ANTITRUST LAW

Unit 10: Market Definition

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Introduction

INTRODUCTION TO MARKET DEFINITION

By its terms, Section 7 of the Clayton Act requires that the requisite anticompetitive effect be located in some "line of commerce" and in some "section of the country."[1] A properly defined market for antitrust purposes is a called a *relevant market* and, as the language of Section 7 suggests, it has two dimensions: a *relevant product market* ("line of commerce") and a *relevant geographic market* (a "section of the country"). The Supreme Court has held that Section 7's language makes proof of the product and geographic boundaries of the relevant market in which the anticompetitive effect is allegedly likely to occur an essential element of the plaintiff's prima facie Section 7 case.[2] As we will see, the outcomes of merger antitrust cases turn on market definition more than any other factor.

There has been some movement at the Antitrust Division and the Federal Trade Commission, especially in connection with the drafting of the 2010 revisions to the Horizontal Merger Guidelines, to allow the requisite anticompetitive effect to be proved directly without the need to formally define markets. We have already seen the court moving in this direction in Sherman Act § 1 cases, especially when the "quick look" is used in evaluating unreasonableness. No doubt that direct proof of likely anticompetitive effect will be increasingly emphasized in merger antitrust cases, but it is unlikely that the courts will eliminate market definition as an essential element of a prima facie Section 7 case anytime soon.

Although "line of commerce" and "section of the country" are not part of the statutory language of either the Sherman Act or the FTC Act, because courts and the Commission today will apply a Section 7-style analysis regardless of which statute technically is invoked, the delineation of the relevant market is an element of the prima facie offense when mergers and acquisitions are prosecuted under any of these provisions.[3] Perhaps even more significantly, because the notion of market power—

1. 15 U.S.C. § 18.

2. *See, e.g.*, Brown Shoe Co. v. United States, 370 U.S. 294, 324 (1962); *accord* United States v. Marine Bancorporation, Inc., 418 U.S. 602, 618 (1974) ("Determination of the relevant product and geographic markets is 'a necessary predicate' to deciding whether a merger contravenes the Clayton Act."); *see also* United States v. E. I. Du Pont de Nemours & Co., 353 U.S. 586, 593 (1957) (defining relevant market is "necessary predicate" to finding Section 7 violation because question of whether transaction has "substantial" effect on competition can be answered only in context of affected market); FTC v. Freeman Hosp., 69 F.3d 260, 268 n.12 (8th Cir. 1995) ("Without a well-defined relevant market, a particular transaction's effect on competition cannot be evaluated. . . . It is therefore essential that the FTC identify a credible relevant market before a preliminary injunction may issue.").

3. *See, e.g.*, *In re* Weyerhaeuser Co., 106 F.T.C. 172, 265 n.2, 1985 WL 668940 (1985) (FTC Act to be considered in pari materia with Section 7 when applied to mergers and acquisitions). Moreover, merger challenges under Section 1 of the Sherman Act are subject to the rule of reason, which usually requires the showing of a relevant market. A prima facie case of monopolization or

which is typically proved through evidence of high market share in a properly defined relevant market—is the same across all areas of antitrust law, courts and the enforcement agencies use the same techniques and cite the same cases for defining relevant markets whether they are considering a rule of reason case under Section 1 of the Sherman Act, a monopolization or attempted monopolization case under Section 2 of the Sherman Act, or a merger case under Section 7 of the Clayton Act.

The determination of the boundaries of the relevant market is a question of fact.[4] The plaintiff bears the burden of proof on market definition.[5] In the wake of the Supreme Court's decision in *Bell Atlantic Corp. v. Twombly*,[6] since market definition is an essential element of a Section 7 *prima facie* case, the complaint must contain sufficient factual allegations to make the alleged market definition plausible under the market definitions standards in the case law. The plaintiff's failure to adequately

attempted monopolization under Section 2 of the Sherman Act also generally requires the showing of a relevant market. The standards for determining market definition applied in Sherman Act and FTC Act cases are the same as those for Clayton Act cases. *See* United States v. Engelhard Corp., 970 F. Supp. 1463, 1466 n.6 (M.D. Ga. 1997) (citing United States v. Grinnell Corp., 384 U.S. 563, 573 (1966)).

4. *See, e.g.*, FTC v. Lundbeck, Inc., 650 F.3d 1236, 1239 (8th Cir. 2011); United States v. Engelhard Corp., 126 F.3d 1302, 1305 (11th Cir. 1997); H.J., Inc. v. International Tel. & Tel. Corp., 867 F.2d 1531, 1537 (8th Cir. 1989) (Sherman Act); Syufy Enters. v. American Multicinema, Inc., 793 F.2d 990, 994 (9th Cir. 1986); Kaiser Aluminum & Chem. Corp. v. FTC, 652 F.2d 1324, 1329 (7th Cir. 1981); Columbia Metal Culvert Co. v. Kaiser Aluminum & Chem. Corp., 579 F.2d 20, 28 (3d Cir. 1978) (Sherman Act); FTC v. Lundbeck, Inc., 2010 WL 3810015, at 19 (D. Minn.2010).

5. *See, e.g.*, United States v. Connecticut Nat'l Bank, 418 U.S. 656, 669 (1974);); FTC v. Lundbeck, Inc., 650 F.3d 1236, 1239 (8th Cir. 2011); United States v. Baker Hughes Inc., 908 F.2d 981, 982-83 (D.C. Cir. 1990); H.J., Inc. v. International Tel. & Tel. Corp., 867 F.2d 1531, 1537 (8th Cir. 1989) (Sherman Act); Gough v. Rossmoor Corp., 585 F.2d 381, 389 (9th Cir. 1978) (Sherman Act); Malaney v. UAL Corp., 2010 WL 3790296, at *5 (N.D. Cal. 2010) (not for publication), *aff'd*, 434 F. App'x 620 (9th Cir. 2011) (unpublished); FTC v. Lundbeck, Inc., 2010 WL 3810015, at *19 (D. Minn. 2010); Golden Gate Pharmacy Servs., Inc. v. Pfizer, Inc., 2009 WL 3320272, at *1-2 (N.D. Cal. 2009); United States v. Oracle Corp., 331 F. Supp. 2d 1098, 1158 (N.D. Cal. 2004); FTC v. Arch Coal, Inc., 329 F. Supp. 2d 109, 119 (D.D.C. 2004); United States v. Dairy Farmers of Am., Inc., 2004 WL 2186215 (E.D. Ky. 2004); United States v. Sungard Data Sys., Inc., 172 F. Supp. 2d 172, 181 (D.D.C. 2001); United States v. Engelhard Corp., 970 F. Supp. 1463 (M.D. Ga. 1997); Pennsylvania. v. Russell Stover Candies, Inc., 1993-1 Trade Cas. (CCH) ¶ 70,224, at 70,090, 1993 WL 145264 (E.D. Pa. 1993) (dismissing motion for preliminary injunction for plaintiff's failure of proof on relevant product market); United States v. Country Lake Foods, Inc., 754 F. Supp. 669, 675 (D. Minn. 1990); FTC v. R.R. Donnelley & Sons Co., 120 F.T.C. 36, 152 (D.D.C. 1990); Carter Hawley Hale Stores, Inc. v. Limited, Inc., 587 F. Supp. 246, 250 (C.D. Cal. 1984). Some pre-*Twombly* cases have held that Rule 8 of the Federal Rules of Civil Procedure does not require a plaintiff to define specifically the boundaries of its purported relevant markets and that questions of market definition can be narrowed and determined through the discovery process. *See, e.g.*, Frito-Lay, Inc. v. Bachman Co., 659 F. Supp. 1129, 1137 (S.D.N.Y. 1986); Minpeco, S.A. v. ContiCommodity Servs., Inc., 552 F. Supp. 327, 331 (S.D.N.Y. 1982).

6. Bell Atlantic Corp. v. Twombly, 550 U.S. 544 (2007); *see* Ashcroft v. Iqbal, 556 U.S. 662 (2009).

plead market definition in a complaint will result in the complaint's dismissal,[7] although many valid motions to dismiss are simply not brought because the market definition could be easily repleaded to make it adequate. Similarly, in a proceeding on the merits, the plaintiff's failure to carry its burden of proof on market definition will result in dismissal of its Section 7 claim.[8] On appeal, a finding of market definition is reviewed under the "clearly erroneous" standard,[9] or, in the event of an FTC adjudicative determination, the substantial evidence rule.[10]

Beyond being a legal requirement, determining the boundaries of the relevant market can be an essential step in applying the economic tools typically used to determine the likely competitive effect of the transaction.[11] The economic role of

7. *See, e.g.*, City of New York v. Group Health Inc., 649 F.3d 151, 155-56 (2d Cir. 2011) (affirming dismissal of complaint where the plaintiff defined the relevant market in terms of its preferences and not according to reasonable interchangeability and cross-elasticity of demand); Shred-It America, Inc. v. MacNaughton, CV No. 10-00547 DAE-KSC, 2011 WL 1842997, at *3, *5-6 (D. Haw. May 13, 2011) (dismissing complaint for pleading relevant product market only in conclusory terms); Golden Gate Pharmacy Servs., Inc. v. Pfizer, Inc., 2010 WL 1541257 (N.D. Cal. 2010) (dismissing complaint after granting two opportunities to amend to correct deficiencies in alleging relevant market), *aff'd*, No. 10-15978, 2011 WL 1898150 (9th Cir. May 19, 2011) (not for publication); Korkala v. Allpro Imaging, Inc., 2009 WL 2496506, at *7 (D.N.J. 2009) (not for publication) (complaint dismissed for failure to plead sufficient facts to properly define relevant product market); Cupp v. Alberto-Culver USA, Inc., 310 F. Supp. 2d 963, 975 (W.D. Tenn. 2004) (dismissing complaint for failure to plead sufficient facts to properly define relevant geographic market). This is consistent with the rule in nonmerger cases where market definition is an element of the prima facie case. *See, e.g.*, Chapman v. New York State Div. for Youth, 546 F.3d 230, 237 (2d Cir. 2008); Apani Southwest, Inc. v. Coca-Cola Enterprises, Inc., 300 F.3d 620, 628 (5th Cir. 2002); Todd v. Exxon Corp., 275 F.3d 191, 199-200 (2d Cir. 2001); Tanaka v. University of Southern California, 252 F.3d 1059, 1063-64 (9th Cir. 2001); Hack v. President and Fellows of Yale College, 237 F.3d 81 (2d Cir. 2000); Queen City Pizza, Inc. v. Domino's Pizza, Inc., 124 F.3d 430, 436 (3d Cir. 1997).

8. *See, e.g.*, FTC v. Laboratory Corp. of Am., 2011 WL 3100372, at *21 (C.D. Cal. 2011) (preliminary injunction denied for failure of the plaintiff to discharge its burden on product market definition). FTC v. Freeman Hosp., 911 F. Supp. 1213, 1227 (W.D. Mo. 1995) (preliminary injunction denied for failure of the plaintiff to discharge its burden on geographic market definition).

9. *See, e.g.*, United States v. Engelhard Corp., 126 F.3d 1302, 1305 (11th Cir. 1997); FTC v. Freeman Hosp., 69 F.3d 260, 267 (8th Cir. 1995); United States v. Rockford Mem'l Corp., 898 F.2d 1278, 1285 (7th Cir. 1990); United States v. Central State Bank, 817 F.2d 22, 24 (6th Cir. 1987) (per curiam); Westman Comm'n Co. v. Hobart Int'l, Inc., 796 F.2d 1216, 1220 (10th Cir. 1986); White and White, Inc. v. American Hosp. Supply Corp., 723 F.2d 495, 499-500 (6th Cir. 1983) (Sherman Act).

10. *See, e.g.*, Olin Corp. v. FTC, 986 F.2d 1295, 1297 (9th Cir. 1993); Hospital Corp. of Am. v. FTC, 807 F.2d 1381, 1384-85 (7th Cir. 1986); Kaiser Aluminum & Chem. Corp. v. FTC, 652 F.2d 1324, 1329 (7th Cir. 1981). *Cf.* FTC v. Indiana Federation of Dentists, 476 U.S. 447, 454 (1986).

11. *See* FTC v. Freeman Hosp., 69 F.3d 260, 268 (8th Cir. 1995) ("Without a well-defined market, an examination of a transaction's competitive effect is without context or meaning"); United States v. Engelhard Corp., 970 F. Supp. 1463, 1466 (M.D. Ga. 1997) ("If the market is incorrectly defined, the market shares would have no meaning."), *aff'd*, 126 F.3d 1302 (11th Cir. 1997).

market definition is to identify the firm or firms that, through unilateral conduct or coordinated interaction, can exercise market power.[12] Notwithstanding the clear indication in the cases that the product and geographic markets are distinct in concept and can be determined sequentially, when used as an economic tool the product and geographic dimensions of the market should be determined simultaneously.[13]

Since merger antitrust law is forward-looking—that is, it makes unlawful mergers and acquisitions that are likely to lessen competition substantially in the future as compared to what competitive conditions would have been in the future absent the transaction—market definition equally must be forward-looking. Product market definition, for example, should take into account new products that shortly will be released or old products that will soon be obsolete. Likewise, geographic market definition should take into account the construction of new facilities, changing transportation modes or patterns, or new methods of purchasing or distribution.[14]

Despite the central role of market definition in merger antitrust analysis, courts have recognized that markets cannot be defined with scientific precision and that by its very nature, market definition is an imprecise task.[15] Courts often state that "actual market realities" must guide market definition,[16] although all too often this observation substitutes for more rigorous analysis.

12. *See, e.g.*, H.J., Inc. v. International Tel. & Tel. Corp., 867 F.2d 1531, 1537 (8th Cir. 1989) (Sherman Act § 2); United States v. H&R Block, Inc., 833 F. Supp. 2d 36, 50 (D.D.C. 2011); United States v. Oracle Corp., 331 F. Supp. 2d 1098 (N.D. Cal. 2004); FTC v. Swedish Match, 131 F. Supp. 2d 151, 156 (D.D.C. 2000); FTC v. Cardinal Health, Inc., 12 F. Supp. 2d 34, 45 (D.D.C. 1998) ("Defining the relevant market is critical in an antitrust case because the legality of the proposed mergers in question almost always depends upon the market power of the parties involved."); FTC v. Butterworth Health Corp., 946 F. Supp. 1285, 1289-90 (W.D. Mich. 1996); Community Publishers, Inc. v. Donrey Corp., 892 F. Supp. 1146, 1166-63 (W.D. Ark. 1995); *In re* Weyerhaeuser Co., 106 F.T.C. 172, 274 (1985); 2010 DOJ/FTC HORIZONTAL MERGER GUIDELINES § 4.

13. *See, e.g.*, Town of Massena v. Niagara Mohawk Power Corp., 1980-2 Trade Cas. (CCH) ¶ 63,526, at 76,796, 1980 WL 1889 (N.D. N.Y. 1980); 2010 DOJ/FTC HORIZONTAL MERGER GUIDELINES § 4.

14. *See, e.g.*, United States v. Mercy Health Servs., 902 F. Supp. 968, 97880 (N.D. Iowa 1995).

15. *See, e.g.*, United States v. Connecticut Nat'l Bank, 418 U.S. 656, 669 (1974) (geographic markets "need not—indeed cannot—be defined with scientific precision"); United States v. Pabst Brewing Co., 384 U.S. 546, 549 (1966) (geographic markets not required to be defined by "metes and bounds"); United States v. Continental Can Co., 378 U.S. 441, 449 (1964) (in defining markets, legal "guidelines offer no precise formula for judgment and they necessitate, rather than avoid, careful consideration based on the entire record"); United States v. Philadelphia Nat'l Bank, 374 U.S. 321, 360 n.37 (1963) (element of "fuzziness would seem inherent in any attempt to delineate the relevant geographic market").

16. *See, e.g.*, FTC v. Tenet Health Care Corp., 186 F.3d 1045, 1052 (8th Cir. 1999) (relevant market can only be determined after a "factual inquiry into the commercial realities faced by consumers"); General Indus. Corp. v. Hartz Mountain Corp., 810 F.2d 795, 805 (8th Cir. 1987) ("the reality of the marketplace must serve as the lodestar" in defining markets) (Sherman Act § 2); Monfort of Colorado, Inc. v. Cargill, Inc., 761 F.2d 570, 579 (10th Cir. 1985) ("Market definition is by its nature an imprecise task."); Bon-Ton Stores, Inc. v. May Dep't Stores Co., 881 F. Supp. 860,

Relevant product markets

Market definition usually begins by considering the dimensions of the relevant "line of commerce" or *product market.*[17] A relevant product market defines the product boundaries within which competition meaningfully exists.[18] Although the convention is to use the term "product" in discussing the line of commerce requirement, a line of commerce equally may be a service or group of services. The same analysis applies to defining markets for services as to defining markets for products.[19] The judicial approach to product market analysis takes its point of departure from the Supreme Court's decision in *Brown Shoe Co. v. United States*,[20] which identified a variety of factors to be considered but said very little about how to consider them. The result was enormous confusion and inconsistency in the courts. Much of the confusion in the courts, and essentially all of the doctrinal disarray in the Antitrust Division and the FTC, has been eliminated by the new market definition approach introduced in the 1982 DOJ Merger Guidelines and largely continued today in the 2010 DOJ/FTC Horizontal Merger Guidelines. The Guidelines' approach seeks to identify markets as product and geographical groupings that are susceptible to the exercise of market power by a hypothetical monopolist. This approach, rather than the *Brown Shoe* factor approach, is the one used by the Antitrust Division and the FTC as a matter of prosecutorial discretion. In the courts, although the Guidelines' approach is not binding as a matter of law, some conception of the Guidelines' hypothetical monopolist test has been adopted increasingly as conceptually appealing and practically workable.

Almost all modern judicial discussions of market definition begin with the Supreme Court's 1962 *Brown Shoe* decision, in which the Court declared that "[t]he outer boundaries of a product market are determined by the reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it."[21] *Reasonable interchangeability of use* exists if two products

869 (W.D. N.Y. 1994) ("Hypothetical formulas and paradigms are less important in [market definition] than concrete economic realities.").

17. FTC v. Swedish Match, 131 F. Supp. 2d 151, 156 (D.D.C. 2000) ("Merger analysis begins with defining the relevant product market.") (citing Brown Shoe Co. v. United States, 370 U.S. 294, 324 (1962)); *accord* United States v. H&R Block, Inc., 833 F. Supp. 2d 36, 50 (D.D.C. 2011).

18. *See* United States v. Continental Can Co., 378 U.S. 441, 449 (1964) ("[W]e must recognize meaningful competition where it is found to exist.").

19. *See, e.g.*, United States v. Connecticut Nat'l Bank, 418 U.S. 656 (1974); United States v. Grinnell Corp., 384 U.S. 563 (1966); International Boxing Club of N. Y., Inc. v. United States, 358 U.S. 242 (1959).

