MERGER ANTITRUST LAW

Unit 9: H&R Block/TaxACT

Classes 11-15

Professor Dale Collins
Georgetown University Law Center
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DOJ Merger Challenges

FEDERAL COURT INJUNCTIONS

CLAYTON ACT

Clayton Act § 15. Restraining violations; procedure

The several district courts of the United States are invested with jurisdiction to prevent and restrain violations of this Act, and it shall be the duty of the several United States attorneys, in their respective districts, under the direction of the Attorney General, to institute proceedings in equity to prevent and restrain such violations. Such proceedings may be by way of petition setting forth the case and praying that such violation shall be enjoined or otherwise prohibited. When the parties complained of shall have been duly notified of such petition, the court shall proceed, as soon as may be, to the hearing and determination of the case; and pending such petition, and before final decree, the court may at any time make such temporary restraining order or prohibition as shall be deemed just in the premises. Whenever it shall appear to the court before which any such proceeding may be pending that the ends of justice require that other parties should be brought before the court, the court may cause them to be summoned whether they reside in the district in which the court is held or not, and subpoenas to that end may be served in any district by the marshal thereof. [15 U.S.C. § 25]

FEDERAL RULES OF CIVIL PROCEDURE

Rule 65. Injunctions and Restraining Orders

(a) Preliminary Injunction.
- (1) *Notice.* The court may issue a preliminary injunction only on notice to the adverse party.
- (2) *Consolidating the Hearing with the Trial on the Merits.* Before or after beginning the hearing on a motion for a preliminary injunction, the court may advance the trial on the merits and consolidate it with the hearing. Even when consolidation is not ordered, evidence that is received on the motion and that would be admissible at trial becomes part of the trial record and need not be repeated at trial. But the court must preserve any party's right to a jury trial.

(b) Temporary Restraining Order.
- (1) *Issuing Without Notice.* The court may issue a temporary restraining order without written or oral notice to the adverse party or its attorney only if:
  - (A) specific facts in an affidavit or a verified complaint clearly show that immediate and irreparable injury, loss, or damage will result

to the movant before the adverse party can be heard in opposition; and

(B) the movant's attorney certifies in writing any efforts made to give notice and the reasons why it should not be required.

(2) *Contents; Expiration.* Every temporary restraining order issued without notice must state the date and hour it was issued; describe the injury and state why it is irreparable; state why the order was issued without notice; and be promptly filed in the clerk's office and entered in the record. The order expires at the time after entry—not to exceed 14 days—that the court sets, unless before that time the court, for good cause, extends it for a like period or the adverse party consents to a longer extension. The reasons for an extension must be entered in the record.

(3) *Expediting the Preliminary-Injunction Hearing.* If the order is issued without notice, the motion for a preliminary injunction must be set for hearing at the earliest possible time, taking precedence over all other matters except hearings on older matters of the same character. At the hearing, the party who obtained the order must proceed with the motion; if the party does not, the court must dissolve the order.

(4) *Motion to Dissolve.* On 2 days' notice to the party who obtained the order without notice—or on shorter notice set by the court—the adverse party may appear and move to dissolve or modify the order. The court must then hear and decide the motion as promptly as justice requires

(c) Security. The court may issue a preliminary injunction or a temporary restraining order only if the movant gives security in an amount that the court considers proper to pay the costs and damages sustained by any party found to have been wrongfully enjoined or restrained. The United States, its officers, and its agencies are not required to give security.

(d) Contents and Scope of Every Injunction and Restraining Order.

(1) *Contents.* Every order granting an injunction and every restraining order must:

(A) state the reasons why it issued;

(B) state its terms specifically; and

(C) describe in reasonable detail—and not by referring to the complaint or other document—the act or acts restrained or required.

(2) *Persons Bound.* The order binds only the following who receive actual notice of it by personal service or otherwise:

(A) the parties;

(B) the parties' officers, agents, servants, employees, and attorneys; and

(C) other persons who are in active concert or participation with anyone described in Rule 65(d)(2)(A) or (B).

(e) Other Laws Not Modified. These rules do not modify the following:

(1) any federal statute relating to temporary restraining orders or preliminary injunctions in actions affecting employer and employee;
(2) 28 U.S.C. §2361, which relates to preliminary injunctions in actions of interpleader or in the nature of interpleader; or
(3) 28 U.S.C. §2284, which relates to actions that must be heard and decided by a three-judge district court.

(f) Copyright Impoundment. This rule applies to copyright-impoundment proceedings.

Philadelphia National Bank

A NOTE ON *PHILADELPHIA NATIONAL BANK*

In *United States v. Philadelphia National Bank*,[1] one of the most important cases in antitrust law, the Supreme Court held that the plaintiff can make a prima facie showing of the requisite anticompetitive effect of a horizontal acquisition through an evidentiary presumption where the combined share of the merging firms is sufficiently high and the merger significantly increases market concentration:

> [A] merger which produces a firm controlling an undue percentage of the relevant market, and results in a significant increase in the concentration of firms in that market, is so inherently likely to lessen competition substantially that it must be enjoined in the absence of evidence clearly showing that the merger is not likely to have such anticompetitive effects.[2]

The *Philadelphia National Bank* Court did not fix numerical figures for invoking this presumption. In *Philadelphia National Bank* itself, however, the Court found the presumption established when the merging firms combined held over 30% of a relevant market in which the combined market share of the largest two firms increased from 44% to 59%.[3]

On February 25, 1961, the Department of Justice filed a civil suit to enjoin the proposed merger of The Philadelphia National Bank ("PNB") and Girard Trust Corn Exchange Bank ("Girard"). The complaint charged that the acquisition may tend substantially to lessen competition in commercial bank services in the four-county Philadelphia metropolitan region in violation of Section 1 of the Sherman Act and Section 7 of the Clayton Act and sought to enjoin the transaction. PNB was a national bank with assets in excess of $1 billion and the second largest commercial bank in the four-county region. Girard was a state bank with assets of over $750 million and the third largest commercial bank in the area. PNB and Girard, which were both headquartered in Philadelphia, accounted for 21% and 16.1%, respectively, of the total commercial bank deposits in the four-county area.[4] If the merger was consummated, the resulting bank would become the largest in the area, with 37.1% of the area's total

1. 374 U.S. 321 (1963), *rev'g* 201 F. Supp. 348 (E.D. Pa. 1962). For modern commentary on *Philadelphia National Bank*, see, for example, *An Interview with Judge Richard Posner*, 80 ANTITRUST L.J. 205 (2015); Peter C. Carstensen, *The Philadelphia National Bank Presumption: Merger Analysis in an Unpredictable World*, 80 ANTITRUST L.J. 219 (2015); Steven C. Salop, *The Evolution and Vitality of Merger Presumptions: A Decision-Theoretic Approach,* 80 ANTITRUST L.J. 269 (2015); Douglas H. Ginsburg & Joshua D. Wright, *Philadelphia National Bank: Bad Economics, Bad Law, Good Riddance*, 80 ANTITRUST L.J. 377 (2015); Daniel A. Crane, *Balancing Effects across Markets*, 80 ANTITRUST L.J. 397 (2015).
2. *Philadelphia Nat'l Bank*, 374 U.S. at 363.
3. *Id*. at 364.
4. *Philadelphia Nat'l Bank*, 201 F. Supp. at 366.

bank assets.[5] As a result of the merger, the two-firm concentration ratio in total bank assets would rise from 43.9% to 59%, and the four-firm concentration would rise from ___% to 77%.[6]

The government's case at trial was straightforward. The Justice Department relied principally on statistical market share evidence. The Department also introduced testimony by economists and bankers that, notwithstanding the extensive degree of federal and state regulation of the banking industry, there remained substantial areas where product availability, price, and quality were determined by competitive forces; that concentration in commercial banking, which the proposed merger would increase, would reduce these competitive forces; that the "area of the country" in which the competitive effect of the merger would be felt primarily would be the area in which the merging parties had their offices and branches, that is, a four-county area around Philadelphia; and that the relevant "line of commerce" was commercial banking. PNB and Girard responded by introducing contrary evidence on these propositions, as well as evidence that the merger was justified because the resulting bank would be better able to compete with out-of-state (particularly New York) banks, would attract new business to Philadelphia, and would generally promote the economic development of the region.

Philadelphia National Bank Corporate Headquarters

After a trial on the merits, the district court found that commercial banking was a proper relevant product market, but that the four-county metropolitan area was not a relevant geographic market because of competition with other banks for bank business throughout the greater northeastern United States. The district court also found that, even if the four-county region was an appropriate "area of the country" for merger antitrust analysis, there was no reasonable probability that the challenged transaction would substantially lessen competition among commercial banks in that area. Finally, the court found that the merger would economically benefit the Philadelphia metropolitan area. Accordingly, the district court dismissed the complaint.

The government appealed directly to the Supreme Court under the Expediting Act. In a six-to-two decision, the Supreme Court reversed, holding that the merger would violate Section 7 of the Clayton Act, and remanded the case with instructions to the

5. *Id*. For some reason, the Supreme Court's opinion reports this share as 36%. *See* Philadelphia Nat'l Bank, 374 U.S. at 331.

6. *Id*. I have not yet been able to find or calculate the premerger four-firm concentration ratio.

district court to enter judgment enjoining the combination.[7] Justice William J. Brennan, Jr., wrote the opinion for the six-member majority.[8]

Product market definition presented "no difficulty" for the Court. With virtually no analysis, the Court agreed with the district court that "the cluster of products (various kinds of credit) and services (such as checking accounts and trust administration) denoted by the term 'commercial banking' composes a distinct line of commerce."[9] The Court devoted more attention to the question of geographic market definition. Here, the Court departed from the district court's conclusion that the northeastern United States was the relevant area of the country. In an oft-quoted passage, the Court observed that "the proper question" to be asked is "not where the parties to the merger do business or even where they compete, but where, within the area of competitive overlap, the effect of the merger on competition will be direct and immediate."[10] This "area of effective competition" is determined as much by where existing purchasers can turn for supplies as by the trade area in which the parties operate.[11] The Court found that convenience of location is essential in banking and, consequently, that inconvenience localizes competition in banking the same way that high transportation costs localize competition in other industries.[12] The Court then quickly leaped from the statement of these rules to the conclusion that the relevant geographic market was the four-county metropolitan area, where the "vast bulk" of both PNB's and Girard's business originated.

Girard Trust Corn Exchange Bank Main office

Having defined the product and geographic dimensions of the relevant market, the Court turned to the merger's expected effect on competition. The Court observed:

> Clearly, this is not the kind of question which is susceptible of a ready and precise answer in most cases. It requires not merely an appraisal of the immediate impact of the merger upon competition, but a prediction of its impact upon competitive conditions in the future; this is what is meant when it is said that the amended § 7

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7. The Court reserved the question of whether the combination also violated Section 1 of the Sherman Act.

8. Justice John Marshall Harlan, joined by Justice Potter Stewart, dissented. Justice Byron White did not participate.

9. *Philadelphia Nat'l Bank*, 374 U.S. at 356.

10. *Id*. at 357 (citing BETTY BOCK, MERGERS AND MARKETS 42 (1960)).

11. *Id*. at 359 (citing Tampa Electric Co. v. Nashville Coal Co., 365 U.S. 320, 327 (1961)).

12. *Id*. at 358-59 (citing Crystal Sugar Co. v. Cuban-American Sugar Co., 152 F. Supp. 387, 398 (S.D.N.Y. 1957), *aff'd*, 259 F.2d 524 (2d Cir. 1958)).

> was intended to arrest anticompetitive tendencies in their "incipiency." Such a prediction is sound only if it is based upon a firm understanding of the structure of the relevant market; yet the relevant economic data are both complex and elusive. And unless businessmen can assess the legal consequences of a merger with some confidence, sound business planning is retarded. So also, we must be alert to the danger of subverting congressional intent by permitting a too-broad economic investigation. And so in any case in which it is possible, without doing violence to the congressional objective embodied in § 7, to simplify the test of illegality, the courts ought to do so in the interest of sound and practical judicial administration.[13]

Balancing these concerns, the Court concluded that "in certain cases . . . elaborate proof of market structure, market behavior, or probable anticompetitive effects" was unnecessary and unwarranted.[14] Instead, given that the dominant theme motivating the Celler-Kefauver Act was an "intense congressional concern" over "a rising tide of economic concentration in the American economy,"[15] the Court held the requisite anticompetitive effect could be presumed from the changes in the market share distribution:

> Specifically, we think that a merger which produces a firm controlling an undue percentage of the relevant market, and results in a significant increase in the concentration of firms in that market, is so inherently likely to lessen competition substantially that it must be enjoined in the absence of evidence clearly showing that the merger is not likely to have such anticompetitive effects.[16]

The Court noted that this presumption is "fully consonant with economic theory": "That '[c]ompetition is likely to be greatest when there are many sellers, none of which has a significant market share,' is a common ground among most economists, and was undoubtedly a premise of congressional reasoning about the antimerger statute."[17]

Without establishing a hard and fast threshold, the Court held that PNB and Girard's combined market share of "at least 30%" was "undue," and that an increase in the two-firm concentration ratio from 44% to 59% represented a "significant increase" in market concentration, so that the presumptive rule of illegality was

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13. *Id*. at 362 (citations omitted).

14. *Id*. at 363.

15. *Id*.

16. *Id*. (citing United States v. Koppers Co., 202 F. Supp. 437 (W.D. Pa. 1962)).

17. *Id*. (internal citations and footnote omitted). To support the basic economic proposition, the Court cited JOE S. BAIN, BARRIERS TO NEW COMPETITION 27 (1956); CARL KAYSEN & DONALD TURNER, ANTITRUST POLICY 133 (1959); FRITZ MACHLUP, THE ECONOMICS OF SELLERS' COMPETITION 84-93, 333-36 (1952); Derek Bok, *Section 7 of the Clayton Act and the Merging of Law and Economics*, 74 HARV. L. REV. 226, 308-16, 328 (1960); Jesse M. Markham, *Merger Policy under the New Section 7: A Six-Year Appraisal*, 43 VA. L. REV. 489, 521-22 (1957); Edward S. Mason, *Market Power and Business Conduct: Some Comments*, 46 AM. ECON. REV. 471 (1956); George Stigler, *Mergers and Preventive Antitrust Policy*, 104 U. PA. L. REV. 176, 182 (1955). *See Philadelphia Nat'l Bank*, 374 U.S. at 363 nn.38-39, 364 n.41.

triggered.[18] The Court observed in a footnote[19] that Carl Kaysen and Donald Turner recommended in their seminal work that a combined 20% share should be the threshold of prima facie unlawfulness,[20] George Stigler also would employ a 20% threshold,[21] Jesse Markham would use a 25% test,[22] and Derek Bok would look primarily to changes in market concentration of 7% or 8%.[23] The Supreme Court observed that since a 30% combined share presents a "clear" threat to competition, it was unnecessary to specify a minimum threshold and emphasized that mergers resulting in a firm with less than 30% could nonetheless violate Section 7.[24]

Although the *Philadelphia National Bank* Court stressed that a presumption of anticompetitive effect based on market shares was rebuttable, with the acquiescence, if not encouragement, of the Supreme Court, the lower courts rapidly transformed that rather mechanical presumption into a conclusive evidentiary inference. As a result, for years, market definition—from which the market shares and market concentrations would be derived—was the battleground on which antitrust challenges were fought, making *Philadelphia National Bank* the critical case for results, if not theory.

NOTES

1. Richard Posner, Brennan's law clerk during the 1962-63 term, reports that he wrote Brennan's opinion for the majority in *Philadelphia National Bank*.[25] Posner said that Brennan "wasn't very interested in the details of legal analysis, so we law clerks wrote the opinions and he would go over them."[26] While on the Harvard Law Review, Posner had been assigned to cite check a portion of a path-breaking article by Derek Bok entitled *Section 7 of the Clayton Act and the Merging of Law and Economics,* in which Bok had argued for a simplified approach to Section 7 cases.[27] In *Philadelphia*

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18. *Philadelphia Nat'l Bank*, 374 U.S. at 364 ("Without attempting to specify the smallest market share which would still be considered to threaten undue concentration, we are clear that 30% presents that threat.").

19. *Id*. at 364 n.41.

20. CARL KAYSEN & DONALD TURNER, ANTITRUST POLICY 133 (1959).

21. George Stigler, *Mergers and Preventive Antitrust Policy*, 104 U. PA. L. REV. 176, 182 (1955).

22. Jesse M. Markham, *Merger Policy under the New Section 7: A Six-Year Appraisal*, 43 VA. L. REV. 489, 522 (1957).

23. Derek Bok, *Section 7 of the Clayton Act and the Merging of Law and Economics*, 74 HARV. L. REV. 226, 328-29 (1960). Actually, in his published article Bok recommended 5% as a threshold. *Id*.

24. *Philadelphia Nat'l Bank*, 374 U.S. at 364 n.41 ("Needless to say, the fact that a merger results in a less-than-30% market share, or in a less substantial increase in concentration than in the instant case, does not raise an inference that the merger is not violative of § 7.").

25, *See* Interview with Richard Posner, Securities and Exchange Commission Historical Society Oral History Project 2 (Jan. 25, 2011). A fuller account is provided in *An Interview with Judge Richard Posner*, 80 ANTITRUST L.J. 205, 218 (2015).

26. *Id*. at 2.

27. *See* Derek C. Bok, *Section 7 of the Clayton Act and the Merging of Law and Economics*, 74 HARV. L. REV. 226 (1960).

National Bank, Posner incorporated the idea of a simple prima facie showing of anticompetitive effect in what is now known as the *PNB* presumption.[28]

2. The *PNB* presumption, which was not suggested in the briefs of the parties, was based on the price-concentration hypothesis of the structure-conduct-performance paradigm, which at the time was the theory of dominant industrial organization. The idea was that the structure of the market determined the market's performance and that markets performed less efficiently and exhibited higher prices as they became more concentrated (at least past some threshold). In this light, the *PNB* presumption was (implicitly) an effort to stop mergers that would impair economic efficiency and result in higher prices.[29]

3. The *Philadelphia National Bank* Court, however, did not fix any minimum numerical thresholds for invoking the presumption. The Court only said that the combined market share and increase in market concentration in the case were sufficient to trigger the presumption, but held open the possibility that much lower numbers could also predicate the presumption. The Court decided *Philadelphia National Bank* in one of the most restrictive periods in U.S. antitrust history, and that prospect quickly came to pass.

4. In 1966, in one of the more infamous cases in antitrust law, the Supreme Court held that the acquisition by Von's Grocery of Shopping Bag Food Stores satisfied the *PNB* presumption.[30] The merging firms were the third and sixth largest grocery store chains in Los Angeles, although they had market shares of only 4.7% and 4.2%, respectively. While the merger produced the second largest firm in the Los Angeles retail grocery store market with a market share of 8.9%, the market was relatively unconcentrated, with the largest four chains accounting for only 24.4% of total market

[28] After clerking for Justice Brennan, Posner served from 1963 to 1965 as an attorney-advisor to FTC Commissioner Philip Elman. For the next two years, Posner was an assistant to Solicitor General Thurgood Marshall. Posner joined the faculty of the Stanford Law School in 1968 as an associate professor and moved to the University of Chicago Law School as a professor in 1969. In 1981, Posner was nominated by President Ronald Reagan to be a judge on the Court of Appeals for the Seventh Circuit, where he served as chief judge from 1993 to 2000. Judge Posner retired from the federal bench on September 2, 2017. He is currently a Senior Lecturer in Law at the University of Chicago Law School.

[29] Recall from Unit 1 that in 1962 the Supreme Court in *Brown Shoe* had interpreted Section 7 in light of the legislative history of the Celler-Kefauver Amendments to be a guard against "the rising tide of economic concentration in the American economy," the loss of opportunity for small business when competing with large enterprises, and the spread of multistate enterprises and the loss of local control over industry. These are somewhat different concerns than the loss of economic efficiency and higher prices that concentrative mergers may cause under the price-concentration hypothesis. On the other hand, since the *PNB* presumption was—at least at the time of its creation—only a sufficient but not necessary means of proving a prima facie case of anticompetitive effect under Section 7, the fact that the *PNB* presumption was more narrowly based may not have been significant.

30. United States v. Von's Grocery Co., 384 U.S. 270 (1966). Richard Posner, who was then in the Solicitor General's office, successfully argued the case for the United States. For a more detailed summary of the case than the slides provide, see Seminal Cases of the 1960s, at 37 (in the supplemental materials).

sales premerger. In applying the presumption, the Court gave short shrift to the low concentration as measured by the four-firm concentration ratio. Instead, the Court relied heavily on the fact that the number of owners operating single stores in the Los Angeles retail grocery market had decreased from 5,365 in 1950 to 3,818 in 1961, while during roughly the same period, the number of chains with two or more grocery stores increased from 96 to 150, and that both Von's and Shopping Bag were successful firms that had been growing largely through acquisitions. The Court reversed the district court's dismissal of the complaint and remanded the case to the district court with instructions to "order divestiture without delay."

5. The following month, the Court held that the combination of Pabst Brewing and Blatz Brewing triggered the *PNB* presumption with even lower market shares.[31] The merger combined the tenth and eighteenth largest brewers in the country, with national market shares of 3.02% and 1.47%, respectively, and produced the country's fifth largest brewer with a share of 4.49%.[32] Again, the market overall was unconcentrated, but the number of breweries operating in the United States declined from 714 in 1934 to 229 in 1961, and the total number of different competitors selling beer had fallen from 206 in 1957 to 162 in 1961—a "steady trend toward economic concentration" in the words of the Court.[33]

6. Notably, although the *Philadelphia National Bank* presumption was expressly based on the theory that, at least beyond some threshold, increases in market concentration resulted in less efficiently performing markets and higher prices, the Court in *Von's Grocery* and *Pabst* did not cite any economic reasons to believe that the combinations in those cases changed the market structure in ways that would impair economic efficiency and result in higher prices. Instead, the Court appeared to condemn the mergers simply because they each involved successful firms in markets exhibiting a trend toward consolidation, even though the market shares of the merging parties and the level of market concentration were remarkably low. For the moment, at least, Posner's effort to shift the focus of merger antitrust law away from banning mergers that simply created large firms and increased market concentration and toward prohibiting mergers that increased prices and reduced economic efficiency failed.

7. Moreover, although *Philadelphia National Bank* itself regarded the presumption as rebuttable in principle, in application the presumption quickly became conclusive. Moreover, the courts were quite flexible in defining markets and strongly tended to accept the government's alleged markets. Given this flexibility in market definition and the low market shares, the Court found sufficient in *Von's Grocery* and

31. United States v. Pabst Brewing Co., 384 U.S. 546 (1966). For a more detailed summary of the case than the slides provide, see Seminal Cases of the 1960s, at 40.

32. *Id*. at 550-51. The Court also examined shares and market concentration in a three-state area of Wisconsin, Illinois, and Michigan, and the single state of Wisconsin alone. The shares and market concentration were higher in these areas, but as the Court found that the merger presented a Section 7 violation in each geographic area, the national market with the lowest shares and market concentration is the most significant precedentially.

33. *Id*. at 550.

Pabst to predicate the presumption, the *PNB* presumption could be triggered in almost every government case. As a practical matter, horizontal acquisitions by large companies of even small competitors had become per se unlawful.

8. This changed dramatically in 1974 when the Supreme Court decided *General Dynamics*.[34] Not only did the Court return the *PNB* presumption to its rebuttable roots, the Court also brought a new emphasis to the importance of non-market share factors probative of the competitive consequences of horizontal acquisitions. Notwithstanding market shares of 15.1% and 8.1% in the relevant market and a rapidly declining number of industry participants—more than enough to invoke the rule of presumptive illegality under *Von's* and the other post-*Philadelphia National Bank* cases—the Court permitted one coal producer to acquire a controlling interest in another coal producer. The Court found that the acquired company's coal reserves were already committed by long-term contracts to electric utilities at predetermined prices. Lacking a supply of uncommitted coal that could be sold in the future at terms and conditions of the acquired firm's choosing, the Court found that the acquired firm no longer was a significant independent competitive force that could affect prices and output in the marketplace. Accordingly, not only was the presumption of likely anticompetitive effect unreliable in this case, but on the evidence before it, the Court found no likelihood that the acquisition would substantially lessen competition in the future.

9. *General Dynamics* reflects a significant generational shift in the composition of the Court. Of the five members of the majority, not a single one other than Stewart was on the Court for any of the prior antitrust merger cases. On the other hand, except for Marshall—who as the Solicitor General argued vigorously to block or dissolve the mergers in *Von's* and *Pabst*—all of the dissenting justices were present for all of the Court's merger antitrust decisions in the 1960s.

United States v. General Dynamics Corp. (1974)

	President	Sworn In	Replaced
Majority			
Potter Stewart (author)	Eisenhower	Oct. 14, 1958	Harold Burton
Warren E. Burger (C.J.)	Nixon	June 23, 1969	Earl Warren
Harry Blackmun	Nixon	June 9, 1970	Abe Fortas
Lewis F. Powell	Nixon	Jan. 7, 1972	Hugo Black
William Rehnquist	Nixon	Jan. 7, 1972	John M. Harlan
Minority			
William O. Douglas (author)	Roosevelt	Apr. 17, 1939	Louis Brandeis
William J. Brennan, Jr.	Eisenhower	Oct. 16, 1956	Sherman Minton
Byron White	Kennedy	Apr. 16, 1962	Charles E. Whittaker
Thurgood Marshall	Johnson	Oct. 2, 1967	Tom C. Clark

[34] United States v. General Dynamics Corp., 415 U.S. 486 (1974), *aff'g* 341 F. Supp. 534 (N.D. Ill. 1972) (Blue Book No. 1861).

10. Since *General Dynamics,* lower courts increasingly have employed more detailed and flexible qualitative analysis (albeit with varying degrees of theoretical guidance) of the likely competitive effects of proposed horizontal mergers and acquisitions. While concentration statistics continue to be a threshold showing for predicting an acquisition's future competitive effects, plaintiffs today bear more of a burden of demonstrating the probative value of these statistics. Courts have considered a wide variety of factors in assessing the ability of the simple market structure model to predict the likelihood that the acquisition in question will be anticompetitive, including the degree of concentration and the level of sophistication among buyers; volatility in the market share distribution (particularly any trend towards deconcentration); changing demand patterns; the degree of product heterogeneity within the relevant market; the extent of excess industry capacity; the existence of vigorous competition from smaller, but strong and growing, competitors; the ease of entry into the relevant market; volatility in supplier or new customer relationships; a history of innovation from different companies in the market; the financial health of either or both of the parties, the likelihood that the acquired firm will exit the market in the absence of an acquisition; any preacquisition anticompetitive conduct by the parties; and postacquisition continuation of price competition in the market.

Baker-Hughes
Three-Step Burden-Shifting Approach

1. The *Baker Hughes* Three-Step Burden Shifting Approach

UNITED STATES V. BAKER HUGHES INC.
908 F.2d 981, 982, 989-92 (D.C. Cir. 1990)
(excerpt[1])

CLARENCE THOMAS, Circuit Judge

. . .

The basic outline of a section 7 horizontal acquisition case is familiar. By showing that a transaction will lead to undue concentration in the market for a particular product in a particular geographic area, the government establishes a presumption that the transaction will substantially lessen competition. *See United States v. Citizens & Southern Nat'l Bank,* 422 U.S. 86, 120-22 (1975); *United States v. Philadelphia Nat'l Bank,* 374 U.S. 321, 363 (1963). The burden of producing evidence to rebut this presumption then shifts to the defendant. *See, e.g., United States v. Marine Bancorporation,* 418 U.S. 602, 631 (1974); *United States v. General Dynamics Corp.,* 415 U.S. 486, 496-504 (1974); *Philadelphia Bank,* 374 U.S. at 363. If the defendant successfully rebuts the presumption, the burden of producing additional evidence of anticompetitive effect shifts to the government, and merges with the ultimate burden of persuasion, which remains with the government at all times. *See Kaiser Aluminum & Chem. Corp. v. FTC,* 652 F.2d 1324, 1340 & n. 12 (7th Cir.1981).

. . .

III.

Finally, we consider the strength of the showing that a section 7 defendant must make to rebut a prima facie case. The district court simply reviewed the evidence that the defendants presented and concluded that the acquisition was not likely to substantially lessen competition. The government argues that the court erred by failing to require the defendants to make a "clear" showing. *See* Brief for Appellant at 13. The relevant precedents, however, suggest that this formulation overstates the defendants' burden. We conclude that a "clear" showing is unnecessary, and we are satisfied that the district court required the defendants to produce sufficient evidence.

The government's "clear showing" language is by no means unsupported in the case law. In the mid-1960s, the Supreme Court construed section 7 to prohibit virtually any horizontal merger or acquisition. At the time, the Court envisioned an ideal market as one composed of many small competitors, each enjoying only a small market share; the more closely a given market approximated this ideal, the more competitive it was presumed to be. *See United States v. Aluminum Co. of Am.,* 377 U.S. 271, 280 (1964) ("It is the basic premise of [section 7] that competition will be most vital 'when there

[1] Most footnotes omitted.

are many sellers, none of which has any significant market share.'") (quoting *United States v. Philadelphia Nat'l Bank,* 374 U.S. 321, 363 (1963)).

This perspective animated a series of decisions in which the Court stated that a section 7 defendant's market share measures its market power, that statistics alone establish a prima facie case, and that a defendant carries a heavy burden in seeking to rebut the presumption established by such a prima facie case. The Court most clearly articulated this approach in *Philadelphia Bank:*

> Th[e] intense congressional concern with the trend toward concentration [underlying section 7] warrants dispensing, in certain cases, with elaborate proof of market structure, market behavior, or probable anticompetitive effects. Specifically, we think that a merger which produces a firm controlling an undue percentage share of the relevant market, and results in a significant increase in the concentration of firms in that market, is so inherently likely to lessen competition substantially that it must be enjoined in the absence of evidence *clearly showing* that the merger is not likely to have such anticompetitive effects.

374 U.S. at 363 (emphasis added). *Philadelphia Bank* involved a proposed merger that would have created a bank commanding over 30% of a highly concentrated market. While acknowledging that the banks could in principle rebut the government's prima facie case, the Court found unpersuasive the banks' evidence challenging the alleged anticompetitive effect of the merger. *See id.* at 366-72.

In *United States v. Von's Grocery Co.,* 384 U.S. 270 (1966), the Court further emphasized the weight of a defendant's burden. Despite evidence that a post-merger company had only a 7.5% share of the Los Angeles retail grocery market, the Court, citing anticompetitive "trends" in that market, ordered the merger undone. The Court summarily dismissed the defendants' contention that the post-merger market was highly competitive. *Id.* at 277-78. Noting that the market was "marked at the same time by both a continuous decline in the number of small businesses and a large number of mergers," the *Von's Grocery* Court predicted that, if the merger were not undone, the market "would slowly but inevitably gravitate from a market of many small competitors to one dominated by one or a few giants, and competition would thereby be destroyed." *Id.* at 278; *see also United States v. Pabst Brewing Co.,* 384 U.S. 546, 550-52 (1966) (acquisition producing brewer accounting for 4.49% of nationwide beer sales violates section 7; brewer's rebuttal evidence virtually ignored).

Although the Supreme Court has not overruled these section 7 precedents, it has cut them back sharply. In *General Dynamics,* 415 U.S. at 498-504, the Court affirmed a district court determination that, by presenting evidence that undermined the government's statistics, section 7 defendants had successfully rebutted a prima facie case. In so holding, the Court did not expressly reaffirm or disavow *Philadelphia Bank*'s statement that a company must "clearly" show that a transaction is not likely to have substantial anticompetitive effects. The Court simply held that the district court was justified, based on all the evidence, in finding that "no substantial lessening of competition occurred or was threatened by the acquisition." *General Dynamics,* 415 U.S. at 498.

General Dynamics began a line of decisions differing markedly in emphasis from the Court's antitrust cases of the 1960s. Instead of accepting a firm's market share as virtually conclusive proof of its market power, the Court carefully analyzed defendants' rebuttal evidence.[12] These cases discarded *Philadelphia Bank* 's insistence that a defendant "clearly" disprove anticompetitive effect, and instead described the rebuttal burden simply in terms of a "showing." *See, e.g., United States v. Marine Bancorporation,* 418 U.S.602, 631 (1974) (after government established prima facie case, "the burden was then upon appellees *to show* that the concentration ratios, which can be unreliable indicators of actual market behavior, did not accurately depict the economic characteristics of the [relevant] market") (citation omitted) (emphasis added);*United States v. Citizens & Southern Nat'l Bank,* 422 U.S. 86, 120 (1975) (after government established prima facie case, "[i]t was . . . incumbent upon [the defendant] *to show* that the market-share statistics gave an inaccurate account of the acquisitions' probable effects on competition") (emphasis added). Without overruling *Philadelphia Bank,* then, the Supreme Court has at the very least lightened the evidentiary burden on a section 7 defendant. *See generally* Note, 92 Harv. L. Rev. at 491 (describing impact of *General Dynamics* on section 7 jurisprudence).

In the aftermath of *General Dynamics* and its progeny, a defendant seeking to rebut a presumption of anticompetitive effect must show that the prima facie case inaccurately predicts the relevant transaction's probable effect on future competition. *See American Stores,* 872 F.2d at 842 (defendant can rebut prima facie case "through evidence *demonstrating* that statistics on market share, market concentration, and market concentration trends portray inaccurately the merger's probable effects on competition") (emphasis added); *cf. Waste Management,* 743 F.2d at 981 (defendant can rebut prima facie case "by *a demonstration* that the merger will not have anticompetitive effects") (emphasis added). The more compelling the prima facie case, the more evidence the defendant must present to rebut it successfully. A defendant can make the required showing by affirmatively showing why a given transaction is unlikely to substantially lessen competition, or by discrediting the data underlying the initial presumption in the government's favor.

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[12] Judge Posner has elucidated this point:

> The most important developments that cast doubt on the continued vitality of such cases as *Brown Shoe* and *Von's* are found in other cases, where the Supreme Court, echoed by the lower courts, has said repeatedly that the economic concept of competition, rather than any desire to preserve rivals as such, is the lodestar that shall guide the contemporary application of the antitrust laws, not excluding the Clayton Act. . . . Applied to cases brought under Section 7, this principle requires the district court . . . to make a judgment whether the challenged acquisition is likely to hurt consumers, as by making it easier for the firms in the market to collude, expressly or tacitly, and thereby force price above or farther above the competitive level.

Hospital Corp. of Am. v. FTC, 807 F.2d 1381, 1386 (7th Cir.1986), *cert. denied*, 481 U.S. 1038 (1987).

By focusing on the future, section 7 gives a court the uncertain task of assessing probabilities. In this setting, allocation of the burdens of proof assumes particular importance. By shifting the burden of producing evidence, present law allows both sides to make competing predictions about a transaction's effects. If the burden of production imposed on a defendant is unduly onerous, the distinction between that burden and the ultimate burden of persuasion—always an elusive distinction in practice--disintegrates completely. A defendant required to produce evidence "clearly" disproving future anticompetitive effects must essentially persuade the trier of fact on the ultimate issue in the case—whether a transaction is likely to lessen competition substantially. Absent express instructions to the contrary, we are loath to depart from settled principles and impose such a heavy burden. *See Kaiser Aluminum & Chem. Corp. v. FTC,* 652 F.2d 1324, 1340 & n. 12 (7th Cir.1981); *cf. Texas Dep't of Community Affairs v. Burdine,* 450 U.S. 248, 253-56 (1981) (applying similar production-burden-shifting analysis to employment discrimination suits under title VII, and noting that "[t]he ultimate burden of persuading the trier of fact . . . remains at all times with the plaintiff," *id.* at 253, 101 S.Ct. at 1093); 9 J. Wigmore, *Evidence* § 2489, at 300 (J. Chadbourn rev.ed. 1981) (burden of persuasion "never shifts" away from plaintiff).

Imposing a heavy burden of production on a defendant would be particularly anomalous where, as here, it is easy to establish a prima facie case. The government, after all, can carry its initial burden of production simply by presenting market concentration statistics. To allow the government virtually to rest its case at that point, leaving the defendant to prove the core of the dispute, would grossly inflate the role of statistics in actions brought under section 7. The Herfindahl-Hirschman Index cannot guarantee litigation victories. *Cf. Ball Memorial Hosp.,* 784 F.2d at 1336 (explaining that "[m]arket share is just a way of estimating market power, which is the ultimate consideration," and noting that "[w]hen there are better ways to estimate market power, the court should use them"). Requiring a "clear showing" in this setting would move far toward forcing a defendant to rebut a probability with a certainty.

A NOTE ON *BAKER HUGHES*

1. The *Baker-Hughes* three-step burden-shifting approach has been adopted by all modern courts in analyzing horizontal merger challenges under Section 7 of the Clayton Act. This is not too surprising since, apart from its analytical appeal, the opinion was written by a now-Supreme Court Justice Thomas and joined by now Supreme Court Justice Ginsberg..

2. The *Baker-Hughes* approach was also adopted by Judge Richard Leon in his vertical merger analysis of AT&T/Time Warner.[1] Unlike horizontal cases, where *Philadelphia National Bank*[2] provides a rebuttable presumption of likely substantial

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[1] United States v. AT&T Inc., 310 F. Supp. 3d 161 (D.D.C. June 12, 2018) (denying injunction and dismissing complaint in AT&T/Time Warner), *aff'd*, 916 F.3d 1029 (D.C. Cir. Feb. 26, 2019).

[2] United States v. Philadelphia Nat'l Bank, 374 U.S. 321 (1963).

lessening of competition based on the combined firm's market share and changes in the level of market concentration,[3] there are no analogous presumptions in vertical merger cases.[4] Accordingly, Judge Leon sensibly generalized *Baker Hughes* so that the first step requires the plaintiff to prove a prima facie case of likely substantially lessening of competition as a result of the merger by whatever means available the law permits.[5] The D.C. Circuit endorsed Judge Leon's generalized approach:

> Under this framework, the government must first establish a *prima facie* case that the merger is likely to substantially lessen competition in the relevant market. . . . [Since no presumption is available,] [t]he government must make a "fact-specific" showing that the proposed merger is "likely to be anticompetitive." Once the *prima facie* case is established, the burden shifts to the defendant to present evidence that the *prima facie* case "inaccurately predicts the relevant transaction's probable effect on future competition" or to "sufficiently discredit" the evidence underlying the *prima facie* case. Upon such rebuttal, "the burden of producing additional evidence of anticompetitive effects shifts to the government, and merges with the ultimate burden of persuasion, which remains with the government at all times."[6]

3. The *Baker Hughes* approach is grounded in the principle that Section 7 only admits negative defenses to the element of anticompetitive harm. As generalized by Judge Leon and endorsed by the D.C. Circuit, *Baker Hughes* requires the plaintiffs to bear the initial burden of making out a prima facie case of the *gross* anticompetitive effect. I emphasize gross anticompetitive effect here because the plaintiff's burden is only to adduce sufficient evidence to support a finding that the challenged transaction would result in the requisite anticompetitive effect, say under a theory of coordinated or unilateral effects, without considering countervailing effects. So, in the case of a horizontal merger, the plaintiffs can prove their prima facie case of anticompetitive harm by applying the *Philadelphia National Bank* presumption to market shares and concentration statistics, without regard to any countervailing factors.[7] There is no reason why the plaintiffs' burden in the first step should be any greater in proving a prima facie case of anticompetitive harm in the case of a nonhorizontal merger.

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[3] *Id*. at 363 ("Specifically, we think that a [horizontal] merger which produces a firm controlling an undue percentage share of the relevant market, and results in a significant increase in the concentration of firms in that market is so inherently likely to lessen competition substantially that it must be enjoined in the absence of evidence clearly showing that the merger is not likely to have such anticompetitive effects."). In *General Dynamics*, the Supreme Court reaffirmed that the *PNB* presumption was only rebuttable, not conclusive. *See* United States v. General Dynamics Corp., 415 U.S. 486, 497-98 (1974).

[4] *AT&T*, 310 F. Supp. 3d at 192.

[5] *Id*. at 192-93.

[6] *AT&T*, 916 F.3d at 1032 (internal citations omitted); *accord* United States v. UnitedHealth Grp. Inc., No. 1:22-CV-0481 (CJN), 2022 WL 4365867, at *6 (D.D.C. Sept. 21, 2022).

[7] *See* Fed. R. Evid. 301 ("In a civil case, unless a federal statute or these rules provide otherwise, the party against whom a presumption is directed has the burden of producing evidence to rebut the presumption. But this rule does not shift the burden of persuasion, which remains on the party who had it originally.").

4. These countervailing considerations enter into the second step, where the defendants have the burden of production. So, for example, where the plaintiff has made out its prima case of anticompetitive harm through some theory that the challenged conduct will result in significant upward pricing pressure, the defendants can raise the downward pricing pressure resulting from entry, repositioning, countervailing bargaining power, product improvement, cost reductions or other efficiencies as a negative defense to say that the *net* effect of the challenged conduct will not be to raise price. It is important to note that *Baker Hughes* itself is explicit that the defendants only have the burden of production (sometimes called the burden of going forward),[8] which requires the defendants to adduce sufficient evidence to raise a genuine issue for the trier of fact—that is, enough evidence to support a finding in the defendants' favor in light of all of the evidence in the record—whether there would be a likely net anticompetitive effect when these additional considerations are taken into account.[9] While the strength of the plaintiffs' prima facie case determines the quantum of evidence necessary for the defendants to raise a genuine issue (hence the idea of a sliding scale that *Baker Hughes* recognized[10]), as the Supreme Court has stated the burden of production does not require the defendants to prove anything by a preponderance of the evidence.[11]

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[8] United States v. Baker Hughes Inc., 908 F.2d 981, 982 (D.C. Cir. 1990) ("The *burden of producing evidence* to rebut this presumption then shifts [in the second step] to the defendant.") (emphasis added) *accord* FTC v. Sanford Health, 926 F.3d 959, 962-63 (8th Cir. 2019); FTC v. Butterworth Health Corp., No. 96-2440, 1997 WL 420543, at *1 (6th Cir. July 8, 1997) (per curiam) (unpublished); FTC v. Univ. Health, Inc., 938 F.2d 1206, 1219 (11th Cir. 1991); United States v. Aetna Inc., 240 F. Supp. 3d 1, 60 (D.D.C. 2017); FTC v. ProMedica Health Sys., Inc., No. 3:11 CV 47, 2011 WL 1219281, at *53 (N.D. Ohio Mar. 29, 2011); FTC v. Swedish Match, 131 F. Supp. 2d 151, 167 (D.D.C. 2000); California v. Sutter Health Sys., 84 F. Supp. 2d 1057, 1067 (N.D. Cal.), *aff'd*, 217 F.3d 846 (9th Cir. 2000).

[9] *See* Microsoft Corp. v. I4I Ltd. P'ship, 564 U.S. 91, 100 n.4 (2011) (noting that the "burden of production" specifies "which party must come forward with evidence at various stages in the litigation").

[10] *See Baker Hughes*, 908 F.2d at 981 ("The more compelling the prima facie case, the more evidence the defendant must present to rebut it successfully."); *accord* United States v. Anthem, Inc., 855 F.3d 345, 349-50 (D.C. Cir. 2017); Chicago Bridge & Iron Co. N.V. v. FTC, 534 F.3d 410, 426 (5th Cir. 2008); FTC v. H.J. Heinz Co., 246 F.3d 708, 725 (D.C. Cir. 2001); FTC v. Tronox Ltd., 332 F. Supp. 3d 187, 212 (D.D.C. 2018); FTC v. Sysco Corp., 113 F. Supp. 3d 1, 72 (D.D.C. 2015); FTC v. ProMedica Health Sys., Inc., No. 3:11 CV 47, 2011 WL 1219281, at *56 (N.D. Ohio Mar. 29, 2011); FTC v. Foster, No. CIV 07-352 JBACT, 2007 WL 1793441, at *55 (D.N.M. May 29, 2007); FTC v. Arch Coal, Inc., 329 F. Supp. 2d 109, 129 (D.D.C. 2004).

[11] *See* Director, Office of Workers' Comp. Programs, Dep't of Labor v. Greenwich Collieries, 512 U.S. 267, 278 (1994) ("A standard of proof, such as preponderance of the evidence, can apply only to a burden of persuasion, not to a burden of production."). Some merger antitrust opinions say only that the defendants in the second stage have the burden to "rebut" the prima facie case without explicitly noting that the burden is one of production, but even these cases cite the three-step *Baker Hughes* approach and implicitly acknowledge that the burden cannot be so high as the burden of persuasion, since they also say that this burden always rests with the plaintiffs. *See Anthem*, 855 F.3d at 349-50.

5. If the defendants are successful in raising a genuine issue as to anticompetitive effect, then in the third step the burden of persuasion is on the plaintiffs to prove a net anticompetitive effect, all evidence considered. As *Baker Hughes* stated, the ultimate burden of persuasion on the elements of the plaintiffs' prima facie case—which includes the element of net anticompetitive effect—"remains with the [plaintiff] at all times."[12] If the defendants fail to adduce sufficient evidence to rebut the plaintiff's prima facie case (that is, to raise a genuine issue whether the transaction is not likely anticompetitive), the case ends and the plaintiff wins. When the evidence equally favors both sides on each element of the offense, the party that bears the burden of persuasion loses.[13]

6. Thomas modeled his three-step burden-shifting approach in *Baker Hughes* after the Supreme Court's allocation of the burden of proof in *Texas Dep't of Community Affairs v. Burdine*, a Title VII case alleging unlawful disparate treatment.[14] In *Burdine*, the issue was whether the Fifth Circuit correctly held that once the plaintiff in a Title VII case had made out a prima facie case of discrimination, the burden shifts to the defendant to prove by a preponderance of the evidence the existence of legitimate nondiscriminatory reasons for the employment decisions as well as prove that the individuals hired or promoted were better qualified than the plaintiff. The Supreme Court, in a unanimous decision, reversed. In assessing the burden on the plaintiffs to establish a prima facie case in the first step, the Court observed:

> The burden of establishing a prima facie case of disparate treatment is not onerous. The plaintiff must prove by a preponderance of the evidence that she applied for an available position for which she was qualified, but was rejected under circumstances which give rise to an inference of unlawful discrimination. The prima facie case serves an important function in the litigation: it eliminates the most common nondiscriminatory reasons for the plaintiff's rejection. . . . [T]he prima facie case "raises an inference of discrimination only because we presume these acts, if otherwise unexplained, are more likely than not based on the consideration of impermissible factors." Establishment of the prima facie case in effect creates a presumption that the employer unlawfully discriminated against the employee. If the trier of fact believes the plaintiff's evidence, and if the employer is silent in the face of the presumption, the court must enter judgment for the plaintiff because no issue of fact remains in the case.[15]

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[12] *See, e.g.*, *Baker Hughes*, 908 F.2d at 983 ("If the defendant successfully rebuts the presumption, the burden of producing additional evidence of anticompetitive effect shifts [in the third step] to the government, and merges with the ultimate burden of persuasion, which remains with the government at all times."); *accord Anthem*, 855 F.3d at *Sanford Health*, 926 F.3d at 962-63; *Chicago Bridge & Iron*, 534 F.3d at 423; *Heinz*, 246 F.3d at 715; *Butterworth Health*, 1997 WL 420543, at *1; FTC v. Univ. Health, Inc., 938 F.2d 1206, 1219 (11th Cir. 1991).

[13] *See* Microsoft Corp., 564 U.S. at 100 n.4 (noting that the "burden of persuasion" specifies "which party loses if the evidence is balanced").

[14] *See Baker Hughes*, 908 F.2d at 991 (citing Texas Dep't of Cmty. Affairs v. Burdine, 450 U.S. 248, 253-56 1981).

[15] *Burdine*. 450 U.S. at 253-54 (internal citations and footnotes omitted).

Under *Baker Hughes*, the plaintiff in a Section 7 bears an analogous burden: to prove by a preponderance of the evidence that the merger is likely to be anticompetitive in the absent of atypical countervailing factors. The *Burdine* Court's treatment of the defendant's burden in the second step is equally instructive:

> The burden that shifts to the defendant, therefore, is to rebut the presumption of discrimination by producing evidence that the plaintiff was rejected, or someone else was preferred, for a legitimate, nondiscriminatory reason. The defendant need not persuade the court that it was actually motivated by the proffered reasons. It is sufficient if the defendant's evidence raises a genuine issue of fact as to whether it discriminated against the plaintiff.To accomplish this, the defendant must clearly set forth, through the introduction of admissible evidence, the reasons for the plaintiff's rejection. The explanation provided must be legally sufficient to justify a judgment for the defendant.[16]

This is the heart of the *Burdine* decision in rejecting the Fifth Circuit's assignment of the burden of persuasion to the defendant in the second step. In effect, proof of the prima facie case, which considers only a subset of factors probative of intentional discrimination, establishes a rebuttable presumption of unlawful conduct.

7. If the defendant succeeds in raising a genuine issue of fact whether an essential element of the violation is present—intentional discrimination in *Burdine* and anticompetitive effect in Section 7 cases—the burden returns to the plaintiff in the third step, where it merges with the burden of persuasion. This follows "the ordinary default rule that plaintiffs bear the risk of failing to prove their claims" and hence "bear the burden of persuasion regarding the essential aspects of their claims,"[17] a rule that the Court has presumed or held that the default rule applies in a wide variety of cases.[18] The *Burdine* Court has acknowledged that there are exceptions to this rule where the burden of persuasion on certain elements of the plaintiff's claim may be shifted to the defendant, but these elements are typically affirmative defenses.[19] The element of anticompetitive effect is the core of an antitrust violation, and Thomas was correct in applying the default rule on the burden of persuasion to it.

[16] Id. at 254-55 (internal citations and footnotes omitted).

[17] Schaffer *ex rel.* Schaffer v. Weast, 546 U.S. 49, 56, 57 (2005).

[18] *See, e.g.*, Lujan v. Defenders of Wildlife, 504 U.S. 555, 561 (1992) (standing); Cleveland v. Policy Management Systems Corp., 526 U.S. 795, 806 (1999) (Americans with Disabilities Act); Hunt v. Cromartie, 526 U.S. 541, 553 (1999) (equal protection); Wharf (Holdings) Ltd. v. United Int'l Holdings, Inc., 532 U.S. 588, 593 (2001) (securities fraud); Doran v. Salem Inn, Inc., 422 U.S. 922, 931 (1975) (preliminary injunctions); Mt. Healthy City Bd. of Ed. v. Doyle, 429 U.S. 274, 287 (1977) (First Amendment).

[19] *Schaffer*, 546 U.S. at 534.

United States v. H&R Block, Inc

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Exhibit 99.1

News Release

H&R BLOCK ANNOUNCES AGREEMENT TO ACQUIRE TAXACT DIGITAL TAX PREPARATION BUSINESS

- Cash purchase price of $287.5 million
- More than 5 million tax filers used TaxACT solutions last season
- Estimated to add $0.05 to earnings per share if closed by calendar year end

For Immediate Release: Oct. 13, 2010

KANSAS CITY, Mo. — H&R Block (NYSE: HRB) announced today it has signed a definitive merger agreement to acquire all of the outstanding shares of 2SS Holdings, Inc., developer of TaxACT digital tax preparation solutions, for $287.5 million in cash.

The company plans to combine its H&R Block At Home digital business and the acquired TaxACT business, into a single unit led by the TaxACT management team, but continue to offer both brands in the market place.

"This transaction is a significant step for H&R Block in a segment that is strategically important. This will provide us with innovative growth-oriented leadership to accelerate our digital tax offerings and results." said Alan Bennett, president and chief executive officer of H&R Block. "I am looking forward to working with the TaxACT management team on developing our multi-brand digital strategy for the future."

TaxACT has approximately 70 full time associates and is headquartered in Cedar Rapids, Iowa. More than 5 million tax filers used TaxACT last season through online, desktop download and professional software, with the vast majority of those clients filing online.

Lance Dunn, president of TaxACT, said, "The entire team is excited by the opportunity to partner with H&R Block. We are committed to providing a tremendous value for customers by continuing to offer the TaxACT Free Federal Edition."

H&R Block estimates the transaction would add $0.05 to earnings per share in its fiscal year ending April 30, 2011, assuming the transaction closes by the end of the current calendar year. The purchase will be funded by excess available liquidity from cash-on-hand or short-term borrowings. Completion of the transaction is subject to the satisfaction of customary closing conditions, including the expiration of the applicable waiting period under the Hart-Scott-Rodino Act.

Conference Call

At 9 a.m. Eastern time on Thursday, October 14, the company will host a conference call for analysts, institutional investors and shareholders. To access the call, please dial the number below approximately five to ten minutes prior to the scheduled starting time:

U.S./Canada (877) 247-6355 or International (706) 679-0371
Conference ID: 10673363

The call also will be webcast in a listen-only format for the media and public. The link to the webcast can be accessed directly at http://investor-relations.hrblock.com.

A replay of the call will be available beginning at 9:30 a.m. Eastern time on Oct. 14, and continuing until Nov. 5, 2010, by dialing (800) 642-1687 (U.S./Canada) or (706) 645-9291 (International). The conference ID is 10673363. The webcast will be available for replay beginning on Oct.15 at http://investor-relations.hrblock.com

Forward Looking Statements

This announcement may contain forward-looking statements, which are any statements that are not historical facts. These forward-looking statements are based upon the Company's current expectations and there can be no assurance that such expectations will prove to be correct. Because forward-looking statements involve risks and uncertainties and speak only as of the date on which they are made, the Company's actual results could differ materially from these statements. These risks and uncertainties relate to, among other things, uncertainties regarding the Company's ability to attract and retain clients; meet its prepared returns targets; uncertainties and potential contingent liabilities arising from our former mortgage loan origination and servicing business; uncertainties in the residential mortgage market and its impact on loan loss provisions; uncertainties pertaining to the commercial debt market; competitive factors; the Company's effective income tax rate; litigation defense expenses and costs of judgments or settlements; uncertainties regarding the level of share repurchases; and changes in market, economic, political or regulatory conditions. Information concerning these risks and uncertainties is contained in Item 1A of the Company's 2010 annual report on Form 10-K and in other filings by the Company with the Securities and Exchange Commission. The Company does not undertake any duty to update any forward-looking statements, whether as a result of new information, future events, or otherwise.

About H&R Block

H&R Block Inc. (NYSE: HRB) is one of the world's largest tax services providers, having prepared more than 550 million tax returns worldwide since 1955. In fiscal 2010, H&R Block had annual revenues of $3.9 billion and prepared more than 23 million tax returns worldwide, utilizing more than 100,000 highly trained tax professionals. The Company provides tax return preparation services in person, through H&R Block At Home™ online and desktop software products, and through other channels. The Company is also one of the leading providers of business services through RSM McGladrey. For more information, visit our Online Press Center at www.hrblock.com.

For Further Information

Investor Relations: Derek Drysdale, (816) 854-4513, derek.drysdale@hrblock.com
Media Relations: Jennifer Love**,** (816)854-4448, jennifer.love@hrblock.com

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Department of Justice

FOR IMMEDIATE RELEASE
MONDAY, MAY 23, 2011
WWW.JUSTICE.GOV

AT
(202) 514-2007
TDD (202) 514-1888

JUSTICE DEPARTMENT FILES ANTITRUST LAWSUIT TO STOP H&R BLOCK INC. FROM BUYING TAXACT

Deal Would Substantially Reduce Competition in Sale of Digital Do-It-Yourself Tax Preparation Products and Result in Higher Prices and a Reduction in Innovation and Quality

WASHINGTON — The Department of Justice filed a civil antitrust lawsuit today to block the proposed acquisition by H&R Block Inc. of TaxACT, a digital do-it-yourself tax preparation software provider. The department said that the proposed deal would substantially lessen competition in the growing U.S. digital do-it-yourself tax preparation software market, resulting in higher prices and reduced innovation and quality for products that are used annually by millions of American taxpayers.

The Department of Justice's Antitrust Division filed its lawsuit in U.S. District Court in Washington, D.C., to prevent H&R Block from acquiring 2SS Holdings Inc., an entity within TA IX L.P. and the maker of TaxACT.

Between 35 and 40 million taxpayers use digital software products, either on the provider's website or uploaded onto the taxpayers' computers, to prepare and file their federal and state income taxes. Currently, three companies account for 90 percent of all sales of digital do-it-yourself tax preparation products, and the acquisition would combine H&R Block and TaxACT, respectively the second- and third-largest providers of digital do-it-yourself tax preparation products, the department said.

"The combination of H&R Block and TaxACT would likely lead to millions of American taxpayers paying higher prices for digital do-it-yourself tax preparation products," said Christine Varney, Assistant Attorney General in charge of the Department of Justice's Antitrust Division. "In addition, TaxACT has aggressively competed in the digital do-it-yourself tax preparation market with innovations such as free federal filing. If this merger is allowed to proceed, that type of innovation will be lost."

On Oct. 13, 2010, H&R Block agreed to purchase 2SS Holdings in a transaction valued at $287.5 million.

According to the department's complaint, H&R Block's acquisition of 2SS Holdings would eliminate a company that has aggressively competed with H&R Block and disrupted the

U.S. digital do-it-yourself tax preparation market through low pricing and product innovation. By ending the head-to-head competition between TaxACT and H&R Block, American taxpayers would be left with only two major digital do-it-yourself tax preparation providers. This would lead to higher prices, lower quality, and reduced innovation. In addition, by taking control of the TaxACT business, which has been a maverick in the market, it would be easier for H&R Block to coordinate on prices, quality, and other business decisions with the other remaining industry leader – Mountain View, Calif.-based Intuit, which makes personal finance programs such as Quicken and TurboTax – the department said.

The complaint includes statements from H&R Block presentations and emails, such as:

- A primary benefit for H&R Block in acquiring TaxACT is: "Elimination of competitor."

- In discussing the potential acquisition of TaxAct, one of the "[s]trategic [o]pportunities" of the acquisition is: "Acquire TaxACT and eliminate the brand to regain control of industry pricing and further price erosion."

- The rationale for launching the H&R Block's free online product was "[t]o match competitor offerings and stem online share loss to Intuit and TaxACT."

- "Retail volume at Staples [is] at risk due to introduction of TaxACT [r]etail software on combined display."

The department also alleges that by eliminating TaxACT, a significant, disruptive and aggressive competitor, the acquisition would likely substantially lessen competition between H&R Block and Intuit by facilitating coordination between them. H&R Block would likely degrade TaxACT's free product and H&R Block and Intuit would increase the prices for their paid products. An internal H&R Block email said, "The other possible strategic consideration is that Intuit and HRB together would have 84% of the digital market and we both obviously have great incentive to keep this channel profitable."

H&R Block is a Missouri corporation headquartered in Kansas City, Mo. H&R Block is one of the world's largest tax service providers, utilizing more than 100,000 trained tax professionals. The company, with its H&R Block At Home products, is the second largest provider of digital do-it-yourself tax preparation products. In its fiscal year 2010, ending April 30, 2010, H&R Block prepared more than 23 million tax returns worldwide and earned revenues of more than $3.8 billion. Its digital do-it-yourself tax preparation product was used in 2010 by more than 5.9 million customers to prepare and file their federal and state income tax returns.

2SS Holdings, the maker of the TaxACT digital do-it-yourself tax preparation products, is a Delaware corporation headquartered in Cedar Rapids, Iowa. 2SS Holdings is the third-largest digital do-it-yourself tax preparation product provider in the United States, and the second-largest provider of such products online through the Internet. TaxACT products were used in 2010 by more than 5 million customers to prepare and file their federal and state income tax returns.

TA IX L.P. is a limited partnership organized and existing under the laws of Delaware and headquartered in Boston. TA IX L.P. is the majority shareholder of 2SS Holdings.

# # #

11-661

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA,
U.S. Department of Justice
Antitrust Division
450 Fifth Street, NW, Suite 7100
Washington, DC 20530,

Plaintiff,

v.

H&R BLOCK, INC.
One H&R Block Way
Kansas City, MO 64105;

2SS HOLDINGS, INC.
5925 Dry Creek Lane NE
Cedar Rapids, IA 52402; and

TA IX L.P.
John Hancock Tower, 56th Floor
200 Clarendon Street
Boston, MA 02116,

Defendants.

Case: 1:11-cv-00948
Assigned To : Howell, Beryl A.
Assign. Date : 5/23/2011
Description: Antitrust

COMPLAINT

The United States of America, acting under the direction of the Attorney General of the United States, brings this civil action to enjoin the proposed acquisition by Defendant H&R Block, Inc. ("H&R Block") of Defendant 2SS Holdings, Inc. ("TaxACT"), an entity within Defendant TA IX L.P. ("TA"). The United States alleges as follows:

I. INTRODUCTION

1. Last year, approximately 140 million Americans filed their tax returns with the Internal Revenue Service ("IRS"). Increasingly, taxpayers are choosing to prepare their U.S.

federal and state tax returns using digital do-it-yourself tax preparation products ("Digital DIY Tax Preparation Products"), either over the Internet or on their desktop computers. Last year, an estimated 35 to 40 million taxpayers filed their taxes using Digital DIY Tax Preparation Products. In the U.S. Digital DIY Tax Preparation Product market, the three largest firms service approximately 90% of all consumers. H&R Block's proposed acquisition of TaxACT, if allowed to proceed, would combine the second- and third-largest providers in that market and essentially create a duopoly. The proposed acquisition would (1) eliminate aggressive head-to-head competition between H&R Block and TaxACT, and (2) increase the likelihood that the two remaining significant providers would substantially reduce competition through successful coordination; both in violation of Section 7 of the Clayton Act, 15 U.S.C. § 18.

2. TaxACT has aggressively competed with H&R Block in the Digital DIY Tax Preparation Product market for over a decade. That competition has resulted in product innovations and lower prices that have benefitted the millions of U.S. taxpayers who use Digital DIY Tax Preparation Products. The proposed acquisition would remove this competition, resulting in less innovation and higher prices for consumers. H&R Block's internal documents acknowledge that acquiring TaxACT would result in the "[e]limination of [a] competitor," and would allow H&R Block to "regain control of industry pricing and avoid further price erosion."

3. The reason the acquisition would "avoid further price erosion" is that TaxACT has, in its own words, been a "maverick" in the Digital DIY Tax Preparation Product market. Over the years, TaxACT has touted to the public that it is a "catalyst for change" that has "consistently forced the tax preparation industry to become more competitive, and in doing so [has] forced [its] competitors to change as well." These views of TaxACT as a maverick and significant force of change in the market are also shared amongst TaxACT's competitors.

According to H&R Block internal documents, in 2005 TaxACT "disrupted" the entire marketplace by offering all taxpayers the ability to digitally prepare and electronically file ("e-file") their federal returns for free over the Internet. This disruption caused the industry leader, Intuit, Inc. ("Intuit," maker of "TurboTax") and then H&R Block to provide their own free tax preparation and e-file offers. TaxACT has continued its pattern of disrupting H& R Block's and Intuit's businesses by offering products that are functionally comparable to those of H&R Block and Intuit, at comparatively lower prices. Most recently, TaxACT's products have entered the retail (boxed software) segment of the market. Through lower prices and unique offerings at Staples, H&R Block's second-largest retailer, TaxACT has, in H&R Block's own words, put H&R Block's sales volumes in those stores "at risk." With the removal of this maverick from the marketplace, Intuit and H&R Block would be left with a virtual duopoly in which they need not aggressively compete with one another and can more successfully coordinate their pricing and other business actions.

4. For these reasons, as set forth and detailed below, the proposed acquisition violates Section 7 of the Clayton Act, 15 U.S.C. § 18. The United States, therefore, seeks injunctive relief preventing the consummation of the proposed acquisition.

II. JURISDICTION, VENUE, AND COMMERCE

5. This action is filed by the United States under Section 15 of the Clayton Act, 15 U.S.C. § 25, to prevent and restrain the Defendants from violating Section 7 of the Clayton Act, 15 U.S.C. § 18.

6. This Court has subject matter jurisdiction over this action pursuant to Section 15 of the Clayton Act, 15 U.S.C. § 25 and 28 U.S.C. § 1345. This Court also has subject matter jurisdiction pursuant to 28 U.S.C. §§ 1331 and 1337 as H&R Block and TaxACT are engaged in

interstate commerce and in activities substantially affecting interstate commerce. H&R Block and TaxACT sell Digital DIY Tax Preparation Products and related services throughout the United States. H&R Block and TaxACT are engaged in a regular, continuous, and substantial flow of interstate commerce, and their digital DIY tax preparation businesses have had a substantial effect upon interstate commerce.

7. This Court has personal jurisdiction over each Defendant. Defendants H&R Block and TaxACT both transact business and are found within the District of Columbia. This Court has personal jurisdiction over Defendant TA because it transacts business in the District of Columbia through TaxACT, in which it has a two-thirds ownership interest.

8. Venue is proper under Section 12 of the Clayton Act, 15 U.S.C. § 22, and 28 U.S.C. § 1391(b) and (c).

III. THE DEFENDANTS AND THE TRANSACTION

9. H&R Block is a corporation organized and existing under the laws of Missouri, with its headquarters located in Kansas City, Missouri. H&R Block claims that it prepares 1 in every 7 tax returns filed in the United States and has a brick-and-mortar assisted tax preparation office within 5 miles of most Americans. H&R Block's digital DIY products, called "H&R Block At Home" (formerly called "TaxCut"), were used to file approximately 5.9 million U.S. individual federal tax returns in 2010. H&R Block is the second-largest provider of Digital DIY Tax Preparation Products, behind Intuit. These digital products are an increasingly important source of business for H&R Block.

10. 2SS Holdings, Inc. is a corporation organized and existing under the laws of Delaware and headquartered in Cedar Rapids, Iowa. 2SS Holdings, Inc.'s products are currently sold as, and referred to by the industry under the brand, "TaxACT." TaxACT's products were

used to file approximately 5.2 million U.S. individual federal tax returns last year. TaxACT is the third-largest Digital DIY Tax Preparation Product provider in the United States and the second-largest provider of such products through the online channel.

11. In 2004, the private equity firm TA made a significant investment in 2SS Holdings, Inc. As a result, Defendant TA IX L.P., a limited partnership organized and existing under the laws of Delaware and headquartered in Boston, Massachusetts, now holds approximately a two-thirds interest in TaxACT. TaxACT executives and employees retain the approximate other one-third interest.

12. On October 13, 2010, H&R Block, 2SS Holdings, Inc., and the TaxACT shareholders entered into an Agreement and Plan of Merger, pursuant to which H&R Block would ultimately acquire TaxACT for approximately $287.5 million in cash.

IV. THE RELEVANT MARKET

A. Description of the Product

13. With the rise of the Internet and personal computer usage, in the 1990s, several companies began to offer consumers a unique method of preparing their individual U.S. federal and state tax returns without any professional tax assistance — Digital DIY Tax Preparation Products.

14. These Digital DIY Tax Preparation Products are offered through three basic channels: (1) online; (2) software that can be downloaded from an Internet website; and (3) software on a disc that is either sent directly to the consumer or purchased by the consumer from a third-party retailer. Intuit, H&R Block, and TaxACT are the only major suppliers of Digital DIY Tax Preparation Products, and they are the only digital DIY tax preparation firms that offer their products through all three channels.

15. The online channel allows digital DIY tax preparation firms to offer their products to taxpayers that wish to complete their returns on the provider's website using a personal computer, an Internet connection, and an Internet browser. By way of example, a taxpayer can direct his or her Internet browser to H&R Block's website and access an online version of H&R Block At Home. The taxpayer can then fill out relevant information directly on the company's website. When using the online channel, all tax calculations are conducted remotely on the servers owned by the company. After all relevant information is entered and tax calculations are made, a completed tax return is generated and the information is saved on the company's servers. That return can then either be printed by the individual to mail to the IRS or state revenue agency, or filed electronically (sometimes referred to as "e-filed") with the IRS or state revenue agency over the Internet. In recent years, e-filing has been an increasingly popular method of filing tax returns.

16. The second and third channels for using Digital DIY Tax Preparation Products entail a taxpayer installing software on his or her personal computer. The second channel permits taxpayers to access an Internet website and download the software onto the taxpayer's personal computer. The third channel permits taxpayers to load and install software, which is stored on a CD-ROM or DVD, onto his or her personal computer. The CD-ROM or DVD is either sent directly to the consumer, or purchased by the consumer from a retail store (such as Staples or Best Buy). When using any software product, the information that is entered by the taxpayer for generating the return is not transmitted over the Internet. Similarly, the calculations necessary for creating the tax return are conducted on the taxpayer's computer, not a company's servers, and the completed tax return is saved to the taxpayer's computer. As with the online version, the completed return can either be printed or e-filed.

17. Regardless of the channel, all Digital DIY Tax Preparation Products function in the same way and consist of the same two basic parts: the user interface, which prompts users to provide relevant information, and the underlying tax engine, which processes that information.

18. A user interface is the means by which individuals interact with the tax engine. The standard user interface for the Digital DIY Tax Preparation Products of Intuit, H&R Block, and TaxACT is referred to as an "interview," and it provides consumers with a series of questions relating to their personal and financial information. The answers the consumer gives during the interview are provided to the tax engine for calculation.

19. The tax engine is essentially a complicated software program based upon federal and state tax code and regulations. A taxpayer's relevant personal and financial information is provided to the tax engine by way of the user interface, and the tax engine processes the information. Based upon the state or federal tax code, the tax engine determines what forms should be provided to the IRS or the state revenue agency and records the appropriate figures on the relevant tax forms.

20. Digital DIY Tax Preparation Product providers typically offer their products in more than one version and at different prices. The different versions and the pricing differences are often based on one or more of the following: (a) the number of tax returns filed; (b) whether the tax return prepared is a federal or state return; (c) the tax forms used and complexity of the tax return (*e.g.*, an individual who files with a federal 1040EZ tax form could pay less than someone who files with a 1040 tax form); (d) the channel through which the individual accesses the product (*i.e.*, online, download, or software on a disc); (e) the amount and type of support the individual desires for the process (*e.g.*, whether the individual can contact the company for

technical support or tax advice, or can demand support from the company in the event of an audit); and (f) whether the federal and/or state tax return will be e-filed.

21. Digital DIY tax preparation companies also sometimes offer related products and services to individuals. Some of these products include: (a) refund anticipation checks, which permit an individual to deduct the price of the Digital DIY Tax Preparation Product from the individual's tax refund; (b) prepaid debit cards, which permit individuals to transfer their tax refunds to a prepaid debit card; (c) the ability to access a copy of the individual's prior year tax returns that were filed using the company's product; and (d) additional support services.

22. Companies that offer Digital DIY Tax Preparation Products compete based upon price and quality of their products, including the number of forms, schedules, and states that they support. The "Big Three" digital DIY tax preparation companies — Intuit, H&R Block, and TaxACT — all support the vast majority of forms, schedules, and states, though TaxACT's prices are lower than those of H&R Block and Intuit.

B. Relevant Product Market

23. Digital DIY tax preparation products for the preparation of U.S. federal and state tax returns (referred to throughout this Complaint as "Digital DIY Tax Preparation Products") is a relevant product market and line of commerce under Section 7 of the Clayton Act. A hypothetical monopolist would impose at least a small but significant and nontransitory increase in the price of all Digital DIY Tax Preparation Products.

24. There are no reasonable product alternatives to Digital DIY Tax Preparation Products. Other means that consumers can use to prepare their personal tax returns are not sufficiently substitutable to discipline even a small but significant and nontransitory increase in the price of Digital DIY Tax Preparation Products.

25. Other methods of preparing individual tax returns are not in the same product market as Digital DIY Tax Preparation Products because those methods of preparation either do not offer comparable functionality, are less convenient, are more cumbersome, or are too expensive. For instance, the "pen-and-paper" method of tax preparation (*i.e.*, taking a copy of a tax return form and manually writing in the appropriate calculations) is a tedious, complicated, and highly error-prone process that lacks the ease of use and functionality that Digital DIY Tax Preparation Products offer. Digital DIY Tax Preparation Products guide individuals through an easy-to-use interview process, ask them relevant questions in generally understandable language, do not require the individual to know tax rules and regulations, and do not require the individual to understand what information should be recorded or calculated on particular lines of particular tax forms. For these and other reasons, an insufficient number of individuals would choose pen-and-paper instead of Digital DIY Tax Preparation Products to make even a small but significant increase in the price of Digital DIY Tax Preparation Products unprofitable.

26. Another method of tax preparation that is not in the product market is assisted tax preparation (*e.g.*, the use of a certified public accountant or a professional tax service such as an H&R Block brick-and-mortar store). Assisted tax preparation provides consumers with one-on-one professional tax guidance that is generally unavailable with Digital DIY Tax Preparation Products. In addition, Digital DIY Tax Preparation Products are more convenient to use than assisted tax preparation because they do not require users to schedule time to deal with third-party professionals. Assisted tax preparation is substantially more expensive than a Digital DIY Tax Preparation Product that prepares comparably complex tax returns and would remain substantially more expensive than Digital DIY Tax Preparation Products even after a small but significant nontransitory increase in the price of Digital DIY Tax Preparation Products. An

insufficient number of individuals would substitute to assisted tax preparation products to make even a small but significant increase in the price of Digital DIY Tax Preparation Products unprofitable.

C. Relevant Geographic Market

27. The Digital DIY Tax Preparation Products that H&R Block and TaxACT offer assist individuals with filing their U.S. federal and state income tax returns. Customers that are required to file tax returns in jurisdictions outside of the United States cannot use the Digital DIY Tax Preparation Products at issue for those purposes. Similarly, Digital DIY Tax Preparation Products that have been engineered to assist individuals with filing tax returns in jurisdictions outside of the United States cannot be used by customers to prepare U.S. federal and state tax returns. Both customers and suppliers of Digital DIY Tax Preparation Products predominately are located within the United States. However, because many Digital DIY Tax Preparation Products are provided over the Internet, there do not appear to be any physical restrictions on the location of suppliers or customers. Accordingly, a relevant geographic market within the meaning of Section 7 of the Clayton Act, 15 U.S.C. § 18 is a worldwide market.

V. TAXACT'S HISTORY OF "DISRUPTING" THE MARKET THROUGH AGGRESSIVE PRICING, QUALITY, AND INNOVATIONS

28. TaxACT's conduct over the past several years has significantly "disrupted" the market and forced competitors, including Intuit and H&R Block, to offer free products and increase the quality of their products for American taxpayers. The first major instance of maverick behavior by TaxACT that prompted a competitive reaction from H&R Block and Intuit occurred in 2004 in relation to the Free File Alliance ("FFA"), a public-private partnership of digital DIY tax preparation companies and the IRS designed to offer qualified individuals the ability to prepare and e-file free federal income tax returns. As H&R Block itself recognized,

TaxACT was the first company to aggressively pursue lower prices in the Digital DIY Tax Preparation Product market for all taxpayers through the FFA: "The first year [2003] was rather uneventful but in the second year [2004] TaxAct introduced an offer that was free to all individual US taxpayers. . . . At the beginning of [2005] Intuit made their offer available to all US taxpayers and just about all other members followed."

29. TaxACT's FFA offering threatened the profits of all Digital DIY Tax Preparation Product providers. Accordingly, though they matched TaxACT's offering, members of the FFA, including H&R Block and Intuit, lobbied the government to limit the number of taxpayers to whom FFA members could offer free federal e-filing. Ultimately, the IRS, in October 2005, limited the type and the number of customers that could be offered a free product through the FFA.

30. TaxACT responded to the FFA limitations by pursuing an even more aggressive strategy to lower prices and increase quality for taxpayers. In or about December 2005, TaxACT began offering all taxpayers the ability to prepare and e-file their federal individual tax returns for free directly from TaxACT's website. This aggressive pricing decision by TaxACT was a major turning point in the market for Digital DIY Tax Preparation Products. As TaxACT's press release in December 2005 announced: "users of its TaxACT Standard 2005 Federal editions can e-file their tax returns without charge through www.TaxACT.com, as well as prepare and print them for free. . . . For eight consecutive tax seasons, TaxACT — the first tax-preparation software company to offer free e-file capabilities — has been a pioneer in free tax preparation. Now TaxACT is making it possible for everyone to prepare, print and e-file their taxes for free." TaxACT's "free-free-free" offering, giving consumers the ability to prepare and then either e-file or print and mail their federal tax returns for free through its website, significantly disrupted the

market. Indeed, TaxACT investment presentations trumpeted its move to free federal as having "disrupted the then prevalent 'paid' model under which tax preparation software was sold by its competitors." TaxACT subsequently boasted to the public that it was a "*tax industry maverick* [that] has broken down the barrier for everyone to prepare, print, and now even e-file their returns, all for free." (Emphasis added).

31. Internal H&R Block documents (as well as internal documents from other digital DIY providers) make clear that TaxACT's move to "free federal" was a major change in the Digital DIY Tax Preparation Product market that resulted in significant pressure to lower prices. An H&R Block internal presentation on competition within the Digital DIY Tax Preparation Product market states that "[t]he growth in Free Federal Offers Online was driven primarily by the growth of TaxACT's Standard and TaxACT Standard+State both [of which] include Free federal units." The presentation goes on to note that "TaxACT's success in gaining market share propelled Intuit to offer the Free Edition on its Home Page. At one point, TurboTax Deluxe was offered free through email and tested on the TurboTax Home Page." The result of this pressure by TaxACT was, as H&R Block lamented, a "[c]ontinued erosion of Paid units for middle and lower SKUs," and likely continued "price compression across ***all*** tax prep." (Emphasis in original). After Intuit began offering "free federal" for individuals, H&R Block followed suit by offering its own free product. Presentations made by the heads of H&R Block's Digital Tax Solutions division to H&R Block's CEO and CFO note explicitly that the rationale for launching the H&R Block's free online product was "[t]o match competitor offerings and stem online share loss to Intuit and TaxAct."

32. TaxACT is also a maverick in terms of product quality. Over the years, TaxACT has continuously expanded the functionality of its free version. As a result, TaxACT's free

version is, in many respects, the functional equivalent of products for which H&R Block and Intuit charge a significant price. TaxACT's improvements to its free products have forced H&R Block and Intuit to enhance the functionality of their free products. Nonetheless, TaxACT's free version continues to offer more functionality by, among other things, providing and supporting *all* e-filable federal forms and schedules. In contrast, the free products offered by competitors such as H&R Block and Intuit do not support all e-filable federal forms and schedules, and thus require taxpayers who need the missing functionality to upgrade to a paid product or switch to another provider.

33. The competitive pressure that TaxACT created through its maverick prices and functionality has persisted and continues to the present. Each year since December 2005, TaxACT has relentlessly offered high quality Digital DIY Tax Preparation Products to taxpayers at low prices. TaxACT's aggressive pricing continues to put competitive pressure on both Intuit and H&R Block to lower their prices on all Digital DIY Tax Preparation Products. As late as January 22, 2009, an H&R Block executive remarked: "I was shocked at the TaxAct price. . . . It appears that the online market is moving towards a 'free' space or a de minimis cost." Consistent with that executive's concern over TaxACT's pricing, a late 2010 H&R Block presentation notes that H&R Block lowered the price of its premium software product offering by almost 30% specifically "[i]n order to better compete with online free."

34. Another recent example of TaxACT's maverick behavior in the market relates to the features of the product that it introduced into the retail sector. Around December 2010, TaxACT's desktop software began being offered through a major retailer — Staples. TaxACT's retail software sells at a lower price than the comparable offerings from H&R Block and Intuit — the only major Digital DIY Tax Preparation Products sold at retail stores prior to TaxACT's

introduction into retail. In addition, in contrast to Intuit and H&R Block, TaxACT (1) does not charge an additional amount to its customers to e-file their state returns, and (2) does not attempt to sell users additional features after purchase. Internally commenting on these features, one H&R Block employee stated: "ouch! They knew exactly what to exploit."

35. TaxACT's low price and innovative offering at retail poses a threat to H&R Block and Intuit. An internal H&R Block presentation notes: "Retail volume at Staples at risk due to introduction of TaxACT [r]etail software on combined display."

36. It is based on all of the above that TaxACT's President and Founder, Lance Dunn, has noted publicly that TaxACT is a "catalyst for change" that has "consistently forced the tax preparation industry to become more competitive, and in doing so [has] forced [its] competitors to change as well." By acquiring TaxACT, H&R Block would be able to eliminate the threat that TaxACT, as a maverick, poses to its business.

VI. MARKET CONCENTRATION

37. The relevant market is highly concentrated and would become significantly more concentrated as a result of the proposed transaction.

38. As articulated in the *Horizontal Merger Guidelines* issued by the Department of Justice and the Federal Trade Commission, the Herfindahl-Hirschman Index ("HHI") is a measure of market concentration.[1] Market concentration is often one useful indicator of the level

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[1] *See* U.S. Dep't of Justice and Federal Trade Commission, Horizontal Merger Guidelines § 5.3 (2010), available at http://www.justice.gov/atr/public/guidelines/hmg-2010.html The HHI is calculated by squaring the market share of each firm competing in the market and then summing the resulting numbers. For example, for a market consisting of four firms with shares of 30, 30, 20, and 20 percent, the HHI is 2,600 ($30^2 + 30^2 + 20^2 + 20^2 = 2,600$). The HHI takes into account the relative size distribution of the firms in a market. It approaches zero when a market is occupied by a large number of firms of relatively equal size and reaches its maximum of 10,000 points when a market is controlled by a single firm. The HHI increases both as the

of competitive vigor in a market and the likely competitive effects of a merger. The more concentrated a market, and the more a transaction would increase concentration in a market, the more likely it is that a transaction would result in a meaningful reduction in competition harming consumers. Markets in which the HHI is between 1,500 and 2,500 points are considered to be moderately concentrated, and markets in which the HHI is in excess of 2,500 points are considered to be highly concentrated. Transactions that increase the HHI by more than 200 points in highly concentrated markets will be presumed likely to enhance market power.

39. In 2010, approximately 5.2 million federal individual tax returns that were prepared using H&R Block's Digital DIY Tax Preparation Products were e-filed, accounting for approximately 15.6% of the total Digital DIY Tax Preparation Product market.[2] During the same time period, approximately 4.3 million federal tax returns prepared using TaxACT's Digital DIY Tax Preparation Products were e-filed, accounting for approximately 12.8% of the Digital DIY Tax Preparation Product market. And, in 2010, approximately 21 million federal tax returns prepared using Intuit's TurboTax products were e-filed — accounting for a 62.2% share of the market. Using these figures, the market has a pre-acquisition HHI of approximately 4,276, and H&R Block's acquisition of TaxACT would increase that figure by approximately 399, resulting in a post-acquisition HHI of approximately 4,675. Consistent with the *Horizontal Merger*

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number of firms in the market decreases and as the disparity in size between those firms increases.

[2] 2010 is the most recent year for which accurate data on market shares and concentration currently is available. E-filing figures are used for purposes of calculating market share and concentration because they are the most accurate figures currently available industry-wide. Because e-filing figures do not include taxpayers who use a Digital DIY Tax Preparation Product but choose to print-and-mail the completed tax return, they provide useful but rough approximations. The total annual filing figures contained in paragraphs 9 and 10 include both e-filing numbers and company estimates on the number of print-and-mail filings.

Guidelines, this means that the market for Digital DIY Tax Preparation Products is highly concentrated and would become substantially more concentrated as a result of the acquisition.

VII. ANTICOMPETITIVE EFFECTS

A. The Proposed Transaction Would Eliminate Head-to-Head Competition Between H&R Block and TaxACT

40. As noted above, H&R Block's acquisition of TaxACT would combine the second- and third-largest digital DIY tax preparation companies. The acquisition would allow H&R Block to raise prices and to reduce the quality of its Digital DIY Tax Preparation Products by eliminating the intense head-to-head competition between H&R Block and TaxACT.

41. Digital DIY tax preparation companies compete with each other on price and quality of their products. On price, competition between the digital DIY tax preparation companies has resulted in lower prices on these products for taxpayers. Competition from TaxACT in particular has led to significant decreases in prices through the offering of free products. As illustrated by the examples described above, H&R Block lowered its prices in response to TaxACT.

42. Digital DIY tax preparation companies also compete on the quality of their products. TaxACT has been a particularly aggressive competitor in offering consumers high quality and high functionality Digital DIY Tax Preparation Products for low prices. TaxACT's products continue to improve in quality and functionality through, for example, a better user interface, a better log-on screen, and the ability to prepare and file all e-filable federal forms and schedules. H&R Block has been pressured and responded to TaxACT's improvements by improving the quality of its Digital DIY Tax Preparation Products. TaxACT has also, in turn, responded to competition from H&R Block by improving the quality of its Digital DIY Tax

Preparation Products, such as adding and improving data import capabilities, and offering audit assistance and a maximum refund guarantee.

43. H&R Block is fully aware of the effect that competition from TaxACT has in the Digital DIY Tax Preparation Product market: "Having disrupted the digital tax prep market with cheaper, lower-end solutions, TaxACT [is] surpassing [H&R Block's] TaxCut in market share and continu[es] to improve in quality (surpassing TaxCut in some press reviews in 2009)." It should come as no surprise then that a primary benefit for H&R Block in acquiring TaxACT is: "Elimination of competitor."

44. Internal H&R Block documents repeatedly recognize the competitive significance of "[e]liminati[ng this] competitor" and pulling the maverick off of the market. For example, in an internal H&R Block presentation discussing the potential acquisition of TaxACT, one of the "[s]trategic [o]pportunities" of the acquisition is: "Acquire TaxAct and eliminate the brand to regain control of industry pricing and avoid further price erosion." Compared to the benefits of this acquisition to H&R Block, the benefit to taxpayers, as set forth in the same document, stands in stark contrast: "None."

45. By eliminating this intense head-to-head competition, H&R Block's acquisition of TaxACT would make it less likely that H&R Block would lower its prices or continue to innovate. Thus, with this reduction in competition, taxpayers would bear the cost in terms of higher prices and lower quality Digital DIY Tax Preparation Products.

B. The Proposed Acquisition Would Make Anticompetitive Coordination Substantially More Likely

46. The Digital DIY Tax Preparation Product market possesses several structural features that increase the likelihood of coordination post-acquisition, including a small number of significant competitors, high barriers to entry and expansion, homogeneity of the relevant

product, relatively inelastic demand for the products, and availability of substantial market and competitor information.

47. After the acquisition, purchasers would only have two well-established and widely-used digital DIY tax preparation companies from which to choose. By eliminating TaxACT, a significant, disruptive, and aggressive competitor, the acquisition would likely substantially lessen competition between H&R Block and Intuit by enabling coordination among them. H&R Block would likely degrade TaxACT's free product, and H&R Block and Intuit would increase the prices for their paid products.

48. In fact, in an internal H&R Block email discussion leading up to the transaction, an H&R Block executive explained exactly how H&R Block's acquisition of TaxACT (in contrast to TaxACT being acquired by another entity) would lead to anticompetitive coordination between H&R Block and Intuit: "The other possible strategic consideration is that Intuit and HRB together would have 84% of the digital market and we both obviously have great incentive to keep this channel profitable. Other potential TA purchasers could decide to cut their prices even further to see if they could make large market share gains & build short-term profitability by 'winning the race to the bottom.'" Another H&R Block executive responded: "I think the strategic gains are that we lock up the share that is up for grabs by another potential player. The defensive play in and of itself has value. . . . One could also argue that there is value in taking control of this 'segment' by not encouraging a a [sic] race to free, which Intuit would have no interest in doing, and therefore has value to HRB by preventing it through the acquisition." As H&R Block so clearly explains, H&R Block and Intuit each have the incentive to charge more for their Digital DIY Tax Preparation Products. This acquisition would give H&R Block the ability to make that happen.

49. H&R Block viewed TaxACT as an aggressive and threatening competitor that forced it to lower prices and raise quality of its Digital DIY Tax Preparation Products on several occasions. By reducing the number of competitors serving the market and eliminating an aggressive competitor, the acquisition would enable the virtual duopolists — H&R Block and Intuit — to coordinate with one another.

C. Lack of Countervailing Factors

50. It is unlikely that entry or expansion in the Digital DIY Tax Preparation Product market would occur in a timely manner or on a scale sufficient to undo the competitive harm that the acquisition would produce. Entry and expansion to a level that would be sufficient to replace the competitive influence now exerted on the market by TaxACT would be difficult, take many years, and require the entrant to incur large sunk costs and significant other expenditures to develop a good Digital DIY Tax Preparation Product, obtain the requisite expertise, and build an effective brand. Successful entrants have spent years and millions of dollars in sunk costs developing their Digital DIY Tax Preparation Products to include support for all or most e-filable forms as well as additional features, such as data import capability and an intuitive user interface. These development requirements are made more challenging by a demanding annual development cycle required to incorporate tax law and tax forms changes in time for the short tax preparation and filing season (January through mid-April). These development efforts can be adversely affected by delays in the adoption of, or last minute changes in, new laws or regulations, delays in the availability of new or revised tax forms, and regulatory agency difficulties in receiving electronic submissions.

51. In addition to developing good digital DIY tax preparation functionality, companies seeking to enter or expand in this market would be required to develop a well-known

brand and good reputation for products that allow individuals to prepare tax returns easily, accurately, and securely. Developing and maintaining a good reputation and brand awareness is crucial to the widespread acceptance of consumer products like Digital DIY Tax Preparation Products, as users rely on reputation to ensure their taxes will be prepared easily, accurately, and securely. Developing a good reputation takes years of consistently good performance, and developing a well-known brand requires years of significant and sophisticated marketing efforts. One competitive advantage held by the Big Three is that their large customer bases can lead to additional growth through word-of-mouth customer referrals. Indeed, TaxACT itself believes that it benefits significantly from word-of-mouth customer referrals. However, a digital DIY tax preparation business must first develop a large customer base before its word-of-mouth customer referrals are sufficient to have a significant impact on the overall market.

