

MERGER ANTITRUST LAW

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Tuesdays and Thursdays, 3:30 pm – 5:30 pm
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Class 13 (October 6): H&R Block/TaxACT (Unit 5)

In Class 12, we completed market definition, briefly reviewed the *PNB* presumption, and examined coordinated effects. In this class, we will continue our examination of explicit theories of anticompetitive harm with the elimination of a maverick and unilateral effects. We looked at these theories in Unit 3 on *Sanford Health*; here we develop them in greater depth and connect them to the quantitative tools used to evaluate mergers. We will cover compensating marginal cost reductions, merger simulation, and GUPPIs through the one-product price prediction. Class 14 will complete the GUPPI applications and address entry and efficiencies, finishing Unit 5. All slide references are to the Unit 5B class notes.

Elimination of a maverick. A maverick is a firm whose conduct disrupts accommodation that other suppliers would otherwise find profitable and pursue. Its competitive significance can be much greater than the maverick's market share suggests. Acquiring a maverick may eliminate the disruption and permit greater coordination among the remaining suppliers. Although we treat the elimination of a maverick separately, this version of the theory is a special case of coordinated effects.¹ Read the maverick provisions of the 2010 and 2023 Guidelines (p. 211) and the class notes (slides 56-60), and briefly revisit the TaxACT discussion already assigned in Class 12 (pp. 79-82).

H&R Block illustrates both the theory's appeal and the difficulty of defining a maverick. TaxACT departed from prevailing pricing practices by offering high-quality, full-featured software for free, with associated products at low prices. Its strategy induced procompetitive "quality" responses from other firms and constrained their pricing. The court was appropriately impatient with a debate over the label "maverick" in the absence of clear criteria. The economically relevant point was TaxACT's demonstrated role in keeping the market competitive, and the central question of the theory was whether that role would survive the acquisition. Low prices or innovation alone do not establish the theory; their significance lies in the constraint they impose on the other firms.

The class notes discuss how an acquisition can change the incentives (slides 61-62). A price cut yields gains from additional sales but sacrifices margin on sales that would have occurred at the original price. These existing sales are inframarginal. In the diagrams, the independent maverick finds a price cut profitable because the gain on additional sales exceeds the loss on inframarginal sales. The combined firm has a larger volume of inframarginal sales affected by the cut, making the same aggressive strategy more costly. Under the illustrated conditions, the comparison reverses, and the price cut is no longer profitable.

In *H&R Block*, the related concern was that a combined firm with a larger portfolio of paid offerings would incur a greater opportunity cost from attractive free and low-priced products.

¹ As we will see, the maverick theory can also apply in unilateral effects.

Limiting those products' features could move customers toward higher-priced offerings. Retaining TaxACT's managers would not by itself preserve the incentives they faced when TaxACT was independent. At the same time, the diagrams illustrate a possible incentive change, not a proposition that every increase in size suppresses aggressive competition. The result depends on the affected sales, margins, competitive opportunities, and, not insignificantly, the merged firm's management objectives (although predicting these objectives correctly premerger can be problematic).

The *Edgewell* complaint supplies another application (pp. 212-228). The FTC alleged that Harry's entry into retail stores disrupted a longstanding pattern of price increases by Gillette and Schick, producing lower prices and new offerings. Edgewell, Schick's owner, proposed acquiring Harry's for \$1.37 billion, which would place that disruptive competitor under an incumbent's control. The alleged harm included losing Harry's independent influence on the broader competitive landscape. The assigned document is a complaint; its account presents the FTC's allegations rather than adjudicated findings. On February 3, 2020, the Federal Trade Commission (FTC) filed an administrative complaint to block the acquisition. One week later, on February 10, 2020, Edgewell announced it would not fight the lawsuit and chose to terminate the merger agreement. Edgewell's CEO, Rod Little, said the time, financial resources, and corporate distraction required to fight the government in court made pursuing a "standalone" strategy the best path forward.²

The four elements proposed in the class notes make the causal chain explicit (slide 63): (1) the market must be capable of materially greater coordination than it exhibits before the merger; (2) the maverick's conduct must materially impede that coordination; (3) the acquisition must be likely to discontinue the disruptive conduct; and (4) its discontinuance must be likely to produce materially greater coordination to the detriment of consumers. These elements are an analytical synthesis suggested by *H&R Block*, not a four-part test the court expressly announced. They also explain why a general description of a firm as innovative or aggressive is insufficient.

