UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA,

Plaintiff,

v.

H&R BLOCK, INC.;
2SS HOLDINGS, INC.; and
TA IX L.P.,

Defendants.

Civil Action No. 11-00948 (BAH)

PLAINTIFF'S POST-TRIAL MEMORANDUM

REDACTED VERSION FOR PUBLIC FILING*

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

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PRELIMINARY STATEMENT

The trial record confirms what was clear from Defendants' ordinary course business documents before trial and detailed in Plaintiff's preliminary injunction papers: HRB and TaxACT compete aggressively in the market for Digital DIY tax preparation products. PF 27-28. The evidence establishing the nature of the relevant market and the scope of competition is overwhelming. Both Defendants have consistently identified each other as two of the "Big 3" competitors in a distinct digital market, which they routinely track, measure and analyze. PF 27. Indeed, as Defendants analyzed the strategic value of the transaction now before the Court, they measured share in the "digital market," recognized how the acquisition would create barriers to expansion for other competitors in this market, and justified the merger to the investment community as a way of competing against their largest competitor in the digital market. PF 22.

At trial, Defendants' witnesses and expert tried to explain away the multitude of pre-trial admissions demonstrating that they recognize and aggressively compete in a digital market by pointing to general statements about all forms of tax preparation. But these general statements frequently appear in the same documents in which Defendants identify competitors in two distinct markets — assisted and digital — and make clear that competition in each of the markets is having little effect on the other. That fact was confirmed in: Defendants' pre-trial submissions to the Department of Justice, in which HRB admitted that its digital business does not affect its assisted business; the admissions of Defendants' executives that they do not set digital prices on the basis of assisted prices; and in the statement of HRB's former CEO that the "choice of digital versus retail as a tax preparation alternative is not an economic one." PF 43.

Defendants' witnesses tried to wiggle through these admissions and other pre-trial statements to the Department of Justice that tacked back and forth between assertions that there are separate markets for "value" and "premium" products and that there is a single overall tax

preparation market. PF 50. But, not surprisingly, they could not tell a consistent story: the CEO of TaxACT tried to describe separate "value" and "premium" segments (without calling them a market), but he could not identify market shares in either of these segments and finally admitted that his company only tracks shares in the overall digital market. PF 51. And HRB's new CEO acknowledged that just one month ago, during his deposition, he could not answer whether assisted and digital products compete, even though he was asked the question six times. PF 52.

It is, of course, hard to tell a story if it does not make sense. And it simply makes no sense that there is a single market that includes (1) a task (manually completing a tax return) that is not a product produced or sold by anyone, (2) a do-it-yourself software tax preparation product, and (3) face-to-face assistance from a tax professional that costs many times more than the software product. Indeed, it makes no sense, as Defendants' economist claimed, that a 5 or 10 percent increase in the price of a software product with an average of cost of $10 to $40 would cause substantial diversion to an assisted product costing often substantially more than $100. But when her "analysis" of an HRB pricing simulator apparently produced that result, she reported it without question, asserting that the "largest diversion from HRB's TaxCut, in the event of a price increase, is to CPAs and accountants." PF 73. At trial, of course, Dr. Meyer had to admit that there were serious flaws in a simulator that could produce such a result. PF 78.

Tellingly, the person most likely to shed light on the Defendants' various and changing conceptions of digital competition was not called to testify by the Defendants, although he was named on their pre-trial list. Jason Houseworth is the head of the digital business at HRB, but rather than calling Mr. Houseworth, Defendants called their new CEO, who had trouble answering questions about the difference between digital and assisted products at his deposition. Just one month before trial, Mr. Houseworth testified at his deposition that HRB does not view

its assisted business as competing with its digital business, PF 52, and that pen-and-paper was not a constraint on HRB's digital prices, PF 20.

There were other notable omissions in Defendants' witness list. Despite asserting repeatedly that Intuit's marketing was "blurring the lines" between assisted and digital, Defendants did not call anyone from Intuit to testify to Intuit's business strategy or how it views the market. Had Defendants done so, it would have exposed the fact that Intuit (as is clear from their executive's deposition and declaration) does not consider the prices of assisted when setting its digital prices. PF 38. Similarly, despite asserting that the 2009 HRB pricing simulator and the 2011 TaxACT litigation survey supported their sweeping market definition, Defendants failed to proffer any individual who assisted in the creation of those documents or used them in the ordinary course of business — because to do so would have made even clearer that there are fundamental flaws in those materials that render them useless for the purpose of estimating diversion. PF 65. And despite asserting this transaction would result in significant IT savings for HRB through platform consolidation, Defendants did not call HRB's chief technology executive, Richard Agar, to testify about those savings — because his sworn deposition testimony made clear that HRB could achieve those efficiencies absent acquiring TaxACT.

In short, Defendants' trial witnesses could not dispute that when and where it counted — when they were speaking to the public and potential investors, and analyzing this transaction in board meetings — Defendants viewed one another as competitors and analyzed this transaction in terms of how it would impact the Digital DIY market. PF 85. In fact, nowhere in the deal documents was there any discussion of how this acquisition would impact an overall tax preparation market, or how hybrid products are anything other than a disappointment.

Just as there can be no doubt about the relevant product market, there can be no doubt

about the likely anticompetitive effect of this transaction. Plaintiffs' expert, Dr. Frederick Warren-Bolton applied standard analytical tools to show that the transaction will cause significant consumer harm, confirming what is obvious when the low-price, innovative competitor is eliminated in a merger to effective duopoly. And Defendants' documents reflect exactly what is likely to happen. Pre-transaction, HRB priced its digital products below Intuit's. PF 102. Post-transaction, HRB plans to raise its prices to Intuit's level, or even higher. PF 102. Pre-transaction, because of competition from TaxACT, HRB marketed its free product to the point where [redacted] of its digital customers were totally free. PF 54. Post-transaction, HRB plans to promote its free product only with "limited [] exposure." PF 95. Pre-transaction, TaxACT was an industry maverick committed to a product that was consistently high-quality and low-cost and that "overdeliver[ed]" for its customers. PF 113,132. Post-transaction, there will be an effort to "push [TaxACT] users up the price ladder" by requiring them to pay more for features they can get for less from TaxACT today. PF 100. If this transaction is *not* approved, HRB has pledged to "improve its website," "drive more costs out" and "more aggressively market" its free product; all of which would benefit consumers. PF 225. In contrast, HRB candidly assessed the benefits consumers can expect if the transaction *is* approved: "none." PF 102.

