MERGER ANTITRUST LAW

LAW 1469
Georgetown University Law Center
Fall 2024

Tuesdays and Thursdays, 3:30 pm – 5:30 pm
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CLASS 15 WRITTEN ASSIGNMENT—INSTRUCTOR'S ANSWER

Instructions

Submit by email by 3:30 pm on Thursday, October 17
Send to wdc30@georgetown.edu
Subject line: Merger Antitrust Law: Assignment for Class 15

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

Dianne Lockhart has read your memorandum on coordinated effects. She would now like you to expand the memo to include a description of the unilateral effects theory of anticompetitive harm. As before, she also would like you to address what factors the agencies consider in deciding whether a merger is anticompetitive under the unilateral effects theory.

If you have any questions, send me an email. See you in class.

ABLE & BAKER LLP

INSTRUCTOR'S ANSWER

TO: Dianne Lockhart
FROM: Dale Collins

Unilateral Effects[1]

You have asked me to prepare a brief memorandum explaining the unilateral effects theory of anticompetitive harm under the 2010 Horizontal Merger Guidelines. You also have asked that the memorandum address what factors the agencies and the courts consider in deciding whether a merger is anticompetitive under the unilateral effects theory.

Overview of the theory. Unilateral effects was first introduced in the 1992 DOJ/FTC Horizontal Merger Guidelines and, with modifications, was carried forward into the 2010 Horizontal Merger Guidelines and the 2023 Merger Guidelines. The 2010 Guidelines, which were in effect during much of the time the theory was adopted by the courts, explain:

> A merger between firms selling differentiated products may diminish competition by enabling the merged firm to profit by unilaterally raising the price of one or both products above the premerger level. Some of the sales lost due to the price rise will merely be diverted to the product of the merger partner and, depending on relative margins, capturing such sales loss through merger may make the price increase profitable even though it would not have been profitable prior to the merger.[2]

The 2023 Guidelines state more succinctly:

> A merger eliminates competition between the merging firms by bringing them under joint control. If evidence demonstrates substantial competition between the merging parties prior to the merger, that ordinarily suggests that the merger may substantially lessen competition.[3]

In essence, the unilateral effects theory addresses the elimination of significant "local" competition between the merging firms, allowing the merged entity to raise prices or otherwise act anticompetitively independently of how other competitors inside or outside the market react.[4] The theory holds that the merged firm can increase prices, for example, for a specific group of customers, even if other competitors in the market do not raise their prices. Such a price increase

[1] [**Note to students:** Actually, there are two variations of unilateral effects: (1) recapture unilateral effects and (2) auction unilateral effects. Class 15 focuses on recapture unilateral effects, and Class 17 examines auction unilateral effects.

[2] U.S. Dep't of Justice & Fed Trade. Comm'n, Horizontal Merger Guidelines § 6.1 (Aug. 19, 2010) ("2010 Merger Guidelines).

[3] U.S. Dep't of Justice & Fed Trade. Comm'n, Merger Guidelines § 2.2 (Dec. 18, 2023) ("2023 Merger Guidelines"). Interestingly, the 2023 Guidelines do not use the term "unilateral effects," but it is clear they mean the same concept as the 2010 Guidelines.

[4] United States v. H&R Block, Inc., 833 F. Supp. 2d 36, 81 (D.D.C. 2011) ("A merger is likely to have unilateral anticompetitive effect if the acquiring firm will have the incentive to raise prices or reduce quality after the acquisition, independent of competitive responses from other firms.").

is considered a cognizable anticompetitive effect under Section 7. The theory has been widely accepted by courts.[5]

Key elements in proving unilateral effects. Under the 1992 Merger Guidelines, the unilateral effects theory applied when: (1) the two merging firms were each other's closest competitors, and (2) their combined market share was greater than 35%. The 2010 and 2023 Merger Guidelines relaxed these conditions, requiring only that the firms be close competitors (though not necessarily the closest) and eliminating the 35% market share requirement. In practice, modern courts generally require four elements to prove unilateral effects:

1. *Differentiated products*: The products of the merging firms must be sufficiently differentiated. Differentiation can exist premerger or postmerger, but it is essential for diversion between the products to occur. Without differentiation, the merging firms are less likely to have the power to raise prices profitably.
2. *Close substitutes*: The products of the merging firms must be close substitutes for one another. However, it is not necessary for the merging firms' products to be each other's closest substitutes. It is sufficient that a significant proportion of sales lost by one firm due to a price increase are diverted to the other firm, implying few other close substitutes exist in the market.
3. *Distant substitutes from other firms*: The products of (most) other firms in the market must be sufficiently distant substitutes, allowing the merged firm to profitably raise prices for at least one of its products. This lack of close substitutes prevents customers from turning to non-merging competitors, making the price increase sustainable.
4. *Barriers to entry, expansion, or repositioning*: Entry, expansion, or repositioning by other firms must be sufficiently difficult to prevent them from countering the profitability of the merged firm's price increases postmerger. In other words, if new competitors can quickly enter the market or existing competitors can expand, the merged firm will have less ability to profitably raise prices.