The acquiring firm can itself be the maverick (slide 64). Continued control by its managers may support an argument that its strategy will persist, but the transaction can still change the economic rewards of that strategy. The analysis therefore concerns both management's likely decisions and the combined business's incentives.

Unilateral effects. A unilateral effects theory addresses the elimination of competition between the merging firms. When the products are substitutes, a price increase by one firm may divert some customers to the other. Before the merger, the first firm does not receive the profits on those diverted sales. After the merger, the combined firm does, making a price increase more attractive. This change does not require accommodating conduct by nonmerging rivals. Their existing products and prices remain competitive constraints, but the theory can apply even if their conduct is held constant. Read the class notes on the definition and its connection to the one-product SSNIP recapture test (slides 65-68).

The underlying accounting is familiar from our study of the hypothetical monopolist test. A price increase adds margin on retained sales, loses margin on departing customers, and generates recaptured profits from customers who switch to another product owned by the combined firm. The legal inquiries nevertheless differ. The HMT tests the profitability of a specified SSNIP to

² See Press Release, Edgewell, [Edgewell Personal Care to Pursue Standalone Value Creation Strategy](#) (Feb. 10, 2020).

identify a candidate market. Unilateral effects analysis concerns the merger's effect on competition and, in the pricing model, the incentive to raise price and the magnitude of the resulting increase. A price increase smaller than the SSNIP is not automatically outside Section 7, although there must still be a reasonable probability that the merger will substantially lessen competition.

The class notes then examine the profit-maximizing logic behind unilateral effects. Before the merger, a profit-maximizing firm has already balanced the gains and losses from changing its price or output. In the marginal revenue formulation, its marginal revenue equals marginal cost. Expanding output requires a lower price and may take sales from a rival, but the independent firm does not count the rival's resulting profit loss. After acquiring the rival, the combined firm does count that loss. At the old output, the marginal contribution of further expansion is therefore lower. Under the model's assumptions, the combined firm increases profits by reducing output and raising price (slide 69).

The first numerical example in the Unit 5B class notes makes the recapture mechanism concrete (slides 70-72). Product A initially sells six units at \$7, with marginal cost of \$4. Increasing its price to \$7.50 reduces sales to five units. The lost unit costs A \$3 in margin, while the additional \$0.50 on each of the five retained units adds \$2.50. Standing alone, A loses \$0.50 from the increase. If half the lost sales divert to Product B and B earns a \$2 margin, however, B gains \$1. The combined firm gains \$0.50 overall. The merger has made a price increase profitable that was unprofitable for A alone, holding B's price constant.

The class notes describe this as *internalizing an externality* (slide 73). An independent firm ignores the profits that its competitive actions add to or subtract from its rival. Common ownership brings those effects into the same profit calculation. The second example and the accompanying diagrams show the resulting change in the profit-maximizing price and quantity (slides 74-80). Describing the mechanism as a cost of expanding A's output and taking sales from B, or as a benefit from raising A's price and recapturing sales through B, gives two perspectives on the same change in incentives. Larger diversion and a higher margin on the recapturing product generally strengthen that incentive. The class notes also provide optional algebraic explanations of the same mechanism (slides 81-82).

