would need to be expanded to include front-loading machines.

Likewise, in defining relevant geographic markets, the *Guidelines* test considers the scenario in which a hypothetical monopolist selling in a particular region profitably increases prices by a small, nontransitory amount. If consumers would likely switch to providers in other locations in sufficient number to render the price increase unprofitable, then the geographic market would have to be expanded to include that location. Supply substitution by existing firms (e.g., shifting production into products or product lines in which a price increase is profitable) is also considered in identifying firms that participate in the relevant geographic market.

The Relevant Geographic Markets

In the case of laundry appliances, the relevant geographic market is arguably a national one. Whirlpool and Maytag do not own their own dedicated retail outlets. Rather, consumers can locally shop for laundry appliances produced by the various manufacturers through three major "bricks and mortar" distribution channels, each of which accounts for roughly 30% of purchases. These include: (1) Sears, (2) the "big boxes" such as Lowes, Home Depot, and Best Buy, and (3) independent appliance dealers.[9] Retailers in the Big Box and independent dealer channels sell both domestic and foreign appliances, but Sears tends to favor domestic manufacturers. Consumers can also shop via the internet where selection tends to be broader[10] and the desired product can be ordered and delivered through national or regional distribution systems and installed through the local distributor or it subcontractors.

Relevant Product Markets

Defining relevant product markets involves looking at a number of possible indicators, as discussed generally in Section 1.11 of the *Guidelines* and more specifically, for example, in *Brown Shoe Co. v. United States*. These factors include sensitivity to price changes, product characteristics, unique production facilities and specialized sellers, and distinct

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[9] Walmart does not sell large home appliances.
[10] The Sears, Lowes, and Best Buy online sites, for example, choices of laundry appliances that number in the hundreds.

customers and prices.[11] Information that would aid in developing product market definitions is available from a number of sources. In appliances, these sources include industry and trade data, and consumer guides to appliances purchasing (e.g., *Consumer Reports*), and a large quantity of online information from various retail distribution channels regarding pricing and product characteristics.

The Top-Loading and Front-Loading Washer Markets

Washing machines sold in the U.S. are distinguished by a number of features. These include loading orientation, efficiency (water and energy), variety of cycles and settings, capacity, styling, and price. Washers are either top-loading or front-loading. Top-loaders clean clothes by agitating them in water. These are a few high efficiency top-loading models that use non-traditional motions to clean. The Maytag "Neptune," for example, uses two-arms to tumble clothes on a horizontal axis. But this and other non-conventional top-loaders are much more expensive than conventional top-loaders.

Front-loaders clean clothes by tumbling them in water and can thus cause less wear-and-tear on fabrics than top-loaders. Unlike top-loaders, front-loaders can wash delicate fabrics like silk and wool. Top-loaders tend to use more water and energy (and are sometimes more noisy) than front-loaders. This is because top-loading technology is less effective at spinning water out of the clothing and fewer top-loaders are rated as Energy Star (i.e., uses at least 35% less energy than a conventional washer) and "high efficiency" (i.e., is Energy Star compliant *and* uses 67% less water than conventional technology).[12] For the more style-oriented buyer, front-loading washers are generally sleeker looking than top-loading models and may come in more color options than the basic white, off-white, and black.

Product market definition for washing machines requires an evaluation of the products consumers would consider substitutes for washers. Clearly, there are no reasonable substitutes for washing machines, so it makes sense ask whether there are separate markets for top-loading and front-loading washers. As discussed later, the definition of an all-washer versus separate top-loading and front-loading washer markets affects the strength of the competitive concerns raised by the proposed merger. The AAI did not have access to the information necessary to perform more sophisticated demand or critical loss analysis that might facilitate defining product markets. In the absence of such data, however, it is still possible to look at a variety of factors that are helpful in assessing the likelihood of separate relevant markets for top-loading and front-loading washers.

