

# NOTES

## Identifying a Maverick: When Antitrust Law Should Protect a Low-Cost Competitor

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### INTRODUCTION

Shortly after taking office, President Barack Obama announced that his Administration would pursue a policy of vigorous antitrust

enforcement in order to ensure healthy competition in the economy.<sup>1</sup> In two of the highest-profile antitrust cases that have followed, the United States Department of Justice (“DOJ”) sought to block two proposed mergers in which the target companies were low-cost competitors in their industries. The DOJ won a judgment in November 2011 that blocked retail-tax giant H&R Block from acquiring 2nd Story Software, maker of the low-cost digital tax-preparation program TaxACT.<sup>2</sup> A month later, the DOJ scored another “victory” when AT&T dropped its bid to acquire the low-cost telecommunications provider T-Mobile USA.<sup>3</sup>

These enforcement actions provide a relatively rare glimpse<sup>4</sup> into the government’s interpretation of section 7 of the Clayton Act,<sup>5</sup> which is designed to stop potentially problematic mergers before the reduction in competition causes consumers harm.<sup>6</sup> Since the acquiring firm in each of these proposed mergers was the second largest in its industry, the mergers could have been seen as facilitating competition by making the second-place firms more efficient or innovative and thus more capable of competing against the first-place firms. But the

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1. Stephen Labaton, *Obama Takes Tougher Antitrust Line*, N.Y. TIMES, May 11, 2009, <http://www.nytimes.com/2009/05/12/business/economy/12antitrust.html>.

2. See *United States v. H&R Block, Inc.*, 833 F. Supp. 2d 36, 45 (D.D.C. 2011) (judgment for the United States enjoining the merger).

3. See Press Release, U.S. Dep’t of Justice, Justice Department Issues Statements Regarding AT&T Inc.’s Abandonment of Its Proposed Acquisition of T-Mobile USA Inc. (Dec. 19, 2011), available at [http://www.justice.gov/atr/public/press\\_releases/2011/278406.pdf](http://www.justice.gov/atr/public/press_releases/2011/278406.pdf) (calling AT&T’s dropped bid after the DOJ filed suit to enjoin the AT&T/T-Mobile merger “a victory”).

4. The H&R Block/TaxACT victory was the DOJ’s first merger enforcement action since 2004 that had gone to trial. Brent Kendall, *TaxAct Deal Spurs Rare Court Action*, WALL ST. J., Sept. 3, 2011, <http://online.wsj.com/article/SB10001424053111904716604576546282753784982.html>. The vast majority of enforcement activity goes unreported because the enforcement agencies either help the parties to restructure their deals before a complaint is even filed or offer consent decrees at the same time as complaints, indicating that the Agency will not legitimately contest the proposed merger. See, e.g., 33 FTC & U.S. DEPT OF JUSTICE HART-SCOTT-RODINO ANN. REP. 1–2, available at <http://www.ftc.gov/os/2011/02/1101hrsreport.pdf> (summarizing all of the enforcement actions from fiscal year 2010, which included only nineteen actions by the DOJ and twenty-two by the FTC); see also *id.* at 5 fig.2 (showing that “second requests” occurred in only two to four percent of all mergers that were notified to the enforcement agencies between fiscal years 2001 and 2010).

5. 15 U.S.C. § 18 (2006).

6. See *Brown Shoe Co. v. United States*, 370 U.S. 294, 332 (1962) (“[T]he very wording of § 7 requires a prognosis of the probable future effect of the merger.” (emphasis omitted)); U.S. DEPT OF JUSTICE & FTC, HORIZONTAL MERGER GUIDELINES § 1 (rev. ed. 2010) [hereinafter 2010 GUIDELINES], available at <http://www.justice.gov/atr/public/guidelines/hmg-2010.pdf> (“[T]hese Guidelines reflect the congressional intent that merger enforcement should interdict competitive problems in their incipency and that certainty about anticompetitive effect is seldom possible and not required for a merger to be illegal.”).

DOJ did not see the mergers that way. Instead, the DOJ moved to protect the low-cost competitors from acquisition on the theory that their independence was an essential ingredient for competition in the industry.

These markedly similar enforcement actions might suggest that the government has a new focus in antitrust enforcement; at very least, they provide a ripe opportunity to identify and evaluate the specific theory of anticompetitive harm that the government argued in those cases and might argue in the future. This Note refers to that specific theory as “the maverick-firm theory of anticompetitive harm.” Both federal agencies in charge of antitrust enforcement—the DOJ and the Federal Trade Commission (“FTC”)—use the “maverick” label to refer to firms that play a special competitive role in their industries and thus require protection under antitrust law.<sup>7</sup> In *United States v. H&R Block*, for instance, the court observed that the government had committed quite heavily to this maverick-firm theory of anticompetitive harm: “The parties have spilled substantial ink debating TaxACT’s maverick status.”<sup>8</sup> It is axiomatic, then, that the persuasiveness of this theory depends on how the government defines a maverick firm and whether that definition can accurately identify specific firms whose independence is truly essential for healthy competition. Otherwise, as the court noted, this label “amounts to little more than a game of semantic gotcha.”<sup>9</sup>

The first goal of this Note is to show that neither the government nor any other legal authority has offered a persuasive definition of a maverick firm. A natural first place to look for a definition is in the 2010 Horizontal Merger Guidelines, the joint publication of the DOJ and the FTC that “describe[s] the principal analytical techniques and the main types of evidence on which the Agencies usually rely to predict whether a horizontal merger may substantially lessen competition.”<sup>10</sup> Indeed, the 2010 Guidelines do define a maverick firm as “a firm that plays a disruptive role in the market to the benefit of customers.”<sup>11</sup> Demonstrating that a firm

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7. 2010 GUIDELINES, *supra* note 6, § 2.1.5.

8. 833 F. Supp. 2d 36, 79 (D.D.C. 2011).

9. *Id.*

10. 2010 GUIDELINES, *supra* note 6, § 1.

11. *Id.* § 2.1.5; *see also* discussion *infra* Section I.B (arguing that while the text of the 2010 Guidelines provides a definition of a maverick, that definition is not effective in identifying the class of target firms that should remain independent).

meets this definition is supposed to be “informative” evidence that the merger will have adverse competitive effects.<sup>12</sup>

The DOJ did in fact follow this prescription and identified both TaxACT and T-Mobile as mavericks in their respective industries by pointing to evidence that they “disrupt[ed]” the market for retail tax preparation and mobile telecommunications, respectively.<sup>13</sup> However, as the court noted in *H&R Block*, this definition only helps a plaintiff or court identify a special subset of firms in need of protection if “disruptive” behavior is distinguishable from the type of competitive behavior in which every firm must engage to survive. The court observed: “The government has not set out a clear standard, based on functional or economic considerations, to distinguish a maverick from any other aggressive competitor. At times, the government . . . seems to suggest that almost any competitive activity on TaxACT’s part is a ‘disruptive’ indicator of a maverick.”<sup>14</sup> Commentators characterized the opinion as “chastis[ing] the parties” for relying too heavily on the maverick label, and suggested that it threw the theory’s viability into question.<sup>15</sup>

The second goal of this Note, which is inspired by this critique, is to restore the viability of the maverick-firm theory of anticompetitive harm by offering a more specific definition of a maverick firm based on the business-management concept of *disruptive innovation*. Although legal authorities have been seemingly unable to articulate a set of criteria that distinguishes disruptive behavior from ordinary competitive behavior, business-management scholars have had more success. In the field of business management, disruptive behavior is defined as competing by offering a product or service that is significantly worse than the market leader’s in some ways, but better meets the needs of unserved customers in other

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12. 2010 GUIDELINES, *supra* note 6, § 2.

13. Plaintiff’s Memorandum of Points and Authorities in Support of Its Motion for a Preliminary Injunction *passim*, *United States v. H&R Block*, 833 F. Supp. 2d 36 (D.D.C. 2011) (No. 11-00948), available at <http://www.justice.gov/atr/cases/f273600/273683.pdf>; Amended Complaint ¶¶ 3, 32–33, 36, *United States v. AT&T Inc.*, No. 11-01560 (D.D.C. Sept. 16, 2011), available at <http://www.justice.gov/atr/cases/f275100/275128.pdf>; see also *H&R Block*, 833 F. Supp. 2d at 79 (“At times, the government has emphasized TaxACT’s low pricing as evidence of its maverick status, while, at other times, the government seems to suggest that almost any competitive activity on TaxACT’s part is a ‘disruptive’ indicator of a maverick.”).

14. *H&R Block*, 833 F. Supp. 2d at 79.

15. *Government Prevails in Antitrust Challenge to Software Merger*, COOLEY LLP (Dec. 5, 2011), <http://www.cooley.com/government-prevails-in-antitrust-challenge-to-software-merger>.

ways.<sup>16</sup> One common disruptive strategy is trading off higher performance in favor of lower price. This strategy is distinct from traditional competition in that disruptive innovators do not try to beat the most successful firms at their own game. It turns out that the subset of firms that employ this type of strategy not only “play a disruptive role in the market to the benefit of consumers,”<sup>17</sup> but also tend to require independence from firms that employ traditional strategies. Therefore, it is the recommendation of this Note that the government adopt a set of criteria for identifying disruptive innovators as its definition of a maverick firm. This more specific proposed definition of a maverick is not intended to drastically change the government’s approach to reviewing mergers. In fact, this Note will demonstrate that the DOJ’s recent enforcement actions would likely have reached the same result under the new definition. The proposed definition is merely meant to articulate and clarify the discomfort that could have been motivating the government’s recent actions to block the acquisition of low-cost competitors; this will help make the maverick-firm theory of anticompetitive harm more persuasive going forward.

