
Unit 16: Saul Michaels/Salon One Shampoo Merger

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1. Ask the setup questions

- a. Who are you/what role are you being asked to play?
 - You are an attorney at the FTC
- b. What is the transaction?
 - Saul Michael's pending acquisition of Salon One
- c. What is the form of the work product?
 - A reasoned memorandum of law recommending whether to bring a Section 13(b) action for a preliminary injunction blocking the transaction pending a resolution of an administrative trial on the merits
- d. What questions are you being asked to address?
 - Major implicit question: *Can the FTC win a Section 13(b) case?*
 - Explicit questions:
 - What is the best prima facie case the FTC can make?
 - What are the response defenses the merging parties can raise?
 - Will the parties "litigate the fix"?
 - Who has the better case to appeal to the "heart" of the judge?
 - What is the FTC's likelihood of success?
- e. What statutes(s) apply?
 - Clayton Act § 5
 - FTC Act § 13(b)

2. Quick read to spot the issues

- The problem will have multiple issues
- Some issues will be substantively more important than others
- DO NOT get hung up spending too much time on the small issues at the cost of not adequately addressing the major issues
- DO NOT dwell on the technical aspects of some test at the cost of losing the persuasive thrust of the argument

So what do I need to spot?

Typical structure of a formal merger analysis

- Part 1: The prima facie case
 - Relevant product market
 - *Brown Shoe* “outer boundaries” and “practical indicia” for the product market
 - Merger Guidelines hypothetical monopolist test
 - *Homogeneous products*: Critical loss implementations
 - *Differentiated products*: One-product/uniform SSNIP recapture implementations
 - Relevant geographic market
 - “Commercial realities” test
 - Merger Guidelines hypothetical monopolist test
 - *PNB* presumption (only in horizontal cases)
 - Market participants and market shares
 - Applicability of the *PNB* presumption
 - Judicial precedent support
 - Merger Guidelines support
 - Other evidence of anticompetitive effect
 - Unilateral effects
 - Coordinated effects
 - Elimination of a maverick
 - Foreclosure/raising rivals’ costs (for vertical transactions)
 - Other vertical theories/potential competition theories

Effectively to show gross upward pricing pressure or other anticompetitive effect

Include merging parties’ rebuttals of the government’s arguments

Typical structure of a formal merger analysis

■ Part 2: Defendants' rebuttal: Downward pricing pressure defenses

- Entry/expansion/repositioning
- Efficiencies
- Countervailing buyer power ("power buyers")
- Failing company/division

To show sufficient gross downward pricing pressure to offset any upward pricing pressure or other anticompetitive effect due to the merger

■ Part 3: Balancing (if necessary)

■ Also, in this problem you will need to address the standards for the entry of a Section 13(b) preliminary injunction

- Likelihood of success on the merits
- Weighing the equities/public interest

Do not forget this!

3. Annotate/Outline

- Write out the major points you think will be important to the analysis and then—



SIT BACK AND THINK FOR A FEW MINUTES!!

3. Annotate/Outline

1. The FTC may not be able to make out its prima facie case
 - a. No vertical theory
 - i. Merging firms not in different positions in the chain of distribution; products not complementary
 - b. No elimination of potential competition
 - i. Perceived potential competition—Neither firm is perceived as a potential entrant
 - ii. Actual potential competition
 - 1) Salon One is not an actual potential entrant
 - 2) Saul Michael has contemplated entry into salon-only products, but—
 - a) Speculative whether entry would occur absent the transaction
 - b) Not timely—would take four to five years
 - c) Speculative as to how successful entry would be (if successful at all)

3. Annotate/Outline

1. The FTC may not be able to make out its prima facie case

c. Horizontal case is problematic

- i. Horizontal only if the relevant market includes salon-only + mixed channel products
 - i. Parties agree that the United States is the relevant geographic market
 - ii. May not be able to support the product market definition
 - 1) Products highly differentiated—especially in price
 - 2) No substitution between salon-only products (except at the time of adoption)
 - 3) Minor substitution from salon-only to mixed channel
 - 4) No substitution from mixed channel to salon-only
- ii. *PNB* presumption probably not strong
 - i. 5→4, with no customer complaints and no bad documents in the investigation record
 - ii. Probably borderline HHIs
 - iii. Presumption even weaker if Fauve's entry in January 2023 is taken into account
 - iv. → FTC has not brought challenges in these circumstances since the 1960s/1970s

3. Annotate/Outline

1. The FTC may not be able to make out its prima facie case

c. Horizontal case is problematic

iii. Weak to nonexistent explicit theories of anticompetitive harm

1) Weak unilateral effects

- a) *Mixed channel*: No diversion from Saul Michael to Salon One → Salon One does not constrain Saul Michael's price → No Saul Michael unilateral price increase
- b) *Salon-only*: Some diversion to Salon One to Saul Michael → Possible Salon One unilateral price increase

2) No coordinated effects

- a) Probably too much differentiation/unaligned interests for tacit coordination among all firms

b) *Salon-only*:

- 1) Probably not a collusive group since there is no diversion between products

c) *Mixed channel*:

- 1) Possible collusive group: Diversion among products sold at retail
- 2) But the merger does not change the structure or competitive conditions for either group → unlikely that the merger will increase likelihood or effectiveness of coordinated interaction in the mixed channel
- 3) ALSO, Fauve will discount its new mixed product and charge a wholesale price of \$5.00, not the prevailing \$6.00 → Likely to precipitate a competition-increasing response by incumbent firms and undermine any propensity to coordinated interaction in mixed products

3) No elimination of a maverick: Neither Salon One nor Saul Michael is a maverick

