MERGER ANTITRUST LAW

LAW 1469
Georgetown University Law Center
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Class 10 (September 25): H&R Block/TaxACT (Unit 5)[1]

We now start a three-class unit on H&R Block/TaxACT. We will focus primarily on how Judge Beryl A. Howell of the District Court of the District of Columbia explained her decision that the transaction, if consummated, would violate Section 7 of the Clayton Act.

The case involves the proposed 2010 acquisition by H&R Block of TaxACT for $287.5 million in cash. H&R Block was the largest firm in "assisted preparation" of income tax returns and the second largest firm in digital "do-it-yourself" (DDIY) tax software (15.6%). TaxACT was the third-largest firm in DDIY tax software (12.8%). Nonparty Intuit was the largest firm in the DDIY space (62.2%). The space was highly concentrated, with a three-firm concentration ratio (3-FCR) of 90.6%, so the transaction was a three-to-two merger with a fringe group of firms with a collective market share totaling slightly less than 10% *if* DDIY is the proper relevant product market. The DOJ challenged the deal and ultimately prevailed at trial, resulting in a permanent injunction blocking the transaction. The parties then voluntarily terminated their merger agreement without taking an appeal. Shortly thereafter, TaxACT was acquired by InfoSpace.[2]

The institutional context. First, look at Section 15 of the Clayton Act, which gives the Attorney General a right of action to seek injunctive relief for threatened or actual violations of Section 7 (p. 6). Also, read Rule 65 of the Federal Rules of Civil Procedure, which governs actions for injunctions and restraining orders (pp. 6-8).

The Block/TaxACT facts. Next, turn to the case study. As usual, we begin with some developments leading up to the decision. On October 13, 2010, the parties announced the deal (pp. 9-10). On May 23, 2011, following the completion of its HSR merger review seven months after the announcement, the DOJ issued a news release (pp. 11-13) and filed a complaint seeking a permanent injunction to block the transaction. The merging parties filed an answer denying any violation just over a month later. After the parties' unsuccessful motion to transfer venue and the completion of discovery, the court's minute order of August 4, 2011, set a hearing date of September 6, 2011, and the parameters for trial. Eight days of trial began on September 6, 2011, and concluded on September 19, 2011 (trial days are often not continuous). The court heard closing arguments on October 3, 2011.

The district court issued an order entering a blocking permanent injunction on October 31, 2011 (pp. 14-15) and released a public version of the memorandum opinion in support of the order on

[1] A reasonably complete set of the most important filings in the litigation (including the trial transcript) may be found here on AppliedAntitrust.com.

[2] Unlike the usual case when the first deal fails, InfoSpace paid $287.5 million in cash to acquire TaxACT, the same amount H&R Block was to pay. *See* Press Release, TaxACT, *InfoSpace to Acquire TaxACT* (Jan. 9, 2012). After the acquisition, 2nd Story Software, the operating company for the TaxACT business, became a wholly-owned subsidiary of InfoSpace, and continued operations in Cedar Rapids, Iowa as a standalone business unit led by the TaxACT management team.

November 10, 2011. Read the opinion up to the expert opinion section on critical loss (pp. 16-51). Pay particular attention to the organization of the opinion as set out in the table of contents (p. 18).

The early sections of the opinion address the parties to the deal, the history of TaxACT and the transaction, and the deal rationale (pp. 19-25). They also discuss tax preparation products and the role of free products (pp. 25-28). In light of these facts, think about the transaction's antitrust risk and what antitrust risk-shifting provisions the seller might want in the acquisition agreement.

Standard of review. With that behind us, it is time to look at the merits. Typically, courts start with an overview of the standard of review (pp. 28-30). This section provides a brief review of the legal framework governing merger challenges under Section 7 of the Clayton Act, beginning with the basic prohibition against acquisitions that may substantially lessen competition or tend to create a monopoly, and the government's authority under Section 15 to seek injunctive relief to block such transactions. The section notes that the government bears the burden of proving violations by a preponderance of the evidence and must demonstrate only that a pending acquisition is reasonably likely to cause anticompetitive effects under the incipiency standard. The section concludes by outlining the *Baker Hughes* three-step burden-shifting framework. You have seen all of these concepts in Unit 3 (Sanford Health/MDC). If you need a refresher, go back and review the relevant materials in that section.

Market definition: The judicial tests. Following the standard of review, the court turned to market definition (pp. 30-46). As you know, an essential element of every Section 7 violation is the finding of a *relevant product market*, which identifies the "line of commerce" (product market), and a *relevant geographic market*, which identifies the "area of the country" in which the threatened anticompetitive effect of the merger is to be located.[3] The parties stipulated to a worldwide market, so the geographic market was not an issue.[4] Product market definition, however, was the key to the case outcome. Be sure to read this section carefully and understand the court's structuring of the analysis.

