

MERGER ANTITRUST LAW

LAW 1469
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Tuesdays and Thursdays, 3:30 pm – 5:30 pm
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Class 12 (October 1): H&R Block/TaxACT (Unit 5)¹

In this class, we will finish market definition in H&R Block/TaxACT, briefly review the government's structural prima facie case under *Philadelphia National Bank* and *Baker Hughes*, and begin our examination of explicit theories of anticompetitive harm with coordinated effects. The first half of the class will complete the market definition analysis. The *PNB* materials principally review what we covered in Unit 3, and we will touch on that review only briefly in class. The bulk of the second half of class will be devoted to coordinated effects.

Finishing market definition

The Warren-Boulton analysis. In the last class, we developed both one-product and uniform SSNIP recapture tests. We will begin this class by examining how Warren-Boulton used the evidence available in H&R Block/TaxACT to apply the HMT to the candidate DDIY market. The key evidentiary problem was that the IRS data on which he relied were switching data: they identify where taxpayers went when they changed tax preparation methods, but they do not isolate customer switching resulting from a price change in one of the products. That distinction matters because a recapture test ideally uses substitution generated by the price experiment being tested.

Warren-Boulton treated the IRS switching shares as proxies for aggregate recapture. Using a 10% SSNIP and an assumed 50% gross margin, he calculated a critical recapture rate of 16.7%.² His estimated recapture rates were approximately 57% for H&R Block At Home, 53% for TaxACT, and 39% for TurboTax. Because each estimate exceeded the critical recapture rate, he concluded that a uniform 10% SSNIP would be profitable and that DDIY satisfied the HMT. The arithmetic is straightforward. The more important question is whether the switching data are an appropriate proxy for the recapture rates required by the test.

With that framework in mind, begin with the final worked uniform SSNIP sufficiency example (slide 181) and then work through Warren-Boulton's application and the caution about using switching evidence as a proxy for uniform SSNIP recapture (slides 182-84). Focus on the distinction between switching and diversion. The IRS data did not directly observe either a one-product or a uniform SSNIP. Also remember why one-product recapture ordinarily should be higher than uniform SSNIP recapture: in the one-product experiment, the prices of the other

¹ A reasonable set of the most important filings in the litigation (including the trial transcript) may be found [here](http://www.appliedantitrust.com) on AppliedAntitrust.com.

² Although the opinion does not explicitly explain why Warren-Boulton used a 10% SSNIP, it was probably because he was using the profitability test to establish that the candidate market satisfied the profit-maximization version at a 5% threshold. Remember, if a candidate market passes the profitability (breakeven) version of the HMT test with a SSNIP of δ , it presumably passes the profit-maximization version with a SSNIP of $\delta/2$. (This is true mathematically when demand is linear and marginal costs are constant and usually a good approximation otherwise).

products remain unchanged, making them relatively more attractive to customers leaving the product whose price increased.

The quantitative HMT evidence was not the court's starting point. By the time the court reached the economists' testimony, it had already relied on the qualitative evidence discussed in Class 10—including the parties' documents, the functional differences among tax preparation methods, and the *Brown Shoe* practical indicia—to support a DDIY market. The economists' analyses therefore should be read as additional evidence testing and corroborating that conclusion rather than as a self-contained market definition exercise.

The defendants' market definition rebuttal. Dr. Christine Meyer attacked the government's market definition in three ways. First, she argued that Warren-Boulton's analysis was unreliable because IRS switching data do not measure price-induced diversion. Second, she argued that his DDIY market violated the smallest market principle because smaller groupings involving H&R Block and Intuit or TaxACT and Intuit could also satisfy the HMT. Third, she offered affirmative evidence for a broader market including all methods of tax preparation. Her affirmative case relied in part on H&R Block's pricing simulator and on a 2011 email survey of TaxACT customers. The court found serious problems with both: the simulator omitted prices for important alternatives and produced anomalous results, while the survey asked about switching generally rather than switching caused by a price increase and had an extremely low response rate.

With these competing approaches in mind, read the section of the *H&R Block* opinion discussing the economists' testimony and evidence on the HMT (pp. 51-65). As you read, ask yourself: (1) What HMT implementation did Warren-Boulton actually use? (2) Was the IRS switching data an appropriate proxy for the diversion or recapture rates required by that implementation? (3) How did the court describe the analysis, and did it get the economics right? (4) How persuasive were Meyer's criticisms and alternative evidence? and (5) What role did the quantitative analysis play in the court's ultimate market definition conclusion—central, corroborative, or peripheral? The court ultimately found Warren-Boulton's analysis more persuasive, but its DDIY conclusion rested on the quantitative evidence together with the qualitative evidence considered earlier.