3. Annotate/Outline

2. Even if the FTC can make out a prima facie case, the merging parties have strong entry and efficiencies defenses

a. *Entry defense*: Fauve in mixed channel products

- i. Will enter with a new mixed channel shampoo in January 2023
 - Not entering in response to the merger
 - Not an entry defense under the Guidelines; rather, treated as a nonseller market participant
 - BUT courts have analyzed committed future entry as an entry defense (see *Staples/Office Depot*)
 - → Merging parties likely to play this as a defense rather than a nonmarket participant
- ii. Expects 5m sales to salons and 10m sales to retailers within two years (presumably taken pro rata from incumbents)
- iii. Invested \$3m so far in the project
- iv. Will offer mixed channel product at an introductory wholesale price of \$5.00, not the prevailing \$6.00
- v. → Entry likely to precipitate a competition-increasing response by incumbent firms and prevent any price increase in mixed products as a result of the merger

3. Annotate/Outline

2. Even if the FTC can make out a prima facie case, the merging parties have strong entry and efficiencies defenses
 - b. *Expansion defense*: Saul Michael in salon-only products
 - i. Salon One has been losing market share for five year due to a loss of strategic direction
 - ii. For each of the next three years, Saul Michael's business plans is to invest \$3 million from the transaction to revitalize Salon One and regain market share by—
 - 1) Updating the product formula
 - 2) Improving the brand image through a sustained advertising campaign
 - 3) Hiring more representatives to work with high-end salons
 - 4) Promoting Salon One at trade shows
 - iii. Considering reducing Salon One's wholesale price from \$25 to \$22
 - iv. Salons carrying Salon One support the transaction and Saul Michael's plans to revitalize the product
 - v. → Efforts to increase market share should negate any upward pricing pressure on Salon One (the only plausible theory of anticompetitive harm)

3. Annotate/Outline

2. Even if the FTC can make out a prima facie case, the merging parties have strong entry and efficiencies defenses

c. *Efficiencies defense*: Transaction cost savings

i. Projected savings of \$5.3 million annually

- 1) *Fixed cost savings*: \$3.5 million from closing SM plant and consolidating into Salon One plant and from consolidating management, back office, and logistics
- 2) *Marginal cost savings*: \$1.8 million from lower Salon One ingredient cost without reduction in quality

ii. The staff has confirmed the numbers

iii. Cognizable efficiencies

- i. Fixed cost savings are not cognizable in an efficiencies defense because they are not passed on to customers
- ii. Marginal cost efficiencies are cognizable

iv. *Key question*: To what extent will the downward pricing pressure from the marginal cost savings offset the upward pricing pressure from the unilateral price effect on Salon One?

3. Annotate/Outline

3. There is no fix, BUT there is no need for a fix

- There is no economically viable fix for the parties
 - The merging parties are each one-product firms
 - Acquiring Salon One is product extension merger and not a “trade up” opportunity for Saul Michael
- But there is no need for a fix given the weakness of the FTC’s case

4. The merging parties have the advantage in capturing the “heart” of the judge

- The FTC has a weak to nonexistent merits case
- Fauve entry will significantly increase competition among mixed product producers
- Saul Michael plans on investing significantly to revitalize a flailing Salon One and may even lowering Salon One’s wholesale price will increase competition in salon-only products
- Salons carrying Salon One support the transaction
- There is no customer opposition, and no customers appear willing to testify for the FTC
- The transaction will produce significant cost savings

3. Annotate/Outline

5. The judge will not grant a preliminary injunction

- The FTC is unlikely to fail on the merits
- The public equities will not overcome the lack of a likelihood of success on the merits

4. Write: Some rules

A. Be organized

Exam instructions:

Present your analysis in a well-organized, linear, and concise manner. Think about your answers before writing. **Remember Pascal's apology:** "I am sorry that this was such a long letter, but I did not have the time to write you a short one." Clarity of thinking and exposition is much more important than throwing in the kitchen sink. Penalties will be levied for excessive length, verbosity, lack of organization, or the inclusion of irrelevant boilerplate.

B. Prepare in advance

Exam instructions:

As we discussed in class, you may cut and paste short passages **from materials you have collected in a single document** to introduce a concept, a rule of law, a legal principle, or an economic proposition or formula ("boilerplate"). You may include quotes from cases in the materials you create for this purpose, but if you do so, prepare the quote and cite the case (in proper Blue Book form) as you would in a brief. You are prohibited from copying/cutting and pasting any other text into your take-home answer, regardless of who authored the text.

4. Write: Some rules

C. BE CAREFUL in using your boilerplate

- ❑ Especially on conclusions, be sure that your boilerplate accurately reflects your conclusions
- ❑ E.g., if the boilerplate says there is a “strong likelihood of success on the merits” but you conclude that success is borderline, be sure to change the boilerplate

D. When analyzing an issue, be sure to include a conclusion

- ❑ The discussion of an issue is not complete until you write a conclusion
- ❑ Do not make me guess where your analysis takes you

E. For every conclusionary statement, you need an argument to support the statement

F. Make sure that you analyze the issue in the correct box

- ❑ Courts pigeonhole issues into boxes and each box has its own rules and requirements
- ❑ So, for example, you are likely to get the wrong answer (in the sense that the courts would reject your analysis and conclusion) if you analyze a merging firm’s incentives not to enter with a new product as an explicit theory of anticompetitive harm to strengthen an otherwise weak or nonexistent *PNB* presumption rather than as the elimination of an actual potential entrant

4. Write: Some rules

F. Blue Book the cites in your boilerplate

- E.g., there are no periods in FTC and the United States is always spelled out in a case name

G. Be professional

- This is a formal memorandum of law—no causal informality or colloquialisms

4. Write: Structure

- Canonical form for a reasoned memorandum of law
 - Introduction
 - Statement of the assignment
 - “You have asked me”—State the assignment, including all the questions you have been asked to address
 - Usually one paragraph (but you can make exceptions to make the memo easier to read)
 - Short conclusion
 - Give a summary of your answers to all the questions presented
 - Usually one paragraph (but you can make exceptions to make the memo easier to read)
 - If you have a good outline and know where you are going, write this (tentatively) now
 - Roadmap
 - Describe how the analysis is organized
 - Analysis
 - Horizontal theories
 - Potential competition theories
 - Vertical theories
 - Answer any remaining questions
 - Conclusion
 - Style this like the short conclusion in the introduction
 - If you have modified your conclusion, replace your short conclusion in the introduction with a “copy and paste” of your final conclusion