The Nestlé-Dreyer's ice cream example connects unilateral effects to the structural presumption (slides 83-85). Within a broad all-ice cream market, a plaintiff could argue that the parties' super-premium products competed especially closely and that eliminating their rivalry would allow higher prices for those products. Alternatively, if substitution evidence supports a separate super-premium ice cream market, the parties' shares and the resulting concentration become much greater, strengthening a *PNB* case.

These are different ways of organizing the same competitive concern, but each requires evidentiary support. A shared characteristic, such as super-premium quality, is not enough on its own to establish a relevant market or likely unilateral harm. The characteristic matters if it makes the products close substitutes and leaves other products insufficiently attractive to prevent a profitable price increase. The example illustrates why market definition and explicit effects analysis often reinforce one another.

Read Section 6 of the 2010 Horizontal Merger Guidelines (pp. 229-234), Section 2.2 of the 2023 Merger Guidelines (pp. 235-238), and the related class notes (slides 86-91). The differentiated product pricing model emphasizes substitution between the merging products and

the profits earned on recaptured sales. The products need not have different dollar margins for this mechanism to operate. Nor must the merging firms be each other's closest competitors. The 2010 Guidelines dropped the "closest substitutes" and "35% combined share" requirements widely read into the 1992 formulation. The important economic issue is whether eliminating the rivalry permits a harmful change in conduct despite the alternatives available to customers.

Guideline 2 of the 2023 Merger Guidelines raises an important issue concerning the sufficiency of evidence of substantial competition between the merging firms to establish that their merger may substantially lessen competition in the relevant market. The Guidelines state that substantial competition between the parties "ordinarily suggests that the merger may substantially lessen competition." But the strength of their premerger rivalry and the likely consequences of eliminating it are distinct questions. Two firms may compete aggressively with each other while facing other competitors that will continue to constrain the merged firm. The issue is therefore how much evidence about the remaining competitive constraints and the likely effects of the merger is needed to establish a *prima facie* case. The Guidelines support an initial inference of harm from substantial rivalry, but they do not themselves establish a binding judicial rule that shifts the burden of production whenever such rivalry is shown. The analysis therefore encompasses both the competitive constraint the parties impose on each other and the constraints other firms would continue to impose on the merged firm. These questions arise in bidding and competition over innovation or other nonprice terms as well as in differentiated product pricing.

The 2023 Guidelines emphasize eliminating substantial competition between the merging firms. Their evidentiary considerations include the firms' monitoring of one another, strategic responses, customer substitution, natural experiments, and merger planning. Each can illuminate a competitive constraint. For example, a firm's price reduction after a rival enters may show that the rival limits its pricing. Repeated head-to-head bidding and customer evidence that alternative suppliers are inadequate may similarly show why combining the bidders would worsen the customer's alternatives. Shared product attributes and ancillary services matter insofar as they explain those substitution patterns.

The *Bazaarvoice* excerpt (pp. 239-243) illustrates unilateral harm to customers who regarded the merging suppliers as their two most attractive alternatives and considered the next alternative distinctly inferior. Bazaarvoice's win/loss records and salespeople's "how the deal was done" reports showed that PowerReviews was identified far more often as a competitive alternative than any other supplier or an in-house solution. The court found these records reliable despite their incompleteness because no evidence showed systematic bias and their results were consistent with other evidence. The opinion identifies several ways the loss of competition could harm customers. Existing customers lost the ability to play the suppliers against each other at renewal. PowerReviews customers could be migrated to the higher-priced Bazaarvoice platform with additional features they would not otherwise have chosen. Individualized pricing could extract higher prices from new customers lacking satisfactory alternatives. Customers who particularly valued syndication—the distribution of reviews across participating sites—also lost bargaining leverage because PowerReviews had been the only credible alternative with a significant syndication network. Even where the merger provided access to a larger network, weakened bargaining leverage could allow Bazaarvoice to capture the additional value through higher prices. The opinion demonstrates how ordinary business evidence can establish both the importance of the lost rivalry and the inadequacy of the remaining alternatives, while identifying the particular customers and terms of competition likely to be affected.