Before leaving market definition, step back and make sure you can distinguish the three HMT implementations we have studied: critical loss in homogeneous product markets, one-product SSNIP recapture in differentiated product markets, and uniform SSNIP recapture when the available evidence corresponds to a price increase across the candidate market. The summary in the class notes collects these approaches and also reminds you of the 2023 Guidelines' change: unlike the 2010 Guidelines and prevailing judicial formulation, the 2023 Guidelines do not require the SSNIPT to be imposed on a product of one of the merging firms (slides 185-89).

Merger simulation. Warren-Boulton also used a merger simulation as additional support for DDIY. For market definition purposes, he simulated a merger to monopoly among H&R Block, TaxACT, and Intuit and predicted price increases of 83% for TaxACT, 37% for H&R Block At Home, and 11% for TurboTax. Those predictions all exceed an ordinary SSNIP, so the simulation provided additional support for the DDIY market. This is distinct from Warren-Boulton's later simulation of the actual H&R Block/TaxACT merger used in the unilateral effects analysis. For now, understand the role of the market definition simulation, but do not

worry about its mechanics; we will return to simulation models when we study unilateral effects (slides 190-91).

Pulling the market definition analysis together, the court used qualitative and quantitative evidence together: the Brown Shoe evidence, the HMT/recapture analysis, and the simulation all supported DDIY, while the court found the defendants' competing economic evidence insufficiently reliable.

At this point, market definition is complete. The second half of the class will briefly revisit the structural prima facie case and then examine how a merger can increase the likelihood, effectiveness, or stability of coordinated conduct.

Unit 5B: Anticompetitive Effects

Review of the structural presumption. We covered the *PNB* presumption, the *Baker Hughes* allocation of the burdens of proof, and the use of market shares and concentration in some detail in Unit 3. The materials in this class principally review that framework and apply it to *H&R Block* and two additional cases. You should review the *PNB* readings and associated class notes as this reading guidance provides, but we will cover this topic only briefly in class before turning to coordinated effects.

The structural prima facie case. Now that the relevant market is defined, the analysis turns to the likely effect of the merger within that market. Recall the *Baker Hughes* framework from Unit 3: the government must first make a prima facie showing; the defendants may then produce evidence rebutting it; and the court must consider the entire record while the ultimate burden of persuasion remains with the government. One way to make the initial showing is the *Philadelphia National Bank* presumption. A sufficiently large combined share and increase in concentration permit an inference that the merger may substantially lessen competition. The presumption is rebuttable; market shares are evidence about likely future competition, not the final answer. The opening Unit 5B class notes place this method alongside explicit theories of harm and identify the defendants' principal responses (slides 2-10). Review the court's statement of the presumption and the *Baker Hughes* treatment of rebuttal in the *H&R Block* opinion (pp. 65-67).

Applying the presumption in H&R Block. The court used the 2010 Horizontal Merger Guidelines' HHI thresholds to evaluate the DDIY market. The HHI is the sum of the squares of the participants' percentage market shares; the increase from combining firms with shares a and b is $2ab$. The court found a premerger HHI of 4,291, an increase of approximately 400 points, and a postmerger HHI of 4,691. *H&R Block* and TaxACT would have a combined share of 28.4%. Work through the court's calculations and its response to the defendants' objection that federal tax filing data omitted state returns (pp. 65-66; class notes, slides 11-13). A reasonable approximation of shares can be sufficient even when the measure does not capture every transaction in the relevant market.

The 2010 Guidelines presumed likely enhancement of market power when the postmerger HHI exceeded 2,500 and the increase exceeded 200 points. *H&R Block/TaxACT* exceeded both thresholds by a substantial margin. The 2023 Guidelines state lower HHI thresholds and an additional presumption when the merged firm's share exceeds 30% and the HHI increase exceeds 100. Under the share measure used by the court, the proposed combined firm's 28.4% share falls below that separate 30% trigger, even though the transaction exceeds the

2023 HHI thresholds. The class notes compare the two sets of thresholds and show the relationship between the 30% share trigger and an HHI increase of 100 (slides 14-17). Focus on which threshold each calculation satisfies; the Guidelines thresholds do not themselves establish a statutory cutoff for the *PNB* presumption.

