UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA,

Plaintiff,

v.

ALCOA INC., et al.,

Defendants.

Civil No.: 00-CV-954 (RMU)

Judge: Ricardo M. Urbina

COMPETITIVE IMPACT STATEMENT

The United States, pursuant to Section 2(b) of the Antitrust Procedures and Penalties Act ("APPA"), 15 U.S.C. § 16(b)-(h), files this Competitive Impact Statement relating to the proposed Final Judgment submitted for entry in this civil antitrust proceeding.

I.
NATURE AND PURPOSE OF THE PROCEEDING

On May 3, 2000, the United States filed a civil antitrust Complaint alleging that the proposed acquisition by Alcoa Inc. ("Alcoa") of Reynolds Metals Company ("Reynolds") would, if consummated, violate Section 7 of the Clayton Act, 15 U.S.C. § 18. The Complaint alleges that the proposed merger will substantially lessen competition in the refining and sale of both smelter grade alumina ("SGA"), which is used to produce aluminum ingots, and chemical grade alumina ("CGA" or "hydrate"), an ingredient used in numerous industrial and consumer products. This competition has benefitted consumers through lower prices and higher output. The proposed merger of Alcoa and Reynolds would substantially increase the concentration of SGA and CGA markets. Unless the merger is blocked, the loss of competition will substantially enhance Alcoa's control over the prices of SGA and CGA, while also increasing the likelihood of anticompetitive coordination in the SGA and CGA markets.

The prayer for relief in the Complaint seeks: (1) a judgment that the proposed acquisition would violate Section 7 of the Clayton Act; (2) a permanent injunction preventing Alcoa from acquiring Reynolds; (3) an award to the United States of its costs in bringing the lawsuit; and (4) such other relief as the Court deems proper.

When the Complaint was filed, the United States also filed a proposed settlement that would permit Alcoa to complete its acquisition of Reynolds, but would require divestitures that will preserve competition in the relevant markets. This settlement consists of a Hold Separate Stipulation and Order and a proposed Final Judgment.

The proposed Final Judgment orders Defendants to divest, (1) within two hundred seventy (270) days after the filing of the Complaint in this matter, or five (5) days after notice of entry of the Final Judgment by the Court, whichever is later, all of Reynolds' interest in the Worsley Joint Venture, established by agreement dated February 7, 1980, and subsequently amended ("Worsley Interest"); and (2) within one hundred eighty (180) days after the filing of the Complaint in this matter, or five (5) days after notice of entry of the Final Judgment by the Court, whichever is later, all assets, interests, and rights owned by Reynolds at Reynolds' alumina refinery located near Corpus Christi, Texas, that are used or held for use for alumina refining ("Corpus Christi Assets") (collectively referred to as "the Divestiture Assets") to an acquirer or acquirers acceptable to the Antitrust Division of the Department of Justice ("DOJ").

Until the required divestitures are completed, the terms of the Hold Separate Stipulation and Order entered into by the parties apply to ensure that the Divestiture Assets shall be maintained and operated as independent, ongoing, economically viable, and active competitors in the manufacture and sale of SGA and CGA.

The Plaintiff and Defendants have stipulated that the proposed Final Judgment may be entered after compliance with the APPA. Entry of the proposed Final Judgment would terminate the action, except that the Court would retain jurisdiction to construe, modify, or enforce the provisions of the proposed Final Judgment and to punish violations thereof.

II.
DESCRIPTION OF THE EVENTS GIVING RISE TO THE ALLEGED VIOLATION

A. The Defendants and the Proposed Transaction

Alcoa is a Pennsylvania corporation, with its principal offices located in Pittsburgh, Pennsylvania. Alcoa is the largest integrated aluminum company in the United States and the world with 1999 revenues of over $16 billion. Alcoa engages in all stages of aluminum production, including mining raw aluminum ore ("bauxite"), refining bauxite into alumina powder, smelting alumina into metal ingots, and ultimately fabricating the metal ingots into end products.

