

**UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF COLUMBIA**

UNITED STATES OF AMERICA,  
U.S. Department of Justice  
Antitrust Division  
450 Fifth Street, NW, Suite 7100  
Washington, DC 20530,

*Plaintiff,*

v.

Civil Action No. 1:11-cv-00948 (BAH)

H&R BLOCK, INC.  
One H&R Block Way  
Kansas City, MO 64105;

2SS HOLDINGS, INC.  
5925 Dry Creek Lane NE  
Cedar Rapids, IA 52402; and

TA IX L.P.  
John Hancock Tower, 56<sup>th</sup> Floor  
200 Clarendon Street  
Boston, MA 02116,

*Defendants.*

Declaration of Mark E. Zmijewski

September 1, 2011

**REDACTED VERSION  
FOR PUBLIC FILING\***

\*The United States files this non-confidential redacted version pursuant to the Protective Order entered on June 15, 2011.

## **I. Summary**

1. I am the Leon Carroll Marshall Professor of Accounting and Deputy Dean at The University of Chicago Booth School of Business, where I have been a member of the faculty since 1984. As an expert in areas of accounting, economics, and finance as they relate to financial analysis, security analysis, and valuation, I have provided analysis regarding projected merger-related efficiencies since 2003, both on a consulting basis, and as a testifying expert in antitrust litigation. I have performed such analyses on behalf of both government enforcement agencies (“Agencies”) and parties to transactions under review.

2. After analyzing the Defendants’ claimed efficiencies in this matter,<sup>1</sup> I have concluded that, (i) Defendants’ efficiencies claims are not verifiable, with one minor exception;<sup>2</sup> and (ii) in several important respects, Defendants have failed to demonstrate that their claimed efficiencies are merger-specific – that is, have failed to demonstrate that they are likely to be accomplished with the proposed merger and unlikely to be accomplished in the absence of the proposed merger.<sup>3</sup> My conclusions regarding each individual claimed efficiency are summarized in Exhibit I hereto.

## **II. Methodology**

3. The Merger Guidelines state, “Cognizable efficiencies are merger-specific efficiencies that have been verified and do not arise from anticompetitive reductions in output or service.”<sup>4</sup>

The Merger Guidelines further state, “. . . [P]urported efficiency claims based on lower prices

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<sup>1</sup> The claimed efficiencies are presented in Defendant H&R Block, Inc.’s Response to Plaintiff’s First Set of Interrogatories to Defendant H&R Block, Inc., July 20, 2011, Exhibit A.

<sup>2</sup> See discussion of [REDACTED] efficiency, ¶ 20 herein.

<sup>3</sup> See U.S. Department of Justice (“DOJ”) and Federal Trade Commission (“FTC”) *Horizontal Merger Guidelines* (“Merger Guidelines”), Aug. 19, 2010, p. 30.

<sup>4</sup> Merger Guidelines, p. 30.

can be undermined if they rest on reductions in product quality or variety that customers value.”<sup>5</sup>

Finally, the Merger Guidelines note that “efficiency claims will not be considered if they are vague, speculative, or otherwise cannot be verified by reasonable means.”<sup>6</sup>

4. Consistent with the Merger Guidelines and with previous work that I conducted in this area for both Agencies and for companies negotiating with Agencies, I base my opinions on the extent to which the Defendant’s efficiency claims in this matter (“Alleged Efficiencies”) are verifiable by assessing whether or not the Defendants: (1) provided adequate documentation so the Court can understand the underpinning and support for each of the Alleged Efficiencies to the extent it exists; (2) used facts and data (foundation); and (3) used standard, widely accepted and reliable principles, methods, and analyses appropriately to measure the Alleged Efficiencies. As part of this review, I assess whether each of the Alleged Efficiencies “arise from anticompetitive reductions in output or service” or a reduction in product variety. Any such cost savings are not verified. Also, for each of the Alleged Efficiencies, I assess the evidence regarding what alternatives may exist for realizing the Alleged Efficiencies absent the H&R Block (“HRB”) and TaxACT (“TA”) merger (i.e., merger specificity).<sup>7</sup>

