MERGER ANTITRUST LAW

LAWJ/G-1469-05	Tuesdays and Thursdays, 3:30-5:30 pm
Georgetown University Law Center	Dale Collins
Fall 2022	wdc30@georgetown.edu
	www.appliedantitrust.com

CLASS 11 WRITTEN ASSIGNMENT—INSTRUCTOR'S ANSWER

Instructions

Submit by email by 3:30 pm on Thursday, October 6
Send to wdc30@georgetown.edu
Subject line: Merger Antitrust Law: Assignment for Class 11

Assignment

Calls for a memorandum to a partner (which may be sent to a client).

John Clark, a partner in Able & Baker LLP with whom you work, has asked you to prepare a short memorandum explaining the role of market definition in merger antitrust cases. Clark believes that the relevant geographic market will not be in dispute, so he would like for you to focus on product market definition. Clark understands that the courts typically apply two different tests determining the dimensions of a relevant product market: (1) *the Brown Shoe* "outer boundaries" tests that uses reasonable interchangeablity of use and high cross-elasticity of demand" as factors and which is informed by the *Brown Shoe* "*practical indicia*," and (2) the hypothetical monopolist test under the 2010 DOJ/FTC Horizontal Merger Guidelines. As part of the memorandum, Clark would like for you to describe these two tests so that the client can gain a basic understanding of what they are and how they may apply in practice

ABLE & BAKER LLP

TO: John Clark

FROM: Dale Collins

Product Market Definition Tests

You have asked me to prepare a short memorandum explaining the role of product market definition in merger antitrust analysis and the tests that the courts use to define relevant product markets.

Section 7 of the Clayton Act prohibits acquisitions of stock or acquisitions that "where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly."[1] By its terms, a Section 7 violation contains three essential elements: (1) a relevant product market ("line of commerce"), (2) a relevant geographic market ("section of the country"), and (3) a reasonably probable anticompetitive effect in the relevant market (that is, the combination of the relevant product market and the relevant geographic market). Accordingly, adducing sufficient evidence to make out a relevant product market is an essential element in the proof of a Section 7 violation.

There are two complementary judicial "tests" for whether a particular product grouping—usually called a "candidate" or "provisional" market—is a relevant product market for the purpose of merger antitrust analysis under Section 7: the "outer boundaries" and "practical indicia" test set forth by the Supreme Court in *Brown Shoe Co. v. United States*[2] and the hypothetical monopolist test under the Merger Guidelines.[3] Modern courts typically apply both tests in analyzing market definition. The DOJ and FTC, not surprisingly, look primarily to the hypothetical monopolist test when making prosecutorial decisions, but if they have to prove their case in court, they will also invoke the *Brown Shoe* criteria.

The *Brown Shoe* test. Under *Brown Shoe*, the "outer boundaries" of the relevant product market "are determined by the reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it."[4] Moreover, "within this broad market, well-defined submarkets may exist which, in themselves, constitute product markets for antitrust purposes. The boundaries of such a submarket may be determined by examining such practical indicia as industry or public recognition of the submarket as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers,

[1] 15 U.S.C. § 18.

[2] 370 U.S. 294, 325 (1962).

[3] U.S. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines § 4 (rev. Aug. 19, 2010).

[4] *Brown Shoe*, 370 U.S. at 325.

distinct prices, sensitivity to price changes, and specialized vendors."[5] This list is not exhaustive and courts may use any factors that may be qualitatively probative of the presence or absence of high cross-elasticity of demand. Courts, for example, have used the reputation of a supplier or the product where it is important to customer choice.

The original purpose of the *Brown Shoe* "practical indicia" was to enable the finding of relevant (sub)markets within larger markets defined by the "outer boundaries" test. Modern courts, however, do not view submarkets as any different from markets and regard the *Brown Shoe* "practical indicia" as factors probative of reasonable interchangeability of use and high cross-elasticity of demand.

The hypothetical monopolist test. Under the 2010 Merger Guidelines, the hypothetical monopolist test "requires that a hypothetical profit-maximizing firm, not subject to price regulation, that was the only present and future seller of those products ('hypothetical monopolist') likely would impose at least a small but significant and non-transitory increase in price ('SSNIP') on at least one product in the market, including at least one product sold by one of the merging firms."[6] The idea is that if a hypothetical monopolist—effectively a merger of all firms in the candidate market—would not be able to raise price, then a fortiori a merger of only two firms in the market would not be able to raise prices either by itself unilaterally or in tacit coordination with other firms in the market.

The hypothetical monopolist test was introduced in the 1982 DOJ Merger Guidelines. That version of the test required only that the hypothetical monopolist be able to increase prices profitably by a SSNIP, not that the profit-maximizing increase in price be at least as large as the SSNIP. By contrast, the 2010 Merger Guidelines technically require that the profit-maximizing price of the hypothetical monopolist be equal to or greater than a SSNIP. To illustrate, say, for example, for a SSNIP of 5%, the hypothetical monopolist would make more profits—that is, be more profitable—with the SSNIP than at prevailing prices, but the hypothetical monopolist's profit-maximizing price increase would only by 4.3%, a little less than the SSNIP. In this case, the candidate market would be a relevant market under the profitability test of the 1982 guidelines, but would be rejected as a relevant market under the profit-maximizing test of the 2010 guidelines.

