MERGER ANTITRUST LAW

Unit 5: H&R Block/TaxACT

Classes 10-12

Prof. Dale Collins
Georgetown University Law Center
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The several district courts of the United States are invested with jurisdiction to prevent and restrain violations of this Act, and it shall be the duty of the several United States attorneys, in their respective districts, under the direction of the Attorney General, to institute proceedings in equity to prevent and restrain such violations. Such proceedings may be by way of petition setting forth the case and praying that such violation shall be enjoined or otherwise prohibited. When the parties complained of shall have been duly notified of such petition, the court shall proceed, as soon as may be, to the hearing and determination of the case; and pending such petition, and before final decree, the court may at any time make such temporary restraining order or prohibition as shall be deemed just in the premises. Whenever it shall appear to the court before which any such proceeding may be pending that the ends of justice require that other parties should be brought before the court, the court may cause them to be summoned whether they reside in the district in which the court is held or not, and subpoenas to that end may be served in any district by the marshal thereof. [15 U.S.C. § 25]

FEDERAL RULES OF CIVIL PROCEDURE

Rule 65. Injunctions and Restraining Orders

(a) Preliminary Injunction.
  (1) *Notice.* The court may issue a preliminary injunction only on notice to the adverse party.
  (2) *Consolidating the Hearing with the Trial on the Merits.* Before or after beginning the hearing on a motion for a preliminary injunction, the court may advance the trial on the merits and consolidate it with the hearing. Even when consolidation is not ordered, evidence that is received on the motion and that would be admissible at trial becomes part of the trial record and need not be repeated at trial. But the court must preserve any party's right to a jury trial.

(b) Temporary Restraining Order.
  (1) *Issuing Without Notice.* The court may issue a temporary restraining order without written or oral notice to the adverse party or its attorney only if:
    (A) specific facts in an affidavit or a verified complaint clearly show that immediate and irreparable injury, loss, or damage will result

to the movant before the adverse party can be heard in opposition; and

(B) the movant's attorney certifies in writing any efforts made to give notice and the reasons why it should not be required.

(2) *Contents; Expiration.* Every temporary restraining order issued without notice must state the date and hour it was issued; describe the injury and state why it is irreparable; state why the order was issued without notice; and be promptly filed in the clerk's office and entered in the record. The order expires at the time after entry—not to exceed 14 days—that the court sets, unless before that time the court, for good cause, extends it for a like period or the adverse party consents to a longer extension. The reasons for an extension must be entered in the record.

(3) *Expediting the Preliminary-Injunction Hearing.* If the order is issued without notice, the motion for a preliminary injunction must be set for hearing at the earliest possible time, taking precedence over all other matters except hearings on older matters of the same character. At the hearing, the party who obtained the order must proceed with the motion; if the party does not, the court must dissolve the order.

(4) *Motion to Dissolve.* On 2 days' notice to the party who obtained the order without notice—or on shorter notice set by the court—the adverse party may appear and move to dissolve or modify the order. The court must then hear and decide the motion as promptly as justice requires

(c) Security. The court may issue a preliminary injunction or a temporary restraining order only if the movant gives security in an amount that the court considers proper to pay the costs and damages sustained by any party found to have been wrongfully enjoined or restrained. The United States, its officers, and its agencies are not required to give security.

(d) Contents and Scope of Every Injunction and Restraining Order.

(1) *Contents.* Every order granting an injunction and every restraining order must:

(A) state the reasons why it issued;

(B) state its terms specifically; and

(C) describe in reasonable detail—and not by referring to the complaint or other document—the act or acts restrained or required.

(2) *Persons Bound.* The order binds only the following who receive actual notice of it by personal service or otherwise:

(A) the parties;

(B) the parties' officers, agents, servants, employees, and attorneys; and

(C) other persons who are in active concert or participation with anyone described in Rule 65(d)(2)(A) or (B).

(e) Other Laws Not Modified. These rules do not modify the following:

H&R Block/TaxACT

EX-99.1 3 c60723exv99w1.htm EX-99.1

Exhibit 99.1

H&R BLOCK®

News Release

H&R BLOCK ANNOUNCES AGREEMENT TO ACQUIRE TAXACT DIGITAL TAX PREPARATION BUSINESS

- Cash purchase price of $287.5 million
- More than 5 million tax filers used TaxACT solutions last season
- Estimated to add $0.05 to earnings per share if closed by calendar year end

For Immediate Release: Oct. 13, 2010

KANSAS CITY, Mo. — H&R Block (NYSE: HRB) announced today it has signed a definitive merger agreement to acquire all of the outstanding shares of 2SS Holdings, Inc., developer of TaxACT digital tax preparation solutions, for $287.5 million in cash.

The company plans to combine its H&R Block At Home digital business and the acquired TaxACT business, into a single unit led by the TaxACT management team, but continue to offer both brands in the market place.

"This transaction is a significant step for H&R Block in a segment that is strategically important. This will provide us with innovative growth-oriented leadership to accelerate our digital tax offerings and results." said Alan Bennett, president and chief executive officer of H&R Block. "I am looking forward to working with the TaxACT management team on developing our multi-brand digital strategy for the future."

TaxACT has approximately 70 full time associates and is headquartered in Cedar Rapids, Iowa. More than 5 million tax filers used TaxACT last season through online, desktop download and professional software, with the vast majority of those clients filing online.

Lance Dunn, president of TaxACT, said, "The entire team is excited by the opportunity to partner with H&R Block. We are committed to providing a tremendous value for customers by continuing to offer the TaxACT Free Federal Edition."

H&R Block estimates the transaction would add $0.05 to earnings per share in its fiscal year ending April 30, 2011, assuming the transaction closes by the end of the current calendar year. The purchase will be funded by excess available liquidity from cash-on-hand or short-term borrowings. Completion of the transaction is subject to the satisfaction of customary closing conditions, including the expiration of the applicable waiting period under the Hart-Scott-Rodino Act.

Conference Call

At 9 a.m. Eastern time on Thursday, October 14, the company will host a conference call for analysts, institutional investors and shareholders. To access the call, please dial the number below approximately five to ten minutes prior to the scheduled starting time:

U.S./Canada (877) 247-6355 or International (706) 679-0371
Conference ID: 10673363

The call also will be webcast in a listen-only format for the media and public. The link to the webcast can be accessed directly at http://investor-relations.hrblock.com.

A replay of the call will be available beginning at 9:30 a.m. Eastern time on Oct. 14, and continuing until Nov. 5, 2010, by dialing (800) 642-1687 (U.S./Canada) or (706) 645-9291 (International). The conference ID is 10673363. The webcast will be available for replay beginning on Oct.15 at http://investor-relations.hrblock.com

Forward Looking Statements

This announcement may contain forward-looking statements, which are any statements that are not historical facts. These forward-looking statements are based upon the Company's current expectations and there can be no assurance that such expectations will prove to be correct. Because forward-looking statements involve risks and uncertainties and speak only as of the date on which they are made, the Company's actual results could differ materially from these statements. These risks and uncertainties relate to, among other things, uncertainties regarding the Company's ability to attract and retain clients; meet its prepared returns targets; uncertainties and potential contingent liabilities arising from our former mortgage loan origination and servicing business; uncertainties in the residential mortgage market and its impact on loan loss provisions; uncertainties pertaining to the commercial debt market; competitive factors; the Company's effective income tax rate; litigation defense expenses and costs of judgments or settlements; uncertainties regarding the level of share repurchases; and changes in market, economic, political or regulatory conditions. Information concerning these risks and uncertainties is contained in Item 1A of the Company's 2010 annual report on Form 10-K and in other filings by the Company with the Securities and Exchange Commission. The Company does not undertake any duty to update any forward-looking statements, whether as a result of new information, future events, or otherwise.

About H&R Block

H&R Block Inc. (NYSE: HRB) is one of the world's largest tax services providers, having prepared more than 550 million tax returns worldwide since 1955. In fiscal 2010, H&R Block had annual revenues of $3.9 billion and prepared more than 23 million tax returns worldwide, utilizing more than 100,000 highly trained tax professionals. The Company provides tax return preparation services in person, through H&R Block At Home™ online and desktop software products, and through other channels. The Company is also one of the leading providers of business services through RSM McGladrey. For more information, visit our Online Press Center at www.hrblock.com.

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Department of Justice

FOR IMMEDIATE RELEASE
MONDAY, MAY 23, 2011
WWW.JUSTICE.GOV

AT
(202) 514-2007
TDD (202) 514-1888

JUSTICE DEPARTMENT FILES ANTITRUST LAWSUIT TO STOP H&R BLOCK INC. FROM BUYING TAXACT

Deal Would Substantially Reduce Competition in Sale of Digital Do-It-Yourself Tax Preparation Products and Result in Higher Prices and a Reduction in Innovation and Quality

WASHINGTON — The Department of Justice filed a civil antitrust lawsuit today to block the proposed acquisition by H&R Block Inc. of TaxACT, a digital do-it-yourself tax preparation software provider. The department said that the proposed deal would substantially lessen competition in the growing U.S. digital do-it-yourself tax preparation software market, resulting in higher prices and reduced innovation and quality for products that are used annually by millions of American taxpayers.

The Department of Justice's Antitrust Division filed its lawsuit in U.S. District Court in Washington, D.C., to prevent H&R Block from acquiring 2SS Holdings Inc., an entity within TA IX L.P. and the maker of TaxACT.

Between 35 and 40 million taxpayers use digital software products, either on the provider's website or uploaded onto the taxpayers' computers, to prepare and file their federal and state income taxes. Currently, three companies account for 90 percent of all sales of digital do-it-yourself tax preparation products, and the acquisition would combine H&R Block and TaxACT, respectively the second- and third-largest providers of digital do-it-yourself tax preparation products, the department said.

"The combination of H&R Block and TaxACT would likely lead to millions of American taxpayers paying higher prices for digital do-it-yourself tax preparation products," said Christine Varney, Assistant Attorney General in charge of the Department of Justice's Antitrust Division. "In addition, TaxACT has aggressively competed in the digital do-it-yourself tax preparation market with innovations such as free federal filing. If this merger is allowed to proceed, that type of innovation will be lost."

On Oct. 13, 2010, H&R Block agreed to purchase 2SS Holdings in a transaction valued at $287.5 million.

According to the department's complaint, H&R Block's acquisition of 2SS Holdings would eliminate a company that has aggressively competed with H&R Block and disrupted the

U.S. digital do-it-yourself tax preparation market through low pricing and product innovation. By ending the head-to-head competition between TaxACT and H&R Block, American taxpayers would be left with only two major digital do-it-yourself tax preparation providers. This would lead to higher prices, lower quality, and reduced innovation. In addition, by taking control of the TaxACT business, which has been a maverick in the market, it would be easier for H&R Block to coordinate on prices, quality, and other business decisions with the other remaining industry leader – Mountain View, Calif.-based Intuit, which makes personal finance programs such as Quicken and TurboTax – the department said.

The complaint includes statements from H&R Block presentations and emails, such as:

- A primary benefit for H&R Block in acquiring TaxACT is: "Elimination of competitor."

- In discussing the potential acquisition of TaxAct, one of the "[s]trategic [o]pportunities" of the acquisition is: "Acquire TaxACT and eliminate the brand to regain control of industry pricing and further price erosion."

- The rationale for launching the H&R Block's free online product was "[t]o match competitor offerings and stem online share loss to Intuit and TaxACT."

- "Retail volume at Staples [is] at risk due to introduction of TaxACT [r]etail software on combined display."

The department also alleges that by eliminating TaxACT, a significant, disruptive and aggressive competitor, the acquisition would likely substantially lessen competition between H&R Block and Intuit by facilitating coordination between them. H&R Block would likely degrade TaxACT's free product and H&R Block and Intuit would increase the prices for their paid products. An internal H&R Block email said, "The other possible strategic consideration is that Intuit and HRB together would have 84% of the digital market and we both obviously have great incentive to keep this channel profitable."

H&R Block is a Missouri corporation headquartered in Kansas City, Mo. H&R Block is one of the world's largest tax service providers, utilizing more than 100,000 trained tax professionals. The company, with its H&R Block At Home products, is the second largest provider of digital do-it-yourself tax preparation products. In its fiscal year 2010, ending April 30, 2010, H&R Block prepared more than 23 million tax returns worldwide and earned revenues of more than $3.8 billion. Its digital do-it-yourself tax preparation product was used in 2010 by more than 5.9 million customers to prepare and file their federal and state income tax returns.

2SS Holdings, the maker of the TaxACT digital do-it-yourself tax preparation products, is a Delaware corporation headquartered in Cedar Rapids, Iowa. 2SS Holdings is the third-largest digital do-it-yourself tax preparation product provider in the United States, and the second-largest provider of such products online through the Internet. TaxACT products were used in 2010 by more than 5 million customers to prepare and file their federal and state income tax returns.

TA IX L.P. is a limited partnership organized and existing under the laws of Delaware and headquartered in Boston. TA IX L.P. is the majority shareholder of 2SS Holdings.

# # #

11-661

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA, Plaintiff, v. H&R BLOCK, INC., *et al.*, Defendants.	Civil Action No. 11-00948 (BAH)

ORDER

This matter comes before the Court on the plaintiff's motion for a permanent injunction against the acquisition of 2SS Holdings, Inc. ("TaxACT") by H&R Block, Inc. ("HRB"). Upon consideration of all the evidence before the Court, including documents and factual and expert testimony presented at an evidentiary hearing, the applicable law, and the parties' legal memoranda and arguments, the Court finds that the proposed acquisition of TaxACT by HRB violates Section 7 of the Clayton Act, 15 U.S.C. § 18, for the reasons explained in the accompanying Memorandum Opinion.[1] Accordingly, it is hereby

ORDERED that, for the reasons explained in the accompanying Memorandum Opinion, the plaintiff's motion for a permanent injunction is GRANTED; and it is further

ORDERED that HRB and any parent, affiliate, subsidiary, or division thereof are enjoined and restrained, pursuant to Section 15 of the Clayton Act, 15 U.S.C. § 25, from acquiring any stock, assets, or other interest, directly or indirectly, in defendant TaxACT; and it is further

[1] The accompanying Memorandum Opinion has been filed under seal to enable the parties to review it and to redact any confidential business information. Once the parties have had an opportunity to redact any confidential information, the Memorandum Opinion will be filed on the public docket.

ORDERED that the defendants take any and all necessary steps to prevent any of their domestic or foreign agents, divisions, subsidiaries, affiliates, partnerships, and joint ventures from completing such acquisition, and from taking any steps or actions in furtherance thereof; and it is further

ORDERED that the defendants return all confidential information received directly or indirectly from one another and destroy all notes relating to such information; and it is further

ORDERED that the parties to this case shall review the Memorandum Opinion that accompanies this Order and shall redact any confidential business information that should not be disclosed publicly. The parties shall jointly contact Chambers on or before November 4, 2011 with any recommended redactions.

DATED: October 31, 2011

/s/ Beryl A. Howell
BERYL A. HOWELL
United States District Judge

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA, Plaintiff, v. H&R BLOCK, INC., *et al.*, Defendants.	Civil Action No. 11-00948 (BAH)

MEMORANDUM OPINION[1]

Last year, approximately 140 million Americans filed tax returns with the Internal Revenue Service ("IRS"). Paying taxes is a fundamental civic duty in our democracy. Taxes pay for the government to carry out its constitutionally mandated functions and enable the government to give force to the laws and policies adopted by the people of the United States through their elected representatives. Despite the necessity of taxes to fund our government and to sustain services that many citizens depend upon, the task of preparing a tax return brings joy to the hearts of few. Many find it to be a complex and tedious exercise. Fortunately, various businesses offer different products and services designed to assist taxpayers with preparing their returns. These tax preparation businesses principally include accountants, retail tax stores, and digital tax software providers – all of which provide important services to the American taxpayer. In this case, the United States, through the Antitrust Division of the Department of Justice, seeks to enjoin a proposed merger between two companies that offer tax software

[1] The Court provided this Memorandum Opinion to the parties in final form on October 31, 2011, but public release was delayed to ensure that no confidential business information that had been submitted under seal was released. Based on input from the parties, confidential business information has been redacted from the opinion, with such redactions reflected by the insertion of the text "{redacted}." In some instances, redacted confidential business information has been replaced by more general language that reflects the same underlying concepts without revealing the confidential business information. Such substitutions are indicated by braces surrounding the substituted text.

products – H&R Block and TaxACT – on the grounds that the merger violates the antitrust laws and will lead to an anticompetitive duopoly in which the only substantial providers of digital tax software in the marketplace would be H&R Block and Intuit, the maker of the popular "TurboTax" software program. After carefully considering all of the evidence, including documents and factual and expert testimony, the applicable law, and the arguments before the Court, the Court will enjoin the proposed merger for the reasons explained in detail below.

* * *

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I. BACKGROUND

A. Overview

The United States, through the Antitrust Division of the Department of Justice (the "DOJ," the "government," or the "plaintiff"), filed this action on May 23, 2011. The DOJ seeks to enjoin Defendant H&R Block, Inc. from acquiring Defendant 2SS Holdings, Inc. ("TaxACT"), which sells digital do-it-yourself tax preparation products marketed under the brand name TaxACT. Compl. ¶ 10. H&R Block ("HRB") is a Missouri corporation headquartered in Kansas City, Missouri. *Id.* ¶ 9. 2SS Holdings, or TaxACT, is a Delaware corporation headquartered in Cedar Rapids, Iowa. *Id.* ¶ 10. Defendant TA IX, L.P. ("TA"), a Delaware limited partnership headquartered in Boston, Massachusetts, owns a two-thirds interest in TaxACT. *Id.* ¶ 11.

As noted above, approximately 140 million Americans filed tax returns with the IRS in 2010. *Id.* ¶ 1. Broadly speaking, there are three methods for preparing a tax return. The "pen and paper" or "manual" method includes preparation by hand and with free, electronically fillable forms available on the IRS website. A second method, known as "assisted" preparation, involves hiring a tax professional – typically either a certified public accountant ("CPA") or a specialist at a retail tax store. HRB operates the largest retail tax store chain in the United States. Cobb, TT, 9/19/11 a.m., at 37. The companies Jackson-Hewitt and Liberty Tax Service also operate well-known retail tax stores. Finally, many taxpayers now prepare their returns using digital do-it-yourself tax preparation products ("DDIY"), such as the popular software product "TurboTax." DDIY preparation is becoming increasingly popular and an estimated 35 to 40 million taxpayers used DDIY in 2010. GX 19 at 3; *see also* GX 27.[2]

[2] In this opinion, the Court will use the abbreviations "GX", "GTX", "DX", and "DTX" to refer to the government's exhibits, the government's trial exhibits, the defendants' exhibits, and the defendants' trial exhibits, respectively.

The three most popular DDIY providers are HRB, TaxACT, and Intuit, the maker of TurboTax. According to IRS data, these three firms accounted for approximately 90 percent of the DDIY-prepared federal returns filed in tax season 2010.[3] GX 27. The next largest firm is TaxHawk, also known as FreeTaxUSA, with 3.2 percent market share, followed by TaxSlayer, with 2.7 percent. *Id*. The remainder of the market is divided among numerous smaller firms. *Id.* Intuit accounted for 62.2 percent of DDIY returns, HRB for 15.6 percent, and TaxACT for 12.8 percent. *Id*. DDIY products are offered to consumers through three channels: (1) online through an internet browser; (2) personal computer software downloaded from a website; and (3) personal computer software installed from a disk, which is either sent directly to the consumer or purchased by the consumer from a third-party retailer. GX 629 at 11. In industry parlance, DDIY products provided through an internet browser are called "online" products, while software applications downloaded onto the user's computer via the web or installed from a disk are referred to as "software" products. *See id.*

The proposed acquisition challenged in this case would combine HRB and TaxACT, the second and third most popular providers of DDIY products, respectively. According to the government, this combination would result in an effective duopoly between HRB and Intuit in the DDIY market, in which the next nearest competitor will have an approximately 3 percent market share, and most other competitors will have less than a 1 percent share. GX 27. The government also alleges that unilateral anticompetitive effects would result from the elimination of head-to-head competition between the merging parties. Compl. ¶ 45.

"TT" refers to trial testimony. "PFF" refers the plaintiff's proposed findings of fact. "DFF" refers to the defendants' proposed findings of fact.

[3] The denomination of different years in the tax industry can be somewhat confusing. Tax returns are typically due in the month of April following the relevant tax year. Thus, each "tax season" refers to the period when returns for the prior "tax year" are generally completed. For example, "tax season 2010" refers to returns filed primarily in early 2010, corresponding to income earned in "tax year 2009."

Thus, the DOJ alleges that because the proposed acquisition would reduce competition in the DDIY industry by eliminating head-to-head competition between the merging parties and by making anticompetitive coordination between the two major remaining market participants substantially more likely, the proposed acquisition violates Section 7 of the Clayton Act, 15 U.S.C. § 18. *Id.* ¶¶ 40-49. Accordingly, the government seeks a permanent injunction blocking HRB from acquiring TaxACT. *Id.* ¶¶ 53-55.

On July 6, 2011, the Court entered a scheduling order in this case that provided for an expedited schedule of fact and expert discovery and briefing on the government's anticipated motion to enjoin the transaction. Joint Scheduling and Case Mgmt. Order, ECF No. 30. On August 1, 2011, the DOJ filed a motion for preliminary injunction against the merger, which was fully briefed by August 18, 2011. The parties subsequently agreed to forego the preliminary injunction phase and proceed directly to a trial on the merits of this action. TT, 9/6/11 a.m., at 8-9.

On September 2, 2011, the Court held a pre-trial conference. On September 6, the Court began a nine-day bench trial that was held on September 6, 7, 8, 9, 12, 13, 15, 19, and 20. Eight fact witnesses and three expert witnesses testified at the hearing. The parties presented testimony from additional witnesses by affidavit and deposition. Each side submitted over 800 exhibits, totaling many thousands of pages. Following the conclusion of the evidentiary phase of the trial, the Court gave the parties approximately two weeks to submit post-trial memoranda and proposed findings of fact, which were filed on September 28, 2011. ECF Nos. 98-99. The Court then heard closing arguments on October 3, 2011.

The government's motion to enjoin HRB's acquisition of TaxACT is presently before the Court. For the reasons explained in this opinion, the Court grants the government's motion.

Before proceeding to a discussion of the relevant legal standards governing this case, the Court will provide additional background regarding the parties, their proposed transaction, and the tax preparation industry in general.

B. The Merging Parties

HRB is a Missouri corporation with its principal place of business in Kansas City, Missouri. Compl. ¶ 9; Defs.' Answer, ECF No. 31, ¶ 9. HRB provides both assisted tax preparation services and DDIY products through separate business units. Bennett, TT, 9/6/11 a.m., at 106. HRB offers its DDIY products for consumers under the brand name "H&R Block At Home" (formerly known as "TaxCut"). GX 629 at 9.

In 2011, HRB's DDIY products generated {significant} revenue. GX 296-2. For the same period, HRB sold approximately 6.69 million DDIY units to consumers. GX 296-2. Separately, in 2011, HRB's assisted tax preparation business generated approximately $2.7 billion in revenue (based on 14,756,000 U.S. tax returns at an average fee of $182.96, as reported in HRB's 2011 Annual Report). GX 532 (Cobb Dep.) at 32; GX 565 at 19.

2SS Holdings, Inc. ("2SS") is a Delaware corporation with its principal place of business in Cedar Rapids, Iowa. Compl. ¶ 10; Defs.' Answer ¶ 10. 2SS owns 2nd Story Software, Inc., which offers DDIY products under the brand name "TaxACT." GX 629 at 8-9.

In the fiscal year ending April 30, 2011, TaxACT products generated approximately {half as much revenue as H&R Block}. GX 151 at 6. In the same year, consumers used TaxACT to electronically file approximately 5 million federal tax returns. GX 151 at 3-4.

TA IX, L.P. ("TA") is a private equity firm organized under the laws of Delaware with its headquarters in Boston, Massachusetts. Compl. ¶ 11; Defs.' Answer ¶ 11. In December of 2004, TA purchased a majority interest in 2SS for $85 million, and as a result TA has majority

control of 2SS Holdings and 2nd Story Software. GX 55 (Greif Dep.) at 72-73; GX 28-3.

C. The History Of TaxACT And The Proposed Transaction

TaxACT was founded in 1998 by Lance Dunn and three others, with Mr. Dunn serving as president. Dunn, TT, 9/7/11 p.m., at 49-52. Before founding TaxACT, Mr. Dunn and the other co-founders of the company had worked at Parsons Technology, a software company that had created a DDIY tax preparation product called "Personal Tax Edge." *Id.* at 49-52. In 1994, Intuit acquired Parsons Technology and continued to operate Personal Tax Edge as a separate product for approximately two years before merging it into its TurboTax product line. *Id.* at 51. Mr. Dunn testified that the business objective of founding TaxACT was "to make money selling value tax software which . . . was a category that did not exist at that time" because Intuit's acquisition of Parsons Technology had eliminated Personal Tax Edge, which had previously occupied a value tax software niche. *Id.* at 52. Thus, TaxACT "recreated" the category or "niche that the Personal Tax Edge product line filled when it existed." *Id.*

Over the years, TaxACT has emphasized high-quality free product offerings as part of its business strategy. *Id.* at 53. TaxACT initially offered a DDIY tax preparation product that made it free to prepare and print a federal tax return, but TaxACT charged a fee for electronic filing ("e-filing") or preparation of a state tax return. *Id.* at 54. Thus, from the beginning, TaxACT's business strategy relied on promoting "free" or "freemium" products, in which a basic part of the service is offered for free and add-ons and extra features are sold for a price.[4] As Mr. Dunn put it, "Free is an integral part of the value model. And the beauty of it is it has universal appeal. Everybody likes something for free." *Id.*

[4] The business model of offering free products and then soliciting customers to purchase additional, related features or services is sometimes referred to as "freemium." *See* GX 130 ("H&R Block Strategic Planning Working Session, April 16 &17, 2010") at 103 ("'Freemium' is a known market dynamic that has arisen in multiple product categories and will continue to grow.").

Currently, TaxACT's free product offering allows customers to prepare, print, and e-file a federal tax return completely for free. *Id.* at 54; GX 28-10 at 5-7. TaxACT's "Deluxe" edition, which costs $9.95, contains additional features, such as the ability to import data from a return filed the prior year through TaxACT. GX 55-26; Dunn, TT, 9/7/11 p.m., at 91-92; GX 28-10 at 5-7; GX 28 (Dunn. Dep.) at 219. Customers who use TaxACT to prepare a state tax return in addition to a federal return pay either $14.95 for the state return in combination with the free federal product or $17.95 for the state return in combination with the "Deluxe" federal product. GX 55-26; Dunn, TT, 9/8/11 a.m., at 49. TaxACT's prices have generally remained unchanged for the past decade. Dunn, TT, 9/7/11 p.m., at 91.

The parties first began discussing the potential acquisition of TaxACT by HRB in July 2009. Bowen, TT, 9/15/11 p.m., at 14. During the fall of 2009, teams from HRB and TaxACT met to discuss the possibilities for the potential acquisition and HRB performed due diligence on TaxACT. *See* DX 244 at 8-9; Bowen, TT, 9/15/11 p.m., at 19-23, 26; DX 9527 at 35.

Negotiations between the parties stalled in December 2009 and the proposed deal collapsed. Bowen, TT, 9/15/11 p.m., at 33. The CEOs of the two companies continued to discuss a potential acquisition through the spring of 2010, however. *Id.* at 34. Serious merger talks resumed in July 2010. *Id.* at 38-39; DX1005.

In October 2010, the HRB Board of Directors approved a plan for HRB to acquire TaxACT. DX 600 at 12-13; Bowen, TT, 9/15/11 p.m., at 59-60. On October 13, 2010, HRB entered into a merger agreement with 2SS and TA. GX 120 at 1. Under this agreement, HRB would acquire control of 2SS for $287.5 million. GX 120 at 6; GX 119 at 1. HRB's stated post-merger plan is to maintain both the HRB and TaxACT brands – with the HRB-brand focusing on higher priced-products and the TaxACT brand focusing on the lower-priced products. *See*

Bennett, TT, 9/6/11 a.m., at 101-102; DX 1005 at 1. HRB plans {redacted} ultimately to rely on TaxACT's current technological platform and intends to give Mr. Dunn responsibility for running the combined firm's entire DDIY business operation from Cedar Rapids, Iowa. Dunn, TT, 9/8/11 p.m. (sealed), at 14-16; *see also* Bennett, TT, 9/6/11 a.m., at 110.

D. Free Products And The Free File Alliance

The evolution of TaxACT's free product offerings and the other free offerings in the DDIY market is important for understanding the claims in this case. The players in the DDIY market offer various "free" tax preparation products, but the features and functionality offered in these free products vary significantly, as do the ways in which these free products are ultimately combined with paid products to earn revenue. While the availability of some types of free product offers has long been a feature of the DDIY market, a spike in free offerings occurred during the last decade in parallel with the growth of e-filing.

As a matter of public policy, the IRS actively promotes e-filing because it has an interest in efficient and accessible tax return preparation and filing. The Internal Revenue Service Restructuring and Reform Act of 1998 set a goal of having eighty percent of individual taxpayers e-filing their returns by 2007. IRS Stip., ECF No. 80, ¶ 2. The IRS is close to achieving that goal and the IRS Oversight Board has recommended that the 80 percent benchmark be achieved by 2012. *Id.* According to stipulated facts attested to by IRS employees, in 2001, the IRS adopted an initiative "to decrease the tax preparation and filing burden of wage earners by providing greater access to free online tax preparation and filing options for a significant number of taxpayers." *Id.* ¶ 4. The IRS also determined that it could save a substantial amount of public money by encouraging filers to switch to e-filing, since e-filed returns are cheaper for the IRS to process. *Id.* ¶ 5.

The IRS determined that the most effective and efficient way to accomplish its goal of promoting access to free online tax preparation and filing options was to partner with a consortium of companies in the electronic tax preparation and filing industry. *Id.* ¶ 6; GX 297-D7 at E-2. In 2002, this consortium of companies formed Free File Alliance, LLC ("FFA") in order to partner with the IRS on this initiative to promote free filing. IRS Stip. ¶ 6; GX 297-D7 at E-2. HRB, TaxACT, and Intuit are all members of the FFA, as are approximately fifteen smaller companies. *See* IRS Stip. ¶ 8; DX 328. On October 30, 2002, the IRS and the FFA entered into a "Free On-Line Electronic Tax Filing Agreement" to provide free online tax return preparation and filing to individual taxpayers. IRS Stip. ¶ 9. Pursuant to this agreement, members of the FFA would offer free, online tax preparation and filing services to taxpayers, and the IRS would provide taxpayers with links to those free services through a web page, hosted at irs.gov and accessible through another government website. *Id.* ¶ 12. HRB, TaxACT, and Intuit were among the original members to make free offers through the FFA. *Id.* ¶ 8.

"In 2003, the first year in which free services were available to taxpayers through the FFA, none of the FFA members offered free services to all taxpayers." *Id.* ¶ 14. Rather, each "member set eligibility criteria. Most members, including H&R Block, TaxACT, and Intuit, used adjusted gross income ('AGI') as a way to define which taxpayers were eligible" for their offers of free federal tax return preparation services. *Id.* "For example, H&R Block offered free services to taxpayers with an AGI of $28,000 or less." *Id.* Some members that offered free federal return preparation services based on AGI also offered free services to taxpayers who met other conditions, such as eligibility to file a Form 1040EZ. *Id.* "Several members did not define eligibility based on AGI. Of the eleven FFA members that offered free services based on AGI, only TaxACT's AGI-based offering was available to individuals with AGI over $33,000." *Id.*

Specifically, TaxACT made its free federal services available exclusively to taxpayers who had AGI over $100,000 or were eligible to file a Form 1040EZ. *Id.*

In 2004, the second year in which free services for federal returns were available to taxpayers through the FFA, TaxACT introduced a new offer through the FFA that offered free preparation and e-filing of federal returns for all taxpayers regardless of AGI or other limitations ("free for all"). *See id.* ¶ 15; Dunn, TT, 9/7/11 p.m., at 65, 78. After TaxACT introduced a free-for-all offer through the FFA, other companies followed by introducing federal free-for-all offers of their own. Dunn, TT, 9/7/11 p.m., at 78 ("After we offered free for everyone in 2003, in 2004, a lot of companies offered free for everyone on the FFA.").

According to Mr. Dunn's testimony, after TaxACT made its FFA offer of a free federal product for all taxpayers, without any AGI or other limitations, other companies made efforts to restrict the wide availability of free offers on the FFA. *Id.* at 79. Specifically, according to Mr. Dunn, Intuit proposed that companies in the FFA collude by agreeing to restrict free offers. *Id.* Mr. Dunn and TaxACT opposed Intuit's proposal and believed that it was "probably not legal for that group to restrain trade." *Id.*

Subsequently, HRB, Intuit and others successfully lobbied the IRS to implement restrictions on the number of taxpayers that could be covered by a free offer through the FFA website. GX 28 (Dunn Dep.) at 114-15; GX 28-4; GX 35 at HRB-DOJ-00912870; GX 569 (DuMars Dep.) at 108, 112-113; Ernst, TT, 9/7/11 a.m., 26-27; GX 41 at 4; GX 25 (TaxHawk Decl.) ¶ 16. HRB desired these restrictions because, among other things, it was concerned about how free-for-all offers would affect the pricing structure for the industry and believed that such offers might undermine the company's ability to generate money through the paid side of its DDIY business. Ernst, TT, 9/7/11 a.m., at 26-27; GX 531 (Ciaramitaro Dep.) at 60-62; *see also*

GX 41 at 4; GX 25 (TaxHawk Decl.) ¶ 16.

The IRS amended the FFA rules in October 2005 to prevent FFA members from making free-for-all offers. Dunn, TT, 9/7/11 p.m., at 78-79; Ernst, TT, 9/7/11 a.m., at 29; GX 42; GX 25 (TaxHawk Decl.) ¶ 16; GX 29 (Intuit Decl.) ¶ 9. Therefore, TaxACT could no longer make its free-for-all offer through the FFA.

In tax year 2005, in response to restrictions that the IRS imposed on the scope of offers that could be made through the FFA, TaxACT became the first DDIY company to offer all tax payers a free DDIY product for preparation of federal returns directly on its website. Dunn, TT, 9/7/11 p.m., at 79-80; GX 28 (Dunn Dep.) at 122-23. Today, free offers in various forms are an entrenched part of the DDIY market. Dunn, TT, 9/8/11 a.m., 85; Defs.' Opening Stmt., TT, 9/6/11 a.m., at 86-87.

II. STANDARD OF REVIEW

"Section 7 of the Clayton Act, 15 U.S.C. § 18, prohibits a corporation from acquiring 'the whole or any part of the assets of another [corporation] engaged also in commerce or in any activity affecting commerce, where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly." *United States v. Sungard Data Sys., Inc.*, 172 F. Supp. 2d 172, 180 (D.D.C. 2001) (quoting 15 U.S.C. § 18). "The United States is authorized by Section 15 of the Clayton Act to seek an injunction to block a pending acquisition." *Id.* (citing 15 U.S.C. § 25). "The United States has the ultimate burden of proving a Section 7 violation by a preponderance of the evidence." *Id.*

"To establish a Section 7 violation, plaintiff must show that a pending acquisition is reasonably likely to cause anticompetitive effects." *Id.* (citing *United States v. Penn-Olin Chem.*

Co., 378 U.S. 158, 171 (1964)); *see also United States v. Oracle Corp.*, 331 F. Supp. 2d 1098, 1109 (N.D. Cal. 2004). "Congress used the words '*may* be substantially to lessen competition' (emphasis supplied), to indicate that its concern was with probabilities, not certainties.'" *FTC v. H.J. Heinz Co*., 246 F.3d 708, 713 (D.C. Cir. 2001) (*quoting Brown Shoe Co. v. United States*, 370 U.S. 294, 323 (1962)). "Section 7 does not require proof that a merger or other acquisition has caused higher prices in the affected market. All that is necessary is that the merger create an appreciable danger of such consequences in the future." *Hosp. Corp. of Am. v. FTC*, 807 F.2d 1381, 1389 (7th Cir. 1986).

"As this Circuit explained in *Heinz*, 246 F.3d at 715, the decision in *United States v. Baker Hughes Inc.*, 908 F.2d 981 (D.C. Cir. 1990), sets forth the analytical approach for establishing a Section 7 violation."[5] *Sungard*, 172 F. Supp. 2d at 180.[6] "The basic outline of a section 7 horizontal acquisition case is familiar. By showing that a transaction will lead to undue concentration in the market for a particular product in a particular geographic area, the government establishes a presumption that the transaction will substantially lessen competition." *Baker Hughes*, 908 F.2d at 982. To establish this presumption, the government must "show that the merger would produce 'a firm controlling an undue percentage share of the relevant market, and [would] result [ ] in a significant increase in the concentration of firms in that market.'" *Heinz*, 246 F.3d at 715 (quoting *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 363

[5] Two current Supreme Court justices, in their prior capacities as judges on the Court of Appeals, participated in the D.C. Circuit's ruling in *Baker Hughes*. Then-Judge Clarence Thomas wrote the opinion and then-Judge Ruth Bader Ginsburg joined in it.

[6] In their closing argument, the defendants chided the government for citing Clayton Act Section 7 cases brought by the Federal Trade Commission for the relevant standard to apply in this case rather than citing to *United States v. Baker Hughes Inc*., 908 F.2d 981, 982-83 (D.C. Cir. 1990), a case brought by the DOJ. Since this Circuit's FTC precedents themselves rely heavily on the analytical approach set forth in *Baker Hughes*, the defendants' distinction on this point is ultimately of little import. *See FTC v. H.J. Heinz Co*., 246 F.3d 708, 715 (D.C. Cir. 2001) ("In *United States v. Baker Hughes Inc*., 908 F.2d 981, 982-83 (D.C.Cir.1990), we explained the analytical approach by which the government establishes a section 7 violation."). While a lesser showing is required to obtain preliminary relief in an FTC preliminary injunction case, as opposed to a full merits trial like this case, the Court must apply the *Baker Hughes* analytical framework in either type of Section 7 case.

(1963)) (alterations in original). Once the government has established this presumption, the burden shifts to the defendants to rebut the presumption by "show[ing] that the market-share statistics give an inaccurate account of the merger's probable effects on competition in the relevant market." *Heinz*, 246 F.3d at 715 (internal quotation omitted). "'If the defendant successfully rebuts the presumption [of illegality], the burden of producing additional evidence of anticompetitive effect shifts to the government, and merges with the ultimate burden of persuasion, which remains with the government at all times.'" *Id.* (quoting *Baker Hughes*, 908 F.2d at 983). Ultimately, "[t]he Supreme Court has adopted a totality-of-the-circumstances approach to the statute, weighing a variety of factors to determine the effects of particular transactions on competition." *Baker Hughes*, 908 F.2d at 984.

III. DISCUSSION

A. The Relevant Product Market

"Merger analysis begins with defining the relevant product market." *FTC v. Swedish Match*, 131 F. Supp. 2d 151, 156 (D.D.C. 2000) (citing *Brown Shoe*, 370 U.S. 294, 324 (1962)). "Defining the relevant market is critical in an antitrust case because the legality of the proposed merger[] in question almost always depends upon the market power of the parties involved." *Id.* (quoting *FTC v. Cardinal Health, Inc.*, 12 F. Supp. 2d 34, 45 (D.D.C. 1998)). Indeed, the relevant market definition is often "the key to the ultimate resolution of this type of case because of the relative implications of market power."[7] *Id.*

[7] "A relevant market has two components: (1) the relevant product market and (2) the relevant geographic market. . . . The 'relevant geographic market' identifies the geographic area in which the defendants compete in marketing their products or services." *FTC v. CCC Holdings, Inc.*, 605 F. Supp. 2d 26, 37 (D.D.C. 2009). The parties have stipulated that the relevant geographic market in this case is worldwide. Joint Pre-Hearing Statement ¶ IX, C, 12. DDIY products are provided online and can be used by any individual worldwide – either within the United States or abroad – who needs to prepare and file a U.S. tax return. The products at issue in this case are not used for preparation of foreign tax returns. *See* Pl.'s Mot. For Prelim. Inj. at 29-30. The Court accepts the parties' stipulation as to the relevant geographic market.

The government argues that the relevant market in this case consists of all DDIY products, but does not include assisted tax preparation or pen-and-paper. Under this view of the market, the acquisition in this case would result in a DDIY market that is dominated by two large players – H&R Block and Intuit – that together control approximately 90 percent of the market share, with the remaining 10 percent of the market divided amongst a plethora of smaller companies. In contrast, the defendants argue for a broader market that includes all tax preparation methods ("all methods"), comprised of DDIY, assisted, and pen-and-paper. Under this view of the market, the market concentration effects of this acquisition would be much smaller and would not lead to a situation in which two firms control 90 percent of the market. This broader view of the market rests primarily on the premise that providers of all methods of tax preparation compete with each other for the patronage of the same pool of customers – U.S. taxpayers. After carefully considering the evidence and arguments presented by all parties, the Court has concluded that the relevant market in this case is, as the DOJ contends, the market for digital do-it-yourself tax preparation products.

A "relevant product market" is a term of art in antitrust analysis. The Supreme Court has set forth the general rule for defining a relevant product market: "The outer boundaries of a product market are determined by the reasonable interchangeability of use [by consumers] or the cross-elasticity of demand between the product itself and substitutes for it." *Brown Shoe*, 370 U.S. at 325; *see also United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377, 395 (1956). In other words, courts look at "whether two products can be used for the same purpose, and, if so, whether and to what extent purchasers are willing to substitute one for the other." *FTC v. Staples, Inc*., 970 F. Supp. 1066, 1074 (D.D.C. 1997) (citation omitted); *see also Bon-Ton Stores,*

Inc. v. May Dep't Stores Co., 881 F. Supp. 860, 868 (W.D.N.Y. 1994) (citing *Hayden Pub. Co. v. Cox Broad. Corp.*, 730 F.2d 64, 71 (2d Cir. 1984)).

A broad, overall market may contain smaller markets which themselves "constitute product markets for antitrust purposes."[8] *Brown Shoe*, 370 U.S. at 325. "[T]he mere fact that a firm may be termed a competitor in the overall marketplace does not necessarily require that it be included in the relevant product market for antitrust purposes." *Staples*, 970 F. Supp. at 1075. Traditionally, courts have held that the boundaries of a relevant product market within a broader market "may be determined by examining such practical indicia as industry or public recognition of the [relevant market] as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors." *FTC v. Whole Foods Market, Inc.* 548 F.3d 1028, 1037-38 (D.C. Cir. 2008) (Brown, J.) (quoting *Brown Shoe*, 370 U.S. at 325).[9] *See also FTC v. CCC Holdings, Inc.*, 605 F. Supp. 2d 26, 38 (D.D.C. 2009). These "practical indicia" of market boundaries may be viewed as evidentiary proxies for proof of substitutability and cross-elasticities of supply and demand. *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210, 218 (D.C. Cir. 1986).

[8] Courts have sometimes referred to such markets-within-markets as "submarkets." *See Brown Shoe*, 370 U.S. at 325; *Whole Foods*, 548 F.3d at 1037-38 (Brown, J.). Other courts and commentators have criticized this "submarket" terminology as unduly confusing, however. *See* 5C PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 533, at 251 (3d ed. 2007) ("Courts sometimes describe the closest substitutes as a 'submarket' within a larger 'market' of less-close substitutes. Although degrees of constraint do in fact vary, the 'market' for antitrust purposes is the *one* relevant to the particular legal issue at hand.") (internal citations omitted); *Geneva Pharms. Tech. Corp. v. Barr Labs, Inc.*, 386 F.3d 485, 496 (2d Cir. 2004) ("The term 'submarket' is somewhat of a misnomer, since the 'submarket' analysis simply clarifies whether two products are in fact 'reasonable' substitutes and are therefore part of the same market.").

[9] The D.C. Circuit's decision in *Whole Foods* lacked a majority opinion. *See Whole Foods*, 548 F.3d at 1061 n.8 (Kavanaugh, J., dissenting). Judges Brown and Tatel filed separate opinions concurring in the judgment to reverse the District Court and Judge Kavanaugh, in dissent, would have affirmed. *See id.* at 1032 (Brown, J.); *id.* at 1041 (Tatel, J.); *id.* at 1051 n.1 (Kavanaugh, J., dissenting). Thus, in referring to the opinions in *Whole Foods*, the Court will indicate the name of the Judge whose opinion is cited.

An analytical method often used by courts to define a relevant market is to ask hypothetically whether it would be profitable to have a monopoly over a given set of substitutable products. If so, those products may constitute a relevant market. *See* 5C PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW (hereinafter, "Areeda & Hovenkamp"), ¶ 530a, at 226 (3d ed. 2007) ("[A] market can be seen as the array of producers of substitute products that could control price if united in a hypothetical cartel or as a hypothetical monopoly."). This approach – sometimes called the "hypothetical monopolist test" – is endorsed by the Horizontal Merger Guidelines issued by the DOJ and Federal Trade Commission. *See Fed. Trade Comm'n & U.S. Dep't of Justice Horizontal Merger Guidelines* (2010) (hereinafter, "Merger Guidelines"), § 4.1.1.[10] In the merger context, this inquiry boils down to whether "a hypothetical profit-maximizing firm, not subject to price regulation, that was the only present and future seller of those products . . . likely would impose at least a small but significant and non-transitory increase in price ("SSNIP") on at least one product in the market, including at least one product sold by one of the merging firms." *Id*. The "small but significant and non-transitory increase in price," or SSNIP, is typically assumed to be five percent or more. *Id.* § 4.1.2.

Thus, the question here is whether it would be hypothetically useful to have a monopoly over all DDIY tax preparation products because the monopolist could then profitably raise prices for those products by five percent or more; or whether, to the contrary, there would be no reason to monopolize all DDIY tax preparation products because substitution and price competition with other methods of tax preparation would restrain any potential DDIY monopolist from profitably raising prices. In other words, would enough DDIY users switch to the assisted or

[10] The Merger Guidelines are not binding upon this Court, but courts in antitrust cases often look to them as persuasive authority. *See Staples*, 970 F. Supp. at 1081-82.

pen-and-paper methods of tax preparation in response to a five-to-ten percent increase in DDIY prices to make such a price increase unprofitable?

In evaluating the relevant product market here, the Court considers business documents from the defendants and others, the testimony of the fact witnesses, and the analyses of the parties' expert economists. This evidence demonstrates that DDIY is the relevant product market in this case.

1. The Defendants' Documents Show That DDIY Is The Relevant Product Market.

When determining the relevant product market, courts often pay close attention to the defendants' ordinary course of business documents. *See, e.g.*, *Staples*, 970 F. Supp. at 1076; *CCC Holdings*, 605 F. Supp. 2d at 41-42. The government argues that the defendants' ordinary course of business documents in this case "conclusively demonstrate that competition with other [DDIY] firms drive Defendants' pricing decisions, quality improvements, and corporate strategy" for their own DDIY products—thus supporting the government's view of the relevant market. Pl.'s Post-Trial Mem. at 7. The defendants contend that the government has relied on "select, 'out-of-context' snippets from documents," and that the documents as a whole support the defendants' view that the relevant product market is all methods of tax preparation. Defs.' Post-Trial Mem. at 1. The Court finds that the documentary evidence in this case supports the conclusion that DDIY is the relevant product market.

Internal TaxACT documents establish that TaxACT has viewed DDIY offerings by HRB and TurboTax as its primary competitors, that it has tracked their marketing, product offerings, and pricing, and that it has determined its own pricing and business strategy in relation to those companies' DDIY products. *See* GX 295-16 ("Competitive Analysis" comparing the three companies); GX 102 (email explaining TaxACT is a "direct competitor" with HRB and Intuit's

products); GX 55 (Greif Dep.) at 137-38 (describing TaxACT's compilation of a routine, end-of-season competitive analysis that "typically" covers Intuit, HRB, and TaxACT). Confidential memoranda prepared by TaxACT's investment bankers for potential private equity buyers of TaxACT identify HRB and TurboTax as TaxACT's primary competitors in a DDIY market. *See* GX 7 (Greene Holcomb & Fisher "Confidential Memorandum") at 14 ("The Company's major competitors for both desktop and Internet-based income tax software and e-filing services include Intuit (the makers of TurboTax software) and H&R Block (the makers of TaxCut software)."); GX 134 (Deutsche Bank "Confidential Information Memorandum") at 17 ("The Company's two main competitors, Intuit and H&R Block. . ."); *see also* Dunn, TT, 9/7/11 p.m., at 97-104. These documents also recognize that TaxACT's strategy for competing with Intuit and HRB is to offer a lower price for what it deems a superior product. GX 7 at 14 ("Relative to its two major competitors, 2nd Story has positioned its product offerings as being of equal or higher quality, and completely fulfilling the needs of a vast portion of the potential market. It also pursues a pricing strategy that positions its products and services meaningfully below either Intuit or H&R Block, in some instances free.").