52. Although H&R Block asserts that the acquisition would produce efficiencies, it cannot demonstrate acquisition-specific and cognizable efficiencies that would be sufficient to offset the acquisition's anticompetitive effects.

VIII. VIOLATION ALLEGED

53. The United States realleges and incorporates paragraphs 1 through 52 as if set forth fully herein.

54. H&R Block's acquisition of TaxACT would likely substantially lessen competition in the market for Digital DIY Tax Preparation Products, in violation of Section 7 of the Clayton Act, 15 U.S.C. § 18. The transaction would likely have the following effects, among others:

(a) competition between H&R Block and TaxACT in the provision of Digital DIY Tax Preparation Products would be eliminated;

(b) elimination of TaxACT as a "maverick" — a substantial, independent, and competitive force — in the Digital DIY Tax Preparation Product market, creating a combined firm with reduced incentives to lower price or increase quality;

(c) competition generally in the provision of Digital DIY Tax Preparation Products would be eliminated or substantially lessened;

(d) prices of Digital DIY Tax Preparation Products would likely increase to levels above those that would prevail absent the transaction, forcing millions of taxpayers to pay higher prices to prepare and file their federal and state tax returns each year;

(e) quality and innovation of and in Digital DIY Tax Preparation Products would likely be less than levels that would prevail absent the transaction; and

(f) the acquisition would increase the likelihood of, or enable, successful anticompetitive competitor coordination in the market for Digital DIY Tax Preparation Products, and actual or tacit collusion among H&R Block and Intuit.

REQUEST FOR RELIEF

55. The United States requests:

(a) that the proposed acquisition be adjudged to violate Section 7 of the Clayton Act, 15 U.S.C. § 18;

(b) that the Defendants be permanently enjoined and restrained from carrying out the Agreement and Plan of Merger dated October 13, 2010, or from entering into or carrying out any agreement, understanding, or plan by which H&R Block would acquire TaxACT, its stock, or any of its assets;

(c) that the United States be awarded costs of this action; and

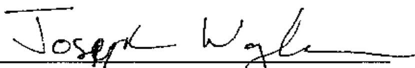
(d) that the United States be awarded such other relief as the Court may deem just and proper.

Dated this 23rd day of May 2011.

Respectfully submitted,

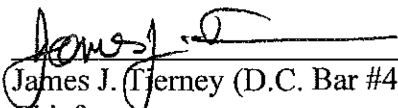
FOR PLAINTIFF UNITED STATES:

Christine A. Varney (D.C. Bar #411654)
Assistant Attorney General
Antitrust Division



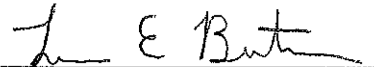
Joseph F. Wayland
Deputy Assistant Attorney General
Antitrust Division

Patricia A. Brink
Director of Civil Enforcement
Antitrust Division



James J. Tierney (D.C. Bar #434610)
Chief
Networks and Technology Section

Scott A. Scheele (D.C. Bar #429061)
Assistant Chief
Networks and Technology Section



Lawrence E. Buterman (D.C. Bar #998738)
Kent Brown
Brent E. Marshall
Danielle G. Hauck
Anthony D. Scicchitano
H. Joseph Pinto III
Trial Attorneys

U.S. Department of Justice
Antitrust Division
Networks and Technology Section
450 Fifth Street, NW
Suite 7100
Washington, DC 20530
Telephone: (202) 307-6200
Facsimile: (202) 616-8544
lawrence.buterman@usdoj.gov

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA, *Plaintiff,* v. H&R BLOCK, INC., 2SS HOLDINGS, INC., and TA IX L.P., *Defendants.*	)	Civil Action No. 1:11-cv-00948 (BAH)

ANSWER OF DEFENDANTS H&R BLOCK, INC.,
2SS HOLDINGS, INC., AND TA IX L.P.

Pursuant to Federal Rule of Civil Procedure 12, H&R Block, Inc., 2SS Holdings, Inc., and TA IX L.P. hereby answer the United States of America's May 23, 2011 Complaint as follows:

PRELIMINARY STATEMENT

H&R Block, Inc.'s ("H&R Block's") proposed acquisition of 2SS Holdings, Inc. ("TaxACT") will enhance competition at all levels of the tax preparation industry and will thereby benefit consumers.[1] To that end, Plaintiff's characterization of the transaction as potentially anti-competitive is wrong and is contrary to logic and the evidence.

A. Competition at All Levels of the Industry Is Robust.

Taxpayers have numerous alternatives for tax preparation and filing, including numerous professional tax preparation options and numerous do-it-yourself ("DIY") options. Taxpayers

1 Defendants note that the Complaint defines the terms "H&R Block" and "TaxACT" as referencing only H&R Block, Inc. and 2SS Holdings, Inc., neither of which sells tax preparation products and services. For convenience and clarity, Defendants have adopted the same naming conventions in answering Plaintiff's allegations and have used more specific, accurate terms (where appropriate) in the Preliminary Statement.

utilizing DIY options typically choose between preparing their taxes with "pencil and paper" or using some form of tax preparation software. Taxpayers who choose to use tax preparation software can purchase software that runs on their home computers via Internet download or electronic media ("desktop"). They can also purchase (or obtain for free) access to an online service on servers controlled by the provider ("online"). Almost two dozen companies offer desktop and/or online products.

The products being offered by these companies can generally be separated into two categories: "premium" and "value." "Premium" products are typically offered by companies with strong brand-name recognition like Intuit's TurboTax and H&R Block at Home. Premium products typically cost significantly more than value products. Premium products also typically include more features and functionality than value products.

B. The Transaction Will Benefit Consumers.

This transaction involves H&R Block, which through its subsidiaries HRB Digital LLC and HRB Technology LLC (collectively "H&R Block Digital") primarily sells premium products, acquiring TaxACT, which through its subsidiary 2nd Story Software, Inc. ("2SS") sells only value products. The acquisition will enhance competition and benefit consumers in two fundamental ways. First, it will replace H&R Block Digital's costly digital infrastructure with 2SS' efficient, low-cost technology platform (and experienced personnel). This will allow the combined firm to compete more effectively against premium providers of tax services (including Intuit, the largest provider of tax preparation services in the United States) on price, features, and innovation. Second, H&R Block Digital will acquire a low-cost value brand that is already an effective and profitable competitor in the value segment.

C. Plaintiff's Competitive Effects Theory Is Illogical

The proposed transaction will not harm competition or lead to increased prices in the value segment. First, increasing 2SS' prices would significantly erode TaxACT's profitability because the value segment has many strong competitors who would quickly move to take share should 2SS falter. Indeed, the IRS website states that at least seventeen providers of DIY tax software—most of which are in the value segment—meet IRS' "high standards" for tax preparation and provide "fast," "safe," and "accurate tax return[s]." Within the value segment, firms such as FreeTaxUSA, TaxSlayer, On Line Taxes, and others have significant customer bases, have been growing quickly, and have the capacity to grow significantly.[2] As a result, these companies would be quick to react to any competitive mistakes made by 2SS.

Second, contrary to the DOJ's allegations, H&R Block Digital cannot and would not raise 2SS' prices in the hope of driving more sales to H&R Block Digital's more expensive premium products because such a move would destroy the profitability of 2SS' proven business model. As Alan Bennett, the then-President and Chief Executive Officer of H&R Block told the public when the deal was announced, 2SS' "business model has enabled the company to generate consistently strong financial results," and "I love how they run their business." More recently, the new Chief Executive Officer, Bill Cobb, emphasized: "Consumers will be the primary beneficiaries of the merger through innovation, enhanced functionality and low prices." H&R Block's Digital abandoning the proven 2SS low-cost model is thus implausible and contrary to the plain statements in documents written by the executives who recommended this merger.

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[2] For example, the products offered by TaxSlayer and FreeTaxUSA each can process a sufficiently broad number of forms to serve more than 95% of taxpayers, and OLT likewise provides a broad offering of federal forms.

For all of the above reasons, H&R Block and H&R Block Digital have already committed to the DOJ that they would not raise any prices on 2SS' tax preparation products for at least three years and would continue offering 2SS' free tax preparation product to all taxpayers for at least three years. Even with this knowledge, the DOJ brought this case claiming that H&R Block's intentions are the opposite. Defendants deny these allegations and seek a decision on this matter as soon as is practicable, so that the merger can close in early Fall 2011. Permitting consummation of this merger will allow consumers to benefit from more innovation, enhanced functionality and low prices.

I. INTRODUCTION

1. Defendants are without knowledge and information sufficient to form a belief as to the truth of allegations in the first sentence of Paragraph 1 and therefore deny them. Defendants admit that some taxpayers choose to prepare their U.S. federal and state tax returns using digital do-it-yourself tax preparation products (defined by the Plaintiff as "Digital DIY Tax Preparation Products") over the Internet or on their desktop computers. Defendants are without knowledge and information sufficient to form a belief as to the truth of allegations in the third sentence and therefore deny them. Defendants deny the allegations contained in the fourth, fifth, and sixth sentences, except to the extent that they contain legal conclusions to which no response is necessary.

2. Defendants deny the allegations contained in the first, second, and third sentences of Paragraph 2. Defendants admit that documents produced to Plaintiff by H&R Block contain the phrases quoted by Plaintiff in the fourth sentence. Defendants deny, however, that the documents are "internal" as they were not authored by H&R Block, Inc. or H&R Block Digital employees. Moreover, the documents speak for themselves. To the extent Plaintiff

alleges the quoted statements are admissions by Defendants, these allegations are denied. To the extent that any allegation is not expressly admitted, it is denied.

3. Defendants deny the allegations contained in the first sentence in Paragraph 3, except to the extent that the allegations contain legal conclusions to which no response is necessary. While Defendants admit that a document produced by H&R Block contains the phrase "avoid further price erosion," Defendants note that the document was not authored by an H&R Block or an H&R Block Digital employee, did not use the word "maverick," and does not refer to any other document using the word "maverick." Moreover, the document speaks for itself. Defendants admit that 2SS used the word "maverick" in a 2005 press release. The document speaks for itself. To the extent Plaintiff alleges the quoted statement is an admission by Defendants, this allegation is denied. Defendants admit that 2SS produced documents containing the phrases quoted by Plaintiff in the second sentence of Paragraph 3. Defendants otherwise deny the allegations contained in the second sentence of Paragraph 3. The documents speak for themselves. To the extent Plaintiff alleges the quoted statements are admissions by Defendants, these allegations are denied. Defendants deny the allegations in the third sentence of Paragraph 3. With regard to the fourth sentence of Paragraph 3, Defendants deny that documents produced by H&R Block contain the word "disrupted" in reference to TaxACT's or 2SS' actions in 2005. The documents speak for themselves. To the extent Plaintiff alleges the quoted word is an admission by Defendants, this allegation is denied. Defendants otherwise deny the allegations contained in the fourth sentence of Paragraph 3. Defendants admit the allegation contained in the fifth sentence of Paragraph 3 that Intuit is the industry leader. Defendants otherwise deny the allegations contained in the fifth, sixth, and seventh sentences of Paragraph 3, except insofar as these sentences contain legal conclusions to which no

response is necessary. Defendants admit that a document produced by H&R Block contains the phrase "at risk," as alleged in the eighth sentence of Paragraph 3. The document speaks for itself. To the extent Plaintiff alleges the quoted statement is an admission by Defendants, this allegation is denied. Defendants otherwise deny the allegations contained in the eighth sentence of Paragraph 3. Defendants deny the allegations in the final sentence of Paragraph 3, except to the extent that they contain legal conclusions to which no response is necessary. To the extent that any allegation is not expressly admitted, it is denied.

4. Paragraph 4 contains legal conclusions to which no response is necessary.

II. JURISDICTION AND VENUE

5. Defendants admit that this action was filed by the United States under Section 15 of the Clayton Act, 15 U.S.C. § 25, purportedly to prevent and restrain Defendants from violating Section 7 of the Clayton Act 15 U.S.C. § 18. To the extent that this paragraph contains legal conclusions, no response is necessary.

6. The first and second sentences of Paragraph 6 contain legal conclusions to which no response is necessary. Defendants deny that H&R Block or TaxACT sell Digital DIY Tax Preparation Products. The final sentence of Paragraph 6 contains legal conclusions to which no response is necessary.

7. Defendants deny that either of H&R Block or TaxACT transacts business in the District of Columbia. The remaining allegations in Paragraph 7 are legal conclusions to which no response is necessary.

8. The allegations in Paragraph 8 are legal conclusions to which no response is necessary.

III. THE DEFENDANTS AND THE TRANSACTION

9. Defendants admit the allegations in the first sentence of Paragraph 9. Defendants deny the remaining allegations in Paragraph 9.

10. Defendants admit the allegations contained in the first sentence of Paragraph 10. Defendants deny the remaining allegations in Paragraph 10.

11. Defendants admit the allegations in the first and second sentence of Paragraph 11. Defendants deny that the approximately one-third interest in 2SS Holdings, Inc. not held by TA I.X. L.P. is held wholly by TaxACT executives and employees.

12. Defendants admit the allegations in Paragraph 12.

IV. THE RELEVANT MARKET

A. Description of the Product

13. Defendants are without knowledge and information sufficient to form a belief as to the truth of allegations in Paragraph 13 and therefore deny them.

14. Defendants admit the allegations contained in the first sentence of Paragraph 14. Defendants deny the allegations contained in the second sentence of Paragraph 14.

15. Defendants admit the allegations contained in the first sentence of Paragraph 15, except to the extent that they purport to describe how all digital DIY tax preparation products offered by companies other than Defendants work. Defendants deny the

allegations contained in the second, third, fourth, fifth, and sixth sentences. Defendants admit the allegations contained in the seventh sentence.

16. Defendants admit the allegations contained in first, second, sixth, and seventh sentences of Paragraph 16, except to the extent that they purport to describe how all digital DIY tax preparation products offered by companies other than Defendants work. Defendants admit the allegations in the third sentence, except to the extent that Plaintiff alleges that users of the "software" channel (as defined by Plaintiff) are limited to CD-ROM or DVD, which Defendants deny. Defendants admit that consumers may be sent electronic media containing digital DIY tax preparation products directly from a company, through a distributor, or through a retailer. To the extent that Plaintiff alleges that users of the "software" channel are limited to purchasing products directly or from "retail stores," Defendants also deny this allegation.

17. Defendants deny that "all Digital Tax Preparation Products function in the same way," as alleged in Paragraph 17. Defendants are without knowledge and information sufficient to form a belief as to the truth of the remaining allegations in Paragraph 17 and therefore deny them.

18. Defendants admit the allegations contained in the first sentence of Paragraph 18. Defendants deny the remaining allegations relating to TaxACT and H&R Block. Defendants are without knowledge and information sufficient to form a belief as to the truth of allegations regarding Intuit and therefore deny them.

19. Defendants admit the allegations in Paragraph 19, except Plaintiff's characterization of tax engines as "complicated," which Plaintiff has not defined; Defendants are

without sufficient information to form a belief as to the truth of the allegation and therefore deny it.

20. Defendants are without knowledge and information sufficient to form a belief as to the truth of the allegations contained in Paragraph 20 and therefore deny them.

21. Defendants admit the allegations in Paragraph 21.

22. Defendants admit that 2SS' published prices are generally lower than H&R Block Digital's and Intuit's published prices. Defendants deny the remaining allegations in Paragraph 22.

B. Relevant Product Market

23. Defendants deny the allegations contained in Paragraph 23, except to the extent that these allegations contain legal conclusions to which no response is necessary.

24. Defendants deny the allegations contained in Paragraph 24, except to the extent that these allegations contain legal conclusions to which no response is necessary.

25. Defendants deny the allegations contained in Paragraph 25, except to the extent that these allegations contain legal conclusions to which no response is necessary.

26. Defendants deny the allegations contained in Paragraph 26, except to the extent that these allegations contain legal conclusions to which no response is necessary.

C. Relevant Geographic Market

27. Defendants deny the allegations in the first sentence of Paragraph 27. The final sentence contained in Paragraph 27 is a legal conclusion to which no response is necessary.

Defendants are without knowledge and information sufficient to form a belief as to the truth of the remaining allegations in Paragraph 27 and therefore deny them.

V. TAXACT's ALLEGED HISTORY OF "DISRUPTING" THE MARKET

28. Defendants admit that documents produced by H&R Block contain the word "disrupted" as well as the language quoted at the end of Paragraph 28. The documents speak for themselves. To the extent Plaintiff alleges the quoted statements are admissions by Defendants, these allegations are denied. Defendants deny the remaining allegations contained in Paragraph 28.

29. Defendants are without knowledge and information sufficient to form a belief as to the truth of allegations contained in the first and second sentences of Paragraph 29 to the extent that these allegations pertain to companies other than Defendants, and therefore Defendants deny the allegations to the extent that they pertain to such companies. Defendants also deny the allegations contained in the first and second sentences of Paragraph 29 as they relate to Defendants. Defendants admit the allegations contained in the third sentence of Paragraph 29.

30. Defendants admit that the documents cited in Paragraph 30 contain the language quoted therein. The documents speak for themselves. To the extent Plaintiff alleges the quoted statements are admissions by Defendants, these allegations are denied. Defendants deny the remaining allegations in Paragraph 30.

31. Defendants admit that documents produced by H&R Block to Plaintiff cited in Paragraph 31 contain the language quoted therein. The documents speak for themselves.

To the extent Plaintiff alleges the quoted statements are admissions by Defendants, they are denied. Defendants deny the remaining allegations in Paragraph 31.

32. Defendants deny the allegations in the first sentence contained in Paragraph 32, except to the extent that these allegations are legal conclusions to which no response is necessary. Defendants are without knowledge and information sufficient to form a belief as to the truth of the allegations in Paragraph 32 regarding Intuit and therefore deny them. Defendants deny the remaining allegations in Paragraph 32.

33. Defendants admit that documents produced by H&R Block contain the language quoted in Paragraph 33. Defendants deny that an H&R Block executive in January 22, 2009 made the statements quoted by Plaintiff in the third sentence of Paragraph 33. The documents speak for themselves. To the extent Plaintiff alleges the quoted statements are admissions by Defendants, these allegations are denied. Defendants deny the remaining allegations in Paragraph 33.

34. Defendants admit that a document produced by H&R Block contains the phrase quoted in the final sentence of Paragraph 34. The document speaks for itself. To the extent Plaintiff alleges the quoted statement is an admission by Defendants, this allegation is denied. Defendants deny the remaining allegations in Paragraph 34.

35. Defendants admit that a document produced by H&R Block contains the quoted language in Paragraph 35. The document speaks for itself. To the extent Plaintiff alleges the quoted statements are admissions by Defendants, they are denied. Defendants deny the remaining allegations in Paragraph 35.

36. Defendants deny that Lance Dunn authored any documents "based on" facts alleged in the Complaint and denied by Defendants, as alleged in Paragraph 36. Defendants further deny that Lance Dunn based the press release cited in Paragraph 36 on facts post-dating the press release and/or on facts otherwise unknowable to Lance Dunn as alleged by Paragraph 36. Defendants deny the remaining allegations contained in Paragraph 36.

VI. MARKET CONCENTRATION

37. Defendants deny the allegations contained in Paragraph 37.

38. Defendants admit that the Herfindahl-Hirschman Index ("HHI") is cited as a measure of market concentration in the *Horizontal Merger Guidelines* issued by the Department of Justice. The remaining allegations contained in Paragraph 38 are legal conclusions to which no response is necessary.

39. Defendants deny the allegations in the first and second sentences of Paragraph 39. Defendants are without knowledge and information sufficient to form a belief as to the truth of the allegations concerning TurboTax in Paragraph 39 and therefore deny them. Defendants deny that the market alleged in the Complaint is a relevant market. Defendants are without knowledge and information sufficient to form a belief as to the truth of the allegations concerning market share or HHI in the market alleged by the Complaint and therefore deny them. Defendants admit that 399 plus 4,276 is 4,675. Defendants admit that the *Horizontal Merger Guidelines* state that a market with an HHI of 4,675 is highly concentrated. Defendants deny that any properly defined market would become substantially more concentrated as a result of the acquisition. Defendants deny the remaining allegations contained in Paragraph 39.

VII. ALLEGED ANTICOMPETITIVE EFFECTS

A. Alleged Head-to-Head Competition Between H&R Block and TaxACT

40. Defendants deny the allegations in Paragraph 40.

41. Defendants admit the allegations contained in the first and second sentences of Paragraph 41, except insofar as these sentences suggest that (1) all digital tax preparation companies compete with one another, and (2) competition between private companies is the only or primary pricing constraint for Digital DIY tax preparation companies. Defendants deny the remaining allegations contained in Paragraph 41.

42. Defendants admit the allegations contained in the first sentence of Paragraph 42, except insofar as this sentence suggests that all digital tax preparation companies compete with one another. Defendants deny the remaining allegations contained in Paragraph 42.

43. Defendants deny the allegations contained in Paragraph 43. Defendants admit that documents produced by H&R Block contain the language quoted in Paragraph 43. The documents speak for themselves. To the extent Plaintiff alleges the quoted statements are admissions by Defendants, these allegations are denied.

44. Defendants deny the allegations contained in Paragraph 44. Defendants admit that documents produced by H&R Block contain the language quoted in Paragraph 44. Defendants deny that the documents were "internal" as they were not authored by H&R Block or H&R Block Digital employees. Moreover, the documents speak for themselves. To the extent Plaintiff alleges the quoted statements are admissions by Defendants, these allegations are denied.

45. Defendants deny the allegations contained in Paragraph 45.

B. Alleged Increase in the Likelihood of Anticompetitive Coordination

46. Defendants deny the allegations contained in Paragraph 46.

47. Defendants deny the allegations contained in Paragraph 47.

48. Defendants deny the allegations contained in Paragraph 48. Defendants admit that documents produced by H&R Block contain the language quoted in Paragraph 48. Defendants deny that the language quoted in Paragraph 48 was authored by an H&R Block executive or by any person with authority or input on the transaction or decisions regarding post-transaction planning. The documents speak for themselves. To the extent Plaintiff alleges the quoted statements are admissions by Defendants, these allegations are denied.

49. Defendants deny the allegations contained in Paragraph 49.

C. Alleged Lack of Countervailing Factors

50. Defendants are without knowledge and information sufficient to admit or deny allegations concerning other companies in Paragraph 50. Defendants deny the remaining allegations contained in Paragraph 50.

51. Defendants deny the allegations contained in Paragraph 51.

52. Defendants admit that H&R Block asserts that the acquisition will produce efficiencies. Defendants deny the remaining allegations contained in Paragraph 52.

VIII. VIOLATION ALLEGED

53. Defendants incorporate their admissions and denials from Paragraphs 1 through 52 as set forth above in response to Plaintiff's incorporation of said paragraphs in Paragraph 53.

54. Defendants deny the allegations contained in Paragraph 54.

55. Defendants admit that the United States requests in Paragraph 55 that the proposed acquisition be adjudged to violate Section 7 of the Clayton Act, 15 U.S.C. § 18. Defendants further admit that the United States requests that Defendants be permanently enjoined and restrained from carrying out the Agreement and Plan of Merger dated October 13, 2010, or from entering into or carrying out any agreement, understanding, or plan by which H&R Block would acquire TaxACT, its stock, or its assets. Defendants also admit that the United States requests that it be awarded costs of this action and that the United States requests that it be awarded such other relief as the Court may deem just and proper. Defendants deny that the United States is entitled to any of the relief it is seeking.

IX. AFFIRMATIVE DEFENSES

The inclusion of any ground within this section does not constitute an admission that Defendants bear the burden of proof on each or any of the matters, nor does it excuse Plaintiff from establishing each element of its purported claim for relief.

56. The Complaint fails to state a claim on which relief can be granted.

57. The contemplated relief would not be in the public interest because it would, among other things, harm consumers.

58. Efficiencies and other pro-competitive benefits resulting from the acquisition outweigh any and all proffered anticompetitive effects.

59. Defendants reserve the right to assert any other defenses as they become known to Defendants.

WHEREFORE, Defendants respectfully request that the Court (i) deny Plaintiff's contemplated relief, (ii) dismiss the Complaint in its entirety with prejudice, (iii) award Defendants their costs of suit, including attorneys' fees, and (iv) award such other and further relief as the Court may deem proper.

Dated: July 7, 2011

Respectfully submitted,

J. Robert Robertson (DC Bar #501873)
(DDC Bar #IL0001)
Corey W. Roush (DC Bar #466337)
Hogan Lovells US LLP
Columbia Square
555 Thirteenth Street, NW
Washington, DC 20004
Tel: 202 637 5600
Fax: 202 637 5910
Attorneys for Defendants H&R BLOCK, INC., 2SS Holdings, Inc. and TA IX L.P.

Minute Order, United States v. H&R Block, Inc., No. 11-00948 (BAH) (D.D.C. Aug. 4, 2011)

MINUTE ORDER (paperless) granting in part and denying in part Joint Motion for Order Regarding Proposed Hearing Length and Findings of Fact. For the hearing set to commence on September 6, 2011, the plaintiff and the defendants will each be limited to twenty-five (25) total hours of testimony for their respective cases-in-chief, which will not include their opening and closing statements, but will include direct testimony, cross-examination, and argument before the Court during the hearing. Additionally, the plaintiff will be entitled to no more than six (6) hours of total combined time for its rebuttal witnesses; defendants will have no more than three (3) hours of total combined time to cross-examine plaintiffs rebuttal witnesses. Each side shall have no more than one (1) hour for their respective opening statements and one (1) hour for their respective closing statements. The Court will not waive the requirements of Paragraph 11(a)(ix) of the Court's Standing Order, which requires the parties to submit, as part of the Joint Pre-Hearing Statement, a statement of facts that the parties have stipulated to, or have agreed are undisputed, or that the parties propose for stipulation. Such a statement will help the Court identify the areas of factual dispute and agreement in advance of the hearing. Finally, unless the parties are otherwise notified, the Court will convene the hearing from 9:30 AM to 12:30 PM and 1:45 PM to 5:00 PM, Monday through Friday, except that on September 13 and September 14, 2011, court will not be held due to the necessary attendance of the Judge at a meeting of the United States Sentencing Commission. Signed by Judge Beryl A. Howell on 8/4/2011. (lcbah2) (Entered: 08/04/2011)

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA, Plaintiff, v. H&R BLOCK, INC., *et al.*, Defendants.	Civil Action No. 11-00948 (BAH)

ORDER

This matter comes before the Court on the plaintiff's motion for a permanent injunction against the acquisition of 2SS Holdings, Inc. ("TaxACT") by H&R Block, Inc. ("HRB"). Upon consideration of all the evidence before the Court, including documents and factual and expert testimony presented at an evidentiary hearing, the applicable law, and the parties' legal memoranda and arguments, the Court finds that the proposed acquisition of TaxACT by HRB violates Section 7 of the Clayton Act, 15 U.S.C. § 18, for the reasons explained in the accompanying Memorandum Opinion.[1] Accordingly, it is hereby

ORDERED that, for the reasons explained in the accompanying Memorandum Opinion, the plaintiff's motion for a permanent injunction is GRANTED; and it is further

ORDERED that HRB and any parent, affiliate, subsidiary, or division thereof are enjoined and restrained, pursuant to Section 15 of the Clayton Act, 15 U.S.C. § 25, from acquiring any stock, assets, or other interest, directly or indirectly, in defendant TaxACT; and it is further

[1] The accompanying Memorandum Opinion has been filed under seal to enable the parties to review it and to redact any confidential business information. Once the parties have had an opportunity to redact any confidential information, the Memorandum Opinion will be filed on the public docket.

ORDERED that the defendants take any and all necessary steps to prevent any of their domestic or foreign agents, divisions, subsidiaries, affiliates, partnerships, and joint ventures from completing such acquisition, and from taking any steps or actions in furtherance thereof; and it is further

ORDERED that the defendants return all confidential information received directly or indirectly from one another and destroy all notes relating to such information; and it is further

ORDERED that the parties to this case shall review the Memorandum Opinion that accompanies this Order and shall redact any confidential business information that should not be disclosed publicly. The parties shall jointly contact Chambers on or before November 4, 2011 with any recommended redactions.

DATED: October 31, 2011

/s/ Beryl A. Howell
BERYL A. HOWELL
United States District Judge

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA, Plaintiff, v. H&R BLOCK, INC., *et al.*, Defendants.	Civil Action No. 11-00948 (BAH)

MEMORANDUM OPINION[1]

Last year, approximately 140 million Americans filed tax returns with the Internal Revenue Service ("IRS"). Paying taxes is a fundamental civic duty in our democracy. Taxes pay for the government to carry out its constitutionally mandated functions and enable the government to give force to the laws and policies adopted by the people of the United States through their elected representatives. Despite the necessity of taxes to fund our government and to sustain services that many citizens depend upon, the task of preparing a tax return brings joy to the hearts of few. Many find it to be a complex and tedious exercise. Fortunately, various businesses offer different products and services designed to assist taxpayers with preparing their returns. These tax preparation businesses principally include accountants, retail tax stores, and digital tax software providers – all of which provide important services to the American taxpayer. In this case, the United States, through the Antitrust Division of the Department of Justice, seeks to enjoin a proposed merger between two companies that offer tax software

[1] The Court provided this Memorandum Opinion to the parties in final form on October 31, 2011, but public release was delayed to ensure that no confidential business information that had been submitted under seal was released. Based on input from the parties, confidential business information has been redacted from the opinion, with such redactions reflected by the insertion of the text "{redacted}." In some instances, redacted confidential business information has been replaced by more general language that reflects the same underlying concepts without revealing the confidential business information. Such substitutions are indicated by braces surrounding the substituted text.

products – H&R Block and TaxACT – on the grounds that the merger violates the antitrust laws and will lead to an anticompetitive duopoly in which the only substantial providers of digital tax software in the marketplace would be H&R Block and Intuit, the maker of the popular "TurboTax" software program. After carefully considering all of the evidence, including documents and factual and expert testimony, the applicable law, and the arguments before the Court, the Court will enjoin the proposed merger for the reasons explained in detail below.

* * *

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I. BACKGROUND

A. Overview

The United States, through the Antitrust Division of the Department of Justice (the "DOJ," the "government," or the "plaintiff"), filed this action on May 23, 2011. The DOJ seeks to enjoin Defendant H&R Block, Inc. from acquiring Defendant 2SS Holdings, Inc. ("TaxACT"), which sells digital do-it-yourself tax preparation products marketed under the brand name TaxACT. Compl. ¶ 10. H&R Block ("HRB") is a Missouri corporation headquartered in Kansas City, Missouri. *Id.* ¶ 9. 2SS Holdings, or TaxACT, is a Delaware corporation headquartered in Cedar Rapids, Iowa. *Id.* ¶ 10. Defendant TA IX, L.P. ("TA"), a Delaware limited partnership headquartered in Boston, Massachusetts, owns a two-thirds interest in TaxACT. *Id.* ¶ 11.

As noted above, approximately 140 million Americans filed tax returns with the IRS in 2010. *Id.* ¶ 1. Broadly speaking, there are three methods for preparing a tax return. The "pen and paper" or "manual" method includes preparation by hand and with free, electronically fillable forms available on the IRS website. A second method, known as "assisted" preparation, involves hiring a tax professional – typically either a certified public accountant ("CPA") or a specialist at a retail tax store. HRB operates the largest retail tax store chain in the United States. Cobb, TT, 9/19/11 a.m., at 37. The companies Jackson-Hewitt and Liberty Tax Service also operate well-known retail tax stores. Finally, many taxpayers now prepare their returns using digital do-it-yourself tax preparation products ("DDIY"), such as the popular software product "TurboTax." DDIY preparation is becoming increasingly popular and an estimated 35 to 40 million taxpayers used DDIY in 2010. GX 19 at 3; *see also* GX 27.[2]

[2] In this opinion, the Court will use the abbreviations "GX", "GTX", "DX", and "DTX" to refer to the government's exhibits, the government's trial exhibits, the defendants' exhibits, and the defendants' trial exhibits, respectively.

The three most popular DDIY providers are HRB, TaxACT, and Intuit, the maker of TurboTax. According to IRS data, these three firms accounted for approximately 90 percent of the DDIY-prepared federal returns filed in tax season 2010.[3] GX 27. The next largest firm is TaxHawk, also known as FreeTaxUSA, with 3.2 percent market share, followed by TaxSlayer, with 2.7 percent. *Id*. The remainder of the market is divided among numerous smaller firms. *Id.* Intuit accounted for 62.2 percent of DDIY returns, HRB for 15.6 percent, and TaxACT for 12.8 percent. *Id*. DDIY products are offered to consumers through three channels: (1) online through an internet browser; (2) personal computer software downloaded from a website; and (3) personal computer software installed from a disk, which is either sent directly to the consumer or purchased by the consumer from a third-party retailer. GX 629 at 11. In industry parlance, DDIY products provided through an internet browser are called "online" products, while software applications downloaded onto the user's computer via the web or installed from a disk are referred to as "software" products. *See id.*

The proposed acquisition challenged in this case would combine HRB and TaxACT, the second and third most popular providers of DDIY products, respectively. According to the government, this combination would result in an effective duopoly between HRB and Intuit in the DDIY market, in which the next nearest competitor will have an approximately 3 percent market share, and most other competitors will have less than a 1 percent share. GX 27. The government also alleges that unilateral anticompetitive effects would result from the elimination of head-to-head competition between the merging parties. Compl. ¶ 45.

"TT" refers to trial testimony. "PFF" refers the plaintiff's proposed findings of fact. "DFF" refers to the defendants' proposed findings of fact.

[3] The denomination of different years in the tax industry can be somewhat confusing. Tax returns are typically due in the month of April following the relevant tax year. Thus, each "tax season" refers to the period when returns for the prior "tax year" are generally completed. For example, "tax season 2010" refers to returns filed primarily in early 2010, corresponding to income earned in "tax year 2009."

Thus, the DOJ alleges that because the proposed acquisition would reduce competition in the DDIY industry by eliminating head-to-head competition between the merging parties and by making anticompetitive coordination between the two major remaining market participants substantially more likely, the proposed acquisition violates Section 7 of the Clayton Act, 15 U.S.C. § 18. *Id.* ¶¶ 40-49. Accordingly, the government seeks a permanent injunction blocking HRB from acquiring TaxACT. *Id.* ¶¶ 53-55.

On July 6, 2011, the Court entered a scheduling order in this case that provided for an expedited schedule of fact and expert discovery and briefing on the government's anticipated motion to enjoin the transaction. Joint Scheduling and Case Mgmt. Order, ECF No. 30. On August 1, 2011, the DOJ filed a motion for preliminary injunction against the merger, which was fully briefed by August 18, 2011. The parties subsequently agreed to forego the preliminary injunction phase and proceed directly to a trial on the merits of this action. TT, 9/6/11 a.m., at 8-9.

On September 2, 2011, the Court held a pre-trial conference. On September 6, the Court began a nine-day bench trial that was held on September 6, 7, 8, 9, 12, 13, 15, 19, and 20. Eight fact witnesses and three expert witnesses testified at the hearing. The parties presented testimony from additional witnesses by affidavit and deposition. Each side submitted over 800 exhibits, totaling many thousands of pages. Following the conclusion of the evidentiary phase of the trial, the Court gave the parties approximately two weeks to submit post-trial memoranda and proposed findings of fact, which were filed on September 28, 2011. ECF Nos. 98-99. The Court then heard closing arguments on October 3, 2011.

The government's motion to enjoin HRB's acquisition of TaxACT is presently before the Court. For the reasons explained in this opinion, the Court grants the government's motion.

Before proceeding to a discussion of the relevant legal standards governing this case, the Court will provide additional background regarding the parties, their proposed transaction, and the tax preparation industry in general.

B. The Merging Parties

HRB is a Missouri corporation with its principal place of business in Kansas City, Missouri. Compl. ¶ 9; Defs.' Answer, ECF No. 31, ¶ 9. HRB provides both assisted tax preparation services and DDIY products through separate business units. Bennett, TT, 9/6/11 a.m., at 106. HRB offers its DDIY products for consumers under the brand name "H&R Block At Home" (formerly known as "TaxCut"). GX 629 at 9.

In 2011, HRB's DDIY products generated {significant} revenue. GX 296-2. For the same period, HRB sold approximately 6.69 million DDIY units to consumers. GX 296-2. Separately, in 2011, HRB's assisted tax preparation business generated approximately $2.7 billion in revenue (based on 14,756,000 U.S. tax returns at an average fee of $182.96, as reported in HRB's 2011 Annual Report). GX 532 (Cobb Dep.) at 32; GX 565 at 19.

2SS Holdings, Inc. ("2SS") is a Delaware corporation with its principal place of business in Cedar Rapids, Iowa. Compl. ¶ 10; Defs.' Answer ¶ 10. 2SS owns 2nd Story Software, Inc., which offers DDIY products under the brand name "TaxACT." GX 629 at 8-9.

In the fiscal year ending April 30, 2011, TaxACT products generated approximately {half as much revenue as H&R Block}. GX 151 at 6. In the same year, consumers used TaxACT to electronically file approximately 5 million federal tax returns. GX 151 at 3-4.

TA IX, L.P. ("TA") is a private equity firm organized under the laws of Delaware with its headquarters in Boston, Massachusetts. Compl. ¶ 11; Defs.' Answer ¶ 11. In December of 2004, TA purchased a majority interest in 2SS for $85 million, and as a result TA has majority

control of 2SS Holdings and 2nd Story Software. GX 55 (Greif Dep.) at 72-73; GX 28-3.

C. The History Of TaxACT And The Proposed Transaction

TaxACT was founded in 1998 by Lance Dunn and three others, with Mr. Dunn serving as president. Dunn, TT, 9/7/11 p.m., at 49-52. Before founding TaxACT, Mr. Dunn and the other co-founders of the company had worked at Parsons Technology, a software company that had created a DDIY tax preparation product called "Personal Tax Edge." *Id.* at 49-52. In 1994, Intuit acquired Parsons Technology and continued to operate Personal Tax Edge as a separate product for approximately two years before merging it into its TurboTax product line. *Id.* at 51. Mr. Dunn testified that the business objective of founding TaxACT was "to make money selling value tax software which . . . was a category that did not exist at that time" because Intuit's acquisition of Parsons Technology had eliminated Personal Tax Edge, which had previously occupied a value tax software niche. *Id.* at 52. Thus, TaxACT "recreated" the category or "niche that the Personal Tax Edge product line filled when it existed." *Id.*

Over the years, TaxACT has emphasized high-quality free product offerings as part of its business strategy. *Id.* at 53. TaxACT initially offered a DDIY tax preparation product that made it free to prepare and print a federal tax return, but TaxACT charged a fee for electronic filing ("e-filing") or preparation of a state tax return. *Id.* at 54. Thus, from the beginning, TaxACT's business strategy relied on promoting "free" or "freemium" products, in which a basic part of the service is offered for free and add-ons and extra features are sold for a price.[4] As Mr. Dunn put it, "Free is an integral part of the value model. And the beauty of it is it has universal appeal. Everybody likes something for free." *Id.*

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[4] The business model of offering free products and then soliciting customers to purchase additional, related features or services is sometimes referred to as "freemium." *See* GX 130 ("H&R Block Strategic Planning Working Session, April 16 &17, 2010") at 103 ("'Freemium' is a known market dynamic that has arisen in multiple product categories and will continue to grow.").

Currently, TaxACT's free product offering allows customers to prepare, print, and e-file a federal tax return completely for free. *Id.* at 54; GX 28-10 at 5-7. TaxACT's "Deluxe" edition, which costs $9.95, contains additional features, such as the ability to import data from a return filed the prior year through TaxACT. GX 55-26; Dunn, TT, 9/7/11 p.m., at 91-92; GX 28-10 at 5-7; GX 28 (Dunn. Dep.) at 219. Customers who use TaxACT to prepare a state tax return in addition to a federal return pay either $14.95 for the state return in combination with the free federal product or $17.95 for the state return in combination with the "Deluxe" federal product. GX 55-26; Dunn, TT, 9/8/11 a.m., at 49. TaxACT's prices have generally remained unchanged for the past decade. Dunn, TT, 9/7/11 p.m., at 91.

The parties first began discussing the potential acquisition of TaxACT by HRB in July 2009. Bowen, TT, 9/15/11 p.m., at 14. During the fall of 2009, teams from HRB and TaxACT met to discuss the possibilities for the potential acquisition and HRB performed due diligence on TaxACT. *See* DX 244 at 8-9; Bowen, TT, 9/15/11 p.m., at 19-23, 26; DX 9527 at 35.

Negotiations between the parties stalled in December 2009 and the proposed deal collapsed. Bowen, TT, 9/15/11 p.m., at 33. The CEOs of the two companies continued to discuss a potential acquisition through the spring of 2010, however. *Id.* at 34. Serious merger talks resumed in July 2010. *Id.* at 38-39; DX1005.

In October 2010, the HRB Board of Directors approved a plan for HRB to acquire TaxACT. DX 600 at 12-13; Bowen, TT, 9/15/11 p.m., at 59-60. On October 13, 2010, HRB entered into a merger agreement with 2SS and TA. GX 120 at 1. Under this agreement, HRB would acquire control of 2SS for $287.5 million. GX 120 at 6; GX 119 at 1. HRB's stated post-merger plan is to maintain both the HRB and TaxACT brands – with the HRB-brand focusing on higher priced-products and the TaxACT brand focusing on the lower-priced products. *See*

Bennett, TT, 9/6/11 a.m., at 101-102; DX 1005 at 1. HRB plans {redacted} ultimately to rely on TaxACT's current technological platform and intends to give Mr. Dunn responsibility for running the combined firm's entire DDIY business operation from Cedar Rapids, Iowa. Dunn, TT, 9/8/11 p.m. (sealed), at 14-16; *see also* Bennett, TT, 9/6/11 a.m., at 110.

D. Free Products And The Free File Alliance

The evolution of TaxACT's free product offerings and the other free offerings in the DDIY market is important for understanding the claims in this case. The players in the DDIY market offer various "free" tax preparation products, but the features and functionality offered in these free products vary significantly, as do the ways in which these free products are ultimately combined with paid products to earn revenue. While the availability of some types of free product offers has long been a feature of the DDIY market, a spike in free offerings occurred during the last decade in parallel with the growth of e-filing.

As a matter of public policy, the IRS actively promotes e-filing because it has an interest in efficient and accessible tax return preparation and filing. The Internal Revenue Service Restructuring and Reform Act of 1998 set a goal of having eighty percent of individual taxpayers e-filing their returns by 2007. IRS Stip., ECF No. 80, ¶ 2. The IRS is close to achieving that goal and the IRS Oversight Board has recommended that the 80 percent benchmark be achieved by 2012. *Id.* According to stipulated facts attested to by IRS employees, in 2001, the IRS adopted an initiative "to decrease the tax preparation and filing burden of wage earners by providing greater access to free online tax preparation and filing options for a significant number of taxpayers." *Id.* ¶ 4. The IRS also determined that it could save a substantial amount of public money by encouraging filers to switch to e-filing, since e-filed returns are cheaper for the IRS to process. *Id.* ¶ 5.

The IRS determined that the most effective and efficient way to accomplish its goal of promoting access to free online tax preparation and filing options was to partner with a consortium of companies in the electronic tax preparation and filing industry. *Id.* ¶ 6; GX 297-D7 at E-2. In 2002, this consortium of companies formed Free File Alliance, LLC ("FFA") in order to partner with the IRS on this initiative to promote free filing. IRS Stip. ¶ 6; GX 297-D7 at E-2. HRB, TaxACT, and Intuit are all members of the FFA, as are approximately fifteen smaller companies. *See* IRS Stip. ¶ 8; DX 328. On October 30, 2002, the IRS and the FFA entered into a "Free On-Line Electronic Tax Filing Agreement" to provide free online tax return preparation and filing to individual taxpayers. IRS Stip. ¶ 9. Pursuant to this agreement, members of the FFA would offer free, online tax preparation and filing services to taxpayers, and the IRS would provide taxpayers with links to those free services through a web page, hosted at irs.gov and accessible through another government website. *Id.* ¶ 12. HRB, TaxACT, and Intuit were among the original members to make free offers through the FFA. *Id.* ¶ 8.

"In 2003, the first year in which free services were available to taxpayers through the FFA, none of the FFA members offered free services to all taxpayers." *Id.* ¶ 14. Rather, each "member set eligibility criteria. Most members, including H&R Block, TaxACT, and Intuit, used adjusted gross income ('AGI') as a way to define which taxpayers were eligible" for their offers of free federal tax return preparation services. *Id.* "For example, H&R Block offered free services to taxpayers with an AGI of $28,000 or less." *Id.* Some members that offered free federal return preparation services based on AGI also offered free services to taxpayers who met other conditions, such as eligibility to file a Form 1040EZ. *Id.* "Several members did not define eligibility based on AGI. Of the eleven FFA members that offered free services based on AGI, only TaxACT's AGI-based offering was available to individuals with AGI over $33,000." *Id.*

Specifically, TaxACT made its free federal services available exclusively to taxpayers who had AGI over $100,000 or were eligible to file a Form 1040EZ. *Id.*

In 2004, the second year in which free services for federal returns were available to taxpayers through the FFA, TaxACT introduced a new offer through the FFA that offered free preparation and e-filing of federal returns for all taxpayers regardless of AGI or other limitations ("free for all"). *See id.* ¶ 15; Dunn, TT, 9/7/11 p.m., at 65, 78. After TaxACT introduced a free-for-all offer through the FFA, other companies followed by introducing federal free-for-all offers of their own. Dunn, TT, 9/7/11 p.m., at 78 ("After we offered free for everyone in 2003, in 2004, a lot of companies offered free for everyone on the FFA.").

According to Mr. Dunn's testimony, after TaxACT made its FFA offer of a free federal product for all taxpayers, without any AGI or other limitations, other companies made efforts to restrict the wide availability of free offers on the FFA. *Id.* at 79. Specifically, according to Mr. Dunn, Intuit proposed that companies in the FFA collude by agreeing to restrict free offers. *Id.* Mr. Dunn and TaxACT opposed Intuit's proposal and believed that it was "probably not legal for that group to restrain trade." *Id.*

Subsequently, HRB, Intuit and others successfully lobbied the IRS to implement restrictions on the number of taxpayers that could be covered by a free offer through the FFA website. GX 28 (Dunn Dep.) at 114-15; GX 28-4; GX 35 at HRB-DOJ-00912870; GX 569 (DuMars Dep.) at 108, 112-113; Ernst, TT, 9/7/11 a.m., 26-27; GX 41 at 4; GX 25 (TaxHawk Decl.) ¶ 16. HRB desired these restrictions because, among other things, it was concerned about how free-for-all offers would affect the pricing structure for the industry and believed that such offers might undermine the company's ability to generate money through the paid side of its DDIY business. Ernst, TT, 9/7/11 a.m., at 26-27; GX 531 (Ciaramitaro Dep.) at 60-62; *see also*

GX 41 at 4; GX 25 (TaxHawk Decl.) ¶ 16.

The IRS amended the FFA rules in October 2005 to prevent FFA members from making free-for-all offers. Dunn, TT, 9/7/11 p.m., at 78-79; Ernst, TT, 9/7/11 a.m., at 29; GX 42; GX 25 (TaxHawk Decl.) ¶ 16; GX 29 (Intuit Decl.) ¶ 9. Therefore, TaxACT could no longer make its free-for-all offer through the FFA.

In tax year 2005, in response to restrictions that the IRS imposed on the scope of offers that could be made through the FFA, TaxACT became the first DDIY company to offer all tax payers a free DDIY product for preparation of federal returns directly on its website. Dunn, TT, 9/7/11 p.m., at 79-80; GX 28 (Dunn Dep.) at 122-23. Today, free offers in various forms are an entrenched part of the DDIY market. Dunn, TT, 9/8/11 a.m., 85; Defs.' Opening Stmt., TT, 9/6/11 a.m., at 86-87.

II. STANDARD OF REVIEW

"Section 7 of the Clayton Act, 15 U.S.C. § 18, prohibits a corporation from acquiring 'the whole or any part of the assets of another [corporation] engaged also in commerce or in any activity affecting commerce, 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." *United States v. Sungard Data Sys., Inc.*, 172 F. Supp. 2d 172, 180 (D.D.C. 2001) (quoting 15 U.S.C. § 18). "The United States is authorized by Section 15 of the Clayton Act to seek an injunction to block a pending acquisition." *Id.* (citing 15 U.S.C. § 25). "The United States has the ultimate burden of proving a Section 7 violation by a preponderance of the evidence." *Id.*

"To establish a Section 7 violation, plaintiff must show that a pending acquisition is reasonably likely to cause anticompetitive effects." *Id.* (citing *United States v. Penn-Olin Chem.*

Co., 378 U.S. 158, 171 (1964)); *see also United States v. Oracle Corp.*, 331 F. Supp. 2d 1098, 1109 (N.D. Cal. 2004). "Congress used the words '*may* be substantially to lessen competition' (emphasis supplied), to indicate that its concern was with probabilities, not certainties.'" *FTC v. H.J. Heinz Co*., 246 F.3d 708, 713 (D.C. Cir. 2001) (*quoting Brown Shoe Co. v. United States*, 370 U.S. 294, 323 (1962)). "Section 7 does not require proof that a merger or other acquisition has caused higher prices in the affected market. All that is necessary is that the merger create an appreciable danger of such consequences in the future." *Hosp. Corp. of Am. v. FTC,* 807 F.2d 1381, 1389 (7th Cir. 1986).

"As this Circuit explained in *Heinz*, 246 F.3d at 715, the decision in *United States v. Baker Hughes Inc.,* 908 F.2d 981 (D.C. Cir. 1990), sets forth the analytical approach for establishing a Section 7 violation."[5] *Sungard*, 172 F. Supp. 2d at 180.[6] "The basic outline of a section 7 horizontal acquisition case is familiar. By showing that a transaction will lead to undue concentration in the market for a particular product in a particular geographic area, the government establishes a presumption that the transaction will substantially lessen competition." *Baker Hughes*, 908 F.2d at 982. To establish this presumption, the government must "show that the merger would produce 'a firm controlling an undue percentage share of the relevant market, and [would] result [ ] in a significant increase in the concentration of firms in that market.'" *Heinz*, 246 F.3d at 715 (quoting *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 363

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[5] Two current Supreme Court justices, in their prior capacities as judges on the Court of Appeals, participated in the D.C. Circuit's ruling in *Baker Hughes*. Then-Judge Clarence Thomas wrote the opinion and then-Judge Ruth Bader Ginsburg joined in it.

[6] In their closing argument, the defendants chided the government for citing Clayton Act Section 7 cases brought by the Federal Trade Commission for the relevant standard to apply in this case rather than citing to *United States v. Baker Hughes Inc*., 908 F.2d 981, 982-83 (D.C. Cir. 1990), a case brought by the DOJ. Since this Circuit's FTC precedents themselves rely heavily on the analytical approach set forth in *Baker Hughes*, the defendants' distinction on this point is ultimately of little import. *See FTC v. H.J. Heinz Co*., 246 F.3d 708, 715 (D.C. Cir. 2001) ("In *United States v. Baker Hughes Inc*., 908 F.2d 981, 982-83 (D.C.Cir.1990), we explained the analytical approach by which the government establishes a section 7 violation."). While a lesser showing is required to obtain preliminary relief in an FTC preliminary injunction case, as opposed to a full merits trial like this case, the Court must apply the *Baker Hughes* analytical framework in either type of Section 7 case.

(1963)) (alterations in original). Once the government has established this presumption, the burden shifts to the defendants to rebut the presumption by "show[ing] that the market-share statistics give an inaccurate account of the merger's probable effects on competition in the relevant market." *Heinz*, 246 F.3d at 715 (internal quotation omitted). "'If the defendant successfully rebuts the presumption [of illegality], the burden of producing additional evidence of anticompetitive effect shifts to the government, and merges with the ultimate burden of persuasion, which remains with the government at all times.'" *Id.* (quoting *Baker Hughes*, 908 F.2d at 983). Ultimately, "[t]he Supreme Court has adopted a totality-of-the-circumstances approach to the statute, weighing a variety of factors to determine the effects of particular transactions on competition." *Baker Hughes*, 908 F.2d at 984.

III. DISCUSSION

A. The Relevant Product Market

"Merger analysis begins with defining the relevant product market." *FTC v. Swedish Match*, 131 F. Supp. 2d 151, 156 (D.D.C. 2000) (citing *Brown Shoe*, 370 U.S. 294, 324 (1962)). "Defining the relevant market is critical in an antitrust case because the legality of the proposed merger[] in question almost always depends upon the market power of the parties involved." *Id.* (quoting *FTC v. Cardinal Health, Inc.*, 12 F. Supp. 2d 34, 45 (D.D.C. 1998)). Indeed, the relevant market definition is often "the key to the ultimate resolution of this type of case because of the relative implications of market power."[7] *Id.*

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[7] "A relevant market has two components: (1) the relevant product market and (2) the relevant geographic market. . . . The 'relevant geographic market' identifies the geographic area in which the defendants compete in marketing their products or services." *FTC v. CCC Holdings, Inc.*, 605 F. Supp. 2d 26, 37 (D.D.C. 2009). The parties have stipulated that the relevant geographic market in this case is worldwide. Joint Pre-Hearing Statement ¶ IX, C, 12. DDIY products are provided online and can be used by any individual worldwide – either within the United States or abroad – who needs to prepare and file a U.S. tax return. The products at issue in this case are not used for preparation of foreign tax returns. *See* Pl.'s Mot. For Prelim. Inj. at 29-30. The Court accepts the parties' stipulation as to the relevant geographic market.

The government argues that the relevant market in this case consists of all DDIY products, but does not include assisted tax preparation or pen-and-paper. Under this view of the market, the acquisition in this case would result in a DDIY market that is dominated by two large players – H&R Block and Intuit – that together control approximately 90 percent of the market share, with the remaining 10 percent of the market divided amongst a plethora of smaller companies. In contrast, the defendants argue for a broader market that includes all tax preparation methods ("all methods"), comprised of DDIY, assisted, and pen-and-paper. Under this view of the market, the market concentration effects of this acquisition would be much smaller and would not lead to a situation in which two firms control 90 percent of the market. This broader view of the market rests primarily on the premise that providers of all methods of tax preparation compete with each other for the patronage of the same pool of customers – U.S. taxpayers. After carefully considering the evidence and arguments presented by all parties, the Court has concluded that the relevant market in this case is, as the DOJ contends, the market for digital do-it-yourself tax preparation products.

A "relevant product market" is a term of art in antitrust analysis. The Supreme Court has set forth the general rule for defining a relevant product market: "The outer boundaries of a product market are determined by the reasonable interchangeability of use [by consumers] or the cross-elasticity of demand between the product itself and substitutes for it." *Brown Shoe*, 370 U.S. at 325; *see also United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377, 395 (1956). In other words, courts look at "whether two products can be used for the same purpose, and, if so, whether and to what extent purchasers are willing to substitute one for the other." *FTC v. Staples, Inc.*, 970 F. Supp. 1066, 1074 (D.D.C. 1997) (citation omitted); *see also Bon-Ton Stores,*

Inc. v. May Dep't Stores Co., 881 F. Supp. 860, 868 (W.D.N.Y. 1994) (citing *Hayden Pub. Co. v. Cox Broad. Corp*., 730 F.2d 64, 71 (2d Cir. 1984)).

A broad, overall market may contain smaller markets which themselves "constitute product markets for antitrust purposes."[8] *Brown Shoe*, 370 U.S. at 325. "[T]he mere fact that a firm may be termed a competitor in the overall marketplace does not necessarily require that it be included in the relevant product market for antitrust purposes." *Staples*, 970 F. Supp. at 1075. Traditionally, courts have held that the boundaries of a relevant product market within a broader market "may be determined by examining such practical indicia as industry or public recognition of the [relevant market] as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors." *FTC v. Whole Foods Market, Inc.* 548 F.3d 1028, 1037-38 (D.C. Cir. 2008) (Brown, J.) (quoting *Brown Shoe*, 370 U.S. at 325).[9] *See also FTC v. CCC Holdings, Inc.*, 605 F. Supp. 2d 26, 38 (D.D.C. 2009). These "practical indicia" of market boundaries may be viewed as evidentiary proxies for proof of substitutability and cross-elasticities of supply and demand. *Rothery Storage & Van Co. v. Atlas Van Lines, Inc*., 792 F.2d 210, 218 (D.C. Cir. 1986).

[8] Courts have sometimes referred to such markets-within-markets as "submarkets." *See Brown Shoe*, 370 U.S. at 325; *Whole Foods*, 548 F.3d at 1037-38 (Brown, J.). Other courts and commentators have criticized this "submarket" terminology as unduly confusing, however. *See* 5C PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 533, at 251 (3d ed. 2007) ("Courts sometimes describe the closest substitutes as a 'submarket' within a larger 'market' of less-close substitutes. Although degrees of constraint do in fact vary, the 'market' for antitrust purposes is the *one* relevant to the particular legal issue at hand.") (internal citations omitted); *Geneva Pharms. Tech. Corp. v. Barr Labs, Inc.*, 386 F.3d 485, 496 (2d Cir. 2004) ("The term 'submarket' is somewhat of a misnomer, since the 'submarket' analysis simply clarifies whether two products are in fact 'reasonable' substitutes and are therefore part of the same market.").

[9] The D.C. Circuit's decision in *Whole Foods* lacked a majority opinion. *See Whole Foods*, 548 F.3d at 1061 n.8 (Kavanaugh, J., dissenting). Judges Brown and Tatel filed separate opinions concurring in the judgment to reverse the District Court and Judge Kavanaugh, in dissent, would have affirmed. *See id.* at 1032 (Brown, J.); *id.* at 1041 (Tatel, J.); *id.* at 1051 n.1 (Kavanaugh, J., dissenting). Thus, in referring to the opinions in *Whole Foods*, the Court will indicate the name of the Judge whose opinion is cited.

An analytical method often used by courts to define a relevant market is to ask hypothetically whether it would be profitable to have a monopoly over a given set of substitutable products. If so, those products may constitute a relevant market. *See* 5C PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW (hereinafter, "Areeda & Hovenkamp"), ¶ 530a, at 226 (3d ed. 2007) ("[A] market can be seen as the array of producers of substitute products that could control price if united in a hypothetical cartel or as a hypothetical monopoly."). This approach – sometimes called the "hypothetical monopolist test" – is endorsed by the Horizontal Merger Guidelines issued by the DOJ and Federal Trade Commission. *See Fed. Trade Comm'n & U.S. Dep't of Justice Horizontal Merger Guidelines* (2010) (hereinafter, "Merger Guidelines"), § 4.1.1.[10] In the merger context, this inquiry boils down to whether "a hypothetical profit-maximizing firm, not subject to price regulation, that was the only present and future seller of those products . . . 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." *Id.* The "small but significant and non-transitory increase in price," or SSNIP, is typically assumed to be five percent or more. *Id.* § 4.1.2.

Thus, the question here is whether it would be hypothetically useful to have a monopoly over all DDIY tax preparation products because the monopolist could then profitably raise prices for those products by five percent or more; or whether, to the contrary, there would be no reason to monopolize all DDIY tax preparation products because substitution and price competition with other methods of tax preparation would restrain any potential DDIY monopolist from profitably raising prices. In other words, would enough DDIY users switch to the assisted or

[10] The Merger Guidelines are not binding upon this Court, but courts in antitrust cases often look to them as persuasive authority. *See Staples*, 970 F. Supp. at 1081-82.

pen-and-paper methods of tax preparation in response to a five-to-ten percent increase in DDIY prices to make such a price increase unprofitable?

In evaluating the relevant product market here, the Court considers business documents from the defendants and others, the testimony of the fact witnesses, and the analyses of the parties' expert economists. This evidence demonstrates that DDIY is the relevant product market in this case.

1. The Defendants' Documents Show That DDIY Is The Relevant Product Market.

When determining the relevant product market, courts often pay close attention to the defendants' ordinary course of business documents. *See, e.g., Staples*, 970 F. Supp. at 1076; *CCC Holdings*, 605 F. Supp. 2d at 41-42. The government argues that the defendants' ordinary course of business documents in this case "conclusively demonstrate that competition with other [DDIY] firms drive Defendants' pricing decisions, quality improvements, and corporate strategy" for their own DDIY products—thus supporting the government's view of the relevant market. Pl.'s Post-Trial Mem. at 7. The defendants contend that the government has relied on "select, 'out-of-context' snippets from documents," and that the documents as a whole support the defendants' view that the relevant product market is all methods of tax preparation. Defs.' Post-Trial Mem. at 1. The Court finds that the documentary evidence in this case supports the conclusion that DDIY is the relevant product market.

Internal TaxACT documents establish that TaxACT has viewed DDIY offerings by HRB and TurboTax as its primary competitors, that it has tracked their marketing, product offerings, and pricing, and that it has determined its own pricing and business strategy in relation to those companies' DDIY products. *See* GX 295-16 ("Competitive Analysis" comparing the three companies); GX 102 (email explaining TaxACT is a "direct competitor" with HRB and Intuit's

products); GX 55 (Greif Dep.) at 137-38 (describing TaxACT's compilation of a routine, end-of-season competitive analysis that "typically" covers Intuit, HRB, and TaxACT). Confidential memoranda prepared by TaxACT's investment bankers for potential private equity buyers of TaxACT identify HRB and TurboTax as TaxACT's primary competitors in a DDIY market. *See* GX 7 (Greene Holcomb & Fisher "Confidential Memorandum") at 14 ("The Company's major competitors for both desktop and Internet-based income tax software and e-filing services include Intuit (the makers of TurboTax software) and H&R Block (the makers of TaxCut software)."); GX 134 (Deutsche Bank "Confidential Information Memorandum") at 17 ("The Company's two main competitors, Intuit and H&R Block. . ."); *see also* Dunn, TT, 9/7/11 p.m., at 97-104. These documents also recognize that TaxACT's strategy for competing with Intuit and HRB is to offer a lower price for what it deems a superior product. GX 7 at 14 ("Relative to its two major competitors, 2nd Story has positioned its product offerings as being of equal or higher quality, and completely fulfilling the needs of a vast portion of the potential market. It also pursues a pricing strategy that positions its products and services meaningfully below either Intuit or H&R Block, in some instances free.").

While, as defendants point out, parts of these TaxACT documents also discuss the broader tax preparation industry, these documents make clear that TaxACT's own view – and that conveyed by its investment bankers to potential buyers – is that the company primarily competes in a DDIY market against Intuit and HRB and that it develops its pricing and business strategy with that market and those competitors in mind. These documents are strong evidence that DDIY is the relevant product market. *See Whole Foods*, 548 F.3d at 1045 (Tatel, J.) ("[E]vidence of industry or public recognition of the submarket as a separate economic unit

matters because we assume that economic actors usually have accurate perceptions of economic realities.") (internal quotation omitted).

Internal HRB documents also evidence HRB's perception of a discrete DDIY market or market segment. HRB and its outside consultants have tracked its digital competitors' activities, prices, and product offerings. *See* GX 28-19 ("2009 Competitive Price Comparison"); GX 118 (independent analyst's report analyzing digital competitors as one of three separate categories of competitors); GX 61-8 at 1 (slide on competition in "digital market" identifying TurboTax and TaxACT as competitors); GX 199 (HRB "digital strategy update" Powerpoint tracking features and prices for TurboTax and TaxACT); GX 188 (HRB spreadsheet comparing HRB, TurboTax, and TaxACT prices for various product offerings). Documents from HRB's DDIY business have also referred to HRB, TaxACT, and TurboTax as the "Big Three" competitors in the DDIY market. GX 61-3 ("OCS Offsite Competitive Intelligence Review of TS07") at 5; GX 61-4 at 1 (email referencing request for data from consultant regarding "big 3 digital tax prep companies"); *see also* GX 70 (email from head of HRB's digital business stating its "only real direct competitors are turbotax in san diego and taxact in cedar rapids" [sic]); Ernst, TT, 9/7/11 a.m., at 13-14. Finally, the documents show that, in connection with a proposed acquisition of TaxACT, HRB identified the proposed transaction as a way to grow its digital "market share" and has measured TaxACT's market share in a DDIY market. GX 130 at 96-99; GX 21-37 (projections from 2009 for different potential scenarios for acquisition of TaxACT, including their effect on DDIY market share); *see also* Newkirk, TT, 9/7/11 a.m., at 95-96 (explaining GX 21-37). All of these documents also provide evidence that DDIY is a relevant product market.

The defendants acknowledge that "the merging parties certainly have documents that discuss each other and digital competitors generally, and even reference a digital market and the

'Big Three,'" but contend this evidence is insufficient to prove a market. Defs.' Post-Trial Mem. at 9. Rather, the defendants argue that the documents show that the relevant market is all methods of tax preparation, especially in light of documented competition between DDIY providers and assisted providers for the same overall pool of U.S. taxpayers who are potential customers. *See id.* 9-10; *see, e.g.*, DX 78 at 4 (Intuit document explaining 2011 strategic goal of acquiring tax store customers); GX 650 at 41 (Intuit document noting goal of acquiring tax store customers and specifically mentioning HRB). As discussed below, the Court disagrees and finds that the relevant product market is DDIY products.

2. The Relevant Product Market Does Not Include Assisted Tax Preparation Or Manual Preparation.

It is beyond debate – and conceded by the plaintiff – that all methods of tax preparation are, to some degree, in competition. Pl.'s Post-Trial Mem. at 8. All tax preparation methods provide taxpayers with a means to perform the task of completing a tax return, but each method is starkly different. Thus, while providers of all tax preparation methods may compete at some level, this "does not necessarily require that [they] be included in the relevant product market for antitrust purposes." *Staples,* 970 F. Supp. at 1075. DDIY tax preparation products differ from manual tax preparation and assisted tax preparation products in a number of meaningful ways. As compared to manual and assisted methods, DDIY products involve different technology, price, convenience level, time investment, mental effort and type of interaction by the consumer. Taken together, these different attributes make the consumer experience of using DDIY products quite distinct from other methods of tax preparation. *See Whole Foods*, 548 F.3d at 1037-38 (Brown, J.) (noting that a "product's peculiar characteristics and uses" and "distinct prices" may distinguish a relevant market) (citing *Brown Shoe,* 370 U.S. at 325); *see also, e.g.,* GX 130 at 140 (HRB internal analysis discussing convenience and price as factors differentiating DDIY and

assisted methods for consumers). The question for this court is whether DDIY and other methods of tax preparation are "reasonably interchangeable" so that it would not be profitable to have a monopoly over only DDIY products.

a. Assisted Tax Preparation Is Not In The Relevant Product Market.

Apart from the analysis of their economic expert, the defendants' main argument for inclusion of assisted tax preparation in the relevant market is that DDIY and assisted companies compete for customers.[11] As evidence for this point, the defendants emphasize that Intuit's marketing efforts have targeted HRB's assisted customers. *See* DX 78 at 3 (Intuit document noting strategic goal to "Beat Tax Store[s]"). While the evidence does show that companies in the DDIY and assisted markets all generally compete with each other for the same overall pool of potential customers – U.S. taxpayers – that fact does not necessarily mean that DDIY and assisted must be viewed as part of the same relevant product market. DDIY provides customers with tax preparation services through an entirely different method, technology, and user experience than assisted preparation. As Judge Tatel explained in *Whole Foods*:

> [W]hen the automobile was first invented, competing auto manufacturers obviously took customers primarily from companies selling horses and buggies, not from other auto manufacturers, but that hardly shows that cars and horse-drawn carriages should be treated as the same product market. That Whole Foods and Wild Oats have attracted many customers away from conventional grocery stores by offering extensive selections of natural and organic products thus tells us nothing about whether Whole Foods and Wild Oats should be treated as operating in the same market as conventional grocery stores. Indeed, courts have often found that sufficiently innovative retailers can constitute a distinct product market even when they take customers from existing retailers.

Whole Foods, 548 F.3d at 1048; *see also Staples*, 970 F. Supp. at 1074-80 (finding a distinct market of office supply superstores despite competition from mail-order catalogues and stores carrying a broader range of merchandise).

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[11] The defendants' primary argument for inclusion of both assisted and pen-and-paper in the relevant market is based upon their economic expert's analysis of data derived from two consumer surveys commissioned by the defendants. The Court will analyze the arguments of the defendants' expert economist separately below.

The key question for the Court is whether DDIY and assisted products are sufficiently close substitutes to constrain any anticompetitive DDIY pricing after the proposed merger. Evidence of the absence of close price competition between DDIY and assisted products makes clear that the answer to that question is no—and that DDIY is the relevant product market here. *See Swedish Match*, 131 F. Supp. 2d at 165 ("Distinct pricing is also a consideration" in determining the relevant product market) (citing *Brown Shoe*, 370 U.S. at 325). Significantly, despite some DDIY efforts to capture tax store customers, none of the major DDIY competitors sets their prices based on consideration of assisted prices. *See, e.g.,* Ernst, TT, 9/7/11 a.m., at 35 (HRB set its digital and assisted prices separately); {redacted} (Dep.) at 183:18-25 (explaining that {redacted} does not consider assisted pricing in setting prices because its prices are already "substantially less than both tax stores and most professionals"). Indeed, there are quite significant price disparities between the average prices of DDIY and assisted products. The average price of TurboTax, the most popular DDIY brand is approximately $55. GX 293 (Intuit Dep.) at 21. The average price of HRB's DDIY products is approximately $25. GX 296-7 at 6. Overall, the DDIY industry average price is $44.13. GX 121 at 57. In contrast, the typical price of an assisted tax return is significantly higher, in the range of $150-200.[12] A 10 percent or even 20 percent price increase in the average price of DDIY would only move the average price up to $48.54 or $52.96, respectively – still substantially below the average price of assisted tax products. The overall lack of evidence of price competition between DDIY and assisted products supports the conclusion that DDIY is a separate relevant product market for evaluating this transaction, despite the fact that DDIY and assisted firms target their marketing efforts at the same pool of customers.

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[12] *See* GX 128 (HRB "TS10 Market Dynamics" presentation) at 38 {redacted}; *see also id.* {redacted}; GX 293 (Intuit Dep.) at 21:9-14 ("The average price of a tax store is in the range of $200."); Bennett, TT, 9/6/11 p.m., at 100 (estimating $150 range for assisted returns offered at Jackson Hewitt and HRB offices at Wal-Mart locations).

The defendants point to some evidence that HRB sets prices for certain assisted products to compete with DDIY. For example, defendants note that in 2009, HRB "reduced prices on its assisted tax preparation services to $39 for federal 1040EZ preparation and $29 for state tax preparation to compete with and {redacted}" to DDIY. DFF ¶ 77a. These are limited product offerings for which prices appear well below even the 25th percentile price for HRB's assisted products. *See* GX 128 (HRB "TS10 Market Dynamics" presentation) at 38 (noting, for Tax Season 2010, that the 25th percentile for prices at HRB stores was {higher than DDIY}). Relatedly, the defendants' claim that prices for assisted and DDIY products "significantly overlap" is not strongly supported and relies on a comparison of the most limited, low-end assisted products with DDIY products generally. *See* DFF ¶ 78b (citing tax year 2009 data that show that 14 percent of customers using name-brand tax stores paid $50 or less and another 20 percent paid between $51-100); *id.* ¶ 78c-d (quoting prices for Jackson Hewitt's preparation of form 1040EZ, a simplified tax form, at Wal-Mart and for HRB's Second Look service, which actually only double-checks an already completed tax return for errors). In sum, while defendants' have identified isolated instances in which assisted product offerings are priced lower than the average prices for typical assisted products, they do not and cannot demonstrate that this is generally the case.

Testimony from HRB executives further supports treating DDIY as a relevant product market in evaluating this transaction. HRB's DDIY and assisted businesses are run as separate business units. Bennett, TT, 9/6/11 a.m., at 106. Alan Bennett, who was the CEO of HRB in 2010 when the parties reached the proposed merger agreement, testified that "net-net," he did not believe that HRB's DDIY business had impacted its assisted business in terms of taking away

customers.[13] *Id.* at 108; *see also* GX 1151 at 4 (HRB internal analysis stating "Online is not growing materially at the expense of assisted."). Mark Ernst, HRB's CEO from 2001 to 2007, also explained that, in his opinion based on research he reviewed while at HRB, the primary reason consumers switched between assisted and DDIY was because of "life events" that led to changes in tax status. Ernst, TT, 9/7/11 a.m., at 34-35.

Finally, defendants argue that their broad relevant market is appropriate because there is "industry movement toward 'hybrid' products that combine some elements of both digital and assisted tax preparation." Defs.' Post-Trial Mem. at 11. Based on the evidence presented at the hearing, however, it would be premature for the Court to identify any trend toward hybrid products. In fact, neither Intuit nor TaxACT presently offers a hybrid product and the defendants openly concede that HRB's current hybrid product has had "somewhat limited success," which defendants attribute to "technical issues" and a "lack of consistent marketing." *Id.* at 11 n.16. {redacted} {T}he Court finds it unlikely that there will be a sufficiently large scale shift into these products in the immediate future to compel the conclusion that DDIY and assisted products make up the same relevant product market.

b. Manual Tax Preparation Is Not In The Relevant Product Market.

The defendants also argue that manual tax preparation, or pen-and-paper, should be included in the relevant product market. At the outset, the Court notes that pen-and-paper is not a "product" at all; it is the task of filling out a tax return by oneself without any interactive assistance. Even so, the defendants argue pen-and-paper should be included in the relevant product market because it acts as a "significant competitive constraint" on DDIY. Defs.' Post-

[13] By "net-net," Mr. Bennett meant that while there is customer switching between the DDIY and assisted businesses, the total share of customers in each has been relatively stable over the past few years, such that Mr. Bennett could conclude that the two business lines "do not steal customers back and forth net." Bennett, TT, 9/6/11 a.m., at 108.

Trial Mem. at 11. The defendants' argument relies primarily on two factors. First, the defendants' cite the results of a 2011 email survey of TaxACT customers. *See id.* For reasons detailed in the following section, the Court declines to rely on this email survey. Second, the defendants point to documents and testimony indicating that TaxACT has considered possible diversion to pen-and-paper in setting its prices. *See id.* at 11-12.

The Court finds that pen-and-paper is not part of the relevant market because it does not believe a sufficient number of consumers would switch to pen-and-paper in response to a small, but significant increase in DDIY prices. The possibility of preparing one's own tax return necessarily constrains the prices of other methods of preparation at some level. For example, if the price of DDIY and assisted products were raised to $1 million per tax return, surely all but the most well-heeled taxpayers would switch to pen-and-paper. Yet, at the more practical price increase levels that trigger antitrust concern – the typical five to ten percent price increase of the SSNIP test – pen-and-paper preparation is unlikely to provide a meaningful restraint for DDIY products, which currently sell for an average price of $44.13. GX 121 at 57.

The government well illustrated the overly broad nature of defendants' proposed relevant market by posing to the defendants' expert the hypothetical question of whether "sitting at home and drinking chicken soup [would be] part of the market for [manufactured] cold remedies?" Meyer, TT, 9/13/11 a.m., at 65. The defendants' expert responded that the real "question is if the price of cold medicines went up sufficiently, would people turn to chicken soup?" *Id.* As an initial matter, in contrast to the defendants' expert, the Court doubts that it would ever be legally appropriate to define a relevant product market that included manufactured cold remedies and ordinary chicken soup. This conclusion flows from the deep functional differences between those products. Setting that issue aside, however, a price has increased "sufficiently" to trigger

antitrust concern at the level of a five to ten percent small, but significant non-transitory increase in price. Just as chicken soup is unlikely to constrain the price of manufactured cold remedies sufficiently, the Court concludes that a SSNIP in DDIY would not be constrained by people turning to pen-and-paper. First, the share of returns prepared via pen-and-paper has dwindled over the past decade, as the DDIY market has grown. Bennett, TT, 9/6/11 a.m, at 118; GX 296 (Houseworth Dep.) at 66-68. Second, while pen-and-paper filers have been a net source of new customers for DDIY companies, both HRB and {redacted} executives have testified that they do not believe their DDIY products compete closely with pen-and-paper methods. {redacted} (Dep.) at 37:20-38:10; *see* GX 296 (Houseworth Dep.) 89-90. Third, courts in antitrust cases frequently exclude similar "self-supply" substitutes from relevant product markets. *See, e.g.*, *FTC v. H.J. Heinz Co.*, 116 F. Supp. 2d 190, 195 (D.D.C. 2000), *rev'd on other grounds*, 246 F.3d 708 (D.C. Cir. 2001) (noting that homemade baby food and breast milk should not be included in the jarred baby food market even though substitution was possible because "the Supreme Court's interchangeability test refers to *products*."); *CCC Holdings*, 605 F. Supp. 2d at 41-42 (excluding books that can be used to perform insurance loss valuations by hand from market for loss valuation software); *United States v. Visa U.S.A. Inc.*, 163 F. Supp. 2d 322, 338 (S.D.N.Y. 2001) (excluding cash and checks from general purpose credit card market).

The main case the defendants rely on to show that "self-supply" substitutes should be included in the relevant market involved a consumer market consisting of vertically integrated companies and explicitly distinguished cases, such as this one, involving markets of individual consumers. In *United States v. Sungard Data Systems, Inc.*, Judge Huvelle found that disaster recovery computer systems developed internally by companies were in the same relevant product market as shared data recovery systems provided by outside vendors. *Sungard*, 172 F. Supp. 2d

at 187-89. The *Sungard* court, however, distinguished the case before it – which involved vertical integration – from the situation in *Heinz*, the case involving the market for jarred baby food, because "homemade baby food is not an aspect of vertical integration . . . [and] individual consumers cannot vertically integrate by producing a product that they would otherwise have to purchase." *Id.* at 187 n.15. In finding that in-house computer systems were included in its relevant product market, the *Sungard* court cited the following example from Areeda & Hovenkamp ¶ 535e regarding vertical integration:

> If iron ore is the relevant market and if shares are best measured there by sales, then internally used ore—so-called captive output—is part of the ore market even though it is not sold as such.
>
> In measuring the market power of a defendant selling iron ore, the ore used internally by other firms constrains the defendant's ability to profit by raising ore prices to monopoly levels. The higher ore price may induce an integrated firm to expand its ore production—to supply others in direct competition with the alleged monopolist or to expand its own steel production and thereby reduce the demand of other steel makers for ore, or both. Hence, captive output constrains the defendant regardless of whether integrated firms sell their ore to other steel makers previously purchasing from the defendant. In sum, the integrated firm's ore output belongs in the market.

Id. at 186 n.14. This rationale for including "self-supply" in a relevant product market does not appear to apply to the DDIY market in which the consumers are individuals and not also potential traders or producers.

While some diversion from DDIY to manual filing may occur in response to a SSNIP, the Court finds that it would likely be limited and marginal. The functional experience of using a DDIY product is meaningfully different from the self-service task of filling out tax forms independently. Manual completion of a tax return requires different tools, effort, resources, and time investment by a consumer than use of either DDIY or assisted methods. The following discussion from *United States v. Visa U.S.A. Inc.* regarding why cash and checks should not be included in the credit card market is instructive here:

> [A]lthough it is literally true that, in a general sense, cash and checks compete with general purpose cards as an option for payment by consumers and that growth in payments via cards takes share from cash and checks in some instances, cash and checks do not drive many of the means of competition in the general purpose card market. In this respect, [the expert's] analogy of the general purpose card market to that for airplane travel is illustrative. [The expert] argues that while it is true that at the margin there is some competition for customers among planes, trains, cars and buses, the reality is that airplane travel is a distinct product in which airlines are the principal drivers of competition. Any airline that had monopoly power over airline travel could raise prices or limit output without significant concern about competition from other forms of transportation. The same holds true for competition among general purpose credit and charge cards.

Visa U.S.A. Inc., 163 F. Supp. 2d at 338. Here, the same analogy to airplane travel holds true for competition among DDIY providers, who provide a distinct product for completion of tax returns. Indeed, the pen-and-paper method, in which the consumer essentially relies on his or her own labor to prepare a tax return, is perhaps most analogous to walking as opposed to purchasing a ride on any means of transportation. In sum, filling out a tax return manually is not reasonably interchangeable with DDIY products that effectively fill out the tax return with data input provided by the consumer.

Inclusion of all possible methods of tax preparation, including pen-and-paper, in the relevant product market also violates the principle that the relevant product market should ordinarily be defined as the smallest product market that will satisfy the hypothetical monopolist test. *See* Merger Guidelines § 4.1.1 ("When the Agencies rely on market shares and concentration, they usually do so in the smallest relevant market satisfying the hypothetical monopolist test."); *see also* Warren-Boulton, TT, 9/8/11 p.m., at 35-36. Indeed, the defendants' inclusion of pen-and-paper in the relevant market ignores at least one obvious, smaller market possibility that they might have proposed – the combined market of all DDIY and assisted tax preparation products. It is hardly plausible that a monopolist of this market – to which the only alternative would be pen-and-paper – could not impose a SSNIP.

The defendants' proposed relevant market of all methods of tax return preparation is so broadly defined that, as the plaintiff's expert testified, there are no conceivable alternatives besides going to jail, fleeing to Canada, or not earning any taxable income. Warren-Boulton, TT, 9/8/11 p.m., at 35-36. As the plaintiff's expert put it, "if you're talking about the market for all tax preparation, you're talking about a market where, in economist terms, demand is completely [in]elastic. There are no alternatives." *Id.* at 35. In such circumstances, the usual tools of antitrust analysis – such as the hypothetical monopolist test – cease being useful because it is self-evident that a monopolist of all forms of tax preparation, including self-preparation, could impose a small, but significant price increase. Indeed, a monopolist in that situation could essentially name any price since taxpayers would have no alternative but to pay it. As the plaintiff's expert testified, defining a market that broadly

> negates the entire purpose of defining a relevant market in an antitrust case. You want to define a relevant market in an antitrust case so then [you can calculate] shares and the change in shares makes sense. I don't want to go to infinity . . . I want to define a relevant market under . . .the smallest market principle, which is I want to define the relevant market so that if a hypothetical monopolist . . . did manage to control all of those products, they would impose a significant price increase, large enough to be of concern but not so large as to make the whole exercise pointless.

Id. at 35-36. The Court agrees with this assessment and finds the defendants' proposed relevant market to be overbroad.

3. The Economic Expert Testimony Tends To Confirm That DDIY Is The Relevant Product Market.

Both the plaintiff and the defendants presented testimony from expert economists to support their view of the relevant product market.[14] In addition to their testimony at the hearing,

[14] The plaintiff presented expert testimony on market definition from Frederick R. Warren-Boulton, an economist at MiCRA, an economics consulting and research firm. GX 121 (Warren-Boulton Rep.) at 1. Dr. Warren-Boulton holds a B.A. from Yale University, a Ph.D. in economics from Princeton University, and formerly served as the chief economist for the Antitrust Division of the U.S. Department of Justice. *Id.* Dr. Warren-Boulton has previously served as an expert witness in other antitrust cases, including cases challenging the possible

these expert witnesses also provided a detailed expert report and an affidavit summarizing their analysis and conclusions.

The Court finds that the analysis performed by the plaintiff's expert tends to confirm that DDIY is a relevant product market, although the available data in this case limited the predictive power of the plaintiff's expert's economic models. The Court also finds that it cannot draw any conclusions from defendants' expert's analysis because of severe shortcomings in the underlying consumer survey data upon which the defendants' expert relied.

a. Plaintiff's Expert - Dr. Warren-Boulton

The plaintiff's expert, Dr. Warren-Boulton, found the relevant product market to be DDIY. He determined that a hypothetical monopolist of DDIY products could profitably impose a SSNIP for at least one DDIY product, and that consumer substitution to assisted methods or pen-and-paper would be insufficient to defeat the SSNIP. GX 121 (Warren-Boulton Rep.) at 12.

Dr. Warren-Boulton began his analysis by postulating that DDIY was the relevant product market and then he used two principal analytical tests to confirm the validity of that assumption. He began by testing DDIY as a relevant market for a few reasons. First, he concluded that the parties' DDIY products are substantially similar in terms of functionality. GX 121 (Warren-Boulton Rep.) at 12-18. Second, he concluded from his review of the defendants' business documents that they viewed DDIY as a discrete product market when competing in the

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anticompetitive effects of a merger or acquisition. *Id.* (noting involvement in *FTC v. Staples, Inc.,* 970 F. Supp. 1066, 1074 (D.D.C. 1997)).

The defendants presented expert testimony from Christine Siegwarth Meyer, an economist at National Economic Research Associates, Inc., an economics consulting and research firm. DX 17 (Meyer Rep.) at 1. Dr. Meyer holds a B.A. from the United States Military Academy at West Point, a Ph.D. in economics from the Massachusetts Institute of Technology, and has taught economics at the university level. *Id.* Dr. Meyer has not previously provided expert testimony regarding the possible anticompetitive effects of a merger or acquisition. Meyer, TT, 9/13/11 a.m., at 39.

ordinary course of business. *Id*. Third, he ruled out including pen-and-paper and assisted products in the relevant product market based on a consideration of various data. *Id.* at 24-32.

Dr. Warren-Boulton's decision to begin the relevant market analysis with DDIY was appropriate. *See* Areeda & Hovenkamp ¶ 536, at 287 ("[T]wo products are provisionally part of the same market [for hypothetical monopolist analysis] when they employ similar technologies and similar costs and customers use them interchangeably. . . In cases of doubt, [products] should generally be excluded from the provisional market, for incorrect exclusions will ultimately be brought into the market via the price increase methodology."). The parties' DDIY products all provide a fundamentally similar service and a similar user experience for the consumer when compared with other methods of tax preparation. The DDIY consumer sits down at a computer and interacts with the DDIY software, which prompts the consumer for information and ultimately completes the consumer's tax return. This experience is qualitatively different than that of hiring a tax professional or figuring out how to complete one's own tax return manually. Various other evidence in the record also supports the fundamental functional similarity of the technology underlying the parties' DDIY products – perhaps most notably the testimony that post-merger, HRB plans to migrate {redacted} onto TaxACT's software "engine" {redacted}. *See* Dunn, TT, 9/8/11 p.m. (sealed), at 16-17.

As discussed in detail above, various documentary evidence suggests that the parties treat DDIY as a distinct product market in the ordinary course of business.

Dr. Warren-Boulton also considered whether the pen-and-paper and assisted methods should be included in the provisional relevant market, as the defendants contend, and concluded that they should not be.

Dr. Warren-Boulton ruled out including pen-and-paper in the relevant product market, concluding instead that historical tax return data reflects "a gradual migration of customers to [DDIY] from more traditional methods like pen-and paper." GX 121 (Warren-Boulton Rep.) at 24. The percentage of returns prepared by pen-and-paper has fallen considerably over the last decade, while the percentage of DDIY has grown. *Id.* Changes in the yearly percentage shares of taxpayers using pen-and-paper do not appear correlated to changes in the yearly average price of DDIY. *Id.* at 27. Finally, based on IRS data, Dr. Warren-Boulton observed that taxpayers who switched from DDIY to pen-and-paper for tax seasons 2008 and 2009 on average experienced a decrease in tax return complexity, suggesting that much switching from DDIY products to pen-and-paper is driven by such complexity decreases.[15]

Dr. Warren-Boulton also ruled out including the assisted tax preparation methods in the relevant market based on consideration of several factors. He reviewed HRB documents that conclude that growth in DDIY has not come at the expense of HRB's assisted business. *Id.* at 28. Testimony from HRB employees, including the former CEO, also reinforced the same conclusion. *Id.* at 28-29. He also cited HRB internal studies, which concluded that consumers who have switched from DDIY to assisted are likely to have experienced a change in tax complexity. He found that HRB's internal conclusion was consistent with IRS switching data, which also indicated a correlation between switching from DDIY to assisted and an increase in tax complexity. *Id*. at 29-30. Finally, Dr. Warren-Boulton noted that, based on data from tax years 2004-2009, increases in the relative price of assisted products were not associated with decreases in the relative market share of assisted products and increases in the relative market

[15] Switching, as discussed further below, refers to the switching of consumers between different products for any reason. The IRS categorizes tax returns into one of three complexity categories: Simple, Intermediate, and Complex. Accordingly, the IRS data only reflects complexity changes that are sufficient to result in assignment to a different one of the three categories.

share of DDIY, as might be expected if DDIY and assisted prices moved in a single, price-responsive market. *Id.* at 32.

Therefore, having determined that the best provisional relevant market is DDIY and not all methods of tax preparation, Dr. Warren-Boulton then performed two economic tests to confirm that a hypothetical monopolist of all DDIY products could profitably impose a SSNIP. If these economic tests indicated that a hypothetical monopolist could not profitably impose a SSNIP, then the tests would call for the relevant market to be expanded. The tests, however, validated the relevant market as DDIY, as detailed below.

The economic tests Dr. Warren-Boulton applied relied heavily upon switching data from the IRS. Switching refers to the number of consumers who switch between different products for any reason. In any given year, many taxpayers switch from the tax preparation method they used in the prior year to a new method. Since the IRS processes all U.S. tax returns each year and tracks data about the methods of tax preparation that taxpayers used, there is ample, reliable data that market analysts can use to see how many taxpayers switched between methods each year. The IRS data, however, provides little direct insight about *why* any given taxpayer switched methods of preparation. The switch could have been for reasons of price, convenience, changes in the consumer's personal situation, an increase or decrease in tax complexity, a loss of confidence in the prior method of preparation, or any other reason.

As opposed to switching, diversion refers to a consumer's response to a measured increase in the price of a product. In other words, diversion measures to what extent consumers of a given product will switch (or be "diverted") to other products in response to a price increase in the given product. The IRS switching data does not directly measure diversion because switching can occur for any number of reasons, many of which may not involve price.