Alcoa produces SGA at several facilities around the world. Alcoa owns alumina refineries in Kwinana, Pinjarra, and Wagerup, Western Australia; Pocos de Caldas, Brazil; San Ciprian, Spain; St. Croix, U.S. Virgin Islands; and Pt. Comfort, Texas. Alcoa also manages the operations of three alumina refinery joint ventures in which it has an ownership interest: Paranam, Suriname (55 percent Alcoa ownership); Sao Luis, Brazil (54 percent Alcoa ownership); and Clarendon, Jamaica (50 percent Alcoa ownership). Alcoa produces CGA for North America at its Pt. Comfort refinery.

Reynolds is a Virginia corporation with its principal offices in Richmond, Virginia. Reynolds is the second largest integrated aluminum company in the United States and the third largest in the world with 1999 revenues of over $4.6 billion. Reynolds engages in all stages of aluminum production, including mining bauxite, refining bauxite into alumina powder, smelting alumina into metal ingots, and ultimately fabricating the metal ingots into end products.

Reynolds produces SGA at several facilities around the world. Reynolds owns the Corpus Christi Refinery and owns a 56 percent interest along with operating control of the management of the Worsley refinery. Reynolds also owns a 50 percent interest in a refinery in Stade, Germany, and manages and is entitled to 10 percent of the production of the Friguia, Guinea alumina refinery. Reynolds produces CGA for North America at its Corpus Christi refinery.

On August 18, 1999, Alcoa and Reynolds entered into an agreement under which Alcoa would acquire Reynolds in a stock exchange. This transaction, which would substantially increase concentration in the markets for SGA and CGA, precipitated the government's suit.

B. Affected Markets

1. The World SGA Market

The fabrication of aluminum products begins with the mining of bauxite. Bauxite is processed at refineries to extract alumina. SGA is alumina that is used by aluminum smelters to make aluminum metal. About two-thirds of total SGA production is internally consumed by smelters owned by SGA producers. Surplus SGA refined by vertically integrated firms is sold to third-party purchasers. Some of the third-party purchasers are themselves vertically integrated firms that have a deficit of internal SGA production; other purchasers of SGA are independent smelters with no alumina operations.

There is no product that can be substituted for SGA to make aluminum metal. If aluminum smelters were confronted with a small but significant SGA price increase, smelter owners would have to pay the higher price or close their smelters.

Aluminum smelters purchase alumina from refineries located throughout the world. Alcoa, Reynolds, and other alumina refiners refine and sell SGA throughout the United States and the world.

It is extremely costly and inefficient to shut down a smelting operation; smelters therefore require a stable and steady supply of SGA to maintain production. A small decrease in the supply of SGA will cause a significant increase in the price of SGA (i.e., demand for SGA is highly inelastic). When the July 1999 explosion at Kaiser Aluminum Corporation's Gramercy, Louisiana, refinery removed 2 percent of world alumina capacity, SGA "spot" prices nearly tripled, and long-term SGA contract prices increased 20 percent to 30 percent.

2. The North America CGA Market

Alumina refineries produce two different products -- SGA and CGA. Until the last stage of the refining process, SGA and CGA undergo the identical refining process. At that stage, SGA is calcined in kilns. CGA is removed prior to calcining and sold as "wetcake" or dried and sold as dry hydrate.

CGA is an important ingredient in numerous products such as zeolites (used in detergents), solid surface counter tops, catalysts for oil refineries and auto exhaust systems, white pigments in the paper industry, flame retardants, and water treatment chemicals. Other products are not reasonable substitutes for CGA. If the price of CGA were to increase by a small but significant amount, a significant number of current purchasers are unlikely to switch to alternative products in sufficient numbers to undermine the price increase. In order to substitute another less suitable product, the product in which CGA was used would have to be reformulated, a lengthy and expensive process.

Prices of CGA vary in different regions throughout the world. CGA is sold in North America, and North American producers of CGA compete for sales to customers located throughout North America. Imports of CGA into North America account for less than 5 percent of the CGA sold in North America.

