MERGER ANTITRUST LAW

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Tuesdays and Thursdays, 11:10 am – 1:10 pm
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Class 12 (October 5): H&R Block/TaxACT (Unit 9)[1]

Following the analysis of the *Brown Shoe* factors, the court turned to expert testimony on the application of the hypothetical monopolist test. We will spend this class examining the *critical loss* implementation of the hypothetical monopolist test. In the next class, we will explore the implementation of the hypothetical monopolist test through diversion ratio tests.

As noted in the reading guidance for Class 11, the "hypothetical monopolist test," originally introduced by the 1982 Merger Guidelines and now adopted in one form or another by the courts, was designed to introduce some economic sense and analytical rigor into market definition. The HMT deems a product grouping as a relevant market if a hypothetical monopolist of all products in the product group could profitably raise the prices in the product grouping over premerger levels by "a small but significant nontransitory increase in price" (SSNIP), usually taken to be 5% for a period of one year. The idea is that if a hypothetical monopolist of a group of products could not profitably raise their prices, then a fortiori the merged firm—either individually or tacitly with other firms in the market—could not raise prices as a result of the merger.

An expert economist almost always introduces evidence of the HMT's application in a case. More generally, expert testimony is essential in most antitrust cases and in all merger antitrust cases, which makes familiarity with the rules governing expert testimony equally essential. The note on expert evidence gives the basic rules (pp. 182-89). You should read it with some care.

The idea behind critical loss is straightforward. Assume a group of homogeneous products produced by various firms to be tested as a relevant market under the HMT. These firms are competing to some degree, so the market price will be below the profit-maximizing price for a hypothetical monopolist of this product group. If all the firms merge into a hypothetical monopolist, the monopolist could profitably increase its price. But the magnitude of the monopolist's profitable price increase is not unlimited. If the price increase is high enough, so many sales will be lost that the profit loss on the marginal customers will exceed the profit gain on the inframarginal customers, and the monopolist will be worse off than if it charged the original market price. At some point as the price increase from the original price gets larger, the resulting incremental profits will turn from positive to negative. The loss in sales that causes the hypothetical monopolist to break even at a higher price than the original price is called the *critical loss*.

Applied to market definition, if the SSNIP causes an actual loss in sales less than the critical loss for that SSNIP, then the candidate market satisfies the profitability version of the HMT.

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

Conversely, if the SSNIP causes an actual loss in sales greater than the critical loss for that SSNIP, then the SSNIP will not be profitable and the HMT will fail.

The DOJ's expert used a diversion ratio implementation of the hypothetical monopolist test, so we will not spend too much time on the *H&R Block* decision in this class. We will make up the difference with the class notes. Review slides 39-64 on the basic hypothetical monopolist paradigm and its evolution through the various versions of the Merger Guidelines. Slides 95-117 then operationalize the HMT through the notion of *critical loss*.[2] Make sure that you understand all of the examples in the market definition class notes—these illustrate techniques you should know how to apply if given a hypothetical merger. These slides can be challenging but will be well worth your time to understand them.

I have added an excerpt from *FTC v. Tronox* on critical loss (pp. 213-14). It is short and does a nice job explaining the basics of critical loss from a judicial perspective.

Now read pages 105-10 of the *H&R Block* decision. This section starts the court's treatment of the expert economic testimony on market definition. Market definition is an essential element of the plaintiff's prima facie case, so the DOJ's expert analysis comes first. Note that the DOJ's expert did not start his HMT analysis with a candidate market consisting of an overlapping product from one of the merging firms. Rather, he used other, qualitative evidence (of the type probative of the *Brown Shoe* factors) to define an initial candidate market consisting of all DDIY products. As we will see in the next class, he then applied the HMT to that candidate market. This is a common departure from the Merger Guidelines that we will see in judicial opinions.

As we will also see in the next class, if the DOJ's expert had started the analysis with one of the overlapping products, then that product plus either of the other two DDIY would have passed the HMT. Accordingly, all DDIY products is not the smallest relevant market under the HMT. As noted in the last class, the 2010 Merger Guidelines eliminated the smallest market requirement and courts—as here—are increasingly finding larger relevant markets to better fit with industry conceptions of the boundaries of the market.

In Class 13, we will examine product market definition using diversion ratio tests and look at how these tests were applied in *H&R Block*. We will also examine how the defense attempted to refute the DOJ's market definition.

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

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[2] Slides 65-94 adresses market definition topics not presented in *H&R Block*. We will pick them up in later case studies. I thought that students would prefer having one deck that addressed all market definition topics in one place rather than have them scattered over several decks. Let me know if you think if would be better for the class notes to address only those topics presented by the case study.