ARGUMENT

I. Governing Legal Standard

Section 7 of the Clayton Act prohibits mergers "the effect of [which] *may be* substantially to lessen competition, or to tend to create a monopoly." 15 U.S.C. § 18 (emphasis added). Section 7 is designed to arrest anticompetitive mergers "in their incipiency." *Brown Shoe Co. v. United States*, 370 U.S. 294, 318 n.32 (1962). Thus, the Court must make a "predictive judgment, necessarily probabilistic and judgmental" on the merger's competitive effects. *FTC v.*

H.J. Heinz Co., 246 F.3d 708, 719 (D.C. Cir. 2001).

II. The Relevant Product Market Is Digital DIY Tax Preparation

As with many merger trials, this case "hinges on the proper definition of the relevant product market." *FTC v. Staples, Inc.*, 970 F. Supp. 1066, 1073 (D.D.C. 1997). If, as Plaintiff contends, Digital DIY tax preparation is a relevant product market, the transaction is presumptively unlawful, *Heinz*, 246 F.3d at 715, and Defendants have not come forward with sufficient evidence to rebut that presumption.

Digital DIY tax preparation constitutes a relevant product market if a "hypothetical monopolist [of all Digital DIY products] would profitably impose at least a small but significant and nontransitory price increase (SSNIP)." *Staples*, 970 F. Supp. at 1076 n.8.[1] Products which are similar to those sold by the merging firms — but which would not prevent a hypothetical monopolist from raising prices — are not included in the relevant market. *United States v. Archer-Daniels-Midland Co.*, 866 F.2d 242, 246 (8th Cir. 1988). In addition, products that are not functionally similar to those sold by the merging firms are also excluded from the relevant market. *United States v. Microsoft Corp.*, 253 F.3d 34, 53-54 (D.C. Cir. 2001). The pivotal question then, is whether a price increase in the proposed market would "drive [enough] consumers to an alternate product" to render such a price increase unprofitable. *Whole Foods Mkt.*, 548 F.3d at 1038.

A. Economic Expert Testimony Establishes That Digital DIY Tax Preparation Is A Relevant Product Market

Plaintiff's economic expert — Dr. Frederick Warren-Boulton — found that a hypothetical monopolist of the Digital DIY market would be likely to impose a SSNIP, and that

[1] S*ee also FTC v. Whole Foods Mkt., Inc.*, 548 F.3d 1028, 1038 (D.C. Cir. 2008); *FTC v. CCC Holdings Inc.*, 605 F. Supp. 2d 26, 38 (D.D.C. 2009); *FTC v. Swedish Match*, 131 F. Supp. 2d 151, 160 (D.D.C. 2000).

accordingly Digital DIY is a relevant product market. PF 56-57. This conclusion was not seriously disputed by Defendants' expert, Dr. Meyer, who never conducted her own hypothetical monopolist test — or any other analysis — in defining the relevant product market. PF 58-59. In fact, Dr. Meyer's decision to ignore the hypothetical monopolist test in defining the relevant product market could even justify the Court excluding her report and testimony as to the relevant product market. *See, e.g., Kentucky Speedway LLC v. NASCAR*, 588 F.3d 908, 918-19 (6th Cir. 2009) (failure to perform standard hypothetical monopolist test contributed to finding expert report and testimony "unreliable under *Daubert*"). PF 59.

In contrast to Dr. Warren-Boulton's economic analysis, Dr. Meyer based her opinion primarily on her review of two surveys conducted by third-parties for Defendants. PF 64. Dr. Meyer did not design those surveys and she relied on descriptions of their usefulness from a third party who did not appear at trial to validate or otherwise explain the surveys.[2] PF 65.

Dr. Meyer claims that one of the two surveys — the 2009 pricing simulator — provides her with diversion ratios, which she then uses to make her product market determination. PF 73. Not only is Dr. Meyer's methodology flawed, but the pricing simulator is a wholly unreliable basis for calculating diversion. The simulator fails to mimic real-world conditions — respondents are forced to choose between priced and unpriced tax preparation choices — and produces results that are so obviously flawed as to render those results meaningless. PF 75-80.

TaxACT's 2011 litigation survey is no better. Dr. Meyer initially testified that she relied on the survey because it was relevant to the issue of what would happen in the event of a change in the price of TaxACT's products, but later admitted that the survey does *not* ask respondents what they would likely do in the event of an increase in the price of TaxACT. PF 70. At the

[2] For example, Dr. Meyer admitted she "focused on the slide [of the pricing simulator] that Directions Research thought was the most applicable to reporting diversion ratios to H&R Block." Meyer 9/12/11 P.M. (Public Tr.), at 46:2-4.

same time, Dr. Meyer ignored surveys that *did* ask the relevant questions, including an HRB normal course of business survey that specifically asked what respondents would do if TaxACT charged for its free product. That survey found that the vast majority of respondents would divert to other Digital DIY products. PF 71.

B. The Factual Record Supports The Conclusion That Digital DIY Tax Preparation Is A Relevant Product Market

When determining the relevant product market, courts focus heavily on Defendants' ordinary course of business documents.[3] Here, those documents — including documents such as 10-Ks and presentations to bond rating agencies and potential investors, where Defendants have independent obligations to be truthful — conclusively demonstrate that competition with other Digital DIY firms drive Defendants' pricing decisions, quality improvements, and corporate strategy. PF 22-26, 29-36, 40.