Importation of CGA into North America is unlikely to increase significantly in response to a small but significant anticompetitive increase in the price of CGA in North America. The additional handling of the product that occurs in importing CGA increases the likelihood that it will become contaminated. Also, the costs of freight, handling, and storage are too high to import the product economically in the quantities required by customers in North America.

C. Harm to Competition as a Consequence of the Acquisition

By merging with Reynolds, Alcoa's market share will increase approximately from 29 to 38 percent of world SGA capacity and from 39 to 59 percent of North American CGA production. These increases in market shares will significantly enhance Alcoa's incentive and ability to exercise market power unilaterally by reducing its output in the world SGA and North American CGA markets. Alcoa's increased market shares resulting from the acquisition would give it larger sales bases on which it can profit from the higher prices.

The proposed transaction will also increase the likelihood of anticompetitive coordination among the remaining firms in the world SGA and North American CGA markets. The SGA market has certain characteristics conducive to anticompetitive coordination, including product homogeneity; stable, predictable, and inelastic demand and supply; and transparency of actions by suppliers and customers. The CGA market also has certain characteristics conducive to coordinated interaction, including product homogeneity and high concentration (there are only five producers of CGA in North America and post-merger the top three CGA producers will account for 90 percent of the market).

An increase in output of SGA or CGA in response to anticompetitive price increases is unlikely to be timely or sufficient to undermine the price increases. Firms are currently operating at or near capacity and are expected to continue to do so during at least the next two years. Successful entry through the construction of a new "greenfield" alumina refinery or through the expansion of an existing "brownfield" refinery is slow, costly, and difficult. A minimum efficient scale greenfield refinery could cost $1 billion and take four years or longer from planning to operation. Reynolds' expansion of its Worsley refinery is costing $700 million and was scheduled to take thirty-two months. No company attempted entry or expansion in response to the Gramercy closure despite the significant increase in SGA prices after the closure.

In the world market for SGA and the North American market for CGA, the proposed merger threatens substantial and serious harm to consumers. By substantially increasing Alcoa's market shares of SGA and CGA capacity in the relevant markets, the proposed merger will provide Alcoa with substantially enhanced control over the prices of SGA and CGA, while also increasing the likelihood of anticompetitive coordination in these markets.

The Complaint alleges that the effect of Alcoa's proposed acquisition of Reynolds would be to eliminate actual and potential competition between Alcoa and Reynolds; to lessen substantially competition in the production and sale of SGA and CGA; to increase prices for SGA and CGA; and to decrease the amount of SGA and CGA produced.

III.
EXPLANATION OF THE PROPOSED FINAL JUDGMENT

The provisions of the proposed Final Judgment are designed to eliminate the anticompetitive effects of the acquisition of Reynolds by Alcoa. The divestitures required by the Final Judgment will ensure that competition will continue and be preserved in the SGA and CGA markets. Divestiture of the Divestiture Assets preserves competition because it will restore the world SGA and North American CGA markets to the structures that existed prior to the acquisition and will preserve the existence of independent competitors in these markets.

Divestiture of the Worsley Interest and the Corpus Christi Assets preserves competition in the SGA market by requiring Alcoa to sell virtually all of the world-wide SGA refining capacity owned by Reynolds.[1] Divesting the Corpus Christi Assets also preserves competition in the North American CGA market by requiring Alcoa to sell all of Reynolds' refining capacity used to supply the North American CGA market. Without the divestitures, consumers of SGA and CGA would suffer from higher prices for these products.

The proposed Final Judgment provides that Alcoa must divest, (1) the Worsley Interest within two hundred seventy (270) days after the filing of the Complaint in this matter, or five (5) days after notice of entry of the Final Judgment by the Court, whichever is later; and, (2) the Corpus Christi Assets within one hundred eighty (180) days after the filing of the Complaint in

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[1] Reynolds' relatively small SGA output at its Stade, Germany, refinery will be divested pursuant to an undertaking with the European Commission. After the divestitures required by the European Commission and the proposed Final Judgment, all of the alumina refining capacity owned by Reynolds will have been divested.

this matter, or five days (5) after notice of entry of the Final Judgment by the Court, whichever is later, to an acquirer or acquirers acceptable to the DOJ. The time period for the divestiture of the Worsley Interest is longer than that for the Corpus Christi Assets in order to allow for the exercise of certain rights of Reynolds' co-venturers in the Worsley Joint Venture. The assets to be divested are defined in detail in Section II of the Final Judgment.