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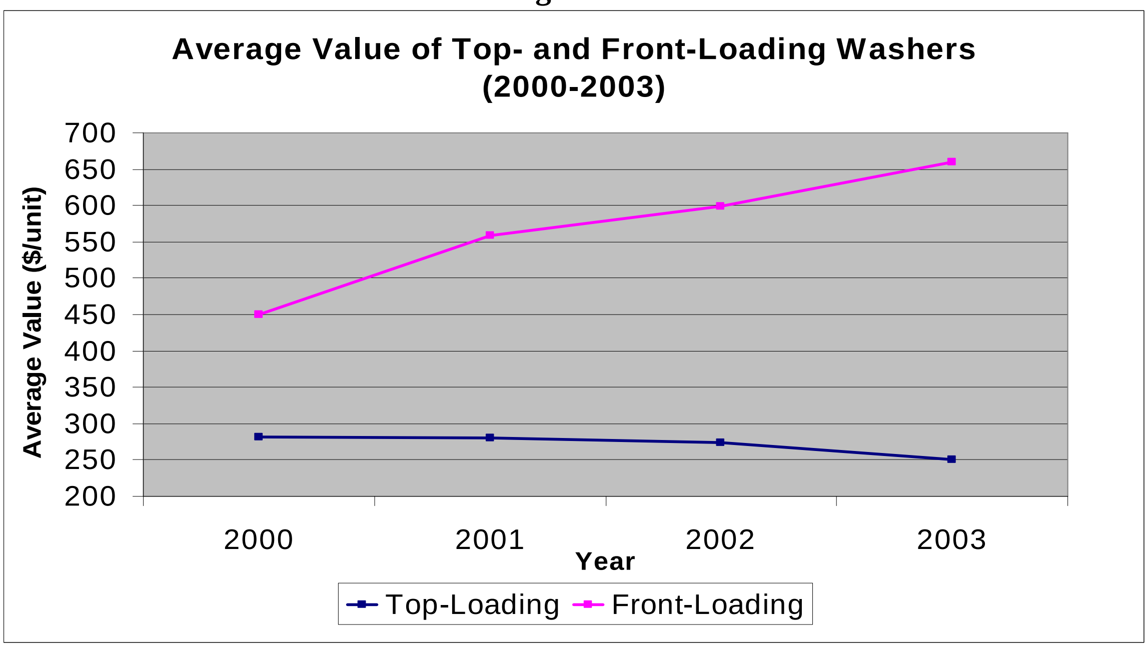
[11] *Brown Shoe v. United States*, 370 U.S. 294 (1962).

[12] The Energy Star label indicates that the machine uses at least 35% less energy than a conventional washer while the high efficiency rating includes not only the Energy Star label, but additional water savings of up to 67%. The Sears website indicates that all front-loading models are Energy Star Compliant and of those models, about 21% are high efficiency. In contrast, only 34% of top-loading units are Energy Star Compliant and of those units, 27% are high efficiency. Sears buying guide information distinguishes between conventional versus "Energy Star" and conventional versus "high efficiency." Online. Available http://www.sears.com/sr/javasr/dpp.do?BV_SessionID=@@@@1615044726.1136869486@@@@&BV_EngineID=cchjaddgjljllfecegecegjdghldghf.0&splash=true&cat=Laundry&vertical=Buying+Guides&ihtoken=1 ("Washer and Dryer Guide").

First, survey data from a number of online sites indicate that prices for top-loaders range in price from about \$300 to \$850 while front-loaders range in price from \$600 to \$1,900.[13] *Consumer Reports* notes that the prices for new-technology top- and front-loading machines range from ". . .about \$800 to \$1,500, at least twice the price of most conventional top-loaders with agitators."[14] Thus, while there is some overlap in prices between the high end of the top loading segment and the low end of the front-loading segment, the price tiers for the two technologies are very different. Moreover, the gap between prices of top-loaders versus front-loaders has widened over time, as shown in Figure 5. For example, prices for top-loaders have declined, on average by about 3% per year from 2000 to 2003 while prices for front-loaders increased on average by about 10% per year. Different price points and ranges for top- versus front-loading washers--much like luxury versus non-luxury automobiles—likely indicate discrete underlying consumer preferences.

Figure 5[15]



Second, consumer preferences for the top-loading versus front-loading models that are likely indicated by pricing data are reinforced by anecdotal evidence. Analysts report, for example, that consumers are increasingly "shopping either at the high or low end,"[16] that interest in design, technology, and styling has fueled demand for high-end machines"[17]

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[13] Based on a survey of Lowes, Sears, and Consumer Reports online offerings or ratings data. This range excludes a very small number (e.g., one or two) non-conventional top-loading machines.
[14] Online. Available. http://www.consumerreports.org/cro/appliances/washing-machines/washing-machines-205/overview.htm. ("Washer Update: A New Spin").
[15] See Association of Home Appliance Manufacturers (AHAM).
[16] Longbow Research, Whirlpool rating, November 4, 2005.
[17] Ibid.

and that high-end appliances are successful, even when positioned on the sales floor next to low-end models.[18]

Third, residential consumers very likely do not make their washer appliance decisions on a life-cycle cost basis, which might otherwise make them indifferent to the top-loading versus front-loading distinction. For example, a number of sources indicate that higher capital costs from high efficiency *non-conventional* top-loading technology and front-loading technology will generate variable cost savings from lower water and energy consumption over the life of the appliance. Sears estimates that washer costs can be recovered in about 8 to 10 years.[19] Arguably, a life-cycle cost approach to the purchase of top- and front-loading washing machines could eliminate the purchase price disparities across the two technologies, leveling their total costs over the consumer's investment horizon.

