

MERGER ANTITRUST LAW

LAW 1469
Georgetown University Law Center
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Tuesdays and Thursdays, 3:30 pm – 5:30 pm
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CLASS 13 HOMEWORK ASSIGNMENT—INSTRUCTOR’S ANSWER

Instructions

Submit by email by 3:30 pm on Tuesday, October 6
Send to wdc30@georgetown.edu
Subject line: Merger Antitrust Law: Assignment for Class 13

Assignment

Part A. Unilateral effects and the size of a price increase

Calls for calculations (preferably using a spreadsheet) and short explanations. Show your work.

AeroSound proposes to acquire ClearTone. The companies sell competing, differentiated headphones. At prevailing prices, AeroSound sells 10,000 pairs of headphones per week for \$100 per pair, with a marginal cost of \$60. The \$100 price maximizes AeroSound’s standalone profits. ClearTone charges \$80 and has a marginal cost of \$60 per pair. The merger itself does not change demand at unchanged prices. Assume constant marginal costs, no changes in fixed costs, and sufficient capacity to serve the stated quantities. Except in part (d), the merger does not change marginal costs.

Reliable evidence establishes the following weekly sales for AeroSound at alternative prices. Assume AeroSound’s demand is linear over the relevant range of prices, including between the listed prices. The prices and other competitive conduct of ClearTone and all other suppliers remain unchanged:

AeroSound’s price per pair	AeroSound’s weekly sales (pairs)
\$100	10,000
\$101	9,750
\$102	9,500
\$103	9,250
\$104	9,000
\$105	8,750

For each price above \$100, 20% of the sales AeroSound loses, compared with its original 10,000 sales, would divert to ClearTone; 50% would divert to StudioWave, an independently owned competitor; and the remaining 30% would go to other suppliers or be purchases forgone. Each diverted sale is one pair of headphones. Assume these diversion ratios remain constant over the relevant range of price changes.

(a) For each listed price, calculate the change in AeroSound’s weekly profits, the additional profits recaptured by ClearTone, and the net change in the combined firm’s weekly profits,

relative to leaving both products at their original prices. Present your calculations in a table. Which listed price is most profitable for the combined firm, holding ClearTone's price constant?

(b) Calculate AeroSound's Gross Upward Pricing Pressure Index (GUPPI). Under the assumptions of this problem, use the GUPPI to determine the positive breakeven percentage increase in AeroSound's price and the profit-maximizing percentage increase, holding ClearTone's price constant. Reconcile both results with your table in part (a). What assumptions are needed to translate the GUPPI into this price prediction?

(c) AeroSound's CEO argues that the acquisition cannot raise a unilateral effects concern for two reasons: a 5% increase in AeroSound's price would not be profitable, and more of AeroSound's lost sales would divert to StudioWave than to ClearTone. Using your calculations, explain whether either argument is correct. You need not analyze changes in ClearTone's price.

(d) *Bonus (optional)*. You need not submit an answer to this part. For this part only, suppose the merger reduces AeroSound's marginal cost while ClearTone's price and marginal cost remain unchanged. All demand and diversion assumptions also remain unchanged. Calculate the compensating marginal cost reduction needed to offset AeroSound's merger-created incentive to raise its price above the original \$100. Express the reduction both in dollars per pair and as a percentage of AeroSound's original marginal cost. Explain why that percentage differs from the GUPPI calculated in part (b). You need not assess whether the cost saving would satisfy the legal requirements for a cognizable efficiency.

Part B. Elimination of a maverick

Calls for a short memorandum of law to the client of about 1,000 words.

You are an associate at Able & Baker LLP working with partner Margaret Chen. The firm represents Stonebridge Technologies, Inc., a supplier of personal cloud-backup services that is considering acquiring one of several smaller competitors. Elaine Porter, Stonebridge's general counsel, reports that a director has read that the antitrust agencies sometimes challenge acquisitions of "mavericks" even when the target's market share is small, and the board has asked what that means. Chen has asked you to draft a memorandum to Porter that she can share in confidence with the board.

The memorandum should explain:

1. what a maverick is and why its competitive significance can exceed its market share;
2. how the elimination of a maverick relates to coordinated effects;
3. what a plaintiff must show to establish the theory, as reflected in the Merger Guidelines and *H&R Block*; and
4. why an acquirer's plan to keep the target's managers or continue its competitive strategy does not necessarily answer the concern.