The divestitures shall be accomplished by selling or otherwise conveying the Divestiture Assets to a purchaser or purchasers in such a way as to satisfy the United States, in its sole discretion, that the Divestiture Assets can and will be used by the purchaser or purchasers as part of a viable, ongoing business or businesses engaged in the refining and sale of SGA or CGA. The divestitures shall be made to a purchaser or purchasers with respect to whom it is demonstrated to the United States' sole satisfaction that (a) the purchaser or purchasers have the intent to compete effectively in the refining and sale of SGA or CGA and (b) the purchaser or purchasers have the managerial, operational, and financial capability to compete effectively in the refining and sale of SGA or CGA. In addition, none of the terms of any agreement between the purchaser or purchasers and Defendants, including any joint venture, governance, operation, or shareholder agreements, shall give Defendants the ability to limit the purchaser's capacity or output, to raise a purchaser's costs, to lower a purchaser's efficiency, or otherwise to interfere in the ability of the purchaser or purchasers to compete effectively.

If Defendants fail to divest the Divestiture Assets within the prescribed time, a trustee selected by DOJ will be appointed. The Final Judgment provides that Defendants will pay all costs and expenses of the trustee. At the end of six (6) months, if the divestiture has not been accomplished, the trustee and the parties will have the opportunity to make recommendations to the Court, which shall enter such orders as appropriate in order to carry out the purpose of the proposed Final Judgment, including extending the trust or the term of the trustee's appointment.

In connection with the sale of the Divestiture Assets, the Final Judgment permits Defendants to enter certain agreements with the new owner(s) to purchase SGA under two specified circumstances. Neither of the permitted arrangements would give Alcoa any mechanism for limiting SGA output by any new owner of Divestiture Assets. First, the Final Judgment allows, but does not require, Alcoa to negotiate agreements to purchase SGA from the new owner(s) to supply, on a transitional basis, the smelters that Reynolds had previously supplied internally from the Divestiture Assets. Because of the importance of assuring a large, reliable supply of SGA, smelter operators that depend on SGA supplies from an independent source enter long-term contracts for that supply, and often begin negotiations a year or more in advance of the expiration of current contracts. In addition, the chemical characteristics of SGA vary by source, and a smelter must be recalibrated to the specifications of its new SGA supply, a time consuming process. Because the sale of the Divestiture Assets would remove the historical source of captive SGA supply for a number of former Reynolds smelters, the Final Judgment permits Alcoa a transition period to locate new SGA supplies. Any agreement entered pursuant to this provision may have a term of no more than three (3) years, which is significantly shorter than the industry average for SGA supply contracts, and may cover only partial requirements for that period. Volume requirements during the first year may be up to 100 percent of the annual volumes supplied by the divested refineries to such smelters during the year prior to the closing of the merger transaction, up to 75 percent of that volume during the second year, and up to 50 percent during the third year.

Second, the Final Judgment requires Alcoa to divest, as one of the assets included in the Worsley Interest, Reynolds' long-term contractual right to sell SGA to Billiton Plc ("Billiton"). Because Billiton retains a veto over assignment of its contract to the new owner, however, Alcoa may remain the party legally obligated to supply SGA to Billiton. If and only if Billiton exercises its veto, Alcoa may enter an agreement with the new owner of the Worsley Interest to purchase the amount of SGA needed to satisfy Reynolds' existing contractual obligation to Billiton. The Final Judgment requires Alcoa to resell, as an intermediary, any SGA so obtained to Billiton in fulfillment of the existing Reynolds-Billiton contract. By requiring Alcoa to simply pass through this volume of SGA to Billiton, the Final Judgment prevents Alcoa from gaining additional control over SGA output by entering into such an arrangement.