### **III. Verification of Defendants’ Alleged Efficiencies**

5. Many of the Defendants’ Alleged Efficiencies relate to transferring HRB activities formerly performed by HRB personnel, or by outside vendors, to TA. Generally, the purported savings on these efficiencies are calculated by summing the HRB costs for these activities and subtracting the estimated TA incremental costs of fulfilling these functions. None of the Alleged Efficiencies include an adjustment for the cost savings that one of the companies could possibly

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<sup>5</sup> Merger Guidelines, p. 31.

<sup>6</sup> Merger Guidelines, p. 30.

<sup>7</sup> Merger Guidelines, p. 30.

achieve without the merger (standalone cost savings). As I explain below, the Alleged Efficiencies that include standalone cost savings are in error, and thus cannot be verified.

6. Regarding the inputs underpinning the calculations of the Alleged Efficiencies, most, but not all, of the HRB estimated costs of these activities are based on accounting and planning documents prepared in the ordinary course of business. As such, these HRB estimates of the gross cost savings (i.e., not net of the incremental TA costs and not excluding the standalone cost savings) are verifiable. That was not what I found for TA, however.

7. Regarding the inputs underpinning the calculations of the Alleged Efficiencies, most of the TA incremental cost estimates contain key cost factors that are not based on facts or analyses but based solely on management assertions that have no analytical underpinnings or factual foundation, and thus cannot be verified. The TA incremental cost estimates are presented in a “Preliminary Integration Cost Analysis,” which was prepared by TA and was utilized by HRB in its efficiency estimates. In the “native format” version of this exhibit, each individual cost estimate is a “hard coded” number that does not link to any support or subordinate calculations, and the Defendants identify no other documentation for these assumptions.<sup>8</sup> Thus, Defendants provide no detail to the TA cost estimates other than what is shown on the one piece of paper in HRB’s Alleged Efficiencies Submission.

8. Regarding this “Preliminary Integration Cost Analysis,” Mr. Lance Dunn, President of 2nd Story Software, discussed how TA estimated the figures for the “develop fountain TY 2011 based on island platform” entry:

Q. . . . Was any mathematical calculation or analysis done to come up with the employees listed in the HR description column?

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<sup>8</sup> HRB-DOJ-60099524.

A. No, that was drawn purely upon the experience of the founders and the executive management team.<sup>9</sup>

9. Mr. Dunn acknowledged that this process applied to all of the figures on this sheet.<sup>10</sup> The process did not involve the types of verifiable analysis that I have seen other merging parties conduct and that I have calculated for other merging parties, such as review of past cost data, budgets, or other documentation showing the parties' past experience with analogous changes to the scope of their operations or similar projects. For example, TA asserts that the addition of hosting of HRB's [REDACTED] platform could be accomplished in-house by TA using two employees,<sup>11</sup> but TA provided no documentation or analytical foundation for this estimate, so it cannot be verified by a third party. Each of the major areas of TA's preliminary integration cost estimate suffers this same lack of verifiability. In describing TA's process for reaching its initial cost estimates, Camela Greif testified that the projection was "thrown together" and "back of the envelope."<sup>12</sup> This lack of analytical foundation makes it impossible for a neutral party to verify its accuracy.

10. Further, the Defendants' Alleged Efficiencies cannot be verified when they rely on unfounded assumptions. As admitted by Defendants, many of the Alleged Efficiencies result from assuming that HRB can transfer activities it now performs to TA, which allegedly has a lower cost structure. When questioned in his deposition about Online IT and Software IT, Mr. Bowen stated in more general terms that large organizations like HRB tend to be less efficient.<sup>13</sup> Clearly, the post-merger company would be even larger than today. To the extent Mr. Bowen's

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<sup>9</sup> Deposition of Lance Dunn, August 8, 2011, p. 31.

<sup>10</sup> Deposition of Lance Dunn, August 8, 2011, p. 29.