However, there is a good deal of empirical economic research into consumer investments in energy efficiency that would suggest that a life-cycle cost approach is more the exception than the norm.[20] This research probes into the "efficiency gap" or failure of consumers to avail themselves of cost-effective technologies that reduce energy consumption. Such failures are due to higher perceived risk and irreversibility of the investment, which leads to a higher required rate of return and lower demand price for the appliance or efficiency improvement.[21] From a more pedestrian perspective, *Consumer Reports* implies that consumers go into a washing machine purchase with a particular price point or range in mind—casting some doubt on the applicability of a life-cycle cost approach. For example, they note that if a consumer ". . .plan[s] to spend $1,000 or so, at this point we'd steer you to a front-loader. . ." and that top-loaders would suit the consumer who ". . .want a less expensive machine. . ."[22]

Fourth, differences in market growth for top-loading and front-loading machines reinforce distinct consumer preferences for the new technology in front-loading models. For example, growth in top-loaders has averaged about 2% per year from 1996 to 2004 while growth in front-loaders over the same period has been about 50% per year (Figures 3 and 4).[23] These different growth rates reflect the growing popularity of front-loading technology.

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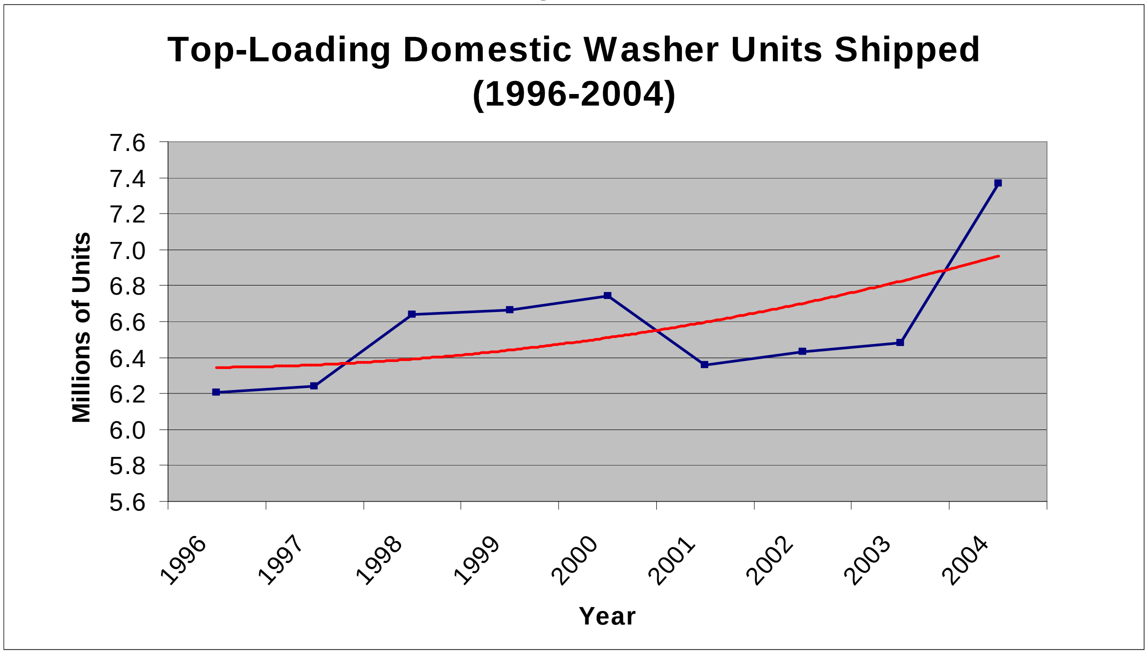
[18] Ibid.
[19] Sears, op. cit., "Washer and Dryer Guide."
[20] Commercial consumers of washers and dryers such as hotels and Laundromats may perform more rigorous cost/benefit analysis before purchasing appliances for institutional use.
[21] See, for example, Philip B. Thompson, 2002, "Consumer Theory, Home Production, and Energy Efficiency," *Contemporary Economic Policy* 20(1), p. 50-59; Adam B. Jaffe, and Robert N. Stavins, 1994. "Energy-Efficiency Investments and Public Policy," *The Energy Journal* 15(2), p. 43-66; and Ronald J. Sutherland, 1991. "Market Barriers to Energy-Efficiency Investments," *The Energy Journal* 12(3), pp. 15-35.
[22] Consumer Reports, "Washers: A Whole New Spin," June 2004. Online. Available http://www.consumerreports.org/cro/appliances/washing-machines/washing-machines-205/overview.htm ("Washers: A Whole New Spin").
[23] See AHAM.

