

WSGR ALERT

NOVEMBER 2011

FEDERAL DISTRICT JUDGE ISSUES PERMANENT INJUNCTION AGAINST H&R BLOCK'S ACQUISITION OF TAXACT IN *UNITED STATES V. H&R BLOCK, INC.*

On October 31, 2011, the U.S. District Court for the District of Columbia announced its decision to issue a permanent injunction blocking H&R Block's proposed acquisition of the company that markets the TaxACT line of tax-preparation software. The court found that the proposed acquisition would substantially lessen competition in the global market for digital do-it-yourself tax-preparation products. The decision is a noteworthy win for the Department of Justice (DOJ), marking the first time that it has won a merger trial in several years.

The Proposed Transaction

H&R Block markets a line of tax-preparation software under the brand name "H&R Block At Home" (formerly known as "TaxCut"). On October 13, 2010, H&R Block entered into a \$287.5 million agreement to acquire 2SS Holdings, Inc., which markets the tax-preparation software "TaxACT."

The Department of Justice's Challenge

On May 23, 2011, the Antitrust Division of the United States Department of Justice filed a suit challenging the proposed acquisition. The DOJ alleged that H&R Block's acquisition of TaxACT would reduce competition in the market for "digital do-it-yourself tax preparation products" (DDIY products) by 1) eliminating competition between H&R Block At Home products and TaxACT products and 2) facilitating coordinated conduct by H&R Block and Intuit, which markets the TurboTax line of products. H&R Block and TaxACT are the second- and third-largest participants in

the DDIY market, with H&R Block accounting for 15.6 percent of the market and TaxACT accounting for 12.8 percent. In tandem with Intuit (which sells TurboTax and Quicken products), they account for over 90 percent of the DDIY market.

The Honorable Beryl A. Howell of the U.S. District Court for the District of Columbia presided over the nine-day trial in September 2011, and heard final arguments on October 3, 2011. The court announced its decision to block the merger on October 31, 2011, and, after performing redactions proposed by the parties, released a public version of its memorandum opinion in the matter on November 10, 2011.

The Court's Decision

The district court reviewed the DOJ's request for a permanent injunction under the rubric set forth in *United States v. Baker Hughes Inc.*, 908 F.2d 981 (D.C. Cir. 1990). The initial burden was on the government to show that the transaction would lead to "undue concentration" in the relevant product and geographic markets. The likelihood of such undue concentration creates a presumption that the merger is anticompetitive, and it then falls to the defendants to rebut the presumption by showing that the post-merger market concentration gives an "inaccurate account" of the likely impact of the merger on competition. If the defendants succeed, then the burden shifts back to the government to bring forward other evidence showing that the merger is likely to be anticompetitive.

Relevant Market

The parties agreed that the relevant geographic market was worldwide, so the market-definition dispute centered on the relevant product market. The DOJ claimed that only DDIY products were in the relevant antitrust market, arguing that the availability of other tax-preparation methods did not exert sufficient competitive pressures on DDIY products to merit inclusion in the antitrust analysis. The defendants, by contrast, argued that manual preparation (i.e., filling out forms with pen and paper) and assisted preparation (i.e., hiring an accountant or other professional to prepare the tax returns) should be included in the market.

The court accepted the DOJ's market definition, finding that "practical indicia" of the boundaries of the antitrust market and application of the "hypothetical monopolist" test from the *Horizontal Merger Guidelines* led to the conclusion that DDIY products compete with each other but do not face significant competition from manual preparation or assisted preparation. Importantly, the court found that the defendants' own business documents showed that TaxACT viewed H&R Block At Home and TurboTax as its primary competition, and that H&R Block viewed DDIY products as "a discrete . . . market or market segment."

The court found that assisted preparation was outside of the relevant market. The court noted that the evidence in favor of price competition between DDIY and assisted preparation was weak, and it found that

Continued on page 2...

Federal District Judge Issues Permanent Injunction Against H&R Block's . . .