<sup>11</sup> See Defendant H& R Block, Inc.'s Response to Plaintiff's First Set of Interrogatories to Defendant H&R Block, Inc., July 20, 2011, Exhibit A, p. 2.

<sup>12</sup> Deposition of Camela Greif, April 5, 2011, pp. 329-332.

<sup>13</sup> Deposition of Tony Bowen, March 14, 2011, pp. 62-63.

statement that large organizations are less efficient is correct, the assumption that the post-merger company would attain TA's cost structure, which is the premise of many of the Alleged Efficiencies, is not reliable. Further, as I discuss below in Section IV, for many of the Alleged Efficiencies, the companies did not first adjust the efficiencies to remove potential standalone cost savings. This shortcoming precludes the verification of the Alleged Efficiencies because Defendants provide no analysis, documents, or other foundation to ascertain the amount of projected cost savings that would remain once the standalone cost savings are removed.

11. In addition to the lack of foundation for TA incremental cost projections, there are other errors in the Defendants' Alleged Efficiency calculations: A) I conclude that the Emerald Card efficiency is calculated using an inappropriate methodology. Specifically, the Parties' calculation compares purported increases in the profit of the merged firm, not decreases in the cost. This calculation thus includes any price differences between the two firms, which is inappropriate for an efficiencies calculation. Note that Defendants claim an efficiency of \$ [REDACTED] per card,<sup>14</sup> even though they claim that TA's cost of prepaid debit cards is only "approximately \$ [REDACTED] per customer."<sup>15</sup> B) HRB provides no foundation for its incremental cost in the Refund Anticipation Check efficiency.<sup>16</sup> C) According to Mr. Dunn, the Software IT efficiency might have been calculated without consideration of TA's producing a Macintosh version of the HRB software.<sup>17</sup> As such, the calculated efficiency might incorporate a reduction in product variety that consumers value. Cost savings from reducing product variety that consumers value are not

<sup>14</sup> Revenue Synergy of \$ [REDACTED] / [REDACTED] TA cards = \$ [REDACTED] claimed efficiency per card.

<sup>15</sup> Response of H&R Block, Inc. to the Request for Additional Information and Documentary Material Issued by the Antitrust Division of the Department of Justice submitted on February 11, 2011 ("Interrogatory Responses (dated February 11, 2011)"), p. 35.

<sup>16</sup> Deposition of Tony Bowen, August 9, 2011, pp. 230-231.

<sup>17</sup> Deposition of Lance Dunn, August 8, 2011, pp. 97-99.

efficiencies. D) Further, Defendants fail to adjust the Alleged Efficiencies for the standalone cost savings that could be attained without the merger, as described further below.

#### IV. Merger Specificity of Defendants' Alleged Efficiencies

12. The report of Dr. Christine Siegwarth Meyer claims that the efficiencies identified by the parties to the proposed merger between HRB and TA “appear to be largely merger-specific in that they could not be realized by either party alone.”<sup>18</sup> As I show below, many of the Alleged Efficiencies may be achieved by the merging parties absent the merger.

13. Regarding its online IT and software IT, HRB plans to merge its [REDACTED] platforms into the [REDACTED] platform of TA.<sup>19</sup> Thus, HRB believes it would be able to achieve cost savings from two sources, (i) [REDACTED], and (ii) by achieving the cost controls that TA has been able to sustain.

Evidence in the record suggests that HRB could [REDACTED] [REDACTED] without the need to merge with TA. Richard Agar, Chief Information Officer at HRB,<sup>20</sup> testified that HRB would not incur any incremental expenses above budget to consolidate [REDACTED].<sup>21</sup> Mr. Agar opined that HRB could likely, on a standalone basis, save about [REDACTED] % of \$ [REDACTED] million to \$ [REDACTED] million from this [REDACTED].

[REDACTED]<sup>22</sup> In his deposition, when Mr. Bowen was asked why HRB hasn't [REDACTED] [REDACTED] he answered, “There's probably not a good reason. I

<sup>18</sup> Expert Report of Dr. Christine Siegwarth Meyer, August 12, 2011, ¶ 88.