But top-loading washers still constitute the majority of all washer purchases. For example, top-loaders accounted for almost 100% of total domestic washer units shipped in 1996 and 83% in 2004, a large percentage of the market despite strong growth in front-loading technology.[24] In dollar terms, top-loading washers comprised about a $1.6 million market in 2003, as compared to about an $800 million front-loading washer market.[25] In light of their dominance and positive growth in the market, it is clear that top-loaders will retain a foothold in new purchases, replacements, and new residential construction. This is supported by industry analysis. *Consumer Reports* notes, for example, that "Despite the advantages of front-loaders, many American still prefer a top-loading design"[26] and that "[t]raditional top-loaders are still going strong—accounting for about three out of four purchases last year."[27] Sears reports that while "newer front-load washers have gained popularity in recent years with their innovative technologies. . .the tried-and-true top-load washers have also kept pace with the needs of today's consumer."[28]

Figure 3[29]



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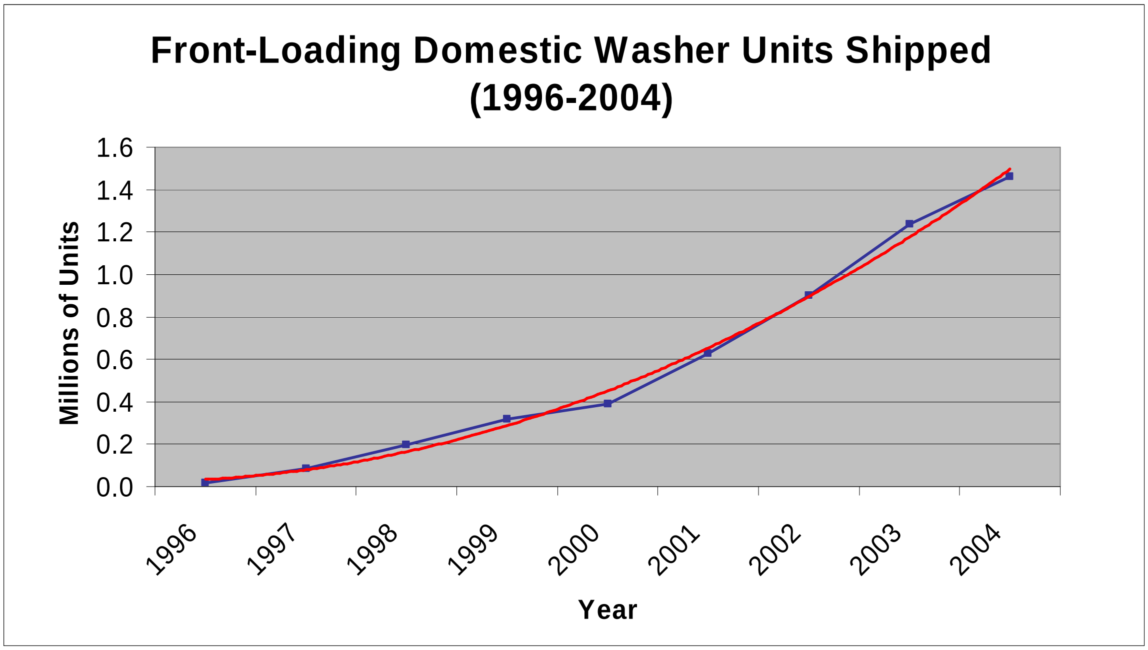
[24] See AHAM. Data collected from online sites, including Sears, Lowes, Home Depot, Best Buy, and the *Consumer Reports* ratings indicate that top-loading washers account for a somewhat smaller percentage of washers (based on about 70% of models available on the market).
[25] See AHAM.
[26] Online. Available http://www.consumerreports.org/cro/appliances/washing-machines/washing-machines/how-to-choose.htm.
[27] Consumer Reports, op. cit., "Washers: A Whole New Spin," June 2004.
[28] Sears, op. cit., "Washer and Dryer Guide."
[29] See AHAM. Trend lines in Figures 3 and 4 are indicated in red.

Figure 4[30]



Based on the foregoing information, it is reasonable to conclude that the top-loading washer market will remain viable in the U.S. for the foreseeable future. It is also unlikely that increases in the price of top-loading washers would be constrained by consumer switching to front-loading models, or vice-versa. The remaining analysis therefore proceeds under the assumption that there are separate product markets for top-loading and front-loading washers.