Specifically, TaxACT believes its "major competitors" to be HRB's digital business and TurboTax. PF 28. When TaxACT increased its prices, it kept them below those two "main competitors." PF 31. Moreover, TaxACT's competitive pricing comparisons focused only on other Digital DIY competitors, PF 51, and TaxACT's "2009 Competitive Analysis" explained that competition with HRB digital and TurboTax was driving changes in TaxACT's messaging, product quality, and strategy. PF 35. And this past year, TaxACT believed it failed to increase its market share because of increased advertising by TurboTax and HRB digital. PF 158.

The evidence from HRB documents that Digital DIY is its own product market also is strong. In analyzing this acquisition, HRB examined what its market share would be in the

[3] *See, e.g., Whole Foods Mkt.*, 548 F.3d at 1045 (Tatel, J.) (placing emphasis on how merging firms viewed market in their contemporaneous documents); *Staples*, 970 F. Supp. at 1076; *FTC v. Coca-Cola Co.*, 641 F. Supp. 1128, 1132 (D.D.C. 1986), *vacated mem.*, 829 F.2d 191 (D.C. Cir. 1987) (defining product market based on "the business reality" of "how the market is perceived by those who strive to profit in it"); *Swedish Match*, 131 F. Supp. 2d at 159; *FTC v. Cardinal Health, Inc.*, 12 F. Supp. 2d 34, 46 (D.D.C. 1998).

Digital DIY market; PF 22; and even *after* the acquisition was announced, HRB's head of digital, Mr. Houseworth, still identified TaxACT and TurboTax as HRB digital's "two rivals" (yet another reason why Defendants presumably would not permit him to testify). PF 27. HRB has acknowledged offering a free digital product because of competition from other Digital DIY firms, and admits that it lowered the price of its software product in order to better compete with free online offerings. PF 30, 127-28. HRB regularly tracked the performance and pricing of TurboTax and TaxACT,[4] PF 25, 30, and when assessing key trends and making long range plans for its digital products, HRB focused solely on other digital competitors — in documents that regularly evince concerns about TaxACT as a competitive threat. PF 40, 139.

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

Defendants and Dr. Meyer marshal almost no evidence beyond the 2009 simulator and the 2011 litigation survey to support their candidate product market of all tax preparation.[5] At best, Defendants rely on a smattering of statements that suggest some degree of competition between Digital DIY companies, tax stores, and pen and paper for customers from the universe of taxpayers. Undoubtedly, all forms of tax preparation do compete with one another at some level. But, "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." *Swedish Match*, 131 F. Supp. 2d at 159; *see also United States v. Visa U.S.A., Inc*, 163 F. Supp. 2d 322, 336-38 (S.D.N.Y. 2001) (holding that "although it is literally true that, in a general sense, cash and checks compete with [credit/debit] cards as an option for payment by consumers

[4] "[W]hether a firm tracks, and responds to, other firms' price changes is often taken as an indicator of whether they . . . are in the same market." Carl Shapiro & Joseph Farrell, *Improving Critical Loss Analysis*, Antitrust Source 1, 7 (Feb. 2008).

[5] The existence of a Digital DIY product market and a product market consisting of all forms of tax preparation are not mutually exclusive. *See, e.g.*, Herbert Hovenkamp, *Federal Antitrust Policy* § 3.2c (2d ed. 1999) ("the existence of a relatively large relevant market does not preclude the existence of smaller markets within it.").

and that growth in payments via cards takes share from cash and checks in some instances," the products are still in different markets because "cash and checks do not drive many of the means of competition in the [credit/debit] card market").[6] Indeed, if markets were defined solely based on the fact that two products compete for customers, it would be "hard to conceive of any merger or acquisition [] that would have an anti-competitive effect." *Bon-Ton Stores, Inc. v. May Dept. Stores*, 881 F. Supp. 860, 869 (W.D.N.Y. 1994).

Here, the *Swedish Match* Court's admonition rings especially true. Under Defendants' market definition, HRB could acquire TaxACT *and Intuit* — without that transaction being presumptively anticompetitive under the Merger Guidelines.[7] In fact, under Defendants' candidate market, if those three firms merged, the merged entity would not be able to raise prices, even though it would have more than 90% of the Digital DIY market. PF 86.

1. Assisted Tax Preparation Is Not In The Market

The *pre-litigation* record amply demonstrates that assisted tax preparation is not in the relevant market because substitution to assisted preparation would not defeat a SSNIP by a hypothetical monopolist of Digital DIY products. Currently, there are "significant disparities" in price between Digital DIY and assisted tax preparation products.[8] PF 39. If Defendants' market definition were correct, a 10% increase in the price of Digital DIY products (from the current industry average of $44.13), to $48.54, would send a significant number of customers to assisted

[6] S*ee Merger Guidelines* § 4.1.1 ("The hypothetical monopolist test may identify a group of products as a relevant market even if customers would substitute significantly to products outside that group in response to a price increase.").

[7] Under Defendants' market definition, a combined HRB, Intuit, and TaxACT would result in an HHI for the tax preparation industry of 1499, which would be "unlikely to have adverse competitive effects and ordinarily require no further analysis." *Merger Guidelines* § 5.3.

[8] *See, e.g.*, *Swedish Match*, 131 F. Supp. 2d at 161 n.8 (price differences between moist snuff and loose leaf chewing tobacco supported finding that the two products were not in the same market); *B.A.T. Indus.*, 104 F.T.C. 852, 931-32 (1984) ("a substantially and persistently higher price [for one of two products at issue] . . . . [i]ndicates that a small price change for either product would be unlikely to induce [switching]").

preparation, which on the low-end costs at least $150, and often costs much more. PF 39. There is *no* testimony or reliable business document that would support such a result.

There is, however, testimony from the five largest Digital DIY firms — including both Defendants — that they do not even *consider* the prices charged by assisted preparation providers when setting digital prices. PF 38-39 & n. 6. Courts regularly define product markets to exclude those products that are not considered by industry participants in setting their prices.[9]

Moreover, the switching that does occur between Digital DIY and assisted tax preparation is due primarily to life events and other changes that affect the complexity of an individual's tax returns. PF 16, 42-43, 46. As the former CEO of HRB correctly stated at an investor conference, "the choice between digital and assisted is not an economic one." PF 43.