20. Brown Shoe Co. v. United States, 370 U.S. 294 (1962).

21. Brown Shoe Co. v. United States, 370 U.S. 294, 325 (1962); *accord* United States v. Continental Can Co., 378 U.S. 441, 449 (1964); *see also* United States v. E. I. Du Pont de Nemours & Co., 351 U.S. 377, 404 (1956) (cellophane). For applications of the *Brown Shoe* criteria, see, for example, FTC v. H.J. Heinz Co., 246 F.3d 708, 718 (D.C. Cir. 2001); U.S. Anchor Mfg., Inc. v. Rule Indus., Inc., 7 F.3d 986, 995 (11th Cir. 1993) (Sherman Act); Olin Corp. v. FTC, 986 F.2d 1295, 1298 (9th Cir. 1993) (Clayton Act); T. Harris Young & Assocs., Inc. v. Marquette Elecs.,

are functional substitutes for one another given their physical and performance attributes. Products that share the same essential attributes and are employed for the same uses will be found to be in the same relevant product market, while products that differ significantly will not. *Cross-elasticity of demand*, which measures how changes in the relative price of one product affect the demand for another product, is simply a quantification of reasonable interchangeability of use that takes into account differences in price as well as attributes.[22] Sometimes regulation can prevent otherwise interchangeable products from having high cross-elasticities of demand,[23] but in most situations reasonable interchangeability of use will entail a high cross-elasticity of demand.[24]

The extent to which there exist substitutes that are reasonably interchangeable and exhibit a high cross-elasticity with the products under scrutiny is central to market definition, as the *Brown Shoe* Court held, because these substitutes determine the extent to which customers of the merging firms can protect themselves against anticompetitive price increases, quality decreases, or declines in the rate of technological innovation or product improvement. The hallmark of an anticompetitive effect is injury to customers, and, if customers have readily available,

Inc., 931 F.2d 816, 824 (11th Cir. 1991) (Sherman Act); Omni Outdoor Advertising, Inc. v. Columbia Outdoor Advertising, Inc., 891 F.2d 1127, 1140 (4th Cir. 1989) (Sherman Act).

22. *See* Jacobs v. Tempur-Pedic Int'l, Inc., 626 F.3d 1327, 1337 n.13 (11th Cir. 2010); FTC v. Whole Foods Mkt., Inc., 548 F.3d 1028, 1037 (D.C. Cir. 2008) (Brown, J.) ("Whether one product is reasonably interchangeable for another depends not only on the ease and speed with which customers can substitute it and the desirability of doing so, but also on the cost of substitution, which depends most sensitively on the price of the products.") (citation omitted); Forsyth v. Humana, Inc., 114 F.3d 1467, 1483-84 (9th Cir. 1997) (Wallace, J., concurring and dissenting) (explaining concept of cross-elasticity in detail); *In re* Live Concert Antitrust Litig., 247 F.R.D. 98, 123 (C.D. Cal. 2007) ("Cross-elasticity of demand measures the substitutability of two products by determining whether consumers will shift from one product to another in response to changes in the relative costs of the two products.").

23. *See* United States v. Archer-Daniels-Midland Co., 866 F.2d 242, 245-46 (8th Cir. 1988) (in light of congressional price supports that artificially inflate price of sugar significantly over that of high-fructose corn syrup, the two products, although functionally interchangeable, not considered to be in same relevant product market).

24. *See, e.g.*, *In re* IBM Peripheral EDP Devices Antitrust Litig., 481 F. Supp. 965, 975 (N.D. Cal. 1979); *see also* FTC v. CCC Holdings, Inc., 605 F. Supp. 2d 26, 38 (D.D.C. 2009) (noting that "[c]ourts generally will include functionally interchangeable products in the same product market unless factors other than use indicate that they are not actually part of the same market"). In some cases, reasonable interchangeability of use will not entail a high cross-elasticity of demand because the "use" or "function" of the products is too broadly defined. This is often the situation in "cluster market" cases. *See, e.g.*, White & White, Inc. v. American Hosp. Supply Corp., 723 F.2d 495, 500-02 (6th Cir. 1983); *see also* FTC v. Staples, Inc., 970 F. Supp. 1066, 1080 (D.D.C. 1997) (although consumable office products were identical and therefore perfectly interchangeable, significant cross-elasticity of demand not found between identical products sold by office superstores and normal retailers); FTC v. Swedish Match, 131 F. Supp. 2d 151, 157-65 (D.D.C. 2000) (notwithstanding functional interchangeability of loose leaf and moist snuff as smokeless tobacco products, lack of significant cross-elasticity of demand required them to be in separate relevant product markets).

satisfactory alternatives to which they can easily turn, they can protect themselves against any injury that otherwise might result from the merger.[25] If the combined firm attempts to act anticompetitively, either alone or in concert with others, it will only lose sales and, more importantly, profits. The availability of substitutes serves to discipline the combined firm to act competitively. The alternative products in the relevant market need not be the first choice of all customers; it is enough that a significant number of customers of the merging parties would turn to the other products in the market if the merged firm's prices were to increase relative to the prices of these other products. In this sense, market definition, as properly conceived in the reasonable interchangeability of use and high cross-elasticity of demand criteria of *Brown Shoe*, seeks to identify substitutes for the products of the merging firms as a first step in ascertaining whether the disciplining effects of these substitutes are likely to be sufficient to maintain the competitive *status quo ex ante* in the wake of a merger or acquisition.[26] As a result, when evaluating evidence of customer switching behavior as evidence of cross-elasticity of demand, it is important the switching occurs as a result of changes in relative prices and not some other reason. Customers who switch products because of fundamental changes in preferences or technological requirements, for example, are unlikely to switch back because of small changes in relative prices, and hence such switching behavior is not evidence of the type of high cross-elasticity of demand that will discipline the exercise of market power.[27] Conversely, there is a suggestion in the cases that even if firms adjust their prices in response to price changes by other firms—say, because of

25. *See* United States v. H&R Block, Inc., 833 F. Supp. 2d 36, 55 (D.D.C. 2011) ("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.").

26. *See* SmithKline Corp. v. Eli Lilly & Co., 575 F.2d 1056, 1063 (3d Cir. 1978) (defining a relevant product market is primarily "a process of describing those groups of producers which, because of the similarity of their products, have the ability—actual or potential—to take significant amounts of business away from each other"); *accord* U.S. Anchor Mfg., Inc. v. Rule Indus., Inc., 7 F.3d 986, 995 (11th Cir. 1993); Thurman Indus., Inc. v. Pay 'N Pak Stores, Inc., 875 F.2d 1369, 1374 (9th Cir. 1989); General Indus. Corp. v. Hartz Mountain Corp., 810 F.2d 795, 805 (8th Cir. 1987); Malaney v. UAL Corp., 2010 WL 3790296, at *5 (N.D. Cal. 2010) (not for publication), *aff'd*, 434 F. App'x 620 (9th Cir. 2011) (unpublished); FTC v. CCC Holdings, Inc., 605 F. Supp. 2d 26, 38 (D.D.C. 2009); FTC v. Arch Coal, Inc., 329 F. Supp. 2d 109, 119 (D.D.C. 2004); United States v. Engelhard Corp., 970 F. Supp. 1463 (M.D. Ga. 1997); Moore Corp. Ltd. v. Wallace Computer Servs., Inc., 907 F. Supp. 1545, 1575 (D. Del. 1995); *see also* Rothery Storage & Van Co. v. Atlas Van Lines, Inc., 792 F.2d 210, 218 (D.C. Cir. 1986) ("Because the ability of consumers to turn to other suppliers restrains a firm from raising prices above the competitive level, the definition of the 'relevant market' rests on the determination of available substitutes."); FTC v. Arch Coal, Inc., 329 F. Supp. 2d 109, 119 (D.D.C. 2004) ("Relevant markets will generally include producers who, given product similarity, have the ability to take significant business from each other."); FTC v. Swedish Match, 131 F. Supp. 2d 151, 157 (D.D.C. 2000); FTC v. Cardinal Health, Inc., 12 F. Supp. 2d 34, 46 (D.D.C. 1998); FTC v. Staples, Inc., 970 F. Supp. 1066, 1080 (D.D.C. 1997); FTC v. Butterworth Health Corp., 946 F. Supp. 1285, 1290 (W.D. Mich. 1996); United States v. Mercy Health Servs., 902 F. Supp. 968, 97576 (N.D. Iowa 1995); Community Publishers, Inc. v. Donrey Corp., 892 F. Supp. 1146, 1153 (W.D. Ark. 1995).

27. *See* United States v. Sungard Data Sys., Inc., 172 F. Supp. 2d 172, 184 (D.D.C. 2001).

benchmarking—this price response is not evidence that the products are in the same relevant market if customers do not change their purchasing decisions in response to changes in relative prices of those products.[28]

Relevant geographic markets

Section 7 of the Clayton Act also calls for locating the likely competitive effects of a merger or acquisition in some section of the country.[29] Courts have long held that a proper definition of the relevant geographic area is a necessary step in the examination of the likely competitive effects of a transaction.[30] As in product market definition, a proper delineation of the relevant geographic market is essential if the resulting market shares are to have any probative value in predicting the economic consequences of a transaction. In *United States v. Marine Bancorp, Inc.*,[31] the Supreme Court made it clear that proof of the boundaries of the relevant geographic market is an essential element of the plaintiff's *prima facie* case.[32] The failure of the merging parties to establish the boundaries of the relevant market in which to analyze the transaction has no legal significance except to the extent it undermines the plaintiff's proof.[33]

The leading case on geographic market definition is the Supreme Court decision in *Brown Shoe Co. v. United States*,[34] in which the Court observed that the criteria for determining the relevant geographic market are essentially similar to those used

28. *See* Golden Gate Pharmacy Servs., Inc. v. Pfizer, Inc., 2010 WL 1541257, at *3 (N.D. Cal. 2010) (not for publication). *See generally* United States v. H&R Block, Inc., 833 F. Supp. 2d 36, 62, 64-65 (D.D.C. 2011) (finding generalized switching data as a proxy for cross-elasticity of demand in the form of diversion ratios, especially since no better data existed).

29. Clayton Act § 7, 15 U.S.C. § 14.

30. *See, e.g.*, United States v. Connecticut Nat'l Bank, 418 U.S. 656, 660 (1974); United States v. Marine Bancorporation, Inc., 418 U.S. 602, 618 (1974); Brown Shoe Co. v. United States, 370 U.S. 294, 324 (1962); Jim Walter Corp. v. FTC, 625 F.2d 676, 681 (5th Cir. 1980); FTC v. Freeman Hosp., 69 F.3d 260, 268 (8th Cir. 1995). There is an unexplained, and incorrect, suggestion in at least one case that a preliminary injunction may be appropriate in some circumstances even when the government has not shown a probability of success in establishing the relevant geographic market. *See* United States v. Country Lake Foods, Inc., 754 F. Supp. 669, 678 (D. Minn. 1990).

31. United States v. Marine Bancorp, Inc, 418 U.S. 602 (1974).

32. United States v. Marine Bancorporation, Inc., 418 U.S. 602, 631 (1974); *accord* United States v. Connecticut Nat'l Bank, 418 U.S. 656, 669 (1974); FTC v. Tenet Health Care Corp., 186 F.3d 1045, 105155 (8th Cir. 1999) (vacating preliminary injunction blocking merger where FTC failed to demonstrate likelihood of success in proving its alleged relevant geographic market); FTC v. Arch Coal, Inc., 329 F. Supp. 2d 109, 119 (D.D.C. 2004); United States v. Sungard Data Sys., 172 F. Supp. 2d 172, 182-83 (D.D.C. 2001); United States v. Mercy Health Servs., 902 F. Supp. 968, 976 (N.D. Iowa 1995); *In re* Adventist Health Sys./West, 117 F.T.C. 224, 288-97 (1994) (dismissing for counsel's failure to prove relevant geographic markets alleged in complaint).

33. FTC v. Tenet Health Care Corp., 186 F.3d 1045, 1053 n.12 (8th Cir. 1999).

34. Brown Shoe Co. v. United States, 370 U.S. 294 (1962).

to test the boundaries of a relevant product market.[35] The *Brown Shoe* Court also stated that the submarket concept applies equally to geographic markets and product markets.[36] In determining the boundaries of the relevant geographic market, the Court emphasized that a "pragmatic, factual approach," rather than a "formal, legalistic one," must be used and that the relevant geographic market must both "correspond to the commercial realities" of the industry and be "economically significant."[37] The Court, employing a level of generality similar to that it used in describing the outer boundaries of product markets, has defined the relevant geographic market to be "the area of effective competition . . . in which the seller operates, and to which the purchaser can practically turn for supplies."[38] The Court also observed that an element of "fuzziness would seem inherent in any attempt to delineate the relevant geographic market"[39] and that the market need not be defined by "metes and bounds as a surveyor would lay off a plot of ground."[40] Even so, to sustain a relevant geographic market there must be sufficient evidence to conclude that the market boundaries adequately capture the material competitive forces. Plaintiffs cannot rely on political boundaries (such as towns, counties, or states) to establish the boundaries of a relevant geographic market without providing evidence of the competitive forces within these boundaries.[41]

35. Brown Shoe Co. v. United States, 370 U.S. 294, 336 (1962) (citing S Rep No 1775, 81st Cong, 2d Sess 5 to 6 (1950)); United States v. E. I. Du Pont de Nemours & Co., 353 U.S. 586, 593 (1957).

36. Brown Shoe Co. v. United States, 370 U.S. 294, 336 (1962). *See, e.g.*, White & White, Inc. v. American Hosp. Supply Corp., 723 F.2d 495, 501 (6th Cir. 1983) (Sherman Act).

37. Brown Shoe Co. v. United States, 370 U.S. 294, 336-37 (1962).

38. United States v. Philadelphia Nat'l Bank, 374 U.S. 321, 359 (1963) (emphasis removed) (quoting Tampa Elec. Co. v. Nashville Coal Co., 365 U.S. 320, 327 (1961) (Sherman Act § 2)). *See, e.g.*, FTC v. Tenet Health Care Corp., 186 F.3d 1045, 1052 (8th Cir. 1999); FTC v. Freeman Hosp., 69 F.3d 260, 268-69 (8th Cir. 1995); Morgenstern v. Wilson, 29 F.3d 1291, 1296 (8th Cir. 1994); White & White, Inc. v. American Hosp. Supply Corp., 723 F.2d 495, 501 (6th Cir. 1983) (Sherman Act); FTC v. OSF Healthcare Sys., 852 F. Supp. 2d 1069, 1076 (N.D. Ill. 2012); Malaney v. UAL Corp., 2010 WL 3790296, at *6 (N.D. Cal. 2010) (not for publication), *aff'd*, 434 F. App'x 620 (9th Cir. 2011) (unpublished); FTC v. Arch Coal, Inc., 329 F. Supp. 2d 109, 123 (D.D.C. 2004); FTC v. Libbey, Inc., 211 F. Supp. 2d 34, 45 (D.D.C. 2002); California v. Sutter Health Sys., 130 F. Supp. 2d 1109, 1120 (N.D. Cal. 2001); FTC v. Cardinal Health, Inc., 12 F. Supp. 2d 34, 49 (D.D.C. 1998); FTC v. Staples, Inc., 970 F. Supp. 1066, 1073 (D.D.C. 1997); United States v. Mercy Health Servs., 902 F. Supp. 968, 978 (N.D. Iowa 1995); FTC v. Butterworth Health Corp., 946 F. Supp. 1285, 1290, (W.D. Mich. 1996); United States v. Country Lake Foods, Inc., 754 F. Supp. 669, 675 (D. Minn. 1990); *see also* FTC v. CCC Holdings, Inc., 605 F. Supp. 2d 26, 37 (D.D.C. 2009) ("The 'relevant geographic market' identifies the geographic area in which the defendants compete in marketing their products or services."); *accord* United States v. H&R Block, Inc., 833 F. Supp. 2d 36, 50 n.7 (D.D.C. 2011).

39. United States v. Philadelphia Nat'l Bank, 374 U.S. 321, 360 n.37 (1963). *See, e.g.*, United States v. Connecticut Nat'l Bank, 418 U.S. 656, 669 (1974) (geographic markets "need not-indeed cannot-be defined with scientific precision").

40. United States v. Pabst Brewing Co., 384 U.S. 546, 549 (1966).

41. *See, e.g.*, United States v. Connecticut Nat'l Bank, 418 U.S. 656, 67071 (1974); FTC v. Cardinal Health, Inc., 12 F. Supp. 2d 34, 5051 (D.D.C. 1998) (use of Rand McNally "Major

Trading Areas" inappropriate as boundaries of relevant geographic markets when they were not created for antitrust purposes and were not independently shown to be proper relevant markets; government could not rely on Standard Metropolitan Statistical Areas ("SMSAs") developed by the Office of Management and Budget because they were "not defined in terms of banking criteria, and they were not developed as a tool for analyzing banking markets"); *In re* Hosp. Corp. of Am., 106 F.T.C. 361, 471, 1985 WL 668927 (1985) ("[g]eopolitical designations such as 'MSA' may reflect a host of considerations that do not concern the issue of competition").

Seminal Cases

UNITED STATES v. E.I. DUPONT DE NEMOURS & CO.,
353 U.S. 586 (1957)
(EXCERPT)*

MR. JUSTICE BRENNAN delivered the opinion of the Court.

This is a direct appeal under § 2 of the Expediting Act 1 from a judgment of the District Court for the Northern District of Illinois dismissing the Government's action brought in 1949 under § 15 of the Clayton Act. The complaint alleged a violation of § 7 of the Act resulting from the purchase by E. I. du Pont de Nemours and Company in 1917-1919 of a 23% stock interest in General Motors Corporation. This appeal is from the dismissal of the action as to du Pont, General Motors and the corporate holders of large amounts of du Pont stock, Christiana Securities Corporation and Delaware Realty & Investment Company.

The primary issue is whether du Pont's commanding position as General Motors' supplier of automotive finishes and fabrics was achieved on competitive merit alone, or because its acquisition of the General Motors' stock, and the consequent close intercompany relationship, led to the insulation of most of the General Motors' market from free competition, with the resultant likelihood, at the time of suit, of the creation of a monopoly of a line of commerce.

The first paragraph of § 7, pertinent here, provides:

> "That no corporation engaged in commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital of another corporation engaged also in commerce, where the effect of such acquisition may be to substantially lessen competition between the corporation whose stock is so acquired and the corporation making the acquisition, or to restrain such commerce in any section or community, or tend to create a monopoly of any line of commerce."

Section 7 is designed to arrest in its incipiency not only the substantial lessening of competition from the acquisition by one corporation of the whole or any part of the stock of a competing corporation, but also to arrest in their incipiency restraints or monopolies in a relevant market which, as a reasonable probability, appear at the time of suit likely to result from the acquisition by one corporation of all or any part of the stock of any other corporation. The section is violated whether or not actual restraints or monopolies, or the substantial lessening of competition, have occurred or are intended. Acquisitions solely for "investment are excepted, but only if, and so long as, the stock is not used by voting or otherwise to bring about, or in attempting to bring about, the substantial lessening of competition.

. . .

* Internal citations and footnotes omitted without indication.

We hold that any acquisition by one corporation of all or any part of the stock of another corporation, competitor or not, is within the reach of the section whenever the reasonable likelihood appears that the acquisition will result in a restraint of commerce or in the creation of a monopoly of any line of commerce. Thus, although du Pont and General Motors are not competitors, a violation of the section has occurred if, as a result of the acquisition, there was at the time of suit a reasonable likelihood of a monopoly of any line of commerce. . . .

. . .