Continued from page 1...

"DDIY provides customers with tax preparation services through an entirely different method, technology, and user experience." In rejecting the defendants' arguments that the presence of "hybrid" DDIY and assisted-preparation offerings justified a broader market, the court held that it was "premature" to see a trend toward such products.

The court likewise rejected "pen-and-paper" preparation as a substitute for DDIY products, noting "that pen-and-paper is not a 'product' at all; it is the task of filling out a tax return by oneself without any interactive assistance." The court found that "pen-and-paper preparation is unlikely to provide a meaningful restraint for DDIY products, which currently sell for an average price of \$44.13." Of note, the court rejected an attempt to analogize this to cases where the self-supply activities of vertically integrated firms were included in the relevant product market, finding that those cases "explicitly distinguished cases, such as this one, involving markets of individual consumers."

The court reviewed extensive testimony from expert economists in the matter, ultimately finding the DOJ's expert analysis more persuasive and critiquing the "severe shortcomings in the underlying consumer survey data upon which the defendants' expert relied." The DOJ's economist utilized switching data from the Internal Revenue Service (IRS) to provide a basis for assessing trends in both consumer responses to the availability of DDIY technologies and any shifts in use attributable to changes in price between different DDIY products. While there were limitations in the expert's methodologies, the court found the expert's analysis useful as "another data point suggesting that DDIY is the correct relevant market . . ."

By contrast, the court found that the defendants' expert relied on unreliable methodologies and discounted her testimony. In particular, the court noted that a consumer survey purporting to show that a price

increase in DDIY products would lead to a shift to assisted preparation assigned no price to the option of using a CPA, which is generally "the most expensive form of tax preparation assistance . . ." Such flaws led the court to conclude that the DOJ's expert presented the "more persuasive" analysis. In the end, "the full body of evidence" led the court to conclude that "DDIY is the correct relevant market for evaluating this merger."

Post-Merger Concentration

Having concluded that the relevant market was limited to DDIY products, the court calculated the Herfindahl-Hirschman Index (HHI), a measure of market concentration that relies on the sum of the squares of the market shares of all firms competing in the relevant market. An HHI above 2,500 renders a market "highly concentrated" under the revised *Horizontal Merger Guidelines*, and where the merger would result in an HHI increase of more than 200 points, the merger is "presumed to be likely to enhance market power." The court found that the current HHI in the DDIY product market is 4,291, and that the merger would increase the HHI by "approximately 400 points." The government thus easily "established a prima facie case of anticompetitive effects."

Competitive Effects

The court rejected all of the defendants' arguments in support of the merger. Relying heavily on the *Horizontal Merger Guidelines*, the court assessed whether competing DDIY companies (most of which are, according to the court, "very small-time operators") would expand output sufficiently to counteract any price increases implemented on the low-cost TaxACT product. The court found that one company, TaxHawk, lacked the "entrepreneurial verve" needed to provide such a competitive check, and that another competitor, TaxSlayer, has only managed to grow from 2.5 percent of the market to 2.7 percent of the market in the past five years. The court concluded that barriers to entry and expansion were high because "tax returns are

highly personal documents that carry significant financial and legal consequences for consumers," and consumers therefore responded to "reputation and brand" because they "must trust and have confidence in their tax service provider."

The court likewise found a high risk of coordinated effects. It found that Intuit and H&R Block, unchecked by TaxACT, likely would come to a mutual recognition that neither benefits from a "race to free," and that they likely would engage in coordinated pricing to maintain the price points of their products. The court placed particular emphasis on TaxACT's status as "a particularly aggressive competitor" or "maverick." It found that TaxACT "play[s] a special role in this market that constrains price" because "it has remained the only competitor with significant market share to embrace a business strategy that relies primarily on offering high-quality, full-featured products for free with associated products at low prices." Thus, the court found that eliminating TaxACT would substantially increase the likelihood of coordinated effects to the detriment of competition.