The fact that movement between digital and assisted tax preparation is predominantly not an economic choice explains why HRB's executives — including two of its former CEOs, and the current head of its digital business — all testified that they did not view their digital business as impacting (or even competing with) their assisted business. PF 16, 40.

Moreover, Dr. Warren-Boulton found that in fiscal years 2005, 2008, and 2009 the relative price of assisted products rose, and the share of assisted tax preparation *also rose*. PF 44.[10] These findings are in accord with HRB's own internal analysis that "online is not pulling incrementally from assisted." PF 45. They are also consistent with the simple fact that over the past decade, while Digital DIY tax preparation has undergone explosive growth, the portion of taxpayers utilizing assisted tax preparation has remained largely unchanged. PF 44.

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[9] *See, e.g., Whole Foods Mkt.*, 548 F.3d at 1040; *Swedish Match*, 131 F. Supp. 2d at 165; *Staples*, 970 F. Supp. at 1079; *Community Publishers, Inc., v. Donrey Corp.*, 892 F. Supp. 1146, 1153-54 (W.D. Ark. 1995); *Coca-Cola Co.*, 641 F. Supp. at 1133.

[10] *See, e.g., Forsyth v. Humana, Inc.*, 114 F.3d 1467, 1477 (9th Cir. 1997) (two products are probably not in the same relevant market "when demand for the commodity of one producer shows no relation to the price for the commodity of another producer"), *aff'd on other grounds*, 525 U.S. 299 (1999).

2. Pen And Paper Is Not In The Market

Defendants ignore the fact that pen-and-paper is not a product. PF 17. While Digital DIY can be replaced by pen-and-paper, "the Supreme Court's interchangeability test refers [only] to *products*." *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) (holding relevant product market to be jarred baby food even though substitution to homemade baby food was possible) (emphasis in original). Thus, Defendants' argument that pen-and-paper belongs in the relevant *product* market must fail as a matter of law.

The record also is devoid of facts that would support including pen-and-paper in the relevant product market. Defendants' sole argument is that Digital DIY firms have been successful at taking customers from pen-and-paper. This hardly suffices. As Judge Tatel's opinion in *Whole Foods* aptly noted:

> [W]hen the automobile was first invented, competing auto manufacturers obviously took customers primarily from companies selling horse 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. 548 F.3d at 1048.

What the relevant facts show is that pen-and-paper is not a constraint on Digital DIY, and would not constrain a SSNIP. PF 20. HRB's head of digital, Mr. Houseworth testified pen-and-paper is not a constraint on digital pricing, PF 20, HRB's former CEO Mr. Ernst stated emphatically that HRB never set its prices in competition with pen-and-paper, PF 20, and Mr. Rhodes of TaxSlayer stated that he does "not believe any of TaxSlayer's customers would switch to pen-and-paper [if TaxSlayer raised its prices a material amount] . . . ." PF 20 n.4.

III. The Transaction Is Likely To Result In Anticompetitive Effects

The proposed acquisition will give HRB and Intuit collectively 90% of the market. PF 86. It will also increase the Herfindahl-Hirschman Index ("HHI"), by approximately 400,

resulting in a post-acquisition HHI of 4,691. PF 86. Merger law presumes anticompetitive effects if the combined entity would have a significant market share in a highly concentrated market and such transactions "must be enjoined in the absence of evidence clearly showing that the merger is not likely to have such anticompetitive effects." *United States v. Phila. Nat'l Bank*, 374 U.S. 321, 363 (1963); *Heinz*, 246 F.3d at 716. This presumption of harm is particularly strong where, as here, the acquisition would result in a market where fewer than three significant rivals remain. *Heinz*, 246 F.3d at 717. Apart from the presumption, the record shows that the proposed transaction is likely to result in anticompetitive unilateral and coordinated effects.

A. Unilateral Effects

A merger is likely to have a unilateral anticompetitive effect if the acquiring firm will have the incentive to raise prices or reduce quality after acquisition, independent of competitive responses from rival firms. *See Swedish Match*, 131 F. Supp. 2d at 169; *Staples*, 970 F. Supp. at 1082-83.[11] Central to the unilateral effects evaluation is the extent of direct competition between the merging parties' products. *Id.* The elimination of head-to-head competition between HRB and TaxACT will, as HRB admits, likely result in HRB raising prices on both the TaxACT and HRB digital products.[12] PF 92-97, 102. Post-acquisition, HRB will also have less incentive to improve the quality of its products — particularly its low-price offerings.[13] PF 107, 141.

1. Head-To-Head Competition Between HRB And TaxACT Benefits Consumers

The record demonstrates extensive direct competition between HRB and TaxACT that

[11] For a unilateral price increase to be profitable, the products at issue need not be the closest substitutes for all consumers. *See* Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶ 914 ("[U]nilateral effects theories do not require that the output of the two merging firms be the closest possible substitutes for one another.").

[12] It may also result in HRB lessening its existing discounts. "The fact that prices might be *lower* than current prices after the merger does not mean that the merger will not have an anticompetitive effect. Consumers would still be hurt if prices after the merger did not fall as far as they would have absent the merger." *Staples*, 970 F. Supp. at 1092 (emphasis added).

[13] Pricing promises also provide no assurances for such concerns about a merger's effect on quality, especially in this market given the innumerable ways in which the merged firm might restrict quality.

would be lost if this transaction is approved.[14] HRB and TaxACT regularly compete to win the same customers. PF 33-34. When TaxACT increased its advertising in select metropolitan areas, its sales in those areas increased compared to areas where it did not advertise. At the same time, HRB's digital sales in those same areas declined compared to areas where TaxACT did not advertise. PF 34. These data results are confirmed by Mr. Houseworth, who feared that if HRB did not acquire TaxACT, TaxACT would continue "to grow and HRB [would continue to] lose[] market share." PF 93. This past year, when TaxACT was introduced at Staples, HRB projected that its retail volume was "at risk," and in fact sold [redacted] fewer units at Staples than in the prior year. PF 135. HRB has even recognized that TaxACT's customer base "seems to match [HRB's customer base] better than they match Turbo's . . . ." PF 33.