While, as defendants point out, parts of these TaxACT documents also discuss the broader tax preparation industry, these documents make clear that TaxACT's own view – and that conveyed by its investment bankers to potential buyers – is that the company primarily competes in a DDIY market against Intuit and HRB and that it develops its pricing and business strategy with that market and those competitors in mind. These documents are strong evidence that DDIY is the relevant product market. *See Whole Foods*, 548 F.3d at 1045 (Tatel, J.) ("[E]vidence of industry or public recognition of the submarket as a separate economic unit

matters because we assume that economic actors usually have accurate perceptions of economic realities.") (internal quotation omitted).

Internal HRB documents also evidence HRB's perception of a discrete DDIY market or market segment. HRB and its outside consultants have tracked its digital competitors' activities, prices, and product offerings. *See* GX 28-19 ("2009 Competitive Price Comparison"); GX 118 (independent analyst's report analyzing digital competitors as one of three separate categories of competitors); GX 61-8 at 1 (slide on competition in "digital market" identifying TurboTax and TaxACT as competitors); GX 199 (HRB "digital strategy update" Powerpoint tracking features and prices for TurboTax and TaxACT); GX 188 (HRB spreadsheet comparing HRB, TurboTax, and TaxACT prices for various product offerings). Documents from HRB's DDIY business have also referred to HRB, TaxACT, and TurboTax as the "Big Three" competitors in the DDIY market. GX 61-3 ("OCS Offsite Competitive Intelligence Review of TS07") at 5; GX 61-4 at 1 (email referencing request for data from consultant regarding "big 3 digital tax prep companies"); *see also* GX 70 (email from head of HRB's digital business stating its "only real direct competitors are turbotax in san diego and taxact in cedar rapids" [sic]); Ernst, TT, 9/7/11 a.m., at 13-14. Finally, the documents show that, in connection with a proposed acquisition of TaxACT, HRB identified the proposed transaction as a way to grow its digital "market share" and has measured TaxACT's market share in a DDIY market. GX 130 at 96-99; GX 21-37 (projections from 2009 for different potential scenarios for acquisition of TaxACT, including their effect on DDIY market share); *see also* Newkirk, TT, 9/7/11 a.m., at 95-96 (explaining GX 21-37). All of these documents also provide evidence that DDIY is a relevant product market.

The defendants acknowledge that "the merging parties certainly have documents that discuss each other and digital competitors generally, and even reference a digital market and the

'Big Three,'" but contend this evidence is insufficient to prove a market. Defs.' Post-Trial Mem. at 9. Rather, the defendants argue that the documents show that the relevant market is all methods of tax preparation, especially in light of documented competition between DDIY providers and assisted providers for the same overall pool of U.S. taxpayers who are potential customers. *See id.* 9-10; *see, e.g.*, DX 78 at 4 (Intuit document explaining 2011 strategic goal of acquiring tax store customers); GX 650 at 41 (Intuit document noting goal of acquiring tax store customers and specifically mentioning HRB). As discussed below, the Court disagrees and finds that the relevant product market is DDIY products.

2. The Relevant Product Market Does Not Include Assisted Tax Preparation Or Manual Preparation.

It is beyond debate – and conceded by the plaintiff – that all methods of tax preparation are, to some degree, in competition. Pl.'s Post-Trial Mem. at 8. All tax preparation methods provide taxpayers with a means to perform the task of completing a tax return, but each method is starkly different. Thus, while providers of all tax preparation methods may compete at some level, this "does not necessarily require that [they] be included in the relevant product market for antitrust purposes." *Staples*, 970 F. Supp. at 1075. DDIY tax preparation products differ from manual tax preparation and assisted tax preparation products in a number of meaningful ways. As compared to manual and assisted methods, DDIY products involve different technology, price, convenience level, time investment, mental effort and type of interaction by the consumer. Taken together, these different attributes make the consumer experience of using DDIY products quite distinct from other methods of tax preparation. *See Whole Foods*, 548 F.3d at 1037-38 (Brown, J.) (noting that a "product's peculiar characteristics and uses" and "distinct prices" may distinguish a relevant market) (citing *Brown Shoe*, 370 U.S. at 325); *see also, e.g.*, GX 130 at 140 (HRB internal analysis discussing convenience and price as factors differentiating DDIY and

assisted methods for consumers). The question for this court is whether DDIY and other methods of tax preparation are "reasonably interchangeable" so that it would not be profitable to have a monopoly over only DDIY products.

a. Assisted Tax Preparation Is Not In The Relevant Product Market.

Apart from the analysis of their economic expert, the defendants' main argument for inclusion of assisted tax preparation in the relevant market is that DDIY and assisted companies compete for customers.[11] As evidence for this point, the defendants emphasize that Intuit's marketing efforts have targeted HRB's assisted customers. *See* DX 78 at 3 (Intuit document noting strategic goal to "Beat Tax Store[s]"). While the evidence does show that companies in the DDIY and assisted markets all generally compete with each other for the same overall pool of potential customers – U.S. taxpayers – that fact does not necessarily mean that DDIY and assisted must be viewed as part of the same relevant product market. DDIY provides customers with tax preparation services through an entirely different method, technology, and user experience than assisted preparation. As Judge Tatel explained in *Whole Foods*:

> [W]hen the automobile was first invented, competing auto manufacturers obviously took customers primarily from companies selling horses and buggies, not from other auto manufacturers, but that hardly shows that cars and horse-drawn carriages should be treated as the same product market. That Whole Foods and Wild Oats have attracted many customers away from conventional grocery stores by offering extensive selections of natural and organic products thus tells us nothing about whether Whole Foods and Wild Oats should be treated as operating in the same market as conventional grocery stores. Indeed, courts have often found that sufficiently innovative retailers can constitute a distinct product market even when they take customers from existing retailers.

Whole Foods, 548 F.3d at 1048; *see also Staples*, 970 F. Supp. at 1074-80 (finding a distinct market of office supply superstores despite competition from mail-order catalogues and stores carrying a broader range of merchandise).

[11] The defendants' primary argument for inclusion of both assisted and pen-and-paper in the relevant market is based upon their economic expert's analysis of data derived from two consumer surveys commissioned by the defendants. The Court will analyze the arguments of the defendants' expert economist separately below.

The key question for the Court is whether DDIY and assisted products are sufficiently close substitutes to constrain any anticompetitive DDIY pricing after the proposed merger. Evidence of the absence of close price competition between DDIY and assisted products makes clear that the answer to that question is no—and that DDIY is the relevant product market here. *See Swedish Match,* 131 F. Supp. 2d at 165 ("Distinct pricing is also a consideration" in determining the relevant product market) (citing *Brown Shoe,* 370 U.S. at 325). Significantly, despite some DDIY efforts to capture tax store customers, none of the major DDIY competitors sets their prices based on consideration of assisted prices. *See, e.g.*, Ernst, TT, 9/7/11 a.m., at 35 (HRB set its digital and assisted prices separately); {redacted} (Dep.) at 183:18-25 (explaining that {redacted} does not consider assisted pricing in setting prices because its prices are already "substantially less than both tax stores and most professionals"). Indeed, there are quite significant price disparities between the average prices of DDIY and assisted products. The average price of TurboTax, the most popular DDIY brand is approximately $55. GX 293 (Intuit Dep.) at 21. The average price of HRB's DDIY products is approximately $25. GX 296-7 at 6. Overall, the DDIY industry average price is $44.13. GX 121 at 57. In contrast, the typical price of an assisted tax return is significantly higher, in the range of $150-200.[12] A 10 percent or even 20 percent price increase in the average price of DDIY would only move the average price up to $48.54 or $52.96, respectively – still substantially below the average price of assisted tax products. The overall lack of evidence of price competition between DDIY and assisted products supports the conclusion that DDIY is a separate relevant product market for evaluating this transaction, despite the fact that DDIY and assisted firms target their marketing efforts at the same pool of customers.

[12] *See* GX 128 (HRB "TS10 Market Dynamics" presentation) at 38 {redacted}; *see also id.* {redacted}; GX 293 (Intuit Dep.) at 21:9-14 ("The average price of a tax store is in the range of $200."); Bennett, TT, 9/6/11 p.m., at 100 (estimating $150 range for assisted returns offered at Jackson Hewitt and HRB offices at Wal-Mart locations).

The defendants point to some evidence that HRB sets prices for certain assisted products to compete with DDIY. For example, defendants note that in 2009, HRB "reduced prices on its assisted tax preparation services to $39 for federal 1040EZ preparation and $29 for state tax preparation to compete with and {redacted}" to DDIY. DFF ¶ 77a. These are limited product offerings for which prices appear well below even the 25th percentile price for HRB's assisted products. *See* GX 128 (HRB "TS10 Market Dynamics" presentation) at 38 (noting, for Tax Season 2010, that the 25th percentile for prices at HRB stores was {higher than DDIY}). Relatedly, the defendants' claim that prices for assisted and DDIY products "significantly overlap" is not strongly supported and relies on a comparison of the most limited, low-end assisted products with DDIY products generally. *See* DFF ¶ 78b (citing tax year 2009 data that show that 14 percent of customers using name-brand tax stores paid $50 or less and another 20 percent paid between $51-100); *id.* ¶ 78c-d (quoting prices for Jackson Hewitt's preparation of form 1040EZ, a simplified tax form, at Wal-Mart and for HRB's Second Look service, which actually only double-checks an already completed tax return for errors). In sum, while defendants' have identified isolated instances in which assisted product offerings are priced lower than the average prices for typical assisted products, they do not and cannot demonstrate that this is generally the case.

Testimony from HRB executives further supports treating DDIY as a relevant product market in evaluating this transaction. HRB's DDIY and assisted businesses are run as separate business units. Bennett, TT, 9/6/11 a.m., at 106. Alan Bennett, who was the CEO of HRB in 2010 when the parties reached the proposed merger agreement, testified that "net-net," he did not believe that HRB's DDIY business had impacted its assisted business in terms of taking away

customers.[13] *Id.* at 108; *see also* GX 1151 at 4 (HRB internal analysis stating "Online is not growing materially at the expense of assisted."). Mark Ernst, HRB's CEO from 2001 to 2007, also explained that, in his opinion based on research he reviewed while at HRB, the primary reason consumers switched between assisted and DDIY was because of "life events" that led to changes in tax status. Ernst, TT, 9/7/11 a.m., at 34-35.

Finally, defendants argue that their broad relevant market is appropriate because there is "industry movement toward 'hybrid' products that combine some elements of both digital and assisted tax preparation." Defs.' Post-Trial Mem. at 11. Based on the evidence presented at the hearing, however, it would be premature for the Court to identify any trend toward hybrid products. In fact, neither Intuit nor TaxACT presently offers a hybrid product and the defendants openly concede that HRB's current hybrid product has had "somewhat limited success," which defendants attribute to "technical issues" and a "lack of consistent marketing." *Id.* at 11 n.16. {redacted} {T}he Court finds it unlikely that there will be a sufficiently large scale shift into these products in the immediate future to compel the conclusion that DDIY and assisted products make up the same relevant product market.

b. Manual Tax Preparation Is Not In The Relevant Product Market.

The defendants also argue that manual tax preparation, or pen-and-paper, should be included in the relevant product market. At the outset, the Court notes 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. Even so, the defendants argue pen-and-paper should be included in the relevant product market because it acts as a "significant competitive constraint" on DDIY. Defs.' Post-

[13] By "net-net," Mr. Bennett meant that while there is customer switching between the DDIY and assisted businesses, the total share of customers in each has been relatively stable over the past few years, such that Mr. Bennett could conclude that the two business lines "do not steal customers back and forth net." Bennett, TT, 9/6/11 a.m., at 108.

Trial Mem. at 11. The defendants' argument relies primarily on two factors. First, the defendants' cite the results of a 2011 email survey of TaxACT customers. *See id.* For reasons detailed in the following section, the Court declines to rely on this email survey. Second, the defendants point to documents and testimony indicating that TaxACT has considered possible diversion to pen-and-paper in setting its prices. *See id.* at 11-12.

The Court finds that pen-and-paper is not part of the relevant market because it does not believe a sufficient number of consumers would switch to pen-and-paper in response to a small, but significant increase in DDIY prices. The possibility of preparing one's own tax return necessarily constrains the prices of other methods of preparation at some level. For example, if the price of DDIY and assisted products were raised to $1 million per tax return, surely all but the most well-heeled taxpayers would switch to pen-and-paper. Yet, at the more practical price increase levels that trigger antitrust concern – the typical five to ten percent price increase of the SSNIP test – pen-and-paper preparation is unlikely to provide a meaningful restraint for DDIY products, which currently sell for an average price of $44.13. GX 121 at 57.

The government well illustrated the overly broad nature of defendants' proposed relevant market by posing to the defendants' expert the hypothetical question of whether "sitting at home and drinking chicken soup [would be] part of the market for [manufactured] cold remedies?" Meyer, TT, 9/13/11 a.m., at 65. The defendants' expert responded that the real "question is if the price of cold medicines went up sufficiently, would people turn to chicken soup?" *Id.* As an initial matter, in contrast to the defendants' expert, the Court doubts that it would ever be legally appropriate to define a relevant product market that included manufactured cold remedies and ordinary chicken soup. This conclusion flows from the deep functional differences between those products. Setting that issue aside, however, a price has increased "sufficiently" to trigger

antitrust concern at the level of a five to ten percent small, but significant non-transitory increase in price. Just as chicken soup is unlikely to constrain the price of manufactured cold remedies sufficiently, the Court concludes that a SSNIP in DDIY would not be constrained by people turning to pen-and-paper. First, the share of returns prepared via pen-and-paper has dwindled over the past decade, as the DDIY market has grown. Bennett, TT, 9/6/11 a.m, at 118; GX 296 (Houseworth Dep.) at 66-68. Second, while pen-and-paper filers have been a net source of new customers for DDIY companies, both HRB and {redacted} executives have testified that they do not believe their DDIY products compete closely with pen-and-paper methods. {redacted} (Dep.) at 37:20-38:10; *see* GX 296 (Houseworth Dep.) 89-90. Third, courts in antitrust cases frequently exclude similar "self-supply" substitutes from relevant product markets. *See, e.g.*, *FTC v. H.J. Heinz Co.*, 116 F. Supp. 2d 190, 195 (D.D.C. 2000), *rev'd on other grounds*, 246 F.3d 708 (D.C. Cir. 2001) (noting that homemade baby food and breast milk should not be included in the jarred baby food market even though substitution was possible because "the Supreme Court's interchangeability test refers to *products*."); *CCC Holdings*, 605 F. Supp. 2d at 41-42 (excluding books that can be used to perform insurance loss valuations by hand from market for loss valuation software); *United States v. Visa U.S.A. Inc.*, 163 F. Supp. 2d 322, 338 (S.D.N.Y. 2001) (excluding cash and checks from general purpose credit card market).

The main case the defendants rely on to show that "self-supply" substitutes should be included in the relevant market involved a consumer market consisting of vertically integrated companies and explicitly distinguished cases, such as this one, involving markets of individual consumers. In *United States v. Sungard Data Systems, Inc.*, Judge Huvelle found that disaster recovery computer systems developed internally by companies were in the same relevant product market as shared data recovery systems provided by outside vendors. *Sungard*, 172 F. Supp. 2d

at 187-89. The *Sungard* court, however, distinguished the case before it – which involved vertical integration – from the situation in *Heinz*, the case involving the market for jarred baby food, because "homemade baby food is not an aspect of vertical integration . . . [and] individual consumers cannot vertically integrate by producing a product that they would otherwise have to purchase." *Id.* at 187 n.15. In finding that in-house computer systems were included in its relevant product market, the *Sungard* court cited the following example from Areeda & Hovenkamp ¶ 535e regarding vertical integration:

> If iron ore is the relevant market and if shares are best measured there by sales, then internally used ore—so-called captive output—is part of the ore market even though it is not sold as such.
>
> In measuring the market power of a defendant selling iron ore, the ore used internally by other firms constrains the defendant's ability to profit by raising ore prices to monopoly levels. The higher ore price may induce an integrated firm to expand its ore production—to supply others in direct competition with the alleged monopolist or to expand its own steel production and thereby reduce the demand of other steel makers for ore, or both. Hence, captive output constrains the defendant regardless of whether integrated firms sell their ore to other steel makers previously purchasing from the defendant. In sum, the integrated firm's ore output belongs in the market.

Id. at 186 n.14. This rationale for including "self-supply" in a relevant product market does not appear to apply to the DDIY market in which the consumers are individuals and not also potential traders or producers.

While some diversion from DDIY to manual filing may occur in response to a SSNIP, the Court finds that it would likely be limited and marginal. The functional experience of using a DDIY product is meaningfully different from the self-service task of filling out tax forms independently. Manual completion of a tax return requires different tools, effort, resources, and time investment by a consumer than use of either DDIY or assisted methods. The following discussion from *United States v. Visa U.S.A. Inc.* regarding why cash and checks should not be included in the credit card market is instructive here:

> [A]lthough it is literally true that, in a general sense, cash and checks compete with general purpose cards as an option for payment by consumers and that growth in payments via cards takes share from cash and checks in some instances, cash and checks do not drive many of the means of competition in the general purpose card market. In this respect, [the expert's] analogy of the general purpose card market to that for airplane travel is illustrative. [The expert] argues that while it is true that at the margin there is some competition for customers among planes, trains, cars and buses, the reality is that airplane travel is a distinct product in which airlines are the principal drivers of competition. Any airline that had monopoly power over airline travel could raise prices or limit output without significant concern about competition from other forms of transportation. The same holds true for competition among general purpose credit and charge cards.

Visa U.S.A. Inc., 163 F. Supp. 2d at 338. Here, the same analogy to airplane travel holds true for competition among DDIY providers, who provide a distinct product for completion of tax returns. Indeed, the pen-and-paper method, in which the consumer essentially relies on his or her own labor to prepare a tax return, is perhaps most analogous to walking as opposed to purchasing a ride on any means of transportation. In sum, filling out a tax return manually is not reasonably interchangeable with DDIY products that effectively fill out the tax return with data input provided by the consumer.

Inclusion of all possible methods of tax preparation, including pen-and-paper, in the relevant product market also violates the principle that the relevant product market should ordinarily be defined as the smallest product market that will satisfy the hypothetical monopolist test. *See* Merger Guidelines § 4.1.1 ("When the Agencies rely on market shares and concentration, they usually do so in the smallest relevant market satisfying the hypothetical monopolist test."); *see also* Warren-Boulton, TT, 9/8/11 p.m., at 35-36. Indeed, the defendants' inclusion of pen-and-paper in the relevant market ignores at least one obvious, smaller market possibility that they might have proposed – the combined market of all DDIY and assisted tax preparation products. It is hardly plausible that a monopolist of this market – to which the only alternative would be pen-and-paper – could not impose a SSNIP.

The defendants' proposed relevant market of all methods of tax return preparation is so broadly defined that, as the plaintiff's expert testified, there are no conceivable alternatives besides going to jail, fleeing to Canada, or not earning any taxable income. Warren-Boulton, TT, 9/8/11 p.m., at 35-36. As the plaintiff's expert put it, "if you're talking about the market for all tax preparation, you're talking about a market where, in economist terms, demand is completely [in]elastic. There are no alternatives." *Id.* at 35. In such circumstances, the usual tools of antitrust analysis – such as the hypothetical monopolist test – cease being useful because it is self-evident that a monopolist of all forms of tax preparation, including self-preparation, could impose a small, but significant price increase. Indeed, a monopolist in that situation could essentially name any price since taxpayers would have no alternative but to pay it. As the plaintiff's expert testified, defining a market that broadly

> negates the entire purpose of defining a relevant market in an antitrust case. You want to define a relevant market in an antitrust case so then [you can calculate] shares and the change in shares makes sense. I don't want to go to infinity . . . I want to define a relevant market under . . .the smallest market principle, which is I want to define the relevant market so that if a hypothetical monopolist . . . did manage to control all of those products, they would impose a significant price increase, large enough to be of concern but not so large as to make the whole exercise pointless.

Id. at 35-36. The Court agrees with this assessment and finds the defendants' proposed relevant market to be overbroad.

3. The Economic Expert Testimony Tends To Confirm That DDIY Is The Relevant Product Market.

Both the plaintiff and the defendants presented testimony from expert economists to support their view of the relevant product market.[14] In addition to their testimony at the hearing,

[14] The plaintiff presented expert testimony on market definition from Frederick R. Warren-Boulton, an economist at MiCRA, an economics consulting and research firm. GX 121 (Warren-Boulton Rep.) at 1. Dr. Warren-Boulton holds a B.A. from Yale University, a Ph.D. in economics from Princeton University, and formerly served as the chief economist for the Antitrust Division of the U.S. Department of Justice. *Id.* Dr. Warren-Boulton has previously served as an expert witness in other antitrust cases, including cases challenging the possible

these expert witnesses also provided a detailed expert report and an affidavit summarizing their analysis and conclusions.

The Court finds that the analysis performed by the plaintiff's expert tends to confirm that DDIY is a relevant product market, although the available data in this case limited the predictive power of the plaintiff's expert's economic models. The Court also finds that it cannot draw any conclusions from defendants' expert's analysis because of severe shortcomings in the underlying consumer survey data upon which the defendants' expert relied.

a. Plaintiff's Expert - Dr. Warren-Boulton

The plaintiff's expert, Dr. Warren-Boulton, found the relevant product market to be DDIY. He determined that a hypothetical monopolist of DDIY products could profitably impose a SSNIP for at least one DDIY product, and that consumer substitution to assisted methods or pen-and-paper would be insufficient to defeat the SSNIP. GX 121 (Warren-Boulton Rep.) at 12.

Dr. Warren-Boulton began his analysis by postulating that DDIY was the relevant product market and then he used two principal analytical tests to confirm the validity of that assumption. He began by testing DDIY as a relevant market for a few reasons. First, he concluded that the parties' DDIY products are substantially similar in terms of functionality. GX 121 (Warren-Boulton Rep.) at 12-18. Second, he concluded from his review of the defendants' business documents that they viewed DDIY as a discrete product market when competing in the

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anticompetitive effects of a merger or acquisition. *Id.* (noting involvement in *FTC v. Staples, Inc.*, 970 F. Supp. 1066, 1074 (D.D.C. 1997)).

The defendants presented expert testimony from Christine Siegwarth Meyer, an economist at National Economic Research Associates, Inc., an economics consulting and research firm. DX 17 (Meyer Rep.) at 1. Dr. Meyer holds a B.A. from the United States Military Academy at West Point, a Ph.D. in economics from the Massachusetts Institute of Technology, and has taught economics at the university level. *Id.* Dr. Meyer has not previously provided expert testimony regarding the possible anticompetitive effects of a merger or acquisition. Meyer, TT, 9/13/11 a.m., at 39.

ordinary course of business. *Id*. Third, he ruled out including pen-and-paper and assisted products in the relevant product market based on a consideration of various data. *Id.* at 24-32.

Dr. Warren-Boulton's decision to begin the relevant market analysis with DDIY was appropriate. *See* Areeda & Hovenkamp ¶ 536, at 287 ("[T]wo products are provisionally part of the same market [for hypothetical monopolist analysis] when they employ similar technologies and similar costs and customers use them interchangeably. . . In cases of doubt, [products] should generally be excluded from the provisional market, for incorrect exclusions will ultimately be brought into the market via the price increase methodology."). The parties' DDIY products all provide a fundamentally similar service and a similar user experience for the consumer when compared with other methods of tax preparation. The DDIY consumer sits down at a computer and interacts with the DDIY software, which prompts the consumer for information and ultimately completes the consumer's tax return. This experience is qualitatively different than that of hiring a tax professional or figuring out how to complete one's own tax return manually. Various other evidence in the record also supports the fundamental functional similarity of the technology underlying the parties' DDIY products – perhaps most notably the testimony that post-merger, HRB plans to migrate {redacted} onto TaxACT's software "engine" {redacted}. *See* Dunn, TT, 9/8/11 p.m. (sealed), at 16-17.

As discussed in detail above, various documentary evidence suggests that the parties treat DDIY as a distinct product market in the ordinary course of business.

Dr. Warren-Boulton also considered whether the pen-and-paper and assisted methods should be included in the provisional relevant market, as the defendants contend, and concluded that they should not be.

Dr. Warren-Boulton ruled out including pen-and-paper in the relevant product market, concluding instead that historical tax return data reflects "a gradual migration of customers to [DDIY] from more traditional methods like pen-and paper." GX 121 (Warren-Boulton Rep.) at 24. The percentage of returns prepared by pen-and-paper has fallen considerably over the last decade, while the percentage of DDIY has grown. *Id.* Changes in the yearly percentage shares of taxpayers using pen-and-paper do not appear correlated to changes in the yearly average price of DDIY. *Id.* at 27. Finally, based on IRS data, Dr. Warren-Boulton observed that taxpayers who switched from DDIY to pen-and-paper for tax seasons 2008 and 2009 on average experienced a decrease in tax return complexity, suggesting that much switching from DDIY products to pen-and-paper is driven by such complexity decreases.[15]

Dr. Warren-Boulton also ruled out including the assisted tax preparation methods in the relevant market based on consideration of several factors. He reviewed HRB documents that conclude that growth in DDIY has not come at the expense of HRB's assisted business. *Id.* at 28. Testimony from HRB employees, including the former CEO, also reinforced the same conclusion. *Id.* at 28-29. He also cited HRB internal studies, which concluded that consumers who have switched from DDIY to assisted are likely to have experienced a change in tax complexity. He found that HRB's internal conclusion was consistent with IRS switching data, which also indicated a correlation between switching from DDIY to assisted and an increase in tax complexity. *Id*. at 29-30. Finally, Dr. Warren-Boulton noted that, based on data from tax years 2004-2009, increases in the relative price of assisted products were not associated with decreases in the relative market share of assisted products and increases in the relative market

[15] Switching, as discussed further below, refers to the switching of consumers between different products for any reason. The IRS categorizes tax returns into one of three complexity categories: Simple, Intermediate, and Complex. Accordingly, the IRS data only reflects complexity changes that are sufficient to result in assignment to a different one of the three categories.

share of DDIY, as might be expected if DDIY and assisted prices moved in a single, price-responsive market. *Id.* at 32.

Therefore, having determined that the best provisional relevant market is DDIY and not all methods of tax preparation, Dr. Warren-Boulton then performed two economic tests to confirm that a hypothetical monopolist of all DDIY products could profitably impose a SSNIP. If these economic tests indicated that a hypothetical monopolist could not profitably impose a SSNIP, then the tests would call for the relevant market to be expanded. The tests, however, validated the relevant market as DDIY, as detailed below.

The economic tests Dr. Warren-Boulton applied relied heavily upon switching data from the IRS. Switching refers to the number of consumers who switch between different products for any reason. In any given year, many taxpayers switch from the tax preparation method they used in the prior year to a new method. Since the IRS processes all U.S. tax returns each year and tracks data about the methods of tax preparation that taxpayers used, there is ample, reliable data that market analysts can use to see how many taxpayers switched between methods each year. The IRS data, however, provides little direct insight about *why* any given taxpayer switched methods of preparation. The switch could have been for reasons of price, convenience, changes in the consumer's personal situation, an increase or decrease in tax complexity, a loss of confidence in the prior method of preparation, or any other reason.

As opposed to switching, diversion refers to a consumer's response to a measured increase in the price of a product. In other words, diversion measures to what extent consumers of a given product will switch (or be "diverted") to other products in response to a price increase in the given product. The IRS switching data does not directly measure diversion because switching can occur for any number of reasons, many of which may not involve price.

Unfortunately, no direct, reliable data on diversion exists in this case. The plaintiff's expert argues, however, that the IRS switching data can provide at least some estimate of diversion. While this approach is not without its limitations, as discussed further below, the Court finds that the switching data is at least somewhat indicative of likely diversion ratios. Moreover, the IRS data is highly reliable because (1) the sample size is enormous, since it encompasses over 100 million taxpayers, and (2) the data reflects actual historical tax return filing patterns as opposed to predicted behavior.[16]

The defendant's expert, who criticizes reliance on this switching data, suggests instead that a better analysis can be based upon simulated diversion data derived from consumer surveys commissioned by the defendants. As described more fully below, however, the shortcomings of these survey-derived diversion data are so substantial that the Court cannot rely on them.

i. Critical Loss Analysis

The first economic test Dr. Warren-Boulton performed is known as a "critical loss" analysis. This test attempts to calculate "the largest amount of sales that a monopolist can lose before a price increase becomes unprofitable." *Swedish Match*, 131 F. Supp. 2d at 160. Dr. Warren-Boulton calculated that for a 10 percent price increase in DDIY, the price increase would

[16] One limitation in the IRS data set is that if a taxpayer uses a DDIY product to prepare the return, but then prints and mails the return instead of e-filing it, the IRS does not attribute the filing to the DDIY provider and instead lists it in a generic "v-coded" pool of returns. At the hearing, the defendants' criticized the IRS switching data set as problematic on these grounds, suggesting that up to 30 million returns may be "v-coded." *See* Warren-Boulton, TT 9/20/11 a.m., at 21-22. As Dr. Warren-Boulton fully addressed in his expert report, however, a "conservative method for dealing with this issue is to drop all v-coded returns from the analysis," which would still leave well over 100 million returns in the IRS data set. *Id.*; GX 121 (Warren-Boulton Rep.) at 47. The defendants did not identify any reason the v-coded data would be likely to skew the data set. Thus, even if the v-coded data is disregarded, the IRS data set remains extensive and reliable. It is also worth noting that the IRS data does not distinguish between the DDIY providers' various products, so only firm-level switching rates are available. GX 121 (Warren-Boulton Rep.) at 47

be profitable if the resulting lost sales did not surpass 16.7 percent.[17] GX 121 (Warren-Boulton Rep.) at 34.

Dr. Warren-Boulton then sought to compare this critical loss threshold with "aggregate diversion ratios." The aggregate diversion ratio for any given product represents the proportion of lost sales that are recaptured by all other firms in the proposed market as the result of a price increase. Since these lost sales are recaptured within the proposed market, they are not lost to the hypothetical monopolist. According to Dr. Warren-Boulton, economists have shown that if the aggregate diversion ratio to products inside the proposed relevant market exceeds the critical loss threshold, then the critical loss analysis indicates that a SSNIP at that level would be profitable for a hypothetical monopolist. *Id.* at 34 (citing Michael Katz and Carl Shapiro, *Critical Loss: Let's Tell the Whole Story*, ANTITRUST (Spring 2003) at 49 -56); *see also* Warren-Boulton, TT, 9/9/11 p.m., at 33-34.

Because no diversion data is available, Dr. Warren-Boulton relied instead on IRS switching data to estimate aggregate diversion ratios. *Id.* These data show that of the taxpayers who left HRB's DDIY products between tax year 2007 and 2008,[18] 57 percent went to other DDIY providers. Of those who left TaxACT, 53 percent stayed in DDIY, and for TurboTax, 39 percent stayed in DDIY. *Id.* at 34-35. Since these numbers are all well above the 16.7 percent critical loss threshold, Dr. Warren-Boulton concluded a 10 percent SSNIP in the DDIY market would be profitable for a hypothetical monopolist.

In cross-examining Dr. Warren-Boulton, the defendants suggested that the critical loss test is meaningless because it would seem to validate numerous different candidate markets

[17] The formula for critical loss is L = X/(X + M), where L is the critical loss, X is the percentage price increase, and M is the hypothetical monopolist's gross margin. Assuming a 50 percent margin, which Dr. Warren-Boulton claims is a conservative estimate for firms in the DDIY market, then the critical loss for a 10 percent SSNIP is 16.7 percent. 16.7 percent is the result of applying 10 percent and 50 percent in the formula X/(X+M): .167 = .1/(.1+.5).

[18] These are the last two years for which this data was available.

consisting of various assortments of tax preparation businesses. Warren-Boulton, TT, 9/9/11 p.m., at 20-42. For example, the defendants demonstrated that the test could also validate a market consisting of just HRB and Intuit or a market consisting of just TaxACT and Intuit. *See* DX 9802. Dr. Warren-Boulton noted in his testimony, however, that such markets are "smaller, irrelevant" markets for evaluating the proposed transaction between HRB and TaxACT. Warren-Boulton, TT, 9/9/11 p.m., at 41; *see also* Areeda & Hovenkamp ¶ 533c, at 254 ("[C]ourts correctly search for a 'relevant market' – that is a market relevant to the particular legal issue being litigated."). The fact that critical loss analysis would validate other groupings of businesses does not undermine Dr. Warren-Boulton's reliance on it to validate DDIY as the relevant market in this case.[19] Indeed, rather than urging a smaller relevant market definition, the defendants urged the Court to define the market much more broadly. Nonetheless, the Court appreciates the defendants' point that the critical loss test alone cannot answer the relevant market inquiry. While some inappropriate proposed relevant markets would be ruled out by the critical loss test, the fact that the test could still confirm multiple relevant markets means that the Court must rely on additional evidence in reaching the single, appropriate market definition.

ii. Merger Simulation

In addition to the critical loss analysis, Dr. Warren-Boulton also performed an economic simulation of a merger among the HRB, TaxACT, and Intuit. GX 121 (Warren-Boulton Rep.) at

[19] The defendants also referred obliquely in cross examination to an academic debate surrounding the proper way to perform critical loss analysis. Warren-Boulton, TT, 9/9/11 p.m., at 23. Dr. Warren-Boulton acknowledged his awareness of the existence of this debate and the defendants' counsel did not pursue the topic further. *Id.* The Court has no basis for disputing Dr. Warren-Boulton's application of critical loss analysis based merely on the existence of unspecified academic critiques. The Court notes that the critical loss analysis is specifically endorsed by the Merger Guidelines as a method for implementing the SSNIP test, *see* Merger Guidelines § 4.1.3, and has been accepted by courts as a standard methodology. *See FTC v. CCC Holdings Inc.*, 605 F. Supp. 2d 26, 40 n.16 (D.D.C. 2009) ("Critical loss analysis is a standard tool used by economists to study potentially relevant markets."). The court in *CCC Holdings* ultimately did not rely on the expert's application of critical loss analysis due to what the court deemed a "gap" or oversight in the expert's reasoning, but the court nonetheless adopted the same relevant product market that the critical loss analysis had validated. *See id.* at 40-41.

35. This simulation, known as a Bertrand model, predicted that a monopolist of the DDIY products of these three companies would find it profit-maximizing to raise TaxACT's price by 83 percent, HRB's price by 37 percent and TurboTax's price by 11 percent absent efficiencies. *Id.* Dr. Warren Boulton concluded that this simulation also confirms that DDIY is the relevant product market.[20]

iii. Critiques of Dr. Warren-Boulton's Analysis

The defendants' expert, Dr. Meyer, critiques Dr. Warren-Boulton's analysis in numerous ways. Her most fundamental critique is that his reliance on switching data as a proxy for diversion is flawed because switching can occur for any number of reasons and, therefore, it is not necessarily indicative of what products consumers would switch to in response to a price increase. DX 17 (Meyer Rep.) at 59-60. Dr. Meyer is certainly correct in this critique. Dr. Warren-Boulton, however, testified forthrightly about the limitations involved in relying on switching data as a proxy for diversion:

> Using migration [i.e., switching] doesn't really answer, or it doesn't answer the precise question of [the] merger guidelines, which of course is, where would you go if there was a small but significant price increase? It basically asks the question, where did you go? And you could go for a lot of reasons. You could go because the price has changed, you could go because the quality changes, you could go because you changed. Complexity changes. And there's a lot of evidence in the record that people switch because of changes in their own complexity. But using migration percentages, or using those gives you, I think, a reasonable second estimate of diversion ratios, because it's really asking the question, you know, if you went to some -- if for some reason you decided to go from HRB to TaxACT, for all those reasons, is that roughly about the same percentages if you went due to a price increase?

Warren-Boulton, TT, 9/9/11 a.m., at 13-14. Thus, switching data does not necessarily indicate diversion for the reasons both experts have identified. In light of all the evidence in the record and the general similarity of DDIY products, the Court credits Dr. Warren-Boulton's conclusion

[20] Dr. Warren-Boulton's merger simulation is addressed further below in the Court's discussion of unilateral effects in Section III.B.2.c.

that it was reasonable to use switching data as a proxy for diversion, especially since no more refined historical data apparently exists. Bearing in mind the shortcomings of the switching data, the Court will not treat Dr. Warren-Boulton's hypothetical monopolist analysis as conclusive. The Court will treat it as another data point suggesting that DDIY is the correct relevant market, however.

Another major critique of Dr. Warren-Boulton's hypothetical monopolist analysis – and one that the defendants repeatedly emphasized at the hearing – is that Dr. Warren-Boulton decided "arbitrarily to *exclude* some alternatives that are closer substitutes than the products that he *included*." DX 17 (Meyer Rep.) at 70; *see* Meyer, TT, 9/12/11 p.m., at 20-22. As Dr. Meyer put it at the hearing, "Dr. Warren-Boulton's relevant market is a miscellaneous set of unconnected links, because it doesn't include . . . the closest substitute to H&R Block [At Home], which is assisted tax preparation. It doesn't include pen and paper, which is the closest substitute to TaxACT." Meyer, TT, 9/12/11 p.m., at 24-25. Dr. Meyer identified the "closest substitutes" to the merging parties' products using simulated diversion data. As discussed below, the Court finds this data unreliable and declines to rely upon it. Dr. Meyer opines, however, that Dr. Warren-Boulton failed to include the closest substitutes for the defendants' products in his market, even if switching data is treated as a proxy for diversion, as Dr. Warren-Boulton suggests. For example, Dr. Meyer states that "11.2% of TaxACT's customers in TY2007 switched to assisted preparation in TY2008, while only 2.7% switched to H&R Block At Home and 9.1% switched to TurboTax." DX 17 (Meyer Rep.) at 72. Thus, the defendants contend Dr. Warren-Boulton violated the following principle from the Merger Guidelines: "When applying the hypothetical monopolist test to define a market around a product offered by one of the merging firms, if the market includes a second product, the Agencies will normally

also include a third product if that third product is a closer substitute for the first product than is the second product." *Id.* at 72 (quoting Merger Guidelines § 4.1.1).

The government persuasively illustrated the key flaw in this critique during the cross-examination of the defendants' expert. *See* Meyer, TT, 9/13/11 a.m., at 90-96. Simply put, when determining the "closest substitutes" for products within the DDIY category, Dr. Meyer looked at diversion to individual DDIY brands, such as TurboTax and H&R Block At Home, but when assessing substitutes outside the DDIY category, Dr. Meyer lumped all products and methods together into large, aggregated market categories, such as "assisted" or "pen-and-paper." *See id.* If, instead, DDIY products are grouped together as an aggregated category, similar to the treatment of assisted and pen-and-paper in Dr. Meyer's analysis, then the IRS switching data would indicate that other DDIY products are the closest substitutes for both the DDIY products of HRB and TaxACT. *See* GTX 15, 16 (illustrating this analysis). For HRB, the numbers show 56.8 percent switching to other DDIY, 36.9 percent to assisted, and 6.3 percent to pen-and-paper. GTX 15. For TaxACT, the numbers show 52.7 percent switching to other DDIY, 40.1 percent to assisted, and 7.3 percent to pen-and-paper. GTX 16.

Some of Dr. Meyer's additional critiques have more merit. For example, one datum Dr. Warren-Boulton relied on in his analysis was the outcome of an advertising study showing that HRB's sales {were affected} in cities where TaxACT pursued an advertising campaign. *See* GX 121 (Warren-Boulton Rep.) at 43. The Court accepts Dr. Meyer's critique that few conclusions can be drawn from this observation because the observed correlation could have been due to other variables – for example, the advertising of a third competitor like TurboTax. *See* DX 17 (Meyer Rep.) at 69. Similarly, Dr. Warren-Boulton's observations that changes in relative

market share of DDIY, assisted, and pen-and-paper do not appear correlated to changes in relative price could also have been affected by confounding variables. *Id.* at 67.

b. Defendants' Expert - Dr. Meyer

Dr. Meyer found the relevant product market to be all methods of tax preparation, including DDIY, assisted, and pen-and-paper. Her conclusion rested on various factors, including an analysis of documents and testimony. *See, e.g.*, *id*. at 15. This Court, however, has already discussed its own analysis of the relevant documents and testimony above. Therefore, the Court will focus now on Dr. Meyer's analysis of pricing data and, in particular, her use of and reliance on data derived from customer surveys commissioned by the defendants.

Dr. Meyer found that assisted preparation competes with DDIY in part because the assisted method is the most popular method of tax preparation across all complexity levels. *See id.* at 12-13. Dr. Meyer concedes, however, that "taxpayers with the most complex tax returns are the most likely to use [assisted preparation]." *Id.* Indeed, her data show that this effect is pronounced, with approximately 70 percent of filers of complex returns using assisted and approximately 44 percent of filers of simple returns using assisted. *Id.* DDIY, by contrast, accounts for approximately 37 percent of simple returns and 23 percent of complex returns. *Id.* If anything, these data indicate that assisted products are linked to the needs of consumers with complex returns, suggesting a partially different consumer profile from DDIY products.

Dr. Meyer also noted that the pricing of DDIY and assisted products overlaps, but her analysis of this overlap rests primarily on comparing high-end DDIY products, such as HRB's Best of Both product,[21] with low-end assisted products, such as Jackson Hewitt's offering of

[21] The Best of Both product, as the name implies, actually combines aspects of DDIY and assisted. It enables a return completed on HRB's DDIY product to be reviewed by a tax professional. *See* DX 17 (Meyer Rep.) at 13 n.44. Thus, it is hardly surprising that this "hybrid" product, which features such exhaustive service, is priced more expensively than a typical DDIY product.

limited, simple return preparation at Wal-Mart. *See id.* at 13-14. Dr. Meyer concedes that the median price of assisted is higher than the median DDIY price, *see id.* at 13, and that is the more useful point of comparison.

Apart from these comparisons and her conclusions about how industry participants view the market based on her review of documents and testimony in the record, Dr. Meyer's definition of the relevant market rests primarily on her analysis of simulated diversion data obtained from a "pricing simulator" created for HRB in 2009 and an email survey conducted by TaxACT in 2011. *See id.* at 17-20. These two sources for her conclusions are discussed seriatim below.

i. Pricing Simulator

Dr. Meyer asserts in her report that the pricing simulator "created for HRB in 2009, provides the only direct test of the likely diversion from HRB's [DDIY] products in reaction to a change in price." *Id.* at 17. The simulator itself is a pricing model that runs as a dynamic Excel spreadsheet. *See* Meyer, TT, 9/13/11 a.m., at 42. Dr. Meyer's report in several instances relies upon an internal HRB Powerpoint presentation that reflects the simulator's data output under several different scenarios. *See, e.g.*, DX 17 (Meyer Rep.) at 37 n.155 (citing the Powerpoint). As Dr. Meyer describes, the "simulator was prepared using a discrete choice survey of 6,119 respondents." *Id.* at 17. She explains that "[t]he respondents were shown five pricing scenarios, and the options included online DIY options, software DIY options, assisted tax preparation options, and other DIY options (including pen-and-paper and friends/family)." *Id.* Dr. Meyer further states that the "pricing of the various options changed across scenarios" and a "conjoint analysis was conducted to analyze the effect of a change in the price of each product on its own sales and the sales of the other tax preparation options." *Id.*

Based on the pricing simulator's results, Dr. Meyer calculated diversion ratios for DDIY products. Dr. Meyer found that "the largest diversion from HRB's [DDIY products], in the event of a price increase, is to CPAs and accountants." *Id.* at 18. She found the "second largest diversion from HRB's [DDIY products]" was to pen-and-paper. *Id.* at 19-20. In addition, "the fourth largest diversion is to HRB retail stores." *Id.* at 18. Accordingly, Dr. Meyer concluded that assisted preparation and pen-and-paper were the closest substitutes to HRB's DDIY products and should be included in the relevant market.

There is a critical flaw in the design of the pricing simulator, however, that renders conclusions based on its output unreliable. Despite Dr. Meyer's assertion that the "pricing of the various options changed across [the] scenarios" presented to the survey respondents, not all of the options in the survey underlying the simulator actually had prices associated with them. *See* Meyer, TT, 9/13/11 a.m., at 27-28. Several "non-priced choice options" were available to the survey respondents and these non-priced options included, importantly, "CPA or Accountant," "H&R Block Retail Office," and "Paper & Pencil." DX 9231 (May 2009 Pricing Simulator Powerpoint) at 4. Thus, while the pricing of the various options changed *for some products* across the different scenarios presented in the survey, no prices at all were associated with these critical "non-priced choice options."

The fact that the pricing simulator survey failed to assign any prices to these particular products is, of course, especially significant given Dr. Meyer's findings that the highest diversion from HRB DDIY was to CPAs and then to pen-and-paper. DX 17 (Meyer Rep.) at 18. Indeed, the conclusion that the largest diversion from HRB's DDIY products would be to CPAs is puzzling on its face. This outcome is counterintuitive because CPAs in general tend to be the most expensive form of tax preparation assistance, while DDIY tends to be the least expensive.

See GTX 14. The Court finds that these surprising results are most likely due to the fact that the survey did not, in fact, assign any price at all to the CPA option. Due to this flaw in the survey's design, respondents may well have selected the CPA option and the other non-priced options without even attempting to consider price as a factor in their decision. Accordingly, the Court finds that it simply cannot rely on the diversion ratios predicted by the simulator.

Additional problems with the pricing simulator also render its output unreliable. As Dr. Warren-Boulton noted in his rebuttal of Dr. Meyer's report, the compilation of pricing simulator data which Dr. Meyer relied upon to calculate her diversion ratios contains results that appear to violate what is "[p]erhaps the most fundamental principle in economics." *See* GX 665 (Warren-Boulton Reply Rep.) at 9-10. Increasing the price of one HRB DDIY product in the simulation, TaxCut Online Basic, appears to increase the quantity of the product sold, holding other variables constant. *Id.* This anomaly violates the fundamental economic principle that "demand curves almost always slope downward," which holds that, all other things being equal, consumers buy less of a product when the price goes up. *See id.* In another anomalous result, Dr. Warren-Boulton found that, based on the simulator data, cutting the price of TaxCut Online Basic from $29.95 to $14.95 approximately doubles its predicted market share, but cutting the price only to $19.95 greatly reduces its market share.[22] *Id.* Dr. Warren-Boulton also found that analysis of different print outs of simulator data in the HRB Powerpoint may yield inexplicably different results. For example, relying on the data on one page of the simulator Powerpoint, Dr. Meyer determined that the "the diversion rate from HRB to TaxACT is only 1.6 percent." DX 17 (Meyer Rep.) at 37. Yet, Dr. Warren-Boulton applied the same methodology for calculating

[22] Dr. Meyer testified at the hearing that these anomalies are not reflected in the underlying simulator Excel data, but rather appear only in the printouts of simulator data contained in the internal HRB Powerpoint. In addition, Dr. Meyer explained that she redid her calculations excluding the anomalous data and came up with the same conclusions. *See* Meyer, TT, 9/12/11 p.m., at 45-47. Dr. Meyer never identified the source or cause of the anomalies, however. *Id.* at 49.

the diversion rate to the simulator data reflected on another slide of the same Powerpoint purporting to show the same simulator data as applied to a different scenario. This calculation yielded the "wildly different estimate" of a 32.4 percent diversion rate from HRB to TaxACT. *See* GX 665 (Warren-Boulton Reply Rep.) at 10. These inconsistent and anomalous results provide additional reasons to discredit the diversion ratios Dr. Meyer predicted from the simulator data.

ii. 2011 Email Survey

Dr. Meyer's analysis also relied on a 2011 email survey of TaxACT customers commissioned by the defendants.[23] *See* DX 17 (Meyer Rep.) at 20, 38. In April 2011, TaxACT and HRB jointly commissioned this survey "to determine to which products TaxACT's customers would switch if those customers were displeased with TaxACT because of price, quality, or functionality." *Id.* at 20. The survey asked one primary question: "If you had become dissatisfied with TaxACT's price, functionality, or quality, which of these products or services would you have considered using to prepare your federal taxes?" GX 604 (Survey Summary) at 1. The survey then offered the respondents a list of other products or services from which to choose and instructed them to select all applicable options. *Id.* The list of options that respondents were given varied somewhat depending on the respondents' filing status and the payments they had made for their 2011 tax returns.[24] *Id.* A follow-up question asked the respondents to narrow their selections to a single choice. *Id.*

[23] Prior to the hearing in this case, the government filed a motion in limine to exclude this survey from evidence and to limit Dr. Meyer's opinion to the extent it relied on the survey. *See* ECF No. 60. The government argued that the survey's wording and methodology made it inherently unreliable and therefore inadmissible. While the Court noted that the government had identified a number of defects in the methodology and wording of the survey, the Court concluded that these defects did not undermine the survey and the expert's reliance on it so overwhelmingly as to render the survey inadmissible, especially in a bench trial. *See* Memorandum Opinion and Order on Motion in Limine, September 6, 2011, ECF No. 84.