Review Guideline 1 and its commentary in the 2023 Merger Guidelines (pp. 158-161) and the *IQVIA* excerpt (pp. 162-168). Although all these materials were assigned in the reading for Unit 3, they are worth a quick review. The *Tapestry* excerpt, however, is new and deserves a more careful reading (pp. 169-180). These readings show how courts apply the structural presumption and evaluate challenges to the market share and concentration evidence. Compare their treatment with *H&R Block*, paying particular attention to the thresholds applied, the evidence used to estimate shares, and the courts' responses to objections about omitted sales or imperfect data. Distinguish identifying an error in the government's calculations from demonstrating that correcting the error undermines the structural inference.

Market participants and shares. An HHI calculation is only as sound as its account of who participates in the market and how much competitive significance each participant has. Market definition principally asks which products customers regard as substitutes; market participation also takes account of certain supply responses. Under the Guidelines, current sellers are ordinarily included. Some firms that do not currently sell in the market may also count if they can enter rapidly in response to a price increase without significant sunk costs. Slower or costly entry is considered when assessing the entry defense. Read the distinction and the tomato example in the notes (slides 18-20), paying particular attention to why counting a potential entrant as an existing market participant requires more than a general possibility of future entry.

Attributing shares to participants. For current sellers, historical sales provide the usual starting point, although capacity or other measures can better predict future competition in some homogeneous product markets. In differentiated product markets, revenue shares ordinarily account for differences in prices; reliable changes in future capacity or sales can warrant adjustments. Assigning a share to a nonseller is harder: it requires a measure of its likely competitive significance that can be compared with the shares of current sellers. The notes explain these choices and their evidentiary limits (slides 21-22). Be able to distinguish a reason to adjust a participant's share from a reason to expect later entry that might rebut an anticompetitive effect.

Explicit theories of anticompetitive harm. Having found that the concentration evidence established the government's prima facie case, the court turned to the defendants' rebuttal and other evidence about likely competitive effects. Read the court's transition to those issues (p. 67).

The Unit 5B class notes give an overview of the three explicit theories of anticompetitive harm under the Merger Guidelines (slides 23-24). Coordinated effects arise when a merger facilitates accommodating conduct among firms in the market. The elimination of a maverick removes an unusually disruptive competitive constraint and is commonly a special case of coordinated effects. Unilateral effects arise from the elimination of competition between the merging firms without requiring accommodating conduct by their rivals. A single transaction may support more than one theory.

Coordinated effects. In this class, we will examine coordinated effects, the first of the explicit theories of harm. We introduced this theory in Unit 3; the following materials develop its economic framework and evidentiary foundations in greater depth.

A coordinated effects theory depends on the merger making oligopolistic interdependence more likely, effective, or stable. Firms recognize that their profits depend in part on how their competitors behave and may find it individually profitable to refrain from aggressive competition when others do the same. This conduct can produce higher prices, lower quality, or less innovation without an express agreement. Section 7 can reach a merger that increases the risk of such conduct even though the conduct itself would not establish the agreement required for liability under Sherman Act § 1. The theory therefore addresses a competitive problem that the prohibition against agreements does not fully reach.

When one firm raises its price, its rivals may continue their existing conduct, compete more aggressively to capture its customers, or accommodate the increase by pulling their competitive punches. Accommodation need not involve matching the price increase. A rival might instead refrain from expanding output, improving its product, or offering a discount that would otherwise attract the price-increasing firm's customers. Nor must coordination cover every dimension of competition. Firms may compete actively for customers while avoiding competition on a particular product feature or term. The introduction in the class notes develops these distinctions (slides 25-28).

The history in the notes traces the movement from a general oligopoly rationale for the structural presumption to a more explicit account of how coordination works (slides 29-35). The 1992 Guidelines emphasized the ability to reach terms of coordination, detect deviations, and punish deviations. These requirements addressed the problem that a small number of firms does not necessarily imply weak competition. Even a highly concentrated market can be intensely competitive if firms cannot settle on common terms or have strong incentives to depart from them.

The 2010 Guidelines use a broader formulation. Their inquiry considers the market's vulnerability to coordinated conduct and whether the merger may enhance that vulnerability. The 2023 Guidelines organize the inquiry around whether the merger increases the likelihood, stability, or effectiveness of coordination. They identify three primary factors—high concentration, prior actual or attempted coordination, and the elimination of a maverick—and additional factors concerning concentration, observability, competitive responses, aligned incentives, and the advantages of coordination. These are ways of assessing the firms' ability and incentives to accommodate one another. Read Section 7 of the 2010 Horizontal Merger Guidelines (pp. 181-185) and Section 2.3 of the 2023 Merger Guidelines (pp. 186-189) with this background.