Appellees argue that there exists no basis for a finding of a probable restraint or monopoly within the meaning of § 7 because the total General Motors market for finishes and fabrics constituted only a negligible percentage of the total market for these materials for all uses, including automotive uses. It is stated in the General Motors brief that in 1947 du Pont's finish sales to General Motors constituted 3.5% of all sales of finishes to industrial users, and that its fabrics sales to General Motors comprised 1.6% of the total market for the type of fabric used by the automobile industry.

Determination 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 record shows that automotive finishes and fabrics have sufficient peculiar characteristics and uses to constitute them products sufficiently distinct from all other finishes to make them a "line of commerce" within the meaning of the Clayton Act. Thus, the bounds of the relevant market for the purposes of this case are not coextensive with the total market for finishes and fabrics, but are coextensive with the automobile industry, the relevant market for automotive finishes and fabrics.

. . .

NOTES

1. *Du Pont/GM* was the first merger case to reach the Supreme Court after the passage of the Celler-Kefauver Act in 1950. Although the Court agreed that the challenged acquisition of stock, which occurred through various purchases between 1917 and 1919, was governed by the original 1914 version of Section 7, the decision very much reflects the concerns of the 1950 Congress. The case established some basic rules that remain operative today on the questions of incipiency, post-acquisition evidence, and laches. The decision also serves as the point of departure for the judicial activism in antitrust cases of the Warren Court generally and of William Joseph Brennan, Jr., a newly appointed associate justice and author of the four-to-two majority opinion, in particular.[1]

1. Unfortunately, neither the trial court nor Supreme Court opinions are especially lucid on the circumstances surrounding the DuPont stock purchases and involvement in General Motors. A more complete story can be found in ALFRED D. CHANDLER, JR. AND STEPHEN SALSBURY, PIERRE D. DUPONT

2. On June 30, 1949, the Department of Justice filed a civil complaint for injunctive relief against individual members of the du Pont family and organization, E.I. du Pont de Nemours and Company, General Motors Corporation, and United States Rubber Company. The complaint broadly alleges a combination among the defendants with three objectives: (1) obtain practical control of the DuPont,[2] GM, and U.S. Rubber through stock acquisitions and domination of management; (2) use this control to cause the companies to buy preferentially from one another to the exclusion of competitor-suppliers; and (3) allocate among the manufacturing defendants exclusive fields of production to the du Pont Company. The complaint alleged that this combination restrained and monopolized trade in certain products manufactured by produced by DuPont and U.S. Rubber and purchased by GM in violation of Sections 1 and 2 of the Sherman Act. The complaint also alleged that as part of this combination DuPont purchased 23 percent of GM's outstanding stock, which DuPont used to foreclose competitors from supplying automotive fabrics and finishes to GM in violation of Section 7 of the Clayton Act. Among other things, the government sought divestiture of defendants' stock interest in each other, an injunction against interlocking directorates, cancellation of contracts regarding reciprocal sales, patent licenses, and exchanges of information.

The government tried the action primarily as Section 1 a conspiracy case to limit GM's ability to deal freely in purchasing supplies from competitors of DuPont and U.S. Rubber. After a trial on the merits, the district court dismissed the Sherman Act counts, finding that GM was not restrained as to either specific products manufactured by DuPont or U.S. Rubber or to its development of new products. On the Clayton Act count, the court acknowledged that it may be possible to make out a violation of Section 7 in the absence of an actual restraint of trade if the government proves that that there was a reasonable probability that a condemned restraint would result from the challenged acquisition. But the court found that the absence of any restraint emerging in the more than 30 years following du Pont's acquisition of the GM stock showed that there was no reasonable probability that the challenged acquisition had a

AND THE MAKING OF THE MODERN CORPORATION 433-604 (1971); ALFRED D. CHANDLER, JR., STRATEGY AND STRUCTURE: CHAPTERS IN THE HISTORY OF INDUSTRIAL ENTERPRISE 115-22 (1962); Arthur Pound, THE TURNING WHEEL: THE STORY OF GENERAL MOTORS THROUGH TWENTY-FIVE YEARS, 1908-1933 ch. 10 (1934); and LAWRENCE H. SELTZER, A FINANCIAL HISTORY OF THE AMERICAN AUTOMOBILE INDUSTRY 145-72 (1928).

2. There is always a question about how to spell the company's name. It uses "DuPont" on its web site, so I will use that here. I will continue to refer to family members as "du Pont."

reasonable probability of restraining trade, and so the court dismissed the Section 7 count as well.[3]

The government appealed directly to the Supreme Court under the Expediting Act. The Court, in a four-to-two decision, reversed on the Section 7 count and found it unnecessary to decide the Sherman Act claims. To Justice Brennan, writing for the majority, the central issue was whether "du Pont's commanding position as General Motor's supplier of automotive finishes and fabrics was achieved on competitive merit alone" or rather that the "close intracompany relationship" due to DuPont's acquisition of GM stock insulated DuPont from third-party competition.[4] After concluding that automotive finishes and fabrics constituted the appropriate relevant market in which to analyze the acquisition, Brennan observed that at and around the time that the complaint was filed General Motors accounted for roughly 40 percent of automobile sales in the United States and presumably at like percentage of automotive finishes and fabrics. Brennan then noted that DuPont supplied 67 percent of GM's requirements for finishes in 1946, and 68 percent in 1947, and that in fabrics it supplied 52 percent and 38.5 percent in the same two years respectively. Brennan concluded, as a result, that DuPont supplied a substantial part of the automotive finishes and fabrics market; it only remained to determine whether its success stemmed from the competitive merit of its products and prices or from anticompetitive foreclosure of GM to third-party manufacturers resulting from DuPont's stock interests.

Brennan concluded that GM's success was due to anticompetitive foreclosure. Brennan began by noting that DuPont's sales to GM were relatively insignificant until shortly after its first purchase of a sizeable block of stock in 1917. Brennan cited the recommendation of John J. Raskob, Pierre du Pont's closest business associate and the DuPont Company treasurer, to the DuPont board on the advantages of purchasing GM shares: "Our interest in the General Motors Company will undoubtedly secure for us the entire Fabrikoid, Pyralin, paint and varnish business of those companies, which is a substantial factor."[5] All told, however, Brennan pointed only to three bits of evidence relating DuPont's "control" of GM to the foreclosure of competitors. First, the Court gave great weight to a 1921 query from Pierre to Lammot du Pont, Pierre's brother, first vice president of the DuPont Company and chairman of its Executive Committee, "whether General Motors was taking its entire requirements of du Pont products from du Pont," and Lammont's reply that four of GM's eight operating divisions bought from DuPont all of their requirements of paints and varnishes, five their requirements of Fabrikoid (an artificial leather), four their requirements of rubber cloth, and seven their requirements of Pyralin (celluloid), and that the prospects for the future for supplying all of the requirements of all of the divisions were improving.[6] Second, by 1926, of all the GM operations only the Fisher Body Company, then 60 percent owned

3. *See* United States v. E. I. Du Pont De Nemours & Co., 126 F. Supp. 235 (N.D. Ill. 1954), *rev'd*, 353 U.S. 586 (1957).

4. 353 U.S. at 588.

5. *Id*. at 602.

6. *Id*. at 604.

by GM but with a voting trust giving the Fisher brothers a great deal of independence, was obtaining any substantial portion of its requirements from DuPont's competitors; by 1947, when Fisher "resistance had collapsed," Fisher purchases of its requirements from DuPont were roughly similar to those of other GM divisions.[7] Third, once a GM division began to purchase supplies from DuPont, it continued to do so over time at a relatively constant level, and Brennan speculated that GM had turned to purchases from DuPont competitors at least in part because GM's demands outstripped DuPont's production capacity.[8] Brennan concluded that DuPont "purposely employed its stock to pry open the General Motors market" and that its position as the primary supplier of GM fabrics and finishes "was not gained solely on competitive merit."[9] Brennan concluded:

> The fact that sticks out in this voluminous record is that the bulk of du Pont's production has always supplied the largest part of the requirements of the one customer in the automobile industry connected to du Pont by a stock interest. The inference is overwhelmingthat du Pont's commanding position was promoted by its stock interest and was not gained solely on competitive merit.
>
> We agree with the trial court that considerations of price, quality and service were not overlooked by either du Pont or General Motors. Pride in its products and its high financial stake in General Motors' success would naturally lead du Pont to try to supply the best. But the wisdom of this business judgment cannot obscure the fact, plainly revealed by the record, that du Pont purposely employed its stock to pry open the General Motors market to entrench itself as the primary supplier of General Motors' requirements for automotive finishes and fabrics.[10]

Having found a violation of Section 7, the lower court was instructed to fashion appropriate relief. The district court's plan "sterilize" the Du Pont block interest by passing the voting rights in the GM stock pro rata to Du Pont shareholders (except for Du Pont entities) was rejected by the Supreme Court in a later decision, and ultimately Du Pont was required to divest its GM shares.

Having found a violation of Section 7, the lower court was instructed to fashion appropriate relief. The district court's plan "sterilize" the Du Pont block interest by passing the voting rights in the GM stock pro rata to Du Pont shareholders (except for Du Pont entities) was rejected by the Supreme Court in a later decision,[11] and ultimately Du Pont was required to divest its GM shares.[12]

3. The *DuPont/GM* decision raises a number of troubling questions: Was Brennan justified in concluding that from 1917 forward DuPont's sales to GM were the proximate result of DuPont's 1917 stock purchase in order to provide the (probable) causal link between the original stock purchase and the foreclosure of the

7. *Id*. at 604-05.
8. *Id*. at 605.
9. *Id*. at 604, 605.
10. *Id*. at 605-06 (footnote omitted).
11. 366 U.S. 316 (1961), *rev'g* 177 F. Supp. 1 (N.D. Ill. 1959).
12. 1962 Trade Cas. (CCH) ¶ 70,245 (N.D. Ill. 1962).

automobile fabrics and finishes market necessary to yield a Section 7 violation, especially when the district court found no such link? What is the significance of the facts that, at the time of the original purchase, automobile fabrics and finishes standing alone could not have constituted a relevant antitrust market, much less one subject to anticompetitive foreclosure, and that to the extent such a market emerged it did so only years later as the automobile industry grew in size and advanced in technological sophistication? Indeed, should the Court have considered the facts that, particularly in the early years after the stock purchase, DuPont was far and away the leader in research and development in automobile fabrics and finishes—and as such responsible for the very uniqueness that enabled the Court to conclude in 1957 that these products formed a relevant product market for antitrust purposes—and that DuPont's incentives to innovate in this area stemmed largely from its ownership interest in GM? What are the limits of use of post-acquisition evidence to prove a Section 7 violation? Although the Court's conclusion turned on the question of control, should the analysis take into account DuPont's acquisition of a minority interest in GM as opposed to 100 percent of the company? And just what was the theory of threatened anticompetitive harm in the case anyway?[13]

4. *DuPont/GM* is a *vertical merger case* where the theory of anticompetitive harm was the (partial) foreclosure of DuPont's competitors. While it is good to know the basic facts underlying the case, on the same facts that case would likely be decided much differently today. We will examine vertical mergers in Unit 12.

5. Almost *DuPont/GM* is not a great precedential significance today as a vertical merger case, it did establish some fundamental merger antitrust rules on the incipiency standard, the use of postacquisition evidence, and laches in government cases.

Incipiency standard: "[T]he test of a violation of § 7 is whether, at the time of suit, there is a reasonable probability that the acquisition is likely to result in the condemned restraints."[14] Note that only a *reasonable probability* of a future anticompetitive is required; there is no requirement that the transaction will be anticompetitive at some point in the future. Since *DuPont*, courts have consistently employed the "reasonable probability" standard as the threshold for an actionable incipient anticompetitive effect under Section 7.

Postacquisition evidence rule. The conventional view is that a merger is either lawful or unlawful under Section 7 at the time of its consummation and that the legality a transaction does not change as time passes. The *DuPont/GM* Court used postacquisition evidence available at the time of trial—thirty years after the challenged acquisitions took place—to demonstrate actual or threatened ex post anticompetitive effect, and therefore to show the ex ante likelihood at the time of consummation that the acquisition was reasonably probable to be anticompetitive sometime in the future. The *DuPont/GM* case says that a court can use whatever evidence is available at the time of trial to determine, as of the date of the transaction's consummation, the

[13] More on this when we look at nonhorizontal mergers in Unit 12.

[14] *General Motors*, 353 U.S. at 607.

probability the transaction will have the requisite anticompetitive effect sometime in the future.

The post-acquisition evidence rule allows consideration of evidence of the absence as well as the presence of an actual or threatened anticompetitive effect between the transaction's consummation and the time of trial. Historically, however, courts have given little weight to evidence that there was no actual competitive injury up to the time of trial. Indeed, no merger that appeared likely to be anticompetitive at the time of consummation has ever been exonerated on the basis of post-acquisition conduct evidence that the expected anticompetitive effect did not occur. On the other hand, post-acquisition of an actual anticompetitive effect is usually accorded great weight by courts in concluding that the transaction had a reasonable probability of success at the time of consummation.

Laches. When there is no statute of limitations applicable to an equitable action, equity fashions its own time limitations through the doctrine of laches.[15] The equitable defense of laches is often summarized by the maxim that "equity aids the vigilant and not those who slumber on their rights."[16] Laches is defined as neglect to assert a right or claim which, taken together with lapse of time and other circumstances, causes prejudice to the adverse party. Laches serves as an absolute defense to a private action in equity, including injunctions, specific performance, and equitable accounting.

In *DuPont/GM*, the government filed a complaint for injunctive relief against a series of stock acquisitions that had taken thirty years earlier. Not even the dissenters, however, argued that the government's action was barred by laches; rather "[i]t means only that if the Government chooses to bring its action many years later, it must prove what § 7 plainly requires—that the acquisition threatened competition when made."[17] *DuPont/GM* is an example of the general rule that laches cannot ordinarily be asserted against the sovereign.[18] Furthermore, the remedy in Section 15,[19] which provides the government its right of action to seek injunctive relief, is not expressly limited, as is Section 16, by "the same conditions and principles" as govern relief granted by courts

15. *See, e.g.*, Russell v. Todd, 309 U.S. 280, 287 (1940) ("From the beginning, equity, in the absence of any statute of limitations made applicable to equity suits, has provided its own rule of limitations through the doctrine of laches, the principle that equity will not aid a plaintiff whose unexcused delay, if the suit were allowed, would be prejudicial to the defendant.").

16. *See* Kansas v. Colorado, 514 U.S. 675, 687 (1995); *see also* Upton v. Tribilcock, 91 U.S. 45, 55 (1875) ("Mere lapse of time, where a party has not asserted his claim with reasonable diligence, is a bar to relief. Relief is not given to those who sleep on their rights. Equity will not assist a man whose condition is attributable only to that want of diligence which may be fairly expected from a reasonable person.") (citations omitted).

17. *General Motors*, 353 U.S. at 624 (Burton, J., dissenting).

18. *See* Guaranty Trust Co. v. United States, 304 U.S. 126, 132 (1938); Utah Power & Light Co. v. United States, 243 U.S. 389, 409 (1917).

19. 15 U.S.C. § 25 (investing district courts with "with jurisdiction to prevent and restrain violations" of the antitrust laws upon a petition from the government and authorizing them to issue a "temporary restraining order or prohibition as shall be deemed just in the premises").

of equity.[20] DuPont/GM establishes that the government is not barred by laches from pursuing injunctive relief against mergers and acquisitions, no matter how long ago the acquisition took place.

20. *Id*. at § 26 (authorizing private parties to obtain injunctive relief from actual or threatened violation s of the antitrust laws "when and under the same conditions and principles as injunctive relief against threatened conduct that will cause loss or damage is granted by courts of equity").

BROWN SHOE CO. v. UNITED STATES, 370 U.S. 294 (1962) (EXCERPT)

MR. CHIEF JUSTICE WARREN delivered the opinion of the Court.

I.

This suit was initiated in November 1955 when the Government filed a civil action in the United States District Court for the Eastern District of Missouri alleging that a contemplated merger between the G. R. Kinney Company, Inc. (Kinney), and the Brown Shoe Company, Inc. (Brown), through an exchange of Kinney for Brown stock, would violate § 7 of the Clayton Act, 15 U. S. C. § 18. . . . The complaint sought injunctive relief under § 15 of the Clayton Act, 15 U. S. C. § 25, to restrain consummation of the merger.

A motion by the Government for a preliminary injunction *pendente lite* was denied, and the companies were permitted to merge provided, however, that their ·businesses be operated separately and that their assets be kept separately identifiable. The merger was then effected on May 1, 1956.

In the District Court, the Government contended that the effect of the merger of Brown—the third largest seller of shoes by dollar volume in the United States, a leading manufacturer of men's, women's, and children's shoes, and a retailer with over 1,230 owned, operated or controlled retail outlets—and Kinney—the eighth largest company, by dollar volume, among those primarily engaged in selling shoes, itself a large manufacturer of shoes, and a retailer with over 350 retail outlets—"may be substantially to lessen competition or to tend to create a monopoly" by eliminating actual or potential competition in the production of shoes for the national wholesale shoe market and in the sale of shoes at retail in the Nation, by foreclosing competition from "a market represented by Kinney's retail outlets whose annual sales exceed $42,000,000," and by enhancing Brown's competitive advantage over other producers, distributors and sellers of shoes. The Government argued that the "line of commerce" affected by this merger is "footwear," or alternatively, that the "line[s]" are "men's," "women's," and "children's" shoes, separately considered, and that the "section of the country," within which the anticompetitive effect of the merger is to be judged, is the Nation as a whole, or alternatively, each separate city or city and its immediate surrounding area in which the parties sell shoes at retail.

In the District Court, Brown contended that the merger would be shown not to endanger competition if the "line[s] of commerce" and the "section[s] of the country" were properly determined. Brown urged that not only were the age and sex of the intended customers to be considered in determining the relevant line of commerce, but that differences in grade of material, quality of workmanship, price, and customer use of shoes resulted in establishing different lines of commerce. While agreeing with the Government that, with regard to manufacturing, the relevant geographic market for assessing the effect of the merger upon competition is the country as a whole, Brown contended that with regard to retailing, the market must vary with economic reality from the central business district of a large city to a "standard metropolitan area" for a smaller community. Brown further contended that, both at the manufacturing level and at the retail level, the shoe industry enjoyed healthy competition and that the vigor of this competition would not, in any event, be diminished by the proposed merger because Kinney manufactured less than 0.5% and retailed less than 2% of the Nation's shoes.

. . .

IV.

THE VERTICAL ASPECTS OF THE MERGER.

The Product Market.

The outer boundaries of a product market are determined by the reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it. However, within this broad market, well-defined submarkets may exist which, in themselves, constitute product markets for antitrust purposes. *United States v. E. I. duPont de Nemours & Co.*, 353 U. S. 586, 593-595.[1] The boundaries of such a submarket may be determined by examining such practical indicia as industry or public recognition of the submarket 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.43 Because § 7 of the Clayton Act prohibits any merger which may substantially lessen competition "in any line of commerce" (emphasis supplied), it is necessary to examine the effects of a merger in each such economically significant submarket to determine if there is a reasonable probability that the merger will substantially lessen competition. If such a probability is found to exist, the merger is proscribed.

Applying these considerations to the present case, we conclude that the record supports the District Court's finding that the relevant lines of commerce are men's, women's, and children's shoes. These product lines are recognized by the public; each line is manufactured in separate plants; each has characteristics peculiar to itself rendering it generally noncompetitive with the others; and each is, of course, directed toward a distinct class of customers.