[24] The response options varied among four different categories of filers, which are discussed further below. For example, the list of options presented to filers who completed a free federal tax return and no state return were: "I

The research firm conducting the survey initially sent out 46,899 email requests to TaxACT customers inviting them to participate in the survey and then subsequently targeted 24,898 customers who had purchased a federal tax return product but not a state product. *Id.* Survey respondents were also asked screening questions to determine their membership in one of four categories of customers: (1) those who paid to complete both a federal and state tax return; (2) those who completed a free federal return and paid to complete a state return; (3) those who completed a paid federal return but did not complete a state return; and (4) those who completed a free federal return and did not complete a state return. *Id.*

A total of 1,089 customers responded to the survey. *Id.* at 1-3. The response rates for the four categories of customers were: (1) 2.45 percent for paid federal / paid state filing (422); (2) 2.08 percent for free federal / paid state filing (245); (3) 0.6 percent for paid federal / no state filing (182); and (4) 1.7 percent for free federal / no state filing (240). *Id.*

Dr. Meyer opined that "this survey is closer to the concept of a diversion ratio than are data on overall switching between products." DX 17 (Meyer Rep.) at 20 n.85. Based on the survey's results, she concluded that the survey "provides direct evidence that digital DIY products compete with pen-and-paper" because the percentage of TaxACT customers who reported that, if they were dissatisfied with TaxACT, they would switch to pen-and-paper in each group ranged from 27 to 34 percent. DX 17 (Meyer Rep.) at 20. Dr. Meyer also noted that the survey showed that few TaxACT customers would switch to H&R Block At Home, since only 4 to 10 percent of respondents selected that option. *Id.* at 38. Accordingly, Dr. Meyer found this outcome indicative that "HRB is not a particularly close competitor to TaxACT." *Id.*

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would prepare myself without help," "TurboTax Free Edition," "H&R Block at Home Free Edition," "Free TaxUSA Free Edition," "Complete Tax Free Basic," "An Accountant," "I would use a product on FFA [i.e., Free File Alliance]," "TaxSlayer Free Edition," "Jackson Hewitt Free Basic," "Tax$imple Free Basic," and "Other." GX604 at 2.

In response to Dr. Meyer's reliance upon this survey, the government submitted a rebuttal expert report from Dr. Ravi Dhar, a professor of management at Yale University, which credibly critiques the survey on several levels.[25] GX 623 (Dhar Rep.). Most fundamentally, the government points out that the phrasing of the survey question – which asks about dissatisfaction with "TaxACT's price, functionality, or quality" – appears to ask a hypothetical question about *switching*, not diversion based solely on a price change. Since the phrasing of the survey question conflates customer concerns about price, functionality, or quality, the government argues that the survey cannot shed any light on customer reactions to price changes alone. *See id.* at 5. Further, to the extent that the wording of the question addresses price, it does not ask about a change in price, but rather suggests a change in the customer's satisfaction with TaxACT's existing price. *See id.*

At the hearing, Dr. Meyer explained that she viewed the email survey data as "closer to diversion than is pure switching data" because switching could occur for any reason at all, while the survey only asked about potential switching due to dissatisfaction with "price, functionality, or quality." Meyer, TT, 9/13/11 a.m., at 87. Yet the Court finds that almost any reason for switching from a product could be characterized as dissatisfaction with the "functionality" or "quality" offered by the product in some respect. Therefore, the survey question does not come much closer to identifying diversion ratios than pure switching data does. Moreover, since there is extensive IRS data reflecting actual switching behavior in the marketplace – as opposed to the hypothetical switching behavior asked about in the email survey – the Court will not rely on the "diversion ratios" suggested by the 2011 email survey.

Furthermore, additional defects in the 2011 email survey's methodology also render the reliability of its findings questionable. First, the high level of non-response to the defendants'

[25] Dr. Dhar did not testify in person at the hearing, but provided an expert report and affidavit.

email invitations to participate in the survey could have biased the results. Dr. Dhar explained that the "level of nonresponse . . . is extremely high (more than 98%)" and that the "extremely low response rates makes it difficult to determine whether the results were impacted by a certain segment who were systematically more likely to respond to the survey (e.g., those who were price sensitive or time insensitive) in relation to those who did not respond." GX 623 (Dhar Rep.) at 10. The Court agrees that non-response bias is a potential pitfall of the survey. *See University of Kansas v. Sinks*, No. 06-2341, 2008 WL 755065, at *4 (D. Kan. Mar. 19, 2008) (noting, in trademark case, that a consumer survey response rate of "2.16% appears, by any standard, to be quite low."). Second, by providing survey respondents with a pre-selected list of alternative options, rather than letting respondents respond organically, the survey leads respondents to think about the market for tax preparation services in the same terms that the defendants do, which may have led respondents to select options they otherwise would not have selected. Since the survey's question essentially asks about hypothetical switching, and since the actual IRS switching data in this case reflect a much larger sample size without the methodological deficiencies of the 2011 survey, the Court declines to rely on the purported diversion ratios calculated from the email survey.

On the whole, the Court views Dr. Warren-Boulton's expert analysis as more persuasive than Dr. Meyer's.[26] First, Dr. Warren-Boulton's testimony was generally more credible than Dr. Meyer's.[27] Second, the diversion ratios that Dr. Meyer calculated from the pricing simulator and the 2011 email survey are unreliable, as discussed above. Without these simulated diversion

[26] Of course, the Court remains cognizant that the plaintiff bears the burden of proof in demonstrating the relevant market.

[27] For example, Dr. Meyer's description of the pricing simulator survey as one in which the "pricing of the various options changed across scenarios" was inaccurate insofar as several of the most significant products for the purposes of Dr. Meyer's analysis did not have any prices associated with them at all. *See* discussion *supra*.

ratios, little remains of Dr. Meyer's expert conclusions apart from her analysis of documents in the record.

Dr. Warren-Boulton's analysis is not without its limitations. The main shortcoming for his approach is that he relied on switching data as a proxy for diversion. Since there is evidence in the record that switching among different products in the broader tax preparation industry occurs for reasons other than price competition, switching cannot serve as a complete proxy for diversion. Even so, the Court credits Dr. Warren-Boulton's conclusion that switching data can provide a "reasonable second estimate" of diversion ratios here. Therefore, the Court finds that Dr. Warren-Boulton's analysis tends to confirm that the relevant market is DDIY, although the Court would not rely on his analysis exclusively. As explained above, however, the full body of evidence in this case makes clear that DDIY is the correct relevant market for evaluating this merger.

B. Likely Effect on Competition

1. The Plaintiff's Prima Facie Case

Having defined the relevant market as DDIY tax preparation products, "the Court must next consider the likely effects of the proposed acquisition on competition within that market." *Swedish Match*, 131 F. Supp. 2d at 166. The government must now make out its prima facie case by showing "that the merger would produce 'a firm controlling an undue percentage share of the relevant market, and [would] result[ ] in a significant increase in the concentration of firms in that market.'" *Heinz*, 246 F.3d at 715 (quoting *Philadelphia Nat'l Bank*, 374 U.S. at 363). "Such a showing establishes a 'presumption' that the merger will substantially lessen competition." *Id.*

"Market concentration, or the lack thereof, is often measured by the Herfindahl-Hirschmann Index ('HHI')." *Id.* at 716. "The HHI is calculated by totaling the squares of the market shares of every firm in the relevant market. For example, a market with ten firms having market shares of 20%, 17%, 13%, 12%, 10%, 10%, 8%, 5%, 3% and 2% has an HHI of 1304 ($20^2 + 17^2 + 13^2 + 12^2 + 10^2 + 10^2 + 8^2 + 5^2 + 3^2 + 2^2$)." *Id.* at 715 n.9. Sufficiently large HHI figures establish the government's prima facie case that a merger is anticompetitive. *Id.* Under the Horizontal Merger Guidelines, markets with an HHI above 2500 are considered "highly concentrated" and mergers "resulting in highly concentrated markets that involve an increase in the HHI of more than 200 points will be presumed to be likely to enhance market power." Merger Guidelines § 5.3.

In this case, market concentration as measured by HHI is currently 4,291, indicating a highly concentrated market under the Merger Guidelines. GX 121 (Warren-Boulton Rep.) at 38. The most recent measures of market share show Intuit with 62.2 percent of the market, HRB with 15.6 percent, and TaxACT with 12.8 percent. GX 27. These market share calculations are based on data provided by the IRS for federal tax filings for 2010, the most recent data available.

The defendants argue that market share calculations based exclusively on federal filing data are insufficient to meet the plaintiff's burden in establishing its alleged relevant product market, which includes both federal and state filings. Defs.' Post-Trial Mem. at 12-13. The Court rejects this argument. State tax return products are typically sold as add-ons to or in combination with federal return products and the Court finds that there is little reason to conclude that the market share proportions within the state DDIY segment would be significantly different from federal DDIY. *See* GX 600 at 8 (HRB market research study stating that "[t]he desire to file State and Federal taxes together, and, inherently, for ease/convenience overruled all

other rationales for the method chosen for State taxes."). While, as defendants point out, many customers of federal tax return DDIY products do not also purchase state returns, that may be because they live in states without income tax or because their state returns are simple enough to prepare very easily without assistance. *See* Dunn, TT, 9/8/11 a.m., at 48-49. A reliable, reasonable, close approximation of relevant market share data is sufficient, however. *FTC v. PPG Indus., Inc.*, 798 F.2d 1500, 1505 (D.C. Cir. 1986). Further, the defendants' own ordinary course of business documents analyze the market based on IRS federal e-file data, without reference to state filings, even though the defendants' clearly sell state tax return products. *See, e.g.*, GX 27.

The proposed acquisition in this case would give the combined firm a 28.4 percent market share and will increase the HHI by approximately 400, resulting in a post-acquisition HHI of 4,691. *Id.* These HHI levels are high enough to create a presumption of anticompetitive effects. *See, e.g., Heinz,* 246 F.3d at 716 (three-firm to two-firm merger that would have increased HHI by 510 points from 4,775 created presumption of anticompetitive effects by a "wide margin"); *Swedish Match*, 131 F. Supp. 2d at 166-67 (60 percent market share and 4,733 HHI established presumption). Accordingly, the government has established a prima facie case of anticompetitive effects.

"Upon the showing of a *prima facie* case, the burden shifts to defendants to show that traditional economic theories of the competitive effects of market concentration are not an accurate indicator of the merger's probable effect on competition in these markets or that the procompetitive effects of the merger are likely to outweigh any potential anticompetitive effects." *CCC Holdings*, 605 F. Supp. 2d at 46. "The courts have not established a clear standard that the merging parties must meet in order to rebut a prima facie case, other than to

advise that '[t]he more compelling the prima facie case, the more evidence the defendant must present to rebut [the presumption] successfully.'" *Id*. at 46-47 (quoting *Baker Hughes*, 908 F.2d at 991). Even in cases where the government has made a strong prima facie showing:

> [i]mposing a heavy burden of production on a defendant would be particularly anomalous where, as here, it is easy to establish a prima facie case. The government, after all, can carry its initial burden of production simply by presenting market concentration statistics. To allow the government virtually to rest its case at that point, leaving the defendant to prove the core of the dispute, would grossly inflate the role of statistics in actions brought under section 7. The Herfindahl-Hirschman Index cannot guarantee litigation victories.

Baker Hughes, 908 F.2d at 992. Thus, ultimately,"[t]he Supreme Court has adopted a totality-of-the-circumstances approach to the [Clayton Act], weighing a variety of factors to determine the effects of particular transactions on competition." *Id.* at 984. With these observations in mind, the Court will evaluate the parties' evidence and arguments about the likely effect of the transaction on competition in the DDIY market.

2. Defendants' Rebuttal Arguments

a. Barriers to Entry

Defendants argue that the likelihood of expansion by existing DDIY companies besides Intuit, HRB, and TaxACT will offset any potential anticompetitive effects from the merger. Courts have held that likely entry or expansion by other competitors can counteract anticompetitive effects that would otherwise be expected. *See Heinz*, 246 F.3d at 717 n.13 ("Barriers to entry are important in evaluating whether market concentration statistics accurately reflect the pre- and likely post-merger competitive picture."); *Baker Hughes*, 908 F.2d at 987 ("In the absence of significant barriers, a company probably cannot maintain supracompetitive pricing for any length of time."). According to the Merger Guidelines, entry or expansion must be "timely, likely, and sufficient in its magnitude, character, and scope to deter or counteract the competitive effects of concern." Merger Guidelines § 9; *see also CCC Holdings*, 605 F. Supp.

2d at 47; *United States v. Visa USA, Inc.*, 163 F. Supp. 2d 322, 342 (S.D.N.Y. 2001) (entry must be "timely, likely, and [of a] sufficient scale to deter or counteract any anticompetitive restraints"). "Determining whether there is ease of entry hinges upon an analysis of barriers to new firms entering the market or existing firms expanding into new regions of the market." *CCC Holdings*, 605 F. Supp. 2d at 47 (quoting *FTC v. Cardinal Health, Inc.*, 12 F. Supp. 2d 34, 55 (D.D.C. 1998)). In this case, the parties essentially agree that the proper focus of this inquiry is on the likelihood of expansion by existing competitors rather than new entry into the market.[28] *See* Defs.' Post-Trial Mem. at 21-22. Since the government has established its prima facie case, the defendants carry the burden to show that ease of expansion is sufficient "to fill the competitive void that will result if [defendants are] permitted to purchase" their acquisition target. *Swedish Match*, 131 F. Supp. 2d at 169.

In describing the competitive landscape, the defendants note there are eighteen companies offering various DDIY products through the FFA. Defs.' Post-Trial Mem. at 22. Most of these companies are very small-time operators, however. The defendants acknowledge this fact, but nevertheless contend that the companies "TaxSlayer and TaxHawk are the two largest and most poised to replicate the scale and strength of TaxACT." *Id.* at 23. Witnesses from TaxSlayer and TaxHawk were the only witnesses from other DDIY companies to testify at the hearing. As such, the Court's ease of expansion analysis will focus on whether these two competitors are poised to expand in a way that is "timely, likely, and sufficient in its magnitude,

[28] New entrants to the market would not only face all of the barriers to expansion already faced by the existing small firms offering DDIY products, they would also have to develop their own products, including a software platform and a sufficient level of tax expertise. For entry to be considered timely, it typically must occur within approximately two years post-merger. *See* Commentary on the Horizontal Merger Guidelines (2006) at 45-46 (discussing prior Merger Guidelines § 3.2, which specified that timely entry should occur within two years). It is unlikely that an entirely new entrant to the market could compete meaningfully with the established DDIY firms within that time frame.

character, and scope to deter or counteract" any potential anticompetitive effects resulting from the merger.

TaxHawk runs five different websites, including FreeTaxUSA.com, that all market the same underlying DDIY product. Kimber, TT, 9/12/11 a.m., at 12, 40. TaxHawk was founded in 2001, three years after TaxACT, although it has a significantly smaller market share of 3.2 percent. *Id.* at 11; GX 27. TaxHawk's vice-president and co-founder, Mr. Dane Kimber, testified that the company has the technical infrastructure to grow by five to seven times the number of customers in any given year. Kimber, TT, 9/12/11 a.m., at 21. TaxHawk's marketing strategy relies substantially on search engine advertising and search term optimization, including by using the FreeTaxUSA.com domain name, which contains the keywords "free" and "tax." *See id.* at 19-27. Despite having been in business for a decade, its products are functionally more limited than those of Intuit, HRB, and TaxACT in various ways. *See* PFF ¶ 185. Although TaxHawk services the forms that cover most taxpayers, its program does not service all federal forms, it excludes two states' forms in their entirety, and it does not service city income tax forms for major cities that have income taxes – notably, New York City. Kimber, TT, 9/12/11 a.m., at 44. In fact, Mr. Kimber testified that the company would likely need another decade before its DDIY products could fully support all the tax forms. *Id.* at 45. The reason is that TaxHawk is what Mr. Kimber "like[s] to call . . . a 'lifestyle' company. We like the lifestyle we have as owners. We want our employees to have a life, if you will. I do feel we have the expertise to [expand functionality] more rapidly, but we choose not to." *Id.* Mr. Kimber also testified that TaxHawk had suddenly experienced an unprecedented growth rate of over 60 percent since April 2011, *id.* at 20-21, but that the company had not done any analysis to attempt to explain this unanticipated (and presumably welcome) growth. *Id.* at 39.

TaxHawk's relaxed attitude toward its business stands in stark contrast to the entrepreneurial verve that was apparent throughout the testimony of Mr. Dunn and that has been rewarded by the impressive growth of TaxACT over the years. In short, TaxHawk is a very different company from TaxACT. TaxHawk is a small company that has developed a string of search-engine-optimized DDIY websites, which deliver a sufficient income stream to sustain its owners' comfortable lifestyle, without requiring maximal effort on their part. While TaxHawk's decision to prioritize a relaxed lifestyle over robust competition and innovation is certainly a valid one, expansion from TaxHawk that would allow it to compete "on the same playing field" as the merged company appears unlikely. *Chicago Bridge & Iron Co. N.V. v. FTC*, 534 F.3d 410, 430 (5th Cir. 2008).

After TaxHawk, TaxSlayer is the next largest DDIY competitor, with a 2.7 percent market share. GX 27. TaxSlayer.com launched in 2003, although the same company started selling a software product to tax professionals several years earlier. Rhodes, TT, 9/12/11 a.m., at 71. TaxSlayer is part of the same corporate family as Rhodes Murphy, a tax firm that provides assisted tax preparation through sixteen retail offices in the Augusta, Georgia area. *Id.* The company is a family business and James Brian Rhodes, the product manager of TaxSlayer and the son of the company's founder, testified at the hearing. *Id.* at 70,73. Mr. Rhodes testified that, in the event of an increase in TaxACT's prices or a decrease in its quality, he "believe[s] that [TaxSlayer is] poised and ready to take those customers who would want to go elsewhere for lower prices." *Id.* at 81. TaxSlayer's marketing strategy relies heavily on sponsorship of sporting events, including the Gator Bowl and NASCAR. *Id.* at 75. TaxSlayer typically invests {a significant amount of its budget in marketing}. Rhodes, TT, 9/12/11 a.m. (sealed), at 86, 92. For example, TaxSlayer plans to spend ${redacted} on marketing in 2012 based on 2011

revenues of ${redacted}. *Id.* at 84, 87. Despite this {high} level of marketing spending, TaxSlayer's DDIY market share has not changed substantially since 2006, despite steady growth in TaxSlayer's revenue and number of units sold. *See id.* at 94-96; GX 21-7 (IRS e-file share data chart showing 2.5 percent share for TaxSlayer in 2006 and 2.7 percent in 2010). Rather, TaxSlayer's growth in unit sales and revenue has come from maintaining the same slice of an expanding pie – the growing DDIY market. *See* GX 21-7.

TaxSlayer's stable market share despite its {significant} marketing expenditure as a proportion of revenue points to what the government considers the key barrier to entry in this market – the importance of reputation and brand in driving consumer behavior in purchasing DDIY products. Simply put, tax returns are highly personal documents that carry significant financial and legal consequences for consumers. Consumers, therefore, must trust and have confidence in their tax service provider. As one of TaxACT's bankers put it a confidential memorandum, "[t]ax filers must have confidence that sensitive data is being handled with care and that returns are processed in a secure, error-free and timely manner." GX 125 at 12.

Building a reputation that a significant number of consumers will trust requires time and money. As HRB's former CEO noted, it takes millions of dollars and lots of time to develop a brand. Bennett, TT, 9/6/11 p.m., at 30. TaxACT's offering memoranda also point to the difficulty in building a brand in the industry as a barrier to competition. *See* GX 28-24 at 2SS-CORPe-2419 (2009 memorandum stating "With over 11 years of building reliable, robust software solutions, 2SS has created a valuable brand within the online tax preparation market which Management believes would take years of competitive investment to replicate."). In the DDIY industry, the Big Three incumbent players spend millions on marketing and advertising each year to build and maintain their brands, dwarfing the combined spending of the smaller

companies. For example, in tax year 2009, Intuit, HRB, and TaxACT collectively spent approximately {over $100 million} on marketing and advertising. GX 29 (Intuit Decl.) ¶ 38; GX 61-22 at 3; GX 138 at 37. By contrast, {TaxSlayer and TaxHawk spent a significantly smaller amount}.[29] Rhodes, TT, 9/12/11 a.m. (sealed), at 95; GX 25 (TaxHawk Decl.) ¶ 14.

Even TaxACT's successful business strategy has been premised on the notion that it cannot outspend Intuit and HRB on marketing. Dunn, TT, 9/7/11 p.m., at 71-72. The massive marketing expenditures of the two major DDIY firms create high per customer acquisition costs and limit the easy marketing channels that are open to smaller competitors. *See, e.g.*, *id.* at 88-89 (noting that "Web advertising is the most competitive. . . I think [TaxACT is] going to get shut out on Yahoo [the popular web portal]. I think Intuit is going to buy it lock, stock and barrel," and explaining that this outcome would hurt TaxACT's business if it doesn't find effective alternative advertising venues). Rather than attempting to outspend HRB and Intuit, TaxACT's growth strategy has largely depended on providing "great customer service, a great product, and a great customer experience" and then relying on word-of-mouth referrals to spread the awareness of the brand. *Id.* at 71-72. This process is inherently time-consuming and difficult to replicate.

In support of their argument that TaxSlayer and TaxHawk are poised to expand in response to a price increase, the defendants emphasize that these companies "are at about the same position in terms of customer base as TaxACT was in 2002, which was the year before it did the Free For All [offer on] the FFA." Meyer, TT, 9/12/11 p.m., at 130. The government points out, however, that there are two flaws in this comparison, even assuming that TaxSlayer

[29] The defendants attempt to reframe this disparity by noting that their calculation of TaxSlayer's projected tax season 2015 marketing budget would slightly surpass the amount of TaxACT's actual 2011 marketing budget. Defs.' Post-Trial Mem. at 23. Setting aside the validity of the defendants' aggressive projections of TaxSlayer's 2015 budget, a proper comparison would have to be founded upon a comparable projection of TaxACT's 2015 budget—not TaxACT's actual 2011 numbers, for which the relevant comparison is TaxSlayer's 2011 numbers.

and TaxHawk were TaxACT's competitive equals. First, while these companies may have a similar number of customers to TaxACT in 2002 in absolute terms, TaxACT's market share at 8 percent was already significantly larger than the market shares of these firms today, despite the fact that TaxACT had been in the market for fewer years. *See* GTX 17.

Second, the DDIY market has matured considerably since 2002, in parallel with the general ripening of various online industries during the past decade. Notably, the pool of pen-and-paper customers has dwindled as DDIY preparation has grown. Thus, the "low hanging fruit" of DDIY customer acquisition may have been plucked. *See* GX 296 (Houseworth Dep.) at 66-68 (noting that "there's probably only two or three years of continued mid teens category growth for online" because of the shrinking pool of new potential customers that can be converted from the pen-and-paper method). This trend suggests existing market shares may become further entrenched and that growing market share may be even harder, especially because there are barriers to switching from one DDIY product to another. For example, the hearing evidence showed that it is difficult to import prior-year tax return data across DDIY brands. If a taxpayer uses, say, TurboTax or TaxACT in one year, then when the taxpayer returns the next year, the program can automatically import the prior year's data, which is not only convenient but can also help the taxpayer identify useful tax information, such as carry forwards and available deductions. Dunn, TT, 9/8/11 a.m., at 111-14. Currently, it is not possible to import much of this data if the taxpayer switches to a competitor's product. *Id.* Thus, this feature lends a "stickiness" to each particular DDIY product once a customer has used it.

Upon consideration of all of the evidence relating to barriers to entry or expansion, the Court cannot find that expansion is likely to avert anticompetitive effects from the transaction.

The Court will next consider whether the evidence supports a likelihood of coordinated or unilateral anticompetitive effects from the merger.

b. Coordinated Effects

Merger law "rests upon the theory that, where rivals are few, firms will be able to coordinate their behavior, either by overt collusion or implicit understanding in order to restrict output and achieve profits above competitive levels." *CCC Holdings*, 605 F. Supp. 2d at 60 (quoting *Heinz*, 246 F.3d at 715). The government argues that the "elimination of TaxACT, one of the 'Big 3' Digital DIY firms" will facilitate tacit coordination between Intuit and HRB. Pl.'s Post-Trial Mem. at 15. "Whether a merger will make coordinated interaction more likely depends on whether market conditions, on the whole, are conducive to reaching terms of coordination and detecting and punishing deviations from those terms." *CCC Holdings*, 605 F. Supp. 2d at 60 (internal quotation omitted). Since the government has established its prima facie case, the burden is on the defendants to produce evidence of "structural market barriers to collusion" specific to this industry that would defeat the "ordinary presumption of collusion" that attaches to a merger in a highly concentrated market. *See Heinz*, 246 F.3d at 725.

The defendants argue the primary reason that coordinated effects will be unlikely is that Intuit will have no incentive to compete any less vigorously post-merger. The defendants assert that the competition between Intuit and HRB's retail stores would be "fundamentally nullified if Intuit decided to reduce the competitiveness of TurboTax." Defs.' Post-Trial Mem. at 17. Further, defendants contend that Intuit has no incentive to reduce the competitiveness of its free product because it views its free product as a critical driver of new customers. *Id.* at 17-18 Therefore, the defendants conclude that if HRB does not compete as aggressively as possible with its post-merger products, it will lose customers to Intuit. *Id.* at 18.

The most compelling evidence the defendants marshal in support of these arguments consists of documents and testimony indicating that Intuit engaged in a series of "war games" designed to anticipate and defuse new competitive threats that might emerge from HRB post-merger. *See* GX 293 (Intuit Dep.) at 98-101; DX 84. The documents and testimony do indicate that Intuit and HRB will continue to compete for taxpayers' patronage after the merger—indeed, in the DDIY market, they would be the only major competitors. This conclusion, however, is not necessarily inconsistent with some coordination. As the Merger Guidelines explain, coordinated interaction involves a range of conduct, including unspoken understandings about *how* firms will compete or refrain from competing. *See* Merger Guidelines § 7.

In this case, the government contends that coordination would likely take the form of mutual recognition that neither firm has an interest in an overall "race to free" in which high-quality tax preparation software is provided for free or very low prices. Indeed, the government points to an outline created as part of the Intuit "war games" regarding post-merger competition with HRB that also indicates an Intuit employee's perception that part of HRB's post-merger strategy would be to "not escalate free war: Make free the starting point not the end point for customers." GX 293-13 at INT-DOJ0015942.[30] Since, as defendants point out, DDIY companies have found "free" offers to be a useful marketing tool, it is unlikely that free offers would be eliminated. Rather, the government argues, it is more likely that HRB and Intuit may

[30] The government also cites an informal analysis written by Adam Newkirk, an analyst for HRB's DDIY business. Mr. Newkirk's analysis hypothesized that one possible reason for HRB to acquire TaxACT was that HRB and Intuit would jointly control a large DDIY market share post-merger and would "both obviously have great incentive to keep this channel profitable," while other potential purchasers of TaxACT "could decide to cut prices even further . . . ." *See* Newkirk, TT, 9/7/11 a.m., at 100; GX 18. The Court finds that the government overemphasized the importance and relevance of Mr. Newkirk's analysis. The hearing testimony showed that Mr. Newkirk is a data analyst who had no decision-making role or authority in relation to the merger and that his discussion about the rationales for the merger was informal speculation. *See* Newkirk, TT, 9/7/11 p.m., at 42-44. Even so, this reasoning – independently reached by Intuit – is essentially a précis of the government's coordinated effects concern.

find it "in their mutual interest to reduce the quality of their free offerings . . . offer a lower quality free product and maintain higher prices for paid products . . . ." PFF ¶ 141.

The government points to a highly persuasive historical act of cooperation between HRB and Intuit that supports this theory. *Cf.* Merger Guidelines § 7.2 ("[M]arket conditions are conducive to coordinated interaction if firms representing a substantial share in the relevant market appear to have previously engaged in express collusion."). After TaxACT launched its free-for-all offer in the FFA, Intuit proposed that the firms in the market limit their free FFA offers, a move which TaxACT opposed and which Mr. Dunn believed was an illegal restraint on trade. Dunn, TT, 9/7/11 p.m., at 79. HRB, Intuit, and others then joined together and successfully lobbied the IRS for limitations on the scope of the free offers through the FFA – limitations that remain in place today. Ernst, TT, 9/7/11 a.m., at 26-27; Warren-Boulton, TT, 9/9/11 p.m., at 78. This action illustrates how the pricing incentives of HRB and Intuit differ from those of TaxACT and it also shows that HRB and Intuit, although otherwise competitors, are capable of acting in concert to protect their common interests.

The defendants also argue that coordinated effects are unlikely because the DDIY market consists of differentiated products and has low price transparency. *See CCC Holdings*, 605 F. Supp. 2d at 62 (recognizing the importance of price transparency to the likelihood of coordinated effects). To the contrary, the record clearly demonstrates that the players in the DDIY industry are well aware of the prices and features offered by competitors. Since DDIY products are marketed to a large swath of the American population and available via the Internet, DDIY firms can easily monitor their competitors' offerings and pricing. The fact that competitors may offer various discounts and coupons to some customers via email hardly renders industry pricing "not transparent," as defendants submit. *See* Defs.' Post-Trial Mem. at 21. Moreover, while

collusion may, in some instances, be more likely in markets for homogenous products than differentiated products, product differentiation in this market would not necessarily make collusion more difficult. *See Heinz*, 246 F.3d at 716-17, 724-25 (finding likelihood of coordinated effects in product market differentiated by brand); *see also CCC Holdings*, 605 F. Supp. 2d at 65 n.42 ("[T]acit collusion may be easier when products are differentiated.") (quoting Lawrence A. Sullivan & Warren S. Grimes, *The Law of Antitrust: An Integrated Handbook*, § 11.2e1, at 635 (2d ed. 2006)).

Other indicia of likely coordination are also present in the DDIY market. Transactions in the market are small, numerous, and spread among a mass of individual consumers, each of whom has low bargaining power; prices can be changed easily; and there are barriers to switching due to the "stickiness" of the DDIY products. *See CCC Holdings*, 605 F. Supp. 2d at 65-66 (discussing these factors as characteristic of markets conducive to coordination); *see also supra* Section III.B.2.a (discussing the difficulty of importing data as a barrier to switching from one DDIY product to another).

Finally, the Court notes that the "merger would result in the elimination of a particularly aggressive competitor in a highly concentrated market, a factor which is certainly an important consideration when analyzing possible anti-competitive effects." *Staples*, 970 F. Supp. at 1083; *see also FTC v. Libbey*, 211 F. Supp. 2d 34, 47 (D.D.C. 2002). The evidence presented at the hearing from all parties demonstrated TaxACT's impressive history of innovation and competition in the DDIY market. Mr. Dunn's trial testimony revealed him to be a dedicated and talented entrepreneur and businessman, with deep knowledge and passion for providing high-quality, low-cost tax solutions. TaxACT's history of expanding the scope of its high-quality, free product offerings has pushed the industry toward lower pricing, even when the two major

players were not yet ready to follow – most notably in TaxACT's introduction of free-for-all into the market.

The government presses the argument that TaxACT's role as an aggressive competitor is particularly important by urging this Court to find that TaxACT is a "maverick." *See* Pl.'s Post-Trial Mem. at 18-19. In the context of antitrust law, a maverick has been defined as a particularly aggressive competitor that "plays a disruptive role in the market to the benefit of customers." Merger Guidelines § 2.1.5. The most recent revision of the Merger Guidelines endorses this concept and gives a few examples of firms that may be industry mavericks, such as where "one of the merging firms may have the incentive to take the lead in price cutting or . . . a firm that has often resisted otherwise prevailing industry norms to cooperate on price setting or other terms of competition." *Id.*

The parties have spilled substantial ink debating TaxACT's maverick status. The arguments over whether TaxACT is or is not a "maverick" – or whether perhaps it once was a maverick but has not been a maverick recently – have not been particularly helpful to the Court's analysis. The government even put forward as supposed evidence a TaxACT promotional press release in which the company described itself as a "maverick." *See* GX 28-6. This type of evidence amounts to little more than a game of semantic gotcha. 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. Other competitors, including HRB and Intuit, have also been aggressive and innovative in forcing companies in the DDIY market to respond to new product offerings to the benefit of consumers. *See* Defs.' Post-Trial Mem. at 20.

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 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. For example, the government claims that "[m]ost recently, TaxACT continued to disrupt the Digital DIY market by entering the boxed retail software segment of the market, which had belonged solely to HRB and [Intuit]." Pl.'s Post-Trial Mem. at 19. Credible evidence at the hearing, however, showed {otherwise}. *See* Dunn, TT, 9/8/11 p.m. (sealed), at 4. Moreover, the Court credits Mr. Dunn's explanation that TaxACT has little interest in selling boxed retail software because he believes this market segment is {redacted} not particularly significant. *See* Dunn, TT, 9/7/11 p.m. (sealed), at 123 ({redacted}).

What the Court finds particularly germane for the "maverick" or "particularly aggressive competitor" analysis in this case is this question: Does TaxACT consistently play a role within the competitive structure of this market that constrains prices? *See Staples*, 970 F. Supp. 1083 (finding "merger would result in the elimination of a particularly aggressive competitor in a highly concentrated market" where the merger would remove competition between "the two lowest cost and lowest priced firms" in the market); Merger Guidelines § 2.1.5 (noting maverick concerns may arise where "one of the merging firms may have the incentive to take the lead in price cutting or [with] . . . a firm that has often resisted otherwise prevailing industry norms to cooperate on price setting or other terms of competition."). The Court finds that TaxACT's competition does play a special role in this market that constrains prices. Not only did TaxACT buck prevailing pricing norms by introducing the free-for-all offer, which others later matched, 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.

Moreover, as the plaintiff's expert, Dr. Warren-Boulton, explained, the pricing incentives of the merged firm will differ from those of TaxACT pre-merger because the merged firm's opportunity cost for offering free or very low-priced products will increase as compared to TaxACT now. *See* Warren-Boulton, 9/9/11 p.m., at 14-16. In other words, the merged firm will have a greater incentive to migrate customers into its higher-priced offerings – for example, by limiting the breadth of features available in the free or low-priced offerings or only offering innovative new features in the higher-priced products. *See* Commentary on the Horizontal Merger Guidelines (2006) at 24 (noting the importance of asking "whether the acquired firm has behaved as a maverick and whether the incentives that are expected to guide the merged firm's behavior likely would be different.").

While the defendants oppose the government's maverick theory, they do not deny that TaxACT has been an aggressive competitor. Indeed, they submit that "that's why H&R Block wants to buy them." Defs.' Closing Argument, TT, 10/3/11 a.m., at 132. HRB contends that the acquisition of TaxACT will result in efficiencies and management improvements that "will lead to better, more effective, and/or cheaper H&R Block digital products post-merger" that are better able to compete with Intuit. Defs.' Post-Trial Mem. at 17. This argument is quite similar to the argument of the defendants in *Heinz*, which some commentators have described as arguing that the merger would create a maverick. *Heinz*, 246 F.3d at 720-22; *see* Jonathan B. Baker, *Mavericks, Mergers, and Exclusion: Proving Coordinated Competitive Effects Under the Antitrust Laws*, 77 N.Y.U. L. Rev. 135, 184 (2002). While the district court in *Heinz* accepted this argument that the merger would enhance rather than stifle competition, the D.C. Circuit reversed, finding that the "district court's analysis [fell] short of the findings necessary for a successful efficiencies defense" in that case. *Heinz*, 246 F.3d at 721. As explained more fully in

Section III.B.2.d below, the defendants' efficiency arguments fail here for some of the same reasons the D.C. Circuit identified in *Heinz.*

Finally, the defendants suggest that coordinated effects are unlikely because of the ease of expansion for other competitors in the market. As detailed above in the Court's discussion of barriers to entry and expansion, the Court does not find that ease of expansion would counteract likely anticompetitive effects.

Accordingly, the defendants have not rebutted the presumption that anticompetitive coordinated effects would result from the merger. To the contrary, the preponderance of the evidence suggests the acquisition is reasonably likely to cause such effects. *See id.* at 711-12 (finding, in market characterized by high barriers to entry and high HHI figures, that "no court has ever approved a merger to duopoly under similar circumstances.").

c. Unilateral Effects

A merger is likely to have unilateral anticompetitive effect if the acquiring firm will have the incentive to raise prices or reduce quality after the acquisition, independent of competitive responses from other firms. *See Swedish Match*, 131 F. Supp. 2d at 169; Merger Guidelines § 6 ("The elimination of competition between two firms that results from their merger may alone constitute a substantial lessening of competition."). "The extent of direct competition between the products sold by the merging parties is central to the evaluation of unilateral price effects." Merger Guidelines § 6.1. As Judge Collyer in *CCC Holdings* explained:

> Unilateral effects in a differentiated product market are likely to be profitable under the following conditions: (1) the products must be differentiated; (2) the products controlled by the *merging* firms must be close substitutes, *i.e.*, "a substantial number of the customers of one firm would turn to the other in response to a price increase"; (3) other products must be sufficiently different from the products offered by the merging firms that a merger would make a small but significant and non-transitory price increase profitable for the merging firm; and (4) repositioning must be unlikely.

605 F. Supp. 2d at 68 (citing *Oracle*, 331 F. Supp. 2d at 1117-18).[31] Since the Court has already found that the preponderance of the evidence shows a reasonable likelihood of coordinated effects, the Court need not reach the issue of unilateral effects. *See id*. at 67. The Court will discuss it, however, since there has been substantial argument on this topic and the Court's findings regarding unilateral effects bolster the conclusion that this proposed merger would violate Section 7 of the Clayton Act. As with coordinated effects, since the government has established its prima facie case, the burden is on the defendants to produce evidence showing that the presumption of anticompetitive effects that attaches to a merger in a highly concentrated market is unfounded, but the ultimate burden of proof remains with the government.

i. Elimination of Direct Competition Between the Merging Parties

The government argues that unilateral effects are likely because the merger will eliminate head-to-head competition between HRB and TaxACT that has benefited taxpaying American consumers. Much of the evidence indicating direct competition between HRB and TaxACT is discussed above in relation to the market definition. *See supra* Section III.A. The government emphasizes that HRB has lowered its DDIY prices to better compete with free online products, the category pioneered by TaxACT, and has directly considered TaxACT's prices in setting its own prices. *See* GX 53 at 2, 8; GX 188; GX 199 at 5-9. HRB has also determined the nature of its free offerings in response to competitive activity from TaxACT. *See, e.g.*, GX 304 at 5 (HRB changed timing of FFA offering in response to TaxACT's offer); GX 44 (recognizing need to compete with TaxACT offerings); GX 79 (comparing contemplated free product description on HRB's website with TaxACT's website); GX 51 at 4 (noting launch of free online products intended "[t]o match competitor offerings and stem online share loss to Intuit and TaxACT"). The government also points to HRB documents that appear to acknowledge that TaxACT has put

[31] The first criterion in this analysis is satisfied because it is undisputed that DDIY products are differentiated.

downward pressure on HRB's pricing ability. *See* GX 296-16 at 20-21 (noting TaxACT's association with the "commoditization of online space" and downward price pressure from commoditization); GX 20 at 11 ({redacted}). From all of this evidence, and the additional evidence discussed in this opinion, it is clear that HRB and TaxACT are head-to-head competitors.

ii. Pledge to Maintain TaxACT's Current Prices

Defendants press a few different arguments against a finding of likely unilateral anticompetitive effects. First, the defendants have pledged to maintain TaxACT's current prices for three years.[32] While the Court has no reason to doubt that defendants would honor their promise, this type of guarantee cannot rebut a likelihood of anticompetitive effects in this case. *See Cardinal Health*, 12 F. Supp. 2d at 64 (finding that "even with such guarantees [to maintain prices], the mergers would likely result in anti-competitive prices."). Even if TaxACT's list price remains the same, the merged firm could accomplish what amounts to a price increase through other means. For example, instead of raising TaxACT's prices, it could limit the functionality of TaxACT's products, reserving special features or innovations for higher priced, HRB-branded products. The merged firm could also limit the availability of TaxACT to consumers by marketing it more selectively and less vigorously. Indeed, the defendants concede that one immediate effect of the merger will be the removal of TaxACT from the IRS-sponsored FFA website, a marketing channel whose importance the defendants themselves emphasize in their argument regarding barriers to expansion. *See* Dunn, TT, 9/7/11 p.m., at 76-77; Defs.' Post-Trial Mem. at 22.

[32] Before the hearing, the plaintiff filed a motion in limine to exclude evidence relating to this guarantee. ECF No. 44. Following oral argument at the pre-hearing conference, the plaintiff withdrew this motion. *See* Minute Entry dated September 2, 2011.

iii. Value Versus Premium Market Segments

Second, defendants argue that HRB and TaxACT are not particularly close competitors. The defendants contend that HRB and TaxACT largely compete in distinct segments of the market – with HRB in the higher-priced, "premium" segment and TaxACT in the lower-priced, "value" segment.[33] The defendants also argue that there can be no unilateral effects because the evidence shows that both TaxACT and HRB are closer competitors to TurboTax than to each other. Defs.' Post-Trial Mem. at 15.

As part of the argument that HRB and TaxACT focus on separate value and premium segments, the defendants argued that for several years in the mid-2000s, HRB was trapped in the "murky middle" between TaxACT's value offerings and Intuit's premium offerings. *See* DX 17 (Meyer Rep.) at 29; Meyer, TT, 9/13/2011 a.m., at 103-107. The defendants argue that, in recent years, HRB has positioned itself more clearly as a premium provider, as evidenced by the fact that the list price of its online federal plus state DDIY product has tracked Intuit's price more closely since 2010. *See* DX 17 (Meyer Rep.) at 29. This comparison is misleading because it focuses solely on the comparison of the list prices for the companies' highest-priced products. *See id.* at 29 n.116. During the past few years, while HRB has increased the list price of its top-priced DDIY offering, it has also more heavily marketed free products. *See* GX 51 at 4; *see also* Meyer, TT, 9/13/2011 a.m., at 105-106. Accordingly, since 2008, HRB's average DDIY sales price has declined, while the average revenue per paid customer has remained roughly the same.

[33] In the defendants' submissions to the Antitrust Division of the DOJ prior to this litigation, the defendants appeared to emphasize this "value" and "premium" distinction as the basis for their definition of the relevant market. *See* GX 135 at 14-15; GX 629 at 18-30. As a result, the government accuses the defendants of having "tacked back and forth" regarding their proposed relevant market definition. Pl.'s Post-Trial Mem. at 1-2. While the Court agrees that the import of the hearing testimony about value and premium products was not always clear, the defendants' counsel clarified during closing arguments that the "only real relevance" of the premium versus value distinction was to show that HRB and TaxACT are not closest the competitors for the purposes of unilateral effects analysis. Defs.' Closing Argument, TT, 10/3/2011 a.m., at 93-94.

See GX 296-7 ("Digital Tax Solutions FY11 Actual Deep Dive") at 1; Meyer, TT, 9/13/11 a.m., at 107-108.

Further, the evidence discussed above indicating direct price and feature competition between HRB and TaxACT negates the conclusion that they operate in separate value and premium segments of the market. There are certainly occasional references to different pricing levels in the defendants' documents. *See* GX 20 at 11 (HRB document noting {redacted}) (emphasis added). This hardly means that the companies are not in close competition, however. Rather, as Mr. Dunn's testimony reflects, TaxACT competes with capital-rich HRB and Intuit by offering high-quality products at substantially lower prices. *See* Dunn, TT, 9/7/11 p.m., at 71-72 (noting that rather than attempting to outspend its richer competitors on marketing, TaxACT's growth strategy has depended on providing "great customer service, a great product, and a great customer experience" for a much lower price, including free). *Id.* This type of healthy competition benefits taxpaying consumers.

The fact that Intuit may be the closest competitor for both HRB and TaxACT also does not necessarily prevent a finding of unilateral effects for this merger. *See* Areeda & Hovenkamp, ¶ 914, 77-80 (explaining that the merging parties need not be the closest rivals for there to be unilateral anticompetitive effects); *see also* Commentary on the Horizontal Merger Guidelines (2006) at 28 ("A merger may produce significant unilateral effects even though a non-merging product is the 'closest' substitute for every merging product . . ."). Using a simple estimate of diversion based on market share would indeed suggest that HRB and TaxACT are each other's second closest rivals after Intuit.[34] *See* GX 121 (Warren-Boulton Rep.) at 44 (explaining that

[34] The relevance of the diversion estimates provided by the expert economists to the unilateral effects analysis is discussed more fully below.

using market share to estimate diversion is a "benchmark" assumption in standard empirical models of consumer demand).

iv. Merged Company's Combined Market Share

Another argument that the defendants present against a likelihood of unilateral effects is that, in their view, unilateral effects cannot be demonstrated where the combined firm's market share does not surpass a certain threshold. The defendants point out that in *Oracle*, the court stated that "[a] presumption of anticompetitive effects from a combined share of 35% in a differentiated products market is unwarranted. Indeed, the opposite is likely true." 331 F. Supp. 2d at 1123. The *Oracle* court stated that "[t]o prevail on a differentiated products unilateral effects claim, a plaintiff must prove a relevant market in which the merging parties would have essentially a monopoly or dominant position." *Id.* Some commentators have criticized this standard, however, because "impermissible price increases . . . can be achieved on far lower market shares" than *Oracle*'s standard evidently requires. Areeda & Hovenkamp ¶ 914, at 84. Indeed, Judge Brown's subsequent opinion from this Circuit in *Whole Foods* implied that a market definition itself may not even be required for proving a Section 7 violation based on unilateral effects. *See Whole Foods*, 548 F.3d at 1036. In a footnote, Judge Brown explained that "a merger between two close competitors can sometimes raise antitrust concerns due to unilateral effects in highly differentiated markets. In such a situation, it might not be necessary to understand the market definition to conclude a preliminary injunction should issue."[35] *Id*. at

[35] "As a matter of applied economics, evaluation of unilateral effects does not require a market definition in the traditional sense at all." Areeda & Hovenkamp ¶ 913a, at 66. This is so because unilateral effects analysis focuses on measuring a firm's market power directly by "estimating the change in residual demand facing the post-merger firm. 'Residual demand' refers to the demand for a firm's goods after the output of all other competing firms has been taken into account." *Id.* at 63. If market power itself can be directly measured or estimated reliably, then in theory market definition is superfluous, at least as a matter of economics, because "[i]dentifying a market and computing market shares provide an indirect means for measuring market power." *Id.* ¶ 532a at 242-43; *see also id.* ¶ 521c. The 2010 revisions to the Merger Guidelines also appear to reflect this understanding. *See* Merger Guidelines § 4 ("The Agencies' analysis need not start with market definition. Some of the analytical tools used by

n.1 (citation omitted). The Court therefore declines the defendants' invitation, in reliance on *Oracle*, to impose a market share threshold for proving a unilateral effects claim.[36]

v. Post-Merger Dual Brand Strategy

HRB's plans for the post-merger company raise anticompetitive questions. Post-merger, HRB's stated plan is to maintain both the HRB and TaxACT brands –with the HRB-brand focusing on higher priced-products and the TaxACT brand focusing on the lower-priced products. *See* Bennett, TT, 9/6/11 a.m., 101-102; DX 1005 at 1. HRB's general pre-merger pricing strategy has been to price its products a bit below Intuit's products. Bennett, TT, 9/6/11 a.m., at 99. Part of HRB's post-merger strategy, however, appears to involve raising prices on HRB-branded products. Under this two-brand strategy, HRB would price its "premium" HRB-branded products equal to or above Intuit's prices. *See* Bennett, TT, 9/6/11 a.m., 101-102; DX 1005 at 1. At the same time, the company would "offer TaxACT as its free and value brand." DX 17 (Meyer Rep.) at 78. Yet, the defendants have never convincingly explained how this two-brand strategy would work in practice because defendants have repeatedly emphasized how

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the Agencies to assess competitive effects do not rely on market definition, although evaluation of competitive alternatives available to customers is always necessary at some point in the analysis."). As a legal matter, however, a market definition may be required by Section 7 of the Clayton Act. *See Brown Shoe*, 370 U.S. at 324 ("[D]etermination of the relevant market is a necessary predicate to a finding of a violation of the Clayton Act because the threatened monopoly must be one which will substantially lessen competition 'within the area of effective competition.' Substantiality can be determined only in terms of the market affected. The 'area of effective competition' must be determined by reference to a product market (the 'line of commerce') and a geographic market (the 'section of the country').") (internal citation omitted); *see also Heinz*, 246 F.3d at 719 n.17 ("Courts interpret 'line of commerce' [in the language of the Clayton Act] as synonymous with the relevant product market."). The Court is not aware of any modern Section 7 case in which the court dispensed with the requirement to define a relevant product market, although Judge Brown's opinion in *Whole Foods* may be read to endorse this possibility in accordance with the evolving understandings in economics. *See Whole Foods*, 548 F.3d at 1036 (Brown, J.) (stating that the *Baker Hughes* analytical framework, which "rests on defining a market and showing undue concentration in that market," "does not exhaust the possible ways to prove a § 7 violation on the merits").