Unsurprisingly, the competition between HRB and TaxACT regularly took the form of price competition that benefitted consumers. First, HRB lowered the price of its software product by $20 to better compete with TaxACT's free online product. PF 30. Then, HRB launched its own free online product through its website, to stem its market share loss to TaxACT. PF 128. Recently, HRB increased the functionality of its free online offering, PF 35, heavily marketed its free online product, PF 95, and [redacted]

In June 2010, HRB's Board of Directors received a presentation stating that TaxACT was responsible for the "commoditization of online space," which in turn was exerting downward pressure on digital prices and causing "disruption" in the Digital space. PF 105. Indeed, as HRB has noted, TaxACT's offerings are responsible for a "continued erosion of [HRB's] paid units." PF 107. HRB's competitive concessions to TaxACT have resulted in HRB having more than [redacted]

[14] *Staples*, 970 F. Supp. at 1083 (elimination of "significant head-to-head competition" between merging firms "an important consideration" in evaluating proposed transaction).

million *completely free* digital customers, a [redacted] increase from three years earlier. PF 54. This shift has come at a cost — HRB's digital revenue per customer has dropped from an inflation-adjusted [redacted] in 2008 to [redacted] in FY 2011 — a [redacted] decline. PF 108. Thus, there is a widening gap between HRB and TurboTax's average revenue per customer.[15] PF 54.

Notwithstanding its rhetoric to the contrary, HRB has acknowledged that it plans to achieve price parity, or even charge more than TurboTax after the transaction via a unilateral price increase.[16] PF 102. Dr. Meyer testified that HRB may increase its prices by withdrawing its low-price offerings over concerns that they dilute HRB's brand, and inhibit HRB's ability to charge prices as high as or higher than TurboTax. PF 96.

2. Expert Economic Testimony Confirms A Unilateral Price Increase Is Likely

Dr. Warren-Boulton's analysis also concluded that Digital DIY customers are likely to see substantially higher prices as a result of the proposed acquisition. PF 90. The key factors here are HRB and TaxACT's price-cost margins and the diversion ratio between their products. *Swedish Match*, 131 F. Supp. 2d at 169. "Higher margins and diversion ratios support large price increases." *Id.* PF 88.

Dr. Warren-Boulton analyzed HRB's and TaxACT's businesses, and found just such diversion ratios and margins which, when employed as inputs into a merger simulation, lead him to predict significant unilateral harm to consumers. Specifically, he found, as a result of unilateral effects alone, customers would be forced to pay an extra $16.7 to $24.1 million annually. PF 90. *See Swedish Match*, 131 F. Supp. 2d at 169 (merger enjoined where similar

[15] In contrast, the gap between HRB and TaxACT's average revenue per customer continues to narrow. PF 54.

[16] *See, e.g., FTC v. Univ. Health, Inc.*, 938 F.2d 1206, 1220 n. 27 (11th Cir. 1991) (relying on evidence showing that "appellees, *by their own admissions*, intend[ed] to eliminate competition through the proposed acquisition") (emphasis in original); *Cardinal Health*, 12 F. Supp. 2d at 63-64 (relying on statements of senior executives that merger would curb downward pricing pressure to block proposed transaction).

analysis predicted an annual anticompetitive effect of $24 million). Defendants' expert actually confirmed that Dr. Warren-Bolton's simulation model predicts significant harm. PF 91.

3. The Acquisition Is Likely To Harm Product Quality And Innovation

TaxACT and HRB have been engaged in feature competition for years.[17] PF 26, 35. For example, in mid-2010, HRB focused on improving its website's ease of use, including its login process. In deciding how to improve that process, HRB decided to emulate TaxACT's approach. PF 35. In the most recent tax year, HRB has decided to add audit support to its free tax products in the hopes of better differentiating its free offering from TaxACT's free offering, which itself has added support for all e-fileable forms. PF 131. Similarly, TurboTax added an audit support center, a live community, and "point of need" help to its free product to better compete with the functionality of TaxACT's free product. PF 126.

But the proposed acquisition will end that competition. As Mr. Dunn and Mr. Bennett admitted, if TaxACT were acquired by HRB, HRB would have no incentive to improve the quality of TaxACT's low-price products because the merged entity would want to steer customers to HRB's higher-priced products. PF 94. This is consistent with Dr. Warren-Boulton's finding that once HRB gains control of TaxACT, HRB will be less likely to offer a free product through TaxACT that is as robust as it is today. PF 96, 107.

B. The Acquisition Is Likely To Result In Coordinated Effects

The elimination of TaxACT, one of the "Big 3" Digital DIY firms, PF 27, will facilitate coordination between TurboTax and HRB. *See*, *e.g.*, *CCC Holdings*, 605 F. Supp. 2d at 66 ("it is easier for two firms to collude without being detected than for three to do so"). Indeed, "with

[17] One possible anticompetitive effect from a proposed acquisition is that it may "diminish innovation competition by encouraging the merged firm to curtail its innovative efforts below the level that would prevail in the absence of the merger." *Merger Guidelines* § 6.4.

only two dominant firms left in the market, the incentives to preserve market shares would be even greater, and the costs of price cutting even riskier, as an attempt by either firm to undercut the other may result in a debilitating race to the bottom." *Id.* at 67. The risk of future coordination is heightened here because, by its own admission, TaxACT has been a "maverick," and a "catalyst for change in the tax preparation industry . . . . [that] has consistently forced the tax preparation industry to become more competitive, and in doing so [has] forced [its] competitors to change as well." PF 113.

1. The Digital DIY Market Is Conducive To Coordination

"The combination of a concentrated market and barriers to entry is a recipe for price coordination." *Heinz*, 246 F.3d at 724. Post-acquisition, HRB and Intuit will collectively dominate 90% of the market. PF 86. Even if smaller firms remain on the competitive fringe, "[i]f a few large firms make most of the sales in a market, and if they coordinated their activities, they can raise price without involving all the other (smaller) firms in the market."[18]

Further, the Digital DIY market's structure is ripe for coordination. "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."[19] The record demonstrates that Digital DIY firms can easily collect and verify pricing information, PF 151, and prices are published on the firms' websites and are visible. PF 151. Indeed, HRB and TurboTax presently offer four largely identical SKU's online. PF 150. The ease of tracking price changes is witnessed by HRB recently increasing the price of one SKU after seeing that TurboTax had done the same. PF 147.