Use *H&R Block* and the FTC's *Edgewell* complaint as illustrations, keeping in mind that the complaint states allegations, not findings. Write for intelligent nonlawyers, and support your explanation with citations to the assigned materials.

The assigned materials, class notes, and class slides contain the materials needed to complete the assignment. No outside research is required.

If you have any questions, send me an email.

INSTRUCTOR'S ANSWER

Part A. Unilateral effects and the size of a price increase

(a) *The profitability of price increases.* Because AeroSound's demand is linear, it loses 250 pairs of weekly sales for each \$1 increase in its price above \$100. Each pair it no longer sells costs it the original \$40 margin (\$100 – \$60), while each pair it continues to sell earns an additional margin equal to the price increase. Of the pairs AeroSound loses, 20% divert to ClearTone, which earns a \$20 margin (\$80 – \$60) on each. The combined firm's net change in weekly profit is the change in AeroSound's profit plus the profit ClearTone earns on the diverted sales, all measured against leaving both products at their original prices.

Because fixed costs do not change, they cancel when we calculate changes in profit; every profit change in the table is therefore also the change in profit after fixed costs.¹

AeroSound price	AeroSound sales	AeroSound profit before fixed costs	Change in AeroSound profit	Pairs diverted to ClearTone	ClearTone recaptured profit	Net change (combined firm)
\$100	10,000	\$400,000	—	—	—	—
\$101	9,750	\$399,750	–\$250	50	+\$1,000	+\$750
\$102	9,500	\$399,000	–\$1,000	100	+\$2,000	+\$1,000
\$103	9,250	\$397,750	–\$2,250	150	+\$3,000	+\$750
\$104	9,000	\$396,000	–\$4,000	200	+\$4,000	\$0
\$105	8,750	\$393,750	–\$6,250	250	+\$5,000	–\$1,250

The calculation at \$102 shows the three components. AeroSound sells 9,500 pairs at a gross margin of \$42 for gross profits of \$399,000 before fixed costs.² This represents a \$1,000 loss from AeroSound's original profits of \$400,000. At the same time, ClearTone gains 100 pairs (20% × 500) at a \$20 margin, or \$2,000. The combined firm is \$1,000 a week better off with the \$2 price increase.

(b) *GUPPI and the predicted price increase.* The GUPPI for AeroSound measures the profit ClearTone recaptures for each dollar of revenue associated with AeroSound's departing sales, valued at AeroSound's original price.³

$$\begin{aligned}
 GUPPI_1 &= \frac{\text{gross profit on Product 2 sales recaptured from Product 1}}{\text{revenue associated with all sales lost by product 1}} \\
 &= \frac{\$2000}{500 \times \$100} = 0.04 = 4\%.
 \end{aligned}$$

Under the assumptions of this problem, the GUPPI is also the breakeven percentage increase in AeroSound's price: 4%, or \$104. The profit-maximizing percentage increase is GUPPI/2: 2%, or

¹ Make sure you know how every number in the table was determined.

² An alternative way to do the calculation is to calculate the gross gain on the inframarginal sales $[(q - \Delta q) \times \Delta p = (10,000 - 500) \times \$2 = \$19,000]$ minus the loss on marginal sales $[\Delta q \times \$m = 500 \times \$40 = \$20,000]$, for a net loss of \$1,000.

³ See Unit 5B slide 112. You could also calculate the GUPPI by determining the diversion ratio and using the formula on slide 105: $GUPPI_A = D_{AC} \times m_C \times (p_C/p_A) = 20\% \times 25\% \times (\$80/\$100) = 4\%$, where the A and C subscripts are for AeroSound and ClearTone, respectively.

\$102. Both results match the table above, which shows the maximum profits at a postmerger price of \$102.

Translating the GUPPI into a 2% price prediction requires the following assumptions, all of which the problem supplies:

- The original \$100 price maximizes AeroSound's standalone profit. If it did not, AeroSound's own profit would not peak at \$100, and the breakeven and profit-maximizing increases would not equal GUPPI and GUPPI/2. The demand schedule is consistent with this assumption: each \$1 increase reduces AeroSound's standalone profit, and, if the same linear demand schedule extends below \$100, a \$1 decrease would also reduce it, by \$250.
- AeroSound's demand is linear over the relevant range of prices.
- The diversion ratio to ClearTone remains constant over that range.
- Marginal costs are constant and unchanged by the merger.
- ClearTone's price, and the prices and other conduct of all other suppliers, remain unchanged.