This Note will proceed in three parts. Part I will describe the legal rationale for blocking a proposed merger and demonstrate that neither the 2010 Guidelines nor the government’s recent filings offer a definition of a maverick that comports with this rationale. It will also point out a similar gap in legal scholarship on the subject. Part II will then fill in this gap by drawing on a different field of study: business-management theory. It will define the concept of disruptive innovation and discuss how the characteristics of a disruptive innovator are consistent with those that antitrust law seeks to protect. Part III suggests that this new definition should be adopted and announced by the DOJ and FTC, and analyzes the recent H&R Block/TaxACT and AT&T/T-Mobile deals through this lens. A brief conclusion will follow.

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16. For a general description of the theory of disruptive innovation, see the introduction to CLAYTON M. CHRISTENSEN, *THE INNOVATOR’S DILEMMA* (Collins Business Essentials 2006) (1997). The definition will be discussed in more detail in Section II.A.

17. 2010 GUIDELINES, *supra* note 6, § 2.1.5.

## I. EXISTING DEFINITIONS OF A MAVERICK FIRM

A. *The Goals of Antitrust and the Rise of the Maverick-Firm Theory of Harm*

Federal law empowers the antitrust agencies to block a merger if it poses either of two threats to competition: (1) if it could result in one dominant firm unilaterally setting prices, or (2) if the firms remaining postmerger would be likely to coordinate with each other to raise prices.<sup>18</sup> The maverick-firm theory of anticompetitive harm falls into the second category; it is an argument that the proposed merger makes coordination more likely.<sup>19</sup> However, it is only since the 2010 revision to the Horizontal Merger Guidelines that the agencies have considered eliminating a maverick to be direct evidence of an anticompetitive merger.<sup>20</sup> Prior versions discussed the maverick status of a target firm as one piece of evidence in a totality-of-the-circumstances approach to predicting whether a postmerger group of firms would be able to overcome the difficulties inherent in coordination.<sup>21</sup> This totality-of-the-circumstances approach is consistent with the view—which rose to prominence during the Chicago school revolution in the 1970s—that the law should not credit formalistic evidence, but look to a case-by-case analysis of the economic effects of a proposed merger.<sup>22</sup> This Part summarizes the

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18. These two concerns are known as “unilateral effects” and “coordinated effects,” respectively. 2010 GUIDELINES, *supra* note 6, §§ 6–7.

19. The revised version of the Horizontal Merger Guidelines, released in 1997, discussed maverick firms in the section on mergers that might result in coordinated interaction: “[A]cquisition of a maverick firm is one way in which a merger may make coordinated interaction more likely, more successful, or more complete.” U.S. DEPT OF JUSTICE & FTC, HORIZONTAL MERGER GUIDELINES § 2.12 (rev. ed. 1997), available at <http://www.justice.gov/atr/public/guidelines/hmg.pdf>.

20. *Cf.* 2010 GUIDELINES, *supra* note 6, § 2 (referring to the “Disruptive Role of a Merging Party” as one of the categories of evidence “that the Agencies, in their experience, have found most informative in predicting the likely competitive effects of mergers”); *AAI Says DOJ Complaint in H&R Block/TaxACT Merger Provides Transparency on Maverick Firms*, AM. ANTITRUST INST., <http://www.antitrustinstitute.org/content/aai-says-doj-complaint-hr-blocktaxact-merger-provides-transparency-maverick-firms> (last visited Sept. 22, 2012) (“The 2010 revised Horizontal Merger Guidelines stress the usefulness of direct evidence, such as eliminating a maverick, in showing that a merger will potentially harm competition.”).

21. See U.S. DEPT OF JUSTICE & FTC, *supra* note 19, § 2.12 (discussing the maverick status of a merging party as one of several factors that could prove a merger would have “coordinated effects”).

22. See Richard A. Posner, *The Chicago School of Antitrust Analysis*, 127 U. PA. L. REV. 925, 931–32 (1979) (discussing the fact that the Chicago school has prevailed on the point that

development of this legal test for predicting whether a postmerger group of firms will be able to coordinate to raise prices. It also demonstrates that the existing definitions of a maverick firm—in the Horizontal Merger Guidelines, government case filings, and legal scholarship—do not meaningfully assist in that analysis and, therefore, should not provide a shortcut around the totality-of-the-circumstances approach.

The early history of merger enforcement was dominated by the concern that industries with a lot of merger activity could be trending toward a dangerous level of concentration.<sup>23</sup> Theorists feared that when the number of firms in an industry was small, coordination would be inevitable.<sup>24</sup> As a result, courts blocked mergers well in advance of those industries reaching such levels.<sup>25</sup> The seminal Supreme Court case, *United States v. Philadelphia National Bank*, put it this way:

[The] intense congressional concern with the trend toward concentration warrants dispensing, in certain cases, with elaborate proof of market structure, market behavior, or probable anticompetitive effects. Specifically, we think that a merger which produces a firm controlling an undue percentage share of the relevant market, and results in a significant increase in the concentration of firms in that market is so inherently likely to lessen competition substantially that it must be enjoined in the absence of evidence clearly showing that the merger is not likely to have such anticompetitive effects.<sup>26</sup>

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economic analysis rather than “unsystematic” observation is the superior way of proving that a firm’s behavior is anticompetitive).

23. See generally Jonathan B. Baker, *Mavericks, Mergers, and Exclusion: Proving Coordinated Competitive Effects Under the Antitrust Laws*, 77 N.Y.U. L. REV. 135, 142–43 & nn.27–30 (2002) (surveying the prevailing pre-1970 merger analysis and concluding that courts and antitrust practitioners acted with a strong presumption against concentrated markets).

24. See *id.* at 138 (“The dominant and largely unquestioned view among economists and antitrust commentators was that when only a few firms competed in an industry, they readily would find a way to reduce rivalry, collude tacitly, and raise prices above the competitive level.”); Posner, *supra* note 22, at 944 (referring to the two schools of antitrust thought and describing the pre-Chicagoan industrial organizationists—also known as the Harvard school—as “continu[ing] to believe that persistently high concentration in an industry warrants breaking up the leading firms”); Leonard W. Weiss, *The Structure-Conduct-Performance Paradigm and Antitrust*, 127 U. PA. L. REV. 1104, 1106 (1979) (discussing the threat from coordinated effects).

25. See *Brown Shoe Co. v. United States*, 370 U.S. 294, 317–18 (1962) (holding that Congress intended merger enforcement to halt a trend toward concentration before the structure became problematic); see also *United States v. Von’s Grocery Co.*, 384 U.S. 270, 272–73, 281 (1966) (prohibiting a merger between firms with market share of 4.7 percent and 4.2 percent because the large number of independent Los Angeles grocery stores had been shrinking over the past decade); *United States v. Pabst Brewing Co.*, 384 U.S. 546, 547, 552–53 (1966) (prohibiting a merger between the tenth-largest brewer in the nation and the eighteenth-largest on the trend-toward-concentration grounds).

26. *United States v. Phila. Nat’l Bank*, 374 U.S. 321, 363 (1963).

This abundance of caution is inconsistent with the modern notion that a merger should only be blocked if its direct effect would be a substantial reduction in competition due to a heightened ability to coordinate.

The Chicago school revolution of the 1970s, with its emphasis on proving economic harm, had the effect of significantly reducing antitrust law's emphasis on structure.<sup>27</sup> Instead, practitioners of the era focused on the factors that suggested whether firms in a particular concentrated industry would be able to overcome the difficulties inherent to coordinating prices or outputs, and whether other firms would enter the industry to compete down price if the incumbent firms did overcome the difficulties.<sup>28</sup> The 1982 Horizontal Merger Guidelines reflected this new emphasis.<sup>29</sup> They stated that the government would “focus first” on the structure of the hypothetical postmerger market, but then take into consideration a variety of other factors that “will create, enhance or facilitate the exercise of market power.”<sup>30</sup> One influential case described this new paradigm as a “totality-of-the-circumstances approach.”<sup>31</sup>

This paradigm still prevails today, with the most recent version of the Guidelines—the 2010 edition—making clear that a merger creating a highly concentrated market can still survive scrutiny if there is evidence that demonstrates ease of entry, merger-specific efficiencies, likely failure of one of the firms in the absence of the

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27. See generally Jonathan B. Baker & Steven C. Salop, *Should Concentration Be Dropped from the Merger Guidelines?*, in AM. BAR ASS'N, SECTION OF ANTITRUST LAW, PERSPECTIVES ON FUNDAMENTAL ANTITRUST THEORY 339 (2001); Jonathan B. Baker, *The Problem with Baker Hughes and Syufy: On the Role of Entry in Merger Analysis*, 65 ANTITRUST L.J. 353, 354–56 (1997) (describing the Chicago school's influence on the courts).

28. See Baker, *supra* note 23, at 146–47 (stating that as a result of the Chicago school revolution, “[h]igh prices were no longer seen as the inevitable result of high market concentration; the success of tacit collusion instead was understood to depend upon whether the firms were able to overcome the difficulties of identifying a consensus on price and market shares and deterring cheating on that consensus”); Posner, *supra* note 22, at 945 (“The Chicago school does not deny that concentration is a factor that facilitates collusion of a sort difficult to detect, although it attaches less significance to concentration per se than do the oligopoly theorists. It asks, rather, how it is that excessive profitability can persist without attracting new entry that will cause prices to fall to the competitive level.”).