Unfortunately, no direct, reliable data on diversion exists in this case. The plaintiff's expert argues, however, that the IRS switching data can provide at least some estimate of diversion. While this approach is not without its limitations, as discussed further below, the Court finds that the switching data is at least somewhat indicative of likely diversion ratios. Moreover, the IRS data is highly reliable because (1) the sample size is enormous, since it encompasses over 100 million taxpayers, and (2) the data reflects actual historical tax return filing patterns as opposed to predicted behavior.[16]

The defendant's expert, who criticizes reliance on this switching data, suggests instead that a better analysis can be based upon simulated diversion data derived from consumer surveys commissioned by the defendants. As described more fully below, however, the shortcomings of these survey-derived diversion data are so substantial that the Court cannot rely on them.

i. Critical Loss Analysis

The first economic test Dr. Warren-Boulton performed is known as a "critical loss" analysis. This test attempts to calculate "the largest amount of sales that a monopolist can lose before a price increase becomes unprofitable." *Swedish Match*, 131 F. Supp. 2d at 160. Dr. Warren-Boulton calculated that for a 10 percent price increase in DDIY, the price increase would

[16] One limitation in the IRS data set is that if a taxpayer uses a DDIY product to prepare the return, but then prints and mails the return instead of e-filing it, the IRS does not attribute the filing to the DDIY provider and instead lists it in a generic "v-coded" pool of returns. At the hearing, the defendants' criticized the IRS switching data set as problematic on these grounds, suggesting that up to 30 million returns may be "v-coded." *See* Warren-Boulton, TT 9/20/11 a.m., at 21-22. As Dr. Warren-Boulton fully addressed in his expert report, however, a "conservative method for dealing with this issue is to drop all v-coded returns from the analysis," which would still leave well over 100 million returns in the IRS data set. *Id.*; GX 121 (Warren-Boulton Rep.) at 47. The defendants did not identify any reason the v-coded data would be likely to skew the data set. Thus, even if the v-coded data is disregarded, the IRS data set remains extensive and reliable. It is also worth noting that the IRS data does not distinguish between the DDIY providers' various products, so only firm-level switching rates are available. GX 121 (Warren-Boulton Rep.) at 47

be profitable if the resulting lost sales did not surpass 16.7 percent.[17] GX 121 (Warren-Boulton Rep.) at 34.

Dr. Warren-Boulton then sought to compare this critical loss threshold with "aggregate diversion ratios." The aggregate diversion ratio for any given product represents the proportion of lost sales that are recaptured by all other firms in the proposed market as the result of a price increase. Since these lost sales are recaptured within the proposed market, they are not lost to the hypothetical monopolist. According to Dr. Warren-Boulton, economists have shown that if the aggregate diversion ratio to products inside the proposed relevant market exceeds the critical loss threshold, then the critical loss analysis indicates that a SSNIP at that level would be profitable for a hypothetical monopolist. *Id.* at 34 (citing Michael Katz and Carl Shapiro, *Critical Loss: Let's Tell the Whole Story,* ANTITRUST (Spring 2003) at 49 -56); *see also* Warren-Boulton, TT, 9/9/11 p.m., at 33-34.

Because no diversion data is available, Dr. Warren-Boulton relied instead on IRS switching data to estimate aggregate diversion ratios. *Id.* These data show that of the taxpayers who left HRB's DDIY products between tax year 2007 and 2008,[18] 57 percent went to other DDIY providers. Of those who left TaxACT, 53 percent stayed in DDIY, and for TurboTax, 39 percent stayed in DDIY. *Id.* at 34-35. Since these numbers are all well above the 16.7 percent critical loss threshold, Dr. Warren-Boulton concluded a 10 percent SSNIP in the DDIY market would be profitable for a hypothetical monopolist.

In cross-examining Dr. Warren-Boulton, the defendants suggested that the critical loss test is meaningless because it would seem to validate numerous different candidate markets

[17] The formula for critical loss is $L = X/(X + M)$, where L is the critical loss, X is the percentage price increase, and M is the hypothetical monopolist's gross margin. Assuming a 50 percent margin, which Dr. Warren-Boulton claims is a conservative estimate for firms in the DDIY market, then the critical loss for a 10 percent SSNIP is 16.7 percent. 16.7 percent is the result of applying 10 percent and 50 percent in the formula $X/(X+M)$: $.167 = .1/(.1+.5)$.
[18] These are the last two years for which this data was available.

consisting of various assortments of tax preparation businesses. Warren-Boulton, TT, 9/9/11 p.m., at 20-42. For example, the defendants demonstrated that the test could also validate a market consisting of just HRB and Intuit or a market consisting of just TaxACT and Intuit. *See* DX 9802. Dr. Warren-Boulton noted in his testimony, however, that such markets are "smaller, irrelevant" markets for evaluating the proposed transaction between HRB and TaxACT. Warren-Boulton, TT, 9/9/11 p.m., at 41; *see also* Areeda & Hovenkamp ¶ 533c, at 254 ("[C]ourts correctly search for a 'relevant market' – that is a market relevant to the particular legal issue being litigated."). The fact that critical loss analysis would validate other groupings of businesses does not undermine Dr. Warren-Boulton's reliance on it to validate DDIY as the relevant market in this case.[19] Indeed, rather than urging a smaller relevant market definition, the defendants urged the Court to define the market much more broadly. Nonetheless, the Court appreciates the defendants' point that the critical loss test alone cannot answer the relevant market inquiry. While some inappropriate proposed relevant markets would be ruled out by the critical loss test, the fact that the test could still confirm multiple relevant markets means that the Court must rely on additional evidence in reaching the single, appropriate market definition.

ii. Merger Simulation

In addition to the critical loss analysis, Dr. Warren-Boulton also performed an economic simulation of a merger among the HRB, TaxACT, and Intuit. GX 121 (Warren-Boulton Rep.) at

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[19] The defendants also referred obliquely in cross examination to an academic debate surrounding the proper way to perform critical loss analysis. Warren-Boulton, TT, 9/9/11 p.m., at 23. Dr. Warren-Boulton acknowledged his awareness of the existence of this debate and the defendants' counsel did not pursue the topic further. *Id.* The Court has no basis for disputing Dr. Warren-Boulton's application of critical loss analysis based merely on the existence of unspecified academic critiques. The Court notes that the critical loss analysis is specifically endorsed by the Merger Guidelines as a method for implementing the SSNIP test, *see* Merger Guidelines § 4.1.3, and has been accepted by courts as a standard methodology. *See FTC v. CCC Holdings Inc.*, 605 F. Supp. 2d 26, 40 n.16 (D.D.C. 2009) ("Critical loss analysis is a standard tool used by economists to study potentially relevant markets."). The court in *CCC Holdings* ultimately did not rely on the expert's application of critical loss analysis due to what the court deemed a "gap" or oversight in the expert's reasoning, but the court nonetheless adopted the same relevant product market that the critical loss analysis had validated. *See id.* at 40-41.

35. This simulation, known as a Bertrand model, predicted that a monopolist of the DDIY products of these three companies would find it profit-maximizing to raise TaxACT's price by 83 percent, HRB's price by 37 percent and TurboTax's price by 11 percent absent efficiencies. *Id.* Dr. Warren Boulton concluded that this simulation also confirms that DDIY is the relevant product market.[20]

iii. Critiques of Dr. Warren-Boulton's Analysis

The defendants' expert, Dr. Meyer, critiques Dr. Warren-Boulton's analysis in numerous ways. Her most fundamental critique is that his reliance on switching data as a proxy for diversion is flawed because switching can occur for any number of reasons and, therefore, it is not necessarily indicative of what products consumers would switch to in response to a price increase. DX 17 (Meyer Rep.) at 59-60. Dr. Meyer is certainly correct in this critique. Dr. Warren-Boulton, however, testified forthrightly about the limitations involved in relying on switching data as a proxy for diversion:

> Using migration [i.e., switching] doesn't really answer, or it doesn't answer the precise question of [the] merger guidelines, which of course is, where would you go if there was a small but significant price increase? It basically asks the question, where did you go? And you could go for a lot of reasons. You could go because the price has changed, you could go because the quality changes, you could go because you changed. Complexity changes. And there's a lot of evidence in the record that people switch because of changes in their own complexity. But using migration percentages, or using those gives you, I think, a reasonable second estimate of diversion ratios, because it's really asking the question, you know, if you went to some -- if for some reason you decided to go from HRB to TaxACT, for all those reasons, is that roughly about the same percentages if you went due to a price increase?

Warren-Boulton, TT, 9/9/11 a.m., at 13-14. Thus, switching data does not necessarily indicate diversion for the reasons both experts have identified. In light of all the evidence in the record and the general similarity of DDIY products, the Court credits Dr. Warren-Boulton's conclusion

[20] Dr. Warren-Boulton's merger simulation is addressed further below in the Court's discussion of unilateral effects in Section III.B.2.c.

that it was reasonable to use switching data as a proxy for diversion, especially since no more refined historical data apparently exists. Bearing in mind the shortcomings of the switching data, the Court will not treat Dr. Warren-Boulton's hypothetical monopolist analysis as conclusive. The Court will treat it as another data point suggesting that DDIY is the correct relevant market, however.

Another major critique of Dr. Warren-Boulton's hypothetical monopolist analysis – and one that the defendants repeatedly emphasized at the hearing – is that Dr. Warren-Boulton decided "arbitrarily to *exclude* some alternatives that are closer substitutes than the products that he *included*." DX 17 (Meyer Rep.) at 70; *see* Meyer, TT, 9/12/11 p.m., at 20-22. As Dr. Meyer put it at the hearing, "Dr. Warren-Boulton's relevant market is a miscellaneous set of unconnected links, because it doesn't include . . . the closest substitute to H&R Block [At Home], which is assisted tax preparation. It doesn't include pen and paper, which is the closest substitute to TaxACT." Meyer, TT, 9/12/11 p.m., at 24-25. Dr. Meyer identified the "closest substitutes" to the merging parties' products using simulated diversion data. As discussed below, the Court finds this data unreliable and declines to rely upon it. Dr. Meyer opines, however, that Dr. Warren-Boulton failed to include the closest substitutes for the defendants' products in his market, even if switching data is treated as a proxy for diversion, as Dr. Warren-Boulton suggests. For example, Dr. Meyer states that "11.2% of TaxACT's customers in TY2007 switched to assisted preparation in TY2008, while only 2.7% switched to H&R Block At Home and 9.1% switched to TurboTax." DX 17 (Meyer Rep.) at 72. Thus, the defendants contend Dr. Warren-Boulton violated the following principle from the Merger Guidelines: "When applying the hypothetical monopolist test to define a market around a product offered by one of the merging firms, if the market includes a second product, the Agencies will normally

also include a third product if that third product is a closer substitute for the first product than is the second product." *Id.* at 72 (quoting Merger Guidelines § 4.1.1).

The government persuasively illustrated the key flaw in this critique during the cross-examination of the defendants' expert. *See* Meyer, TT, 9/13/11 a.m., at 90-96. Simply put, when determining the "closest substitutes" for products within the DDIY category, Dr. Meyer looked at diversion to individual DDIY brands, such as TurboTax and H&R Block At Home, but when assessing substitutes outside the DDIY category, Dr. Meyer lumped all products and methods together into large, aggregated market categories, such as "assisted" or "pen-and-paper." *See id.* If, instead, DDIY products are grouped together as an aggregated category, similar to the treatment of assisted and pen-and-paper in Dr. Meyer's analysis, then the IRS switching data would indicate that other DDIY products are the closest substitutes for both the DDIY products of HRB and TaxACT. *See* GTX 15, 16 (illustrating this analysis). For HRB, the numbers show 56.8 percent switching to other DDIY, 36.9 percent to assisted, and 6.3 percent to pen-and-paper. GTX 15. For TaxACT, the numbers show 52.7 percent switching to other DDIY, 40.1 percent to assisted, and 7.3 percent to pen-and-paper. GTX 16.

Some of Dr. Meyer's additional critiques have more merit. For example, one datum Dr. Warren-Boulton relied on in his analysis was the outcome of an advertising study showing that HRB's sales {were affected} in cities where TaxACT pursued an advertising campaign. *See* GX 121 (Warren-Boulton Rep.) at 43. The Court accepts Dr. Meyer's critique that few conclusions can be drawn from this observation because the observed correlation could have been due to other variables – for example, the advertising of a third competitor like TurboTax. *See* DX 17 (Meyer Rep.) at 69. Similarly, Dr. Warren-Boulton's observations that changes in relative

market share of DDIY, assisted, and pen-and-paper do not appear correlated to changes in relative price could also have been affected by confounding variables. *Id.* at 67.

b. Defendants' Expert - Dr. Meyer

Dr. Meyer found the relevant product market to be all methods of tax preparation, including DDIY, assisted, and pen-and-paper. Her conclusion rested on various factors, including an analysis of documents and testimony. *See*, *e.g.*, *id.* at 15. This Court, however, has already discussed its own analysis of the relevant documents and testimony above. Therefore, the Court will focus now on Dr. Meyer's analysis of pricing data and, in particular, her use of and reliance on data derived from customer surveys commissioned by the defendants.

Dr. Meyer found that assisted preparation competes with DDIY in part because the assisted method is the most popular method of tax preparation across all complexity levels. *See id.* at 12-13. Dr. Meyer concedes, however, that "taxpayers with the most complex tax returns are the most likely to use [assisted preparation]." *Id.* Indeed, her data show that this effect is pronounced, with approximately 70 percent of filers of complex returns using assisted and approximately 44 percent of filers of simple returns using assisted. *Id.* DDIY, by contrast, accounts for approximately 37 percent of simple returns and 23 percent of complex returns. *Id.* If anything, these data indicate that assisted products are linked to the needs of consumers with complex returns, suggesting a partially different consumer profile from DDIY products.

Dr. Meyer also noted that the pricing of DDIY and assisted products overlaps, but her analysis of this overlap rests primarily on comparing high-end DDIY products, such as HRB's Best of Both product,[21] with low-end assisted products, such as Jackson Hewitt's offering of

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[21] The Best of Both product, as the name implies, actually combines aspects of DDIY and assisted. It enables a return completed on HRB's DDIY product to be reviewed by a tax professional. *See* DX 17 (Meyer Rep.) at 13 n.44. Thus, it is hardly surprising that this "hybrid" product, which features such exhaustive service, is priced more expensively than a typical DDIY product.

limited, simple return preparation at Wal-Mart. *See id.* at 13-14. Dr. Meyer concedes that the median price of assisted is higher than the median DDIY price, *see id.* at 13, and that is the more useful point of comparison.

Apart from these comparisons and her conclusions about how industry participants view the market based on her review of documents and testimony in the record, Dr. Meyer's definition of the relevant market rests primarily on her analysis of simulated diversion data obtained from a "pricing simulator" created for HRB in 2009 and an email survey conducted by TaxACT in 2011. *See id.* at 17-20. These two sources for her conclusions are discussed seriatim below.

i. Pricing Simulator

Dr. Meyer asserts in her report that the pricing simulator "created for HRB in 2009, provides the only direct test of the likely diversion from HRB's [DDIY] products in reaction to a change in price." *Id.* at 17. The simulator itself is a pricing model that runs as a dynamic Excel spreadsheet. *See* Meyer, TT, 9/13/11 a.m., at 42. Dr. Meyer's report in several instances relies upon an internal HRB Powerpoint presentation that reflects the simulator's data output under several different scenarios. *See*, *e.g.*, DX 17 (Meyer Rep.) at 37 n.155 (citing the Powerpoint). As Dr. Meyer describes, the "simulator was prepared using a discrete choice survey of 6,119 respondents." *Id.* at 17. She explains that "[t]he respondents were shown five pricing scenarios, and the options included online DIY options, software DIY options, assisted tax preparation options, and other DIY options (including pen-and-paper and friends/family)." *Id.* Dr. Meyer further states that the "pricing of the various options changed across scenarios" and a "conjoint analysis was conducted to analyze the effect of a change in the price of each product on its own sales and the sales of the other tax preparation options." *Id.*

Based on the pricing simulator's results, Dr. Meyer calculated diversion ratios for DDIY products. Dr. Meyer found that "the largest diversion from HRB's [DDIY products], in the event of a price increase, is to CPAs and accountants." *Id.* at 18. She found the "second largest diversion from HRB's [DDIY products]" was to pen-and-paper. *Id.* at 19-20. In addition, "the fourth largest diversion is to HRB retail stores." *Id.* at 18. Accordingly, Dr. Meyer concluded that assisted preparation and pen-and-paper were the closest substitutes to HRB's DDIY products and should be included in the relevant market.

There is a critical flaw in the design of the pricing simulator, however, that renders conclusions based on its output unreliable. Despite Dr. Meyer's assertion that the "pricing of the various options changed across [the] scenarios" presented to the survey respondents, not all of the options in the survey underlying the simulator actually had prices associated with them. *See* Meyer, TT, 9/13/11 a.m., at 27-28. Several "non-priced choice options" were available to the survey respondents and these non-priced options included, importantly, "CPA or Accountant," "H&R Block Retail Office," and "Paper & Pencil." DX 9231 (May 2009 Pricing Simulator Powerpoint) at 4. Thus, while the pricing of the various options changed *for some products* across the different scenarios presented in the survey, no prices at all were associated with these critical "non-priced choice options."

The fact that the pricing simulator survey failed to assign any prices to these particular products is, of course, especially significant given Dr. Meyer's findings that the highest diversion from HRB DDIY was to CPAs and then to pen-and-paper. DX 17 (Meyer Rep.) at 18. Indeed, the conclusion that the largest diversion from HRB's DDIY products would be to CPAs is puzzling on its face. This outcome is counterintuitive because CPAs in general tend to be the most expensive form of tax preparation assistance, while DDIY tends to be the least expensive.

See GTX 14. The Court finds that these surprising results are most likely due to the fact that the survey did not, in fact, assign any price at all to the CPA option. Due to this flaw in the survey's design, respondents may well have selected the CPA option and the other non-priced options without even attempting to consider price as a factor in their decision. Accordingly, the Court finds that it simply cannot rely on the diversion ratios predicted by the simulator.

Additional problems with the pricing simulator also render its output unreliable. As Dr. Warren-Boulton noted in his rebuttal of Dr. Meyer's report, the compilation of pricing simulator data which Dr. Meyer relied upon to calculate her diversion ratios contains results that appear to violate what is "[p]erhaps the most fundamental principle in economics." *See* GX 665 (Warren-Boulton Reply Rep.) at 9-10. Increasing the price of one HRB DDIY product in the simulation, TaxCut Online Basic, appears to increase the quantity of the product sold, holding other variables constant. *Id.* This anomaly violates the fundamental economic principle that "demand curves almost always slope downward," which holds that, all other things being equal, consumers buy less of a product when the price goes up. *See id.* In another anomalous result, Dr. Warren-Boulton found that, based on the simulator data, cutting the price of TaxCut Online Basic from $29.95 to $14.95 approximately doubles its predicted market share, but cutting the price only to $19.95 greatly reduces its market share.[22] *Id.* Dr. Warren-Boulton also found that analysis of different print outs of simulator data in the HRB Powerpoint may yield inexplicably different results. For example, relying on the data on one page of the simulator Powerpoint, Dr. Meyer determined that the "the diversion rate from HRB to TaxACT is only 1.6 percent." DX 17 (Meyer Rep.) at 37. Yet, Dr. Warren-Boulton applied the same methodology for calculating

[22] Dr. Meyer testified at the hearing that these anomalies are not reflected in the underlying simulator Excel data, but rather appear only in the printouts of simulator data contained in the internal HRB Powerpoint. In addition, Dr. Meyer explained that she redid her calculations excluding the anomalous data and came up with the same conclusions. *See* Meyer, TT, 9/12/11 p.m., at 45-47. Dr. Meyer never identified the source or cause of the anomalies, however. *Id.* at 49.

the diversion rate to the simulator data reflected on another slide of the same Powerpoint purporting to show the same simulator data as applied to a different scenario. This calculation yielded the "wildly different estimate" of a 32.4 percent diversion rate from HRB to TaxACT. *See* GX 665 (Warren-Boulton Reply Rep.) at 10. These inconsistent and anomalous results provide additional reasons to discredit the diversion ratios Dr. Meyer predicted from the simulator data.

ii. 2011 Email Survey

Dr. Meyer's analysis also relied on a 2011 email survey of TaxACT customers commissioned by the defendants.[23] *See* DX 17 (Meyer Rep.) at 20, 38. In April 2011, TaxACT and HRB jointly commissioned this survey "to determine to which products TaxACT's customers would switch if those customers were displeased with TaxACT because of price, quality, or functionality." *Id.* at 20. The survey asked one primary question: "If you had become dissatisfied with TaxACT's price, functionality, or quality, which of these products or services would you have considered using to prepare your federal taxes?" GX 604 (Survey Summary) at 1. The survey then offered the respondents a list of other products or services from which to choose and instructed them to select all applicable options. *Id.* The list of options that respondents were given varied somewhat depending on the respondents' filing status and the payments they had made for their 2011 tax returns.[24] *Id.* A follow-up question asked the respondents to narrow their selections to a single choice. *Id.*

[23] Prior to the hearing in this case, the government filed a motion in limine to exclude this survey from evidence and to limit Dr. Meyer's opinion to the extent it relied on the survey. *See* ECF No. 60. The government argued that the survey's wording and methodology made it inherently unreliable and therefore inadmissible. While the Court noted that the government had identified a number of defects in the methodology and wording of the survey, the Court concluded that these defects did not undermine the survey and the expert's reliance on it so overwhelmingly as to render the survey inadmissible, especially in a bench trial. *See* Memorandum Opinion and Order on Motion in Limine, September 6, 2011, ECF No. 84.

[24] The response options varied among four different categories of filers, which are discussed further below. For example, the list of options presented to filers who completed a free federal tax return and no state return were: "I

The research firm conducting the survey initially sent out 46,899 email requests to TaxACT customers inviting them to participate in the survey and then subsequently targeted 24,898 customers who had purchased a federal tax return product but not a state product. *Id.* Survey respondents were also asked screening questions to determine their membership in one of four categories of customers: (1) those who paid to complete both a federal and state tax return; (2) those who completed a free federal return and paid to complete a state return; (3) those who completed a paid federal return but did not complete a state return; and (4) those who completed a free federal return and did not complete a state return. *Id.*

A total of 1,089 customers responded to the survey. *Id.* at 1-3. The response rates for the four categories of customers were: (1) 2.45 percent for paid federal / paid state filing (422); (2) 2.08 percent for free federal / paid state filing (245); (3) 0.6 percent for paid federal / no state filing (182); and (4) 1.7 percent for free federal / no state filing (240). *Id.*

Dr. Meyer opined that "this survey is closer to the concept of a diversion ratio than are data on overall switching between products." DX 17 (Meyer Rep.) at 20 n.85. Based on the survey's results, she concluded that the survey "provides direct evidence that digital DIY products compete with pen-and-paper" because the percentage of TaxACT customers who reported that, if they were dissatisfied with TaxACT, they would switch to pen-and-paper in each group ranged from 27 to 34 percent. DX 17 (Meyer Rep.) at 20. Dr. Meyer also noted that the survey showed that few TaxACT customers would switch to H&R Block At Home, since only 4 to 10 percent of respondents selected that option. *Id.* at 38. Accordingly, Dr. Meyer found this outcome indicative that "HRB is not a particularly close competitor to TaxACT." *Id.*

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would prepare myself without help," "TurboTax Free Edition," "H&R Block at Home Free Edition," "Free TaxUSA Free Edition," "Complete Tax Free Basic," "An Accountant," "I would use a product on FFA [i.e., Free File Alliance]," "TaxSlayer Free Edition," "Jackson Hewitt Free Basic," "Tax$imple Free Basic," and "Other." GX604 at 2.

In response to Dr. Meyer's reliance upon this survey, the government submitted a rebuttal expert report from Dr. Ravi Dhar, a professor of management at Yale University, which credibly critiques the survey on several levels.[25] GX 623 (Dhar Rep.). Most fundamentally, the government points out that the phrasing of the survey question – which asks about dissatisfaction with "TaxACT's price, functionality, or quality" – appears to ask a hypothetical question about *switching*, not diversion based solely on a price change. Since the phrasing of the survey question conflates customer concerns about price, functionality, or quality, the government argues that the survey cannot shed any light on customer reactions to price changes alone. *See id.* at 5. Further, to the extent that the wording of the question addresses price, it does not ask about a change in price, but rather suggests a change in the customer's satisfaction with TaxACT's existing price. *See id.*

At the hearing, Dr. Meyer explained that she viewed the email survey data as "closer to diversion than is pure switching data" because switching could occur for any reason at all, while the survey only asked about potential switching due to dissatisfaction with "price, functionality, or quality." Meyer, TT, 9/13/11 a.m., at 87. Yet the Court finds that almost any reason for switching from a product could be characterized as dissatisfaction with the "functionality" or "quality" offered by the product in some respect. Therefore, the survey question does not come much closer to identifying diversion ratios than pure switching data does. Moreover, since there is extensive IRS data reflecting actual switching behavior in the marketplace – as opposed to the hypothetical switching behavior asked about in the email survey – the Court will not rely on the "diversion ratios" suggested by the 2011 email survey.

Furthermore, additional defects in the 2011 email survey's methodology also render the reliability of its findings questionable. First, the high level of non-response to the defendants'

[25] Dr. Dhar did not testify in person at the hearing, but provided an expert report and affidavit.

email invitations to participate in the survey could have biased the results. Dr. Dhar explained that the "level of nonresponse . . . is extremely high (more than 98%)" and that the "extremely low response rates makes it difficult to determine whether the results were impacted by a certain segment who were systematically more likely to respond to the survey (e.g., those who were price sensitive or time insensitive) in relation to those who did not respond." GX 623 (Dhar Rep.) at 10. The Court agrees that non-response bias is a potential pitfall of the survey. *See University of Kansas v. Sinks,* No. 06-2341, 2008 WL 755065, at *4 (D. Kan. Mar. 19, 2008) (noting, in trademark case, that a consumer survey response rate of "2.16% appears, by any standard, to be quite low."). Second, by providing survey respondents with a pre-selected list of alternative options, rather than letting respondents respond organically, the survey leads respondents to think about the market for tax preparation services in the same terms that the defendants do, which may have led respondents to select options they otherwise would not have selected. Since the survey's question essentially asks about hypothetical switching, and since the actual IRS switching data in this case reflect a much larger sample size without the methodological deficiencies of the 2011 survey, the Court declines to rely on the purported diversion ratios calculated from the email survey.

On the whole, the Court views Dr. Warren-Boulton's expert analysis as more persuasive than Dr. Meyer's.[26] First, Dr. Warren-Boulton's testimony was generally more credible than Dr. Meyer's.[27] Second, the diversion ratios that Dr. Meyer calculated from the pricing simulator and the 2011 email survey are unreliable, as discussed above. Without these simulated diversion

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[26] Of course, the Court remains cognizant that the plaintiff bears the burden of proof in demonstrating the relevant market.
[27] For example, Dr. Meyer's description of the pricing simulator survey as one in which the "pricing of the various options changed across scenarios" was inaccurate insofar as several of the most significant products for the purposes of Dr. Meyer's analysis did not have any prices associated with them at all. *See* discussion *supra*.

ratios, little remains of Dr. Meyer's expert conclusions apart from her analysis of documents in the record.

Dr. Warren-Boulton's analysis is not without its limitations. The main shortcoming for his approach is that he relied on switching data as a proxy for diversion. Since there is evidence in the record that switching among different products in the broader tax preparation industry occurs for reasons other than price competition, switching cannot serve as a complete proxy for diversion. Even so, the Court credits Dr. Warren-Boulton's conclusion that switching data can provide a "reasonable second estimate" of diversion ratios here. Therefore, the Court finds that Dr. Warren-Boulton's analysis tends to confirm that the relevant market is DDIY, although the Court would not rely on his analysis exclusively. As explained above, however, the full body of evidence in this case makes clear that DDIY is the correct relevant market for evaluating this merger.

B. Likely Effect on Competition

1. The Plaintiff's Prima Facie Case

Having defined the relevant market as DDIY tax preparation products, "the Court must next consider the likely effects of the proposed acquisition on competition within that market." *Swedish Match*, 131 F. Supp. 2d at 166. The government must now make out its prima facie case by showing "that the merger would produce 'a firm controlling an undue percentage share of the relevant market, and [would] result[ ] in a significant increase in the concentration of firms in that market.'" *Heinz*, 246 F.3d at 715 (quoting *Philadelphia Nat'l Bank*, 374 U.S. at 363). "Such a showing establishes a 'presumption' that the merger will substantially lessen competition." *Id.*

"Market concentration, or the lack thereof, is often measured by the Herfindahl-Hirschmann Index ('HHI')." *Id.* at 716. "The HHI is calculated by totaling the squares of the market shares of every firm in the relevant market. For example, a market with ten firms having market shares of 20%, 17%, 13%, 12%, 10%, 10%, 8%, 5%, 3% and 2% has an HHI of 1304 ($20^2 + 17^2 + 13^2 + 12^2 + 10^2 + 10^2 + 8^2 + 5^2 +3^2 +2^2$)." *Id.* at 715 n.9. Sufficiently large HHI figures establish the government's prima facie case that a merger is anticompetitive. *Id.* Under the Horizontal Merger Guidelines, markets with an HHI above 2500 are considered "highly concentrated" and mergers "resulting in highly concentrated markets that involve an increase in the HHI of more than 200 points will be presumed to be likely to enhance market power." Merger Guidelines § 5.3.

In this case, market concentration as measured by HHI is currently 4,291, indicating a highly concentrated market under the Merger Guidelines. GX 121 (Warren-Boulton Rep.) at 38. The most recent measures of market share show Intuit with 62.2 percent of the market, HRB with 15.6 percent, and TaxACT with 12.8 percent. GX 27. These market share calculations are based on data provided by the IRS for federal tax filings for 2010, the most recent data available.

The defendants argue that market share calculations based exclusively on federal filing data are insufficient to meet the plaintiff's burden in establishing its alleged relevant product market, which includes both federal and state filings. Defs.' Post-Trial Mem. at 12-13. The Court rejects this argument. State tax return products are typically sold as add-ons to or in combination with federal return products and the Court finds that there is little reason to conclude that the market share proportions within the state DDIY segment would be significantly different from federal DDIY. *See* GX 600 at 8 (HRB market research study stating that "[t]he desire to file State and Federal taxes together, and, inherently, for ease/convenience overruled all

other rationales for the method chosen for State taxes."). While, as defendants point out, many customers of federal tax return DDIY products do not also purchase state returns, that may be because they live in states without income tax or because their state returns are simple enough to prepare very easily without assistance. *See* Dunn, TT, 9/8/11 a.m., at 48-49. A reliable, reasonable, close approximation of relevant market share data is sufficient, however. *FTC v. PPG Indus., Inc.,* 798 F.2d 1500, 1505 (D.C. Cir. 1986). Further, the defendants' own ordinary course of business documents analyze the market based on IRS federal e-file data, without reference to state filings, even though the defendants' clearly sell state tax return products. *See, e.g.,* GX 27.

The proposed acquisition in this case would give the combined firm a 28.4 percent market share and will increase the HHI by approximately 400, resulting in a post-acquisition HHI of 4,691. *Id.* These HHI levels are high enough to create a presumption of anticompetitive effects. *See, e.g., Heinz,* 246 F.3d at 716 (three-firm to two-firm merger that would have increased HHI by 510 points from 4,775 created presumption of anticompetitive effects by a "wide margin"); *Swedish Match,* 131 F. Supp. 2d at 166-67 (60 percent market share and 4,733 HHI established presumption). Accordingly, the government has established a prima facie case of anticompetitive effects.

"Upon the showing of a *prima facie* case, the burden shifts to defendants to show that traditional economic theories of the competitive effects of market concentration are not an accurate indicator of the merger's probable effect on competition in these markets or that the procompetitive effects of the merger are likely to outweigh any potential anticompetitive effects." *CCC Holdings*, 605 F. Supp. 2d at 46. "The courts have not established a clear standard that the merging parties must meet in order to rebut a prima facie case, other than to

advise that '[t]he more compelling the prima facie case, the more evidence the defendant must present to rebut [the presumption] successfully.'" *Id.* at 46-47 (quoting *Baker Hughes*, 908 F.2d at 991). Even in cases where the government has made a strong prima facie showing:

> [i]mposing a heavy burden of production on a defendant would be particularly anomalous where, as here, it is easy to establish a prima facie case. The government, after all, can carry its initial burden of production simply by presenting market concentration statistics. To allow the government virtually to rest its case at that point, leaving the defendant to prove the core of the dispute, would grossly inflate the role of statistics in actions brought under section 7. The Herfindahl-Hirschman Index cannot guarantee litigation victories.

Baker Hughes, 908 F.2d at 992. Thus, ultimately,"[t]he Supreme Court has adopted a totality-of-the-circumstances approach to the [Clayton Act], weighing a variety of factors to determine the effects of particular transactions on competition." *Id.* at 984. With these observations in mind, the Court will evaluate the parties' evidence and arguments about the likely effect of the transaction on competition in the DDIY market.

2. Defendants' Rebuttal Arguments

a. Barriers to Entry

Defendants argue that the likelihood of expansion by existing DDIY companies besides Intuit, HRB, and TaxACT will offset any potential anticompetitive effects from the merger. Courts have held that likely entry or expansion by other competitors can counteract anticompetitive effects that would otherwise be expected. *See Heinz*, 246 F.3d at 717 n.13 ("Barriers to entry are important in evaluating whether market concentration statistics accurately reflect the pre- and likely post-merger competitive picture."); *Baker Hughes,* 908 F.2d at 987 ("In the absence of significant barriers, a company probably cannot maintain supracompetitive pricing for any length of time."). According to the Merger Guidelines, entry or expansion must be "timely, likely, and sufficient in its magnitude, character, and scope to deter or counteract the competitive effects of concern." Merger Guidelines § 9; *see also CCC Holdings*, 605 F. Supp.

2d at 47; *United States v. Visa USA, Inc.,* 163 F. Supp. 2d 322, 342 (S.D.N.Y. 2001) (entry must be "timely, likely, and [of a] sufficient scale to deter or counteract any anticompetitive restraints"). "Determining whether there is ease of entry hinges upon an analysis of barriers to new firms entering the market or existing firms expanding into new regions of the market." *CCC Holdings*, 605 F. Supp. 2d at 47 (quoting *FTC v. Cardinal Health, Inc.*, 12 F. Supp. 2d 34, 55 (D.D.C. 1998)). In this case, the parties essentially agree that the proper focus of this inquiry is on the likelihood of expansion by existing competitors rather than new entry into the market.[28] *See* Defs.' Post-Trial Mem. at 21-22. Since the government has established its prima facie case, the defendants carry the burden to show that ease of expansion is sufficient "to fill the competitive void that will result if [defendants are] permitted to purchase" their acquisition target. *Swedish Match*, 131 F. Supp. 2d at 169.

In describing the competitive landscape, the defendants note there are eighteen companies offering various DDIY products through the FFA. Defs.' Post-Trial Mem. at 22. Most of these companies are very small-time operators, however. The defendants acknowledge this fact, but nevertheless contend that the companies "TaxSlayer and TaxHawk are the two largest and most poised to replicate the scale and strength of TaxACT." *Id*. at 23. Witnesses from TaxSlayer and TaxHawk were the only witnesses from other DDIY companies to testify at the hearing. As such, the Court's ease of expansion analysis will focus on whether these two competitors are poised to expand in a way that is "timely, likely, and sufficient in its magnitude,

[28] New entrants to the market would not only face all of the barriers to expansion already faced by the existing small firms offering DDIY products, they would also have to develop their own products, including a software platform and a sufficient level of tax expertise. For entry to be considered timely, it typically must occur within approximately two years post-merger. *See* Commentary on the Horizontal Merger Guidelines (2006) at 45-46 (discussing prior Merger Guidelines § 3.2, which specified that timely entry should occur within two years). It is unlikely that an entirely new entrant to the market could compete meaningfully with the established DDIY firms within that time frame.

character, and scope to deter or counteract" any potential anticompetitive effects resulting from the merger.

TaxHawk runs five different websites, including FreeTaxUSA.com, that all market the same underlying DDIY product. Kimber, TT, 9/12/11 a.m., at 12, 40. TaxHawk was founded in 2001, three years after TaxACT, although it has a significantly smaller market share of 3.2 percent. *Id.* at 11; GX 27. TaxHawk's vice-president and co-founder, Mr. Dane Kimber, testified that the company has the technical infrastructure to grow by five to seven times the number of customers in any given year. Kimber, TT, 9/12/11 a.m., at 21. TaxHawk's marketing strategy relies substantially on search engine advertising and search term optimization, including by using the FreeTaxUSA.com domain name, which contains the keywords "free" and "tax." *See id.* at 19-27. Despite having been in business for a decade, its products are functionally more limited than those of Intuit, HRB, and TaxACT in various ways. *See* PFF ¶ 185. Although TaxHawk services the forms that cover most taxpayers, its program does not service all federal forms, it excludes two states' forms in their entirety, and it does not service city income tax forms for major cities that have income taxes – notably, New York City. Kimber, TT, 9/12/11 a.m., at 44. In fact, Mr. Kimber testified that the company would likely need another decade before its DDIY products could fully support all the tax forms. *Id.* at 45. The reason is that TaxHawk is what Mr. Kimber "like[s] to call . . . a 'lifestyle' company. We like the lifestyle we have as owners. We want our employees to have a life, if you will. I do feel we have the expertise to [expand functionality] more rapidly, but we choose not to." *Id.* Mr. Kimber also testified that TaxHawk had suddenly experienced an unprecedented growth rate of over 60 percent since April 2011, *id.* at 20-21, but that the company had not done any analysis to attempt to explain this unanticipated (and presumably welcome) growth. *Id.* at 39.

TaxHawk's relaxed attitude toward its business stands in stark contrast to the entrepreneurial verve that was apparent throughout the testimony of Mr. Dunn and that has been rewarded by the impressive growth of TaxACT over the years. In short, TaxHawk is a very different company from TaxACT. TaxHawk is a small company that has developed a string of search-engine-optimized DDIY websites, which deliver a sufficient income stream to sustain its owners' comfortable lifestyle, without requiring maximal effort on their part. While TaxHawk's decision to prioritize a relaxed lifestyle over robust competition and innovation is certainly a valid one, expansion from TaxHawk that would allow it to compete "on the same playing field" as the merged company appears unlikely. *Chicago Bridge & Iron Co. N.V. v. FTC*, 534 F.3d 410, 430 (5th Cir. 2008).

After TaxHawk, TaxSlayer is the next largest DDIY competitor, with a 2.7 percent market share. GX 27. TaxSlayer.com launched in 2003, although the same company started selling a software product to tax professionals several years earlier. Rhodes, TT, 9/12/11 a.m., at 71. TaxSlayer is part of the same corporate family as Rhodes Murphy, a tax firm that provides assisted tax preparation through sixteen retail offices in the Augusta, Georgia area. *Id.* The company is a family business and James Brian Rhodes, the product manager of TaxSlayer and the son of the company's founder, testified at the hearing. *Id.* at 70,73. Mr. Rhodes testified that, in the event of an increase in TaxACT's prices or a decrease in its quality, he "believe[s] that [TaxSlayer is] poised and ready to take those customers who would want to go elsewhere for lower prices." *Id.* at 81. TaxSlayer's marketing strategy relies heavily on sponsorship of sporting events, including the Gator Bowl and NASCAR. *Id.* at 75. TaxSlayer typically invests {a significant amount of its budget in marketing}. Rhodes, TT, 9/12/11 a.m. (sealed), at 86, 92. For example, TaxSlayer plans to spend ${redacted} on marketing in 2012 based on 2011

revenues of ${redacted}. *Id.* at 84, 87. Despite this {high} level of marketing spending, TaxSlayer's DDIY market share has not changed substantially since 2006, despite steady growth in TaxSlayer's revenue and number of units sold. *See id.* at 94-96; GX 21-7 (IRS e-file share data chart showing 2.5 percent share for TaxSlayer in 2006 and 2.7 percent in 2010). Rather, TaxSlayer's growth in unit sales and revenue has come from maintaining the same slice of an expanding pie – the growing DDIY market. *See* GX 21-7.

TaxSlayer's stable market share despite its {significant} marketing expenditure as a proportion of revenue points to what the government considers the key barrier to entry in this market – the importance of reputation and brand in driving consumer behavior in purchasing DDIY products. Simply put, tax returns are highly personal documents that carry significant financial and legal consequences for consumers. Consumers, therefore, must trust and have confidence in their tax service provider. As one of TaxACT's bankers put it a confidential memorandum, "[t]ax filers must have confidence that sensitive data is being handled with care and that returns are processed in a secure, error-free and timely manner." GX 125 at 12.

Building a reputation that a significant number of consumers will trust requires time and money. As HRB's former CEO noted, it takes millions of dollars and lots of time to develop a brand. Bennett, TT, 9/6/11 p.m., at 30. TaxACT's offering memoranda also point to the difficulty in building a brand in the industry as a barrier to competition. *See* GX 28-24 at 2SS-CORPe-2419 (2009 memorandum stating "With over 11 years of building reliable, robust software solutions, 2SS has created a valuable brand within the online tax preparation market which Management believes would take years of competitive investment to replicate."). In the DDIY industry, the Big Three incumbent players spend millions on marketing and advertising each year to build and maintain their brands, dwarfing the combined spending of the smaller

companies. For example, in tax year 2009, Intuit, HRB, and TaxACT collectively spent approximately {over $100 million} on marketing and advertising. GX 29 (Intuit Decl.) ¶ 38; GX 61-22 at 3; GX 138 at 37. By contrast, {TaxSlayer and TaxHawk spent a significantly smaller amount}.[29] Rhodes, TT, 9/12/11 a.m. (sealed), at 95; GX 25 (TaxHawk Decl.) ¶ 14.

Even TaxACT's successful business strategy has been premised on the notion that it cannot outspend Intuit and HRB on marketing. Dunn, TT, 9/7/11 p.m., at 71-72. The massive marketing expenditures of the two major DDIY firms create high per customer acquisition costs and limit the easy marketing channels that are open to smaller competitors. *See, e.g., id.* at 88-89 (noting that "Web advertising is the most competitive. . . I think [TaxACT is] going to get shut out on Yahoo [the popular web portal]. I think Intuit is going to buy it lock, stock and barrel," and explaining that this outcome would hurt TaxACT's business if it doesn't find effective alternative advertising venues). Rather than attempting to outspend HRB and Intuit, TaxACT's growth strategy has largely depended on providing "great customer service, a great product, and a great customer experience" and then relying on word-of-mouth referrals to spread the awareness of the brand. *Id.* at 71-72. This process is inherently time-consuming and difficult to replicate.

In support of their argument that TaxSlayer and TaxHawk are poised to expand in response to a price increase, the defendants emphasize that these companies "are at about the same position in terms of customer base as TaxACT was in 2002, which was the year before it did the Free For All [offer on] the FFA." Meyer, TT, 9/12/11 p.m., at 130. The government points out, however, that there are two flaws in this comparison, even assuming that TaxSlayer

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[29] The defendants attempt to reframe this disparity by noting that their calculation of TaxSlayer's projected tax season 2015 marketing budget would slightly surpass the amount of TaxACT's actual 2011 marketing budget. Defs.' Post-Trial Mem. at 23. Setting aside the validity of the defendants' aggressive projections of TaxSlayer's 2015 budget, a proper comparison would have to be founded upon a comparable projection of TaxACT's 2015 budget—not TaxACT's actual 2011 numbers, for which the relevant comparison is TaxSlayer's 2011 numbers.

and TaxHawk were TaxACT's competitive equals. First, while these companies may have a similar number of customers to TaxACT in 2002 in absolute terms, TaxACT's market share at 8 percent was already significantly larger than the market shares of these firms today, despite the fact that TaxACT had been in the market for fewer years. *See* GTX 17.

Second, the DDIY market has matured considerably since 2002, in parallel with the general ripening of various online industries during the past decade. Notably, the pool of pen-and-paper customers has dwindled as DDIY preparation has grown. Thus, the "low hanging fruit" of DDIY customer acquisition may have been plucked. *See* GX 296 (Houseworth Dep.) at 66-68 (noting that "there's probably only two or three years of continued mid teens category growth for online" because of the shrinking pool of new potential customers that can be converted from the pen-and-paper method). This trend suggests existing market shares may become further entrenched and that growing market share may be even harder, especially because there are barriers to switching from one DDIY product to another. For example, the hearing evidence showed that it is difficult to import prior-year tax return data across DDIY brands. If a taxpayer uses, say, TurboTax or TaxACT in one year, then when the taxpayer returns the next year, the program can automatically import the prior year's data, which is not only convenient but can also help the taxpayer identify useful tax information, such as carry forwards and available deductions. Dunn, TT, 9/8/11 a.m., at 111-14. Currently, it is not possible to import much of this data if the taxpayer switches to a competitor's product. *Id.* Thus, this feature lends a "stickiness" to each particular DDIY product once a customer has used it.

Upon consideration of all of the evidence relating to barriers to entry or expansion, the Court cannot find that expansion is likely to avert anticompetitive effects from the transaction.

The Court will next consider whether the evidence supports a likelihood of coordinated or unilateral anticompetitive effects from the merger.

b. Coordinated Effects

Merger law "rests upon the theory that, where rivals are few, firms will be able to coordinate their behavior, either by overt collusion or implicit understanding in order to restrict output and achieve profits above competitive levels." *CCC Holdings*, 605 F. Supp. 2d at 60 (quoting *Heinz*, 246 F.3d at 715). The government argues that the "elimination of TaxACT, one of the 'Big 3' Digital DIY firms" will facilitate tacit coordination between Intuit and HRB. Pl.'s Post-Trial Mem. at 15. "Whether a merger will make coordinated interaction more likely depends on whether market conditions, on the whole, are conducive to reaching terms of coordination and detecting and punishing deviations from those terms." *CCC Holdings*, 605 F. Supp. 2d at 60 (internal quotation omitted). Since the government has established its prima facie case, the burden is on the defendants to produce evidence of "structural market barriers to collusion" specific to this industry that would defeat the "ordinary presumption of collusion" that attaches to a merger in a highly concentrated market. *See Heinz*, 246 F.3d at 725.

The defendants argue the primary reason that coordinated effects will be unlikely is that Intuit will have no incentive to compete any less vigorously post-merger. The defendants assert that the competition between Intuit and HRB's retail stores would be "fundamentally nullified if Intuit decided to reduce the competitiveness of TurboTax." Defs.' Post-Trial Mem. at 17. Further, defendants contend that Intuit has no incentive to reduce the competitiveness of its free product because it views its free product as a critical driver of new customers. *Id.* at 17-18 Therefore, the defendants conclude that if HRB does not compete as aggressively as possible with its post-merger products, it will lose customers to Intuit. *Id.* at 18.

The most compelling evidence the defendants marshal in support of these arguments consists of documents and testimony indicating that Intuit engaged in a series of "war games" designed to anticipate and defuse new competitive threats that might emerge from HRB post-merger. *See* GX 293 (Intuit Dep.) at 98-101; DX 84. The documents and testimony do indicate that Intuit and HRB will continue to compete for taxpayers' patronage after the merger—indeed, in the DDIY market, they would be the only major competitors. This conclusion, however, is not necessarily inconsistent with some coordination. As the Merger Guidelines explain, coordinated interaction involves a range of conduct, including unspoken understandings about *how* firms will compete or refrain from competing. *See* Merger Guidelines § 7.

In this case, the government contends that coordination would likely take the form of mutual recognition that neither firm has an interest in an overall "race to free" in which high-quality tax preparation software is provided for free or very low prices. Indeed, the government points to an outline created as part of the Intuit "war games" regarding post-merger competition with HRB that also indicates an Intuit employee's perception that part of HRB's post-merger strategy would be to "not escalate free war: Make free the starting point not the end point for customers." GX 293-13 at INT-DOJ0015942.[30] Since, as defendants point out, DDIY companies have found "free" offers to be a useful marketing tool, it is unlikely that free offers would be eliminated. Rather, the government argues, it is more likely that HRB and Intuit may

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[30] The government also cites an informal analysis written by Adam Newkirk, an analyst for HRB's DDIY business. Mr. Newkirk's analysis hypothesized that one possible reason for HRB to acquire TaxACT was that HRB and Intuit would jointly control a large DDIY market share post-merger and would "both obviously have great incentive to keep this channel profitable," while other potential purchasers of TaxACT "could decide to cut prices even further . . . ." *See* Newkirk, TT, 9/7/11 a.m., at 100; GX 18. The Court finds that the government overemphasized the importance and relevance of Mr. Newkirk's analysis. The hearing testimony showed that Mr. Newkirk is a data analyst who had no decision-making role or authority in relation to the merger and that his discussion about the rationales for the merger was informal speculation. *See* Newkirk, TT, 9/7/11 p.m., at 42-44. Even so, this reasoning – independently reached by Intuit – is essentially a précis of the government's coordinated effects concern.

find it "in their mutual interest to reduce the quality of their free offerings . . . offer a lower quality free product and maintain higher prices for paid products . . . ." PFF ¶ 141.

The government points to a highly persuasive historical act of cooperation between HRB and Intuit that supports this theory. *Cf.* Merger Guidelines § 7.2 ("[M]arket conditions are conducive to coordinated interaction if firms representing a substantial share in the relevant market appear to have previously engaged in express collusion."). After TaxACT launched its free-for-all offer in the FFA, Intuit proposed that the firms in the market limit their free FFA offers, a move which TaxACT opposed and which Mr. Dunn believed was an illegal restraint on trade. Dunn, TT, 9/7/11 p.m., at 79. HRB, Intuit, and others then joined together and successfully lobbied the IRS for limitations on the scope of the free offers through the FFA – limitations that remain in place today. Ernst, TT, 9/7/11 a.m., at 26-27; Warren-Boulton, TT, 9/9/11 p.m., at 78. This action illustrates how the pricing incentives of HRB and Intuit differ from those of TaxACT and it also shows that HRB and Intuit, although otherwise competitors, are capable of acting in concert to protect their common interests.

The defendants also argue that coordinated effects are unlikely because the DDIY market consists of differentiated products and has low price transparency. *See CCC Holdings*, 605 F. Supp. 2d at 62 (recognizing the importance of price transparency to the likelihood of coordinated effects). To the contrary, the record clearly demonstrates that the players in the DDIY industry are well aware of the prices and features offered by competitors. Since DDIY products are marketed to a large swath of the American population and available via the Internet, DDIY firms can easily monitor their competitors' offerings and pricing. The fact that competitors may offer various discounts and coupons to some customers via email hardly renders industry pricing "not transparent," as defendants submit. *See* Defs.' Post-Trial Mem. at 21. Moreover, while

collusion may, in some instances, be more likely in markets for homogenous products than differentiated products, product differentiation in this market would not necessarily make collusion more difficult. *See Heinz*, 246 F.3d at 716-17, 724-25 (finding likelihood of coordinated effects in product market differentiated by brand); *see also CCC Holdings*, 605 F. Supp. 2d at 65 n.42 ("[T]acit collusion may be easier when products are differentiated.") (quoting Lawrence A. Sullivan & Warren S. Grimes, *The Law of Antitrust: An Integrated Handbook*, § 11.2e1, at 635 (2d ed. 2006)).

Other indicia of likely coordination are also present in the DDIY market. Transactions in the market are small, numerous, and spread among a mass of individual consumers, each of whom has low bargaining power; prices can be changed easily; and there are barriers to switching due to the "stickiness" of the DDIY products. *See CCC Holdings*, 605 F. Supp. 2d at 65-66 (discussing these factors as characteristic of markets conducive to coordination); *see also supra* Section III.B.2.a (discussing the difficulty of importing data as a barrier to switching from one DDIY product to another).

Finally, the Court notes that the "merger would result in the elimination of a particularly aggressive competitor in a highly concentrated market, a factor which is certainly an important consideration when analyzing possible anti-competitive effects." *Staples*, 970 F. Supp. at 1083; *see also FTC v. Libbey*, 211 F. Supp. 2d 34, 47 (D.D.C. 2002). The evidence presented at the hearing from all parties demonstrated TaxACT's impressive history of innovation and competition in the DDIY market. Mr. Dunn's trial testimony revealed him to be a dedicated and talented entrepreneur and businessman, with deep knowledge and passion for providing high-quality, low-cost tax solutions. TaxACT's history of expanding the scope of its high-quality, free product offerings has pushed the industry toward lower pricing, even when the two major

players were not yet ready to follow – most notably in TaxACT's introduction of free-for-all into the market.

The government presses the argument that TaxACT's role as an aggressive competitor is particularly important by urging this Court to find that TaxACT is a "maverick." *See* Pl.'s Post-Trial Mem. at 18-19. In the context of antitrust law, a maverick has been defined as a particularly aggressive competitor that "plays a disruptive role in the market to the benefit of customers." Merger Guidelines § 2.1.5. The most recent revision of the Merger Guidelines endorses this concept and gives a few examples of firms that may be industry mavericks, such as where "one of the merging firms may have the incentive to take the lead in price cutting or . . . a firm that has often resisted otherwise prevailing industry norms to cooperate on price setting or other terms of competition." *Id.*

The parties have spilled substantial ink debating TaxACT's maverick status. The arguments over whether TaxACT is or is not a "maverick" – or whether perhaps it once was a maverick but has not been a maverick recently – have not been particularly helpful to the Court's analysis. The government even put forward as supposed evidence a TaxACT promotional press release in which the company described itself as a "maverick." *See* GX 28-6. This type of evidence amounts to little more than a game of semantic gotcha. Here, the record is clear that while TaxACT has been an aggressive and innovative competitor in the market, as defendants admit, TaxACT is not unique in this role. Other competitors, including HRB and Intuit, have also been aggressive and innovative in forcing companies in the DDIY market to respond to new product offerings to the benefit of consumers. *See* Defs.' Post-Trial Mem. at 20.

The government has not set out a clear standard, based on functional or economic considerations, to distinguish a maverick from any other aggressive competitor. At times, the

government has emphasized TaxACT's low pricing as evidence of its maverick status, while, at other times, the government seems to suggest that almost any competitive activity on TaxACT's part is a "disruptive" indicator of a maverick. For example, the government claims that "[m]ost recently, TaxACT continued to disrupt the Digital DIY market by entering the boxed retail software segment of the market, which had belonged solely to HRB and [Intuit]." Pl.'s Post-Trial Mem. at 19. Credible evidence at the hearing, however, showed {otherwise}. *See* Dunn, TT, 9/8/11 p.m. (sealed), at 4. Moreover, the Court credits Mr. Dunn's explanation that TaxACT has little interest in selling boxed retail software because he believes this market segment is {redacted} not particularly significant. *See* Dunn, TT, 9/7/11 p.m. (sealed), at 123 ({redacted}).

What the Court finds particularly germane for the "maverick" or "particularly aggressive competitor" analysis in this case is this question: Does TaxACT consistently play a role within the competitive structure of this market that constrains prices? *See Staples*, 970 F. Supp. 1083 (finding "merger would result in the elimination of a particularly aggressive competitor in a highly concentrated market" where the merger would remove competition between "the two lowest cost and lowest priced firms" in the market); Merger Guidelines § 2.1.5 (noting maverick concerns may arise where "one of the merging firms may have the incentive to take the lead in price cutting or [with] . . . a firm that has often resisted otherwise prevailing industry norms to cooperate on price setting or other terms of competition."). The Court finds that TaxACT's competition does play a special role in this market that constrains prices. Not only did TaxACT buck prevailing pricing norms by introducing the free-for-all offer, which others later matched, it has remained the only competitor with significant market share to embrace a business strategy that relies primarily on offering high-quality, full-featured products for free with associated products at low prices.

Moreover, as the plaintiff's expert, Dr. Warren-Boulton, explained, the pricing incentives of the merged firm will differ from those of TaxACT pre-merger because the merged firm's opportunity cost for offering free or very low-priced products will increase as compared to TaxACT now. *See* Warren-Boulton, 9/9/11 p.m., at 14-16. In other words, the merged firm will have a greater incentive to migrate customers into its higher-priced offerings – for example, by limiting the breadth of features available in the free or low-priced offerings or only offering innovative new features in the higher-priced products. *See* Commentary on the Horizontal Merger Guidelines (2006) at 24 (noting the importance of asking "whether the acquired firm has behaved as a maverick and whether the incentives that are expected to guide the merged firm's behavior likely would be different.").

While the defendants oppose the government's maverick theory, they do not deny that TaxACT has been an aggressive competitor. Indeed, they submit that "that's why H&R Block wants to buy them." Defs.' Closing Argument, TT, 10/3/11 a.m., at 132. HRB contends that the acquisition of TaxACT will result in efficiencies and management improvements that "will lead to better, more effective, and/or cheaper H&R Block digital products post-merger" that are better able to compete with Intuit. Defs.' Post-Trial Mem. at 17. This argument is quite similar to the argument of the defendants in *Heinz*, which some commentators have described as arguing that the merger would create a maverick. *Heinz*, 246 F.3d at 720-22; *see* Jonathan B. Baker, *Mavericks, Mergers, and Exclusion: Proving Coordinated Competitive Effects Under the Antitrust Laws*, 77 N.Y.U. L. Rev. 135, 184 (2002). While the district court in *Heinz* accepted this argument that the merger would enhance rather than stifle competition, the D.C. Circuit reversed, finding that the "district court's analysis [fell] short of the findings necessary for a successful efficiencies defense" in that case. *Heinz*, 246 F.3d at 721. As explained more fully in

Section III.B.2.d below, the defendants' efficiency arguments fail here for some of the same reasons the D.C. Circuit identified in *Heinz.*

Finally, the defendants suggest that coordinated effects are unlikely because of the ease of expansion for other competitors in the market. As detailed above in the Court's discussion of barriers to entry and expansion, the Court does not find that ease of expansion would counteract likely anticompetitive effects.

Accordingly, the defendants have not rebutted the presumption that anticompetitive coordinated effects would result from the merger. To the contrary, the preponderance of the evidence suggests the acquisition is reasonably likely to cause such effects. *See id.* at 711-12 (finding, in market characterized by high barriers to entry and high HHI figures, that "no court has ever approved a merger to duopoly under similar circumstances.").

c. Unilateral Effects

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. *See Swedish Match*, 131 F. Supp. 2d at 169; Merger Guidelines § 6 ("The elimination of competition between two firms that results from their merger may alone constitute a substantial lessening of competition."). "The extent of direct competition between the products sold by the merging parties is central to the evaluation of unilateral price effects." Merger Guidelines § 6.1. As Judge Collyer in *CCC Holdings* explained:

> Unilateral effects in a differentiated product market are likely to be profitable under the following conditions: (1) the products must be differentiated; (2) the products controlled by the *merging* firms must be close substitutes, *i.e.*, "a substantial number of the customers of one firm would turn to the other in response to a price increase"; (3) other products must be sufficiently different from the products offered by the merging firms that a merger would make a small but significant and non-transitory price increase profitable for the merging firm; and (4) repositioning must be unlikely.

605 F. Supp. 2d at 68 (citing *Oracle*, 331 F. Supp. 2d at 1117-18).[31] Since the Court has already found that the preponderance of the evidence shows a reasonable likelihood of coordinated effects, the Court need not reach the issue of unilateral effects. *See id.* at 67. The Court will discuss it, however, since there has been substantial argument on this topic and the Court's findings regarding unilateral effects bolster the conclusion that this proposed merger would violate Section 7 of the Clayton Act. As with coordinated effects, since the government has established its prima facie case, the burden is on the defendants to produce evidence showing that the presumption of anticompetitive effects that attaches to a merger in a highly concentrated market is unfounded, but the ultimate burden of proof remains with the government.

i. Elimination of Direct Competition Between the Merging Parties

The government argues that unilateral effects are likely because the merger will eliminate head-to-head competition between HRB and TaxACT that has benefited taxpaying American consumers. Much of the evidence indicating direct competition between HRB and TaxACT is discussed above in relation to the market definition. *See supra* Section III.A. The government emphasizes that HRB has lowered its DDIY prices to better compete with free online products, the category pioneered by TaxACT, and has directly considered TaxACT's prices in setting its own prices. *See* GX 53 at 2, 8; GX 188; GX 199 at 5-9. HRB has also determined the nature of its free offerings in response to competitive activity from TaxACT. *See*, *e.g.*, GX 304 at 5 (HRB changed timing of FFA offering in response to TaxACT's offer); GX 44 (recognizing need to compete with TaxACT offerings); GX 79 (comparing contemplated free product description on HRB's website with TaxACT's website); GX 51 at 4 (noting launch of free online products intended "[t]o match competitor offerings and stem online share loss to Intuit and TaxACT"). The government also points to HRB documents that appear to acknowledge that TaxACT has put

[31] The first criterion in this analysis is satisfied because it is undisputed that DDIY products are differentiated.

downward pressure on HRB's pricing ability. *See* GX 296-16 at 20-21 (noting TaxACT's association with the "commoditization of online space" and downward price pressure from commoditization); GX 20 at 11 ({redacted}). From all of this evidence, and the additional evidence discussed in this opinion, it is clear that HRB and TaxACT are head-to-head competitors.

ii. Pledge to Maintain TaxACT's Current Prices

Defendants press a few different arguments against a finding of likely unilateral anticompetitive effects. First, the defendants have pledged to maintain TaxACT's current prices for three years.[32] While the Court has no reason to doubt that defendants would honor their promise, this type of guarantee cannot rebut a likelihood of anticompetitive effects in this case. *See Cardinal Health*, 12 F. Supp. 2d at 64 (finding that "even with such guarantees [to maintain prices], the mergers would likely result in anti-competitive prices."). Even if TaxACT's list price remains the same, the merged firm could accomplish what amounts to a price increase through other means. For example, instead of raising TaxACT's prices, it could limit the functionality of TaxACT's products, reserving special features or innovations for higher priced, HRB-branded products. The merged firm could also limit the availability of TaxACT to consumers by marketing it more selectively and less vigorously. Indeed, the defendants concede that one immediate effect of the merger will be the removal of TaxACT from the IRS-sponsored FFA website, a marketing channel whose importance the defendants themselves emphasize in their argument regarding barriers to expansion. *See* Dunn, TT, 9/7/11 p.m., at 76-77; Defs.' Post-Trial Mem. at 22.

[32] Before the hearing, the plaintiff filed a motion in limine to exclude evidence relating to this guarantee. ECF No. 44. Following oral argument at the pre-hearing conference, the plaintiff withdrew this motion. *See* Minute Entry dated September 2, 2011.

iii. Value Versus Premium Market Segments

Second, defendants argue that HRB and TaxACT are not particularly close competitors. The defendants contend that HRB and TaxACT largely compete in distinct segments of the market – with HRB in the higher-priced, "premium" segment and TaxACT in the lower-priced, "value" segment.[33] The defendants also argue that there can be no unilateral effects because the evidence shows that both TaxACT and HRB are closer competitors to TurboTax than to each other. Defs.' Post-Trial Mem. at 15.

As part of the argument that HRB and TaxACT focus on separate value and premium segments, the defendants argued that for several years in the mid-2000s, HRB was trapped in the "murky middle" between TaxACT's value offerings and Intuit's premium offerings. *See* DX 17 (Meyer Rep.) at 29; Meyer, TT, 9/13/2011 a.m., at 103-107. The defendants argue that, in recent years, HRB has positioned itself more clearly as a premium provider, as evidenced by the fact that the list price of its online federal plus state DDIY product has tracked Intuit's price more closely since 2010. *See* DX 17 (Meyer Rep.) at 29. This comparison is misleading because it focuses solely on the comparison of the list prices for the companies' highest-priced products. *See id.* at 29 n.116. During the past few years, while HRB has increased the list price of its top-priced DDIY offering, it has also more heavily marketed free products. *See* GX 51 at 4; *see also* Meyer, TT, 9/13/2011 a.m., at 105-106. Accordingly, since 2008, HRB's average DDIY sales price has declined, while the average revenue per paid customer has remained roughly the same.

[33] In the defendants' submissions to the Antitrust Division of the DOJ prior to this litigation, the defendants appeared to emphasize this "value" and "premium" distinction as the basis for their definition of the relevant market. *See* GX 135 at 14-15; GX 629 at 18-30. As a result, the government accuses the defendants of having "tacked back and forth" regarding their proposed relevant market definition. Pl.'s Post-Trial Mem. at 1-2. While the Court agrees that the import of the hearing testimony about value and premium products was not always clear, the defendants' counsel clarified during closing arguments that the "only real relevance" of the premium versus value distinction was to show that HRB and TaxACT are not closest the competitors for the purposes of unilateral effects analysis. Defs.' Closing Argument, TT, 10/3/2011 a.m., at 93-94.

See GX 296-7 ("Digital Tax Solutions FY11 Actual Deep Dive") at 1; Meyer, TT, 9/13/11 a.m., at 107-108.

Further, the evidence discussed above indicating direct price and feature competition between HRB and TaxACT negates the conclusion that they operate in separate value and premium segments of the market. There are certainly occasional references to different pricing levels in the defendants' documents. *See* GX 20 at 11 (HRB document noting {redacted}) (emphasis added). This hardly means that the companies are not in close competition, however. Rather, as Mr. Dunn's testimony reflects, TaxACT competes with capital-rich HRB and Intuit by offering high-quality products at substantially lower prices. *See* Dunn, TT, 9/7/11 p.m., at 71-72 (noting that rather than attempting to outspend its richer competitors on marketing, TaxACT's growth strategy has depended on providing "great customer service, a great product, and a great customer experience" for a much lower price, including free). *Id.* This type of healthy competition benefits taxpaying consumers.

The fact that Intuit may be the closest competitor for both HRB and TaxACT also does not necessarily prevent a finding of unilateral effects for this merger. *See* Areeda & Hovenkamp, ¶ 914, 77-80 (explaining that the merging parties need not be the closest rivals for there to be unilateral anticompetitive effects); *see also* Commentary on the Horizontal Merger Guidelines (2006) at 28 ("A merger may produce significant unilateral effects even though a non-merging product is the 'closest' substitute for every merging product . . ."). Using a simple estimate of diversion based on market share would indeed suggest that HRB and TaxACT are each other's second closest rivals after Intuit.[34] *See* GX 121 (Warren-Boulton Rep.) at 44 (explaining that

[34] The relevance of the diversion estimates provided by the expert economists to the unilateral effects analysis is discussed more fully below.

using market share to estimate diversion is a "benchmark" assumption in standard empirical models of consumer demand).

iv. Merged Company's Combined Market Share

Another argument that the defendants present against a likelihood of unilateral effects is that, in their view, unilateral effects cannot be demonstrated where the combined firm's market share does not surpass a certain threshold. The defendants point out that in *Oracle*, the court stated that "[a] presumption of anticompetitive effects from a combined share of 35% in a differentiated products market is unwarranted. Indeed, the opposite is likely true." 331 F. Supp. 2d at 1123. The *Oracle* court stated that "[t]o prevail on a differentiated products unilateral effects claim, a plaintiff must prove a relevant market in which the merging parties would have essentially a monopoly or dominant position." *Id.* Some commentators have criticized this standard, however, because "impermissible price increases . . . can be achieved on far lower market shares" than *Oracle*'s standard evidently requires. Areeda & Hovenkamp ¶ 914, at 84. Indeed, Judge Brown's subsequent opinion from this Circuit in *Whole Foods* implied that a market definition itself may not even be required for proving a Section 7 violation based on unilateral effects. *See Whole Foods*, 548 F.3d at 1036. In a footnote, Judge Brown explained that "a merger between two close competitors can sometimes raise antitrust concerns due to unilateral effects in highly differentiated markets. In such a situation, it might not be necessary to understand the market definition to conclude a preliminary injunction should issue."[35] *Id*. at

[35] "As a matter of applied economics, evaluation of unilateral effects does not require a market definition in the traditional sense at all." Areeda & Hovenkamp ¶ 913a, at 66. This is so because unilateral effects analysis focuses on measuring a firm's market power directly by "estimating the change in residual demand facing the post-merger firm. 'Residual demand' refers to the demand for a firm's goods after the output of all other competing firms has been taken into account." *Id.* at 63. If market power itself can be directly measured or estimated reliably, then in theory market definition is superfluous, at least as a matter of economics, because "[i]dentifying a market and computing market shares provide an indirect means for measuring market power." *Id.* ¶ 532a at 242-43; *see also id.* ¶ 521c. The 2010 revisions to the Merger Guidelines also appear to reflect this understanding. *See* Merger Guidelines § 4 ("The Agencies' analysis need not start with market definition. Some of the analytical tools used by

n.1 (citation omitted). The Court therefore declines the defendants' invitation, in reliance on *Oracle*, to impose a market share threshold for proving a unilateral effects claim.[36]

v. Post-Merger Dual Brand Strategy

HRB's plans for the post-merger company raise anticompetitive questions. Post-merger, HRB's stated plan is to maintain both the HRB and TaxACT brands –with the HRB-brand focusing on higher priced-products and the TaxACT brand focusing on the lower-priced products. *See* Bennett, TT, 9/6/11 a.m., 101-102; DX 1005 at 1. HRB's general pre-merger pricing strategy has been to price its products a bit below Intuit's products. Bennett, TT, 9/6/11 a.m., at 99. Part of HRB's post-merger strategy, however, appears to involve raising prices on HRB-branded products. Under this two-brand strategy, HRB would price its "premium" HRB-branded products equal to or above Intuit's prices. *See* Bennett, TT, 9/6/11 a.m., 101-102; DX 1005 at 1. At the same time, the company would "offer TaxACT as its free and value brand." DX 17 (Meyer Rep.) at 78. Yet, the defendants have never convincingly explained how this two-brand strategy would work in practice because defendants have repeatedly emphasized how

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the Agencies to assess competitive effects do not rely on market definition, although evaluation of competitive alternatives available to customers is always necessary at some point in the analysis."). As a legal matter, however, a market definition may be required by Section 7 of the Clayton Act. *See Brown Shoe*, 370 U.S. at 324 ("[D]etermination of the relevant market is a necessary predicate to a finding of a violation of the Clayton Act because the threatened monopoly must be one which will substantially lessen competition 'within the area of effective competition.' Substantiality can be determined only in terms of the market affected. The 'area of effective competition' must be determined by reference to a product market (the 'line of commerce') and a geographic market (the 'section of the country').") (internal citation omitted); *see also Heinz*, 246 F.3d at 719 n.17 ("Courts interpret 'line of commerce' [in the language of the Clayton Act] as synonymous with the relevant product market."). The Court is not aware of any modern Section 7 case in which the court dispensed with the requirement to define a relevant product market, although Judge Brown's opinion in *Whole Foods* may be read to endorse this possibility in accordance with the evolving understandings in economics. *See Whole Foods*, 548 F.3d at 1036 (Brown, J.) (stating that the *Baker Hughes* analytical framework, which "rests on defining a market and showing undue concentration in that market," "does not exhaust the possible ways to prove a § 7 violation on the merits").

[36] The Commentary on the Merger Guidelines, for its part, explains that while "[a]s an empirical matter, the unilateral effects challenges made by the Agencies nearly always have involved combined shares greater than 35%," "the Agencies may challenge mergers when the combined share falls below 35% if the analysis of the mergers' particular unilateral competitive effects indicates that they would be likely substantially to lessen competition." Commentary on the Horizontal Merger Guidelines (2006) at 26. "Combined shares less than 35% may be sufficiently high to produce a substantial unilateral anticompetitive effect if the products are differentiated and the merging products are especially close substitutes . . . ." *Id.*

important "free" product offerings are for all DDIY brands. *See* DFF ¶ 185 ("Free is a highly profitable method of acquiring customers for H&R Block."); DX 600 at 10 (HRB Board of Directors presentation for merger approval stating that after the merger TaxACT would be the "low cost value provider focused on free" but that the company would "[c]ontinue to offer a free product in the HRB brand to drive client acquisition").

Part of the government's concern with HRB's two-brand strategy is that the incentives for the combined firm in marketing and developing the TaxACT product would be quite different from the incentives that exist in the current market. HRB may feel comfortable raising its "premium" prices because it knows that consumers looking for lower-cost DDIY options would be most likely to migrate to TaxACT, the established "value leader" in the market. Since HRB will also control TaxACT post-merger, however, HRB can still ensure that TaxACT's value proposition does not get "too good" and undermine the paid HRB products with the highest profit margins. For example, HRB might restrict the features of TaxACT's free and low-cost products to ensure they do not cannibalize sales of HRB's higher priced offerings. Indeed, assuming that there are high barriers to entry and expansion, this strategy would appear logical because it would maximize HRB's profit per customer. Post-merger, TaxACT will not have the same incentives it has today to develop robust free and low-cost offerings that can compete with the functionality offered by HRB and Intuit. *See* Warren-Boulton, TT, 9/8/11 p.m., at 32-33. Thus, this merger could potentially have the effect of stifling price and feature competition compared with maintaining TaxACT as an independent firm.

vi. Merger Simulation Shows Likely Unilateral Price Increase

The government's expert economist, Dr. Warren-Boulton, did a merger simulation analysis that suggests a unilateral price increase is likely. Warren-Boulton, TT, 9/9/11 a.m., at 5-

11; GX 121 (Warren-Boulton Rep.) at 52. The key factors in this simulation are HRB and TaxACT's price-cost margins and the diversion ratios between their products. *Cf. Swedish Match*, 131 F. Supp. 2d at 169 ("High margins and high diversion ratios support large price increases, a tenet endorsed by most economists.").

(a). Diversion Ratios Between the Merging Parties' DDIY Products

As explained above, the diversion rate from TaxACT to HRB measures the proportion of customers that would leave TaxACT in response to a price increase and switch to HRB. Dr. Warren-Boulton's report explains that higher diversion rates between merging parties "allow the firms to recapture more lost sales following a price increase, and therefore lead to greater upward pricing pressure and post-merger unilateral price increases." GX 121 (Warren-Boulton Rep.) at 44. Dr. Warren-Boulton estimated diversion ratios from two sources: the parties' DDIY market share data and the IRS switching data.[37] *Id.* at 44-48.

By assuming diversion rates in accordance with market share, Dr. Warren-Boulton estimated the diversion rate from TaxACT to HRB to be 12 percent and from HRB to TaxACT to be 14 percent. *Id.* at 44-45. Dr. Warren-Boulton notes that these diversion estimates likely underestimate what the actual post-merger diversion rates will be since the merged company will likely implement marketing strategies to keep customers within the umbrella of the combined company. *Id.* at 45.

Dr. Warren-Boulton estimated diversion ratios using IRS switching data as well. As discussed above in Section III.A.3.a, he also used this switching data to test the relevant market definition. As previously noted in that prior discussion, switching data is not equivalent to diversion, since diversion measures switching in response to a price increase as opposed to all

[37] Dr. Warren-Boulton declined to rely on the defendants' proposed diversion data, derived from their consumer surveys, for the reasons already discussed *supra* in Section III.A.3.

switching generally. In particular, Dr. Warren-Boulton found that switching data is especially likely to overstate diversion from DDIY products to assisted preparation. *Id.* at 46-47. Therefore, Dr. Warren-Boulton discounted the switching rates from DDIY to assisted by half to correct for this effect.[38] *Id.* After this correction, Dr. Warren-Boulton calculated estimated diversion rates from TaxACT to HRB and from HRB to TaxACT of 12 percent. *Id.*at 47-48.

(b). Price-Cost Margins

The next step in his analysis was to estimate the firms' price-cost margins. "All else equal, higher margins lead to greater unilateral price increases because the value of recaptured sales is higher." *Id.* at 48. Using a procedure described in his report, Dr. Warren-Boulton estimated {that the merging parties have high margins}. *Id.* at 49. The merger simulation also required quantities of units sold and average revenue per unit. Dr. Warren-Boulton obtained this data from the companies' submissions. *Id.* at 50.

(c). Simulation Results

Using all of these data, Dr. Warren-Boulton performed a linear demand Bertrand model simulation. *Id.* at 51. Unless there are significant efficiencies from the merger that are passed on to consumers, this simulation predicts a unilateral price increase.[39] *Id.* at 52. Assuming diversion ratios according to market share, the model predicts TaxACT's price will increase by 12.2 percent and HRB's price by 2.5 percent. *Id.* Assuming diversion ratios based on the IRS switching data as discussed above, the model predicts TaxACT's price will increase by 10.5 percent and HRB's price by 2.2 percent. *Id.*

[38] As a basis for this conclusion that switching data overstates diversion and for his choice to discount the DDIY-to-assisted switching rate by half, Dr. Warren-Boulton relies upon HRB documents that suggest that more than half of switching from DDIY to assisted occurs for reasons unrelated to price, such as a change in tax complexity. GX 121 (Warren-Boulton Rep.) at 46 n.128 (citing GX 635, GX 126). He also relies on IRS data showing that customers switching from DDIY to assisted were twice as likely to have a complexity increase as taxpayers who stayed within DDIY. *Id.* at 47.

[39] As discussed in Section III.B.2.d below, the Court finds most of defendants' claimed efficiencies are not merger-specific or unverifiable.

(d). Critique of the Simulation's Unilateral Effects Results

The defendants attack Dr. Warren-Boulton's simulation on several grounds. The defendants reiterate their critique that switching data is an inappropriate proxy for diversion data. Further, defendants criticize the way in which Dr. Warren-Boulton discounted the switching rates from DDIY products to assisted preparation. *See* Warren-Boulton, TT, 9/9/9 p.m., at 60-65. In addition, the defendants contend that Dr. Warren-Boulton's simulator model is flawed because it will always predict a price increase with any positive diversion and because the model is "static," does not take various factors into account, such as the parties' different products, innovation, and marketing, and would never predict that a firm would offer free products, even though free products are a staple of the industry. DX 17 (Meyer Rep.) at 74-75.

The Court agrees that Dr. Warren-Boulton's discounting by half of the switching data from DDIY to assisted appears imprecise. Dr. Warren-Boulton clarified in his report, however, that "the model still predicts significant unilateral harm when non-discounted switching rates are used to approximate diversion rates." GX 121 (Warren-Boulton Rep.) at 47. Further, and more importantly, Dr. Warren-Boulton also estimated diversion ratios based on market share and the Court has concluded above that DDIY is the appropriate relevant product market.[40]

As for the defendants' critiques about Dr. Warren-Boulton's economic model itself, Dr. Warren-Boulton addressed these directly. First, insofar as the model will predict at least some price increase absent efficiencies with any positive diversion ratios, Dr. Warren-Boulton explained that outcome is fully consistent with correct economic theory. GX 665 (Warren-

[40] The defendants suggest that Dr. Warren-Boulton's reliance on market share as an estimate of diversion ratios is somewhat circular in that his market shares derive from his market definition, which, in turn, relied on his use of switching data as a proxy for diversion ratios. DX 17 (Meyer Rep.) at 76. As discussed above, however, the Court's finding that DDIY is the correct relevant product market is not dependent on Dr. Warren-Boulton's analysis.

Boulton Reply Rep.) at 14 ("Economic theory concludes that absent merger specific efficiencies, a merger between competing firms will cause the merging firms to increase their prices by at least some amount. Thus, it is not a deficiency, but a strength, of merger simulation models that they reflect this aspect of economic reality."). In response to the critique that his "static" model would never predict that companies would offer free products, Dr. Warren-Boulton contends that because free DDIY products are often packaged with other paid products, these "free" products actually provide the companies with a positive average revenue per free unit, which his model does take into account. *See id.* at 14-15. As for the remaining critiques that the model does not factor in marketing or innovation, Dr. Warren-Boulton replies that any model is inherently a simplification of the real world, but there is no reason to assume these factors negate the price effect findings of the model. *Id.*

The Court finds that the merger simulation model used by the government's expert is an imprecise tool, but nonetheless has some probative value in predicting the likelihood of a potential price increase after the merger. The results of the merger simulation tend to confirm the Court's conclusions based upon the documents, testimony, and other evidence in this case that HRB and TaxACT are head-to-head competitors, that TaxACT's competition has constrained HRB's pricing, and that, post-merger, overall prices in the DDIY products of the merged firms are likely to increase to the detriment of the American taxpayer.

vii. Repositioning Unlikely to Defeat Unilateral Price Increase

Repositioning by smaller competitors in response to a unilateral price increase is unlikely for the same reasons discussed above regarding barriers to entry and expansion. *See* Merger Guidelines § 6.1 ("Repositioning is a supply-side response that is evaluated much like entry, with consideration given to timeliness, likelihood, and sufficiency.").

Repositioning by Intuit is also unlikely due to the coordinated effects incentives discussed above. The Merger Guidelines make clear that a unilateral price increase may be defeated where "non-merging firms [are] able to reposition their products to offer close substitutes for the products offered by the merging firms." Merger Guidelines § 6.1. Since the Court has already found that HRB and Intuit would have coordinated pricing incentives post-merger, that finding implies that repositioning by Intuit would not prevent HRB from raising prices. By relying on its finding of coordinated effects to predict the likelihood of repositioning by Intuit, the Court acknowledges that its unilateral effects finding is not strictly "unilateral" in the sense that it does take coordination into account. The case law and the Merger Guidelines, however, require that "repositioning" be considered in assessing unilateral effects, and the repositioning inquiry necessarily entails a consideration of the likely actions of other competitors in response to a price increase. *See CCC Holdings, Inc*., 605 F. Supp. 2d at 67 (noting that the distinction between coordinated and unilateral effects "has more significance in law than it does in economics" and citing expert testimony describing the distinction as "artificial").

viii. Finding Unilateral Anticompetitive Effects Likely

On balance, and considering the evidence as a whole, the Court finds that, absent efficiencies, the plaintiff has demonstrated a reasonable likelihood of unilateral effects by a preponderance of the evidence. *See Swedish Match*, 131 F. Supp. 2d at 169 (finding likelihood of unilateral price increase where merger would eliminate one of the larger merging firm's "primary direct competitors," "the third largest selling" brand "that has consistently played a role in constraining the price" of the larger firm's products); *see also Staples* 970 F. Supp. at 1083 (finding anticompetitive effects where the "merger would eliminate significant head-to-head competition between the two lowest cost and lowest priced firms in the . . . market.").

The Court will now turn to the defendants' final rebuttal argument – the existence of significant, merger-specific efficiencies.

d. Post-Merger Efficiencies

One of the key benefits of a merger to the economy is its potential to generate efficiencies. *See Heinz*, 246 F.3d at 720. As the Merger Guidelines recognize, merger-generated efficiencies can "enhance the merged firm's ability and incentive to compete, which may result in lower prices, improved quality, enhanced service, or new products." Merger Guidelines § 10. Courts have recognized that a showing of sufficient efficiencies may rebut the government's showing of likely anticompetitive effects. *Heinz*, 246 F.3d at 720. High market concentration levels require "proof of extraordinary efficiencies," however, and courts "generally have found inadequate proof of efficiencies to sustain a rebuttal of the government's case." *Id.* (citation omitted).

"[T]he court must undertake a rigorous analysis of the kinds of efficiencies being urged by the parties in order to ensure that those 'efficiencies' represent more than mere speculation and promises about post-merger behavior." *Id.* at 721. As the Merger Guidelines explain, "[c]ognizable efficiencies are merger-specific efficiencies that have been verified and do not arise from anticompetitive reductions in output or service." Merger Guidelines § 10. Efficiencies are inherently "difficult to verify and quantify" and "it is incumbent upon the merging firms to substantiate efficiency claims" so that it is possible to "verify by reasonable means the likelihood and magnitude of each asserted efficiency, how and when each would be achieved (and any costs of doing so), how each would enhance the merged firm's ability and incentive to compete, and why each would be merger-specific." *Id.* In other words, a "cognizable" efficiency claim must represent a type of cost saving that could not be achieved

without the merger and the estimate of the predicted saving must be reasonably verifiable by an independent party.

The defendants claim that "H&R Block's primary motivation for the TaxACT acquisition is to achieve significant synergies that will enable H&R Block to provide better products at a lower price and to compete more effectively."[41] Defs.' Post-Trial Mem. at 24. The defendants predict that they will achieve over ${redacted} million in annual efficiencies in ten different areas.[42] *Id.* at 24-25.

The chart below summarizes the defendants' claimed efficiencies and predicted annual cost savings:

[41] "Cognizable efficiencies" are a subset of "synergies." "Synergies" refer more generally to any business performance benefits that result from the merger of two companies. *See* Zmijewski, TT, 9/19/11 a.m., at 99.
[42] Originally, the defendants claimed 11 efficiencies, including an efficiency related to {redacted}. This task is "really not an efficiency" but "an additional cost," Dunn, TT, 9/8/11 p.m. (sealed) at 7, and defendants do not reference it in their proposed findings of fact. DFF ¶ 291.

Efficiency	Description	Estimated Annual Cost Saving
1. Online IT	{redacted}	${redacted} million
2. Emerald Card	Allowing TaxACT's prepaid debit card offerings to be fulfilled through HRB's bank	${redacted} million
3. H&R Block Bank Refund Anticipation Checks	Funding TaxACT's refund anticipation checks through HRB's bank	${redacted} million
4. {redacted}	{redacted}	${redacted}million
5. {redacted}	{redacted}	${redacted} million
6. {redacted}	{redacted}	${redacted} million
7. Corporate Website	{redacted}	${redacted} million
8. Software IT	{redacted}	${redacted} million
9. Download Fulfillment	{redacted}	${redacted} million
10. {redacted}	{redacted}	${redacted}million

DFF ¶ 292; *see also* DX236-007.

Dr. Mark E. Zmijewski, an expert witness for the government, analyzed the defendants' alleged efficiencies and concluded that – with the exception of {one efficiency related to eliminating third-party contracts} – the proposed efficiencies identified by the defendants are either not merger-specific or not verifiable.[43] *See generally* GX 664 (Zmijewski Rep.).

The Court agrees with Dr. Zmijewski that the defendants have not demonstrated that their claimed efficiencies are merger-specific. If a company could achieve certain cost savings

[43] Dr. Zmijewski is a professor of accounting and deputy dean at The University of Chicago Booth School of Business and a founder and principal of Navigant Economics, a consulting firm. GX 664 (Zmijewski Rep.) at 5. He holds a Ph.D. in accounting. *Id.*

without any merger at all, then those stand-alone cost savings cannot be credited as merger-specific efficiencies. The defendants must show that their "efficiencies . . . cannot be achieved by either company alone because, if they can, the merger's asserted benefits can be achieved without the concomitant loss of a competitor." *Heinz*, 246 F.3d at 722. For example, if HRB's {redacted} are not running in the most efficient, cost-effective manner, it is hard to see why a merger with TaxACT is necessary to improve their cost structure. The reasons HRB claims it has higher {redacted} costs than TaxACT include (1) that TaxACT has lower labor costs in Cedar Rapids than HRB has in Kansas City and (2) that TaxACT is simply more cost conscious. Bowen, TT, 9/15/11 p.m., (sealed), at 104-105. Plainly, then, HRB could therefore achieve at least some of the {redacted} cost savings on its own – by relocating {redacted} and taking a more cost conscious attitude toward them. Likewise, the efficiencies related to bringing HRB's outsourced {redacted} functions in-house are unlikely to be wholly merger-specific.

Similarly, the defendants' IT-related efficiencies, which account for the largest efficiency claims, are not entirely merger-specific either. Both TaxACT and HRB witnesses testified that {redacted} – suggesting that the platform consolidation would result in at least some merger-specific efficiencies. *See* Dunn, TT, 9/8/11 p.m. (sealed), at 16-17; Bowen, TT, 9/15/11 p.m. (sealed), at 67-68. One way in which {redacted}. Dunn, TT, 9/8/11 p.m. (sealed), at 16-17; Bowen, TT, 9/15/11 p.m. (sealed), at 67-68; Bowen, TT, 9/19/11 a.m., at 12. Thus, the IT consolidation efficiency actually can be thought of as entailing two distinct consolidations: (1) {redacted} and (2) HRB's platform will be merged with TaxACT's platform. Bowen, TT, 9/19/11 a.m., at 12. Yet the claimed IT efficiency is not discounted for whatever savings HRB could obtain by {performing the first consolidation} on its own – an option the company considered in the past but did not adopt – and the defendants did not present evidence explaining

why, as a technical matter, {performing the first consolidation} would not be feasible or, in fact, would not be more feasible than {the double consolidation}. Bowen, TT, 9/19/11 a.m., at 12; 9/15/11 p.m. (sealed) at 75. The IT efficiencies also apparently account for cost reductions associated with TaxACT's more cost-conscious culture and practices. *See* Dunn, TT, 9/8/11 a.m. (sealed), at 5 ("for Block to achieve these [efficiencies] would require them to come up with an entirely different corporate culture {redacted}.").

Even if the efficiencies were entirely merger-specific, many of them are also not independently verifiable. As Dr. Zmijewski explained, for the various efficiencies that involve the activities now performed by HRB or its vendors that are proposed to be transferred to TaxACT, TaxACT's predicted cost figures for taking over these activities were not based on an analysis of facts that could be verified by a third party. Instead, TaxACT based its cost estimates on management judgments. GX 664 (Zmijewski Rep.) at 22-25. By comparison, HRB's estimated costs for the relevant activities were rooted in accounting and planning documents prepared in the ordinary course of business.

The testimony at the hearing confirmed that TaxACT's recurring cost estimates were largely premised on its managers experiential judgment about likely costs, rather than a detailed analysis of historical accounting data. *See, e.g.*, Dunn, TT, 9/8/11 p.m. (sealed), at 28-31. While reliance on the estimation and judgment of experienced executives about costs may be perfectly sensible as a business matter, the lack of a verifiable method of factual analysis resulting in the cost estimates renders them not cognizable by the Court. If this were not so, then the efficiencies defense might well swallow the whole of Section 7 of the Clayton Act because management would be able to present large efficiencies based on its own judgment and the Court would be hard pressed to find otherwise. The difficulty in substantiating efficiency claims in a verifiable

way is one reason why courts "generally have found inadequate proof of efficiencies to sustain a rebuttal of the government's case." *Heinz*, 246 F.3d at 720 (citation omitted); *see also Staples*, 970 F. Supp. at 1089 (finding "defendants failed to produce the necessary documentation for verification" of efficiencies).