Each assumption matters. With nonlinear demand, the share of the pricing pressure passed through to price may be more or less than one-half, so GUPPI/2 is not a general lower bound on the price increase (slide 110). Allowing ClearTone's price to change could raise AeroSound's price further. If ClearTone's \$80 price maximizes its standalone profit and some of ClearTone's lost sales would divert to AeroSound, the combined firm would also have an incentive to raise ClearTone's price, and in the linear model AeroSound's profit-maximizing price would then exceed \$102 (slide 109). The problem supplies neither fact, nor ClearTone's own demand, so the outcome when both prices can change cannot be determined. And the GUPPI is a *gross* measure: it does not account for efficiencies, entry, or repositioning by rivals, any of which could offset some or all of the upward pricing pressure.

Two common errors. First, a student may omit the price ratio. The ratio matters because the two products sell at different prices: ClearTone's 25% margin is measured against ClearTone's \$80 price, but the GUPPI expresses the recaptured profit as a percentage of AeroSound's \$100 price. Omitting the ratio yields $20\% \times 25\% = 5\%$, which predicts a breakeven price of \$105 and a profit-maximizing price of \$102.50. The table shows that this cannot be right: at \$105 the combined firm loses \$1,250 a week. Reconciling the GUPPI with the table catches the mistake.

Second, a student may use the wrong denominator. The GUPPI divides the recaptured profit by the revenue on AeroSound's departing sales, valued at the original price—not by AeroSound's net revenue decline. At \$102, the 500 departing pairs represent \$50,000 in revenue at the original \$100 price. AeroSound's net revenue decline is only \$31,000 because the higher price adds \$19,000 on retained sales. The GUPPI is the \$2,000 recaptured by ClearTone divided by \$50,000, or 4%; it is not \$2,000 divided by \$31,000.

(c) *The CEO's arguments.* Neither argument is correct. Unilateral effects analysis asks whether the merger gives the combined firm an incentive to raise price, and by how much. It does not require that a 5% increase be profitable or that the merging products be each other's closest substitutes. As the *H&R Block* court put it, a merger is likely to have unilateral anticompetitive effects "if the acquiring firm will have the incentive to raise prices or reduce quality after the acquisition, independent of competitive responses from other firms." *United States v. H&R*

Block, Inc., 833 F. Supp. 2d 36, 81 (D.D.C. 2011). Parts (a) and (b) show that AeroSound's acquisition of ClearTone creates that incentive.

A 5% increase would not be profitable. The premise is true: raising AeroSound's price to \$105 would reduce the combined firm's weekly profit by \$1,250. But the conclusion does not follow. The CEO has borrowed the SSNIP from the hypothetical monopolist test, which uses a specified price increase to determine whether a candidate market is a relevant market. That is a different question. The unprofitability of a 5% increase does not rule out profitable smaller increases: increases of 1%, 2%, and 3% are all profitable for the combined firm, and the profit-maximizing increase is 2%. The 2010 Guidelines make the point expressly: 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." U.S. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines § 4.1.1 (2010). Nor does Section 7 contain a safe harbor for price increases smaller than a SSNIP. The statutory question remains whether the merger may substantially lessen competition (slides 68 and 92).

The remaining legal question is whether the predicted harm, together with the other evidence, establishes a reasonable probability that the merger will substantially lessen competition. In the model, the combined firm would earn \$1,000 more a week, while AeroSound's customers would pay \$19,000 more a week on the 9,500 pairs they continue to buy—almost \$1 million a year—and sales of 500 pairs a week would shift to alternatives that customers had previously passed over or be forgone. The key point here to remember is that the merged firm's \$1,000 profit gain is not a measure of customer harm. Under the consumer welfare standard, the loss of consumer surplus is at least the \$19,000 wealth transfer from the inframarginal customers who continue to buy at the higher price to the merged firm. But this is only a lower bound since it ignores the loss of consumer welfare from the marginal customers who switch to a less preferred alternative or forgo purchasing.