[18] Dennis Carlton and Jeffery Perloff, *Modern Industrial Organization* 135 (2005).

[19] *Merger Guidelines* § 7.2; *See also CCC Holdings*, 605 F. Supp. 2d at 62 (noting importance of price transparency to likelihood of coordinated effects);

Other indicia of coordination also are present. Transactions in the market are small and numerous, PF 151, HRB and Intuit have the opportunity to communicate regularly, PF 151, prices can be changed easily, PF 151, products are relatively standardized, PF 151, there are high switching costs,[20] PF 151, and the market is relatively stable, in that HRB and Intuit have been "competing against each other for a decade." PF 22. *CCC Holdings*, 605 F. Supp. 2d at 65-66.[21]

Another important factor in assessing the likelihood of future coordination is whether "firms representing a substantial share in the relevant market appear to have previously engaged in express collusion affecting the relevant market . . . ." *Merger Guidelines* § 7.2.[22] As HRB's former CEO Mr. Ernst testified, after TaxACT launched its free-for-all offer in the FFA, HRB and Intuit joined together to lobby the IRS for strict limitations on the number and kind of taxpayers eligible for free FFA filing. PF 120. While by no means improper, the companies were able to effectuate changes to the FFA requirements. The joint conduct illustrates how TurboTax and HRB's incentives on pricing differ from TaxACT, and demonstrate the danger of removing TaxACT as an independent entity.

In fact, HRB's own business people recognized that buying TaxACT would increase the likelihood of coordination. In examining the transaction, one HRB Director noted that Intuit and HRB would have significant incentives to raise prices. PF 142. Another Director agreed that "there is value in taking control of this 'segment' by not encouraging a race to free, which Intuit would have no interest in doing, and therefore has value to HRB by preventing it through the acquisition." PF 143. Intuit similarly believed that long-term, [redacted]

[20] TaxACT successfully retains more than [redacted] of its new users after one year and more than [redacted] of the users of its products after three years. PF 151.

[21] *See* Richard Posner, *Antitrust Law* 69-79 (2d ed. 2001) (listing indicia that make market conducive to coordination).

[22] *See also Hosp. Corp. of America v. FTC*, 807 F.2d 1381, 1389-90 (7th Cir. 1986) (tradition of cooperation among competing entities indicated market prone to collusion); *Cardinal Health*, 12 F. Supp. 2d at 65.

[redacted]

Notwithstanding all this evidence, Dr. Meyer said that coordinated effects are unlikely because Digital DIY products are differentiated. The fact is, differentiation in the Digital DIY market is primarily based on brand, which hardly makes coordination harder.[23] Indeed, differentiation, in certain instances, may *enhance* the likelihood of coordination. *See CCC Holdings*, 605 F. Supp. 2d at 65 n.42 ("tacit 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)).

2. The Proposed Acquisition Increases The Likelihood Of Coordination Because TaxACT Is A Market Maverick

In the context of antitrust law, a maverick is a particularly aggressive competitor that "plays a disruptive role in the market to the benefit of consumers." *Merger Guidelines* § 2.1.5. Common maverick activity includes aggressively targeting other firms' customers with prices substantially below the norm. *FTC v. Libbey*, 211 F. Supp. 2d 34, 47 (D.D.C. 2002). A transaction that eliminates such a "particularly aggressive competitor" is likely to facilitate coordination and be anticompetitive. *See id.* at 47; Jonathan Baker, *Mavericks, Mergers, and Exclusion: Proving Coordinated Competitive Effects Under the Antitrust Laws*, 77 N.Y.U. L. Rev. 135, 177 (2002).

The record is replete with examples of TaxACT's maverick behavior impacting the Digital DIY industry. When TaxACT became the first participant in the FFA to offer all taxpayers the opportunity to prepare and e-file their tax returns for free, HRB saw the action as "creat[ing] a huge disruption in the paid side of the business" and a "suicide pact." PF 118.

[23] Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶ 942b. *See also Heinz*, 246 F.3d at 716-17 (finding likelihood of coordinated effects in product market differentiated primarily by brand).

After HRB and Intuit banded together to change the FFA rules, TaxACT's free-for-all offer through its website further disrupted the industry, forcing TurboTax and HRB to introduce their own free-for-all products. PF 126-28. TurboTax referred to TaxACT's pricing as "radical" and "unique." PF 126. And after HRB and TurboTax introduced their free offerings, TaxACT upped the ante even further by providing support for all e-fileable forms for its free product. PF 131.

Most 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 TaxACT. PF 133. TaxACT's aggressive offering, with free e-filing of state tax returns, took market share from HRB, with a TaxACT survey finding that 56% of TaxACT's customers had previously used HRB digital products. PF 134-35. Now, with TaxACT planning to introduce its product at a host of additional retailers, including [redacted]

Absent the acquisition, TaxACT will continue as the market maverick because it has a stronger incentive to behave disruptively than HRB and Intuit. Most importantly, TaxACT does not share HRB and Intuit's concern about cannibalizing higher-priced digital products by offering a low-priced, high-quality product. PF 107, 118.

IV. Expansion Will Not Deter The Anticompetitive Effects From This Transaction

A Defendant may rebut the presumption of illegality from a heavily concentrated market by showing that anticompetitive effects are not likely to result because of low barriers to new entry[24] or expansion from existing firms. *Heinz,* 246 F.3d at 715-16. Defendants must show that expansion would be timely, likely, and of sufficient magnitude to deter or counteract the

[24] Defendants made no argument in either their Response brief or at trial regarding likely entry. Accordingly, Plaintiff focuses this argument on the likelihood of expansion. As a matter of law, barriers to expansion by fringe firms are treated in the same manner as new firms entering the market for the first time. *See CCC Holdings,* 605 F. Supp. 2d at 47; *Cardinal Health,* 12 F. Supp. 2d at 54.

competitive effects if TaxACT is acquired by HRB. *Merger Guidelines* § 9.0; *Chi. Bridge & Iron v. FTC*, 534 F.3d 410, 427-29 (5th Cir. 2008); *CCC Holdings*, 605 F. Supp. 2d at 47.