Particular scrutiny of HRB's efficiencies claims is also warranted in light of HRB's historical acquisitions. In 2006, HRB acquired a software company called TaxWorks, which was renamed "RedGear." Bowen, TT, 9/15/11 p.m. (sealed), at 84. For the RedGear acquisition, which was much smaller in scale than the proposed TaxACT deal, HRB projected a total of ${redacted} million in efficiencies over three years. GX 1459 (February 2009 "Taxworks Financial Analysis") at 5. HRB failed to achieve these {efficiencies} {redacted}. *Id.* In this case, the efficiency estimates are much more aggressive, in that defendants are claiming approximately ${redacted} million in efficiencies for 2013 and ${redacted} million in annual savings going forward thereafter, as opposed to ${redacted} million over three years. *See* Bowen, TT, 9/15/11 p.m. (sealed), at 77-78. While HRB has attempted to learn from the mistakes of the RedGear acquisition, *id.* at 85-87, the Court finds that this history only underscores the need for any claimed efficiencies to be independently verifiable in order to constitute evidence that can rebut the government's presumption of anticompetitive effects.

Considering all of the evidence regarding efficiencies, the Court finds that most of the defendants' claimed efficiencies are not cognizable because the defendants have not demonstrated that they are merger-specific and verifiable.[44]

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[44] In addition, the defendants have not addressed how much of the claimed efficiencies would be passed through to consumers. *See Staples*, 970 F. Supp. at 1090 (analyzing projected pass-through rate for claimed efficiencies).

IV. CONCLUSION

The Court concludes that the proposed merger between HRB and TaxACT violates Section 7 of the Clayton Act because it is reasonably likely to cause anticompetitive effects. The law of this Circuit supports this conclusion. In *Heinz*, the Court of Appeals reversed a district court's denial of a preliminary injunction against a merger involving the second- and third-largest jarred baby food companies. 246 F.3d at 711-12. After noting the high barriers to entry and high HHI figures that characterized the market, the D.C. Circuit observed that "[a]s far as we can determine, no court has ever approved a merger to duopoly under similar circumstances." *Id.* at 717. The situation in this case is similar. The government established a prima facie case indicating that anticompetitive effects are likely to result from the merger. The defendants have not made a showing of evidence that rebuts the presumption of anticompetitive effects by demonstrating that the government's market share statistics give an inaccurate account of the merger's probable effects on competition in the relevant market. To the contrary, the totality of the evidence confirms that anticompetitive effects are a likely result of the merger, which would give H&R Block and Intuit control over 90 percent of the market for digital do-it-yourself tax preparation products.

Accordingly, the Court will enjoin H&R Block's proposed acquisition of TaxACT. An appropriate Order will accompany this Memorandum Opinion.

DATED: November 10, 2011

/s/ Beryl A. Howell
BERYL A. HOWELL
United States District Judge

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. 20549

FORM 8-K

CURRENT REPORT

Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Date of Report (date of earliest event reported): November 14, 2011

H&R BLOCK, INC.
(Exact name of registrant as specified in charter)

Missouri	**1-6089**	**44-0607856**
(State of Incorporation)	(Commission File Number)	(I.R.S. Employer Identification Number)

One H&R Block Way, Kansas City, MO 64105
(Address of Principal Executive Offices) (Zip Code)

(816) 854-3000
(Registrant's telephone number, including area code)

Not Applicable
(Former name or former address, if changed since last report)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions (see General Instruction A.2. below):

[ ] Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)

[ ] Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)

[ ] Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))

[ ] Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

Item 1.02. Termination of a Material Definitive Agreement.

H&R Block, Inc. (the "Company"), 2SS Holdings, Inc. ("2SS"), TA Associates Management, L.P., and Lance Dunn have mutually agreed effective November 14, 2011 to terminate the Agreement and Plan of Merger dated October 13, 2010, as amended (the "Merger Agreement"), among the Company and HRB Island Acquisition, Inc. ("Sub"), an indirect wholly owned subsidiary of the Company, 2SS, TA Associates Management, L.P. in its capacity as a stockholder representative, and Lance Dunn in his capacity as a stockholder representative, pursuant to which Sub would have merged with and into 2SS (the "Merger"), with 2SS continuing as the surviving corporation and an indirect subsidiary of the Company after the Merger.

A description of the terms of the Merger Agreement was included in Item 1.01 of the Current Reports on Form 8-K filed by the Company with the Securities and Exchange Commission on October 14, 2010 and March 9, 2011 and in Item 9B of the Annual Report on Form 10-K filed by the Company with the Securities and Exchange Commission on June 23, 2011 and, to the extent required by Item 1.02 of Form 8-K, such descriptions are incorporated by reference in this Item 1.02 pursuant to General Instruction B.3 of Form 8-K.

As previously disclosed, the United States Department of Justice (the "DOJ") filed a civil antitrust lawsuit in the United States District Court in Washington, D.C. to block the Merger. On October 31, 2011, the United States District Court granted the DOJ's motion for a permanent injunction. On November 14, 2011, the Company, 2SS, TA Associates Management, L.P. in its capacity as a stockholder representative, and Lance Dunn in his capacity as a stockholder representative, mutually agreed to a termination of the Merger Agreement.

The Company is not expected to incur any early termination penalties as a result of the termination of the Merger Agreement.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

H&R BLOCK, INC.

Date: November 14, 2011 By: /s/ Jeffrey T. Brown

Jeffrey T. Brown
Senior Vice President and Chief Financial Officer

EX-99.1 3 d278620dex991.htm PRESS RELEASE ISSUED JANUARY 9, 2010

Exhibit 99.1

INFOSPACE TO ACQUIRE TAXACT

Transaction Provides InfoSpace Strong Presence and Growth Opportunities in Online Consumer Tax Preparation

BELLEVUE, Wash. – January 9, 2012 – InfoSpace, Inc. (NASDAQ: INSP), a leader in online search, today announced that it has signed a definitive agreement to acquire TaxACT, a leading provider of online tax solutions, for $287.5 million in cash. The acquisition is subject to satisfaction of customary closing conditions and is expected to close in the first quarter of 2012.

"The acquisition of TaxACT is significant for our Company, and consistent with our capital deployment objectives," said William J. Ruckelshaus, President and Chief Executive Officer of InfoSpace. "As a leading brand with a loyal, growing customer base and a sustained track record, TaxACT is well positioned to grow in the large and enduring tax preparation category. As the market continues its shift toward online 'do-it-yourself' tax preparation, we are confident that we can leverage our online expertise, TaxACT's industry leading solutions, and the fantastic TaxACT management team to drive future growth. The financial benefits of this transaction are compelling and provide us ongoing flexibility to invest in our businesses to further enhance shareholder value."

The transaction is expected to be immediately accretive to InfoSpace earnings per share, and year one return on share holder capital is expected to exceed 16%. For the twelve months ending September 30, 2011, TaxACT had revenues of $78.1 million and adjusted EBITDA of $37.8 million. For the twelve months ending September 30, 2011, InfoSpace and TaxACT together generated pro forma revenue of $290.0 million, pro forma adjusted EBITDA of $72.5 million, and pro forma non-GAAP net income of $45.6 million or $1.21 per diluted share.

Based in Cedar Rapids, Iowa, TaxACT is the second largest provider of online individual income tax solutions. With approximately 70 full-time employees, TaxACT participates in the large and growing $20 billion tax preparation market. The Company had more than five million tax filers last season, with the vast majority of those customers filing online.

TaxACT offers the only complete free federal tax solution for "*everyone.*" Its offerings include the free edition, deluxe edition, and state edition for individual tax filers, and TaxACT professional for businesses. TaxACT's offerings are available through a secure online delivery system, complemented by available desktop downloads and extensive tax and IRS expertise.

"On behalf of the entire TaxACT team, I want to express my excitement as we partner with InfoSpace," said JoAnn Kintzel, president of TaxACT. "We are committed to

providing a superior customer experience and working hard to ensure that everyone is comfortable using the TaxACT products to complete their federal tax returns for free. We have the right tools, tremendous in-house expertise, and an established consumer following. With the support of InfoSpace, we are confident that we can further strengthen our position and capitalize on the substantial opportunities in the market for online tax preparation."

InfoSpace will fund the acquisition through a combination of cash on hand and debt, having secured a commitment for approximately $95 million of financing in connection with this transaction. The combined company is expected to have a solid balance sheet with an estimated cash and short term investments in excess of $90 million.

Upon completion of the acquisition, 2nd Story Software, the operating company for the TaxACT business, will become a wholly-owned subsidiary of InfoSpace, and will continue operations in Cedar Rapids, Iowa as a standalone business unit led by the TaxACT management team. TA Associates, the majority shareholder of the TaxACT business, will sell its full holdings as part of this transaction.

Conference Call and Webcast

InfoSpace will host a conference today at 5:30 a.m. Pacific time / 8:30 a.m. Eastern time to discuss the acquisition of TaxACT. The live webcast and a set of slides with additional information can be accessed in the Investor Relations section of the Company's website, at http://www.infospaceinc.com.

About InfoSpace, Inc.

InfoSpace, Inc., a leading developer of metasearch products, is focused on bringing the best of the Web to Internet users. InfoSpace's proprietary metasearch technology combines the top results from several of the largest online search engines, providing fast and comprehensive search results. InfoSpace sites include Dogpile(R) (www.dogpile.com), InfoSpace.com (R) (www.infospace.com), MetaCrawler(R) (www.metacrawler.com), WebCrawler(R) (www.webcrawler.com), and WebFetch(R) (www.webfetch.com). InfoSpace's metasearch technology is also available on nearly 100 partner sites, including content, community, and connectivity sites. In addition, the Company operates an innovative online search engine optimization tool, WebPosition(R) (www.webposition.com). Additional information may be found at www.infospaceinc.com.

About TaxACT

TaxACT, is a privately held company founded in 1998 and critically acclaimed as a leader in developing affordable tax preparation software and Web-based services directly for consumers. TaxACT was the first to offer free Federal tax software and free e-file to all American taxpayers in the 2005 tax season. TaxACT is the 2nd most visited online destination for tax preparation services. Since 2000, TaxACT Online has assisted with more than 20 million e-filed federal returns. TaxACT is also the only Web-based tax

planning and preparation product to offer a year-round tax preparation solution, with Preview Versions released in October and Final Versions released in January. Learn more about TaxACT individual, business and professional products at www.taxact.com and in the Press Center at www.taxact.com/press.

InfoSpace.com, InfoSpace, Dogpile, MetaCrawler, WebCrawler, WebFetch, and other marks are trademarks of InfoSpace, Inc. TaxACT and 2nd Story Software are trademarks of 2nd Story Software, Inc.

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Investor Contact:
Stacy Ybarra, InfoSpace
(425) 709-8127
stacy.ybarra@infospace.com

This announcement contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this release, and which may differ significantly from actual results due to various risks and uncertainties including, but not limited to: general economic, industry, and market sector conditions; the timing and extent of market acceptance of developed products and services and related costs; the successful execution of the Company's strategic initiatives, business integration plans, operating plans, and marketing strategies. A more detailed description of these and certain other factors that could affect actual results is included in InfoSpace, Inc.'s most recent Annual Report on Form 10-K and subsequent reports filed with or furnished to the Securities and Exchange Commission. InfoSpace, Inc. undertakes no obligation to update any forward-looking statements to reflect new information, events, or circumstances after the date of this release or to reflect the occurrence of unanticipated events.

This opinion was unsealed by order of Judge Howell on 12/8/11.

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

FILED
SEP 06 2011
Clerk, U.S. District and
Bankruptcy Courts

UNITED STATES OF AMERICA,

Plaintiff,

v.

H&R BLOCK, INC., *et al.*,

Defendants.

Civil Action No. 11-00948 (BAH)

UNSEALED

MEMORANDUM OPINION AND ORDER

The United States, through the Antitrust Division of the Department of Justice (the "DOJ" or the "plaintiff"), brought this civil case to enjoin the proposed acquisition of a digital do-it-yourself tax preparation company known as TaxACT by H&R Block, another company that sells digital do-it-yourself tax preparation products as well as provides other tax preparation services.[1] A preliminary injunction hearing in this case is scheduled for September 6, 2011, and the plaintiff has filed a motion in limine to exclude evidence of an email survey commissioned by the defendants and the portions of a defendants' expert opinion that relies upon the survey. For the reasons that follow, the Court denies the motion in limine.[2]

I. BACKGROUND

The DOJ filed this action on May 23, 2011, seeking to enjoin Defendant H&R Block, Inc. from acquiring Defendant 2SS Holdings, Inc. ("TaxACT"), which sells digital do-it-yourself

[1] The Court has subject matter jurisdiction to hear this suit under 15 U.S.C. § 25, and 28 U.S.C. §§ 1331, 1337 and 1345.

[2] The plaintiff initially filed an additional motion in limine to exclude evidence of defendants' guarantee to maintain TaxACT's current prices for three years following the acquisition. *See* ECF No. 44. The plaintiff withdrew that motion at oral argument on September 2, 2011.

tax preparation products marketed under the brand name TaxACT. Compl. ¶ 10. Defendant TA IX, L.P. ("TA"), owns a two-thirds interest in TaxACT.[3] *Id.* ¶ 11.

According to the Complaint, last year an estimated 35 to 40 million taxpayers filed their taxes using digital do-it-yourself tax preparation products ("Digitial DIY Tax Preparation Products"). *Id.* ¶ 1. In the U.S. Digital DIY Tax Preparation Product market, the three largest firms collectively have about 90% of the market share. *Id.* The leading company in the market is Intuit, Inc., the maker of "TurboTax." *Id.* ¶ 3. H&R Block's proposed acquisition of TaxACT, if allowed to proceed, would combine the second- and third-largest providers in the market – i.e., H&R Block and TaxACT, respectively. *Id.*

The Complaint alleges that TaxACT is a "maverick" competitor that has a history of "disrupting" the Digital DIY Tax Preparation market and has forced its competitors, including H&R Block and Intuit, "to offer free products and increase the quality of their products for American taxpayers." *Id.* ¶ 28. The Complaint alleges that TaxACT has aggressively competed with H&R Block and Intuit by providing high-quality products and services at low cost. *See id.* ¶¶ 30-40. The DOJ alleges that the acquisition of TaxACT by H&R Block would reduce competition in the industry and make anticompetitive coordination between the two major remaining market participants – H&R Block and Intuit – substantially more likely. *Id.* ¶¶ 40-49. The DOJ alleges that therefore the proposed acquisition violates Section 7 of the Clayton Act, 15 U.S.C. § 18, and accordingly it seeks an injunction blocking H&R Block from acquiring TaxACT. *Id.* ¶¶ 53-55.

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[3] 2nd Story Software, Inc. ("2SS") is a wholly-owned subsidiary of 2SS Holdings, Inc., which is the entity being purchased by H&R Block. Declaration of Lance Dunn, dated May 27, 2011 ("Dunn Decl."), ¶¶ 2, 4. Both 2SS and 2SS Holdings, Inc. share the same address in Cedar Rapids, Iowa.

The defendants dispute that the appropriate product market is Digital DIY Tax Preparation products, but argue that the relevant market instead consists of "all methods of tax preparation for the U.S. federal and state income taxes." Report of Dr. Christine Siegwarth Meyer, DX0017-006, at 2. Furthermore, even assuming *arguendo* that the plaintiff's alleged market definition were correct, the defendants deny that the transaction would result in anticompetitive effects because, *inter alia*, "H&R Block and TaxAct are not close substitutes and the merger is likely to lead to substantial, incremental, merger-specific efficiencies." Joint Pre-Hearing Statement at 4.

A pre-hearing conference in this matter, including oral argument on the motion in limine, was held on September 2, 2011.

II. DISCUSSION

The plaintiff has moved, pursuant to Federal Rules of Evidence 702 and 703, to exclude evidence of an email survey of defendants' customers and to limit defendants' expert opinion to the extent that it relies on this survey (the "2011 email survey"). Pl.'s Mem. in Supp. of Pl.'s Mot. to Exclude the 2011 Litigation Survey and Limit Defs.' Expert Report ("Pl.'s Mem.") at 1-2. The plaintiff contends the survey's "methodology falls far short of the requirements of Federal Rules of Evidence 703 and 702 because: (1) it fails to ask a question relevant to this proceeding; (2) it suffers from extraordinary non-response bias, with response rates far below what courts have found necessary to establish reliability; and (3) the response options provided are leading and fail to discourage guessing." *Id.* at 2. For the reasons below, the Court declines to exclude the evidence or to limit the expert's opinion.

A. Standard of Review

"Under Rule 702, a trial court may only admit expert testimony that is both relevant and reliable." *Harris v. Koenig*, No. 02-618, 2011 WL 2531257, at *1 (D.D.C. June 27, 2011) (citing *Kumho Tire Co. v. Carmichael*, 526 U.S. 137, 141 (1999); *Daubert v. Merrell Dow Pharmaceuticals, Inc.*, 509 U.S. 579, 589 (1993)). "Courts take a flexible approach to deciding Rule 702 motions and have 'broad discretion in determining whether to admit or exclude expert testimony." *Id.* (quoting *U.S. ex rel. Miller v. Bill Harbert Int'l Constr., Inc.*, 608 F.3d 871, 895 (D.C. Cir. 2010) (internal citation omitted). "In considering Rule 702 motions, the court assumes only a 'limited gate-keep[ing] role' directed at excluding expert testimony that is based upon 'subjective belief' or 'unsupported speculation.'" *Id.* (quoting *Ambrosini v. Labarraque*, 101 F.3d 129, 135-36 (D.C. Cir. 1996)). In addition, "the importance of the trial court's gatekeeper role is significantly diminished in bench trials . . . because, there being no jury, there is no risk of tainting the trial by exposing a jury to unreliable evidence." *Whitehouse Hotel Ltd. Partnership v. Comm'r of Internal Revenue*, 615 F.3d 321, 330 (5th Cir. 2010). "The party seeking to introduce expert testimony must demonstrate its admissibility by a preponderance of the evidence." *Harris*, 2011 WL 2531257, at *1 (citing *Daubert*, 509 U.S. at 592 n.10).

Under Rule 703, the facts or data underlying an expert's opinion "need not be admissible in evidence in order for the opinion or inference to be admitted" if the facts or data are "of a type reasonably relied upon by experts in the particular field." Fed. R. Evid. 703. In addition, such "facts or data that are otherwise inadmissible" may be disclosed by the proponent of the opinion if their probative value substantially outweighs any prejudicial effect. *Id.*

B. Background Regarding the 2011 Email Survey

In late April 2011, following the 2011 tax season, the defendants commissioned Directions Research, a market research firm, to conduct an Internet-based survey of TaxACT's customers. GX 604. According to the defendants, during the investigation of the transaction, the DOJ did not accept the defendants' evidence of an "extremely low switching between the Defendants' products" as an appropriate proxy for diversion – i.e., the government contended that current switching rates are not necessarily predictive of how TaxACT customers would react to a price increase or functionality decrease. Defs.' Mem. in Opp'n to Pl.'s Mot. In Limine ("Defs.' Mem.") at 3. The survey was therefore initiated to respond to a question raised by the DOJ – namely, "how TaxAct consumers would react to a price increase, service decrease or functionality decrease in the TaxAct products." *Id.* The survey asked one primary question: "If you had become dissatisfied with TaxACT's price, functionality or quality, which of these products or services would you have considered using to prepare your federal taxes?" GX 604 (Results of the 2011 email survey); GX623 (App'x 2 to Report of Dr. Dhar). The survey then offered the respondents a list of eleven options, including other products or services, from which to choose and instructed them to select all applicable options. *Id.* The list of options that respondents were given varied somewhat depending on the respondents' filing status and the payments they had made for their 2011 tax returns.[4] *Id.* A follow-up question asked the respondents to narrow their selections to a single choice. *Id.*

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[4] The response options varied among four different categories of filers, which are discussed further below. For example, the list of options presented to filers who completed a free federal tax return and no state return were: "I would prepare myself without help," "TurboTax Free Edition," "H&R Block at Home Free Edition," "Free TaxUSA Free Edition," "Complete Tax Free Basic," "An Accountant," "I would use a product on FFA [i.e., Free File Alliance]," "TaxSlayer Free Edition," "Jackson Hewitt Free Basic," "Tax$imple Free Basic," and "Other." GX604 at 2.

The research firm sent over 70,000 surveys via email to a statistically-random selection of TaxACT customers inviting them to participate in the survey. Declaration of Tina Ruddy, dated August 24, 2011 ("Ruddy Decl.") ¶¶ 9, 10. Survey respondents were asked screening questions to determine their membership in one of four categories of customers: (1) those who paid to use TaxAct's products for filing both federal and state tax returns (denominated in the survey report analysis by Directions Research as "Paid Fed/Paid State"); (2) those who paid to use TaxAct's federal return product but not for filing the state return ("Paid Fed/No State"); (3) those who used TaxAct's free product for filing a federal return and paid to use a TaxAct product to file a state return ("Free Fed/Paid State"); and (4) those who used TaxAct's free product for filing a federal return but not for filing the state return ("Free Fed/No State").[5] GX604 (Results of the 2011 email survey).

A total of 1,089 customers responded to the survey. *Id.* at 2-3. The response rates for the four categories of customers were: (1) 2.45% for paid federal / paid state filing (422); (2) 0.6% for paid federal / no state filing (182); (245); (3) 2.08% for free federal / paid state filing; and (4) 1.7% for free federal / no state filing (240). *Id.*; *see also* Pl.'s Mem. at 3.

Defendants' expert, Dr. Christine Siegwarth Meyer, summarized the results of the survey as follows:

> [A] survey of TaxACT customers indicates that few would switch to H&R Block At Home in the event that they were satisfied with TaxACT. In each of the four groups, the comparable HRB product was neither the first nor second most likely alternative tax products for the respondents. The percentage of TaxACT customers that would switch to H&R Block At Home ranged from 4 to 10 percent, with a weighted average of only 6 percent. Instead, in each group, pen-and-paper and TurboTax were the two options with the

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[5] By contrast to federal tax returns, TaxAct does not provide free state return preparation software but does offer free electronic filing of state returns to those customers who purchase a TaxAct-branded desktop software product available at Staples retail stores. Report of Dr. Meyer ¶¶ 191-92. The Court understands the survey's category for "No State" to cover those respondents who did not purchase TaxAct's state return preparation software from Staples or any other source.

> highest responses. In only one of the four groups was HRB the third response. Instead, Free TaxUSA (Tax Hawk) was a more prevalent choice than HRB for three of the four groups.

Report of Dr. Meyer, DX0017-042 (footnotes omitted). Based upon this analysis of the results, Dr. Meyer opined that:

> This further indicates that HRB is not a particularly close competitor to TaxACT. Following the merger, consumers who are dissatisfied with TaxACT will have numerous other choices to which they can and would turn, including TurboTax, pen-and-paper, other software products, and assisted tax preparation.

Id.

C. Analysis

In order to admit expert testimony under Rule 702, the Court must find that it is "relevant and reliable." *Kumho Tire Co.*, 526 U.S. at 141; *Daubert*, 509 U.S. at 589. "In general, Rule 702 has been interpreted to favor admissibility." *Khairkhwa v. Obama*, No. 08-1805, 2011 WL 2490960, at *7 (D.D.C. May 27, 2011) (citing *Daubert*, 509 U.S. at 587; Fed. R. Evid. 702 Advisory Committee's Note (2000) ("A review of the caselaw after *Daubert* shows that the rejection of expert testimony is the exception rather than the rule.")). "The adversarial system remains the 'traditional and appropriate' mechanism for exposing 'shaky but admissible evidence.' *Id.* (citing Fed. R. Evid. 702 Advisory Committee's Note (2000) (quoting *Daubert*, 509 U.S. at 596)).

Facts or data underlying an expert's opinion that are "of a type reasonably relied upon by experts in the particular field" need not be admissible in evidence in order for the opinion or inference to be admitted. Fed. R. Evid. 703. Regarding survey results in particular, technical and methodological deficiencies in a survey generally go to the weight of the evidence, not the admissibility, unless the deficiencies are so substantial as to render the survey unreliable. *See Univ. of Kan. v. Sinks*, No. 06-2341, 2008 WL 755065, at *3 (D. Kan. Mar. 19, 2008) (discussing customer confusion survey in trademark case).

As discussed in more detail below, having reviewed the report of defendants' expert, Dr. Christine Siegwarth Meyer, the Court finds that Dr. Meyer's anticipated testimony regarding the 2011 email survey meets the criteria for admissibility. Dr. Meyer is an accomplished economist with a Ph.D. in economics from the Massachusetts Institute of Technology. *See* DX0017, Ex. 1. Her conclusions regarding the level of competition between TaxACT and H&R Block, as expressed in her report, are not based solely upon the results of the survey to which the plaintiff objects. *See* DX0017-022-26, 28-42 (discussing various documents and data to support Dr. Meyer's conclusions regarding competition with manual filing and unilateral effects); Meyer Dep. 175:6-16 ("I think [the 2011 email survey] – it's an important data point. It's not the only data point to make any of the points that I use it to make.") (cited in Defs.' Mem. at 18 n.58).

As for the survey itself, the Court finds that Dr. Meyer's use of the survey as a datum in reaching her conclusions is not unreliable. While the plaintiff has identified cogent concerns about the wording and the methodology of the survey, the Court finds that these concerns go to the weight, not the admissibility, of the evidence, especially in this bench hearing where there is no concern about jury confusion or prejudice.[6] *See Seaboard Lumber Co. v. United States*, 308 F.3d 1283, 1301-02 (Fed. Cir. 2002) (noting that "concerns [about jury confusion] are of lesser import in a bench trial," although "*Daubert* standards of relevance and reliability" still apply).

[6] At oral argument and in its briefs, the plaintiff urged the Court to follow *United States v. Dentsply Int'l Inc.*, an antitrust case in which the district court excluded a survey. 277 F. Supp. 2d 387, 436 (D. Del. 2003), *rev'd on other grounds*, 399 F.3d 181 (3d Cir. 2005). The court excluded the survey in that case because it suffered from myriad flaws: "(1) the screening questionnaire failed to identify relevant respondents; (2) the questionnaire instructions were complex and confusing; (3) a pre-test was not conducted; (4) the response rate was low; (5) non-response bias was not addressed; (6) respondents were unwilling or unable to devote time to take the survey seriously; (7) the results could not be replicated; (8) a standard error measurement was not calculated; and (9) a key parameter estimate was arbitrarily changed." *Id.* at 453-54. As discussed herein, the Court finds that the deficiencies the plaintiff has identified regarding the 2011 email survey affect the weight the Court will accord the survey, but do not sufficiently undermine the methodology used to design, execute and analyze the survey's results to bar admissibility.

1. Relevance

The Court finds that the survey is relevant because it is probative of the degree to which TaxACT and H&R Block are competitors, whether the market is defined, as alleged by the plaintiff, to be Digital DIY tax preparation products or more broadly, as alleged by the defendants, to be all tax preparation products and services. The options provided to survey respondents encompassed both competing Digital DIY tax preparation products as well as alternative services.

The plaintiff argues that the survey is irrelevant because Dr. Meyer asserted in her report that "this survey is closer to the concept of a diversion ratio than are data on overall switching between products," Pl.'s Mem. at 5 (citing Dr. Meyer's Report at DX0017-024 n.85). According to the plaintiff, diversion refers to "a measured customer reaction to a measured increase in price." *Id.* Since the phrasing of the survey question conflates customer concerns about price, functionality, and quality, and does not actually ask about a change in price, the plaintiff argues that the survey cannot shed any light on customer reactions to price changes. *Id.* Even accepting the plaintiff's critique, however, would not obliterate the survey's relevance entirely. Further, Dr. Meyer's report, in the portion cited by the plaintiff, did not state that the survey provided direct evidence of diversion, but rather that "this survey is closer to the concept of a diversion ratio than are data on overall switching between products," which the Court understands as expressing a different idea. While the wording of the survey question may limit its relevance on specific issues, because the survey provides at least some indication of the products and services that compete with TaxACT, the Court cannot say that it does not have "any tendency to make the existence of any fact that is of consequence to the determination of the action more probable or

less probable than it would be without the evidence." Fed. R. Evid. 401 (defining relevant evidence).

2. Reliability

Customer surveys generally are a type of evidence that may be reasonably relied upon by experts in defining markets in antitrust cases. *See* GX622 (Christine Meyer, "Designing and Using Surveys to Define Relevant Markets," in *Economics of Antitrust: Complex Issues in a Dynamic Economy* 101, 108 (Lawrence Wu, ed. 2007)); GX624 (Shari Seidman Diamond, "Reference Guide on Survey Research," in Federal Judicial Center, *Reference Manual on Scientific Evidence*, hereinafter "Diamond," at 234-35).

In determining whether a particular survey may be admissible under Rule 703, courts examine the validity of the survey's methods and ask "Was the poll or survey conducted in accordance with generally accepted survey principles, and were the results used in a statistically correct way?" Diamond at 233-34. The methodological validity of a survey is necessarily a question of degree. As discussed above, technical deficiencies that can be adequately explored on cross-examination generally go to the weight, rather than the admissibility, of the evidence, unless the methodological deficiencies are so sweeping or fundamental as to render the survey wholly unreliable and therefore inadmissible.

a. Response Rate

The plaintiff argues that the survey is not reliable because it suffers from an "extraordinary level of non-response bias" due to its low response rate. Pl.'s Mem. at 7. The plaintiff cites authority indicating that a response rate below 50% "should be regarded with significant caution as a basis for precise quantitative statements from which the sample was drawn." Pl.'s Mem. at 7 (citing Diamond at 245). The plaintiff's rebuttal expert, Dr. Ravi Dhar,

has concluded that the "level of nonresponse . . . is extremely high (more than 98%)" and that the "extremely low response rates makes it difficult to determine whether the results were impacted by a certain segment who were systematically more likely to respond to the survey (e.g., those who were price sensitive or time insensitive) in relation to those who did not respond." GX 623 (Report of Dr. Dhar at 10).

The defendants respond by citing authority indicating that web-based surveys typically have significantly lower response rates than other types of surveys. Defs.' Mem. at 7-8. They also point to jury trials in which courts have admitted surveys with response rates of 10% or lower. Defs.' Mem. at 7-8 (citing *Sinks*, 2008 WL 755065, at *4; *Kinetic Concepts, Inc. v. Bluesky Med. Corp.*, No. SA-03-CA-0832, 2006 WL 6505346, at *6 (W.D. Tex. Aug. 11, 2006)).

The defendants further argue that the survey's sample size and response rate comply with industry standards for market research. A declaration from the Vice President of the market research firm that performed the survey affirms that large national companies commonly use similar survey results "to make business and pricing decisions." Ruddy Decl. ¶¶ 3-4. This declaration also states that "[t]he standard, industry-expected response rate for surveys of this kind is generally between 1% - 2%" and that, for web-based email surveys, "a response rate above 50% is so improbable as to be considered entirely unavailable." Ruddy Decl. ¶¶ 13, 16.

While the Court agrees with the plaintiff that the survey's response rate "appears, by any standard, to be quite low," *Sinks*, 2008 WL 755065, at *4, this concern goes to the weight, not the admissibility, of the evidence because the survey is not so unreliable as to be deemed inadmissible. The Court finds that the survey's sample size of over 1,000 TaxACT customers from the most recent tax season, the testimony of Dr. Meyer in relying on the survey, and the

testimony that the survey's sample size and response rate are in line with industry standards for similar surveys establish sufficient reliability to allow admission of the survey evidence. The Court is cognizant of the detailed critique of the survey's response rate presented by the plaintiff's expert, Dr. Dhar, and the Court is fully capable of taking this critique into account in determining how much weight to accord the survey's results in its analysis. *See Sinks*, 2008 WL 755065, at *4 (admitting survey despite low response rate); *Kinetic Concepts, Inc.*, 2006 WL 6505346, at *6 (same).

b. Closed-Ended Questions and Discouragement of Guessing

The plaintiff also contends that the survey is fatally flawed because it asks only "closed-ended, leading questions" and that it failed to discourage guessing by not including a "no opinion" or "I don't know" option.

The plaintiff contends that the survey's closed-ended response options are "severely flawed because they are not exhaustive and fail to take into account that some people may not switch [products] even though they are dissatisfied." Pl.'s Mem. at 9 (citing GX 623, Report of Dr. Dhar, ¶¶ 18-19). The plaintiff also argues that, by providing survey respondents with a list of options from which to choose, the survey "hardly mirrors competition in the marketplace where the Big Three competitors spend millions of dollars annually to get their message in front of potential customers. In contrast, the [survey] counterfactually de-emphasizes the significance of brand and the millions spent building and maintaining it." *Id.* at 10. In addition, the plaintiff contends that the survey questions are leading because the response options vary depending on the product the respondent stated he or she used during the prior tax year. *Id.*

The defendants respond that the questions in the survey were not inappropriately leading and that authority cited by the plaintiff's expert actually establishes that "closed-ended questions

are more suitable for assessing choices between well-identified options or obtaining ratings on a clear set of alternatives." Defs.' Mem. at 8-9 (citing Diamond at 253). The defendants also note that the questions were not wholly closed-ended in that "Other" was an option that respondents could select. *Id.* at 9.

By providing survey respondents with a pre-selected list of alternative options, rather than letting respondents respond organically, the survey does lead respondents to think about the market for tax preparation services in the same terms that the defendants do, which may have led respondents to select options they otherwise would not have selected. This effect is not so inherently suggestive as to render the survey's results wholly unreliable and therefore inadmissible, however. The survey does not appear to lead respondents to select any particular answer; the response choices included the major market participants under both parties' views of the market; and it also included an "Other" option. Moreover, the survey question cannot be considered to be as "leading" as the questions identified as problematic in the plaintiff's cited authority.[7] Accordingly, this critique goes to the weight of the evidence and not to admissibility.

The same is true of plaintiffs' concerns about the survey's failure to discourage guessing by not including an "I don't know" option. The plaintiff argues that "[s]urveys should explicitly mention that it is completely appropriate for respondents to have no opinion [on] a given question" and that failure to include an "I don't know" opinion skews the results by failing to

[7] In *Novartis Consumer Health, Inc. v. Johnson & Johnson-Merck Consumer Pharms. Co.*,290 F.3d 578, 591 (3d Cir. 2002), cited by the plaintiff, the Court discussed a case in which the Third Circuit identified a highly suggestive survey question. In that case, the party offering the survey evidence sought to defend an advertisement claiming that its medicine, Maalox, was "the strongest." The survey at issue asked respondents the following question: "In the commercial you just saw, they said Maalox tablets are the strongest. What does that mean to you?" The Third Circuit held that this question improperly led respondents to answer that "strongest" meant something other than its ordinary, obvious meaning. *See id.* at 593 (discussing *Johnson & Johnson-Merck Consumer Pharm. Co. v. Rhone-Poulenc Rorer Pharms., Inc.*, 19 F.3d 125 (3d Cir. 1994)).

provide an adequate answer for respondents who have no opinion on the question. Pl.'s Mem. at 10-11. While this concern is valid and the absence of such an "I don't know" option does diminish the weight the Court should accord this survey, the failure to include this option is partially mitigated here by the inclusion of the "Other" option. The Court does not find that this defect so undermines the survey as to require it to be deemed inadmissible. *See Kinetic Concepts*, 2006 WL 6505346, at *6 (admitting survey that did not have an "I don't know" option and concluding that any objections went to the weight of the survey rather than to admissibility).

3. Consideration of All Critiques

In sum, the plaintiff has identified a number of aspects about the methodology and wording of the defendants' 2011 email survey that will impact the weight that the Court gives this survey in its analysis. These defects do not undermine the survey and the expert's reliance on it so overwhelmingly that they render the survey wholly irrelevant or unreliable—and therefore inadmissible. While the admissibility of this survey might be a closer question in the context of a jury trial, since this hearing is not before a jury, "the importance of the trial court's gatekeeper role is significantly diminished . . . because, there being no jury, there is no risk of tainting the trial by exposing a jury to unreliable evidence." *Whitehouse Hotel Ltd. Partnership*, 615 F.3d at 330; *accord United States v. Oracle Corporation*, 331 F. Supp. 2d 1098, 1158 (N.D. Cal. 2004) (court at injunction hearing considered government's expert witness testimony on product market definition despite "shortcomings" in cited statistics and "sketchy" statistical tabulations based in part on "tiny sample" of Oracle customer surveys). Accordingly, the Court will deny the motion in limine to exclude the survey and to preclude defendant's expert from expressing opinions based upon the survey.

III. CONCLUSION

For the reasons explained above, the plaintiff's motion in limine is DENIED. This Memorandum Opinion and Order shall be filed under seal. On or before September 12, 2011, the parties shall advise the Court regarding whether any portion of this Memorandum Opinion should be redacted before public filing because it contains confidential information. In addition, if the parties have not already filed versions of their legal memoranda that may be filed publicly, they shall do so by September 12, 2011.

DATED: September 6, 2011

/s/ Beryl A. Howell
BERYL A. HOWELL
United States District Judge

A NOTE ON EXPERT EVIDENCE

As a general rule, a witness may not testify at trial to a matter on which the witness lacks personal knowledge. Rule 602 of the Federal Rules of Evidence provides:

> A witness may not testify to a matter unless evidence is introduced sufficient to support a finding that the witness has personal knowledge of the matter. Evidence to prove personal knowledge may, but need not, consist of the witness' own testimony. This rule is subject to the provisions of rule 703, relating to opinion testimony by expert witnesses.[1]

Rule 702 governs the admissibility of opinion testimony by a qualified expert.[2] Rule 702 embodies separate requirements on qualifications, relevance, and reliability:

> A witness who is qualified as an expert by knowledge, skill, experience, training, or education may testify in the form of an opinion or otherwise if:
>
> (a) the expert's scientific, technical, or other specialized knowledge will help the trier of fact to understand the evidence or to determine a fact in issue;
>
> (b) the testimony is based on sufficient facts or data;
>
> (c) the testimony is the product of reliable principles and methods; and
>
> (d) the expert has reliably applied the principles and methods to the facts of the case.[3]

Subject to Rule 702 and the other rules of evidence, Rule 704(a) permits experts to offer opinion testimony about an ultimate issue of fact in the case.[4] But neither Rule 702 nor Rule 704(a) allows an expert to offer legal conclusions.[5]

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1. FED. R. EVID. 602.
2. *Id*. 702.
3. *Id*. 702. In limited circumstances, lay persons may give opinion testimony under Rule 701: "If a witness is not testifying as an expert, testimony in the form of an opinion is limited to one that is: (a) rationally based on the witness's perception; (b) helpful to clearly understanding the witness's testimony or to determining a fact in issue; and (c) not based on scientific, technical, or other specialized knowledge within the scope of Rule 702." FED. R. EVID. 701.
4. *Id*. 704(a) ("An opinion is not objectionable just because it embraces an ultimate issue."). Rule 704 abolished the old common law prohibition against any witness, including an expert, from offering an opinion on the "ultimate issue" in the case.
5. *See, e.g.*, Nationwide Transp. Fin. v. Cass Info. Sys., 523 F.3d 1051, 1059-60 (9th Cir. 2008); C.P. Interests, Inc. v. Cal. Pools, Inc., 238 F.3d 690, 697 (5th Cir. 2001); Berry v. City of Detroit, 25 F.3d 1342, 1353 (6th Cir. 1994) ("Although an expert's opinion may embrace an ultimate issue to be decided by the trier of fact, the issue embraced must be a factual one.") (citation, brackets, and quotation marks omitted).

Rule 702 was amended in 2000 to its current form to incorporate the principles of *Daubert v. Merrell Dow Pharmaceuticals, Inc.*[6] and *Kumho Tire Co. v. Carmichael*.[7] *Daubert*, which involved scientific expert testimony, assigned the trial court the "gatekeeper" role of "of ensuring that an expert's testimony both rests on a reliable foundation and is relevant to the task at hand."[8] *Kumho* clarified that *Daubert's* gatekeeping obligation applies as well to all types of expert testimony.[9] The 2000 amendment reaffirms the trial court's role as a gatekeeper and imposes requirements of relevance, qualification, and reliability on expert testimony.

Relevance. Rule 702 requires that the "expert's scientific, technical, or other specialized knowledge will help the trier of fact to understand the evidence or to determine a fact in issue."[10] The Advisory Committee observed that the helpfulness inquiry is "whether the untrained layman would be qualified to determine intelligently and to the best possible degree the particular issue without enlightenment from those having a specialized understanding of the subject involved in the dispute."[11] Expert testimony that is not helpful to the trier of fact is inadmissible.[12]

Once aspect of the relevancy requirement is that the expert's analysis is probative of a question of fact in the case under the proper legal standard. At trial, the expert must testify in a manner that does not run counter to the established legal rules or that runs the risk of confusing the jury as to the proper legal test. So, for example, courts have excluded expert testimony where expert's theory of market definition contradicted the applicable legal standards.[13]

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6. 509 U.S. 579 (1993).
7. 526 U.S. 137 (1999).
8. *Daubert*, 509 U. at 597; *accord Kumho*, 526 U.S. at 141.
9. *Kumho*, 526 U.S. at 147.
10. FED. R. EVID. 702.
11. Fed. R. Evid. 702 advisory committee's note to the original proposed rule; *see* Superior Prod. P'ship v. Gordon Auto Body Parts Co., 784 F.3d 311, 323 (6th Cir. 2015) (affirming exclusion of expert testimony that the defendant's pricing strategy reflected an intent to force the plaintiff out of the market where no expert testimony on intent was needed); *In re* Se. Milk Antitrust Litig., No. 2:07-CV 208, 2010 WL 8228830, at *3 (E.D. Tenn. Dec. 8, 2010) (granting motion to exclude expert testimony that did no more than collate the plaintiffs' evidence and summarize it in nontechnical form, without the application of any expertise).
12. *See* United States v. Duncan, 42 F.3d 97, 101 (2d Cir. 1994) ("When an expert undertakes to tell the jury what result to reach, this does not *aid* the jury in making a decision, but rather attempts to substitute the expert's judgment for the jury's. When this occurs, the expert acts outside his limited role of providing the groundwork in the form of an opinion to enable the jury to make its own informed determination. In evaluating the admissibility of expert testimony, this Court requires the exclusion of testimony which states a legal conclusion.") (emphasis in original).
13. *See, e.g.*, Superior Prod. P'ship v. Gordon Auto Body Parts Co., 784 F.3d 311, 325 (6th Cir. 2015) (affirming exclusion of expert testimony that defendant's prices were below cost where expert used an incorrect test for below-cost pricing under Sixth Circuit precedent); Rebel Oil Co. v. Atlantic Richfield Co., 51 F.3d 1421, 1436 (9th Cir. 1995); Bailey v. Allgas, Inc., 148 F.Supp.2d 1222, 1242-45 (N.D. Ala. 2000), *aff'd*, 284 F.3d 1237, 1247-49 (11th Cir. 2002).

Qualifications. Rule 702 requires that an expert witness be qualified by scientific, technical, or other specialized knowledge. Without this specialized knowledge, the expert's testimony would not be helpful to the jury: the trier of fact can simply perform the analysis on their own. Courts have construed this requirement liberally.[14] In assessing an expert's qualifications, the court should consider a proposed expert's full range of practical experience as well as academic or technical training.[15] When the expert is otherwise qualified, courts should not exclude the expert's testimony merely because the expert did not have the degree or training which the court believed would be most appropriate.[16] But the expert's qualifications must be relevant to the opinion the expert is offering. A person, although qualified as an expert in one area of expertise, may be precluded from offering opinions beyond that area of expertise.[17] Moreover, while an expert may be "qualified" sufficient to satisfy the standards of Rule 702, the nature of the qualifications may affect the weight to be given to the testimony.[18]

Facts and data. By its terms, a necessary requirement under Rule 702 for the admissibility of expert opinion testimony is that the testimony be based on "sufficient data or facts." An expert may obtain her data or facts from one of three sources:[19]

1. The expert may have first-hand personal knowledge of them, such as when the expert is a treating physician who directly observed the patient.
2. The expert may be provided data and facts at trial, such as when the expert attended the testimony of fact witnesses in which the data and facts were disclosed or when counsel during the expert's examination (especially cross-examination) presented the expert with data or facts in a hypothetical situation on which the expert was asked to opine.
3. More commonly, especially for economic experts in antitrust cases, the expert obtained her data or facts from third-party sources and so does not have "personal knowledge" of them within the meaning of Rule 602.

Rule 703 governs the facts or data on which an expert may base an opinion:

> An expert may base an opinion on facts or data in the case that the expert has been made aware of or personally observed. If experts in the particular field

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14. *See, e.g.*, *In re* Paoli R.R. Yard PCB Litig. (Paoli II), 35 F.3d 717, 741 (3d Cir. 1994).

15. *See In re* Ready-Mixed Concrete Antitrust Litig., 261 F.R.D. 154, 163 (S.D. Ind. 2009).

16. *See, e.g.*, *Paoli II*, 35 F.3d at 741.

17. *See* Weisgram v. Marley Co., 169 F.3d 514, 518 (8th Cir. 1999) (holding that a city fire captain, although qualified as an expert on fire investigation, and therefore qualified to testify as to his opinion that a fire started in the entryway and radiated to a sofa, was not qualified to testify as to his unsubstantiated theories of a malfunction that might have caused the fire)

18. *See, e.g.*, *In re* Mushroom Direct Purchaser Antitrust Litig., No. 06-0620, 2015 WL 5767415, at *3-*5 (E.D. Pa. July 29, 2015) (finding Einer Elhauge, a professor at Harvard who teaches and has published in antitrust law, "qualified" within the meaning of Rule 702 to offer economic opinions based on the use of regression analysis, although he has no formal training in economics, econometrics or statistics, but noting that his lack of formal training typical of testifying economic experts would factor in the weight given to his testimony).

19. FED. R. EVID. 703 advisory committee's note to the original proposed rule.

> would reasonably rely on those kinds of facts or data in forming an opinion on the subject, they need not be admissible for the opinion to be admitted. But if the facts or data would otherwise be inadmissible, the proponent of the opinion may disclose them to the jury only if their probative value in helping the jury evaluate the opinion substantially outweighs their prejudicial effect.[20]

The first sentence of Rule 703 handles the expert's first-hand knowledge as well as data or facts provided at trial. The rest of the rule handles data and facts from third-party sources. Note that the expert may rely on data and facts that are not admitted, or even are inadmissible, if experts in the field reasonably rely on them.[21]

Under Rule 703, experts are entitled to use assistance in formulating expert opinion, and their assistants need not themselves testify to make the expert's opinion testimony admissible.[22] The opposing party, however, may examine the expert to determine whether there was adequate supervision and whether relying on such assistance was standard practice in the field.[23] Where the expert relied on an assistant's work, the opposing party may also depose the assistant to determine how the task was performed and whether it was performed competently. Where the data or facts on which the expert relied cannot be shown to be reliable, either by the expert herself or other testimony, the opinions that depend on those data or facts will be excluded.[24]

As a general rule, an expert does not have to disclose in the expert's direct testimony the data and facts on which an opinion is based, but the relevant data and facts may be the subject of cross-examination. Rule 705 provides:

> Unless the court orders otherwise, an expert may state an opinion—and give the reasons for it—without first testifying to the underlying facts or data. But the expert may be required to disclose those facts or data on cross-examination.[25]

Rules 26(a)(2)(B) and 26(e)(1) of the Federal Rules of Civil Procedure and Rule 16 of the Federal Rules of Criminal Procedure, however, require disclosure in advance of trial of the basis and reasons for an expert's opinions.[26]

Reliable principles. Rule 702 requires that the expert testimony "is the product of reliable principles and methods."[27] The *Daubert* Court identified several factors that

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20. FED. R. EVID. 703.

21. This is an exception to Rule 104(b), which provides: "When the relevance of evidence depends on whether a fact exists, proof must be introduced sufficient to support a finding that the fact does exist. The court may admit the proposed evidence on the condition that the proof be introduced later." *Id*. 104(b).

22. *See In re* Sulfuric Acid Antitrust Litig., 235 F.R.D. 646, 658 (N.D. Ill. 2006).

23. *Id*.

24. *See, e.g.*, Orthofix Inc. v. Lemanski, No. 13-11421, 2015 WL 12990115, at *1 (E.D. Mich. Sept. 29, 2015).

25. FED. R. EVID. 705. Rules 26(a)(2)(B) and 26(e)(1) of the Federal Rules of Civil Procedure and Rule 16 of the Federal Rules of Criminal Procedure, however, require disclosure in advance of trial of the basis and reasons for an expert's opinions. *See* FED. R. CIV. P. 26(a)(2)(B), 26(e)(1); FED. R. CRIM. P. 16.

26. *See* FED. R. CIV. P. 26(a)(2)(B), 26(e)(1); FED. R. CRIM. P. 16.

the court may consider when making this determination, including: (1) whether the expert's technique or theory can be or has been tested; (2) whether the technique or theory has been subject to peer review and publication; (3) the known or potential rate of error of the technique or theory when applied; (4) the existence, and maintenance of standards and controls; and (5) whether the technique or theory has been generally accepted in the scientific community.[28] These factors are not exhaustive, and the trial court has "broad latitude when it decides *how* to determine reliability."[29]

Reliable application. Rule 702 requires that "the expert has reliably applied the principles and methods to the facts of the case."[30] In other words, "the expert's testimony must be relevant for the purposes of the case and must assist the trier of fact."[31] This requirement is commonly known as "fit."[32] The *Daubert* Court observed that "[f]it" is not always obvious, and scientific validity for one purpose is not necessarily scientific validity for other, unrelated purposes."[33]

As a general matter, flaws in a proffered expert's analysis typically go to the weight, rather than the admissibility, of the expert's testimony.[34] The evidentiary requirement of reliability is lower than the merits standard of correctness.[35] As the Third Circuit explained:

> A judge frequently should find an expert's methodology helpful even when the judge thinks that the expert's technique has flaws sufficient to render the conclusions inaccurate. He or she will often still believe that hearing the expert's testimony and assessing its flaws was an important part of assessing what conclusion was correct and may certainly still believe that a jury attempting to reach an accurate result should consider the evidence.[36]

Two areas of particular interest in antitrust cases are regression analysis and surveys.

Regression analysis is a well-accepted economic tool that courts have accepted when reliably applied.[37] The Supreme Court addressed application reliability of

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27. FED. R. EVID. 702.

28. *See, e.g.*, *In re* Paoli R.R. Yard PCB Litig. (Paoli II), 35 F.3d 717, 742 n.8 (3d Cir. 1994).

29. Kumho Tire Co. v. Carmichael, 526 U.S. 137, 142 (1999) (emphasis in original).

30. FED. R. EVID. 702.

31. Schneider ex rel. Estate of Schneider v. Fried, 320 F.3d 396, 404 (3d Cir. 2003); *accord In re* Mushroom Direct Purchaser Antitrust Litig., No. 06-0620, 2015 WL 5767415, at *2 (E.D. Pa. July 29, 2015).

32. *See, e.g.*, *Paoli II*, 35 F.3d at 743; *In re* Nexium (Esomeprazole) Antitrust Litig., 842 F.3d 34, 52 (1st Cir. 2016); Concord Boat Corp. v. Brunswick Corp., 207 F.3d 1039, 1055 (8th Cir. 2000).

33. *Daubert*, 509 U. at 591.

34. *See, e.g.*, *In re* Live Concert Antitrust Litig., 863 F. Supp. 2d 966, 973 (C.D. Cal. 2012).

35. *Paoli II*, 35 F.3d at 744; *In re* Mushroom Direct Purchaser Antitrust Litig., No. 06-0620, 2015 WL 5767415, at *6 (E.D. Pa. July 29, 2015).

36. *Id*. at 744-45.

37. *See, e.g.*, *In re* Flat Glass Antitrust Litig., 191 F.R.D. 472, 486 (W.D. Pa. 1999) (collecting cases).

opinions based on regression analysis in *Bazemore v. Friday*, an employment discrimination case:

> While the omission of variables from a regression analysis may render the analysis less probative than it otherwise might be, it can hardly be said, absent some other infirmity, that an analysis which accounts for the major factors "must be considered unacceptable as evidence of discrimination." Normally, failure to include variables will affect the analysis' probativeness, not its admissibility.[38]

Generally, courts recognize that the economic tools used in antitrust cases require the exercise of professional judgment often resulting in disagreements between the opposing experts, and that these disagreements typically should be resolved by the trier of fact in the adversarial process and not by the court in a *Daubert* proceeding.[39] In some cases, however, the analysis may be so incomplete as to the "major factors" as to be inadmissible as irrelevant.[40] Courts have yet to establish a bright-line test for determining when a regression analysis "so incomplete" as to be irrelevant, but rather have more generally held that the burden is on the opposing party to show that the regression omitted material variables or was otherwise misspecified in a way that, if the regression analysis had been properly performed, would have changed the outcome of the analysis.[41] Merely identifying variables that the opposing party believes should have been included in the analysis, without showing how the inclusion of these variables would affect the result, is not enough.[42]

To assess application reliability of opinions based on surveys courts have examined a variety of factors, including whether (1) the "universe" of the survey was properly defined, (2) a representative sample of that universe was selected, (3) the questions to be asked of interviewees were framed in a clear, precise and non-leading manner, (4) sound interview procedures were followed by competent interviewers who had no knowledge of the litigation or the purpose for which the survey was

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38. Bazemore v. Friday, 478 U.S. 385, 400 (1986). For applications in antitrust cases, see, for example, *In re* Mushroom Direct Purchaser Antitrust Litig., No. 06-0620, 2015 WL 5767415, at *11 (E.D. Pa. July 29, 2015) (Daubert decision denying motion to exclude Einer Elhauge); *In re* Linerboard Antitrust Litig., 497 F. Supp. 2d 666, 678 (E.D. Pa. 2007) ("[I]t is only the rare case where the regressions are so incomplete as to be irrelevant and the expert's decisions regarding control variables are the basis to exclude the analysis.") (internal citations omitted).

39. *See In re* Mushroom Direct Purchaser Antitrust Litig., No. 06-0620, 2015 WL 5767415, at *6 (E.D. Pa. July 29, 2015); *In re* Air Cargo Shipping Servs. Antitrust Litig., No. 06–1175, 2014 WL 7882100, at *8 (E.D.N.Y. Oct. 15, 2014).

40. *See Live Concert*, 863 F. Supp. at 973 (quoting *Bazemore*, 478 U.S. at 400 n.10); Blue Cross & Blue Shield United of Wisc. v. Marshfield Clinic, 152 F.3d 588, 593 (7th Cir.1998) (finding expert damages reports were "worthless" because they controlled for only a single factor).

41. *See, e.g.*, Resco Prod., Inc. v. Bosai Minerals Grp., No. CIV.A. 06-235, 2015 WL 5521768, at *5 (W.D. Pa. Sept. 18, 2015); *In re* Mushroom Direct Purchaser Antitrust Litig., No. 06-0620, 2015 WL 5767415, at *11 (E.D. Pa. July 29, 2015) (rejecting Daubert challenge on omitted variables for failure to show that the omitted variables mattered).

42. *See, e.g.*, Resco, 2015 WL 5521768, at *5; *In re* Linerboard Antitrust Litig., 497 F. Supp. 2d 666, 678 (E.D. Pa. 2007); *In re* Polypropylene Carpet Antitrust Litig., 93 F. Supp. 2d 1348, 1365 (N.D. Ga. 2000).

conducted, (5) the data gathered was accurately reported, (6) the data was analyzed in accordance with accepted statistical principles and (7) the objectivity of the entire process was ensured.[43] Still, these are only factors for the court to consider. Unless the court determines that the survey is fundamentally unreliable, the expert testimony should be admitted and then tested through cross-examination at trial.[44]

Prejudice. Even if admissible under Rule 702, expert testimony is still subject to exclusion under Rule 403, which permits the court to exclude otherwise admissible evidence "if its probative value is substantially outweighed by a danger of one or more of the following: unfair prejudice, confusing the issues, misleading the jury, undue delay, wasting time, or needlessly presenting cumulative evidence."[45] Courts are likely to use this rule if there is substantially more reliable and accurate evidence to answer the question in issue.

Daubert motions. The admissibility of expert testimony is a question for the court. Rule 104(a) requires that "[t]he court must decide any preliminary question about whether a witness is qualified, a privilege exists, or evidence is admissible. In so deciding, the court is not bound by evidence rules, except those on privilege."[46] *Daubert* held that when a party proffers expert testimony, the trial court pursuant to Rule 104(a) must "determine at the outset" whether the testimony is admissible.[47] The court's inquiry must focus on qualifications, relevance, and reliability of the expert and her testimony, not on the conclusions the expert reaches nor the expert's credibility.[48]

Although Rule 103(a) generally provides that parties must make a timely objection to the admission of evidence in order to impose an obligation on the court to determine admissibility (and to preserve a claim of error as to the determination), *Daubert* imposes an independent requirement that trial courts conduct a preliminary assessment of the admissibility of expert testimony, even in the absence of an objection.[49] There is no requirement, however. that the district court conduct sua sponte an in-depth *Daubert* analysis and make explicit findings on the record as to the elements of Rule 702. Rather, it is enough that the district court is alert to the requirements on the admissibility of expert testimony and assure itself that these requirements are facially satisfied by the proffered expert testimony.

Finally, *Daubert* imposed the gatekeeper role on the courts to the Court to ensure that the trier of fact will not be exposed to unreliable or irrelevant testimony about

43. *See, e.g.*, Estes Park Taffy Co., LLC v. Original Taffy Shop, Inc., No. 15-CV-01697-CBS, 2017 WL 2472149, at *3 (D. Colo. June 8, 2017); LG Electronics U.S.A., Inc. v. Whirlpool Corp., 661 F. Supp. 2d 940, 952 (N.D. Ill. 2009).

44. *See, e.g.*, *Estes Park Taffy*, 2017 WL 2472149, at *4 (denying motion to exclude).

45. FED. R. EVID. 403.

46. *Id*. 104(a).

47. *Daubert*, 509 U.S. at 592.

48. *See, e.g.*, *In re* Scrap Metal Antitrust Litig., 527 F.3d 517, 529 (6th Cir. 2008); *In re* Paoli R.R. Yard PCB Litig. (Paoli II), 35 F.3d 717, 743 (3d Cir. 1994)

49. *See* Hoult v. Hoult, 57 F.3d 1, 4-5 (1st Cir. 1995).

scientific, technical or other specialized matters. But the need for a gatekeeper in advance is significantly diminished when the trier of fact is the judge and not a jury.

> That is not to say that the scientific reliability requirement is lessened in such situations; the point is only that the court can hear the evidence and make its reliability determination during, rather than in advance of, trial. Thus, where the factfinder and the gatekeeper are the same, the court does not err in admitting the evidence subject to the ability later to exclude it or disregard it if it turns out not to meet the standard of reliability established by Rule 702.[50]

While courts certainly can make Rule 702 determinations as the evidence is presented, not making an earlier determination can creates significant inefficiency on the court and the parties. In the absence of an earlier *Daubert* decision, the parties must prepare and present their evidence and arguments for both contingencies: that the expert evidence will be accepted and that it will be excluded. Especially when multiple experts are testifying, all of which are being challenged, the burden can be substantial.

Burden of proof and standard of review. The burden of laying the proper foundation for the admission of expert testimony is on the party offering the testimony and admissibility must be shown by a preponderance of the evidence.[51] As with other evidentiary rulings, the decision to admit or exclude expert testimony is within the discretion of the court.[52] Appellate court review the district court's decision for abuse of discretion.[53]

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50. *In re* Salem, 465 F.3d 767, 777 (7th Cir. 2006) (internal citation omitted); *accord In re* Rail Freight Fuel Surcharge Antitrust Litig., No. 07-0489 (PLF), 2016 WL 2962186, at *1 (D.D.C. May 20, 2016) (denying motion to exclude).

51. *See, e.g.*, *Daubert*, 509 U.S. at 593 n.10 (1993); Wills v. Amerada Hess Corp., 379 F.3d 32, 47 n.9 (2d Cir. 2004); Hall v. United Ins. Co. of Am., 367 F.3d 1255, 1261 (11th Cir. 2004); Lauzon v. Senco Prods., Inc., 270 F.3d 681, 686 (8th Cir. 2001); Meister v. Medical Engineering Corp., 267 F.3d 1123, 1128 n.9 (D.C. Cir. 2001); Cooper v. Smith and Nephew, Inc., 259 F.3d 194, 199 (4th Cir. 2001); Nelson v. Tenn. Gas Pipeline Co., 243 F.3d 244, 251 (6th Cir. 2001); Oddi v. Ford Motor Co., 234 F.3d 136, 144 (3d Cir. 2000); Allison v. McGhan Med. Corp., 184 F.3d 1300, 1306 (11th Cir. 1999); United States v. Griffith, 118 F.3d 318, 321 (5th Cir. 1997); FED. R. EVID. 702 advisory committee's note to 2000 amendments (observing that "the proponent has the burden of establishing that the pertinent admissibility requirements are met by a preponderance of the evidence.").

52. *See, e.g.*, Champagne Metals v. Ken-Mac Metals, Inc., 458 F.3d 1073, 1079 (10th Cir. 2006); United States v. Gabaldon, 389 F.3d 1090, 1098 (10th Cir. 2004); Amorgianos v. Nat'l R.R. Passenger Corp., 303 F.3d 256, 264-65 (2d Cir. 2002).

53. *See, e.g.*, Superior Prod. P'ship v. Gordon Auto Body Parts Co., 784 F.3d 311, 322 (6th Cir. 2015); *In re* Nexium (Esomeprazole) Antitrust Litig., 842 F.3d 34, 52 (1st Cir. 2016).

Judicial Tests of Market Definition

BROWN SHOE CO. V. UNITED STATES
370 U.S. 294 (1962)
(excerpt[1])

MR. CHIEF JUSTICE WARREN delivered the opinion of the Court.

. . .

The Product Market.

The outer boundaries of a product market are determined by the reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it.42 However, within this broad market, well-defined submarkets may exist which, in themselves, constitute product markets for antitrust purposes. *United States v. E. I. duPont de Nemours & Co.,* 353 U. S. 586, 593-595 [1957]. 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, distinct prices, sensitivity to price changes, and specialized vendors. Because § 7 of the Clayton Act prohibits any merger which may substantially lessen competition "in any line of commerce" (emphasis supplied), it is necessary to examine the effects of a merger in each such economically significant submarket to determine if there is a reasonable · probability that the merger will substantially lessen competition. If such a probability is found to exist, the merger is proscribed.

. . .

The Geographic Market.

We agree with the parties and the District Court that insofar as the vertical aspect of this merger is concerned, the relevant geographic market is the entire Nation. The relationships of product value, bulk, weight and consumer demand enable manufacturers to distribute their shoes on a nationwide basis, as Brown and Kinney, in fact, do. The anticompetitive effects of the merger are to be measured within this range of distribution.

1 Footnotes omitted.

Horizontal Merger Guidelines

U.S. Department of Justice

and the

Federal Trade Commission

Issued: August 19, 2010

impractical due to transportation costs. Arbitrage on a modest scale may be possible but sufficiently costly or limited that it would not deter or defeat a discriminatory pricing strategy.

4. Market Definition

When the Agencies identify a potential competitive concern with a horizontal merger, market definition plays two roles. First, market definition helps specify the line of commerce and section of the country in which the competitive concern arises. In any merger enforcement action, the Agencies will normally identify one or more relevant markets in which the merger may substantially lessen competition. Second, market definition allows the Agencies to identify market participants and measure market shares and market concentration. See Section 5. The measurement of market shares and market concentration is not an end in itself, but is useful to the extent it illuminates the merger's likely competitive effects.

The Agencies' analysis need not start with market definition. Some of the analytical tools used by the Agencies to assess competitive effects do not rely on market definition, although evaluation of competitive alternatives available to customers is always necessary at some point in the analysis.

Evidence of competitive effects can inform market definition, just as market definition can be informative regarding competitive effects. For example, evidence that a reduction in the number of significant rivals offering a group of products causes prices for those products to rise significantly can itself establish that those products form a relevant market. Such evidence also may more directly predict the competitive effects of a merger, reducing the role of inferences from market definition and market shares.

Where analysis suggests alternative and reasonably plausible candidate markets, and where the resulting market shares lead to very different inferences regarding competitive effects, it is particularly valuable to examine more direct forms of evidence concerning those effects.

Market definition focuses solely on demand substitution factors, i.e., on customers' ability and willingness to substitute away from one product to another in response to a price increase or a corresponding non-price change such as a reduction in product quality or service. The responsive actions of suppliers are also important in competitive analysis. They are considered in these Guidelines in the sections addressing the identification of market participants, the measurement of market shares, the analysis of competitive effects, and entry.

Customers often confront a range of possible substitutes for the products of the merging firms. Some substitutes may be closer, and others more distant, either geographically or in terms of product attributes and perceptions. Additionally, customers may assess the proximity of different products differently. When products or suppliers in different geographic areas are substitutes for one another to varying degrees, defining a market to include some substitutes and exclude others is inevitably a simplification that cannot capture the full variation in the extent to which different products compete against each other. The principles of market definition outlined below seek to make this inevitable simplification as useful and informative as is practically possible. Relevant markets need not have precise metes and bounds.

Defining a market broadly to include relatively distant product or geographic substitutes can lead to misleading market shares. This is because the competitive significance of distant substitutes is unlikely to be commensurate with their shares in a broad market. Although excluding more distant substitutes from the market inevitably understates their competitive significance to some degree, doing so often provides a more accurate indicator of the competitive effects of the merger than would the alternative of including them and overstating their competitive significance as proportional to their shares in an expanded market.

> *Example 4:* Firms A and B, sellers of two leading brands of motorcycles, propose to merge. If Brand A motorcycle prices were to rise, some buyers would substitute to Brand B, and some others would substitute to cars. However, motorcycle buyers see Brand B motorcycles as much more similar to Brand A motorcycles than are cars. Far more cars are sold than motorcycles. Evaluating shares in a market that includes cars would greatly underestimate the competitive significance of Brand B motorcycles in constraining Brand A's prices and greatly overestimate the significance of cars.

Market shares of different products in narrowly defined markets are more likely to capture the relative competitive significance of these products, and often more accurately reflect competition between close substitutes. As a result, properly defined antitrust markets often exclude some substitutes to which some customers might turn in the face of a price increase even if such substitutes provide alternatives for those customers. However, a group of products is too narrow to constitute a relevant market if competition from products outside that group is so ample that even the complete elimination of competition within the group would not significantly harm either direct customers or downstream consumers. The hypothetical monopolist test (see Section 4.1.1) is designed to ensure that candidate markets are not overly narrow in this respect.

The Agencies implement these principles of market definition flexibly when evaluating different possible candidate markets. Relevant antitrust markets defined according to the hypothetical monopolist test are not always intuitive and may not align with how industry members use the term "market."

Section 4.1 describes the principles that apply to product market definition, and gives guidance on how the Agencies most often apply those principles. Section 4.2 describes how the same principles apply to geographic market definition. Although discussed separately for simplicity of exposition, the principles described in Sections 4.1 and 4.2 are combined to define a relevant market, which has both a product and a geographic dimension. In particular, the hypothetical monopolist test is applied to a group of products together with a geographic region to determine a relevant market.

4.1 Product Market Definition

When a product sold by one merging firm (Product A) competes against one or more products sold by the other merging firm, the Agencies define a relevant product market around Product A to evaluate the importance of that competition. Such a relevant product market consists of a group of substitute products including Product A. Multiple relevant product markets may thus be identified.

4.1.1 The Hypothetical Monopolist Test

The Agencies employ the hypothetical monopolist test to evaluate whether groups of products in candidate markets are sufficiently broad to constitute relevant antitrust markets. The Agencies use the

hypothetical monopolist test to identify a set of products that are reasonably interchangeable with a product sold by one of the merging firms.

The hypothetical monopolist test requires that a product market contain enough substitute products so that it could be subject to post-merger exercise of market power significantly exceeding that existing absent the merger. 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.[4] For the purpose of analyzing this issue, the terms of sale of products outside the candidate market are held constant. The SSNIP is employed solely as a methodological tool for performing the hypothetical monopolist test; it is not a tolerance level for price increases resulting from a merger.

Groups of products may satisfy the hypothetical monopolist test without including the full range of substitutes from which customers choose. The hypothetical monopolist test may identify a group of products as a relevant market even if customers would substitute significantly to products outside that group in response to a price increase.

> *Example 5:* Products A and B are being tested as a candidate market. Each sells for $100, has an incremental cost of $60, and sells 1200 units. For every dollar increase in the price of Product A, for any given price of Product B, Product A loses twenty units of sales to products outside the candidate market and ten units of sales to Product B, and likewise for Product B. Under these conditions, economic analysis shows that a hypothetical profit-maximizing monopolist controlling Products A and B would raise both of their prices by ten percent, to $110. Therefore, Products A and B satisfy the hypothetical monopolist test using a five percent SSNIP, and indeed for any SSNIP size up to ten percent. This is true even though two-thirds of the sales lost by one product when it raises its price are diverted to products outside the relevant market.

When applying the hypothetical monopolist test to define a market around a product offered by one of the merging firms, if the market includes a second product, the Agencies will normally also include a third product if that third product is a closer substitute for the first product than is the second product. The third product is a closer substitute if, in response to a SSNIP on the first product, greater revenues are diverted to the third product than to the second product.

> *Example 6:* In Example 5, suppose that half of the unit sales lost by Product A when it raises its price are diverted to Product C, which also has a price of $100, while one-third are diverted to Product B. Product C is a closer substitute for Product A than is Product B. Thus Product C will normally be included in the relevant market, even though Products A and B together satisfy the hypothetical monopolist test.

The hypothetical monopolist test ensures that markets are not defined too narrowly, but it does not lead to a single relevant market. The Agencies may evaluate a merger in any relevant market

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[4] If the pricing incentives of the firms supplying the products in the candidate market differ substantially from those of the hypothetical monopolist, for reasons other than the latter's control over a larger group of substitutes, the Agencies may instead employ the concept of a hypothetical profit-maximizing cartel comprised of the firms (with all their products) that sell the products in the candidate market. This approach is most likely to be appropriate if the merging firms sell products outside the candidate market that significantly affect their pricing incentives for products in the candidate market. This could occur, for example, if the candidate market is one for durable equipment and the firms selling that equipment derive substantial net revenues from selling spare parts and service for that equipment.

satisfying the test, guided by the overarching principle that the purpose of defining the market and measuring market shares is to illuminate the evaluation of competitive effects. Because the relative competitive significance of more distant substitutes is apt to be overstated by their share of sales, when the Agencies rely on market shares and concentration, they usually do so in the smallest relevant market satisfying the hypothetical monopolist test.

> *Example 7:* In Example 4, including cars in the market will lead to misleadingly small market shares for motorcycle producers. Unless motorcycles fail the hypothetical monopolist test, the Agencies would not include cars in the market in analyzing this motorcycle merger.

4.1.2 Benchmark Prices and SSNIP Size

The Agencies apply the SSNIP starting from prices that would likely prevail absent the merger. If prices are not likely to change absent the merger, these benchmark prices can reasonably be taken to be the prices prevailing prior to the merger.[5] If prices are likely to change absent the merger, e.g., because of innovation or entry, the Agencies may use anticipated future prices as the benchmark for the test. If prices might fall absent the merger due to the breakdown of pre-merger coordination, the Agencies may use those lower prices as the benchmark for the test. In some cases, the techniques employed by the Agencies to implement the hypothetical monopolist test focus on the difference in incentives between pre-merger firms and the hypothetical monopolist and do not require specifying the benchmark prices.

The SSNIP is intended to represent a "small but significant" increase in the prices charged by firms in the candidate market for the value they contribute to the products or services used by customers. This properly directs attention to the effects of price changes commensurate with those that might result from a significant lessening of competition caused by the merger. This methodology is used because normally it is possible to quantify "small but significant" adverse price effects on customers and analyze their likely reactions, not because price effects are more important than non-price effects.

The Agencies most often use a SSNIP of five percent of the price paid by customers for the products or services to which the merging firms contribute value. However, what constitutes a "small but significant" increase in price, commensurate with a significant loss of competition caused by the merger, depends upon the nature of the industry and the merging firms' positions in it, and the Agencies may accordingly use a price increase that is larger or smaller than five percent. Where explicit or implicit prices for the firms' specific contribution to value can be identified with reasonable clarity, the Agencies may base the SSNIP on those prices.

> *Example 8:* In a merger between two oil pipelines, the SSNIP would be based on the price charged for transporting the oil, not on the price of the oil itself. If pipelines buy the oil at one end and sell it at the other, the price charged for transporting the oil is implicit, equal to the difference between the price paid for oil at the input end and the price charged for oil at the output end. The relevant product sold by the pipelines is better described as "pipeline transportation of oil from point A to point B" than as "oil at point B."

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[5] Market definition for the evaluation of non-merger antitrust concerns such as monopolization or facilitating practices will differ in this respect if the effects resulting from the conduct of concern are already occurring at the time of evaluation.

Example 9: In a merger between two firms that install computers purchased from third parties, the SSNIP would be based on their fees, not on the price of installed computers. If these firms purchase the computers and charge their customers one package price, the implicit installation fee is equal to the package charge to customers less the price of the computers.

Example 10: In Example 9, suppose that the prices paid by the merging firms to purchase computers are opaque, but account for at least ninety-five percent of the prices they charge for installed computers, with profits or implicit fees making up five percent of those prices at most. A five percent SSNIP on the total price paid by customers would at least double those fees or profits. Even if that would be unprofitable for a hypothetical monopolist, a significant increase in fees might well be profitable. If the SSNIP is based on the total price paid by customers, a lower percentage will be used.

4.1.3 Implementing the Hypothetical Monopolist Test

The hypothetical monopolist's incentive to raise prices depends both on the extent to which customers would likely substitute away from the products in the candidate market in response to such a price increase and on the profit margins earned on those products. The profit margin on incremental units is the difference between price and incremental cost on those units. The Agencies often estimate incremental costs, for example using merging parties' documents or data the merging parties use to make business decisions. Incremental cost is measured over the change in output that would be caused by the price increase under consideration.

In considering customers' likely responses to higher prices, the Agencies take into account any reasonably available and reliable evidence, including, but not limited to:

- how customers have shifted purchases in the past in response to relative changes in price or other terms and conditions;
- information from buyers, including surveys, concerning how they would respond to price changes;
- the conduct of industry participants, notably:
  - sellers' business decisions or business documents indicating sellers' informed beliefs concerning how customers would substitute among products in response to relative changes in price;
  - industry participants' behavior in tracking and responding to price changes by some or all rivals;
- objective information about product characteristics and the costs and delays of switching products, especially switching from products in the candidate market to products outside the candidate market;
- the percentage of sales lost by one product in the candidate market, when its price alone rises, that is recaptured by other products in the candidate market, with a higher recapture percentage making a price increase more profitable for the hypothetical monopolist;
- evidence from other industry participants, such as sellers of complementary products;

- legal or regulatory requirements; and
- the influence of downstream competition faced by customers in their output markets.

When the necessary data are available, the Agencies also may consider a "critical loss analysis" to assess the extent to which it corroborates inferences drawn from the evidence noted above. Critical loss analysis asks whether imposing at least a SSNIP on one or more products in a candidate market would raise or lower the hypothetical monopolist's profits. While this "breakeven" analysis differs from the profit-maximizing analysis called for by the hypothetical monopolist test in Section 4.1.1, merging parties sometimes present this type of analysis to the Agencies. A price increase raises profits on sales made at the higher price, but this will be offset to the extent customers substitute away from products in the candidate market. Critical loss analysis compares the magnitude of these two offsetting effects resulting from the price increase. The "critical loss" is defined as the number of lost unit sales that would leave profits unchanged. The "predicted loss" is defined as the number of unit sales that the hypothetical monopolist is predicted to lose due to the price increase. The price increase raises the hypothetical monopolist's profits if the predicted loss is less than the critical loss.

The Agencies consider all of the evidence of customer substitution noted above in assessing the predicted loss. The Agencies require that estimates of the predicted loss be consistent with that evidence, including the pre-merger margins of products in the candidate market used to calculate the critical loss. Unless the firms are engaging in coordinated interaction (see Section 7), high pre-merger margins normally indicate that each firm's product individually faces demand that is not highly sensitive to price.[6] Higher pre-merger margins thus indicate a smaller predicted loss as well as a smaller critical loss. The higher the pre-merger margin, the smaller the recapture percentage necessary for the candidate market to satisfy the hypothetical monopolist test.

Even when the evidence necessary to perform the hypothetical monopolist test quantitatively is not available, the conceptual framework of the test provides a useful methodological tool for gathering and analyzing evidence pertinent to customer substitution and to market definition. The Agencies follow the hypothetical monopolist test to the extent possible given the available evidence, bearing in mind that the ultimate goal of market definition is to help determine whether the merger may substantially lessen competition.

4.1.4 Product Market Definition with Targeted Customers

If a hypothetical monopolist could profitably target a subset of customers for price increases, the Agencies may identify relevant markets defined around those targeted customers, to whom a hypothetical monopolist would profitably and separately impose at least a SSNIP. Markets to serve targeted customers are also known as price discrimination markets. In practice, the Agencies identify price discrimination markets only where they believe there is a realistic prospect of an adverse competitive effect on a group of targeted customers.

> *Example 11:* Glass containers have many uses. In response to a price increase for glass containers, some users would substitute substantially to plastic or metal containers, but baby food manufacturers would not. If a

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[6] While margins are important for implementing the hypothetical monopolist test, high margins are not in themselves of antitrust concern.

> hypothetical monopolist could price separately and limit arbitrage, baby food manufacturers would be vulnerable to a targeted increase in the price of glass containers. The Agencies could define a distinct market for glass containers used to package baby food.

The Agencies also often consider markets for targeted customers when prices are individually negotiated and suppliers have information about customers that would allow a hypothetical monopolist to identify customers that are likely to pay a higher price for the relevant product. If prices are negotiated individually with customers, the hypothetical monopolist test may suggest relevant markets that are as narrow as individual customers (see also Section 6.2 on bargaining and auctions). Nonetheless, the Agencies often define markets for groups of targeted customers, i.e., by type of customer, rather than by individual customer. By so doing, the Agencies are able to rely on aggregated market shares that can be more helpful in predicting the competitive effects of the merger.

4.2 Geographic Market Definition

The arena of competition affected by the merger may be geographically bounded if geography limits some customers' willingness or ability to substitute to some products, or some suppliers' willingness or ability to serve some customers. Both supplier and customer locations can affect this. The Agencies apply the principles of market definition described here and in Section 4.1 to define a relevant market with a geographic dimension as well as a product dimension.

The scope of geographic markets often depends on transportation costs. Other factors such as language, regulation, tariff and non-tariff trade barriers, custom and familiarity, reputation, and service availability may impede long-distance or international transactions. The competitive significance of foreign firms may be assessed at various exchange rates, especially if exchange rates have fluctuated in the recent past.

In the absence of price discrimination based on customer location, the Agencies normally define geographic markets based on the locations of suppliers, as explained in subsection 4.2.1. In other cases, notably if price discrimination based on customer location is feasible as is often the case when delivered pricing is commonly used in the industry, the Agencies may define geographic markets based on the locations of customers, as explained in subsection 4.2.2.

4.2.1 Geographic Markets Based on the Locations of Suppliers

Geographic markets based on the locations of suppliers encompass the region from which sales are made. Geographic markets of this type often apply when customers receive goods or services at suppliers' locations. Competitors in the market are firms with relevant production, sales, or service facilities in that region. Some customers who buy from these firms may be located outside the boundaries of the geographic market.

The hypothetical monopolist test requires that a hypothetical profit-maximizing firm that was the only present or future producer of the relevant product(s) located in the region would impose at least a SSNIP from at least one location, including at least one location of one of the merging firms. In this exercise the terms of sale for all products produced elsewhere are held constant. A single firm may operate in a number of different geographic markets, even for a single product.

> *Example 12:* The merging parties both have manufacturing plants in City X. The relevant product is expensive to transport and suppliers price their products for pickup at their locations. Rival plants are some distance away in City Y. A hypothetical monopolist controlling all plants in City X could profitably impose a SSNIP at these plants. Competition from more distant plants would not defeat the price increase because supplies coming from more distant plants require expensive transportation. The relevant geographic market is defined around the plants in City X.

When the geographic market is defined based on supplier locations, sales made by suppliers located in the geographic market are counted, regardless of the location of the customer making the purchase.

In considering likely reactions of customers to price increases for the relevant product(s) imposed in a candidate geographic market, the Agencies consider any reasonably available and reliable evidence, including:

- how customers have shifted purchases in the past between different geographic locations in response to relative changes in price or other terms and conditions;
- the cost and difficulty of transporting the product (or the cost and difficulty of a customer traveling to a seller's location), in relation to its price;
- whether suppliers need a presence near customers to provide service or support;
- evidence on whether sellers base business decisions on the prospect of customers switching between geographic locations in response to relative changes in price or other competitive variables;
- the costs and delays of switching from suppliers in the candidate geographic market to suppliers outside the candidate geographic market; and
- the influence of downstream competition faced by customers in their output markets.

4.2.2 Geographic Markets Based on the Locations of Customers

When the hypothetical monopolist could discriminate based on customer location, the Agencies may define geographic markets based on the locations of targeted customers.[7] Geographic markets of this type often apply when suppliers deliver their products or services to customers' locations. Geographic markets of this type encompass the region into which sales are made. Competitors in the market are firms that sell to customers in the specified region. Some suppliers that sell into the relevant market may be located outside the boundaries of the geographic market.

The hypothetical monopolist test requires that a hypothetical profit-maximizing firm that was the only present or future seller of the relevant product(s) to customers in the region would impose at least a SSNIP on some customers in that region. A region forms a relevant geographic market if this price increase would not be defeated by substitution away from the relevant product or by arbitrage,

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[7] For customers operating in multiple locations, only those customer locations within the targeted zone are included in the market.

e.g., customers in the region travelling outside it to purchase the relevant product. In this exercise, the terms of sale for products sold to all customers outside the region are held constant.

> *Example 13:* Customers require local sales and support. Suppliers have sales and service operations in many geographic areas and can discriminate based on customer location. The geographic market can be defined around the locations of customers.

> *Example 14:* Each merging firm has a single manufacturing plant and delivers the relevant product to customers in City X and in City Y. The relevant product is expensive to transport. The merging firms' plants are by far the closest to City X, but no closer to City Y than are numerous rival plants. This fact pattern suggests that customers in City X may be harmed by the merger even if customers in City Y are not. For that reason, the Agencies consider a relevant geographic market defined around customers in City X. Such a market could be defined even if the region around the merging firms' plants would not be a relevant geographic market defined based on the location of sellers because a hypothetical monopolist controlling all plants in that region would find a SSNIP imposed on all of its customers unprofitable due to the loss of sales to customers in City Y.

When the geographic market is defined based on customer locations, sales made to those customers are counted, regardless of the location of the supplier making those sales.

> *Example 15:* Customers in the United States must use products approved by U.S. regulators. Foreign customers use products not approved by U.S. regulators. The relevant product market consists of products approved by U.S. regulators. The geographic market is defined around U.S. customers. Any sales made to U.S. customers by foreign suppliers are included in the market, and those foreign suppliers are participants in the U.S. market even though located outside it.

5. Market Participants, Market Shares, and Market Concentration

The Agencies normally consider measures of market shares and market concentration as part of their evaluation of competitive effects. The Agencies evaluate market shares and concentration in conjunction with other reasonably available and reliable evidence for the ultimate purpose of determining whether a merger may substantially lessen competition.

Market shares can directly influence firms' competitive incentives. For example, if a price reduction to gain new customers would also apply to a firm's existing customers, a firm with a large market share may be more reluctant to implement a price reduction than one with a small share. Likewise, a firm with a large market share may not feel pressure to reduce price even if a smaller rival does. Market shares also can reflect firms' capabilities. For example, a firm with a large market share may be able to expand output rapidly by a larger absolute amount than can a small firm. Similarly, a large market share tends to indicate low costs, an attractive product, or both.

5.1 Market Participants

All firms that currently earn revenues in the relevant market are considered market participants. Vertically integrated firms are also included to the extent that their inclusion accurately reflects their competitive significance. Firms not currently earning revenues in the relevant market, but that have committed to entering the market in the near future, are also considered market participants.

Firms that are not current producers in a relevant market, but that would very likely provide rapid supply responses with direct competitive impact in the event of a SSNIP, without incurring

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4.2.E. Considerations for Innovation and Product Variety Competition

Firms can compete for customers by offering varied and innovative products and features, which could range from minor improvements to the introduction of a new product category. Features can include new or different product attributes, services offered along with a product, or higher-quality services standing alone. Customers value the variety of products or services that competition generates, including having a variety of locations at which they can shop.

Offering the best mix of products and features is an important dimension of competition that may be harmed as a result of the elimination of competition between the merging parties.

When a firm introduces a new product or improves a product's features, some of the sales it gains may be at the expense of its rivals, including rivals that are competing to develop similar products and features. As a result, competition between firms may lead them to make greater efforts to offer a variety of products and features than would be the case if the firms were jointly owned, for example, if they merged. The merged firm may have a reduced incentive to continue or initiate development of new products that would have competed with the other merging party, but post-merger would "cannibalize" what would be its own sales.[73] A service provider may have a reduced incentive to continue valuable upgrades offered by the acquired firm. The merged firm may have a reduced incentive to engage in disruptive innovation that would threaten the business of one of the merging firms. Or it may have the incentive to change its product mix, such as by ceasing to offer one of the merging firms' products, leaving worse off the customers who previously chose the product that was eliminated. For example, competition may be harmed when customers with a preference for a low-price option lose access to it, even if remaining products have higher quality.

The incentives to compete aggressively on innovation and product variety depend on the capabilities of the firms and on customer reactions to the new offerings. Development of new features depends on having the appropriate expertise and resources. Where firms are two of a small number of companies with specialized employees, development facilities, intellectual property, or research projects in a particular area, competition between them will have a greater impact on their incentives to innovate.

Innovation may be directed at outcomes beyond product features; for example, innovation may be directed at reducing costs or adopting new technology for the distribution of products.

4.3. Market Definition

The Clayton Act protects competition "in any line of commerce in any section of the country."[74] The Agencies engage in a market definition inquiry in order to identify whether there is any line of commerce or section of the country in which the merger may substantially lessen competition or tend to create a monopoly. The Agencies identify the "area of effective competition" in which competition may be lessened "with reference to a product market (the 'line of commerce') and a geographic market (the 'section of the country.')."[75] The Agencies refer to the process of identifying market(s) protected by the Clayton Act as a "market definition" exercise and the markets so defined as "relevant antitrust markets,"

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[73] Sales "cannibalization" refers to a situation where customers of a firm substitute away from one of the firm's products to another product offered by the same firm.

[74] 15 U.S.C. § 18.

[75] *Brown Shoe*, 370 U.S. at 324.

or simply "relevant markets." Market definition can also allow the Agencies to identify market participants and measure market shares and market concentration.

A relevant antitrust market is an area of effective competition, comprising both product (or service) and geographic elements. The outer boundaries of a 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."[76] Within a broad relevant market, however, effective competition often occurs in numerous narrower relevant markets.[77] Market definition ensures that relevant antitrust markets are sufficiently broad, but it does not always lead to a single relevant market. Section 7 of the Clayton Act prohibits any merger that may substantially lessen competition "in any line of commerce" and in "any section of the country," and the Agencies protect competition by challenging a merger that may lessen competition in any one or more relevant markets.

Market participants often encounter a range of possible substitutes for the products of the merging firms. However, a relevant market cannot meaningfully encompass that infinite range of substitutes.[78] There may be effective competition among a narrow group of products, and the loss of that competition may be harmful, making the narrow group a relevant market, even if competitive constraints from significant substitutes are outside the group. The loss of both the competition between the narrow group of products and the significant substitutes outside that group may be even more harmful, but that does not prevent the narrow group from being a market in its own right.

Relevant markets need not have precise metes and bounds. Some substitutes may be closer, and others more distant, and defining a market necessarily requires including some substitutes and excluding others. Defining a relevant market sometimes requires a line-drawing exercise around product features, such as size, quality, distances, customer segment, or prices. There can be many places to draw that line and properly define a relevant market. The Agencies recognize that such scenarios are common, and indeed "fuzziness would seem inherent in any attempt to delineate the relevant . . . market."[79] Market participants may use the term "market" colloquially to refer to a broader or different set of products than those that would be needed to constitute a valid relevant antitrust market.

The Agencies rely on several tools to demonstrate that a market is a relevant antitrust market. For example, the Agencies may rely on any one or more of the following to identify a relevant antitrust market.

A. Direct evidence of substantial competition between the merging parties can demonstrate that a relevant market exists in which the merger may substantially lessen competition and can be sufficient to identify the line of commerce and section of the country affected by a merger, even if the metes and bounds of the market are only broadly characterized.

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[76] *Id.* at 325.

[77] *Id.* ("[W]ithin [a] broad market, well-defined submarkets may exist which, in themselves, constitute product markets for antitrust purposes."). Multiple overlapping markets can be appropriately defined relevant markets. For example, a merger to monopoly for food worldwide would lessen competition in well-defined relevant markets for, among others, food, baked goods, cookies, low-fat cookies, and premium low-fat chocolate chip cookies. Illegality in any of these in any city or town comprising a relevant geographic market would suffice to prohibit the merger, and the fact that one area comprises a relevant market does not mean a larger, smaller, or overlapping area could not as well.

[78] *United States v. Cont'l Can Co.*, 378 U.S. 441, 449 (1964); *see also FTC v. Advoc. Health Care Network*, 841 F.3d 460, 469 (7th Cir. 2016) ("A geographic market does not need to include all of the firm's competitors; it needs to include the competitors that would substantially constrain the firm's price-increasing ability." (cleaned up)).

[79] *Phila. Nat'l Bank*, 374 U.S. at 360 n.37.