4. Write: Relevant product market

- Salon-only + mixed channel is a relevant market
 - *Brown Shoe* factors
 - Both are “higher-end” shampoos sold in salons at prices much higher than retail-only brands
 - Recognized by the public as “salon” brands
 - Salon-only products do not substitute for one another—Both salon-only brands are constrained by mixed channel products
 - Both products are manufactured on the same types of equipment

4. Write: Relevant product market

- Salon-only + mixed channel is a relevant market

- HMT: Salon-only products do not satisfy the HMT

See the next slide if you read the hypothetical differently

- Formula tests

- Have zero diversion to one another → candidate market fails a one-product SSNIP test
 - Products are sufficiently homogeneous to apply a percentage critical loss test

- SSNIP = 5%
 - %Margin = 60%
 - Critical loss:
 - Actual loss: 8.3%

$$\%CL = \frac{\delta}{\delta + m} = \frac{5\%}{5\% + 60\%} = 7.7\%$$

- Since actual loss exceeds critical loss, salon-only fails the percentage critical loss test
 - CONCLUSION: Salon-only fails the HMT

- Brute force

Parameters

Price =	\$25.00
q =	4.80 million units
$\Delta q = q \times \%L =$	0.40 million units
\$margin =	\$15.00
$\$SSNIP = \%SSNIP \times p =$	\$1.25

Gain on inframarginal sales

q - $\Delta q =$	4.40 million units
$\$SSNIP =$	<u>\$1.25</u>
Gross gain =	\$5.50 million

Loss on marginal sales

$\Delta q =$	0.40 million units
\$m =	\$15.00
Gross loss =	<u>\$5.98 million</u>
NET	<u>-\$0.47 million</u>

FAILS

4. Write: Relevant product market

- Salon-only + mixed channel is a relevant market
 - HMT: Salon-only products do not satisfy the HMT
 - An ambiguity in the hypothetical
 - Given that salon customers would not switch salons in response to a price increase in the shampoo and that the costs to the salon of switching shampoo products were high, I thought the hypothetical implied that there was no diversion.
 - I was wrong—A number of students read the hypothetical differently
 - If you posited that there would be switching between salon-only products if the price of one of the salon-only products was subject to a SSNIP, I graded your answer as if the hypothetical contained your assumption
 - Depending on how much switching you assumed, this could have three implications for the analysis—
 - Salon-only products could satisfy the one-product SSNIP recapture test and eliminate the only significant argument that the relevant market in which to analyze the merger was salon-only + mixed channel
 - The salon-only products could be the closest substitutes for one another, making the mixed products more distant substitutes, and weaken or eliminate the unilateral effect of the merger on Salon One's price
 - The two salon-only manufacturers could be a collusive group in the coordinated effects analysis, but the merger still would not increase the likelihood or effectiveness of tacit collusion

4. Write: Relevant product market

- Salon-only + mixed channel is a relevant market

- HMT: Salon-only + mixed channel satisfy the HMT

- Formula tests

- Use one-product SSNIP recapture test (salon-only to mixed channel)

- %SSNIP = 5%

- \$SSNIP = \$1.25

- \$m_{RAve} = \$3.00

- Critical recapture ratio: $R_{Critical}^{SalonOne} = \frac{\$SSNIP_{SalonOne}}{\$m_{RAve}} = \frac{\$SSNIP_{SalonOne}}{\$m_{MixedChannel}} = \frac{1.25}{3.00} = 41.7\%$

- Actual recapture ratio = 100%

- CONCLUSION: Salon-only + mixed channel satisfies the HMT

When applying the one-product SSNIP test, you must specify the product that is subject to the SSNIP

- Brute force

Parameters: Salon One

Price = \$25.00
 q = 4.80 million units
 Δq = q × %L = 0.40 million units
 \$margin = \$15.00
 \$SSNIP = %SSNIP × p = \$1.25

Gain on inframarginal sales

q - Δq = 4.40 million units
 \$SSNIP = \$1.25
 Gross gain = \$5.50 million

Gain on recaptured sales

Recaptured units = 0.40 million units
 \$m_{Mixed} = \$3.00
\$1.20 million
 HM NET GAIN: \$0.72 million

Loss on marginal sales

Δq = 0.40 million units
 \$m = \$15.00
 Gross loss = \$5.98 million
 NET on Salon One -\$0.47 million

HMT: **PASSES**

Parameters: Mixed channel

Recapture rate = 100%
 Recaptured units = 0.40 million units
 \$margin = \$3.00

4. Write: Relevant product market

- Salon-only + mixed channel is a relevant market
 - Anticipated defense rebuttal: Merging parties are in two separate markets
 1. Differences in price/reputation are very large → Suggests that salon-only and mixed channel should be in separate markets
 - Salon-only product have a whole price of \$25, more than 4x the \$6.00 wholesale price of mixed channel products
 - The difference is even more stark at retail: \$55 vs. \$10.80
 2. Mixed channel products are a relevant market
 - *Brown Shoe* factors: Essentially homogeneous products
 - Same price at wholesale/Same price at retail
 - Very distinct prices from salon-only and retail-only
 - Only products with dual channels of distribution
 - Distinct customers: Salons whose customers will pay \$10.80 but not \$55 for a 16 oz bottle
 - Industry and public recognition as a separate class of products from salon-only and retail-only
 - Mixed channel products satisfy the HMT
 - Use percentage critical loss
$$\%CL = \frac{\delta}{\delta + m} = \frac{5\%}{5\% + 50\%} = 9.1\%$$
 - SSNIP = 5%
 - %Margin = 50%
 - Critical loss:
 - Actual loss: 5.0%
 - Since actual loss is less than critical loss, mixed channel products satisfy the percentage critical loss test
 - CONCLUSION: Mixed channel product pass the HMT