Almost not explicitly addressed in with the Merger Guidelines or the courts, arguably only the first two requirements are part of the plaintiff's prima facie case of unilateral effects and give rise to a rebuttable presumption of unilateral effects. The 2023 Guidelines likely reflect this view, placing the burden of production on the merging parties to adduce evidence negating the third and fourth requirements. Even if adopted by the courts, however, if the merging parties satisfy their burden of production, the burden of persuasion on all four elements will be on the plaintiff.

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[5] *See, e.g.*, ProMedica Health Sys., Inc. v. FTC, 749 F.3d 559, 568-70 (6th Cir. 2014); United States v. JetBlue Airways Corp., 712 F. Supp. 3d 109, 151-52 (D. Mass. 2024); United States v. Bertelsmann SE & Co. KGaA, 646 F. Supp. 3d 1, 38-42 (D.D.C. 2022); FTC v. Peabody Energy Corp., 492 F. Supp. 3d 865, 903-04 (E.D. Mo. 2020); New York v. Deutsche Telekom AG, 439 F. Supp. 3d 179, 237 (S.D.N.Y. 2020); FTC v. RAG-Stiftung, 436 F. Supp. 3d 278, 318-21 (D.D.C. 2020); United States v. Anthem, Inc., 236 F. Supp. 3d 171, 215-20 (D.D.C.), aff'd, 855 F.3d 345 (D.C. Cir. 2017); FTC v. Sysco Corp., 113 F. Supp. 3d 1, 61-65, 67-70 (D.D.C. 2015); United States v. Bazaarvoice, Inc., No. 13-CV-00133-WHO, 2014 WL 203966, at *54 (N.D. Cal. Jan. 8, 2014); H&R Block, 833 F. Supp. at 81-88; FTC v. CCC Holdings Inc., 605 F. Supp. 2d 26, 67-72 (D.D.C. 2009); FTC v. Foster, No. CIV 07-352 JBACT, 2007 WL 1793441, at *27-*31 (D.N.M. May 29, 2007); United States v. Oracle Corp., 331 F. Supp. 2d 1098,1113-23, 1166-73 (N.D. Ca. 2004).

Economics of recapture in unilateral effects. To understand how recapture operates under unilateral effects, consider firm A before the merger. Suppose A raises its price and loses some unit sales (its "marginal sales"). If firm B, a close competitor, captures a significant portion of these lost sales due to its substitutability with A's product, this creates a positive externality for B. A's price increase effectively benefits B by boosting B's profits from the diverted sales.

Premerger, when A maximizes its profits, it ignores this externality.

and maximizes its own profits, so any price increase that reduces its marginal sales would result in a net profit loss. Assuming A was maximizing its profits premerger, then any price increase would decrease A's profitability: the gain of incremental profits on the sales A keeps at the higher price (its "inframarginal sales") will be outweighed by the incremental loss of profits on its foregone marginal sales, for a net profit loss.

However, when firms A and B merge, the combined firm seeks to maximize their joint profits. In the right circumstances, the combined firm can profitably increase the price of firm A's product above its premerger level to some degree, even if all other competitors maintain their prices at their premerger levels. A price increase in A's product is profitable when B's incremental profits on the recaptured sales outweigh A's net profit loss. The ability of the combined firm to increase the price of at least one of the merging firm's products above the premerger level because of the diversion of lost sales to the other merging firm while all other firms hold at their premerger prices is the anticompetitive effect of the recapture unilateral effects theory of anticompetitive harm.

The critical factor in assessing product substitutability is the *proportion of unit sales* lost by firm A that are recaptured by firm B, rather than the total volume of sales lost by A. The inframarginal sales that are retained by A, despite the price increase, will generate additional profits at the higher price, while A will incur profit losses only on the sales it no longer makes (its "marginal sales"). This balance between marginal losses and inframarginal gains is crucial in determining whether the price increase will be profitable for the merged firm.

Additionally, the profit-maximizing price for firm A may differ depending on whether the merged firm can also raise B's price. If both A and B are close substitutes, the optimal strategy often involves a smaller price increase for A and a simultaneous price increase for B. The incremental profits from increasing only A's price represent a lower bound on the merged firm's profit-maximizing potential if both prices are raised.

Beyond price: Other dimensions of anticompetitive harm. Although price is the most common dimension of unilateral effects, the theory extends to other forms of competition. The 2023 Guidelines emphasize that mergers can have anticompetitive unilateral effects along dimensions such as product variety, product features, and innovation.[6] Courts already applied this principle under the 2010 Guidelines. For example, in *H&R Block*, H&R Block produced a free, low-functionality software product restricted to customers with an adjusted gross income below a threshold level alongside a paid, higher-functionality software product. By contrast, TaxACT produced an unrestricted free low-functionality product and a higher-functionality paid product.[7] The court determined that, postmerger, the merged firm could profit by limiting the availability

[6] 2023 Merger Guidelines § 2.2.

[7] Both firms utilized a "freemium" business model, where a free product induced customers to try the firm's product. When the customer desired a higher-functionality product, they would "migrate" to a product extension of the free product offered by the same firm.

of TaxACT's free product, inducing some former TaxACT customers to purchase one of the paid products instead. The recapture unilateral effect arises because the merged firm, in effect, would raise the price to the customers who were no longer eligible to purchase TaxACT's free product and recapture some of the lost sales with the paid products.

If you have any questions or would like to discuss these theories further, please let me know.