A plaintiff could investigate whether allowing ClearTone's price to change would increase the predicted harm, but that conclusion would require additional evidence. The defendants would respond that a predicted 2% increase is small, depends on the model's assumptions, and must be assessed in light of the competitive constraints that remain. They would add that the 2010 Guidelines regard significant unilateral effects as unlikely "[i]f the value of diverted sales is proportionately small." *Id.* § 6.1. A court would weigh the prediction together with the other evidence of competition between the parties. What the CEO cannot do is dismiss the concern because a 5% increase is unprofitable.

A note on market definition. The calculation does not resolve market definition. It establishes that a 5% increase in AeroSound's price alone is unprofitable for a hypothetical monopolist owning both products. Failure of this particular one-product test does not establish that the two-product candidate market fails the HMT. A hypothetical monopolist might profitably impose a 5% increase on ClearTone or adjust both prices. *See id.* § 4.1.1 (testing a SSNIP on at least one product in the candidate market). Moreover, if the candidate market is headphones, a one-product SSNIP recapture test would also have to include recaptured sales by StudioWave and other as yet unidentified headphone manufacturers. Finally, a unilateral effects theory does not depend on the merging products forming a market by themselves; it can be applied within a broader relevant market, as in the Nestlé/Dreyer's example (slides 83–85).

More of AeroSound's lost sales go to StudioWave. This premise of the CEO's argument is true: 50% of AeroSound's lost sales divert to StudioWave and only 20% to ClearTone, so StudioWave, not ClearTone, is AeroSound's closest substitute by this diversion measure. But as a matter of economics, the merging products need not be each other's closest substitutes. The incentive to raise AeroSound's price depends on the value of the sales ClearTone recaptures—the diversion ratio to ClearTone multiplied by ClearTone's margin—compared with the profit AeroSound loses. Parts (a) and (b) show that 20% diversion at a \$20 margin produces a GUPPI of 4% and a profitable 2% increase, even though most of AeroSound's lost sales go elsewhere.

StudioWave's importance is already reflected in the calculation. Because 80% of AeroSound's lost sales escape the combined firm, including the 50% of lost sales that go to StudioWave, the recapture is modest and so is the predicted increase. If ClearTone rather than StudioWave received 50% of the lost sales, the GUPPI would be 10% ($50\% \times \$20 / \100) and the predicted increase 5%. Under this problem's assumptions, positive diversion to a merger partner with a positive margin creates an incentive to raise price. Greater diversion strengthens that incentive; a stronger outside substitute does not automatically eliminate it.

The Guidelines and the case law follow the economics. The 1992 Guidelines were widely read to require that the merging products be each other's closest substitutes and that the combined firm have at least a 35% share; the 2010 Guidelines do not impose either condition (slide 87). They explain that substantial unilateral price elevation “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,” but that, unless premerger margins are low, “that significant fraction need not approach a majority.” *Id.* § 6.1; see 2023 Merger Guidelines §§ 2.2, 4.2.B. Here, 20% of AeroSound's departing sales go to ClearTone. For the incentive to raise AeroSound's price, the relevant recaptured margin is ClearTone's \$20 per pair (25% of its price). The calculation demonstrates that this diversion and margin can support a profitable price increase without majority diversion. Similarly, courts recognize that the merging firms need not be each other's closest competitors; eliminating competition between sufficiently close alternatives can create upward pricing pressure. See *United States v. JetBlue Airways Corp.*, 712 F. Supp. 3d 109 (D. Mass. 2024); *United States v. H&R Block, Inc.*, 833 F. Supp. 2d 36, 83 (D.D.C. 2011).

(d) Bonus: Compensating marginal cost reduction. The compensating marginal cost reduction (CMCR) is the reduction in marginal cost needed to offset the upward pricing incentive created by a merger. The merger makes a price increase more attractive because the combined firm recaptures some of the lost sales through its other product. A reduction in marginal cost works in the opposite direction: it makes each sale more profitable and therefore makes losing sales through a price increase more costly. The CMCR identifies the cost saving that exactly balances these incentives, leaving the original price profit maximizing, holding the other product's price and marginal cost constant. It can be expressed either as a dollar saving per unit or as a percentage of the product's original marginal cost.