4. Write: Relevant product market

- Salon-only + mixed channel is a relevant market
 - Anticipated defense rebuttal: Merging parties are in two separate markets
 - 3. Salon-only products are a relevant market
 - *Brown Shoe* factors: Essentially homogeneous products
 - Industry and public recognition as a separate class of products than mixed channel and retail-only
 - Have similar high-end reputations
 - Same price at wholesale/Same price at retail
 - Very distinct prices from mixed channel and retail-only
 - Distinct customers: Salons whose customers will pay \$55 for a 16 oz bottle
 - Use similar high-quality ingredients
 - Compete for adoption by high-end salons

4. Write: Relevant product market

- Salon-only + mixed channel is a relevant market
 - Anticipated defense rebuttal: Merging parties are in two separate markets
 - 3. Salon-only products are a relevant market
 - The results of the one-product SSNIP test—on which the unified market depends—are not reliable and should not override the *Brown Shoe* factors
 - 1. Actual loss (8.3%) exceeds critical loss (7.7%) by only 0.5% points, which could be measurement error in the actual loss rate or the margin
 - 2. Moreover, the one-product SSNIP test assumes that the only variable that changes is the price of salon-only products and fails to account for other factors, especially—
 - Salon One declining competitive significance and market share
 - Increasing Salon One's price would only further hurt its market position
 - Saul Michael's plans for revitalizing Salon One, including possibly decreasing its price
 - strongly mitigates the anticompetitive output reduction predicted by the test
 - 3. In any event, the difference between actual loss and critical loss, even if taken at face value, is too small to override the more compelling *Brown Shoe* factors
 - Courts use the HMT to confirm a market definition based on the *Brown Shoe* factors, not the other way around

4. Write: Relevant product market

- Salon-only + mixed channel is a relevant market
 - Anticipated defense rebuttal: Merging parties are in two separate markets
 - Conclusions
 1. The *Brown Shoe* factors weigh in favor of separate markets and not a single market
 2. Courts use the HMT to confirm a market definition based on the *Brown Shoe* factors, not the other way around
 3. The results of the one-product SSNIP test—on which a unified market depends—are subject to strong challenges on reliability and weight
 4. If the court is convinced for whatever reasons that the deal is not anticompetitive, concluding that the merging products are in separate markets and that the transaction is a conglomerate merger makes the outcome easy to justify
 5. The finding of the dimensions of the relevant market is a question of fact, which in a bench trial is subject to the “clearly erroneous rule”
 - Very differential to the judge
 - Gives the judge confidence that an appeals court is unlikely to reject a market finding

Bottom line: The FTC is more likely than not to lose on proving a product market definition that would make the transaction horizontal

4. Write: Relevant geographic market

- The United States

- No dispute: Both sides agree that the relevant geographic market is the United States
- The “area of effective competition” test (test and application)
 - Nationwide sales by majors
 - Uniform nationwide pricing by majors
 - Low transportation costs relevant to the value of the product
- Hypothetical monopolist test—performed above
 - Remember, the HMT always needs a relevant product market and a relevant geographic market

4. Write: *PNB* presumption

- Market participants and market shares
 - Assume that the relevant market is the manufacture and sale of salon-only and mixed channel shampoo
 - *Market participants*: Incumbent sellers
 - *Share measurement*: Revenue (since this is a differentiated market)
 - Queries:
 - Should revenues for mixed channel products include only sales to salons or should they also include sales to retailers?
 - Does it matter in applying the *PNB* presumption?
 - What should we do about Fauve's entry into mixed channel products in January 2023?

4. Write: *PNB* presumption

- The *PNB* presumption applies

Company/Brand	Salon Sales			All Sales		
	Revenues	Share	HHI	Revenues	Share	HHI
Salon Professional	\$75	31.3%	977	\$75	15.6%	244
Salon One	\$45	18.8%	352	\$45	9.4%	88
Saul Michael	\$60	25.0%	625	\$180	37.5%	1406
Mexxus	\$30	12.5%	156	\$120	25.0%	625
Fumble & Fumble	\$30	12.5%	156	\$60	12.5%	156
	\$240	100.0%	2266	\$480	100.0%	2520
Combined share		43.8%			46.9%	
Premerger HHI			2266			2520
Delta			938			703
Postmerger HHI			3203			3223

4. Write: *PNB* presumption

- The *PNB* presumption applies

Combined share	43.8%	46.9%
Premerger HHI	2266	2520
Delta	938	703
Postmerger HHI	3203	3223

1. Satisfies the Merger Guidelines thresholds

- Postmerger HHI > 2500
- Delta > 200

“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.”

- Guidelines presumption adopted by the courts¹

¹ See, e.g., *United States v. Anthem, Inc.*, 855 F.3d 345, 349 (D.C. Cir. 2017); *FTC v. Penn State Hershey Med. Ctr.*, 838 F.3d 327, 347 (3d Cir. 2016); *Saint Alphonsus Med. Ctr.-Nampa Inc. v. St. Luke’s Health Sys., Ltd.*, 778 F.3d 775, 786 (9th Cir. 2015); *ProMedica Health Sys., Inc. v. FTC*, 749 F.3d 559, 568 (6th Cir. 2014); *FTC v. Staples, Inc.*, 190 F. Supp. 3d 100, 128 (D.D.C. 2016).