Deutsche Telekom (pp. 250-252) illustrates a court's rejection of a predicted unilateral effect based on its assessment of the economic analysis and the merged firm's likely competitive behavior. Shapiro used diversion ratios, prices, and profit margins to calculate upward pricing pressure, then assumed that half of that pressure would be passed on to consumers, producing estimated annual consumer harm of \$4.6 billion. The predicted harm included slower price reductions or service improvements, not simply increases in nominal prices. The court questioned the reliability of the switching data and the analysis's ability to account for changes in products, entry, and business strategy in a rapidly evolving industry. Although it did not categorically reject the upward pricing pressure analysis, it found other evidence more persuasive in this setting. In particular, consumers' perception that AT&T and Verizon offered superior networks would continue to pressure T-Mobile to differentiate itself through lower prices and innovative services. The merger's capacity benefits would enable T-Mobile to pursue that strategy on a larger scale. Sprint's declining competitive strength and DISH's expected entry, including its acquisition of Boost, reinforced the court's conclusion. The court thus accepted that T-Mobile and Sprint competed directly but found that eliminating their rivalry was unlikely to substantially lessen competition in light of the merged firm's incentives and the anticipated competitive environment. The opinion contrasts with *Bazaarvoice*, where the court found that the remaining alternatives would not adequately constrain the merged firm.

Bertelsmann applies unilateral effects theory on the buying side of a market (pp. 253-257). Publishers competed to acquire rights to anticipated top-selling books, and their bidding increased the advances paid to authors. The government established the closeness of competition between Penguin Random House and Simon & Schuster through diversion estimates based on market shares, win/loss records, runner-up data, and editorial meeting minutes. Here, diversion measures the proportion of authors lost by one publisher following a reduction in its advances who would turn to the other merging publisher. Although each source had limitations, the consistent results supported the conclusion that PRH was S&S's closest competitor and S&S was a significant competitor to PRH. This asymmetry did not negate the rivalry's competitive significance. Direct bidding contests demonstrated how competition between the parties increased advances, but the court's analysis extended beyond transactions in which they were the final two bidders. Eliminating an independent bidder could also weaken bidding incentives more broadly and reduce the likelihood of an unusually high offer. Competition mattered even in one-on-one negotiations because an author's ability to approach another publisher strengthened the author's bargaining position. These broader effects supported the court's rejection of the defendants' argument that direct head-to-head encounters were too infrequent to establish substantial harm. The opinion thus illustrates how the loss of an independent buyer can worsen sellers' terms through both auction and bargaining mechanisms, without coordination among the remaining buyers.

JetBlue returns to a selling market (pp. 258-261). The court found that eliminating head-to-head competition between JetBlue and Spirit on multiple routes would weaken the competitive pressure that disciplined JetBlue's prices and encouraged innovation. The merging firms need not be each other's closest competitors: eliminating competition between sufficiently close alternatives can create upward pricing pressure. The opinion also emphasizes the competitive significance of the acquired firm's business model. Spirit's ultra-low-cost, often unbundled offerings served budget-conscious passengers and exerted downward pressure on other airlines' fares. Although the court expected a larger JetBlue to compete more strongly against the largest airlines, that benefit did not overcome the anticipated harm to consumers who relied on Spirit's

distinctive offering. Nor did the possibility of entry establish that Spirit's competitive influence would be replaced. Despite the industry's dynamism and low barriers to entry, other airlines faced aircraft supply constraints that would make Spirit's competitive role exceedingly difficult to replicate. The opinion thus contrasts with *Deutsche Telekom* in assessing whether the merged firm's greater competitive strength and the prospects for competition from other firms would adequately address the loss of rivalry between the merging parties.³

The class notes next discuss the relationship of unilateral effects and market definition (slide 92). If common ownership of the merging products makes a one-product SSNIP profitable, a candidate market consisting of those products satisfies the HMT. The same substitution and margin evidence can therefore support both a unilateral effects theory and a narrow candidate market with high concentration. The candidate market may be expanded as appropriate to reflect commercial realities. Conversely, a predicted unilateral price increase below the SSNIP does not defeat a Section 7 claim; the statutory inquiry remains whether the merger is reasonably likely to lessen competition substantially. The connection explains why a structural case and an explicit effects case can provide complementary support for the same challenge.