The calculation follows from the first-order profit-maximization condition that marginal revenue equals marginal cost. We know that a marginal cost reduction decreases the profit-maximizing price of a firm facing a downward-sloping residual demand curve. We want to determine the cost reduction that would leave AeroSound's original price of \$100 and sales of 10,000 pairs profit maximizing after the merger. We therefore evaluate all marginal revenues at that original price

and quantity, holding ClearTone's price and marginal cost constant. Before the merger, AeroSound maximizes its standalone profit at that quantity, so:

$$mr_A^{postmerger} = mc_A$$

After the merger, expanding AeroSound's sales takes some sales from ClearTone. The combined firm must count the resulting loss of ClearTone profit. For each additional AeroSound sale, ClearTone loses D_{AC} sales, each earning a dollar margin of $\$m_C$. Thus, the combined firm's effective marginal revenue from expanding AeroSound's sales is:

$$mr_A^{postmerger} = mr_A^{premerger} - D_{AC} \$m_C,$$

Here, "effective marginal revenue" means AeroSound's marginal revenue less the profit lost on displaced ClearTone sales. Under the problem's constant-diversion assumption, the same $D_{AC} = 0.20$ applies when AeroSound lowers its price and expands sales.

Let e be the reduction in AeroSound's marginal cost expressed as a fraction of its original marginal cost. Its new marginal cost is $(1 - e)mc_A$.

To leave the original price and quantity profit maximizing, the cost reduction must satisfy:

$$mr_A^{postmerger} = mr_A^{premerger} - D_{AC} \$m_C = (1 - e)mc_A$$

Because $mr_A^{premerger} = mc_A$ at the original quantity, substitution gives:

$$mc_A - D_{AC} \times \$m_C = mc_A - e \times mc_A$$

Cancelling equal terms and rearranging gives:

$$D_{AC} \$m_C = e \times mc_A,$$

This is the relationship shown on slide 93. Solving for e :

$$e = \frac{D_{AC} \$m_C}{mc_A}.$$

Solving this equation for e in the hypothetical gives:

$$e = \frac{0.20 \times \$20}{\$60} = 6.67\%.$$

The required marginal cost reduction is therefore \$4 per pair, which would lower AeroSound's marginal cost from \$60 to \$56. Slides 94-95 of the Unit 5B class notes explain why this saving offsets the merger's pricing incentive. When AeroSound expands sales by lowering its price, some additional sales come at ClearTone's expense. After the merger, the combined firm counts ClearTone's lost profit as an opportunity cost of expanding AeroSound's sales. Here, each additional AeroSound sale displaces an average of 0.20 ClearTone sales earning \$20 each, creating a \$4 opportunity cost. Slide 95 depicts the same effect as a downward shift in marginal revenue, although the opportunity cost in that example is \$42. A \$4 reduction in AeroSound's marginal cost exactly offsets the \$4 reduction in marginal revenue, restoring the original profit-maximizing price of \$100, holding ClearTone's price and marginal cost constant.

The CMCR lowers the price relative to what the merged firm would charge without the cost reduction, but it does not lower the price below the profit-maximizing premerger level. Without the \$4 cost reduction, the merged firm would charge \$102. With that reduction, it would charge \$100. Thus, the cost saving reduces the postmerger price by \$2 and prevents the price increase that the merger would otherwise cause. The comparison matters: customers pay less than they would after a merger without the saving, but they pay the same price as before the merger. That is what makes the cost reduction “compensating”: it exactly offsets the merger’s upward pricing incentive.

To confirm the result, compare the combined firm’s profit at \$100 with its profit at higher prices, using the new \$56 marginal cost in both cases. At \$100, AeroSound’s margin is \$44 and its profit before fixed costs is \$440,000. The combined firm loses profit at every listed price above \$100:

AeroSound price	Change in AeroSound profit (marginal cost \$56)	ClearTone recaptured profit	Net change (combined firm)
\$100	—	—	—
\$101	−\$1,250	+\$1,000	−\$250
\$102	−\$3,000	+\$2,000	−\$1,000
\$103	−\$5,250	+\$3,000	−\$2,250
\$104	−\$8,000	+\$4,000	−\$4,000
\$105	−\$11,250	+\$5,000	−\$6,250

The CMCR is approximately 6.67%, while the GUPPI is 4%, because the two percentages measure the same \$4 against different amounts. The GUPPI divides the \$4 in recaptured ClearTone profit per lost AeroSound sale by AeroSound’s original \$100 price: $\$4 \div \$100 = 4\%$. The CMCR divides the \$4 cost saving needed to offset that incentive by AeroSound’s original \$60 marginal cost: $\$4 \div \$60 \approx 6.67\%$. The percentages differ because one uses price as its denominator and the other uses marginal cost.