4. Write: *PNB* presumption

- The *PNB* presumption applies

Combined share	43.8%		46.9%
Premerger HHI		2266	2520
Delta		938	703
Postmerger HHI		3203	3223

2. *PNB* itself supports the application of the presumption

	<u><i>PNB</i></u>	<u>Salon</u>	<u>All</u>
Combined share	30.0%	43.8%	46.9%
2FCR (premerger)	65.9%	56.3%	62.5%
2FCR (postmerger)	80.5%	75.0%	71.9%
Increase (points)	14.6%	18.8%	9.4%

- Compared to *PNB*:
 - ❑ *Salon sales only*: Transaction has a larger combined market share and larger point increase in the 2-firm concentration ratio
 - ❑ *All sales*: Transaction has a larger combined market share and a large but somewhat smaller point increase in the 2-firm concentration ratio

4. Write: *PNB* presumption

- The *PNB* presumption applies

Combined share	43.8%	46.9%
Premerger HHI	2266	2520
Delta	938	703
Postmerger HHI	3203	3223

3. Modern case precedent supports the application of the presumption

Agency	Complaint	Defendant	Combined share	PreHHI	PostHHI	Delta	Deal Status
FTC	2020	Hackensack	≈50	1994	2835	841	Preclosing
DOJ	2016	Anthem	47	2463	3000	537	Preclosing
DOJ	2011	H&R Block	28	4291	4691	400	Preclosing
FTC	2004	Evanston	35	2355	2739	384	Consummated
DOJ	2003	UPM-Kemmene	20	2800	2990	190	Preclosing
FTC	2000	Heinz	33	4775	5285	510	Preclosing

4. Write: *PNB* presumption

Bottom line: *On the numbers, establishes the PNB presumption of anticompetitive effect*

1. *Not significant whether all sales of mixed channel products are included*
2. *Should not take on the burden of incorporating Fauve into the analysis*

4. Write: *PNB* presumption

■ Anticipated defense rebuttal

□ Argument

- Incumbent sellers are not the only market participants—Fauve is a committed entrant into the mixed channel and must be included in the market shares under the Merger Guidelines
- When Fauve is included, the HHIs are too low for the *PNB* presumption to apply

□ Merger Guidelines rules

- “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.”¹
- “In most contexts, the Agencies measure each firm’s market share based on its actual or projected revenues in the relevant market.”²

□ Fauve will enter with a commercial mixed channel product in January 2023

- Lower introductory price of \$5.00 (not the prevailing \$6.00)
- Has contracted for retail space at most major retailers
- Signed contracts with 100 salons to carry product
- Within two years, expects—
 - 5 million units sold in salons
 - 10 million units sold in retail stores
- Staff confirms that industry analysts believe that Fauve can achieve its projections

¹ 2010 Merger Guidelines § 5.1.

² *Id.* § 5.2.

4. Write: *PNB* presumption

■ Anticipated defense rebuttal

- Giving Fauve full credit for its two-year projections and assuming it takes share pro rata from incumbent mixed channel producers:
 - Fauve takes 5 millions out 20 million units in mixed channel sales sold through salons (25%)
 - Fauve takes 10 million out 40 million units in mixed channel sales sold through retail stores (25%)
 - Each incumbent mixed channel unit sales is reduced by a pro rata 25% loss to Fauve
 - Fauve charges \$5.00; incumbent producers (unrealistically) continue to charge \$6.00

Sold to:	Fauve sales		%Capture	Price	Revenues
	Fauve sales	Market			
Salon	5.00	20.00	25%	\$5.00	\$25.00
Retailers	10.00	40.00	25%	\$5.00	\$50.00

Company/Brand	Sales to Salons				Sales to Retailers			All Sales		
	Units	Revenues	Share	HHI	Units	Price	Revenues	Revenues	Share	HHI
Salon Professional	3.00	\$75	31.9%	1019				\$75	16.1%	260
Salon One	1.80	\$45	19.1%	367				\$45	9.7%	94
Saul Michael	7.50	\$45	19.1%	367	15.00	\$6.00	\$90.00	\$135	29.0%	843
Mexxus	3.75	\$23	9.6%	92	11.25	\$6.00	\$67.50	\$90	19.4%	375
Fumble & Fumble	3.75	\$23	9.6%	92	3.75	\$6.00	\$22.50	\$45	9.7%	94
Fauve (new mixed)	5.00	\$25	10.6%	113	10.00	\$5.00	\$50.00	\$75	16.1%	260
	24.80	\$235	100.0%	2048	40.00		\$230.00	\$465	100.0%	1925

Combined share	38.3%	38.7%
Premerger HHI	2048	1925
Delta	733	562
Postmerger HHI	2782	2487

4. Write: *PNB* presumption

- Anticipated defense rebuttal
 - Accounting for Fauve’s entry into a new mixed product significantly lowers the HHIs

WITHOUT FAUVE ENTRY

Combined share	43.8%		46.9%
Premerger HHI		2266	2520
Delta		938	703
Postmerger HHI		3203	3223

WITH SUCCESSFUL FAUVE ENTRY:

Combined share	38.3%		38.7%
Premerger HHI		2048	1925
Delta		733	562
Postmerger HHI		2782	2487

- Merger Guidelines

- Salon sales: Borderline over “red zone”
- All sales: Borderline under “red zone”

- *PNB*

- Salon sales: Borderline
- All sales: Probably not (2-FCR too low)

WITH SUCCESSFUL FAUVE ENTRY:

	<i>PNB</i>	Salon	All
Combined share	30.0%	38.3%	38.7%
2FCR (premerger)	65.9%	51.1%	48.4%
2FCR (postmerger)	80.5%	70.2%	58.1%
Increase (points)	14.6%	19.1%	9.7%

4. Write: *PNB* presumption

- Anticipated defense rebuttal
 - Accounting for Fauve’s entry into a new mixed product significantly lowers the HHIs

WITHOUT FAUVE ENTRY

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- Modern judicial precedent only weakly supports the application of the *PNB* presumption
 - *UPM-Kemmene* and *Evanston*—two older cases—are the only ones that squarely support application