The Guidelines do not bind the courts, and judicial approaches differ. Some courts separately examine susceptibility and the merger's contribution to coordination. Others infer a risk of coordination from the concentration evidence establishing the *PNB* presumption and require the defendants to produce evidence rebutting that inference. This difference affects the showing the plaintiff must make in its prima facie case. Under *Baker Hughes*, however, a shift in the burden of production does not transfer the ultimate burden of persuasion to the defendants.

The class notes organize the economic analysis around three impediments to coordination: selection, internal stability, and external interference (slides 36-46). The *selection problem* concerns the terms on which firms would coordinate. There are many possible combinations of price, output, quality, and other terms that could increase collective profits, and the firms need not prefer the same combination. Differences in costs, capacity, product attributes, or business

strategies can make one firm's preferred outcome unattractive to another. Greater similarity among firms may make common terms easier to identify. Prior attempts at coordination may indicate both a willingness to coordinate and a belief that workable terms are available.

Internal stability concerns each firm's incentive to depart from the coordinated outcome. Even when all firms would earn more from mutual accommodation than from vigorous competition, each may earn still more by competing aggressively while its rivals continue to accommodate. The prisoner's dilemma illustrates this conflict (slide 40). Each firm earns 45 when both cooperate and 25 when both compete, but a firm that competes while the other cooperates earns 50. In the single-period ("one shot") game, competing is individually preferable regardless of the other firm's choice, even though mutual cooperation would produce higher profits for both. Repeated interaction can change this comparison because a firm's current conduct can induce competitive responses that reduce its future profits.

The incentive to depart from coordination depends on the gain from doing so and the speed and likelihood of detection and response. A large, infrequent sale or a long-term contract may make a departure especially rewarding. Available capacity may allow a firm to capture substantial additional business. Conversely, transparent terms and rapid responses may shorten the period during which a firm can profit from a secret discount. Demand volatility can make it harder to distinguish a rival's aggressive conduct from an ordinary fluctuation in sales. The probability illustration in the class notes shows why reducing the number of independent firms can reduce the opportunities for a departure from coordination (slide 42). Its assumption of independent, identical defection probabilities is deliberately unrealistic; the illustration is a heuristic, not an empirical estimate of merger effects.

External interference concerns competitive constraints outside the coordinating group. That group need not include every firm in the relevant market. A sufficiently important subset of firms may be able to maintain higher prices while smaller firms continue to compete. Its ability to do so depends on the responses available to customers and outside suppliers. Expansion by fringe firms, entry, substitution to products outside the market, or a buyer's ability to induce an individual supplier to break ranks can undermine coordination. The relevant consideration is whether those responses are strong enough to prevent the coordinating group from exercising market power. The class notes connect these market conditions to internal stability and external interference (slides 43-46).

Susceptibility alone does not establish that a particular merger is harmful. The merger must create a reasonable probability of increasing the likelihood, effectiveness, or stability of harmful coordination. The comparison is between likely competition with the transaction and likely competition without it. A market that is already vulnerable to coordination may become still more vulnerable when a merger eliminates an independent decision maker, aligns the remaining firms' incentives, or removes a source of disruption. A merger need not initiate coordination for the first time to be harmful; it may make existing accommodation more effective or durable.

The same economic framework also identifies changes that may cut against the theory. Merger efficiencies may make aggressive competition more profitable for the combined firm, and a change in its capacity or business strategy may weaken its willingness to accommodate rivals. The significance of a reduction in the number of firms therefore depends on the competitive role and incentives of the firms involved. The class notes bring together the ways in which a merger can affect selection, internal stability, and external interference (slides 47-48).

Read the coordinated effects discussion in the opinion (pp. 75-82), together with the associated class notes (slides 49-53). The court began with the structural prima facie case and placed on the defendants the burden of producing evidence of industry-specific barriers to coordination.³ It also examined evidence bearing on both the susceptibility of DDIY to coordination and the merger's likely effect on that susceptibility.

Several features supported susceptibility. The major suppliers could observe one another's publicly available prices and product features. Sales were numerous and individually small, and individual consumers had little bargaining power. Smaller suppliers were not sufficiently important to disrupt accommodation among the three major firms. The court also relied on earlier cooperation over efforts to persuade the IRS to restrict eligibility for free products. That episode was relevant as evidence of the firms' ability and willingness to cooperate even though the government did not have to establish that the earlier conduct was unlawful.