[*Application of facts to these factors omitted*]

[1. This reference is to the last two paragraphs of *du Pont* quoted above. There is no mention in these paragraphs of markets and submarkets, although the *du Pont* Court does reject all fabrics and finishes sold to industrial users (apparently the broader market) as the relevant line of commerce in which to analyze the transaction in favor of fabrics and finishes sold to automotive users (apparently the submarket).]

The Geographic Market.

We agree with the parties and the District Court that insofar as the vertical aspect of this merger is concerned, the relevant geographic market is the entire Nation. The relationships of product value, bulk, weight and consumer demand enable manufacturers to distribute their shoes on a nationwide basis, as Brown and Kinney, in fact, do. The anticompetitive effects of the merger are to be measured within this range of distribution.

[*Competitive effects analysis omitted*]

. . .

V.

THE HORIZONTAL ASPECTS OF THE MERGER.

An economic arrangement between companies performing similar functions in the production or sale of comparable goods or services is characterized as "horizontal." The effect on competition of such an arrangement depends, of course, upon its character and scope. Thus, its validity in the face of the antitrust laws will depend upon such factors as: the relative size and number of the parties to the arrangement; whether it allocates shares of the market among the parties; whether it fixes prices at which the parties will sell their product; or whether it absorbs or insulates competitors. Where the arrangement effects a horizontal merger between companies occupying the same product and geographic market, whatever competition previously may have existed in that market between the parties to the merger is eliminated. Section 7 of the Clayton Act, prior to its amendment, focused upon this aspect of horizontal combinations by proscribing acquisitions which might result in a lessening of competition between the acquiring and the acquired companies. The 1950 amendments made plain Congress' intent that the validity of such combinations was to be gauged on a broader scale: their effect on competition generally in an economically significant market.

Thus, again, the proper definition of the market is a "necessary predicate" to an examination of the competition that may be affected by the horizontal aspects of the merger. The acquisition of Kinney by Brown resulted in a horizontal combination at both the manufacturing and retailing levels of their businesses. Although the District Court found that the merger of Brown's and Kinney's manufacturing facilities was economically too insignificant to come within the prohibitions of the Clayton Act, the Government has not appealed from this portion of the lower court's decision. Therefore, we have no occasion to express our views with respect to that finding. On the other hand, appellant does contest the District Court's finding that the merger of the companies' retail outlets may tend substantially to lessen competition.

The Product Market.

Shoes are sold in the United States in retail shoe stores and in shoe departments of general stores. These outlets sell: (1) men's shoes, (2) women's shoes, (3) women's or children's shoes, or (4) men's, women's or children's shoes. Prior to the merger, both Brown and Kinney sold their shoes in competition with one another through the enumerated kinds of outlets characteristic of the industry. In Part IV of this opinion we hold that the District Court correctly defined men's, women's, and children's shoes as the relevant lines of commerce in which to analyze the vertical aspects of the merger. For the reasons there stated we also hold that the same lines of commerce are appropriate for considering the horizontal aspects of the merger.

The Geographic Market.

The criteria to be used in determining the appropriate geographic market are essentially similar to those used to determine the relevant product market. Moreover, just as a product submarket may have § 7 significance as the proper "line of commerce," so may a geographic submarket be considered the appropriate "section of the country." Congress prescribed a pragmatic, factual approach to the definition of the relevant market and not a formal, legalistic one. The geographic market selected must, therefore, both "correspond to the commercial realities" of the industry and be economically significant. Thus, although the geographic market in some instances may encompass the entire Nation, under other circumstances it may be as small as a single metropolitan area. The fact that two merging firms have competed directly on the horizontal level in but a fraction of the geographic markets in which either has operated, does not, in itself, place their merger outside the scope of § 7. That section speaks of "any . . . section of the country," and if anticompetitive effects of a merger are probable in "any" significant market, the merger—at least to that extent—is proscribed.

The parties do not dispute the findings of the District Court that the Nation as a whole is the relevant geographic market for measuring the anticompetitive effects of the merger viewed vertically or of the horizontal merger of Brown's and Kinney's manufacturing facilities. As to the retail level, however, they disagree.

The District Court .found that the effects of this aspect of the merger must be analyzed in every city with a population exceeding 10,000 and its immediate contiguous surrounding territory in which both Brown and Kinney sold shoes at retail through stores they either owned or controlled. By this definition of the geographic market, less than one-half of all the cities in which either Brown or Kinney sold shoes through such outlets are represented. The appellant recognizes that if the District Court's characterization of the relevant market is proper, the number of markets in which both Brown and Kinney have outlets is sufficiently numerous so that the validity of the entire merger is properly judged by testing its effects in those markets. However, it is appellant's contention that the areas of effective competition in shoe retailing were improperly defined by the District Court. It claims that such areas should, in some cases, be defined so as to include only the central business districts of large cities, and in others, so as to encompass the "standard metropolitan areas" within which smaller communities are found. It argues that any test failing to distinguish between these competitive situations is improper.

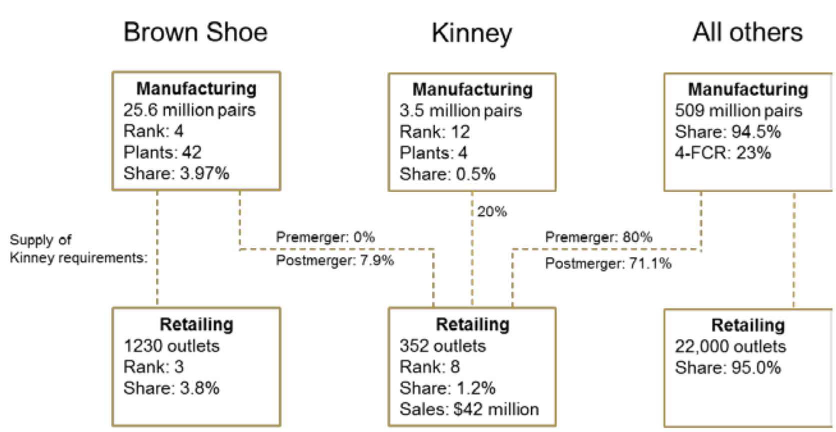
We believe, however, that the record fully supports the District Court's findings that shoe stores in the outskirts of cities compete effectively with stores in central downtown areas, and that while there is undoubtedly some commercial intercourse between smaller communities within a single "standard metropolitan area," the most intense and important competition in retail sales will be confined to stores within the particular communities in such an area and their immediate environs.

We therefore agree that the District Court properly defined the relevant geographic markets in which to analyze this merger as those cities with a population exceeding 10,000 and their environs in which both Brown and Kinney retailed shoes through their own outlets. Such markets are large enough to include the downtown shops and suburban shopping centers in areas contiguous to the city, which are the important competitive factors, and yet are small enough to exclude stores beyond the immediate environs of the city, which are of little competitive significance.

[*Competitive effects analysis omitted*]

NOTES

1. *Brown Shoe* was the first merger antitrust case the Supreme Court decided on the substantive merits under Section 7 as amended by the Celler-Kefauver Act. On November 28, 1955, the Department of Justice filed suit seeking to block the merger of the Brown Shoe Company (of "Buster Brown" fame) and the G.R. Kinney Company, two major integrated shoe manufacturers and retailers, on the grounds that the combination would violate Section 7 in the production, distribution and retail sale of shoes. At the time of the acquisition, Brown was the nation's fourth largest manufacturer of shoes, but only with a 3.97% market share, and the third largest retailer, but only with a 3.8% market share. Kinney was the nation's twelfth largest manufacturer (0.5%) and the eight largest retailer (1.2%). The government challenged both the vertical and horizontal aspects of the transaction.



At the time of the acquisition, domestic shoe production remained fragmented among a large number of manufacturers, but producers were rapidly consolidating as well as acquiring independent retail outlets. Brown was a leading participant in the consolidation of the industry, especially in retailing. Brown had re-entered retailing in

1951 and through a series of acquisitions had become the nation's third-largest retailer by 1955. With the acquisition of Kinney, Brown would move from the nation's fourth largest to the third largest shoe manufacturer, with approximately five percent of total domestic shoe production. Moreover, the acquisition gave Brown more retail outlets than any other shoe manufacturer and moved it from third to second in net sales of shoes at retail nationwide. While prior to the merger Kinney had bought no shoes from Brown, by 1957 Brown had become Kinney's largest outside supplier, accounting for 7.9 percent of all Kinney's requirements, and was continuing to grow in importance as a supplier. For its part, Kinney supplied a rapidly increasing percentage of the shoes it produced to Brown retail outlets, while diminishing its sales to independent retailers.

2. The *Brown Shoe* majority opinion was written by Chief Justice Earl Warren joined by at least four associate justices, the Court affirmed the lower court's judgment that Brown's acquisition of Kinney violated the amended Section 7. Justice Tom C. Clark concurred in at least the result (his opinion is not clear as to how much, if at all, he agreed with the majority's reasoning), while Justice John Marshall Harlan II, grandson of the Justice Harlan of *Northern Securities* fame, dissented as to the Court's jurisdiction but concurred in the result, although not the majority opinion, on the merits.[2]

3. The *Brown Shoe* Court reaffirmed the *DuPont/GM* observation that merger antitrust analysis bifurcates into a determination of the product and geographic boundaries of the relevant "line of commerce" and "section of the country" as well as an assessment of the competitive effect of the transaction within this market. Warren held that the "outer boundaries" of a product market are determined by the "reasonable interchangeability of use" and the "cross-elasticity of demand" between the products in question.[3] But these two concepts did not exhaustively identify all relevant "lines of commerce" for Section 7 purposes. Apparently building upon *DuPont/GM's* observation that "automotive finishes and fabrics have sufficient peculiar characteristics and uses to constitute them sufficiently different from all other finishes and fabrics to make them a 'line of commerce' within the meaning of the Clayton Act,"[4] the *Brown Shoe* Court formally recognized the existence of "submarkets," that is, relevant lines of commerce within the broader market defined by reasonable

2. Justice Felix Frankfurter, who was in the process of retiring (to be replaced by Arthur J. Goldberg), and Justice Byron R. White, who had just been appointed to the Court (replacing Charles Evans Whittaker), did not participate in the decision.

3. *Brown Shoe*, 370 U.S. at 325. The Court also observed in a footnote that "cross-elasticity of production"—presumably cross-elasticity of supply—could also be an important factor in defining product markets. *Id.* at 325 n. 42. The idea that supply-side substitution can be used to define product markets was never fully developed in the case law, and was ultimately rejected as a defining principle by the federal enforcement agencies beginning with the 1982 Merger Guidelines.

4. *Id.* (citing United States v. E.I. du Pont de Nemours & Co., 353 U.S. 586, 593-95 (1957)). *DuPont/GM* did not employ the concept of a "submarket," and the *Brown Shoe* Court did not say exactly why it was citing the case. The language from *DuPont/GM* quoted in the text is the only suggestion I can find that links the case to the *Brown Shoe* submarket concept.

interchangeability of use and the cross-elasticity of demand. Submarkets, the Court said, could be determined

> by examining such practical indicia as industry or public recognition of the submarket as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, sensitivity to price changes, and specialized vendors.[5]

While the discussion in *Brown Shoe* initially addressed product submarkets, the *Brown Shoe* Court also applied the concept to "areas of the country" or geographic submarkets.[6] If a submarket was "economically significant," then it, like a "market" proper, was a "line of commerce" in a "section of the country" to which Section 7 applied. The Court held that, because Section 7 prohibits any merger or acquisition that may substantially lessen competition "in *any* line of commerce in *any* section of the country," the finding of the requisite anticompetitive effect in any relevant market *or submarket* is sufficient to make the combination unlawful, even if the transaction would be significantly procompetitive or have other socially redeeming virtues in other markets or submarkets.[7]

4. Significantly, although the *Brown Shoe* Court's discussion of submarkets clearly implied that not all of the enumerated indicia had to be present, the Court give no indication of the relative importance of these factors or in any other way indicated a test or threshold to distinguish product groupings that constituted submarkets from those that did not. Nor did a test later emerge in the case law. The lack of a sharp principle to delineate submarkets was to leave the courts, the antitrust enforcement agencies and the public at sea in judging the legality of mergers and acquisitions as market shares and market concentration became the critical factors in merger antitrust analysis. Probably no other concept has done as much damage to merger antitrust policy as that of submarkets.

5. *Id*.

6. *Id*. at 336 (citing Erie Sand & Gravel Co. v. FTC, 291 F.2d 279, 283 (3d Cir. 1961); United States v. Bethlehem Steel Corp., 168 F. Supp. 576, 595-603 (S.D.N.Y. 1958)).

7. *Id*. at 325 (citing United States v. E.I. du Pont de Nemours & Co., 353 U.S. 586, 592, 595 (1957)).

Horizontal Merger Guidelines
Market Definition

Horizontal Merger Guidelines

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

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1. Market Definition, Measurement and Concentration

1.0 Overview

A merger is unlikely to create or enhance market power or to facilitate its exercise unless it significantly increases concentration and results in a concentrated market, properly defined and measured. Mergers that either do not significantly increase concentration or do not result in a concentrated market ordinarily require no further analysis.

The analytic process described in this section ensures that the Agency evaluates the likely competitive impact of a merger within the context of economically meaningful markets -- i.e., markets that could be subject to the exercise of market power. Accordingly, for each product or service (hereafter "product") of each merging firm, the Agency seeks to define a market in which firms could effectively exercise market power if they were able to coordinate their actions.

Market definition focuses solely on demand substitution factors -- i.e., possible consumer responses. Supply substitution factors -- i.e., possible production responses -- are considered elsewhere in the Guidelines in the identification of firms that participate in the relevant market and the analysis of entry. See Sections 1.3 and 3. A market is defined as a product or group of products and a geographic area in which it is produced or sold such that a hypothetical profit-maximizing firm, not subject to price regulation, that was the only present and future producer or seller of those products in that area likely would impose at least a "small but significant and nontransitory" increase in price, assuming the terms of sale of all other products are held constant. A relevant market is a group of products and a geographic area that is no bigger than necessary to satisfy this test. The "small but significant and nontransitory" increase in price is employed solely as a methodological tool for the analysis of mergers: it is not a tolerance level for price increases.

Absent price discrimination, a relevant market is described by a product or group of products and a geographic area. In determining whether a hypothetical monopolist would be in a position to exercise market power, it is necessary to evaluate the likely demand responses of consumers to a price increase. A price increase could be made unprofitable by consumers either switching to other products or switching to the same product produced by firms at other locations. The nature and magnitude of these two types of demand responses respectively determine the scope of the product market and the geographic market.

In contrast, where a hypothetical monopolist likely would discriminate in prices charged to different groups of buyers, distinguished, for example, by their uses or locations, the Agency may delineate different relevant markets corresponding to each such buyer group. Competition for sales to each such group may be affected differently by a particular merger and markets are delineated by evaluating the demand response of each such buyer group. A relevant market of this kind is described by a collection of products for sale to a given group of buyers.

Once defined, a relevant market must be measured in terms of its participants and concentration. Participants include firms currently producing or selling the market's products in the market's geographic area. In addition, participants may include other firms depending on their likely supply responses to a "small but significant and nontransitory" price increase. A firm is viewed as a participant if, in response to a "small but significant and nontransitory" price increase, it likely would enter rapidly into production or sale of a market product in the market's area, without incurring significant sunk costs of entry and exit. Firms likely to make any of these supply responses are considered to be "uncommitted" entrants because their supply response would create new production or sale in the relevant market and because that production or sale could be quickly terminated without significant loss.[7] Uncommitted entrants are capable of making such quick and uncommitted supply responses that they likely influenced the market premerger, would influence it post-merger, and accordingly are considered as market participants at both times. This analysis of market definition and market measurement applies equally to foreign and domestic firms.

If the process of market definition and market measurement identifies one or more relevant markets in which the merging firms are both participants, then the merger is considered to be horizontal. Sections 1.1 through 1.5 describe in greater detail how product and geographic markets will be defined, how market shares will be calculated and how market concentration will be assessed.

[7] Probable supply responses that require the entrant to incur significant sunk costs of entry and exit are not part of market measurement, but are included in the analysis of the significance of entry. See Section 3. Entrants that must commit substantial sunk costs are regarded as "committed" entrants because those sunk costs make entry irreversible in the short term without foregoing that investment; thus the likelihood of their entry must be evaluated with regard to their long-term profitability.

1.1 Product Market Definition

The Agency will first define the relevant product market with respect to each of the products of each of the merging firms. [8]

1.11 General Standards

Absent price discrimination, the Agency will delineate the product market to be a product or group of products such that a hypothetical profit-maximizing firm that was the only present and future seller of those products ("monopolist") likely would impose at least a "small but significant and nontransitory" increase in price. That is, assuming that buyers likely would respond to an increase in price for a tentatively identified product group only by shifting to other products, what would happen? If the alternatives were, in the aggregate, sufficiently attractive at their existing terms of sale, an attempt to raise prices would result in a reduction of sales large enough that the price increase would not prove profitable, and the tentatively identified product group would prove to be too narrow.

Specifically, the Agency will begin with each product (narrowly defined) produced or sold by each merging firm and ask what would happen if a hypothetical monopolist of that product imposed at least a "small but significant and nontransitory" increase in price, but the terms of sale of all other products remained constant. If, in response to the price increase, the reduction in sales of the product would be large enough that a hypothetical monopolist would not find it profitable to impose such an increase in price, then the Agency will add to the product group the product that is the next-best substitute for the merging firm's product.[9]

In considering the likely reaction of buyers to a price increase, the Agency will take into account all relevant evidence, including, but not limited to, the following:

(1) evidence that buyers have shifted or have considered shifting purchases between products in response to relative changes in price or other competitive variables;

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[8] Although discussed separately, product market definition and geographic market definition are interrelated. In particular, the extent to which buyers of a particular product would shift to other products in the event of a "small but significant and nontransitory" increase in price must be evaluated in the context of the relevant geographic market.

[9] Throughout the Guidelines, the term "next best substitute" refers to the alternative which, if available in unlimited quantities at constant prices, would account for the greatest value of diversion of demand in response to a "small but significant and nontransitory" price increase.

(2) evidence that sellers base business decisions on the prospect of buyer substitution between products in response to relative changes in price or other competitive variables;

(3) the influence of downstream competition faced by buyers in their output markets; and

(4) the timing and costs of switching products.

The price increase question is then asked for a hypothetical monopolist controlling the expanded product group. In performing successive iterations of the price increase test, the hypothetical monopolist will be assumed to pursue maximum profits in deciding whether to raise the prices of any or all of the additional products under its control. This process will continue until a group of products is identified such that a hypothetical monopolist over that group of products would profitably impose at least a "small but significant and nontransitory" increase, including the price of a product of one of the merging firms. The Agency generally will consider the relevant product market to be the smallest group of products that satisfies this test.

In the above analysis, the Agency will use prevailing prices of the products of the merging firms and possible substitutes for such products, unless premerger circumstances are strongly suggestive of coordinated interaction, in which case the Agency will use a price more reflective of the competitive price.[10] However, the Agency may use likely future prices, absent the merger, when changes in the prevailing prices can be predicted with reasonable reliability. Changes in price may be predicted on the basis of, for example, changes in regulation which affect price either directly or indirectly by affecting costs or demand.