<sup>19</sup> Interrogatory Responses (dated February 11, 2011), pp. 27-30.

<sup>20</sup> Deposition of Richard Agar, August 11, 2011, p. 10.

<sup>21</sup> Deposition of Richard Agar, August 11, 2011, pp. 43-44.

<sup>22</sup> Deposition of Richard Agar, August 11, 2011, pp. 39-40.

think we've attempted to several times...”<sup>23</sup>

14. HRB claims that by running its digital tax business as a separate unit out of TA’s current location and with the expertise of TA’s current management, it will be able to achieve TA-like cost controls.<sup>24</sup> However, the record indicates that senior executives have already considered running HRB’s digital business away from HRB’s main operations, which is an alternative method of achieving the cost-conscious “culture” that they hope to achieve through the TA merger.<sup>25</sup>

15. In summary, HRB could potentially consolidate [REDACTED], without merging with TA. Further, Defendants have not demonstrated why the “corporate culture” aspect of the Alleged Efficiencies is merger-specific and cannot be attained, at least in part, by improving HRB’s management on a standalone basis.

16. Regarding its [REDACTED], HRB anticipates merging its [REDACTED] function for online and software customers with that of TA and taking advantage of TA’s lower cost structure.<sup>26</sup> HRB seems to attribute its claimed inability to achieve TA-like cost controls for the company’s [REDACTED] to geographic factors and factors related to the company’s organizational culture.<sup>27</sup> In essence, this represent a “best practices” efficiency that Defendants have not demonstrated is merger-specific, and which might be achievable by moving the [REDACTED] to another location or implementing “best practices” in managing it. To the extent HRB has the ability to move its [REDACTED] and improve HRB’s management, this claimed efficiency includes

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<sup>23</sup> Deposition of Tony Bowen, March 14, 2011, p. 111.

<sup>24</sup> Deposition of Tony Bowen, March 14, 2011, p. 64.

<sup>25</sup> E-mail dated August 19, 2010 from Richard Breeden to Alan Bennett; Bowen Deposition Exhibit 14, March 14, 2011.

<sup>26</sup> Interrogatory Responses (dated February 11, 2011), pp. 30-32.

<sup>27</sup> Deposition of Tony Bowen, March 14, 2011, pp. 153-155.

standalone cost savings.

17. Regarding HRB's [REDACTED] costs, HRB estimates that it will achieve efficiencies from savings in [REDACTED] expenses by ceasing to outsource certain [REDACTED] functions and using TA's in-house capabilities (augmented with new hires). HRB attributes its purported inability to realize these cost savings on its own to HRB's organizational culture.<sup>28</sup> In essence, this represents a "best practices" efficiency that Defendants have not demonstrated is merger-specific. To the extent HRB can move and operate efficiently this function in-house absent the merger, as TA has, this claimed efficiency includes standalone cost savings.

18. Similarly, HRB estimates that it will achieve efficiencies from having TA [REDACTED] [REDACTED] the HRB corporate website instead of paying an outside vendor for that service.<sup>29</sup> To the extent that HRB can move and operate efficiently this function in-house, as TA has, absent the merger, this claimed efficiency is a "best practice" and includes standalone cost savings.

19. Regarding [REDACTED]'s software download fulfillment, HRB estimates that it will achieve efficiencies "by [REDACTED] customers with software download products."<sup>30</sup> This would replace [REDACTED]'s out-sourced vendor. Mr. [REDACTED] testified that, around 2007 or 2008, [REDACTED] had considered bringing the software download function in-house, but opted not to do so at that time.<sup>31</sup> Mr. [REDACTED] did not know the details of that decision and did not provide them.<sup>32</sup> To the extent [REDACTED] can move and operate efficiently this function in-house absent the merger, as [REDACTED] has, this claimed efficiency is a "best practice" and includes standalone cost savings.