The court structured its product market analysis around the established judicial framework from *Brown Shoe*, which defines market boundaries through "reasonable interchangeability of use" and "cross-elasticity of demand," supplemented by practical indicia such as industry recognition, unique product characteristics, distinct customer bases, differentiated prices, and specialized vendors. The court applied this framework using a three-pronged approach:

1. First, the court examined the defendants' own business documents, which consistently showed that TaxACT and H&R Block viewed themselves as competing primarily against other DDIY providers rather than against assisted or manual tax preparation methods.
2. Second, the court analyzed the practical differences between DDIY products and other tax preparation methods in terms of technology, price, convenience, time investment, and user experience.

[3] The nomenclature is not precise since the relevant product market and the relevant geographic market are not separate markets but rather the product and geographic dimensions of the *relevant market*.

[4] The parties agreed that the relevant product market involved only tax preparation products or services for filing U.S. tax returns and that they could be used by persons worldwide filing such returns.

3. Third, the court employed the hypothetical monopolist test to determine whether a DDIY monopolist could profitably impose a small but significant nontransitory price increase without losing customers to assisted or manual preparation.

Notably, the court's application of the hypothetical monopolist test was predominantly qualitative rather than quantitative, relying on observational evidence and logical reasoning rather than formal econometric analysis. Instead of estimating cross-elasticity of demand or diversion ratios, the court emphasized the record showed persistent price disparities between DDIY products (averaging $44) and assisted preparation ($150-200), reasoning that even a 10-20% DDIY price increase would still leave prices substantially below those of assisted alternatives. The court also noted that DDIY providers do not set prices based on assisted preparation pricing, examined the functional differences between tax preparation methods, and used analogical reasoning (comparing the situation to airplane travel versus other transportation methods) to conclude that DDIY products were not reasonably interchangeable with other tax preparation methods. Through this primarily qualitative analysis, the court concluded that DDIY constituted a distinct relevant product market, rejecting the defendants' argument for a broader "all methods" market that would include assisted tax preparation and pen-and-paper filing.

Market definition: confirming economic expert testimony. After establishing, through business documents and practical indicia, that the relevant product market was DDIY tax preparation software, the court turned to economic expert testimony to confirm its market definition.

Before turning to that section of the opinion, however, first read the note on expert evidence (pp. 108-17) and the court's ruling on the motion in limine challenging the defendants' survey methodology (pp. 118-32). Understanding the legal framework governing expert testimony is essential because antitrust market definition cases routinely involve battles between competing economic experts, and courts must rigorously evaluate the reliability of their methodologies and conclusions under Federal Rules of Evidence 702 and 703. The court's ultimate finding that it "cannot draw any conclusions from the defendants' expert's analysis because of severe shortcomings in the underlying consumer survey data," while crediting the government expert's analysis, cannot be fully appreciated without first understanding how courts apply the *Daubert* reliability standards to economic evidence. Moreover, these documents demonstrate how procedural evidentiary rulings can significantly influence substantive antitrust outcomes, as the court's dismissal of the defendants' survey-based expert analysis effectively removed a key pillar of their argument for a broader "all methods" market definition.

With this background, turn to the court's evaluation of the competing economic expert testimony on market definition (pp. 46-51). As you read, pay attention to how the court applies the reliability standards you just studied and note the sharp contrast between the government expert's comprehensive methodology and the defendants' reliance on the problematic survey evidence. Observe how the procedural battle over survey reliability proved consequential to the substantive market definition analysis, as the court found significant differences in the reliability and methodology of the competing analyses.

The government's expert, Dr. Frederick Warren-Boulton, employed a methodologically sound approach that departed from the typical Merger Guidelines framework in an important way. Rather than starting his hypothetical monopolist test analysis with a candidate market consisting of an overlapping product from one of the merging firms, he used qualitative evidence of the type probative of the *Brown Shoe* factors to define an initial candidate market consisting of all

DDIY products. Then, he applied economic testing to that candidate market. This approach exemplifies a common judicial departure from the Merger Guidelines that frequently appears in court opinions. Dr. Warren-Boulton distinguished between "switching" data—consumers changing tax preparation methods for any reason—and "diversion" data—consumers changing methods specifically in response to price increases. Using reliable IRS data covering over 100 million taxpayers as a proxy for estimating diversion patterns, Dr. Warren-Boulton found that the two types of data were distinct. The court concluded that this data-driven approach was far more reliable than the defendants' expert analysis, which relied primarily on the survey that the court had already found methodologically deficient, demonstrating how *Daubert* reliability standards can determine whether expert testimony supports or undermines a party's market definition theory.

The next section of the opinion examines Dr. Warren-Boulton's application of specific economic tests to validate DDIY as the relevant market, demonstrating how economists move from qualitative market definition to quantitative confirmation using the hypothetical monopolist test framework. Dr. Warren-Boulton employed two complementary approaches: a critical loss analysis and a merger simulation. We will examine Dr. Warren-Boulton's analysis in detail in the next class. But first, we need to understand the critical loss implementation of the hypothetical monopolist test in homogeneous markets, as this provides the foundation for more complex applications in differentiated product markets.