In general, the price for which an increase will be postulated will be whatever is considered to be the price of the product at the stage of the industry being examined.[11] In attempting to determine objectively the effect of a "small but significant and nontransitory" increase in price, the Agency, in most contexts, will use a price increase of five percent lasting for the foreseeable future. However, what constitutes a "small but significant and nontransitory" increase in price will depend on the nature of the

[10] The terms of sale of all other products are held constant in order to focus market definition on the behavior of consumers. Movements in the terms of sale for other products, as may result from the behavior of producers of those products, are accounted for in the analysis of competitive effects and entry. See Sections 2 and 3.

[11] For example, in a merger between retailers, the relevant price would be the retail price of a product to consumers. In the case of a merger among oil pipelines, the relevant price would be the tariff -- the price of the transportation service.

industry, and the Agency at times may use a price increase that is larger or smaller than five percent.

1.12 Product Market Definition in the Presence of Price Discrimination

The analysis of product market definition to this point has assumed that price discrimination -- charging different buyers different prices for the same product, for example -- would not be profitable for a hypothetical monopolist. A different analysis applies where price discrimination would be profitable for a hypothetical monopolist.

Existing buyers sometimes will differ significantly in their likelihood of switching to other products in response to a "small but significant and nontransitory" price increase. If a hypothetical monopolist can identify and price differently to those buyers ("targeted buyers") who would not defeat the targeted price increase by substituting to other products in response to a "small but significant and nontransitory" price increase for the relevant product, and if other buyers likely would not purchase the relevant product and resell to targeted buyers, then a hypothetical monopolist would profitably impose a discriminatory price increase on sales to targeted buyers. This is true regardless of whether a general increase in price would cause such significant substitution that the price increase would not be profitable. The Agency will consider additional relevant product markets consisting of a particular use or uses by groups of buyers of the product for which a hypothetical monopolist would profitably and separately impose at least a "small but significant and nontransitory" increase in price.

1.2 Geographic Market Definition

For each product market in which both merging firms participate, the Agency will determine the geographic market or markets in which the firms produce or sell. A single firm may operate in a number of different geographic markets.

1.21 General Standards

Absent price discrimination, the Agency will delineate the geographic market to be a region such that a hypothetical monopolist that was the only present or future producer of the relevant product at locations in that region would profitably impose at least a "small but significant and nontransitory" increase in price, holding constant the terms of sale for all products produced elsewhere. That is, assuming that buyers likely would respond to a price increase on products produced within the tentatively identified region only by shifting to products produced at locations of production outside the region, what would happen? If those locations of production outside the region were, in the aggregate, sufficiently attractive at their existing terms of sale, an attempt to raise price would result in a reduction in sales large enough that the price increase would not prove profitable, and the tentatively identified geographic area would prove to be too narrow.

In defining the geographic market or markets affected by a merger, the Agency will begin with the location of each merging firm (or each plant of a multiplant firm) and ask what would happen if a hypothetical monopolist of the relevant product at that point imposed at least a "small but significant and nontransitory" increase in price, but the terms of sale at all other locations remained constant. If, in response to the price increase, the reduction in sales of the product at that location would be large enough that a hypothetical monopolist producing or selling the relevant product at the merging firm's location would not find it profitable to impose such an increase in price, then the Agency will add the location from which production is the next-best substitute for production at the merging firm's location.

In considering the likely reaction of buyers to a price increase, the Agency will take into account all relevant evidence, including, but not limited to, the following:

(1) evidence that buyers have shifted or have considered shifting purchases between different geographic locations in response to relative changes in price or other competitive variables;

(2) evidence that sellers base business decisions on the prospect of buyer substitution between geographic locations in response to relative changes in price or other competitive variables;

(3) the influence of downstream competition faced by buyers in their output markets; and

(4) the timing and costs of switching suppliers.

The price increase question is then asked for a hypothetical monopolist controlling the expanded group of locations. In performing successive iterations of the price increase test, the hypothetical monopolist will be assumed to pursue maximum profits in deciding whether to raise the price at any or all of the additional locations under its control. This process will continue until a group of locations is identified such that a hypothetical monopolist over that group of locations would profitably impose at least a "small but significant and nontransitory" increase, including the price charged at a location of one of the merging firms.

The "smallest market" principle will be applied as it is in product market definition. The price for which an increase will be postulated, what constitutes a "small but significant and nontransitory" increase in price, and the substitution decisions of consumers all will be determined in the same way in which they are determined in product market definition.

1.22 Geographic Market Definition in the Presence of Price Discrimination

The analysis of geographic market definition to this point has assumed that geographic price discrimination -- charging different prices net of transportation costs for the same product to buyers in different areas, for example -- would not be profitable for a hypothetical monopolist. However, if a hypothetical monopolist can identify and price differently to buyers in certain areas ("targeted buyers") who would not defeat the targeted price increase by substituting to more distant sellers in response to a "small but significant and nontransitory" price increase for the relevant product, and if other buyers likely would not purchase the relevant product and resell to targeted buyers,[12] then a hypothetical monopolist would profitably impose a discriminatory price increase. This is true even where a general price increase would cause such significant substitution that the price increase would not be profitable. The Agency will consider additional geographic markets consisting of particular locations of buyers for which a hypothetical monopolist would profitably and separately impose at least a "small but significant and nontransitory" increase in price.

[12] This arbitrage is inherently impossible for many services and is particularly difficult where the product is sold on a delivered basis and where transportation costs are a significant percentage of the final cost.

1.3 Identification of Firms That Participate in the Relevant Market

1.31 Current Producers or Sellers

The Agency's identification of firms that participate in the relevant market begins with all firms that currently produce or sell in the relevant market. This includes vertically integrated firms to the extent that such inclusion accurately reflects their competitive significance in the relevant market prior to the merger. To the extent that the analysis under Section 1.1 indicates that used, reconditioned or recycled goods are included in the relevant market, market participants will include firms that produce or sell such goods and that likely would offer those goods in competition with other relevant products.

1.32 Firms That Participate Through Supply Response

In addition, the Agency will identify other firms not currently producing or selling the relevant product in the relevant area as participating in the relevant market if their inclusion would more accurately reflect probable supply responses. These firms are termed "uncommitted entrants." These supply responses must be likely to occur within one year and without the expenditure of significant sunk costs of entry and exit, in response to a "small but significant and nontransitory" price increase. If a firm has the technological capability to achieve such an uncommitted supply response, but likely would not (e.g., because difficulties in achieving product acceptance, distribution, or production would render such a response unprofitable), that firm will not be considered to be a market participant. The competitive significance of supply responses that require more time or that require firms to incur significant sunk costs of entry and exit will be considered in entry analysis. See Section 3.[13]

Sunk costs are the acquisition costs of tangible and intangible assets that cannot be recovered through the redeployment of these assets outside the relevant market, i.e., costs uniquely incurred to supply the relevant product and geographic market. Examples of sunk costs may include mar-

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13 If uncommitted entrants likely would also remain in the market and would meet the entry tests of timeliness, likelihood and sufficiency, and thus would likely deter anticompetitive mergers or deter or counteract the competitive effects of concern (see Section 3, *infra*), the Agency will consider the impact of those firms in the entry analysis.

ket-specific investments in production facilities, technologies, marketing (including product acceptance), research and development, regulatory approvals, and testing. A significant sunk cost is one which would not be recouped within one year of the commencement of the supply response, assuming a "small but significant and nontransitory" price increase in the relevant market. In this context, a "small but significant and nontransitory" price increase will be determined in the same way in which it is determined in product market definition, except the price increase will be assumed to last one year. In some instances, it may be difficult to calculate sunk costs with precision. Accordingly, when necessary, the Agency will make an overall assessment of the extent of sunk costs for firms likely to participate through supply responses.

These supply responses may give rise to new production of products in the relevant product market or new sources of supply in the relevant geographic market. Alternatively, where price discrimination is likely so that the relevant market is defined in terms of a targeted group of buyers, these supply responses serve to identify new sellers to the targeted buyers. Uncommitted supply responses may occur in several different ways: by the switching or extension of existing assets to production or sale in the relevant market; or by the construction or acquisition of assets that enable production or sale in the relevant market.

1.321 Production Substitution and Extension: The Switching or Extension of Existing Assets to Production or Sale in the Relevant Market

The productive and distributive assets of a firm sometimes can be used to produce and sell either the relevant products or products that buyers do not regard as good substitutes. Production substitution refers to the shift by a firm in the use of assets from producing and selling one product to producing and selling another. Production extension refers to the use of those assets, for example, existing brand names and reputation, both for their current production and for production of the relevant product. Depending upon the speed of that shift and the extent of sunk costs incurred in the shift or extension, the potential for production substitution or extension may necessitate treating as market participants firms that do not currently produce the relevant product.[14]

If a firm has existing assets that likely would be shifted or extended into production and sale of the relevant product within one year, and without incurring significant sunk costs of entry and exit, in response to a "small but significant and nontransitory" increase in price for only the relevant product, the Agency will treat that firm as a market participant. In assessing whether a firm is such a market participant, the Agency will take into account the costs of substitution or extension relative to the profitability of sales at the elevated price, and whether the firm's capacity is elsewhere committed or elsewhere so profitably employed that such capacity likely would not be available to respond to an increase in price in the market.

1.322 Obtaining New Assets for Production or Sale of the Relevant Product

A firm may also be able to enter into production or sale in the relevant market within one year and without the expenditure of significant sunk costs of entry and exit, in response to a "small but significant and nontransitory" increase in price for only the relevant product, even if the firm is newly organized or is an existing firm without products or productive assets closely related to the relevant market. If new firms, or existing firms without closely related products or productive assets, likely would enter into production or sale in the relevant market within one year without the expenditure of significant sunk costs of entry and exit, the Agency will treat those firms as market participants.

1.4 Calculating Market Shares

1.41 General Approach

The Agency normally will calculate market shares for all firms (or plants) identified as market participants in Section 1.3 based on the total sales or capacity currently devoted to the relevant market together with that

14 Under other analytical approaches, production substitution sometimes has been reflected in the description of the product market. For example, the product market for stamped metal products such as automobile hub caps might be described as "light metal stamping," a production process rather than a product. The Agency believes that the approach described in the text provides a more clearly focused method of incorporating this factor in merger analysis. If production substitution among a group of products is nearly universal among the firms selling one or more of those products, however, the Agency may use an aggregate description of those markets as a matter of convenience.

which likely would be devoted to the relevant market in response to a "small but significant and nontransitory" price increase. Market shares can be expressed either in dollar terms through measurement of sales, shipments, or production, or in physical terms through measurement of sales, shipments, production, capacity, or reserves.

Market shares will be calculated using the best indicator of firms' future competitive significance. Dollar sales or shipments generally will be used if firms are distinguished primarily by differentiation of their products. Unit sales generally will be used if firms are distinguished primarily on the basis of their relative advantages in serving different buyers or groups of buyers. Physical capacity or reserves generally will be used if it is these measures that most effectively distinguish firms.[15] Typically, annual data are used, but where individual sales are large and infrequent so that annual data may be unrepresentative, the Agency may measure market shares over a longer period of time.

In measuring a firm's market share, the Agency will not include its sales or capacity to the extent that the firm's capacity is committed or so profitably employed outside the relevant market that it would not be available to respond to an increase in price in the market.

1.42 Price Discrimination Markets

When markets are defined on the basis of price discrimination (Sections 1.12 and 1.22), the Agency will include only sales likely to be made into, or capacity likely to be used to supply, the relevant market in response to a "small but significant and nontransitory" price increase.

1.43 Special Factors Affecting Foreign Firms

Market shares will be assigned to foreign competitors in the same way in which they are assigned to domestic competitors. However, if exchange rates fluctuate significantly, so that comparable dollar calculations on an annual basis may be unrepresentative, the Agency may measure market shares over a period longer than one year.

If shipments from a particular country to the United States are subject to a quota, the market shares assigned to firms in that country will not

[15] Where all firms have, on a forward-looking basis, an equal likelihood of securing sales, the Agency will assign firms equal shares.

exceed the amount of shipments by such firms allowed under the quota.[16] In the case of restraints that limit imports to some percentage of the total amount of the product sold in the United States (i.e., percentage quotas), a domestic price increase that reduced domestic consumption also would reduce the volume of imports into the United States. Accordingly, actual import sales and capacity data will be reduced for purposes of calculating market shares. Finally, a single market share may be assigned to a country or group of countries if firms in that country or group of countries act in coordination.

1.5 Concentration and Market Shares

Market concentration is a function of the number of firms in a market and their respective market shares. As an aid to the interpretation of market data, the Agency will use the Herfindahl-Hirschman Index ("HHI") of market concentration. The HHI is calculated by summing the squares of the individual market shares of all the participants.[17] Unlike the four-firm concentration ratio, the HHI reflects both the distribution of the market shares of the top four firms and the composition of the market outside the top four firms. It also gives proportionately greater weight to the market shares of the larger firms, in accord with their relative importance in competitive interactions.

The Agency divides the spectrum of market concentration as measured by the HHI into three regions that can be broadly characterized as unconcentrated (HHI below 1000), moderately concentrated (HHI between 1000 and 1800), and highly concentrated (HHI above 1800). Although the resulting regions provide a useful framework for merger analysis, the numerical divisions suggest greater precision than is possible with the available economic tools and information. Other things being equal, cases falling just above and just below a threshold present comparable competitive issues.

[16] The constraining effect of the quota on the importer's ability to expand sales is relevant to the evaluation of potential adverse competitive effects. See Section 2.

[17] For example, a market consisting of four firms with market shares of 30 percent, 30 percent, 20 percent and 20 percent has an HHI of 2600 ($30^2 + 30^2 + 20^2 + 20^2 = 2600$). The HHI ranges from 10,000 (in the case of a pure monopoly) to a number approaching zero (in the case of an atomistic market). Although it is desirable to include all firms in the calculation, lack of information about small firms is not critical because such firms do not affect the HHI significantly.

Horizontal Merger Guidelines

U.S. Department of Justice

and the

Federal Trade Commission

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impractical due to transportation costs. Arbitrage on a modest scale may be possible but sufficiently costly or limited that it would not deter or defeat a discriminatory pricing strategy.

4. Market Definition

When the Agencies identify a potential competitive concern with a horizontal merger, market definition plays two roles. First, market definition helps specify the line of commerce and section of the country in which the competitive concern arises. In any merger enforcement action, the Agencies will normally identify one or more relevant markets in which the merger may substantially lessen competition. Second, market definition allows the Agencies to identify market participants and measure market shares and market concentration. See Section 5. The measurement of market shares and market concentration is not an end in itself, but is useful to the extent it illuminates the merger's likely competitive effects.

The Agencies' analysis need not start with market definition. Some of the analytical tools used by 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.

Evidence of competitive effects can inform market definition, just as market definition can be informative regarding competitive effects. For example, evidence that a reduction in the number of significant rivals offering a group of products causes prices for those products to rise significantly can itself establish that those products form a relevant market. Such evidence also may more directly predict the competitive effects of a merger, reducing the role of inferences from market definition and market shares.

Where analysis suggests alternative and reasonably plausible candidate markets, and where the resulting market shares lead to very different inferences regarding competitive effects, it is particularly valuable to examine more direct forms of evidence concerning those effects.

Market definition focuses solely on demand substitution factors, i.e., on customers' ability and willingness to substitute away from one product to another in response to a price increase or a corresponding non-price change such as a reduction in product quality or service. The responsive actions of suppliers are also important in competitive analysis. They are considered in these Guidelines in the sections addressing the identification of market participants, the measurement of market shares, the analysis of competitive effects, and entry.

Customers often confront a range of possible substitutes for the products of the merging firms. Some substitutes may be closer, and others more distant, either geographically or in terms of product attributes and perceptions. Additionally, customers may assess the proximity of different products differently. When products or suppliers in different geographic areas are substitutes for one another to varying degrees, defining a market to include some substitutes and exclude others is inevitably a simplification that cannot capture the full variation in the extent to which different products compete against each other. The principles of market definition outlined below seek to make this inevitable simplification as useful and informative as is practically possible. Relevant markets need not have precise metes and bounds.

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. Although excluding more distant substitutes from the market inevitably understates their competitive significance to some degree, doing so often provides a more accurate indicator of the competitive effects of the merger than would the alternative of including them and overstating their competitive significance as proportional to their shares in an expanded market.

> *Example 4:* Firms A and B, sellers of two leading brands of motorcycles, propose to merge. If Brand A motorcycle prices were to rise, some buyers would substitute to Brand B, and some others would substitute to cars. However, motorcycle buyers see Brand B motorcycles as much more similar to Brand A motorcycles than are cars. Far more cars are sold than motorcycles. Evaluating shares in a market that includes cars would greatly underestimate the competitive significance of Brand B motorcycles in constraining Brand A's prices and greatly overestimate the significance of cars.

Market shares of different products in narrowly defined markets are more likely to capture the relative competitive significance of these products, and often more accurately reflect competition between close substitutes. As a result, properly defined antitrust markets often exclude some substitutes to which some customers might turn in the face of a price increase even if such substitutes provide alternatives for those customers. However, a group of products is too narrow to constitute a relevant market if competition from products outside that group is so ample that even the complete elimination of competition within the group would not significantly harm either direct customers or downstream consumers. The hypothetical monopolist test (see Section 4.1.1) is designed to ensure that candidate markets are not overly narrow in this respect.

The Agencies implement these principles of market definition flexibly when evaluating different possible candidate markets. Relevant antitrust markets defined according to the hypothetical monopolist test are not always intuitive and may not align with how industry members use the term "market."

Section 4.1 describes the principles that apply to product market definition, and gives guidance on how the Agencies most often apply those principles. Section 4.2 describes how the same principles apply to geographic market definition. Although discussed separately for simplicity of exposition, the principles described in Sections 4.1 and 4.2 are combined to define a relevant market, which has both a product and a geographic dimension. In particular, the hypothetical monopolist test is applied to a group of products together with a geographic region to determine a relevant market.

4.1 Product Market Definition

When a product sold by one merging firm (Product A) competes against one or more products sold by the other merging firm, the Agencies define a relevant product market around Product A to evaluate the importance of that competition. Such a relevant product market consists of a group of substitute products including Product A. Multiple relevant product markets may thus be identified.

4.1.1 The Hypothetical Monopolist Test

The Agencies employ the hypothetical monopolist test to evaluate whether groups of products in candidate markets are sufficiently broad to constitute relevant antitrust markets. The Agencies use the hypothetical monopolist test to identify a set of products that are reasonably interchangeable with a product sold by one of the merging firms.

The hypothetical monopolist test requires that a product market contain enough substitute products so that it could be subject to post-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.[4] For the purpose of analyzing this issue, the terms of sale of products outside the candidate market are held constant. The SSNIP is employed solely as a methodological tool for performing the hypothetical monopolist test; it is not a tolerance level for price increases resulting from a merger.

Groups of products may satisfy the hypothetical monopolist test without including the full range of substitutes from which customers choose. 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.

> *Example 5:* Products A and B are being tested as a candidate market. Each sells for $100, has an incremental cost of $60, and sells 1200 units. For every dollar increase in the price of Product A, for any given price of Product B, Product A loses twenty units of sales to products outside the candidate market and ten units of sales to Product B, and likewise for Product B. Under these conditions, economic analysis shows that a hypothetical profit-maximizing monopolist controlling Products A and B would raise both of their prices by ten percent, to $110. Therefore, Products A and B satisfy the hypothetical monopolist test using a five percent SSNIP, and indeed for any SSNIP size up to ten percent. This is true even though two-thirds of the sales lost by one product when it raises its price are diverted to products outside the relevant market.