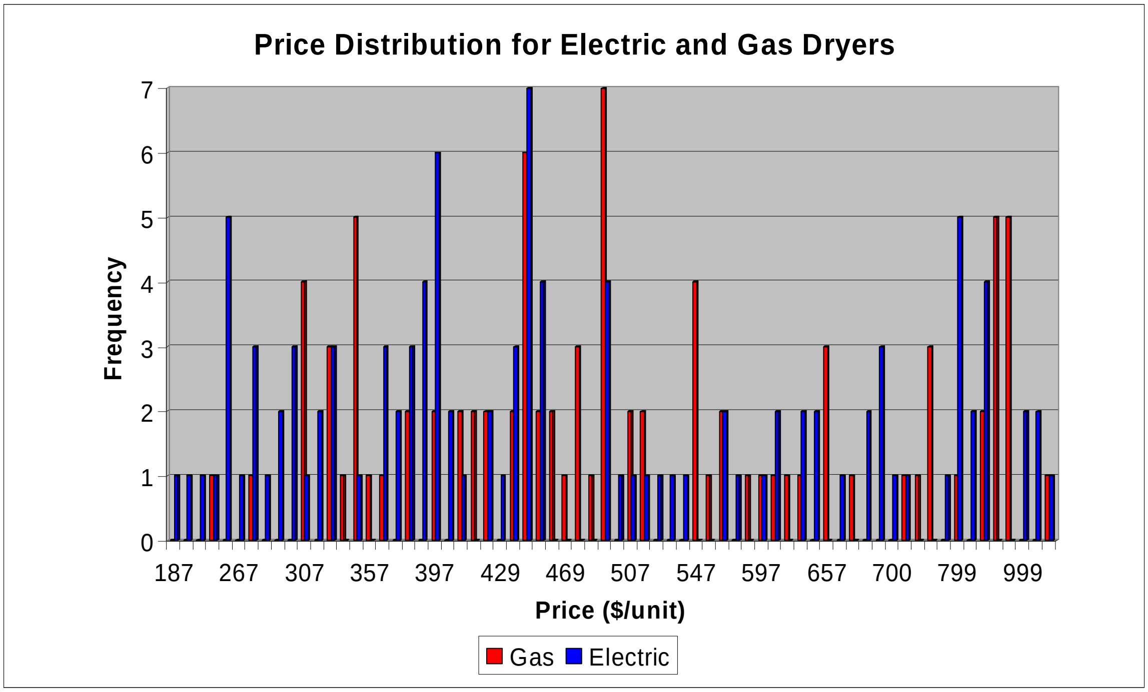
The All-Dryer Market

Clothes dryers sold in the U.S. are distinguished primarily by fuel source and efficiency (e.g., electricity is less efficient that gas), variety of cycles and settings, capacity, styling, and price. Unlike washers, however, where the loading feature is critically important in defining separate product markets, there appear to be no similar distinctions on the dryer side of the laundry business. Consumers may well go into a dryer purchase with some price point or range in mind, but unlike front-loading versus top-loading washers, those ranges do not correspond to any distinct product categories or market segments.

For example, some sources report that gas dryers are more expensive than electric, but a survey of Lowes online data (Figure 6) indicates a relatively uniform dispersion of prices for electric and gas dryers in the range of $200-$1,000. Thus, while dryers, much like washers within each product markets are differentiated according to capacity, styling, and options for various cycles and treatments, it seems reasonable to suggest that there exists a single relevant product market for dryers.

[30] See AHAM.

Figure 6[31]



The Proposed Merger Increases Concentration by an Unacceptable Amount in Highly Concentrated Laundry Markets

The U.S. laundry appliance industry is dominated by four manufacturers—Whirlpool, Maytag, GE, and Electrolux. Of these four, Whirlpool and Maytag are the first and second largest firms. As noted in an earlier section, treatment of the Sears Kenmore brand for the purposes of evaluating the effects of the proposed merger on market structure raises an important issue. Sears' control of retail pricing, marketing, and promotion for Kenmore appliances could arguably temper concerns about the impact on Kenmore consumers of post-merger price increases by the merged firm. But insulation of Kenmore consumers from post-merger price increases hinges importantly on the ability of Sears to exploit competitive pressures in appliance manufacture to obtain the best bid to produce the Kenmore brand. This ability may be limited by two major factors.

First, not all manufacturers are able to meet Kenmore technical specifications. For example, information available to the AAI indicates that Sears is locked-in to Whirlpool for the production of the popular top-loading washer. This is because Whirlpool is the only manufacturer that has the production technology to produce the Kenmore brand to Sears' specifications (e.g., with a porcelain washer tub). Second, not all home appliance manufacturers may have the capacity to supply all or a part of the significant share accounted for by *all* Kenmore washers and dryers. As indicated in Table 2 below, brand

[31] See http://www.lowes.com/lowes/lkn?action=productList&Ne=5000&category=Washers+and+Dryers&N=0+1000083.

shares for Kenmore are close to 30%, a significant portion of the market. Whirlpool's own 2004 Form 10-K notes, for example, that "The Company has been the principal supplier of home laundry appliances to Sears, Roebuck and Co. ("Sears") for over 80 years."[32] Both of these factors have served to narrow the field of possible manufacturers for the Kenmore brand. The proposed merger will narrow this field even more, reducing Sears' ability to control pricing, marketing, and promotion for the Kenmore brand.