B. Direct evidence of the exercise of market power can demonstrate the existence of a relevant market in which that power exists. This evidence can be valuable when assessing the risk that a dominant position may be entrenched, maintained, or extended, since the same evidence identifies market power and can be sufficient to identify the line of commerce and section of the country affected by a merger, even if the metes and bounds of the market are only broadly characterized.

C. A relevant market can be identified from evidence on observed market characteristics ("practical indicia"), such 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, distinct prices, sensitivity to price changes, and specialized vendors.[80] Various practical indicia may identify a relevant market in different settings.

D. Another common method employed by courts and the Agencies is the hypothetical monopolist test.[81] This test examines whether a proposed market is too narrow by asking whether a hypothetical monopolist over this market could profitably worsen terms significantly, for example, by raising price. An analogous hypothetical monopsonist test applies when considering the impact of a merger on competition among buyers.

The Agencies use these tools to define relevant markets because they each leverage market realities to identify an area of effective competition.

Section 4.3.A below describes the Hypothetical Monopolist Test in greater detail. Section 4.3.B addresses issues that may arise when defining relevant markets in several specific scenarios.

4.3.A. The Hypothetical Monopolist Test

This Section describes the Hypothetical Monopolist Test, which is a method by which the Agencies often define relevant antitrust markets. As outlined above, a relevant antitrust market is an area of effective competition. The Hypothetical Monopolist/Monopsonist Test ("HMT") evaluates whether a group of products is sufficiently broad to constitute a relevant antitrust market. To do so, the HMT asks whether eliminating the competition among the group of products by combining them under the control of a hypothetical monopolist likely would lead to a worsening of terms for customers. The Agencies generally focus their assessment on the constraints from competition, rather than on constraints from regulation, entry, or other market changes. The Agencies are concerned with the impact on economic incentives and assume the hypothetical monopolist would seek to maximize profits.

When evaluating a merger of sellers, the HMT asks whether a hypothetical profit-maximizing firm, not prevented by regulation from worsening terms, that was the only present and future seller of a group of products ("hypothetical monopolist") likely would undertake at least a small but significant and non-transitory increase in price ("SSNIP") or other worsening of terms ("SSNIPT") for at least one

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[80] *Brown Shoe*, 370 U.S. at 325, *quoted in United States v. U.S. Sugar Corp.*, 73 F.4th 197, 204-07 (3d Cir. 2023) (affirming district court's application of *Brown Shoe* practical indicia to evaluate relevant product market that included, based on the unique facts of the industry, those distributors who "could counteract monopolistic restrictions by releasing their own supplies").

[81] *See FTC v. Penn State Hershey Med. Center*, 838 F.3d 327, 338 (3d Cir. 2016). While these guidelines focus on applying the hypothetical monopolist test in analyzing mergers, the test can be adapted for similar purposes in cases involving alleged monopolization or other conduct. *See, e.g.*, *McWane, Inc. v. FTC*, 783 F.3d 814, 829-30 (11th Cir. 2015).

product in the group.[82] For the purpose of analyzing this issue, the terms of sale of products outside the candidate market are held constant. Analogously, when considering a merger of buyers, the Agencies ask the equivalent question for a hypothetical monopsonist. This Section often focuses on merging sellers to simplify exposition.

4.3.B. Implementing the Hypothetical Monopolist Test

The SSNIPT. A SSNIPT may entail worsening terms along any dimension of competition, including price (SSNIP), but also other terms (broadly defined) such as quality, service, capacity investment, choice of product variety or features, or innovative effort.

Input and Labor Markets. When the competition at issue involves firms buying inputs or employing labor, the HMT considers whether the hypothetical monopsonist would undertake at least a SSNIPT, such as a decrease in the offered price or a worsening of the terms of trade offered to suppliers, or a decrease in the wage offered to workers or a worsening of their working conditions or benefits.

The Geographic Dimension of the Market. The hypothetical monopolist test is generally applied to a group of products together with a geographic region to determine a relevant market, though for ease of exposition the two dimensions are discussed separately, with geographic market definition discussed in Section 4.3.D.2.

Negotiations or Auctions. The HMT is stated in terms of a hypothetical monopolist *undertaking* a SSNIPT. This covers settings where the hypothetical monopolist sets terms and makes them worse. It also covers settings where firms bargain, and the hypothetical monopolist would have a stronger bargaining position that would likely lead it to extract a SSNIPT during negotiations, or where firms sell their products in an auction, and the bids submitted by the hypothetical monopolist would result in the purchasers of its products experiencing a SSNIPT.

Benchmark for the SSNIPT. The HMT asks whether the hypothetical monopolist likely would worsen terms relative to those that likely would prevail absent the proposed merger. In some cases, the Agencies will use as a benchmark different outcomes than those prevailing prior to the merger. For example, if outcomes are likely to change absent the merger, e.g., because of innovation, entry, exit, or exogenous trends, the Agencies may use anticipated future outcomes as the benchmark. Or, if suppliers in the market are coordinating prior to the merger, the Agencies may use a benchmark that reflects conditions that would arise if coordination were to break down. When evaluating whether a merging firm is dominant (Guideline 6), the Agencies may use terms that likely would prevail in a more competitive market as a benchmark.[83]

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[82] If the pricing incentives of the firms supplying the products in the group differ substantially from those of the hypothetical monopolist, for reasons other than the latter's control over a larger group of substitutes, the Agencies may instead employ the concept of a hypothetical profit-maximizing cartel comprised of the firms (with all their products) that sell the products in the candidate market. This approach is most likely to be appropriate if the merging firms sell products outside the candidate market that significantly affect their pricing incentives for products in the candidate market. This could occur, for example, if the candidate market is one for durable equipment and the firms selling that equipment derive substantial net revenues from selling spare parts and service for that equipment. Analogous considerations apply when considering a SSNIPT for terms other than price.

[83] In the entrenchment context, if the inquiry is being conducted after market or monopoly power has already been exercised, using prevailing prices can lead to defining markets too broadly and thus inferring that dominance does not exist when, in

Magnitude of the SSNIPT. What constitutes a "small but significant" worsening of terms depends upon the nature of the industry and the merging firms' positions in it, the ways that firms compete, and the dimension of competition at issue. When considering price, the Agencies will often use a SSNIP of five percent of the price charged by firms for the products or services to which the merging firms contribute value. The Agencies, however, may consider a different term or a price increase that is larger or smaller than five percent.[84]

The Agencies may base a SSNIP on explicit or implicit prices for the firms' specific contribution to the value of the product sold, or an upper bound on the firms' specific contribution, where these can be identified with reasonable clarity. For example, the Agencies may derive an implicit price for the service of transporting oil over a pipeline as the difference between the price the pipeline firm paid for oil at one end and the price it sold the oil for at the other and base the SSNIP on this implicit price.

4.3.C. Evidence and Tools for Carrying Out the Hypothetical Monopolist Test

Section 4.2 describes some of the qualitative and quantitative evidence and tools the Agencies can use to assess the extent of competition among firms. The Agencies can use similar evidence and analogous tools to apply the HMT, in particular to assess whether competition among a set of firms likely leads to better terms than a hypothetical monopolist would undertake.

To assess whether the hypothetical monopolist likely would undertake at least a SSNIP on one or more products in the candidate market, the Agencies sometimes interpret the qualitative and quantitative evidence using an economic model of the profitability to the hypothetical monopolist of undertaking price increases; the Agencies may adapt these tools to apply to other forms of SSNIPTs.

One approach utilizes the concept of a "recapture rate" (the percentage of sales lost by one product in the candidate market, when its price alone rises, that is recaptured by other products in the candidate market). A price increase is profitable when the recapture rate is high enough that the incremental profits from the increased price plus the incremental profits from the recaptured sales going to other products in the candidate market exceed the profits lost when sales are diverted outside the candidate market. It is possible that a price increase is profitable even if a majority of sales are diverted outside the candidate market, for example if the profits on the lost sales are relatively low or the profits on the recaptured sales are relatively high.

Sometimes evidence is presented in the form of "critical loss analysis," which can be used to assess whether undertaking at least a SSNIPT on one or more products in a candidate market would raise or lower the hypothetical monopolist's profits. Critical loss analysis compares the magnitude of the two offsetting effects resulting from the worsening of terms. The "critical loss" is defined as the number of lost unit sales that would leave profits unchanged. The "predicted loss" is defined as the number of unit sales that the hypothetical monopolist is predicted to lose due to the worsening of terms. The worsening of terms raises the hypothetical monopolist's profits if the predicted loss is less than the

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fact, it does. The problem with using prevailing prices to define the market when a firm is already dominant is known as the "Cellophane Fallacy."

[84] The five percent price increase is not a threshold of competitive harm from the merger. Because the five percent SSNIP is a minimum expected effect of a hypothetical monopolist of an *entire* market, the actual predicted effect of a merger within that market may be significantly lower than five percent. A merger within a well-defined market that causes undue concentration can be illegal even if the predicted price increase is well below the SSNIP of five percent.

critical loss. While this “breakeven” analysis differs somewhat from the profit-maximizing analysis called for by the HMT, it can sometimes be informative.

The Agencies require that estimates of the predicted loss be consistent with other evidence, including the pre-merger margins of products in the candidate market used to calculate the critical loss. Unless the firms are engaging in coordinated interaction, high pre-merger margins normally indicate that each firm’s product individually faces demand that is not highly sensitive to price. Higher pre-merger margins thus indicate a smaller predicted loss as well as a smaller critical loss. The higher the pre-merger margin, the smaller the recapture rate[85] necessary for the candidate market to satisfy the hypothetical monopolist test. Similar considerations inform other analyses of the profitability of a price increase.

4.3.D. Market Definition in Certain Specific Settings

This Section provides details on market definition in several specific common settings. In much of this section, concepts are presented for the scenario where the merger involves sellers. In some cases, clarifications are provided as to how the concepts apply to merging buyers; in general, the concepts apply in an analogous way.

4.3.D.1. Targeted Trading Partners

If the merged firm could profitably target a subset of customers for changes in prices or other terms, the Agencies may identify relevant markets defined around those targeted customers. The Agencies may do so even if firms are not currently targeting specific customer groups but could do so after the merger.

For targeting to be feasible, two conditions typically must be met. First, the suppliers engaging in targeting must be able to set different terms for targeted customers than other customers. This may involve identification of individual customers to which different terms are offered or offering different terms to different types of customers based on observable characteristics.[86] Markets for targeted customers need not have precise metes and bounds. In particular, defining a relevant market for targeted customers sometimes requires a line-drawing exercise on observable characteristics. There can be many places to draw that line and properly define a relevant market. Second, the targeted customers must not be likely to defeat a targeted worsening of terms by arbitrage (e.g., by purchasing indirectly from or through other customers). Arbitrage may be difficult if it would void warranties or make service more difficult or costly for customers, and it is inherently impossible for many services. Arbitrage on a modest scale may be possible but sufficiently costly or limited, for example due to transaction costs or search costs, that it would not deter or defeat a discriminatory pricing strategy.

If prices are negotiated or otherwise set individually, for example through a procurement auction, there may be relevant markets that are as narrow as an individual customer. Nonetheless, for analytic convenience, the Agencies may define cluster markets for groups of targeted customers for whom the

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[85] The recapture rate is sometimes referred to as the aggregate diversion ratio, defined in Section 4.2.B.

[86] In some cases, firms offer one or more versions of products or services defined by their characteristics (where brand might be a characteristic). When customers can select among these products and terms do not vary by customer, the Agencies will typically define markets based on products rather than the targeted customers. In such cases, relevant antitrust markets may include only some of the differentiated products, for example products with only “basic” features, or products with “premium features.” The tools described in Section 4.2 can be used to assess competition among differentiated products.

conditions of competition are reasonably similar. (See Section 4.3.D.4 for further discussion of cluster markets.)

Analogous considerations arise for a merger involving one or more buyers or employers. In this case, the analysis considers whether buyers target suppliers, for example by paying targeted suppliers or workers less, or by degrading the terms of supply contracts for targeted suppliers. Arbitrage would involve a targeted supplier selling to the buyer indirectly, through a different supplier who could obtain more favorable terms from the buyer.

If the HMT is applied in a setting where targeting of customers is feasible, it requires that a hypothetical profit-maximizing firm that was the only present or future seller of the relevant product(s) to customers in the targeted group would undertake at least a SSNIPT on some, though not necessarily all, customers in that group. The products sold to those customers form a relevant market if the hypothetical monopolist likely would undertake at least a SSNIPT despite the potential for customers to substitute away from the product or to take advantage of arbitrage. In this exercise, the terms of sale for products sold to all customers outside the region are held constant.

4.3.D.2. Geographic Markets

A relevant antitrust market is an area of effective competition, comprising both product (or service) and geographic elements. A market's geography depends on the limits that distance puts on some customers' willingness or ability to substitute to some products, or some suppliers' willingness or ability to serve some customers. Factors that may limit the geographic scope of the market include transportation costs, language, regulation, tariff and non-tariff trade barriers, custom and familiarity, reputation, and local service availability.

4.3.D.2.a. Geographic Markets Based on the Locations of Suppliers

The Agencies sometimes define geographic markets as regions encompassing a group of supplier locations. When they do, the geographic market's scope is determined by customers' willingness to switch between suppliers. Geographic markets of this type often apply when customers receive goods or services at suppliers' facilities, for example when customers buy in-person from retail stores. A single firm may offer the same product in a number of locations, both within a single geographic market or across geographic markets; customers' willingness to substitute between products may depend on the location of the supplier. When calculating market shares, sales made from supplier locations in the geographic market are included, regardless of whether the customer making the purchase travelled from outside the boundaries of the geographic market (see Section 4.4 for more detail about calculating market shares).

If the HMT is used to evaluate the geographic scope of the market, it requires that a hypothetical profit-maximizing firm that was the only present or future supplier of the relevant product(s) at supplier locations in the region likely would undertake at least a SSNIPT in at least one location. In this exercise, the terms of sale for products sold to all customers at facilities outside the region are typically held constant.[87]

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[87] In some circumstances, as when the merging parties operate in multiple geographies, if applying the HMT, the Agencies may apply a "Hypothetical Cartel" framework for market definition, following the approach outlined in Section 4.3.A, n.81.

4.3.D.2.b. Geographic Markets Based on Targeting of Customers by Location

When targeting based on customer location is feasible (see Section 4.3.D.1), the Agencies may define geographic markets as a region encompassing a group of customers.[88] For example, geographic markets may sometimes be defined this way when suppliers deliver their products or services to customers' locations, or tailor terms of trade based on customers' locations. Competitors in the market are firms that sell to customers that are located in the specified region. Some suppliers may be located outside the boundaries of the geographic market, but their sales to customers located within the market are included when calculating market shares (see Section 4.4 for more detail about calculating market shares).

If prices are negotiated individually with customers that may be targeted, geographic markets may be as narrow as individual customers. Nonetheless, the Agencies often define a market for a cluster of customers located within a region if the conditions of competition are reasonably similar for these customers. (See Section 4.3.D.4 for further discussion of cluster markets.)

A firm's attempt to target customers in a particular area with worsened terms can sometimes be undermined if some customers in the region substitute by travelling outside it to purchase the product. Arbitrage by customers on a modest scale may be possible but sufficiently costly or limited that it would not deter or defeat a targeting strategy.[89]

If the HMT is used to evaluate market definition when customers may be targeted by location, it requires that a hypothetical profit-maximizing firm that was the only present or future seller of the relevant product(s) to customers in the region likely would undertake at least a SSNIPT on some, though not necessarily all, customers in that region. The products sold in that region form a relevant market if the hypothetical monopolist would undertake at least a SSNIPT despite the potential for customers to substitute away from the product or to locations outside the region. In this exercise, the terms of sale for products sold to all customers outside the region are held constant.[90]

4.3.D.3. Supplier Responses

Market definition focuses solely on demand substitution factors, that is, on customers' ability and willingness to substitute away from one product or location to another in response to a price increase or other worsening of terms. Supplier responses may be considered in the analysis of competition between firms (Guideline 2 and Section 4.2), entry and repositioning (Section 3.2), and in calculating market shares and concentration (Section 4.4).

4.3.D.4. Cluster Markets

A relevant antitrust market is generally a group of products that are substitutes for each other. However, when the competitive conditions for multiple relevant markets are reasonably similar, it may be appropriate to aggregate the products in these markets into a "cluster market" for analytic convenience, even though not all products in the cluster are substitutes for each other. For example, competing hospitals may each provide a wide range of acute health care services. Acute care for one health issue is not a substitute for acute care for a different health issue. Nevertheless, the Agencies may

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[88] For customers operating in multiple locations, only those customer locations within the targeted region are included in the market.

[89] Arbitrage by suppliers is a type of supplier response and is thus not considered in market definition. (See Section 4.3.D.3)

[90] In some circumstances, as when the merging parties operate in multiple geographies, the Agencies may apply a "Hypothetical Cartel" framework for market definition, as described in Section 4.3.A, n.81.

aggregate them into a cluster market for acute care services if the conditions of competition are reasonably similar across the services in the cluster.

The Agencies need not separately analyze market definition for each product included in the cluster market, and market shares will typically be calculated for the cluster market as a whole.

Analogously, the Agencies sometimes define a market as a cluster of targeted customers (see Section 4.3.D.1) or a cluster of customers located in a region (see Section 4.3.D.2.b).

4.3.D.5. Bundled Product Markets

Firms may sell a combination of products as a bundle or a "package deal," rather than offering products "*a la carte*," that is, separately as standalone products. Different bundles offered by the same or different firms might package together different combinations of component products and therefore be differentiated according to the composition of the bundle. If the components of a bundled product are also available separately, the bundle may be offered at a price that represents a discount relative to the sum of the *a la carte* product prices.

The Agencies take a flexible approach based on the specific circumstances to determine whether a candidate market that includes one or more bundled products, standalone products, or both is a relevant antitrust market. In some cases, a relevant market may consist of only bundled products. A market composed of only bundled products might be a relevant antitrust market even if there is significant competition from the unbundled products. In other cases, a relevant market may include both bundled products and some unbundled component products.

Even in cases where firms commonly sell combinations of products or services as a bundle or a "package deal," relevant antitrust markets do not necessarily include product bundles. In some cases, a relevant market may be analyzed as a cluster market, as discussed in Section 4.3.D.4.

4.3.D.6. One-Stop Shop Markets

In some settings, the Agencies may consider a candidate market that includes one or more "one-stop shops," where customers can select a combination of products to purchase from a single seller, either in a single purchase instance or in a sequence of purchases. Products are commonly sold at a one-stop shop when customers value the convenience, which might arise because of transaction costs or search costs, savings of time, transportation costs, or familiarity with the store or web site.

A multi-product retailer such as a grocery store or online retailer is an example of a one-stop shop. Customers can select a particular basket of groceries from a range of available goods and different customers may select different baskets. Some customers may make multiple stops at specialty shops (e.g., butcher, baker, greengrocer), or they may do the bulk of their shopping at a one-stop shop (the grocery store) but also shop at specialty shops for particular product categories.

There are several ways in which markets may be defined in one-stop shop settings, depending on market realities, and the Agencies may further define more than one relevant antitrust market for a particular merger. For example, a relevant market may consist of only one-stop shops, even if there is significant competition from specialty shops; or it may include both one-stop shops and specialty shops. When a product category is sold by both one-stop shops and specialty suppliers (such as a type of produce sold in grocery stores and produce stands), the Agencies may define relevant antitrust markets for the product category sold by a particular type of supplier, or it may include multiple types of suppliers.

4.3.D.7. Market Definition When There is Harm to Innovation

When considering harm to competition in innovation, market definition may follow the same approaches that are used to analyze other dimensions of competition. In the case where a merger may substantially lessen competition by decreasing incentives to innovate, the Agencies may define relevant antitrust markets around the products that would result from that innovation if successful, even if those products do not yet exist.[91] In some cases, the Agencies may analyze different relevant markets when considering innovation than when considering other dimensions of competition.

4.3.D.8. Market Definition for Input Markets and Labor Markets

The same market definition tools and principles discussed above can be used for input markets and labor markets, where labor is a particular type of input. In input markets, firms compete with each other to attract suppliers, including workers. Therefore, input suppliers are analogous to customers in the discussions above about market definition. In defining relevant markets, the Agencies focus on the alternatives available to input suppliers. An antitrust input market consists of a group of products and a geographic area defined by the location of the buyers or input suppliers. Just as buyers of a product may consider products to be differentiated according to the brand or the identity of the seller, suppliers of a product or service may consider different buyers to be differentiated. For example, if the suppliers are contractors, they may have distinct preferences about who they provide services to, due to different working conditions, location, reliability of buyers in terms of paying invoices on time, or the propensity of the buyer to make unexpected changes to specifications.

The HMT considers whether a hypothetical monopsonist likely would undertake a SSNIPT, such as a reduction in price paid for inputs, or imposing less favorable terms on suppliers. (See Section 4.2.C for more discussion about competition in settings where terms are set through auctions and negotiations, as is common for input markets.)

When defining a market for labor the Agencies will consider the job opportunities available to workers who supply a relevant type of labor service, where worker choice among jobs or between geographic areas is the analog of consumer choices among products and regions when defining a product market. The Agencies may consider workers' willingness to switch in response to changes to wages or other aspects of working conditions, such as changes to benefits or other non-wage compensation, or adoption of less flexible scheduling. Depending on the occupation, alternative job opportunities might include the same occupation with alternative employers, or alternative occupations. Geographic market definition may involve considering workers' willingness or ability to commute, including the availability of public transportation. The product and geographic market definition may involve assessing whether workers may be targeted for less favorable wages or other terms of employment according to factors such as education, experience, certifications, or work locations. The Agencies may define cluster markets for different jobs when firms employ workers in a variety of jobs characterized by similar competitive conditions (see Section 4.3.D.4).

4.4. Calculating Market Shares and Concentration

This subsection further describes how the Agencies calculate market shares and concentration metrics.

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[91] *See Illumina*, slip op. at 12 (affirming a relevant market defined around "what . . . developers reasonably sought to achieve, not what they currently had to offer").

FTC v. META PLATFORMS, INC., 2023 WL 2346238, at *8-*17 (N.D. Cal. 2023) (excerpt on market definition[1])

EDWARD J. DAVILA, J.

[The FTC brought an action alleging that the vertical acquisition by Meta Platforms, Inc. of Within Unlimited, Inc. violated Section 7 and seeking a preliminary injunction to block the closing of the deal pending an administrative trial on the merits. Meta, formerly known as Facebook, is the leading developer of virtual reality ("VR") devices and apps, including the Oculus Quest 2 VR headset. Within, a privately owned company founded in 2014, creates products, original content, formats, proprietary software, and tools for virtual and augmented reality entertainment, fitness, and learning. Its flagship product, Supernatural, is a complete fitness subscription service exclusively for the Oculus Quest 2 VR headset and is the leading VR dedicated fitness app. The FTC's amended complaint alleges that the acquisition, if consummated, would substantially lessen competition in the national market for VR dedicated fitness apps in violation of Section 7. The complaint's principal theory of anticompetitive harm was that the acquisition would eliminate the possibility that Meta would enter into VR dedicated fitness apps through other means, which the complaint alleges is reasonably probable but for the acquisition—essentially the elimination of actual potential competition. We will examine the application of potential competition theory to this case in Uit 14. For now, we will focus on the court's analysis of product market definition.]

B. Relevant Market Definition

The first step in analyzing a merger challenge under Section 7 of the Clayton Act is to determine the relevant market. *U.S. v. Marine Bancorporation, Inc*., 418 U.S. 602, 619 (1974) (citing [*United States v.*] *E.I. Du Pont*, 353 U.S. 586, 593 (1957)); *see FTC v. Qualcomm Inc.*, 969 F.3d 974, 992 (9th Cir. 2020) ("A threshold step in any antitrust case is to accurately define the relevant market, which refers to 'the area of effective competition.'"). The relevant market for antitrust purposes is determined by (1) the relevant product market and (2) the relevant geographic market. *Brown Shoe Co. v. U.S.*, 370 U.S. 294, 324 (1962).

1. Product Market

"The outer boundaries of a product market are determined by the reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it." *Brown Shoe*, 370 U.S. at 325. "Within a general product market, 'well-defined submarkets may exist which, in themselves, constitute product markets

[1] Record citations footnotes omitted.

for antitrust purposes.'" *Hicks v. PGA Tour, Inc.*, 897 F.3d 1109, 1121 (9th Cir. 2018) (quoting *Brown Shoe*, 370 U.S. at 325); *see also Newcal Indus., Inc. v. Ikon Office Sol'n*, 513 F.3d 1038, 1045 (9th Cir. 2008) ("[A]lthough the general market must include all economic substitutes, it is legally permissible to premise antitrust allegations on a submarket."). The definition of the relevant market is "basically a fact question dependent upon the special characteristics of the industry involved." *Twin City Sportservice, Inc. v. Charles O. Finley & Co., Inc.*, 676 F.2d 1291, 1299 (9th Cir. 1982). Products need not be fungible to be included in a relevant market, but a relevant market "cannot meaningfully encompass th[e] infinite range" of substitutes for a product. *Id*. at 1271 (quoting *Times Picayune Publishing Co. v. United States*, 345 U.S. 594, 611, 612 n. 31, (1953)). The overarching goal of market definition is to "recognize competition where, in fact, competition exists." *Brown Shoe*, 370 U.S. at 326; *see also U.S. v. Continental Can Co.*, 378 U.S. 441, 449 (1964) ("In defining the product market between these terminal extremes [of fungibility and infinite substitution], we must recognize meaningful competition where it is found to exist."); *FTC v. Whole Foods Market, Inc.*, 548 F.3d 1028, 1039 (D.C. Cir. 2008) ("As always in defining a market, we must 'take into account the realities of competition.'") (citations omitted).

Courts have used both qualitative and quantitative tools to aid their determinations of relevant markets. A qualitative analysis of the relevant antitrust market, including submarkets, involves "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, distinct prices, sensitivity to price changes, and specialized vendors." *Brown Shoe*, 370 U.S. at 325; *see also*, *e.g.*, *Klein v. Facebook, Inc*., 580 F. Supp. 3d 743, 766–68 (N.D. Cal. 2022) (applying *Brown* Shoe factors). A common quantitative metric used by parties and courts to determine relevant markets is the Hypothetical Monopolist Test ("HMT"), as described in the U.S. Department of Justice and the FTC's 2010 Merger Guidelines. U.S. Dep't of Justice & FTC, *Horizontal Merger Guidelines* ("2010 Merger Guidelines") § 4 (2010); *see also*, *e.g.*, *U.S. v. H & R Block, Inc*., 833 F. Supp. 2d 36, 51 (D.D.C. 2011) ("An analytical method often used by courts to define a relevant market is to ask hypothetically whether it would be profitable to have a monopoly over a given set of substitutable products. If so, those products may constitute a relevant market.").

There is "no requirement to use any specific methodology in defining the relevant market." *Optronic Techs., Inc. v. Ningbo Sunny Elec. Co., Ltd*., 20 F.4th 466, 482 (9th Cir. 2021). As such, courts have determined relevant antitrust markets using, for example, only the Brown Shoe factors, or a combination of the *Brown Shoe* factors and the HMT. *See, e.g.*, *Lucas Auto. Eng., Inc. v. Bridgestone/Firestone, Inc.*, 275 F.3d 762, 766–68 (9th Cir. 2001) (relying on *Brown Shoe* factors alone in review of district court's determination of relevant market); *United States v. Aetna Inc*., 240 F. Supp. 3d 1, 20–21 (D.D.C. 2017) (using HMT and *Brown Shoe* factors to analyze relevant market). The Ninth Circuit has "repeatedly noted that the *Brown Shoe* indicia are practical aids for identifying the areas of actual or potential competition and that their presence or absence does not decide automatically the submarket issue." *Thurman*

Indus., Inc. v. Pay 'N Pak Stores, Inc., 875 F.2d 1369, 1375 (9th Cir. 1989) (citations omitted). The suitability of a submarket as a relevant antitrust market "turns ultimately upon whether the factors used to define the submarket are 'economically significant.'" *Id*.

The FTC proposes a relevant product market consisting of VR dedicated fitness apps, meaning VR apps "designed so users can exercise through a structured physical workout in a virtual setting." According to the FTC, VR dedicated fitness apps are distinct from (1) other VR apps and (2) other fitness offerings. To differentiate their proposed market from other VR app markets, the FTC claims that VR dedicated fitness apps have distinct customers and pricing strategies. The FTC further argues that VR dedicated fitness apps are in a separate market from other fitness offerings (e.g., gyms, at-home fitness equipment) because they provide users with "fully immersive, 360-degree environments," are fully portable, save space, cost less, and target a different type of consumer. The FTC claims that these qualitative product differences satisfy the *Brown Shoe* practical indicia of a relevant market, and that the Hypothetical Monopolist Test conducted by the FTC's economics expert further confirms the relevant product market definition.

Unsurprisingly, Defendants disagree. They claim that the FTC's proposed market is impermissibly narrow because it excludes "scores of products, services, and apps" that are "reasonably interchangeable" with VR dedicated fitness apps, including dozens of VR apps categorized as "fitness" apps on the Quest platform, fitness apps on gaming consoles and other VR platforms, and non-VR connected fitness products and services. Defendants argue that members of the FTC's proposed market subjectively consider other VR apps and other fitness offerings to be competing products, and that several such products also possess the very features—portability, immersion, and pricing models—that the FTC highlights as distinguishing or unique to its proposed market. Defendants also contend that Dr. Singer's HMT analysis is fatally flawed due to methodological errors in the survey underlying the test.

In this case, the Court finds the FTC has made a sufficient evidentiary showing that there exists a well-defined relevant product market consisting of VR dedicated fitness apps.

a. *Brown Shoe* Analysis

The Court first examines in turn each of the *Brown Shoe* factors, i.e., "practical indicia [such] 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, distinct prices, sensitivity to price changes, and specialized vendors." 370 U.S. at 325.

i. Industry or Public Recognition

The evidence indicates that Defendants and other VR dedicated fitness app makers viewed VR dedicated fitness apps as an economic submarket of VR apps. For example, [REDACTED] Within's contemporaneous view of untapped market segments indicates that a "fitness first" app paired with a VR headset—i.e., a VR dedicated fitness app—would be in a distinct segment of the overall VR market. Likewise, as

explained in greater detail in the sections below, Meta repeatedly stated that VR dedicated fitness apps constituted a distinct market opportunity within the VR ecosystem due to their unique uses, distinct customers, and distinct prices. And a representative the VR app company Odders Lab testified that the launch of its VR dedicated fitness app did not diminish sales of its VR rhythm app, acknowledging that its VR fitness app "compete[d] more directly with fitness dedicated applications than gaming applications." Industry companies' internal communications showing frequent distinctions between various categories of applications is "strong[] support" of a distinct submarket. *Klein* [*v. Facebook*], 580 F. Supp. 3d [743] at 758 [(N.D. Cal. 2022)].

Participants in the broader fitness industry also recognized VR fitness as a "separate economic entity." [REDACTED] *See United States v. Microsoft Corp.*, 253 F.3d 34, 53 (D.C. Cir. 2001) (rejecting inclusion of middleware products in the relevant market where middleware was a potential, rather than current, competitor).

Defendants claim that members of the VR dedicated fitness app industry understood the market in which they operated to consist of "[s]cores of products, services, and apps available to consumers who want to exercise." [REDACTED] Defendants also contend that "[e]stablished fitness and technology firms . . . view VR fitness as competitive with off-VR products," and point as an example to Apple's inclusion of Supernatural and the Peloton Guide in the "competitive landscape" when it [REDACTED].

Defendants' evidence shows that there is a broad fitness market that includes everything from VR apps to bicycles. This in no way precludes the existence of a submarket constituting a relevant product market for antitrust purposes. *Brown Shoe*, 370 U.S. at 325; *Newcal Indus*., 513 F.3d at 1045. As the Ninth Circuit has noted, a relevant antitrust market "cannot meaningfully encompass th[e] infinite range" of substitutes for a product—yet this is exactly how Defendants propose to define the market. *Twin City Sportservice, Inc. v. Charles O'Finley & Co., Inc*., 512 F.2d 1264, 1271 (9th Cir. 1975). The Court therefore acknowledges that VR dedicated fitness apps compete for consumers with every manner of exercise (including gyms, bike rides, and connected fitness), but finds that Defendants and the broader fitness industry recognized VR dedicated fitness apps as an economically distinct submarket.

ii. Peculiar Characteristics and Uses

The evidence indicates that VR dedicated fitness apps have several "peculiar characteristics and uses" in comparison to both other VR apps and non-VR fitness offerings. *Brown Shoe*, 370 U.S. at 325. Even assuming "[a]lmost all VR applications require body movement," VR dedicated fitness apps are "specifically marketed to customers for the purpose of exercise," To support that marketing, VR dedicated fitness apps (unlike other VR apps) are often characterized by their fitness-specific features, such as trainer-led workout regimens, calorie tracking, and the ability to set and track progress toward fitness goals.

The most "peculiar characteristic" of VR dedicated fitness apps in comparison to non-VR fitness offerings is, of course, the VR technology itself. A VR user is "embodied" in a virtual environment. She is "teleported to a different place, feeling

like when you move your head and look around, you're in a new space and seeing virtual things as if they are real, which is virtual reality." Defendants' fitness industry expert, Dr. Vickey, submitted that non-VR fitness options could also be immersive, describing the non-VR Hydrow rowing machine as an "immersive exercise piece of equipment" because the Hydrow displayed video footage of various locations on a touchscreen the user viewed while rowing. The Court finds that no matter how crisp or accurate a video may be, a two-dimensional screen display is inherently far less immersive than a 360-degree environment. The evidence does not suggest—and the Court is not aware of—any other at-home fitness offering that can transport the user in this way. That a user of a VR dedicated fitness app can exercise in a VR setting is, therefore, a "distinct core functionality" indicative of a submarket. *Klein*, 580 F. Supp. 3d at 767 (quoting *Datel Holdings, Ltd. v. Microsoft Corp.*, 712 F. Supp. 2d 974, 997 (N.D. Cal. 2010)).

The FTC puts forth other hallmarks of VR dedicated fitness apps that generally differ from characteristics of non-VR fitness offerings. For example, the FTC argues that "VR headsets are fully portable and take up little space." These appear to be distinguishing features in relation to bulky connected fitness devices, such as the Peloton Bike or Hydrow rowing machine, but Defendants persuasively argue that mobile fitness apps can offer these same functionalities. Nonetheless, the virtual reality fitness experience created by VR dedicated fitness apps appears to be vastly different from a workout conducted on a large and stationary device or based off a mobile phone screen.

With respect to "peculiar . . . uses," Defendants have shown that consumers use non-VR fitness offerings for exercise. Defendants have additionally shown that consumers may use other VR apps for fitness. As explained above, the existence of a broader fitness market does not mean a relevant submarket does not exist. Defendants have themselves recognized the characteristics that distinguish VR dedicated fitness apps from other The Court therefore finds that the "peculiar characteristics and uses" factor of the *Brown Shoe* analysis supports the finding that VR dedicated fitness apps constitute a relevant antitrust product market. *See, e.g.*, *SC Innovations, Inc. v. Uber Techs., Inc.*, 434 F. Supp. 3d 782, 792 (N.D. Cal. 2020) (finding plaintiffs alleged a submarket for ride-sharing services excluding taxis, in part due to distinguishing features such as ability to rate and review drivers and share rides).

iii. Unique Production Facilities

The parties did not explicitly develop arguments regarding unique production facilities in support of their positions regarding the relevant product market. The Court notes, however, that VR dedicated fitness apps require a unique combination of production inputs. [REDACTED] Similarly, most VR companies are unlikely to have the fitness expertise and equipment necessary to create content for VR dedicated fitness apps. [REDACTED]

Although relevant markets are generally defined by demand-side substitutability, supply-side substitution also informs whether alternative products may be counted in the relevant market. *Twin City Sportservice, Inc.*, 512 F.2d at 1271 ("While the majority of the decided cases in which the rule of reasonable interchangeability is

employed deal with the 'use' side of the market, the courts have not been unaware of the importance of substitutability on the 'production' side as well."); *see also Brown Shoe*, 370 U.S. at 325 n.42 ("The cross-elasticity of production facilities may also be an important factor in defining a product market."); Julian von Kalinowski et al., 2 Antitrust Laws & Trade Regulation § 24.02[1][c], at 24–55 (2d ed. 2012) ("Another important factor in defining a product market is the ability of existing companies to alter their facilities to produce the defendant's product. . . . The Supreme Court has long recognized the significance of this factor, often referred to as cross-elasticity of supply.") (footnote omitted); 2010 Merger Guidelines, § 5.1 & n.8 (high supply side substitutability may be used to aggregate products into a market description).

Supply-side substitution focuses on suppliers' "responsiveness to price increases and their ability to constrain anticompetitive pricing by readily shifting what they produce." [*FTC v.*] *RAG-Stiftung*, 436 F. Supp. 3d [278] at 293 [(D.D.C. 2020] (citing *Rebel Oil Co. v. Atlantic Richfield Co.*, 51 F.3d 1421, 1436 (9th Cir. 1995) ("reasonable market definition must also be based on 'supply elasticity'"), *cert. denied*, 516 U.S. 987 (1995)). Here, as explained above, the evidence indicates that neither general fitness firms nor general VR firms have the production facilities to readily produce a substitute VR dedicated fitness app product, even if VR dedicated fitness apps were to raise prices and make market entry more attractive. That existing companies are not easily able to alter their facilities to produce VR dedicated fitness apps is additional evidence that such apps constitute a distinct product market.

iv. Distinct Customers

The FTC proffered evidence showing that users of VR dedicated fitness apps differ from those of other VR apps along multiple axes. Internal evaluations by Meta and Within found that although overall users of VR apps skewed younger and male, users of VR dedicated fitness apps tended to have an older and more female user base. For example, Meta claimed in its response to the FTC's Second Request regarding the Meta-Within transaction that the overall Quest user base was about [REDACTED]. Meta expected that VR dedicated fitness apps would expand the reach of virtual reality to new customer segments. To that end, Meta's Vice President of Metaverse Content informed the company's board of directors that "Supernatural, FitXR, and . . . other fitness applications, . . . unlike our gaming population . . . had tended to be more successful with on average an older person, on average more women. It was a very different demographic, and . . . we had always been in search of expanding VR beyond gaming into more of a general computing platform."

Defendants acknowledge that VR fitness appeals to different user demographics than other VR apps. Defendants do, however, dispute that VR dedicated fitness apps have a customer base that is distinct from that of non-VR fitness offerings. The evidence indicates that VR dedicated fitness apps are targeted more toward "[REDACTED]" who have less fitness experience and more difficulty finding motivating fitness products (rather than to individuals who have long-term or well-developed fitness routines.) As stated by Within's executive vice president of business development and finance, it was "Within's understanding that Supernatural appeals to [REDACTED] in a way that other existing fitness products do not." Within insiders

also compared Supernatural to [REDACTED]. And in summer 2021—when Meta was in negotiations regarding the acquisition of Supernatural—a Meta employee described Within's business model as "encouraging users who don't think about fitness much as well as users with a light routine, not the fitness buff who is better served by the likes of Peloton cycling or Crossfit classes." [REDACTED] The Court finds the VR dedicated fitness apps have a customer base that is distinct from those of both other VR apps and several other fitness offerings—[REDACTED]. *See, e.g.*, *FTC v. Sysco Corp.*, 113 F. Supp. 3d 1, 29–30 (D.D.C. 2015) (finding relevant product market in part based on erstwhile competitors' inability to serve certain types of customers).

v. Distinct Prices

The pricing of VR dedicated fitness apps likewise differs in at least one key respect from other VR apps and non-VR fitness offerings. The main difference in comparison to the former category is that VR dedicated fitness apps are more likely to have a subscription-based pricing model. As one of Within's founders testified, Within's daily release of new workout content requires ongoing revenue, which is supported by a subscription membership. Likewise, Meta's Director of Content Ecosystem testified that "subscriptions are particularly good monetization strategies for [fitness] applications" because "fitness applications need to produce content on an ongoing basis . . . in order to not get boring." However, subscription pricing does not provide a clear basis for delineating between VR dedicated fitness apps and other VR apps. Some VR dedicated fitness apps do not charge subscription fees, and other VR apps may also be a good fit for subscription pricing. Nonetheless, the evidence indicates that "the majority of the video game applications on the Quest platform are not a good fit for subscriptions" including because "most of them don't have [an] ongoing content pipeline."

Many fitness offerings, whether virtual or physical, use subscription models. As Meta noted in its June 2022 white paper to the FTC, Supernatural's "monthly subscription model . . . is similar in structure to other connected fitness solutions included specialized equipment solutions (e.g., Peloton, Mirror, Tonal), paid apps (e.g., Apple Fitness+), and other VR fitness apps (e.g., FitXR, Holofit, VZfit), as well as in-person gym memberships (e.g., Equinox, CrossFit, 24 Hour Fitness)." The FTC argues that despite sharing a subscription pricing model, VR dedicated fitness apps tend to be "far less expensive" than "other at-home smart fitness devices." The evidence supports this assertion with respect to several connected fitness devices—Supernatural, the most expensive VR dedicated fitness app,6 costs $399 plus $18.99 per month, while Peloton costs $1,445 plus $44 per month and Tonal costs $3,495 plus $49 per month. There are, however, digital fitness options—generally mobile phone apps—with subscriptions "in the sort of $8 to $12 range."

The Court finds that the VR app and non-VR pricing evidence tilts slightly in favor of the existence of a VR dedicated fitness app market. *See, e.g.*, *FTC v. Tronox Ltd.*, 332 F. Supp. 3d 187, 200–01 (D.D.C. 2018) ("The existence of distinct prices . . . are 'not what one would expect if North American customers were willing and able to substitute one type of titanium dioxide for another in response to a change in their relative prices.'") (citations omitted). Testimony from both Within and Meta indicate

a practical reason for VR fitness apps to be generally best served by a subscription pricing model, which is in line with broader non-VR fitness offerings. And VR dedicated fitness apps are much more affordable than the non-VR fitness products that come closest to offering the level of immersion available in VR. However, in light of the evidence that there exist both other VR apps that can strategically employ a subscription model and non-VR fitness offerings that are comparably priced to VR fitness apps, the overall weight of this factor is lessened.

vi. Sensitivity to Price Changes

The sixth *Brown Shoe* factor evaluates the change in sales of a possible substitute product given a change in the price of products within the relevant market. Because this is in essence the same question posed by the HMT, *see FTC v. Staples*, 970 F. Supp. 1066, 1075 (D.D.C. 1997), the Court will not duplicate its analysis here. Drawing from that analysis, the Court finds this factor to be neutral as to the existence of a VR dedicated fitness app market.

vii. Specialized Vendors

The final *Brown Shoe* factor considers whether a product's distribution requires vendors with specialized knowledge or practices. *See Brown Shoe*, 370 U.S. at 325; *FTC v. Staples, Inc.*, 190 F. Supp. 3d 100, 120–21 (D.D.C. 2016) (defining product market in part due to necessity that vendors have distinguishing capabilities such as sophisticated IT systems, personalized and high-quality service, and next-day delivery). The FTC has not presented evidence that the VR dedicated fitness app market requires specialized vendors.

* * *

For the reasons explained above, the Court finds that the following *Brown Shoe* "practical indicia" support the FTC's assertion that VR dedicated fitness apps constitute the relevant product market: industry or public recognition; peculiar characteristics and uses; unique production facilities; distinct customers; and (to a lesser degree) distinct prices. These factors indicate that VR dedicated fitness apps present in-market firms with an economic opportunity that is distinct from both other VR apps and other fitness offerings. *See Thurman Indus., Inc.*, 875 F.2d at 1375. The Court therefore finds that the FTC has met its burden of showing that VR dedicated fitness apps constitute a relevant antitrust product market. *Brown Shoe*, 370 U.S. at 325–28; *see also Lucas Auto. Eng*., 275 F.3d at 766–68 (relying on *Brown Shoe* factors alone in review of relevant market); *Klein*, 580 F. Supp. 3d at 766–73 (same); *Newcal Indus.*, 513 F.3d at 1051 ("Even when a submarket is an Eastman Kodak submarket, though, it must bear the 'practical indicia' of an independent economic entity in order to qualify as a cognizable submarket under *Brown Shoe*.").

b. Hypothetical Monopolist Test (HMT)

In the interests of thoroughness, the Court also addresses the parties' HMT arguments. The HMT is a quantitative tool used by courts to help define a relevant market by determining reasonably interchangeable products. *Optronic Techs., Inc.*, 20 F.4th at 482 n.1. The test asks whether a "hypothetical monopolist that owns a given

set of products likely would impose at least a small but significant and nontransitory increase in price (SSNIP) on at least one product in the market, including at least one product sold by one of the merging firms." [*S*]*ee* 2010 Merger Guidelines § 4.1.1. If enough consumers would respond to a SSNIP—often calculated as a five percent increase in price—by making purchases outside the proposed market definition so as to make the SSNIP not profitable, then the proposed market is defined too narrowly. *Optronic Techs., Inc.*, 20 F.4th at 482 n.1.

The FTC's economics expert, Dr. Singer, conducted a hypothetical monopolist test on the VR dedicated fitness app market. To inform his analysis of the response to a SSNIP in the VR dedicated fitness app market, Dr. Singer commissioned Qualtrics to conduct "a survey of Supernatural users to determine what fitness apps they perceive to be a reasonably close substitutes to Supernatural and to VR dedicated fitness products generally." Dr. Singer testified that although an economist's natural path would be to collect data about Supernatural customers' transactions and reactions to any price increases, such data was unavailable here because Supernatural has never changed its price from $18.99 per month. The survey was his "next best" option, and the approach is supported by the 2010 Merger Guidelines. 2010 Merger Guidelines § 4.1.3. Based on his analysis of the survey, Dr. Singer determined that VR dedicated fitness apps constituted a relevant market.

Defendants deride Dr. Singer's survey as "junk science" and urge this Court not to rely on it. In support of their arguments, Defendants relied on the expert reports and testimony of Dr. Dube and Dr. Carlton, who the Court found qualified as experts [respectively] in the design and implementation of surveys and the economics of consumer demand for branded goods, and industrial organizations and microeconomics. Based on the testimony elicited by Defendants from Dr. Singer, Dr. Dube, and Dr. Carlton, the Court is troubled by various apparent flaws in the survey underlying Dr. Singer's HMT. Most pertinently, there appear to be several indications that a high fraction of the 150 surveyed individuals, on whose answers Dr. Singer's analysis necessarily relied, were untruthful in one or more responses. See, e.g., Dube Hr'g Tr. 895:12–25 (respondents claimed to own multiple pieces of bulky, expensive equipment); Carlton Report ¶ 93 (over two dozen respondents claimed to regularly use all 27 fitness products listed on survey). Another facet of concern is the survey's apparent inclusion of a non-VR product in the question designed to capture a hypothetical monopolist's pricing power in a VR-only market. Carlton Hr'g Tr. 1428:21–1429:9. These questions, among others, suggest that the survey data underlying Dr. Singer's HMT analysis may not be reliable, which in turn casts doubt on the conclusions to be drawn from the HMT.

The Court's reservations about the survey do not change its finding that VR dedicated fitness apps constitute a relevant antitrust product market. Because the Court bases its determination of the relevant product market on its *Brown Shoe* analysis, rather than the HMT, it need not determine the validity of Dr. Singer's survey methodology. The *Brown Shoe* factors are sufficient to inform the Court's understanding of the "business reality" of the VR dedicated fitness app market. *Lucas Auto. Eng.*, 275 F.3d at 766–68; *see also United States v. Anthem, Inc.*, 236 F. Supp.

3d 171, (D.D.C. 2017) (noting *Brown Shoe* factors supported the "business reality" of the government's relevant market despite defense argument of "[in]sufficient economic rigor"); *RAG-Stiftung*, 436 F. Supp. 3d at 293 n.3 ("The *Brown Shoe* practical indicia may indeed be old school, and its analytical framework relegated 'to the jurisprudential sidelines.' But *Brown Shoe* remains the law, and this court cannot ignore its dictates.") (citations omitted). Because the Court does not rely on the challenged portions of Dr. Singer's report, the Court DENIES AS MOOT Defendants' motion to strike Dr. Singer's opinion that VR dedicated fitness apps constitute a relevant product market.

2. Geographic Market

"The relevant geographic market is the 'area of effective competition where buyers can turn for alternate sources of supply.'" *Saint Alphonsus Med. Ctr.-Nampa Inc. v. St. Luke's Health Sys., Ltd.*, 778 F.3d 775, 784 (9th Cir. 2015) (citations omitted). "[I]n a potential-competition case like this one, the relevant geographic market or appropriate section of the country is the area in which the acquired firm is an actual, direct competitor." *Marine Bancorporation*, 418 U.S. at 622. That is, the geographic market must "correspond to the commercial realities of the industry." *Brown Shoe*, 370 U.S. at 336; *see also Staples*, 970 F. Supp. at 1073 (relevant geographic market is region where "consumers can practically turn for alternative sources of the product and in which the antitrust defendant faces competition").

The FTC asserts that the United States is the relevant geographic market, and Defendants do not argue to the contrary. The Court agrees. As one of Within's founders testified, Supernatural is only available to Quest headset users in the United States and Canada mainly [REDACTED]. More broadly, Quest headsets are designed so that a user's geolocation determines the availability and prices of content. Because content developed in other countries may not be available in the United States, and because Supernatural is not available outside of the United States and Canada, the Court finds that the United States is an appropriate relevant geographic market. *See Staples*, 970 F. Supp. at 1073.

Accordingly, the relevant antitrust market for the analysis of the competitive impacts of Meta's acquisition of Within is VR dedicated fitness apps in the United States.

NOTES

1. On January 31, 2023, Judge Davila issued an opinion finding that the FTC failed to show a likelihood of success on the merits of anticompetitive harm and denying the FTC's motion for a preliminary injunction pending the resolution of the merits in an administrative adjudication. The FTC elected not to appeal the district court's decision. In the absence of a preliminary injunction, Meta closed on its

acquisition of Within on February 8.[2] Two weeks later, the FTC dismissed its administrative complaint,[3] ending the FTC's efforts to intervene in the transaction.

2. Unfortunately, expert reports, although cited frequently by the court when admitted into the record, are almost always filed under seal. That was the case here. Expert reports are publicly available.

3. The FTC's economic expert in this case was Dr. Hal J. Singer. Singer received his Ph.D. in economics from The Johns Hopkins University in 1999 and has worked for various economic consulting firms since 1994. He is currently a managing director of Econ One. Since 2022, Singer has also been Professor of Economics at the University of Utah and Director of the Utah Project on Antitrust and Consumer Protection. He is an experienced economic expert witness, testifying almost exclusively for private plaintiffs.

4. Meta's economic expert witness was Professor Dennis W. Carlton. Carlton earned his Ph.D. in Economics in 1975 from MIT and has been an economics professor at the University of Chicago since 1976. He co-authored the leading industrial organization textbook and was Deputy Assistant Attorney General for Economics at the Antitrust Division from 2006 to 2008. He is a leading figure in industrial organization and is an experienced antitrust economics expert.

5. Meta also retained Dr. Theodore Vickey, a fitness expert, and Dr. Jean-Pierre Dube, a marketing expert. I have been able to find essentially nothing on Vickey. Dube has been a professor at the University of Chicago Booth School of Business since receiving his Ph.D. in economics at Northwestern University in 2000. Dube presumably qualified as an expert in market surveys and provided testimony on the inadequacy and unreliability of Singer's market survey that provided data for Singer's HMT application.

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[2] Jason Rubin, Meta VP of Play, *Within Joins Meta*, Meta Quest Blog (Feb. 8, 2023).

[3] Order Returning Matter To Adjudication and Dismissing Complaint, Meta Platforms, Inc., No. 9411 (F.T.C. Feb. 24, 2923),

FTC V. TRONOX LTD.,
332 F. Supp. 3d 187, 204-05 (D.D.C. 2018)
(excerpt on critical loss[1])

TREVOR N. MCFADDEN, U.S.D.J.

[The FTC sought a preliminary injunction under FTC Act § 13(b) to enjoin the acquistion by Tronox Limited of the National Titanium Dioxide Company's titanium dioxide (TiO_2) business (known as "Cristal") for $1.67 billion in cash and a 24% equity stake in the combined firm. TiO_2 is a pigment used to add whiteness, brightness, and opacity to products like paints, plastics, and paper. It is manufactured by subjecting raw titanium ores to either a chloride or a sulfate production process. A central issue in the case was the relevant product market definition. The FTC alleged that the relevant product market was TiO_2 produced by the chloride process, while the parties argued that the market must also include TiO_2 produced by the sulfate process. The court accepted the FTC's definition, relying in part on the testimony of Dr. Nicholas Hill, the FTC's economic expert, on his application of the critical loss test.]

. . .

Dr. Hill also conducted several iterations of the "hypothetical monopolist test" to prove that the relevant market consists of North American sales of chloride-process TiO_2. The test seeks to determine whether a hypothetical company that is the only seller of the relevant product to customers in the relevant geography could profitably impose a "small but significant and non-transitory increase in price" ("SSNIP"). See Merger Guidelines §§ 4.1.1; 4.2.2. If this hypothetical monopolist can profit from imposing a SSNIP without losing a critical mass of customers, then a relevant antitrust market has been defined. If, on the other hand, customers can defeat the price increase "by substitution away from the relevant product or by arbitrage," the market definition must be broadened. *Id. See also [FTC v.] Sysco [Corp.],* 113 F. Supp. 3d [1] at 33-34 [(D.D.C. 2015)].

To run the test, Dr. Hill conducted a "critical loss analysis." He began by calculating the "critical loss," which is the percentage of "lost unit sales that would leave profits unchanged" if a hypothetical monopolist imposed a SSNIP. Merger Guidelines § 4.1.3. Dr. Hill determined that, with an SSNIP of 10%, a hypothetical monopolist could lose up to 15.4% of its sales and still break even. PX5000-051. The critical loss threshold is thus 15.4%.

Next, Dr. Hill estimated the "predicted loss" that would be observed in the event of a SSNIP of 10%. If the predicted loss is less than the critical loss, imposing a SSNIP would be profitable for the hypothetical monopolist, and the relevant antitrust market has been correctly defined. Dr. Hill used three methods to calculate the predicted loss:

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[1] Record citations omitted.

the "price elasticity of demand" method, a "substitution components" method, and a "documentary evidence" method. Each showed that a hypothetical monopolist could profitably raise North American chloride TiO_2 prices by 10%.

Price elasticity of demand measures the responsiveness of a product's sales to a 1% change in the product's price. Demand for a product is "elastic" if a 1% price increase decreases demand by more than 1%. It is "inelastic" if a 1% price increase decreases demand by less than 1%. The more inelastic a product's demand, the less likely it is that the product has adequate substitutes. Dr. Hill found that the price elasticity of North American chloride TiO_2 is -0.45% (*i.e.*, a 1% increase in price reduces sales by 0.45%). He multiplied this number and a 10% SSNIP to show that the predicted loss of sales, 4.5%, would be considerably lower than the critical loss of 15.4%. In other words, estimates of price elasticity show that a hypothetical monopolist could profitably increase North American chloride TiO_2 prices by 10%.

Dr. Hill's "substitution components method" used the Defendants' data to estimate the expected increase of TiO_2 imports in response to a 10% SSNIP. The TiO_2 that firms acquire from imports or from other producers repatriating their exports represents lost sales for a hypothetical monopolist. Dr. Hill found that a 10% SSNIP would lead to roughly 75,000 more metric tons of TiO_2 being imported or repatriated, and another 3% decrease in the monopolist's sales of rutile TiO_2. Together, this represents roughly 12.6% of total North American chloride TiO_2 sales. As a 12.6% loss is lower than the critical loss threshold of 15.4%, the substitution components method predicts that the hypothetical monopolist could profitably raise prices.

Finally, Dr. Hill used data from Tronox documents. At some future point, Tronox contends, "Chinese sulfate could take up to 15 percent of [all TiO_2] applications" in North America, thus "reducing the share of chloride titanium dioxide by at most five percent." Dr. Hill assumed that such sulfate substitution would occur in response to a 10% SSNIP. He and calculated that the resulting loss of sales to the hypothetical monopolist would be about 8.7%, which again is lower than the critical loss threshold. Based on these calculations and his other analyses, Dr. Hill concluded that the relevant market for evaluating the merger's potential anticompetitive effects consists of North American chloride TiO_2 sales.

FTC v. SANFORD HEALTH
No. 1:17-CV-133, at 21-24 (D.N.D. Dec. 15, 2017), *aff'd*, 926 F.3d 959 (8th Cir. June 13, 2019)

Excepts on the Relevant Geographic Market[1]

ALICE R. SENECHAL, United States Magistrate Judge

[The FTC and the State of North Dakota filed a complaint alleging that the proposed acquisition by Sanford Health of Mid Dakota Clinic, P.C. would likely substantially lessen competition in four relevant medical service markets (adult primary care physician (PCP) services, pediatric services, OB/GYN services, and general surgery physician services) in the four-county Bismarck, ND Metropolitan Statistical Area. Sanford Health is an integrated healthcare system operating in North Dakota and several other states. In the Bismarck-Mandan region of North Dakota, Sanford operates an acute care hospital, eight primary care clinics, and several specialty clinics. MDC is a multispecialty for-profit physician group with nine clinics and one ambulatory surgery center in the region. Among other things, the complaint alleged that the proposed transaction would create by far the largest—and in one case, the only—group of physicians offering these services in Bismarck MSA.]

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FINDINGS OF FACT

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63. The geographic market definition considers "where, within the area of competitive overlap, the effect of the merger on competition will be direct and immediate." United States v. Phila. Nat'l Bank, 374 U.S. 321, 357 (1963).

64. The Merger Guidelines support use of the HMT to define a geographic market, and other courts have endorsed that approach. See Horizontal Merger Guidelines § 4.2; Advocate Health, 841 F.3d at 468-73. Dr. Town agreed that, if one were going to define a geographic market in this situation, use of the HMT—or SSNIP—test would be an appropriate method for doing so. (Tr-4, p. 112). It is appropriate to use the HMT to define the geographic market for this case.

65. The Bismarck-Mandan area includes the cities of Bismarck and Mandan and smaller communities within the surrounding 40 to 50 mile radius. The population of the Bismarck-Mandan area is approximately 130,000, with approximately 93,000 of those people living within either Bismarck or Mandan. The cities closest to Bismarck and Mandan (Minot, Dickinson, and Jamestown) are each between 90 and 110 miles away. Clinics within the Bismarck-Mandan area are almost all within an eight-mile radius of central Bismarck. (PX 3002, p. 2; PX 6000, pp. 55, 235).

66. Both MDC and Sanford Bismarck consider their primary geographic market to be the area encompassing the four counties that the plaintiffs include in their proposed

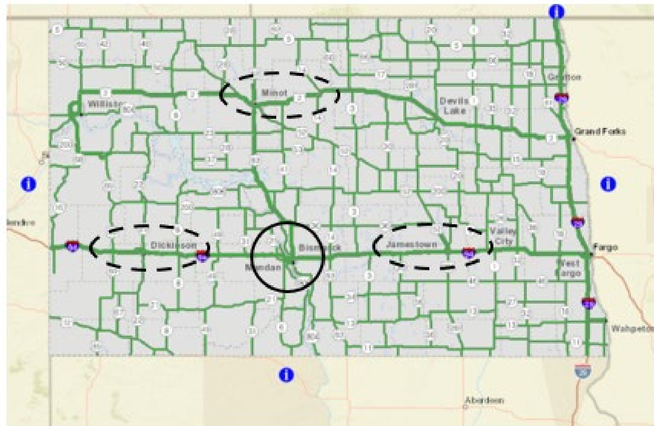
[1] Reported at 2017 WL 10810016, at *11. Footnotes omitted.

definition of the relevant market. (JX 0012, pp. 202-03; JX 0007, p. 31). Dr. Sacher's quantitative analysis confirms that patients residing within the Bismarck-Mandan area prefer to receive healthcare services within that area, (PX 6000, pp. 62, 64, 70, 155), and the defendants do not question that fact. A health insurance plan that did not include Bismarck-Mandan area adult PCP services, pediatrician services, OB/GYN physician services, and general surgeon services would not be marketable in the Bismarck-Mandan area. The relevant geographic market is the Bismarck-Mandan area—Burleigh, Morton, Oliver, and Sioux Counties.

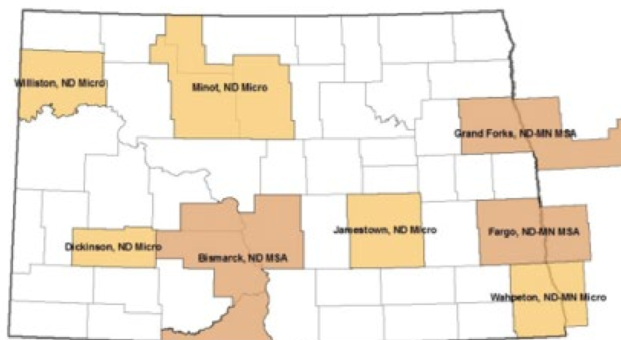
67. The plaintiffs established that commercial health insurers would accept a hypothetical monopolist's SSNIP rather than market a health insurance plan in the Bismarck-Mandan area that did not include Bismarck-Mandan area adult PCP services, pediatrician services, OB/GYN physician services, and general surgeon services.

68. The relevant market is adult PCP services, pediatrician services, OB/GYN physician services, and general surgeon services sold to or provided to commercial insurers and their members in the Bismarck-Mandan area.

North Dakota County Map



Metropolitan and Micropolitan Areas in North Dakota



Explicit Theories of Anticompetitive Harm:

The *PNB* Presumption and the Merger Guidelines

This guidance is inactive; the manual was withdrawn in December 2023. The information here may be outdated and links may no longer function. Please contact webmaster@usdoj.gov if you have any questions about the archive site.

Horizontal Merger Guidelines

U.S. Department of Justice

and the

Federal Trade Commission

Issued: August 19, 2010

e.g., customers in the region travelling outside it to purchase the relevant product. In this exercise, the terms of sale for products sold to all customers outside the region are held constant.

> *Example 13:* Customers require local sales and support. Suppliers have sales and service operations in many geographic areas and can discriminate based on customer location. The geographic market can be defined around the locations of customers.

> *Example 14:* Each merging firm has a single manufacturing plant and delivers the relevant product to customers in City X and in City Y. The relevant product is expensive to transport. The merging firms' plants are by far the closest to City X, but no closer to City Y than are numerous rival plants. This fact pattern suggests that customers in City X may be harmed by the merger even if customers in City Y are not. For that reason, the Agencies consider a relevant geographic market defined around customers in City X. Such a market could be defined even if the region around the merging firms' plants would not be a relevant geographic market defined based on the location of sellers because a hypothetical monopolist controlling all plants in that region would find a SSNIP imposed on all of its customers unprofitable due to the loss of sales to customers in City Y.

When the geographic market is defined based on customer locations, sales made to those customers are counted, regardless of the location of the supplier making those sales.

> *Example 15:* Customers in the United States must use products approved by U.S. regulators. Foreign customers use products not approved by U.S. regulators. The relevant product market consists of products approved by U.S. regulators. The geographic market is defined around U.S. customers. Any sales made to U.S. customers by foreign suppliers are included in the market, and those foreign suppliers are participants in the U.S. market even though located outside it.

5. Market Participants, Market Shares, and Market Concentration

The Agencies normally consider measures of market shares and market concentration as part of their evaluation of competitive effects. The Agencies evaluate market shares and concentration in conjunction with other reasonably available and reliable evidence for the ultimate purpose of determining whether a merger may substantially lessen competition.

Market shares can directly influence firms' competitive incentives. For example, if a price reduction to gain new customers would also apply to a firm's existing customers, a firm with a large market share may be more reluctant to implement a price reduction than one with a small share. Likewise, a firm with a large market share may not feel pressure to reduce price even if a smaller rival does. Market shares also can reflect firms' capabilities. For example, a firm with a large market share may be able to expand output rapidly by a larger absolute amount than can a small firm. Similarly, a large market share tends to indicate low costs, an attractive product, or both.

5.1 Market Participants

All firms that currently earn revenues in the relevant market are considered market participants. Vertically integrated firms are also included to the extent that their inclusion accurately reflects their competitive significance. Firms not currently earning revenues in the relevant market, but that have committed to entering the market in the near future, are also considered market participants.

Firms that are not current producers in a relevant market, but that would very likely provide rapid supply responses with direct competitive impact in the event of a SSNIP, without incurring

significant sunk costs, are also considered market participants. These firms are termed "rapid entrants." Sunk costs are entry or exit costs that cannot be recovered outside the relevant market. Entry that would take place more slowly in response to adverse competitive effects, or that requires firms to incur significant sunk costs, is considered in Section 9.

Firms that produce the relevant product but do not sell it in the relevant geographic market may be rapid entrants. Other things equal, such firms are most likely to be rapid entrants if they are close to the geographic market.

> *Example 16:* Farm A grows tomatoes halfway between Cities X and Y. Currently, it ships its tomatoes to City X because prices there are two percent higher. Previously it has varied the destination of its shipments in response to small price variations. Farm A would likely be a rapid entrant participant in a market for tomatoes in City Y.

> *Example 17:* Firm B has bid multiple times to supply milk to School District S, and actually supplies milk to schools in some adjacent areas. It has never won a bid in School District S, but is well qualified to serve that district and has often nearly won. Firm B would be counted as a rapid entrant in a market for school milk in School District S.

More generally, if the relevant market is defined around targeted customers, firms that produce relevant products but do not sell them to those customers may be rapid entrants if they can easily and rapidly begin selling to the targeted customers.

Firms that clearly possess the necessary assets to supply into the relevant market rapidly may also be rapid entrants. In markets for relatively homogeneous goods where a supplier's ability to compete depends predominantly on its costs and its capacity, and not on other factors such as experience or reputation in the relevant market, a supplier with efficient idle capacity, or readily available "swing" capacity currently used in adjacent markets that can easily and profitably be shifted to serve the relevant market, may be a rapid entrant.[8] However, idle capacity may be inefficient, and capacity used in adjacent markets may not be available, so a firm's possession of idle or swing capacity alone does not make that firm a rapid entrant.

5.2 Market Shares

The Agencies normally calculate market shares for all firms that currently produce products in the relevant market, subject to the availability of data. The Agencies also calculate market shares for other market participants if this can be done to reliably reflect their competitive significance.

Market concentration and market share data are normally based on historical evidence. However, recent or ongoing changes in market conditions may indicate that the current market share of a particular firm either understates or overstates the firm's future competitive significance. The Agencies consider reasonably predictable effects of recent or ongoing changes in market conditions when calculating and interpreting market share data. For example, if a new technology that is important to long-term competitive viability is available to other firms in the market, but is not available to a particular firm, the Agencies may conclude that that firm's historical market share

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[8] If this type of supply side substitution is nearly universal among the firms selling one or more of a group of products, the Agencies may use an aggregate description of markets for those products as a matter of convenience.

overstates its future competitive significance. The Agencies may project historical market shares into the foreseeable future when this can be done reliably.

The Agencies measure market shares based on the best available indicator of firms' future competitive significance in the relevant market. This may depend upon the type of competitive effect being considered, and on the availability of data. Typically, annual data are used, but where individual transactions are large and infrequent so annual data may be unrepresentative, the Agencies may measure market shares over a longer period of time.

In most contexts, the Agencies measure each firm's market share based on its actual or projected revenues in the relevant market. Revenues in the relevant market tend to be the best measure of attractiveness to customers, since they reflect the real-world ability of firms to surmount all of the obstacles necessary to offer products on terms and conditions that are attractive to customers. In cases where one unit of a low-priced product can substitute for one unit of a higher-priced product, unit sales may measure competitive significance better than revenues. For example, a new, much less expensive product may have great competitive significance if it substantially erodes the revenues earned by older, higher-priced products, even if it earns relatively few revenues. In cases where customers sign long-term contracts, face switching costs, or tend to re-evaluate their suppliers only occasionally, revenues earned from recently acquired customers may better reflect the competitive significance of suppliers than do total revenues.

In markets for homogeneous products, a firm's competitive significance may derive principally from its ability and incentive to rapidly expand production in the relevant market in response to a price increase or output reduction by others in that market. As a result, a firm's competitive significance may depend upon its level of readily available capacity to serve the relevant market if that capacity is efficient enough to make such expansion profitable. In such markets, capacities or reserves may better reflect the future competitive significance of suppliers than revenues, and the Agencies may calculate market shares using those measures. Market participants that are not current producers may then be assigned positive market shares, but only if a measure of their competitive significance properly comparable to that of current producers is available. When market shares are measured based on firms' readily available capacities, the Agencies do not include capacity that is committed or so profitably employed outside the relevant market, or so high-cost, that it would not likely be used to respond to a SSNIP in the relevant market.

> *Example 18:* The geographic market is defined around customers in the United States. Firm X produces the relevant product outside the United States, and most of its sales are made to customers outside the United States. In most contexts, Firm X's market share will be based on its sales to U.S. customers, not its total sales or total capacity. However, if the relevant product is homogeneous, and if Firm X would significantly expand sales to U.S. customers rapidly and without incurring significant sunk costs in response to a SSNIP, the Agencies may base Firm X's market share on its readily available capacity to serve U.S. customers.

When the Agencies define markets serving targeted customers, these same principles are used to measure market shares, as they apply to those customers. In most contexts, each firm's market share is based on its actual or projected revenues from the targeted customers. However, the Agencies may instead measure market shares based on revenues from a broader group of customers if doing so would more accurately reflect the competitive significance of different suppliers in the relevant market. Revenues earned from a broader group of customers may also be used when better data are thereby available.

5.3 Market Concentration

Market concentration is often one useful indicator of likely competitive effects of a merger. In evaluating market concentration, the Agencies consider both the post-merger level of market concentration and the change in concentration resulting from a merger. Market shares may not fully reflect the competitive significance of firms in the market or the impact of a merger. They are used in conjunction with other evidence of competitive effects. See Sections 6 and 7.

In analyzing mergers between an incumbent and a recent or potential entrant, to the extent the Agencies use the change in concentration to evaluate competitive effects, they will do so using projected market shares. A merger between an incumbent and a potential entrant can raise significant competitive concerns. The lessening of competition resulting from such a merger is more likely to be substantial, the larger is the market share of the incumbent, the greater is the competitive significance of the potential entrant, and the greater is the competitive threat posed by this potential entrant relative to others.

The Agencies give more weight to market concentration when market shares have been stable over time, especially in the face of historical changes in relative prices or costs. If a firm has retained its market share even after its price has increased relative to those of its rivals, that firm already faces limited competitive constraints, making it less likely that its remaining rivals will replace the competition lost if one of that firm's important rivals is eliminated due to a merger. By contrast, even a highly concentrated market can be very competitive if market shares fluctuate substantially over short periods of time in response to changes in competitive offerings. However, if competition by one of the merging firms has significantly contributed to these fluctuations, perhaps because it has acted as a maverick, the Agencies will consider whether the merger will enhance market power by combining that firm with one of its significant rivals.

The Agencies may measure market concentration using the number of significant competitors in the market. This measure is most useful when there is a gap in market share between significant competitors and smaller rivals or when it is difficult to measure revenues in the relevant market. The Agencies also may consider the combined market share of the merging firms as an indicator of the extent to which others in the market may not be able readily to replace competition between the merging firms that is lost through the merger.

The Agencies often calculate the Herfindahl-Hirschman Index ("HHI") of market concentration. The HHI is calculated by summing the squares of the individual firms' market shares,[9] and thus gives proportionately greater weight to the larger market shares. When using the HHI, the Agencies

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[9] For example, a market consisting of four firms with market shares of thirty percent, thirty percent, twenty percent, and twenty percent has an HHI of 2600 ($30^2 + 30^2 + 20^2 + 20^2 = 2600$). The HHI ranges from 10,000 (in the case of a pure monopoly) to a number approaching zero (in the case of an atomistic market). Although it is desirable to include all firms in the calculation, lack of information about firms with small shares is not critical because such firms do not affect the HHI significantly.

consider both the post-merger level of the HHI and the increase in the HHI resulting from the merger. The increase in the HHI is equal to twice the product of the market shares of the merging firms.[10]

Based on their experience, the Agencies generally classify markets into three types:

- Unconcentrated Markets: HHI below 1500
- Moderately Concentrated Markets: HHI between 1500 and 2500
- Highly Concentrated Markets: HHI above 2500

The Agencies employ the following general standards for the relevant markets they have defined:

- *Small Change in Concentration:* Mergers involving an increase in the HHI of less than 100 points are unlikely to have adverse competitive effects and ordinarily require no further analysis.
- *Unconcentrated Markets:* Mergers resulting in unconcentrated markets are unlikely to have adverse competitive effects and ordinarily require no further analysis.
- *Moderately Concentrated Markets:* Mergers resulting in moderately concentrated markets that involve an increase in the HHI of more than 100 points potentially raise significant competitive concerns and often warrant scrutiny.
- *Highly Concentrated Markets:* Mergers resulting in highly concentrated markets that involve an increase in the HHI of between 100 points and 200 points potentially raise significant competitive concerns and often warrant scrutiny. Mergers resulting in highly concentrated markets that involve an increase in the HHI of more than 200 points will be presumed to be likely to enhance market power. The presumption may be rebutted by persuasive evidence showing that the merger is unlikely to enhance market power.

The purpose of these thresholds is not to provide a rigid screen to separate competitively benign mergers from anticompetitive ones, although high levels of concentration do raise concerns. Rather, they provide one way to identify some mergers unlikely to raise competitive concerns and some others for which it is particularly important to examine whether other competitive factors confirm, reinforce, or counteract the potentially harmful effects of increased concentration. The higher the post-merger HHI and the increase in the HHI, the greater are the Agencies' potential competitive concerns and the greater is the likelihood that the Agencies will request additional information to conduct their analysis.

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[10] For example, the merger of firms with shares of five percent and ten percent of the market would increase the HHI by 100 ($5 \times 10 \times 2 = 100$).

Merger Guidelines

U.S. Department of Justice and the Federal Trade Commission

Issued: December 18, 2023

1. Overview

These Merger Guidelines identify the procedures and enforcement practices the Department of Justice and the Federal Trade Commission (the "Agencies") most often use to investigate whether mergers violate the antitrust laws. The Agencies enforce the federal antitrust laws, specifically Sections 1 and 2 of the Sherman Act, 15 U.S.C. §§ 1, 2; Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45; and Sections 3, 7, and 8 of the Clayton Act,[1] 15 U.S.C. §§ 14, 18, 19.[2] Congress has charged the Agencies with administering these statutes as part of a national policy to promote open and fair competition, including by preventing mergers and acquisitions that would violate these laws. "Federal antitrust law is a central safeguard for the Nation's free market structures" that ensures "the preservation of economic freedom and our free-enterprise system."[3] It rests on the premise that "[t]he unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress, while at the same time providing an environment conducive to the preservation of our democratic political and social institutions."[4]

Section 7 of the Clayton Act ("Section 7") prohibits mergers and acquisitions 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." Competition is a process of rivalry that incentivizes businesses to offer lower prices, improve wages and working conditions, enhance quality and resiliency, innovate, and expand choice, among many other benefits. Mergers that substantially lessen competition or tend to create a monopoly increase, extend, or entrench market power and deprive the public of these benefits. Mergers can lessen competition when they diminish competitive constraints, reduce the number or attractiveness of alternatives available to trading partners, or reduce the intensity with which market participants compete.

Section 7 was designed to arrest anticompetitive tendencies in their incipiency.[5] The Clayton Act therefore requires the Agencies to assess whether mergers present risk to competition. The Supreme Court has explained that "Section 7 itself creates a relatively expansive definition of antitrust liability: To show that a merger is unlawful, a plaintiff need only prove that its effect '*may be* substantially to lessen competition'" or to tend to create a monopoly.[6] Accordingly, the Agencies do not attempt to

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[1] As amended under the Celler-Kefauver Antimerger Act of 1950, Pub. L. No. 81-899, 64 Stat. 1125 (1950), and the Hart-Scott-Rodino Antitrust Improvements Act of 1976, 15 U.S.C. § 18a.

[2] Although these Guidelines focus primarily on Section 7 of the Clayton Act, the Agencies consider whether any of these statutes may be violated by a merger. The various provisions of the Sherman, Clayton, and FTC Acts each have separate standards, and one may be violated when the others are not.

[3] *North Carolina State Bd. of Dental Examiners v. FTC*, 574 U.S. 494, 502 (2015).

[4] *NCAA v. Board of Regents*, 468 U.S. 85, 104 n.27 (1984) (quoting *Northern Pac. R. Co. v. United States*, 356 U.S. 1, 4-5 (1958)); *see also NCAA v. Alston*, 141 S. Ct. 2141, 2147 (2021) (quoting *Board of Regents*, 468 U.S. at 104 n.27).

[5] *See, e.g.*, *Brown Shoe Co. v. United States*, 370 U.S. 294, 318 nn.32-33 (1962); *see also United States v. AT&T, Inc.*, 916 F.3d 1029, 1032 (D.C. Cir. 2019) (Section 7 "halt[s] incipient monopolies and trade restraints outside the scope of the Sherman Act." (quoting *Brown Shoe*, 370 U.S. at 318 n.32)); *Saint Alphonsus Medical Center-Nampa v. St. Luke's*, 778 F.3d 775, 783 (9th Cir. 2015) (Section 7 "intended to arrest anticompetitive tendencies in their incipiency." (quoting *Brown Shoe*, 370 U.S. at 322)); *Polypore Intern., Inc. v. FTC*, 686 F.3d 1208, 1213-14 (11th Cir. 2012) (same). Some other aspects of *Brown Shoe* have been subsequently revisited.

[6] *California v. Am. Stores Co.*, 495 U.S. 271, 284 (1990) (quoting 15 U.S.C. § 18 with emphasis) (citing *Brown Shoe*, 370 U.S. at 323).

predict the future or calculate precise effects of a merger with certainty. Rather, the Agencies examine the totality of the evidence available to assess the risk the merger presents.

Competition presents itself in myriad ways. To assess the risk of harm to competition in a dynamic and complex economy, the Agencies begin the analysis of a proposed merger by asking: how do firms in this industry compete, and does the merger threaten to substantially lessen competition or to tend to create a monopoly?

The Merger Guidelines set forth several different analytical frameworks (referred to herein as "Guidelines") to assist the Agencies in assessing whether a merger presents sufficient risk to warrant an enforcement action. These frameworks account for industry-specific market realities and use a variety of indicators and tools, ranging from market structure to direct evidence of the effect on competition, to examine whether the proposed merger may harm competition.

How to Use These Guidelines: When companies propose a merger that raises concerns under one or more Guidelines, the Agencies closely examine the evidence to determine if the facts are sufficient to infer that the effect of the merger may be to substantially lessen competition or to tend to create a monopoly (sometimes referred to as a "prima facie case").[7] **Section 2** describes how the Agencies apply these Guidelines. Specifically, Guidelines 1-6 describe distinct frameworks the Agencies use to identify that a merger raises prima facie concerns, and Guidelines 7-11 explain how to apply those frameworks in several specific settings. In all of these situations, the Agencies will also examine relevant evidence to determine if it disproves or rebuts the prima facie case and shows that the merger does not in fact threaten to substantially lessen competition or tend to create a monopoly. **Section 3** identifies rebuttal evidence that the Agencies consider, and that merging parties can present, to rebut an inference of potential harm under these frameworks.[8] **Section 4** sets forth a non-exhaustive discussion of analytical, economic, and evidentiary tools the Agencies use to evaluate facts, understand the risk of harm to competition, and define relevant markets.

These Guidelines are not mutually exclusive, as a single transaction can have multiple effects or raise concerns in multiple ways. To promote efficient review, for any given transaction the Agencies may limit their analysis to any one Guideline or subset of Guidelines that most readily demonstrates the risks to competition from the transaction.

Guideline 1: Mergers Raise a Presumption of Illegality When They Significantly Increase Concentration in a Highly Concentrated Market. Market concentration is often a useful indicator of a merger's likely effects on competition. The Agencies therefore presume, unless sufficiently disproved or rebutted, that a merger between competitors that significantly increases concentration and creates or further consolidates a highly concentrated market may substantially lessen competition.

Guideline 2: Mergers Can Violate the Law When They Eliminate Substantial Competition Between Firms. The Agencies examine whether competition between the merging parties is substantial since their merger will necessarily eliminate any competition between them.

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[7] *See, e.g.*, *United States v. AT&T, Inc.*, 916 F.3d at 1032 (explaining that a *prima facie* case can demonstrate a "reasonable probability" of harm to competition either through "statistics about the change in market concentration" or a "fact-specific" showing (quoting *Brown Shoe*, 370 U.S. at 323 n.39)); *United States v. Baker Hughes*, 908 F.2d 981, 982-83 (D.C. Cir. 1990).
[8] These Guidelines pertain only to the Agencies' consideration of whether a merger or acquisition may substantially lessen competition or tend to create a monopoly. The consideration of remedies appropriate for mergers that pose that risk is beyond the Merger Guidelines' scope. The Agencies review proposals to revise a merger in order to alleviate competitive concerns consistent with applicable law regarding remedies.

Guideline 3: Mergers Can Violate the Law When They Increase the Risk of Coordination. The Agencies examine whether a merger increases the risk of anticompetitive coordination. A market that is highly concentrated or has seen prior anticompetitive coordination is inherently vulnerable and the Agencies will infer, subject to rebuttal evidence, that the merger may substantially lessen competition. In a market that is not highly concentrated, the Agencies investigate whether facts suggest a greater risk of coordination than market structure alone would suggest.

Guideline 4: Mergers Can Violate the Law When They Eliminate a Potential Entrant in a Concentrated Market. The Agencies examine whether, in a concentrated market, a merger would (a) eliminate a potential entrant or (b) eliminate current competitive pressure from a perceived potential entrant.

Guideline 5: Mergers Can Violate the Law When They Create a Firm That May Limit Access to Products or Services That Its Rivals Use to Compete. When a merger creates a firm that can limit access to products or services that its rivals use to compete, the Agencies examine the extent to which the merger creates a risk that the merged firm will limit rivals' access, gain or increase access to competitively sensitive information, or deter rivals from investing in the market.

Guideline 6: Mergers Can Violate the Law When They Entrench or Extend a Dominant Position. The Agencies examine whether one of the merging firms already has a dominant position that the merger may reinforce, thereby tending to create a monopoly. They also examine whether the merger may extend that dominant position to substantially lessen competition or tend to create a monopoly in another market.

Guideline 7: When an Industry Undergoes a Trend Toward Consolidation, the Agencies Consider Whether It Increases the Risk a Merger May Substantially Lessen Competition or Tend to Create a Monopoly. A trend toward consolidation can be an important factor in understanding the risks to competition presented by a merger. The Agencies consider this evidence carefully when applying the frameworks in Guidelines 1-6.

Guideline 8: When a Merger is Part of a Series of Multiple Acquisitions, the Agencies May Examine the Whole Series. If an individual transaction is part of a firm's pattern or strategy of multiple acquisitions, the Agencies consider the cumulative effect of the pattern or strategy when applying the frameworks in Guidelines 1-6.

Guideline 9: When a Merger Involves a Multi-Sided Platform, the Agencies Examine Competition Between Platforms, on a Platform, or to Displace a Platform. Multi-sided platforms have characteristics that can exacerbate or accelerate competition problems. The Agencies consider the distinctive characteristics of multi-sided platforms when applying the frameworks in Guidelines 1-6.

Guideline 10: When a Merger Involves Competing Buyers, the Agencies Examine Whether It May Substantially Lessen Competition for Workers, Creators, Suppliers, or Other Providers. The Agencies apply the frameworks in Guidelines 1-6 to assess whether a merger between buyers, including employers, may substantially lessen competition or tend to create a monopoly.

Guideline 11: When an Acquisition Involves Partial Ownership or Minority Interests, the Agencies Examine Its Impact on Competition. The Agencies apply the frameworks in Guidelines 1-6 to assess if an acquisition of partial control or common ownership may substantially lessen competition.

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This edition of the Merger Guidelines consolidates, revises, and replaces the various versions of Merger Guidelines previously issued by the Agencies. The revision builds on the learning and experience reflected in those prior Guidelines and successive revisions. These Guidelines reflect the collected experience of the Agencies over many years of merger review in a changing economy and have been refined through an extensive public consultation process.

As a statement of the Agencies' law enforcement procedures and practices, the Merger Guidelines create no independent rights or obligations, do not affect the rights or obligations of private parties, and do not limit the discretion of the Agencies, including their staff, in any way. Although the Merger Guidelines identify the factors and frameworks the Agencies consider when investigating mergers, the Agencies' enforcement decisions will necessarily continue to require prosecutorial discretion and judgment. Because the specific standards set forth in these Merger Guidelines will be applied to a broad range of factual circumstances, the Agencies will apply them reasonably and flexibly to the specific facts and circumstances of each merger.

Similarly, the factors contemplated in these Merger Guidelines neither dictate nor exhaust the range of theories or evidence that the Agencies may introduce in merger litigation. Instead, they set forth various methods of analysis that may be applicable depending on the availability and/or reliability of information related to a given market or transaction. Given the variety of industries, market participants, and acquisitions that the Agencies encounter, merger analysis does not consist of uniform application of a single methodology. The Agencies assess any relevant and meaningful evidence to evaluate whether the effect of a merger may be substantially to lessen competition or to tend to create a monopoly. Merger review is ultimately a fact-specific exercise. The Agencies follow the facts and the law in analyzing mergers as they do in other areas of law enforcement.

These Merger Guidelines include references to applicable legal precedent. References to court decisions do not necessarily suggest that the Agencies would analyze the facts in those cases identically today. While the Agencies adapt their analytical tools as they evolve and advance, legal holdings reflecting the Supreme Court's interpretation of a statute apply unless subsequently modified. These Merger Guidelines therefore reference applicable propositions of law to explain core principles that the Agencies apply in a manner consistent with modern analytical tools and market realities. References herein do not constrain the Agencies' interpretation of the law in particular cases, as the Agencies will apply their discretion with respect to the applicable law in each case in light of the full range of precedent pertinent to the issues raised by each enforcement action.

2. Applying the Merger Guidelines

This section discusses the frameworks the Agencies use to assess whether a merger may substantially lessen competition or tend to create a monopoly.

2.1. Guideline 1: Mergers Raise a Presumption of Illegality When They Significantly Increase Concentration in a Highly Concentrated Market.

Market concentration and the change in concentration due to the merger are often useful indicators of a merger's risk of substantially lessening competition. In highly concentrated markets, a merger that eliminates a significant competitor creates significant risk that the merger may substantially lessen competition or tend to create a monopoly. As a result, a significant increase in concentration in a highly concentrated market can indicate that a merger may substantially lessen competition, depriving the public of the benefits of competition.

The Supreme Court has endorsed this view and held that "a merger which produces a firm controlling an undue percentage share of the relevant market, and results in a significant increase in the concentration of firms in that market[,] is so inherently likely to lessen competition substantially that it must be enjoined in the absence of [rebuttal] evidence."[9] In the Agencies' experience, this legal presumption provides a highly administrable and useful tool for identifying mergers that may substantially lessen competition.

An analysis of concentration involves calculating pre-merger market shares of products[10] within a relevant market (see Section 4.3 for a discussion of market definition and Section 4.4 for more details on computing market shares). The Agencies assess whether the merger creates or further consolidates a highly concentrated market and whether the increase in concentration is sufficient to indicate that the merger may substantially lessen competition or tend to create a monopoly.[11]

The Agencies generally measure concentration levels using the Herfindahl-Hirschman Index ("HHI").[12] The HHI is defined as the sum of the squares of the market shares; it is small when there are many small firms and grows larger as the market becomes more concentrated, reaching 10,000 in a market with a single firm. Markets with an HHI greater than 1,800 are highly concentrated, and a change of more than 100 points is a significant increase.[13] A merger that creates or further consolidates a highly

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[9] *United States v. Phila. Nat'l Bank*, 374 U.S. 321, 363 (1963); *see, e.g.*, *FTC v. v. Hackensack Meridian Health, Inc.*, 30 F.4th 160, 172-73 (3d Cir. 2022); *United States v. AT&T, Inc.*, 916 F.3d at 1032.

[10] These Guidelines use the term "products" to encompass anything that is traded between firms and their suppliers, customers, or business partners, including physical goods, services, or access to assets. Products can be as narrow as an individual brand, a specific version of a product, or a product that includes specific ancillary services such as the right to return it without cause or delivery to the customer's location.

[11] Typically, a merger eliminates a competitor by bringing two market participants under common control. Similar concerns arise if the merger threatens to cause the exit of a current market participant, such as a leveraged buyout that puts the target firm at significant risk of failure.

[12] The Agencies may instead measure market concentration using the number of significant competitors in the market. This measure is most useful when there is a gap in market share between significant competitors and smaller rivals or when it is difficult to measure shares in the relevant market.

[13] For illustration, the HHI for a market of five equal firms is 2,000 ($5 \times 20^2 = 2{,}000$) and for six equal firms is 1,667 ($6 \times 16.67^2 = 1667$).

concentrated market that involves an increase in the HHI of more than 100 points[14] is presumed to substantially lessen competition or tend to create a monopoly.[15] The Agencies also may examine the market share of the merged firm: a merger that creates a firm with a share over thirty percent is also presumed to substantially lessen competition or tend to create a monopoly if it also involves an increase in HHI of more than 100 points.[16]

Indicator	Threshold for Structural Presumption
Post-merger HHI	Market HHI greater than 1,800 AND Change in HHI greater than 100
Merged Firm's Market Share	Share greater than 30% AND Change in HHI greater than 100

When exceeded, these concentration metrics indicate that a merger's effect may be to eliminate substantial competition between the merging parties and may be to increase coordination among the remaining competitors after the merger. This presumption of illegality can be rebutted or disproved. The higher the concentration metrics over these thresholds, the greater the risk to competition suggested by this market structure analysis and the stronger the evidence needed to rebut or disprove it.