[36] The Commentary on the Merger Guidelines, for its part, explains that while "[a]s an empirical matter, the unilateral effects challenges made by the Agencies nearly always have involved combined shares greater than 35%," "the Agencies may challenge mergers when the combined share falls below 35% if the analysis of the mergers' particular unilateral competitive effects indicates that they would be likely substantially to lessen competition." Commentary on the Horizontal Merger Guidelines (2006) at 26. "Combined shares less than 35% may be sufficiently high to produce a substantial unilateral anticompetitive effect if the products are differentiated and the merging products are especially close substitutes . . . ." *Id.*

important "free" product offerings are for all DDIY brands. *See* DFF ¶ 185 ("Free is a highly profitable method of acquiring customers for H&R Block."); DX 600 at 10 (HRB Board of Directors presentation for merger approval stating that after the merger TaxACT would be the "low cost value provider focused on free" but that the company would "[c]ontinue to offer a free product in the HRB brand to drive client acquisition").

Part of the government's concern with HRB's two-brand strategy is that the incentives for the combined firm in marketing and developing the TaxACT product would be quite different from the incentives that exist in the current market. HRB may feel comfortable raising its "premium" prices because it knows that consumers looking for lower-cost DDIY options would be most likely to migrate to TaxACT, the established "value leader" in the market. Since HRB will also control TaxACT post-merger, however, HRB can still ensure that TaxACT's value proposition does not get "too good" and undermine the paid HRB products with the highest profit margins. For example, HRB might restrict the features of TaxACT's free and low-cost products to ensure they do not cannibalize sales of HRB's higher priced offerings. Indeed, assuming that there are high barriers to entry and expansion, this strategy would appear logical because it would maximize HRB's profit per customer. Post-merger, TaxACT will not have the same incentives it has today to develop robust free and low-cost offerings that can compete with the functionality offered by HRB and Intuit. *See* Warren-Boulton, TT, 9/8/11 p.m., at 32-33. Thus, this merger could potentially have the effect of stifling price and feature competition compared with maintaining TaxACT as an independent firm.

vi. Merger Simulation Shows Likely Unilateral Price Increase

The government's expert economist, Dr. Warren-Boulton, did a merger simulation analysis that suggests a unilateral price increase is likely. Warren-Boulton, TT, 9/9/11 a.m., at 5-

11; GX 121 (Warren-Boulton Rep.) at 52. The key factors in this simulation are HRB and TaxACT's price-cost margins and the diversion ratios between their products. *Cf. Swedish Match*, 131 F. Supp. 2d at 169 ("High margins and high diversion ratios support large price increases, a tenet endorsed by most economists.").

(a). Diversion Ratios Between the Merging Parties' DDIY Products

As explained above, the diversion rate from TaxACT to HRB measures the proportion of customers that would leave TaxACT in response to a price increase and switch to HRB. Dr. Warren-Boulton's report explains that higher diversion rates between merging parties "allow the firms to recapture more lost sales following a price increase, and therefore lead to greater upward pricing pressure and post-merger unilateral price increases." GX 121 (Warren-Boulton Rep.) at 44. Dr. Warren-Boulton estimated diversion ratios from two sources: the parties' DDIY market share data and the IRS switching data.[37] *Id.* at 44-48.

By assuming diversion rates in accordance with market share, Dr. Warren-Boulton estimated the diversion rate from TaxACT to HRB to be 12 percent and from HRB to TaxACT to be 14 percent. *Id.* at 44-45. Dr. Warren-Boulton notes that these diversion estimates likely underestimate what the actual post-merger diversion rates will be since the merged company will likely implement marketing strategies to keep customers within the umbrella of the combined company. *Id.* at 45.

Dr. Warren-Boulton estimated diversion ratios using IRS switching data as well. As discussed above in Section III.A.3.a, he also used this switching data to test the relevant market definition. As previously noted in that prior discussion, switching data is not equivalent to diversion, since diversion measures switching in response to a price increase as opposed to all

[37] Dr. Warren-Boulton declined to rely on the defendants' proposed diversion data, derived from their consumer surveys, for the reasons already discussed *supra* in Section III.A.3.

switching generally. In particular, Dr. Warren-Boulton found that switching data is especially likely to overstate diversion from DDIY products to assisted preparation. *Id.* at 46-47. Therefore, Dr. Warren-Boulton discounted the switching rates from DDIY to assisted by half to correct for this effect.[38] *Id.* After this correction, Dr. Warren-Boulton calculated estimated diversion rates from TaxACT to HRB and from HRB to TaxACT of 12 percent. *Id.*at 47-48.

(b). Price-Cost Margins

The next step in his analysis was to estimate the firms' price-cost margins. "All else equal, higher margins lead to greater unilateral price increases because the value of recaptured sales is higher." *Id.* at 48. Using a procedure described in his report, Dr. Warren-Boulton estimated {that the merging parties have high margins}. *Id.* at 49. The merger simulation also required quantities of units sold and average revenue per unit. Dr. Warren-Boulton obtained this data from the companies' submissions. *Id.* at 50.

(c). Simulation Results

Using all of these data, Dr. Warren-Boulton performed a linear demand Bertrand model simulation. *Id.* at 51. Unless there are significant efficiencies from the merger that are passed on to consumers, this simulation predicts a unilateral price increase.[39] *Id.* at 52. Assuming diversion ratios according to market share, the model predicts TaxACT's price will increase by 12.2 percent and HRB's price by 2.5 percent. *Id.* Assuming diversion ratios based on the IRS switching data as discussed above, the model predicts TaxACT's price will increase by 10.5 percent and HRB's price by 2.2 percent. *Id.*

[38] As a basis for this conclusion that switching data overstates diversion and for his choice to discount the DDIY-to-assisted switching rate by half, Dr. Warren-Boulton relies upon HRB documents that suggest that more than half of switching from DDIY to assisted occurs for reasons unrelated to price, such as a change in tax complexity. GX 121 (Warren-Boulton Rep.) at 46 n.128 (citing GX 635, GX 126). He also relies on IRS data showing that customers switching from DDIY to assisted were twice as likely to have a complexity increase as taxpayers who stayed within DDIY. *Id.* at 47.

[39] As discussed in Section III.B.2.d below, the Court finds most of defendants' claimed efficiencies are not merger-specific or unverifiable.

(d). Critique of the Simulation's Unilateral Effects Results

The defendants attack Dr. Warren-Boulton's simulation on several grounds. The defendants reiterate their critique that switching data is an inappropriate proxy for diversion data. Further, defendants criticize the way in which Dr. Warren-Boulton discounted the switching rates from DDIY products to assisted preparation. *See* Warren-Boulton, TT, 9/9/9 p.m., at 60-65. In addition, the defendants contend that Dr. Warren-Boulton's simulator model is flawed because it will always predict a price increase with any positive diversion and because the model is "static," does not take various factors into account, such as the parties' different products, innovation, and marketing, and would never predict that a firm would offer free products, even though free products are a staple of the industry. DX 17 (Meyer Rep.) at 74-75.

The Court agrees that Dr. Warren-Boulton's discounting by half of the switching data from DDIY to assisted appears imprecise. Dr. Warren-Boulton clarified in his report, however, that "the model still predicts significant unilateral harm when non-discounted switching rates are used to approximate diversion rates." GX 121 (Warren-Boulton Rep.) at 47. Further, and more importantly, Dr. Warren-Boulton also estimated diversion ratios based on market share and the Court has concluded above that DDIY is the appropriate relevant product market.[40]

As for the defendants' critiques about Dr. Warren-Boulton's economic model itself, Dr. Warren-Boulton addressed these directly. First, insofar as the model will predict at least some price increase absent efficiencies with any positive diversion ratios, Dr. Warren-Boulton explained that outcome is fully consistent with correct economic theory. GX 665 (Warren-

[40] The defendants suggest that Dr. Warren-Boulton's reliance on market share as an estimate of diversion ratios is somewhat circular in that his market shares derive from his market definition, which, in turn, relied on his use of switching data as a proxy for diversion ratios. DX 17 (Meyer Rep.) at 76. As discussed above, however, the Court's finding that DDIY is the correct relevant product market is not dependent on Dr. Warren-Boulton's analysis.

Boulton Reply Rep.) at 14 ("Economic theory concludes that absent merger specific efficiencies, a merger between competing firms will cause the merging firms to increase their prices by at least some amount. Thus, it is not a deficiency, but a strength, of merger simulation models that they reflect this aspect of economic reality."). In response to the critique that his "static" model would never predict that companies would offer free products, Dr. Warren-Boulton contends that because free DDIY products are often packaged with other paid products, these "free" products actually provide the companies with a positive average revenue per free unit, which his model does take into account. *See id.* at 14-15. As for the remaining critiques that the model does not factor in marketing or innovation, Dr. Warren-Boulton replies that any model is inherently a simplification of the real world, but there is no reason to assume these factors negate the price effect findings of the model. *Id.*

The Court finds that the merger simulation model used by the government's expert is an imprecise tool, but nonetheless has some probative value in predicting the likelihood of a potential price increase after the merger. The results of the merger simulation tend to confirm the Court's conclusions based upon the documents, testimony, and other evidence in this case that HRB and TaxACT are head-to-head competitors, that TaxACT's competition has constrained HRB's pricing, and that, post-merger, overall prices in the DDIY products of the merged firms are likely to increase to the detriment of the American taxpayer.

vii. Repositioning Unlikely to Defeat Unilateral Price Increase

Repositioning by smaller competitors in response to a unilateral price increase is unlikely for the same reasons discussed above regarding barriers to entry and expansion. *See* Merger Guidelines § 6.1 ("Repositioning is a supply-side response that is evaluated much like entry, with consideration given to timeliness, likelihood, and sufficiency.").

Repositioning by Intuit is also unlikely due to the coordinated effects incentives discussed above. The Merger Guidelines make clear that a unilateral price increase may be defeated where "non-merging firms [are] able to reposition their products to offer close substitutes for the products offered by the merging firms." Merger Guidelines § 6.1. Since the Court has already found that HRB and Intuit would have coordinated pricing incentives post-merger, that finding implies that repositioning by Intuit would not prevent HRB from raising prices. By relying on its finding of coordinated effects to predict the likelihood of repositioning by Intuit, the Court acknowledges that its unilateral effects finding is not strictly "unilateral" in the sense that it does take coordination into account. The case law and the Merger Guidelines, however, require that "repositioning" be considered in assessing unilateral effects, and the repositioning inquiry necessarily entails a consideration of the likely actions of other competitors in response to a price increase. *See CCC Holdings, Inc*., 605 F. Supp. 2d at 67 (noting that the distinction between coordinated and unilateral effects "has more significance in law than it does in economics" and citing expert testimony describing the distinction as "artificial").

viii. Finding Unilateral Anticompetitive Effects Likely

On balance, and considering the evidence as a whole, the Court finds that, absent efficiencies, the plaintiff has demonstrated a reasonable likelihood of unilateral effects by a preponderance of the evidence. *See Swedish Match*, 131 F. Supp. 2d at 169 (finding likelihood of unilateral price increase where merger would eliminate one of the larger merging firm's "primary direct competitors," "the third largest selling" brand "that has consistently played a role in constraining the price" of the larger firm's products); *see also Staples* 970 F. Supp. at 1083 (finding anticompetitive effects where the "merger would eliminate significant head-to-head competition between the two lowest cost and lowest priced firms in the . . . market.").

The Court will now turn to the defendants' final rebuttal argument – the existence of significant, merger-specific efficiencies.

d. Post-Merger Efficiencies

One of the key benefits of a merger to the economy is its potential to generate efficiencies. *See Heinz*, 246 F.3d at 720. As the Merger Guidelines recognize, merger-generated efficiencies can "enhance the merged firm's ability and incentive to compete, which may result in lower prices, improved quality, enhanced service, or new products." Merger Guidelines § 10. Courts have recognized that a showing of sufficient efficiencies may rebut the government's showing of likely anticompetitive effects. *Heinz*, 246 F.3d at 720. High market concentration levels require "proof of extraordinary efficiencies," however, and courts "generally have found inadequate proof of efficiencies to sustain a rebuttal of the government's case." *Id.* (citation omitted).

"[T]he court must undertake a rigorous analysis of the kinds of efficiencies being urged by the parties in order to ensure that those 'efficiencies' represent more than mere speculation and promises about post-merger behavior." *Id.* at 721. As the Merger Guidelines explain, "[c]ognizable efficiencies are merger-specific efficiencies that have been verified and do not arise from anticompetitive reductions in output or service." Merger Guidelines § 10. Efficiencies are inherently "difficult to verify and quantify" and "it is incumbent upon the merging firms to substantiate efficiency claims" so that it is possible to "verify by reasonable means the likelihood and magnitude of each asserted efficiency, how and when each would be achieved (and any costs of doing so), how each would enhance the merged firm's ability and incentive to compete, and why each would be merger-specific." *Id.* In other words, a "cognizable" efficiency claim must represent a type of cost saving that could not be achieved

without the merger and the estimate of the predicted saving must be reasonably verifiable by an independent party.

The defendants claim that "H&R Block's primary motivation for the TaxACT acquisition is to achieve significant synergies that will enable H&R Block to provide better products at a lower price and to compete more effectively."[41] Defs.' Post-Trial Mem. at 24. The defendants predict that they will achieve over ${redacted} million in annual efficiencies in ten different areas.[42] *Id.* at 24-25.

The chart below summarizes the defendants' claimed efficiencies and predicted annual cost savings:

[41] "Cognizable efficiencies" are a subset of "synergies." "Synergies" refer more generally to any business performance benefits that result from the merger of two companies. *See* Zmijewski, TT, 9/19/11 a.m., at 99.
[42] Originally, the defendants claimed 11 efficiencies, including an efficiency related to {redacted}. This task is "really not an efficiency" but "an additional cost," Dunn, TT, 9/8/11 p.m. (sealed) at 7, and defendants do not reference it in their proposed findings of fact. DFF ¶ 291.

Efficiency	**Description**	**Estimated Annual Cost Saving**
1. Online IT	{redacted}	${redacted} million
2. Emerald Card	Allowing TaxACT's prepaid debit card offerings to be fulfilled through HRB's bank	${redacted} million
3. H&R Block Bank Refund Anticipation Checks	Funding TaxACT's refund anticipation checks through HRB's bank	${redacted} million
4. {redacted}	{redacted}	${redacted}million
5. {redacted}	{redacted}	${redacted} million
6. {redacted}	{redacted}	${redacted} million
7. Corporate Website	{redacted}	${redacted} million
8. Software IT	{redacted}	${redacted} million
9. Download Fulfillment	{redacted}	${redacted} million
10. {redacted}	{redacted}	${redacted}million

DFF ¶ 292; *see also* DX236-007.

Dr. Mark E. Zmijewski, an expert witness for the government, analyzed the defendants' alleged efficiencies and concluded that – with the exception of {one efficiency related to eliminating third-party contracts} – the proposed efficiencies identified by the defendants are either not merger-specific or not verifiable.[43] *See generally* GX 664 (Zmijewski Rep.).

The Court agrees with Dr. Zmijewski that the defendants have not demonstrated that their claimed efficiencies are merger-specific. If a company could achieve certain cost savings

[43] Dr. Zmijewski is a professor of accounting and deputy dean at The University of Chicago Booth School of Business and a founder and principal of Navigant Economics, a consulting firm. GX 664 (Zmijewski Rep.) at 5. He holds a Ph.D. in accounting. *Id.*

without any merger at all, then those stand-alone cost savings cannot be credited as merger-specific efficiencies. The defendants must show that their "efficiencies . . . cannot be achieved by either company alone because, if they can, the merger's asserted benefits can be achieved without the concomitant loss of a competitor." *Heinz*, 246 F.3d at 722. For example, if HRB's {redacted} are not running in the most efficient, cost-effective manner, it is hard to see why a merger with TaxACT is necessary to improve their cost structure. The reasons HRB claims it has higher {redacted} costs than TaxACT include (1) that TaxACT has lower labor costs in Cedar Rapids than HRB has in Kansas City and (2) that TaxACT is simply more cost conscious. Bowen, TT, 9/15/11 p.m., (sealed), at 104-105. Plainly, then, HRB could therefore achieve at least some of the {redacted} cost savings on its own – by relocating {redacted} and taking a more cost conscious attitude toward them. Likewise, the efficiencies related to bringing HRB's outsourced {redacted} functions in-house are unlikely to be wholly merger-specific.

Similarly, the defendants' IT-related efficiencies, which account for the largest efficiency claims, are not entirely merger-specific either. Both TaxACT and HRB witnesses testified that {redacted} – suggesting that the platform consolidation would result in at least some merger-specific efficiencies. *See* Dunn, TT, 9/8/11 p.m. (sealed), at 16-17; Bowen, TT, 9/15/11 p.m. (sealed), at 67-68. One way in which {redacted}. Dunn, TT, 9/8/11 p.m. (sealed), at 16-17; Bowen, TT, 9/15/11 p.m. (sealed), at 67-68; Bowen, TT, 9/19/11 a.m., at 12. Thus, the IT consolidation efficiency actually can be thought of as entailing two distinct consolidations: (1) {redacted} and (2) HRB's platform will be merged with TaxACT's platform. Bowen, TT, 9/19/11 a.m., at 12. Yet the claimed IT efficiency is not discounted for whatever savings HRB could obtain by {performing the first consolidation} on its own – an option the company considered in the past but did not adopt – and the defendants did not present evidence explaining

why, as a technical matter, {performing the first consolidation} would not be feasible or, in fact, would not be more feasible than {the double consolidation}. Bowen, TT, 9/19/11 a.m., at 12; 9/15/11 p.m. (sealed) at 75. The IT efficiencies also apparently account for cost reductions associated with TaxACT's more cost-conscious culture and practices. *See* Dunn, TT, 9/8/11 a.m. (sealed), at 5 ("for Block to achieve these [efficiencies] would require them to come up with an entirely different corporate culture {redacted}.").

Even if the efficiencies were entirely merger-specific, many of them are also not independently verifiable. As Dr. Zmijewski explained, for the various efficiencies that involve the activities now performed by HRB or its vendors that are proposed to be transferred to TaxACT, TaxACT's predicted cost figures for taking over these activities were not based on an analysis of facts that could be verified by a third party. Instead, TaxACT based its cost estimates on management judgments. GX 664 (Zmijewski Rep.) at 22-25. By comparison, HRB's estimated costs for the relevant activities were rooted in accounting and planning documents prepared in the ordinary course of business.

The testimony at the hearing confirmed that TaxACT's recurring cost estimates were largely premised on its managers experiential judgment about likely costs, rather than a detailed analysis of historical accounting data. *See, e.g.*, Dunn, TT, 9/8/11 p.m. (sealed), at 28-31. While reliance on the estimation and judgment of experienced executives about costs may be perfectly sensible as a business matter, the lack of a verifiable method of factual analysis resulting in the cost estimates renders them not cognizable by the Court. If this were not so, then the efficiencies defense might well swallow the whole of Section 7 of the Clayton Act because management would be able to present large efficiencies based on its own judgment and the Court would be hard pressed to find otherwise. The difficulty in substantiating efficiency claims in a verifiable

way is one reason why courts "generally have found inadequate proof of efficiencies to sustain a rebuttal of the government's case." *Heinz*, 246 F.3d at 720 (citation omitted); *see also Staples*, 970 F. Supp. at 1089 (finding "defendants failed to produce the necessary documentation for verification" of efficiencies).

Particular scrutiny of HRB's efficiencies claims is also warranted in light of HRB's historical acquisitions. In 2006, HRB acquired a software company called TaxWorks, which was renamed "RedGear." Bowen, TT, 9/15/11 p.m. (sealed), at 84. For the RedGear acquisition, which was much smaller in scale than the proposed TaxACT deal, HRB projected a total of ${redacted} million in efficiencies over three years. GX 1459 (February 2009 "Taxworks Financial Analysis") at 5. HRB failed to achieve these {efficiencies} {redacted}. *Id.* In this case, the efficiency estimates are much more aggressive, in that defendants are claiming approximately ${redacted} million in efficiencies for 2013 and ${redacted} million in annual savings going forward thereafter, as opposed to ${redacted} million over three years. *See* Bowen, TT, 9/15/11 p.m. (sealed), at 77-78. While HRB has attempted to learn from the mistakes of the RedGear acquisition, *id.* at 85-87, the Court finds that this history only underscores the need for any claimed efficiencies to be independently verifiable in order to constitute evidence that can rebut the government's presumption of anticompetitive effects.

Considering all of the evidence regarding efficiencies, the Court finds that most of the defendants' claimed efficiencies are not cognizable because the defendants have not demonstrated that they are merger-specific and verifiable.[44]

[44] In addition, the defendants have not addressed how much of the claimed efficiencies would be passed through to consumers. *See Staples*, 970 F. Supp. at 1090 (analyzing projected pass-through rate for claimed efficiencies).

IV. CONCLUSION

The Court concludes that the proposed merger between HRB and TaxACT violates Section 7 of the Clayton Act because it is reasonably likely to cause anticompetitive effects. The law of this Circuit supports this conclusion. In *Heinz*, the Court of Appeals reversed a district court's denial of a preliminary injunction against a merger involving the second- and third-largest jarred baby food companies. 246 F.3d at 711-12. After noting the high barriers to entry and high HHI figures that characterized the market, the D.C. Circuit observed that "[a]s far as we can determine, no court has ever approved a merger to duopoly under similar circumstances." *Id.* at 717. The situation in this case is similar. The government established a prima facie case indicating that anticompetitive effects are likely to result from the merger. The defendants have not made a showing of evidence that rebuts the presumption of anticompetitive effects by demonstrating that the government's market share statistics give an inaccurate account of the merger's probable effects on competition in the relevant market. To the contrary, the totality of the evidence confirms that anticompetitive effects are a likely result of the merger, which would give H&R Block and Intuit control over 90 percent of the market for digital do-it-yourself tax preparation products.

Accordingly, the Court will enjoin H&R Block's proposed acquisition of TaxACT. An appropriate Order will accompany this Memorandum Opinion.

DATED: November 10, 2011

/s/ *Beryl A. Howell*
BERYL A. HOWELL
United States District Judge

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. 20549

FORM 8-K

CURRENT REPORT

Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Date of Report (date of earliest event reported): November 14, 2011

H&R BLOCK, INC.
(Exact name of registrant as specified in charter)

Missouri	**1-6089**	**44-0607856**
(State of Incorporation)	(Commission File Number)	(I.R.S. Employer Identification Number)

One H&R Block Way, Kansas City, MO 64105
(Address of Principal Executive Offices) (Zip Code)

(816) 854-3000
(Registrant's telephone number, including area code)

Not Applicable
(Former name or former address, if changed since last report)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions (see General Instruction A.2. below):

[ ] Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)

[ ] Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)

[ ] Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))

[ ] Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

Item 1.02. Termination of a Material Definitive Agreement.

H&R Block, Inc. (the "Company"), 2SS Holdings, Inc. ("2SS"), TA Associates Management, L.P., and Lance Dunn have mutually agreed effective November 14, 2011 to terminate the Agreement and Plan of Merger dated October 13, 2010, as amended (the "Merger Agreement"), among the Company and HRB Island Acquisition, Inc. ("Sub"), an indirect wholly owned subsidiary of the Company, 2SS, TA Associates Management, L.P. in its capacity as a stockholder representative, and Lance Dunn in his capacity as a stockholder representative, pursuant to which Sub would have merged with and into 2SS (the "Merger"), with 2SS continuing as the surviving corporation and an indirect subsidiary of the Company after the Merger.

A description of the terms of the Merger Agreement was included in Item 1.01 of the Current Reports on Form 8-K filed by the Company with the Securities and Exchange Commission on October 14, 2010 and March 9, 2011 and in Item 9B of the Annual Report on Form 10-K filed by the Company with the Securities and Exchange Commission on June 23, 2011 and, to the extent required by Item 1.02 of Form 8-K, such descriptions are incorporated by reference in this Item 1.02 pursuant to General Instruction B.3 of Form 8-K.

As previously disclosed, the United States Department of Justice (the "DOJ") filed a civil antitrust lawsuit in the United States District Court in Washington, D.C. to block the Merger. On October 31, 2011, the United States District Court granted the DOJ's motion for a permanent injunction. On November 14, 2011, the Company, 2SS, TA Associates Management, L.P. in its capacity as a stockholder representative, and Lance Dunn in his capacity as a stockholder representative, mutually agreed to a termination of the Merger Agreement.

The Company is not expected to incur any early termination penalties as a result of the termination of the Merger Agreement.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

H&R BLOCK, INC.

Date: November 14, 2011 By: /s/ Jeffrey T. Brown
Jeffrey T. Brown
Senior Vice President and Chief Financial Officer

EX-99.1 3 d278620dex991.htm PRESS RELEASE ISSUED JANUARY 9, 2010

Exhibit 99.1

INFOSPACE TO ACQUIRE TAXACT

Transaction Provides InfoSpace Strong Presence and Growth Opportunities in Online Consumer Tax Preparation

BELLEVUE, Wash. – January 9, 2012 – InfoSpace, Inc. (NASDAQ: INSP), a leader in online search, today announced that it has signed a definitive agreement to acquire TaxACT, a leading provider of online tax solutions, for $287.5 million in cash. The acquisition is subject to satisfaction of customary closing conditions and is expected to close in the first quarter of 2012.

"The acquisition of TaxACT is significant for our Company, and consistent with our capital deployment objectives," said William J. Ruckelshaus, President and Chief Executive Officer of InfoSpace. "As a leading brand with a loyal, growing customer base and a sustained track record, TaxACT is well positioned to grow in the large and enduring tax preparation category. As the market continues its shift toward online 'do-it-yourself' tax preparation, we are confident that we can leverage our online expertise, TaxACT's industry leading solutions, and the fantastic TaxACT management team to drive future growth. The financial benefits of this transaction are compelling and provide us ongoing flexibility to invest in our businesses to further enhance shareholder value."

The transaction is expected to be immediately accretive to InfoSpace earnings per share, and year one return on share holder capital is expected to exceed 16%. For the twelve months ending September 30, 2011, TaxACT had revenues of $78.1 million and adjusted EBITDA of $37.8 million. For the twelve months ending September 30, 2011, InfoSpace and TaxACT together generated pro forma revenue of $290.0 million, pro forma adjusted EBITDA of $72.5 million, and pro forma non-GAAP net income of $45.6 million or $1.21 per diluted share.

Based in Cedar Rapids, Iowa, TaxACT is the second largest provider of online individual income tax solutions. With approximately 70 full-time employees, TaxACT participates in the large and growing $20 billion tax preparation market. The Company had more than five million tax filers last season, with the vast majority of those customers filing online.

TaxACT offers the only complete free federal tax solution for "*everyone.*" Its offerings include the free edition, deluxe edition, and state edition for individual tax filers, and TaxACT professional for businesses. TaxACT's offerings are available through a secure online delivery system, complemented by available desktop downloads and extensive tax and IRS expertise.

"On behalf of the entire TaxACT team, I want to express my excitement as we partner with InfoSpace," said JoAnn Kintzel, president of TaxACT. "We are committed to

providing a superior customer experience and working hard to ensure that everyone is comfortable using the TaxACT products to complete their federal tax returns for free. We have the right tools, tremendous in-house expertise, and an established consumer following. With the support of InfoSpace, we are confident that we can further strengthen our position and capitalize on the substantial opportunities in the market for online tax preparation."

InfoSpace will fund the acquisition through a combination of cash on hand and debt, having secured a commitment for approximately $95 million of financing in connection with this transaction. The combined company is expected to have a solid balance sheet with an estimated cash and short term investments in excess of $90 million.

Upon completion of the acquisition, 2nd Story Software, the operating company for the TaxACT business, will become a wholly-owned subsidiary of InfoSpace, and will continue operations in Cedar Rapids, Iowa as a standalone business unit led by the TaxACT management team. TA Associates, the majority shareholder of the TaxACT business, will sell its full holdings as part of this transaction.

Conference Call and Webcast

InfoSpace will host a conference today at 5:30 a.m. Pacific time / 8:30 a.m. Eastern time to discuss the acquisition of TaxACT. The live webcast and a set of slides with additional information can be accessed in the Investor Relations section of the Company's website, at http://www.infospaceinc.com.

About InfoSpace, Inc.

InfoSpace, Inc., a leading developer of metasearch products, is focused on bringing the best of the Web to Internet users. InfoSpace's proprietary metasearch technology combines the top results from several of the largest online search engines, providing fast and comprehensive search results. InfoSpace sites include Dogpile(R) (www.dogpile.com), InfoSpace.com (R) (www.infospace.com), MetaCrawler(R) (www.metacrawler.com), WebCrawler(R) (www.webcrawler.com), and WebFetch(R) (www.webfetch.com). InfoSpace's metasearch technology is also available on nearly 100 partner sites, including content, community, and connectivity sites. In addition, the Company operates an innovative online search engine optimization tool, WebPosition(R) (www.webposition.com). Additional information may be found at www.infospaceinc.com.

About TaxACT

TaxACT, is a privately held company founded in 1998 and critically acclaimed as a leader in developing affordable tax preparation software and Web-based services directly for consumers. TaxACT was the first to offer free Federal tax software and free e-file to all American taxpayers in the 2005 tax season. TaxACT is the 2nd most visited online destination for tax preparation services. Since 2000, TaxACT Online has assisted with more than 20 million e-filed federal returns. TaxACT is also the only Web-based tax

planning and preparation product to offer a year-round tax preparation solution, with Preview Versions released in October and Final Versions released in January. Learn more about TaxACT individual, business and professional products at www.taxact.com and in the Press Center at www.taxact.com/press.

InfoSpace.com, InfoSpace, Dogpile, MetaCrawler, WebCrawler, WebFetch, and other marks are trademarks of InfoSpace, Inc. TaxACT and 2nd Story Software are trademarks of 2nd Story Software, Inc.

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This announcement contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this release, and which may differ significantly from actual results due to various risks and uncertainties including, but not limited to: general economic, industry, and market sector conditions; the timing and extent of market acceptance of developed products and services and related costs; the successful execution of the Company's strategic initiatives, business integration plans, operating plans, and marketing strategies. A more detailed description of these and certain other factors that could affect actual results is included in InfoSpace, Inc.'s most recent Annual Report on Form 10-K and subsequent reports filed with or furnished to the Securities and Exchange Commission. InfoSpace, Inc. undertakes no obligation to update any forward-looking statements to reflect new information, events, or circumstances after the date of this release or to reflect the occurrence of unanticipated events.

A NOTE ON EXPERT EVIDENCE

As a general rule, a witness may not testify at trial to a matter on which the witness lacks personal knowledge. Rule 602 of the Federal Rules of Evidence provides:

> A witness may testify to a matter only if evidence is introduced sufficient to support a finding that the witness has personal knowledge of the matter. Evidence to prove personal knowledge may consist of the witness's own testimony. This rule does not apply to a witness's expert testimony under Rule 703.[1]

Rule 702 governs the admissibility of opinion testimony by a qualified expert.[2] Rule 702 embodies separate requirements on qualifications, relevance, and reliability:

> A witness who is qualified as an expert by knowledge, skill, experience, training, or education may testify in the form of an opinion or otherwise if the proponent demonstrates to the court that it is more likely than not that:
>
> (a) the expert's scientific, technical, or other specialized knowledge will help the trier of fact to understand the evidence or to determine a fact in issue;
>
> (b) the testimony is based on sufficient facts or data;
>
> (c) the testimony is the product of reliable principles and methods; and
>
> (d) the expert's opinion reflects a reliable application of the principles and methods to the facts of the case.[3]

Subject to Rule 702 and the other rules of evidence, Rule 704(a) permits experts to offer opinion testimony about an ultimate issue of fact in the case.[4] But neither Rule 702 nor Rule 704(a) allows an expert to offer legal conclusions.[5]

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1. FED. R. EVID. 602.
2. *Id*. 702.
3. *Id*. 702 (as amended in 2023). In limited circumstances, lay persons may give opinion testimony under Rule 701: "If a witness is not testifying as an expert, testimony in the form of an opinion is limited to one that is: (a) rationally based on the witness's perception; (b) helpful to clearly understanding the witness's testimony or to determining a fact in issue; and (c) not based on scientific, technical, or other specialized knowledge within the scope of Rule 702." FED. R. EVID. 701.
4. *Id*. 704(a) ("An opinion is not objectionable just because it embraces an ultimate issue."). Rule 704 abolished the old common law prohibition against any witness, including an expert, from offering an opinion on the "ultimate issue" in the case. *See* FED. E. EVID. Advisory committee's note to Rule 704.
5. *See, e.g.*, Nationwide Transp. Fin. v. Cass Info. Sys., 523 F.3d 1051, 1059-60 (9th Cir. 2008); C.P. Interests, Inc. v. Cal. Pools, Inc., 238 F.3d 690, 697 (5th Cir. 2001); Berry v. City of

Rule 702 was amended in 2000 to incorporate the principles established in *Daubert v. Merrell Dow Pharmaceuticals, Inc.*[6] and *Kumho Tire Co. v. Carmichael*.[7] *Daubert*, which involved scientific expert testimony, assigned the trial court the "gatekeeper" role "of ensuring that an expert's testimony both rests on a reliable foundation and is relevant to the task at hand."[8] *Kumho* clarified that *Daubert's* gatekeeping obligation applies as well to all types of expert testimony.[9] The 2000 amendment reaffirmed the trial court's role as a gatekeeper and imposed requirements of relevance, qualification, and reliability on expert testimony.[10]

Rule 702 was again amended, effective December 1, 2023, to make two significant changes that strengthen judicial gatekeeping over expert testimony. First, the amendment clarifies that courts must apply the preponderance of evidence standard ("more likely than not") to determine whether expert testimony meets all admissibility requirements before allowing it to reach the jury.[11] This change addresses a widespread problem where courts incorrectly treated reliability questions as matters of "weight" for the jury rather than "admissibility" for the judge. The amendment emphasizes that judges must rigorously evaluate the three reliability requirements added in 2000 and that expert testimony need only "help" the trier of fact rather than meet the higher "appreciably help" standard some courts had imposed.[12] Once the admissibility requirements are satisfied, further challenges focus on the weight of the evidence rather than admissibility.[13]

Second, the amendment strengthened Rule 702(d) to emphasize that expert opinions must stay within the bounds of what their basis and methodology can

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Detroit, 25 F.3d 1342, 1353 (6th Cir. 1994) ("Although an expert's opinion may embrace an ultimate issue to be decided by the trier of fact, the issue embraced must be a factual one.") (citation, brackets, and quotation marks omitted).

6. 509 U.S. 579 (1993).

7. 526 U.S. 137 (1999).

8. *Daubert*, 509 U. at 597; *accord Kumho*, 526 U.S. at 141.

9. *Kumho*, 526 U.S. at 147.

10. Rule 702 was amended in 2011 as part of the restyling of the Federal Rules of Evidence. The purpose was to make the Rules more easily understood and to ensure stylistic and terminological consistency across the Rules. The Advisory Committee emphasized that these changes were stylistic only and were not intended to change the substantive standards governing the admissibility of expert testimony. *See* FED. R. EVID. 702 advisory committee's note to the 2011 amendment.

11. FED. R. EVID. 702 (as amended effective Dec. 1, 2023) (prefatory clause). However, proponents "do not have to demonstrate to the judge by a preponderance of the evidence that the assessments of their experts are correct, they only have to demonstrate by a preponderance of evidence that their opinions are reliable." Fed. R. Evid. 702, advisory committee note 1 to 2023 amendment (quoting *In re* Paoli R.R. Yard PCB Litig., 35 F.3d 717, 744 (3d Cir. 1994)); *accord In* re NFL "Sunday Ticket" Antitrust Litig., No. 15-ml-02668, 2024 WL 3628118, at *2 (C.D. Cal. Aug. 1, 2024).

12. *See* FED. R. EVID. 702 advisory committee's note to 2023 amendment; FED. R. EVID. 104(a); Bourjaily v. United States, 483 U.S. 171, 175 (1987); Huddleston v. United States, 485 U.S. 681, 687 n.5 (1988).

13. *See* FED. R. EVID. 702 advisory committee's note to 2023 amendment.

reliably support.[14] While the amendment includes specific guidance for traditional forensic evidence—such as fingerprint analysis, handwriting comparison, and other pattern-matching disciplines—where experts should avoid claims of absolute or 100% certainty when using subjective methodologies, the broader principle applies to all expert testimony. For economic experts in antitrust merger cases, this means acknowledging the limitations, assumptions, and potential sources of error in their economic models, econometric analyses, and market simulations rather than overstating the precision or certainty of their conclusions. Judges should seek error rate estimates when available for any methodology, and all expert testimony must be limited to reasonable inferences from reliable methods. The amendment does not impose new procedures or require courts to nitpick expert opinions to perfection, but it does prevent experts from making unsupported claims that exceed what their methodology can reliably establish. When experts disagree on contested facts, both sides' experts may still be admissible, allowing the jury to decide credibility.[15]

Significantly for merger antitrust injunctive relief proceedings, these clarifications do not require a pretrial *Daubert* ruling in a bench trial. When the court is both gatekeeper and factfinder, it may hear the expert evidence and resolve Rule 702 issues during trial, admitting subject to later exclusion or disregard, so long as it ultimately finds under Rule 104(a) that Rule 702's requirements are met by a preponderance of the evidence.[16] Nor does the 2023 amendment impose any new procedures or require a sua sponte reliability finding in the absence of an objection.[17] However, if a *Daubert* motion to exclude is made and denied before trial, the opposing party may re-raise the issue in a post-trial motion for judgment as a matter of law based on the expert's actual testimony during trial.[18]

Relevance. Rule 702 requires that the "expert's scientific, technical, or other specialized knowledge will help the trier of fact to understand the evidence or to determine a fact in issue."[19] The Advisory Committee observed that the helpfulness inquiry is "whether the untrained layman would be qualified to determine intelligently and to the best possible degree the particular issue without enlightenment from those having a specialized understanding of the subject involved

14. FED. R. EVID. 702(d) (requiring "the expert's opinion reflect[ ] a reliable application of the principles and methods to the facts of the case") (as amended effective Dec. 1, 2023).

15. *See* FED. R. EVID. 702 advisory committee's note to 2023 amendment.

16. *In re* Rail Freight Fuel Surcharge Antitrust Litig., No. 07-0489 (PLF), 2016 WL 2962186, at 1 (D.D.C. May 20, 2016).

17. FED. R. EVID. 702 advisory committee's note to 2023 amendment ("Nor does the amendment require that the court make a finding of reliability in the absence of objection."; "Nothing in the amendment imposes any new, specific procedures.").

18. *See In* re NFL "Sunday Ticket" Antitrust Litig., No. 15-ml-02668, 2024 WL 3628118, at *4 (C.D. Cal. Aug. 1, 2024) (granting JMOL after concluding that the plaintiffs' expert testimony at trial about the "but-for" world in a damages analysis was "not the product of sound economic methodology").

19. FED. R. EVID. 702.

in the dispute."[20] Expert testimony that is not helpful to the trier of fact is inadmissible.[21]

One aspect of the relevancy requirement is that the expert's analysis is probative of a question of fact in the case under the proper legal standard. At trial, the expert must testify in a manner that does not contradict established legal rules or risk confusing the jury regarding the proper legal test. So, for example, courts have excluded expert testimony where the expert's theory of market definition contradicted the applicable legal standards.[22]

Qualifications. Rule 702 requires that an expert witness be qualified by scientific, technical, or other specialized knowledge. Without this specialized knowledge, the expert's testimony would not be helpful to the jury: the trier of fact can simply perform the analysis on their own. Courts have construed this requirement liberally.[23] In assessing an expert's qualifications, the court should consider a proposed expert's full range of practical experience as well as academic or technical training.[24] When the expert is otherwise qualified, courts should not exclude the expert's testimony merely because the expert did not have the degree or training that the court believes would be most appropriate.[25] But the expert's qualifications must be relevant to the opinion the expert is offering. A person, although qualified as an expert in one area of expertise, may be precluded from offering opinions beyond that area of expertise.[26] Moreover, while an expert may be "qualified" sufficient to

20. Fed. R. Evid. 702 advisory committee's note to the original proposed rule; *see* Superior Prod. P'ship v. Gordon Auto Body Parts Co., 784 F.3d 311, 323 (6th Cir. 2015) (affirming exclusion of expert testimony that the defendant's pricing strategy reflected an intent to force the plaintiff out of the market where no expert testimony on intent was needed); *In re* Se. Milk Antitrust Litig., No. 2:07-CV 208, 2010 WL 8228830, at *3 (E.D. Tenn. Dec. 8, 2010) (granting motion to exclude expert testimony that did no more than collate the plaintiffs' evidence and summarize it in nontechnical form, without the application of any expertise).

21. *See* United States v. Duncan, 42 F.3d 97, 101 (2d Cir. 1994) ("When an expert undertakes to tell the jury what result to reach, this does not *aid* the jury in making a decision, but rather attempts to substitute the expert's judgment for the jury's. When this occurs, the expert acts outside his limited role of providing the groundwork in the form of an opinion to enable the jury to make its own informed determination. In evaluating the admissibility of expert testimony, this Court requires the exclusion of testimony which states a legal conclusion.") (emphasis in original).

22. *See, e.g.*, Superior Prod. P'ship v. Gordon Auto Body Parts Co., 784 F.3d 311, 325 (6th Cir. 2015) (affirming exclusion of expert testimony that defendant's prices were below cost where expert used an incorrect test for below-cost pricing under Sixth Circuit precedent); Rebel Oil Co. v. Atlantic Richfield Co., 51 F.3d 1421, 1436 (9th Cir. 1995); Bailey v. Allgas, Inc., 148 F.Supp.2d 1222, 1242-45 (N.D. Ala. 2000), *aff'd*, 284 F.3d 1237, 1247-49 (11th Cir. 2002).

23. *See, e.g.*, *In re* Paoli R.R. Yard PCB Litig. (Paoli II), 35 F.3d 717, 741 (3d Cir. 1994).

24. *See In re* Ready-Mixed Concrete Antitrust Litig., 261 F.R.D. 154, 163 (S.D. Ind. 2009).

25. *See, e.g.*, *Paoli II*, 35 F.3d at 741.

26. *See* Weisgram v. Marley Co., 169 F.3d 514, 518 (8th Cir. 1999) (holding that a city fire captain, although qualified as an expert on fire investigation, and therefore qualified to testify as to his opinion that a fire started in the entryway and radiated to a sofa, was not qualified to testify as to his unsubstantiated theories of a malfunction that might have caused the fire).

satisfy the standards of Rule 702, the nature of the qualifications may affect the weight to be given to the testimony.[27]

Facts and data. By its terms, Rule 702(b) requires that expert opinion testimony be based on "sufficient data or facts."[28] An expert may obtain her data or facts from one of three sources:[29]

1. The expert may have first-hand personal knowledge of them, such as when the expert is a treating physician who directly observed the patient.
2. The expert may be provided data and facts at trial, such as when the expert attended the testimony of fact witnesses in which the data and facts were disclosed, or when counsel during the expert's examination (especially cross-examination) presented the expert with data or facts in a hypothetical situation on which the expert was asked to opine.
3. More commonly, especially in antitrust cases involving economic experts, the expert obtains her data or facts from third-party sources and therefore does not have "personal knowledge" of them within the meaning of Rule 602.

Rule 703 governs the facts or data on which an expert may base an opinion:

> An expert may base an opinion on facts or data in the case that the expert has been made aware of or personally observed. If experts in the particular field would reasonably rely on those kinds of facts or data in forming an opinion on the subject, they need not be admissible for the opinion to be admitted. But if the facts or data would otherwise be inadmissible, the proponent of the opinion may disclose them to the jury only if their probative value in helping the jury evaluate the opinion substantially outweighs their prejudicial effect.[30]

The first sentence of Rule 703 addresses the expert's first-hand knowledge, as well as the data or facts provided at trial. The rest of the rule handles data and facts from third-party sources. Note that the expert may rely on data and facts that are not admitted, or even are inadmissible, if experts in the field reasonably rely on them.[31]

Under Rule 703, experts are entitled to use assistance in formulating expert opinion, and their assistants need not themselves testify to make the expert's opinion

27. *See, e.g.*, *In re* Mushroom Direct Purchaser Antitrust Litig., No. 06-0620, 2015 WL 5767415, at *3-*5 (E.D. Pa. July 29, 2015) (finding Einer Elhauge, a professor at Harvard who teaches and has published in antitrust law, "qualified" within the meaning of Rule 702 to offer economic opinions based on the use of regression analysis, although he has no formal training in economics, econometrics or statistics, but noting that his lack of formal training typical of testifying economic experts would factor in the weight given to his testimony).

28. FED. R. EVID. 702(b).

29. FED. R. EVID. 703 advisory committee's note to the original proposed rule.

30. FED. R. EVID. 703.

31. This is an exception to Rule 104(b), which provides: "When the relevance of evidence depends on whether a fact exists, proof must be introduced sufficient to support a finding that the fact does exist. The court may admit the proposed evidence on the condition that the proof be introduced later." *Id*. 104(b).

testimony admissible.[32] The opposing party, however, may examine the expert to determine whether there was adequate supervision and whether relying on such assistance was standard practice in the field.[33] Where the expert relied on an assistant's work, the opposing party may also depose the assistant to determine how the task was performed and whether it was performed competently. Where the data or facts on which the expert relied cannot be shown to be reliable, either by the expert herself or other testimony, the opinions that depend on those data or facts will be excluded.[34]

As a general rule, an expert does not have to disclose in the expert's direct testimony the data and facts on which an opinion is based, but the relevant data and facts may be the subject of cross-examination. Rule 705 provides:

> Unless the court orders otherwise, an expert may state an opinion—and give the reasons for it—without first testifying to the underlying facts or data. But the expert may be required to disclose those facts or data on cross-examination.[35]

Rules 26(a)(2)(B) and 26(e)(1) of the Federal Rules of Civil Procedure and Rule 16 of the Federal Rules of Criminal Procedure, however, require disclosure in advance of trial of the basis and reasons for an expert's opinions.[36]

Reliable principles. Rule 702 requires that the expert testimony "is the product of reliable principles and methods."[37] The *Daubert* Court identified several factors that the court may consider when making this determination, including: (1) whether the expert's technique or theory can be or has been tested; (2) whether the technique or theory has been subject to peer review and publication; (3) the known or potential rate of error of the technique or theory when applied; (4) the existence, and maintenance of standards and controls; and (5) whether the technique or theory has been generally accepted in the scientific community.[38] These factors are not exhaustive, and the trial court has "broad latitude when it decides *how* to determine reliability."[39]

Reliable application. Rule 702 requires that "the expert's opinion reflects a reliable application of the principles and methods to the facts of the case."[40] In other words, "the expert's testimony must be relevant for the purposes of the case and must

32. *See In re* Sulfuric Acid Antitrust Litig., 235 F.R.D. 646, 658 (N.D. Ill. 2006).

33. *Id*.

34. *See, e.g.*, Orthofix Inc. v. Lemanski, No. 13-11421, 2015 WL 12990115, at *1 (E.D. Mich. Sept. 29, 2015).

35. FED. R. EVID. 705. Rules 26(a)(2)(B) and 26(e)(1) of the Federal Rules of Civil Procedure and Rule 16 of the Federal Rules of Criminal Procedure, however, require disclosure in advance of trial of the basis and reasons for an expert's opinions. *See* FED. R. CIV. P. 26(a)(2)(B), 26(e)(1); FED. R. CRIM. P. 16.

36. *See* FED. R. CIV. P. 26(a)(2)(B), 26(e)(1); FED. R. CRIM. P. 16.

37. FED. R. EVID. 702.

38. *See, e.g.*, *In re* Paoli R.R. Yard PCB Litig. (Paoli II), 35 F.3d 717, 742 n.8 (3d Cir. 1994).

39. Kumho Tire Co. v. Carmichael, 526 U.S. 137, 142 (1999) (emphasis in original).

40. FED. R. EVID. 702.

assist the trier of fact."[41] This requirement is commonly known as "fit."[42] The *Daubert* Court observed that "[f]it" is not always obvious, and scientific validity for one purpose is not necessarily scientific validity for other, unrelated purposes."[43]

As a general matter, flaws in a proffered expert's analysis typically go to the weight, rather than the admissibility, of the expert's testimony.[44] The evidentiary requirement of reliability is lower than the merits standard of correctness.[45] As the Third Circuit explained:

> A judge frequently should find an expert's methodology helpful even when the judge thinks that the expert's technique has flaws sufficient to render the conclusions inaccurate. He or she will often still believe that hearing the expert's testimony and assessing its flaws was an important part of assessing what conclusion was correct and may certainly still believe that a jury attempting to reach an accurate result should consider the evidence.[46]

Two areas of particular interest in antitrust cases are regression analysis and surveys.