Agency	Complaint	Defendant	Combined share	PreHHI	PostHHI	Delta	Deal Status
FTC	2020	Hackensack	≈50	1994	2835	841	Preclosing
DOJ	2016	Anthem	47	2463	3000	537	Preclosing
DOJ	2011	H&R Block	28	4291	4691	400	Preclosing
FTC	2004	Evanston	35	2355	2739	384	Consummated
DOJ	2003	UPM-Kemmene	20	2800	2990	190	Preclosing
FTC	2000	Heinz	33	4775	5285	510	Preclosing

4. Write: *PNB* presumption

■ Conclusion

- Without considering Fauve's entry, the *PNB* presumption is adequately supported — although not particularly strong
- With Fauve's entry, the *PNB* presumption is borderline even without considering—
 - Fauve's discounting of its new mixed channel product, which almost surely will precipitate a competition-increasing response by the incumbent mixed channel producers
 - Saul Michael's plans to revitalize Salon One

Bottom line: The PNB presumption of anticompetitive effect is relatively weak. A court could easily reject it or find it overcome by downward pricing pressure evidence unless further supported by strong explicit theories of anticompetitive effect

4. Write: Explicit theories of harm

- Unilateral effects: Incumbent sellers only

- No diversion from Salon One to Saul Michael
 - A zero recapture ratio means no recapture and hence no unilateral effect
- There is diversion from Salon One to Saul Michael
 - Saul Michael is the “closest substitute” to Salon One among the incumbent sellers

- Use the relative share method to calculate diversion ratios

- Diversion to mixed channel = 100%

- Shares in mixed channel:

Saul Michael

	Revenues	share	Relative Recapture ratio
Saul Michael	\$120	50.0%	50.0%
Mexxus	\$90	37.5%	37.5%
Fumble & Fumble	\$30	12.5%	12.5%
	\$240	100.0%	100.0%

- Diversion ratio to Saul Michael (from relative share method) = 50%

- BUT still don't look like “close substitutes”

- Use a $\delta/2$ unilateral effects merger simulation to predict unilateral effects price increase:

$$R_{Actual}^{SalonOne} = \frac{\$SSNIP_{SalonOne}}{\$m_{SaulMichael}} = \frac{\delta p_{SalonOne}}{\$m_{SaulMichael}}$$

$$50\% = \frac{\delta \times 25}{3}$$

$$\delta = 6.0\% \rightarrow \frac{\delta}{2} = 3.0\%$$

- This implies a unilateral price increase for Salon One of 3.0%
 - WEAK (Remember Sysco/U.S. Foods), but still meaningful

4. Write: Explicit theories of harm

- Unilateral effects: incumbent sellers + Fauve new entry

- There is diversion from Salon One to Saul Michael

- Saul Michael remains the “closest substitute” to Salon One—Although with a smaller share

- Use the relative share method to calculate diversion ratios

- Diversion to mixed channel = 100%

- Shares in mixed channel:

- Diversion ratio (from relative share method) = 37.5%

	Revenues	share	Relative Diversion ratio
Saul Michael	\$45	37.5%	37.5%
Mexxus	\$23	18.8%	18.8%
Fumble & Fumble	\$23	18.8%	18.8%
Fauve (new mixed)	\$30	25.0%	25.0%
	\$120	100.0%	100.0%

- BUT still don't look like “close substitutes”

- Can use a $\delta/2$ unilateral effects merger simulation to predict unilateral effects price increase:

$$R_{Actual}^{SalonOne} = \frac{\$SSNIP_{SalonOne}}{\$m_{SaulMichael}} = \frac{\delta p_{SalonOne}}{\$m_{SaulMichael}}$$

$$37.5\% = \frac{\delta \times 25}{3}$$

$$\delta = 4.5\% \rightarrow \frac{\delta}{2} = 2.25\%$$

- This implies a unilateral price increase for Salon One of 2.25%
- EVEN WEAKER (Remember Sysco/U.S. Foods)

4. Write: Explicit theories of harm

- Unilateral effects: Defense rebuttal
 - Products are highly differentiated and not “close” for the purpose of unilateral effects theory
 - Given the strict assumptions of the simulation, a unilateral effect price simulation of a 2.25%-3.0% price increase cannot be taken to be significantly different than zero
 - Even if the simulated price increase is assumed to be significantly different than zero, it does not yield a “substantial lessening of competition” within the meaning of Section 7

- Unilateral effects: FTC reply
 - A 3% price increase in Salon One shifts \$1.35 million in wealth from salons to the merged firm
 - \$1.0125 million in wealth if the price increase is 2.25%
 - These are sufficiently large numbers to prove a Section 7 anticompetitive effect

Bottom line: A weak theory at best and could likely be rejected by the court

4. Write: Explicit theories of harm

- Coordinated effects—NOT APPLICABLE
 - *Generally*: Tacit collusion depends on coordinated interaction to reduce the attractiveness/substitutability of price-constraining substitute products
 - Premerger susceptibility
 - Five firms—low side of concentrated (premerger HHI of 2266 or 2520)
 - Not all firms' incentives are aligned
 - Salon-only products are substitutable only for products sold at retail (mixed and retail-only)
 - Mixed channel products sold at retail price-constrain (somewhat) salon-only products
 - Mixed channel products are substitutable only for products sold at retail
 - Salon-only products do not price-constrain mixed channel products
 - So mixed channel products have no interest in tacitly colluding with salon-only
 - BUT mixed channel products can be a collusive group
 - Only three firms
 - Differentiated from salon-only products/aligned incentives with one another
 - Can support a uniform SSNIP among themselves
 - Merger's effect on the likelihood and effectiveness of tacit collusion
 - Adds a recapture element to Salon One, but this just incentivizes the merged firm to free-ride on any existing tacit collusion in mixed channel products and increase the price of Salon One through a unilateral effect
 - The merger does not eliminate or reduce any price-constraining force on mixed channel products and hence does not increase the likelihood or effectiveness of tacit collusion by the collusive group