29. See Thomas E. Kauper, *The 1982 Horizontal Merger Guidelines: Of Collusion, Efficiency, and Failure*, 71 CALIF. L. REV. 497, 505–25 (1983) (summarizing the rise and focus of the 1982 Guidelines).

30. U.S. DEPT OF JUSTICE, 1982 MERGER GUIDELINES § III (1982), available at <http://www.justice.gov/atr/hmerger/11248.pdf>.

31. *United States v. Baker Hughes Inc.*, 908 F.2d 981, 984 (D.C. Cir. 1990).



merger, or some structural barrier to coordination.<sup>32</sup> These extenuating factors are meant to more accurately predict whether the concentrated industry will actually result in anticompetitive harm in the form of higher price, reduced output, or diminished innovation.<sup>33</sup>

However, the 2010 Guidelines also recommend several ways to demonstrate “adverse competitive effects” with evidence that supposedly obviates the need for a full inquiry into the structure of the market and the possible extenuating factors.<sup>34</sup> Showing that the target firm is a maverick is one of those recommended ways.<sup>35</sup> This label is supposed to attach when several competitors would prefer to collude to raise prices or reduce innovation but one or more firms play a special role in making that impossible. For instance, if one firm has a unique incentive to cut prices it will “often resist[] otherwise prevailing industry norms to cooperate on price setting.”<sup>36</sup> That resistance will require all the other firms to keep their prices low or else suffer losing their customers to the unique firm.<sup>37</sup> If the firm playing this role is always the same one, it is supposed to be evidence that the remaining parties would coordinate in the absence of that maverick firm.<sup>38</sup> However, labeling a firm a maverick under the Guidelines’ prescription does not address whether the acquiring firm would play a similar role once it obtained the unique firm’s assets.

The key to employing this maverick-firm theory of anticompetitive harm is to be able to identify what the effect of a firm’s *elimination* would be.<sup>39</sup> Only those firms that need to remain

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32. See 2010 GUIDELINES, *supra* note 6, §§ 9–11 (outlining “Entry,” “Efficiencies,” and “Failure and Exiting Assets” as three mitigating factors in an otherwise problematic merger); *id.* § 7.2 (discussing the structural factors that make an industry vulnerable to coordinated conduct).

33. See *id.* § 1 (stressing the “fact-specific” nature of the agencies’ inquiry into a proposed merger and stating the basic legal principle that “[a] merger enhances market power if it is likely to encourage one or more firms to raise price, reduce output, diminish innovation, or otherwise harm customers”); see also Baker, *supra* note 23, at 154–56 (discussing the development of antitrust theory from the conclusions of predictive economic modeling).

34. 2010 GUIDELINES, *supra* note 6, § 2.

35. *Id.* § 2.1.5 (section entitled “Disruptive Role of a Merging Party”).

36. *Id.*

37. *Id.*

38. *Id.*

39. Jonathan B. Baker & Carl Shapiro, *Detecting and Reversing the Decline in Horizontal Merger Enforcement*, ANTITRUST, Summer 2008, at 29, 34 (discussing the use of the maverick-firm theory of harm and stating that the agency would need to “identify the likely maverick, and explain how the merger would change the maverick’s incentives so as to make coordination more likely or more effective”).

independent to prevent coordination should be labeled “mavericks.”<sup>40</sup> Being able to identify a true maverick and its incentives is key to understanding the incentives of each of the firms in a postmerger world.<sup>41</sup> This picture of the postmerger world will establish whether, in the words of section 7 of the Clayton Act, “the effect of such acquisition may be substantially to lessen competition.”<sup>42</sup> As a result, to employ this theory, the plaintiff should use a definition that comports with economic principles driving antitrust analysis.<sup>43</sup> As the next several Sections will show, neither the 2010 Guidelines themselves nor the government’s arguments in case filings nor legal scholarship have offered a definition that identifies a subset of firms that must remain independent to retain the incentive to flout coordination.

### *B. Definitions in the Horizontal Merger Guidelines*

Since the 2010 Horizontal Merger Guidelines recommend special protection for maverick firms, it seems obvious that they should enable practitioners to identify firms that require independence. But, in fact, they do not. A “maverick” is defined as “a firm that plays a disruptive role in the market to the benefit of customers,” but the Guidelines never go on to explain what a disruptive role entails.<sup>44</sup> There are merely four examples of general behaviors that “may” indicate a maverick firm.<sup>45</sup> A firm might be a maverick if (1) it “threatens to disrupt market conditions with a new technology or business model,” (2) it has an “incentive to take the lead in price cutting,” (3) it has “the ability and incentive to expand production rapidly using available capacity,” or (4) it “has often

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40. See Baker, *supra* note 23, at 136 (defining a maverick as “the firm that keeps the [other competitors’] price increases lower than they otherwise would have been”).

41. See *id.* at 140–41 (stating that identifying the maverick is the “key” to explaining which changes in market structure are troublesome and why).

42. 15 U.S.C. § 18 (2006).

43. Cf. *United States v. H&R Block, Inc.*, 833 F. Supp. 2d 36, 79–80 (D.D.C. 2011) (suggesting that the maverick-firm theory is unpersuasive since the United States had supplied no definition); David Gilo & Ariel Porat, *The Hidden Roles of Boilerplate and Standard-Form Contracts: Strategic Imposition of Transaction Costs, Segmentation of Consumers, and Anticompetitive Effects*, 104 MICH. L. REV. 983, 1004 (2006) (arguing that the desire of a maverick firm to cut prices directly affects collusion); David Gilo, *The Anticompetitive Effect of Passive Investment*, 99 MICH. L. REV. 1, 5–6 (2000) (discussing how investment in rivals, especially by an aggressive competitor, can harm competition).

44. 2010 GUIDELINES, *supra* note 6, § 2.1.5.

45. *Id.*

resisted otherwise prevailing industry norms to cooperate on price setting or other terms of competition.”<sup>46</sup> These examples are not specific enough to allow a practitioner to identify a subset of firms that require protection. Firms that meet these criteria do not necessarily need to remain independent in order to encourage competition in the industry.

Although the first example of behavior encourages practitioners to protect firms with a new technology or business model, the Guidelines do not indicate which types of technologies or business models necessitate protection. The only clue is that they must “threaten[] to disrupt market conditions,” but without more detail about what constitutes disruption, this guidance is merely conclusory.<sup>47</sup> Furthermore, since the technology or business model would be acquired along with the target firm, it is unclear why the merged firm would not have the same ability to disrupt the market with the technology or business model as the supposed maverick.<sup>48</sup>

Similar problems accompany the other examples of behaviors in which a maverick “may” engage. There are many reasons why a firm might “take the lead in price cutting” or resist “prevailing industry norms to cooperate,” but most of them are not unique to a firm in need of protection. Every firm has an incentive to compete vigorously by dropping price or otherwise undercutting the prevailing norm of cooperation if doing so will expand market share enough to make up for the loss in profit margin.<sup>49</sup> The Guidelines do point out that a firm with excess capacity could be a special case since the firm might have a lower cost of expanding share and a greater ability to undercut prices, but that characteristic is both transferrable and exhaustible.<sup>50</sup> It is transferrable because the excess capacity would still exist postmerger, so there is no reason to think that the merged firm would not play the same role that the acquired firm did premerger. It is exhaustible because the excess capacity would eventually become dedicated to production if the firm kept frustrating coordination attempts by expanding its market share.

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46. *Id.*

47. *Id.*

48. This Note will build on the disruptive-technology idea to suggest that this example gets closest to setting out an acceptable criterion for maverick firms. *See infra* Section II.B.

49. *See Baker, supra* note 23, at 158 (“Firms are led to compete rather than collude by their motive to maximize profits. By lowering price, a firm can increase the quantity it sells. If the additional profit from selling more exceeds the lost profit from cutting price, a firm will find that lowering price raises its profits.” (footnote omitted)).

50. 2010 GUIDELINES, *supra* note 6, § 2.1.5.

The *H&R Block* court specifically called out this troubling aspect of the maverick-firm theory: “The government has not set out a clear standard, based on functional or economic considerations, to distinguish a maverick from any other aggressive competitor.”<sup>51</sup> Although the court noted the criteria supplied by the Guidelines, it refused to use the criteria as a way of identifying a subset of firms that warranted protection.<sup>52</sup> It found instead that TaxACT “play[ed] a special role in this market that constrains prices,” and it engaged in more of a full totality-of-the-circumstances analysis to enjoin the merger.<sup>53</sup> This reasoning suggests that the underlying maverick-firm theory is viable, but that the government needs to provide a more helpful definition of a maverick firm that comports with the goals of antitrust law in order to rely on the classification as a shortcut.

### *C. Definitions in Recent Merger Cases*

The antitrust agencies’ filings could be another place to find criteria suggesting how to distinguish a maverick firm from a mere vigorous competitor. Since the agencies must allege a plausible theory of anticompetitive harm in order to sustain an action,<sup>54</sup> one might expect that they would provide a more helpful definition in the filings than they do in the Guidelines. However, recent filings (those filed since the 2010 Guidelines were released) do not identify criteria for a subset of firms that need to remain independent in order to encourage competition in their industries.

Over the last three years (FY 2009–FY 2011), the DOJ and the FTC have filed section 7 complaints<sup>55</sup> in a combined total of eighty-two cases.<sup>56</sup> Of those eighty-two complaints, five indicated that the

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51. United States v. H&R Block, Inc., 833 F. Supp. 2d 36, 79 (D.D.C. 2011).

52. *Id.* at 79–80.

53. *Id.* at 80.