Regression analysis is a well-accepted economic tool that courts have accepted when reliably applied.[47] The Supreme Court addressed the application reliability of opinions based on regression analysis in *Bazemore v. Friday*, an employment discrimination case:

> While the omission of variables from a regression analysis may render the analysis less probative than it otherwise might be, it can hardly be said, absent some other infirmity, that an analysis which accounts for the major factors "must be considered unacceptable as evidence of discrimination." Normally, failure to include variables will affect the analysis' probativeness, not its admissibility.[48]

41. Schneider ex rel. Estate of Schneider v. Fried, 320 F.3d 396, 404 (3d Cir. 2003); *accord In re* Mushroom Direct Purchaser Antitrust Litig., No. 06-0620, 2015 WL 5767415, at *2 (E.D. Pa. July 29, 2015).

42. *See, e.g.*, *Paoli II*, 35 F.3d at 743; *In re* Nexium (Esomeprazole) Antitrust Litig., 842 F.3d 34, 52 (1st Cir. 2016); Concord Boat Corp. v. Brunswick Corp., 207 F.3d 1039, 1055 (8th Cir. 2000).

43. *Daubert*, 509 U. at 591.

44. *See, e.g.*, *In re* Live Concert Antitrust Litig., 863 F. Supp. 2d 966, 973 (C.D. Cal. 2012).

45. *Paoli II*, 35 F.3d at 744; *In re* Mushroom Direct Purchaser Antitrust Litig., No. 06-0620, 2015 WL 5767415, at *6 (E.D. Pa. July 29, 2015).

46. *Id*. at 744-45.

47. *See, e.g.*, *In re* Flat Glass Antitrust Litig., 191 F.R.D. 472, 486 (W.D. Pa. 1999) (collecting cases).

48. Bazemore v. Friday, 478 U.S. 385, 400 (1986). For applications in antitrust cases, see, for example, *In re* Mushroom Direct Purchaser Antitrust Litig., No. 06-0620, 2015 WL 5767415, at *11 (E.D. Pa. July 29, 2015) (Daubert decision denying motion to exclude Einer Elhauge); *In re* Linerboard Antitrust Litig., 497 F. Supp. 2d 666, 678 (E.D. Pa. 2007) ("[I]t is only the rare case where the regressions are so incomplete as to be irrelevant and the expert's decisions regarding control variables are the basis to exclude the analysis.") (internal citations omitted).

Generally, courts recognize that the economic tools used in antitrust cases require the exercise of professional judgment, often resulting in disagreements between opposing experts, and that these disagreements typically should be resolved by the trier of fact in the adversarial process, rather than by the court in a *Daubert* proceeding.[49] However, there are limits to this deference. In some cases, the analysis may be so incomplete as to the "major factors" as to be inadmissible as irrelevant.[50] Courts have yet to establish a bright-line test for determining when a regression analysis is "so incomplete" as to be irrelevant, but instead have more generally held that the burden is on the opposing party to show that the regression omitted material variables or was otherwise misspecified in a way that, if the regression analysis had been properly performed, would have changed the outcome of the analysis.[51] Merely identifying variables that the opposing party believes should have been included in the analysis, without showing how the inclusion of these variables would affect the result, is not enough.[52] Recent decisions applying the 2023 Rule 702 amendments have reinforced that economic modeling in antitrust cases—including "but for" analyses commonly used to establish damages—must be grounded in sufficient factual support and reliable methodology, rather than mere assumptions about how market participants would behave.[53]

To assess application reliability of opinions based on surveys, courts have examined a variety of factors, including whether (1) the "universe" of the survey was defined correctly, (2) a representative sample of that universe was selected, (3) the questions to be asked of interviewees were framed in a clear, precise and non-leading manner, (4) sound interview procedures were followed by competent interviewers who had no knowledge of the litigation or the purpose for which the survey was conducted, (5) the data gathered was accurately reported, (6) the data was analyzed in accordance with accepted statistical principles and (7) the objectivity of the entire process was ensured.[54] Still, these are only factors for the court to consider. Unless

49. *See In re* Mushroom Direct Purchaser Antitrust Litig., No. 06-0620, 2015 WL 5767415, at *6 (E.D. Pa. July 29, 2015); *In re* Air Cargo Shipping Servs. Antitrust Litig., No. 06–1175, 2014 WL 7882100, at *8 (E.D.N.Y. Oct. 15, 2014).

50. *See Live Concert*, 863 F. Supp. at 973 (quoting *Bazemore*, 478 U.S. at 400 n.10); Blue Cross & Blue Shield United of Wisc. v. Marshfield Clinic, 152 F.3d 588, 593 (7th Cir.1998) (finding expert damages reports were "worthless" because they controlled for only a single factor).

51. *See, e.g.*, Resco Prod., Inc. v. Bosai Minerals Grp., No. CIV.A. 06-235, 2015 WL 5521768, at *5 (W.D. Pa. Sept. 18, 2015); *In re* Mushroom Direct Purchaser Antitrust Litig., No. 06-0620, 2015 WL 5767415, at *11 (E.D. Pa. July 29, 2015) (rejecting Daubert challenge on omitted variables for failure to show that the omitted variables mattered).

52. *See, e.g.*, Resco, 2015 WL 5521768, at *5; *In re* Linerboard Antitrust Litig., 497 F. Supp. 2d 666, 678 (E.D. Pa. 2007); *In re* Polypropylene Carpet Antitrust Litig., 93 F. Supp. 2d 1348, 1365 (N.D. Ga. 2000).

53. *See In* re NFL "Sunday Ticket" Antitrust Litig., No. 15-ml-02668, 2024 WL 3628118, at *2-*8 (C.D. Cal. Aug. 1, 2024) (excluding expert testimony that relied on unsupported assumptions about market behavior in hypothetical scenarios).

54. *See, e.g.*, Estes Park Taffy Co., LLC v. Original Taffy Shop, Inc., No. 15-CV-01697-CBS, 2017 WL 2472149, at *3 (D. Colo. June 8, 2017); LG Electronics U.S.A., Inc. v. Whirlpool Corp., 661 F. Supp. 2d 940, 952 (N.D. Ill. 2009).

the court determines that the survey is fundamentally unreliable, the expert testimony should be admitted and then tested through cross-examination at trial.[55]

Prejudice. Even if admissible under Rule 702, expert testimony is still subject to exclusion under Rule 403, which permits the court to exclude otherwise admissible evidence "if its probative value is substantially outweighed by a danger of one or more of the following: unfair prejudice, confusing the issues, misleading the jury, undue delay, wasting time, or needlessly presenting cumulative evidence."[56] Courts are likely to use this rule if there is substantially more reliable and accurate evidence to answer the question in issue.

Daubert motions. The admissibility of expert testimony is a question for the court. Rule 104(a) requires that "[t]he court must decide any preliminary question about whether a witness is qualified, a privilege exists, or evidence is admissible. In so deciding, the court is not bound by evidence rules, except those on privilege."[57] *Daubert* held that when a party proffers expert testimony, the trial court, pursuant to Rule 104(a), must "determine at the outset" whether the testimony is admissible.[58] The court's inquiry must focus on qualifications, relevance, and reliability of the expert and her testimony, not on the conclusions the expert reaches nor the expert's credibility.[59]

Although Rule 103(a) generally provides that parties must make a timely objection to the admission of evidence to impose an obligation on the court to determine admissibility (and to preserve a claim of error as to the determination), *Daubert* imposes an independent requirement that trial courts conduct a preliminary assessment of the admissibility of expert testimony, even in the absence of an objection.[60] There is no requirement, however, that the district court conduct sua sponte an in-depth *Daubert* analysis and make explicit findings on the record as to the elements of Rule 702. Instead, it is enough that the district court is alert to the requirements on the admissibility of expert testimony and assures itself that these requirements are facially satisfied by the proffered expert testimony.

Finally, *Daubert* imposed the gatekeeper role on the courts to ensure that the trier of fact will not be exposed to unreliable or irrelevant testimony about scientific, technical or other specialized matters. However, the need for a gatekeeper in advance is significantly diminished when the trier of fact is the judge, rather than a jury.

> That is not to say that the scientific reliability requirement is lessened in such situations; the point is only that the court can hear the evidence and make its reliability determination during, rather than in advance of, trial. Thus, where the factfinder and the gatekeeper are the same, the court does not err in admitting

55. *See, e.g.*, *Estes Park Taffy*, 2017 WL 2472149, at *4 (denying motion to exclude).

56. FED. R. EVID. 403.

57. *Id*. 104(a).

58. *Daubert*, 509 U.S. at 592.

59. *See, e.g.*, *In re* Scrap Metal Antitrust Litig., 527 F.3d 517, 529 (6th Cir. 2008); *In re* Paoli R.R. Yard PCB Litig. (Paoli II), 35 F.3d 717, 743 (3d Cir. 1994)

60. *See* Hoult v. Hoult, 57 F.3d 1, 4-5 (1st Cir. 1995).

> the evidence subject to the ability later to exclude it or disregard it if it turns out not to meet the standard of reliability established by Rule 702.[61]

While courts certainly can make Rule 702 determinations as the evidence is presented, not making an earlier determination can create significant inefficiency for both the court and the parties. In the absence of an earlier *Daubert* decision, the parties must prepare and present their evidence and arguments for both contingencies: that the expert evidence will be accepted and that it will be excluded. Especially when multiple experts are testifying and all are being challenged, the burden can be substantial.

Burden of proof and standard of review. The burden of laying the proper foundation for the admission of expert testimony is on the party offering the testimony, and a preponderance of the evidence must show admissibility.[62] As with other evidentiary rulings, the decision to admit or exclude expert testimony is within the discretion of the court.[63] Appellate courts review the district court's decision for abuse of discretion.[64]

61. *In re* Salem, 465 F.3d 767, 777 (7th Cir. 2006) (internal citation omitted); *accord In re* Rail Freight Fuel Surcharge Antitrust Litig., No. 07-0489 (PLF), 2016 WL 2962186, at *1 (D.D.C. May 20, 2016) (denying motion to exclude).

62. *See, e.g.*, *Daubert*, 509 U.S. at 593 n.10 (1993); Wills v. Amerada Hess Corp., 379 F.3d 32, 47 n.9 (2d Cir. 2004); Hall v. United Ins. Co. of Am., 367 F.3d 1255, 1261 (11th Cir. 2004); Lauzon v. Senco Prods., Inc., 270 F.3d 681, 686 (8th Cir. 2001); Meister v. Medical Engineering Corp., 267 F.3d 1123, 1128 n.9 (D.C. Cir. 2001); Cooper v. Smith and Nephew, Inc., 259 F.3d 194, 199 (4th Cir. 2001); Nelson v. Tenn. Gas Pipeline Co., 243 F.3d 244, 251 (6th Cir. 2001); Oddi v. Ford Motor Co., 234 F.3d 136, 144 (3d Cir. 2000); Allison v. McGhan Med. Corp., 184 F.3d 1300, 1306 (11th Cir. 1999); United States v. Griffith, 118 F.3d 318, 321 (5th Cir. 1997); FED. R. EVID. 702 advisory committee's note to 2000 amendments (observing that "the proponent has the burden of establishing that the pertinent admissibility requirements are met by a preponderance of the evidence.").

63. *See, e.g.*, Champagne Metals v. Ken-Mac Metals, Inc., 458 F.3d 1073, 1079 (10th Cir. 2006); United States v. Gabaldon, 389 F.3d 1090, 1098 (10th Cir. 2004); Amorgianos v. Nat'l R.R. Passenger Corp., 303 F.3d 256, 264-65 (2d Cir. 2002).

64. *See, e.g.*, Superior Prod. P'ship v. Gordon Auto Body Parts Co., 784 F.3d 311, 322 (6th Cir. 2015); *In re* Nexium (Esomeprazole) Antitrust Litig., 842 F.3d 34, 52 (1st Cir. 2016).

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA,

Plaintiff,

v.

H&R BLOCK, INC., *et al.*,

Defendants.

Civil Action No. 11-00948 (BAH)

MEMORANDUM OPINION AND ORDER

The United States, through the Antitrust Division of the Department of Justice (the "DOJ" or the "plaintiff"), brought this civil case to enjoin the proposed acquisition of a digital do-it-yourself tax preparation company known as TaxACT by H&R Block, another company that sells digital do-it-yourself tax preparation products as well as provides other tax preparation services.[1] A preliminary injunction hearing in this case is scheduled for September 6, 2011, and the plaintiff has filed a motion in limine to exclude evidence of an email survey commissioned by the defendants and the portions of a defendants' expert opinion that relies upon the survey. For the reasons that follow, the Court denies the motion in limine.[2]

I. BACKGROUND

The DOJ filed this action on May 23, 2011, seeking to enjoin Defendant H&R Block, Inc. from acquiring Defendant 2SS Holdings, Inc. ("TaxACT"), which sells digital do-it-yourself

[1] The Court has subject matter jurisdiction to hear this suit under 15 U.S.C. § 25, and 28 U.S.C. §§ 1331, 1337 and 1345.

[2] The plaintiff initially filed an additional motion in limine to exclude evidence of defendants' guarantee to maintain TaxACT's current prices for three years following the acquisition. *See* ECF No. 44. The plaintiff withdrew that motion at oral argument on September 2, 2011.

tax preparation products marketed under the brand name TaxACT. Compl. ¶ 10. Defendant TA IX, L.P. ("TA"), owns a two-thirds interest in TaxACT.[3] *Id.* ¶ 11.

According to the Complaint, last year an estimated 35 to 40 million taxpayers filed their taxes using digital do-it-yourself tax preparation products ("Digitial DIY Tax Preparation Products"). *Id.* ¶ 1. In the U.S. Digital DIY Tax Preparation Product market, the three largest firms collectively have about 90% of the market share. *Id.* The leading company in the market is Intuit, Inc., the maker of "TurboTax." *Id.* ¶ 3. H&R Block's proposed acquisition of TaxACT, if allowed to proceed, would combine the second- and third-largest providers in the market – i.e., H&R Block and TaxACT, respectively. *Id.*

The Complaint alleges that TaxACT is a "maverick" competitor that has a history of "disrupting" the Digital DIY Tax Preparation market and has forced its competitors, including H&R Block and Intuit, "to offer free products and increase the quality of their products for American taxpayers." *Id.* ¶ 28. The Complaint alleges that TaxACT has aggressively competed with H&R Block and Intuit by providing high-quality products and services at low cost. *See id.* ¶¶ 30-40. The DOJ alleges that the acquisition of TaxACT by H&R Block would reduce competition in the industry and make anticompetitive coordination between the two major remaining market participants – H&R Block and Intuit – substantially more likely. *Id.* ¶¶ 40-49. The DOJ alleges that therefore the proposed acquisition violates Section 7 of the Clayton Act, 15 U.S.C. § 18, and accordingly it seeks an injunction blocking H&R Block from acquiring TaxACT. *Id.* ¶¶ 53-55.

[3] 2nd Story Software, Inc. ("2SS") is a wholly-owned subsidiary of 2SS Holdings, Inc., which is the entity being purchased by H&R Block. Declaration of Lance Dunn, dated May 27, 2011 ("Dunn Decl."), ¶¶ 2, 4. Both 2SS and 2SS Holdings, Inc. share the same address in Cedar Rapids, Iowa.

The defendants dispute that the appropriate product market is Digital DIY Tax Preparation products, but argue that the relevant market instead consists of "all methods of tax preparation for the U.S. federal and state income taxes." Report of Dr. Christine Siegwarth Meyer, DX0017-006, at 2. Furthermore, even assuming *arguendo* that the plaintiff's alleged market definition were correct, the defendants deny that the transaction would result in anticompetitive effects because, *inter alia*, "H&R Block and TaxAct are not close substitutes and the merger is likely to lead to substantial, incremental, merger-specific efficiencies." Joint Pre-Hearing Statement at 4.

A pre-hearing conference in this matter, including oral argument on the motion in limine, was held on September 2, 2011.

II. DISCUSSION

The plaintiff has moved, pursuant to Federal Rules of Evidence 702 and 703, to exclude evidence of an email survey of defendants' customers and to limit defendants' expert opinion to the extent that it relies on this survey (the "2011 email survey"). Pl.'s Mem. in Supp. of Pl.'s Mot. to Exclude the 2011 Litigation Survey and Limit Defs.' Expert Report ("Pl.'s Mem.") at 1-2. The plaintiff contends the survey's "methodology falls far short of the requirements of Federal Rules of Evidence 703 and 702 because: (1) it fails to ask a question relevant to this proceeding; (2) it suffers from extraordinary non-response bias, with response rates far below what courts have found necessary to establish reliability; and (3) the response options provided are leading and fail to discourage guessing." *Id.* at 2. For the reasons below, the Court declines to exclude the evidence or to limit the expert's opinion.

A. Standard of Review

"Under Rule 702, a trial court may only admit expert testimony that is both relevant and reliable." *Harris v. Koenig*, No. 02-618, 2011 WL 2531257, at *1 (D.D.C. June 27, 2011) (citing *Kumho Tire Co. v. Carmichael*, 526 U.S. 137, 141 (1999); *Daubert v. Merrell Dow Pharmaceuticals, Inc.*, 509 U.S. 579, 589 (1993)). "Courts take a flexible approach to deciding Rule 702 motions and have 'broad discretion in determining whether to admit or exclude expert testimony." *Id.* (quoting *U.S. ex rel. Miller v. Bill Harbert Int'l Constr., Inc.*, 608 F.3d 871, 895 (D.C. Cir. 2010) (internal citation omitted). "In considering Rule 702 motions, the court assumes only a 'limited gate-keep[ing] role' directed at excluding expert testimony that is based upon 'subjective belief" or 'unsupported speculation.'" *Id.* (quoting *Ambrosini v. Labarraque*, 101 F.3d 129, 135-36 (D.C. Cir. 1996)). In addition, "the importance of the trial court's gatekeeper role is significantly diminished in bench trials . . . because, there being no jury, there is no risk of tainting the trial by exposing a jury to unreliable evidence." *Whitehouse Hotel Ltd. Partnership v. Comm'r of Internal Revenue*, 615 F.3d 321, 330 (5th Cir. 2010). "The party seeking to introduce expert testimony must demonstrate its admissibility by a preponderance of the evidence." *Harris*, 2011 WL 2531257, at *1 (citing *Daubert*, 509 U.S. at 592 n.10).

Under Rule 703, the facts or data underlying an expert's opinion "need not be admissible in evidence in order for the opinion or inference to be admitted" if the facts or data are "of a type reasonably relied upon by experts in the particular field." Fed. R. Evid. 703. In addition, such "facts or data that are otherwise inadmissible" may be disclosed by the proponent of the opinion if their probative value substantially outweighs any prejudicial effect. *Id.*

B. Background Regarding the 2011 Email Survey

In late April 2011, following the 2011 tax season, the defendants commissioned Directions Research, a market research firm, to conduct an Internet-based survey of TaxACT's customers. GX 604. According to the defendants, during the investigation of the transaction, the DOJ did not accept the defendants' evidence of an "extremely low switching between the Defendants' products" as an appropriate proxy for diversion – i.e., the government contended that current switching rates are not necessarily predictive of how TaxACT customers would react to a price increase or functionality decrease. Defs.' Mem. in Opp'n to Pl.'s Mot. In Limine ("Defs.' Mem.") at 3. The survey was therefore initiated to respond to a question raised by the DOJ – namely, "how TaxAct consumers would react to a price increase, service decrease or functionality decrease in the TaxAct products." *Id.* The survey asked one primary question: "If you had become dissatisfied with TaxACT's price, functionality or quality, which of these products or services would you have considered using to prepare your federal taxes?" GX 604 (Results of the 2011 email survey); GX623 (App'x 2 to Report of Dr. Dhar). The survey then offered the respondents a list of eleven options, including other products or services, from which to choose and instructed them to select all applicable options. *Id.* The list of options that respondents were given varied somewhat depending on the respondents' filing status and the payments they had made for their 2011 tax returns.[4] *Id.* A follow-up question asked the respondents to narrow their selections to a single choice. *Id.*

[4] The response options varied among four different categories of filers, which are discussed further below. For example, the list of options presented to filers who completed a free federal tax return and no state return were: "I would prepare myself without help," "TurboTax Free Edition," "H&R Block at Home Free Edition," "Free TaxUSA Free Edition," "Complete Tax Free Basic," "An Accountant," "I would use a product on FFA [i.e., Free File Alliance]," "TaxSlayer Free Edition," "Jackson Hewitt Free Basic," "Tax$imple Free Basic," and "Other." GX604 at 2.

The research firm sent over 70,000 surveys via email to a statistically-random selection of TaxACT customers inviting them to participate in the survey. Declaration of Tina Ruddy, dated August 24, 2011 ("Ruddy Decl.") ¶¶ 9, 10. Survey respondents were asked screening questions to determine their membership in one of four categories of customers: (1) those who paid to use TaxAct's products for filing both federal and state tax returns (denominated in the survey report analysis by Directions Research as "Paid Fed/Paid State"); (2) those who paid to use TaxAct's federal return product but not for filing the state return ("Paid Fed/No State"); (3) those who used TaxAct's free product for filing a federal return and paid to use a TaxAct product to file a state return ("Free Fed/Paid State"); and (4) those who used TaxAct's free product for filing a federal return but not for filing the state return ("Free Fed/No State").[5] GX604 (Results of the 2011 email survey).

A total of 1,089 customers responded to the survey. *Id.* at 2-3. The response rates for the four categories of customers were: (1) 2.45% for paid federal / paid state filing (422); (2) 0.6% for paid federal / no state filing (182); (245); (3) 2.08% for free federal / paid state filing; and (4) 1.7% for free federal / no state filing (240). *Id.*; *see also* Pl.'s Mem. at 3.

Defendants' expert, Dr. Christine Siegwarth Meyer, summarized the results of the survey as follows:

> [A] survey of TaxACT customers indicates that few would switch to H&R Block At Home in the event that they were satisfied with TaxACT. In each of the four groups, the comparable HRB product was neither the first nor second most likely alternative tax products for the respondents. The percentage of TaxACT customers that would switch to H&R Block At Home ranged from 4 to 10 percent, with a weighted average of only 6 percent. Instead, in each group, pen-and-paper and TurboTax were the two options with the

[5] By contrast to federal tax returns, TaxAct does not provide free state return preparation software but does offer free electronic filing of state returns to those customers who purchase a TaxAct-branded desktop software product available at Staples retail stores. Report of Dr. Meyer ¶¶ 191-92. The Court understands the survey's category for "No State" to cover those respondents who did not purchase TaxAct's state return preparation software from Staples or any other source.

> highest responses. In only one of the four groups was HRB the third response. Instead, Free TaxUSA (Tax Hawk) was a more prevalent choice than HRB for three of the four groups.

Report of Dr. Meyer, DX0017-042 (footnotes omitted). Based upon this analysis of the results, Dr. Meyer opined that:

> This further indicates that HRB is not a particularly close competitor to TaxACT. Following the merger, consumers who are dissatisfied with TaxACT will have numerous other choices to which they can and would turn, including TurboTax, pen-and-paper, other software products, and assisted tax preparation.

Id.

C. Analysis

In order to admit expert testimony under Rule 702, the Court must find that it is "relevant and reliable." *Kumho Tire Co.*, 526 U.S. at 141; *Daubert*, 509 U.S. at 589. "In general, Rule 702 has been interpreted to favor admissibility." *Khairkhwa v. Obama*, No. 08-1805, 2011 WL 2490960, at *7 (D.D.C. May 27, 2011) (citing *Daubert*, 509 U.S. at 587; Fed. R. Evid. 702 Advisory Committee's Note (2000) ("A review of the caselaw after *Daubert* shows that the rejection of expert testimony is the exception rather than the rule.")). "The adversarial system remains the 'traditional and appropriate' mechanism for exposing 'shaky but admissible evidence.' *Id.* (citing Fed. R. Evid. 702 Advisory Committee's Note (2000) (quoting *Daubert*, 509 U.S. at 596)).

Facts or data underlying an expert's opinion that are "of a type reasonably relied upon by experts in the particular field" need not be admissible in evidence in order for the opinion or inference to be admitted. Fed. R. Evid. 703. Regarding survey results in particular, technical and methodological deficiencies in a survey generally go to the weight of the evidence, not the admissibility, unless the deficiencies are so substantial as to render the survey unreliable. *See Univ. of Kan. v. Sinks*, No. 06-2341, 2008 WL 755065, at *3 (D. Kan. Mar. 19, 2008) (discussing customer confusion survey in trademark case).

As discussed in more detail below, having reviewed the report of defendants' expert, Dr. Christine Siegwarth Meyer, the Court finds that Dr. Meyer's anticipated testimony regarding the 2011 email survey meets the criteria for admissibility. Dr. Meyer is an accomplished economist with a Ph.D. in economics from the Massachusetts Institute of Technology. *See* DX0017, Ex. 1. Her conclusions regarding the level of competition between TaxACT and H&R Block, as expressed in her report, are not based solely upon the results of the survey to which the plaintiff objects. *See* DX0017-022-26, 28-42 (discussing various documents and data to support Dr. Meyer's conclusions regarding competition with manual filing and unilateral effects); Meyer Dep. 175:6-16 ("I think [the 2011 email survey] – it's an important data point. It's not the only data point to make any of the points that I use it to make.") (cited in Defs.' Mem. at 18 n.58).

As for the survey itself, the Court finds that Dr. Meyer's use of the survey as a datum in reaching her conclusions is not unreliable. While the plaintiff has identified cogent concerns about the wording and the methodology of the survey, the Court finds that these concerns go to the weight, not the admissibility, of the evidence, especially in this bench hearing where there is no concern about jury confusion or prejudice.[6] *See Seaboard Lumber Co. v. United States*, 308 F.3d 1283, 1301-02 (Fed. Cir. 2002) (noting that "concerns [about jury confusion] are of lesser import in a bench trial," although "*Daubert* standards of relevance and reliability" still apply).

[6] At oral argument and in its briefs, the plaintiff urged the Court to follow *United States v. Dentsply Int'l Inc.*, an antitrust case in which the district court excluded a survey. 277 F. Supp. 2d 387, 436 (D. Del. 2003), *rev'd on other grounds*, 399 F.3d 181 (3d Cir. 2005). The court excluded the survey in that case because it suffered from myriad flaws: "(1) the screening questionnaire failed to identify relevant respondents; (2) the questionnaire instructions were complex and confusing; (3) a pre-test was not conducted; (4) the response rate was low; (5) non-response bias was not addressed; (6) respondents were unwilling or unable to devote time to take the survey seriously; (7) the results could not be replicated; (8) a standard error measurement was not calculated; and (9) a key parameter estimate was arbitrarily changed." *Id.* at 453-54. As discussed herein, the Court finds that the deficiencies the plaintiff has identified regarding the 2011 email survey affect the weight the Court will accord the survey, but do not sufficiently undermine the methodology used to design, execute and analyze the survey's results to bar admissibility.

1. Relevance

The Court finds that the survey is relevant because it is probative of the degree to which TaxACT and H&R Block are competitors, whether the market is defined, as alleged by the plaintiff, to be Digital DIY tax preparation products or more broadly, as alleged by the defendants, to be all tax preparation products and services. The options provided to survey respondents encompassed both competing Digital DIY tax preparation products as well as alternative services.

The plaintiff argues that the survey is irrelevant because Dr. Meyer asserted in her report that "this survey is closer to the concept of a diversion ratio than are data on overall switching between products," Pl.'s Mem. at 5 (citing Dr. Meyer's Report at DX0017-024 n.85). According to the plaintiff, diversion refers to "a measured customer reaction to a measured increase in price." *Id.* Since the phrasing of the survey question conflates customer concerns about price, functionality, and quality, and does not actually ask about a change in price, the plaintiff argues that the survey cannot shed any light on customer reactions to price changes. *Id.* Even accepting the plaintiff's critique, however, would not obliterate the survey's relevance entirely. Further, Dr. Meyer's report, in the portion cited by the plaintiff, did not state that the survey provided direct evidence of diversion, but rather that "this survey is closer to the concept of a diversion ratio than are data on overall switching between products," which the Court understands as expressing a different idea. While the wording of the survey question may limit its relevance on specific issues, because the survey provides at least some indication of the products and services that compete with TaxACT, the Court cannot say that it does not have "any tendency to make the existence of any fact that is of consequence to the determination of the action more probable or

less probable than it would be without the evidence." Fed. R. Evid. 401 (defining relevant evidence).

2. Reliability

Customer surveys generally are a type of evidence that may be reasonably relied upon by experts in defining markets in antitrust cases. *See* GX622 (Christine Meyer, "Designing and Using Surveys to Define Relevant Markets," in *Economics of Antitrust: Complex Issues in a Dynamic Economy* 101, 108 (Lawrence Wu, ed. 2007)); GX624 (Shari Seidman Diamond, "Reference Guide on Survey Research," in Federal Judicial Center, *Reference Manual on Scientific Evidence*, hereinafter "Diamond," at 234-35).

In determining whether a particular survey may be admissible under Rule 703, courts examine the validity of the survey's methods and ask "Was the poll or survey conducted in accordance with generally accepted survey principles, and were the results used in a statistically correct way?" Diamond at 233-34. The methodological validity of a survey is necessarily a question of degree. As discussed above, technical deficiencies that can be adequately explored on cross-examination generally go to the weight, rather than the admissibility, of the evidence, unless the methodological deficiencies are so sweeping or fundamental as to render the survey wholly unreliable and therefore inadmissible.

a. Response Rate

The plaintiff argues that the survey is not reliable because it suffers from an "extraordinary level of non-response bias" due to its low response rate. Pl.'s Mem. at 7. The plaintiff cites authority indicating that a response rate below 50% "should be regarded with significant caution as a basis for precise quantitative statements from which the sample was drawn." Pl.'s Mem. at 7 (citing Diamond at 245). The plaintiff's rebuttal expert, Dr. Ravi Dhar,

has concluded that the "level of nonresponse . . . is extremely high (more than 98%)" and that the "extremely low response rates makes it difficult to determine whether the results were impacted by a certain segment who were systematically more likely to respond to the survey (e.g., those who were price sensitive or time insensitive) in relation to those who did not respond." GX 623 (Report of Dr. Dhar at 10).

The defendants respond by citing authority indicating that web-based surveys typically have significantly lower response rates than other types of surveys. Defs.' Mem. at 7-8. They also point to jury trials in which courts have admitted surveys with response rates of 10% or lower. Defs.' Mem. at 7-8 (citing *Sinks*, 2008 WL 755065, at *4; *Kinetic Concepts, Inc. v. Bluesky Med. Corp.*, No. SA-03-CA-0832, 2006 WL 6505346, at *6 (W.D. Tex. Aug. 11, 2006)).

The defendants further argue that the survey's sample size and response rate comply with industry standards for market research. A declaration from the Vice President of the market research firm that performed the survey affirms that large national companies commonly use similar survey results "to make business and pricing decisions." Ruddy Decl. ¶¶ 3-4. This declaration also states that "[t]he standard, industry-expected response rate for surveys of this kind is generally between 1% - 2%" and that, for web-based email surveys, "a response rate above 50% is so improbable as to be considered entirely unavailable." Ruddy Decl. ¶¶ 13, 16.

While the Court agrees with the plaintiff that the survey's response rate "appears, by any standard, to be quite low," *Sinks*, 2008 WL 755065, at *4, this concern goes to the weight, not the admissibility, of the evidence because the survey is not so unreliable as to be deemed inadmissible. The Court finds that the survey's sample size of over 1,000 TaxACT customers from the most recent tax season, the testimony of Dr. Meyer in relying on the survey, and the

testimony that the survey's sample size and response rate are in line with industry standards for similar surveys establish sufficient reliability to allow admission of the survey evidence. The Court is cognizant of the detailed critique of the survey's response rate presented by the plaintiff's expert, Dr. Dhar, and the Court is fully capable of taking this critique into account in determining how much weight to accord the survey's results in its analysis. *See Sinks*, 2008 WL 755065, at *4 (admitting survey despite low response rate); *Kinetic Concepts, Inc.*, 2006 WL 6505346, at *6 (same).

b. Closed-Ended Questions and Discouragement of Guessing

The plaintiff also contends that the survey is fatally flawed because it asks only "closed-ended, leading questions" and that it failed to discourage guessing by not including a "no opinion" or "I don't know" option.

The plaintiff contends that the survey's closed-ended response options are "severely flawed because they are not exhaustive and fail to take into account that some people may not switch [products] even though they are dissatisfied." Pl.'s Mem. at 9 (citing GX 623, Report of Dr. Dhar, ¶¶ 18-19). The plaintiff also argues that, by providing survey respondents with a list of options from which to choose, the survey "hardly mirrors competition in the marketplace where the Big Three competitors spend millions of dollars annually to get their message in front of potential customers. In contrast, the [survey] counterfactually de-emphasizes the significance of brand and the millions spent building and maintaining it." *Id.* at 10. In addition, the plaintiff contends that the survey questions are leading because the response options vary depending on the product the respondent stated he or she used during the prior tax year. *Id.*

The defendants respond that the questions in the survey were not inappropriately leading and that authority cited by the plaintiff's expert actually establishes that "closed-ended questions

are more suitable for assessing choices between well-identified options or obtaining ratings on a clear set of alternatives." Defs.' Mem. at 8-9 (citing Diamond at 253). The defendants also note that the questions were not wholly closed-ended in that "Other" was an option that respondents could select. *Id.* at 9.

By providing survey respondents with a pre-selected list of alternative options, rather than letting respondents respond organically, the survey does lead respondents to think about the market for tax preparation services in the same terms that the defendants do, which may have led respondents to select options they otherwise would not have selected. This effect is not so inherently suggestive as to render the survey's results wholly unreliable and therefore inadmissible, however. The survey does not appear to lead respondents to select any particular answer; the response choices included the major market participants under both parties' views of the market; and it also included an "Other" option. Moreover, the survey question cannot be considered to be as "leading" as the questions identified as problematic in the plaintiff's cited authority.[7] Accordingly, this critique goes to the weight of the evidence and not to admissibility.

The same is true of plaintiffs' concerns about the survey's failure to discourage guessing by not including an "I don't know" option. The plaintiff argues that "[s]urveys should explicitly mention that it is completely appropriate for respondents to have no opinion [on] a given question" and that failure to include an "I don't know" opinion skews the results by failing to

[7] In *Novartis Consumer Health, Inc. v. Johnson & Johnson-Merck Consumer Pharms. Co.*,290 F.3d 578, 591 (3d Cir. 2002), cited by the plaintiff, the Court discussed a case in which the Third Circuit identified a highly suggestive survey question. In that case, the party offering the survey evidence sought to defend an advertisement claiming that its medicine, Maalox, was "the strongest." The survey at issue asked respondents the following question: "In the commercial you just saw, they said Maalox tablets are the strongest. What does that mean to you?" The Third Circuit held that this question improperly led respondents to answer that "strongest" meant something other than its ordinary, obvious meaning. *See id.* at 593 (discussing *Johnson & Johnson-Merck Consumer Pharm. Co. v. Rhone-Poulenc Rorer Pharms., Inc.*, 19 F.3d 125 (3d Cir. 1994)).

provide an adequate answer for respondents who have no opinion on the question. Pl.'s Mem. at 10-11. While this concern is valid and the absence of such an "I don't know" option does diminish the weight the Court should accord this survey, the failure to include this option is partially mitigated here by the inclusion of the "Other" option. The Court does not find that this defect so undermines the survey as to require it to be deemed inadmissible. *See Kinetic Concepts*, 2006 WL 6505346, at *6 (admitting survey that did not have an "I don't know" option and concluding that any objections went to the weight of the survey rather than to admissibility).

3. Consideration of All Critiques

In sum, the plaintiff has identified a number of aspects about the methodology and wording of the defendants' 2011 email survey that will impact the weight that the Court gives this survey in its analysis. These defects do not undermine the survey and the expert's reliance on it so overwhelmingly that they render the survey wholly irrelevant or unreliable—and therefore inadmissible. While the admissibility of this survey might be a closer question in the context of a jury trial, since this hearing is not before a jury, "the importance of the trial court's gatekeeper role is significantly diminished . . . because, there being no jury, there is no risk of tainting the trial by exposing a jury to unreliable evidence." *Whitehouse Hotel Ltd. Partnership*, 615 F.3d at 330; *accord United States v. Oracle Corporation*, 331 F. Supp. 2d 1098, 1158 (N.D. Cal. 2004) (court at injunction hearing considered government's expert witness testimony on product market definition despite "shortcomings" in cited statistics and "sketchy" statistical tabulations based in part on "tiny sample" of Oracle customer surveys). Accordingly, the Court will deny the motion in limine to exclude the survey and to preclude defendant's expert from expressing opinions based upon the survey.

III. CONCLUSION

For the reasons explained above, the plaintiff's motion in limine is DENIED. This Memorandum Opinion and Order shall be filed under seal. On or before September 12, 2011, the parties shall advise the Court regarding whether any portion of this Memorandum Opinion should be redacted before public filing because it contains confidential information. In addition, if the parties have not already filed versions of their legal memoranda that may be filed publicly, they shall do so by September 12, 2011.

DATED: September 6, 2011

/s/ Beryl A. Howell

BERYL A. HOWELL
United States District Judge

The Hypothetical Monopolist Test: Critical Loss

FTC v. TRONOX LTD.,
332 F. Supp. 3d 187, 204-05 (D.D.C. 2018)
(excerpt on critical loss[1])

TREVOR N. MCFADDEN, U.S.D.J.

[The FTC sought a preliminary injunction under FTC Act § 13(b) to enjoin the acquistion by Tronox Limited of the National Titanium Dioxide Company's titanium dioxide (TiO_2) business (known as "Cristal") for $1.67 billion in cash and a 24% equity stake in the combined firm. TiO_2 is a pigment used to add whiteness, brightness, and opacity to products like paints, plastics, and paper. It is manufactured by subjecting raw titanium ores to either a chloride or a sulfate production process. A central issue in the case was the relevant product market definition. The FTC alleged that the relevant product market was TiO_2 produced by the chloride process, while the parties argued that the market must also include TiO_2 produced by the sulfate process. The court accepted the FTC's definition, relying in part on the testimony of Dr. Nicholas Hill, the FTC's economic expert, on his application of the critical loss test.]

. . .

Dr. Hill also conducted several iterations of the "hypothetical monopolist test" to prove that the relevant market consists of North American sales of chloride-process TiO_2. The test seeks to determine whether a hypothetical company that is the only seller of the relevant product to customers in the relevant geography could profitably impose a "small but significant and non-transitory increase in price" ("SSNIP"). See Merger Guidelines §§ 4.1.1; 4.2.2. If this hypothetical monopolist can profit from imposing a SSNIP without losing a critical mass of customers, then a relevant antitrust market has been defined. If, on the other hand, customers can defeat the price increase "by substitution away from the relevant product or by arbitrage," the market definition must be broadened. *Id. See also [FTC v.] Sysco [Corp.],* 113 F. Supp. 3d [1] at 33-34 [(D.D.C. 2015)].

To run the test, Dr. Hill conducted a "critical loss analysis." He began by calculating the "critical loss," which is the percentage of "lost unit sales that would leave profits unchanged" if a hypothetical monopolist imposed a SSNIP. Merger Guidelines § 4.1.3. Dr. Hill determined that, with an SSNIP of 10%, a hypothetical monopolist could lose up to 15.4% of its sales and still break even. PX5000-051. The critical loss threshold is thus 15.4%.

Next, Dr. Hill estimated the "predicted loss" that would be observed in the event of a SSNIP of 10%. If the predicted loss is less than the critical loss, imposing a SSNIP would be profitable for the hypothetical monopolist, and the relevant antitrust market has been correctly defined. Dr. Hill used three methods to calculate the predicted loss:

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1 Record citations omitted.

the "price elasticity of demand" method, a "substitution components" method, and a "documentary evidence" method. Each showed that a hypothetical monopolist could profitably raise North American chloride TiO_2 prices by 10%.

Price elasticity of demand measures the responsiveness of a product's sales to a 1% change in the product's price. Demand for a product is "elastic" if a 1% price increase decreases demand by more than 1%. It is "inelastic" if a 1% price increase decreases demand by less than 1%. The more inelastic a product's demand, the less likely it is that the product has adequate substitutes. Dr. Hill found that the price elasticity of North American chloride TiO_2 is -0.45% (*i.e.*, a 1% increase in price reduces sales by 0.45%). He multiplied this number and a 10% SSNIP to show that the predicted loss of sales, 4.5%, would be considerably lower than the critical loss of 15.4%. In other words, estimates of price elasticity show that a hypothetical monopolist could profitably increase North American chloride TiO_2 prices by 10%.

Dr. Hill's "substitution components method" used the Defendants' data to estimate the expected increase of TiO_2 imports in response to a 10% SSNIP. The TiO_2 that firms acquire from imports or from other producers repatriating their exports represents lost sales for a hypothetical monopolist. Dr. Hill found that a 10% SSNIP would lead to roughly 75,000 more metric tons of TiO_2 being imported or repatriated, and another 3% decrease in the monopolist's sales of rutile TiO_2. Together, this represents roughly 12.6% of total North American chloride TiO_2 sales. As a 12.6% loss is lower than the critical loss threshold of 15.4%, the substitution components method predicts that the hypothetical monopolist could profitably raise prices.

Finally, Dr. Hill used data from Tronox documents. At some future point, Tronox contends, "Chinese sulfate could take up to 15 percent of [all TiO_2] applications" in North America, thus "reducing the share of chloride titanium dioxide by at most five percent." Dr. Hill assumed that such sulfate substitution would occur in response to a 10% SSNIP. He and calculated that the resulting loss of sales to the hypothetical monopolist would be about 8.7%, which again is lower than the critical loss threshold. Based on these calculations and his other analyses, Dr. Hill concluded that the relevant market for evaluating the merger's potential anticompetitive effects consists of North American chloride TiO_2 sales.

FTC v. WHOLE FOODS MKT., INC.,
502 F. Supp. 2d 1, 15-22 (D.D.C. 2007), *rev'd*, 548 F.3d 1028 (D.C. Cir. 2008)
(excerpt on critical loss[1])

PAUL L. FRIEDMAN, District Judge

[On June 6, 2007, the FTC filed a Section 13(b) complaint for a preliminary injunction to enjoin the acquisition by Whole Foods Market, Inc. of Wild Oats Markets, Inc. for approximately $700 million (including assumed debt). Both companies operated supermarkets specializing in natural and organic foods. Whole Foods operated approximately 194 stores, while Wild Oats operated approximately 110 stores at the time of the proposed merger. The central issue in the case was the definition of the relevant product market. The FTC alleged that the relevant product market was "premium natural and organic supermarkets" (PNOS), consisting only of Whole Foods, Wild Oats, and two other small chains. If accepted, the transaction would be a merger-to-monopoly with a small fringe. The defendants argued that the market must include all supermarkets, which would make the transaction competitively insignificant. After a hearing on the FTC's motion for a preliminary injunction, the district court rejected the FTC's market definition and dismissed the case. In accepting the defendants' broader market definition, the court relied heavily on the testimony of Dr. David Scheffman, the defendants' economic expert, and his critical loss analysis, which showed that customers would readily switch to conventional supermarkets if PNOS prices increased. On appeal, the decision in favor of the merging firms was reversed and remanded. Judge Friedman's description of the critical loss test below, however, is accurate.]

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V. RELEVANT PRODUCT MARKET

As noted above, and as was the case in *Staples*, "the definition of the relevant product market in this case is crucial. In fact, to a great extent, this case hinges on the proper definition of the relevant product market." *FTC v. Staples, Inc.*, 970 F. Supp. at 1073. The FTC believes the relevant product market is premium natural and organic supermarkets ("PNOS"), of which it alleges there are four in the entire country—Whole Foods (the largest), Wild Oats (the second largest), Earth Fare (with 13 stores in only four states), and New Seasons (with eight stores, all in Oregon). Defendants Whole Foods and Wild Oats believe that the relevant product market is one that includes all supermarkets. "[O]nly examination of the particular market—its structure, history, and probable future"—how it operates in the real world—can provide the appropriate setting for determining the relevant product (and geographic) market and for judging the probable anticompetitive effects of a merger or acquisition. *FTC v.*

1 Record citations and footnotes omitted.

Arch Coal, Inc., 329 F. Supp. 2d [109,] at 116-17 [(D.D.C. 2004)]. Antitrust theory "cannot trump facts, and even Section 13(b) cases must be resolved on the basis of the record evidence relating to the market and its probable future." *Id*.

The Court looks first at the Horizontal Merger Guidelines and the testimony and reports of the economic experts and then examines what the evidence shows is really happening in the marketplace.

A. The Horizontal Merger Guidelines and the Economic Evidence

The Horizontal Merger Guidelines issued by the Department of Justice and the Federal Trade Commission in 1992, and revised in 1997 ("Merger Guidelines"), articulate the analytical framework the Justice Department and the FTC apply in determining whether a merger is "likely substantially to lessen competition." Merger Guidelines § 0.1. Under the Guidelines, as under the case law, the relevant product market is determined according to the "reasonable interchangeability of use" or cross-elasticity of demand between the product sold and "substitutes for it." Merger Guidelines §§ 1.0, 1.11; *Brown Shoe Co. v. United States*, 370 U.S. at 325. The analytical framework set forth in the Merger Guidelines approaches the inquiry regarding the reasonable interchangeability of use or cross-elasticity of demand by asking whether a "hypothetical monopolist . . . would profitably impose at least a 'small but significant and nontransitory [price] increase' " ("SSNIP"). Merger Guidelines § 1.11.9 Reasonable interchangeability of use in effect means "substitutability"—the practical ability of a consumer to switch from one product to another. *See Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d at 218-19; *FTC v. Arch Coal, Inc.*, 329 F. Supp. 2d at 119-20; FTC v. Swedish Match, 131 F. Supp. 2d [151,] at 158 [(D.D.C. 2000)]. The forward-looking test of the Horizontal Merger Guidelines therefore asks where customers would turn if a hypothetical monopolist of the candidate product imposed a SSNIP. Merger Guidelines § 1.11.

As the FTC explained it, the issue is whether there is a group of customers for whom there are not sufficiently close substitutes that a price increase—a "small but significant nontransitory increase in price"—can be inflicted on them. If there are alternatives to which customers could readily take their business such that the price increases would not be profitable for the hypothetical monopolist, the proposed product market is too narrow and additional alternatives must be included in the relevant product market, even if customers did not view them as substitutes at the lower price.

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In order to determine which products should be included in the relevant product market, the Guidelines methodology begins with each of the products sold by the two firms in question and then performs the hypothetical monopolist test. If a hypothetical firm that was the sole seller of a given set of products would find it profitable to impose a small but significant non-transitory increase in the price of any of those products, then the given set of products satisfies the relevant product market test. If not, then the product which is the next best substitute (defined in the Guidelines as the product that gains the largest share of the revenue diverted by a price increase) is added. Merger Guidelines § 1.11. The test is then repeated. Products are added sequentially in this way until a sole seller would find it profitable to increase price by the amount deemed to be "small but significant."

Because the FTC contends that the relevant market is "premium and natural organic supermarkets" ("PNOS"), Dr. Scheffman applied the hypothetical monopolist test by focusing on how consumers likely would behave if the price of grocery products in PNOS rose relative to the price of grocery products in other supermarkets. He stated that the economic implication of this framework is that product market definition must focus its attention on "consumers at the margin" rather than consumers who are "inframarginal."

A marginal consumer is someone who would switch where he or she shops in response to a SSNIP—that is, if his supermarket of choice imposed a small but significant and nontransitory price increase. According to Dr. Scheffman, in the context of supermarkets—including premium natural and organic supermarkets—such marginal consumers can switch or divert their purchases in any of three ways. First, they can reduce the size of their shopping basket at one supermarket and substitute by buying the same or similar items at another retailer—if that other retailer offers similar products for sale. Second, from the set of supermarkets that the consumer currently frequents, the consumer can switch a particular shopping trip from one supermarket to another. Third, the consumer can change retailers by deciding to no longer frequent a particular supermarket that the consumer no longer believes offers good quality for value.

Dr. Scheffman concludes that firms compete to retain existing business and win new business by competing for marginal consumers. It is these consumers who are susceptible to being won or retained by offering better prices, improved service, higher quality or more diverse product offerings. Supermarket retailers make their pricing, quality and service decisions in ways designed to retain and attract marginal consumers. While businesses value "core" customers, they simply "cannot survive—let alone grow and remain profitable—solely by catering to this small segment of customers." The appropriate focus for defining the relevant product (and geographic) market therefore is those marginal consumers. Dr. Scheffman concludes that the "marginal" consumer, not the so-called "core" or "committed" consumer, must be the focus of any antitrust analysis. He believes that this is consistent with the analytical framework set out in the Merger Guidelines. The Court agrees.