2.2. Guideline 2: Mergers Can Violate the Law When They Eliminate Substantial Competition Between Firms.

A merger eliminates competition between the merging firms by bringing them under joint control.[17] If evidence demonstrates substantial competition between the merging parties prior to the

[14] The change in HHI from a merger of firms with shares *a* and *b* is equal to 2*ab*. For example, in a merger between a firm with 20% market share and a firm with 5% market share, the change in HHI is 2 x 20 x 5 = 200.

[15] The first merger guidelines to reference an HHI threshold were the merger guidelines issued in 1982. These guidelines referred to mergers with HHI above 1,000 as concentrated markets, with HHI between 1,000 and 1,800 as "moderately concentrated" and above 1,800 as "highly concentrated," while they referred to an increase in HHI of 100 as a "significant increase." Each subsequent iteration until 2010 maintained those thresholds. *See* Fed. Trade Comm'n & U.S. Dep't of Justice, Horizontal Merger Guidelines § 1.51 (1997); Fed. Trade Comm'n & U.S. Dep't of Justice, Horizontal Merger Guidelines § 1.51 (1992); U.S. Dep't of Justice, Merger Guidelines § 3(A) (1982). During this time, courts routinely cited to the guidelines and these HHI thresholds in decisions. *See, e.g.*, *Chicago Bridge & Iron Co. N.V. v. FTC*, 534 F.3d 410, 431 (5th Cir. 2008); *FTC v. H.J. Heinz Co.*, 246 F.3d 708, 716 (D.C. Cir. 2001); *FTC v. Univ. Health, Inc.*, 938 F.2d 1206, 1211 (11th Cir. 1991). Although the Agencies raised the thresholds for the 2010 guidelines, based on experience and evidence developed since, the Agencies consider the original HHI thresholds to better reflect both the law and the risks of competitive harm suggested by market structure and have therefore returned to those thresholds.

[16] *Phila. Nat'l Bank*, 374 U.S. at 364-65 ("Without attempting to specify the smallest market share which would still be considered to threaten undue concentration, we are clear that 30% presents that threat.").

[17] The competitive harm from the elimination of competition between the merging firms, without considering the risk of coordination, is sometimes referred to as unilateral effects. The elimination of competition between the merging firms can also lessen competition with and among other competitors. When the elimination of competition between the merging firms

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4.3.D.7. Market Definition When There is Harm to Innovation

When considering harm to competition in innovation, market definition may follow the same approaches that are used to analyze other dimensions of competition. In the case where a merger may substantially lessen competition by decreasing incentives to innovate, the Agencies may define relevant antitrust markets around the products that would result from that innovation if successful, even if those products do not yet exist.[91] In some cases, the Agencies may analyze different relevant markets when considering innovation than when considering other dimensions of competition.

4.3.D.8. Market Definition for Input Markets and Labor Markets

The same market definition tools and principles discussed above can be used for input markets and labor markets, where labor is a particular type of input. In input markets, firms compete with each other to attract suppliers, including workers. Therefore, input suppliers are analogous to customers in the discussions above about market definition. In defining relevant markets, the Agencies focus on the alternatives available to input suppliers. An antitrust input market consists of a group of products and a geographic area defined by the location of the buyers or input suppliers. Just as buyers of a product may consider products to be differentiated according to the brand or the identity of the seller, suppliers of a product or service may consider different buyers to be differentiated. For example, if the suppliers are contractors, they may have distinct preferences about who they provide services to, due to different working conditions, location, reliability of buyers in terms of paying invoices on time, or the propensity of the buyer to make unexpected changes to specifications.

The HMT considers whether a hypothetical monopsonist likely would undertake a SSNIPT, such as a reduction in price paid for inputs, or imposing less favorable terms on suppliers. (See Section 4.2.C for more discussion about competition in settings where terms are set through auctions and negotiations, as is common for input markets.)

When defining a market for labor the Agencies will consider the job opportunities available to workers who supply a relevant type of labor service, where worker choice among jobs or between geographic areas is the analog of consumer choices among products and regions when defining a product market. The Agencies may consider workers' willingness to switch in response to changes to wages or other aspects of working conditions, such as changes to benefits or other non-wage compensation, or adoption of less flexible scheduling. Depending on the occupation, alternative job opportunities might include the same occupation with alternative employers, or alternative occupations. Geographic market definition may involve considering workers' willingness or ability to commute, including the availability of public transportation. The product and geographic market definition may involve assessing whether workers may be targeted for less favorable wages or other terms of employment according to factors such as education, experience, certifications, or work locations. The Agencies may define cluster markets for different jobs when firms employ workers in a variety of jobs characterized by similar competitive conditions (see Section 4.3.D.4).

4.4. Calculating Market Shares and Concentration

This subsection further describes how the Agencies calculate market shares and concentration metrics.

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[91] *See Illumina*, slip op. at 12 (affirming a relevant market defined around "what . . . developers reasonably sought to achieve, not what they currently had to offer").

As discussed above, the Agencies may use evidence about market shares and market concentration as part of their analysis. These structural measures can provide insight into the market power of firms as well as into the extent to which they compete. Although any market that is properly identified using the methods in Section 4.3 is valid, the extent to which structural measures calculated in that market are probative in any given context depends on a number of considerations. The following market considerations affect the extent to which structural measures are probative in any given context.[92]

First, structural measures may be probative if the market used to estimate them includes the products that are the focus of the competitive concern that the structural inquiry intends to address. For example, the concentration measures discussed in Guideline 1 will be most probative about whether the merger eliminates substantial competition between the merging parties when calculated on a market that includes at least one competing product from each merging firm.

Second, the market used to estimate shares should be broad enough that it contains sufficient additional products so that a loss of competition among all the suppliers of the products in the market would lead to significantly worse terms for at least some customers of at least one product. Markets identified using the various tools in Section 4.3 can satisfy this condition—for example, all markets that satisfy the HMT do so.

Third, the competitive significance of the parties may be understated by their share when calculated on a market that is broader than needed to satisfy the considerations above, particularly when the market includes products that are more distant substitutes, either in the product or geographic dimension, for those produced by the parties.

4.4.A. Market Participants

All firms that currently supply products (or consume products, when buyers merge) in a relevant market are considered participants in that market. Vertically integrated firms are also included to the extent that their inclusion accurately reflects their competitive significance. Firms not currently supplying products in the relevant market, but that have committed to entering the market in the near future, are also considered market participants.

Firms that are not currently active in a relevant market, but that very likely would rapidly enter with direct competitive impact in the event of a small but significant change in competitive conditions, without incurring significant sunk costs, are also considered market participants. These firms are termed "rapid entrants." Sunk costs are entry or exit costs that cannot be recovered outside a relevant market. Entry that would take place more slowly in response to a change in competitive conditions, or that requires firms to incur significant sunk costs, is considered in Section 3.2.

Firms that are active in the relevant product market but not in the relevant geographic market may be rapid entrants. Other things equal, such firms are most likely to be rapid entrants if they are already active in geographies that are close to the geographic market. Factors such as transportation

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[92] For simplicity, the discussion in the text focuses on the case where concerns arise that involve competition among the suppliers of products; analogous considerations may also arise for suppliers of services, or when concerns arise about competition among buyers of a product or service, or when analyzing market shares in certain specific settings (see Section 4.3.D).

costs are important; or for services or digital goods, other factors may be important, such as language or regulation.

In markets for relatively homogeneous goods where a supplier's ability to compete depends predominantly on its costs and its capacity, and not on other factors such as experience or reputation in the relevant market, a supplier with efficient idle capacity, or readily available "swing" capacity currently used in adjacent markets that can easily and profitably be shifted to serve the relevant market, may be a rapid entrant. However, idle capacity may be inefficient, and capacity used in adjacent markets may not be available, so a firm's possession of idle or swing capacity alone does not make that firm a rapid entrant.

4.4.B. Market Shares

The Agencies normally calculate product market shares for all firms that currently supply products (or consume products, when buyers merge) in a relevant market, subject to the availability of data. The Agencies measure each firm's market share using metrics that are informative about the market realities of competition in the particular market and firms' future competitive significance. When interpreting shares based on historical data, the Agencies may consider whether significant recent or reasonably foreseeable changes to market conditions suggest that a firm's shares overstate or understate its future competitive significance.

How market shares are calculated may further depend on the characteristics of a particular market, and on the availability of data. Moreover, multiple metrics may be informative in any particular case. For example:

- Revenues in a relevant market often provide a readily available basis on which to compute shares and are often a good measure of attractiveness to customers.
- Unit sales may provide a useful measure of competitive significance in cases where one unit of a low-priced product can serve as a close substitute for one unit of a higher-priced product. For example, a new, much less expensive product may have great competitive significance if it substantially erodes the revenues earned by older, higher-priced products, even if it earns relatively low revenues.
- Revenues earned from recently acquired customers (or paid to recently acquired buyers, in the case of merging buyers) may provide a useful measure of competitive significance of firms in cases where trading partners sign long-term contracts, face switching costs, or tend to re-evaluate their relationships only occasionally.
- Measures based on capacities or reserves may be used to calculate market shares in markets for homogeneous products where a firm's competitive significance may derive principally from its ability and incentive to rapidly expand production in a relevant market in response to a price increase or output reduction by others in that market (or to rapidly expand its purchasing in the case of merging buyers).
- Non-price indicators, such as number of users or frequency of use, may be useful indicators in markets where price forms a relatively small or no part of the exchange of value.

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complementary capabilities that cannot be otherwise combined or for some other merger-specific reason. See Section 10.

The Agencies also consider whether a merger is likely to give the merged firm an incentive to cease offering one of the relevant products sold by the merging parties. Reductions in variety following a merger may or may not be anticompetitive. Mergers can lead to the efficient consolidation of products when variety offers little in value to customers. In other cases, a merger may increase variety by encouraging the merged firm to reposition its products to be more differentiated from one another.

If the merged firm would withdraw a product that a significant number of customers strongly prefer to those products that would remain available, this can constitute a harm to customers over and above any effects on the price or quality of any given product. If there is evidence of such an effect, the Agencies may inquire whether the reduction in variety is largely due to a loss of competitive incentives attributable to the merger. An anticompetitive incentive to eliminate a product as a result of the merger is greater and more likely, the larger is the share of profits from that product coming at the expense of profits from products sold by the merger partner. Where a merger substantially reduces competition by bringing two close substitute products under common ownership, and one of those products is eliminated, the merger will often also lead to a price increase on the remaining product, but that is not a necessary condition for anticompetitive effect.

> *Example 21:* Firm A sells a high-end product at a premium price. Firm B sells a mid-range product at a lower price, serving customers who are more price sensitive. Several other firms have low-end products. Firms A and B together have a large share of the relevant market. Firm A proposes to acquire Firm B and discontinue Firm B's product. Firm A expects to retain most of Firm B's customers. Firm A may not find it profitable to raise the price of its high-end product after the merger, because doing so would reduce its ability to retain Firm B's more price-sensitive customers. The Agencies may conclude that the withdrawal of Firm B's product results from a loss of competition and materially harms customers.

7. Coordinated Effects

A merger may diminish competition by enabling or encouraging post-merger coordinated interaction among firms in the relevant market that harms customers. Coordinated interaction involves conduct by multiple firms that is profitable for each of them only as a result of the accommodating reactions of the others. These reactions can blunt a firm's incentive to offer customers better deals by undercutting the extent to which such a move would win business away from rivals. They also can enhance a firm's incentive to raise prices, by assuaging the fear that such a move would lose customers to rivals.

Coordinated interaction includes a range of conduct. Coordinated interaction can involve the explicit negotiation of a common understanding of how firms will compete or refrain from competing. Such conduct typically would itself violate the antitrust laws. Coordinated interaction also can involve a similar common understanding that is not explicitly negotiated but would be enforced by the detection and punishment of deviations that would undermine the coordinated interaction. Coordinated interaction alternatively can involve parallel accommodating conduct not pursuant to a prior understanding. Parallel accommodating conduct includes situations in which each rival's response to competitive moves made by others is individually rational, and not motivated by

retaliation or deterrence nor intended to sustain an agreed-upon market outcome, but nevertheless emboldens price increases and weakens competitive incentives to reduce prices or offer customers better terms. Coordinated interaction includes conduct not otherwise condemned by the antitrust laws.

The ability of rival firms to engage in coordinated conduct depends on the strength and predictability of rivals' responses to a price change or other competitive initiative. Under some circumstances, a merger can result in market concentration sufficient to strengthen such responses or enable multiple firms in the market to predict them more confidently, thereby affecting the competitive incentives of multiple firms in the market, not just the merged firm.

7.1 Impact of Merger on Coordinated Interaction

The Agencies examine whether a merger is likely to change the manner in which market participants interact, inducing substantially more coordinated interaction. The Agencies seek to identify how a merger might significantly weaken competitive incentives through an increase in the strength, extent, or likelihood of coordinated conduct. There are, however, numerous forms of coordination, and the risk that a merger will induce adverse coordinated effects may not be susceptible to quantification or detailed proof. Therefore, the Agencies evaluate the risk of coordinated effects using measures of market concentration (see Section 5) in conjunction with an assessment of whether a market is vulnerable to coordinated conduct. See Section 7.2. The analysis in Section 7.2 applies to moderately and highly concentrated markets, as unconcentrated markets are unlikely to be vulnerable to coordinated conduct.

Pursuant to the Clayton Act's incipiency standard, the Agencies may challenge mergers that in their judgment pose a real danger of harm through coordinated effects, even without specific evidence showing precisely how the coordination likely would take place. The Agencies are likely to challenge a merger if the following three conditions are all met: (1) the merger would significantly increase concentration and lead to a moderately or highly concentrated market; (2) that market shows signs of vulnerability to coordinated conduct (see Section 7.2); and (3) the Agencies have a credible basis on which to conclude that the merger may enhance that vulnerability. An acquisition eliminating a maverick firm (see Section 2.1.5) in a market vulnerable to coordinated conduct is likely to cause adverse coordinated effects.

7.2 Evidence a Market is Vulnerable to Coordinated Conduct

The Agencies presume that market conditions are conducive to coordinated interaction if firms representing a substantial share in the relevant market appear to have previously engaged in express collusion affecting the relevant market, unless competitive conditions in the market have since changed significantly. Previous express collusion in another geographic market will have the same weight if the salient characteristics of that other market at the time of the collusion are comparable to those in the relevant market. Failed previous attempts at collusion in the relevant market suggest that successful collusion was difficult pre-merger but not so difficult as to deter attempts, and a merger may tend to make success more likely. Previous collusion or attempted collusion in another product market may also be given substantial weight if the salient characteristics of that other market at the time of the collusion are closely comparable to those in the relevant market.

A market typically is more vulnerable to coordinated conduct if each competitively important firm's significant competitive initiatives can be promptly and confidently observed by that firm's rivals. This is more likely to be the case if the terms offered to customers are relatively transparent. Price transparency can be greater for relatively homogeneous products. Even if terms of dealing are not transparent, transparency regarding the identities of the firms serving particular customers can give rise to coordination, e.g., through customer or territorial allocation. Regular monitoring by suppliers of one another's prices or customers can indicate that the terms offered to customers are relatively transparent.

A market typically is more vulnerable to coordinated conduct if a firm's prospective competitive reward from attracting customers away from its rivals will be significantly diminished by likely responses of those rivals. This is more likely to be the case, the stronger and faster are the responses the firm anticipates from its rivals. The firm is more likely to anticipate strong responses if there are few significant competitors, if products in the relevant market are relatively homogeneous, if customers find it relatively easy to switch between suppliers, or if suppliers use meeting-competition clauses.

A firm is more likely to be deterred from making competitive initiatives by whatever responses occur if sales are small and frequent rather than via occasional large and long-term contracts or if relatively few customers will switch to it before rivals are able to respond. A firm is less likely to be deterred by whatever responses occur if the firm has little stake in the status quo. For example, a firm with a small market share that can quickly and dramatically expand, constrained neither by limits on production nor by customer reluctance to switch providers or to entrust business to a historically small provider, is unlikely to be deterred. Firms are also less likely to be deterred by whatever responses occur if competition in the relevant market is marked by leapfrogging technological innovation, so that responses by competitors leave the gains from successful innovation largely intact.

A market is more apt to be vulnerable to coordinated conduct if the firm initiating a price increase will lose relatively few customers after rivals respond to the increase. Similarly, a market is more apt to be vulnerable to coordinated conduct if a firm that first offers a lower price or improved product to customers will retain relatively few customers thus attracted away from its rivals after those rivals respond.

The Agencies regard coordinated interaction as more likely, the more the participants stand to gain from successful coordination. Coordination generally is more profitable, the lower is the market elasticity of demand.

Coordinated conduct can harm customers even if not all firms in the relevant market engage in the coordination, but significant harm normally is likely only if a substantial part of the market is subject to such conduct. The prospect of harm depends on the collective market power, in the relevant market, of firms whose incentives to compete are substantially weakened by coordinated conduct. This collective market power is greater, the lower is the market elasticity of demand. This collective market power is diminished by the presence of other market participants with small market shares and little stake in the outcome resulting from the coordinated conduct, if these firms can rapidly expand their sales in the relevant market.

Buyer characteristics and the nature of the procurement process can affect coordination. For example, sellers may have the incentive to bid aggressively for a large contract even if they expect strong responses by rivals. This is especially the case for sellers with small market shares, if they can realistically win such large contracts. In some cases, a large buyer may be able to strategically undermine coordinated conduct, at least as it pertains to that buyer's needs, by choosing to put up for bid a few large contracts rather than many smaller ones, and by making its procurement decisions opaque to suppliers.

8. Powerful Buyers

Powerful buyers are often able to negotiate favorable terms with their suppliers. Such terms may reflect the lower costs of serving these buyers, but they also can reflect price discrimination in their favor.

The Agencies consider the possibility that powerful buyers may constrain the ability of the merging parties to raise prices. This can occur, for example, if powerful buyers have the ability and incentive to vertically integrate upstream or sponsor entry, or if the conduct or presence of large buyers undermines coordinated effects. However, the Agencies do not presume that the presence of powerful buyers alone forestalls adverse competitive effects flowing from the merger. Even buyers that can negotiate favorable terms may be harmed by an increase in market power. The Agencies examine the choices available to powerful buyers and how those choices likely would change due to the merger. Normally, a merger that eliminates a supplier whose presence contributed significantly to a buyer's negotiating leverage will harm that buyer.

> *Example 22:* Customer C has been able to negotiate lower pre-merger prices than other customers by threatening to shift its large volume of purchases from one merging firm to the other. No other suppliers are as well placed to meet Customer C's needs for volume and reliability. The merger is likely to harm Customer C. In this situation, the Agencies could identify a price discrimination market consisting of Customer C and similarly placed customers. The merger threatens to end previous price discrimination in their favor.

Furthermore, even if some powerful buyers could protect themselves, the Agencies also consider whether market power can be exercised against other buyers.

> *Example 23:* In Example 22, if Customer C instead obtained the lower pre-merger prices based on a credible threat to supply its own needs, or to sponsor new entry, Customer C might not be harmed. However, even in this case, other customers may still be harmed.

9. Entry

The analysis of competitive effects in Sections 6 and 7 focuses on current participants in the relevant market. That analysis may also include some forms of entry. Firms that would rapidly and easily enter the market in response to a SSNIP are market participants and may be assigned market shares. See Sections 5.1 and 5.2. Firms that have, prior to the merger, committed to entering the market also will normally be treated as market participants. See Section 5.1. This section concerns entry or adjustments to pre-existing entry plans that are induced by the merger.

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about price, quality, wages, or another dimension of competition. Section 4.2 describes a variety of approaches to measuring such impacts.

Additional Evidence, Tools, and Metrics. The Agencies may use additional evidence, tools, and metrics to assess the loss of competition between the firms. Depending on the realities of the market, different evidence, tools, or metrics may be appropriate.

Section 4.2 provides additional detail about the approaches that the Agencies use to assess competition between or among firms.

2.3. Guideline 3: Mergers Can Violate the Law When They Increase the Risk of Coordination.

The Agencies determine that a merger may substantially lessen competition when it meaningfully increases the risk of coordination among the remaining firms in a relevant market or makes existing coordination more stable or effective.[19] Firms can coordinate across any or all dimensions of competition, such as price, product features, customers, wages, benefits, or geography. Coordination among rivals lessens competition whether it occurs explicitly—through collusive agreements between competitors not to compete or to compete less—or tacitly, through observation and response to rivals. Because tacit coordination often cannot be addressed under Section 1 of the Sherman Act, the Agencies vigorously enforce Section 7 of the Clayton Act to prevent market structures conducive to such coordination.

Tacit coordination can lessen competition even when it does not rise to the level of an agreement and would not itself violate the law. For example, in a concentrated market a firm may forego or soften an aggressive competitive action because it anticipates rivals responding in kind. This harmful behavior is more common the more concentrated markets become, as it is easier to predict the reactions of rivals when there are fewer of them.

To assess the extent to which a merger may increase the likelihood, stability, or effectiveness of coordination, the Agencies often consider three primary factors and several secondary factors. The Agencies may consider additional factors depending on the market.

2.3.A. Primary Factors

The Agencies may conclude that post-merger market conditions are susceptible to coordinated interaction and that the merger materially increases the risk of coordination if any of the three primary factors are present.

Highly Concentrated Market. By reducing the number of firms in a market, a merger increases the risk of coordination. The fewer the number of competitively meaningful rivals prior to the merger, the greater the likelihood that merging two competitors will facilitate coordination. Markets that are highly concentrated after a merger that significantly increases concentration (see Guideline 1) are presumptively susceptible to coordination. If merging parties assert that a highly concentrated market is not susceptible to coordination, the Agencies will assess this rebuttal evidence using the framework

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[19] *See Brooke Grp. Ltd. v. Brown & Williamson Tobacco Corp.,* 509 U.S. 209, 229-30 (1993) ("In the § 7 context, it has long been settled that excessive concentration, and the oligopolistic price coordination it portends, may be the injury to competition the Act prohibits.").

described below. Where a market is not highly concentrated, the Agencies may still consider other risk factors.

Prior Actual or Attempted Attempts to Coordinate. Evidence that firms representing a substantial share in the relevant market appear to have previously engaged in express or tacit coordination to lessen competition is highly informative as to the market's susceptibility to coordination. Evidence of failed attempts at coordination in the relevant market suggest that successful coordination was not so difficult as to deter attempts, and a merger reducing the number of rivals may tend to make success more likely.

Elimination of a Maverick. A maverick is a firm with a disruptive presence in a market. The presence of a maverick, however, only reduces the risk of coordination so long as the maverick retains the disruptive incentives that drive its behavior. A merger that eliminates a maverick or significantly changes its incentives increases the susceptibility to coordination.

2.3.B. Secondary Factors

The Agencies also examine whether secondary factors demonstrate that a merger may meaningfully increase the risk of coordination, even absent the primary risk factors. Not all secondary factors must be present for a market to be susceptible to coordination.

Market Concentration. Even in markets that are not highly concentrated, coordination becomes more likely as concentration increases. The more concentrated a market, the more likely the Agencies are to conclude that the market structure suggests susceptibility to coordination.

Market Observability. A market is more susceptible to coordination if a firm's behavior can be promptly and easily observed by its rivals. Rivals' behavior is more easily observed when the terms offered to customers are readily discernible and relatively observable (that is, known to rivals). Observability can refer to the ability to observe prices, terms, the identities of the firms serving particular customers, or any other competitive actions of other firms. Information exchange arrangements among market participants, such as public exchange of information through announcements or private exchanges through trade associations or publications, increase market observability. Regular monitoring of one another's prices or customers can indicate that the terms offered to customers are relatively observable. Pricing algorithms, programmatic pricing software or services, and other analytical or surveillance tools that track or predict competitor prices or actions likewise can increase the observability of the market.

Competitive Responses. A market is more susceptible to coordination if a firm's prospective competitive reward from attracting customers away from its rivals will be significantly diminished by its rivals' likely responses. This is more likely to be the case the stronger and faster the responses from its rivals because such responses reduce the benefits of competing more aggressively. Some factors that increase the likelihood of strong or rapid responses by rivals include: (1) the market has few significant competitors, (2) products in the relevant market are relatively homogeneous, (3) customers find it relatively easy to switch between suppliers, (4) suppliers use algorithmic pricing, or (5) suppliers use meeting-competition clauses. The more predictable are rivals' responses to strategic actions or changing competitive conditions, and the more interactions firms have across multiple markets, the greater the susceptibility to coordination.

Aligned Incentives. Removing a firm that has different incentives from most other firms in a market can increase the risk of coordination. For example, a firm with a small market share may have

less incentive to coordinate because it has more to gain from winning new business than other firms. The same issue can arise when a merger more closely aligns one or both merging firms' incentives with the other firms in the market. In some cases, incentives might be aligned or strengthened when firms compete with one another in multiple markets ("multi-market contact"). For example, firms might compete less aggressively in some markets in anticipation of reciprocity by rivals in other markets. The Agencies examine these and any other market realities that suggest aligned incentives increase susceptibility to coordination.

Profitability or Other Advantages of Coordination for Rivals. The Agencies regard coordinated interaction as more likely to occur when participants in the market stand to gain more from successful coordination. Coordination generally is more profitable or otherwise advantageous for the coordinating firms the less often customers substitute outside the market when firms offer worse terms.

Rebuttal Based on Structural Barriers to Coordination Unique to the Industry. When market structure evidence suggests that a merger may substantially lessen competition through coordination, the merging parties sometimes argue that anticompetitive coordination is nonetheless impossible due to structural market barriers to coordinating. The Agencies consider this rebuttal evidence using the framework in Section 3. In so doing, the Agencies consider whether structural market barriers to coordination are "so much greater in the [relevant] industry than in other industries that they rebut the normal presumption" of coordinated effects.[20] In the Agencies' experience, structural conditions that prevent coordination are exceedingly rare in the modern economy. For example, coordination is more difficult when firms are unable to observe rivals' competitive offerings, but technological change has made this situation less common than in the past and reduced many traditional barriers or obstacles to observing the behavior of rivals in a market. The greater the level of concentration in the relevant market, the greater must be the structural barriers to coordination in order to show that no substantial lessening of competition is threatened.

2.4. Guideline 4: Mergers Can Violate the Law When They Eliminate a Potential Entrant in a Concentrated Market.

Mergers can substantially lessen competition by eliminating a potential entrant. For instance, a merger can eliminate the possibility that entry or expansion by one or both firms would have resulted in new or increased competition in the market in the future. A merger can also eliminate current competitive pressure exerted on other market participants by the mere perception that one of the firms might enter. Both of these risks can be present simultaneously.

A merger that eliminates a potential entrant into a concentrated market can substantially lessen competition or tend to create a monopoly.[21] The more concentrated the market, the greater the magnitude of harm to competition from any lost potential entry and the greater the tendency to create a monopoly. Accordingly, for mergers involving one or more potential entrants, the higher the market concentration, the lower the probability of entry that gives rise to concern.

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[20] *See H.J. Heinz Co.*, 246 F.3d at 724.
[21] *United States v. Marine Bancorp.*, 418 U.S. 602, 630 (1974). A concentrated market is one with an HHI greater than 1,000 (See Guideline 1, n.15).

FTC. V. OSF HEALTHCARE SYS.,
852 F. Supp. 2d 1069, 1086 (N.D. Ill. 2012)
(excerpt on coordinated effects[1])

FREDERICK J. KAPALA, J.

[The FTC sought a preliminary injunction under FTC Act § 13(b) to enjoin the defendants, OSF Healthcare System ("OSF") and Rockford Health System ("RHS"), from consummating their affiliation agreement executed on January 31, 2011, or otherwise acquiring each other's assets or interests. The FTC alleged, among other things, that the arrangement would create a highly concentrated market and increase the likelihood of coordinated effects.]

. . .

b. Coordinated effects

Defendants next argue that the FTC has no evidence that the merger will result in any unlawful coordination. "A merger may diminish competition by enabling or encouraging post-merger coordinated interaction among firms in the relevant market that harms customers." Merger Guidelines § 7; *see also Hosp. Corp*. [*v. FTC*], 807 F.2d [1381] at 1387 [7th Cir. 1986)] ("The fewer competitors there are in a market, the easier it is for them to coordinate their pricing . . . ."). Although "the risk that a merger will induce adverse coordinated effects may not be susceptible to quantification or detailed proof," such a risk can be evaluated by reviewing market concentration and any history of collusion in the relevant market. Merger Guidelines § 7.1. Here, the relevant market is highly concentrated and there is at least some history of coordinated efforts among the Rockford hospitals.

Generally, once "the government has established its prima facie case [through the *PNB* presumption], the burden is on the defendants to produce evidence of 'structural market barriers to collusion' specific to this industry that would defeat the 'ordinary presumption of collusion' that attaches to a merger in a highly concentrated market." *H & R Block*, 833 F. Supp. 2d at 76 (quoting [*FTC v. H.J.*] *Heinz* [*Co.*], 246 F.3d [708] at 725 [(D.C. Cir. 2001)]). In this case, however, the FTC has not relied solely on its prima facie case, but has also detailed several incidents which it claims demonstrate coordinated activity. While the court finds that some of the claimed coordination is fairly benign, such as hiring a consultant to help evaluate the healthcare market in the region, there is some evidence that suggests that there is a risk of coordinated activity by the hospitals in Rockford after the merger, especially once "communication becomes easier and more effective" with only two competitors.

The first example showing at least some history of coordination involves efforts by one hospital to determine if it was in a bidding war against a competitor for a contract

[1] Citations to briefs and the evidentiary record and to footnotes omitted.

with a health insurance company. The first hospital contacted the Managed Care Director for the competitor and was told that they were not in contract negotiations with the insurance company at that time. "[T]he ultimate effect [of this coordinated activity] was that they did not agree to give the larger discount to the health plan in question, but instead held out for a higher amount" of reimbursement from the health plan. Another example involves two of the hospitals allegedly contacting a health plan and stating that, if the health plan wanted to contract with either one of them, it had to exclude the third hospital from its network. This evidence of hospitals putting up a type of "united front in negotiations with the third-party payors" is an example of the dangers of collusion that the antitrust laws seek to prevent. *Hosp. Corp*., 807 F.2d at 1389.

Defendants try to rebut the FTC's charge that the proposed merger comes with an increased risk of unlawful coordination by arguing generally that the FTC's theory is implausible, that the facts it relies on are stale, and that the executives at all three hospitals have testified that they would not allow coordinated behavior to occur in the future. These arguments are insufficient to overcome the presumption of collusion that arises from the combination of the FTC's strong prima facie case, see *H & R Block*, 833 F. Supp. 2d at 76–77, and the evidence of coordinated behavior discussed above. First, defendants' argument that it is implausible to suggest that the merger would allow OSF Northern Region to both exclude and collude with SwedishAmerican misconstrues the FTC's position. Although the court agrees that OSF Northern Region could not simultaneously both exclude and collude, plaintiff's expert explained that the combined entity could use the threat of exclusion to induce collusive behavior from SwedishAmerican. Second, the court disagrees with defendants' characterizations of the FTC's evidence as stale, where the conduct the court finds most damaging occurred within the past seven years. Finally, relying on the testimony of hospital executives adds little to the analysis of this particular issue, as they would be expected to publically disavow any improper conduct and not condone such conduct in the future.

Based on the foregoing, the court agrees with the FTC that the proposed merger in this case does involve an increased risk of coordinated conduct in the relevant market, and that defendants have failed to successfully rebut this aspect of the FTC's case. To be clear, the court is not finding that the hospitals would necessarily collude after the merger, only that this merger adds to the risk of such behavior. Accordingly, the court finds that the FTC has raised serious and substantial questions on the issue of coordinated behavior that require further investigation and determination during the merits trial.

NOTES

1. *OSF* unfortunately followed *H&R Block* in concluding its analysis of the DOJ's prima facie case with nothing more than the *PNB* presumption. It did not follow the rubric of the 2010 DOJ/FTC Horizontal Merger Guidelines and look at the other evidence the DOJ presented to strengthen the *PNB* presumption as more modern courts do.

IN RE TRONOX LTD.,
Slip op. at 33-43, No. 9377 (F.T.C. Dec. 14, 2018) (initial decision)
(excerpt on coordinated effects[1])

D. MICHAEL CHAPPELL, Chief Administrative Law Judge

[The FTC sought a preliminary injunction under FTC Act § 13(b) to enjoin the acquistion by Tronox Limited of the National Titanium Dioxide Company's titanium dioxide (TiO_2) business (known as "Cristal") for $1.67 billion in cash and a 24% equity stake in the combined firm. TiO_2 is a pigment used to add whiteness, brightness, and opacity to products like paints, plastics, and paper. It is manufactured by subjecting raw titanium ores to either a chloride or a sulfate production process. A central issue in the case was the relevant product market definition. The FTC alleged, among other things, that the acquisition created a highly concentrated market and increased the likelihood of coordinated effects.]

. . .

2. Reasonable probability of anticompetitive effects

a. Overview

As the court explained in *ProMedica Health Systems v. FTC*, anticompetitive effects of a merger can include coordinated effects and/or unilateral effects.

> [T]he idea behind coordinated effects is that, "where rivals are few, firms will be able to coordinate their behavior, either by overt collusion or implicit understanding in order to restrict output and achieve profits above competitive levels." *H&R Block*, 833 F. Supp. 2d at 77. . . . Unilateral effects theory, on the other hand, holds that "[t]he elimination of competition between two firms that results from their merger may alone constitute a substantial lessening of competition." Merger Guidelines § 6 at 20.

749 F.3d 559, 568-69 (6th Cir. 2014). In the instant case, to support the argument that the Acquisition is likely to have anticompetitive effects, Complaint Counsel asserts: (1) the Acquisition will facilitate coordination among competitors, in a highly concentrated market that is vulnerable to coordination (coordinated effects); and (2) the Acquisition will enable the combined entity to engage in strategic output withholding, in a market with incentives for and a history of such conduct (unilateral effects). Respondents dispute that anticompetitive effects are likely, arguing that the evidence fails to show that coordination among competitors or unilateral strategic output withholding by the combined entity is likely. The question of likely coordinated effects is analyzed below.

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[1] Citations to briefs and to factual findings with parentheticals omitted.

b. Likelihood of coordinated effects

i. Legal principles

"Tacit collusion, sometimes called oligopolistic price coordination or conscious parallelism, describes the process, not in itself unlawful, by which firms in a concentrated market might in effect share monopoly power, setting their prices at a profit-maximizing, supracompetitive level by recognizing their shared economic interests and their interdependence with respect to price and output decisions." *Brooke Group v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 227 (1993). *See also* Merger Guidelines § 7 (Coordinated interaction includes an implied understanding or parallel accommodating conduct not pursuant to a prior understanding.).

> Coordinated interaction involves conduct by multiple firms that is profitable for each of them only as a result of the accommodating reactions of the others. These reactions can blunt a firm's incentive to offer customers better deals by undercutting the extent to which such a move would win business away from rivals. They also can enhance a firm's incentive to raise prices, by assuaging the fear that such a move would lose customers to rivals.

Merger Guidelines § 7.

"It is a central object of merger policy to obstruct the creation or reinforcement by merger" of market structures in which tacit coordination can occur. [*FTC v.*] *Heinz*, 246 F.3d [246,] at 725 [(D.C. Cir. 2001)]. "Tacit coordination is feared by antitrust policy even more than express collusion, for tacit coordination, even when observed, cannot easily be controlled directly by the antitrust laws." *Id*. "[P]ermit[ting] mergers to be challenged prior to their occurrence and thus before the harm from coordinated interaction has materialized . . . is particularly valuable in situations where coordinated interaction is difficult to detect and remedy directly under § 1 of the Sherman Act." Herbert Hovenkamp, *Prophylactic Merger Policy*, HASTINGS L.J. (August 2018) at 12.

It is not necessary to prove that tacit coordination has already occurred in order to demonstrate a reasonable probability of future coordination. *See* [*FTC v.*] *Arch Coal*, [*Inc.*,]329 F. Supp. 2d [109,] at 116 [D.D.C. 2004)] ("While proof of prior cooperative behavior is relevant, it is not a necessary element of likely future coordination in violation of Section 7.")

ii. Analysis

Under the Merger Guidelines, a merger may substantially lessen competition if: (1) the merger would significantly increase concentration and lead to a moderately or highly concentrated market; (2) that market shows signs of vulnerability to coordinated conduct; and (3) the merger is likely to enhance that vulnerability. Merger Guidelines § 7.1. As shown above, the evidence proves that the Acquisition in this case would significantly increase concentration in the relevant market and lead to a highly concentrated market. As discussed below, the evidence further proves that the North American chloride TiO2 market is vulnerable to coordinated conduct, and that this vulnerability will be enhanced by the Acquisition. *See generally* Merger Guidelines § 7.2 (discussing factors evidencing vulnerability to coordination).

First, with only five participants selling chloride TiO2 in North America, the number of firms in the relevant market is small. "The fewer competitors there are in a market, the easier it is for them to coordinate their pricing without committing detectable violations of section 1 of the Sherman Act . . . ." *Hosp. Corp. of Am. v. FTC*, 807 F.2d 1381, 1387 (7th Cir. 1986). In the instant case, the Acquisition will reduce the number of firms to four, thereby making it easier for the remaining firms to coordinate on price or output. *See* [*FTC v.*] *Elders Grain*, [*Inc.*,] 868 F.2d. [901,] at 905 [(D.C. Cir. 1989)] (holding that acquisition reducing firms from six to five would make it easier for leading members of the industry to collude on price and output); [*FTC v.*] *Univ. Health*, [*Inc.*,] 938 F.2d [1206,] at 1219 [(11th Cir. 1991)] (holding that four businesses remaining after merger could easily collude to raise price and decrease output without committing detectable violations of the Sherman Act). In particular, the Acquisition would not only simplify coordination by eliminating Cristal, a current competitor, but would also create a new firm of a similar size to Chemours, the current market leader. Indeed, the Acquisition will result in only two firms—Tronox and Chemoursεin control of [redacted—nearly three-quarters] of North American sales, and over of [redacted] North American capacity. "With only two dominant firms left in the market, the incentives to preserve market shares would be even greater, and the costs of price cutting riskier, as an attempt by either firm to undercut the other may result in a debilitating race to the bottom." [*FTC v.*] *CCC Holdings* [*Inc.*], 605 F. Supp. 2d [26,] at 67 [(D.D.C. 2009)].

Second, chloride TiO2 is a commodity product. Markets for homogenous products are more susceptible to coordination. One reason for this is that reactions by rivals to attempts to steal their business are likely to be strong, given that each firm's product is largely interchangeable with its rivals' products. In this case, given the small number of market participants in the relevant market, and the commodity nature of chloride TiO2, the market is fairly characterized as an oligopoly. *See* [4A PHILLIP E.] AREEDA [& HERBERT HOVENKAMP, ANTITRUST LAW] ¶ 1429a at 221 [(3d ed. 2009)]; *Blomkest Fertilizer, Inc. v. Potash Corp. of Saskatchewan, Inc.*, 203 F.3d 1028, 1031 n.3 (8th Cir. 2000) (quoting Black's Law Dictionary 1086 (6th ed. 1990)); *see also* Preliminary Injunction Opinion, [*FTC v. Tronox Ltd.*, 332 F. Supp. 3d 187, 195 (D.D.C. 2018)] ("The titanium dioxide market has been described as an 'oligopoly,' as TiO2 is a 'commodity-like product with no substitutes, the market is dominated by a handful of firms, and there are substantial barriers to entry.'" (quoting *Valspar Corp. v. E.I. Du Pont De Nemours & Co.*, 873 F.3d 185, 190 (3d Cir. 2017)).

Third, mutually recognized interdependence is indicative of a market that is vulnerable to coordination. In such a market, each [competitor] knows that his choice will affect the others, who are likely to respond, and that their responses will affect the profitability of his initial choice. Each knows that expanding his sales or lowering his price will reduce the sales of rivals, who will notice that fact, identify the cause, and probably respond with a matching price reduction. Unless he can somehow conceal his price reduction, or unless his own position is improved by a lower market price, he will hesitate to reduce prices at all. Areeda ¶ 1410b at 65 (emphasis and footnote omitted). Recognized interdependence is a distinct characteristic of an oligopolistic

market. Areeda ¶ 404a; *see also Rebel Oil Co. v. Atlantic Richfield Co*., 51 F.3d 1421, 1443 (9th Cir. 1995) ("[b]y definition, oligopolists are interdependent . . ." (citation omitted); *In re Flat Glass Antitrust Litig*., 385 F.3d 350, 359 (3rd Cir. 2004) (explaining that a participant in an oligopoly market "'must take into account the anticipated reaction of the other [] firms'") (citation omitted)).

In the instant case, the evidence proves that the North American chloride TiO2 market is characterized by mutually recognized interdependence. As acknowledged in a November 2016 Tronox presentation, the "TiO2 market shows oligopoly pricing behavior (one supplier can drive price down, action of all suppliers needed to pull prices up)." Indeed, the record is replete with testimony and documents from Tronox and Cristal demonstrating recognized interdependence among market participants. *E.g.*, F. 207 (Tronox's Mr. Romano testifying that "it only takes one to make the price go down. The whole market has to go up. But any one competitor can make pricing go down."); F. 212 (Tronox's Mr. Romano testifying that success of a price increase "depends on what our competition is doing"); F. 213 (Tronox's Mr. Casey stating in an email: "[T]he success of this [Tronox December 2015 price increase] initiative will be materially affected by how Huntsman [now Venator], Cristal and Kronos respond. Chemours announced an equivalent price increase yesterday . . . ."); F. 208 (Mr. Gigou of Cristal testifying that when considering whether to issue a price increase and for what amount, Cristal takes into account information from customers regarding other TiO2 suppliers); F. 217 (Mark Stoll, general manager of mergers and acquisitions for Cristal, stating in a 2012 email: "In current market conditions of excessive inventory we cannot raise price and gain market share at the same time unless all suppliers support the price movement.").

In addition, the evidence shows mutual accommodating conduct by chloride TiO2 producers in order to support market discipline and avoid triggering adverse competitor responses. For example, in a July 2015 email discussing pricing for a customer, Mr. Duvekot of Tronox wrote: "Especially on a highly visible account like [this particular customer] any price move will be seen by the competitors, even more so if we use it to take a piece of the pie. That will cause a reaction from the competition, at this account or elsewhere in the market, which will just lead to more price erosion in the market. Tronox does not want to play this game (anymore)." In a March 2016 email, Tronox's Mr. Mouland wrote to two salespeople: "We will have to pass on this opportunity as I do not want to undercut a competitor. The price increase is taking hold and any attempt to get volume at the expense of price could undermine our progress." F. 246. *See also* F. 231 ("The problem we face is that pricing is falling and if we take action to go after market share, price will deteriorate further and we do not want [to] facilitate or fuel that process. Everyone is defending their business and matching offers from the competition to maintain their share as no one want[s] to loose [sic] business."); F. 235 (Cristal email stating: "All of the large global TiO2 suppliers are still acting in a disciplined manner, respecting each other's market positions and share and holding on to price. No volume stalking of any great consequence is taking place yet, which is very good news.").

Fourth, "[a] market typically is more vulnerable to coordinated conduct if each competitively important firm's significant competitive initiatives can be promptly and confidently observed by that firm's rivals. . . . Regular monitoring by suppliers of one another's prices or customers can indicate that the terms offered to customers are relatively transparent." Merger Guidelines § 7.2. *See also* [*United States v.*] *Oracle*, [*Corp.*,] 331 F. Supp. 2d [1098,] at 1166 [N.D. Cal. 2004)] ("Without homogeneity or transparency, the market conditions are not conducive to coordinated effects, either tacit or express."). The evidence in this case shows that TiO2 suppliers monitor, and are able to observe, significant moves by their competitors, including as to price and output, from public statements by competitors and information obtained from customers.

Tronox and Cristal monitor and analyze public statements by competitors such as quarterly earnings updates, presentations at industry conferences, and ratings agency meetings. For example, Tronox's Mr. Engle, vice president of marketing, listens to competitors' earnings calls to learn about their production plans and other announcements, and to obtain competitive intelligence. Indeed, these sources represent Tronox's largest source of competitor intelligence. Reports and analyses are provided to Tronox's executives. Cristal also monitors TiO2 competitors' public calls and circulates detailed analyses to executives, highlighting information such as production curtailments, capacity utilization, and planned price increases.

The information provided in public earnings calls and similar public presentations can be specific. Tronox discusses in its quarterly results earnings calls such matters as changes in sales volume, changes in the selling prices by region, margin information, and operation related information such as relative plant utilization rate and inventory levels. Tronox publicly announced in a second quarter 2015 earnings call its decision to reduce production at two facilities, including Tronox's Hamilton plant, and specifically noted that "these processing line curtailments represent approximately 15% of total pigment production." In a first quarter 2016 conference call, Tronox described its plan to continue to be "disciplined" about production and not to bring back "full production" on the first sign of price recovery. In a second quarter 2016 earnings call, Chemours stated its prediction that for "the rest of the year, you'll see a cadence up in our price as you look at third quarter . . . ." At a basic materials conference sponsored by Goldman Sachs, the executive vice president of Huntsman (now Venator) stated: "Well, there's the April 1 effective price increase. It was roughly $235 a ton, nominated. And we have communicated and signaled that we would expect the realization on that price would be on the upper end of what we've been realizing over the last 3 or 4 quarters. That is closer to 2/3, 70% realization.".

Publically disclosing information in a market characterized by interdependence can serve as a signal to the market, enhancing predictability and the potential for tacit coordination. North American chloride TiO2 producers over the years have increased TiO2 prices typically in close proximity to each other in time. For example, Chemours announced a price increase of $150 per metric ton on December 17, 2015. Within about a half hour of learning this information, Mr. Casey of Tronox reacted by directing that "[w]e will put out a [redacted] global price increase announcement of our own before

9:30 tomorrow," which Tronox did. In an internal email, Tronox explained that, with its price increase, Tronox was "testing whether [the market] is ready for price increases or at least to stop declines." Cristal learned of the price increase by Tronox on the same day it was announced, and remarked in an internal email: "Tronox follows the trend. . . . Expectedly, other TiO2 manufacturer's [sic] may follow the trend." Cristal characterized these announced pricing moves as "an initiative to taste the market readiness to accept this announced price increase." Later that day on December 18, 2015, Cristal confirmed that both Chemours and Huntsman had also announced price increases. From Cristal's perspective, the December 2015 price increase announcements were "[n]ot based on supply/demand dynamics."

In another example, shortly after Tronox publicly announced in its second quarter 2015 earnings call its decision to reduce production at its Hamilton plant, Chemours closed its Edge Moor plant in Delaware, and shut down a production line at its Johnsonville, Tennessee plant, removing 150,000 metric tons of capacity. Tronox considered this "Good news!!" with then-CEO Mr. Casey responding that "[i]t's good that [Chemours] can follow the leader!"

The Acquisition will increase the competitive information available to market participants through earnings calls and similar public presentations. Tronox, Chemours, Kronos, and Venator are publically traded companies, and therefore required to report earnings and similar business information to investors and others in the ordinary course of business. Presently, Cristal is a privately held company. With the merger, all participants will be reporting as public companies.

Chloride TiO2 producers also monitor competitive actions in the market through information obtained from their customers. It is part of Tronox's price increase implementation process to collect competitive intelligence on its competitors' pricing in order to assess whether its competitors are "maintain[ing] a disciplined approach" with respect to a price increase. Customer-provided information is included in reports provided to senior management and is used to make pricing decisions. In many instances, this can include specific pricing information. *E.g.*, F. 276 ("Per [redacted] , Purchasing Mgr, Kronos and DuPont have moved their price by [redacted]"); F. 276 ("customer confirmed Kronos is taking them up "; F. 276 (describing that Cristal is offering [redacted] per pound lower than Tronox at [redacted]); F. 279 (Cristal email reporting that customer "indicated that Huntsman offered [redacted] for volume . . . "); F. 279 (internal Cristal email stating: "Our refusal to . . . meet [redacted] price resulted in [a customer] moving 5 trucks per month away from us and over to [redacted] . . ."). Competitor price information, once disclosed, gets further communicated within the market "from competitor to customer to other supplier."[10]

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[10] Respondents contend that customer-provided pricing information is not reliable because customers in a negotiation may not necessarily be truthful about competing offers. RRFF 476-85. However, the fact that suppliers report and rely on customer-provided competitor pricing information in making their own pricing decision is indicative of the information's reliability. In addition, Cristal's redbook, a data compilation, uses customer-provided sales information to track suppliers' sales volumes, and market share data calculated from the data proved to be a close match to market

Fifth, the fact that the chloride TiO2 market has low demand elasticity makes coordination more profitable, which increases incentives to coordinate. Price elasticity of demand is how responsive demand is to changes in price. Inelastic demand makes a market more susceptible to coordination because if prices of all firms were to rise, few sales would be lost, which makes the reward for coordinating greater. Here, the price elasticity of demand for chloride TiO2 in North America is low.[11]

iii. Respondents' opposing arguments

Respondents argue that Complaint Counsel has failed to prove that coordinated effects are likely, citing *United States v. Oracle Corporation*, 331 F. Supp. 2d 1098 (N.D. Cal. 2004). RB at 57. Oracle does not support Respondents' argument. In that case, the court denied a preliminary injunction under Section 7, finding, among other things, that "the products of Oracle and SAP are not homogeneous, but are differentiated products, and that the pricing of these products is not standardized or transparent." 331 F. Supp. 2d at 1109. Indeed, the plaintiffs in Oracle did not contend that any of those conditions were present in the proposed merger. *Id*. at 1113. In the instant case, by contrast, the evidence proves that chloride TiO2 is a commodity product and suppliers are able to gain relatively detailed and specific information about competitors' pricing.

Respondents further assert that the evidence fails to show coordination has occurred in the past. However, as explained above, proof of prior tacit coordination is not necessary to demonstrate a reasonable probability of future coordination. *See Arch Coal*, 329 F. Supp. 2d at 116. Respondents additionally contend that coordination would be difficult to conceive, monitor, or enforce because announced prices are not necessarily the actual price paid by customers; rather, prices are individually negotiated with each customer. Respondents' argument ignores the facts that suppliers obtain reliable information about actual prices being offered by the competition directly from customers, among other sources, and that such information spreads to other suppliers in the market. Moreover, knowledge of precise competitor pricing is not necessary to be able to coordinate price movements through parallel price increases, which are publicly disclosed. In any event, it is not necessary to demonstrate that market participants can form and enforce an agreement. Coordinated interaction includes a range of conduct, and can involve parallel conduct "in which each rival's response to competitive moves made by others is individually rational, and not motivated by retaliation or deterrence but nevertheless emboldens price increases and

shares calculated from actual data derived from suppliers' invoices. The totality of the evidence belies the notion that customers routinely provide false information as part of the negotiation process.

[11] It is also noteworthy that customers in the relevant market are concerned about the increased consolidation of suppliers post-Acquisition. F. 293 (Mr. Vanderpool of True Value testifying: "[We're] going from five major suppliers down to four major suppliers . . . . [redacted]. So we see raw material prices continue to go up and tightening in the market from allocation, and that's a very big concern of ours"); F. 294 (Ampacet email stating, "The acquisition of Cristal by Tronox is cause for concern for Ampacet" noting the "20% reduction in [its] supply base").

weakens competitive incentives to reduce prices or offer customers better terms." Merger Guidelines § 7.

Respondents also argue that TiO2 sales are subject to "fierce competition." Respondents assert that most customer contracts do not set price but rather provide for prices to be negotiated; that contracts typically contain an option to switch suppliers if they find a better price (a "meet or release" clause), which can result in a lower price; and that buyers "pit" suppliers against each other to obtain a lower price. However, such evidence does not logically preclude a finding that the market is also vulnerable to coordination, particularly where, as here, the market is characterized by oligopolistic interdependence, exacerbated by relative transparency and product homogeneity.[12] Furthermore, "[a]s the statutory language suggests, Congress enacted Section 7 to curtail anticompetitive harm in its incipiency." [*In re*] *Polypore* , [Int'l, Inc., 150 F.T.C. 586, 598 (FTC Nov. 5, 2010) (No. D-9327),] 2010 WL 9549988 at *8 (citing *Chicago Bridge* [& Iron Co. v. FTC], 534 F.3d [410,] at 423 [(5th Cir. 2008)]) (emphasis added). *See also* Merger Guidelines § 7.1 ("Pursuant to the Clayton Act's incipiency standard, the Agencies may challenge mergers that in their judgment pose a real danger of harm through coordinated effects, even without specific evidence showing precisely how the coordination likely would take place.").

iv. Summary

Based on the foregoing, the evidence proves that the North American chloride TiO2 market is vulnerable to coordinated conduct, and that this vulnerability will be enhanced by the Acquisition.

NOTES

1. The theory of coordinated effects has two elements: (a) the relevant market must be susceptible to coordinated interaction (oligopolistic interdependence); and (b) the merger must increase the likelihood or success of coordinated interaction. In the *Tronox* excerpt, be sure you know the headline factual findings supporting each element. Note that most of the factual findings go to susceptibility; if a market is susceptible to coordinated interaction, the then elimination of the independence of a major competitor through a horizontal merger is usually enough to support a finding of increased likelihood or success.

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[12] According to the Merger Guidelines, "meet or release" clauses tend to increase the vulnerability of a market to coordinated interaction by increasing visibility of competitive initiatives. *See* Merger Guidelines § 7.2 ("A market typically is more vulnerable to coordinated conduct if a firm's prospective competitive reward from attracting customers away from its rivals will be significantly diminished by likely responses of those rivals. This is more likely to be the case, the stronger and faster are the responses the firm anticipates from its rivals. The firm is more likely to anticipate strong responses if there are few significant competitors, if products in the relevant market are relatively homogeneous, if customers find it relatively easy to switch between suppliers, or if suppliers use meeting-competition clauses.").

NEW YORK V. DEUTSCHE TELEKOM AG,
439 F. Supp. 3d 179, 234-37 (S.D.N.Y. 2020)
(excerpt on coordinated effects[1])

VICTOR MARRERO, J.

[Thirteen states and the District of Columbia brought an action alleging that the proposed 4-to-3 merger of T-Mobile US, Inc. and Sprint Corporation, the third and fourth largest wireless telecommunications service providers in the United States, would substantially lessen competition in the national and various local markets for retail mobile wireless telecommunications services (RMWTS), in violation of Section 7 of the Clayton Act. Before the filing of the states' complaint, the U.S. Department of Justice and seven states had entered into a settlement with the merging parties under which they would sell Sprint's prepaid business and some wireless spectrum to Dish Network to form an additional competitor. The instant action attacked the DOJ divestiture settlement as insufficient to preserve competition in the various RMWTS markets. The state plaintiffs alleged, among other things, that the arrangement would create highly concentrated markets and increase the likelihood of coordinated effects in these markets.]

. . .

C. ADDITIONAL EVIDENCE OF ANTICOMPETITIVE EFFECTS

Defendants' rebuttal of Plaintiff States' prima facie case now leaves Plaintiff States with the ultimate burden of proof. Plaintiff States attempt to carry this burden by showing that: (1) the Proposed Merger would increase the likelihood that the three remaining MNOs [mobile network operators] would effectively agree, whether explicitly or merely through mutual awareness, that competing less strenuously and thus delivering fewer consumer benefits would be in their collective interests ("coordinated effects" of the merger); and (2) the lost competition between Sprint and T-Mobile would cause New T-Mobile to charge higher prices than T-Mobile ordinarily would have without the merger, regardless of its remaining competitors' actions ("unilateral effects" of the merger). As evidence that these two effects are likely, Plaintiff States relied primarily on the testimony of [Professor Carl] Shapiro as supplemented by various emails and internal presentations suggesting that during the course of merger discussions, T-Mobile and Sprint considered the possibility that the Proposed Merger might create opportunities to charge higher prices or otherwise decrease competition.

The Court addresses each type of effect in turn and concludes that neither is reasonably likely, particularly in the short term. As further detailed in Section II.D. below [omitted in this excerpt], each type of effect would require that T-Mobile

[1] Record citations omitted.

reverse course and effectively disestablish the business strategy and reputation it has developed over the past decade, even though the Proposed Merger gives it the ability to simply continue that business strategy on a greater scale and thus compete more effectively with the current market leaders AT&T and Verizon. The likelihood of coordinated or unilateral effects is further diminished by Sprint's decline and DISH's entry into the RMWTS Markets.

1. Coordinated Effects

Coordinated effects analysis reflects the theory that "where rivals are few, firms will be able to coordinate their behavior, either by overt collusion or implicit understanding, in order to restrict output and achieve profits above competitive levels." *FTC v. PPG Indus., Inc.*, 798 F.2d 1500, 1503 (D.C. Cir. 1986). The Merger Guidelines set forth the framework by which the DOJ and FTC assess whether a given merger will cause coordinated effects. Beyond the market share analysis used to establish a prima facie case described above, the DOJ and FTC's coordinated effects analysis considers whether the relevant market "shows signs of vulnerability to coordinated conduct" and whether there is "a credible basis on which to conclude that the merger may enhance that vulnerability." Merger Guidelines § 7.1.

Plaintiff States' economic expert Shapiro calculated that the coordinated effects of the Proposed Merger would result in annual consumer harm of $8.7 billion. Under Shapiro's theory, this harm would result from New T-Mobile [the merged company], AT&T, and Verizon "pulling their punches," or competing less strenuously and allowing market prices to stabilize or decline at a lower rate than the 6.3 percent decline in average revenue per user ("ARPU") observed from 2014 to 2017. Shapiro stated that this behavior would in turn result from several industry characteristics that he claims make the RMWTS Market vulnerable to anticompetitive coordination: that there are only a few large firms in the market, that the firms are very similar, that consumer demand is both predictable and inelastic (that is, not greatly affected by price changes), that there are high barriers to entry, and that prices are transparent and rapidly monitored.

Defendants challenge both that the RMWTS Market is vulnerable to coordination and that without the merger prices would continue to decline at the rate claimed by Shapiro. They note that technically ARPU is not the price that consumers pay, and that instead the Bureau of Labor Statistics' producer price index indicates that the prices for cellular and wireless communications have not declined from 2018 to 2019 despite declining in earlier years. Their economic expert, [Professor Michael] Katz, adds that if the producer price index is followed instead, the $8.7 billion harm calculated by Shapiro disappears completely. Katz also questions how similar the major competitors are, considering the various degrees to which they differentiate their mobile wireless services beyond price, such as particular handset deals, various family or data plans, and bundling with content or other communications services beyond the RMWTS Market itself. Katz claims that these various non-price differentials also complicate Plaintiff States' picture of a market with transparent prices, given firms' incentives to continue innovating and distinguishing themselves from their competitors.

The Court agrees . . . that the RMWTS industry is not particularly vulnerable to coordination. As both sides acknowledge, price is not the only dimension on which competition occurs. The non-price factors listed above demonstrate the various strategies that competitors in the market might pursue, drawing also into question whether the firms' pricing is truly so transparent. For example, while T-Mobile might try to compete primarily on the basis of its capacity advantages, AT&T might try to leverage the entertainment content provided by its merger with Time Warner, and a cable MVNO [mobile virtual network operators] like Comcast might advertise the convenience of bundling mobile wireless services with fixed in-home broadband and cable services. Considering also the rapidly changing nature of mobile wireless technological offerings, opportunities for innovation and differentiation may abound and materially alter the terms of competition. Indeed, that Plaintiff States characterize two of the largest four firms in the RMWTS Market as "mavericks" reflects that the market is not so vulnerable as they otherwise suggest. The DOJ's efforts to surmount the industry's admittedly high barriers to entry and position DISH as a new maverick also contradict the claim that the RMWTS Market is vulnerable to coordination. Finally, Shapiro conceded that asymmetric capacity utilization decreases the likelihood of coordination, which is particularly relevant because of the evidence indicating that New T-Mobile would have significantly more unused capacity than AT&T and Verizon.

As evidence that the Proposed Merger presents a credible threat in a vulnerable market. Plaintiff States also cite a number of documents in which employees of Defendants appear to have considered the prospect of anticompetitive coordination. While Defendants do not contest that evidence of intent may be relevant in a Section 7 case, the Court notes an apparent tension with the Second Circuit's guidance that "it is elementary that [one merging party's] intentions in acquiring [the other merging party] are not to be considered in determining whether a Section 7 Clayton Act violation occurred." *FTC v. PepsiCo, Inc.*, 477 F.2d 24, 30 (2d Cir. 1973). But even if this Court could not consider Defendants' intentions in this exact manner, it will nevertheless weigh the evidence cited by Plaintiff States because it might shed light on whether the RMWTS Market is vulnerable to coordination, and whether the Proposed Merger presents a credible threat of coordination in the market.

The main evidence that Plaintiff States cite for the potential of coordination are statements from DT executives suggesting that they supported a "4-to-3" merger of MNOs in the United States because they believed a consolidated market would be more profitable. Plaintiff States also cite some documentary evidence from Sprint suggesting this potential; for example, Sprint's Chief Marketing Officer Roger Sole-Rafols ("Sole-Rafols") suggested to Claure that the Proposed Merger could "end up accommodating plus $5 ARPU in a three-player scenario [including AT&T and Verizon]" and that this demonstrated "the benefit of a consolidated market." Plaintiff States additionally cite multiple T-Mobile and Sprint communications for the proposition that anticompetitive price signaling is already occurring in the RMWTS Market.

The Court is not persuaded that the evidence Plaintiff States point to forms a sufficiently credible or plausible basis to conclude that the Proposed Merger will substantially lessen competition. First, the Court disagrees that the DT statements merit the weight that Plaintiff States ascribe to them.[2] Though DT is T-Mobile's controlling shareholder, the Court places less weight on DT executives' theories regarding the effects of consolidation in a foreign market than T-Mobile's actual history of aggressive competition and the incentives for the company to continue competing that the Proposed Merger would provide. Sole-Rafol's statements lack significant probative value for similar reasons, including that Sole-Rafols lacks any input on T-Mobile pricing or regulatory strategy and stressed at trial that he expressed this hypothetical without any underlying basis. In any event, that DISH will become a fourth MNO in the RMWTS Market effectively nullifies the value of any speculation regarding the potential coordinated effects of a 4-to-3 merger.

Finally, the signalling emails also do not merit the weight they might warrant at first glance. For example, Langheim's notes clearly indicate that any attempts by T-Mobile at signalling failed and that the market was in fact "now at war."[3] Similarly, the correspondence between the two Sprint employees described above appears to have been speculation, in fact largely contradicted by the employees' own observations in the same discussion that "[Legere's] antagonistic approach to competition destroys profitability for the whole industry" and that "[Claure] may take a while [to start anticompetitively colluding] because of strong ego and competitiveness."[4] The other two documents cited by Plaintiff States do little to indicate that the market is actually vulnerable to coordination, either. Since they are hardly probative of the market's vulnerability to coordination, the Court is also not persuaded that they indicate the Proposed Merger would likely present a credible threat of coordination.

Even putting aside the infirmities that undermine the value of the preceding evidence, the Court has spent two full weeks assessing the credibility of each witness and their claims regarding whether coordination would be more or less likely in the RMWTS Market. "Antitrust theory and speculation cannot trump facts, and . . . cases must be resolved on the basis of the record evidence relating to the market and its probable future." [*FTC v.*] *Arch Coal*, [*Inc*.,] 329 F. Supp. 2d [109] at 116-17 (D.D.C. 2004)]. The Court finds that the fact of aggressive competition over the past decade is not so easily reversed, a point the Court elaborates on in Section II.D below. T-Mobile has built its identity and business strategy on insulting, antagonizing, and otherwise challenging AT&T and Verizon to offer pro-consumer packages and lower pricing, and the Court finds it highly unlikely that New T-Mobile will simply rest satisfied with its increased market share after the intense regulatory and public scrutiny of this transaction. As Legere and other T-Mobile executives noted at trial, doing so would essentially repudiate T-Mobile's entire public image. The evidence indicated that the

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[2] *Ed*.: Deutsche Telekom AG ("DT") was the controlling shareholder of T-Mobile.

[3] *Ed*.: Thorsten Langheim was a DT board member.

[4] *Ed.*: John Legere was T-Mobile's CEO. Marcelo Claure was Sprint's CEO.

same executive team that has brought T-Mobile success will continue to lead New T-Mobile, and the merger will provide T-Mobile with the increased capacity that enabled it to pursue the Un-carrier strategy in the first place. Having heard Defendants emphasize the asymmetric capacity advantage that New T-Mobile would have over AT&T and Verizon, the Court concludes that New T-Mobile would likely make use of that advantage by cutting prices to take market share from its biggest competitors. [record citations]; *see also* Merger Guidelines § 2.1.5 ("A firm that may discipline prices based on its ability and incentive to expand production rapidly using available capacity also can be a maverick, as can a firm that has often resisted otherwise prevailing industry norms to cooperate on price setting or other terms of competition.").

Finally, the Court reiterates that the entry of DISH undermines the notion that there will be fewer firms in the market and that coordination will thus be more likely. Even if DISH will initially enter the market at a relatively small scale, the tendency toward anticompetitive coordination "may well be thwarted by the presence of small but significant competitors" such as DISH would be. *See Stanley Works v. FTC*, 469 F.2d 498, 507 (2d Cir. 1972) (internal quotation marks omitted). Trial witnesses were virtually unanimous that DISH chairman [Charles] Ergen is a tough businessman not known to be particularly accommodating of his rivals. Indeed, their numerous references to Ergen as a "poker player" suggest that anticompetitive signaling with DISH would be a difficult endeavor. Having assessed the credibility of DISH's witnesses at trial, the Court is persuaded that, given its extensive preparations and the favorable remedies arranged by the DOJ, DISH fully intends to enter the RMWTS Markets vigorously and assume the mantle of a new maverick. This fact, combined with the high likelihood that New T-Mobile will compete aggressively, renders improbable any potential coordinated effects of the Proposed Merger.

UNITED STATES V. BERTELSMANN SE & CO. KGAA,
646 F. Supp. 3d 1, 44-46 (D.D.C. Nov. 15, 2022)
(excerpt on coordinated interaction[1])

FLORENCE Y. PAN, United States Circuit Judge

[The Department of Justice brought an action alleging that the proposed $2.18 billion acquisition by Bertelsmann, the owner of Penguin Random House, of Simon & Schuster from ViacomCBS. The DOJ alleged that the acquisition would substantially lessen competition in the input market for the U.S. publishing rights to anticipated top-selling books (defined to be books with advances over $250K). Penguin Random House and Simon & Schuster are two of the "Big Five" largest book publishers in the United States, with market shares of 37% and 12%, respectively. The court sustained the DOJ's market definition, found that the merger was likely to substantially harm competition through both unilateral and coordinated effects, and rejected the defenses of the merging parties.]

. . .

ii. Coordinated Effects

Another avenue for the government to prove competitive harm is by showing a likelihood of "coordinated effects," which occur when market participants mutually decrease competition in the relevant market. [*United States v.*] *AT&T*, 310 F. Supp. 3d [161]at 246 [D.D.C. 2018)] ("A proposed merger may violate Section 7 by enabling or encouraging post-merger coordinated interaction among firms in the relevant market that harms customers." (cleaned up)) [, *aff'd*, 916 F.3d 1029 (D.C. Cir. 2019)]; *see also* Merger Guidelines § 7 ("Coordinated interaction involves conduct by multiple firms that is profitable for each of them only as a result of the accommodating reactions of the others."). Coordinated effects can arise from an express or implied agreement among competitors, *see F.T.C. v. CCC Holdings*, 605 F. Supp. 2d 26, 60 (D.D.C. 2009); or from "parallel accommodating conduct" among competitors without a prior agreement, Merger Guidelines § 7. Parallel accommodating conduct involves "situations in which each rival's response to competitive moves made by others is individually rational, and not motivated by retaliation or deterrence nor intended to sustain an agreed-upon market outcome, but nevertheless emboldens price [decreases] and weakens competitive incentives to [raise advances] or offer [authors] better terms." *Id*.

Coordinated effects are likelier in concentrated markets; indeed, the idea that concentration tends to produce anticompetitive coordination is central to merger law. *See* [*FTC v. H.J.*] *Heinz* [*Co.*}, 246 F.3d [708] at 716 [(D.C. Cir. 2001)] ("Merger law 'rests upon the theory that, where rivals are few, firms will be able to coordinate their

[1] Record citations, internal cross-references, and footnotes omitted.

behavior, either by overt collusion or implicit understanding, in order to restrict output and achieve profits above competitive levels.'") (quoting *FTC v. PPG Indus*., 798 F.2d 1500, 1503 (D.C. Cir. 1986)). Therefore, when the government has shown that a merger will substantially increase concentration in an already concentrated market—as it has done here—"the burden is on the defendants to produce evidence of 'structural market barriers to collusion' specific to this industry that would defeat the 'ordinary presumption of collusion' that attaches to a merger in a highly concentrated market." *H&R Block*, 833 F. Supp. 2d at 77 (quoting *Heinz*, 246 F.3d at 725).

As an initial matter, a history of collusion or attempted collusion is highly probative of likely harm from a merger. *See Hosp. Corp*. [*v. FTC*], 807 F.2d [1381] at 1388 [(7th Cir. 1986)]; *see also FTC v. Elders Grain, Inc*., 868 F.2d 901, 906 (7th Cir. 1989) ("[A]n acquisition which reduces the number of significant sellers in a market already highly concentrated and prone to collusion by reason of its history and circumstances is unlawful in the absence of special circumstances."); *H & R Block*, 833 F. Supp. 2d at 78; *Tronox*, 332 F. Supp. 3d at 208–210; Merger Guidelines § 7.2. Thus, it is significant that in *United States v. Apple, Inc*., the Second Circuit upheld a finding that between 2009 and 2012, all the "Big Six"31 publishers, except for Random House, participated in a "horizontal conspiracy . . . to raise e[-]book prices." *See* 791 F.3d at 339. This coordination involved "numerous exchanges between executives at different Big Six publishers," "constant communication" among the publishers "regarding their negotiations with both Apple and Amazon," and "frequent telephone calls among the Publisher Defendants." *Id*. at 302, 318. "[T]he Big Six operated in a close-knit industry and had no qualms communicating about the need to act together." *Id*. at 300. The Second Circuit concluded that the publishers engaged in "express collusion" that was a per se violation of antitrust law. *Id*. at 316, 321–29. Although Random House did not participate in the conspiracy, Penguin Books and S&S both did, *see id*. at 308, and this "history of successful cooperation establishes a precondition to effective collusion—mutual trust and forbearance." *See Hosp. Corp*., 807 F.2d at 1388. The case portrays an industry already "prone to collusion," which may become "even more prone to collusion" after the proposed merger of its largest and third-largest competitors. *See Elders Grain*, 868 F.2d at 905-06.

The *Apple* case provides the backdrop for trends in the industry that appear to demonstrate that the Big Five are already engaging in tacit collusion or parallel accommodating conduct when acquiring books. Recent years have seen the industry-wide standardization of certain contract terms—involving payment structure, audio rights, and e-book royalties—in ways that favor publishers over authors, suggesting that the top publishers have engaged in coordinated conduct. Advances used to be paid to authors in two installments, but publishers uniformly moved to paying them in three installments and then four installments, thereby delaying authors' compensation. After audiobooks became a significant source of revenue in the industry, publishers uniformly refused to acquire books without audio rights included, thereby limiting authors' ability to maximize their compensation and preventing authors from diversifying their sources of income. *See id*. In addition, during the early years of e-books, publishers uniformly shifted e-book royalty rates from 50 percent to 25 percent,

thereby reducing authors' compensation. Thus, in an industry where the competition to acquire anticipated top sellers is intense, the competing publishers nevertheless choose, almost always, not to gain advantage by offering more favorable contract terms. This phenomenon bespeaks a tacit agreement among the publishers to compete only on the basis of advance level because it collectively benefits them not to yield on other contract terms. *Accord H & R Block*, 833 F. Supp. 2d at 77-78 ("[A] highly persuasive historical act of cooperation between [competitors]" supports the theory that "coordination would likely take the form of mutual recognition that neither firm has an interest in an overall 'race to free' ....").

One example involving audio rights is illustrative. When selling the publishing rights to [Redacted] highly sought-after book, her agent attempted to hold an auction that excluded audio rights. S&S wanted the book but refused to bid because "[t]he only way to prevent agents from breaking off audio rights like this is to hold firm to our policy of no deals without audio rights." An S&S editor ruminated, "It will be very interesting to see whether PRH, Hachette, Harper or Macmillan participate. M[y] understanding is that they too have the 'no audio, no deal' rule." Id. The agent was forced to restart the auction with audio rights included, presumably because the book received insufficient offers or only received offers that included audio. See PX 320 at 1 (in the first round, PRH bid for bundled audio rights in violation of the auction's initial rules). In the renewed auction that included audio rights, the bidding was fervid and reflected vigorous competition. This episode starkly demonstrates that the publishers, despite their great enthusiasm for the book, initially engaged in parallel conduct to deny the author the ability to exclude audio rights from the auction. The parallel conduct was effective and mutually beneficial, as the publishers all retained the opportunity to acquire the book, with their preferred contract term concerning audio rights. Based on this evidence, the Court finds that the Big Five publishers have engaged in tacit coordination that is profitable for those involved.

Finally, it is significant that in a market already prone to collusion, where coordinated conduct already appears to be rampant, PRH's acquisition of S&S would reinforce the market's oligopsonistic structure and create a behemoth industry leader that other market participants could easily follow. The Big Five publishers already control 91 percent of the relevant market. The merger would distill the Big Five to a Big Four, with an overwhelmingly dominant top firm, PRH-S&S, controlling 49 percent of the market and dwarfing its nearest competitors. In the newly reconfigured market, the top two firms, the merged entity and [Redacted] would have a 74-percent market share. Under such circumstances, coordinated effects are likely through "sheer market power" because the "post-merger market would feature two firms that control roughly three quarters" of the market. *Tronox*, 332 F. Supp. 3d at 209; *see also Heinz*, 246 F.3d at 724 n.23 (recognizing that "price leadership" is "a danger" in a "duopoly" market). The merger would thus increase the market's already high susceptibility to coordination.

NOTES

1. Judge Florence Pan was a district court judge at the time of trial. Before she rendered her decision in the case, she was elevated to the United States Court of Appeals for the District of Columbia.

2. After a three-week trial in the summer of 2022, Judge Pan entered final judgment permanently enjoining the acquisition on November 2, 2022. Although Bertelsmann's response to the decision was to seek an expedited appeal, on November 21, 2022, the extended drop-dead date of the acquisition agreement, ViacomCBS exercised its unilateral right to terminate the contract, mooting any appeal.[2] Subsequently, Bertelsmann paid ViacomCBS a $200 million antitrust reverse breakup fee. ViacomCBS reauctioned Simon & Schuster, where it was purchased by KKR, a private equity firm, for $1.62 billion.

3. The decision marks the first victory for the Biden DOJ in a merger challenge litigated to a decision. Until this decision, the DOJ had suffered multiple losses in merger cases, including failed challenges to Booz Allen's acquisition of EverWatch,[3] UnitedHealth Care's acquisition of Change Healthcare,[4] and U.S. Sugar's purchase of Imperial Sugar.[5]

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[2] *See* Porter Anderson, On the Termination of the PRH-Simon & Schuster Deal, PublishingPerspectives.com, Nov. 22, 2022.

[3] United States v. Booz Allen Hamilton Inc., No. CV CCB-22-1603, 2022 WL 9976035 (D. Md. Oct. 17, 2022) (denying DOJ's motion for a preliminary injunction), *denying injunctive relief pending appeal*, No. CV CCB-22-1603, 2022 WL 16553230 (D. Md. Oct. 31, 2022).

[4] United States v. UnitedHealth Grp. Inc., No. 1:22-CV-0481 (CJN), 2022 WL 4365867 (D.D.C. Sept. 21, 2022) (final judgment in favor or merging parties), *dismissed*, No. 22-5301, 2023 WL 2717667 (D.C. Cir. Mar. 27, 2023).

[5] United States v. U.S. Sugar Corp., C.A. No. 21-1644 (MN), 2022 WL 4544025 (D. Del. Sept. 9, 2022) (final judgment in favor or merging parties), *aff'd*, 73 F.4th 197 (3d Cir. 2023).

Elimination of a Maverick

U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, HORIZONTAL MERGER GUIDELINES § 2.1.5 (REV. AUG. 19, 2010) (MAVERICKS)

2.1.5 Disruptive Role of a Merging Party

The Agencies consider whether a merger may lessen competition by eliminating a "maverick" firm, i.e., a firm that plays a disruptive role in the market to the benefit of customers. For example, if one of the merging firms has a strong incumbency position and the other merging firm threatens to disrupt market conditions with a new technology or business model, their merger can involve the loss of actual or potential competition. Likewise, one of the merging firms may have the incentive to take the lead in price cutting or other competitive conduct or to resist increases in industry prices. A firm that may discipline prices based on its ability and incentive to expand production rapidly using available capacity also can be a maverick, as can a firm that has often resisted otherwise prevailing industry norms to cooperate on price setting or other terms of competition.

U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, MERGER GUIDELINES § 2.3.A (REV. DEC. 18, 2023)

Elimination of a Maverick. A maverick is a firm with a disruptive presence in a market. The presence of a maverick, however, only reduces the risk of coordination so long as the maverick retains the disruptive incentives that drive its behavior. A merger that eliminates a maverick or significantly changes its incentives increases the susceptibility to coordination.

Unilateral Effects

Horizontal Merger Guidelines

U.S. Department of Justice

and the

Federal Trade Commission

Issued: August 19, 2010

6. Unilateral Effects

The elimination of competition between two firms that results from their merger may alone constitute a substantial lessening of competition. Such unilateral effects are most apparent in a merger to monopoly in a relevant market, but are by no means limited to that case. Whether cognizable efficiencies resulting from the merger are likely to reduce or reverse adverse unilateral effects is addressed in Section 10.

Several common types of unilateral effects are discussed in this section. Section 6.1 discusses unilateral price effects in markets with differentiated products. Section 6.2 discusses unilateral effects in markets where sellers negotiate with buyers or prices are determined through auctions. Section 6.3 discusses unilateral effects relating to reductions in output or capacity in markets for relatively homogeneous products. Section 6.4 discusses unilateral effects arising from diminished innovation or reduced product variety. These effects do not exhaust the types of possible unilateral effects; for example, exclusionary unilateral effects also can arise.

A merger may result in different unilateral effects along different dimensions of competition. For example, a merger may increase prices in the short term but not raise longer-term concerns about innovation, either because rivals will provide sufficient innovation competition or because the merger will generate cognizable research and development efficiencies. See Section 10.

6.1 Pricing of Differentiated Products

In differentiated product industries, some products can be very close substitutes and compete strongly with each other, while other products are more distant substitutes and compete less strongly. For example, one high-end product may compete much more directly with another high-end product than with any low-end product.

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 pre-merger 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.

The extent of direct competition between the products sold by the merging parties is central to the evaluation of unilateral price effects. Unilateral price effects are greater, the more the buyers of products sold by one merging firm consider products sold by the other merging firm to be their next choice. The Agencies consider any reasonably available and reliable information to evaluate the extent of direct competition between the products sold by the merging firms. This includes documentary and testimonial evidence, win/loss reports and evidence from discount approval processes, customer switching patterns, and customer surveys. The types of evidence relied on often overlap substantially with the types of evidence of customer substitution relevant to the hypothetical monopolist test. See Section 4.1.1.

Substantial unilateral price elevation post-merger for a product formerly sold by one of the merging firms normally requires that a significant fraction of the customers purchasing that product view

products formerly sold by the other merging firm as their next-best choice. However, unless pre-merger margins between price and incremental cost are low, that significant fraction need not approach a majority. For this purpose, incremental cost is measured over the change in output that would be caused by the price change considered. A merger may produce significant unilateral effects for a given product even though many more sales are diverted to products sold by non-merging firms than to products previously sold by the merger partner.

> *Example 19:* In Example 5, the merged entity controlling Products A and B would raise prices ten percent, given the product offerings and prices of other firms. In that example, one-third of the sales lost by Product A when its price alone is raised are diverted to Product B. Further analysis is required to account for repositioning, entry, and efficiencies.

In some cases, the Agencies may seek to quantify the extent of direct competition between a product sold by one merging firm and a second product sold by the other merging firm by estimating the diversion ratio from the first product to the second product. The diversion ratio is the fraction of unit sales lost by the first product due to an increase in its price that would be diverted to the second product. Diversion ratios between products sold by one merging firm and products sold by the other merging firm can be very informative for assessing unilateral price effects, with higher diversion ratios indicating a greater likelihood of such effects. Diversion ratios between products sold by merging firms and those sold by non-merging firms have at most secondary predictive value.

Adverse unilateral price effects can arise when the merger gives the merged entity an incentive to raise the price of a product previously sold by one merging firm and thereby divert sales to products previously sold by the other merging firm, boosting the profits on the latter products. Taking as given other prices and product offerings, that boost to profits is equal to the value to the merged firm of the sales diverted to those products. The value of sales diverted to a product is equal to the number of units diverted to that product multiplied by the margin between price and incremental cost on that product. In some cases, where sufficient information is available, the Agencies assess the value of diverted sales, which can serve as an indicator of the upward pricing pressure on the first product resulting from the merger. Diagnosing unilateral price effects based on the value of diverted sales need not rely on market definition or the calculation of market shares and concentration. The Agencies rely much more on the value of diverted sales than on the level of the HHI for diagnosing unilateral price effects in markets with differentiated products. If the value of diverted sales is proportionately small, significant unilateral price effects are unlikely.[11]

Where sufficient data are available, the Agencies may construct economic models designed to quantify the unilateral price effects resulting from the merger. These models often include independent price responses by non-merging firms. They also can incorporate merger-specific efficiencies. These merger simulation methods need not rely on market definition. The Agencies do not treat merger simulation evidence as conclusive in itself, and they place more weight on whether their merger simulations consistently predict substantial price increases than on the precise prediction of any single simulation.

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[11] For this purpose, the value of diverted sales is measured in proportion to the lost revenues attributable to the reduction in unit sales resulting from the price increase. Those lost revenues equal the reduction in the number of units sold of that product multiplied by that product's price.

A merger is unlikely to generate substantial unilateral price increases if non-merging parties offer very close substitutes for the products offered by the merging firms. In some cases, non-merging firms may be able to reposition their products to offer close substitutes for the products offered by the merging firms. Repositioning is a supply-side response that is evaluated much like entry, with consideration given to timeliness, likelihood, and sufficiency. See Section 9. The Agencies consider whether repositioning would be sufficient to deter or counteract what otherwise would be significant anticompetitive unilateral effects from a differentiated products merger.

6.2 Bargaining and Auctions

In many industries, especially those involving intermediate goods and services, buyers and sellers negotiate to determine prices and other terms of trade. In that process, buyers commonly negotiate with more than one seller, and may play sellers off against one another. Some highly structured forms of such competition are known as auctions. Negotiations often combine aspects of an auction with aspects of one-on-one negotiation, although pure auctions are sometimes used in government procurement and elsewhere.

A merger between two competing sellers prevents buyers from playing those sellers off against each other in negotiations. This alone can significantly enhance the ability and incentive of the merged entity to obtain a result more favorable to it, and less favorable to the buyer, than the merging firms would have offered separately absent the merger. The Agencies analyze unilateral effects of this type using similar approaches to those described in Section 6.1.

Anticompetitive unilateral effects in these settings are likely in proportion to the frequency or probability with which, prior to the merger, one of the merging sellers had been the runner-up when the other won the business. These effects also are likely to be greater, the greater advantage the runner-up merging firm has over other suppliers in meeting customers' needs. These effects also tend to be greater, the more profitable were the pre-merger winning bids. All of these factors are likely to be small if there are many equally placed bidders.

The mechanisms of these anticompetitive unilateral effects, and the indicia of their likelihood, differ somewhat according to the bargaining practices used, the auction format, and the sellers' information about one another's costs and about buyers' preferences. For example, when the merging sellers are likely to know which buyers they are best and second best placed to serve, any anticompetitive unilateral effects are apt to be targeted at those buyers; when sellers are less well informed, such effects are more apt to be spread over a broader class of buyers.

6.3 Capacity and Output for Homogeneous Products

In markets involving relatively undifferentiated products, the Agencies may evaluate whether the merged firm will find it profitable unilaterally to suppress output and elevate the market price. A firm may leave capacity idle, refrain from building or obtaining capacity that would have been obtained absent the merger, or eliminate pre-existing production capabilities. A firm may also divert the use of capacity away from one relevant market and into another so as to raise the price in the former market. The competitive analyses of these alternative modes of output suppression may differ.

A unilateral output suppression strategy is more likely to be profitable when (1) the merged firm's market share is relatively high; (2) the share of the merged firm's output already committed for sale at prices unaffected by the output suppression is relatively low; (3) the margin on the suppressed output is relatively low; (4) the supply responses of rivals are relatively small; and (5) the market elasticity of demand is relatively low.

A merger may provide the merged firm a larger base of sales on which to benefit from the resulting price rise, or it may eliminate a competitor that otherwise could have expanded its output in response to the price rise.

> *Example 20:* Firms A and B both produce an industrial commodity and propose to merge. The demand for this commodity is insensitive to price. Firm A is the market leader. Firm B produces substantial output, but its operating margins are low because it operates high-cost plants. The other suppliers are operating very near capacity. The merged firm has an incentive to reduce output at the high-cost plants, perhaps shutting down some of that capacity, thus driving up the price it receives on the remainder of its output. The merger harms customers, notwithstanding that the merged firm shifts some output from high-cost plants to low-cost plants.

In some cases, a merger between a firm with a substantial share of the sales in the market and a firm with significant excess capacity to serve that market can make an output suppression strategy profitable.[12] This can occur even if the firm with the excess capacity has a relatively small share of sales, if that firm's ability to expand, and thus keep price from rising, has been making an output suppression strategy unprofitable for the firm with the larger market share.

6.4 Innovation and Product Variety

Competition often spurs firms to innovate. The Agencies may consider whether a merger is likely to diminish innovation competition by encouraging the merged firm to curtail its innovative efforts below the level that would prevail in the absence of the merger. That curtailment of innovation could take the form of reduced incentive to continue with an existing product-development effort or reduced incentive to initiate development of new products.

The first of these effects is most likely to occur if at least one of the merging firms is engaging in efforts to introduce new products that would capture substantial revenues from the other merging firm. The second, longer-run effect is most likely to occur if at least one of the merging firms has capabilities that are likely to lead it to develop new products in the future that would capture substantial revenues from the other merging firm. The Agencies therefore also consider whether a merger will diminish innovation competition by combining two of a very small number of firms with the strongest capabilities to successfully innovate in a specific direction.

The Agencies evaluate the extent to which successful innovation by one merging firm is likely to take sales from the other, and the extent to which post-merger incentives for future innovation will be lower than those that would prevail in the absence of the merger. The Agencies also consider whether the merger is likely to enable innovation that would not otherwise take place, by bringing together

[12] Such a merger also can cause adverse coordinated effects, especially if the acquired firm with excess capacity was disrupting effective coordination.

complementary capabilities that cannot be otherwise combined or for some other merger-specific reason. See Section 10.

The Agencies also consider whether a merger is likely to give the merged firm an incentive to cease offering one of the relevant products sold by the merging parties. Reductions in variety following a merger may or may not be anticompetitive. Mergers can lead to the efficient consolidation of products when variety offers little in value to customers. In other cases, a merger may increase variety by encouraging the merged firm to reposition its products to be more differentiated from one another.

If the merged firm would withdraw a product that a significant number of customers strongly prefer to those products that would remain available, this can constitute a harm to customers over and above any effects on the price or quality of any given product. If there is evidence of such an effect, the Agencies may inquire whether the reduction in variety is largely due to a loss of competitive incentives attributable to the merger. An anticompetitive incentive to eliminate a product as a result of the merger is greater and more likely, the larger is the share of profits from that product coming at the expense of profits from products sold by the merger partner. Where a merger substantially reduces competition by bringing two close substitute products under common ownership, and one of those products is eliminated, the merger will often also lead to a price increase on the remaining product, but that is not a necessary condition for anticompetitive effect.

> *Example 21:* Firm A sells a high-end product at a premium price. Firm B sells a mid-range product at a lower price, serving customers who are more price sensitive. Several other firms have low-end products. Firms A and B together have a large share of the relevant market. Firm A proposes to acquire Firm B and discontinue Firm B's product. Firm A expects to retain most of Firm B's customers. Firm A may not find it profitable to raise the price of its high-end product after the merger, because doing so would reduce its ability to retain Firm B's more price-sensitive customers. The Agencies may conclude that the withdrawal of Firm B's product results from a loss of competition and materially harms customers.

7. Coordinated Effects

A merger may diminish competition by enabling or encouraging post-merger coordinated interaction among firms in the relevant market that harms customers. Coordinated interaction involves conduct by multiple firms that is profitable for each of them only as a result of the accommodating reactions of the others. These reactions can blunt a firm's incentive to offer customers better deals by undercutting the extent to which such a move would win business away from rivals. They also can enhance a firm's incentive to raise prices, by assuaging the fear that such a move would lose customers to rivals.