The defendants responded that Intuit would continue competing vigorously after the merger. Free products recruited customers who could later purchase paid offerings, giving Intuit an incentive to retain an attractive free product and forcing *H&R Block* to respond. The court's answer was that competition and coordination could coexist. Intuit and the combined firm could continue using free products to attract customers while limiting their features or slowing improvements that would otherwise make paid products less attractive. Thus, an incentive to retain some free offering did not necessarily establish an incentive to maintain its quality or breadth. This was the economic connection between the government's theory and the defendants' rebuttal.

The merger would reduce the principal competitors from three to two and eliminate TaxACT's independent incentive to press for high-quality free and low-priced offerings. Intuit's internal documents supplied additional support for an expectation of less aggressive competition, although other documents anticipated new competitive threats from the combined firm. The Newkirk document also illustrates a limit of documentary evidence: an employee's informal speculation about the acquisition's rationale is not necessarily a considered corporate strategy or a reliable forecast. The court ultimately found that the defendants had not rebutted the inference of coordinated effects and that the evidence affirmatively supported the government's prediction. The force of its reasoning rests on the specific dimension of competition at issue and the change in incentives, as well as the reduction in the number of major firms.

The excerpts from *OSF Healthcare* (pp. 190-191), *Tronox* (pp. 192-199), *Deutsche Telekom* (pp. 200-205), and *Bertelsmann* (pp. 206-210) show the different ways tribunals combine concentration evidence with evidence about market conditions and likely conduct. *OSF Healthcare* and *Bertelsmann* illustrate the use of concentration to support an inference of coordination. The *Tronox* administrative decision develops the application of coordinated effects

³ This is my biggest objection to the *H&R Block* opinion: its use of the structural presumption to supply a prima facie case for separately asserted explicit theories. In my view, applying the *Baker Hughes* framework to those theories should require the government to establish a prima facie case on each theory it asks the court to sustain. The defendants should then bear only a burden of production to put that showing in issue, with the government retaining the ultimate burden of persuasion. The court relied on *Heinz* for its coordinated effects inference and expressly acknowledged that the ultimate burden remained with the government. My objection concerns what suffices to establish a prima facie case on an explicit theory, rather than an express reassignment of the ultimate burden.

to the proposed combination of titanium dioxide producers. These discussions supply examples of how courts and an administrative tribunal state the theory and connect it to the evidence.

Deutsche Telekom provides a contrasting outcome. The court rejected the prediction that the T-Mobile/Sprint merger would materially increase coordination. It credited differences among firms' strategies and offerings, the opportunities for innovation, the combined firm's available capacity, and the expected competitive role of DISH. The comparison with *H&R Block* demonstrates that product differentiation or continuing competition is not automatically dispositive in either direction. Its significance depends on whether it impedes the particular accommodating conduct alleged and whether the transaction changes that constraint. The cases' formulations of the theory, its legal significance, and the relevant evidence may also be useful in assembling your boilerplate.

The final coordinated effects notes discuss the theory's place in merger analysis. They examine an asymmetry between price increases and price decreases that creates a *price ratchet* (slides 54-55). A firm that initiates a price increase risks losing customers if its rivals do not follow. Maintaining an existing price after a common cost decrease may present a different incentive. If a firm expects its rivals promptly to match any price cut, it may anticipate little lasting gain in market share and prefer to wait for another firm to cut first. If each firm waits, prices may remain unchanged even though costs have fallen.

The resulting harm can take the form of a price that fails to fall, or falls less than it otherwise would, rather than a price that rises above its premerger level. This is another application of the forward-looking comparison between competition with and without the transaction. The price ratchet explains a possible mechanism of accommodation; a merger challenge still requires a connection between the transaction and an increased risk of that accommodation.

Where we stop. For Class 12, complete the coordinated effects discussion through the price ratchet in the Unit 5B class notes (slide 55). The additional assigned readings are the coordinated effects portion of H&R Block (pp. 75-82), stopping before "Unilateral Effects," and the coordinated effects Guidelines and case excerpts (pp. 181-210). The separate treatment of elimination of a maverick begins in Class 13 (slides 56-64), followed by unilateral effects. The entry and efficiencies defenses remain for Class 14.

Enjoy the reading! As always, email me if you have any questions.