As a practical matter, the difference between the tests is insignificant. The number of cases in which the results would differ is probably small since this requires that the current price be within 5 percent of the monopolist's profit-maximizing price. I have found no case in the case law where the results would differ depending on the formulation used. Moreover, the courts adopted the hypothetical monopolist test during a time when the agencies looked only at whether a SSNIP by a hypothetical monopolist was profitable, not whether the profit-maximizing price was equal to or greater than a SSNIP. As a result, it was the profitability test that entered into the judicial precedent. Although some courts use the profit-maximizing version of the hypothetical monopolist test, most courts still employ the language of the profitability test.[7]

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[5] *Id*. (internal citations and footnotes omitted).

[6] *Id.* § 4.1.1.

[7] Formally, the profit-maximization formulation was adopted in the 1992 DOJ/FTC Horizontal Merger Guidelines, but the agencies did not emphasize the difference until the 2010 Merger Guidelines were released.

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The current 2010 Merger Guidelines also modified the hypothetical monopolist test in two other significant ways.

- First, the hypothetical monopolist test originally only deemed the *smallest* product grouping that satisfied the test to be a relevant market (the "smallest market principle"). Under the 2010 Merger Guidelines, while the smallest market principle remains the preferred approach, a larger market can be used where appropriate to reflect the economic realities.[8]

- Second, the hypothetical monopolist test originally required the hypothetical monopolist to increase the prices of all of the products in the candidate market by the same SSNIP (the "uniform SSNIP test"). Under the 2010 Merger Guidelines, however, the hypothetical monopolist can raise the prices of one or more differentiated products selectively while leaving the prices of the other products unchanged.[9] The hypothetical monopolist test under the 2010 Merger Guidelines requires only that the hypothetical monopolist be able to profitably raise the price of a subgroup within the candidate market—including *single* product in the candidate market—by a SSNIP for the product grouping to be a relevant market, provided that the subgroup contains a product from at least one of the merging firms (the "one-product SSNIP test").[10]

Indeed, in investigations and in their briefs in court, the agencies continued to use the profitability version of the hypothetical monopolist test (probably because it is much easier to understand and implement).

8 **Note to class**: As we will discuss in class, prior to 2010 the agencies on occasion had alleged relevant markets that satisfied the smallest market principle but did not look like any market or product grouping the industry or its customers had ever recognized. Courts tended to hold this departure from the "business realities" against the agency in rejecting the agency's market definition. The 2010 Merger Guidelines rectified this problem by recognizing broader markets to reflect the business realities. The FTC did this, for example, in alleging its market for DDIY tax preparation software in *H&R Block*. The FTC defined the market to include all DDIY tax products, although any two of the three major products satisfied the hypothetical monopolist test and hence the all-DDIY tax products market did not satisfy the smallest market principle.

9 Note that in the absnce of search costs [which we will assume throughout the course], only if the products in the candidate market are differentiated can the market support different prices for different products. If the products are homogeneous (that is, they are all identical), then customers will purchase only on price and consequently will only purchase from the lowest price supplier. This will drive the market to a single price, so that the hypothetical monopolist test must be performed by uniformly increasing all the prices of all product in the candidate market by the SSNIP.

10 *See* U.S. Dep't of Justice & Fed. Trade Comm'n, Hirizontal Merger Guidelines § 4.1.1 (rev. 2010) ("Specifically, the test requires that a hypothetical profit-maximizing firm, not subject to price regulation, that was the only present and future seller of those products ("hypothetical monopolist") likely would impose at least a small but significant and non-transitory increase in price ("SSNIP") *on at least one product in the market, including at least one product sold by one of the merging firms*.") (emphasis added).

The courts have essentially adopted these modifications.[11]

Please let me know if you need more on this or want to discuss it further.

[11] *See, e.g.*, FTC v. RAG-Stiftung, 436 F. Supp. 3d 278, 293 (D.D.C. 2020); FTC v. Wilh. Wilhelmsen Holding ASA, 341 F. Supp. 3d 27, 47 (D.D.C. 2018); United States v. Anthem, Inc., 236 F. Supp. 3d 171, 198 (D.D.C. 2017); United States v. Aetna Inc., 240 F. Supp. 3d 1, 20 (D.D.C. 2017); FTC v. Staples, Inc., 190 F. Supp. 3d 100, 121 (D.D.C. 2016); FTC v. Sysco Corp., 113 F. Supp. 3d 1, 33 (D.D.C. 2015); United States v. H & R Block, Inc., 833 F. Supp. 2d 36, 51-52 (D.D.C. 2011).

Note to class: The one-product SSNIP test introduces a twist into the profit calculus of the hypothetical monopolist. We will cover this in Class 14.