Dr. Scheffman used critical loss analysis to analyze the FTC's proposed product market. As the FTC acknowledges, this is a widely accepted analytical tool in antitrust

cases both to analyze market definition and competitive effects. That is because critical loss is implicit in the hypothetical monopolist test. The latter tests whether a SSNIP would be profitable over a candidate product; critical loss analysis assesses how much substitution in response to a SSNIP could occur before a SSNIP becomes unprofitable. To put it another way, SSNIP tests at what price increase a consumer will switch where he or she shops; critical loss tests at what point a purveyor's price increases lead to a sufficient amount of lost sales (and lost customers) that the economic loss exceeds the gain from having raised prices (the "critical" loss).

Critical loss analysis stems from the recognition that for almost any product, a price increase results in some lost sales as consumers make do with less, switch to other suppliers, or substitute other products. There is a profit detriment to the price increase equal to the product of the per unit gross margin and the number of units lost. But there is also an economic gain from the increased gross margin earned from the higher price on each remaining unit sold. The "critical loss" is the amount of lost sales at which the economic detriment equals the economic gain. It is a "critical" loss because any greater loss will result in the economic detriment exceeding the economic gain, thereby rendering the price increase unprofitable.

The application of the critical loss technique to market definition is a three step process. The first step is to estimate the incremental margin (gross margin) and determine the volume the hypothetical monopolist (or merged entity) would have to lose to render the price increase unprofitable (i.e., the critical loss). The second step is to separately estimate what the actual loss in volume is likely to be as a result of the hypothesized price increase (i.e., the estimated "actual loss"). The last step is to compare the estimate of the actual loss with the critical loss. If the actual loss is greater than the critical loss, the product market definition must be expanded.

In calculating critical loss, Dr. Scheffman originally used a SSNIP of 5% across all products sold by "premium natural and organic supermarkets." This is the SSNIP used in most contexts under the Merger Guidelines and (according to Dr. Scheffman) traditionally used by the FTC in supermarket mergers. As the FTC has pointed out, however, a lower SSNIP is sometimes used. *See also* Merger Guidelines § 1.11. According to the FTC, Dr. Scheffman himself has acknowledged that a 1% SSNIP may be appropriate to analyze markets characterized by high volume sales but low profit margins.

Whole Foods has an average gross margin at the store level of approximately [Redacted] A 5% price increase implies a critical loss for Whole Foods of about [Redacted] in volume. Wild Oats stores typically have a gross margin at the store level of about [Redacted] or less. A 5% price increase implies a critical loss for Wild Oats of about [Redacted] in volume. In response to Dr. Murphy's report and the FTC's criticism of his use of a 5% SSNIP, Dr. Scheffman also did exactly the same analysis again but this time calculated critical loss for a 1% SSNIP. Critical loss for Whole Foods at that price increase would be a little over [Redacted] in volume—that is, if the hypothetical monopolist lost a little over [Redacted] of its sales, then a 1% SSNIP would not be profitable.

Critical loss analysis next considers what the actual loss is likely to be if prices increase. Actual loss depends on how many marginal customers are likely to exist and how likely they are to shift purchases in response to a SSNIP. There is no evidence in the record from which to determine cross-elasticity of demand between premium natural and organic supermarkets and other supermarkets and grocery retailers. Nor is there statistical evidence of actual loss, as the SSNIP is hypothetical rather than actual. Therefore, Dr. Scheffman based his estimate of actual loss on weighing the evidence in the case, including the 47 market studies he reviewed.

Dr. Scheffman summarized (and then discussed in detail) what the market studies show: (1) grocery shopping is a relatively highly price sensitive category of retail; (2) Whole Foods and Wild Oats customers are shifting purchases between PNOS and other supermarkets, and can further shift purchases costlessly, i.e., without having to change their shopping patterns; (3) most Whole Foods and Wild Oats shoppers shop frequently at other supermarkets and grocery retailers; (4) other supermarkets compete vigorously for the patronage of customers who also shop at Whole Foods and Wild Oats; and (5) Whole Foods (and to a lesser degree Wild Oats) regularly and extensively price check other supermarkets and food retailers in order to gauge their pricing, their assortments, and other strategies that these competitors are using to attract Whole Foods shoppers and other customers into their stores.

Dr. Scheffman concluded that a substantial portion of Whole Foods and Wild Oats business is at the margin such that in the event of a PNOS price increase, the actual loss would substantially exceed the critical loss. "Where marginal customers comprise such a significant portion of the business, there is no doubt that the actual loss from a PNOS price increase would greatly exceed the [Redacted] critical loss." Dr. Scheffman's conclusion obtains regardless if the SSNIP is 5% or 1%.

Even accepting the possibility that certain products are sold only at Whole Foods or Wild Oats, or that certain consumers perceive that the quality they want is only available at those stores, Dr. Scheffman concluded that critical loss analysis shows that, particularly with a small SSNIP, a relatively small sales loss would make a price increase unprofitable. The record evidence, including market research studies and evidence of how both consumers and retailers are actually acting in the marketplace, suggests that because so many people are cross-shopping for natural and organic foods and are marginal rather than core customers, the actual loss from a SSNIP would exceed the critical loss. The Court agrees with Dr. Scheffman.

Dr. Scheffman's critical loss analysis demonstrates that the relevant product market must be broader than the market proposed by the FTC: "If all PNOS raised prices, there would be a substantial loss in business," and the loss necessarily would be to other supermarkets. "Based on this qualitative and quantitative evidence, I have concluded that the relevant product market must encompass at least all supermarkets." Evidence of the significant amount of sales that are "at the margin" shows that it is not plausible that a 5% increase in prices attempted by the proposed merged entity would be profitable, since the actual loss in sales arising from such a price increase is likely to far exceed the critical loss. Actual loss would also defeat a 1% price increase.

Applying the product market definition framework of the case law and the Merger Guidelines, it follows that the relevant product market within which to evaluate the proposed transaction must be at least as broad as the retail sale of food and grocery items in supermarkets. As a result, the FTC's proposed relevant product market of PNOS fails.

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NOTES

1. Whole Foods' economic expert was David T. Scheffman. Scheffman earned his Ph.D. in economics from MIT and has served as an expert witness and consultant in a number of antitrust matters across various industries, including retail, healthcare, and consumer products. He twice served as Director of the Bureau of Economics at the FTC (1985-1988 and 2001-2003), held the Justin Potter Professorship of American Competitive Enterprise at the Owen Graduate School of Management, Vanderbilt University, from 1989 to 1999, and continued as an Adjunct Professor of Business Strategy and Marketing at Owen through 2011. Outside of the FTC and academia, Scheffman has been affiliated with private economics consulting groups. He is currently a Managing Director at Berkeley Research Group and previously held senior positions at LECG and Cornerstone Research.

2. The FTC's economic expert was Kevin M. Murphy. Murphy earned his Ph.D. in economics from the University of Chicago in 1986, following his undergraduate studies at UCLA in 1981. He is the George J. Stigler Distinguished Service Professor of Economics at the University of Chicago Booth School of Business, where he has taught since the mid-1980s. Murphy has consulted and testified in antitrust matters, including mergers, labor economics, price theory, and industrial organization, with consulting roles at Charles River Associates and previously as Managing Director and Principal at Navigant Economics. He received the John Bates Clark Medal in 1997, awarded to the most outstanding American economist under the age of forty, and a MacArthur Fellowship in 2005. Murphy has published extensively in labor economics, industrial organization, public policy, and health economics.

3. This excerpt contains several redactions, reflecting the standard practice by which courts protect confidential business information while preserving the strong presumption of public access to judicial proceedings.[12] This interest reaches its peak for judicial opinions themselves. While Federal Rule of Civil Procedure 26(c)(1)(G) authorizes courts to issue protective orders during discovery to prevent disclosure of trade secrets or other confidential commercial information, [13] a different and heightened standard applies when courts redact their own opinions. Unlike discovery

[12] *See, e.g.*, Richmond Newspapers, Inc. v. Virginia, 448 U.S. 555, 569-75 (1980) (plurality opinion); Nixon v. Warner Commc'ns, Inc., 435 U.S. 589, 597-98 (1978).

[13] Fed. R. Civ. P. 26(c)(1)(G) (in pertinent part: "The court may, for good cause, issue an order to protect a party or person from annoyance, embarrassment, oppression, or undue burden or expense, including one or more of the following: . . . (G) requiring that a trade secret or other confidential research, development, or commercial information not be revealed or be revealed only in a specified way.").

materials, which can be protected under Rule 26(c)'s "good cause" standard,[14] redacting judicial opinions triggers heightened scrutiny grounded in the First Amendment and common law rights of public access.

As a result, when deciding whether to redact portions of judicial opinions, courts engage in a more demanding balancing test, weighing transparency against legitimate confidentiality concerns for competitively sensitive information such as trade secrets, specific pricing data, profit margins, diversion metrics, critical-loss inputs, customer lists, and proprietary methodologies whose disclosure could cause concrete competitive harm to parties and non-party data providers. Any redactions must be narrowly tailored, supported by specific, line-by-line justifications, and leave the court's legal reasoning fully intelligible. Procedurally, judges often issue the opinion under seal first, give parties a brief window (commonly five to seven days) to propose pinpoint redactions, reject overbroad requests, and then release a public version using bracketed "[Redacted]" substitutions rather than sealing opinions wholesale. In merger cases like Whole Foods, this commonly includes redacting store-level margins, critical-loss analysis inputs, and strategic planning materials from both litigants and subpoenaed third parties.

4. Although Judge Friedman redacted the store-level gross margins and the actual loss percentages, we can use fictionalized estimates to illustrate the critical loss analysis Scheffman performed. Assume store-level incremental margins of about 35% for Whole Foods and 30% for Wild Oats. The standard percentage critical loss formula $\delta/(\delta + m)$ then yields the following percentage critical losses for SSNIPs of 5% and 1%:

Whole Foods	Wild Oats
$\%CL_{5\%} = \frac{5}{5+35} = 12.50\%$	$\%CL_{5\%} = \frac{5}{5+30} = 14.29\%$
$\%CL_{1\%} = \frac{1}{1+35} = 2.78\%$	$\%CL_{1\%} = \frac{1}{1+30} = 3.23\%$

Now suppose—consistent with the opinion's description of substantial cross-shopping with regular supermarkets—that a uniform SSNIP (both PNOS chains' prices rise by the same percentage) produces actual outside-market losses of roughly 19.3% (5%) and 5.9% (1%) for Whole Foods, and 22.7% (5%) and 6.6% (1%) for Wild Oats. In each case, the firm's actual loss exceeds its own critical loss, so that each firm would earn lower profits at the SSNIP than it did before the SSNIP. Since the hypothetical monopolist aggregates those losses, a candidate market limited to PNOS fails the HMT.

Scheffman's analysis is not the most common way critical loss is applied in a differentiated products setting. Still, it is a valid one: apply the same percentage SSNIP to each firm, compute each firm's critical loss using its own margin, and compare to that firm's actual loss. If the actual loss exceeds the critical loss for both firms, each

[14] *See* Seattle Times Co. v. Rhinehart, 467 U.S. 20 (1984).

firm would make less profit post-SSNIP compared to its pre-SSNIP level, and the hypothetical monopolist—which aggregates the profits of the two firms—would fail the HMT. That is what Scheffman found in his analysis. Keep in mind that this is only a *sufficient* condition, but not a necessary one. If one firm made a profit and the other firm sustained a loss as a result of the SSNIP, you must determine the relative gains and losses to ascertain whether the hypothetical monopolist makes or loses total incremental profits.

5. On appeal, the D.C. Circuit reversed and remanded in a fractured decision where each panel member wrote separately. Judge Janice Rogers Brown wrote what is commonly considered the court's main opinion, though neither colleague joined it. Judge David S. Tatel concurred only in the judgment, and then-Judge Brett Kavanaugh dissented.

Judge Brown criticized the district court for improperly rejecting the FTC's evidence of a distinct premium natural and organic supermarkets (PNOS) market. She argued the lower court erred by focusing primarily on whether "marginal consumers" would switch to conventional supermarkets, while inadequately considering "core customers" who remained loyal to PNOS stores. Brown found the FTC had presented credible evidence that Whole Foods and Wild Oats could profitably raise prices against these core customers, supporting a narrower market definition and warranting preliminary relief.

Judge Tatel reached the same result but avoided endorsing the core customer theory. He concluded the district court made procedural errors by dismissing or overlooking evidence supporting the FTC's PNOS market theory. Tatel emphasized that such contested factual issues should not be resolved at the preliminary injunction stage, noting the evidence was sufficient only to raise "serious, substantial questions" requiring full investigation rather than proving the FTC's case definitively.

Judge Kavanaugh dissented, arguing the district court correctly rejected the narrow market definition. He contended that despite their product differentiation, Whole Foods and Wild Oats competed within the broader supermarket industry. Kavanaugh criticized the FTC's emphasis on core customers and differentiation as misguided antitrust analysis, maintaining that grocery competition realistically occurred across all supermarket types and that evidence failed to show the merging parties constrained each other's pricing more than conventional competitors.

6. Why all the confusion on market definition? The problem begins with the FTC's product market as PNOS. PNOS stores, however, sell two economically distinct sets of goods: (a) premium and natural organic (PNO) products, for which substitution is probably relatively high between PNOS stores and low with conventional supermarkets, and (b) non-PNO products, for which substitution with conventional supermarkets is relatively high. Scheffman's analysis applies a uniform percentage SSNIP to both sets inside PNOS stores. That move invites a significant diversion of non-PNO purchases in PNOS stores to conventional supermarkets, and, given thinner margins on many conventional items, probably yields incremental profit losses on foregone non-PNO sales that can swamp any incremental profit gains on the more

inelastic PNO items. Read this way, the exercise stacks the deck against a PNOS market by mixing two product types that face very different outside options.

A more coherent framing, consistent with *Brown Shoe*'s product characteristics and purchaser preference "practical indicia," would analyze PNO products as the focal line of commerce and hold non-PNO prices at premerger levels. Under this approach, inside PNOS substitution remains relevant for PNO goods, whereas diversion on non-PNO goods does not significantly impact the profitability calculus. Viewed this way, Judge Brown's emphasis on "core customers" and PNO-type items, and her criticism of the district court's focus on marginal switchers of conventional goods, becomes more understandable. The lesson for critical loss analysis is straightforward: when a candidate market bundles products with materially different substitution patterns, a uniform SSNIP across the bundle can give a misleading result. The test should either separate the product types or implement the profitability check with category-specific pricing that aligns with the proposed line of commerce.[15]

[15] We will see this approach, apparently learned by the FTC in considering what happened in *Whole Foods*, in Unit 8 in the FTC's challenge to the second effort by Staples to acquire Office Depot. There, the FTC alleged a relevant product market of consumable office supplies but carved out ink and toner for computer printers precisely because the different competitive dynamics created distinct residual demand functions for ink and toner compared to other consumable office supplies.

The Hypothetical Monopolist Test: Aggregate Diversion Ratio Recapture Tests

FTC v. IQVIA HOLDINGS INC.,
710 F. Supp. 3d 329, 367-376 (S.D.N.Y. 2024)
(excerpt on the one-product SSNIP recapture test[1])

[EDGARDO] RAMOS, United States District Judge

[On July 18, 2023, the FTC filed a Section 13(b) complaint challenging the acquisition by IQVIA Holdings Inc. (IQVIA), the world's largest health care data provider, of Propel Media, Inc. (PMI). The FTC alleged that the acquisition would substantially lessen competition by combining two of the top three providers of programmatic advertising for health care products, namely prescription drugs and other health care products, to doctors and other health care professionals ("HCP programmatic advertising"), resulting in increased prices, reduced choice, and diminished innovation. Programmatic advertising is the automated, data-driven purchase of digital ad space, using algorithms and real-time bidding to target audiences across multiple websites, social media, and apps. IQVIA's Lasso Marketing and PMI's DeepIntent are two of the top three providers of HCP programmatic advertising. The FTC argued that this form of advertising was not reasonably interchangeable with social media or endemic healthcare website advertising, which offered more limited reach, fixed inventory, and less flexibility. Defendants argued for a broader market including these other channels, claiming advertisers viewed them as viable substitutes. Applying the *Brown Shoe* factors and weighing both qualitative and quantitative evidence, the Court agreed with the FTC that HCP programmatic advertising is a distinct product market. This excerpt focuses on the court's application of the hypothetical monopolist test.]

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1. Relevant Product Market

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a. Brown Shoe *Factors*

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vi. The Court's Conclusion [on the Brown Shoe factors]

For the reasons discussed above, the *Brown Shoe* indicia, on balance, support the FTC's position that HCP programmatic advertising is a relevant product market for antitrust purposes. Most critical to this conclusion is the Court's finding that social media and endemic websites—and Google—are not reasonably interchangeable alternatives for the programmatic offerings in the FTC's candidate market. While the testimony on this subject was not uniform, the Court ultimately finds credible the testimony of several witnesses who explained that programmatic has distinct

[1] Most record citations omitted.

characteristics as compared to social and endemic and that industry participants recognize the differences.

Second, it is important to reiterate that market definition requires an attempt to identify the narrowest possible market. In evaluating reasonable interchangeability, "the mere fact that a firm may be termed a competitor in the overall marketplace does not necessarily require that it be included in the relevant product market for antitrust purposes." [*FTC v.*] *Sysco* [*Corp.*], 113 F. Supp. 3d [1,] at 26 [(D.D.C. 2015)] (quoting [*FTC v.*] *Staples*, 970 F. Supp. [1066,] at 1075) [(D.D.C. 1997)]. And as courts have recognized, a "broad product market . . . may contain smaller markets . . . which themselves 'constitute [relevant] product markets for antitrust purposes.'" [*FTC v.*] *Peabody* [*Energy Corp.*], 492 F. Supp. 3d [865,] at 885 [(E.D. Mo. 2020)] (alteration in original) (quoting *Brown Shoe* [*Co. v. United States*], 370 U.S. [294,] at 325 [1962)]). In other words, the existence of a larger market within which two products compete does not necessarily mean that they are reasonably interchangeable substitutes for one another. In this case, there is undeniably a broader market for digital healthcare advertising in which programmatic, social media, and endemic websites all participate. But "the viability of such additional markets does not render the one identified by the government unusable." *United States v. Bertelsmann SE & Co.*, 646 F. Supp. 3d 1, 28 (D.D.C. 2022). Traditional methods of reaching HCPs such as email or print advertising might also conceivably be within some broader market, yet no one has suggested that those options should be included in the relevant market here.

For all these reasons, the *Brown Shoe* factors and the reasonable interchangeability analysis support the FTC's definition of the relevant product market.

b. Hypothetical Monopolist Test

The Court turns next to the quantitative evidence supporting the FTC's proposed market. In particular, the FTC argues that the hypothetical monopolist test (HMT) confirms its assertion that HCP programmatic advertising is a relevant market for antitrust purposes.

The HMT is "commonly used in antitrust actions to define the relevant market." *Peabody*, 492 F. Supp. 3d at 886 (quoting *FTC v. Sanford Health*, 926 F.3d 959, 963 (8th Cir. 2019)). The 2010 Horizontal Merger Guidelines, used by the Department of Justice (DOJ) and the FTC to evaluate potential mergers, set out the methodology of the HMT.[19] The Guidelines explain:

> The hypothetical monopolist test requires that a product market contain enough substitute products so that it could be subject to post-

[19] The Merger Guidelines are not binding on this Court but have been described as "a helpful tool, in view of the many years of thoughtful analysis they represent, for analyzing proposed mergers." *United States v. Anthem, Inc.*, 855 F.3d 345, 349 (D.C. Cir. 2017); *see also, e.g.,* [*In re*] *AMR Corp.*, [No. 22-901,] 2023 WL 2563897, at *3 n.2 [(2d Cir. Mar. 20, 2023)]. The Court also notes that on December 18, 2023, after briefing and argument in this case had concluded, the DOJ and the FTC jointly issued the revised 2023 Merger Guidelines. Because the parties did not have the opportunity to address whether the final version of the new guidelines would have any material effect on the analysis here, the Court considers only the 2010 Merger Guidelines.

> merger exercise of market power significantly exceeding that existing absent the merger. Specifically, the test requires that a hypothetical profit-maximizing firm, not subject to price regulation, that was the only present and future seller of those products ("hypothetical monopolist") likely would impose at least a small but significant and non-transitory increase in price ("SSNIP") on at least one product in the market, including at least one product sold by one of the merging firms.

Merger Guidelines § 4.1.1; *see also Peabody*, 492 F. Supp. 3d at 886; *Sysco*, 113 F. Supp. 3d at 33. If the monopolist could profitably impose such a price increase, then a relevant product market exists for antitrust purposes. *Peabody*, 492 F. Supp. 3d at 886 (citing Merger Guidelines § 4.1.1). (Federal agencies typically use a price increase—or SSNIP—of 5% when analyzing prospective mergers. *Id*. (citing Merger Guidelines § 4.1.2).) But if enough consumers would be able to substitute away from the hypothetical monopolist's product to another product, thereby making the price increase unprofitable, then the relevant market cannot be limited to the hypothetical monopolist's product and must also include the substitute products. *Sysco*, 113 F. Supp. 3d at 33; *see also H&R Block*, 833 F. Supp. 2d at 52.

In this case, then, the HMT inquiry asks: If a single firm controlled the entire HCP programmatic advertising market, as defined by the FTC, could it profitably impose a price increase? Or would that price increase result in customers moving enough of their business to other alternatives to make the price increase unprofitable? If the price increase would be profitable, then the FTC has defined the relevant product market accurately. If it would not be profitable, then the market is broader than the FTC has contended. *Cf. Sysco*, 113 F. Supp. 3d at 34.

i. Dr. Hatzitaskos's Analysis

The FTC presented expert testimony from Dr. Hatzitaskos, who has a Ph.D. in economics and serves as Senior Vice President at Cornerstone Research, an economics litigation consulting firm. On the issue of market definition, Dr. Hatzitaskos opined that HCP programmatic advertising constitutes a relevant antitrust market. He included in his candidate market "all market participants that shared revenue through discovery," as well as "anybody that IQVIA reported as [a] top customer of their HCP data." The proposed market in his initial report included DeepIntent, Lasso, PulsePoint, and other DSPs providing HCP programmatic advertising. Dr. Hatzitaskos did not include social media platforms in the market he originally tested. Considering all the available evidence, he testified, these platforms did not "seem to be a reasonable substitute, a meaningful constraint." Nor did he include endemic websites such as Medscape, concluding again that the evidence did not indicate that they were "meaningful competitive constraints."[20]

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[20] The firms Dr. Hatzitaskos included in his initial report were: DeepIntent, Lasso, PulsePoint, Proclivity, AdTheorent, TI Health, eHealthcare, Amobee, Nativo, The Trade Desk, Viant, Doceree, and Medicx. In his reply report, he added Healio. Dr. Hatzitaskos also amended several figures in his reply report to reflect updated discovery. In a "conservative thought experiment," moreover, he

Consistent with the case law discussed above, Dr. Hatzitaskos explained that market definition is "not an exercise in just listing every potential competitor." Rather, the goal is to determine "who are the most important competitors, who are the most important for competitive constraints." Defining the market as narrowly as possible allows for "a better prediction about competition." [*S*]*ee also Merger Guidelines* § 4 ("Defining a market broadly to include relatively distant product or geographic substitutes can lead to misleading market shares. This is because the competitive significance of distant substitutes is unlikely to be commensurate with their shares in a broad market.").

Based on the qualitative evidence he evaluated, Dr. Hatzitaskos concluded that "industry participants recognize HCP programmatic advertising as a distinct product." He then used the HMT to confirm that HCP programmatic advertising is a relevant antitrust market. Dr. Hatzitaskos relied on two methods to apply the HMT: (1) critical loss analysis and (2) merger simulation. Under both approaches, he concluded that the HMT was satisfied for the market he tested.

First, critical loss analysis asks how many customers the hypothetical monopolist would have to lose to alternatives outside the market for the price increase to be unprofitable. [*S*]*ee also FTC v. Swedish Match*, 131 F. Supp. 2d 151, 160 (D.D.C. 2000) (describing critical loss as "the largest amount of sales that a monopolist can lose before a price increase becomes unprofitable"). Dr. Hatzitaskos estimated that a 5% price increase for DeepIntent would result in a critical loss of 10.6%, meaning that the hypothetical monopolist would need to regain 10.6% of the customers switching away from DeepIntent. He also estimated that a 10% price increase for DeepIntent would result in a critical loss of 21.2%. For both calculations, he relied on a margin estimate of 47.3% for DeepIntent.

Dr. Hatzitaskos then compared the critical loss figures to an estimate of the aggregate diversion ratio. "The aggregate diversion ratio for any given product represents the proportion of lost sales that are recaptured by all other firms in the proposed market as the result of a price increase." *H&R Block*, 833 F. Supp. 2d at 63. These sales remain within the proposed market and thus are not lost to the hypothetical monopolist. If the aggregate diversion ratio to products within the proposed market exceeds the critical loss threshold, then a price increase would be profitable for the hypothetical monopolist. *H&R Block*, 833 F. Supp. 2d at 63.

Here, Dr. Hatzitaskos used 79.4% as an estimate of the aggregate diversion ratio. That figure was based on his analysis of actual customer choices, which relied on DeepIntent's internal "win/loss data" and campaign data from Lasso and PulsePoint. He found that 79.4% of customers who considered but did not choose DeepIntent ended up choosing Lasso or PulsePoint. Dr. Hatzitaskos characterized this figure as a

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included additional firms proposed by one of Defendants' experts, even though he found the evidence to be "inconsistent with the additional entities having competitive significance that is proportional to their estimated revenues." The additional firms were: Videoamp, Acuity Ads, Stackadapt, Basis, Vericast, Facebook, Sermo, X (formerly known as Twitter), VDX.tv, and LinkedIn. *Id*. at 43, Exhibit R-2. These additions, Dr. Hatzitaskos concluded, did not "meaningfully change the broader picture of industry revenues."

conservative estimate of the aggregate diversion ratio because the hypothetical monopolist would control all providers of HCP programmatic advertising in the candidate market rather than just those three firms.

To reiterate, the ultimate test is whether the aggregate diversion ratio is higher than the critical loss; if it is, then the candidate market passes the HMT. [*S*]*ee also H&R Block*, 833 F. Supp. 2d at 63. The aggregate diversion ratio was 79.4%, while the critical loss was either 10.6% (based on a 5% price increase) or 21.2% (based on a 10% price increase). In both cases, then, the aggregate diversion ratio exceeded the critical loss by a wide margin and thus the HMT was satisfied.

Second, Dr. Hatzitaskos conducted a merger simulation analysis. A merger simulation evaluates how the hypothetical monopolist would change prices after the merger and whether any price increase imposed on the merging firms' products would be more than 5%. Dr. Hatzitaskos's analysis considered a hypothetical merger of DeepIntent, Lasso, and PulsePoint.[21] He asked whether, in those circumstances, the hypothetical monopolist would raise the price of either DeepIntent or Lasso by at least 5%. Dr. Hatzitaskos found that the hypothetical monopolist would increase prices by more than 43%—well above the 5% threshold.

In sum, Dr. Hatzitaskos found that "all of the evidence strongly confirms that HCP programmatic advertising constitutes a relevant antitrust market."

ii. Dr. Israel's Analysis

Defendants challenged Dr. Hatzitaskos's conclusions through the expert testimony of Dr. Israel, who holds a Ph.D. in economics and serves as Senior Managing Director at Compass Lexecon, an economic consulting firm. Dr. Israel opined that the FTC's proposed market "is overly narrow and defines away important competition."

Dr. Israel criticized both of Dr. Hatzitaskos's implementations of the HMT. First, with respect to the critical loss analysis, Dr. Israel stated that Dr. Hatzitaskos's aggregate diversion ratios were based on "fundamentally flawed" win/loss data. That data, Dr. Israel asserted, was limited to DeepIntent RFPs and thus did not include any substitution from agencies that decided to spend on social or other alternatives rather than sending an RFP to DeepIntent. Furthermore, the win/loss data failed to account for the tendency of agencies to work with multiple advertising platforms at the same time. If DeepIntent were to lose an RFP, Dr. Israel reasoned, "it's very likely, from what we have heard, that five or six different platforms get some of that money." But Dr. Hatzitaskos's analysis treated any match in the win/loss data as a 100% substitution to either Lasso or PulsePoint. Dr. Israel cited one $600,000 campaign that DeepIntent lost to Lasso and that Dr. Hatzitaskos treated as a 100% match with Lasso—when in fact, according to Dr. Israel, Lasso received only $12,000 of that total budget.

The critical loss analysis was also flawed, in Dr. Israel's view, because Dr. Hatzitaskos assumed that the profit margin for DeepIntent and Lasso was "roughly

[21] According to Dr. Hatzitaskos, this scenario again represented a conservative approach because the hypothetical monopolist would control additional providers of HCP programmatic advertising beyond those three firms.

50 percent." That figure was too high, Dr. Israel asserted, because it accounted only for data and media costs while omitting the costs of running the platform.

As for the merger simulation, Dr. Israel concluded that Dr. Hatzitaskos's model required market shares as an input and thus was based on "entirely circular logic" that assumed the proposed market was correct. This share-based model, Dr. Israel testified, essentially "says substitution is determined by your market share." In other words, the analysis "doesn't measure substitution. It assumes it is equal to share." According to Dr. Israel, Dr. Hatzitaskos assumed that the market share for any firm outside his candidate market—that is, any firm other than the DSPs he included—was zero. In Dr. Israel's view, this approach failed to establish the proposed market because "[i]t assumes the market by saying if you are not in the market, your share is zero and therefore there is no substitution."

iii. The Court's Conclusions

Having carefully weighed the testimony of both experts, the Court finds that Dr. Hatzitaskos's conclusions further support the FTC's assertion that HCP programmatic advertising is the relevant product market.

At the outset, Defendants argue that Dr. Hatzitaskos's HMT analyses are legally defective because he asked whether the hypothetical monopolist could profitably increase the price of one product rather than all products in the market. Doc. 288 at 56. According to Defendants, "[i]t makes no sense to evaluate substitutability within the candidate market, because the whole point of the HMT is to determine whether firms outside the candidate market competitively constrain pricing." *Id*. By this logic, instead of asking whether the hypothetical monopolist could profitably increase DeepIntent's prices, Dr. Hatzitaskos should have asked whether the hypothetical monopolist could profitably increase the prices of all the firms in the proposed market.

The FTC's position, by contrast, is that the test asks whether the hypothetical monopolist "could raise prices by 5 percent on one product." The question then becomes whether the hypothetical monopolist would lose sales to options outside the candidate market. Potential alternatives such as social media and endemic, therefore, should be included only if, after a price increase, DeepIntent would lose so much business to those channels—rather than to Lasso, PulsePoint, or other DSPs in the candidate market—that the price increase would be unprofitable. Counsel for the FTC asserted that there is no evidence to suggest "that such a significant shift outside of the pool within the FTC's defined market would occur at such a low change in price."

Courts are not entirely consistent in how they frame the HMT, particularly with respect to whether it tests a price increase on one or all of the hypothetical monopolist's products. *Compare, e.g., Peabody*, 492 F. Supp. 3d at 886 ("The HMT is an analytical method that asks 'whether a hypothetical monopolist who has control over the products in an alleged market could profitably raise prices on those products.' " (citation omitted)), with [United States v.] *Aetna* [Inc.], 240 F. Supp. 3d [1,] at 20 [(D.D.C. 2017)] ("To determine whether a group of products could be an antitrust market, the hypothetical monopolist test asks whether a hypothetical monopolist of all the products within a proposed market would likely impose a [SSNIP]—typically of five or ten

percent—on at least one product in the market, including one sold by the merging firms.").

Both the Merger Guidelines and Dr. Israel's own report, however, suggest that it is permissible to test the effects of a price increase on a single product. Dr. Israel described the HMT as asking whether the hypothetical monopolist would impose a price increase "on at least one product in the market." On cross examination, moreover, Dr. Israel was asked if the relevant question for the HMT is "whether the monopolist could profitably impose a SSNIP on one firm's offering." He answered: "I think that one is debated as a matter of law, so I'm not going to weigh in to the law there. . . . [A]s an economist, you could apply it that way. I think I have in cases where I have been instructed to." The Merger Guidelines, likewise, characterize the HMT as evaluating whether the hypothetical monopolist would impose a price increase "on at least one product in the market, including at least one product sold by one of the merging firms." *Merger Guidelines* § 4.1.1. In other words, the Guidelines indicate that the HMT does not require testing whether the hypothetical monopolist could profitably impose a price increase on all products in the candidate market.[22]

Defendants do not identify any authority to sustain their position that the HMT requires analysis of whether the hypothetical monopolist would raise prices on all products in the candidate market. They cite *FTC v. Advocate Health Care Network*, 841 F.3d 460 (7th Cir. 2016), but the language they rely on fails to prove their argument. In discussing the relevant geographic market, the Seventh Circuit described the HMT as asking "what would happen if a single firm became the only seller in a candidate geographic region." *Id*. at 468. If the hypothetical monopolist can profitably raise prices, then the region is a relevant geographic market. *Id*. On the other hand, "if customers would defeat the attempted price increase by buying from outside the region, it is not a relevant market." *Id*. This language hardly demonstrates that it is improper to run the HMT by testing whether the hypothetical monopolist could raise prices on one product. If prices increase on one product, customer substitution to products outside the candidate market might make the price increase unprofitable. To use the Seventh Circuit's language, those customers might "defeat the attempted price increase by buying from outside" the relevant market. And again, several courts have adopted the same framing of the HMT that Dr. Hatzitaskos employed. *See, e.g*., *Aetna*, 240 F. Supp. 3d at 20; *Sysco*, 113 F. Supp. 3d at 33; *H&R Block*, 833 F. Supp. 2d at 60.[23]

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[22] In addition, Dr. Hatzitaskos's report suggests that the aggregate diversion ratio threshold would be even lower in a scenario where the hypothetical monopolist imposes a price increase on all products rather than a single product.

[23] Defendants also make a passing argument in both their pre-hearing and post-hearing briefs that Dr. Hatzitaskos failed to account for "the two-sided nature of HCP programmatic advertising." A two-sided platform is "a business that 'offers different products or services to two different groups who both depend on the platform to intermediate between them.'" *US Airways, Inc. v. Sabre Holdings Corp.*, 938 F.3d 43, 56 (2d Cir. 2019) (quoting *Ohio v. Am. Express Co. (Amex)*, 585 U.S. 529 (2018)). A credit card platform, for instance, includes merchants on one side and cardholders on the

Nor is the Court persuaded by Defendants' argument that Dr. Hatzitaskos made "economic errors" rendering his analysis unreliable. Dr. Hatzitaskos relied on two key inputs for his critical loss analysis: margins and aggregate diversion ratios. As discussed above, he found that the HMT was satisfied for either a 5% or 10% price increase. Dr. Hatzitaskos also explained, however, that the HMT was satisfied even using Dr. Israel's proposed inputs. More specifically, in his reply report, he ran the HMT using Dr. Israel's estimates of both DeepIntent's margins and the aggregate diversion ratio. Using a conservative approach, Dr. Israel estimated DeepIntent's margin to be [Redacted] for 2022. Using that margin, along with Dr. Israel's adjusted diversion ratios, Dr. Hatzitaskos still concluded that the HMT would be satisfied for a merger of just DeepIntent, Lasso, and PulsePoint.

To be sure, Dr. Israel maintained that his proposed adjustments did not address "the core limitations" of the win/loss data or resolve "all of the shortcomings in Dr. Hatzitaskos' analysis." But the Court is not convinced that the win/loss data is as flawed as Dr. Israel asserted. As Dr. Hatzitaskos observed in his reply report, DeepIntent itself relies on win/loss data to assess its own competitive environment. PX6504 at 62; see PX0505 at 191 (DeepIntent CEO stating that win/loss data was used to help "understand what the level of competition was looking like in the marketplace"); *id*. at 192 (win/loss data offered "the best available comprehensive idea

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other. *Id*. The "value of the services that a two-sided platform provides increases as the number of participants on both sides of the platform increases." *Id*. (quoting *Amex*, 138 S. Ct. at 2281).

These two-sided platforms "'must be sensitive to the prices that they charge each side' of the platform." *Id*. (quoting *Amex*, 138 S. Ct. at 2281). They often "cannot raise prices on one side without risking a feedback loop of declining demand." *Id*. (quoting *Amex*, 138 S. Ct. at 2285). Economists refer to this phenomenon as "indirect network effects." *Id*. (quoting *Amex*, 138 S. Ct. at 2280-81). Furthermore, there is a subset of two-sided platforms that always receive two-sided treatment: transaction platforms. *Id*. "A transaction platform is a two-sided platform where the business 'cannot make a sale to one side of the platform without simultaneously making a sale to the other.'" *Id*. (quoting *Amex*, 138 S. Ct. at 2280). These platforms "exhibit more pronounced indirect network effects" because they require that "both sides of the platform simultaneously agree to use their services." *Id*. (quoting *Amex*, 138 S. Ct. at 2286). Accordingly, the relevant market must include both sides of the platform. *Id*.

Defendants argue that DSPs are two-sided transaction platforms that experience indirect network effects. As they put it: "If a DSP were to raise prices to advertisers and lose customer volume in hopes of increasing profit, that departure of customers would affect that [DSP's] ability to attract publishers, thereby reducing the value of the DSP and causing a further departure of advertiser customers."

As the FTC pointed out in its pre-hearing reply brief, however, Defendants do not cite any IQVIA, DeepIntent, or Lasso documents "supporting the claim that their pricing is affected by publisher relationships." Dr. Israel's report, likewise, does not cite any record materials to support his contention that DeepIntent and Lasso are two-sided platforms. Nor did Defendants spend time developing this theory at the evidentiary hearing. The sole hearing testimony Defendants rely on is the PulsePoint witness's statement that PulsePoint's parent company, Internet Brands, "provides digital marketing service in two sided marketplaces where professionals and consumers have complicated journeys." That is plainly insufficient for the Court to conclude that DSPs qualify as two-sided transaction platforms or that Dr. Hatzitaskos's analysis overlooked indirect network effects.

of what's happening among our clients"). Other DSPs also rely on win/loss data: PulsePoint, for instance, tracks wins and losses, and in "the vast majority of cases," the companies it loses business to are DeepIntent and Lasso. Furthermore, Dr. Hatzitaskos explained that he did not limit his consideration of win/loss opportunities to any particular channel; rather, his analysis "focused on opportunities that DeepIntent self-identified as losses to competition." He also pointed out that Dr. Israel's claims of campaign revenue that could have been won by a third party other than Lasso or PulsePoint were "inconsistent with the evidence that providers other than DeepIntent, Lasso, and PulsePoint have small revenues." *Id*. at 64. Finally, Dr. Hatzitaskos testified that there was a wide margin of error in the results he measured: for the test to fail, he would need to have "overestimated the diversion to Lasso and PulsePoint not just by a little bit but by three times as much." In the end, while the Court acknowledges that the win/loss data may not be a flawless metric, the Court largely finds persuasive Dr. Hatzitaskos's responses—explained in part during his testimony and detailed more fully in his reply report—to Dr. Israel's criticisms. And though the Court recognizes that Dr. Israel did not concede the correctness of relying on the win/loss data, the Court nonetheless finds it compelling that the HMT was satisfied even using Dr. Israel's adjusted figures.

Taking a step back from the experts' debates about specific inputs, moreover, the Court ultimately finds Dr. Hatzitaskos's analysis of the market to be more consistent with the weight of the testimony and documentary evidence. Courts in similar proceedings have routinely recognized that, even where some questions have been raised about the precise methods used by expert economists, those experts' conclusions may still support a proposed market definition where they are broadly consistent with the rest of the evidence in the record. See *Sysco*, 113 F. Supp. 3d at 36-37 (in case where Dr. Israel served as the FTC's expert, court noted some issues with aggregate diversion calculations but concluded that, "when evaluated against the record as a whole, Dr. Israel's conclusions are more consistent with the business realities of the food distribution market than [the defense expert's]"); *H&R Block*, 833 F. Supp. 2d at 65 (court declined to treat expert's hypothetical monopolist analysis as "conclusive" but found that it was "another data point" supporting the relevant product market); *see also* [*FTC v.*] *CCC Holdings*, [*Inc.*,] 605 F. Supp. 2d [26,] at 41 [(D.D.C. 2009)] (despite gap in FTC expert's analysis, "the real-world evidence shows that [the two products] are not part of the same product market").

Conversely, the Court does not find Dr. Israel's conception of the market persuasive. On cross examination, Dr. Israel was asked whether, in his opinion, a hypothetical monopolist controlling all the DSPs in the candidate market could profitably impose a price increase on one of those firms' offerings. Dr. Israel testified that if a hypothetical monopolist of all those firms increased DeepIntent's prices by 5%, there would be so much substitution to other channels—that is, firms other than those DSPs—that it would make the price increase unprofitable. He asserted that there would be "ample substitution elsewhere," particularly given the size of Doximity and Medscape, which provide "really the same service."

Having considered the record as a whole, the Court cannot agree with Dr. Israel's conclusion. As discussed above in the section concerning the *Brown Shoe* factors, the Court has found that it is not accurate to characterize Doximity and Medscape as providing "the same service" as the programmatic offerings of the DSPs in the FTC's proposed market. Substantial evidence throughout the record demonstrates that programmatic is distinct from social and endemic channels and is viewed as such by industry participants. As a result, the Court does not find it plausible that, in the event the hypothetical monopolist increased DeepIntent's prices, there would be so much substitution outside of the proposed market that the price increase would become unprofitable. *Cf. Sysco*, 113 F. Supp. 3d at 37 (rejecting expert testimony on market definition that was "inconsistent with business reality" and contradicted by "evidence from industry leaders").

To reiterate, the Court need not and does not conclude that Dr. Hatzitaskos's methods and conclusions are beyond any criticism. *See Aetna*, 240 F. Supp. 3d at 42 ("Although the Court does not (and does not need to) adopt his analysis in every detail, [the government's expert] has performed a battery of tests that all point to the same conclusion . . . ."); *H&R Block*, 833 F. Supp. 2d at 71 (expert's analysis "tends to confirm ... the relevant market" even though "the Court would not rely on his analysis exclusively"); *cf.* [*FTC v.*] *Whole Foods,* [*Inc*.,] 548 F.3d [1028] at 1048 [(D.C. Cir. 2008)] (Tatel, J., concurring in the judgment) ("Although courts certainly must evaluate the evidence in section 13(b) proceedings and may safely reject expert testimony they find unsupported, they trench on the FTC's role when they choose between plausible, well-supported expert studies."). The Court simply finds that, all things considered, his testimony—including the adjustments he made in his reply report in response to Dr. Israel's critiques—tends to reinforce the conclusion that HCP programmatic advertising is a relevant product market.

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NOTES

1. For more background, see the Notes on the excerpt of this case in the Unit 3 reading materials.

2. This case also forms the basis for Problem 2 in the homework for Class 12.

Explicit Theories of Anticompetitive Harm: Coordinated Interaction

Horizontal Merger Guidelines

U.S. Department of Justice

and the

Federal Trade Commission

Issued: August 19, 2010

complementary capabilities that cannot be otherwise combined or for some other merger-specific reason. See Section 10.

The Agencies also consider whether a merger is likely to give the merged firm an incentive to cease offering one of the relevant products sold by the merging parties. Reductions in variety following a merger may or may not be anticompetitive. Mergers can lead to the efficient consolidation of products when variety offers little in value to customers. In other cases, a merger may increase variety by encouraging the merged firm to reposition its products to be more differentiated from one another.

If the merged firm would withdraw a product that a significant number of customers strongly prefer to those products that would remain available, this can constitute a harm to customers over and above any effects on the price or quality of any given product. If there is evidence of such an effect, the Agencies may inquire whether the reduction in variety is largely due to a loss of competitive incentives attributable to the merger. An anticompetitive incentive to eliminate a product as a result of the merger is greater and more likely, the larger is the share of profits from that product coming at the expense of profits from products sold by the merger partner. Where a merger substantially reduces competition by bringing two close substitute products under common ownership, and one of those products is eliminated, the merger will often also lead to a price increase on the remaining product, but that is not a necessary condition for anticompetitive effect.

> *Example 21:* Firm A sells a high-end product at a premium price. Firm B sells a mid-range product at a lower price, serving customers who are more price sensitive. Several other firms have low-end products. Firms A and B together have a large share of the relevant market. Firm A proposes to acquire Firm B and discontinue Firm B's product. Firm A expects to retain most of Firm B's customers. Firm A may not find it profitable to raise the price of its high-end product after the merger, because doing so would reduce its ability to retain Firm B's more price-sensitive customers. The Agencies may conclude that the withdrawal of Firm B's product results from a loss of competition and materially harms customers.

7. Coordinated Effects

A merger may diminish competition by enabling or encouraging post-merger coordinated interaction among firms in the relevant market that harms customers. Coordinated interaction involves conduct by multiple firms that is profitable for each of them only as a result of the accommodating reactions of the others. These reactions can blunt a firm's incentive to offer customers better deals by undercutting the extent to which such a move would win business away from rivals. They also can enhance a firm's incentive to raise prices, by assuaging the fear that such a move would lose customers to rivals.

Coordinated interaction includes a range of conduct. Coordinated interaction can involve the explicit negotiation of a common understanding of how firms will compete or refrain from competing. Such conduct typically would itself violate the antitrust laws. Coordinated interaction also can involve a similar common understanding that is not explicitly negotiated but would be enforced by the detection and punishment of deviations that would undermine the coordinated interaction. Coordinated interaction alternatively can involve parallel accommodating conduct not pursuant to a prior understanding. Parallel accommodating conduct includes situations in which each rival's response to competitive moves made by others is individually rational, and not motivated by

retaliation or deterrence nor intended to sustain an agreed-upon market outcome, but nevertheless emboldens price increases and weakens competitive incentives to reduce prices or offer customers better terms. Coordinated interaction includes conduct not otherwise condemned by the antitrust laws.

The ability of rival firms to engage in coordinated conduct depends on the strength and predictability of rivals' responses to a price change or other competitive initiative. Under some circumstances, a merger can result in market concentration sufficient to strengthen such responses or enable multiple firms in the market to predict them more confidently, thereby affecting the competitive incentives of multiple firms in the market, not just the merged firm.

7.1 Impact of Merger on Coordinated Interaction

The Agencies examine whether a merger is likely to change the manner in which market participants interact, inducing substantially more coordinated interaction. The Agencies seek to identify how a merger might significantly weaken competitive incentives through an increase in the strength, extent, or likelihood of coordinated conduct. There are, however, numerous forms of coordination, and the risk that a merger will induce adverse coordinated effects may not be susceptible to quantification or detailed proof. Therefore, the Agencies evaluate the risk of coordinated effects using measures of market concentration (see Section 5) in conjunction with an assessment of whether a market is vulnerable to coordinated conduct. See Section 7.2. The analysis in Section 7.2 applies to moderately and highly concentrated markets, as unconcentrated markets are unlikely to be vulnerable to coordinated conduct.

Pursuant to the Clayton Act's incipiency standard, the Agencies may challenge mergers that in their judgment pose a real danger of harm through coordinated effects, even without specific evidence showing precisely how the coordination likely would take place. The Agencies are likely to challenge a merger if the following three conditions are all met: (1) the merger would significantly increase concentration and lead to a moderately or highly concentrated market; (2) that market shows signs of vulnerability to coordinated conduct (see Section 7.2); and (3) the Agencies have a credible basis on which to conclude that the merger may enhance that vulnerability. An acquisition eliminating a maverick firm (see Section 2.1.5) in a market vulnerable to coordinated conduct is likely to cause adverse coordinated effects.

7.2 Evidence a Market is Vulnerable to Coordinated Conduct

The Agencies presume that market conditions are conducive to coordinated interaction if firms representing a substantial share in the relevant market appear to have previously engaged in express collusion affecting the relevant market, unless competitive conditions in the market have since changed significantly. Previous express collusion in another geographic market will have the same weight if the salient characteristics of that other market at the time of the collusion are comparable to those in the relevant market. Failed previous attempts at collusion in the relevant market suggest that successful collusion was difficult pre-merger but not so difficult as to deter attempts, and a merger may tend to make success more likely. Previous collusion or attempted collusion in another product market may also be given substantial weight if the salient characteristics of that other market at the time of the collusion are closely comparable to those in the relevant market.

A market typically is more vulnerable to coordinated conduct if each competitively important firm's significant competitive initiatives can be promptly and confidently observed by that firm's rivals. This is more likely to be the case if the terms offered to customers are relatively transparent. Price transparency can be greater for relatively homogeneous products. Even if terms of dealing are not transparent, transparency regarding the identities of the firms serving particular customers can give rise to coordination, e.g., through customer or territorial allocation. Regular monitoring by suppliers of one another's prices or customers can indicate that the terms offered to customers are relatively transparent.