4. Write: Explicit theories of harm

- Elimination of a maverick—NOT APPLICABLE
 - Requirements
 1. Premerger, the market is susceptible to tacit coordination
 2. One of the merging parties is a disruptive force that impedes coordination (the “maverick”)
 3. The acquisition of the maverick will remove the disruptive force and increase the probability or effectiveness of tacit coordination
 - Application
 - Nothing in the investigation record indicates that either Saul Michael or Salon One is a “maverick”

Bottom line: A maverick theory is not applicable to this transaction

4. Write: Potential competition

- Elimination of perceived potential competition
 - Requirements
 1. The relevant market operating *noncompetitively*
 2. The putative potential entrant is *relatively unique*
 3. Incumbent firms must *perceive* the firm as a likely potential entrant
 4. Incumbent firms *respond* to the perceived threat of entry by lowering their prices or otherwise acting more competitively in order to discourage entry
 5. The acquisition would eliminate the perceived threat of entry, resulting in the market operating *less competitively*
 - Application
 - There is no evidence in the investigation record that Salon One is perceived as a potential entrant into mixed products
 - Although Saul Michael may be perceived as a potential entrant into salon-only products absent the acquisition, there is no indication that Salon One or Salon Professional have lowered prices or acted more competitively in order to discourage Saul Michael's entry

Bottom line: A perceived potential competition theory will lose on the merits

4. Write: Potential competition

- Elimination of actual potential competition
 - Requirements
 1. The relevant market operating *noncompetitively*
 2. The putative potential entrant is *relatively unique*
 3. The putative potential entrant has the *ability to enter*
 4. The putative potential entrant has the *incentive/likelihood of entry in the near future*
 5. Entry would *increase competition* in the relevant market
 - Application
 - Salon One
 - No indication in the record that it has ever contemplated entering into mixed channel products
 - Saul Michael
 - Contemplated entry BUT
 - Entry barriers into salon-only shampoo are high
 - Saul Michael's board remains skeptical about the project and has committed only very limited funding to explore the project
 - the company has developed no commercial prototype to test
 - If Saul Michael decided to pursue entry it would take four or five years for it to have a commercial product
 - BOTTOM LINE: Saul Michael fails as an actual potential entrant into a salon-only product because its entry is too speculative that it will happen, not timely even if it occurs—speculative as to how successful it would be (if successful at all)

Bottom line: An actual potential competition theory will lose on the merits

4. Write: Vertical

- Definition

- Involves firms at different levels of the chain of manufacture and distribution
- More generally, involves firms producing complementary products

- Application

- Saul Michael and Salon One are manufacturers of shampoo and do not have a vertical relationship with one another or produce complementary products

Bottom line: A vertical theory is not applicable to this transaction

4. Write: Downward pricing pressure defenses

■ Entry/expansion/repositioning

□ The idea

- Antitrust law posits that firms facing a downward-sloping demand curve increase price by restricting supply. The inframarginal customers then bid up price to clear the market.
- An entry/expansion/repositioning defense requires that the firm entering/expanding/repositioning increase the aggregate supply of the product sufficient to “fill the hole” created by the anticompetitive supply restriction
- Merger Guidelines/case law require that the entry/expansion/ repositioning be—
- For entry to be a defense to a prima facie case, the entry must be—
 1. timely,
 2. likely, and
 3. of a magnitude sufficient

to deter or counteract any likely anticompetitive effects of concern so the merger will not substantially harm customers

■ Important note

- Since the 2010 revisions, the agencies have interpreted the Merger Guidelines to mean that entry/expansion/repositioning must take place so quickly as to prevent any anticompetitive effect from the moment of closing
- The courts have not been so restrictive: As long as the entry/expansion/repositioning will negate an anticompetitive effect reasonably quickly, the courts appear willing to entertain the defense
 - The 1982 Merger Guidelines, for example, permitted a period of two years to negate the anticompetitive effect

4. Write: Downward pricing pressure defenses

■ Entry/expansion/repositioning

□ Application: Expansion defense in salon-only products (Salon One)

- If the court credits the business testimony of the Saul Michael executives on their plans to revitalize Salon One and increase its market share—Makes expansion timely and likely
- How much expansion is sufficient?
 - The only plausible theory of anticompetitive effect is a unilateral effects price increase in Salon One
 - Merger simulation indicates that the maximum price increase would be 3%
 - We know that the residual elasticity of demand for Salon one is:

$$\varepsilon_{SalonOne} = \frac{\% \Delta q}{\% \Delta p} = \frac{8.3\%}{5.0\%} = 1.66$$

- We also know that: $\% \Delta q_{SalonOne} = \delta \varepsilon_{SalonOne}$
- Taking the upward pricing pressure to be 3% in the price of Salon One, this implies a production decrease of:

$$\% \Delta q_{SalonOne} = 3 \times 1.66 = 4.98\%$$

$$\Delta q_{SalonOne} = 4.98\% \times 1.80 \text{ million} = 90\text{K units}$$

- A court is likely to find that any credible effort to regain Salon One's lost market share will more than offset its unilateral effects incentive to reduce its production by 90K units
- Saul Michael's credibility as to revitalizing Salon One is significantly strengthened by the support of Salon One salons for the transaction

Bottom line: Strong expansion defense in salon-only products

4. Write: Downward pricing pressure defenses

■ Entry/expansion/repositioning

□ Application: Entry defense in mixed channel products (Fauve)

■ Facts

- Fauve (now retail-only) will enter the market with a new mixed channel product in January 2023
- Invested \$3m in the project
- Has signed 100 salons and most major retailers to carry product
- Conducting major promotional campaign
- Will discount its new mixed product and charge a wholesale price of \$5.00, not the prevailing \$6.00
- Expects 5m unit sales to salons and 10m unit sales to retailers within two years (presumably taken pro rata from incumbents)
 - Projections that the staff found are supported by independent industry analysts