Part B. Elimination of a maverick

ABLE & BAKER LLP

TO:
FROM:
DATE:

Antitrust Risk in Acquiring a “Maverick” Competitor

You asked what the antitrust agencies mean when they say that an acquisition eliminates a “maverick,” and when that theory can support a challenge. A maverick is a competitor whose conduct keeps a market more competitive than its leading firms would otherwise allow. Acquiring one can be challenged even when its market share is small, because the concern is the loss of its influence on the entire market. The theory is demanding to prove, but a commitment to keep the target’s managers or strategy does not by itself answer it.

What is a maverick? Where a few suppliers lead a market, each may expect that aggressive moves, such as price cuts, will be matched and leave the suppliers worse off, and so may compete less aggressively without any agreement. A maverick does not go along. The 2010 Merger Guidelines describe it as “a firm that plays a disruptive role in the market to the benefit of customers.” U.S. Dep’t of Justice & Fed. Trade Comm’n, Horizontal Merger Guidelines § 2.1.5 (2010). The 2023 Guidelines call it “a firm with a disruptive presence in a market.” U.S. Dep’t of Justice & Fed. Trade Comm’n, Merger Guidelines § 2.3.A (2023).

A maverick’s significance can far exceed its market share because rivals respond to it. When it cuts price or improves its product and the larger firms match, customers of the responding firms can benefit as well. In *United States v. H&R Block, Inc.*, 833 F. Supp. 2d 36 (D.D.C. 2011), TaxACT had only about 13% of the market for digital do-it-yourself tax preparation products, but its introduction of free offers for all taxpayers prompted competing free offers. TaxACT remained distinctive in relying primarily on high-quality, full-featured free products and associated low-priced offerings. The court found that “TaxACT’s competition does play a special role in this market that constrains prices.” 833 F. Supp. 2d 36, 80 (D.D.C. 2011). Similarly, the FTC alleged that Harry’s entry into retail stores had disrupted a longstanding pattern of price increases by Gillette and Schick, and that acquiring Harry’s would remove that disruptive constraint and make an already susceptible market more vulnerable to coordination. Complaint ¶¶ 5-6, 48, 56, 67-70, *In re Edgewell Personal Care Co.*, No. 9390 (F.T.C. Feb. 3, 2020). Those are allegations, not findings; Edgewell abandoned the acquisition a week later.

Relation to coordinated effects. Section 7 of the Clayton Act prohibits a merger when it is reasonably likely to substantially lessen competition, including by making tacit accommodation more likely, effective, or stable. Tacit accommodation means firms restrain their rivalry because they expect one another to do the same. Because there is no agreement, such conduct does not violate Section 1 of the Sherman Act. Courts recognize that “where rivals are few, firms will be able to coordinate their behavior, either by overt collusion or implicit understanding.” *FTC v. CCC Holdings Inc.*, 605 F. Supp. 2d 26, 60 (D.D.C. 2009); accord *H&R Block*, 833 F. Supp. 2d at 77. The elimination of a maverick is ordinarily a special case of this “coordinated effects” theory: the maverick is what keeps the other firms from accommodating one another. The 2010 Guidelines state that an acquisition “eliminating a maverick firm . . . in a market vulnerable

to coordinated conduct is likely to cause adverse coordinated effects.” § 7.1. The 2023 Guidelines treat eliminating a maverick as a primary factor indicating a greater risk of coordination. § 2.3.A.

What a challenger must show. The Guidelines do not bind courts, and there is no settled judicial test. The *H&R Block* court faulted the government for offering no clear standard for identifying a maverick and asked instead whether TaxACT’s competition constrained prices and whether the merged firm would have the same incentives. 833 F. Supp. 2d at 79-81. In our view, a challenger should have to show that (1) the market is susceptible to coordination; (2) the target’s conduct materially constrains, or is likely to constrain, that coordination; (3) the acquisition is likely to end or blunt that constraining conduct; and (4) as a result, (4) the acquisition is likely to make coordination materially more likely, effective, or stable than it would be without the acquisition, harming customers. Describing a target as innovative, aggressive, or low-priced is therefore not enough.