Table 2 below shows market shares for the washer and dryer market based on 2005 data. Shares for top-loading versus front-loading are not available. Electric and gas dryer shares have been averaged to obtain an all-dryer market. Severe limitations on the ability of any firm *but* Whirlpool to supply top-loading washers for the Sears Kenmore brand militate in favor of including Kenmore with Whirlpool shares. Shares and concentrations statistics shown in Column 3 are therefore relevant for the top-loading washer market. The AAI believes that the proposed merger should be viewed as combining the first and second largest firms in a 4-to-3 merger for a combined share of 75%, thus eliminating a significant competitor in Maytag. Concentration would increase by 2,332 HHI, for post-merger market concentration of 5,866 HHI.

There are less stringent technology limitations on the production of Kenmore front-loading washers and dryers. However, capacity constraints may still limit the number of manufacturers that are able to supply front-loading washers and dryers. If this condition limits the ability of Sears to retain control over pricing, then market shares that include Kenmore in Whirlpool share may be more appropriate, as shown in Columns 2 and 4. Under this scenario, the effect of the merger on front-loading washers would be the same as for top-loading washers (Column 2). The story is very similar for dryers (Column 4), where the merging firms' combined share is 75%, merger-induced concentration is 2,234 HHI and post-merger concentration is 5,914. If limitations on Sears' control of Kenmore pricing are less severe, then Kenmore shares might be excluded from Whirlpool. In this case, the merger would combine the second and third largest competitors in a 5-to-4 merger for a combined market share of 46% in front-loading washers and 47% in dryers. The merger would increase concentration by 1,056 HHI in the front-loading washer market, for post-merger concentration of 3,141 (Column 3). In the dryer market, concentration would increase by 1,064 HHI, for post-merger concentration of 3,255 HHI (Column 5).

[32] Whirlpool, 2004 Form 10-K, March 4, 2005.

Table 2[33]
Shares and Concentration for U.S. Laundry Markets Resulting from a Whirlpool/Maytag Combination

Firm	Washers (Kenmore included in Whirlpool)	Washers (Kenmore excluded from Whirlpool)	Dryers (Kenmore included in Whirlpool)	Dryers (Kenmore excluded from Whirlpool)
(1)	(2)	(3)	(4)	(5)
Whirlpool	53	24	55	26
Maytag	22	22	20	20
Kenmore	-	28	-	29
GE	13	13	15	15
Electrolux	6	6	5	5
Others	6	6	5	5
Total	100	100	100	100.0
Combined Share	75	46	75	46
Pre-Merger HHI	3,534	2,085	3,680	2,192
Post-Merger HHI	5,866	3,141	5,914	3,255
Change in HHI	2,332	1,056	2,234	1,064

Under either approach to the Kenmore brand (but particularly for top-loading washers) the proposed combination would significantly increase market concentration beyond the thresholds set forth in the *Guidelines* and above levels that normally raise concerns about the unilateral or coordinated post-merger exercise of market power. For front-loading washers and dryers, assuming that *brand* shares are the most accurate for assessing the effect of the proposed merger in relevant markets, the merger produces a firm with almost half the market. In top-loaders and dryers, assuming that *manufacturer* shares are the most accurate, the merger would create a hugely dominant firm with a three-quarters share, leaving a small number of fringe competitors in an extremely highly concentrated post-merger market.

Under either of the foregoing scenarios, the proposed merger would create barriers to entry and stifle the competition that has produced healthy and beneficial innovation in home appliance manufacture for years. One investment analyst, for example, notes that "The laundry appliance buying public has benefited materially from new product innovation, in our opinion, as these two separate appliance makers competed."[34] In the top-loading washer market, which is void of any foreign competition, the merger would occur against a backdrop of no *de novo* entry, quashing the innovation that has heretofore been provided by competition between Whirlpool and Maytag, to the detriment of competition and consumers.

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[33] See Traqline, op. cit. Observations for electric and gas dryers are a weighted average based on online offerings at Lowes (see http://www.lowes.com/lowes/lkn?action=productList&Ne=5000&category=Washers+and+Dryers&N=0+1000083)

[34] Janney Montgomery Scott, LLC. October 21, 2005. "Good Quarter in a Tough Cost Environment."

The Proposed Merger Will Increase the Chances of Unilateral Effects or Anticompetitive Coordination

Section 2 of the *Guidelines* considers whether a merger is likely to lessen competition by enhancing the probability of coordinated interaction or through unilateral effects. Given the high levels of merger-induced and post-merger concentration, the AAI believes that unilateral and coordinated exercise of market power are both very possible outcomes in post-merger markets. In top-loading washers, in particular, the merger would give Whirlpool/Maytag control over about 75% of the market. Single-firm dominance of this magnitude would likely create the ability and incentive for the merged firm to directly raise prices by restricting output. Price increases could also be implemented by the merged company by reducing or eliminating consumer appliance rebate programs or scaling back on retailer support such as trade promotions and price reductions that would ultimately be felt at the consumer level.