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. The third product is a closer substitute if, in response to a SSNIP on the first product, greater revenues are diverted to the third product than to the second product.

> *Example 6:* In Example 5, suppose that half of the unit sales lost by Product A when it raises its price are diverted to Product C, which also has a price of $100, while one-third are diverted to Product B. Product C is a closer substitute for Product A than is Product B. Thus Product C will normally be included in the relevant market, even though Products A and B together satisfy the hypothetical monopolist test.

The hypothetical monopolist test ensures that markets are not defined too narrowly, but it does not lead to a single relevant market. The Agencies may evaluate a merger in any relevant market

4 If the pricing incentives of the firms supplying the products in the candidate market differ substantially from those of the hypothetical monopolist, for reasons other than the latter's control over a larger group of substitutes, the Agencies may instead employ the concept of a hypothetical profit-maximizing cartel comprised of the firms (with all their products) that sell the products in the candidate market. This approach is most likely to be appropriate if the merging firms sell products outside the candidate market that significantly affect their pricing incentives for products in the candidate market. This could occur, for example, if the candidate market is one for durable equipment and the firms selling that equipment derive substantial net revenues from selling spare parts and service for that equipment.

satisfying the test, guided by the overarching principle that the purpose of defining the market and measuring market shares is to illuminate the evaluation of competitive effects. Because the relative competitive significance of more distant substitutes is apt to be overstated by their share of sales, when the Agencies rely on market shares and concentration, they usually do so in the smallest relevant market satisfying the hypothetical monopolist test.

> *Example 7:* In Example 4, including cars in the market will lead to misleadingly small market shares for motorcycle producers. Unless motorcycles fail the hypothetical monopolist test, the Agencies would not include cars in the market in analyzing this motorcycle merger.

4.1.2 Benchmark Prices and SSNIP Size

The Agencies apply the SSNIP starting from prices that would likely prevail absent the merger. If prices are not likely to change absent the merger, these benchmark prices can reasonably be taken to be the prices prevailing prior to the merger.[5] If prices are likely to change absent the merger, e.g., because of innovation or entry, the Agencies may use anticipated future prices as the benchmark for the test. If prices might fall absent the merger due to the breakdown of pre-merger coordination, the Agencies may use those lower prices as the benchmark for the test. In some cases, the techniques employed by the Agencies to implement the hypothetical monopolist test focus on the difference in incentives between pre-merger firms and the hypothetical monopolist and do not require specifying the benchmark prices.

The SSNIP is intended to represent a "small but significant" increase in the prices charged by firms in the candidate market for the value they contribute to the products or services used by customers. This properly directs attention to the effects of price changes commensurate with those that might result from a significant lessening of competition caused by the merger. This methodology is used because normally it is possible to quantify "small but significant" adverse price effects on customers and analyze their likely reactions, not because price effects are more important than non-price effects.

The Agencies most often use a SSNIP of five percent of the price paid by customers for the products or services to which the merging firms contribute value. However, what constitutes a "small but significant" increase in price, commensurate with a significant loss of competition caused by the merger, depends upon the nature of the industry and the merging firms' positions in it, and the Agencies may accordingly use a price increase that is larger or smaller than five percent. Where explicit or implicit prices for the firms' specific contribution to value can be identified with reasonable clarity, the Agencies may base the SSNIP on those prices.

> *Example 8:* In a merger between two oil pipelines, the SSNIP would be based on the price charged for transporting the oil, not on the price of the oil itself. If pipelines buy the oil at one end and sell it at the other, the price charged for transporting the oil is implicit, equal to the difference between the price paid for oil at the input end and the price charged for oil at the output end. The relevant product sold by the pipelines is better described as "pipeline transportation of oil from point A to point B" than as "oil at point B."

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5 Market definition for the evaluation of non-merger antitrust concerns such as monopolization or facilitating practices will differ in this respect if the effects resulting from the conduct of concern are already occurring at the time of evaluation.

Example 9: In a merger between two firms that install computers purchased from third parties, the SSNIP would be based on their fees, not on the price of installed computers. If these firms purchase the computers and charge their customers one package price, the implicit installation fee is equal to the package charge to customers less the price of the computers.

Example 10: In Example 9, suppose that the prices paid by the merging firms to purchase computers are opaque, but account for at least ninety-five percent of the prices they charge for installed computers, with profits or implicit fees making up five percent of those prices at most. A five percent SSNIP on the total price paid by customers would at least double those fees or profits. Even if that would be unprofitable for a hypothetical monopolist, a significant increase in fees might well be profitable. If the SSNIP is based on the total price paid by customers, a lower percentage will be used.

4.1.3 Implementing the Hypothetical Monopolist Test

The hypothetical monopolist's incentive to raise prices depends both on the extent to which customers would likely substitute away from the products in the candidate market in response to such a price increase and on the profit margins earned on those products. The profit margin on incremental units is the difference between price and incremental cost on those units. The Agencies often estimate incremental costs, for example using merging parties' documents or data the merging parties use to make business decisions. Incremental cost is measured over the change in output that would be caused by the price increase under consideration.

In considering customers' likely responses to higher prices, the Agencies take into account any reasonably available and reliable evidence, including, but not limited to:

- how customers have shifted purchases in the past in response to relative changes in price or other terms and conditions;
- information from buyers, including surveys, concerning how they would respond to price changes;
- the conduct of industry participants, notably:
  - sellers' business decisions or business documents indicating sellers' informed beliefs concerning how customers would substitute among products in response to relative changes in price;
  - industry participants' behavior in tracking and responding to price changes by some or all rivals;
- objective information about product characteristics and the costs and delays of switching products, especially switching from products in the candidate market to products outside the candidate market;
- the percentage of sales lost by one product in the candidate market, when its price alone rises, that is recaptured by other products in the candidate market, with a higher recapture percentage making a price increase more profitable for the hypothetical monopolist;
- evidence from other industry participants, such as sellers of complementary products;

- legal or regulatory requirements; and

- the influence of downstream competition faced by customers in their output markets.

When the necessary data are available, the Agencies also may consider a "critical loss analysis" to assess the extent to which it corroborates inferences drawn from the evidence noted above. Critical loss analysis asks whether imposing at least a SSNIP on one or more products in a candidate market would raise or lower the hypothetical monopolist's profits. While this "breakeven" analysis differs from the profit-maximizing analysis called for by the hypothetical monopolist test in Section 4.1.1, merging parties sometimes present this type of analysis to the Agencies. A price increase raises profits on sales made at the higher price, but this will be offset to the extent customers substitute away from products in the candidate market. Critical loss analysis compares the magnitude of these two offsetting effects resulting from the price increase. The "critical loss" is defined as the number of lost unit sales that would leave profits unchanged. The "predicted loss" is defined as the number of unit sales that the hypothetical monopolist is predicted to lose due to the price increase. The price increase raises the hypothetical monopolist's profits if the predicted loss is less than the critical loss.

The Agencies consider all of the evidence of customer substitution noted above in assessing the predicted loss. The Agencies require that estimates of the predicted loss be consistent with that evidence, including the pre-merger margins of products in the candidate market used to calculate the critical loss. Unless the firms are engaging in coordinated interaction (see Section 7), high pre-merger margins normally indicate that each firm's product individually faces demand that is not highly sensitive to price.[6] Higher pre-merger margins thus indicate a smaller predicted loss as well as a smaller critical loss. The higher the pre-merger margin, the smaller the recapture percentage necessary for the candidate market to satisfy the hypothetical monopolist test.

Even when the evidence necessary to perform the hypothetical monopolist test quantitatively is not available, the conceptual framework of the test provides a useful methodological tool for gathering and analyzing evidence pertinent to customer substitution and to market definition. The Agencies follow the hypothetical monopolist test to the extent possible given the available evidence, bearing in mind that the ultimate goal of market definition is to help determine whether the merger may substantially lessen competition.

4.1.4 Product Market Definition with Targeted Customers

If a hypothetical monopolist could profitably target a subset of customers for price increases, the Agencies may identify relevant markets defined around those targeted customers, to whom a hypothetical monopolist would profitably and separately impose at least a SSNIP. Markets to serve targeted customers are also known as price discrimination markets. In practice, the Agencies identify price discrimination markets only where they believe there is a realistic prospect of an adverse competitive effect on a group of targeted customers.

> *Example 11:* Glass containers have many uses. In response to a price increase for glass containers, some users would substitute substantially to plastic or metal containers, but baby food manufacturers would not. If a

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6 While margins are important for implementing the hypothetical monopolist test, high margins are not in themselves of antitrust concern.

hypothetical monopolist could price separately and limit arbitrage, baby food manufacturers would be vulnerable to a targeted increase in the price of glass containers. The Agencies could define a distinct market for glass containers used to package baby food.

The Agencies also often consider markets for targeted customers when prices are individually negotiated and suppliers have information about customers that would allow a hypothetical monopolist to identify customers that are likely to pay a higher price for the relevant product. If prices are negotiated individually with customers, the hypothetical monopolist test may suggest relevant markets that are as narrow as individual customers (see also Section 6.2 on bargaining and auctions). Nonetheless, the Agencies often define markets for groups of targeted customers, i.e., by type of customer, rather than by individual customer. By so doing, the Agencies are able to rely on aggregated market shares that can be more helpful in predicting the competitive effects of the merger.

4.2 Geographic Market Definition

The arena of competition affected by the merger may be geographically bounded if geography limits some customers' willingness or ability to substitute to some products, or some suppliers' willingness or ability to serve some customers. Both supplier and customer locations can affect this. The Agencies apply the principles of market definition described here and in Section 4.1 to define a relevant market with a geographic dimension as well as a product dimension.

The scope of geographic markets often depends on transportation costs. Other factors such as language, regulation, tariff and non-tariff trade barriers, custom and familiarity, reputation, and service availability may impede long-distance or international transactions. The competitive significance of foreign firms may be assessed at various exchange rates, especially if exchange rates have fluctuated in the recent past.

In the absence of price discrimination based on customer location, the Agencies normally define geographic markets based on the locations of suppliers, as explained in subsection 4.2.1. In other cases, notably if price discrimination based on customer location is feasible as is often the case when delivered pricing is commonly used in the industry, the Agencies may define geographic markets based on the locations of customers, as explained in subsection 4.2.2.

4.2.1 Geographic Markets Based on the Locations of Suppliers

Geographic markets based on the locations of suppliers encompass the region from which sales are made. Geographic markets of this type often apply when customers receive goods or services at suppliers' locations. Competitors in the market are firms with relevant production, sales, or service facilities in that region. Some customers who buy from these firms may be located outside the boundaries of the geographic market.

The hypothetical monopolist test requires that a hypothetical profit-maximizing firm that was the only present or future producer of the relevant product(s) located in the region would impose at least a SSNIP from at least one location, including at least one location of one of the merging firms. In this exercise the terms of sale for all products produced elsewhere are held constant. A single firm may operate in a number of different geographic markets, even for a single product.

Example 12: The merging parties both have manufacturing plants in City X. The relevant product is expensive to transport and suppliers price their products for pickup at their locations. Rival plants are some distance away in City Y. A hypothetical monopolist controlling all plants in City X could profitably impose a SSNIP at these plants. Competition from more distant plants would not defeat the price increase because supplies coming from more distant plants require expensive transportation. The relevant geographic market is defined around the plants in City X.

When the geographic market is defined based on supplier locations, sales made by suppliers located in the geographic market are counted, regardless of the location of the customer making the purchase.

In considering likely reactions of customers to price increases for the relevant product(s) imposed in a candidate geographic market, the Agencies consider any reasonably available and reliable evidence, including:

- how customers have shifted purchases in the past between different geographic locations in response to relative changes in price or other terms and conditions;
- the cost and difficulty of transporting the product (or the cost and difficulty of a customer traveling to a seller's location), in relation to its price;
- whether suppliers need a presence near customers to provide service or support;
- evidence on whether sellers base business decisions on the prospect of customers switching between geographic locations in response to relative changes in price or other competitive variables;
- the costs and delays of switching from suppliers in the candidate geographic market to suppliers outside the candidate geographic market; and
- the influence of downstream competition faced by customers in their output markets.

4.2.2 Geographic Markets Based on the Locations of Customers

When the hypothetical monopolist could discriminate based on customer location, the Agencies may define geographic markets based on the locations of targeted customers.[7] Geographic markets of this type often apply when suppliers deliver their products or services to customers' locations. Geographic markets of this type encompass the region into which sales are made. Competitors in the market are firms that sell to customers in the specified region. Some suppliers that sell into the relevant market may be located outside the boundaries of the geographic market.

The hypothetical monopolist test requires that a hypothetical profit-maximizing firm that was the only present or future seller of the relevant product(s) to customers in the region would impose at least a SSNIP on some customers in that region. A region forms a relevant geographic market if this price increase would not be defeated by substitution away from the relevant product or by arbitrage,

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[7] For customers operating in multiple locations, only those customer locations within the targeted zone are included in the market.

e.g., customers in the region travelling outside it to purchase the relevant product. In this exercise, the terms of sale for products sold to all customers outside the region are held constant.

> *Example 13:* Customers require local sales and support. Suppliers have sales and service operations in many geographic areas and can discriminate based on customer location. The geographic market can be defined around the locations of customers.

> *Example 14:* Each merging firm has a single manufacturing plant and delivers the relevant product to customers in City X and in City Y. The relevant product is expensive to transport. The merging firms' plants are by far the closest to City X, but no closer to City Y than are numerous rival plants. This fact pattern suggests that customers in City X may be harmed by the merger even if customers in City Y are not. For that reason, the Agencies consider a relevant geographic market defined around customers in City X. Such a market could be defined even if the region around the merging firms' plants would not be a relevant geographic market defined based on the location of sellers because a hypothetical monopolist controlling all plants in that region would find a SSNIP imposed on all of its customers unprofitable due to the loss of sales to customers in City Y.

When the geographic market is defined based on customer locations, sales made to those customers are counted, regardless of the location of the supplier making those sales.

> *Example 15:* Customers in the United States must use products approved by U.S. regulators. Foreign customers use products not approved by U.S. regulators. The relevant product market consists of products approved by U.S. regulators. The geographic market is defined around U.S. customers. Any sales made to U.S. customers by foreign suppliers are included in the market, and those foreign suppliers are participants in the U.S. market even though located outside it.

5. Market Participants, Market Shares, and Market Concentration

The Agencies normally consider measures of market shares and market concentration as part of their evaluation of competitive effects. The Agencies evaluate market shares and concentration in conjunction with other reasonably available and reliable evidence for the ultimate purpose of determining whether a merger may substantially lessen competition.

Market shares can directly influence firms' competitive incentives. For example, if a price reduction to gain new customers would also apply to a firm's existing customers, a firm with a large market share may be more reluctant to implement a price reduction than one with a small share. Likewise, a firm with a large market share may not feel pressure to reduce price even if a smaller rival does. Market shares also can reflect firms' capabilities. For example, a firm with a large market share may be able to expand output rapidly by a larger absolute amount than can a small firm. Similarly, a large market share tends to indicate low costs, an attractive product, or both.

5.1 Market Participants

All firms that currently earn revenues in the relevant market are considered market participants. Vertically integrated firms are also included to the extent that their inclusion accurately reflects their competitive significance. Firms not currently earning revenues in the relevant market, but that have committed to entering the market in the near future, are also considered market participants.

Firms that are not current producers in a relevant market, but that would very likely provide rapid supply responses with direct competitive impact in the event of a SSNIP, without incurring

Jury Instructions

Final Jury Instructions, Deutscher Tennis Bund v. ATP Tour Inc., No. 07-CV-00178 (D. Del. Aug. 4, 2008) (relevant market instructions)

Antitrust Jury Instruction 13
Rule of Reason – Proof of Relevant Market

As I mentioned, Plaintiffs must show that the harm to competition occurred in an identified market, known as a "relevant market." There are two aspects to a relevant market. The first aspect is known as a relevant product market. The second aspect is known as the relevant geographic market. It is Plaintiffs' burden to prove the existence of a relevant market.

Relevant Product Market

The basic idea of a relevant product market is that it includes all products that are reasonable substitutes for each other from a buyer's point of view; that is, the products compete with each other. In other words, the relevant product market includes the products that a consumer believes are reasonably interchangeable or reasonable substitutes for each other. This is a practical test with reference to actual behavior of buyers and marketing efforts of sellers. Products need not be identical or precisely interchangeable as long as they are reasonable substitutes. For example, if consumers seeking to cover leftover food for storage considered certain types of flexible wrapping material – such as aluminum foil, cellophane, or even plastic containers – to be reasonable alternatives, then all those products would be in the same relevant product market.

To determine whether products are reasonable substitutes for each other, you should consider whether a small but significant permanent increase in the price of one product would result in a substantial number of consumers switching from that product to another. Generally speaking, a small but permanent increase in price is approximately a five percent increase in price not due to external cost factors. If you find that such switching would occur, then you should conclude that the products are in the same product market.

In evaluating whether various products are reasonably interchangeable or are reasonable substitutes for each other, you may also consider: (1) consumers' views on whether the products are interchangeable; (2) the relationship between the price of one product and sales of another; (3) the presence or absence of specialized vendors; (4) the perceptions of either industry or the public as to whether the products are in separate markets; (5) the views of Plaintiffs and Defendants regarding who their respective competitors are; and (6) the existence or absence of different customer groups or distribution channels.

In this case, Plaintiffs define the relevant product markets as the market for the production of top-tier men's professional tennis, the market for player services for top-tier men's professional tennis, the market for hosting top-tier men's professional tennis, and/or the market for live top-tier men's professional tennis. By contrast, Defendants assert that Plaintiffs have failed to prove a proper relevant product market because Defendants claim that Plaintiffs' alleged product markets do not include all reasonably interchangeable products or substitutes. If you find that Plaintiffs have proven a relevant product market or markets that includes all reasonably interchangeable products or substitutes, then you should continue to evaluate the remainder of Plaintiffs' claim with respect to that market or those markets. However, if you find that Plaintiffs have failed to prove such a market, then you must find in Defendants' favor on this claim.

Relevant Geographic Market

For each relevant product market you determine that Plaintiffs have proven, Plaintiffs must also prove a relevant geographic market. The relevant geographic market for a given relevant product market is the area in which the defendant faces competition from other firms that compete in that relevant product market and to which customers can reasonably turn for purchases. When analyzing the relevant geographic market, you should consider whether changes in prices or product offerings in one area have substantial effects on prices or sales in another area, which would tend to show that both areas are in the same relevant geographic market. The geographic market may be as large as global or nationwide, or as small as a single town or even smaller. The relevant geographic market for one relevant product market may be larger or smaller than that for a different relevant product market.

Plaintiffs have the burden of proving the relevant geographic market by a preponderance of the evidence. In this case, Plaintiffs claim that the relevant geographic market for each of these markets is global. By contrast, Defendants assert that Plaintiffs have failed to prove a proper geographic market. In determining whether Plaintiffs have met their burden and proven that their proposed geographic market is proper, you may consider several factors, including:

- The geographic area in which the relevant products are sold and where customers for the relevant products are located;
- The geographic area to which customers turn for supply of the relevant products or have seriously considered turning; and
- The geographic areas that suppliers of the relevant products view as potential sources of competition.