Where the government establishes a structural prima facie case based on a significant increase in concentration and a highly concentrated postmerger market, some courts, including the *H&R Block* court, presume a risk of coordination and require the merging parties to produce evidence of industry-specific barriers to coordination. *Id.* at 77 (citing *FTC v. H.J. Heinz Co.*, 246 F.3d 708, 725 (D.C. Cir. 2001)). That presumption does not by itself show that a particular target constrains coordination or that acquiring it would remove that constraint, and the government retains the ultimate burden of persuasion.

Why promises of continuity are not enough. A promise to keep the target’s managers and strategy is relevant, but it does not establish that the strategy will remain attractive after the acquisition. An independent target counts the gains from a price cut or an improved free offering without counting profits that the initiative takes from the acquirer’s paid products. After the acquisition, the combined firm counts both. It may therefore prefer to limit the target’s aggressive offering to protect its other products. A strategy that paid for the independent maverick may not pay for the combined firm, whoever runs it. Greater size alone does not establish that the target’s strategy will change. As the *H&R Block* court explained, the merged firm’s “opportunity cost for offering free or very low-priced products will increase,” giving it “a greater incentive to migrate customers into its higher-priced offerings.” 833 F. Supp. 2d at 80. The 2023 Guidelines agree that a merger that “eliminates a maverick or significantly changes its incentives increases the susceptibility to coordination.” § 2.3.A. The mechanism is straightforward: once the target stops expanding its aggressive offering, rivals face less pressure to match it and may more readily sustain higher prices or restrict their own free offerings.

It is also not enough that the combined firm will keep competing on other dimensions, because coordination need not extend to every dimension of competition. In *H&R Block*, the firms could compete for customers while limiting the quality of their free products. 833 F. Supp. 2d at 77.

Evidence of management and strategy continuity is more persuasive when the combined firm’s economic incentives support it. In *New York v. Deutsche Telekom AG*, 439 F. Supp. 3d 179 (S.D.N.Y. 2020), the court credited evidence that T-Mobile would continue its disruptive strategy after acquiring Sprint, because it would still need to differentiate itself from AT&T and Verizon and would have more capacity to do so.

Implications for Stonebridge. In evaluating targets, the board should ask whether a candidate has led price cuts, expanded free offerings, or introduced features that rivals then matched; whether continuing that conduct would reduce the profitability of Stonebridge's existing business; and what the integration plan contemplates. A plan to cancel a target's disruptive initiatives would be central evidence in any investigation. We would be glad to assess particular candidates.

Please let me know if you have any questions or would like to discuss this matter further.

Note to students: The memorandum is written for board members, so it explains the economics in plain terms and uses the authorities to support the explanation rather than to replace it. Four points are worth emphasizing:

- *Treat "maverick" as a role, not a label.* The question is whether the target's conduct constrains the other firms, not whether it is small, innovative, or low-priced. The *H&R Block* court was impatient with the debate over the label for this reason.
- *Explain the causal chain.* For the coordinated effects theory, the question is whether removing the maverick would make coordination more likely, effective, or stable than it would be without the acquisition. A maverick may constrain existing coordination, destabilize it, or be expected to disrupt it through future expansion; it need not have prevented coordination altogether. The four requirements in the memorandum are an analytical synthesis suggested by *H&R Block*, not a test the court announced, and the memorandum presents them as the firm's view. They also adapt the formulation in the class notes (slide 63) to the Guidelines' "likely, effective, or stable" language and recognize that a maverick's expected future disruption can count.
- *Evaluate intentions together with incentives.* Keeping the target's managers does not establish that they will face the same incentives. The key question is which sales and margins the target's strategy would affect after common ownership. The inframarginal-sales example in the class notes (slides 60–64) illustrates one possible mechanism; the loss of profits on the acquirer's competing paid offerings illustrates another. *Deutsche Telekom* shows the other side: continuity can be credited when the combined firm's incentives support it.
- *Distinguish allegations from findings.* The *Edgewell* complaint states the FTC's theory; the parties abandoned the transaction before any court or the Commission made findings.