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<sup>28</sup> Deposition of Tony Bowen, March 14, 2011, p. 168-169.

<sup>29</sup> Deposition of Tony Bowen, August 9, 2011, p. 196.

<sup>30</sup> Interrogatory Responses (dated February 11, 2011), p. 33.

<sup>31</sup> Deposition of [REDACTED] August 9, 2011, pp. 208-209.

<sup>32</sup> Deposition of [REDACTED] August 9, 2011, pp. 209-210.

20. Regarding royalties paid for [REDACTED] to [REDACTED] the overall cost savings attributable to HRB's providing TA with [REDACTED] may be merger specific.

21. Regarding the Emerald Card efficiency, HRB estimates that it will achieve efficiencies by providing TA customers with prepaid debit cards through HRB's bank.<sup>33</sup> Mr. Bowen testified that the HRB Bank is currently in discussion with customers about potentially offering prepaid debit cards to third parties.<sup>34</sup> This HRB service offering presents an alternative to a merger between the two firms, and possibly a non-merger mechanism for capturing some or all of the Alleged Efficiencies. To the extent that these cost savings can be captured by a third party contract, such as the arrangement that HRB is contemplating with other parties, then this claimed efficiency includes standalone cost savings.

22. Similarly, HRB estimates that it will achieve efficiencies by providing TA customers with refund anticipation checks/refund payment transfers ("RACs") through HRB's bank. As I discuss above, HRB has acknowledged that it is in discussions to offer Emerald Card services to third parties, and a firm consulting to HRB has discussed providing RACs to TurboTax customers.<sup>35</sup> To the extent that these cost savings can be captured by implementing a third party contract, as HRB is contemplating for the Emerald Card (a similar banking product), then this claimed efficiency includes standalone cost savings.



September 1, 2011

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<sup>33</sup> Interrogatory Responses (dated February 11, 2011), p. 34.

<sup>34</sup> Deposition of Tony Bowen, August 9, 2011, pp. 226-227.

<sup>35</sup> HRB-DOJ-00343938.ppt, p. 19.

## Exhibit I

Efficiency	Recurring Amount	Verifiable	Notes on Verifiability	Notes on Merger Specificity
Online IT and Software IT	\$ [REDACTED] and \$ [REDACTED]	N	<b>Efficiency cannot be verified</b> - based on TA management judgment with no underpinning document or analyses and excludes potential standalone efficiencies. Also, possibly no Macintosh version of HRB software reducing quality / volume.	Potential consolidation of [REDACTED] absent merger. Based on "corporate culture," a "best practice."
[REDACTED]	\$ [REDACTED] and \$ [REDACTED]	N	<b>Efficiency cannot be verified</b> - based on TA management judgment with no underpinning document or analyses and includes potential standalone efficiencies.	"Best practices"
[REDACTED]	\$ [REDACTED]	N	<b>Efficiency cannot be verified</b> - see [REDACTED] efficiency above	"Best practices"
Software Download Fulfillment	\$ [REDACTED]	N	<b>Efficiency cannot be verified</b> - see [REDACTED] efficiency above	[REDACTED] has considered bringing this function in house absent the merger. "Best practices."
Emerald Card	\$ [REDACTED]	N	<b>Efficiency cannot be verified</b> - see [REDACTED] efficiency above. Inappropriate methodology (includes potential price differences).	HRB considering offering this service to third parties
Refund Anticipation Checks (RAC)	\$ [REDACTED]	N	<b>Efficiency cannot be verified</b> - based on TA management judgment with no underpinning document or analyses and includes potential standalone efficiencies and no foundation for HRB cost figures.	Possible that HRB may offer RACs to third parties, such as Intuit and TA.
[REDACTED]	\$ [REDACTED]	Y	<b>Efficiency verified</b> - reasonable calculation documents, factual basis and analysis	May be merger specific
HRB Corporate Website	\$ [REDACTED]	N	<b>Efficiency cannot be verified</b> - see [REDACTED] efficiency above	"Best practices"