August 4, 2008

Antitrust Jury Instruction 14
Relevant Market – Necessity of Proof

If, after considering all the evidence, you find that Plaintiffs have proven by a preponderance of the evidence both a relevant product market and a relevant geographic market, then you must find that Plaintiffs have met the relevant market requirement and you must consider the remaining elements of this claim.

If you find that Plaintiffs have failed to prove by a preponderance of the evidence either a relevant product market or a relevant geographic market, then you must find for Defendants and against Plaintiffs on their antitrust claims.

DOJ Merger Challenges

FEDERAL COURT INJUNCTIONS

CLAYTON ACT

Clayton Act § 15. Restraining violations; procedure

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 COURT INJUNCTIONS

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:

(1) any federal statute relating to temporary restraining orders or preliminary injunctions in actions affecting employer and employee;

(2) 28 U.S.C. §2361, which relates to preliminary injunctions in actions of interpleader or in the nature of interpleader; or

(3) 28 U.S.C. §2284, which relates to actions that must be heard and decided by a three-judge district court.

(f) *Copyright Impoundment*. This rule applies to copyright-impoundment proceedings.

United States v. H&R Block, Inc

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, U.S. Department of Justice Antitrust Division 450 Fifth Street, NW, Suite 7100 Washington, DC 20530, *Plaintiff*, v. 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, 56th Floor 200 Clarendon Street Boston, MA 02116, *Defendants*.	Case: 1:11-cv-00948 Assigned To : Howell, Beryl A. Assign. Date : 5/23/2011 Description: Antitrust

COMPLAINT

The United States of America, acting under the direction of the Attorney General of the United States, brings this civil action to enjoin the proposed acquisition by Defendant H&R Block, Inc. ("H&R Block") of Defendant 2SS Holdings, Inc. ("TaxACT"), an entity within Defendant TA IX L.P. ("TA"). The United States alleges as follows:

I. INTRODUCTION

1. Last year, approximately 140 million Americans filed their tax returns with the Internal Revenue Service ("IRS"). Increasingly, taxpayers are choosing to prepare their U.S.

federal and state tax returns using digital do-it-yourself tax preparation products ("Digital DIY Tax Preparation Products"), either over the Internet or on their desktop computers. Last year, an estimated 35 to 40 million taxpayers filed their taxes using Digital DIY Tax Preparation Products. In the U.S. Digital DIY Tax Preparation Product market, the three largest firms service approximately 90% of all consumers. H&R Block's proposed acquisition of TaxACT, if allowed to proceed, would combine the second- and third-largest providers in that market and essentially create a duopoly. The proposed acquisition would (1) eliminate aggressive head-to-head competition between H&R Block and TaxACT, and (2) increase the likelihood that the two remaining significant providers would substantially reduce competition through successful coordination; both in violation of Section 7 of the Clayton Act, 15 U.S.C. § 18.

2. TaxACT has aggressively competed with H&R Block in the Digital DIY Tax Preparation Product market for over a decade. That competition has resulted in product innovations and lower prices that have benefitted the millions of U.S. taxpayers who use Digital DIY Tax Preparation Products. The proposed acquisition would remove this competition, resulting in less innovation and higher prices for consumers. H&R Block's internal documents acknowledge that acquiring TaxACT would result in the "[e]limination of [a] competitor," and would allow H&R Block to "regain control of industry pricing and avoid further price erosion."

3. The reason the acquisition would "avoid further price erosion" is that TaxACT has, in its own words, been a "maverick" in the Digital DIY Tax Preparation Product market. Over the years, TaxACT has touted to the public that it is a "catalyst for change" that has "consistently forced the tax preparation industry to become more competitive, and in doing so [has] forced [its] competitors to change as well." These views of TaxACT as a maverick and significant force of change in the market are also shared amongst TaxACT's competitors.

According to H&R Block internal documents, in 2005 TaxACT "disrupted" the entire marketplace by offering all taxpayers the ability to digitally prepare and electronically file ("e-file") their federal returns for free over the Internet. This disruption caused the industry leader, Intuit, Inc. ("Intuit," maker of "TurboTax") and then H&R Block to provide their own free tax preparation and e-file offers. TaxACT has continued its pattern of disrupting H& R Block's and Intuit's businesses by offering products that are functionally comparable to those of H&R Block and Intuit, at comparatively lower prices. Most recently, TaxACT's products have entered the retail (boxed software) segment of the market. Through lower prices and unique offerings at Staples, H&R Block's second-largest retailer, TaxACT has, in H&R Block's own words, put H&R Block's sales volumes in those stores "at risk." With the removal of this maverick from the marketplace, Intuit and H&R Block would be left with a virtual duopoly in which they need not aggressively compete with one another and can more successfully coordinate their pricing and other business actions.

4. For these reasons, as set forth and detailed below, the proposed acquisition violates Section 7 of the Clayton Act, 15 U.S.C. § 18. The United States, therefore, seeks injunctive relief preventing the consummation of the proposed acquisition.

II. JURISDICTION, VENUE, AND COMMERCE

5. This action is filed by the United States under Section 15 of the Clayton Act, 15 U.S.C. § 25, to prevent and restrain the Defendants from violating Section 7 of the Clayton Act, 15 U.S.C. § 18.

6. This Court has subject matter jurisdiction over this action pursuant to Section 15 of the Clayton Act, 15 U.S.C. § 25 and 28 U.S.C. § 1345. This Court also has subject matter jurisdiction pursuant to 28 U.S.C. §§ 1331 and 1337 as H&R Block and TaxACT are engaged in

interstate commerce and in activities substantially affecting interstate commerce. H&R Block and TaxACT sell Digital DIY Tax Preparation Products and related services throughout the United States. H&R Block and TaxACT are engaged in a regular, continuous, and substantial flow of interstate commerce, and their digital DIY tax preparation businesses have had a substantial effect upon interstate commerce.

7. This Court has personal jurisdiction over each Defendant. Defendants H&R Block and TaxACT both transact business and are found within the District of Columbia. This Court has personal jurisdiction over Defendant TA because it transacts business in the District of Columbia through TaxACT, in which it has a two-thirds ownership interest.

8. Venue is proper under Section 12 of the Clayton Act, 15 U.S.C. § 22, and 28 U.S.C. § 1391(b) and (c).

III. THE DEFENDANTS AND THE TRANSACTION

9. H&R Block is a corporation organized and existing under the laws of Missouri, with its headquarters located in Kansas City, Missouri. H&R Block claims that it prepares 1 in every 7 tax returns filed in the United States and has a brick-and-mortar assisted tax preparation office within 5 miles of most Americans. H&R Block's digital DIY products, called "H&R Block At Home" (formerly called "TaxCut"), were used to file approximately 5.9 million U.S. individual federal tax returns in 2010. H&R Block is the second-largest provider of Digital DIY Tax Preparation Products, behind Intuit. These digital products are an increasingly important source of business for H&R Block.

10. 2SS Holdings, Inc. is a corporation organized and existing under the laws of Delaware and headquartered in Cedar Rapids, Iowa. 2SS Holdings, Inc.'s products are currently sold as, and referred to by the industry under the brand, "TaxACT." TaxACT's products were

used to file approximately 5.2 million U.S. individual federal tax returns last year. TaxACT is the third-largest Digital DIY Tax Preparation Product provider in the United States and the second-largest provider of such products through the online channel.

11. In 2004, the private equity firm TA made a significant investment in 2SS Holdings, Inc. As a result, Defendant TA IX L.P., a limited partnership organized and existing under the laws of Delaware and headquartered in Boston, Massachusetts, now holds approximately a two-thirds interest in TaxACT. TaxACT executives and employees retain the approximate other one-third interest.

12. On October 13, 2010, H&R Block, 2SS Holdings, Inc., and the TaxACT shareholders entered into an Agreement and Plan of Merger, pursuant to which H&R Block would ultimately acquire TaxACT for approximately $287.5 million in cash.

IV. THE RELEVANT MARKET

A. Description of the Product

13. With the rise of the Internet and personal computer usage, in the 1990s, several companies began to offer consumers a unique method of preparing their individual U.S. federal and state tax returns without any professional tax assistance — Digital DIY Tax Preparation Products.

14. These Digital DIY Tax Preparation Products are offered through three basic channels: (1) online; (2) software that can be downloaded from an Internet website; and (3) software on a disc that is either sent directly to the consumer or purchased by the consumer from a third-party retailer. Intuit, H&R Block, and TaxACT are the only major suppliers of Digital DIY Tax Preparation Products, and they are the only digital DIY tax preparation firms that offer their products through all three channels.

15. The online channel allows digital DIY tax preparation firms to offer their products to taxpayers that wish to complete their returns on the provider's website using a personal computer, an Internet connection, and an Internet browser. By way of example, a taxpayer can direct his or her Internet browser to H&R Block's website and access an online version of H&R Block At Home. The taxpayer can then fill out relevant information directly on the company's website. When using the online channel, all tax calculations are conducted remotely on the servers owned by the company. After all relevant information is entered and tax calculations are made, a completed tax return is generated and the information is saved on the company's servers. That return can then either be printed by the individual to mail to the IRS or state revenue agency, or filed electronically (sometimes referred to as "e-filed") with the IRS or state revenue agency over the Internet. In recent years, e-filing has been an increasingly popular method of filing tax returns.

16. The second and third channels for using Digital DIY Tax Preparation Products entail a taxpayer installing software on his or her personal computer. The second channel permits taxpayers to access an Internet website and download the software onto the taxpayer's personal computer. The third channel permits taxpayers to load and install software, which is stored on a CD-ROM or DVD, onto his or her personal computer. The CD-ROM or DVD is either sent directly to the consumer, or purchased by the consumer from a retail store (such as Staples or Best Buy). When using any software product, the information that is entered by the taxpayer for generating the return is not transmitted over the Internet. Similarly, the calculations necessary for creating the tax return are conducted on the taxpayer's computer, not a company's servers, and the completed tax return is saved to the taxpayer's computer. As with the online version, the completed return can either be printed or e-filed.

17. Regardless of the channel, all Digital DIY Tax Preparation Products function in the same way and consist of the same two basic parts: the user interface, which prompts users to provide relevant information, and the underlying tax engine, which processes that information.

18. A user interface is the means by which individuals interact with the tax engine. The standard user interface for the Digital DIY Tax Preparation Products of Intuit, H&R Block, and TaxACT is referred to as an "interview," and it provides consumers with a series of questions relating to their personal and financial information. The answers the consumer gives during the interview are provided to the tax engine for calculation.

19. The tax engine is essentially a complicated software program based upon federal and state tax code and regulations. A taxpayer's relevant personal and financial information is provided to the tax engine by way of the user interface, and the tax engine processes the information. Based upon the state or federal tax code, the tax engine determines what forms should be provided to the IRS or the state revenue agency and records the appropriate figures on the relevant tax forms.

20. Digital DIY Tax Preparation Product providers typically offer their products in more than one version and at different prices. The different versions and the pricing differences are often based on one or more of the following: (a) the number of tax returns filed; (b) whether the tax return prepared is a federal or state return; (c) the tax forms used and complexity of the tax return (*e.g.*, an individual who files with a federal 1040EZ tax form could pay less than someone who files with a 1040 tax form); (d) the channel through which the individual accesses the product (*i.e.*, online, download, or software on a disc); (e) the amount and type of support the individual desires for the process (*e.g.*, whether the individual can contact the company for

technical support or tax advice, or can demand support from the company in the event of an audit); and (f) whether the federal and/or state tax return will be e-filed.

21. Digital DIY tax preparation companies also sometimes offer related products and services to individuals. Some of these products include: (a) refund anticipation checks, which permit an individual to deduct the price of the Digital DIY Tax Preparation Product from the individual's tax refund; (b) prepaid debit cards, which permit individuals to transfer their tax refunds to a prepaid debit card; (c) the ability to access a copy of the individual's prior year tax returns that were filed using the company's product; and (d) additional support services.

22. Companies that offer Digital DIY Tax Preparation Products compete based upon price and quality of their products, including the number of forms, schedules, and states that they support. The "Big Three" digital DIY tax preparation companies — Intuit, H&R Block, and TaxACT — all support the vast majority of forms, schedules, and states, though TaxACT's prices are lower than those of H&R Block and Intuit.

B. Relevant Product Market

23. Digital DIY tax preparation products for the preparation of U.S. federal and state tax returns (referred to throughout this Complaint as "Digital DIY Tax Preparation Products") is a relevant product market and line of commerce under Section 7 of the Clayton Act. A hypothetical monopolist would impose at least a small but significant and nontransitory increase in the price of all Digital DIY Tax Preparation Products.

24. There are no reasonable product alternatives to Digital DIY Tax Preparation Products. Other means that consumers can use to prepare their personal tax returns are not sufficiently substitutable to discipline even a small but significant and nontransitory increase in the price of Digital DIY Tax Preparation Products.

25. Other methods of preparing individual tax returns are not in the same product market as Digital DIY Tax Preparation Products because those methods of preparation either do not offer comparable functionality, are less convenient, are more cumbersome, or are too expensive. For instance, the "pen-and-paper" method of tax preparation (*i.e.*, taking a copy of a tax return form and manually writing in the appropriate calculations) is a tedious, complicated, and highly error-prone process that lacks the ease of use and functionality that Digital DIY Tax Preparation Products offer. Digital DIY Tax Preparation Products guide individuals through an easy-to-use interview process, ask them relevant questions in generally understandable language, do not require the individual to know tax rules and regulations, and do not require the individual to understand what information should be recorded or calculated on particular lines of particular tax forms. For these and other reasons, an insufficient number of individuals would choose pen-and-paper instead of Digital DIY Tax Preparation Products to make even a small but significant increase in the price of Digital DIY Tax Preparation Products unprofitable.

26. Another method of tax preparation that is not in the product market is assisted tax preparation (*e.g.*, the use of a certified public accountant or a professional tax service such as an H&R Block brick-and-mortar store). Assisted tax preparation provides consumers with one-on-one professional tax guidance that is generally unavailable with Digital DIY Tax Preparation Products. In addition, Digital DIY Tax Preparation Products are more convenient to use than assisted tax preparation because they do not require users to schedule time to deal with third-party professionals. Assisted tax preparation is substantially more expensive than a Digital DIY Tax Preparation Product that prepares comparably complex tax returns and would remain substantially more expensive than Digital DIY Tax Preparation Products even after a small but significant nontransitory increase in the price of Digital DIY Tax Preparation Products. An

insufficient number of individuals would substitute to assisted tax preparation products to make even a small but significant increase in the price of Digital DIY Tax Preparation Products unprofitable.

C. Relevant Geographic Market

27. The Digital DIY Tax Preparation Products that H&R Block and TaxACT offer assist individuals with filing their U.S. federal and state income tax returns. Customers that are required to file tax returns in jurisdictions outside of the United States cannot use the Digital DIY Tax Preparation Products at issue for those purposes. Similarly, Digital DIY Tax Preparation Products that have been engineered to assist individuals with filing tax returns in jurisdictions outside of the United States cannot be used by customers to prepare U.S. federal and state tax returns. Both customers and suppliers of Digital DIY Tax Preparation Products predominately are located within the United States. However, because many Digital DIY Tax Preparation Products are provided over the Internet, there do not appear to be any physical restrictions on the location of suppliers or customers. Accordingly, a relevant geographic market within the meaning of Section 7 of the Clayton Act, 15 U.S.C. § 18 is a worldwide market.

V. TAXACT'S HISTORY OF "DISRUPTING" THE MARKET THROUGH AGGRESSIVE PRICING, QUALITY, AND INNOVATIONS

28. TaxACT's conduct over the past several years has significantly "disrupted" the market and forced competitors, including Intuit and H&R Block, to offer free products and increase the quality of their products for American taxpayers. The first major instance of maverick behavior by TaxACT that prompted a competitive reaction from H&R Block and Intuit occurred in 2004 in relation to the Free File Alliance ("FFA"), a public-private partnership of digital DIY tax preparation companies and the IRS designed to offer qualified individuals the ability to prepare and e-file free federal income tax returns. As H&R Block itself recognized,

TaxACT was the first company to aggressively pursue lower prices in the Digital DIY Tax Preparation Product market for all taxpayers through the FFA: "The first year [2003] was rather uneventful but in the second year [2004] TaxAct introduced an offer that was free to all individual US taxpayers. . . . At the beginning of [2005] Intuit made their offer available to all US taxpayers and just about all other members followed."

29. TaxACT's FFA offering threatened the profits of all Digital DIY Tax Preparation Product providers. Accordingly, though they matched TaxACT's offering, members of the FFA, including H&R Block and Intuit, lobbied the government to limit the number of taxpayers to whom FFA members could offer free federal e-filing. Ultimately, the IRS, in October 2005, limited the type and the number of customers that could be offered a free product through the FFA.

30. TaxACT responded to the FFA limitations by pursuing an even more aggressive strategy to lower prices and increase quality for taxpayers. In or about December 2005, TaxACT began offering all taxpayers the ability to prepare and e-file their federal individual tax returns for free directly from TaxACT's website. This aggressive pricing decision by TaxACT was a major turning point in the market for Digital DIY Tax Preparation Products. As TaxACT's press release in December 2005 announced: "users of its TaxACT Standard 2005 Federal editions can e-file their tax returns without charge through www.TaxACT.com, as well as prepare and print them for free. . . . For eight consecutive tax seasons, TaxACT — the first tax-preparation software company to offer free e-file capabilities — has been a pioneer in free tax preparation. Now TaxACT is making it possible for everyone to prepare, print and e-file their taxes for free." TaxACT's "free-free-free" offering, giving consumers the ability to prepare and then either e-file or print and mail their federal tax returns for free through its website, significantly disrupted the

market. Indeed, TaxACT investment presentations trumpeted its move to free federal as having "disrupted the then prevalent 'paid' model under which tax preparation software was sold by its competitors." TaxACT subsequently boasted to the public that it was a "*tax industry maverick* [that] has broken down the barrier for everyone to prepare, print, and now even e-file their returns, all for free." (Emphasis added).

31. Internal H&R Block documents (as well as internal documents from other digital DIY providers) make clear that TaxACT's move to "free federal" was a major change in the Digital DIY Tax Preparation Product market that resulted in significant pressure to lower prices. An H&R Block internal presentation on competition within the Digital DIY Tax Preparation Product market states that "[t]he growth in Free Federal Offers Online was driven primarily by the growth of TaxACT's Standard and TaxACT Standard+State both [of which] include Free federal units." The presentation goes on to note that "TaxACT's success in gaining market share propelled Intuit to offer the Free Edition on its Home Page. At one point, TurboTax Deluxe was offered free through email and tested on the TurboTax Home Page." The result of this pressure by TaxACT was, as H&R Block lamented, a "[c]ontinued erosion of Paid units for middle and lower SKUs," and likely continued "price compression across ***all*** tax prep." (Emphasis in original). After Intuit began offering "free federal" for individuals, H&R Block followed suit by offering its own free product. Presentations made by the heads of H&R Block's Digital Tax Solutions division to H&R Block's CEO and CFO note explicitly that 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."