54. *See, e.g.*, Bell Atlantic Corp. v. Twombly, 550 U.S. 544, 545 (holding that evidence of mere parallel conduct without a theory of anticompetitive harm was insufficient to survive the pleading requirement on a motion to dismiss).

55. Or the equivalent, in the case of the FTC.

56. *See* FTC, MERGER ENFORCEMENT ACTIONS – FY 2011, available at <http://www.ftc.gov/bc/caselist/merger/total/2011.pdf> (listing the Agency’s 2011 merger enforcement actions); FTC & U.S. DEP’T OF JUSTICE, HART-SCOTT-RODINO ANNUAL REPORT FISCAL YEAR 2010 (2011) [hereinafter HSR 2010 ANNUAL REPORT], available at <http://www.ftc.gov/os/2011/02/1101hsrreport.pdf> (providing data on FTC and DOJ enforcement actions in 2010); FTC & U.S. DEP’T OF JUSTICE, HART-SCOTT-RODINO ANNUAL REPORT FISCAL YEAR 2009 (2010), available at <http://www.ftc.gov/os/2010/10/101001hsrreport.pdf> (providing data on FTC and DOJ enforcement actions in 2009).

complaining agency objected at least partially on the grounds that one of the firms played a “disruptive role” in the industry.<sup>57</sup> Three of those cases were settled out of court (AT&T/T-Mobile, Ticketmaster/Live Nation, Dean Foods/Foremost Farms),<sup>58</sup> one was dropped by the agency after it lost its motion for preliminary injunction (LabCorp/Westcliff),<sup>59</sup> and one went to verdict for the government (H&R Block/TaxACT).<sup>60</sup> These cases demonstrate how the enforcement agencies employ the maverick-firm theory. Each reference to the theory demonstrates a significant lack of clarity over how the maverick firm was identified as such. If there is any unifying theme, it is that a maverick firm is one that consistently prices below its competitors, which is—again—the incentive of every firm acting competitively.

The proposed AT&T/T-Mobile merger involved the market for mobile wireless telecommunications services.<sup>61</sup> AT&T Inc. was the second-largest provider of those services and was looking to acquire T-Mobile USA, Inc., the fourth-largest provider.<sup>62</sup> The only other nationwide networks were operated by Verizon Wireless and Sprint Nextel Corp.<sup>63</sup> The DOJ’s theory of anticompetitive harm from the merger focused on characterizing T-Mobile as an “aggressive competitor.”<sup>64</sup> The DOJ pointed to T-Mobile’s history of innovation and

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57. Amended Complaint, *United States v. AT&T Inc.*, No. 11-01560 (D.D.C. Sept. 16, 2011), available at <http://www.justice.gov/atr/cases/f275100/275128.pdf>; Complaint, *United States v. H&R Block Inc.*, 833 F. Supp. 2d 36 (D.D.C. 2011) (No. 1:11-CV-00948), available at <http://www.justice.gov/atr/cases/f271500/271579.pdf>; Complaint (Public Version), *Lab. Corp. of Am.*, FTC No. 9345 (Nov. 30, 2010), available at <http://www.ftc.gov/os/adjpro/d9345/1012011apcorpcompt.pdf>; Complaint, *United States v. Ticketmaster Entm’t, Inc.*, No. 1:10-CV-00139 (D.D.C. Jan. 25, 2010), available at <http://www.justice.gov/atr/cases/f254500/254552.pdf>; Complaint, *United States v. Dean Foods Co.*, No. 10-C-0059 (E.D. Wis. Jan. 22, 2010), available at <http://www.justice.gov/atr/cases/f254400/254455.pdf>.

58. See Final Judgment, *United States v. Dean Foods Co.*, No. 10-C-59 (E.D. Wis. July 29, 2011), available at <http://www.justice.gov/atr/cases/f273400/273469.pdf> (settling the case and entering final judgment for the parties); HSR 2010 ANNUAL REPORT, *supra* note 56, at 10 (describing the consent decrees approved in the *Ticketmaster* case); Press Release, U.S. Dept of Justice, *supra* note 3 (announcing AT&T dropped its bid to purchase T-Mobile).

59. Order Returning Matter to Adjudication and Dismissing Complaint, *In re Lab. Corp. of Am.*, FTC No. 9345 (Apr. 21, 2011), available at <http://www.ftc.gov/os/adjpro/d9345/110421labcorporder.pdf>; Order Denying Preliminary Injunction, *FTC v. Lab. Corp. of Am.*, No. SACV 10-1873 AG (MLGx) (C.D. Cal. Mar. 11, 2011), 2011 WL 3100372 (denying the government’s request for preliminary injunction).

60. *United States v. H&R Block, Inc.*, 833 F. Supp. 2d 36, 92 (D.D.C. 2011).

61. Amended Complaint, *United States v. AT&T Inc.*, *supra* note 57.

62. *Id.* ¶¶ 7–8.

63. *Id.* ¶ 2.

64. *Id.* ¶ 27.

the fact that it had positioned itself as a “value option.”<sup>65</sup> It also relied on internal documents to show that T-Mobile had expressed that it would engage in a “challenger” strategy and that it had used “disruptive pricing” plans.<sup>66</sup> The DOJ drew on this evidence to invoke the maverick-firm theory of anticompetitive harm: “[T-Mobile’s] new aggressive and innovative pricing plans, low-priced smartphones, and superior customer service would have been likely to disrupt current industry models and require competitive responses from the other national players.”<sup>67</sup> However, it did not define “disrupt” or explain why those innovations and low prices should be considered unique or nontransferrable to AT&T.

In Ticketmaster/Live Nation, the DOJ sought to block the proposed merger in the market for “primary ticketing services . . . to major concert venues in the United States.”<sup>68</sup> Ticketmaster was “dominant” in this market because its share allegedly exceeded eighty percent.<sup>69</sup> It was looking to acquire Live Nation, the nation’s largest concert promoter, which had just recently launched a competing ticketing service for its own venues and planned to expand similar service to third-party concert venues.<sup>70</sup> The DOJ filed suit to enjoin the merger on the theory that Live Nation was a unique firm worthy of protection because it had a different business model that gave it “economic incentives” to reduce the price of ticketing-service fees.<sup>71</sup> The complaint invoked the language of the maverick-firm theory when it described Live Nation’s ascent: “Thus, entry into primary ticketing created an opportunity for Live Nation to increase its overall profit margin and disrupt Ticketmaster’s business model by lowering service fees.”<sup>72</sup> Though the use of the word “disrupt” suggested that Live Nation’s business model was unique, the complaint failed to define how disruptive competition is different from the normal competition that a dominant firm like Ticketmaster would always prefer to eliminate.

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65. *Id.*

66. *See id.* (citing a T-Mobile presentation that described the firm as “the No. 1 value challenger of the established big guys in the market”); *id.* ¶¶ 4, 15, 16, 18 (referring to disruptive pricing).

67. *Id.* ¶ 36.

68. Complaint, *United States v. Ticketmaster Entm’t, Inc.*, *supra* note 57, ¶ 1.

69. *Id.* ¶ 2.

70. *Id.* ¶ 3.

71. *Id.* ¶ 4.

72. *Id.* ¶ 28.

In Dean Foods/Foremost Farms, the DOJ sought to reverse an already-consummated merger between two fluid-milk suppliers.<sup>73</sup> Prior to the merger, Dean Foods's Dairy Group was the country's largest processor and distributor of milk, and Foremost Farms was a small, local cooperative of independent dairy farmers serving the Wisconsin area.<sup>74</sup> The DOJ pointed to the unique traits of Foremost Farms in arguing that the merger had resulted in anticompetitive harm: it described Foremost Farms as "a significant, disruptive, and aggressive competitor"<sup>75</sup> and pointed specifically to Foremost's history of "dangerous" and "irrational" price cuts, explaining this behavior by reference to the independent producers' excess capacities.<sup>76</sup> The DOJ also indicated that it was relying at least in part on a maverick-firm theory of anticompetitive harm when it argued that entry would not suffice to keep the industry competitive.<sup>77</sup> The complaint stated that none of the other milk suppliers in the area could expand supply "to disrupt coordinated interaction by Dean and its remaining competitors in the fluid milk market."<sup>78</sup> While the complaint alleged examples of Foremost's behavior that fit the examples of maverick-firm behavior in the Guidelines, it did not identify which aspects of this behavior could not be replicated in the postmerger world.

In these three cases, the parties settled the suits by consent decree, and so it is not possible to observe whether the courts would have been persuaded by the government's poorly defined maverick-firm theory. However, in the following two cases, the courts did get a chance to respond.

In LabCorp/Westcliff, the FTC sought to reverse a transaction in which LabCorp acquired all of Westcliff's assets and became one of only two competitors in the clinical-laboratory-testing market in Southern California.<sup>79</sup> The FTC explicitly identified Westcliff as a "price-cutting maverick competitor" whose removal from the market would "allow LabCorp to exercise market power both unilaterally by increasing prices on its own, or in coordination with its only remaining

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73. Complaint, *United States v. Dean Foods Co.*, *supra* note 57, ¶ 1.

74. *Id.* ¶¶ 20, 22.

75. *Id.* ¶ 47.

76. *Id.* ¶¶ 3, 24.

77. *Id.* ¶ 52.