A market typically is more vulnerable to coordinated conduct if a firm's prospective competitive reward from attracting customers away from its rivals will be significantly diminished by likely responses of those rivals. This is more likely to be the case, the stronger and faster are the responses the firm anticipates from its rivals. The firm is more likely to anticipate strong responses if there are few significant competitors, if products in the relevant market are relatively homogeneous, if customers find it relatively easy to switch between suppliers, or if suppliers use meeting-competition clauses.

A firm is more likely to be deterred from making competitive initiatives by whatever responses occur if sales are small and frequent rather than via occasional large and long-term contracts or if relatively few customers will switch to it before rivals are able to respond. A firm is less likely to be deterred by whatever responses occur if the firm has little stake in the status quo. For example, a firm with a small market share that can quickly and dramatically expand, constrained neither by limits on production nor by customer reluctance to switch providers or to entrust business to a historically small provider, is unlikely to be deterred. Firms are also less likely to be deterred by whatever responses occur if competition in the relevant market is marked by leapfrogging technological innovation, so that responses by competitors leave the gains from successful innovation largely intact.

A market is more apt to be vulnerable to coordinated conduct if the firm initiating a price increase will lose relatively few customers after rivals respond to the increase. Similarly, a market is more apt to be vulnerable to coordinated conduct if a firm that first offers a lower price or improved product to customers will retain relatively few customers thus attracted away from its rivals after those rivals respond.

The Agencies regard coordinated interaction as more likely, the more the participants stand to gain from successful coordination. Coordination generally is more profitable, the lower is the market elasticity of demand.

Coordinated conduct can harm customers even if not all firms in the relevant market engage in the coordination, but significant harm normally is likely only if a substantial part of the market is subject to such conduct. The prospect of harm depends on the collective market power, in the relevant market, of firms whose incentives to compete are substantially weakened by coordinated conduct. This collective market power is greater, the lower is the market elasticity of demand. This collective market power is diminished by the presence of other market participants with small market shares and little stake in the outcome resulting from the coordinated conduct, if these firms can rapidly expand their sales in the relevant market.

Buyer characteristics and the nature of the procurement process can affect coordination. For example, sellers may have the incentive to bid aggressively for a large contract even if they expect strong responses by rivals. This is especially the case for sellers with small market shares, if they can realistically win such large contracts. In some cases, a large buyer may be able to strategically undermine coordinated conduct, at least as it pertains to that buyer's needs, by choosing to put up for bid a few large contracts rather than many smaller ones, and by making its procurement decisions opaque to suppliers.

8. Powerful Buyers

Powerful buyers are often able to negotiate favorable terms with their suppliers. Such terms may reflect the lower costs of serving these buyers, but they also can reflect price discrimination in their favor.

The Agencies consider the possibility that powerful buyers may constrain the ability of the merging parties to raise prices. This can occur, for example, if powerful buyers have the ability and incentive to vertically integrate upstream or sponsor entry, or if the conduct or presence of large buyers undermines coordinated effects. However, the Agencies do not presume that the presence of powerful buyers alone forestalls adverse competitive effects flowing from the merger. Even buyers that can negotiate favorable terms may be harmed by an increase in market power. The Agencies examine the choices available to powerful buyers and how those choices likely would change due to the merger. Normally, a merger that eliminates a supplier whose presence contributed significantly to a buyer's negotiating leverage will harm that buyer.

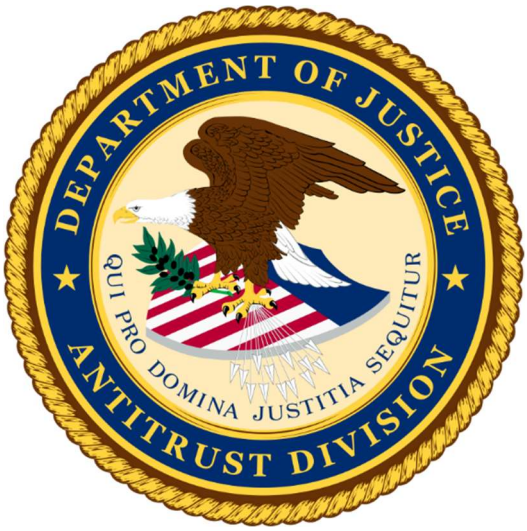
> *Example 22:* Customer C has been able to negotiate lower pre-merger prices than other customers by threatening to shift its large volume of purchases from one merging firm to the other. No other suppliers are as well placed to meet Customer C's needs for volume and reliability. The merger is likely to harm Customer C. In this situation, the Agencies could identify a price discrimination market consisting of Customer C and similarly placed customers. The merger threatens to end previous price discrimination in their favor.

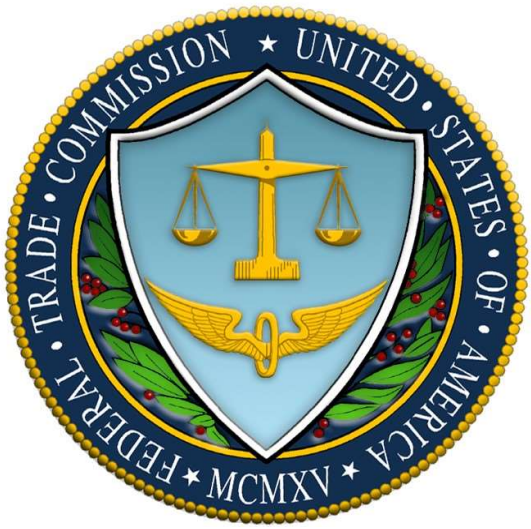
Furthermore, even if some powerful buyers could protect themselves, the Agencies also consider whether market power can be exercised against other buyers.

> *Example 23:* In Example 22, if Customer C instead obtained the lower pre-merger prices based on a credible threat to supply its own needs, or to sponsor new entry, Customer C might not be harmed. However, even in this case, other customers may still be harmed.

9. Entry

The analysis of competitive effects in Sections 6 and 7 focuses on current participants in the relevant market. That analysis may also include some forms of entry. Firms that would rapidly and easily enter the market in response to a SSNIP are market participants and may be assigned market shares. See Sections 5.1 and 5.2. Firms that have, prior to the merger, committed to entering the market also will normally be treated as market participants. See Section 5.1. This section concerns entry or adjustments to pre-existing entry plans that are induced by the merger.





Merger Guidelines

U.S. Department of Justice and the Federal Trade Commission

Issued: December 18, 2023

about price, quality, wages, or another dimension of competition. Section 4.2 describes a variety of approaches to measuring such impacts.

Additional Evidence, Tools, and Metrics. The Agencies may use additional evidence, tools, and metrics to assess the loss of competition between the firms. Depending on the realities of the market, different evidence, tools, or metrics may be appropriate.

Section 4.2 provides additional detail about the approaches that the Agencies use to assess competition between or among firms.

2.3. Guideline 3: Mergers Can Violate the Law When They Increase the Risk of Coordination.

The Agencies determine that a merger may substantially lessen competition when it meaningfully increases the risk of coordination among the remaining firms in a relevant market or makes existing coordination more stable or effective.[19] Firms can coordinate across any or all dimensions of competition, such as price, product features, customers, wages, benefits, or geography. Coordination among rivals lessens competition whether it occurs explicitly—through collusive agreements between competitors not to compete or to compete less—or tacitly, through observation and response to rivals. Because tacit coordination often cannot be addressed under Section 1 of the Sherman Act, the Agencies vigorously enforce Section 7 of the Clayton Act to prevent market structures conducive to such coordination.

Tacit coordination can lessen competition even when it does not rise to the level of an agreement and would not itself violate the law. For example, in a concentrated market a firm may forego or soften an aggressive competitive action because it anticipates rivals responding in kind. This harmful behavior is more common the more concentrated markets become, as it is easier to predict the reactions of rivals when there are fewer of them.

To assess the extent to which a merger may increase the likelihood, stability, or effectiveness of coordination, the Agencies often consider three primary factors and several secondary factors. The Agencies may consider additional factors depending on the market.

2.3.A. Primary Factors

The Agencies may conclude that post-merger market conditions are susceptible to coordinated interaction and that the merger materially increases the risk of coordination if any of the three primary factors are present.

Highly Concentrated Market. By reducing the number of firms in a market, a merger increases the risk of coordination. The fewer the number of competitively meaningful rivals prior to the merger, the greater the likelihood that merging two competitors will facilitate coordination. Markets that are highly concentrated after a merger that significantly increases concentration (see Guideline 1) are presumptively susceptible to coordination. If merging parties assert that a highly concentrated market is not susceptible to coordination, the Agencies will assess this rebuttal evidence using the framework

[19] *See Brooke Grp. Ltd. v. Brown & Williamson Tobacco Corp.,* 509 U.S. 209, 229-30 (1993) ("In the § 7 context, it has long been settled that excessive concentration, and the oligopolistic price coordination it portends, may be the injury to competition the Act prohibits.").

described below. Where a market is not highly concentrated, the Agencies may still consider other risk factors.

Prior Actual or Attempted Attempts to Coordinate. Evidence that firms representing a substantial share in the relevant market appear to have previously engaged in express or tacit coordination to lessen competition is highly informative as to the market's susceptibility to coordination. Evidence of failed attempts at coordination in the relevant market suggest that successful coordination was not so difficult as to deter attempts, and a merger reducing the number of rivals may tend to make success more likely.

Elimination of a Maverick. A maverick is a firm with a disruptive presence in a market. The presence of a maverick, however, only reduces the risk of coordination so long as the maverick retains the disruptive incentives that drive its behavior. A merger that eliminates a maverick or significantly changes its incentives increases the susceptibility to coordination.

2.3.B. Secondary Factors

The Agencies also examine whether secondary factors demonstrate that a merger may meaningfully increase the risk of coordination, even absent the primary risk factors. Not all secondary factors must be present for a market to be susceptible to coordination.

Market Concentration. Even in markets that are not highly concentrated, coordination becomes more likely as concentration increases. The more concentrated a market, the more likely the Agencies are to conclude that the market structure suggests susceptibility to coordination.

Market Observability. A market is more susceptible to coordination if a firm's behavior can be promptly and easily observed by its rivals. Rivals' behavior is more easily observed when the terms offered to customers are readily discernible and relatively observable (that is, known to rivals). Observability can refer to the ability to observe prices, terms, the identities of the firms serving particular customers, or any other competitive actions of other firms. Information exchange arrangements among market participants, such as public exchange of information through announcements or private exchanges through trade associations or publications, increase market observability. Regular monitoring of one another's prices or customers can indicate that the terms offered to customers are relatively observable. Pricing algorithms, programmatic pricing software or services, and other analytical or surveillance tools that track or predict competitor prices or actions likewise can increase the observability of the market.

Competitive Responses. A market is more susceptible to coordination if a firm's prospective competitive reward from attracting customers away from its rivals will be significantly diminished by its rivals' likely responses. This is more likely to be the case the stronger and faster the responses from its rivals because such responses reduce the benefits of competing more aggressively. Some factors that increase the likelihood of strong or rapid responses by rivals include: (1) the market has few significant competitors, (2) products in the relevant market are relatively homogeneous, (3) customers find it relatively easy to switch between suppliers, (4) suppliers use algorithmic pricing, or (5) suppliers use meeting-competition clauses. The more predictable are rivals' responses to strategic actions or changing competitive conditions, and the more interactions firms have across multiple markets, the greater the susceptibility to coordination.

Aligned Incentives. Removing a firm that has different incentives from most other firms in a market can increase the risk of coordination. For example, a firm with a small market share may have

less incentive to coordinate because it has more to gain from winning new business than other firms. The same issue can arise when a merger more closely aligns one or both merging firms' incentives with the other firms in the market. In some cases, incentives might be aligned or strengthened when firms compete with one another in multiple markets ("multi-market contact"). For example, firms might compete less aggressively in some markets in anticipation of reciprocity by rivals in other markets. The Agencies examine these and any other market realities that suggest aligned incentives increase susceptibility to coordination.

Profitability or Other Advantages of Coordination for Rivals. The Agencies regard coordinated interaction as more likely to occur when participants in the market stand to gain more from successful coordination. Coordination generally is more profitable or otherwise advantageous for the coordinating firms the less often customers substitute outside the market when firms offer worse terms.

Rebuttal Based on Structural Barriers to Coordination Unique to the Industry. When market structure evidence suggests that a merger may substantially lessen competition through coordination, the merging parties sometimes argue that anticompetitive coordination is nonetheless impossible due to structural market barriers to coordinating. The Agencies consider this rebuttal evidence using the framework in Section 3. In so doing, the Agencies consider whether structural market barriers to coordination are "so much greater in the [relevant] industry than in other industries that they rebut the normal presumption" of coordinated effects.[20] In the Agencies' experience, structural conditions that prevent coordination are exceedingly rare in the modern economy. For example, coordination is more difficult when firms are unable to observe rivals' competitive offerings, but technological change has made this situation less common than in the past and reduced many traditional barriers or obstacles to observing the behavior of rivals in a market. The greater the level of concentration in the relevant market, the greater must be the structural barriers to coordination in order to show that no substantial lessening of competition is threatened.

2.4. Guideline 4: Mergers Can Violate the Law When They Eliminate a Potential Entrant in a Concentrated Market.

Mergers can substantially lessen competition by eliminating a potential entrant. For instance, a merger can eliminate the possibility that entry or expansion by one or both firms would have resulted in new or increased competition in the market in the future. A merger can also eliminate current competitive pressure exerted on other market participants by the mere perception that one of the firms might enter. Both of these risks can be present simultaneously.

A merger that eliminates a potential entrant into a concentrated market can substantially lessen competition or tend to create a monopoly.[21] The more concentrated the market, the greater the magnitude of harm to competition from any lost potential entry and the greater the tendency to create a monopoly. Accordingly, for mergers involving one or more potential entrants, the higher the market concentration, the lower the probability of entry that gives rise to concern.

[20] *See H.J. Heinz Co.*, 246 F.3d at 724.
[21] *United States v. Marine Bancorp.*, 418 U.S. 602, 630 (1974). A concentrated market is one with an HHI greater than 1,000 (See Guideline 1, n.15).

FTC. v. OSF HEALTHCARE SYS.,
852 F. Supp. 2d 1069, 1086 (N.D. Ill. 2012)
(excerpt on coordinated effects[1])

FREDERICK J. KAPALA, J.

[The FTC sought a preliminary injunction under FTC Act § 13(b) to enjoin the defendants, OSF Healthcare System ("OSF") and Rockford Health System ("RHS"), from consummating their affiliation agreement executed on January 31, 2011, or otherwise acquiring each other's assets or interests. The FTC alleged, among other things, that the arrangement would create a highly concentrated market and increase the likelihood of coordinated effects.]

. . .

b. Coordinated effects

Defendants next argue that the FTC has no evidence that the merger will result in any unlawful coordination. "A merger may diminish competition by enabling or encouraging post-merger coordinated interaction among firms in the relevant market that harms customers." Merger Guidelines § 7; *see also Hosp. Corp*. [*v. FTC*], 807 F.2d [1381] at 1387 [7th Cir. 1986)] ("The fewer competitors there are in a market, the easier it is for them to coordinate their pricing . . . ."). Although "the risk that a merger will induce adverse coordinated effects may not be susceptible to quantification or detailed proof," such a risk can be evaluated by reviewing market concentration and any history of collusion in the relevant market. Merger Guidelines § 7.1. Here, the relevant market is highly concentrated and there is at least some history of coordinated efforts among the Rockford hospitals.

Generally, once "the government has established its prima facie case [through the *PNB* presumption], the burden is on the defendants to produce evidence of 'structural market barriers to collusion' specific to this industry that would defeat the 'ordinary presumption of collusion' that attaches to a merger in a highly concentrated market." *H & R Block*, 833 F. Supp. 2d at 76 (quoting [*FTC v. H.J.*] *Heinz* [*Co.*], 246 F.3d [708] at 725 [(D.C. Cir. 2001)]). In this case, however, the FTC has not relied solely on its prima facie case, but has also detailed several incidents which it claims demonstrate coordinated activity. While the court finds that some of the claimed coordination is fairly benign, such as hiring a consultant to help evaluate the healthcare market in the region, there is some evidence that suggests that there is a risk of coordinated activity by the hospitals in Rockford after the merger, especially once "communication becomes easier and more effective" with only two competitors.

The first example showing at least some history of coordination involves efforts by one hospital to determine if it was in a bidding war against a competitor for a contract

[1] Citations to briefs and the evidentiary record and to footnotes omitted.

with a health insurance company. The first hospital contacted the Managed Care Director for the competitor and was told that they were not in contract negotiations with the insurance company at that time. "[T]he ultimate effect [of this coordinated activity] was that they did not agree to give the larger discount to the health plan in question, but instead held out for a higher amount" of reimbursement from the health plan. Another example involves two of the hospitals allegedly contacting a health plan and stating that, if the health plan wanted to contract with either one of them, it had to exclude the third hospital from its network. This evidence of hospitals putting up a type of "united front in negotiations with the third-party payors" is an example of the dangers of collusion that the antitrust laws seek to prevent. *Hosp. Corp*., 807 F.2d at 1389.

Defendants try to rebut the FTC's charge that the proposed merger comes with an increased risk of unlawful coordination by arguing generally that the FTC's theory is implausible, that the facts it relies on are stale, and that the executives at all three hospitals have testified that they would not allow coordinated behavior to occur in the future. These arguments are insufficient to overcome the presumption of collusion that arises from the combination of the FTC's strong prima facie case, see *H & R Block*, 833 F. Supp. 2d at 76–77, and the evidence of coordinated behavior discussed above. First, defendants' argument that it is implausible to suggest that the merger would allow OSF Northern Region to both exclude and collude with SwedishAmerican misconstrues the FTC's position. Although the court agrees that OSF Northern Region could not simultaneously both exclude and collude, plaintiff's expert explained that the combined entity could use the threat of exclusion to induce collusive behavior from SwedishAmerican. Second, the court disagrees with defendants' characterizations of the FTC's evidence as stale, where the conduct the court finds most damaging occurred within the past seven years. Finally, relying on the testimony of hospital executives adds little to the analysis of this particular issue, as they would be expected to publically disavow any improper conduct and not condone such conduct in the future.

Based on the foregoing, the court agrees with the FTC that the proposed merger in this case does involve an increased risk of coordinated conduct in the relevant market, and that defendants have failed to successfully rebut this aspect of the FTC's case. To be clear, the court is not finding that the hospitals would necessarily collude after the merger, only that this merger adds to the risk of such behavior. Accordingly, the court finds that the FTC has raised serious and substantial questions on the issue of coordinated behavior that require further investigation and determination during the merits trial.

NOTES

1. *OSF* unfortunately followed *H&R Block* in concluding its analysis of the DOJ's prima facie case with nothing more than the *PNB* presumption. It did not follow the rubric of the 2010 DOJ/FTC Horizontal Merger Guidelines and look at the other evidence the DOJ presented to strengthen the *PNB* presumption as more modern courts do.

IN RE TRONOX LTD.,
Slip op. at 33-43, No. 9377 (F.T.C. Dec. 14, 2018) (initial decision)
(excerpt on coordinated effects[1])

D. MICHAEL CHAPPELL, Chief Administrative Law Judge

[The FTC sought a preliminary injunction under FTC Act § 13(b) to enjoin the acquistion by Tronox Limited of the National Titanium Dioxide Company's titanium dioxide (TiO_2) business (known as "Cristal") for $1.67 billion in cash and a 24% equity stake in the combined firm. TiO_2 is a pigment used to add whiteness, brightness, and opacity to products like paints, plastics, and paper. It is manufactured by subjecting raw titanium ores to either a chloride or a sulfate production process. A central issue in the case was the relevant product market definition. The FTC alleged, among other things, that the acquisition created a highly concentrated market and increased the likelihood of coordinated effects.]

. . .

2. Reasonable probability of anticompetitive effects

a. Overview

As the court explained in *ProMedica Health Systems v. FTC*, anticompetitive effects of a merger can include coordinated effects and/or unilateral effects.

> [T]he idea behind coordinated effects is that, "where rivals are few, firms will be able to coordinate their behavior, either by overt collusion or implicit understanding in order to restrict output and achieve profits above competitive levels." *H&R Block*, 833 F. Supp. 2d at 77. . . . Unilateral effects theory, on the other hand, holds that "[t]he elimination of competition between two firms that results from their merger may alone constitute a substantial lessening of competition." Merger Guidelines § 6 at 20.

749 F.3d 559, 568-69 (6th Cir. 2014). In the instant case, to support the argument that the Acquisition is likely to have anticompetitive effects, Complaint Counsel asserts: (1) the Acquisition will facilitate coordination among competitors, in a highly concentrated market that is vulnerable to coordination (coordinated effects); and (2) the Acquisition will enable the combined entity to engage in strategic output withholding, in a market with incentives for and a history of such conduct (unilateral effects). Respondents dispute that anticompetitive effects are likely, arguing that the evidence fails to show that coordination among competitors or unilateral strategic output withholding by the combined entity is likely. The question of likely coordinated effects is analyzed below.

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[1] Citations to briefs and to factual findings with parentheticals omitted.

b. Likelihood of coordinated effects

i. Legal principles

"Tacit collusion, sometimes called oligopolistic price coordination or conscious parallelism, describes the process, not in itself unlawful, by which firms in a concentrated market might in effect share monopoly power, setting their prices at a profit-maximizing, supracompetitive level by recognizing their shared economic interests and their interdependence with respect to price and output decisions." *Brooke Group v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 227 (1993). *See also* Merger Guidelines § 7 (Coordinated interaction includes an implied understanding or parallel accommodating conduct not pursuant to a prior understanding.).

> Coordinated interaction involves conduct by multiple firms that is profitable for each of them only as a result of the accommodating reactions of the others. These reactions can blunt a firm's incentive to offer customers better deals by undercutting the extent to which such a move would win business away from rivals. They also can enhance a firm's incentive to raise prices, by assuaging the fear that such a move would lose customers to rivals.

Merger Guidelines § 7.

"It is a central object of merger policy to obstruct the creation or reinforcement by merger" of market structures in which tacit coordination can occur. [*FTC v.*] *Heinz*, 246 F.3d [246,] at 725 [(D.C. Cir. 2001)]. "Tacit coordination is feared by antitrust policy even more than express collusion, for tacit coordination, even when observed, cannot easily be controlled directly by the antitrust laws." *Id*. "[P]ermit[ting] mergers to be challenged prior to their occurrence and thus before the harm from coordinated interaction has materialized . . . is particularly valuable in situations where coordinated interaction is difficult to detect and remedy directly under § 1 of the Sherman Act." Herbert Hovenkamp, *Prophylactic Merger Policy*, HASTINGS L.J. (August 2018) at 12.

It is not necessary to prove that tacit coordination has already occurred in order to demonstrate a reasonable probability of future coordination. *See* [*FTC v.*] *Arch Coal*, [*Inc.*,]329 F. Supp. 2d [109,] at 116 [D.D.C. 2004)] ("While proof of prior cooperative behavior is relevant, it is not a necessary element of likely future coordination in violation of Section 7.")

ii. Analysis

Under the Merger Guidelines, a merger may substantially lessen competition if: (1) the merger would significantly increase concentration and lead to a moderately or highly concentrated market; (2) that market shows signs of vulnerability to coordinated conduct; and (3) the merger is likely to enhance that vulnerability. Merger Guidelines § 7.1. As shown above, the evidence proves that the Acquisition in this case would significantly increase concentration in the relevant market and lead to a highly concentrated market. As discussed below, the evidence further proves that the North American chloride TiO2 market is vulnerable to coordinated conduct, and that this vulnerability will be enhanced by the Acquisition. *See generally* Merger Guidelines § 7.2 (discussing factors evidencing vulnerability to coordination).

First, with only five participants selling chloride TiO2 in North America, the number of firms in the relevant market is small. "The fewer competitors there are in a market, the easier it is for them to coordinate their pricing without committing detectable violations of section 1 of the Sherman Act . . . ." *Hosp. Corp. of Am. v. FTC*, 807 F.2d 1381, 1387 (7th Cir. 1986). In the instant case, the Acquisition will reduce the number of firms to four, thereby making it easier for the remaining firms to coordinate on price or output. *See* [*FTC v.*] *Elders Grain*, [*Inc.*,] 868 F.2d. [901,] at 905 [(D.C. Cir. 1989)] (holding that acquisition reducing firms from six to five would make it easier for leading members of the industry to collude on price and output); [*FTC v.*] *Univ. Health*, [*Inc.*,] 938 F.2d [1206,] at 1219 [(11th Cir. 1991)] (holding that four businesses remaining after merger could easily collude to raise price and decrease output without committing detectable violations of the Sherman Act). In particular, the Acquisition would not only simplify coordination by eliminating Cristal, a current competitor, but would also create a new firm of a similar size to Chemours, the current market leader. Indeed, the Acquisition will result in only two firms—Tronox and Chemoursɛin control of [redacted—nearly three-quarters] of North American sales, and over of [redacted] North American capacity. "With only two dominant firms left in the market, the incentives to preserve market shares would be even greater, and the costs of price cutting riskier, as an attempt by either firm to undercut the other may result in a debilitating race to the bottom." [*FTC v.*] *CCC Holdings* [*Inc.*], 605 F. Supp. 2d [26,] at 67 [(D.D.C. 2009)].

Second, chloride TiO2 is a commodity product. Markets for homogenous products are more susceptible to coordination. One reason for this is that reactions by rivals to attempts to steal their business are likely to be strong, given that each firm's product is largely interchangeable with its rivals' products. In this case, given the small number of market participants in the relevant market, and the commodity nature of chloride TiO2, the market is fairly characterized as an oligopoly. *See* [4A PHILLIP E.] AREEDA [& HERBERT HOVENKAMP, ANTITRUST LAW] ¶ 1429a at 221 [(3d ed. 2009)]; *Blomkest Fertilizer, Inc. v. Potash Corp. of Saskatchewan, Inc*., 203 F.3d 1028, 1031 n.3 (8th Cir. 2000) (quoting Black's Law Dictionary 1086 (6th ed. 1990)); *see also* Preliminary Injunction Opinion, [*FTC v. Tronox Ltd*., 332 F. Supp. 3d 187, 195 (D.D.C. 2018)] ("The titanium dioxide market has been described as an 'oligopoly,' as TiO2 is a 'commodity-like product with no substitutes, the market is dominated by a handful of firms, and there are substantial barriers to entry.'" (quoting *Valspar Corp. v. E.I. Du Pont De Nemours & Co*., 873 F.3d 185, 190 (3d Cir. 2017)).

Third, mutually recognized interdependence is indicative of a market that is vulnerable to coordination. In such a market, each [competitor] knows that his choice will affect the others, who are likely to respond, and that their responses will affect the profitability of his initial choice. Each knows that expanding his sales or lowering his price will reduce the sales of rivals, who will notice that fact, identify the cause, and probably respond with a matching price reduction. Unless he can somehow conceal his price reduction, or unless his own position is improved by a lower market price, he will hesitate to reduce prices at all. Areeda ¶ 1410b at 65 (emphasis and footnote omitted). Recognized interdependence is a distinct characteristic of an oligopolistic

market. Areeda ¶ 404a; *see also Rebel Oil Co. v. Atlantic Richfield Co.*, 51 F.3d 1421, 1443 (9th Cir. 1995) ("[b]y definition, oligopolists are interdependent . . ." (citation omitted); *In re Flat Glass Antitrust Litig.*, 385 F.3d 350, 359 (3rd Cir. 2004) (explaining that a participant in an oligopoly market "'must take into account the anticipated reaction of the other [] firms'") (citation omitted)).

In the instant case, the evidence proves that the North American chloride TiO2 market is characterized by mutually recognized interdependence. As acknowledged in a November 2016 Tronox presentation, the "TiO2 market shows oligopoly pricing behavior (one supplier can drive price down, action of all suppliers needed to pull prices up)." Indeed, the record is replete with testimony and documents from Tronox and Cristal demonstrating recognized interdependence among market participants. *E.g.*, F. 207 (Tronox's Mr. Romano testifying that "it only takes one to make the price go down. The whole market has to go up. But any one competitor can make pricing go down."); F. 212 (Tronox's Mr. Romano testifying that success of a price increase "depends on what our competition is doing"); F. 213 (Tronox's Mr. Casey stating in an email: "[T]he success of this [Tronox December 2015 price increase] initiative will be materially affected by how Huntsman [now Venator], Cristal and Kronos respond. Chemours announced an equivalent price increase yesterday . . . ."); F. 208 (Mr. Gigou of Cristal testifying that when considering whether to issue a price increase and for what amount, Cristal takes into account information from customers regarding other TiO2 suppliers); F. 217 (Mark Stoll, general manager of mergers and acquisitions for Cristal, stating in a 2012 email: "In current market conditions of excessive inventory we cannot raise price and gain market share at the same time unless all suppliers support the price movement.").

In addition, the evidence shows mutual accommodating conduct by chloride TiO2 producers in order to support market discipline and avoid triggering adverse competitor responses. For example, in a July 2015 email discussing pricing for a customer, Mr. Duvekot of Tronox wrote: "Especially on a highly visible account like [this particular customer] any price move will be seen by the competitors, even more so if we use it to take a piece of the pie. That will cause a reaction from the competition, at this account or elsewhere in the market, which will just lead to more price erosion in the market. Tronox does not want to play this game (anymore)." In a March 2016 email, Tronox's Mr. Mouland wrote to two salespeople: "We will have to pass on this opportunity as I do not want to undercut a competitor. The price increase is taking hold and any attempt to get volume at the expense of price could undermine our progress." F. 246. *See also* F. 231 ("The problem we face is that pricing is falling and if we take action to go after market share, price will deteriorate further and we do not want [to] facilitate or fuel that process. Everyone is defending their business and matching offers from the competition to maintain their share as no one want[s] to loose [sic] business."); F. 235 (Cristal email stating: "All of the large global TiO2 suppliers are still acting in a disciplined manner, respecting each other's market positions and share and holding on to price. No volume stalking of any great consequence is taking place yet, which is very good news.").

Fourth, "[a] market typically is more vulnerable to coordinated conduct if each competitively important firm's significant competitive initiatives can be promptly and confidently observed by that firm's rivals. . . . Regular monitoring by suppliers of one another's prices or customers can indicate that the terms offered to customers are relatively transparent." Merger Guidelines § 7.2. *See also* [*United States v.*] *Oracle*, [*Corp.*,] 331 F. Supp. 2d [1098,] at 1166 [N.D. Cal. 2004)] ("Without homogeneity or transparency, the market conditions are not conducive to coordinated effects, either tacit or express."). The evidence in this case shows that TiO2 suppliers monitor, and are able to observe, significant moves by their competitors, including as to price and output, from public statements by competitors and information obtained from customers.

Tronox and Cristal monitor and analyze public statements by competitors such as quarterly earnings updates, presentations at industry conferences, and ratings agency meetings. For example, Tronox's Mr. Engle, vice president of marketing, listens to competitors' earnings calls to learn about their production plans and other announcements, and to obtain competitive intelligence. Indeed, these sources represent Tronox's largest source of competitor intelligence. Reports and analyses are provided to Tronox's executives. Cristal also monitors TiO2 competitors' public calls and circulates detailed analyses to executives, highlighting information such as production curtailments, capacity utilization, and planned price increases.

The information provided in public earnings calls and similar public presentations can be specific. Tronox discusses in its quarterly results earnings calls such matters as changes in sales volume, changes in the selling prices by region, margin information, and operation related information such as relative plant utilization rate and inventory levels. Tronox publicly announced in a second quarter 2015 earnings call its decision to reduce production at two facilities, including Tronox's Hamilton plant, and specifically noted that "these processing line curtailments represent approximately 15% of total pigment production." In a first quarter 2016 conference call, Tronox described its plan to continue to be "disciplined" about production and not to bring back "full production" on the first sign of price recovery. In a second quarter 2016 earnings call, Chemours stated its prediction that for "the rest of the year, you'll see a cadence up in our price as you look at third quarter . . . ." At a basic materials conference sponsored by Goldman Sachs, the executive vice president of Huntsman (now Venator) stated: "Well, there's the April 1 effective price increase. It was roughly $235 a ton, nominated. And we have communicated and signaled that we would expect the realization on that price would be on the upper end of what we've been realizing over the last 3 or 4 quarters. That is closer to 2/3, 70% realization.".

Publically disclosing information in a market characterized by interdependence can serve as a signal to the market, enhancing predictability and the potential for tacit coordination. North American chloride TiO2 producers over the years have increased TiO2 prices typically in close proximity to each other in time. For example, Chemours announced a price increase of $150 per metric ton on December 17, 2015. Within about a half hour of learning this information, Mr. Casey of Tronox reacted by directing that "[w]e will put out a [redacted] global price increase announcement of our own before

9:30 tomorrow," which Tronox did. In an internal email, Tronox explained that, with its price increase, Tronox was "testing whether [the market] is ready for price increases or at least to stop declines." Cristal learned of the price increase by Tronox on the same day it was announced, and remarked in an internal email: "Tronox follows the trend. . . . Expectedly, other TiO2 manufacturer's [sic] may follow the trend." Cristal characterized these announced pricing moves as "an initiative to taste the market readiness to accept this announced price increase." Later that day on December 18, 2015, Cristal confirmed that both Chemours and Huntsman had also announced price increases. From Cristal's perspective, the December 2015 price increase announcements were "[n]ot based on supply/demand dynamics."

In another example, shortly after Tronox publicly announced in its second quarter 2015 earnings call its decision to reduce production at its Hamilton plant, Chemours closed its Edge Moor plant in Delaware, and shut down a production line at its Johnsonville, Tennessee plant, removing 150,000 metric tons of capacity. Tronox considered this "Good news!!" with then-CEO Mr. Casey responding that "[i]t's good that [Chemours] can follow the leader!"

The Acquisition will increase the competitive information available to market participants through earnings calls and similar public presentations. Tronox, Chemours, Kronos, and Venator are publically traded companies, and therefore required to report earnings and similar business information to investors and others in the ordinary course of business. Presently, Cristal is a privately held company. With the merger, all participants will be reporting as public companies.

Chloride TiO2 producers also monitor competitive actions in the market through information obtained from their customers. It is part of Tronox's price increase implementation process to collect competitive intelligence on its competitors' pricing in order to assess whether its competitors are "maintain[ing] a disciplined approach" with respect to a price increase. Customer-provided information is included in reports provided to senior management and is used to make pricing decisions. In many instances, this can include specific pricing information. *E.g.*, F. 276 ("Per [redacted] , Purchasing Mgr, Kronos and DuPont have moved their price by [redacted]"); F. 276 ("customer confirmed Kronos is taking them up "; F. 276 (describing that Cristal is offering [redacted] per pound lower than Tronox at [redacted]); F. 279 (Cristal email reporting that customer "indicated that Huntsman offered [redacted] for volume . . . "); F. 279 (internal Cristal email stating: "Our refusal to . . . meet [redacted] price resulted in [a customer] moving 5 trucks per month away from us and over to [redacted] . . ."). Competitor price information, once disclosed, gets further communicated within the market "from competitor to customer to other supplier."[10]

[10] Respondents contend that customer-provided pricing information is not reliable because customers in a negotiation may not necessarily be truthful about competing offers. RRFF 476-85. However, the fact that suppliers report and rely on customer-provided competitor pricing information in making their own pricing decision is indicative of the information's reliability. In addition, Cristal's redbook, a data compilation, uses customer-provided sales information to track suppliers' sales volumes, and market share data calculated from the data proved to be a close match to market

Fifth, the fact that the chloride TiO2 market has low demand elasticity makes coordination more profitable, which increases incentives to coordinate. Price elasticity of demand is how responsive demand is to changes in price. Inelastic demand makes a market more susceptible to coordination because if prices of all firms were to rise, few sales would be lost, which makes the reward for coordinating greater. Here, the price elasticity of demand for chloride TiO2 in North America is low.[11]

iii. Respondents' opposing arguments

Respondents argue that Complaint Counsel has failed to prove that coordinated effects are likely, citing *United States v. Oracle Corporation*, 331 F. Supp. 2d 1098 (N.D. Cal. 2004). RB at 57. Oracle does not support Respondents' argument. In that case, the court denied a preliminary injunction under Section 7, finding, among other things, that "the products of Oracle and SAP are not homogeneous, but are differentiated products, and that the pricing of these products is not standardized or transparent." 331 F. Supp. 2d at 1109. Indeed, the plaintiffs in Oracle did not contend that any of those conditions were present in the proposed merger. *Id*. at 1113. In the instant case, by contrast, the evidence proves that chloride TiO2 is a commodity product and suppliers are able to gain relatively detailed and specific information about competitors' pricing.

Respondents further assert that the evidence fails to show coordination has occurred in the past. However, as explained above, proof of prior tacit coordination is not necessary to demonstrate a reasonable probability of future coordination. *See Arch Coal*, 329 F. Supp. 2d at 116. Respondents additionally contend that coordination would be difficult to conceive, monitor, or enforce because announced prices are not necessarily the actual price paid by customers; rather, prices are individually negotiated with each customer. Respondents' argument ignores the facts that suppliers obtain reliable information about actual prices being offered by the competition directly from customers, among other sources, and that such information spreads to other suppliers in the market. Moreover, knowledge of precise competitor pricing is not necessary to be able to coordinate price movements through parallel price increases, which are publicly disclosed. In any event, it is not necessary to demonstrate that market participants can form and enforce an agreement. Coordinated interaction includes a range of conduct, and can involve parallel conduct "in which each rival's response to competitive moves made by others is individually rational, and not motivated by retaliation or deterrence but nevertheless emboldens price increases and

shares calculated from actual data derived from suppliers' invoices. The totality of the evidence belies the notion that customers routinely provide false information as part of the negotiation process.

[11] It is also noteworthy that customers in the relevant market are concerned about the increased consolidation of suppliers post-Acquisition. F. 293 (Mr. Vanderpool of True Value testifying: "[We're] going from five major suppliers down to four major suppliers . . . . [redacted]. So we see raw material prices continue to go up and tightening in the market from allocation, and that's a very big concern of ours"); F. 294 (Ampacet email stating, "The acquisition of Cristal by Tronox is cause for concern for Ampacet" noting the "20% reduction in [its] supply base").

weakens competitive incentives to reduce prices or offer customers better terms." Merger Guidelines § 7.

Respondents also argue that TiO2 sales are subject to "fierce competition." Respondents assert that most customer contracts do not set price but rather provide for prices to be negotiated; that contracts typically contain an option to switch suppliers if they find a better price (a "meet or release" clause), which can result in a lower price; and that buyers "pit" suppliers against each other to obtain a lower price. However, such evidence does not logically preclude a finding that the market is also vulnerable to coordination, particularly where, as here, the market is characterized by oligopolistic interdependence, exacerbated by relative transparency and product homogeneity.[12] Furthermore, "[a]s the statutory language suggests, Congress enacted Section 7 to curtail anticompetitive harm in its incipiency." [*In re*] *Polypore* , [Int'l, Inc., 150 F.T.C. 586, 598 (FTC Nov. 5, 2010) (No. D-9327),] 2010 WL 9549988 at *8 (citing *Chicago Bridge* [& Iron Co. v. FTC], 534 F.3d [410,] at 423 [(5th Cir. 2008)]) (emphasis added). *See also* Merger Guidelines § 7.1 ("Pursuant to the Clayton Act's incipiency standard, the Agencies may challenge mergers that in their judgment pose a real danger of harm through coordinated effects, even without specific evidence showing precisely how the coordination likely would take place.").

iv. Summary

Based on the foregoing, the evidence proves that the North American chloride TiO2 market is vulnerable to coordinated conduct, and that this vulnerability will be enhanced by the Acquisition.

NOTES

1. The theory of coordinated effects has two elements: (a) the relevant market must be susceptible to coordinated interaction (oligopolistic interdependence); and (b) the merger must increase the likelihood or success of coordinated interaction. In the *Tronox* excerpt, be sure you know the headline factual findings supporting each element. Note that most of the factual findings go to susceptibility; if a market is susceptible to coordinated interaction, the then elimination of the independence of a major competitor through a horizontal merger is usually enough to support a finding of increased likelihood or success.

[12] According to the Merger Guidelines, "meet or release" clauses tend to increase the vulnerability of a market to coordinated interaction by increasing visibility of competitive initiatives. *See* Merger Guidelines § 7.2 ("A market typically is more vulnerable to coordinated conduct if a firm's prospective competitive reward from attracting customers away from its rivals will be significantly diminished by likely responses of those rivals. This is more likely to be the case, the stronger and faster are the responses the firm anticipates from its rivals. The firm is more likely to anticipate strong responses if there are few significant competitors, if products in the relevant market are relatively homogeneous, if customers find it relatively easy to switch between suppliers, or if suppliers use meeting-competition clauses.").

NEW YORK V. DEUTSCHE TELEKOM AG,
439 F. Supp. 3d 179, 234-37 (S.D.N.Y. 2020)
(excerpt on coordinated effects[1])

VICTOR MARRERO, J.

[Thirteen states and the District of Columbia brought an action alleging that the proposed 4-to-3 merger of T-Mobile US, Inc. and Sprint Corporation, the third and fourth largest wireless telecommunications service providers in the United States, would substantially lessen competition in the national and various local markets for retail mobile wireless telecommunications services (RMWTS), in violation of Section 7 of the Clayton Act. Before the filing of the states' complaint, the U.S. Department of Justice and seven states had entered into a settlement with the merging parties under which they would sell Sprint's prepaid business and some wireless spectrum to Dish Network to form an additional competitor. The instant action attacked the DOJ divestiture settlement as insufficient to preserve competition in the various RMWTS markets. The state plaintiffs alleged, among other things, that the arrangement would create highly concentrated markets and increase the likelihood of coordinated effects in these markets.]

. . .

C. ADDITIONAL EVIDENCE OF ANTICOMPETITIVE EFFECTS

Defendants' rebuttal of Plaintiff States' prima facie case now leaves Plaintiff States with the ultimate burden of proof. Plaintiff States attempt to carry this burden by showing that: (1) the Proposed Merger would increase the likelihood that the three remaining MNOs [mobile network operators] would effectively agree, whether explicitly or merely through mutual awareness, that competing less strenuously and thus delivering fewer consumer benefits would be in their collective interests ("coordinated effects" of the merger); and (2) the lost competition between Sprint and T-Mobile would cause New T-Mobile to charge higher prices than T-Mobile ordinarily would have without the merger, regardless of its remaining competitors' actions ("unilateral effects" of the merger). As evidence that these two effects are likely, Plaintiff States relied primarily on the testimony of [Professor Carl] Shapiro as supplemented by various emails and internal presentations suggesting that during the course of merger discussions, T-Mobile and Sprint considered the possibility that the Proposed Merger might create opportunities to charge higher prices or otherwise decrease competition.

The Court addresses each type of effect in turn and concludes that neither is reasonably likely, particularly in the short term. As further detailed in Section II.D. below [omitted in this excerpt], each type of effect would require that T-Mobile

[1] Record citations omitted.

reverse course and effectively disestablish the business strategy and reputation it has developed over the past decade, even though the Proposed Merger gives it the ability to simply continue that business strategy on a greater scale and thus compete more effectively with the current market leaders AT&T and Verizon. The likelihood of coordinated or unilateral effects is further diminished by Sprint's decline and DISH's entry into the RMWTS Markets.

1. Coordinated Effects

Coordinated effects analysis reflects the theory that "where rivals are few, firms will be able to coordinate their behavior, either by overt collusion or implicit understanding, in order to restrict output and achieve profits above competitive levels." *FTC v. PPG Indus., Inc.*, 798 F.2d 1500, 1503 (D.C. Cir. 1986). The Merger Guidelines set forth the framework by which the DOJ and FTC assess whether a given merger will cause coordinated effects. Beyond the market share analysis used to establish a prima facie case described above, the DOJ and FTC's coordinated effects analysis considers whether the relevant market "shows signs of vulnerability to coordinated conduct" and whether there is "a credible basis on which to conclude that the merger may enhance that vulnerability." Merger Guidelines § 7.1.

Plaintiff States' economic expert Shapiro calculated that the coordinated effects of the Proposed Merger would result in annual consumer harm of $8.7 billion. Under Shapiro's theory, this harm would result from New T-Mobile [the merged company], AT&T, and Verizon "pulling their punches," or competing less strenuously and allowing market prices to stabilize or decline at a lower rate than the 6.3 percent decline in average revenue per user ("ARPU") observed from 2014 to 2017. Shapiro stated that this behavior would in turn result from several industry characteristics that he claims make the RMWTS Market vulnerable to anticompetitive coordination: that there are only a few large firms in the market, that the firms are very similar, that consumer demand is both predictable and inelastic (that is, not greatly affected by price changes), that there are high barriers to entry, and that prices are transparent and rapidly monitored.

Defendants challenge both that the RMWTS Market is vulnerable to coordination and that without the merger prices would continue to decline at the rate claimed by Shapiro. They note that technically ARPU is not the price that consumers pay, and that instead the Bureau of Labor Statistics' producer price index indicates that the prices for cellular and wireless communications have not declined from 2018 to 2019 despite declining in earlier years. Their economic expert, [Professor Michael] Katz, adds that if the producer price index is followed instead, the $8.7 billion harm calculated by Shapiro disappears completely. Katz also questions how similar the major competitors are, considering the various degrees to which they differentiate their mobile wireless services beyond price, such as particular handset deals, various family or data plans, and bundling with content or other communications services beyond the RMWTS Market itself. Katz claims that these various non-price differentials also complicate Plaintiff States' picture of a market with transparent prices, given firms' incentives to continue innovating and distinguishing themselves from their competitors.

The Court agrees . . . that the RMWTS industry is not particularly vulnerable to coordination. As both sides acknowledge, price is not the only dimension on which competition occurs. The non-price factors listed above demonstrate the various strategies that competitors in the market might pursue, drawing also into question whether the firms' pricing is truly so transparent. For example, while T-Mobile might try to compete primarily on the basis of its capacity advantages, AT&T might try to leverage the entertainment content provided by its merger with Time Warner, and a cable MVNO [mobile virtual network operators] like Comcast might advertise the convenience of bundling mobile wireless services with fixed in-home broadband and cable services. Considering also the rapidly changing nature of mobile wireless technological offerings, opportunities for innovation and differentiation may abound and materially alter the terms of competition. Indeed, that Plaintiff States characterize two of the largest four firms in the RMWTS Market as "mavericks" reflects that the market is not so vulnerable as they otherwise suggest. The DOJ's efforts to surmount the industry's admittedly high barriers to entry and position DISH as a new maverick also contradict the claim that the RMWTS Market is vulnerable to coordination. Finally, Shapiro conceded that asymmetric capacity utilization decreases the likelihood of coordination, which is particularly relevant because of the evidence indicating that New T-Mobile would have significantly more unused capacity than AT&T and Verizon.

As evidence that the Proposed Merger presents a credible threat in a vulnerable market. Plaintiff States also cite a number of documents in which employees of Defendants appear to have considered the prospect of anticompetitive coordination. While Defendants do not contest that evidence of intent may be relevant in a Section 7 case, the Court notes an apparent tension with the Second Circuit's guidance that "it is elementary that [one merging party's] intentions in acquiring [the other merging party] are not to be considered in determining whether a Section 7 Clayton Act violation occurred." *FTC v. PepsiCo, Inc.*, 477 F.2d 24, 30 (2d Cir. 1973). But even if this Court could not consider Defendants' intentions in this exact manner, it will nevertheless weigh the evidence cited by Plaintiff States because it might shed light on whether the RMWTS Market is vulnerable to coordination, and whether the Proposed Merger presents a credible threat of coordination in the market.

The main evidence that Plaintiff States cite for the potential of coordination are statements from DT executives suggesting that they supported a "4-to-3" merger of MNOs in the United States because they believed a consolidated market would be more profitable. Plaintiff States also cite some documentary evidence from Sprint suggesting this potential; for example, Sprint's Chief Marketing Officer Roger Sole-Rafols ("Sole-Rafols") suggested to Claure that the Proposed Merger could "end up accommodating plus $5 ARPU in a three-player scenario [including AT&T and Verizon]" and that this demonstrated "the benefit of a consolidated market." Plaintiff States additionally cite multiple T-Mobile and Sprint communications for the proposition that anticompetitive price signaling is already occurring in the RMWTS Market.

The Court is not persuaded that the evidence Plaintiff States point to forms a sufficiently credible or plausible basis to conclude that the Proposed Merger will substantially lessen competition. First, the Court disagrees that the DT statements merit the weight that Plaintiff States ascribe to them.[2] Though DT is T-Mobile's controlling shareholder, the Court places less weight on DT executives' theories regarding the effects of consolidation in a foreign market than T-Mobile's actual history of aggressive competition and the incentives for the company to continue competing that the Proposed Merger would provide. Sole-Rafol's statements lack significant probative value for similar reasons, including that Sole-Rafols lacks any input on T-Mobile pricing or regulatory strategy and stressed at trial that he expressed this hypothetical without any underlying basis. In any event, that DISH will become a fourth MNO in the RMWTS Market effectively nullifies the value of any speculation regarding the potential coordinated effects of a 4-to-3 merger.