■ Satisfies requirements

- *Timely*: Entry will occur in January 2023
- *Likely*: Entry will occur in January 2023
- *Sufficient*:
 - Almost certainly will precipitate a competition-increasing response by incumbent firms as they attempt to protect their market share
 - Even if there was a good theory of anticompetitive effect in mixed products, faced with Fauve's aggressive entry, no incumbent firm is likely to increase prices postmerger in response to the Saul Michael/Salon One transaction

Bottom line: Strong entry defense in mixed channel products

4. Write: Downward pricing pressure defenses

■ Efficiencies

- The idea
 - “Efficiencies” are loosely defined to be consumer benefits that result from the deal
 - A special case is a marginal cost reduction, which creates downward pricing pressure
- Requirements: To be cognizable in a defense, the putative efficiency must be—
 1. *Merger specific*: Would occur only with the transaction
 - NB: The agencies take a stricter view: The putative efficiency *could* not occur without the transaction, whether or not it would occur.
 2. *Verifiable*: Must be able to objectively verify the likelihood and magnitude of each claimed efficiency and how and when each would be achieved
 3. *Timely and sufficient*. Must occur quickly enough in time and with sufficient magnitude to offset the merger’s anticompetitive effects that would be likely to occur in the absence of the efficiencies
 - Inherent in sufficiency is the requirement that to be cognizable the efficiencies must be passed to consumers and not retained by the merged firm
 - Fixed cost reductions are not passed on to consumers and hence are not cognizable efficiencies
 4. *Not anticompetitive*. Cannot be the result of an anticompetitive effect of the transaction

4. Write: Downward pricing pressure defenses

■ Efficiencies

□ Application

■ Claimed efficiencies

- *Fixed cost reductions*: \$3.5 million annually in saving from plant, management, back office and logistics consolidation—NOT COGNIZABLE
- *Marginal cost reductions*: \$1.8 million in Salon One ingredient cost reductions without reducing quality

NB: Staff does not dispute these claims

■ *Key question*: How significant are the marginal cost reductions in offsetting the unilateral effects upward pricing pressure on Salon One's price?

- *Rule*: For efficiencies to offset the opportunity cost of the merged firm's lost profits from an anticompetitive price increase, the marginal cost saving must be at least as large as the merged firm's lost profits
 - The merger simulation indicated a unilateral increase of 2.25%-3% in Salon One's price
 - A 3% price increase would yield additional profits to the merged firm not more than \$1.35 million (= $0.03 \times \$25 \times 1.8$ million—does not account for Salon One's quantity reduction necessary to increase price or Saul Michael's recapture profits)
 - The claimed marginal cost reductions are \$1.8 million
 - SUFFICIENT

Bottom line: Strong efficiencies defense to offset any upward pricing pressure in salon-only products

4. Write: Downward pricing pressure defenses

- Power buyers
 - Requirements
 - Proof of one or more mechanisms that permit a given buyer to protect itself from any effort by the merged firm to act anticompetitively either unilaterally or through coordination interaction with other firms in the relevant market
 - All buyers must be able to protect themselves through one of these mechanisms
 - Application
 - No evidence in the record that any buyer has a mechanism to protect itself from a price increase or other anticompetitive effect
 - Even if some salons or retailers are power buyers that could protect themselves, there undoubtedly are other salons and retailers that cannot protect themselves

Bottom line: Power buyers defense not applicable

4. Write: Downward pricing pressure defenses

■ Failing firm

□ Requirements: The allegedly failing firm—

1. would be unable to meet its financial obligations in the near future,
2. would not be able to reorganize successfully under Chapter 11 of the Bankruptcy Act, *and*
3. has made unsuccessful good-faith efforts to elicit reasonable alternative offers that would keep its tangible and intangible assets in the relevant market and pose a less severe danger to competition than the proposed merger

NB: The Merger Guidelines requirements have been largely accepted by the courts

□ Application

- While Salon One has suffered a significant decline in its market share, there is nothing in the investigation record that indicates that it would be unable to meet its financial obligations in the near future
 - With sales of 1.8 million units and a gross dollar margin of \$15, Salon One has a profit of \$27 million before deducting annually recurring fixed costs—Maybe this covers its fixed costs, but maybe not
- Moreover, even if Salon One would not be able to meet its financial obligations in the near future, there is no indication in the investigation record that it would not be able to reorganize successfully under Chapter 11 of the Bankruptcy Act
- Finally (and dispositively), Salon One did conduct an auction that elicited three bids, including two from private equity firms
 - Presumably have no product overlaps with Salon One and therefore would pose a less severe danger to competition than the proposed merger

Bottom line: Failing firm defense not applicable

4. Write: Loose ends

1. “Litigating the fix”

- NB: The question asked whether the merging parties should litigate the fix, not whether the FTC should seek or accept a fix
- There is no economically viable fix for the parties
 - The merging parties are each one-product firms—Have to sell all of one firm or the other
 - Acquiring Salon One is a product extension merger and not a “trade up” opportunity for Saul Michael
- But there is no need for a fix given the weakness of the FTC’s case

2. Capturing the “heart” of the judge

- The merging parties have a clear advantage
 - The FTC has a weak prima facie merits case on both market definition and competitive effect
 - Fauve entry will significantly increase competition among mixed product producers
 - Saul Michael plans on investing significantly to revitalize a flailing Salon One and may even lower Salon One’s wholesale price will increase competition in mixed channel products
 - Salons carrying Salon One support the transaction
 - Saul Michaels has a credible efficiency in reducing the marginal cost of Salon One
 - There is no customer opposition, and no customers appear willing to testify for the FTC

4. Write: Loose ends

3. The judge will not grant a preliminary injunction
 - The FTC is unlikely to succeed on the merits in a full trial
 - The public equities will not overcome the lack of a likelihood of success on the merits