A merger of substitute products creates upward pricing pressure because the combined firm earns profits on some sales that a price increase diverts from one product to the other. A reduction in marginal cost works in the opposite direction: it makes retaining or expanding sales more profitable. A compensating marginal cost reduction is the reduction sufficient to offset the merger-created pricing incentive at the original price and output. It connects the unilateral effects analysis to the efficiencies defense that we will examine in Class 14 (slides 93-97).

In the one-product comparison developed in the class notes, the relevant upward pressure is the diversion ratio multiplied by the dollar margin earned on the recapturing product. The compensating dollar reduction in the first product's marginal cost must be at least that large. For example, if 30% of the lost units divert to the other merging product and that product earns a \$20 margin, the recaptured profit is \$6 per unit lost by the first product. A \$6 reduction in that product's marginal cost offsets this pressure under the stated assumptions. This comparison holds the other product's price and marginal cost constant; it does not fully capture a merger that changes both products' costs and prices.

Expressing the required saving as a percentage introduces a separate denominator. If the first product's marginal cost is \$40, a \$6 compensating reduction is 15% of marginal cost. It is not a 15% reduction in price or in the firm's total operating expenses. The *Kroger* illustration makes this distinction important: a required percentage reduction in marginal cost cannot be compared directly with claimed savings expressed as a percentage of total operating costs, which also include fixed costs. The comparison must use consistent cost categories and denominators. Even a saving large enough in this calculation must satisfy the legal requirements for cognizable efficiencies before it can support a rebuttal.

Merger simulation. A merger simulation uses a model of competition, demand estimates, and cost estimates to predict how prices or other competitive outcomes will change under common ownership. Demand estimates describe customers' responses to changes in their suppliers' prices, including substitution between the merging products. Cost estimates establish the profits

³ We will read the *Anthem* unilateral effects excerpt (pp. 244-249) in Class 14 alongside the appellate court's treatment of efficiencies (pp. 292-298).

earned on retained and diverted sales. The model specifies how firms compete and which prices or other decisions can adjust after the merger (slides 98-102).

A model can reduce the amount of data needed by imposing assumptions such as linear demand, constant marginal cost, or symmetry between the firms. Those assumptions also limit the circumstances in which its predictions are reliable. A more elaborate model may permit more realistic competitive responses but require demand and cost estimates that the available evidence cannot support precisely. The numerical result therefore depends on both the model's fit to the industry and the quality of its inputs. Sensitivity to plausible alternative assumptions or estimates bears on the weight the result deserves.

A simulation can be probative without furnishing an exact forecast. It may support the direction or approximate scale of an effect when other evidence establishes that the merging firms constrain one another. The distinction between the two *H&R Block* simulations remains important. The simulated combination of all three major DDIY suppliers supported the market definition; the 83%, 37%, and 11% figures concern that hypothetical merger to monopoly. The simulation of the actual *H&R Block/TaxACT* transaction addressed a different ownership change and a different competitive question (slide 102).

GUPPI and recapture. The Gross Upward Pricing Pressure Index puts the familiar diversion-and-margin relationship into a standardized form. For Product 1, GUPPI equals the diversion ratio from Product 1 to Product 2 multiplied by Product 2's dollar margin, divided by Product 1's price. Equivalently, it equals the diversion ratio multiplied by Product 2's percentage margin and the ratio of Product 2's price to Product 1's price. The price ratio is necessary when the products sell at different prices. When prices are equal, the expression simplifies to diversion multiplied by the recapturing product's percentage margin (slides 103-108).