Eliminating Maytag as a long-standing competitor will also significantly reduce price competition in various laundry markets, potentially enhancing the opportunity for firms tacitly to coordinate price increases or to collectively scale back on rebate programs. This is particularly true of the top-loading market where GE and Electrolux are the only remaining (and much smaller) competitors. A number of factors would support concerns that post-merger, manufacturers could reach and maintain terms of price coordination.

First, while front-loading and top-loading washers each display some variation with respect to capacity, settings and cycles, and efficiency, they are generally homogeneous products within their relevant markets. Second, riding under the "pricing umbrella" of Whirlpool/Maytag would be enhanced by standardized and predictable pricing in appliances, and readily-available information on non-price terms of sale, sales volumes, demand, market shares, and manufacturing capacity. Third, the ability of firms to quickly match price changes would make price-cutting unprofitable as a short-run strategy. Moreover, threat of retaliation would likely dampen thoughts of aggressive price competition by smaller rivals.

The Proposed Merger Will Increase the Possibility of Strategic Behavior Designed to Exclude Competitors

The proposed merger will enhance the ability of the merged company to engage in strategic behavior involving retail floor space through distribution channels, particularly the Big Box stores. Even a casual trip to a store like Lowes or Home Depot reveals the importance of floor placement and accessibility in selling appliances. A merged Whirlpool/Maytag with half to three-quarters of the laundry markets would wield significant power at the distribution level in obtaining favorable floor space and other retail marketing support for their products (e.g., promotional flyers, signage, etc.). Such category management within laundry appliances—and potentially across appliances—would be greatly enhanced by the merger. In distribution channels that do not currently carry one of the merged companies' products, the effect of the proposed merged would likely be to pressure the distributor to either carry *both* Whirlpool and Maytag products (e.g., through bundled advantages that would be difficult for retailers to turn down) or to lose them entirely.

Although the major distributors of appliances are large and sophisticated buyers, it is difficult to see how such buyer power could counter the significantly greater seller power wielded by a merged Whirlpool/Maytag. Strategic behavior on the part of the merged firm would have the effect of stifling competition from existing and potential small competitors like GE, Electrolux, and the small number of foreign firms that compete in the market. Thus, it is reasonable to expect that post-merger, Whirlpool and Maytag will increase the amount of floor space demanded in contracts, ensuring low visibility and little access to promotional space for smaller brands, thus edging out competitors.
The smaller, independent dealer distribution channel will have even less clout vis-à-vis a merged Whirlpool/Maytag, which will be able to demand more and better floor space, additional marketing support, and fuller product lines.

Entry Can Not be Relied on to Mitigate the Anticompetitive Effects of the Proposed Merger

Despite the presence of some foreign competition in laundry, it remains that *de novo* entry or expansion beyond the de minimus level of the scale and timeliness necessary to overcome the anticompetitive effects of the proposed merger is unlikely. There are a number of compelling reasons for this. First, foreign firms such as LG Electronics and Haier have made some progress in penetrating the front-loading washer and dryer markets in the U.S. in the last few years. However, their market shares continue to be small and likely indicative of pre-existing entry barriers associated with obtaining access to distribution. These include multi-year promotional contracts held by larger incumbent firms and other elements of category management. And while the merger would exacerbate entry barriers for *all* rival manufacturers' (domestic and foreign) by limiting or precluding access to floor space and other marketing tools necessary to compete, it would particularly stunt further market penetration by foreign firms.

Second, there is *no* foreign competition in the top-loading washer market which has been--and continues to be--dominated by domestic firms. The chances of entry by foreign firms in the top-loading washer market are thus virtually nil (unless it occurs via the purchase of Maytag if the Whirlpool combination fails). Even if there were a chance of foreign entry into the manufacture of top-loading washers, relatively small market growth means that an entrant would have to capture share from an entrenched incumbent. This would be more difficult than obtaining a slice of growth in the market.

Third, the role of brand-name loyalty in the appliance industry is particularly strong. One analyst notes, ". . .the [Maytag] brands still enjoy a high level of trust and confidence with the consumer."[35] For new entrants to gain a foothold in a distribution channel or persuade distributors to expand their line requires long lead times. Sears, for example, carries only the top four manufacturers—Whirlpool, Maytag, GE, and Electrolux, in

[35] Longbow, op. cit.

addition to the Kenmore brand. The foregoing factors militate against any effective discipline that entry or expansion by non-domestic firms could provide after the merger.