Critical loss in homogeneous product markets. Recall from Unit 3 that the "hypothetical monopolist test," originally introduced by the 1982 Merger Guidelines and now adopted in one form or another by the courts, was designed to introduce some economic sense and analytical rigor into market definition. A candidate market satisfies the HMT if a hypothetical monopolist of all products in the product group could profitably raise the prices in the product grouping over premerger levels by "a small but significant nontransitory increase in price" (SSNIP), usually taken to be 5% for a period of one year.[5] The idea is that if a hypothetical monopolist of a group of products could not profitably raise their prices, then a fortiori, the merged firm—either individually or tacitly with other firms in the market—could not raise prices as a result of the merger.[6]

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[5] Note that we are applying the profitability version of the HMT, not the profit-maximization version. As I mentioned in class, unless otherwise specified, we will consistently use this profitability version. Remember that, when demand curves are linear, a percentage SSNIP δ that satisfies the profitability HMT also satisfies the profit-maximization HMT at a percentage SSNIP of $\delta/2$.

[6] While the various iterations of the hypothetical monopolist test in the 1982, 1992, and 2010 Merger Guidelines, as well as in the court precedents that followed them, focused exclusively on the ability of the hypothetical monopolist to profitably increase price by a SSNIP, the 2023 Merger Guidelines expanded the test. It now includes not just a price increase but also any significant change in the terms of trade that is adverse to customers (a "SSNIPT"). These nonprice changes may include, for example, changes in product or service quality or the rate or direction of technological innovation. *See* U.S. Dep't of Justice & Fed. Trade Comm'n, Merger Guidelines § 4.3 (rev. Dec. 18, 2023).

Conceptually, an expanded HMT is consistent with the consumer welfare standard in antitrust law, which considers all dimensions of consumer harm, not just price. This change reflects the evolving nature of competition, particularly in some high-tech and other markets where nonprice factors play a critical role. However, two practical problems may limit the use of the expanded test. First, there are few, if any, generally accepted economic models for predicting how a monopolist's profit-maximizing behavior on dimensions other than price and output would differ from that of firms currently operating in the marketplace. Second, while the HMT has a quantitative metric for determining whether a price increase is "significant"—typically 5% over prevailing market prices—there is often no

In Unit 3, we applied the HMT by first specifying a candidate relevant market (with its product and geographic dimensions), then calculating the incremental profit gain for a hypothetical monopolist of that market if it uniformly increased prices for all products in the market by a SSNIP. The incremental profit gain from the SSNIP equals the gross incremental profit gain from the inframarginal sales that continued after the price increase, minus the gross incremental profit loss from the foregone marginal sales. If the incremental profit gain was positive, the SSNIP would be profitable and the candidate market would satisfy the HMT. If the incremental profit gain was negative, the SSNIP would not be profitable and the candidate market would fail the HMT. I call this method "brute force accounting."

Critical loss offers a more straightforward way of applying the HMT with a uniform SSNIP in a homogeneous product market. This approach is based on the breakeven condition, which determines the *breakeven SSNIP*, that is, the maximum price increase at which the hypothetical monopolist's profits after the SSNIP would be at least as profitable as the aggregate profits earned by the competing firms in the candidate market before the SSNIP. Associated with the breakeven SSNIP is the *critical loss*, that is, the maximum quantity of unit marginal sales that the hypothetical monopolist could lose before net incremental profit gain would turn negative. The critical loss concept naturally emerges from this breakeven analysis, as it identifies the precise sales threshold at which profitability switches from positive to negative.

Some simple manipulations of the breakeven condition enable us to create tests that are mathematically equivalent to brute force accounting. These tests compare the actual loss in sales from a specified uniform SSNIP to the critical loss for that SSNIP, given the gross margins of the products in the candidate market. If the actual loss in marginal sales from the SSNIP is less than the critical loss, then the candidate market satisfies the hypothetical monopolist test. Conversely, if the actual loss in marginal sales from the SSNIP exceeds the critical loss, then the candidate market fails the hypothetical monopolist test.

The class notes examine critical loss and develop the economic tests used to apply it (all slides for Class 10). Make sure that you understand all of the examples in the market definition class notes—these illustrate techniques you should know how to apply to a hypothetical merger. Some of the slides on the application of critical loss tests to markets where margins are differentiated can be challenging (slides 29-37), but the investment of time to understand them will be worthwhile. Still, what is most important are the examples in this section (slides 31, 35, and 36).

After you have reviewed the class notes, read the short excerpt from *FTC v. Tronox* (pp. 134-35) for a clear judicial statement of the critical loss framework and a step-by-step comparison of predicted losses to the critical loss threshold. Then read the *Whole Foods* (pp. 136-44) excerpt to see how a critical loss analysis can become more complex with differentiated stores selling mixed product types (PNO and non-PNO items) and to understand how framing choices can drive different conclusions about the relevant market.

If you have any questions, send me an email.

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clear metric to measure how adverse a change is in competitive variables other than price and output, much less an accepted quantitative threshold for determining whether the change is "significant." It remains to be seen how useful courts will find this expanded hypothetical monopolist test in practice.