GUPPIs measure the profit recaptured on the other merging product per dollar of sales lost by the product whose price increases, with those lost sales valued at the original price. A larger diversion ratio or a larger dollar margin on the recapturing product increases this gross incentive to raise price. "Gross" means that the index does not deduct offsetting efficiencies or the effects of entry and other competitive responses. It is a quantitative measure of pricing pressure, but it does not by itself predict the price the combined firm will select. Two transactions with different demand conditions can have the same GUPPI and different profit-maximizing price responses.

The connection to the one-product SSNIP test is especially useful under the assumptions used in our numerical examples. The recapture test starts with a specified price increase and determines whether recaptured profits make it profitable. Assuming that the initial price maximizes the independent firm's profit, demand is linear, the diversion ratio is constant over the relevant price change, marginal costs remain constant and unchanged by the merger, and all other prices are held constant, the calculation can instead start with diversion and margins and solve for the price increase at which the gain from recapture offsets the loss on the first product.

Under these assumptions, that breakeven percentage increase is GUPPI and the profit-maximizing percentage price increase is GUPPI/2. In this model, profit changes quadratically: it is zero at the original price and at the positive breakeven increase, and its maximum lies halfway between those points. The result converts the recapture measure into a price prediction by adding specific assumptions about demand and costs (slides 109-112).

The numerical example also shows why the two merging products can have different GUPPIs even when their dollar margins are equal. Product 1 sells for \$1.20 and Product 2 for \$1.00; each has a \$0.60 dollar margin. Diversion from Product 1 to Product 2 is 30%, producing a GUPPI of 15%: $30\% \times \$0.60 \div \1.20 . Diversion in the opposite direction is 40%, producing a GUPPI of 24%: $40\% \times \$0.60 \div \1.00 . The corresponding one-product price predictions are 7.5% and 12%. Each calculation holds the other product's price constant, so they are not simultaneous equilibrium predictions (slide 111).

The qualifications are substantive. With nonlinear demand, the curvature of the demand curve changes how much of the merger-created opportunity cost is reflected in price. Changes in other prices, efficiencies, and supply responses can also change the result. GUPPI/2 may therefore overstate or understate the actual price effect outside the specified model. It is not a general lower bound. The economic meaning of GUPPI survives these qualifications, but translating it into a predicted price change requires additional information (slides 110 and 112).

Unilateral effects in H&R Block. The court combined evidence of direct competition between H&R Block and TaxACT with diversion evidence and Warren-Boulton's simulation of their proposed merger. It treated the simulation as imprecise but probative of a likely price increase. The numerical estimate thus supplemented the broader account of how common ownership would change competitive incentives. Read the unilateral effects discussion in the opinion, stopping before "Post-Merger Efficiencies" (pp. 82-95). The efficiencies discussion and the court's conclusion remain for Class 14 (pp. 95-101).

A methodological criticism can weaken a particular calculation without defeating the underlying theory. A compelling rebuttal ordinarily connects the identified error to its competitive significance: correcting the method or input should undermine the prediction of harm, not merely change a number that still supports that prediction. Conversely, an error that destroys the reliability of the plaintiff's proof can matter even without a competing numerical forecast. This is an evidentiary distinction, not a transfer of the ultimate burden of persuasion. The court must assess what remains of the plaintiff's case in light of the rebuttal and the other evidence.

Where we stop. For Class 13, complete the Unit 5B class notes through GUPPI and the one-product price prediction (slide 112). Class 14 begins with the symmetric model in which both merging products' prices adjust, then considers GUPPI screening and judicial applications (slides 113-124). We will then turn to the defenses framework, entry, and efficiencies in the Unit 5C class notes (slides 2-41). Today's readings establish the mechanisms of harm and the initial quantitative tools; the next class applies those tools and examines the principal defenses to complete Unit 5.

Enjoy the reading! Email me if you have any questions.