In addition, the Final Judgment requires Defendants to offer the purchaser of the Corpus Christi Assets, at that purchaser's option, a contract for a term of at least two (2) years to supply bauxite to the Corpus Christi Refinery. This requirement may make the Corpus Christi Assets more attractive to purchasers by enabling the purchaser to negotiate supply arrangements for the Corpus Christi Refinery that are substantially similar to existing supply arrangements.

IV.
REMEDIES AVAILABLE TO POTENTIAL PRIVATE LITIGANTS

Section 4 of the Clayton Act, 15 U.S.C. § 15, provides that any person who has been injured as a result of conduct prohibited by the antitrust laws may bring suit in federal court to recover three times the damages the person has suffered, as well as costs and reasonable attorneys' fees. Entry of the proposed Final Judgment will neither impair nor assist the bringing of any private antitrust damage action. Under the provisions of Section 5(a) of the Clayton Act, 15 U.S.C. § 16(a), the proposed Final Judgment has no prima facie effect in any subsequent private lawsuit that may be brought against Defendants.

V. PROCEDURES AVAILABLE FOR MODIFICATION OF THE PROPOSED FINAL JUDGMENT

The United States and Defendants have stipulated that the proposed Final Judgment may be entered by the Court after compliance with the provisions of the APPA, provided that the United States has not withdrawn its consent. The APPA conditions entry upon the Court's determination that the proposed Final Judgment is in the public interest.

The APPA provides a period of at least sixty (60) days preceding the effective date of the proposed Final Judgment within which any person may submit to the United States written comments regarding the proposed Final Judgment. Any person who wishes to comment should do so within sixty (60) days of the date of publication of this Competitive Impact Statement in the Federal Register. The United States will evaluate and respond to the comments. All comments will be given due consideration by the Department of Justice, which remains free to withdraw its consent to the proposed Judgment at any time prior to entry. The comments and the response of the United States will be filed with the Court and published in the Federal Register. Written comments should be submitted to:

Roger W. Fones
Chief, Transportation, Energy & Agriculture Section
Antitrust Division
United States Department of Justice
325 Seventh Street, N.W., Suite 500
Washington, DC 20004

The proposed Final Judgment provides that the Court retains jurisdiction over this action, and the parties may apply to the Court for any order necessary or appropriate for the modification, interpretation, or enforcement of the Final Judgment.

VI. ALTERNATIVES TO THE PROPOSED FINAL JUDGMENT

The United States considered, as an alternative to the proposed Final Judgment, a full trial on the merits against the Defendants.

The United States is satisfied that the divestitures specified in the proposed Final Judgment will preserve viable competition in the manufacture and sale of SGA worldwide and of CGA in North America. Thus, the proposed Final Judgment will achieve all the relief that the United States would have obtained through litigation, but avoids the time, expense, and uncertainty of a full trial on the merits of the Complaint.

VII. STANDARD OF REVIEW UNDER THE APPA FOR PROPOSED FINAL JUDGMENT

The APPA requires that proposed consent judgments in antitrust cases brought by the United States be subject to a sixty-day (60) comment period, after which the court shall determine whether entry of the proposed Final Judgment "is in the public interest." In making that determination, the court may consider --

> (1) the competitive impact of such judgment, including termination of alleged violations, provisions for enforcement and modification, duration or relief sought, anticipated effects of alternative remedies actually considered, and any other considerations bearing upon the adequacy of such judgment;
>
> (2) the impact of entry of such judgment upon the public generally and individuals alleging specific injury from the violations set forth in the complaint

> including consideration of the public benefit, if any, to be derived from a determination of the issues at trial.

15 U.S.C. § 16(e). As the Court of Appeals for the District of Columbia Circuit held, the APPA permits a court to consider, among other things, the relationship between the remedy secured and the specific allegations set forth in the government's complaint, whether the decree is sufficiently clear, whether enforcement mechanisms are sufficient, and whether the decree may positively harm third parties. See United States v. Microsoft, 56 F.3d 1448, 1461-62 (D.C. Cir. 1995).

