MERGER ANTITRUST LAW

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Georgetown University Law Center
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Class 12 (October 3): H&R Block/TaxACT (Unit 9)[1]

Following the analysis of the *Brown Shoe* factors, the court turned to expert testimony on applying 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 implementing 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.[2]

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 all merger antitrust cases, making familiarity with the rules governing expert testimony equally essential. The note on expert evidence gives the basic rules (pp. 183-90). You should read it with some care.

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

[2] While the various iterations of the hypothetical monopolist test in the 1982, 1992, and 2010 Merger Guidelines, as well as in the court precedents that followed them, focused exclusively on the ability of the hypothetical monopolist to profitably increase price by a SSNIP, the 2023 Merger Guidelines expanded the test. It now includes not just a price increase but also any significant change in the terms of trade that is adverse to customers (a "SSNIPT"). These nonprice changes may include, for example, changes in product or service quality or the rate or direction of technological innovation. *See* U.S. Dep't of Justice & Fed. Trade Comm'n, Merger Guidelines § 4.3 (rev. Dec. 18, 2023).

Conceptually, an expanded HMT is consistent with the consumer welfare standard in antitrust law, which considers all dimensions of consumer harm, not just price. This change reflects the evolving nature of competition, particularly in some high-tech and other markets where nonprice factors play a critical role. However, two practical problems may limit the use of the expanded test. First, there are few, if any, generally accepted economic models for predicting how a monopolist's profit-maximizing behavior on dimensions other than price and output would differ from that of firms currently operating in the marketplace. Second, while the HMT has a quantitative metric for determining whether a price increase is "significant"—typically 5% over prevailing market prices—there is often no clear metric to measure how adverse a change is in competitive variables other than price and output, much less an accepted quantitative threshold for determining whether the change is "significant." It remains to be seen how useful courts will find this expanded hypothetical monopolist test in practice.

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. However, 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. 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. 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.

In *H&R Block*, the DOJ's expert used a diversion ratio implementation of the hypothetical monopolist test, so we will not spend too much time on the decision in this class. We will make up the difference with the class notes. Review slides 48-75 on the basic hypothetical monopolist paradigm and its evolution through the various versions of the Merger Guidelines. Slides 106-28 then operationalize the HMT through the notion of *critical loss*.[3] Make sure that you understand all of the examples in the market definition class notes—these illustrate techniques you should know how to apply to a hypothetical merger. These slides can be challenging, but the investment of time to understand them will be well worthwhile.

I have added an excerpt from *FTC v. Tronox* on critical loss (pp. 225-26). It is short and does an excellent 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. Instead, 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 are not the smallest relevant market under the HMT. As noted in the last class, the 2010 Merger Guidelines eliminated the smallest market requirement,

[3] Slides 75-105 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.

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.