A. Expansion Would Not Be Timely

To be timely, Defendants must show that expansion would be "rapid enough to make unprofitable overall the actions causing those effects." *Merger Guidelines* § 9.1. When expansion would take a period of years, it will not deter anticompetitive activity by the merged entity. *See FTC v. Elders Grain, Inc.*, 868 F.2d 901, 905 (7th Cir. 1989); *Visa U.S.A., Inc*, 163 F. Supp. 2d at 342 (S.D.N.Y. 2001).

HRB itself has determined that expansion is a time-consuming process. HRB executives considered and rejected a proposal to build a new Digital DIY product (internally referred to as a "fighter brand") because it would require about three years to acquire just one million customers. PF 152. And as HRB's CEO Mr. Cobb testified, any planning beyond three years in the industry "just isn't credible."[25] Mr. Bennett also observed that it takes millions of dollars and a lot of time for a small company to develop a strong brand.[26] The lengthy period for expansion is in part because the cost of new customer acquisition has significantly increased since TaxACT's rise to competitive significance. PF 157-58.[27] Thus, fringe participants lack the necessary funds to compete on advertising, and must depend heavily on word-of-mouth referrals, PF 159-60; 163; 166; 168, but "a small customer base can only provide a small amount of word-of-mouth marketing benefit." PF 166. Due to diminishing marginal returns on marketing efforts, this important referral process cannot be effectively replaced simply by increasing advertising

[25] Cobb, 9/19/11 A.M., at 89:9-20.

[26] Bennett, 9/06/11 P.M., at 30:7-10, 63:6-9.

[27] Dr. Meyer has pointed to TaxACT's growth curve as a potential model for TaxHawk and TaxSlayer to expand because they are the same size as TaxACT was in 2003. This assertion is both factually incorrect and irrelevant. In 2003, TaxACT had a market share three times greater than TaxSlayer or TaxHawk. PF 177. Moreover, the Digital DIY market has changed significantly since 2003.

expenditures. PF 163-65.

B. Rapid Expansion Is Unlikely

Defendants must show that expansion is *likely* to happen — that doing so makes economic sense. *Cardinal Health*, 12 F. Supp. 2d at 56; *Merger Guidelines* § 9.2.

As Dr. Warren-Boulton explained at trial, given the high margins that exist in this industry, companies already have sufficient incentive to expand if possible. PF 176. That they have not is indicative of the fact that they *cannot* because of the inherent barriers that currently exist (and would continue to exist post-acquisition) in this industry.

One such barrier is the importance of reputation for expertise and reliability that consumers demand in their tax preparation solution. PF 153-56. *Swedish Match*, 131 F. Supp. 2d at 170-71; *Cardinal Health*, 12 F. Supp. 2d at 57. Taxpayers will not use a Digital DIY product unless they have "confidence that sensitive data is being handled with care and that returns are processed in a secure, error-free and timely manner." PF 153.

In turn, this creates another significant barrier to rapid expansion — the cost of advertising to create such a reputation. PF 157. TaxSlayer and TaxHawk — Defendants' prime candidates for expansion — spent a combined [redacted] on advertising in tax year 2009. PF 179, 186. By contrast, the "big 3" firms spent [redacted] PF 159. As HRB found, in today's Digital DIY market, even "high levels of marketing, lower prices and an aggressive free message" do not result in "guaranteed market share."[28] PF 164. This means the fringe competitors that have not yet broken through are at a significant disadvantage. PF 163. Thus, it is hardly surprising that HRB found that two dominant players investing heavily in marketing would "create a barrier to enter the category." PF 158. High levels of marketing

[28] [redacted]

expenditure by large incumbents create and maintain a barrier to expansion by smaller competitors who would need to increase their own spending simply "to maintain share." PF 158.

Beyond these barriers lies the fact that the Digital DIY market is rapidly maturing. By Defendants' own account, the pool of consumers switching from pen-and-paper to Digital DIY solutions may be exhausted as a source of meaningful growth within two years. PF 174. As this pool shrinks, successful expansion depends on winning existing customers away from competing Digital DIY firms — which is a difficult way to grow due to the strong tendency of consumers to stick with their existing Digital DIY solution.[29] PF 175.

C. Expansion Would Not Be Sufficient To Deter Anticompetitive Effects

Defendants bear the burden of demonstrating expansion sufficient to "fill the competitive void that would result if the [defendant] is permitted to acquire [the target company]."). *Swedish Match*, 131 F. Supp. 2d at 169. Expansion must allow for the firm to compete "on the same playing field" as the merged entity. *Chi. Bridge & Iron*, 534 F.3d at 430. This means that the expansion would be sufficient, post-acquisition, to constrain the pricing of the dominant firms. *CCC Holdings*, 605 F. Supp. 2d at 59; *Cardinal Health*, 12 F. Supp. 2d at 58.

Neither TaxHawk nor TaxSlayer is capable of replacing TaxACT's competitive significance in the Digital DIY market. TaxSlayer and TaxHawk simply are not in the same league as the "Big 3." Last year, TaxSlayer [redacted] its advertising expenditures (to an amount that is still [redacted] TaxACT's advertising spend) and was only able to *maintain* its existing market share. PF 179. TaxSlayer expressly attributes its failure to gain share to its inability to keep up with the advertising spending of HRB, Intuit, and TaxACT. PF 179.

[29] *See, e.g.*, *United States v. Franklin Elec. Co.*, 130 F. Supp. 2d 1025, 1031-32 (W.D. Wis. 2000) (consumer unwillingness to switch from established manufacturers made entry unlikely); *Coca-Cola Co.*, 641 F. Supp. at 1137 (barriers to entry and expansion in soft drink market are high based, in part, on difficulty overcoming existing customer preferences).