In conducting this inquiry, "the Court is nowhere compelled to go to trial or to engage in extended proceedings which might have the effect of vitiating the benefits of prompt and less costly settlement through the consent decree process."[2] Rather,

> [a]bsent a showing of corrupt failure of the government to discharge its duty, the Court, in making its public interest finding, should . . . carefully consider the explanations of the government in the competitive impact statement and its responses to comments in order to determine whether those explanations are reasonable under the circumstances.

United States v. Mid-America Dairymen, Inc., 1977-1 Trade Cas. ¶ 61,508, at 71,980 (W.D. Mo. 1977).

Accordingly, with respect to the adequacy of the relief secured by the decree, a court may not "engage in an unrestricted evaluation of what relief would best serve the public." United States v. BNS, Inc., 858 F.2d 456, 462 (9th Cir. 1988), quoting United States v. Bechtel Corp.,

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[2] 119 Cong. Rec. 24598 (1973). See also United States v. Gillette Co., 406 F. Supp. 713, 715 (D. Mass. 1975). A "public interest" determination can be made properly on the basis of the Competitive Impact Statement and Response to Comments filed pursuant to the APPA. Although the APPA authorizes the use of additional procedures, 15 U.S.C. § 16(f), those procedures are discretionary. A court need not invoke any of them unless it believes that the comments have raised significant issues and that further proceedings would aid the court in resolving those issues. See H.R. 93-1463, 93rd Cong. 2d Sess. 8-9, reprinted in (1974) U.S. Code Cong. & Ad. News 6535, 6538.

648 F.2d 660, 666 (9th Cir.), cert. denied, 454 U.S. 1083 (1981); see also, Microsoft, 56 F.3d at 1460-62. Precedent requires that

> [t]he balancing of competing social and political interests affected by a proposed antitrust consent decree must be left, in the first instance, to the discretion of the Attorney General. The court's role in protecting the public interest is one of insuring that the government has not breached its duty to the public in consenting to the decree. The court is required to determine not whether a particular decree is the one that will best serve society, but whether the settlement is "within the reaches of the public interest." More elaborate requirements might undermine the effectiveness of antitrust enforcement by consent decree.[3]

The proposed Final Judgment, therefore, should not be reviewed under a standard of whether it is certain to eliminate every anticompetitive effect of a particular practice or whether it mandates certainty of free competition in the future. Court approval of a final judgment requires a standard more flexible and less strict than the standard required for a finding of liability. "[A] proposed decree must be approved even if it falls short of the remedy the court would impose on its own, as long as it falls within the range of acceptability or is 'within the reaches of public interest.'"[4]

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[3] Bechtel, 648 F.2d at 666 (internal citations omitted) (emphasis added); see BNS, 858 F.2d at 463; United States v. National Broad. Co., 449 F. Supp. 1127, 1143 (C.D. Cal. 1978); Gillette, 406 F. Supp. at 716. See also Microsoft, 56 F.3d at 1461 (whether "the remedies [obtained in the decree are] so inconsonant with the allegations charged as to fall outside of the 'reaches of the public interest'") (citations omitted).

[4] United States v. American Tel. & Tel. Co., 552 F. Supp. 131, 151 (citations omitted) (D.D.C. 1982), aff'd sub nom. Maryland v. United States, 460 U.S. 1001 (1983), quoting Gillette, 406 F. Supp. at 716; United States v. Alcan Aluminum, Ltd., 605 F. Supp. 619, 622 (W.D. Ky. 1985).

VIII.
DETERMINATIVE DOCUMENTS

There are no determinative materials or documents within the meaning of the APPA that were considered by the United States in formulating the proposed Final Judgment.

FOR PLAINTIFF UNITED STATES OF AMERICA:

Dated: June 6th, 2000

Respectfully submitted,

A.K. Rosa

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<u>CERTIFICATE OF SERVICE</u>

I hereby certify that I have caused a copy of the foregoing Competitive Impact Statement to be served on counsel for Defendants in this matter in the manner set forth below:

By first class mail, postage prepaid, and by facsimile:

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