MERGER ANTITRUST LAW

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Georgetown University Law Center
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Tuesdays and Thursdays, 3:30-5:30 pm
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Class 16 (October 29): H&R Block/TaxACT (Unit 10)[1]

In this class, we will deal with how the DOJ satisfied its burden to make out a prima facie case on the element of likely anticompetitive effect and begin to examine the defendants' rebuttal case.

Review the section of the opinion on whether the DOJ has made out its prima facie case (pp. 104-107). This portion of the opinion applies the *Philadelphia National Bank* presumption. Be sure to reread Section 5 of the Horizontal Merger Guidelines, which gives the view of the agencies on how the *PNB* presumption should be implemented. The first two sections of the deck on Anticompetitive Effect in Horizontal Mergers give a quick refresher on the anticompetitive effect element of a Section 7 violation and the *PNB* presumption (slides 4-26). These early parts of the deck should be easy going since for the most part they simply review materials we have already covered. Be sure you have a good sense of how the HHIs work and how the court applied them in the case (slides 15-17).

Also, pay special attention to the last several slides in this section on identifying participants and assigning market shares in relevant markets (slides 27-34) and Sections 5.1 and 5.2 of the Horizontal Merger Guidelines. They explain how the Merger Guidelines take supply-side substitution into account in applying the *PNB* presumption.

The next section of the opinion analyzes the defendants' rebuttal arguments. The way the H&R Block/TaxACT opinion is written is somewhat unique: the court concluded its analysis of the DOJ's prima facie case with nothing more than the *PNB* presumption. It did not go on as does the 2010 DOJ/FTC Horizontal Merger Guidelines and look at other evidence the DOJ presented to bolster the *PNB* presumption. Rather, it flipped the express theory and supporting evidence of anticompetitive harm into the second stage of the *Baker Hughes* burden-shifting paradigm and placed the burden on the defendants of going forward with evidence showing that the coordinated effects and unilateral theories of anticompetitive harm do *not* apply in the case. As far as the evidentiary proceeding was concerned, the flip of the burden did not matter—defendants would have to present evidence creating a genuine issue of material fact on each of the theories in any event (which is the test of the burden of production)—but it does make the placement of the analysis of coordinated and unilateral effects unusual. Subsequent opinions have placed the analysis of coordinated and unilateral effects after the *PNB* presumption in the section analyzing the DOJ's prima facie case (i.e., in the first stage of *Baker Hughes*).

The first rebuttal argument of the defendants is that the likelihood of expansion by existing DDIY companies besides Intuit, HRB, and TaxACT will offset any potential anticompetitive

[1] A reasonable set of the most important filings in the litigation (including the trial transcript) may be found here on AppliedAntitrust.com.

effects from the merger (pp. 107-114). This is an ease of entry/expansion/repositioning defense. In an Economics 101 sense, think of a firm increasing price by restricting its output: if the firm faces a downward-sloping demand curve, then the inframarginal customers who value the product the most will bid up the price to clear the market and eliminate the excess demand at the original, lower price. The ease of entry/expansion/repositioning defense is premised on the ability and incentives of other firms—either new, unrelated entrants into the relevant market (entry), incumbent firms already in the relevant market (expansion), or firms in adjacent markets (repositioning)—expanding output in the relevant market to "fill the hole" in output that the merged firm tried to precipitate. Here, the merging firms argued that the smaller DDIY firms already in the DDIY market (especially TaxHawk and TaxSlayer) would have the ability and incentive to fill the hole, thus eliminating the possibility of a price increase resulting from the merger.

The agencies and the courts treat entry, expansion, and repositioning in the same analytical fashion. The general idea is that the firms in question (either individually or collectively) must have the ability and profit-maximizing incentive to produce additional output to fill the hole. In particular, the Merger Guidelines require—and the courts have followed suit—that the output expansion be:

1. *Timely*, that is, "must be rapid enough to make unprofitable overall" the output reduction in the relevant market that otherwise would have created the increase in prices.
2. *Likely*, that is, sufficiently profitable when compared to alternative courses of action by the third-party firms that the firms have a high probably of actually expanding their output if the merging firms (and any other tacitly coordinating firms) attempted to reduce output in the relevant market, and
3. *Sufficient*, that is, that the magnitude of the timely and likely output expansion by these third-party firms will be enough to fill the hole.

First, read the class slides on entry/expansion/repositioning (slides 36-41), then read Section 9 of the 2010 DOJ/FTC Horizontal Merger Guidelines, and finally read the court's analysis of the defendant's expansion argument and evidence (pp. 107-114).

Finally, we will discuss the coordinated effects theory of anticompetitive harm in horizontal mergers. You will recall that the general idea of coordinated effects is that a reduction in the number of firms in the market resulting from the merger increases the likelihood that the remaining firms will be successful in tacitly coordinating their pricing decisions so as to increase the equilibrium market price. The essential characteristic of the coordinating effects theory is that, in addition to the merging firm, the *other* firms in the market will also increase their prices in the wake of the merger. In this part of the H&R Block case study, we will examine coordinated effects in much more detail than we have yet seen.

First, read the coordinated effects section of the opinion (pp. 114-121) and Section 7 of the Horizontal Merger Guidelines. The class notes supply the most detail. The first few slides on coordinated effects provided some essential foundation (slides 43-44). You should pay careful attention to the slide introducing the structure-conduct-performance hypothesis, which you will recall from our original discussion of *Philadelphia National Bank* formed the basis for the *PNB* presumption (slide 45). You may skim the slides on the Cournot model (slides 47-49), which provide some of the theoretical basis for the profit-concentration hypothesis, but you should at

least be aware of and understand the last formula on slide 49 even if you do not go through its derivation.[2] Pay some attention to the theoretical and empirical criticisms of the profit-concentration hypothesis (a good antitrust lawyer should know what they are) (slides 50-53).

The next group of slides on coordinated effects in the class notes examine the evolution of the coordinated effects theory of anticompetitive from its formal introduction in the 1992 Horizontal Merger Guidelines and the significant revision of the theory in the 2010 Horizontal Merger Guidelines (pp. 54-67). The section ends with an example of the DOJ's challenge to the Tronox/Cristal merger on a coordinated effects theory and some concluding thoughts (slides 68-70).

Note that the role that "maverick" firms play in the coordinated effects theory (pp. 118-121, HMG §§ 2.1.5, 7.1, and slides 71-77). The court treats its maverick analysis as part of the coordinated effects theory. While this is analytically proper, I think that it is more convenient in talking to clients to isolate mavericks in their own separate theory.

Enjoy the reading! Email me if you have any questions.

[2] You saw similar slides on the Cournot model in the unit on basic competition economics—yet another example of the redundancy built into this course.