78. *Id.*

79. Memorandum in Support of FTC's Motion for Temporary Restraining Order and Preliminary Injunction at 1, *FTC v. Lab. Corp. of Am.*, No. 10-ap-01564 (D.D.C. Dec. 2, 2010), ECF No. 31-2.

significant competitor, Quest.”<sup>80</sup> In an attempt to explain why Westcliff should be considered a “price-cutting maverick competitor,” the FTC pointed to the company’s background: “As an upstart competitor seeking to expand its share of physician group business, Westcliff had the incentive to win business by pricing capitated contracts aggressively, and did so.”<sup>81</sup> The administrative complaint went on to detail the various ways in which Westfall priced below the two other major players, LabCorp and Quest.<sup>82</sup> The FTC’s motion for preliminary injunction provided more detail and evidence to support the market definition and other elements of the case, but no evidence to demonstrate why Westfall required independence.<sup>83</sup> The motion for preliminary injunction was denied; the court was apparently unmoved by the maverick-firm theory of competitive harm.<sup>84</sup> It held that the FTC incorrectly defined the market, suggesting that the FTC’s shortcut around the structural argument was not compelling evidence of anticompetitive harm.<sup>85</sup>

Finally, in H&R Block/TaxACT, the DOJ sought to prevent the second-largest provider of digital do-it-yourself tax preparation from acquiring the third-largest provider.<sup>86</sup> The DOJ’s argument for protecting TaxACT as a maverick was extensively developed in all the pre-trial filings.<sup>87</sup> Nowhere, however, did the DOJ define what a maverick is. It simply applied the label on two grounds: (1) the parties’ internal documents referred to TaxACT as a “tax industry

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80. Complaint (Public Version) ¶ 4, *In re* Lab. Corp. of Am., FTC No. 9345 (Dec. 1, 2010), available at <http://www.ftc.gov/os/adjpro/d9345/101201lapcorpcmpt.pdf>.

81. *Id.* ¶ 26.

82. *Id.*

83. Memorandum in Support of FTC’s Motion for Temporary Restraining Order and Preliminary Injunction, *supra* note 79, at 6–42.

84. Order Denying Preliminary Injunction, *supra* note 59, at \*23 (denying the government’s request for preliminary injunction).

85. *Id.*; see also Clifford H. Aronson et al., *California District Court Denies Federal Trade Commission Request for a Preliminary Injunction in Medical Laboratory Merger Case*, SKADDEN, ARPS, 2 (March 3, 2011), [http://www.skadden.com/newsletters/California\\_District\\_Court\\_Denies\\_Federal\\_Trade\\_Commission\\_Request.pdf](http://www.skadden.com/newsletters/California_District_Court_Denies_Federal_Trade_Commission_Request.pdf) (commenting that shifting the emphasis away from market definition and toward alternative tools in the new Horizontal Merger Guidelines was not persuasive to the court).

86. See *United States v. H&R Block, Inc.*, 833 F. Supp. 2d 36, 44 (D.D.C. 2011) (“The proposed acquisition challenged in this case would combine HRB and TaxACT, the second and third most popular providers of DDIY products, respectively.”).

87. Complaint, *United States v. H&R Block, Inc.*, *supra* note 57, ¶¶ 28–36; Plaintiff’s Memorandum of Points and Authorities in Support of its Motion for a Preliminary Injunction at 5–10, *United States v. H&R Block*, 833 F. Supp. 2d 36 (D.D.C. 2011) (No. 11-00948) [hereinafter H&R Block PI Memo], available at <http://www.justice.gov/atr/cases/f273600/273683.pdf>.



maverick,”<sup>88</sup> and (2) the firm had a “history” of making the most competitive offerings in the tax-preparation industry<sup>89</sup>—it started the trend of offering some products for free.<sup>90</sup> The DOJ’s memorandum treated “maverick” as a synonym for “competing aggressively with low prices and product innovation,” or as a label that follows from the observation that the company “take[s] market share at the expense of its competitors.”<sup>91</sup> But neither of these descriptions explains why coordination would follow if H&R Block acquired TaxACT; all companies, including the hypothetical postmerger H&R Block, have the incentive to compete aggressively and try to capture the market with lower prices or better products. The DOJ also applied the “disruptive” label to TaxACT’s conduct, but with no more satisfying explanation.<sup>92</sup> It relied mostly on quoted language from internal documents to make the case.<sup>93</sup>

In arguing for special protected status for TaxACT, the DOJ invoked conclusory statements that do not suggest why firms that have been labeled “mavericks” should be treated differently. In fact, the memorandum in support of preliminary injunction merely reinforced the impression that there is no difference between any normal competitor (which would be expected to compete “aggressively”) and a firm playing a disruptive role in the industry. The DOJ only cited one case for the proposition that acquiring a maverick will substantially lessen competition: *FTC v. Libbey, Inc.*, which merely states that an “important consideration when analyzing possible anticompetitive effects” is whether the acquisition “would result in the elimination of a particularly aggressive competitor in a highly concentrated market.”<sup>94</sup>

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88. H&R Block PI Memo, *supra* note 87, at 2.

89. *See id.* (quoting internal documents saying that TaxACT “has consistently forced the tax preparation industry to become more competitive, and in doing so has forced its competitors to change as well”).

90. *Id.* at 5–7.

91. *See id.* at 1 (supporting its labeling TaxACT as a “maverick”); *id.* at 6 (calling such a competitive strategy a “maverick offer”); *see also id.* at 9 (“Over the years, TaxACT has continued to disrupt the market and gain share through its maverick behavior and strategy of offering highly functional products at comparatively low prices.”).

92. *See, e.g., id.* at 9–10 (“Ultimately though, HRB would determine that purchasing TaxACT was a better way to ‘eliminate’ TaxACT’s ‘disruptive’ maverick conduct.” (quoting exhibits)).

93. *Id.*

94. *FTC v. Libbey*, 211 F. Supp. 2d 34, 47 (D.D.C. 2002) (citing *FTC v. Staples*, 970 F. Supp. 1066, 1083 (D.D.C. 1997)).

These instances from the last three years of merger enforcement demonstrate that the enforcement agencies use a maverick-firm theory of the case when one of the firms has a history of pricing below its competitors. But as the court pointed out in *H&R Block*, this aggressive competition is not a unique characteristic that suggests a particular anticompetitive outcome postmerger.<sup>95</sup> A firm may be able to consistently price below competitors because it is a more efficient producer, or because it has excess capacity. Those benefits would be acquired by any purchasing firm, so there is not necessarily a reason to worry about a merger in those instances. Therefore, the agencies' recent case filings shed no additional light on a way to identify low-cost firms that require special protection under antitrust law.

#### *D. Definitions in Legal Scholarship*

Several antitrust scholars have written on the maverick-firm theory of harm in mergers, but none have provided criteria to identify a firm that truly deserves the maverick label. Most fail to distinguish between a firm that requires independence to constrain coordination and a firm that aggressively competes.

David Gilo has written on the collusive effects that result from different business tactics such as passive investment<sup>96</sup> and standard-form contracts.<sup>97</sup> Integral to his analyses is what effect these business tactics have on maverick firms.<sup>98</sup> In discussing these effects, Gilo references the maverick firms of the Guidelines, but only assumes a definition that facilitates his inquiry.<sup>99</sup> Without any support, he states: "[T]he firm most eager to cut prices is the only firm whose incentives matter. If it prefers to cut prices, collusion breaks down, and if it prefers not to cut prices, collusion is sustainable. Antitrust agencies call such firms 'maverick firms.'<sup>100</sup> In another paper, Gilo avoids defining the term by providing a parenthetical description:

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95. See *United States v. H&R Block, Inc.*, 833 F. Supp. 2d 36, 79 (D.D.C. 2011) ("Here, the record is clear that while TaxACT has been an aggressive and innovative competitor in the market, as defendants admit, TaxACT is not unique in this role.").

96. Gilo, *supra* note 43, at 5–6.

97. Gilo & Porat, *supra* note 43, at 1004.

98. See *id.* (discussing how boilerplate can help a "maverick . . . raise its profits by making collusion sustainable"); Gilo, *supra* note 43, at 8 (outlining that the paper will "examine . . . the legal implications of passive investment by a maverick firm").

99. Gilo & Porat, *supra* note 43, at 1004.

100. *Id.*

“[Antitrust agencies] inquire as to whether the merger involves the acquisition of a maverick (i.e., an inherently more aggressive) firm.”<sup>101</sup> Such descriptions assume the answer that antitrust enforcers should seek when trying to decide whether a particular firm deserves protection under the maverick-firm theory of harm. The real questions are why the firm prefers to cut prices, or compete aggressively, and whether the postmerger firms would do so in that firm’s absence.

In one of his papers, Gilo explains in more detail that a maverick firm is one that has an incentive to undercut competitors in the short term, while the other competitors remain at a collusive price.<sup>102</sup> This, he argues, is irrational because the other competitors will never remain at the collusive price, and “all firms, including the maverick, usually earn lower profits than they could have earned had collusion been sustainable.”<sup>103</sup> Of course, Gilo is just describing the classic problem of coordination; this rationale demonstrates that his view of the maverick does not differ from that of a traditional, vigorous competitor.

Another scholarly piece, by David T. Scheffman and Mary Coleman, seeks to quantify the potential competitive effects from eliminating a maverick.<sup>104</sup> But this paper, too, offers a definition that is impossible to meaningfully distinguish from that of a traditional competitor:

Under this [“Removal of a Maverick”] theory, there is compelling evidence that a particular competitor (the maverick) has been a *particularly* aggressive competitor—i.e., the impact of the maverick’s loss is not just from the loss of a competitor but from the loss of a particularly aggressive competitor. In simple terms, the competitive significance of the maverick is significantly greater than would be indicated by its market share.<sup>105</sup>

These authors seem to want to imbue some special meaning to the phrase “*particularly* aggressive” as it modifies the notion of a competitor, but as discussed above, traditional competitors are expected to behave aggressively, consistent with their incentive to win the most customers at the most profitable price possible. Unless these authors mean to suggest that there is some sort of personal aggressive vendetta, or irrationality, behind the behavior of a maverick firm, their definition does not point out any enduring characteristics that

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101. Gilo, *supra* note 43, at 5.