Finally, the signalling emails also do not merit the weight they might warrant at first glance. For example, Langheim's notes clearly indicate that any attempts by T-Mobile at signalling failed and that the market was in fact "now at war."[3] Similarly, the correspondence between the two Sprint employees described above appears to have been speculation, in fact largely contradicted by the employees' own observations in the same discussion that "[Legere's] antagonistic approach to competition destroys profitability for the whole industry" and that "[Claure] may take a while [to start anticompetitively colluding] because of strong ego and competitiveness."[4] The other two documents cited by Plaintiff States do little to indicate that the market is actually vulnerable to coordination, either. Since they are hardly probative of the market's vulnerability to coordination, the Court is also not persuaded that they indicate the Proposed Merger would likely present a credible threat of coordination.

Even putting aside the infirmities that undermine the value of the preceding evidence, the Court has spent two full weeks assessing the credibility of each witness and their claims regarding whether coordination would be more or less likely in the RMWTS Market. "Antitrust theory and speculation cannot trump facts, and . . . cases must be resolved on the basis of the record evidence relating to the market and its probable future." [*FTC v.*] *Arch Coal*, [*Inc*.,] 329 F. Supp. 2d [109] at 116-17 (D.D.C. 2004)]. The Court finds that the fact of aggressive competition over the past decade is not so easily reversed, a point the Court elaborates on in Section II.D below. T-Mobile has built its identity and business strategy on insulting, antagonizing, and otherwise challenging AT&T and Verizon to offer pro-consumer packages and lower pricing, and the Court finds it highly unlikely that New T-Mobile will simply rest satisfied with its increased market share after the intense regulatory and public scrutiny of this transaction. As Legere and other T-Mobile executives noted at trial, doing so would essentially repudiate T-Mobile's entire public image. The evidence indicated that the

[2] *Ed*.: Deutsche Telekom AG ("DT") was the controlling shareholder of T-Mobile.

[3] *Ed*.: Thorsten Langheim was a DT board member.

[4] *Ed.*: John Legere was T-Mobile's CEO. Marcelo Claure was Sprint's CEO.

same executive team that has brought T-Mobile success will continue to lead New T-Mobile, and the merger will provide T-Mobile with the increased capacity that enabled it to pursue the Un-carrier strategy in the first place. Having heard Defendants emphasize the asymmetric capacity advantage that New T-Mobile would have over AT&T and Verizon, the Court concludes that New T-Mobile would likely make use of that advantage by cutting prices to take market share from its biggest competitors. [record citations]; *see also* Merger Guidelines § 2.1.5 ("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.").

Finally, the Court reiterates that the entry of DISH undermines the notion that there will be fewer firms in the market and that coordination will thus be more likely. Even if DISH will initially enter the market at a relatively small scale, the tendency toward anticompetitive coordination "may well be thwarted by the presence of small but significant competitors" such as DISH would be. *See Stanley Works v. FTC*, 469 F.2d 498, 507 (2d Cir. 1972) (internal quotation marks omitted). Trial witnesses were virtually unanimous that DISH chairman [Charles] Ergen is a tough businessman not known to be particularly accommodating of his rivals. Indeed, their numerous references to Ergen as a "poker player" suggest that anticompetitive signaling with DISH would be a difficult endeavor. Having assessed the credibility of DISH's witnesses at trial, the Court is persuaded that, given its extensive preparations and the favorable remedies arranged by the DOJ, DISH fully intends to enter the RMWTS Markets vigorously and assume the mantle of a new maverick. This fact, combined with the high likelihood that New T-Mobile will compete aggressively, renders improbable any potential coordinated effects of the Proposed Merger.

NOTES

1. In an interesting paper, Thomas W. Hazlett & Robert Crandal argue that the T-Mobile/Sprint merger produced consumer gains, while at the same time finding that the consent decree requiring T-Mobile to divest assets—including Sprint's prepaid businesses (Boost Mobile, Virgin Mobile, and Sprint-branded prepaid customers), Sprint's 800 MHz spectrum licenses, and access to at least 20,000 cell sites and hundreds of retail locations to Dish Network—to create a new fourth network has had no plausible procompetitive impact. Price trends indicate a decline in real wireless service prices, with the Bureau of Labor Statistics data showing an 11.79% decrease in the three years following the merger, compared to an 8.22% reduction in the three years prior. Service quality also improved markedly, especially with the rapid expansion of T-Mobile's 5G network, which soon surpassed Verizon and AT&T in coverage and download speeds. Network investment saw a significant boost, with U.S. mobile carriers increasing their capital expenditures from $58.9 billion in 2018-2019 to $63.5 billion in 2020-2021. Subscriber growth also accelerated, with a 20.3% increase in the ten quarters following the merger, up from a 13.0% increase in the ten

previous quarters. Additionally, T-Mobile's stock outperformed the market, while Verizon and AT&T lagged, suggesting that the merger gave T-Mobile competitive advantages without diminishing market competition. Finally, T-Mobile continued to lead with its "Un-Carrier" strategy, offering consumers lower prices and more flexible plans compared to its rivals, ultimately enhancing consumer choice and affordability. *See* Thomas W. Hazlett & Robert Crandall, *Competitive Effects of T-Mobile/Sprint: Analysis of a '4-to-3' Merger*, Proceedings of the TPRC2024 The Research Conference on Communications, Information and Internet Policy (Feb. 20, 2024).

UNITED STATES V. BERTELSMANN SE & CO. KGAA,
646 F. Supp. 3d 1, 44-46 (D.D.C. Nov. 15, 2022)
(excerpt on coordinated interaction[1])

FLORENCE Y. PAN, United States Circuit Judge

[The Department of Justice brought an action alleging that the proposed $2.18 billion acquisition by Bertelsmann, the owner of Penguin Random House, of Simon & Schuster from ViacomCBS. The DOJ alleged that the acquisition would substantially lessen competition in the input market for the U.S. publishing rights to anticipated top-selling books (defined to be books with advances over $250K). Penguin Random House and Simon & Schuster are two of the "Big Five" largest book publishers in the United States, with market shares of 37% and 12%, respectively. The court sustained the DOJ's market definition, found that the merger was likely to substantially harm competition through both unilateral and coordinated effects, and rejected the defenses of the merging parties.]

. . .

ii. Coordinated Effects

Another avenue for the government to prove competitive harm is by showing a likelihood of "coordinated effects," which occur when market participants mutually decrease competition in the relevant market. [*United States v.*] *AT&T*, 310 F. Supp. 3d [161]at 246 [D.D.C. 2018)] ("A proposed merger may violate Section 7 by enabling or encouraging post-merger coordinated interaction among firms in the relevant market that harms customers." (cleaned up)) [, *aff'd*, 916 F.3d 1029 (D.C. Cir. 2019)]; *see also* Merger Guidelines § 7 ("Coordinated interaction involves conduct by multiple firms that is profitable for each of them only as a result of the accommodating reactions of the others."). Coordinated effects can arise from an express or implied agreement among competitors, *see F.T.C. v. CCC Holdings*, 605 F. Supp. 2d 26, 60 (D.D.C. 2009); or from "parallel accommodating conduct" among competitors without a prior agreement, Merger Guidelines § 7. Parallel accommodating conduct involves "situations in which each rival's response to competitive moves made by others is individually rational, and not motivated by retaliation or deterrence nor intended to sustain an agreed-upon market outcome, but nevertheless emboldens price [decreases] and weakens competitive incentives to [raise advances] or offer [authors] better terms." *Id*.

Coordinated effects are likelier in concentrated markets; indeed, the idea that concentration tends to produce anticompetitive coordination is central to merger law. *See* [*FTC v. H.J.*] *Heinz* [*Co.*}, 246 F.3d [708] at 716 [(D.C. Cir. 2001)] ("Merger law 'rests upon the theory that, where rivals are few, firms will be able to coordinate their

[1] Record citations, internal cross-references, and footnotes omitted.

behavior, either by overt collusion or implicit understanding, in order to restrict output and achieve profits above competitive levels.'") (quoting *FTC v. PPG Indus*., 798 F.2d 1500, 1503 (D.C. Cir. 1986)). Therefore, when the government has shown that a merger will substantially increase concentration in an already concentrated market—as it has done here—"the burden is on the defendants to produce evidence of 'structural market barriers to collusion' specific to this industry that would defeat the 'ordinary presumption of collusion' that attaches to a merger in a highly concentrated market." *H&R Block*, 833 F. Supp. 2d at 77 (quoting *Heinz*, 246 F.3d at 725).

As an initial matter, a history of collusion or attempted collusion is highly probative of likely harm from a merger. *See Hosp. Corp*. [*v. FTC*], 807 F.2d [1381] at 1388 [(7th Cir. 1986)]; *see also FTC v. Elders Grain, Inc*., 868 F.2d 901, 906 (7th Cir. 1989) ("[A]n acquisition which reduces the number of significant sellers in a market already highly concentrated and prone to collusion by reason of its history and circumstances is unlawful in the absence of special circumstances."); *H & R Block*, 833 F. Supp. 2d at 78; *Tronox*, 332 F. Supp. 3d at 208–210; Merger Guidelines § 7.2. Thus, it is significant that in *United States v. Apple, Inc*., the Second Circuit upheld a finding that between 2009 and 2012, all the "Big Six"31 publishers, except for Random House, participated in a "horizontal conspiracy . . . to raise e[-]book prices." *See* 791 F.3d at 339. This coordination involved "numerous exchanges between executives at different Big Six publishers," "constant communication" among the publishers "regarding their negotiations with both Apple and Amazon," and "frequent telephone calls among the Publisher Defendants." *Id*. at 302, 318. "[T]he Big Six operated in a close-knit industry and had no qualms communicating about the need to act together." *Id*. at 300. The Second Circuit concluded that the publishers engaged in "express collusion" that was a per se violation of antitrust law. *Id*. at 316, 321–29. Although Random House did not participate in the conspiracy, Penguin Books and S&S both did, *see id*. at 308, and this "history of successful cooperation establishes a precondition to effective collusion—mutual trust and forbearance." *See Hosp. Corp*., 807 F.2d at 1388. The case portrays an industry already "prone to collusion," which may become "even more prone to collusion" after the proposed merger of its largest and third-largest competitors. *See Elders Grain*, 868 F.2d at 905-06.

The *Apple* case provides the backdrop for trends in the industry that appear to demonstrate that the Big Five are already engaging in tacit collusion or parallel accommodating conduct when acquiring books. Recent years have seen the industry-wide standardization of certain contract terms—involving payment structure, audio rights, and e-book royalties—in ways that favor publishers over authors, suggesting that the top publishers have engaged in coordinated conduct. Advances used to be paid to authors in two installments, but publishers uniformly moved to paying them in three installments and then four installments, thereby delaying authors' compensation. After audiobooks became a significant source of revenue in the industry, publishers uniformly refused to acquire books without audio rights included, thereby limiting authors' ability to maximize their compensation and preventing authors from diversifying their sources of income. *See id*. In addition, during the early years of e-books, publishers uniformly shifted e-book royalty rates from 50 percent to 25 percent,

thereby reducing authors' compensation. Thus, in an industry where the competition to acquire anticipated top sellers is intense, the competing publishers nevertheless choose, almost always, not to gain advantage by offering more favorable contract terms. This phenomenon bespeaks a tacit agreement among the publishers to compete only on the basis of advance level because it collectively benefits them not to yield on other contract terms. *Accord H & R Block*, 833 F. Supp. 2d at 77-78 ("[A] highly persuasive historical act of cooperation between [competitors]" supports the theory that "coordination would likely take the form of mutual recognition that neither firm has an interest in an overall 'race to free' ....").

One example involving audio rights is illustrative. When selling the publishing rights to [Redacted] highly sought-after book, her agent attempted to hold an auction that excluded audio rights. S&S wanted the book but refused to bid because "[t]he only way to prevent agents from breaking off audio rights like this is to hold firm to our policy of no deals without audio rights." An S&S editor ruminated, "It will be very interesting to see whether PRH, Hachette, Harper or Macmillan participate. M[y] understanding is that they too have the 'no audio, no deal' rule." Id. The agent was forced to restart the auction with audio rights included, presumably because the book received insufficient offers or only received offers that included audio. See PX 320 at 1 (in the first round, PRH bid for bundled audio rights in violation of the auction's initial rules). In the renewed auction that included audio rights, the bidding was fervid and reflected vigorous competition. This episode starkly demonstrates that the publishers, despite their great enthusiasm for the book, initially engaged in parallel conduct to deny the author the ability to exclude audio rights from the auction. The parallel conduct was effective and mutually beneficial, as the publishers all retained the opportunity to acquire the book, with their preferred contract term concerning audio rights. Based on this evidence, the Court finds that the Big Five publishers have engaged in tacit coordination that is profitable for those involved.

Finally, it is significant that in a market already prone to collusion, where coordinated conduct already appears to be rampant, PRH's acquisition of S&S would reinforce the market's oligopsonistic structure and create a behemoth industry leader that other market participants could easily follow. The Big Five publishers already control 91 percent of the relevant market. The merger would distill the Big Five to a Big Four, with an overwhelmingly dominant top firm, PRH-S&S, controlling 49 percent of the market and dwarfing its nearest competitors. In the newly reconfigured market, the top two firms, the merged entity and [Redacted] would have a 74-percent market share. Under such circumstances, coordinated effects are likely through "sheer market power" because the "post-merger market would feature two firms that control roughly three quarters" of the market. *Tronox*, 332 F. Supp. 3d at 209; *see also Heinz*, 246 F.3d at 724 n.23 (recognizing that "price leadership" is "a danger" in a "duopoly" market). The merger would thus increase the market's already high susceptibility to coordination.

NOTES

1. Judge Florence Pan was a district court judge at the time of trial. Before she rendered her decision in the case, she was elevated to the United States Court of Appeals for the District of Columbia.

2. After a three-week trial in the summer of 2022, Judge Pan entered final judgment permanently enjoining the acquisition on November 2, 2022. Although Bertelsmann's response to the decision was to seek an expedited appeal, on November 21, 2022, the extended drop-dead date of the acquisition agreement, ViacomCBS exercised its unilateral right to terminate the contract, mooting any appeal.[2] Subsequently, Bertelsmann paid ViacomCBS a $200 million antitrust reverse breakup fee. ViacomCBS reauctioned Simon & Schuster, where it was purchased by KKR, a private equity firm, for $1.62 billion.

3. The decision marks the first victory for the Biden DOJ in a merger challenge litigated to a decision. Until this decision, the DOJ had suffered multiple losses in merger cases, including failed challenges to Booz Allen's acquisition of EverWatch,[3] UnitedHealth Care's acquisition of Change Healthcare,[4] and U.S. Sugar's purchase of Imperial Sugar.[5]

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[2] *See* Porter Anderson, *On the Termination of the PRH-Simon & Schuster Deal*, PublishingPerspectives.com, Nov. 22, 2022.

[3] United States v. Booz Allen Hamilton Inc., No. CV CCB-22-1603, 2022 WL 9976035 (D. Md. Oct. 17, 2022) (denying DOJ's motion for a preliminary injunction), *denying injunctive relief pending appeal*, No. CV CCB-22-1603, 2022 WL 16553230 (D. Md. Oct. 31, 2022).

[4] United States v. UnitedHealth Grp. Inc., No. 1:22-CV-0481 (CJN), 2022 WL 4365867 (D.D.C. Sept. 21, 2022) (final judgment in favor or merging parties), *dismissed*, No. 22-5301, 2023 WL 2717667 (D.C. Cir. Mar. 27, 2023).

[5] United States v. U.S. Sugar Corp., C.A. No. 21-1644 (MN), 2022 WL 4544025 (D. Del. Sept. 9, 2022) (final judgment in favor or merging parties), *aff'd*, 73 F.4th 197 (3d Cir. 2023).

Elimination of a Maverick

U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, HORIZONTAL MERGER GUIDELINES § 2.1.5 (REV. AUG. 19, 2010) (MAVERICKS)

2.1.5 Disruptive Role of a Merging Party

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.

U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, MERGER GUIDELINES § 2.3.A (REV. DEC. 18, 2023)

Elimination of a Maverick. A maverick is a firm with a disruptive presence in a market. The presence of a maverick, however, only reduces the risk of coordination so long as the maverick retains the disruptive incentives that drive its behavior. A merger that eliminates a maverick or significantly changes its incentives increases the susceptibility to coordination.

UNITED STATES OF AMERICA
BEFORE THE FEDERAL TRADE COMMISSION

COMMISSIONERS: **Joseph J. Simons, Chairman**
Noah Joshua Phillips
Rohit Chopra
Rebecca Kelly Slaughter
Christine S. Wilson

In the Matter of

Edgewell Personal Care Company,
a corporation

and

Harry's, Inc.,
a corporation.

Docket No. 9390

PUBLIC VERSION

COMPLAINT

Pursuant to the provisions of the Federal Trade Commission Act ("FTC Act"), and by virtue of the authority vested in it by the FTC Act, the Federal Trade Commission ("Commission"), having reason to believe that Respondents Edgewell Personal Care Company ("Edgewell") and Harry's, Inc. ("Harry's") have executed a merger agreement in violation of Section 5 of the FTC Act, 15 U.S.C. § 45, which if consummated would violate Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18, and Section 5 of the FTC Act, and it appearing to the Commission that a proceeding by it in respect thereof would be in the public interest, hereby issues its complaint pursuant to Section 5(b) of the FTC Act, 15 U.S.C. § 45(b), and Section 11(b) of the Clayton Act, 15 U.S.C. § 21(b), stating its charges as follows:

I. NATURE OF THE CASE

1. On May 9, 2019, [redacted], Edgewell signed an agreement to purchase Harry's, a rival manufacturer and seller of razors. Harry's successful 2016 leap from online, direct-to-consumer sales into brick-and-mortar retail stores interrupted over a decade of routine price increases by a once-stable duopoly. This interruption has led to lower prices and new product offerings for razor consumers. The Proposed Acquisition would neutralize "one of the most successful challenger brands ever built," eliminating head-to-head competition between Harry's and Edgewell, and removing the independent competitor that disrupted Edgewell and P&G's longstanding and stable duopoly.

2. Historically, P&G's Gillette brand and Edgewell's Schick brand have dominated the system razors and disposable razors ("wet shave razors") industry. Throughout the years of their shared dominance, Gillette led price increases [redacted]. [redacted]

[redacted] P&G and Edgewell rolled out new and fancier products. Razor manufacturers enjoyed exceptionally high margins, while consumers suffered.

3. As the 2010s progressed, P&G and Edgewell raised their prices ever higher. Purchasers of razors were, as Harry's founders put it, tired of "overpaying for overdesigned razors." Harry's saw an opening: a market ripe for disruption and an untapped platform—the Internet—on which to disrupt. Harry's founders correctly recognized that the market was looking for a no-frills, value-priced system razor product that delivered "a great shave at a fair price." Seizing this opportunity, Harry's, like fellow start-up Dollar Shave Club, launched an Internet-based business to market and sell men's razors directly to consumers at a lower price point than the most comparable razors then available in brick-and-mortar retail stores.

4. Harry's and Dollar Shave Club quickly succeeded in—and largely filled—the previously untapped online space. But the successful entry by Harry's and Dollar Shave Club with their online Direct to Consumer ("DTC") models did not stop the price increases by P&G and Edgewell, both of which sold their products primarily through brick-and-mortar retailers.

5. Significant change came when Harry's made the first—and, to date, only—successful jump from an online DTC platform into brick-and-mortar retail. In August 2016, Harry's launched exclusively at Target with suggested retail prices several dollars below the most comparable Schick and Gillette products, a significant discount. Harry's arrival in Target made a substantial impact, with Harry's immediately winning customers from Edgewell and P&G. Edgewell described Harry's trajectory as one of "[redacted]" and observed that Harry's took "[redacted]."

6. Harry's entry at Target ended the long-standing practice of reciprocal price increases by Gillette and Edgewell. Shortly after Harry's successful launch at Target, P&G implemented a "[redacted]" [redacted] price reduction across its portfolio of razors, reversing course on its practice of leading yearly price increases. Edgewell changed course as well, abandoning its strategy of being a "[redacted]" of Gillette's pricing actions. Rather than match Gillette's [redacted] price decrease, Edgewell began tracking Harry's growth and increased promotional spend (funding for discounts and other promotions) [redacted]. Edgewell hoped that this effort would "[redacted]," [redacted].

7. But Harry's continued its competitive advance. In May 2018, Harry's launched at Walmart—again, successfully stealing shelf space and customers from Edgewell and Gillette.

8. Harry's successful launch at Walmart, coupled with Harry's ongoing success at Target, "[redacted]." Bowing to this competitive pressure, Edgewell implemented its own significant [redacted] price decrease, lowering the prices on its razors by as much as [redacted]. Edgewell also [redacted] with a variety of other competitive initiatives [redacted], competing on price and non-price attributes, including creating "[redacted]" razors: [redacted].

9. Head-to-head competition between Harry's and Edgewell further intensified when, in October 2018, Harry's launched its first women's razor under the Flamingo brand. Edgewell preemptively reduced prices on its Hydro Silk women's razors and ran aggressive promotions [redacted] in anticipation of, [redacted], Flamingo's entry into Target. Again, Edgewell's efforts did not stop Harry's, although they may have slowed its momentum. Flamingo has taken significant market share from both Edgewell and Gillette at Target, and Target made room on its shelves for Flamingo at [redacted] expense.

10. Harry's significant entry into brick-and-mortar retail transformed the wet shave razor market from a comfortable duopoly to a competitive battleground. Edgewell, in particular, has found itself fighting the threat that Harry's poses to both its branded products and its private label offerings (i.e., razors manufactured by Edgewell for a retailer partner, to be sold under the retailer's brand). Consumers benefited from the resulting price discounts and the introduction of additional Edgewell branded and private label choices.

11. The Proposed Acquisition is likely to result in significant harm by eliminating competition between important head-to-head competitors. The Proposed Acquisition also will harm competition by removing a particularly disruptive competitor from the marketplace at a time when that competitor is currently expanding into additional retailers.

12. The Proposed Acquisition would significantly increase concentration in relevant markets that are already highly concentrated today. As a result, the Proposed Acquisition is presumptively anticompetitive. Current market share statistics and concentration measures understate Harry's future competitive significance, however, because Harry's continues to expand into additional retailers with its men's and women's products.

13. Both Edgewell and P&G have publicly recognized that the Proposed Acquisition is likely to benefit them rather than consumers. Edgewell's CEO, who spent more than a decade at P&G before coming to Edgewell, recently explained on a quarterly earnings call that Edgewell is "not interested" in escalating price competition once the Proposed Acquisition is complete, or in "lead[ing] a new round . . . of value destruction"—that is, in lowering prices. On a recent quarterly earnings call, P&G's CEO explained that the Proposed Acquisition does not create a significant competitive threat to P&G's Gillette brand; to the contrary, "Edgewell's [sic] going to have to make money. They bought a company. . . . And to me, that's not a bad thing for the overall value-creation opportunities in the industry."

14. Respondents cannot show that the Proposed Acquisition will induce new entry that would be timely, likely, or sufficient to counteract the anticompetitive effects of the Proposed Acquisition. Significant barriers exist for potential new entrants into the manufacture and sale of wet shave razors, including substantial capital investment in a manufacturing facility; significant intellectual property rights and trade secret protections; the time and difficulty of attracting a broad customer base to secure placement on retailer shelves; and the fact that the market gaps in wet shave in brick-and-mortar and online that Harry's successfully exploited have been largely filled. These barriers make entry difficult and unlikely to constrain the merged entity. Nor is the Proposed Acquisition likely to induce the remaining razor manufacturers to expand or reposition to offset the Proposed Acquisition's likely anticompetitive effects.

15. Respondents cannot show cognizable, merger-specific efficiencies that would offset the likely and substantial competitive harm resulting from the Proposed Acquisition.

II. JURISDICTION

16. Respondents are, and at all relevant times have been, engaged in activities in or affecting "commerce" as defined in Section 4 of the FTC Act, 15 U.S.C. § 44, and Section 1 of the Clayton Act, 15 U.S.C. § 12.

17. The Acquisition constitutes a merger subject to Section 7 of the Clayton Act, 15 U.S.C. § 18.

III. RESPONDENTS

18. Edgewell is a consumer products company based in Chesterfield, Missouri, with a diversified portfolio of over 25 established brand names, including multiple razor brands, such as Schick, Intuition, Hydro Silk, Skintimate, Bulldog, American Safety Razor, and Jack Black. Edgewell also offers private label razor manufacturing for retailers and razor companies selling throughout North America, including [redacted]. In 2018, Edgewell's total branded razor sales were approximately [redacted], broken down as follows: men's system razors ([redacted]), women's system razors ([redacted]), and disposable razors ([redacted]). Additionally, Edgewell's total sales in 2018 for its private label business were approximately [redacted], broken down as follows: men's system razors ([redacted]), women's system razors ([redacted]), and disposable razors ([redacted]).

19. Harry's, based in New York, New York, manufactures wet shave system razors and sells them through its DTC platform, online retailers, and brick-and-mortar retailers under the Harry's and Flamingo brands. Harry's total branded razor sales in 2018 were approximately [redacted]. Harry's also manufactures private label system razors [redacted], and has annual private label revenue of approximately [redacted]. In addition to wet shave razors, Harry's sells a variety of other personal care items such as face wash, shave creams, and body wash.

IV. THE ACQUISITION

20. On May 9, 2019, Edgewell and Harry's signed an Agreement and Plan of Merger, pursuant to which Edgewell would acquire Harry's. Total consideration for the Acquisition is approximately $1.37 billion in stock and cash.

V. RELEVANT MARKETS

21. The relevant market in which to evaluate the effects of the Proposed Acquisition is no broader than the manufacture and sale of wet shave system razors and disposable razors ("wet shave razors") sold in the United States.

22. It is also appropriate to analyze the effects of the Proposed Acquisition in narrower relevant markets within the wet shave razor market. The razor industry recognizes several distinct segments within the wet shave razor market. The relevant market may be divided by gender lines into markets of men's and women's products. Additionally, the relevant

market may be separated into markets for system razors and disposable razors. Finally, the relevant market may be divided by channel of sale, resulting in separate markets for brick-and-mortar sales and online sales. Analyzing the Proposed Acquisition in these segments individually would focus attention on specific narrower markets where the harm is most acute—for example, a market for men's system razors sold in brick-and-mortar retailers. Given consumer preferences for particular retailers or retail categories, relevant markets may even be defined as narrowly as a single retailer or a cluster of retailers in which competitive conditions are similar, such as brick-and-mortar retailers where Harry's is currently available.

A. Relevant Product Markets

23. The relevant product market is no broader than the manufacture and sale of wet shave razors, which includes system razors and disposables.

24. System razors consist of a reusable handle and a detachable razor cartridge. Consumers are able to replace the razor cartridge with refill cartridges sold by the same manufacturer without the need to replace the handle.

25. Disposable razors comprise a single assembly of handle with permanently affixed blade(s). Consumers throw away disposable razors once they are finished using them.

26. Other forms of hair removal, such as electric (or "dry") shaving razors and alternative hair removal products (*e.g.*, hair removal creams or waxes) are not close substitutes for wet shave razors. Industry participants and Respondents recognize that wet shave razors are distinct from dry shave razors and alternative hair removal products and sell these products at distinct price points to distinct consumers.

27. Customers would not switch from wet shave razors to dry shave razors or alternative hair removal products in sufficient numbers to defeat a small but significant non-transitory increase in price ("SSNIP") by a hypothetical monopolist of wet shave razors.

28. A relevant product market is the manufacture and sale of wet shave system razors and disposable razors.

29. Industry participants also recognize narrower product markets divided along gender lines (men's versus women's), by product type (system or disposable), and by channel of sale (brick-and-mortar versus online). Industry participants recognize each segment as distinct from others, and conduct their business accordingly.

30. The Proposed Acquisition would produce anticompetitive effects within multiple narrower relevant markets, in addition to producing anticompetitive effects in the broader wet shave razor market. The Proposed Acquisition would harm competition in narrower relevant markets for the sale of: (i) men's wet shave razors; (ii) women's wet shave razors; (iii) system razors (including both men's and women's); (iv) men's system razors; and (v) women's system razors.

31. The Proposed Acquisition would also harm competition in relevant markets for sales through brick-and-mortar retailers of: (i) wet shave razors (including both men's and

women's); (ii) men's wet shave razors; (iii) women's wet shave razors; (iv) system razors (including both men's and women's); (v) men's system razors; and (vi) women's system razors.

32. In each of these narrower relevant markets, a hypothetical monopolist could profitably impose a SSNIP on purchasers of the relevant product.

B. Relevant Geographic Market

33. A relevant geographic market in which to analyze the Proposed Acquisition is the United States. Razor manufacturers negotiate distinct terms of sale with customers for different countries and, in some cases, offer distinct product assortments in different countries. Respondents and other industry participants generally do not make granular or distinctive purchasing decisions for smaller regions within the United States.

34. A hypothetical monopolist of wet shave razors in the United States profitably could impose a SSNIP on U.S. customers. Customers based in the United States cannot defeat a price increase in the United States via arbitrage or substitution.

VI. MARKET PARTICIPANTS

35. Edgewell is the number two manufacturer of wet shave razors and [redacted] the dominant supplier of private label razors in the United States. It manufactures and sells wet shave system and disposable razors for men and women. Edgewell's branded and private label products are available at many brick-and-mortar retailers and, in 2017, Edgewell launched a DTC website through which consumers may now purchase the Hydro Connect razor online directly from Edgewell. Edgewell owns over 25 consumer brands, including popular wet shave brands such as Schick, Intuition, Hydro Silk, Skintimate, Wilkinson Sword, Personna/American Safety Razor, Bulldog, and Jack Black.

36. Harry's launched in March 2013 as an online-only DTC men's system razor subscription service. Harry's does not manufacture or sell disposable razors. Harry's broke into brick-and-mortar retail in 2016 and has steadily expanded its retail distribution of men's wet shave razors since then. After launching exclusively in Target, Harry's expanded into Walmart in 2018 ([redacted]); and then in Hy-Vee, Meijer, Wegmans, and Kroger in 2019. In addition to its men's system razor, Harry's launched a women's system razor under the brand name Flamingo in October 2018. Shortly thereafter, Flamingo launched exclusively at Target. Flamingo is expected to reach additional retailers' shelves in the near future. In addition to its branded men's and women's razors, Harry's also manufactures a private label system razor for [redacted]. Harry's owns and operates its own razor factory, Feintechnik, in Eisfeld, Germany.

37. P&G is the leading manufacturer and seller of branded system and disposable razors for men and women. P&G's razors are available for purchase online and in brick-and-mortar stores. P&G owns over 50 established brand names, including razor brands Gillette Venus, Gillette Fusion, Gillette Mach3, Gillette Skinguard, Joy, Bevel, and the Art of Shaving.

38. Société BiC ("BiC") manufactures and sells primarily disposable razors for men and women. BiC razors are available for purchase online and in brick-and-mortar stores.

39. Dollar Shave Club, Inc. ("Dollar Shave Club"), now owned by Unilever plc/Unilever N.V. ("Unilever"), sells system razors marketed primarily to men using an online, DTC model. Dollar Shave Club does not manufacture or sell disposable razors, and Dollar Shave Club razors are generally not available in brick-and-mortar retail stores. [redacted].

40. Dorco Company Ltd. ("Dorco") is a manufacturer and supplier of disposable and system razors for men and women. [redacted]. Dorco-manufactured products are available at brick-and-mortar stores and online, [redacted].

VII. THE PROPOSED ACQUISITION IS PRESUMPTIVELY ILLEGAL

41. The Proposed Acquisition would lead to significant increases in concentration in already highly concentrated markets for wet shave razors and in narrower relevant markets.

42. Under the 2010 U.S. Department of Justice and Federal Trade Commission Horizontal Merger Guidelines ("Merger Guidelines"), a post-acquisition market concentration level above 2,500 points, as measured by the Herfindahl-Hirschman Index ("HHI"), and an increase in HHI of more than 200 points renders an acquisition presumptively unlawful. Transactions in highly concentrated markets—markets with an HHI above 2,500 points—with an HHI increase of more than 100 points potentially raise significant competitive concerns and warrant scrutiny. The HHI is calculated by totaling the squares of the market shares of every firm in the relevant market pre- and post-acquisition.

43. The market for the manufacture and sale of wet shave razors in the United States is already highly concentrated, with an HHI of over 3,000. The Proposed Acquisition increases the concentration in this market by more than 200 points and is therefore presumptively illegal.

44. All narrower relevant markets are also highly concentrated, and the Proposed Acquisition would cause significant increases in concentration therein. For example, the manufacture and sale of wet shave system razors sold through brick-and-mortar retail in the United States is already highly concentrated, with an HHI of over 5,000. The Proposed Acquisition increases the concentration in this highly concentrated market by more than 350 points, and is therefore presumptively illegal. In the following narrower relevant markets, the Proposed Acquisition increases the HHI by more than 200 points and results in a post-merger HHI of more than 2,500, rendering the Proposed Acquisition presumptively illegal:

a. sale of wet shave razors at brick-and-mortar retailers;

b. sale of system razors;

c. sale of system razors at brick-and-mortar retailers;

d. sale of men's wet shave razors;

e. sale of men's wet shave razors at brick-and-mortar retailers;

f. sale of men's system razors;

g. sale of women's system razors;

h. sale of men's system razors at brick-and-mortar retailers;

i. sale of women's system razors at brick-and-mortar retailers; and

j. a cluster market composed of sales of wet shave razors at retailers where Harry's is currently available.

45. In the following narrower relevant markets, the Proposed Acquisition increases the HHI by more than 100 points and results in a post-merger HHI of more than 2,500, and potentially raises significant competitive concerns and warrants scrutiny:

a. sale of women's wet shave razors; and

b. sale of women's wet shave razors at brick-and-mortar retailers.

46. Changes in HHI based on current market shares understate the competitive significance of the Proposed Acquisition because Harry's continues to expand into additional brick-and-mortar retailers. Recognizing that the Proposed Acquisition will arrest Harry's independent expansion, it is appropriate to analyze Harry's competitive significance by using prior entry events to project future competitive significance. Moreover, current market shares especially understate the competitive significance of Harry's in markets that include sales of women's razors because Harry's Flamingo product launched very recently.

47. [redacted], the timing, scope, and competitive impact of that entry is speculative and likely would not counteract the Proposed Acquisition's competitive harm or presumptive illegality, especially when balanced against a fair projection of Harry's continued growth as a value razor product already established at retail.

VIII. ANTICOMPETITIVE EFFECTS

48. In the relevant market of wet shave razors, and in each narrower relevant market within that market, the Proposed Acquisition is likely to result in unilateral and coordinated competitive effects. The Proposed Acquisition would eliminate substantial head-to-head competition between Edgewell and Harry's, leading to higher prices for consumers—sufficient harm, on its own, to render the merger illegal. In addition, the Proposed Acquisition would also make an already susceptible market more vulnerable to coordination by eliminating a disruptive competitor.

49. P&G and Edgewell have dominated the wet shave razor market for decades, [redacted]. This effective duopoly was good for manufacturers and bad for consumers:

Edgewell secured gross margins as high as [redacted] on its branded razors while Edgewell and Gillette focused their efforts on selling high-priced razors. Prices ratcheted up, [redacted].

50. By the early 2010s, the wet shave razor market was ripe for disruption. Harry's founders recognized that P&G and Edgewell were failing to offer consumers a quality, no-frills system razor at a value price point. In March 2013, Harry's used the Internet to launch a men's system razor that filled this market gap by selling directly to the consumer, avoiding the initial need for distribution through brick-and-mortar retailers. As Harry's website explains: "Our founders, Jeff and Andy, created Harry's because they were tired of overpaying for overdesigned razors, and of standing around waiting for the person in the drugstore to unlock the cases so they could actually buy them. When they asked around, they learned lots of guys were upset about the situation too, so they decided to do something about it." Harry's was not alone in seeing this opportunity: Dollar Shave Club launched its online DTC platform in 2011.

51. Harry's and Dollar Shave Club soon built an online customer base, but this did not stop Edgewell and P&G from continuing their annual price increases in brick-and-mortar retail stores. Edgewell's internal documents demonstrate that [redacted]. As Edgewell's then-CEO explained in an earnings call, "the jury's out" on shave clubs because they would have to "become more than a shave club to really survive."

52. Everything changed in August 2016, when Harry's expanded into brick-and-mortar retail. Harry's made Target the exclusive brick-and-mortar retailer for Harry's [redacted]. [redacted] taking shelf space away from Edgewell's Schick brands, among others.

53. Harry's entry into Target marked the beginning of meaningful head-to-head competition between Harry's and Edgewell. One of Harry's general objectives was to [redacted] and to "[redacted]," and, specifically, to "[redacted]" at Target.

54. Harry's launch at Target was successful. At the time of its launch, Harry's [redacted] retail prices were roughly $10 cheaper than P&G's Gillette and Edgewell's Schick five blade products. This pricing advantage, coupled with prime product placement, enabled Harry's to take share quickly from Edgewell and P&G.

55. Witnessing Harry's successful launch at Target, Edgewell [redacted] began tracking Harry's progress and started to respond competitively. Edgewell's first competitive strategy was to launch extensive promotional programming, such as [redacted]. Nonetheless, Edgewell lost share to Harry's.

56. In February 2017, months after Harry's successful launch at Target, P&G refrained from implementing its yearly price increase. Instead, P&G announced a significant [redacted] price reduction across its portfolio of wet shave razor products.

57. Edgewell decided not to follow the price cuts. Instead, Edgewell held its [redacted] prices steady while launching new products and offering temporary promotional programs. Because of these efforts, [redacted] despite Gillette's reduced prices. These efforts, however, did not prevent Edgewell from continuing to lose share to Harry's.

58. By early 2018, it was clear to an Edgewell senior executive that the industry had experienced "[redacted]," and it was "[redacted]" that Edgewell could count on "[redacted]."

59. In May 2018, Harry's products appeared on Walmart's shelves. Harry's [redacted] to secure distribution, and again took substantial shelf space and sales from Edgewell.

60. As Edgewell's CEO explained to investors, Harry's launch at Walmart represented "the most significant impact" on Edgewell's wet shave business in fiscal year 2018.

61. In the end, the competitive pressure generated by Harry's successful launches at Target and Walmart defeated Edgewell's plan to maintain [redacted] prices. By the end of 2018, Edgewell had reduced its [redacted] prices significantly, by as much as [redacted] on some razors. At the time, Edgewell's then-CEO [redacted] to explain the reason for the price cuts to his board. He wrote: "[redacted]."

62. Not only did the competitive pressure result in price cuts by Edgewell on existing products, it also forced Edgewell to innovate by [redacted]. Edgewell launched [redacted] razors—[redacted]—alone and in partnership with retailers.

63. On the heels of its men's system razor's growing success, Harry's launched a women's system razor under the Flamingo brand in late 2018. This time, Edgewell acted aggressively before Flamingo razors hit brick-and-mortar retail shelves, implementing preemptive price cuts on its women's system razors as part of the 2018 [redacted] price reduction. Edgewell also developed a [redacted] in response to news of Flamingo's impending entry. Despite Edgewell's efforts, Harry's gained at Edgewell's expense: Flamingo established a significant competitive foothold, and took [redacted] shelf space from Edgewell products.

64. This head-to-head competition continues to the present day. Harry's, with its men's and women's products at value price points, continues to be a fierce competitor. Harry's recently expanded its brick-and-mortar footprint again, selling its products in Hy-Vee, Meijer, and Kroger. And Harry's products are likely to expand into additional retailers in the near term regardless of whether Harry's is acquired by Edgewell.

65. The Proposed Acquisition is anticompetitive because it will eliminate the growing competition between Harry's and Edgewell that has been highly beneficial to consumers. As a result of that competition, consumers today enjoy lower prices on many different types of wet shave razors, and they have a broader selection of razors at value price points.

66. Edgewell recognizes the many ways it can benefit at consumers' expense by acquiring Harry's. As Edgewell's CFO put it, the "[redacted]." Edgewell's Vice President [redacted] has discussed how [redacted]: the combined company could offer "[redacted]" Or, Edgewell could simply "[redacted]."

67. In addition to the loss of important head-to-head competition between Harry's and Edgewell, the Proposed Acquisition would eliminate Harry's as a uniquely disruptive competitor that interrupted the P&G/Edgewell duopoly that Harry's founders and Edgewell's leaders variously called a "[redacted]," a "[redacted]," and "[redacted]." Prior to Harry's entry into brick-and-mortar retail, each year Gillette raised [redacted] prices; and each year Edgewell would do the same, [redacted]. Edgewell maintained a "[redacted]" strategy—[redacted], maintaining a consistent discount to the market leader.

68. On one occasion in 2010, Edgewell employees [redacted]. As a result, Edgewell [redacted]. Edgewell management was incensed: "[redacted]." [redacted]. Moreover, Edgewell immediately [redacted]. Executives subsequently noted that they had "'[redacted]."

69. Competitive conditions for the sale of wet shave razors and narrower relevant markets display various features that make a market vulnerable to coordination as identified in the Merger Guidelines. For example, competitors can promptly and confidently observe the competitive initiatives of their rivals. And relatively few customers would switch to the deviating firm before rivals are able to respond, limiting the incentives to deviate from the terms of coordination.

70. As the above demonstrates, the Proposed Acquisition likely would result in both unilateral and coordinated competitive effects in the relevant market of wet shave razors. The anticompetitive effects alleged in paragraphs 48-69 are also illustrative of the type of harm likely to occur in each of the narrower relevant markets as a result of the Proposed Acquisition.

IX. LACK OF COUNTERVAILING FACTORS

71. Respondents cannot show that the Proposed Acquisition will induce new entry or repositioning by existing razor manufacturers that would be timely, likely, or sufficient to counteract the anticompetitive effects of the Proposed Acquisition.

72. In particular, existing competitors for the manufacture and sale of wet shave razors P&G/Gillette, Dollar Shave Club, and BiC are unlikely to reposition in a way that would deter or counteract the anticompetitive effects of the Proposed Acquisition. P&G [redacted] lead yearly price increases before Harry's disrupted the market rather than to compete vigorously on price. [redacted].

73. The market for the manufacture and sale of wet shave razors, and narrower relevant markets within the wet shave category, have high barriers to entry that make timely, sufficient entry unlikely to occur.

74. In order to be a significant competitor, a razor company must be able to manufacture and sell its own blades: in other words, the razor company must build or buy a factory. Building a razor factory is expensive and can take years even with significant resources. Acquiring and running a factory may be even more costly, and few manufacturing facilities exist today.

75. Even having secured a razor factory, an entrant must navigate a thicket of intellectual property rights and trade secret protections to gain the necessary know-how to deploy its manufacturing capacity and equipment effectively. Among other things, it takes significant time, and significant investment, to develop a competitive razor blade.

76. Once the razor manufacturer has a competitive razor blade, the manufacturer must secure distribution and premier product placement at brick-and-mortar retail in order to scale. In order to secure brick-and-mortar distribution with premier shelf space, Harry's spent years establishing its brand online and then used a slow, staged rollout [redacted]. Replicating that process is likely to render entry or repositioning untimely, but failing to replicate that process decreases the likelihood of success.

77. Any aspiring de novo entrant seeking to follow in Harry's footsteps faces a much steeper path to scale than the one that Harry's trod. Harry's identified and exploited a market opportunity in the form of a previously unmet demand for a quality, no-frills system razor at a value price point. Harry's was successful in developing its brand through the then-nascent online market, using the Internet to sell directly to consumers. More importantly, Harry's was the first to place its product in brick-and-mortar, where it exploited a large gap in product offerings to reach a scale that allowed it to disrupt the industry giants. Any new entrant would lack Harry's early-mover advantage in the now-mature DTC space and on the now-crowded shelves of brick-and-mortar retailers. Because the size of the opportunity to be exploited is now smaller, entry is less profitable. In effect, Harry's has plucked the low-hanging fruit online and in stores.

78. Respondents cannot demonstrate cognizable and merger-specific efficiencies that would be sufficient to rebut the presumption and evidence of the Proposed Acquisition's likely anticompetitive effects.

X. VIOLATION

Count I – Illegal Agreement

79. The allegations of Paragraphs 1 through 78 above are incorporated by reference as though fully set forth.

80. The Merger Agreement constitutes an unfair method of competition in violation of Section 5 of the FTC Act, as amended, 15 U.S.C. § 45.

Count II – Illegal Acquisition

81. The allegations of Paragraphs 1 through 80 above are incorporated by reference as though fully set forth.

82. The Merger, if consummated, may substantially lessen competition in the relevant markets in violation of Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18, and is an unfair method of competition in violation of Section 5 of the FTC Act, as amended, 15 U.S.C. § 45.

NOTICE

Notice is hereby given to the Respondents that the thirtieth day of June, 2020, at 10:00 a.m., is hereby fixed as the time, and the Federal Trade Commission offices at 600 Pennsylvania Avenue, N.W., Room 532, Washington, D.C. 20580, as the place, when and where an evidentiary hearing will be had before an Administrative Law Judge of the Federal Trade Commission, on the charges set forth in this complaint, at which time and place you will have the right under the Federal Trade Commission Act and the Clayton Act to appear and show cause why an order should not be entered requiring you to cease and desist from the violations of law charged in the complaint.

You are notified that the opportunity is afforded you to file with the Commission an answer to this complaint on or before the fourteenth (14th) day after service of it upon you. An answer in which the allegations of the complaint are contested shall contain a concise statement of the facts constituting each ground of defense; and specific admission, denial, or explanation of each fact alleged in the complaint or, if you are without knowledge thereof, a statement to that effect. Allegations of the complaint not thus answered shall be deemed to have been admitted. If you elect not to contest the allegations of fact set forth in the complaint, the answer shall consist of a statement that you admit all of the material facts to be true. Such an answer shall constitute a waiver of hearings as to the facts alleged in the complaint and, together with the complaint, will provide a record basis on which the Commission shall issue a final decision containing appropriate findings and conclusions and a final order disposing of the proceeding. In such answer, you may, however, reserve the right to submit proposed findings and conclusions under Rule 3.46 of the Commission's Rules of Practice for Adjudicative Proceedings.

Failure to file an answer within the time above provided shall be deemed to constitute a waiver of your right to appear and to contest the allegations of the complaint and shall authorize the Commission, without further notice to you, to find the facts to be as alleged in the complaint and to enter a final decision containing appropriate findings and conclusions, and a final order disposing of the proceeding.

The Administrative Law Judge shall hold a prehearing scheduling conference not later than ten (10) days after the Respondents file their answers. Unless otherwise directed by the Administrative Law Judge, the scheduling conference and further proceedings will take place at the Federal Trade Commission, 600 Pennsylvania Avenue, N.W., Room 532, Washington, D.C. 20580. Rule 3.21(a) requires a meeting of the parties' counsel as early as practicable before the pre-hearing scheduling conference (but in any event no later than five (5) days after the Respondents file their answers). Rule 3.31(b) obligates counsel for each party, within five (5) days of receiving the Respondents' answers, to make certain initial disclosures without awaiting a discovery request.

NOTICE OF CONTEMPLATED RELIEF

Should the Commission conclude from the record developed in any adjudicative proceedings in this matter that the Merger challenged in this proceeding violates Section 5 of the Federal Trade Commission Act, as amended, and/or Section 7 of the Clayton Act, as amended,

the Commission may order such relief against Respondents as is supported by the record and is necessary and appropriate, including, but not limited to:

1. If the Merger is consummated, divestiture or reconstitution of all associated and necessary assets, in a manner that restores two or more distinct and separate, viable and independent businesses in the relevant markets, with the ability to offer such products and services as Edgewell and Harry's were offering and planning to offer prior to the Merger.

2. A prohibition against any transaction between Edgewell and Harry's that combines their businesses in the relevant markets, except as may be approved by the Commission.

3. A requirement that, for a period of time, Harry's and Edgewell provide prior notice to the Commission of acquisitions, mergers, consolidations, or any other combinations of their businesses in the relevant markets with any other company operating in the relevant markets

4. A requirement to file periodic compliance reports with the Commission.

5. Any other relief appropriate to correct or remedy the anticompetitive effects of the transaction or to restore Harry's as a viable, independent competitor in the relevant markets.

IN WITNESS WHEREOF, the Federal Trade Commission has caused this complaint to be signed by its Secretary and its official seal to be hereto affixed, at Washington, D.C., this second day of February, 2020.

By the Commission.

April J. Tabor
Acting Secretary

SEAL:

NOTES

1. One week after the complaint was filed, the parties terminated the merger agreement and abandoned the transaction. Interestingly, Edgewell's press release noted that Harry's indicated it was willing to pursue litigation.[1] The FTC complaint counsel moved to dismiss its administrative complaint as moot, and the Commission entered an order formally dismissing the case on February 25, 2020.[2]

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

[2] Order Dismissing Complaint, Edgewell Personal Care Co., No. 9390 (F.T.C. Feb. 25, 2020).