TaxHawk also is unlikely to become a competitive constraint. After ten years of offering a Digital DIY product, the company had only [redacted] in revenues last year. PF 184. TaxHawk also has chosen to limit the utility of its product to broad swaths of the taxpaying public. TaxHawk offers no support for the more than *26 million* people who live in either cities with local income taxes (like New York and Detroit), or states such as Tennessee, or New Hampshire. TaxHawk also does not support many federal tax forms. PF 185. To offer the full complement of forms would take TaxHawk — by its own accounts — more than ten years and require a change in the company's "lifestyle" culture that it is not willing to make. PF 185.

While Defendants' expert testified that Intuit and HRB would avoid anticompetitive price increases merely because of the *threat* that TaxHawk and TaxSlayer could expand,[30] the record is to the contrary. For example, HRB's Mr. Houseworth testified in his deposition that HRB *never* considers the prices of its smaller competitors like TaxHawk and TaxSlayer in setting its own prices. PF 178. This is not surprising. Without substantial growth in share, TaxSlayer and TaxHawk are simply too small to be a meaningful constraint. *CCC Holdings*, 605 F. Supp. 2d at 58 (size of competitors compared to merging firms is a key factor in expansion analysis).

V. Defendants' Claimed Efficiencies Will Not Overcome The Harm To Competition

To overcome harm to competition in a highly-concentrated market, Defendants' efficiencies must be "extraordinary" and withstand "rigorous analysis." *Heinz*, 246 F.3d at 720-22. Here, Defendants' claimed efficiencies fail the basic threshold tests of being merger-specific, verifiable, and likely to result in pro-consumer benefits (*i.e.*, to be "passed through" to consumers). *See Merger Guidelines* § 10.0; *Heinz*, 247 F.3d at 720-22.

A. Defendants' Claims Are Not Merger-Specific

Defendants' largest claimed efficiencies are IT-related. Yet Mr. Bowen, HRB's

[30] Meyer, 9/12/11 P.M., at 15:16-20.

efficiencies witness, was unaware of the details surrounding HRB's *existing* plans to consolidate its IT platforms — and hence did not consider the millions in stand-alone cost savings that HRB could achieve simply by executing those plans. PF 207-08. Similarly, for its call center projections, HRB admits that it could move those centers or improve the operations to obtain lower labor costs, but still included these non-merger-specific savings in its claims. PF 210. As revealed at trial, for the vast bulk of Defendants' efficiencies claims, there simply is no evidence that HRB ever attempted to ascertain whether any part of those efficiencies could be achieved absent the transaction, and if so to what degree.[31] Given the parties' lack of analysis, it would be guesswork for the Court to assign a particular dollar value to the synergies as "merger-specific." *Univ. Health*, 938 F.2d at 1223 (Defendants bear the burden of proof on efficiencies).

In addition, HRB's projected improvements to its management "culture" are not cognizable or merger-specific. HRB plans to hand over to TaxACT control of its digital business, with the hope of achieving better results from TaxACT's (1) more seasoned, capable managers; (2) geographic separation from HRB's headquarters and big-firm traits; (3) consistent business strategies; and (4) culture of cost control. PF 221. Yet even assuming that HRB can achieve all these benefits — an assumption that would be unfounded in light of HRB's previous failures in achieving efficiencies from acquisitions[32] — the record shows that HRB can, and should, do these things on its own. Indeed, in the absence of this transaction, HRB's CEO admitted as much when he specifically proposed the physical separation of Digital, hiring a manager "of stature", and a focus on "driv[ing] costs out." PF 222-23.

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[31] For example, as a non-IT expert, Bowen was unfamiliar with studies the company had conducted regarding in-sourcing of its [redacted] function. PF 209. The company did not even consider the possibility of bringing its [redacted] people in-house, [redacted] to save costs. PF 211.

[32] In the RedGear transaction, HRB projected $[redacted] million in synergies over 3 years that were not achieved. Here, HRB projects $[redacted] million over six years. PF 203.

B. Defendants' Claims Are Not Verifiable

Even if merger specific, the cost projections Defendants base their efficiencies on are unverified. Although Mr. Dunn claimed that it took "hundreds of hours over a month" to develop the projections, Ms. Greif, who also participated in the process, described it as "rough," "back of the envelope," and resulting in some numbers being "thrown together" on a spreadsheet. PF 215. Also, a standard cost analysis comparing TaxACT's past changes in scope of operations with associated changes in cost structure, was not performed — precluding a determination of how much more efficient TaxACT becomes with increases in scope. PF 217, 219. Without either (1) a reproducible methodology, or (2) evidence linking TaxACT's plans to its actual cost experience, the projections are mere "speculation and promises about post-merger behavior" that should receive no credit. *Heinz,* 246 F.3d at 721.

C. Defendants Have Failed To Demonstrate Pass-Through Of Efficiencies

Though the crux of an efficiencies defense is that benefits will be passed through to consumers in sufficient degree to overcome competitive harm, *Heinz,* 246 F.3d at 720, Defendants have barely addressed the issue. Dr. Meyer conducted no independent estimate on pass-through, and Mr. Bowen's counsel did not ask him one question on the topic. Indeed, the entire record, points the other way: (1) HRB has no intention of cutting its prices in the event of merger, PF 102, PF 235; (2) HRB plans to market its free product more aggressively if the acquisition is not approved, than if it is, PF 95; (3) the bulk of the projected savings relate to fixed costs, and thus are unlikely to affect consumer welfare because they are irrelevant to price or output decisions, PF 232; and (4) the financial model that HRB's Board voted on showed the synergies going to shareholders as higher profits, not to consumers as lower prices. PF 234.

CONCLUSION

For the foregoing reasons as well as those set forth in Plaintiff's preliminary injunction papers and established at trial, the United States respectfully requests that this Court enjoin HRB from consummating its acquisition of TaxACT.

Dated this 28th day of September 2011.

Respectfully Submitted,

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