102. Gilo & Porat, *supra* note 43, at 1004.

103. *Id.*

104. David T. Scheffman & Mary Coleman, *Quantitative Analyses of Potential Competitive Effects from a Merger*, 12 GEO. MASON L. REV. 319, 319–20 (2003).

105. *Id.* at 321 (emphasis in original).

suggest the firm is unique in its ability to thwart coordination. It does not distinguish a firm that must remain independent from a common competitor. While their discussion is not incorrect—a maverick will be an aggressive competitor—it fails to assist practitioners in identifying what characteristics make the maverick firm unique in its ability to undercut and disrupt coordination.

Jonathan B. Baker gets closer to laying out a set of criteria for identifying a firm deserving of the maverick label.<sup>106</sup> He recognizes that, before advocating for protection, plaintiffs and courts will need to understand why a maverick behaves in a particularly aggressive way and whether that behavior is unique to the unmerged firm.<sup>107</sup> In so doing, he recognizes that the Guidelines do not themselves define maverick firms in need of protection, but argues that “three strategies are available” to a plaintiff who wants to show that one firm plays a unique role in constraining prices.<sup>108</sup> He calls these strategies “revealed preference,” “natural experiments,” and “the *a priori* factors approach.”<sup>109</sup>

The “revealed preference” strategy looks to past pricing behavior to see if a particular firm is consistently offering the lowest prices or failing to follow other competitors’ price increases.<sup>110</sup> This is the same criteria that the scholars and cases cited above have used.<sup>111</sup> However, this past behavior, even if it has been consistent, does not necessarily mean that the firm’s incentive to undercut prices and expand market share is unique among its competitors. Even if it is, the characteristics causing this unique quality could transfer to the merged firm after an acquisition. Therefore, this evidence alone does not suggest that the antitrust laws should protect the identified firm.

The “natural experiment” approach suffers the same problem. It looks to see if an industry’s prices change when the particular firm in question experiences a change in its marginal costs.<sup>112</sup> While this

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106. See Baker, *supra* note 23, at 173–77 (section entitled “Identifying the Maverick”).

107. *Id.* at 163; see also Baker & Shapiro, *supra* note 39, at 34 (stating that, under the authors’ way of analyzing coordinated effects, the plaintiff would need to “identify the likely maverick, and explain how the merger would change the maverick’s incentives so as to make coordination more likely or more effective”).

108. Baker, *supra* note 23, at 173.

109. *Id.* at 174–75.

110. See *id.* at 174 (citing Northwest Airlines as an example of a maverick firm identified with the revealed preference strategy because it “failed to raise prices” and “forced” the rest of the airlines to rescind price increases).

111. See discussion *supra* Sections I.B–C (discussing the Horizontal Merger Guidelines and several recent merger cases).

112. Baker, *supra* note 23, at 174.

strategy may be able to identify a low-cost firm that is constraining prices, it says nothing about how long its cost savings would endure or how an acquiring entity would incorporate the cost savings into its business strategy postmerger.

Finally, the “*a priori* factors approach” suggests that a firm’s characteristics can indicate that it is both a constraint on industry prices and that its acquisition would remove that constraint.<sup>113</sup> However, Baker stops short of naming the particular characteristics that a practitioner could observe to indicate this special maverick status. He argues that, all other things being equal, a maverick is likely to have a relatively small market share and the ability to “expand sales inexpensively.”<sup>114</sup> These characteristics ensure that the firm will get a greater benefit from a lower price, relative to incumbents with larger market share.<sup>115</sup> While this observation does explain why the firm is uniquely likely to thwart coordination, it still falls short of laying out criteria that a practitioner could use to identify a firm that needs to remain independent to protect competition. A firm that can expand sales inexpensively may also be able to pass that advantage on to an acquiring firm, which would still have the incentive to increase market share further. Therefore, it cannot be that every low-cost, low-market share firm is deserving of protection. The maverick label will only be meaningful when the *a priori* factors indicate that a firm has an advantage that not only stokes aggressive competition but also would be destroyed in a merger. The goal of the next Part is to isolate the characteristics that all those firms have in common so that a practitioner can use them to identify firms truly worthy of the maverick label.

## II. USING THE THEORY OF DISRUPTIVE INNOVATION TO DEFINE A MAVERICK

This Note has so far demonstrated that the Guidelines, recent DOJ and FTC filings, and legal scholarship have only established a list of traits that a practitioner might see in a maverick firm: it might consistently offer low prices, its product offering or business model might be innovative, and it might be able to rapidly expand production (via excess capacity or otherwise). Although these traits may be common among maverick firms, none of them necessarily requires

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113. *Id.* at 175–76.

114. *Id.*

115. *Id.* at 175.

independence to encourage competition in the industry. A further sub-classification is necessary to identify firms that must remain stand-alone entities. The business-management literature provides a potential subset of firms that also exhibit these traits: they are known as disruptive innovators.<sup>116</sup>

#### A. What Is a Disruptive Innovator?

A disruptive innovator is a term of art coined by Clayton Christensen of Harvard Business School.<sup>117</sup> Put simply, a disruptive innovator uses a new technology or business model to introduce a product or service that performs worse than the products or services being sold by the incumbents in the industry.<sup>118</sup> The fact that the product is worse is what ultimately leads to its success.<sup>119</sup> This concept is incredibly counterintuitive, which is why it took Christensen an entire book—*The Innovator's Dilemma*<sup>120</sup>—to credibly support his theory. He uses several case studies describing the success of startup companies with products that seemed laughable to the dominant players in the industry, whose products were superior in every way that had ever mattered.<sup>121</sup> The disruptive innovator is able to stick around, however, because it is able to serve a very specific part of the population: those who do not need superior performance.<sup>122</sup> The disruptive innovator's foot in the door is that it does a bad job cheaply, so its prices are lower for customers who can accept that tradeoff.<sup>123</sup>

This setup produces successful results time and time again because the dominant players in the industry are too focused on their “best” customers, for whom the cheaper, shoddier solution is

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116. CHRISTENSEN, *supra* note 16, at xv.

117. David Whelan, *Clayton Christensen: The Survivor*, FORBES.COM (Feb. 23, 2011), <http://www.forbes.com/forbes/2011/0314/features-clayton-christensen-health-care-cancer-survivor.html> (describing that the author originated the moniker “principles of disruptive innovation”).

118. CHRISTENSEN, *supra* note 16, at xviii.

119. *Cf. id.* (“Ironically, in each of the instances studied in this book, it was a disruptive technology that precipitated the leading firms’ failure.”).

120. *Id.*

121. *See id.* at xx–xxi (summarizing the contents of the book as containing examples from the markets for hard disk drives, earthmoving machines, steelmakers, retail shopping, printers, personal digital assistants, motorcycles, computers, accounting software, and insulin); *see also id.* at xxix (presenting a table of established technologies and their disruptive corollaries).

122. *See id.* at xv (describing disruptive innovations as having “other features that a few fringe (and generally new) customers value”).

123. *See id.* (“Products based on disruptive technologies are typically cheaper, simpler, smaller, and, frequently, more convenient to use.”).

undesirable.<sup>124</sup> Furthermore, the typically small market share that is available to a disruptive innovator does not serve the growth needs of a large, successful firm.<sup>125</sup> Therefore, the incumbents are lulled into complacency while the disruptive innovator is able to improve its product or service without interference.<sup>126</sup> Eventually, the disruptive innovator's cheaper way of doing things catches up to the incumbents' traditional ways, and it becomes truly substitutable for even the best, most demanding customers.<sup>127</sup> By this point, it is often too late for the incumbents to react.<sup>128</sup>

While this Note cannot replicate Christensen's prolific writings on this theory and its applicability to industries of all types,<sup>129</sup> a commonplace example serves to illustrate. Most people are probably familiar with the role of disruptive innovation in a contemporary market: movie rentals. Remember when movie rentals came from Blockbuster or Hollywood Video? With hindsight, it is obvious that Netflix, Redbox, and iTunes were fierce competitors for the retail chains—so why did Blockbuster wait until it was too late to begin a subscription service like Netflix's? The likely reason is that Blockbuster saw Netflix as an inferior business model—its selection was not as good, consumers could not get the movies on a last-minute impulse, and it did not have priority contracts for new releases.<sup>130</sup> Blockbuster's best customers were those who wanted all these features, and so the firm was unable to see Netflix as a true competitor. But for a specific group of customers, the tradeoff made sense to avoid late fees. And, as history has shown, Netflix was able to leverage this advantage for long enough to become a good substitute for the Blockbuster experience, even for the most demanding customers, by investing in novel methods of distribution such as live streaming and by expanding its content.<sup>131</sup>

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124. *See generally id.* at xxiii–xxviii (outlining five principles for why successful incumbent firms fail to catch on to disruptive technologies).

125. *Id.*

126. *Id.*

127. *See id.* at xvi (showing that disruptive innovations improve over time).

128. *Id.* at xv.