Any Efficiencies Generated by the Proposed Merger Would Have to be Enormous in Order to Counteract its Anticompetitive Effects

A final component of the analysis set forth in Section 4 of the *Guidelines* is to consider merger-specific efficiencies that may counteract the effect of a proposed merger on lessening competition. Some analysts estimate pre-tax efficiencies that will accrue from the proposed merger by the third year at $300-$400 million.[36] Whirlpool has made public statements to the effect that ". . .consumers will benefit from this transaction through the efficiencies that are unique to this combination. There will be cost savings, increased innovation and quality"[37] and ". . .an acquisition of Maytag by Whirlpool will further enhance an already dynamic competitive environment, and increased efficiency of production in the appliance industry."[38]

The AAI has not had access to any specific information on the efficiencies the merging companies claim will flow from the merger. However, there are several important and interrelated issues raised by an efficiency claim in this case. First, as a general matter, cost-savings in merger cases are often rejected as unsupportable or found by a court to be much less than claimed.[39] Second, any claim that adding Maytag to Whirlpool's operations would generate cost savings should be viewed with some skepticism. Whirlpool is already the low-cost producer and most economies of scale in the industry are presumably at the plant level. It is not clear how combining with Maytag would result in additional economies of scale or scope. Moreover, efficiencies in marketing and distribution associated, for example, with eliminating duplicative purchasing and sales functions may be limited in scope.

Third, any claims that the closure of idle Maytag plants would generate merger-related savings should be closely scrutinized. Excess capacity in the U.S. appliance industry is due in large part to a trend toward increased outsourcing, a problem that would have to be dealt with outside the confines of the merger. Moreover, savings related to shifting production from high-cost Maytag plants (e.g., in Florence, South Carolina) to lower-cost Whirlpool plants would need to be verified. Fourth, even if there were merger-related efficiencies, it would be difficult to understand what incentive a merged Whirlpool/Maytag would have to pass them on to consumers in the form of lower prices when the merged firm would possess significant market power.

Finally, a rigorous analysis must support any efficiencies defense in light of the high market concentration levels induced by the proposed merger. Efficiencies that outweigh the anticompetitive effects of the mergers would therefore have to be very substantial--and lasting. Approval of the proposal merger—if it generates efficiencies that are passed

[36] Janney Montgomery Scott, LLC, op. cit.
[37] Whirlpool, August 22, 2005, Frequently Asked Questions.
[38] Ibid.
[39] See, for example, Federal Trade Commission v. Staples, Inc., No. 97-701 (1997).

on in lower prices only for a limited period of time—would run counter to Section 7 of the Clayton Act.[40] Indeed, Section 4 of the *Guidelines* provides that cognizable efficiencies are most likely to outweigh anticompetitive risk only when concentration levels are low. Thus, the burden is on those that support the transactions to show that they are, on balance, not anticompetitive. In *Heinz*, the FTC and the Court of Appeals stated that this burden was very high indeed when they said: "Nevertheless, the high market concentration levels present in this case require, in rebuttal, proof of extraordinary efficiencies, which the appellees failed to supply."[41]

<u>Conclusion - the Proposed Merger Should not be Allowed to Proceed as Proposed</u>

Based on the best evidence available to us, the AAI believes that a Whirlpool/Maytag combination raises a substantial risk of competitive harm and should not be permitted, at least in its present form. The potential for competitive harm in top-loading washers is particularly severe, but not the only worrisome area. It is possible that a remedy could be fashioned to eliminate the harm caused by the proposed merger. For example, divestiture of the laundry asset(s) to a viable buyer that is no less strong a competitor than Maytag would eliminate competitive concerns associated with merger-induced concentration in top- and front-loading washers and dryers. At a minimum, divestiture of the top-loading laundry business would be necessary to cure anticompetitive effects in that relevant market. In considering remedies for the proposed combination, the AAI encourages the Antitrust Division to adhere to the principles for effective remedy and administrative process recently set forth by the antitrust agencies.[42]

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[40] Experience shows that most pre-merger claims of efficiency turn out to be overstated, with the result that so many mergers fail to deliver the promised goods. See F.M. Scherer, "Some Principles for Post-Chicago Antitrust Analysis," 52 *Case Western Reserve Law Review* 5, 2001.

[41] Federal Trade Commission v. H.J. Heinz Co. and Milnot Holding Corporation, 345 U.S. App. D.C. 364; 246 F. 3d 708; 2001 U.S. App. LEXIS 7735; 2001-1 Trade Cas. (CCH) P73,243. No. 00-5362. Decided April 27, 2001.

[42] U.S. Department of Justice, Antitrust Division, *Antitrust Division Policy Guide to Merger Remedies*, Washington, D.C., October 2004, pp. 7-8. Online. Available http://www.usdoj.gov/atr/public/guidelines/205108.htm#3 and Federal Trade Commission, Bureau of Competition, *A Study of the Commission's Divestiture Process*. Washington, D.C., 1999. Online. Available http://www.ftc.gov/os/1999/08/divestiture.pdf, and Albert A. Foer, "Toward Guidelines for Merger Remedies," *Case Western Law Review* 52, 2001-2002, p. 214.