Coordinated interaction includes a range of conduct. Coordinated interaction can involve the explicit negotiation of a common understanding of how firms will compete or refrain from competing. Such conduct typically would itself violate the antitrust laws. Coordinated interaction also can involve a similar common understanding that is not explicitly negotiated but would be enforced by the detection and punishment of deviations that would undermine the coordinated interaction. Coordinated interaction alternatively can involve parallel accommodating conduct not pursuant to a prior understanding. Parallel accommodating conduct includes situations in which each rival's response to competitive moves made by others is individually rational, and not motivated by

Merger Guidelines

U.S. Department of Justice and the Federal Trade Commission

Issued: December 18, 2023

concentrated market that involves an increase in the HHI of more than 100 points[14] is presumed to substantially lessen competition or tend to create a monopoly.[15] The Agencies also may examine the market share of the merged firm: a merger that creates a firm with a share over thirty percent is also presumed to substantially lessen competition or tend to create a monopoly if it also involves an increase in HHI of more than 100 points.[16]

Indicator	Threshold for Structural Presumption
Post-merger HHI	Market HHI greater than 1,800 AND Change in HHI greater than 100
Merged Firm's Market Share	Share greater than 30% AND Change in HHI greater than 100

When exceeded, these concentration metrics indicate that a merger's effect may be to eliminate substantial competition between the merging parties and may be to increase coordination among the remaining competitors after the merger. This presumption of illegality can be rebutted or disproved. The higher the concentration metrics over these thresholds, the greater the risk to competition suggested by this market structure analysis and the stronger the evidence needed to rebut or disprove it.

2.2. Guideline 2: Mergers Can Violate the Law When They Eliminate Substantial Competition Between Firms.

A merger eliminates competition between the merging firms by bringing them under joint control.[17] If evidence demonstrates substantial competition between the merging parties prior to the

[14] The change in HHI from a merger of firms with shares *a* and *b* is equal to 2*ab*. For example, in a merger between a firm with 20% market share and a firm with 5% market share, the change in HHI is 2 x 20 x 5 = 200.

[15] The first merger guidelines to reference an HHI threshold were the merger guidelines issued in 1982. These guidelines referred to mergers with HHI above 1,000 as concentrated markets, with HHI between 1,000 and 1,800 as "moderately concentrated" and above 1,800 as "highly concentrated," while they referred to an increase in HHI of 100 as a "significant increase." Each subsequent iteration until 2010 maintained those thresholds. *See* Fed. Trade Comm'n & U.S. Dep't of Justice, Horizontal Merger Guidelines § 1.51 (1997); Fed. Trade Comm'n & U.S. Dep't of Justice, Horizontal Merger Guidelines § 1.51 (1992); U.S. Dep't of Justice, Merger Guidelines § 3(A) (1982). During this time, courts routinely cited to the guidelines and these HHI thresholds in decisions. *See, e.g.*, *Chicago Bridge & Iron Co. N.V. v. FTC*, 534 F.3d 410, 431 (5th Cir. 2008); *FTC v. H.J. Heinz Co.*, 246 F.3d 708, 716 (D.C. Cir. 2001); *FTC v. Univ. Health, Inc.*, 938 F.2d 1206, 1211 (11th Cir. 1991). Although the Agencies raised the thresholds for the 2010 guidelines, based on experience and evidence developed since, the Agencies consider the original HHI thresholds to better reflect both the law and the risks of competitive harm suggested by market structure and have therefore returned to those thresholds.

[16] *Phila. Nat'l Bank*, 374 U.S. at 364-65 ("Without attempting to specify the smallest market share which would still be considered to threaten undue concentration, we are clear that 30% presents that threat.").

[17] The competitive harm from the elimination of competition between the merging firms, without considering the risk of coordination, is sometimes referred to as unilateral effects. The elimination of competition between the merging firms can also lessen competition with and among other competitors. When the elimination of competition between the merging firms

merger, that ordinarily suggests that the merger may substantially lessen competition.[18]Although a change in market structure can also indicate risk of competitive harm (see Guideline 1), an analysis of the existing competition between the merging firms can demonstrate that a merger threatens competitive harm independent from an analysis of market shares.

Competition often involves firms trying to win business by offering lower prices, new or better products and services, more attractive features, higher wages, improved benefits, or better terms relating to various additional dimensions of competition. This can include competition to research and develop products or services, and the elimination of such competition may result in harm even if such products or services are not yet commercially available. The more the merging parties have shaped one another's behavior, or have affected one another's sales, profits, valuation, or other drivers of behavior, the more significant the competition between them.

The Agencies examine a variety of indicators to identify substantial competition. For example:

Strategic Deliberations or Decisions. The Agencies may analyze the extent of competition between the merging firms by examining evidence relating to strategic deliberations or decisions in the regular course of business. For example, in some markets, the firms may monitor each other's pricing, marketing campaigns, facility locations, improvements, products, capacity, output, input costs, and/or innovation plans. This can provide evidence of competition between the merging firms, especially when they react by taking steps to preserve or enhance the competitiveness or profitability of their own products or services.

Prior Merger, Entry, and Exit Events. The Agencies may look to historical events to assess the presence and substantiality of direct competition between the merging firms. For example, the Agencies may examine the competitive impact of recent relevant mergers, entry, expansion, or exit events.

Customer Substitution. Customers' willingness to switch between different firms' products is an important part of the competitive process. Firms are closer competitors the more that customers are willing to switch between their products. The Agencies use a variety of tools, detailed in Section 4.2, to assess customer substitution.

Impact of Competitive Actions on Rivals. When one firm takes competitive actions to attract customers, this can benefit the firm at the expense of its rivals. The Agencies may gauge the extent of competition between the merging firms by considering the impact that competitive actions by one of the merging firms has on the other merging firm. The impact of a firm's competitive actions on a rival is generally greater when customers consider the firm's products and the rival's products to be closer substitutes, so that a firm's competitive action results in greater lost sales for the rival, and when the profitability of the rival's lost sales is greater.

Impact of Eliminating Competition Between the Firms. In some instances, evidence may be available to assess the impact of competition from one firm on the other's actions, such as firm choices

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leads them to compete less aggressively with one another, other firms in the market can in turn compete less aggressively, decreasing the overall intensity of competition.

[18] *See also United States v. First Nat'l Bank & Trust Co. of Lexington*, 376 U.S. 665, 669-70 (1964) (per curiam) ("[I]t [is] clear that the elimination of significant competition between [merging parties] constitutes an unreasonable restraint of trade in violation of § 1 of the Sherman Act. . . . It [can be] enough that the two . . . compete[], that their competition [is] not insubstantial and that the combination [would] put an end to it."); *ProMedica Health Sys., Inc. v. FTC*, 749 F.3d 559, 568-70 (6th Cir. 2014), *cert. denied*, 575 U.S. 996 (2015).

about price, quality, wages, or another dimension of competition. Section 4.2 describes a variety of approaches to measuring such impacts.

Additional Evidence, Tools, and Metrics. The Agencies may use additional evidence, tools, and metrics to assess the loss of competition between the firms. Depending on the realities of the market, different evidence, tools, or metrics may be appropriate.

Section 4.2 provides additional detail about the approaches that the Agencies use to assess competition between or among firms.

2.3. Guideline 3: Mergers Can Violate the Law When They Increase the Risk of Coordination.

The Agencies determine that a merger may substantially lessen competition when it meaningfully increases the risk of coordination among the remaining firms in a relevant market or makes existing coordination more stable or effective.[19] Firms can coordinate across any or all dimensions of competition, such as price, product features, customers, wages, benefits, or geography. Coordination among rivals lessens competition whether it occurs explicitly—through collusive agreements between competitors not to compete or to compete less—or tacitly, through observation and response to rivals. Because tacit coordination often cannot be addressed under Section 1 of the Sherman Act, the Agencies vigorously enforce Section 7 of the Clayton Act to prevent market structures conducive to such coordination.

Tacit coordination can lessen competition even when it does not rise to the level of an agreement and would not itself violate the law. For example, in a concentrated market a firm may forego or soften an aggressive competitive action because it anticipates rivals responding in kind. This harmful behavior is more common the more concentrated markets become, as it is easier to predict the reactions of rivals when there are fewer of them.

To assess the extent to which a merger may increase the likelihood, stability, or effectiveness of coordination, the Agencies often consider three primary factors and several secondary factors. The Agencies may consider additional factors depending on the market.

2.3.A. Primary Factors

The Agencies may conclude that post-merger market conditions are susceptible to coordinated interaction and that the merger materially increases the risk of coordination if any of the three primary factors are present.

Highly Concentrated Market. By reducing the number of firms in a market, a merger increases the risk of coordination. The fewer the number of competitively meaningful rivals prior to the merger, the greater the likelihood that merging two competitors will facilitate coordination. Markets that are highly concentrated after a merger that significantly increases concentration (see Guideline 1) are presumptively susceptible to coordination. If merging parties assert that a highly concentrated market is not susceptible to coordination, the Agencies will assess this rebuttal evidence using the framework

[19] *See Brooke Grp. Ltd. v. Brown & Williamson Tobacco Corp.,* 509 U.S. 209, 229-30 (1993) ("In the § 7 context, it has long been settled that excessive concentration, and the oligopolistic price coordination it portends, may be the injury to competition the Act prohibits.").

UNITED STATES V. BAZAARVOICE, INC.
No. 13-CV-00133-WHO, 2014 WL 203966 (N.D. Cal. Jan. 8, 2014)
(excerpt on unilateral effects[1])

WILLIAM H. ORRICK, United States District Judge

[On June 12, 2012, Bazaarvoice acquired PowerReviews for $168.2 million in a non-HSR reportable transaction.[2] Six months later, on January 10, 2013, the DOJ filed an civil antitrust action alleging the acquisition violated Section 7 and seeking an injunction to require Bazaarvoice to divest PowerReviews. According to the government, Bazaarvoice was the primary supplier of product rating and review (R&R) platforms used by online retailers and other businesses to organize and display customer-generated ratings for their products, and PowerReviews was its primary competitor. In January 2014, following a three-week trial, Judge Orrick found that the merger violated Section 7 because it eliminated Bazaarvoice's only meaningful competitor in the product rating and review platform market.]

. . .

C. It is probable that the transaction will substantially lessen competition and result in higher prices

i. Economic Testimony Supports the Conclusion That the Transaction Will Lead to Substantially Higher Prices for Many Bazaarvoice and PowerReviews Customers

266. The merger of Bazaarvoice and PowerReviews is likely to result in significant anticompetitive unilateral effects. A "unilateral" effect is one that arises solely through the altered behavior of Bazaarvoice without the necessity of coordinated behavior with other R & R platform suppliers.

267. Economic theory predicts that the merger will result in significant unilateral effects for customers that viewed Bazaarvoice and PowerReviews as the most attractive suppliers of R&R platforms and for whom the third-best supplier has a distinctly inferior product compared to the weaker of the two merged parties. This theoretical prediction was supported by evidence at trial, including in the win/loss data in Bazaarvoice's Salesforce database and in the data compiled from "how the deal was done" emails created by Bazaarvoice sales people (HTDWD). While both data sets may be incomplete, as Bazaarvoice charges, there was no policy within Bazaarvoice of only recording certain competitors in the data or taking other action which would create a bias in the data. The Court finds that it is reliable.

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[1] Record citations, internal cross-references, and footnotes omitted.

[2] PowerReviews had less than $12 million in revenues in the year before the transaction, which was below the HSR Act's "size of parties" threshold in effect at the time.

268. The win/loss data in Bazaarvoice's Salesforce database tracks instances in which Bazaarvoice won or lost business. Although [former Bazaarvoice Chief Revenue Officer Michael] Osborne testified that the Salesforce database was not "dependable," he admitted that the data contained in the database was accurate enough to update the management and the Board of Directors about the sales pipeline.

269. Dr. [Carl] Shapiro [the DOJ's expert economist] examined 480 R&R platform sales opportunities in North America identified in the Bazaarvoice Salesforce database that were created between August 2005 and July 2012 and that contained information about competitors. Dr. Shapiro concluded that PowerReviews was identified as a competitive alternative in 75 percent of the opportunities. The next closest alternative, in-house solutions, appears in 18 percent of the opportunities. No other alternative appears in more than three percent of the opportunities.

270. The results are similar when the analysis is limited to customers in the IR500 [the leading 500 internet retailers]. As shown by the chart below, Dr. Shapiro concludes that PowerReviews was identified as a competitive alternative solution in 83 percent of the opportunities. The next closest alternative, in-house solutions, appears in 15 percent of the opportunities. No other competitive alternative appears in more than three percent of the opportunities.

Frequency of Competitors in Bazaarvoice Win/Loss Opportunities

IR500, Core R & R Products Only

Competitor	Opps	Frequency
PowerReviews	121	83%
Internal Build	22	15%
Pluck	4	3%
Viewpoints	4	3%
Reevoo	1	1%
Lithium	0	0%
Expo	0	0%
Jive	0	0%
Zuberance	0	0%
''Other''	2	1%
Total Opportunities	***146***	

271. The Bazaarvoice HTDWD email dataset produces similar results. Bazaarvoice salespeople were generally expected to send a How the Deal Was Done ("HTDWD") email to a specific group email list at the company at the close of each transaction explaining how the transaction was accomplished. It is a useful data set to help evaluate the competition faced by Bazaarvoice.

272. Although Bazaarvoice had no formal process to ensure the HTDWD emails were complete or accurate, Bazaarvoice did not instruct its employees to skew the reports to overstate engagements involving PowerReviews. There was no bias and the

fact that it, like most data, is incomplete does not render the analysis unreliable, especially when it is consistent with the other evidence.

273. As shown in the following chart, Dr. Shapiro examined 143 Bazaarvoice HTDWD emails sent between September 2008 and July 2012 in which a competitor was identified and concluded that PowerReviews accounted for 80 percent of the references to competitors in these emails. The next closest alternative identified was in-house solutions, which accounted for 12 percent of the competitive references. No other competitive alternative appears in more than three percent of the emails.

Competitor Counts in Bazaarvoice ''How the Deal was Done'' Documents

Ratings and Reviews Deals Only

Competitor	**Opps**	**Frequency**
PowerReviews	114	80%
In–house	17	12%
Pluck	4	3%
Shopzilla	2	1%
Viewpoints	2	1%
Buzz Metrics	1	1%
Gigya	1	1%
Reevoo	1	1%
Trip Advisor	1	1%
Total Competitor Counts	*143*	

274. Dr. Shapiro identified three types of customers "that are most likely to be vulnerable and harmed" by the merger. These three groups are Bazaarvoice customers, PowerReviews legacy customers, and customers who place a high value on syndication.

275. Dr. Shapiro concludes that the unilateral price effects of the Bazaarvoice/PowerReviews merger will be most pronounced for their existing customers when those customers' current contracts come up for renewal. These customers have already revealed their preference for a commercial R & R platform and because of the merger they have lost the ability to play Bazaarvoice and PowerReviews off one another to get a lower price.

276. One mechanism Bazaarvoice could employ to unilaterally raise prices would be to eliminate the PowerReviews product from a customer's choice set and migrate legacy customers from the PowerReviews enterprise platform to the higher-priced Bazaarvoice product. While the customer may get additional features, these would not be features that the customer would otherwise choose if PowerReviews's lower-priced alternative were still an option.

277. Bazaarvoice planned to migrate the largest PowerReviews customers to the higher-priced Bazaarvoice platform. In proposing an acquisition of PowerReviews in April 2011, Bazaarvoice's co-founder Brant Barton described this as one "Pro" in

favor of the deal: "[w]e could migrate their Tier 1 customers to our platform...." In addition, a May 2012 Bazaarvoice presentation points out that average revenue from IR500 customers at PowerReviews in terms of annualized cumulative billings is 83% below Bazaarvoice's, adding:

> [The merger p]rovides us with the opportunity to increase revenue from [PowerReviews'] existing clients via migration to the Bazaarvoice platform a [sic] higher price points in return for greater features and functionality that [sic] those of [PowerReviews]. . . .

278. As a result of the acquisition, Bazaarvoice gained the ability to unilaterally charge higher prices for its new customers who do not consider in-house (or fringe competitor solutions) to be a viable option, as compared to its pre-merger new customers. In many instances, Bazaarvoice can effectively price discriminate against such customers because it collects detailed information about a customer's requirements and budget constraints during the sales process. The more effectively Bazaarvoice can engage in targeted "price discrimination" based on customer attributes, the greater the unilateral competitive effects.

279. Customers for whom syndication is particularly important, especially brand customers, are also likely to be harmed by the merger. For brand customers looking for a syndication network with significant retail customers, PowerReviews was the closest and only credible alternative to Bazaarvoice. After the merger, these customers have no alternative R&R platform with a significant syndication network and therefore these customers have lost significant bargaining leverage. This applies both to new customers as well as legacy customers who now have access to a larger syndication network, as "Bazaarvoice will seek to capture that value in the price they charge. The customers' return will depend on what their bargaining leverage is, and that's been weakened."

280. Other commercial suppliers of R & R platforms are not sufficiently close substitutes to Bazaarvoice's platform to prevent a significant post-merger price increase. In April 2011, Barton discussed the absence of competitive alternatives for customers, concluding that Bazaarvoice would "retain an extremely high percentage of [PowerReviews] customers," because available alternatives for disgruntled customers were "scarce" and "low-quality." After the acquisition, a customer made the same point to Luedtke: "from a retailers stand point I have to say I am a little concerned that there is now only one option for customer reviews." Similarly, BBBeyond came to the conclusion that there were only two options for them in 2009, Bazaarvoice and PowerReviews, and came to the same conclusion in 2012.

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NOTES

1. After the court found the acquisition violated Section 7, Bazaarvoice and the DOJ negotiated a consent decree to govern the divestiture.[3] Under the terms of the agreement, Bazaarvoice will divest all of the assets it acquired in the acquisition of PowerReviews almost two years earlier plus assets acquired after the transaction obtained for use with the PowerReviews assets. In addition, Bazaarvoice must provide a four-year license, at cost, to the divestiture buyer to allow it to sell customers Bazaarvoice's syndication services—one of the most distinguishing features of the Bazaarvoice platform and a key to Bazaarvoice's success.[4] Bazaarvoice must also waive any potential breach-of-contract claims against its customers to allow them to switch providers without penalty as well as any trade secret restrictions for its employees hired by the divestiture buyer.

[3] Stipulation and [Proposed] Order, United States v. Bazaarvoice, Inc., No. 13-CV-00133-WHO (N.D. Cal. Apr. 24, 2014) (including Exhibit A—Plaintiff's Second Amended [Proposed] Final Judgment).

[4] "Syndication Services" are products and services currently provided by Bazaarvoice that provide the ability to share product ratings and reviews and related content between two or more customers.

UNITED STATES V. ANTHEM, INC.
236 F. Supp. 3d 171, 178-79, 215-20 (D.D.C. 2017)
(excerpt on unilateral effects[1])

AMY BERMAN JACKSON, J.

Anthem and Cigna, the nation's second and third largest medical health insurance carriers, have agreed to merge. They propose to create the single largest seller of medical healthcare coverage to large commercial accounts, in a market in which there are only four national carriers still standing. The United States Department of Justice, eleven states, and the District of Columbia have sued to stop the merger, and they have carried their burden to demonstrate that the proposed combination is likely to have a substantial effect on competition in what is already a highly concentrated market. Therefore, the Court will not permit the merger to go forward.

Judgment will be entered in favor of the plaintiffs on their first claim, and the merger will be enjoined due to its likely impact on the market for the sale of health insurance to "national accounts"—customers with more than 5000 employees, usually spread over at least two states—within the fourteen states where Anthem operates as the Blue Cross Blue Shield licensee. So the Court does not need to go on to decide the question of whether the combination will also affect competition in the sale to national accounts within the larger geographic market consisting of the entire United States. The Court also does not need to rule on the allegations in plaintiffs' second claim that the merger will harm competition downstream in a different product market: the sale of health insurance to "large group" employers of more than 100 employees in thirty-five separate local regions within the Anthem states. But the evidence has shown that the proposed acquisition will have an anticompetitive effect on the sale of health insurance to large groups in at least one of those markets: Richmond, Virginia. Finally, given the ruling against the merger, the Court need not reach the allegations in the complaint that the merger will also harm competition upstream in the market for the purchase of healthcare services from hospitals and physicians in the same 35 locations.

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III. Plaintiffs have carried their burden to establish that the merger is likely to harm competition.

The Supreme Court has adopted a "totality-of-the-circumstances approach to the statutes, weighing a variety of factors to determine the effects of particular transactions on competition." *Baker Hughes*, 908 F.2d at 984. These factors may include: ease of entry in the marketplace, the significance of market shares and concentration; the likelihood of express collusion or tacit coordination; prevalent marketing and sales

[1] Citations to briefs and the evidentiary record and to footnotes omitted.

methods; the absence of a trend toward concentration; industry structure; any weakness of the data underlying the prima facie case; elasticity of industry demand, product differentiation; and the prospect of efficiencies from the merger. *Id*.

Courts examine two types of effects that may arise from mergers: coordinated effects and unilateral effects. Coordinated effects refer to markets with few competitors, in which firms may "coordinate their behavior, either by overt collusion or implicit understanding in order to restrict output and achieve profits above competitive levels." *ProMedica Health Sys., Inc. v. FTC*, 749 F.3d 559, 568 (6th Cir. 2014), *quoting H & R Block*, 833 F.Supp.2d at 77. An example of this would be parallel pricing by two gas stations located across the street from each other in a remote small town. *Id*. at 568–69. Unilateral effects refers to a merger's elimination of competition between the two merging companies, which "may alone constitute a substantial lessening of competition." *Id*. *quoting* [2010] Guidelines § 6. "The most obvious example of this phenomenon is a 'merger to monopoly'—e.g., where a market has only two firms, which then merge into one—but unilateral effects 'are by no means limited to that case.' " *Id*. *quoting* Guidelines § 6.

Relevant evidence of a merger's potential unilateral effects include the merging companies' ordinary course of business documents, testimony of industry participants, and the history of head-to-head competition between the two merging parties. *See, e.g.*, *Staples II* [*FTC v. Staples, Inc.*], , 190 F. Supp. 3d [100] at 131-33 [(D.D.C. 2016)]; *H & R Block*, 833 F. Supp. 2d at 73-75, 81-82; *Heinz* [*FTC v. H.J. Heinz Co.*], 246 F.3d [708] at 717-18 [(D.C. Cir. 2001)]; *Swedish Match* [*FTC v. Swedish Match*], 131 F. Supp. 2d [151] at 169-70 [(D.D.C. 2000)].

The Court finds that the merger will have the anticompetitive effects of eliminating direct competition between the two firms, reducing the number of national carriers from four to three, and diminishing innovation, and that new entrants and other market conditions identified by the defense are not sufficient to forestall price increases and ameliorate these effects.

A. The merger will have the unilateral effect of eliminating the existing head-to-head competition between Anthem and Cigna.

The Horizontal Merger Guidelines advise that "[u]nilateral price effects are greater, the more the buyers of products sold by one merging firm consider products sold by the other merging firm to be their next choice." Guidelines § 6.1. But "mergers that eliminate head-to-head competition between close competitors often result in a lessening of competition." *Staples II*, 190 F. Supp. 3d at 131; *Staples I* [*FTC v. Staples, Inc.*], 970 F. Supp. [1066] at 1083 [(D.D.C. 1997)] (holding that "the elimination of a particularly aggressive competitor in a highly concentrated market [is] a factor which is certainly an important consideration when analyzing possible anti-competitive effects"). And this is true even where the merging parties are not the only two, or even the two largest, competitors in the market. *Aetna* [United States v. Aetna Inc.], 240 F. Supp. 3d 1, at __ (D.D.C. 2017); s*ee also Sysco*, 113 F. Supp. 3d at 62; *Heinz*, 246 F.3d at 717-19; *H & R Block*, 833 F. Supp. 2d at 83-84.

Given this standard, Anthem's insistence that United, not Cigna, is its "closest" competitor, is beside the point. The acquired firm need not be the other's closest competitor to have an anticompetitive effect; the merging parties only need to be close competitors. *Staples II*, 190 F. Supp. 3d at 131; *see also* Guidelines § 6.1 ("The elimination of competition between two firms that results from their merger may alone constitute a substantial lessening of competition.").

The evidence in this case, including Anthem records and testimony from Anthem witnesses, firmly establishes that United, Cigna, Aetna, and the Blues compete against each other for national accounts, and that together, they dominate the market.

But insurance products are not sold off-the-shelf to every customer for a single price; health benefits coverage sold to national accounts is a "differentiated product," and the carriers compete by submitting bids to individual customers. Therefore, both sides engaged in economic analyses to ascertain what the level of direct competition between Anthem and Cigna has been within the tightly packed national accounts environment. *See* Guidelines § 6.1 (in differentiated product industries, "the extent of direct competition between the products sold by the merging parties is central to the evaluation of unilateral price effects").

Dr. [David] Dranove [the DOJ's expert] conducted a diversion analysis, which is used in markets with differentiated products, to examine the level of competition between merging companies. He explained that customers buying group health insurance are "trying to play the top bidders against each other," economists consider the procurement process for group health insurance to be what the Guidelines and economists refer to as an "auction," and this means that this merger will affect competition most significantly when Anthem and Cigna are both among the top bidders.

For that reason, Dr. Dranove analyzed the company's internal data to first isolate the occasions when the two companies had been the top two bidders for any national account's business and then determine how often each won or lost against the other in that situation. He then compared the data to the market shares he had calculated for the prima facie case.

Dr. Dranove looked first at situations when the merging companies lost business to each other. He determined that the market shares for national accounts in the Anthem territories indicate that Anthem should win 44% of the contracts where Cigna is the incumbent and loses. But Cigna's internal win/loss data showed that Anthem wins those contracts more than the market shares predicted: Anthem won 60% of those solicitations. Dranove Tr. 952–53 (using Cigna's SalesForce.com win/loss data from 2011 to 2017).

Similarly, the market shares indicated that Cigna should win "about 10 percent" of the contracts when Anthem is the incumbent and loses. Dranove Tr. 953–54; PDX 5. But Anthem's internal win/loss data showed that Cigna won "about 17 percent" of those sales. Dranove Tr. 953–54 (using Anthem's iAvenue win/loss data).

Looking at situations when the merging companies won business away from each other, Dr. Dranove testified that market shares predict that Cigna should have won business from Anthem 44% of the time. But Cigna's data showed that when Cigna

wins an account, it does so about 54% of the time from Anthem. Dranove Tr. 954–55 (using Cigna SalesForce.com win data from 2011 to 2017). And looking at Anthem's wins, its market share for national accounts would give rise to the prediction that 11% of the wins would be in situations where Cigna was the incumbent and lost. But Anthem's data showed that when Anthem won a contract from an incumbent, Cigna was the incumbent almost 35% of the time. Dranove Tr. 954–55 (using Anthem's SalesForce data from 2015 to 2017). In sum, the data showed that Anthem and Cigna are winning business from and losing business to each other more than their market shares would predict.

Given these results, Dr. Dranove concluded that his HHI calculations—which are dramatic in and of themselves—actually understate the competitive significance of the merger, because the underlying market shares understate the closeness of competition between the merging firms.

Not surprisingly, Anthem's expert conducted a diversion analysis that reached the opposite conclusion: the level of competition between the merging parties for national accounts is smaller their market shares imply. To calculate his diversion ratios, Dr. [Mark] Israel matched Anthem's and Cigna's bid information from 2015 and 2016 to identify instances in which both companies bid. Using each company's win/loss bid data and customer lists, he calculated how often Anthem and Cigna lost a solicitation that the other company won.

Dr. Israel testified that if Anthem and Cigna were particularly close competitors, then when they both bid for an account, Anthem would be expected to lose more frequently to Cigna than the rate implied by Cigna's overall market share and, similarly, Cigna should lose more frequently to Anthem than the rate implied by Anthem's overall market share. But his diversion ratio calculations found that they lost to each other less frequently than the market shares would suggest.

Dr. Israel's diversion analysis also examined each company's pricing patterns to discover whether one reacted to the presence of the other as a competitor by offering more competitive ASO bids. He concluded that Anthem's presence or absence as a competitor on a given bid had no statistically detectable effect on Cigna's bids, and that the same was true for Anthem's bids with respect to Cigna's presence. So, he found that the loss of direct competition between the two would have little or no effect on the merged company's bids.

In addition, Dr. Israel searched Anthem's data to cull out the competitive situations in which Anthem must have viewed Cigna as a particularly weak competitor because Cigna's discounts were six to eight percentage points lower than Anthem's. He explained that if Cigna were a close competitor, Anthem would be expected to raise its price when Cigna's discounts were not competitive to its own. But he found that Cigna's competitiveness on the discount factor had no statistically significant effect on Anthem's bid.[19]

[19] This analysis does not take into account the fact that even with its discount advantage, Anthem has been forced to fend off Cigna not by lowering its ASO fees, but by offering trend guarantees or making other concessions.

Each witness went to great lengths to discredit the other's economic evaluation of the intensity of the direct competition between the two companies. As noted above, Dr. Dranove compared the RFP [request for proposal] bidding situation to the economic model of an auction, *see, e.g.*, Dranove Tr. 943 ("[I]t's the competition between the two top bidders that ultimately drives the price."), while Dr. Israel favored the model of a negotiation. Dr. Dranove maintained that Dr. Israel's negotiation model unrealistically assumed that customers would be armed with perfect knowledge about the carriers' actual costs and profit margins when responding to a bid, and that they would know "exactly how much the insurance company is willing to sell the product for."[20] According to Dr. Dranove, incorporating this assumption into the merger simulation meant that Dr. Israel's calculation "dramatically reduce[d] the amount of harm resulting from the price increases." Dr. Dranove also criticized Dr. Israel for failing to factor in incumbency, and the role that would play in the outcome of any solicitation. Dranove Tr. 2281–82, 2284–85, 2415–16 ("There's a final two bidders in every single RFP . . . . What's relevant for the win-loss is finding out when they are one and two. As I've testified, we don't know who's two, so I conditioned on incumbency."). In response, Dr. Israel insisted that it was important to consider all instances where one of the carriers bid and lost instead of just those situations when an incumbent was unseated. He characterized Dr. Dranove's diversion analysis as a switching study that used too small a sample and inappropriately assumed that the incumbent was always the customer's second best option. Meanwhile, Dr. Dranove observed that Dr. Israel's regression analysis, which was based on the ASO [administrative services only] fees in Anthem bids, did not take into account occasions when Anthem may have made other concessions to improve its offer without reducing its fees.

Faced with these differences of opinion, the Court notes that these were both highly qualified and articulate economists. As Dr. Israel was wont to emphasize, he has been retained by the Department of Justice in other merger cases. *Sysco*, 113 F. Supp. 3d at 34. Putting aside the technical differences in the two approaches, one thing the diversion analyses had in common was that they were predicated on economic assumptions underlying the various methodologies, and not on the internal communications that shaped and chronicled these events in real time. And, here again, Anthem's ordinary course documents tell a consistent story that contravenes the firm's litigation position.

The documentary record shows that Anthem unquestionably competes directly and aggressively against Cigna for national accounts. In 2011, Anthem found itself losing national accounts to Cigna. In 2012, Anthem specifically set out to win national

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[20] In the Court's view, neither economic model provides a perfect analogy. Dr. Dranove's criticism that customers would not have the level of information assumed in Dr. Israel's model has some force; notwithstanding the evidence that customers were aided by brokers who gather considerable intelligence concerning discounts and other factors, the notion that customers would be certain of a carrier's bottom line was not established by the evidence. But there was testimony from brokers in Phase II to support Dr. Israel's supposition that at least in some instances, the customer may initiate another round of negotiation after the final two bids have been submitted and ranked

accounts from Cigna and Aetna by offering zero percent trend guarantees to customers moving to Anthem from either company. And in 2014, Anthem encouraged this direct competition by offering "strategic alignment bonuses" to national accounts team members who were able to fully replace Cigna, Aetna, or United business with Anthem. As late as February of 2016, Anthem's head of sales for national accounts proclaimed, "we are viewing Cigna as a competitor until we are not."[21] In light of this evidence, and the considerable volume of material presented at trial that exposed the ongoing, direct competition between Anthem and Cigna, the Court finds that Dr. Dranove's analysis is more persuasive, and the merger will in fact result in the loss of head-to-head competition between Cigna and Anthem for national accounts in the fourteen Anthem states.[22]

[21] The Phase II evidence told similar story. The Vice President and General Manager of California large group business exhorted her sales team to go after Cigna ("Wanted—Dead or Alive!") at both the 2015 and 2016 Annual sales and management workshops, as Cigna was identified as a top competitor and Cigna's level funded plan posed a "new competitive threat."

[22] Because the Court is enjoining the merger on the basis of the national accounts market in the fourteen Anthem states, it does not need to consider and its decision does not turn on a finding related to the national accounts market for the entire United States. The Court notes that while it does credit the testimony of Anthem representatives that they look forward to competing under the Cigna brand without needing to obtain a cede, there is no question that merger will also eliminate some head-to-head competition in the thirty-six non-Anthem states as Anthem has historically sought cedes to sell to prospective customers headquartered there. It was also established that there are important aspects of Blue Cross Blue Shield Association membership—in particular, the mutuality and cooperation involved in the cedes, the potential for Blue Card revenue, and the best efforts rules—that redound to the benefit of the Association as a whole, and that these give rise to an inherent conflict of interest that could affect Cigna's competitive conduct in the 36 states.

NEW YORK v. DEUTSCHE TELEKOM AG,
439 F. Supp. 3d 179, 237-39 (S.D.N.Y. 2020)
(excerpt on unilateral effects[1])

VICTOR MARRERO, J.

[Thirteen states and the District of Columbia brought an action alleging that the proposed 4-to-3 merger of T-Mobile US, Inc. and Sprint Corporation, the third and fourth largest wireless telecommunications service providers in the United States, would substantially lessen competition in the national and various local markets for retail mobile wireless telecommunications services (RMWTS), in violation of Section 7 of the Clayton Act. Before the filing of the states' complaint, the U.S. Department of Justice and seven states had entered into a settlement with the merging parties under which they would sell Sprint's prepaid business and some wireless spectrum to Dish Network to form an additional competitor. The instant action attacked the DOJ divestiture settlement as insufficient to preserve competition in the various RMWTS markets. The state plaintiffs alleged, among other things, that the arrangement would create highly concentrated markets and increase the likelihood of coordinated effects in thee markets.]

. . .

2. Unilateral Effects

Unilateral effects refer to "[t]he elimination of competition between two firms that results from their merger[, which] may alone constitute a substantial lessening of competition," and like coordinated effects are analyzed primarily under the Merger Guidelines. *See* [2010] Merger Guidelines § 6. Other courts have noted that unilateral anticompetitive effects are more likely if "the acquiring firm will have the incentive to raise prices or reduce quality after the acquisition, independent of competitive responses from other firms" or if "the merger would result in the elimination of a particularly aggressive competitor in a highly concentrated market." [United States v.] Aetna [Inc.], 240 F. Supp. 3d [1] at 43 [(D.C.C. Oct. 23, 2017)] (internal quotation marks and citations omitted).

Shapiro calculates that the unilateral effects of the Proposed Merger would result in annual consumer harms of $4.6 billion. As is the case regarding coordinated effects, Shapiro's rationale is that New T-Mobile would either raise prices or at least, as the opportunity arises, not lower prices or offer high quality services at the same rate that T-Mobile has pursued in the past, effectively delaying or denying consumers the benefits of more aggressive offers. Shapiro calculated this harm by using a "diversion ratio," which measures how many customers would switch between T-Mobile and Sprint (or their prepaid subsidiaries Metro and Boost) in response to price increases by

[1] Record citations omitted.

the carrier they are using at the time. Shapiro gathered this switching data from a combination of sources, including the FCC and Facebook. Using the diversion ratios, as well as the competitors' prices and profit margins, Shapiro calculated "upward pricing pressure," which roughly reflects the incentive for the companies to increase prices after the merger. To translate this upward pricing pressure into consumer harm, Shapiro assumed that half of the upward pricing pressure would be passed on to consumers in the form of higher prices.

Defendants claim numerous deficiencies in Shapiro's data and upward pricing pressure analysis. They first challenge the reliability of the underlying switching data, arguing that because Facebook users are apparently younger than the average wireless subscriber, Shapiro's use of Facebook data may overstate the importance of T-Mobile as a direct competitor of Sprint. Defendants also challenge upward pricing pressure analysis more generally, noting that it does not account for the repositioning of products, new entry, reputation, or changes in business strategy.

The Court does not doubt that Sprint and T-Mobile are now direct competitors, as the evidence at trial reflected. The Court hesitates, however, to place too much stock in Shapiro's upward pricing pressure analysis given the numerous aspects of the market that it does not capture, as well as the potential that the underlying data may not be sufficiently reliable. Reliance on Shapiro's methodology is further complicated by the theory of consumer harm that Shapiro advances. It essentially asks the Court to assess how slowly or quickly T-Mobile would lower its prices or offer non-price benefits such as high-definition Netflix with or without the merger, regardless of what other competitors do. It is already difficult to assess the competitive effects of a merger in such a rapidly changing industry; asking the Court to assess whether consumers would receive high-definition Netflix in 2020 or 2021 only compounds the necessarily speculative quality of this inquiry.

Without discounting the possibility that upward pricing pressure analysis is a valid form of quantifying the potential unilateral anticompetitive effects of a merger, the Court nevertheless finds that more traditional judicial methods of assessing a merged company's likely future behavior are more reliable and useful in this particular context. As T-Mobile's future CEO Sievert noted at trial, New T-Mobile would be taking a very significant risk by raising prices or slowing its competitive pace, because consumers in the market still generally believe that AT&T and Verizon have superior quality networks; if T-Mobile does not continue to differentiate itself through lower prices and innovative offerings, many consumers might very well choose to pay AT&T and Verizon slightly higher prices for what they believe are better networks and improved service quality. The Court concludes that rather than New T-Mobile assuming the risk entailed by changing a successful business strategy, the merged company would instead more likely prefer to leverage the capacity benefits provided by the Proposed Merger to continue its successful business strategy on a greater scale.

The Court's conclusion in this regard is also bolstered by Sprint's poor condition and DISH's likely entry. While unilateral effects analysis appears particularly concerned with the potential loss of an aggressive maverick firm, there is very little

evidence to support a reliable finding that Sprint can be an aggressive and disruptive maverick in the future. On the contrary, the evidence suggests that Sprint will instead be forced to raise its prices. Moreover, DISH is poised to enter the RMWTS Markets as a new maverick and may compete more sustainably in the long term. Considering also that DISH will acquire Boost, there will be no loss of competition between New T-Mobile and the most successful segment of Sprint's business. The Court thus concludes that the loss of direct competition between T-Mobile and Sprint is insufficient to make reasonable the probability that the Proposed Merger would substantially lessen competition through unilateral effects.

UNITED STATES V. BERTELSMANN SE & CO. KGAA,
646 F. Supp. 3d 1, 38-42 (D.D.C. 2022)
(excerpt on unilateral effects[1])

FLORENCE Y. PAN, United States Circuit Judge

[Simon & Schuster, Inc. ("S&S"), owned by Paramount Global (formerly ViacomCBS), is the third-largest publisher in the United States. S&S publishes about 1,000 new titles yearly and reported over $760 million in net sales in 2020. Penguin Random House ("PRH"), owned by Bertelsmann SE & Co. KGaA ("Bertelsmann"), is the largest book publisher in the United States. PRH annually publishes over 2,000 new books in the U.S. and generates nearly $2.5 billion in revenue. In March 2020, ViacomCBS announced plans to sell S&S. In November 2020, Bertelsmann agreed to purchase S&S for $2.175 billion. The acquisition of S&S would have significantly increased PRH's position as the leading publisher in the United States, increasing its retail market share to almost three times that of its closest competitor.

[In November 2021, the Department of Justice filed a complaint against PRH, S&S, and their parent companies alleging that the merger of PRH and S&S would increase the "monopsony" (buyer) power of the merged company in the market for the acquisition of U.S. publishing rights to anticipated top-selling books and seeking a permanent injunction to block the deal. After a 12-day trial in August 2022, the court concluded that PRH's acquisition of S&S was likely to substantially lessen competition the DOJ's alleged relevant market and enjoined the proposed merger.]

. . .

2. *Other Evidence*

The government does not rely solely on the high degree of market concentration that would result from the merger, and the attendant presumption of anti-competitive harm; instead, the government also "bolster[s] its prima facie case by offering additional evidence." [*FTC v. Wilh.*] *Wilhelmsen* [*Holding ASA*], 341 F. Supp. 3d [27] at 59 [(D.D.C. 2018)]. The government presents evidence that (1) the merger will cause anticompetitive effects from the elimination of competition between PRH and S&S, and (2) the higher concentration in the post-merger market will increase the risk of coordinated anticompetitive conduct by the largest publishers.

i. *Unilateral Effects*

Mergers necessarily eliminate the competition between the merging companies. *See* [*FTC v. H.J.*] *Heinz* [*Co.*], 246 F.3d [708] at 717 [(D.C. Cir. 2001)]. The government contends that PRH and S&S currently compete "fiercely" to publish anticipated top-selling books, and that eliminating direct competition between them is

[1] Footnotes and record citations omitted.

likely to harm authors. Indeed, "[c]ourts have recognized that a merger that eliminates head-to-head competition between close competitors can result in a substantial lessening of competition." [*FTC v.*] *Sysco* [*Corp*.], 113 F. Supp. 3d [1] at 61 [(D.D.C. 2015)]. *see also Wilhelmsen*, 341 F. Supp. 3d at 59. "Unilateral effects" are those that result directly from the elimination of competition between the merging parties. [*United States v.*] *Anthem*, [*Inc*.,] 236 F. Supp. 3d [171] at 216 (D.D.C.) [, *aff'd*, 855 F.3d 345 (D.C. Cir. 2017)]. As explained by the [2010] Merger Guidelines, "[a] merger can enhance market power simply by eliminating competition between the merging parties. This effect can arise even if the merger causes no changes in the way other firms behave." [2020] Merger Guidelines § 1. Unilateral effects may be especially acute in a "highly concentrated market." *Staples I* [*FTC v. Staples*, *Inc*.], 970 F. Supp. [1066] at 1083 [(D.D.C. 1997)].

a. Head-to-Head Competition

The analysis of unilateral effects focuses on how closely the merging firms currently compete, in order to extrapolate the effects of eliminating that competition. *See* [2010] Merger Guidelines § 6.2. Evidence in the record demonstrates that PRH and S&S are close competitors for anticipated top-selling books. Specifically, PRH is the publisher against which S&S competes the most frequently and to which S&S loses the most. Meanwhile, S&S is a significant competitor to PRH, and makes a particularly strong showing in biographies, memoirs, political nonfiction, and books about current events.

The government's expert, Dr. Hill,[1] conducted a variety of economic analyses that assess how closely PRH and S&S compete. Dr. Hill used four different methods to calculate "diversion ratios," which measure head-to head competition between the merging parties by asking the following question: If one merging party lowered advance levels, what percentage of its authors would "divert" their business to the other merging party, as opposed to diverting to other firms in the industry? A higher diversion ratio indicates that the merging parties are close competitors and that the merger is more likely to lead to harm.

Dr. Hill calculated diversion ratios based on: (1) diversion proportional to market shares, which is the largest data set; (2) win/loss data, which examines which publishers the merging parties lose to the most often; (3) runner-up data, which shows how often the other party was the "runner-up" when one of the merging parties won an acquisition; and (4) minutes from the parties' editorial meetings, which provide a window into how frequently one merging party bid on a book and lost to the other party. Recognizing that each methodology has limitations, Dr. Hill performed multiple

[1] Dr. Nicholas D. Hill is a partner at Bates White Economic Consulting in Washington, D.C. He received his Ph.D. in economics in 2006 from Johns Hopkins University. From 2006 to 2013, Dr. Hill was an economist in the Antitrust Division. From 2013 to 2014, he was an economist at the Federal Trade Commission. Dr. Hill returned to the Antitrust Division as an assistant section chief from 2014 to 2017, when he joined Bates White. While in private practice, Dr. Hill has testified on behalf of the Antitrust Division, the FTC, and private parties, on both he plaintiff and defense sides.

tests "to get a holistic understanding of what diversion might look like." All the methodologies employed by Dr. Hill pointed to the same conclusion: that PRH is S&S's closest competitor, and that S&S is a significant competitor to PRH. Specifically, Dr. Hill's diversion ratios indicate that if PRH lowered advances, between 19 and 27 percent of its authors would divert to S&S; and that if S&S lowered advances, between 42 and 59 percent of its authors would divert to PRH. The government summarized the results of the four studies as follows:

Figure **7.** Summary of Dr. Hill's Diversion Estimates (PX 70)

Type of Analysis	**Diversion from PRH to S&S**	**Diversion from S&S to PRH**
Diversion according to share	19%	42%
Win/loss data	19%	59%
Runner-up sh1dy	27%	59%
Editorial minutes	21%	54%

The defendants' expert, Professor Snyder,[2] calculated his own diversion ratios, using a less reliable data set assembled from the records of eighteen agents who responded to subpoenas ("agency data"). Although Professor Snyder's ratios were lower, he also found that PRH is S&S's closest competitor. Professor Snyder determined that the diversion ratio from PRH to S&S is 20 percent, and the diversion ratio from S&S to PRH is 27 percent.

The competition between PRH and S&S benefits authors by increasing advances paid for their books, and industry participants predict that the loss of that competition would be harmful to authors. Kensington's CEO, Steven Zacharius, testified, "I personally would expect that [advances] would go down since there will be less competition for those authors." Macmillan's CEO Don Weisberg testified, "My guess is less competition will . . . long-term probably bring the advance levels down." Agent Ayesha Pande testified, "I think overall [the merger] will limit the choice, the number of editors and imprints and publishing houses that would ... be a good home for my clients . . . . And I believe overall advances for my clients would be suppressed."

The merger would cause an inarguable loss of competition from the elimination of situations where PRH and S&S would have been the top two or the only two bidders for an anticipated top seller. Dr. Hill calculates that this should happen in approximately 12 percent of book transactions based on market share, while Professor

[2] Edward A. Snyder is the William S. Beinecke Professor of Economics and Management at the Yale School of Management. He received Ph.D. in economics in 1984 from the University of Chicago. Prof. Snyder has served as dean at both the Booth School of Business at the University of Chicago and the Yale School of Management. He testifies frequently in antitrust cases.

Snyder calculates that it happened only 6 to 7 percent of the time in his data set. The government's evidence included 27 summaries of competitive episodes, over three and a half years, in which PRH and S&S drove up advances through direct, head-to-head competition. For example, as the only two bidders for one book, PRH and S&S drove the advance offered from $6 million to $8 million. As the last two bidders for another book, PRH and S&S drove the advance offered from $685,000 to $825,000. The loss of such head-to-head match-ups undoubtedly would harm the authors whose advances would have been bid up by the direct competition. *See generally* [2010] Merger Guidelines § 6.2. The defendants argue, however, that the incidence of harm would be too infrequent to be considered substantial.

Even when the merging parties were not the top two bidders, S&S's participation strengthened competition across all auction formats—round-robin, best-bid, and hybrid. Hachette CEO Michael Pietsch testified that a larger number of bidders leads to "more upward pressure" so that "in general . . . the price paid at auction can increase because of the number of participants." Dr. Hill confirmed that when a large number imprints participate in an auction, all of them understand that they need to be more aggressive in their bidding to prevail. [*S*]*ee also Anthem*, 236 F. Supp. 3d at 220-21 ("reducing the number of national carriers from four to three is significant" because of its likely effect on bidding behavior). A higher number of bidders also increases the chances that an author will receive an "outlier" high bid. A book's perceived value may vary significantly among different editors and publishers, and an unusually high bid for a book is likelier when there are more bidders. In one notable example, one bidder offered an advance four times higher than the next closest bidder, reflecting the winner's unique view of the book's potential. The loss of S&S as an independent bidder would weaken bidding incentives and reduce the frequency of events like these.

As previously noted, competition among publishers influences advances even in individual negotiations between an agent and one publisher. That is because publishers know that agents can shop the book to other publishers if the publisher's offer is not high enough. Therefore, the loss of PRH as an outside competitor would weaken authors' leverage in one-on-one negotiations with S&S, and the loss of S&S as an outside competitor would weaken authors' leverage in one-on-one negotiations with PRH. This conclusion is consistent with Dr. Hill's expert testimony, as well as the [2010] Merger Guidelines. See [2010] Merger Guidelines § 6.2 ("A merger between two competing [buyers] prevents [sellers] from playing those [buyers] off against each other in negotiations.").

Finally, the evidence suggests that the acquisition of S&S would reduce PRH's motivation to compete for publishing rights. PRH CEO Markus Dohle testified that there are two ways to increase market share in the industry: publish more successful books or acquire other companies that publish successful books. PRH has most recently pursued a strategy of bidding more aggressively and acquiring more "big books" to organically increase its market share. The acquisition of S&S would give PRH an alternative means of increasing its market share that would remove the pressure on PRH to acquire more books. Thus, accomplishing its goal of increasing

market share through the merger would cause PRH to bid less aggressively for books than it otherwise would.

NOTES

1. Following the court's decision, on November 21, 2022, Paramount Global announced that the $2.2 billion sale of Simon & Schuster to Penguin Random House had been terminated. As a result, Paramount paid a $200 million termination fee to Bertelsmann. In June 2023, Paramount Global reached a new agreement to sell Simon & Schuster to KKR, a private equity firm, for $1.62 billion in an all-cash deal. This transaction is expected to close in 2024, subject to regulatory approvals and customary closing conditions.

UNITED STATES V. JETBLUE CORP.,
712 F. Supp. 3d 109, 122-23, 151-52 (D. Mass. 2024)
(excerpt on unilateral effects[1])

YOUNG, JUDGE of the United States[1]

. . .

I. INTRODUCTION

On July 28, 2022, Jet Blue Airways Corporation ("JetBlue") and Spirit Airlines, Inc. ("Spirit") (collectively, the "Defendant Airlines") executed a final merger agreement. JetBlue, the sixth largest airline in the United States, agreed to pay $3.8 billion to acquire Spirit, the seventh largest airline in the United States. The proposed merger would create the nation's fifth largest airline, accounting for 10.2% of the domestic market. Immediately after the merger agreement was signed, speculation began regarding the merger's antitrust implications.

JetBlue is a so-called low-cost carrier ("LCC"), relying on point-to-point flying using fewer types of aircraft. Spirit is known as an "Ultra-Low-Cost Carrier" ("ULCC"), meaning that its offerings target budget-conscious passengers with low-cost, often unbundled flight options. The proposed merger would transfer all Spirit's assets to JetBlue and remove Spirit from the market.

Invoking the Clayton Act, 15 U.S.C. § 18, the United States Department of Justice, joined by the District of Columbia, the Commonwealth of Massachusetts, and the states of California, Maryland, New Jersey, New York, and North Carolina (collectively hereinafter, "the Government"), filed this action to enjoin the Defendant Airlines from proceeding with the merger. The resulting 17-day bench trial on the merits featured testimony by twenty-two witnesses, over 900 exhibits, and thousands of pages of evidence. The Court also traveled to a nearby location to take in a view of both Defendant Airlines' seat configurations. The trial transcript exceeds 2,500 pages, accompanied by over eighty binders containing exhibits presented to witnesses. Post-trial submissions exceed 700 pages.

The parties' thorough presentation, as well as a careful review of the parties' voluminous submissions, illumines certain key findings: The airline industry is an oligopoly that has become more concentrated due to a series of mergers in the first decades of the twenty-first century, with a small group of firms in control of the vast majority of the market. *See In re Dom. Airline Travel Antitrust Litig.*, 691 F. Supp. 3d

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[1] Record citations omitted.

[1] This is how my predecessor, Peleg Sprague (D. Mass. 1841-1865), would sign official documents. Now that I'm a Senior District Judge I adopt this format in honor of all the judicial colleagues, state and federal, with whom I have had the privilege to serve over the past 45 years.

175, 192-94 (D.D.C. 2023). JetBlue and Spirit are not two of the largest airlines, though were they to merge, they would grow in size to further compete with the larger airlines.

From the Defendant Airlines' perspective, organic growth is too slow, as there are too few new aircraft available to meet industry demand. JetBlue's inorganic growth through acquisition of Spirit's sizable fleet of retrofittable aircraft—of the same type—largely solves this problem and is a tried-and-true growth strategy in this industry.

A post-merger, combined firm of JetBlue and Spirit would likely place stronger competitive pressure on the larger airlines in the country. At the same time, however, the consumers that rely on Spirit's unique, low-price model would likely be harmed. The Defendant Airlines currently compete head-to-head throughout the country, and that competition, particularly Spirit's downward pressure on prices, benefits all consumers. Spirit's unique position in the domestic scheduled passenger airline industry would be exceedingly difficult for another airline, or a combination of other airlines, to replicate, even with low barriers to entry and the dynamic nature of the industry inasmuch as they face the same, industry-wide aircraft sourcing issues.

The Clayton Act was designed to prevent anticompetitive harms for consumers by preventing mergers or acquisitions the effect of which "may be substantially to lessen competition, or tend to create a monopoly." 15 U.S.C. § 18. Summing it up, if JetBlue were permitted to gobble up Spirit—at least as proposed—it would eliminate one of the airline industry's few primary competitors that provides unique innovation and price discipline. It would further consolidate an oligopoly by immediately doubling JetBlue's stakeholder size in the industry. Worse yet, the merger would likely incentivize JetBlue further to abandon its roots as a maverick, low-cost carrier. While it is understandable that JetBlue seeks inorganic growth through acquisition of aircraft that would eliminate one of its primary competitors, the proposed acquisition, in this Court's attempt to predict the future in murky times, does violence to the core principle of antitrust law: to protect the United States' markets—and its market participants—from anticompetitive harm.

Accordingly, for the reasons below, the Court rules that the proposed merger, as it stands, would substantially lessen competition in violation of the Clayton Act. The July 28, 2022 proposed merger, therefore, is enjoined.

. . .

2. Direct Evidence of Anticompetitive Effects

a. Elimination of Head-to-Head Competition Between JetBlue and Spirit

First, the Government has clearly demonstrated that the merger will cause unilateral anticompetitive effects, as JetBlue and Spirit currently compete head-to-head on multiple routes. "The extent of direct competition between the products sold by the merging parties is central to the evaluation of unilateral effects." *ProMedica* [*Health Sys. v. FTC*], 749 F.3d [559] at 569 [(6th Cir. 2014)] (quoting [2010] Horizontal

Merger Guidelines § 6.1).[51] Acquisitions "that eliminate head-to-head competition between close competitors often result in a lessening of competition." *F.T.C. v. Staples, Inc.*, 190 F. Supp. 3d 100, 131 (D.D.C. 2016) ("*Staples II*") (citing Horizontal Merger Guidelines § 6); *see also*, *e.g.*, [*FTC v. H.J.*] *Heinz* [*Co.*], 246 F.3d [708] at 716-17 [(D.C. Cir. 2001)] (ruling that the Government's prima facie case was "bolstered by the indisputable fact that the merger will eliminate competition between the two merging parties"); *H&R Block*, 833 F. Supp. 2d at 81–82 (noting the likelihood of unilateral anticompetitive effects given evidence of H & R Block lowering its prices in response to direct competition from TaxACT, including H & R Block documents that "appear to acknowledge that TaxACT has put downward pressure on HRB's pricing ability").

If the collaborating parties are particularly close competitors, the unilateral effects are especially acute. *See* [*United States v.*] *Bertelsmann* [*SE & Co. KGaA*], 646 F. Supp. 3d [1] at 39 [(D.D.C. Nov. 15, 2022)] ("The analysis of unilateral effects focuses on how closely the merging firms currently compete, in order to extrapolate the effects of eliminating that competition."); *F.T.C. v. Libbey*, 211 F. Supp. 2d 34, 47-48 (D.D.C. 2002) (discussing evidence of head-to-head competition between the merging parties, including taking customers from each other); *F.T.C. v. Swedish Match*, 131 F. Supp. 2d 151, 169 (D.D.C. 2000) ("[T]he weight of the evidence demonstrates that a unilateral price increase by Swedish Match is likely after the acquisition because it will eliminate one of Swedish Match's primary direct competitors."). The parties need not be each other's closest competitors to raise a threat to competition; being close competitors is enough for an acquisition to result in upward pricing pressure. [*United States v.*] *Anthem* [*Inc.*], 236 F. Supp. 3d [171] at 216 [(D.D.C. 2017)] ("Anthem's insistence that United, not Cigna, is its 'closest' competitor, is beside the point. The acquired firm need not be the other's closest competitor to have an anticompetitive effect; the merging parties only need to be close competitors.").

The loss of Spirit's influence on JetBlue as a head-to-head competitor would likely result in less competition to both discipline the prices and spur the innovation of JetBlue as a smaller, maverick—more competitive—market participant.

[51] The Court is aware that after the trial concluded, on December 18, 2023, the F.T.C. and DOJ issued a revised set of Merger Guidelines. See Justice Department and Federal Trade Commission Release 2023 Merge Guidelines, U.S. Dep't of Just., Off. of Pub. Affs., https://www.justice.gov/opa/pr/justice-department-and-federal-trade-commission-release-2023-merger-guidelines (last visited Jan. 12, 2024); 2023 Merger Guidelines, U.S. Dep't of Just., Antitrust Div., https://www.justice.gov/atr/2023-merger-guidelines (last visited Jan. 12, 2024).

Ease of Entry Defenses

Horizontal Merger Guidelines

U.S. Department of Justice

and the

Federal Trade Commission

Issued: August 19, 2010

Buyer characteristics and the nature of the procurement process can affect coordination. For example, sellers may have the incentive to bid aggressively for a large contract even if they expect strong responses by rivals. This is especially the case for sellers with small market shares, if they can realistically win such large contracts. In some cases, a large buyer may be able to strategically undermine coordinated conduct, at least as it pertains to that buyer's needs, by choosing to put up for bid a few large contracts rather than many smaller ones, and by making its procurement decisions opaque to suppliers.

8. Powerful Buyers

Powerful buyers are often able to negotiate favorable terms with their suppliers. Such terms may reflect the lower costs of serving these buyers, but they also can reflect price discrimination in their favor.

The Agencies consider the possibility that powerful buyers may constrain the ability of the merging parties to raise prices. This can occur, for example, if powerful buyers have the ability and incentive to vertically integrate upstream or sponsor entry, or if the conduct or presence of large buyers undermines coordinated effects. However, the Agencies do not presume that the presence of powerful buyers alone forestalls adverse competitive effects flowing from the merger. Even buyers that can negotiate favorable terms may be harmed by an increase in market power. The Agencies examine the choices available to powerful buyers and how those choices likely would change due to the merger. Normally, a merger that eliminates a supplier whose presence contributed significantly to a buyer's negotiating leverage will harm that buyer.

> *Example 22:* Customer C has been able to negotiate lower pre-merger prices than other customers by threatening to shift its large volume of purchases from one merging firm to the other. No other suppliers are as well placed to meet Customer C's needs for volume and reliability. The merger is likely to harm Customer C. In this situation, the Agencies could identify a price discrimination market consisting of Customer C and similarly placed customers. The merger threatens to end previous price discrimination in their favor.

Furthermore, even if some powerful buyers could protect themselves, the Agencies also consider whether market power can be exercised against other buyers.

> *Example 23:* In Example 22, if Customer C instead obtained the lower pre-merger prices based on a credible threat to supply its own needs, or to sponsor new entry, Customer C might not be harmed. However, even in this case, other customers may still be harmed.

9. Entry

The analysis of competitive effects in Sections 6 and 7 focuses on current participants in the relevant market. That analysis may also include some forms of entry. Firms that would rapidly and easily enter the market in response to a SSNIP are market participants and may be assigned market shares. See Sections 5.1 and 5.2. Firms that have, prior to the merger, committed to entering the market also will normally be treated as market participants. See Section 5.1. This section concerns entry or adjustments to pre-existing entry plans that are induced by the merger.

As part of their full assessment of competitive effects, the Agencies consider entry into the relevant market. The prospect of entry into the relevant market will alleviate concerns about adverse competitive effects only if such entry will deter or counteract any competitive effects of concern so the merger will not substantially harm customers.

The Agencies consider the actual history of entry into the relevant market and give substantial weight to this evidence. Lack of successful and effective entry in the face of non-transitory increases in the margins earned on products in the relevant market tends to suggest that successful entry is slow or difficult. Market values of incumbent firms greatly exceeding the replacement costs of their tangible assets may indicate that these firms have valuable intangible assets, which may be difficult or time consuming for an entrant to replicate.

A merger is not likely to enhance market power if entry into the market is so easy that the merged firm and its remaining rivals in the market, either unilaterally or collectively, could not profitably raise price or otherwise reduce competition compared to the level that would prevail in the absence of the merger. Entry is that easy if entry would be timely, likely, and sufficient in its magnitude, character, and scope to deter or counteract the competitive effects of concern.

The Agencies examine the timeliness, likelihood, and sufficiency of the entry efforts an entrant might practically employ. An entry effort is defined by the actions the firm must undertake to produce and sell in the market. Various elements of the entry effort will be considered. These elements can include: planning, design, and management; permitting, licensing, or other approvals; construction, debugging, and operation of production facilities; and promotion (including necessary introductory discounts), marketing, distribution, and satisfaction of customer testing and qualification requirements. Recent examples of entry, whether successful or unsuccessful, generally provide the starting point for identifying the elements of practical entry efforts. They also can be informative regarding the scale necessary for an entrant to be successful, the presence or absence of entry barriers, the factors that influence the timing of entry, the costs and risk associated with entry, and the sales opportunities realistically available to entrants.

If the assets necessary for an effective and profitable entry effort are widely available, the Agencies will not necessarily attempt to identify which firms might enter. Where an identifiable set of firms appears to have necessary assets that others lack, or to have particularly strong incentives to enter, the Agencies focus their entry analysis on those firms. Firms operating in adjacent or complementary markets, or large customers themselves, may be best placed to enter. However, the Agencies will not presume that a powerful firm in an adjacent market or a large customer will enter the relevant market unless there is reliable evidence supporting that conclusion.

In assessing whether entry will be timely, likely, and sufficient, the Agencies recognize that precise and detailed information may be difficult or impossible to obtain. The Agencies consider reasonably available and reliable evidence bearing on whether entry will satisfy the conditions of timeliness, likelihood, and sufficiency.

9.1 Timeliness

In order to deter the competitive effects of concern, entry must be rapid enough to make unprofitable overall the actions causing those effects and thus leading to entry, even though those actions would be profitable until entry takes effect.

Even if the prospect of entry does not deter the competitive effects of concern, post-merger entry may counteract them. This requires that the impact of entrants in the relevant market be rapid enough that customers are not significantly harmed by the merger, despite any anticompetitive harm that occurs prior to the entry.

The Agencies will not presume that an entrant can have a significant impact on prices before that entrant is ready to provide the relevant product to customers unless there is reliable evidence that anticipated future entry would have such an effect on prices.

9.2 Likelihood

Entry is likely if it would be profitable, accounting for the assets, capabilities, and capital needed and the risks involved, including the need for the entrant to incur costs that would not be recovered if the entrant later exits. Profitability depends upon (a) the output level the entrant is likely to obtain, accounting for the obstacles facing new entrants; (b) the price the entrant would likely obtain in the post-merger market, accounting for the impact of that entry itself on prices; and (c) the cost per unit the entrant would likely incur, which may depend upon the scale at which the entrant would operate.

9.3 Sufficiency

Even where timely and likely, entry may not be sufficient to deter or counteract the competitive effects of concern. For example, in a differentiated product industry, entry may be insufficient because the products offered by entrants are not close enough substitutes to the products offered by the merged firm to render a price increase by the merged firm unprofitable. Entry may also be insufficient due to constraints that limit entrants' competitive effectiveness, such as limitations on the capabilities of the firms best placed to enter or reputational barriers to rapid expansion by new entrants. Entry by a single firm that will replicate at least the scale and strength of one of the merging firms is sufficient. Entry by one or more firms operating at a smaller scale may be sufficient if such firms are not at a significant competitive disadvantage.

10. Efficiencies

Competition usually spurs firms to achieve efficiencies internally. Nevertheless, a primary benefit of mergers to the economy is their potential to generate significant efficiencies and thus enhance the merged firm's ability and incentive to compete, which may result in lower prices, improved quality, enhanced service, or new products. For example, merger-generated efficiencies may enhance competition by permitting two ineffective competitors to form a more effective competitor, e.g., by combining complementary assets. In a unilateral effects context, incremental cost reductions may reduce or reverse any increases in the merged firm's incentive to elevate price. Efficiencies also may lead to new or improved products, even if they do not immediately and directly affect price. In a

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U.S. Department of Justice and the Federal Trade Commission

Issued: December 18, 2023

Although merging parties sometimes argue that a poor or weakening position should serve as a defense even when it does not meet these elements, the Supreme Court has "confine[d] the failing company doctrine to its present narrow scope."[63] The Agencies evaluate evidence of a failing firm consistent with this prevailing law.[64]

3.2. Entry and Repositioning

Merging parties sometimes raise a rebuttal argument that a reduction in competition resulting from the merger would induce entry or repositioning[65] into the relevant market, preventing the merger from substantially lessening competition or tending to create a monopoly in the first place. This argument posits that a merger may, by substantially lessening competition, make the market more profitable for the merged firm and any remaining competitors, and that this increased profitability may induce new entry. To evaluate this rebuttal evidence, the Agencies assess whether entry induced by the merger would be "timely, likely, and sufficient in its magnitude, character, and scope to deter or counteract the competitive effects of concern."[66]

Timeliness. To show that no substantial lessening of competition is threatened by a merger, entry must be rapid enough to replace lost competition before any effect from the loss of competition due to the merger may occur. Entry in most industries takes a significant amount of time and is therefore insufficient to counteract any substantial lessening of competition that is threatened by a merger. Moreover, the entry must be durable: an entrant that does not plan to sustain its investment or that may exit the market would not ensure long-term preservation of competition.

Likelihood. Entry induced by lost competition must be so likely that no substantial lessening of competition is threatened by the merger. Firms make entry decisions based on the market conditions they expect once they participate in the market. If the new entry is sufficient to counteract the merger's effect on competition, the Agencies analyze why the merger would induce entry that was not planned in pre-merger competitive conditions.

The Agencies also assess whether the merger may increase entry barriers. For example, the merging firms may have a greater ability to discourage or block new entry when combined than they would have as separate firms. Mergers may enable or incentivize unilateral or coordinated exclusionary

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Liquidation value is the highest value the assets could command outside the market. If a reasonable alternative offer was rejected, the parties cannot claim that the business is failing.

[63] *Citizen Publ'g*, 394 U.S. at 139.

[64] The Agencies do not normally credit claims that the assets of a division would exit the relevant market in the near future unless: (1) applying cost allocation rules that reflect true economic costs, the division has a persistently negative cash flow on an operating basis, and such negative cash flow is not economically justified for the firm by benefits such as added sales in complementary markets or enhanced customer goodwill; and (2) the owner of the failing division has made unsuccessful good-faith efforts to elicit reasonable alternative offers that would keep its assets in the relevant market and pose a less severe danger to competition than does the proposed acquisition. Because firms can allocate costs, revenues, and intra-company transactions among their subsidiaries and divisions, the Agencies require evidence that is not solely based on management plans that could have been prepared for the purpose of demonstrating negative cash flow or the prospect of exit from the relevant market.

[65] Repositioning is a supply-side response that is evaluated like entry. If repositioning requires movement of assets from other markets, the Agencies will consider the costs and competitive effects of doing so. Repositioning that would reduce competition in the markets from which products or services are moved is not a cognizable rebuttal for a lessening of competition in the relevant market.

[66] *FTC v. Sanford Health*, 926 F.3d 959, 965 (8th Cir. 2019).

strategies that make entry more difficult. Entry can be particularly challenging when a firm must enter at multiple levels of the market at sufficient scale to compete effectively.

Sufficiency. Even where timely and likely, the prospect of entry may not effectively prevent a merger from threatening a substantial lessening of competition. Entry may be insufficient due to a wide variety of constraints that limit an entrant's effectiveness as a competitor. Entry must at least replicate the scale, strength, and durability of one of the merging parties to be considered sufficient. The Agencies typically do not credit entry that depends on lessening competition in other markets.

As part of their analysis, the Agencies will consider the economic realities at play. For example, lack of successful entry in the past will likely suggest that entry may be slow or difficult. Recent examples of entry, whether successful or unsuccessful, provide the starting point for identifying the elements of practical entry barriers and the features of the industry that facilitate or interfere with entry. The Agencies will also consider whether the parties' entry arguments are consistent with the rationale for the merger or imply that the merger itself would be unprofitable.

3.3. Procompetitive Efficiencies

The Supreme Court has held that "possible economies [from a merger] cannot be used as a defense to illegality."[67] Competition usually spurs firms to achieve efficiencies internally, and firms also often work together using contracts short of a merger to combine complementary assets without the full anticompetitive consequences of a merger.

Merging parties sometimes raise a rebuttal argument that, notwithstanding other evidence that competition may be lessened, evidence of procompetitive efficiencies shows that no substantial lessening of competition is in fact threatened by the merger. This argument asserts that the merger would not substantially lessen competition in any relevant market in the first place.[68] When assessing this argument, the Agencies will not credit vague or speculative claims, nor will they credit benefits outside the relevant market that would not prevent a lessening of competition in the relevant market. Rather, the Agencies examine whether the evidence[69] presented by the merging parties shows each of the following:

Merger Specificity. The merger will produce substantial competitive benefits that could not be achieved without the merger under review.[70] Alternative ways of achieving the claimed benefits are considered in making this determination. Alternative arrangements could include organic growth of one of the merging firms, contracts between them, mergers with others, or a partial merger involving only those assets that give rise to the procompetitive efficiencies.

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[67] *Phila. Nat'l Bank*, 374 U.S. at 371; *Procter & Gamble Co.*, 386 U.S. at 580 ("Congress was aware that some mergers which lessen competition may also result in economies but it struck the balance in favor of protecting competition.").
[68] *United States v. Anthem*, 855 F.3d 345, 353-55 (D.C. Cir. 2017) (although efficiencies not a "defense" to antitrust liability, evidence sometimes used "to rebut a prima facie case"); *Saint Alphonsus Medical Center-Nampa*, 778 F.3d at 791 ("The Clayton Act focuses on competition, and the claimed efficiencies therefore must show that the prediction of anticompetitive effects from the prima facie case is inaccurate.").
[69] In general, evidence related to efficiencies developed prior to the merger challenge is much more probative than evidence developed during the Agencies' investigation or litigation.
[70] If inter-firm collaborations are achievable by contract, they are not merger specific. The Agencies will credit the merger specificity of efficiencies only in the presence of evidence that a contract to achieve the asserted efficiencies would not be practical. *See Anthem*, 855 F.3d at 357.

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265 F. SUPP. 3D 415, 443-44 (D. DEL. 2017)
(excerpt[1])

ROBINSON, Senior District Judge

[The DOJ challenged the acquisition by Energy Solutions, Inc. of Waste Control Specialists LLC ("WCS"), alleging that the acquisition would violate Section 7 of the Clayton Act by substantially lessening competition for disposal of low-level radioactive waste ("LLRW") generated by commercial entities. In a bench trial, Judge Robinson found that the two companies competed directly with each other and that, for certain categories of radioactive waste, they were the only two viable options for customers. The companies defended in part with an ease of entry/expansion defense.]

1. Ease of entry and expansion

Defendants may rebut the government's prima facie case by showing that new firms can easily enter or existing firms can easily expand into the relevant product market in response to supracompetitive pricing. *Fed. Trade Comm'n v. Cardinal Health, Inc*., 12 F. Supp. 2d 34, 54-55 (D.D.C. 1998); [*United States v.] Anthem*, 236 F. Supp. 3d [171] at 221-22 [(D.D.C. 2017), *aff'd* 855 F.3d 345 (D.C. Cir. 2017)]. How easily firms may enter or expand is determined by the barriers to entry. [*FTC v.*] *Cardinal Health*, 12 F. Supp. 2d [34] at 55 [(D.D.C. 1998)]. Barriers to entry include, among other things, regulatory requirements, high capital costs, or technological obstacles. *Broadcom Corp. v. Qualcomm Inc.*, 501 F.3d 297, 307 (3d Cir. 2007). The entry or expansion must be "timely, likely and sufficient in its magnitude, character, and scope." [*United States v.*] *H & R Block*, 833 F. Supp. 2d [36] at 73 [(D.D.C. 2011]. Entry is timely only if it is rapid enough to deter or render insignificant the anticompetitive effects of the merger. *Anthem*, 236 F. Supp. 3d at 221-22. Entry is likely only if it would be profitable and feasible, accounting for all the attendant costs and difficulties. *Id*. And entry is sufficient only if it can "affect pricing" and "scale to compete on the same playing field" as the merged firm. *Id*.

There is no dispute that the barriers to entry in LLRW disposal are incredibly high. The defendants themselves recognize that these high entry barriers insulate them from competition. Building and operating a LLRW disposal facility requires, among other things, legislative approval, a radioactive waste license from the environmental protection agency, a multi-million dollar upfront capital investment, a site with unique geological features, and employees trained in a multitude of subjects related to radioactive waste and radiation safety.

1. Record citations and footnotes omitted

"[T]he history of entry into the relevant market is a central factor in assessing the likelihood of entry in the future." *Anthem*, 236 F.Supp.3d at 222. WCS's entry cost was over $700 million and took 17 years. WCS is the only firm in the last three decades to successfully enter and obtain a license for commercial disposal of Class A, B, or C LLRW. No other firm is currently pursuing licensing or construction of a commercial LLRW disposal facility. Accordingly, entry of new firms is unlikely.

Recognizing that new entrants were unlikely, defendants instead have argued that existing firms could expand into the relevant product market. Specifically, defendants argue that existing RCRA facilities could expand into LLRW disposal and/or US Ecology could improve its competitive position in a manner to sufficiently offset the anticompetitive effects of the merger. This too, however, is unlikely. [redacted] has three RCRA facilities within the relevant states that currently do not accept LLRW. Accordingly, the court finds expansion by existing RCRA facilities into the market for disposal of lower-activity LLRW to be highly unlikely.

The other competitors currently active in the relevant product market (US Ecology at its Grandview, Idaho facility and BSFR) are also unlikely to expand in a manner sufficient to offset the anticompetitive effects of the merger. Neither have a license to dispose of radioactive waste. Both are, therefore, limited to LLRW that qualifies for disposal under their exemptions which are below the radioactive concentration limits for WCS's exempt cell. Moreover, US Ecology is constrained by its reliance on the NRC's 20.2002 exemption, which involves a significant time lag. The court concludes that defendants have not rebutted the government's prima facie case by demonstrating ease of entry or expansion into the relevant product market. If anything, the government has bolstered its own prima facie case by demonstrating the opposite. [*FTC v.*] *Heinz*, 246 F.3d [708] at 717 [(D.C. Cir. 2001)]; [*FTC v.*] *Univ. Health, Inc*., 938 F.2d [1206] at 1220 [(11th Cir. 1991)].

FTC v. SANFORD HEALTH
926 F.3d 959, 965 (8th Cir. June 13, 2019)
***aff'g*, No. 1:17-CV-133 (D.N.D. Dec. 15, 2017)**

STEVEN M. COLLOTON, United States Circuit Judge

[The FTC and the State of North Dakota filed a complaint alleging that the proposed acquisition by Sanford Health of Mid Dakota Clinic, P.C. (MDC) would likely substantially lessen competition in four relevant medical service markets (adult primary care physician (PCP) services, pediatric services, OB/GYN services, and general surgery physician services) in the four-county Bismarck, ND Metropolitan Statistical Area. Sanford Health is an integrated healthcare system operating in North Dakota and several other states. In the Bismarck-Mandan region of North Dakota, Sanford operates an acute care hospital, eight primary care clinics, and several specialty clinics. MDC is a multispecialty for-profit physician group with nine clinics and one ambulatory surgery center in the region. Among other things, the complaint alleged that the proposed transaction would create by far the largest—and in one case, the only—group of physicians offering these services in Bismarck MSA. The district found for the FTC on the merits and the Eight Circuit affirmed.]

. . .

The companies also argued that Catholic Health, a competitor of Sanford, was poised to enter and compete in the Bismarck-Mandan market. They contend that Catholic Health's entrance would counteract the anticompetitive effects of the merger. Entry of competitors into a market can offset anticompetitive effects, however, only if the entrance is "timely, likely, and sufficient in its magnitude, character, and scope to deter or counteract the competitive effects of concern." Horizontal Merger Guidelines § 9; *see also FTC v. Cardinal Health, Inc*., 12 F. Supp. 2d 34, 55 (D.D.C. 1998). The court found that Catholic Health would not be able to enter the market quickly after the merger. Catholic Health's president testified that the company faced difficulties recruiting physicians in the Bismarck-Mandan area. Although the president testified that the company could recruit doctors to enter the market in the short term, he also explained that it would take up to twice as long to establish a name and reputation that could compete with Sanford. On appeal, the companies point to testimony that Catholic Health intended to enter the market and had recruited a top physician in Bismarck. But the district court did not clearly err in giving more weight to Catholic Health's testimony that it could not timely compete with Sanford in the Bismarck-Mandan market, and in finding that entry of this competitor would not come soon enough to offset anticompetitive effects of the merger.

NOTES

1. At trial, evidence was showing challenges to recent physician recruitment of Sanford, MDC, and Catholic Health in the Bismarck-Mandan area, including the area's geographic location, its perceived adverse weather conditions, and lack of OB/GYN and pediatrics residency programs in North Dakota. The evidence also

showed that it is more difficult to recruit physicians who do not have prior connections to the area, and, because of call coverage requirements for OB/GYN physicians, pediatricians, and general surgeons, it is difficult to recruit to groups of fewer than four physicians in each of those specialties.

2. The district found that the evidence does not demonstrate that Catholic Health would be able to recruit enough physicians to replace the MDC physicians currently referring to Catholic Health. Catholic Health potential expansion therefore cannot be considered timely, likely, or sufficient to counter the anticompetitive effects of the proposed transaction.

UNITED STATES V. BERTELSMANN SE & CO. KGAA,
646 F. Supp. 3d 1, at 51-53 (D.D.C. Nov. 15, 2022)
(excerpt on entry[1])

FLORENCE Y. PAN, United States Circuit Judge

[The Department of Justice brought an action alleging that the proposed $2.18 billion acquisition by Bertelsmann, the owner of Penguin Random House, of Simon & Schuster from ViacomCBS. The DOJ alleged that the acquisition would substantially lessen competition in the input market for the U.S. publishing rights to anticipated top-selling books (defined to be books with advances over $250K). Penguin Random House and Simon & Schuster are two of the "Big Five" largest book publishers in the United States, with market shares of 37% and 12%, respectively. The court sustained the DOJ's market definition, found that the merger was likely to substantially harm competition through both unilateral and coordinated effects, and rejected the defenses of the merging parties.]

. . .

2. Barriers to Entry and Expansion

The defendants argue that there are few barriers to entry that would prevent new or existing publishers from competing effectively with the merged company. New entrants to the market would presumably give authors alternative outlets to publish their books, thereby preventing the merged entity from lowering advances. "The existence and significance of barriers to entry are frequently . . . crucial considerations in a rebuttal analysis. In the absence of significant barriers, a company probably cannot maintain [sub]competitive pricing for any length of time." [*United States v.*] *Baker Hughes*, [*Inc*.,] 908 F.2d [981] at 987 [(D.C. Cir. 1990)]. To constrain the new entity, "entry [by new competitors] must be timely, likely, and sufficient in its magnitude, character, and scope to deter or counteract the competitive effects of concern." [*FTC v. Wilh.*] *Wilhelmsen* [*Holding ASA*], 341 F. Supp. 3d [27] at 66-67 [(D.D.C. 2018)] (quotations omitted). "The expansion of current competitors is regarded as essentially equivalent to new entry, and is therefore evaluated according to the same criteria." *Id.* at 66 (quotations omitted).

Contrary to the defendants' contentions, the evidence demonstrates that there are substantial barriers to entry and expansion in the publishing market for anticipated top-selling books. Established publishers have many advantages that are not easily replicated, including: (1) back lists that generate substantial and consistent revenue, which in turn supports risky acquisitions of high-advance books; (2) large and effective marketing, sales, and distribution teams that have relationships with media and retailers; (3) excellent reputations and track records of success that attract authors; and

[1] Record citations, internal cross-references, and footnotes omitted.

(4) lower variable costs due to economies of scale. In addition, numerous publisher witnesses expressed concern about a lack of access to sufficient printing capacity, which limits the number of books that publishers can physically produce and thus limits opportunity for expansion. Industry insiders, including PRH executives, candidly acknowledged in trial testimony and ordinary-course documents that barriers to entry are high in the publishing business.

The best proof that would-be new competitors face formidable barriers to entry is the stability of market shares in the industry: No publisher has entered the market and become a strong competitor against the Big Five in the past thirty years. Moreover, the Big Five's market share in acquiring anticipated top-selling books has remained stable for the past three years. Thus, there is little evidence that new or existing publishers will grow at a pace and magnitude that would allow them to discipline a merged PRH and S&S. *See Wilhelmsen*, 341 F. Supp. 3d at 68 ("The fact that the merging parties have been able to maintain high margins and market shares without witnessing notable entry and expansion suggests that . . . the market . . . is characterized by significant barriers to entry." (cleaned up)); Merger Guidelines § 5.3 ("The Agencies give more weight to market concentration when market shares have been stable over time . . . ."). The Big Five's market shares are built on "decades of credibility and success," and they cannot be easily challenged by less-established publishers.

Although the defendants argue that social media like "BookTok" and Amazon's online bookstore level the playing field for smaller publishers, those platforms are not new and are far from "game-changing." Despite the current availability of "BookTok" and virtual storefronts, the Big Five still consistently acquire the publishing rights for 91 percent of anticipated top-selling books, demonstrating that the playing field has not been leveled in any meaningful way. For example, PRH utilizes its superior resources to maximize sales even on Amazon.

The defendants nevertheless point to new entrants like Zando, Spiegel & Grau, and Astra House, which have had some success in acquiring publishing rights to anticipated top-selling books. Although those publishing houses are associated with successful and well-respected editors, they lack many of the other advantages enjoyed by the Big Five: big back lists; extensive marketing, sales, and distribution teams; and scale. As a result, those new entrants have barely made a dent in the relevant market —their collective share is less than one percent, and no one in the industry views them as substantial competitors to the Big Five. Moreover, the growth of those new competitors was accompanied by a countervailing shrinkage in the market shares of other non-Big Five publishers: The stability of the overall market share of non-Big Five publishers indicates that the new entrants have done little to change the competitive landscape, and that barriers to entry and expansion remain high.

The defendants contend that Big Five rivals like HarperCollins and well-funded companies like Disney are poised to expand in the relevant market. To be sure, Big Five rivals face low barriers to expansion because they have many of the same advantages that PRH and S&S have. But there is no evidence that HarperCollins, Hachette, or Macmillan could or would compete more aggressively with the merged company. The distribution of market shares among PRH, S&S, and the other Big Five

publishers, has remained relatively constant in recent years. The Court has every reason to believe that all the industry players are already doing their best to compete; it is therefore unlikely that the non-merging Big Five publishers could suddenly expand sufficiently to prevent the anticipated competitive harm.

Two well-funded companies outside the Big Five highlighted by the defendants are Amazon and Disney. Amazon acquired several high-priced books when it first started its publishing business about a decade ago, but it has failed to make significant headway in the industry. From 2019 to 2021, Amazon's share in acquiring the publishing rights to anticipated top-selling books declined from under [Redacted] to under [Redacted]. Amazon also struggles with selling its books outside of its own platform. The Court therefore is not convinced that Amazon is a significant competitive constraint in the relevant market. The defendants argue that [Redacted]. While Disney may have the motivation and financial resources to execute the alleged plan, it will still face many of the previously discussed barriers to entry. There is no evidence to suggest that Disney is better equipped than Amazon to succeed in the relevant market. In addition, it is a strain to characterize Disney's five-year aspirational plan as evidence of "timely" market entry. *See Staples II* [*FTC v. Staples, Inc.*], 190 F. Supp. 3d [100] at 133 [(D.D.C. 2016)] "The relevant time frame for consideration in this forward looking exercise is two to three years.")

FTC V. IQVIA HOLDINGS INC.,
710 F. Supp. 3d 329, 393 (S.D.N.Y. 2024)
(excerpt on entry[1])

[EDGARDO] RAMOS, United States District Judge

[On July 18, 2023, the FTC filed a Section 13(b) complaint alleging that the acquisition by IQVIA Holdings Inc. (IQVIA), the world's largest health care data provider, of Propel Media, Inc. (PMI) would substantially lessen competition by combining two of the top three providers of programmatic advertising for health care products, namely prescription drugs and other health care products, to doctors and other health care professionals ("HCP programmatic advertising"), resulting in increased prices, reduced choice, and diminished innovation. Programmatic advertising is the automated buying and selling of digital ad space using software and data-driven technologies. Unlike traditional ad buying, which involves manual negotiations and requests for proposals, programmatic advertising uses algorithms and real-time bidding (RTB) to place ads in front of targeted audiences—in this case, healthcare professionals—across websites, social media, and apps. IQVIA's Lasso Marketing and PMI's DeepIntent are two of the top three providers of HCP programmatic advertising. The complaint also alleges that the acquisition would increase IQVIA's incentive to withhold key information to prevent rival companies and potential entrants from effectively competing, the complaint states. After the court found that the FTC had made out its prima facie case, the court turned to the defendants' rebuttal arguments.]

. . .

b. Ease of Entry

Defendants' second rebuttal argument focuses on ease of entry into the market. A defendant may attempt to rebut the government's prima facie case by introducing evidence "that entry by new competitors will ameliorate the feared anticompetitive effects of a merger." [*United States v.*] Aetna [*Inc.*], 240 F. Supp. 3d [1] at 52 [(D.D.C. Jan. 23, 2017)]. The [2010] Merger Guidelines require consideration of whether "entry would be timely, likely, and sufficient in its magnitude, character, and scope to deter or counteract the competitive effects of concern." [2010] Merger Guidelines § 9. Defendants take issue with this standard, Doc. 288 at 83, but it has been applied by several courts in similar cases, *see, e.g.*, [*New York v.*] Deutsche Telekom [*AG*], 439 F. Supp. 3d [179], 226 [(S.D.N.Y. 2020)] ("[T]he Merger Guidelines provide that new market entry may counteract concerns about anticompetitive effects if entry would be 'timely, likely, and sufficient in its magnitude, character, and scope' to address those concerns." (quoting [2010] Merger Guidelines § 9)); *United States v. Visa USA,*

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[1] Record citations, internal cross-references, and footnotes omitted.

Inc., 163 F. Supp. 2d 322, 342 (S.D.N.Y. 2001) ("The higher the barriers to entry, and the longer the lags before new entry, the less likely it is that potential entrants would be able to enter the market in a timely, likely, and sufficient scale to deter or counteract any anticompetitive restraints."); *see also Aetna*, 240 F. Supp. 3d at 52–53 (collecting cases). That is true with respect to expansion as well as entry. *See, e.g.*, [*FTC v. Wilh.*] *Wilhelmsen* [*Holding ASA*], 341 F. Supp. 3d [27], 67 [(D.D.C. 2018)] ("The expansion of current competitors is regarded as 'essentially equivalent to new entry,' and is therefore evaluated according to the same criteria." (citation omitted)); *H&R Block*, 833 F. Supp. 2d at 73 (invoking same standard in discussing "the likelihood of expansion by existing competitors rather than new entry into the market").

In this case, internal documents from both DeepIntent and Lasso recognize substantial barriers to entry. PX2581-24 (DeepIntent presentation listing several "primary barriers to entry" including "technical and regulatory complexity of integrating healthcare data within advertising"; "talent scarcity at intersection of healthcare and programmatic"; "deep agency and client integrations and contracts"; and "patents" (capitalization omitted)); PX2504-18 (DeepIntent presentation stating that "barrier to entry remains high for healthcare"); PX1128-12 (Lasso presentation stating that "Lasso's unique and industry-leading healthcare marketing and analytics platform provides significant barriers-to-entry," including that "[i]nfrastructure takes years and millions of dollars to build"). These documents are probative of the significant barriers that a new entrant would face. *See* [*FTC v.*] *CCC Holdings* [*Inc.*], 605 F. Supp. 2d [26,] at 49-50 [(D.D.C. 2009) (relying on documents in which defendants had repeatedly touted barriers to entry); *see also* [*United States v.*] *Bazaarvoice*, [*Inc.*, No. 13-CV-00133-WHO,] 2014 WL 203966, at *49 [(N.D. Cal. Jan. 8, 2014)] (citing defendant's pre-acquisition statements about barriers to entry).

Industry participants confirmed in their testimony that new entrants face significant challenges. One witness from a generalist DSP—AdTheorent—explained that, since 2020, he was "not aware of any new entrants that we come up against when we are competing for budgets in the market today other than PulsePoint, DeepIntent, and Lasso." He elaborated:

> There is a pretty steep learning curve, data curve, and a number of other factors that make it harder for a new company to get into the space: Access to their correct data, expertise around the proxy laws that are relevant to targeting advertisements to, for example, patients.... Generalists don't have the types of expertise and knowledge in products and solutions tailored to help, based on top of the health-specific data relevant to health-specific [key performance indicators] for campaign goals.

Similarly, PulsePoint's testimony highlighted the expertise that is required for firms providing HCP programmatic advertising: "From a capability perspective, the generalist DSPs are lacking certain platform capabilities as they relate to targeting, optimization, that are important for executing HCP digital marketing at a competitive price and scale." [*S*]*ee also* Tr. [Redacted] (ad agency witness noting that DeepIntent, Lasso, and PulsePoint all specialize in healthcare and that "[t]he healthcare field is

highly regulated so working with somebody that knows that space, whether it was HCP or patient, gave myself, the team a great deal of comfort and confidence in relying on their platforms versus others in the market").