129. For a more detailed treatment, see generally CLAYTON M. CHRISTENSEN, ERIK A. ROTH & SCOTT D. ANTHONY, *SEEING WHAT'S NEXT: USING THEORIES OF INNOVATION TO PREDICT INDUSTRY CHANGE* (2004); CLAYTON M. CHRISTENSEN & MICHAEL E. RAYNOR, *THE INNOVATOR'S SOLUTION* (2003); CHRISTENSEN, *supra* note 16.

130. *See generally* Adam Richardson, *Netflix's Bold Disruptive Innovation*, HARV. BUS. REV. BLOG NETWORK (Sept. 17, 2012, 9:35 PM), [http://blogs.hbr.org/cs/2011/09/netflix\\_bold\\_disruptive\\_innovation.html](http://blogs.hbr.org/cs/2011/09/netflix_bold_disruptive_innovation.html) (describing Netflix as an example of a disruptive innovator).

131. *Id.*

More than just a way to describe companies, the business-management literature treats the theory of disruptive innovation as a way to predict the future of industries.<sup>132</sup> Christensen's startling prediction is that disruptive innovators end up toppling the dominant players in the industry because those dominant players cannot do what the disruptive innovator does.<sup>133</sup> This is because incumbent firms have management systems and cultures that prevent the success of disruptive strategies.<sup>134</sup> For instance, incumbents are accustomed to driving growth through higher profit margins, which makes the low profit margins necessary for a disruptive strategy unattractive, so the incumbents pass up the opportunity to capture that segment of the market.<sup>135</sup> The culture at large incumbent firms tends to reward big investment opportunities, and the niche demand for disruptive innovation is not "large enough to be interesting."<sup>136</sup> Additionally, market research usually cannot uncover how consumers hope their products will be worse, so all of an incumbent's data tends to counsel away from the disruptive strategy.<sup>137</sup> These characteristics make incumbent firms inherently inhospitable to disruptive strategies. Christensen goes so far as to instruct incumbent firms to "creat[e] an independent organization" if they want to pursue a disruptive strategy.<sup>138</sup>

*B. The Characteristics of a Disruptive Innovator Are Consistent with the Guidelines' Description of a Maverick Firm*

The business-management theory of disruptive innovation defines a category of firms that have the same characteristics that the 2010 Horizontal Merger Guidelines describe as being typical of a "maverick" firm.<sup>139</sup>

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132. See generally CHRISTENSEN, ROTH & ANTHONY, *supra* note 129 (treating disruptive innovation as a way to predict the future of industries).

133. CHRISTENSEN, *supra* note 16, at xi.

134. See *id.* at xxii ("If good management practice drives the failure of successful firms faced with disruptive technological change, then the usual answers to companies' problems . . . all exacerbate the problem.").

135. See *id.* at xx ("Hence, most companies with a practiced discipline of listening to their best customers and identifying new products that promise greater profitability and growth are rarely able to build a case for investing in disruptive technologies until it is too late.").

136. *Id.*

137. See *id.* at xxi (section entitled "Markets that Don't Exist Can't be Analyzed").

138. *Id.* at xxiv.

139. The 2010 GUIDELINES, *supra* note 6, § 2.1.5, state:



First, a disruptive innovator always utilizes “a new technology or business model.”<sup>140</sup> Furthermore, an acquisition would result in that technology being discarded because the incumbent firm usually believes that it is not and cannot be good enough for the best customers (the ones it is focused on serving). This would result in anticompetitive harm because the least-demanding consumers would have to pay more for performance that they do not need or want, raising the price in the short run and preventing the lower-cost firm from innovating to serve the needs of the more demanding customers in the long run.

Second, the theory of disruptive innovation is consistent with the description that the firm “may have the incentive to take the lead in price cutting or other competitive conduct or to resist increases in industry prices.”<sup>141</sup> The disruptive innovator has the incentive to take the lead in price cutting because that is its value proposition to a niche market. This approach differs from that of the incumbents, which usually have the goal of best-in-class design.

Finally, a disruptive innovator will “often resist[] otherwise prevailing industry norms to cooperate on price setting or other terms of competition.”<sup>142</sup> This is because the disruptive innovator will be an outsider to the group of incumbents that have the most to gain from tacit coordination. Moreover, the incentive to collude will be low because the differentiated price point is the feature on which the disruptive innovator is likely to base its strategy.

The characteristics of a disruptive innovator are also consistent with observations about mavericks in the agencies’ filings and the field’s legal scholarship: Disruptive innovators consistently price below competitors and produce goods or services more inexpensively, due to the strategy of trading off performance for price. They even

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The Agencies consider whether a merger may lessen competition by eliminating a “maverick” firm, i.e., a firm that plays a disruptive role in the market to the benefit of customers. For example, if one of the merging firms has a strong incumbency position and the other merging firm threatens to disrupt market conditions with a new technology or business model, their merger can involve the loss of actual or potential competition. Likewise, one of the merging firms may have the incentive to take the lead in price-cutting or other competitive conduct or to resist increases in industry prices. A firm that may discipline prices based on its ability and incentive to expand production rapidly using available capacity also can be a maverick, as can a firm that has often resisted otherwise prevailing industry norms to cooperate on price setting or other terms of competition.

140. *Id.*

141. *Id.*

142. *Id.*

usually have small market shares, due to the common strategy of targeting a niche segment of the market first.

*C. The Acquisition of a Disruptive Innovator Will Have Anticompetitive Effects*

The theory of disruptive innovation goes beyond the Guidelines' description of a maverick by providing criteria that a practitioner can use to identify which low-cost firms must remain independent to continue constraining prices in the future. This is because the acquisition of a disruptive innovator will result in the loss of a unique value proposition for the consumer. As Clayton Christensen predicts, disruptive strategies are almost always unsuccessful when attempted from inside incumbent firms, and so the acquiring firm will be highly unlikely to offer the disruptive product or service.<sup>143</sup> This will result in higher prices (when the disruptive strategy had been based on trading off performance for price) and less innovation (as often occurs when a disruptive innovator has the chance to keep improving its product). Therefore, the acquisition of a disruptive innovator is likely to result in the loss of those characteristics that created fierce downward pressure on price and the incentive to innovate.

These anticompetitive effects are exactly what the Guidelines seem to anticipate in suggesting that maverick firms should be protected. As such, the antitrust agencies should amend the Guidelines and adopt the definition of a disruptive innovator as a set of criteria for identifying maverick firms that need protection under the antitrust laws.

III. THE ANTITRUST AGENCIES SHOULD USE THE DISRUPTIVE INNOVATION TEST TO DEFINE A MAVERICK FIRM

*A. The Disruptive Innovation Test and Its Benefits*

When regulators or courts observe a firm with a large market share and an established brand trying to acquire a low-cost competitor, they should look to the theory of disruptive innovation to determine if the low-cost competitor must remain independent to constrain coordination in the industry. If they identify a disruptive innovator, they should apply the label of "maverick" and employ the presumption of anticompetitive harm. Summarizing Section II.B, the

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143. See discussion *supra* Section II.B.

criteria for a disruptive innovator are: (1) the firm offers a product or service that is worse in some way than the traditional offerings, (2) the poor quality is accompanied by a lower price (or some other innovative benefit), and (3) the product or service only works well for a niche segment of consumers who substitute away from the traditional competitors.<sup>144</sup>

The benefits of adopting the disruptive innovation test as the criteria for a maverick firm are threefold. First, as Jonathan B. Baker suggests, understanding the motivations of a firm and the other competitors in the industry helps determine when that firm should be protected.<sup>145</sup> If the disruptive innovation test were adopted as the criteria for a maverick-firm theory, the definitional inquiry would simultaneously resolve the predictive inquiry and indicate the firm's motivations in the hypothetical postmerger world. This would result in regulators using the term of art more judiciously and narrowly, since not every firm that competes aggressively and undercuts price consistently will be a disruptive innovator. The narrow and well-defined criteria would render the maverick label more convincing to courts, too, which would be able to see that analytical rigor, rather than mere rhetorical flourish, is behind a maverick-firm theory of the case.

Second, the clarity of this test would improve the transparency of antitrust enforcement. With a more robust theory for why mavericks should be protected, the DOJ and the FTC could clearly announce that they were applying the maverick-firm theory of anticompetitive harm. This would stand in marked contrast to the approach in recent cases, where the government failed to clearly announce how its observations about the target firms were material to its legal theories.<sup>146</sup> Clear announcement would streamline the order of proof and make judicial management of often-complex antitrust litigation more efficient: the parties would only need to litigate whether the target firm is a disruptive innovator and whether the resulting presumption of liability could be rebutted. Furthermore, announcement would deter problematic mergers in the first place. One of the goals of the Guidelines is to “assist the business community . . . by increasing the transparency of the analytical process underlying

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144. See generally CHRISTENSEN, *supra* note 16, at xviii–xx (discussing the criteria for a disruptive innovator).

145. Baker, *supra* note 23, at 147–48.

146. See discussion *supra* Section I.C (discussing filings of the last three years).

the Agencies' enforcement decisions."<sup>147</sup> If firms knew ahead of time that acquiring a disruptive innovator would receive scrutiny, they could save both their resources and taxpayer dollars from being wasted on litigation to defend anticompetitive deals. Announcing this disruptive innovation test in the Guidelines or in a future case could prevent the anticompetitive deals before they happen.

Finally, the disruptive innovation test would help justify the evidentiary value of internal business documents that refer to "disruption." The government has often relied on quotes from board presentations and other business documents to support the characterization of a firm as disruptive to industry coordination.<sup>148</sup> Under the current approach—where the issue of disruption is merely a conclusory legal theory—these quotes seem like irrelevant lay opinions on an issue of law for the court.<sup>149</sup> The disruptive innovation test, however, would translate those quotes from the business world to the legal world. Because the theory of disruptive innovation has its roots in the field of business management, business leaders' observations about whether firms are disruptive innovators would be extremely relevant evidence that a firm is actually a maverick worthy of protection.