The court similarly found a high likelihood of unilateral anticompetitive effects. The merger would have eliminated a head-to-head competitor, and mere pledges by the parties to maintain TaxACT's low prices could not outweigh the incentives that the merged firm would face to "market [TaxACT] more selectively and less vigorously," and otherwise allow it to decline in availability and quality so as to drive users to H&R Block's higher-cost products. Using similar reasoning, the court rejected the claim that TaxACT and H&R Block's products compete in separate "value" and "premium" segments, finding that the companies are in fact in "close competition." It also rejected the hypothesis that the companies would pursue a "dual brand" strategy rather than a strategy to progressively drive users toward the higher-cost product. Importantly, the court also rejected the argument, based on the 2004 decision in *United States v. Oracle Corp.*

Continued on page 3...

Federal District Judge Issues Permanent Injunction Against H&R Block's . . .

Continued from page 2...

declining to enjoin a merger, that a combined-firm market share under 35 percent precluded a finding of unilateral effects. The court cited criticism of the *Oracle* decision and suggested—in line with the revised *Guidelines*—that unilateral effects could be shown without even defining a relevant market or considering market shares.

The court concluded by finding that the various asserted efficiencies from the merger, many of which were redacted from the court's opinion, were "either not merger-specific or not verifiable." Of some importance, the court noted that similar efficiencies predicted by H&R Block in a previous acquisition never materialized, which "underscore[d] the need for any claimed efficiencies to be independently verifiable . . ."

On November 15, 2011, the parties to the proposed transaction announced that they would not appeal the court's decision and would abandon the merger.

Conclusion

United States v. H&R Block, Inc. is a major decision for multiple reasons. First, the court found a narrow product market, even in the face of substantial consumer use of other tax preparation methods. Notably, even though both the DOJ and the defendants offered extensive quantitative economic analysis, the court nevertheless relied heavily on the parties' ordinary course of business documents to define the market and assess competitive effects, illustrating the important role that "bad" documents can play in a merger trial by offering simple evidence to resolve complex issues.

Second, the court blocked the merger even though the combined market share of the merging firms was under 30 percent. Of particular importance, the court emphasized coordinated effects in view of the fact that the merger would have resulted in the top two firms controlling over 90 percent of the market and would have eliminated the one firm capable of interjecting competition into the market. Third, the court found that unilateral effects were possible, even with combined shares below 35 percent, largely because TaxACT was found to be a "particularly aggressive competitor" to H&R Block's product and H&R Block would be less likely to promote the TaxACT product as aggressively as 2SS did if the two firms merged.

Finally, the court's heavy reliance on the newly revised *Horizontal Merger Guidelines*, even where they conflict with (non-binding) precedent, suggests that courts will have a similar level of deference to the new *Guidelines* as they had to the 1992 *Guidelines*, and that the *Guidelines* will continue to play a central role in merger jurisprudence.

For More Information

For more information on the *H&R Block* decision or on any issues regarding merger or non-merger antitrust law, please contact Scott Sher (202-973-8822), Charles E. Biggio (212-497-7780), or another member of the firm's antitrust practice.



Wilson Sonsini Goodrich & Rosati
PROFESSIONAL CORPORATION

This WSGR Alert was sent to our clients and interested parties via email on November 30, 2011. To receive future WSGR Alerts and newsletters via email, please contact Marketing at wsgr_resource@wsgr.com and ask to be added to our mailing list.

This communication is provided for your information only and is not intended to constitute professional advice as to any particular situation. We would be pleased to provide you with specific advice about particular situations, if desired. Do not hesitate to contact us.

650 Page Mill Road
Palo Alto, CA 94304-1050
Tel: (650) 493-9300 Fax: (650) 493-6811
email: wsgr_resource@wsgr.com

www.wsgr.com

© 2011 Wilson Sonsini Goodrich & Rosati,
Professional Corporation
All rights reserved.