Attempting to downplay these barriers to entry, Defendants point to Lasso's rapid ascent as evidence that new firms can easily enter the market and find success. Doc. 288 at 80. While Lasso's trajectory demonstrates that entry is possible, it fails to establish that future entry will be timely, likely, and sufficient to counteract the anticompetitive effects of the proposed acquisition. The weight of the evidence indicates that barriers to entry are significant and that firms may face unique challenges in attempting to break into the HCP programmatic advertising space. Defendants have not offered any reason to think that Lasso's rise to its prominent market position is likely to be replicated. *Cf. Wilhelmsen*, 341 F. Supp. 3d at 68 (defendants' contention that merging party's business was "simple and capable of replication in a short period of time is at odds with inferences drawn from the state of the current market and with documentary and testimonial evidence from customers and suppliers").

Nor is it sufficient that generalist DSPs such as [Redacted] have "aspirations" to expand their HCP programmatic advertising business. Consistent with the barriers to entry already discussed, customer testimony indicates that generalist DSPs currently lack some of the capabilities needed to succeed in HCP programmatic advertising. Tr. [Redacted] (ad agency witness explaining that the agency did not include [Redacted] in a recent RFP due to "their capability in the health care professional focused marketplace" and that he would not currently consider [Redacted] to be a viable substitute for the agency's business with Lasso and PulsePoint); *see Staples*, 190 F. Supp. 3d at 134 (rejecting defendants' ease of entry argument in part because customers did not view the potential entrant "as a viable alternative to [the merging parties]"). As Dr. Hatzitaskos put it: "[I]f we see [some of these players] making only a tiny fraction of the revenues of the merging parties, and some of them have been in the market since 2019 or early on, that means that they are lacking in capabilities, sort of the proof is in the pudding."

Defendants also suggest that the mere threat of entry into the market or expansion by existing firms is enough to provide a competitive constraint and rebut the FTC's prima facie case. As discussed above, the standard is that entry must be "timely, likely, and sufficient." But even setting that aside, the Court is not persuaded by Defendants' argument that firms like Google, Yahoo, and Microsoft pose a competitive threat merely because they are "already involved in HCP programmatic advertising to varying degrees." "The marketplace may be filled with many strong and able companies in adjacent spaces. But that does not mean that entry barriers become irrelevant or are somehow more easily overcome." *Bazaarvoice*, 2014 WL 203966, at *71.

Finally, Defendants place significant emphasis on the Second Circuit's decision in *Waste Management*, but the circumstances in that case are not analogous to those present here. At issue was a proposed acquisition involving two companies in the waste disposal business. *See* [*United States v. Waste Mgmt., Inc.,*] 743 F.2d [976,] at 977-78 [(2d Cir. 1984)]. The district court concluded that the relevant product market included

all trash collection, except for collection at certain residences. *Id*. at 978. After affirming that finding, the Second Circuit turned to the defendants' rebuttal arguments. *Id*. at 980–81. The court held that "entry into the relevant product and geographic market by new firms or by existing firms in the Fort Worth area is so easy that any anti-competitive impact of the merger before us would be eliminated more quickly by such competition than by litigation." *Id*. at 983. In fact, the district court had found that "individuals operating out of their homes can acquire trucks and some containers and compete successfully 'with any other company.' " *Id*. There were "examples in the record of such entrepreneurs entering and prospering." Id. Entry by larger companies, likewise, would be "relatively easy" because "Fort Worth haulers could easily establish themselves in Dallas if the price of trash collection rose above the competitive level." Id. Thus, the merged firm would not be able to exercise market power due to "the ease with which new competitors would appear." Id. at 983–84. In this case, by contrast, the record makes clear that market entry is not nearly as simple as individuals "operating out of their homes" being able to compete with established players. That much should be clear from the fact that IQVIA has proposed [Redacted] to complete the consolidation of DeepIntent and Lasso.

Efficiencies Defense

Horizontal Merger Guidelines

U.S. Department of Justice

and the

Federal Trade Commission

Issued: August 19, 2010

9.1 Timeliness

In order to deter the competitive effects of concern, entry must be rapid enough to make unprofitable overall the actions causing those effects and thus leading to entry, even though those actions would be profitable until entry takes effect.

Even if the prospect of entry does not deter the competitive effects of concern, post-merger entry may counteract them. This requires that the impact of entrants in the relevant market be rapid enough that customers are not significantly harmed by the merger, despite any anticompetitive harm that occurs prior to the entry.

The Agencies will not presume that an entrant can have a significant impact on prices before that entrant is ready to provide the relevant product to customers unless there is reliable evidence that anticipated future entry would have such an effect on prices.

9.2 Likelihood

Entry is likely if it would be profitable, accounting for the assets, capabilities, and capital needed and the risks involved, including the need for the entrant to incur costs that would not be recovered if the entrant later exits. Profitability depends upon (a) the output level the entrant is likely to obtain, accounting for the obstacles facing new entrants; (b) the price the entrant would likely obtain in the post-merger market, accounting for the impact of that entry itself on prices; and (c) the cost per unit the entrant would likely incur, which may depend upon the scale at which the entrant would operate.

9.3 Sufficiency

Even where timely and likely, entry may not be sufficient to deter or counteract the competitive effects of concern. For example, in a differentiated product industry, entry may be insufficient because the products offered by entrants are not close enough substitutes to the products offered by the merged firm to render a price increase by the merged firm unprofitable. Entry may also be insufficient due to constraints that limit entrants' competitive effectiveness, such as limitations on the capabilities of the firms best placed to enter or reputational barriers to rapid expansion by new entrants. Entry by a single firm that will replicate at least the scale and strength of one of the merging firms is sufficient. Entry by one or more firms operating at a smaller scale may be sufficient if such firms are not at a significant competitive disadvantage.

10. Efficiencies

Competition usually spurs firms to achieve efficiencies internally. Nevertheless, a primary benefit of mergers to the economy is their potential to generate significant efficiencies and thus enhance the merged firm's ability and incentive to compete, which may result in lower prices, improved quality, enhanced service, or new products. For example, merger-generated efficiencies may enhance competition by permitting two ineffective competitors to form a more effective competitor, e.g., by combining complementary assets. In a unilateral effects context, incremental cost reductions may reduce or reverse any increases in the merged firm's incentive to elevate price. Efficiencies also may lead to new or improved products, even if they do not immediately and directly affect price. In a

coordinated effects context, incremental cost reductions may make coordination less likely or effective by enhancing the incentive of a maverick to lower price or by creating a new maverick firm. Even when efficiencies generated through a merger enhance a firm's ability to compete, however, a merger may have other effects that may lessen competition and make the merger anticompetitive.

The Agencies credit only those efficiencies likely to be accomplished with the proposed merger and unlikely to be accomplished in the absence of either the proposed merger or another means having comparable anticompetitive effects. These are termed merger-specific efficiencies.[13] Only alternatives that are practical in the business situation faced by the merging firms are considered in making this determination. The Agencies do not insist upon a less restrictive alternative that is merely theoretical.

Efficiencies are difficult to verify and quantify, in part because much of the information relating to efficiencies is uniquely in the possession of the merging firms. Moreover, efficiencies projected reasonably and in good faith by the merging firms may not be realized. Therefore, it is incumbent upon the merging firms to substantiate efficiency claims so that the Agencies can verify by reasonable means the likelihood and magnitude of each asserted efficiency, how and when each would be achieved (and any costs of doing so), how each would enhance the merged firm's ability and incentive to compete, and why each would be merger-specific.

Efficiency claims will not be considered if they are vague, speculative, or otherwise cannot be verified by reasonable means. Projections of efficiencies may be viewed with skepticism, particularly when generated outside of the usual business planning process. By contrast, efficiency claims substantiated by analogous past experience are those most likely to be credited.

Cognizable efficiencies are merger-specific efficiencies that have been verified and do not arise from anticompetitive reductions in output or service. Cognizable efficiencies are assessed net of costs produced by the merger or incurred in achieving those efficiencies.

The Agencies will not challenge a merger if cognizable efficiencies are of a character and magnitude such that the merger is not likely to be anticompetitive in any relevant market.[14] To make the requisite determination, the Agencies consider whether cognizable efficiencies likely would be sufficient to reverse the merger's potential to harm customers in the relevant market, e.g., by preventing price

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[13] The Agencies will not deem efficiencies to be merger-specific if they could be attained by practical alternatives that mitigate competitive concerns, such as divestiture or licensing. If a merger affects not whether but only when an efficiency would be achieved, only the timing advantage is a merger-specific efficiency.

[14] The Agencies normally assess competition in each relevant market affected by a merger independently and normally will challenge the merger if it is likely to be anticompetitive in any relevant market. In some cases, however, the Agencies in their prosecutorial discretion will consider efficiencies not strictly in the relevant market, but so inextricably linked with it that a partial divestiture or other remedy could not feasibly eliminate the anticompetitive effect in the relevant market without sacrificing the efficiencies in the other market(s). Inextricably linked efficiencies are most likely to make a difference when they are great and the likely anticompetitive effect in the relevant market(s) is small so the merger is likely to benefit customers overall.

increases in that market.[15] In conducting this analysis, the Agencies will not simply compare the magnitude of the cognizable efficiencies with the magnitude of the likely harm to competition absent the efficiencies. The greater the potential adverse competitive effect of a merger, the greater must be the cognizable efficiencies, and the more they must be passed through to customers, for the Agencies to conclude that the merger will not have an anticompetitive effect in the relevant market. When the potential adverse competitive effect of a merger is likely to be particularly substantial, extraordinarily great cognizable efficiencies would be necessary to prevent the merger from being anticompetitive. In adhering to this approach, the Agencies are mindful that the antitrust laws give competition, not internal operational efficiency, primacy in protecting customers.

In the Agencies' experience, efficiencies are most likely to make a difference in merger analysis when the likely adverse competitive effects, absent the efficiencies, are not great. Efficiencies almost never justify a merger to monopoly or near-monopoly. Just as adverse competitive effects can arise along multiple dimensions of conduct, such as pricing and new product development, so too can efficiencies operate along multiple dimensions. Similarly, purported efficiency claims based on lower prices can be undermined if they rest on reductions in product quality or variety that customers value.

The Agencies have found that certain types of efficiencies are more likely to be cognizable and substantial than others. For example, efficiencies resulting from shifting production among facilities formerly owned separately, which enable the merging firms to reduce the incremental cost of production, are more likely to be susceptible to verification and are less likely to result from anticompetitive reductions in output. Other efficiencies, such as those relating to research and development, are potentially substantial but are generally less susceptible to verification and may be the result of anticompetitive output reductions. Yet others, such as those relating to procurement, management, or capital cost, are less likely to be merger-specific or substantial, or may not be cognizable for other reasons.

When evaluating the effects of a merger on innovation, the Agencies consider the ability of the merged firm to conduct research or development more effectively. Such efficiencies may spur innovation but not affect short-term pricing. The Agencies also consider the ability of the merged firm to appropriate a greater fraction of the benefits resulting from its innovations. Licensing and intellectual property conditions may be important to this enquiry, as they affect the ability of a firm to appropriate the benefits of its innovation. Research and development cost savings may be substantial and yet not be cognizable efficiencies because they are difficult to verify or result from anticompetitive reductions in innovative activities.

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[15] The Agencies normally give the most weight to the results of this analysis over the short term. The Agencies also may consider the effects of cognizable efficiencies with no short-term, direct effect on prices in the relevant market. Delayed benefits from efficiencies (due to delay in the achievement of, or the realization of customer benefits from, the efficiencies) will be given less weight because they are less proximate and more difficult to predict. Efficiencies relating to costs that are fixed in the short term are unlikely to benefit customers in the short term, but can benefit customers in the longer run, e.g., if they make new product introduction less expensive.

Merger Guidelines

U.S. Department of Justice and the Federal Trade Commission

Issued: December 18, 2023

strategies that make entry more difficult. Entry can be particularly challenging when a firm must enter at multiple levels of the market at sufficient scale to compete effectively.

Sufficiency. Even where timely and likely, the prospect of entry may not effectively prevent a merger from threatening a substantial lessening of competition. Entry may be insufficient due to a wide variety of constraints that limit an entrant's effectiveness as a competitor. Entry must at least replicate the scale, strength, and durability of one of the merging parties to be considered sufficient. The Agencies typically do not credit entry that depends on lessening competition in other markets.

As part of their analysis, the Agencies will consider the economic realities at play. For example, lack of successful entry in the past will likely suggest that entry may be slow or difficult. Recent examples of entry, whether successful or unsuccessful, provide the starting point for identifying the elements of practical entry barriers and the features of the industry that facilitate or interfere with entry. The Agencies will also consider whether the parties' entry arguments are consistent with the rationale for the merger or imply that the merger itself would be unprofitable.

3.3. Procompetitive Efficiencies

The Supreme Court has held that "possible economies [from a merger] cannot be used as a defense to illegality."[67] Competition usually spurs firms to achieve efficiencies internally, and firms also often work together using contracts short of a merger to combine complementary assets without the full anticompetitive consequences of a merger.

Merging parties sometimes raise a rebuttal argument that, notwithstanding other evidence that competition may be lessened, evidence of procompetitive efficiencies shows that no substantial lessening of competition is in fact threatened by the merger. This argument asserts that the merger would not substantially lessen competition in any relevant market in the first place.[68] When assessing this argument, the Agencies will not credit vague or speculative claims, nor will they credit benefits outside the relevant market that would not prevent a lessening of competition in the relevant market. Rather, the Agencies examine whether the evidence[69] presented by the merging parties shows each of the following:

Merger Specificity. The merger will produce substantial competitive benefits that could not be achieved without the merger under review.[70] Alternative ways of achieving the claimed benefits are considered in making this determination. Alternative arrangements could include organic growth of one of the merging firms, contracts between them, mergers with others, or a partial merger involving only those assets that give rise to the procompetitive efficiencies.

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[67] *Phila. Nat'l Bank*, 374 U.S. at 371; *Procter & Gamble Co.*, 386 U.S. at 580 ("Congress was aware that some mergers which lessen competition may also result in economies but it struck the balance in favor of protecting competition.").

[68] *United States v. Anthem*, 855 F.3d 345, 353-55 (D.C. Cir. 2017) (although efficiencies not a "defense" to antitrust liability, evidence sometimes used "to rebut a prima facie case"); *Saint Alphonsus Medical Center-Nampa*, 778 F.3d at 791 ("The Clayton Act focuses on competition, and the claimed efficiencies therefore must show that the prediction of anticompetitive effects from the prima facie case is inaccurate.").

[69] In general, evidence related to efficiencies developed prior to the merger challenge is much more probative than evidence developed during the Agencies' investigation or litigation.

[70] If inter-firm collaborations are achievable by contract, they are not merger specific. The Agencies will credit the merger specificity of efficiencies only in the presence of evidence that a contract to achieve the asserted efficiencies would not be practical. *See Anthem*, 855 F.3d at 357.

Verifiability. These benefits are verifiable, and have been verified, using reliable methodology and evidence not dependent on the subjective predictions of the merging parties or their agents. Procompetitive efficiencies are often speculative and difficult to verify and quantify, and efficiencies projected by the merging firms often are not realized. If reliable methodology for verifying efficiencies does not exist or is otherwise not presented by the merging parties, the Agencies are unable to credit those efficiencies.

Prevents a Reduction in Competition. To the extent efficiencies merely benefit the merging firms, they are not cognizable. The merging parties must demonstrate through credible evidence that, within a short period of time, the benefits will prevent the risk of a substantial lessening of competition in the relevant market.

Not Anticompetitive. Any benefits claimed by the merging parties are cognizable only if they do not result from the anticompetitive worsening of terms for the merged firm's trading partners.[71]

Procompetitive efficiencies that satisfy each of these criteria are called cognizable efficiencies. To successfully rebut evidence that a merger may substantially lessen competition, cognizable efficiencies must be of a nature, magnitude, and likelihood that no substantial lessening of competition is threatened by the merger in any relevant market. Cognizable efficiencies that would not prevent the creation of a monopoly cannot justify a merger that may tend to create a monopoly.

[71] The Agencies will not credit efficiencies if they reflect or require a decrease in competition in a separate market. For example, if input costs are expected to decrease, the cost savings will not be treated as an efficiency if they reflect an increase in monopsony power.

UNITED STATES V. ANTHEM, INC.,
855 F.3d 345, 348-50, 352-64 (D.C. Cir. 2017)
(excerpt on efficiencies[1])

JUDITH W. ROGERS, United States Circuit Judge

This expedited appeal arises from the government's successful challenge to "the largest proposed merger in the history of the health insurance industry, between two of the four national carriers," Anthem, Inc. and Cigna Corporation. In July 2015, Anthem, which is licensed to operate under the Blue Cross Blue Shield brand in fourteen states, reached an agreement to merge with Cigna, with which Anthem competes largely in those fourteen states. The U.S. Department of Justice, along with eleven States and the District of Columbia (together, the "government"), filed suit to permanently enjoin the merger on the ground it was likely to substantially lessen competition in at least two markets in violation of Section 7 of the Clayton Act. Following a bench trial, the district court enjoined the merger, rejecting the factual basis of the centerpiece of Anthem's defense, and focus of its current appeal, that the merger's anticompetitive effects would be outweighed by its efficiencies because the merger would yield a superior Cigna product at Anthem's lower rates. The district court found that Anthem had failed to demonstrate that its plan is achievable and that the merger will benefit consumers as claimed in the market for the sale of medical health insurance to national accounts in the fourteen Anthem states, as well as to large group employers in Richmond, Virginia.

Anthem and Cigna (hereinafter, Anthem) challenge the district court's decision and order permanently enjoining the merger on the principal ground that the court improperly declined to consider the claimed billions of dollars in medical savings. Specifically, Anthem maintains the district court improperly rejected a consumer welfare standard—what it calls "the benchmark of modern antitrust law," id.—and generally abdicated its responsibility to balance likely benefits against any potential harm. According to Anthem, the merger's efficiencies would benefit customers directly by reducing the costs of customer medical claims through lower provider rates, without harm to the providers. The government has not challenged Anthem's reliance on an efficiencies defense per se. Rather, it points out that Anthem neither disputes that the merger would be anticompetitive but for the claimed medical cost savings, nor challenges the district court's findings on the relevant market definition, ease of entry, the effect of sophisticated buyers, or innovation. Instead, Anthem's appeal focuses principally on factual disputes concerning the claimed medical cost savings, which the government maintains were not verified, not specific to the merger, and not even real efficiencies.

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[1] Record citations omitted.

For the following reasons, we hold that the district court did not abuse its discretion in enjoining the merger based on Anthem's failure to show the kind of extraordinary efficiencies necessary to offset the conceded anticompetitive effect of the merger in the fourteen Anthem states: the loss of Cigna, an innovative competitor in a highly concentrated market. Additionally, we hold that the district court did not abuse its discretion in enjoining the merger based on its separate and independent determination that the merger would have a substantial anticompetitive effect in the Richmond, Virginia large group employer market. Accordingly, we affirm the issuance of the permanent injunction on alternative and independent grounds.

II.

[On July 21, 2016, the United States, along with California, Colorado, Connecticut, Georgia, Iowa, Maine, Maryland, New Hampshire, New York, Tennessee, Virginia, and the District of Columbia, sued to enjoin the merger. Following a six-week bench trial, the district court permanently enjoined the merger on the basis of its likely substantial anticompetitive effect in the market for the sale of health insurance to national accounts in the Anthem states, as well as in the market for the sale of health insurance to large group employers in Richmond, Virginia.]

. . .

III.

Our review of the district court's decision whether to issue a permanent injunction under the Clayton Act is limited to determining whether there was an abuse of discretion. *United States v. Borden Co.*, 347 U.S. 514, 518 (1954); *see FTC v. H.J. Heinz Co.*, 246 F.3d 708, 713 (D.C. Cir. 2001) ("Heinz"). The district court's conclusions of law are reviewed de novo, and its findings of fact must be affirmed unless clearly erroneous. *Heinz*, 246 F.3d at 713. If a finding of fact rests on an erroneous legal premise, then the court "must examine the decision in light of the legal principles [it] believe[s] proper and sound." *Id*. (quoting *Ambach v. Bell*, 686 F.2d 974, 979 (D.C. Cir. 1982)).

A.

It is undisputed that the government met its burden to demonstrate a highly concentrated post-merger market, which would be reduced from four to just three competing companies. Anthem also does not dispute the definition of the national accounts market, nor that such a market will be even more highly concentrated post-merger. Anthem's appeal instead hinges on the district court's treatment of its efficiencies defense. The premise of its defense was explained by its expert, Mark Israel, Ph.D. According to Anthem, Dr. Israel quantified the medical cost savings that the combined company could achieve post-merger using a "best of best" methodology, based on the economic theory that the combined company, with its greater volume, would be able to obtain discount rates that are no worse than either of the companies could achieve separately. Using claims data from Anthem and Cigna, he calculated

that the merger would generate $2.4 billion in medical cost savings through improved discount rates, 98% of which he predicted would be passed through to customers, the large national employers with which Anthem and Cigna contract. Of the $2.4 billion in claimed savings, Dr. Israel projected that $1.517 billion would result from Cigna customers accessing Anthem's lower rates, while $874.6 million would result from Anthem customers accessing Cigna's lower rates; when viewed in terms of self-insured versus fully-insured customers, the former would purportedly see $1.772 billion of the claimed $2.4 billion, while the latter would see $619.8 million. Using merger simulation models, he balanced these projected savings against potential anticompetitive effects from the loss of the rivalry between the two companies and found the savings easily outweighed any potential harm. But, as Anthem tends to ignore, the government offered its own evidence and experts to challenge these conclusions, as we discuss below.

Despite, however, widespread acceptance of the potential benefit of efficiencies as an economic matter, see, e.g., Guidelines § 10, it is not at all clear that they offer a viable legal defense to illegality under Section 7. In *FTC v. Procter & Gamble Co*., 386 U.S. 568 (1967), the Supreme Court enjoined a merger without any consideration of evidence that the combined company could purchase advertising at a lower rate. It held that "[p]ossible economies cannot be used as a defense to illegality. Congress was aware that some mergers which lessen competition may also result in economies but it struck the balance in favor of protecting competition." *Id*. at 580. In his concurrence, Justice Harlan criticized this attempt to "brush the question aside," and he "accept[ed] the idea that economies could be used to defend a merger." *Id*. at 597, 603 (Harlan, J., concurring). No matter that Justice Harlan's view may be the more accepted today, the Supreme Court held otherwise, *id*. at 580, and no party points to any subsequent step back by the Court.

Nor does our dissenting colleague, despite his wishful assertion that *Procter & Gamble* can be disregarded by this court because it preceded the "modern approach" adopted in cases like *United States v. General Dynamics Corp.*, 415 U.S. 486 (1974), and *Continental T. V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977). *See* Dis. Op. 375–77, 378–79. The Supreme Court made no mention of *Procter & Gamble* in *General Dynamics*, 415 U.S. 486, and it cannot be read to have implicitly overruled the earlier decision because it did not involve efficiencies. *See id*. at 494–504; *see also* 4A Phillip E. Areeda & Herbert Hovenkamp, Antitrust Law ¶ 976c2, at 115 (2016) ("Areeda & Hovenkamp") (distinguishing between an efficiencies defense and *General Dynamics*' "competitive significance" defense). And whatever significance *Continental T. V.* may have in the area of vertical restraints on trade, 433 U.S. at 54-59, it did not do the yeoman's work that the dissent apparently ascribes to it here, for it did not involve efficiencies, mergers, or Section 7 of the Clayton Act. Even stranger is the dissent's suggestion that our decision in *Baker Hughes*, 908 F.2d at 986, blessed an efficiencies defense, *see* Dis. Op. 376–77, because *Baker Hughes* did not concern efficiencies and, like *Heinz*, 246 F.3d at 720, it could not overrule Supreme Court precedent. Nor has this court even hinted, as the dissent proclaims, that *General Dynamics* overruled *Procter & Gamble's* efficiencies holding. *See Baker Hughes*,

908 F.2d at 988 (citing *Procter & Gamble* favorably); *Heinz*, 246 F.3d at 720 & n.18 (interpreting *Procter & Gamble's* efficiencies holding). Put differently, our dissenting colleague applies the law as he wishes it were, not as it currently is. Even if "the Supreme Court has not decided a case assessing the lawfulness of a horizontal merger under Section 7 of the Clayton Act" since 1975, Dis. Op. 376, it still is not a lower court's role to ignore on-point precedent so as to adhere to what might someday become Supreme Court precedent.

Despite the clear holding of *Procter & Gamble*, 386 U.S. at 580 two circuit courts, and our own, have subsequently recognized the use of efficiencies evidence in rebutting a prima facie case. *Heinz*, 246 F.3d at 720 (citing, inter alia, *FTC v. Tenet Health Care Corp.*, 186 F.3d 1045 (8th Cir. 1999); *FTC v. Univ. Health, Inc.*, 938 F.2d 1206 (11th Cir. 1991)); *see also ProMedica Health Sys., Inc. v. FTC*, 749 F.3d 559, 571 (6th Cir. 2014). The Eighth Circuit, in holding that the government had produced insufficient evidence of a well-defined market, acknowledged that the district court may have properly rejected the efficiencies defense, while observing evidence of enhanced efficiencies should be considered in the context of the competitive effects of the merger. *Tenet Health Care Corp*., 186 F.3d at 1053–55. The Eleventh Circuit similarly concluded that whether an acquisition would yield significant efficiencies in the relevant market is "an important consideration in predicting whether the acquisition would substantially lessen competition," *University Health, Inc.*, 938 F.2d at 1222, while noting both that "[i]t is unnecessary . . . to define the parameters of this defense now," and that "it may further the goals of antitrust law to limit the availability of an efficiency defense," *id*. at 1222 n.30. Other circuits have remained skeptical and simply assumed efficiencies can rebut a prima facie case, before finding that the merging parties had not clearly shown the merger would enhance rather than hinder competition. *See, e.g.*, *FTC v. Penn State Hershey Med. Ctr*., 838 F.3d 327, 348 (3d Cir. 2016); *Saint Alphonsus Med. Ctr.–Nampa, Inc. v. St. Luke's Health Sys., Ltd.*, 778 F.3d 775, 790 (9th Cir. 2015). These very recent decisions put to rest the dissent's notion that "no modern court" recognizes the continued viability of *Procter & Gamble*, *see Penn State Hershey Med. Ctr.*, 838 F.3d at 348; *Saint Alphonsus Med. Ctr.*, 778 F.3d at 789, while even a cursory reading of the court's opinion today puts to rest any suggestion that it "espouses the old . . . position that efficiencies might be reason to condemn a merger." Dis. Op. 379 (emphasis added) (quoting Ernest Gellhorn et al., Antitrust Law and Economics in a Nutshell 463 (5th ed. 2004)).

"Of course, once it is determined that a merger would substantially lessen competition, expected economies, however great, will not insulate the merger from a [S]ection 7 challenge." *Univ. Health*, 938 F.2d at 1222 n.29. Notably, Professors Areeda and Hovenkamp have observed that "Congress may not have wanted anything to do with an efficiencies defense asserted by a firm that was already large or low cost within the market and to whom the efficiencies would give an even greater advantage over rivals." Areeda & Hovenkamp, *supra*, ¶ 950f, at 42; *id*. ¶ 970c, at 31. As our subsequent analysis shows, this court, like our sister circuits, can simply assume the availability of an efficiencies defense to Section 7 illegality because Anthem fails to show that the district court clearly erred in rejecting Anthem's efficiencies defense.

This court was satisfied in *Heinz*, in view of the trend among lower courts and secondary authority, that the Supreme Court can be understood only to have rejected "possible" efficiencies, while efficiencies that are verifiable can be credited. 246 F.3d at 720 & n.18 (discussing 4 Phillip Areeda & Donald Turner, Antitrust Law ¶ 941b, at 154 (1980)). The issue in *Heinz* was whether under Section 13(b) of the Federal Trade Commission Act, 15 U.S.C. § 53(b), preliminary injunctive relief would be in the public interest. 246 F.3d at 727. The court held that the district court "failed to make the kind of factual findings required to render that defense sufficiently concrete to rebut the government's prima facie showing," *id*. at 725, and, upon weighing the equities, remanded for entry of a preliminary injunction. *Id*. at 726–27. The court expressly stated however: "It is important to emphasize the posture of this case. We do not decide whether . . . the defendants' claimed efficiencies will carry the day." *Id*. at 727. These are not the issues in Anthem's appeal from the grant of a permanent injunction. *See LaShawn A. v. Barry*, 87 F.3d 1389, 1393 (D.C. Cir. 1996) (*en banc*).

Consequently, the circuit precedent that binds us allowed that evidence of efficiencies could rebut a prima facie showing, *Heinz*, 246 F.3d at 720-22, which is not invariably the same as an ultimate defense to Section 7 illegality. *Cf. generally Saint Alphonsus Med. Ctr.*, 778 F.3d at 789–90 (and authorities cited therein). In this expedited appeal, prudence counsels that the court should leave for another day whether efficiencies can be an ultimate defense to Section 7 illegality. We will proceed on the assumption that efficiencies as presented by Anthem could be such a defense under a totality of the circumstances approach, *see Baker Hughes*, 908 F.2d at 984–85 (citing *General Dynamics*, 415 U.S. at 498, 94 S.Ct. 1186), because Anthem has failed to show the district court clearly erred in rejecting Anthem's purported medical cost savings as an offsetting efficiency. Guidelines § 10; *cf. Heinz*, 246 F.3d at 720-22. Additionally, because the district court could permissibly conclude that the efficiencies defense failed, because the amount of cost saving that is both merger-specific and verifiable would be insufficient to offset the likely harm to competition, this court has no occasion to decide whether the type of redistributional savings claimed here are cognizable at all under Section 7. It bears noting, though, that all of those other issues pose potentially substantial additional obstacles to this merger.

One further preliminary analytical point. Amici supporting Anthem invite the court to disregard the merger-specificity and verifiability requirements on the ground they place an asymmetric burden on merging parties that could doom beneficial mergers. *See* Br. for Antitrust Economists and Business Professors as Amicus Curiae in Support of Appellant and Reversal ("Amici Economists") at 5-7. Anthem itself has not adopted this argument. *See Burwell v. Hobby Lobby Stores, Inc.*, [573] U.S. [682, 721] (2014); *Eldred v. Reno*, 239 F.3d 372, 378 (D.C. Cir. 2001). We note, however, that Amici Economists misapprehend the nature of Anthem's claimed efficiencies as "direct price reductions," id. at 6–7, rather than as potential price reductions subject to a number of uncertainties. For customers to realize any price reduction, Anthem would first have to succeed in reducing providers' rates, and to that extent the purported reductions would not be a direct effect of the merger. By contrast, the merger would immediately give rise to upward pricing pressure by eliminating a competitor, and Anthem could

unilaterally raise its prices in response. Further, Amici Economists ignore that fully-insured customers, and potentially self-insured customers depending on the terms of their contracts with Anthem, will not see any savings until Anthem takes a second action, renegotiating the customers' contracts to pass through the savings. This illustrates the reason for the verifiability requirement: Perhaps Anthem is certain to take those actions, and there will be no impediments to the savings' realization, but that showing is still necessary for a court to conclude that the merger's direct effect (upward pricing pressure) is likely to be offset by an indirect effect (potential downward pricing pressure). See Guidelines § 10. As for merger-specificity, Amici Economists point to no logical flaw in the policy that consumers should not bear the loss of a competitor if the offsetting benefit could be achieved without a merger. See *Heinz*, 246 F.3d at 722.

B.

Any claimed efficiency must be shown to be merger-specific, meaning that it "cannot be achieved by either company alone because, if [it] can, the merger's asserted benefits can be achieved without the concomitant loss of a competitor." *Heinz*, 246 F.3d at 722. The Guidelines frame the issue slightly differently: an efficiency is said to be merger-specific if it is "likely to be accomplished with the proposed merger and unlikely to be accomplished in the absence of either the proposed merger or another means having comparable anticompetitive effects." Guidelines § 10. Anthem faults the district court for considering whether the efficiencies "could" be achieved absent the merger, without regard to likelihood, Appellant Br. 24, even though in *Heinz*, 246 F.3d at 722, this court spoke repeatedly in terms of possibility ("can" or "could").

Heinz, 246 F.3d at 721-22, cited the Guidelines with approval in describing the standard for merger-specificity. Both the current and then-current Guidelines refer to "practical" alternatives to achieving the efficiency short of merger, alternatives that are more than "merely theoretical." Guidelines § 10 (2010); Guidelines § 4 (1997). Similarly, in *Heinz*, 246 F.3d at 722, the court considered whether it was practical for the company to obtain better baby food recipes by investing more money in product development, or whether that would cost more money than the merger itself. The real question is whether the alternatives to merger are practical and more than merely theoretical, *see id.*; Guidelines § 10. Even assuming there is any difference between the two standards, it would not affect the outcome here on this factual record. Viewed under either articulation, certain of Anthem's claimed efficiencies fall away.

[*Details of the Court's merger-specificity analysis omitted*]

C.

Under the Guidelines, projected efficiencies will not be credited "if they are vague, speculative, or otherwise cannot be verified by reasonable means." Guidelines § 10. Anthem maintains that the district court clearly erred because the $2.4 billion in projected post-merger savings was verified by two independent sources (Dr. Israel and

an integration planning team from McKinsey & Company, which had access to each company's internal files). In Anthem's view, the district court also erred as a matter of law by imposing a "virtually insurmountable burden" of persuasion, when all that is required is to show "probabilities, not certainties," *Baker Hughes*, 908 F.2d at 984.

[*Details of the Court's merger-specificity analysis omitted*]

The savings projected by McKinsey & Co. and Dr. Israel—uncritically relied on by the dissent, *e.g.*, Dis. Op. 373–75, 380—were without a doubt enormous. The problem is, those projections fall to pieces in a stiff breeze. If merging companies could defeat a Clayton Act challenge merely by offering expert testimony of fantastical cost savings, Section 7 would be dead letter.

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NOTES

1. The dissent in *Anthem* was written by then-Judge, now-Justice Brett Kavanaugh. No doubt he will remember Judge Rogers biting criticism when the Supreme Court has an opportunity—and no doubt it will—to examine the efficiencies defense in a merger case. Indeed, I suspect that Justice Kavanaugh, among others on the Court, are looking forward to reconsidering the treatment of efficiencies in *Procter & Gamble*. Obtaining four votes for a writ of certiorari should not be a problem.

2. Judge Rogers (joined in the majority opinion by Patricia A. Millet) correctly explained the *Procter & Gamble* precedent, and the Supreme Court has not abrogated it. But remember, *Procter & Gamble* was decided in 1967, the year after *Von's Grocery* and *Pabst*, two of the most restrictive horizontal merger cases ever decided by the Supreme Court. This was a time when merger antitrust law prevented the concentration of industry and protected small firms and the local control of business.[1] Even if efficiencies reduced prices, lower prices would not serve as a defense when a merger substantially lessened competition along the dimensions of these policy goals.

3. Properly interpreted today, *Procter & Gamble* stands for the proposition that efficiencies are not an *affirmative* defense to an anticompetitive merger. But as you know from Unit 3, the lens through which courts interpreted the antitrust laws changed in the late 1970s into the 1980s to first to the promotion of productive efficiency and then to the promotion of consumer welfare. Under this interpretation, lower prices from a merger that increased in consumer welfare would mean the merger was not anticompetitive within the meaning of Section 7 in the first place. While efficiencies still would not be an affirmative defense to the merger, in the right circumstances they could be a *negative* defense. Modern courts treat the efficiencies defense in this sense, which unfortunately remains all too misunderstood by the bench and the bar today.

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[1] *See* Brown Shoe Co, v. United States, 370 U.S. 294, 311-23 (1962). The Unit 3 reading materials excerpt the relevant portion of the opinion (pp. 19-23).

FTC v. WILH. WILHELMSEN HOLDING ASA
341 F. SUPP. 3D 27, 72-73 (D.D.C. 2018)
(excerpt on efficiencies[1])

TANYA S. CHUTKAN, District Judge

The Federal Trade Commission ("FTC") has moved for a preliminary injunction to block a proposed merger between defendants Wilhelmsen Maritime Services AS ("WMS"), Wilhelmsen Ship Services ("WSS") (collectively "Wilhelmsen"), and The Resolute Fund II, L.P., Drew Marine Intermediate II B.V., and Drew Marine Group, Inc. (collectively "Drew"), two large providers of marine water treatment chemicals and related services. The FTC objects to the merger on the grounds that Defendants are each other's closest and only realistic competition for supplying these chemicals and services on a global scale, and the merger threatens to reduce or eliminate tangible consumer benefits resulting from market competition. Having considered the evidence presented through live testimony, as well as extensive pleadings, exhibits, and other submissions, the court hereby GRANTS the motion for preliminary injunction.

[The court found, for the purpose of deciding whether to enter a preliminary injunction, that the supply of marine water treatment (MWT) products and services, including boiler water treatment (BWT) chemicals, cooling water treatment (CWT) chemicals, and associated products and services, to global fleets, constituted a relevant antitrust market and that, within this market, the FTC had established a prima facie case of anticompetitive effect. In response, the merging parties advanced entry, power buyer, and efficiencies defenses.]

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c. *Efficiencies*

1. LEGAL STANDARD

As the Merger Guidelines explain, "a primary benefit of mergers to the economy is their potential to generate significant efficiencies and thus enhance the merged firm's ability and incentive to compete, which may result in lower prices, improved quality, enhanced services, or new products." Merger Guidelines § 10. Though the Supreme Court has never recognized the so-called "efficiencies" defense in a Section 7 case, other courts and the Horizontal Merger Guidelines acknowledge that evidence of efficiencies may prove "relevant to the competitive effects analysis of the market required to determine whether the proposed transaction will substantially lessen competition," [*FTC v.*] *Arch Coal*, [Inc.,] 329 F.Supp.2d [109,] at 151 [(D.D.C. 2004)], and accordingly that efficiencies produced by a merger can form part of a defendant's rebuttal of the FTC's prima facie case. [*FTC v.*] *Sysco*, [Corp.,] 113 F.Supp.3d [1,] at

1. Record citations omitted.

81 [(D.D.C. 2015)]; [*FTC v.*] *Heinz* [*Co*.], 246 F.3d [708,] at 720 [(D.C. Cir. 2001)]. This is true even though "[c]ourts have rarely, if ever, denied a preliminary injunction solely based on the likely efficiencies." [*FTC v.*] *CCC Holdings*, [*Inc*.,] 605 F.Supp.2d [26,] at 72 [(D.D.C. 2009)].

Potential efficiencies require close judicial scrutiny—"the court must undertake a rigorous analysis of the kinds of efficiencies being urged by the parties in order to ensure that those 'efficiencies' represent more than mere speculation and promises about post-merger behavior," *Heinz*, 246 F.3d at 721, and a defendant must prove "extraordinary efficiencies" where market concentration levels are high. *Id*. at 720-21. An efficiencies analysis must demonstrate that the claimed efficiencies are (1) merger-specific, and (2) verifiable—meaning that efficiency claims "must represent a type of cost saving that could not be achieved without the merger and the estimate of the predicted saving must be reasonably verifiable by an independent party." *United States v. H&R Block, Inc.*, 833 F.Supp.2d 36, 89 (D.D.C. 2011); *see also Sysco*, 113 F.Supp.3d at 82. Moreover, "it is incumbent upon the merging firms to substantiate efficiency claims," as "much of the information relating to efficiencies is uniquely in the possession of the merging firms." Merger Guidelines § 10.

2. ANALYSIS

Defendants claim that the proposed merger will result in significant merger-specific efficiencies in the form of cost savings of [redacted] and that these efficiencies will be realized in four ways: (1) production cost reductions from eliminating duplicative product lines, (2) customer-facing cost reductions from eliminating duplicative account managers and customer service operations, (3) reductions from eliminating duplicative back-office and administrative costs, and (4) price reductions as part of a plan to address expected revenue dis-synergies, in order to compensate for the possibility of lost customers who oppose the merger.

The FTC engaged an expert, Dr. Dov Rothman, to evaluate whether Defendants had substantiated their estimated cost efficiencies, and whether such efficiencies were merger-specific. Dr. Rothman reviewed data and documentation from the merging parties, and the parties' consultants provided him with spreadsheets relevant to their claimed cost savings. Dr. Rothman concluded in his report and his testimony at the evidentiary hearing that the merging parties had failed to provide sufficient information for him to verify the likelihood and magnitude of the claimed cost savings. In particular, Dr. Rothman found that the alleged cost savings in each of the categories were based on a series of significant assumptions—percentage reductions in cost, percentage increases in productivity, or assumed cost/product equivalencies—that were "doing all the work" in calculation of the estimates. Dr. Rothman further pointed out that Wilhelmsen failed to provide any information that would have allowed him to confirm whether those assumptions are reasonable. See, e.g., Rothman Hrg. Tr. at 1039:19–1040:5 ("So what Wilhelmsen has provided here, it's provided a description of the process by which these cost savings were estimated. So it's explained that it had functional teams and Cardo Partners go around and identify and assess areas of duplicative overlap. And Wilhelmsen has . . . provided information that describes the

output of the analysis. What Wilhelmsen hasn't provided is information about the analysis itself. And I think there's an important distinction between describing the process of estimating cost savings and describing the actual analysis, the assumptions that go into that analysis.").

In response to these criticisms, Defendants note that WSS has a history of acquiring companies that produce MWT chemicals—specifically Unitor and Nalfleet—that demonstrates that WSS has previously achieved the cost savings it projected. Defendants also note that the efficiency estimates went through many rounds of internal vetting, and rely on the testimony and report of Dr. [Mark] Israel, who contended that the estimates are verifiable insofar as WSS identified the potential bases for cost savings, performed its own vetting and due diligence, and has a track record of realizing projected cost savings.

The court finds that Defendants have failed to carry their burden to demonstrate the verifiability of their claimed efficiencies. In reaching this decision, the court stresses that the determinative issue is neither the presence of assumptions nor the absence of completely precise estimates. Instead, the critical issue is that because the bases for the assumptions Dr. Rothman identified and their role in the efficiencies analysis is unclear, the reasonableness of those assumptions, along with the ultimate determinations of likelihood and magnitude, cannot be verified with any degree of rigor. *Heinz*, 246 F.3d at 721 ("[G]iven the high concentration levels, the court must undertake a rigorous analysis of the kinds of efficiencies being urged by the parties in order to ensure that those 'efficiencies' represent more than mere speculation and promises about post-merger behavior.") (emphasis added); *see also id*. (scrutinizing quantitative basis for claimed efficiencies). Nor can reference to the merging parties' past practices, managerial expertise and incentives, or internal verification processes serve to substantiate any efficiencies. The court cannot substitute Defendants' assessments and projections for independent verification. *H & R Block*, 833 F.Supp.2d at 91 ("While reliance on the estimation and judgment of experienced executives about costs may be perfectly sensible as a business matter, the lack of a verifiable method of factual analysis resulting in the cost estimates renders them not cognizable by the Court. If this were not so, then the efficiencies defense might well swallow the whole of Section 7 of the Clayton Act because management would be able to present large efficiencies based on its own judgment and the Court would be hard pressed to find otherwise."). The court concludes that Defendants have failed to provide enough information about their estimated efficiencies to render them "reasonably verifiable by an independent party." *Id*. at 89. Given this conclusion, the court need not address the question of merger-specificity.

. . .

FTC v. HACKENSACK MERIDIAN HEALTH, INC., 30 F.4th 160, 164, 175-79 (3d Cir. 2022) (excerpt on efficiencies)

D. MICHAEL FISHER, Circuit Judge

Englewood Healthcare Foundation, a local New Jersey hospital, and Hackensack Meridian Health, Inc., New Jersey's largest healthcare system, agreed to a multi-million-dollar merger. The Federal Trade Commission opposes their merger and filed an administrative complaint alleging it violates Section 7 of the Clayton Act because it is likely to substantially lessen competition. To prevent the parties from merging before the administrative adjudication could occur, the FTC filed suit in the District of New Jersey under Section 13(b) of the Federal Trade Commission Act, requesting a preliminary injunction pending the outcome of the administrative adjudication. The District Court granted the preliminary injunction, holding that the FTC established that there is a reasonable probability that the merger will substantially impair competition. For the reasons that follow, we will affirm

. . .

B. The Hospitals failed to rebut the FTC's prima facie case

Once the FTC establishes a prima facie case that a merger may substantially lessen competition, the burden shifts to the Hospitals to rebut the FTC's case. "[T]he Hospitals must show either that the combination would not have anticompetitive effects or that the anticompetitive effects of the merger will be offset by extraordinary efficiencies resulting from the merger." [*FTC v. Penn State*] *Hershey* [*Med. Ctr.*], 838 F.3d [327,] at 347 [(3d Cir. 2016)]. The "linchpin of any efficiencies defense" is the language of the Clayton Act, which "speaks in terms of 'competition.'" *Id*. at 349 (quoting *St. Alphonsus*, 778 F.3d at 790). The defense "requires proof that a merger is not, despite the existence of a prima facie case, anticompetitive" because "the prima facie case portrays inaccurately the merger's probable effects on competition." *Id*. (quoting *St. Alphonsus* [*Med. Ctr.-Nampa Inc. v. St. Luke's Health Sys., Ltd.*], 778 F.3d [775,] at 790 [(9th Cir. 2015)]. This defense recognizes that efficiencies created by a merger can "enhance the merged firm's ability and incentive to compete, which may result in lower prices, improved quality, enhanced service, or new products." Merger Guidelines, § 10, at 29.

To combat the likely anticompetitive harms the FTC established, the Hospitals offer a panoply of procompetitive benefits that may be reaped from the merger: upgrades and increased capacity limits at Englewood, the expansion of complex tertiary and quaternary care at HUMC, cost-savings that will result from service optimization between the Hospitals, and quality improvements at both Hospitals. They argue that these benefits, which the District Court recognized, show that the FTC did not establish a likelihood that the merger would substantially lessen competition. They

claim they are not making an efficiencies defense, thus the stringent standard developed in other circuits need not apply. They say, instead, that procompetitive effects must simply be weighed in the balance together with anticompetitive effects when considering whether they have rebutted the FTC's prima facie case.

The existence of procompetitive benefits does not mean the absence of anticompetitive harms. The Hospitals' argument that there "would not likely be a substantial lessening of competition when both pro- and anti-competitive effects were duly considered," is merely a different way of saying there would not likely be a substantial lessening of competition because the procompetitive effects offset the anticompetitive effects of the merger. Thus, the Hospitals' procompetitive benefits argument is an efficiencies defense.

Neither this Court nor the Supreme Court has formally adopted the efficiencies defense. *See Hershey*, 838 F.3d at 347. Other Circuits have at least been tentatively willing to recognize the defense, though none have held that it was successfully invoked. *See ProMedica Health Sys., Inc. v. FTC*, 749 F.3d 559, 571 (6th Cir. 2014); *St. Alphonsus*, 778 F.3d at 788–92; [FTC v. H.J.] Heinz [Co.], 246 F.3d [708], at 720 [(D.C. Cir. 2001)]; *FTC v. Univ. Health, Inc.*, 938 F.2d 1206, 1222 (11th Cir. 1991). In *Hershey*, we explained that we were skeptical such a defense exists. 838 F.3d at 348. Although we have yet to see an efficiency so great as to justify a presumptively anticompetitive merger, we do not rule out that the efficiencies defense may be viable. But as in *Hershey*, we are not forced to confront that possibility. *Id*. Although this case is much closer than *Hershey*, the efficiencies defense, as adopted by other Circuits, is clearly not met here. Nonetheless, we address the defense and each of the Hospitals' claimed procompetitive benefits to clarify any ambiguity in *Hershey*.

For the efficiencies defense to be cognizable, the efficiencies must (1) "offset the anticompetitive concerns in highly concentrated markets"; (2) "be merger-specific" (i.e., the efficiencies cannot be achieved by either party alone); (3) "be verifiable, not speculative"; and (4) "not arise from anticompetitive reductions in output or service." *Hershey*, 838 F.3d at 348–49 (internal quotation marks and citations omitted).

In *Hershey*, we expounded on the first element—whether efficiencies offset anticompetitive concerns—in the context of HHI numbers. *Id*. at 350. We stated that even if the hospitals could show an efficiency was verified, was merger-specific, and did not arise from anticompetitive reduction in output, the HHI numbers were so great as to "eclipse any others we have identified in similar cases." *Id*. Therefore, the merger was "so likely to be anticompetitive that 'extraordinarily great . . . efficiencies [were] necessary to prevent the merger from being anticompetitive.' " *Id*. (quoting Merger Guidelines, § 10, at 31). The District Court seems to have interpreted *Hershey* to mean that "extraordinary" efficiencies must be found in every case where a prima facie case is established, regardless of the HHI numbers. *Hackensack*, 2021 WL 4145062, at *26, *30. We now clarify our earlier statements.

Efficiencies are best understood as a sliding scale. The magnitude of the efficiencies needed to overcome a prima facie case depends on the strength of the likely adverse competitive effects of a merger. At a minimum, the defendant must show that "the intended acquisition would result in significant economies and that [those]

economies would ultimately benefit competition and, hence, consumers." *See Univ. Health*, 938 F.2d at 1223. *Hershey* examined the high end of the spectrum. There, the market had an HHI of 5,984—more than twice the highly-concentrated-market threshold—and an increase in HHI of 2,582—more than twelve times the 200-point increase that triggers a presumption of anticompetitive harm when the resulting market is highly concentrated. *Hershey*, 838 F.3d at 347. Recognizing that the HHI numbers were extraordinary, we declared that any efficiencies would have to be equally extraordinary to overcome the likely anticompetitive effects. *Id*. at 350. But not every invocation of the efficiencies defense will require that showing. Courts must take their cues from the HHI numbers and direct evidence presented by the government in each case.

Here, the District Court analyzed the Hospitals' claimed procompetitive benefits as efficiencies and concluded that they were insufficient to overcome the FTC's prima facie case. Although we agree with that conclusion, to the extent the District Court required a showing of extraordinary procompetitive effects, it would have been incorrect. The presumption of anticompetitive effects established by the FTC here does not rise to the level seen in *Hershey*. Nonetheless, we review conclusions of law de novo, *id*. at 335, and our review leads us to the same conclusion. Some procompetitive benefits may exist, but they are not significant enough to offset the likely anticompetitive effects of the merger. Most of the Hospitals' claimed benefits were speculative or non-merger-specific. And the few procompetitive effects that the Hospitals did establish do not constitute significant economies that will ultimately benefit competition and, hence, the patients in Bergen County.

The District Court found that most of the Hospitals' commitments to increase Englewood's capacity and improve its clinical offerings were merely speculative. What the Hospitals called "hard commitments" were only commitments to "explore, assess, and collaborate." *Hackensack*, 2021 WL 4145062, at *26. Furthermore, many of these commitments were not Englewood-specific or enforceable. On the other hand, the Court noted that Hackensack's significant capital contribution could likely amount to a procompetitive benefit to Bergen County in a few ways, such as upgrading some physical facilities and providing Englewood with robotic technology, both of which would offer Bergen County patients more or upgraded services. But these modest upgrades alone are not significant enough to overcome the strong evidence of anticompetitive harms.

The District Court held that cost savings due to post-merger service optimization were also too speculative to be meaningful. The Court found that the $38 million figure the Hospitals relied on failed to account for the $439 million capital contribution by Hackensack. Additionally, the Court found more persuasive the evidence, or rather lack of evidence, presented about cost savings in past Hackensack mergers. Hackensack has previously acquired other hospitals in New Jersey, yet the Hospitals provided no evidence that consumers benefitted from cost savings due to service optimization between the merging parties. Whatever savings the merging entities may have cashed in on, there was no evidence the savings ever flowed through to patients.

The District Court held that the benefit of expanded complex tertiary and quaternary care was both non-merger-specific and speculative. To embark on this expansion, Hackensack claims it must relieve capacity restraints at HUMC. But the District Court found that the only thing preventing HUMC from transferring patients to Englewood was financial or competitive motive. As the District Court stated, this motive may be legitimate, but it nonetheless undercuts the Hospitals' argument that the expansion can only occur if the merger moves forward. The District Court also noted that HUMC is currently expanding capacity and quaternary services through an ongoing upgrade project. Finally, the District Court rightly pointed out that Hackensack has three hospitals near HUMC that are not at capacity and likely could help alleviate HUMC's capacity restraints. The Hospitals have offered nothing to combat these findings.

Furthermore, the District Court found that any procompetitive benefit gained by easing HUMC's capacity restraints is speculative. First, the Hospitals provided no evidence that they have a plan to transfer patients from HUMC to Englewood. At best, the Hospitals have a sense of the number of patients they would like to transfer. Second, the Hospitals failed to account for the fact that many hospital referrals come from physicians not employed by HUMC and those physicians may not recommend their patients seek services at Englewood. Thus, even the Hospitals' transfer goals are speculative. Finally, assuming the capacity restraint problems were confirmed, the expansion of quaternary services is speculative. State approval is required for any such expansion and the process to gain that approval is expensive and time-consuming. Thus, the District Court correctly found that the expansion of services at HUMC is not a cognizable efficiency.

As for the Hospitals' claim that the merger will provide quality improvements to both Englewood and HUMC, the District Court found these too were not merger-specific. Although the Court did not doubt that Hackensack's capital commitment would improve facilities and equipment at Englewood, it explained that such quality improvements were likely to happen regardless of a merger. Englewood is a high-quality hospital. It consistently performs well in multiple quality assessments and is motivated to maintain this quality of care because of its competition with HUMC. Therefore, Englewood would likely make similar quality improvements even if it did not merge with Hackensack. Furthermore, Englewood scores better than HUMC on multiple important performance measures, such as hospital safety, patient experience, timely and effective care, nursing recognition, and healthcare-associated infection rates. If the merger occurs, consumers would likely be disadvantaged because Englewood would no longer have an incentive to outperform HUMC and HUMC would have no reason to strive for improvement in those areas.

The District Court did not directly address the New Jersey Attorney General's finding that the merger is in the public interest under the New Jersey Community Health Care Assets Protection Act. Under the Act, the New Jersey Attorney General and the New Jersey Department of Health evaluate whether a nonprofit hospital transaction is in the public interest. Relevant to their inquiry, they evaluate whether the proposed transaction is "likely to result in the deterioration of quality, availability or

accessibility of heath care services in the affected communities." N.J.S.A. 26:2H-7.11(b). Here, New Jersey concluded that Hackensack made commitments to enhance Englewood's offerings to the community. Although that finding is independent of any antitrust analysis federal courts may perform, we would be remiss not to consider a state's assessment of the effects of a merger within its borders. Therefore, the District Court should have included the interests of the community, as assessed by the New Jersey Attorney General, in analyzing the likely effects of the merger.

Nonetheless, when we consider this assessment of the community's interests along with the modest quality improvements and upgrades likely to occur because of this merger, they are not significant enough to overcome the FTC's strong prima facie case. We thus conclude that the District Court did not err in holding that the Hospitals failed to rebut the prima facie case that the merger is likely to substantially lessen competition. Therefore, no additional evidence is necessary for the FTC to carry its ultimate burden of persuasion. *See Hershey*, 838 F.3d at 337.

III.

For these reasons, we will affirm the District Court's grant of preliminary injunctive relief.

NOTES

1. On October 15, 2019, Hackensack Meridian Health and Englewood Health, two not-for-profit systems, announced the signing of a definitive agreement to merge.[1] The merger would have combined Hackensack's 16-hospital system, including two hospitals in Bergen County, NJ, with Englewood's community hospital located in the county. As a result of the merger, Hackensack would control three of the six inpatient general acute care hospitals in Bergen County. In the announcement, Hackensack Meridian Health reported that it had committed to a $400 million capital investment at Englewood Health.

2. The District Court found the relevant product market to be the "cluster of inpatient [general acute care] services" offered by Englewood and Hackensack's Bergen County hospitals and sold to commercial insurers. *FTC v. Hackensack Meridian Health, Inc.*, No. CV 20-18140, 2021 WL 4145062, at *15 (D.N.J. Aug. 4, 2021) (not for publication), *aff'd*, 30 F.4th 160, 166 (3d Cir. 2022). As in most hospital merger cases, the merging parties did not meaningfully dispute the relevant product market. *Id*.

3. Also as in most hospital merger cases, the relevant geographic market was one of the main points of contention at trial and on appeal. The FTC defined the relevant geographic market in terms of patient location rather than hospital location and sought to prove that a proper relevant market to assess the transaction's competitive effects was all hospitals used by commercially insured patients who reside in Bergen County. The FTC's expert, Dr. Leemore Dafny, chose Bergen County as the

[1] Press Release, Hackensack Meridian Health, *Englewood Health and Hackensack Meridian Health Sign Definitive Agreement to Merge* (Oct. 15, 2019).

proposed market for three principal reasons: "(1) Englewood and HUMC are in Bergen County; (2) the majority of Bergen County residents receive care in Bergen County; and (3) Bergen County is an economically significant area for insurers." *Id*. at 16. Moreover, commercial insurers testified that they cannot offer a marketable plan in Bergen County that does not include a Bergen County hospital. Recognizing the unique commercial realities of the healthcare market and relying heavily on insurer testimony, the District Court accepted the FTC's proposed geographic market. On appeal, the Third Circuit affirmed.

4. On March 22, 2022, the Third Circuit affirmed the district court's entry of a preliminary injunction enjoining the transaction until the conclusion of an adjudication of the merits in an FTC administrative proceeding. On April 5, 2022, the parties notified the FTC that they had terminated their merger agreement and moved for the dismissal of the administrative complaint.[2] Complaint counsel opposed, arguing that the Commission should instead withdraw the matter from adjudication to enable it to discuss with the staff whether the Commission should seek further relief from the merging parties.[3] Over the opposition of the merging parties,[4] the Commission denied the motion to dismiss and withdrew the matter from adjudication.[5] A month later, the Commission determined that no further relief was warranted, returned the matter to adjudication, and dismissed the complaint.[6]

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2 *See* Respondents' Motion To Dismiss Complaint, Hackensack Meridian Health, Inc., No. 9399 (F.T.C. Apr. 5, 2022).

3 *See* Complaint Counsel'S Opposition To Respondents' Motion To Dismiss, Hackensack Meridian Health, Inc., No. 9399 (F.T.C. Apr. 13, 2022). Complaint counsel cited *Coca-Cola* for the proposition that the action was not moot even though the parties had abandoned the deal. *See Coca-Cola Co.*, 117 F.T.C. 795 (F.T.C. 1994) (continuing to litigate the merits of an abandoned deal to determined whether the commission should enjoin Coca-Cola from making future acquisitions in the soft-drink industry without the prior written approval of the Commission).

4 *See* Respondents' Reply in Support of their Motion to Dismiss Complaint, Hackensack Meridian Health, Inc., No. 9399 (F.T.C. Apr. 20, 2022).

5 *See* Order Withdrawing Proceeding from Adjudication, Hackensack Meridian Health, Inc., No. 9399 (F.T.C. May 24, 2022).

6 *See* Order Returning Matter To Adjudication And Dismissing Complaint, Hackensack Meridian Health, Inc., No. 9399 (F.T.C. June 27, 2022).

UNITED STATES V. BERTELSMANN SE & CO. KGAA,
646 F. Supp. 3d 1, 35 (D.D.C. Nov. 15, 2022)
(excerpt on efficiencies)

FLORENCE Y. PAN, United States Circuit Judge

[The Department of Justice brought an action alleging that the proposed $2.18 billion acquisition by Bertelsmann, the owner of Penguin Random House, of Simon & Schuster from ViacomCBS. The DOJ alleged that the acquisition would substantially lessen competition in the input market for the U.S. publishing rights to anticipated top-selling books (defined to be books with advances over $250K). Penguin Random House and Simon & Schuster are two of the "Big Five" largest book publishers in the United States, with market shares of 37% and 12%, respectively. The court sustained the DOJ's market definition, found that the merger was likely to substantially harm competition through both unilateral and coordinated effects, and rejected the defenses of the merging parties.]

. . .

ii. Efficiencies

The defendants argued at trial that efficiencies would limit the merger's anticipated competitive harm. Efficiencies alone might not suffice to rebut a prima facie case, but they "may nevertheless be relevant to the competitive effects analysis on the market required to determine whether the proposed transaction will substantially lessen competition." Sysco, 113 F. Supp. 3d at 82 (quotations omitted). The Court, however, precluded the defendants' evidence of efficiencies, after determining that the defendants had failed to verify the evidence, as required by law. *See* Trial Tr. at 2749:12–2772:24. Efficiencies therefore play no role in the instant analysis.

1 UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA
2
3 THE UNITED STATES OF AMERICA, Civil Action
No. 21-02886
4 Plaintiff(s),
5 vs.
6 BERTELSMANN SE & CO. KGAA, Washington, D.C.
et al, August 17, 2022
7 9:30 a.m.
Defendant(s). **Morning Session**
8 --
9 TRANSCRIPT OF BENCH TRIAL
BEFORE THE HONORABLE FLORENCE Y. PAN
10 UNITED STATES DISTRICT JUDGE
11 APPEARANCES:
12 FOR THE PLAINTIFF: John R. Read, Esquire
Ihan Kim, Esquire
13 Melvin A. Schwarz, I, Esquire
Ethan Stevenson, Esquire
14 United States Department of Justice
Antitrust Division
15 450 Fifth Street, Northwest
Washington, D.C. 20530
16
17 FOR THE DEFENDANTS Daniel M. Petrocelli, Esquire
BERTELSMANN and M. Randall Oppenheimer, Esquire
18 PENGUIN RANDOM HOUSE: Megan Smith, Esquire
O'Melveny & Myers, LLP
19 1999 Avenue of the Stars
Eighth Floor
20 Los Angeles, California 90067
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1 THE COURT: I understand that. Thank you.
2 MR. FRACKMAN: Thank you.
3 THE COURT: Anything else from you, Mr. Schwarz?
4 MR. SCHWARZ: No, Your Honor. Just for the record I
5 would like to say that the Peabody Energy case, which he cited,
6 there was an expert in that case, and the court still rejected
7 most of the efficiencies in any event.
8 And I think the law is clear from the D.C. Circuit in
9 Anthem on the fact that these cannot be vague, speculative, or
10 otherwise cannot be verified by reasonable means. That's at
11 359. And I don't think this is reasonable at all.
12 THE COURT: Okay. Thank you.
13 The Court has heard the evidence on this issue and the
14 arguments of the parties and is prepared to rule.
15 Dr. Snyder is an expert witness for the defendants who
16 is offered to testify on merger-related efficiencies. His
17 expert opinion relies on a projection of synergies produced in
18 November of 2020 by Manuel Sansigre, a senior vice president at
19 Penguin Random House who's in charge of mergers and
20 acquisitions.
21 Mr. Sansigre produced his synergy projections to help
22 Random House evaluate whether it should acquire Simon &
23 Schuster.
24 Dr. Snyder's expert report offers three primary
25 conclusions about Mr. Sansigre's projections.

1 First, that the projected synergies are the type that
2 economists would recognize given the features of the publishing
3 industry.
4 Second, that the projected synergies are
5 merger-specific efficiencies.
6 Third, that the projected synergies would benefit
7 authors through higher income and consumers through greater
8 availability of books.
9 Significantly, however, Dr. Snyder concedes that he
10 did not, quote, independently verify specific dollar amounts,
11 unquote, and did not, quote, independently derive estimates,
12 unquote, of Mr. Sansigre's projected synergies. Thus, the
13 parties agree and stipulate that Dr. Snyder did not verify the
14 projections from the November 2020 model that form the basis of
15 his expert opinion on efficiencies.
16 The government filed a motion in limine to exclude
17 Dr. Snyder's testimony on efficiencies under Federal Rule of
18 Evidence 702. The government argued, among other things, that
19 Dr. Snyder's reliance on unverified projections rendered his
20 efficiencies testimony inadmissible under Rule 702, the
21 horizontal merger guidelines, and cases applying the horizontal
22 merger guidelines.
23 The Court essentially deferred ruling on the motion to
24 preclude the expert testimony on efficiencies determining that
25 it should hear the evidence about Mr. Sansigre's projections

1 before deciding whether the alleged efficiencies are verifiable
2 and verified as required by the horizontal merger guidelines
3 and persuasive case law.
4 The Court decided to hear the evidence during the
5 trial given that this is a bench trial but instructed the
6 parties to arrange the presentation of evidence so that the
7 verifiability of Mr. Sansigre's projected synergies could be
8 considered and argued and the Court could then rule on the
9 government's motion before hearing the totality of Dr. Snyder's
10 expert testimony on efficiencies.
11 The Court determined that it would be more efficient
12 to proceed in this fashion because if defendants were unable to
13 meet their burden to show that the efficiencies were
14 substantiated, verifiable, and verified under the horizontal
15 merger guidelines, then it would be unnecessary to consider any
16 of the other aspects of the efficiencies evidence.
17 The Court has now heard the evidence on the projected
18 efficiencies and arguments from the parties, and it will grant
19 the motion to preclude the efficiencies evidence because the
20 efficiencies projected by Penguin Random House are not
21 substantiated and verified.
22 Although many of the projections may be verifiable,
23 some are not verifiable. Moreover, the efficiencies have not,
24 in fact, been independently verified by anyone, and they,
25 therefore, are not cognizable under the horizontal merger

1 guidelines and are not reliable under Rule 702.
2 Finally, the Court concludes that the efficiencies
3 projections in the November 2020 model are unreliable because
4 they are out of date and include 2021 projections that have
5 been proved to be inaccurate.
6 The applicable legal standards are as follows:
7 Federal Rule of Evidence 702 concerning testimony by
8 expert witnesses provides, quote, a witness who is qualified as
9 an expert by knowledge, skill, experience, training, or
10 education may testify in the form of an opinion or otherwise
11 if, A, the expert's scientific, technical, or other specialized
12 knowledge will help the trier of fact to understand the
13 evidence or to determine a fact in issue; B, the testimony is
14 based on sufficient facts or data; C, the testimony is the
15 product of reliable principles and methods; and D, the expert
16 has reliably applied the principles and methods to the facts of
17 the case, unquote.
18 Rule 702 incorporates the Supreme Court's guidance in
19 Daubert versus Merrell Dow Pharmaceuticals, Inc. which called
20 upon trial judges to serve a gatekeeping role in ensuring that
21 an expert's testimony both rests on a reliable foundation and
22 is relevant to the task at hand.
23 Also in Kumho Tire Company, Limited versus Carmichael,
24 the Supreme Court clarified that the gatekeeper role extends to
25 all expert testimony.

1 And this is confirmed by Rule 702's advisory committee
2 note to the 2000 amendment.
3 The party seeking to introduce expert testimony must
4 demonstrate its admissibility by a preponderance of the
5 evidence. Courts take a flexible approach to deciding Rule 702
6 motions and have broad discretion in determining whether to
7 admit or exclude expert testimony.
8 Horizontal merger guideline section 10.
9 The horizontal merger guidelines outline the analysis
10 and enforcement practices of the Department of Justice and the
11 Federal Trade Commission with respect to horizontal mergers
12 under the federal antitrust laws including section 7 of the
13 Clayton Act. See horizontal merger guideline section 1.
14 Federal courts frequently use the guidelines to
15 develop legal standards in antitrust litigation. See, for
16 example, FTC versus H.J. Heinz Company, 246 F.3d 708. That's a
17 D.C. Circuit case from 2001.
18 Section 10 of the horizontal merger guidelines
19 discusses efficiencies. The guidelines observe that
20 efficiencies are difficult to verify and quantify in part
21 because much of the information relating to efficiencies is
22 uniquely in the possession of the merging firms. Moreover,
23 efficiencies projected reasonably and in good faith by the
24 merging firms may not be realized.
25 Therefore, the merger guidelines say, it is incumbent

1 upon the merging firms to substantiate efficiency claims so
2 that the agencies can verify by reasonable means the likelihood
3 and magnitude of each asserted efficiency.
4 Courts interpret this requirement of substantiation
5 and verification to encompass, quote, how and when each
6 efficiency would be achieved and any costs of doing so, how
7 each efficiency would enhance the merged firm's ability and
8 incentive to compete, and why each would be merger specific,
9 end quote. That's from United States versus H&R Block, 833
10 F.Supp.2d 36 at 89. That's a D.D.C. case from 2011, and it is
11 quoting the horizontal merger guidelines section 10.
12 Under the guidelines, projected efficiencies are
13 generally less credible when generated outside the usual
14 business planning process, and they are more credible when
15 substantiated by analogous past experience.
16 Ultimately, efficiencies must be cognizable to be
17 considered under the guidelines. Quote, cognizable
18 efficiencies are merger-specific efficiencies that have been
19 verified and do not arise from anticompetitive reductions in
20 output or service.
21 A cognizable efficiency claim must represent a type of
22 cost saving that could not be achieved without the merger, and
23 the estimate of the predicted saving must be reasonably
24 verifiable by an independent party. And that's quoting the
25 horizontal merger guidelines and also, I believe, H&R Block.

1 Case law provides that the Court must undertake a
2 rigorous analysis of the kinds of efficiencies being urged by
3 the parties in order to ensure that those efficiencies
4 represent more than mere speculation and promises about
5 post-merger waiver. That's H&R Block at 89.
6 So, thus, in sum, the foregoing legal standards and
7 precedents place the burden on defendants to establish that the
8 projected efficiency relied upon by Dr. Snyder are
9 substantiated, that they are reasonably verifiable by an
10 independent party, and that they are, in fact, verified.
11 Where efficiencies are not independently verifiable
12 and verified, no court in this jurisdiction has ever given any
13 weight to such efficiencies evidence. See H&R Block, 833
14 F.Supp.2d 36, D.D.C. 2011; United States versus Aetna, 240
15 F.Supp.3d, D.D.C. 2017; FTC versus Sysco Corporation, 113
16 F.Supp.3d, 1, D.D.C. 2015; FTC versus Wilhelmsen Holding, ASA,
17 341 F.Supp.3d 27, D.D.C. 2018; FTC versus Staples, 970 F.Supp
18 1066, D.D.C. 1997.
19 This is because it is the parties' interest to be
20 aggressive and optimistic in the projection of efficiencies to
21 justify their own merger. Because courts are not
22 well-positioned to verify such projections, independent
23 verification is critical in order to allow a court to determine
24 whether such projections are reliable.
25 Without verification, the efficiencies analysis could

1 swallow the analytical framework required by the Clayton Act.
2 See H&R Block at 91.
3 The Court's findings and conclusions are as follows:
4 Number one, many of the projected efficiencies in the
5 November 2020 model may be verifiable, but at least some are
6 not verifiable.
7 According to the testimony of Mr. Sansigre, he and his
8 team worked very hard to derive the efficiencies model. They
9 began in March 2020 by including detailed data about Penguin
10 Random House. When data became available from Simon & Schuster
11 in September 2020, he added that data to the model. When
12 additional data became available in October 2020, he included
13 that data as well. The data and assumptions in the model were
14 closely checked by executives in the Bertelsmann M&A group and
15 the ZI risk management group including Markus Dohle and Nihar
16 Malaviya.
17 Mr. Sansigre estimates that the model was revised a
18 hundred times before it became final. All of Mr. Sansigre's
19 judgments and assumptions were based on his broad experience in
20 M&A and in particular in M&A in the publishing industry.
21 And the Court has no doubt that Mr. Sansigre is very
22 competent, an expert in these matters.
23 Mr. Sansigre uses the term synergies and efficiencies
24 interchangeably. His model identified four categories of
25 synergies; real estate, operating expenses, variable costs, and

1 revenue.
2 The real estate efficiencies were largely based on
3 expected consolidation of Simon & Schuster's New York
4 headquarters with Penguin Random House's New York headquarters.
5 Mr. Sansigre consulted with managers within Penguin Random
6 House and determined that the personnel of Simon & Schuster
7 could be accommodated in Penguin Random House's New York office
8 space. He then examined Simon & Schuster's lease and consulted
9 with real estate experts who advised him that he could sublet
10 Simon & Schuster's office space for 50 percent of the rental
11 payments owed under the lease. He also examined other real
12 estate holdings and estimated some additional savings from
13 allowing other leases to expire. Based on those calculations,
14 he projected approximately $10 million in savings per year,
15 almost all of which are from consolidating the New York office
16 space.
17 The operating expense synergies reflect efficiencies
18 in headcount and non-headcount expenses, essentially personnel
19 costs.
20 Mr. Sansigre's November 2020 model projected
21 $ in annual operating expense synergies in 2025.
22 You know, I didn't think of this before, parties, but
23 I do have numbers in this. Is it okay for me to be reading
24 this publicly?
25 MR. FRACKMAN: As the Court knows, we actually made

1 quite an effort to keep the numbers confidential. And I think
2 both Simon & Schuster and Penguin Random House believe they are
3 confidential. They affect personnel issues and subsequent
4 events.
5 THE COURT: I am going to black out the numbers then,
6 and we will issue a blacked out -- I will just black out the
7 numbers and then read on the record. Thank you. I'm sorry
8 about that.
9 Okay. So Mr. Sansigre's November 2020 model projected
10 a certain amount in annual operating expense synergies in 2025.
11 Mr. Sansigre began by predicting a percentage decrease in
12 operating expenses. And this figure was based on prior
13 operating expense synergies in 26 prior acquisitions including
14 the 2013 Penguin Random House merger which had operating
15 expense synergies of a certain percentage as well as
16 consultation with Penguin Random House executives like
17 Mr. Malaviya and Mr. Dohle.
18 Then Mr. Sansigre looked at the data examining costs
19 department by department to identify where operating expense
20 synergies actually might be achieved.
21 In some departments such as sales, IT, and
22 administration, Mr. Sansigre looked at specific employee roles
23 and third party contracts to determine which kinds of positions
24 or contacts might be redundant to estimate headcount and
25 non-headcount savings.

1 In some other departments such as fulfillment,
2 Mr. Sansigre used his judgment to project a percentage of
3 savings based on considerations like Penguin Random House's
4 ability to scale its distribution to meet a portion of Simon &
5 Schuster's distribution demand.
6 After reviewing the department-by-department data,
7 Mr. Sansigre compared the cumulative projected synergies of
8 that analysis with the expected percentage of synergies that he
9 had used based on prior transactions and management judgment,
10 and the two projected synergies number matched.
11 Mr. Sansigre's November 2020 model projected a
12 certain amount of annual variable cost synergies in 2025. As
13 part of the variable costs, Mr. Sansigre considered return
14 rates. He found that Penguin Random House had lower return
15 rates than Simon & Schuster by certain percentage points
16 between 2017 and 2021. He reviewed records of improved rates
17 from the 2013 merger from Penguin and Random House, the
18 acquisition of smaller publishers like Little Tiger, and
19 experiences of Penguin Random House's third party distribution
20 clients. He also consulted Simon & Schuster and Penguin Random
21 House management.
22 Based on those considerations, Mr. Sansigre used his
23 judgment to predict a certain percentage of improvement in
24 Simon & Schuster's post-merger return rate by 2025. Penguin
25 Random House's investments in a supply chain were a significant

1 factor in those projections.
2 Mr. Sansigre's November 2020 model projected a certain
3 amount of annual revenue synergies in 2025. The most
4 significant projected revenue synergies came from gross
5 physical sales and audio. After accounting for certain rising
6 costs, most significantly royalties and advance write-offs, he
7 came up with a particular number that was a projected increase
8 in sales. And the sales projections are based on
9 Mr. Sansigre's judgment and experience.
10 Penguin Random House's large sales force was a
11 significant factor in Mr. Sansigre's gross physical sales
12 projections. He believed this large sales force would get
13 Simon & Schuster books into more stores and, thus, increase
14 sales, namely in independent books stores, specialty stores,
15 and international retailers.
16 Simon & Schuster relies on its top customers for a
17 greater proportion of its sales than Penguin Random House does.
18 Mr. Sansigre interpreted this to mean that Penguin Random House
19 could improve Simon & Schuster's sales among it's non-top
20 customers.
21 Considering past acquisitions, Mr. Sansigre noted that
22 Penguin Random House doubled the sales of Little Tiger's
23 imprints within two years after acquiring the smaller
24 publisher.
25 Notably, however, Mr. Sansigre's sales projections do

1 not align with the historical data from the 2013 merger of
2 Penguin and Random House which is more similar in scale to the
3 proposed merger of Penguin Random House and Simon & Schuster.
4 After the 2013 merger, sales declined. Mr. Sansigre
5 discounts the sales results of the 2013 merger because of
6 changed market conditions including the decline of commercial
7 fiction around 2013 in which Penguin was heavily invested at
8 the time.
9 In audio Mr. Sansigre predicted that Penguin Random
10 House's significant investments in in-house audio production
11 would let it improve Simon & Schuster's audio revenue because
12 Simon & Schuster relied on third parties for much of its audio
13 revenue.
14 Mr. Sansigre used his judgment to predict that Simon &
15 Schuster would have a certain percentage increase in audio
16 revenue post merger through essentially growing with the market
17 and benefiting from Penguin Random House's in-house
18 capabilities.
19 Mr. Sansigre discounted Simon & Schuster's
20 management's relatively high predictions for a Simon & Schuster
21 standalone future audio revenue because he wanted to
22 independently analyze the value of the merger.
23 So in sum, Mr. Sansigre's projected synergies are
24 based on educated management judgments mostly based on past
25 experience and applied to whatever detailed data about the

1 businesses of Penguin Random House and Simon & Schuster that
2 was available to him.
3 Many of the projections about cost savings are
4 arguably verifiable because theoretically an independent party
5 could look at all the underlying data about the costs of each
6 entity that Mr. Sansigre compiled and inputted into his
7 spreadsheets. They could get detailed explanations about the
8 assumptions that Mr. Sansigre made in coming up with his
9 percentage estimates of savings, and they could determine
10 whether those assumptions were reasonable and based on past
11 experience. Relying on past experience is favored by the
12 horizontal merger guidelines.
13 Some of the projections, however, most notably the
14 revenue projections, are not verifiable and are not based on
15 past experience.
16 The November 2020 model projects sales synergies after
17 the merger even though past experience does not support any
18 sales synergies because after Penguin and Random House merged
19 in 2013, they experienced a decrease in sales.
20 There were other merger experiences of Penguin Random
21 House that supported the idea of sales synergies, but
22 Mr. Sansigre picked and chose among the different precedents
23 and he justified his sales projections not relying on Penguin
24 and Random House merger based on his evaluation of changed
25 marketing conditions.

1 Therefore, the actual percentages that Mr. Sansigre
2 chose to apply to revenues as synergies are not verifiable.
3 Indeed, the defendants have conceded that revenue
4 synergies are the least easy to predict, and one of
5 Mr. Sansigre's own emails in the record acknowledges that the
6 sales efficiencies are difficult to predict.
7 Ultimately, however, the projected sales synergies are
8 derived from Mr. Sansigre's personal judgment, and they are not
9 consistent with the most prominent past experience and, thus,
10 the projected sales synergies in particular are not verifiable.
11 Number two, none of the efficiencies are independently
12 verified.
13 The parties agree and stipulate that, regardless of
14 whether the model was verifiable, it was not, in fact, verified
15 by anyone outside of Penguin Random House. Thus, there was no
16 independent verification as the horizontal merger guidelines
17 and prior case law contemplate.
18 Defendants argue that the Court may verify the
19 projections by hearing how they were derived and satisfying
20 itself that Mr. Sansigre put in a lot of work and made
21 reasonable assumptions, but the Court strongly disagrees that
22 this is what is contemplated by horizontal merger guidelines
23 and the case law.
24 The Court is not in a position to fact-check what
25 Mr. Sansigre says that he did or to determine whether his

1 assumptions were reasonable. Notably, none of the cases that
2 have considered this issue support the notion that the Court
3 should provide the independent verification necessary to
4 support efficiencies evidence proffered by defendants.
5 Defendants have said that there's no case that says an
6 expert is necessary. And I think that's true. Nobody has said
7 that explicitly. But the defendants have the burden to
8 establish that these efficiencies were independently verified,
9 and they assume a risk in litigation in arguing to a court that
10 a court should do that work that in many precedents was
11 performed by experts with much more knowledge about the
12 industry and expertise in dealing with financial models and
13 assumptions than a court could reasonably be expected to have.
14 This Court notes that in the Sysco case, that court
15 found that the expert had not verified whether efficiencies
16 predicted by a consulting company were merger specific and for
17 that reason among others declined to consider the efficiencies
18 evidence. That court did not attempt to verify the merger
19 specificity on its own. And this Court is not aware of any
20 other precedent where a court has undertaken the kind of
21 rigorous verification that is necessary in order to rely on
22 efficiencies in an antitrust case.
23 Number three, subsequent updates of the November 2020
24 model undermine its reliability.
25 After the November 2020 model was created,

1 Mr. Sansigre continued to update and refine the model. Most
2 notably, new iterations of the model were created in June 2021
3 and January 2022. The new iterations have some drastically
4 different projections with respect to efficiencies. The Court
5 focuses on the January 2022 model because defendants contend
6 that the June 2021 model was about a special circumstance, a
7 possible large infusion of cash to the business.
8 Looking at the January 2022 model, that model predicts
9 an increase in gross physical sales of [redacted] as
10 compared to [redacted] in the November 2022 model.
11 The January 2022 model predicts -- I'm sorry, I should
12 not have said those numbers.
13 The January '22 model predicts a certain number in
14 fulfilling savings as compared to a much larger number
15 predicted in November 2020, and savings on administration in
16 the 2022 model is far larger as compared to the number in the
17 November 2020 model. And I understand that that includes
18 editorial and art, but the additions of those lines does not
19 account for the magnitude of the change.
20 Furthermore, certain projections of the November 2020
21 model were proved inaccurate by the actual performance of
22 Simon & Schuster in 2021.
23 While the November 2020 model made certain predictions
24 of synergies for a merged company based on inputs regarding
25 Simon & Schuster's expected performance as a standalone

1 company, the actual standalone performance of Simon & Schuster
2 exceeded the predictions.
3 This indicates that the November 2020 model is both
4 out of date because it does not include actual updated
5 performance numbers and also that the November 2020 model
6 relied on proveably wrong projections and predictions.
7 Mr. Sansigre testified that the November 2020 model is
8 still the most reliable because it reflects pre-pandemic market
9 conditions. It appears to be his judgment that the future will
10 look more like the pre-pandemic world than the present world.
11 The Court rejects that testimony because Mr. Sansigre
12 cannot possibly know what the post-pandemic world will be like
13 and whether the book industry will revert to pre-pandemic
14 levels of sales and costs. Even with the benefit of industry
15 expertise, it is clear to this Court that we are in uncharted
16 waters.
17 Thus, the Court concludes that the November 2020 model
18 is unreliable because its inputs are not updated and its
19 projections are proveably inconsistent with actual numbers for
20 Simon & Schuster in 2021. The Court finds that Mr. Sansigre's
21 justifications for continuing to use the November 2020 model
22 are unpersuasive.
23 The Court, thus, finds that the November 2020
24 efficiencies model contains some projected efficiencies that
25 are not verifiable and that, in any event, none of the

1 efficiencies have been verified as required by the horizontal
2 merger guidelines and persuasive case law.
3 Moreover, the model is unreliable because it is not
4 updated and makes proveably inaccurate projections. As a
5 result, Dr. Snyder's expert report based on the November 2020
6 model is not based on sufficient facts and data under Rule 702
7 and must be excluded.
8 Five precedents in this jurisdiction unanimously
9 support this conclusion. Those precedents are H&R Block,
10 Wilhelmsen, Staples, Aetna, and Sysco.
11 In United States versus H&R Block, the court rejected
12 efficiencies evidence where the projected efficiencies, quote,
13 were largely premised on defendant's managers' experiential
14 judgment about likely costs rather than a detailed analysis of
15 historical data.
16 The court noted that, while reliance on the estimation
17 and judgment of experienced executives about costs may be
18 perfectly sensible as a business matter, the lack of a
19 verifiable method of factual analysis resulting in the cost
20 estimates renders them not cognizable by the court.
21 If this were not so, then the efficiencies defense
22 might well swallow the whole of section 7 of the Clayton Act
23 because management would be able to present large efficiencies
24 based on its own judgment and the court would be hard pressed
25 to find otherwise.

1 In this case, many of the efficiencies projections are
2 also premised on management expectations and judgment.
3 In FTC versus Wilhelmsen Holding ASA, the court
4 rejected efficiencies evidence where the projected efficiencies
5 were based on, quote, a series of significant assumptions,
6 percentage reductions in cost, percentage increases in
7 productivity, or assumed cost product equivalencies that were
8 doing all the work in calculation of the estimates.
9 There the critical issue was that because the bases
10 for the assumptions the expert identified and their role in the
11 efficiencies analysis were unclear, the reasonableness of the
12 assumptions along with the ultimate determinations could not be
13 verified with any degree of rigor.
14 Significantly, the court in that case noted that,
15 quote, references to the merging parties' past practices,
16 managerial expertise, and incentives or internal verification
17 processes, unquote, could not, quote, serve to substantiate any
18 efficiencies, unquote, because a court cannot substitute
19 defendants' assessments and projections for independent
20 verification.
21 So here, while Penguin Random House's internal process
22 was rigorous, that internal process cannot substitute for
23 independent verification.
24 In FTC versus Staples, the court rejected efficiencies
25 evidence where, quote, the defendants' projected base case

1 savings of $5 billion were in large part unverified or at least
2 the defendants failed to produce the necessary documentation
3 for verification, unquote.
4 Here the efficiencies also are unverified. And
5 although the defendants will say that they produced the
6 documentation for verification, as the Court has already
7 stated, the Court does not have the capability, the time, or
8 resources to perform the verification.
9 In United States versus Aetna, the court rejected
10 efficiencies evidence where the defendants' experts failed to
11 review the underlying provider contracts after the merging
12 parties approached -- after the merging parties projected
13 efficiencies based on the contracts, and that was criticized.
14 Instead, the expert noted simply that a third party
15 consultant had taken a large haircut to the total savings
16 estimated and without much analysis concluded that the savings
17 were verifiable.
18 The court deemed that insufficient. The court said,
19 without a more robust analysis which the companies have not
20 provided, the court cannot conclude that these network
21 efficiencies are verifiable and likely to be passed on to
22 consumers.
23 Here, like in that case, Dr. Snyder also failed to
24 look closely at the underlying data and did not do any robust
25 analysis to verify the efficiencies.

1 Finally, in FTC versus Sysco, the court rejected
2 efficiencies evidence where defendants' expert relied on
3 synergy projections made by McKinsey, the consulting firm which
4 was hired by Sysco to determine the prospective value of
5 acquiring U.S. Foods.
6 The court there did not question the rigor and scale
7 of the analysis conducted by McKinsey but noted that the expert
8 had not verified that the synergies were merger specific.
9 The court stated that it was not clear what
10 independent analysis the expert did to reduce McKinsey's
11 projected savings to merger-specific savings.
12 The court also noted that in one example, the expert
13 relied exclusively on documents created by either McKinsey or
14 defendants. He performed no independent analysis to verify
15 those numbers.
16 Again, similarly in this case, Dr. Snyder did not
17 perform any independent analysis to verify the numbers. And in
18 that case, the court did not undertake to do the verification
19 itself.
20 As a result, the Court will exclude Dr. Snyder's
21 testimony on efficiencies. No independent party could
22 reasonably verify the magnitude of at least some of the
23 asserted efficiencies in Mr. Sansigre's projected model,
24 especially the sales synergies, and Dr. Snyder made no attempt
25 to provide a quantitative verification of the synergies.

1 Because Dr. Snyder's testimony was not based on sufficient
2 facts and data, that testimony cannot help the trier of fact to
3 determine a fact at issue and, therefore, is not admissible
4 under Rule 702.
5 Although the Court's reasoning is firmly grounded in
6 precedents applying the horizontal merger guidelines, it bears
7 mentioning that the Court's analysis under Rule 702 is also
8 consistent with the application of that rule in other contexts.
9 It is well established that expert testimony may be excluded
10 under Rule 702 where the expert relies uncritically on
11 information provided to them by the party or parties for whom
12 they are working.
13 In the Title VII case, Campbell versus National
14 Railroad Passenger Corporation, the court excluded the
15 testimony of plaintiffs' expert who relied on a summary of
16 testimony prepared by plaintiffs' counsel to form his opinions
17 without independently reviewing or verifying that testimony.
18 That case is at 311 F.Supp.3d 281 from 299 to 300. That's
19 D.D.C. 2018.
20 The court reasoned, quote, such blind reliance on
21 facts provided by plaintiff's counsel combined with his failure
22 to review other sources of information renders his expert
23 report unreliable, unquote. That's at 300.
24 See also McReynolds versus Sodexho Marriott Services,
25 Inc., 349 F.Supp.2d 30 at 38, D.D.C. 2004, allowing in a

1 Title VII case testimony of plaintiffs' expert who relied on
2 data prepared by the opposing party instead of by the same
3 party who retained the expert.
4 And see also United States ex rel Morsell versus
5 NortonLifeLock, Inc. That's 568 F.Supp.3d 248 at 276, D.D.C.
6 2021, where expert and false claims case explicitly disclaimed
7 verification of assumptions, the expert was allowed to opine
8 only conditionally assuming the government succeeds in proving
9 the assumptions upon which the opinions rely.
10 All of these cases support the proposition that an
11 expert's opinion may be excluded as unreliable when the opinion
12 blindly rests on evidence provided by the party that retains
13 the expert. A party may not cloak unexamined assumptions in
14 the authority of expert analysis. See Ask Chemicals, LP versus
15 Computer Packages, Inc, 593 F.Appx. 506, 510, Sixth Circuit,
16 2014.
17 For all the foregoing reasons, the Court grants the
18 government's motion to exclude the defendants' efficiencies
19 evidence.
20 Does any party want any additional findings or
21 conclusions for the record?
22 MR. SCHWARZ: No, Your Honor.
23 MR. FRACKMAN: I think that covers it, Your Honor.
24 THE COURT: Okay. Thank you.
25 So we were in the midst of Dr. Snyder's testimony.