Even though all of these benefits counsel toward adoption of the disruptive innovation test, there is one caution for those applying the test. After establishing that the target firm is a disruptive innovator, the presumption of anticompetitive harm should still be rebuttable. This is particularly important as it applies to the barriers-to-entry defense.<sup>150</sup> Disruptive innovators tend to use business models and technologies that are relatively easy to replicate because their

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147. 2010 GUIDELINES, *supra* note 6, § 1.

148. See discussion *supra* Section I.C (providing examples of such characterizations from filings of the last three years).

149. This is perhaps another reason that the *H&R Block* court seemed so incensed by the government's use of the maverick label and the associated evidence from internal documents, when it was otherwise amenable to the argument that TaxACT played a "special role." See *United States v. H&R Block, Inc.*, 833 F. Supp. 2d 36, 79–80 (D.D.C. 2011) (contrasting disapproval over the maverick label with agreement that TaxACT "play[s] a special role in this market that constrains prices").

150. The barriers-to-entry defense is explained in § 9 of the 2010 GUIDELINES, *supra* note 6. It refers to the fact that even where a merger suggests that the remaining firms will have unilateral power to raise price or will be able to coordinate, other firms may respond to the merger by entering and approximating the role that used to be played by the target firm. If such entry is likely, the law should allow the merger to proceed because the ultimate outcome in the industry will not be anticompetitive.

products are, by definition, lower quality.<sup>151</sup> This lower quality may suggest lower startup costs. In fact, Clayton Christensen points out that one of the main barriers to disruptive innovation is recognizing the market demand for a lower-end product.<sup>152</sup> If a disruptive innovator achieved enough success to warrant an acquisition attempt, then it probably would have demonstrated the market demand, and copycats could have a relatively easy job in replicating that success. Where there are no other structural barriers to entry, this particular set of circumstances could suggest that the postmerger world would be competitive despite the elimination of a disruptive innovator.

*B. Applying the Disruptive Innovation Test to the H&R Block/TaxACT and AT&T/T-Mobile Mergers*

Both of the DOJ's recent cases demonstrate that the government can likely apply the disruptive innovation test where it already has an intuition that a unique low-cost competitor should be protected under the antitrust laws. Both TaxACT and T-Mobile likely meet the definition of a disruptive innovator, and therefore satisfy the criteria of a maverick firm that needs to remain independent to constrain coordination.

TaxACT is likely a disruptive innovator in the retail tax-preparation industry. As a reminder, the three criteria for a disruptive innovator are: (1) the firm offers a product or service that is worse in some way than the traditional offerings; (2) the poor quality is accompanied by lower prices (or some other innovative benefit); and (3) the product or service only works well for a niche segment of consumers who substitute away from the traditional competitors. TaxACT meets all three criteria because it bucked the traditional, highly trusted model and offered its product for free online.<sup>153</sup> The traditional model of one-on-one, in-store assistance is a very high quality, individualized service. Intuit, the maker of TurboTax, was the original disruptive innovator in the field—offering a cheap and crude solution in the form of one-size-fits-all tax-preparation software that

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151. See CHRISTENSEN, *supra* note 16, at xv (“Products based on disruptive technologies are typically cheaper, simpler, smaller, and, frequently, more convenient to use.”).

152. See *id.* at xxi (section entitled “Markets that Don’t Exist Can’t be Analyzed”).

153. See generally *H&R Block*, 833 F. Supp. 2d at 45–46 (summarizing the founding of TaxACT and its free strategy).

users could purchase and install on their computers.<sup>154</sup> TaxACT offered an inferior product to both H&R Block and Intuit, but it did so for *free*. Though the TaxACT brand was likely not well known or trusted, the free online product was probably a good-enough solution for that niche segment of consumers that are less concerned about the security of their data. The disruptive strategy would very likely be unsuccessful inside H&R Block, where the main value proposition throughout the firm's history has been individualized service, which comes with high marginal profits.<sup>155</sup> Additionally, the barriers to entry for startups would probably be relatively high in the short run—preventing TaxACT copycats from filling its role—because consumers likely value using the same service year after year when the service remembers past data entries. Therefore, this merger would likely be illegal under the disruptive innovation version of the maverick-firm theory of anticompetitive harm.

In the mobile telecommunications industry, T-Mobile is also likely a disruptive innovator. Its offering is of lower quality than the offerings of its competitors because its coverage is less comprehensive and it does not have a history of securing relationships with the newest handheld devices.<sup>156</sup> It trades off these disadvantages for lower price: its strategy prior to the proposed merger was to present a smartphone and data-package offer to those customers who could not afford to purchase one from Verizon or AT&T.<sup>157</sup> Given Verizon's and AT&T's race to secure more spectrum and superior coverage,<sup>158</sup> it is

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154. See Clayton Christensen, *Disruptive Innovation*, TEDXBOSTON (July 18, 2011), <http://tedxboston.org/adventure/clayton-christensen-disruptive-innovation> (describing TurboTax as a disruptive innovation).

155. H&R Block PI Memo, *supra* note 87, at 8 (indicating H&R Block's concern that digital solutions would jeopardize brick-and-mortar stores).

156. See, e.g., Christina Bonnington, *T-Mobile Announces LTE, Blames iPhone for Subscriber Losses*, WIRED.COM (Feb. 23, 2012, 3:53 PM), <http://www.wired.com/gadgetlab/2012/02/t-mobile-lte-initiative/> (discussing T-Mobile's inferior performance as being the product of not securing a contract with Apple to carry the iPhone and not offering the superior 4G LTE network to improve data coverage); see also *AT&T Coverage Viewer*, AT&T, <http://www.wireless.att.com/coverageviewer/#?type=voice> (last visited Sept. 18, 2012); *Cell Phone Coverage Maps for Your Calling Coverage Areas*, T-MOBILE, <http://www.t-mobile.com/coverage/pcc.aspx> (last visited Sept. 18, 2012); *Coverage Locator*, VERIZON WIRELESS, <http://www.verizonwireless.com/b2c/support/coverage-locator> (last visited Sept. 18, 2012).

157. See Amended Complaint, *United States v. AT&T Inc.*, *supra* note 57, ¶¶ 32–33 (referring to T-Mobile's plans to make smartphones available to more users by offering prices that AT&T and Verizon cannot match).

158. See, e.g., Scott Mortiz & Todd Shields, *AT&T in Spectrum Spree to Catch Verizon*, BLOOMBERG BUSINESSWEEK, Sept. 5, 2012, <http://www.businessweek.com/news/2012-08-30/at-and-t-amassing-spectrum-deals-in-catch-up-bid-with-verizon> (detailing the race for superior coverage between AT&T and Verizon).

unlikely that this tradeoff is acceptable to more than a niche segment of the population. In fact, T-Mobile's own strategy prior to the proposed merger was to supply this niche segment of the population with a smartphone that they otherwise would not be able to afford.<sup>159</sup> This focus likely indicates that AT&T would have been intolerant of the disruptive strategy once it had acquired T-Mobile. Furthermore, the barriers to entry are quite high for potential copycats: the telecommunications space is highly regulated and bandwidth limitations could prevent startups from entering quickly (or at all).<sup>160</sup> Therefore, the proposed merger would also likely be illegal under the disruptive innovation version of the maverick-firm theory of anticompetitive harm.

### CONCLUSION

The maverick-firm theory of anticompetitive harm needs an overhaul, and this Note suggests a set of criteria that make the maverick label more than just "a game of semantic gotcha." This solution comes at a ripe time, given the government's recent reliance on the maverick label in challenging the H&R Block/TaxACT and AT&T/T-Mobile mergers. Although the DOJ probably would have reached a similar conclusion about these proposed mergers if it applied the solution proposed in this Note, its application of the maverick-firm theory was unnecessarily confusing and failed to meet a basic requirement of antitrust law: showing that postmerger anticompetitive harm is likely.

The disruptive innovation test answers the challenge posed by the *H&R Block* court, which admonished the government for failing to set out "a clear standard, based on functional or economic considerations to distinguish a maverick from any other aggressive competitor."<sup>161</sup> If the government adopts the business-management theory of disruptive innovation as its definition of a maverick, it will be able to show that the target firm is unique in its ability to constrain competitors and that it must remain independent to do so. The theory motivating this test likely already drove some of the logic behind the

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159. See Amended Complaint, *United States v. AT&T Inc.*, *supra* note 57, ¶ 32 ("A key component of T-Mobile's new strategy is to offer 'Disruptive Pricing' plans to attract the estimated 150 million consumers whom T-Mobile believes will want a smartphone but do not have one yet.").

160. See *id.* ¶ 36 (referencing the high barriers to entry in the mobile wireless telecommunications services markets).

161. *United States v. H&R Block, Inc.*, 833 F. Supp. 2d 36, 79 (D.D.C. 2011).

2010 Horizontal Merger Guidelines and recent enforcement actions, but this more specific test will be more persuasive to courts and will allow practitioners to more accurately assess the antitrust implications of acquiring a low-cost firm.

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\* Doctor of Jurisprudence, May 2013, Vanderbilt University Law School. I am grateful to the editors of the VANDERBILT LAW REVIEW for giving me a venue to express these thoughts and for all their help in refining them. I could never have even conceived of this Note without the tutelage of Rebecca Haw, Giorgio Monti, and my colleagues at Innosight LLC—thank you for everything.