32. TaxACT is also a maverick in terms of product quality. Over the years, TaxACT has continuously expanded the functionality of its free version. As a result, TaxACT's free

version is, in many respects, the functional equivalent of products for which H&R Block and Intuit charge a significant price. TaxACT's improvements to its free products have forced H&R Block and Intuit to enhance the functionality of their free products. Nonetheless, TaxACT's free version continues to offer more functionality by, among other things, providing and supporting *all* e-filable federal forms and schedules. In contrast, the free products offered by competitors such as H&R Block and Intuit do not support all e-filable federal forms and schedules, and thus require taxpayers who need the missing functionality to upgrade to a paid product or switch to another provider.

33. The competitive pressure that TaxACT created through its maverick prices and functionality has persisted and continues to the present. Each year since December 2005, TaxACT has relentlessly offered high quality Digital DIY Tax Preparation Products to taxpayers at low prices. TaxACT's aggressive pricing continues to put competitive pressure on both Intuit and H&R Block to lower their prices on all Digital DIY Tax Preparation Products. As late as January 22, 2009, an H&R Block executive remarked: "I was shocked at the TaxAct price. . . . It appears that the online market is moving towards a 'free' space or a de minimis cost." Consistent with that executive's concern over TaxACT's pricing, a late 2010 H&R Block presentation notes that H&R Block lowered the price of its premium software product offering by almost 30% specifically "[i]n order to better compete with online free."

34. Another recent example of TaxACT's maverick behavior in the market relates to the features of the product that it introduced into the retail sector. Around December 2010, TaxACT's desktop software began being offered through a major retailer — Staples. TaxACT's retail software sells at a lower price than the comparable offerings from H&R Block and Intuit — the only major Digital DIY Tax Preparation Products sold at retail stores prior to TaxACT's

introduction into retail. In addition, in contrast to Intuit and H&R Block, TaxACT (1) does not charge an additional amount to its customers to e-file their state returns, and (2) does not attempt to sell users additional features after purchase. Internally commenting on these features, one H&R Block employee stated: "ouch! They knew exactly what to exploit."

35. TaxACT's low price and innovative offering at retail poses a threat to H&R Block and Intuit. An internal H&R Block presentation notes: "Retail volume at Staples at risk due to introduction of TaxACT [r]etail software on combined display."

36. It is based on all of the above that TaxACT's President and Founder, Lance Dunn, has noted publicly that TaxACT is a "catalyst for change" that has "consistently forced the tax preparation industry to become more competitive, and in doing so [has] forced [its] competitors to change as well." By acquiring TaxACT, H&R Block would be able to eliminate the threat that TaxACT, as a maverick, poses to its business.

VI. MARKET CONCENTRATION

37. The relevant market is highly concentrated and would become significantly more concentrated as a result of the proposed transaction.

38. As articulated in the *Horizontal Merger Guidelines* issued by the Department of Justice and the Federal Trade Commission, the Herfindahl-Hirschman Index ("HHI") is a measure of market concentration.[1] Market concentration is often one useful indicator of the level

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[1] *See* U.S. Dep't of Justice and Federal Trade Commission, Horizontal Merger Guidelines § 5.3 (2010), available at http://www.justice.gov/atr/public/guidelines/hmg-2010.html The HHI is calculated by squaring the market share of each firm competing in the market and then summing the resulting numbers. For example, for a market consisting of four firms with shares of 30, 30, 20, and 20 percent, the HHI is 2,600 ($30^2 + 30^2 + 20^2 + 20^2 = 2,600$). The HHI takes into account the relative size distribution of the firms in a market. It approaches zero when a market is occupied by a large number of firms of relatively equal size and reaches its maximum of 10,000 points when a market is controlled by a single firm. The HHI increases both as the

of competitive vigor in a market and the likely competitive effects of a merger. The more concentrated a market, and the more a transaction would increase concentration in a market, the more likely it is that a transaction would result in a meaningful reduction in competition harming consumers. Markets in which the HHI is between 1,500 and 2,500 points are considered to be moderately concentrated, and markets in which the HHI is in excess of 2,500 points are considered to be highly concentrated. Transactions that increase the HHI by more than 200 points in highly concentrated markets will be presumed likely to enhance market power.

39. In 2010, approximately 5.2 million federal individual tax returns that were prepared using H&R Block's Digital DIY Tax Preparation Products were e-filed, accounting for approximately 15.6% of the total Digital DIY Tax Preparation Product market.[2] During the same time period, approximately 4.3 million federal tax returns prepared using TaxACT's Digital DIY Tax Preparation Products were e-filed, accounting for approximately 12.8% of the Digital DIY Tax Preparation Product market. And, in 2010, approximately 21 million federal tax returns prepared using Intuit's TurboTax products were e-filed — accounting for a 62.2% share of the market. Using these figures, the market has a pre-acquisition HHI of approximately 4,276, and H&R Block's acquisition of TaxACT would increase that figure by approximately 399, resulting in a post-acquisition HHI of approximately 4,675. Consistent with the *Horizontal Merger*

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number of firms in the market decreases and as the disparity in size between those firms increases.

[2] 2010 is the most recent year for which accurate data on market shares and concentration currently is available. E-filing figures are used for purposes of calculating market share and concentration because they are the most accurate figures currently available industry-wide. Because e-filing figures do not include taxpayers who use a Digital DIY Tax Preparation Product but choose to print-and-mail the completed tax return, they provide useful but rough approximations. The total annual filing figures contained in paragraphs 9 and 10 include both e-filing numbers and company estimates on the number of print-and-mail filings.

Guidelines, this means that the market for Digital DIY Tax Preparation Products is highly concentrated and would become substantially more concentrated as a result of the acquisition.

VII. ANTICOMPETITIVE EFFECTS

A. The Proposed Transaction Would Eliminate Head-to-Head Competition Between H&R Block and TaxACT

40. As noted above, H&R Block's acquisition of TaxACT would combine the second- and third-largest digital DIY tax preparation companies. The acquisition would allow H&R Block to raise prices and to reduce the quality of its Digital DIY Tax Preparation Products by eliminating the intense head-to-head competition between H&R Block and TaxACT.

41. Digital DIY tax preparation companies compete with each other on price and quality of their products. On price, competition between the digital DIY tax preparation companies has resulted in lower prices on these products for taxpayers. Competition from TaxACT in particular has led to significant decreases in prices through the offering of free products. As illustrated by the examples described above, H&R Block lowered its prices in response to TaxACT.

42. Digital DIY tax preparation companies also compete on the quality of their products. TaxACT has been a particularly aggressive competitor in offering consumers high quality and high functionality Digital DIY Tax Preparation Products for low prices. TaxACT's products continue to improve in quality and functionality through, for example, a better user interface, a better log-on screen, and the ability to prepare and file all e-filable federal forms and schedules. H&R Block has been pressured and responded to TaxACT's improvements by improving the quality of its Digital DIY Tax Preparation Products. TaxACT has also, in turn, responded to competition from H&R Block by improving the quality of its Digital DIY Tax

Preparation Products, such as adding and improving data import capabilities, and offering audit assistance and a maximum refund guarantee.

43. H&R Block is fully aware of the effect that competition from TaxACT has in the Digital DIY Tax Preparation Product market: "Having disrupted the digital tax prep market with cheaper, lower-end solutions, TaxACT [is] surpassing [H&R Block's] TaxCut in market share and continu[es] to improve in quality (surpassing TaxCut in some press reviews in 2009)." It should come as no surprise then that a primary benefit for H&R Block in acquiring TaxACT is: "Elimination of competitor."

44. Internal H&R Block documents repeatedly recognize the competitive significance of "[e]liminati[ng this] competitor" and pulling the maverick off of the market. For example, in an internal H&R Block presentation 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 avoid further price erosion." Compared to the benefits of this acquisition to H&R Block, the benefit to taxpayers, as set forth in the same document, stands in stark contrast: "None."

45. By eliminating this intense head-to-head competition, H&R Block's acquisition of TaxACT would make it less likely that H&R Block would lower its prices or continue to innovate. Thus, with this reduction in competition, taxpayers would bear the cost in terms of higher prices and lower quality Digital DIY Tax Preparation Products.

B. The Proposed Acquisition Would Make Anticompetitive Coordination Substantially More Likely

46. The Digital DIY Tax Preparation Product market possesses several structural features that increase the likelihood of coordination post-acquisition, including a small number of significant competitors, high barriers to entry and expansion, homogeneity of the relevant

product, relatively inelastic demand for the products, and availability of substantial market and competitor information.

47. After the acquisition, purchasers would only have two well-established and widely-used digital DIY tax preparation companies from which to choose. By eliminating TaxACT, a significant, disruptive, and aggressive competitor, the acquisition would likely substantially lessen competition between H&R Block and Intuit by enabling coordination among 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.

48. In fact, in an internal H&R Block email discussion leading up to the transaction, an H&R Block executive explained exactly how H&R Block's acquisition of TaxACT (in contrast to TaxACT being acquired by another entity) would lead to anticompetitive coordination between H&R Block and Intuit: "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. Other potential TA purchasers could decide to cut their prices even further to see if they could make large market share gains & build short-term profitability by 'winning the race to the bottom.'" Another H&R Block executive responded: "I think the strategic gains are that we lock up the share that is up for grabs by another potential player. The defensive play in and of itself has value. . . . One could also argue that there is value in taking control of this 'segment' by not encouraging a a [sic] race to free, which Intuit would have no interest in doing, and therefore has value to HRB by preventing it through the acquisition." As H&R Block so clearly explains, H&R Block and Intuit each have the incentive to charge more for their Digital DIY Tax Preparation Products. This acquisition would give H&R Block the ability to make that happen.

49. H&R Block viewed TaxACT as an aggressive and threatening competitor that forced it to lower prices and raise quality of its Digital DIY Tax Preparation Products on several occasions. By reducing the number of competitors serving the market and eliminating an aggressive competitor, the acquisition would enable the virtual duopolists — H&R Block and Intuit — to coordinate with one another.

C. Lack of Countervailing Factors

50. It is unlikely that entry or expansion in the Digital DIY Tax Preparation Product market would occur in a timely manner or on a scale sufficient to undo the competitive harm that the acquisition would produce. Entry and expansion to a level that would be sufficient to replace the competitive influence now exerted on the market by TaxACT would be difficult, take many years, and require the entrant to incur large sunk costs and significant other expenditures to develop a good Digital DIY Tax Preparation Product, obtain the requisite expertise, and build an effective brand. Successful entrants have spent years and millions of dollars in sunk costs developing their Digital DIY Tax Preparation Products to include support for all or most e-filable forms as well as additional features, such as data import capability and an intuitive user interface. These development requirements are made more challenging by a demanding annual development cycle required to incorporate tax law and tax forms changes in time for the short tax preparation and filing season (January through mid-April). These development efforts can be adversely affected by delays in the adoption of, or last minute changes in, new laws or regulations, delays in the availability of new or revised tax forms, and regulatory agency difficulties in receiving electronic submissions.

51. In addition to developing good digital DIY tax preparation functionality, companies seeking to enter or expand in this market would be required to develop a well-known

brand and good reputation for products that allow individuals to prepare tax returns easily, accurately, and securely. Developing and maintaining a good reputation and brand awareness is crucial to the widespread acceptance of consumer products like Digital DIY Tax Preparation Products, as users rely on reputation to ensure their taxes will be prepared easily, accurately, and securely. Developing a good reputation takes years of consistently good performance, and developing a well-known brand requires years of significant and sophisticated marketing efforts. One competitive advantage held by the Big Three is that their large customer bases can lead to additional growth through word-of-mouth customer referrals. Indeed, TaxACT itself believes that it benefits significantly from word-of-mouth customer referrals. However, a digital DIY tax preparation business must first develop a large customer base before its word-of-mouth customer referrals are sufficient to have a significant impact on the overall market.

52. Although H&R Block asserts that the acquisition would produce efficiencies, it cannot demonstrate acquisition-specific and cognizable efficiencies that would be sufficient to offset the acquisition's anticompetitive effects.

VIII. VIOLATION ALLEGED

53. The United States realleges and incorporates paragraphs 1 through 52 as if set forth fully herein.

54. H&R Block's acquisition of TaxACT would likely substantially lessen competition in the market for Digital DIY Tax Preparation Products, in violation of Section 7 of the Clayton Act, 15 U.S.C. § 18. The transaction would likely have the following effects, among others:

(a) competition between H&R Block and TaxACT in the provision of Digital DIY Tax Preparation Products would be eliminated;

(b) elimination of TaxACT as a "maverick" — a substantial, independent, and competitive force — in the Digital DIY Tax Preparation Product market, creating a combined firm with reduced incentives to lower price or increase quality;

(c) competition generally in the provision of Digital DIY Tax Preparation Products would be eliminated or substantially lessened;

(d) prices of Digital DIY Tax Preparation Products would likely increase to levels above those that would prevail absent the transaction, forcing millions of taxpayers to pay higher prices to prepare and file their federal and state tax returns each year;

(e) quality and innovation of and in Digital DIY Tax Preparation Products would likely be less than levels that would prevail absent the transaction; and

(f) the acquisition would increase the likelihood of, or enable, successful anticompetitive competitor coordination in the market for Digital DIY Tax Preparation Products, and actual or tacit collusion among H&R Block and Intuit.

REQUEST FOR RELIEF

55. The United States requests:

(a) that the proposed acquisition be adjudged to violate Section 7 of the Clayton Act, 15 U.S.C. § 18;

(b) that the Defendants be permanently enjoined and restrained from carrying out the Agreement and Plan of Merger dated October 13, 2010, or from entering into or carrying out any agreement, understanding, or plan by which H&R Block would acquire TaxACT, its stock, or any of its assets;

(c) that the United States be awarded costs of this action; and

(d) that the United States be awarded such other relief as the Court may deem just and proper.

Dated this 23rd day of May 2011.

Respectfully submitted,

FOR PLAINTIFF UNITED STATES:

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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. 1:11-cv-00948 (BAH)

ANSWER OF DEFENDANTS H&R BLOCK, INC.,
2SS HOLDINGS, INC., AND TA IX L.P.

Pursuant to Federal Rule of Civil Procedure 12, H&R Block, Inc., 2SS Holdings, Inc., and TA IX L.P. hereby answer the United States of America's May 23, 2011 Complaint as follows:

PRELIMINARY STATEMENT

H&R Block, Inc.'s ("H&R Block's") proposed acquisition of 2SS Holdings, Inc. ("TaxACT") will enhance competition at all levels of the tax preparation industry and will thereby benefit consumers.[1] To that end, Plaintiff's characterization of the transaction as potentially anti-competitive is wrong and is contrary to logic and the evidence.

A. Competition at All Levels of the Industry Is Robust.

Taxpayers have numerous alternatives for tax preparation and filing, including numerous professional tax preparation options and numerous do-it-yourself ("DIY") options. Taxpayers

[1] Defendants note that the Complaint defines the terms "H&R Block" and "TaxACT" as referencing only H&R Block, Inc. and 2SS Holdings, Inc., neither of which sells tax preparation products and services. For convenience and clarity, Defendants have adopted the same naming conventions in answering Plaintiff's allegations and have used more specific, accurate terms (where appropriate) in the Preliminary Statement.

utilizing DIY options typically choose between preparing their taxes with "pencil and paper" or using some form of tax preparation software. Taxpayers who choose to use tax preparation software can purchase software that runs on their home computers via Internet download or electronic media ("desktop"). They can also purchase (or obtain for free) access to an online service on servers controlled by the provider ("online"). Almost two dozen companies offer desktop and/or online products.

The products being offered by these companies can generally be separated into two categories: "premium" and "value." "Premium" products are typically offered by companies with strong brand-name recognition like Intuit's TurboTax and H&R Block at Home. Premium products typically cost significantly more than value products. Premium products also typically include more features and functionality than value products.

B. The Transaction Will Benefit Consumers.

This transaction involves H&R Block, which through its subsidiaries HRB Digital LLC and HRB Technology LLC (collectively "H&R Block Digital") primarily sells premium products, acquiring TaxACT, which through its subsidiary 2nd Story Software, Inc. ("2SS") sells only value products. The acquisition will enhance competition and benefit consumers in two fundamental ways. First, it will replace H&R Block Digital's costly digital infrastructure with 2SS' efficient, low-cost technology platform (and experienced personnel). This will allow the combined firm to compete more effectively against premium providers of tax services (including Intuit, the largest provider of tax preparation services in the United States) on price, features, and innovation. Second, H&R Block Digital will acquire a low-cost value brand that is already an effective and profitable competitor in the value segment.

C. Plaintiff's Competitive Effects Theory Is Illogical

The proposed transaction will not harm competition or lead to increased prices in the value segment. First, increasing 2SS' prices would significantly erode TaxACT's profitability because the value segment has many strong competitors who would quickly move to take share should 2SS falter. Indeed, the IRS website states that at least seventeen providers of DIY tax software—most of which are in the value segment—meet IRS' "high standards" for tax preparation and provide "fast," "safe," and "accurate tax return[s]." Within the value segment, firms such as FreeTaxUSA, TaxSlayer, On Line Taxes, and others have significant customer bases, have been growing quickly, and have the capacity to grow significantly.[2] As a result, these companies would be quick to react to any competitive mistakes made by 2SS.

Second, contrary to the DOJ's allegations, H&R Block Digital cannot and would not raise 2SS' prices in the hope of driving more sales to H&R Block Digital's more expensive premium products because such a move would destroy the profitability of 2SS' proven business model. As Alan Bennett, the then-President and Chief Executive Officer of H&R Block told the public when the deal was announced, 2SS' "business model has enabled the company to generate consistently strong financial results," and "I love how they run their business." More recently, the new Chief Executive Officer, Bill Cobb, emphasized: "Consumers will be the primary beneficiaries of the merger through innovation, enhanced functionality and low prices." H&R Block's Digital abandoning the proven 2SS low-cost model is thus implausible and contrary to the plain statements in documents written by the executives who recommended this merger.

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2 For example, the products offered by TaxSlayer and FreeTaxUSA each can process a sufficiently broad number of forms to serve more than 95% of taxpayers, and OLT likewise provides a broad offering of federal forms.

For all of the above reasons, H&R Block and H&R Block Digital have already committed to the DOJ that they would not raise any prices on 2SS' tax preparation products for at least three years and would continue offering 2SS' free tax preparation product to all taxpayers for at least three years. Even with this knowledge, the DOJ brought this case claiming that H&R Block's intentions are the opposite. Defendants deny these allegations and seek a decision on this matter as soon as is practicable, so that the merger can close in early Fall 2011. Permitting consummation of this merger will allow consumers to benefit from more innovation, enhanced functionality and low prices.

I. INTRODUCTION

1. Defendants are without knowledge and information sufficient to form a belief as to the truth of allegations in the first sentence of Paragraph 1 and therefore deny them. Defendants admit that some taxpayers choose to prepare their U.S. federal and state tax returns using digital do-it-yourself tax preparation products (defined by the Plaintiff as "Digital DIY Tax Preparation Products") over the Internet or on their desktop computers. Defendants are without knowledge and information sufficient to form a belief as to the truth of allegations in the third sentence and therefore deny them. Defendants deny the allegations contained in the fourth, fifth, and sixth sentences, except to the extent that they contain legal conclusions to which no response is necessary.

2. Defendants deny the allegations contained in the first, second, and third sentences of Paragraph 2. Defendants admit that documents produced to Plaintiff by H&R Block contain the phrases quoted by Plaintiff in the fourth sentence. Defendants deny, however, that the documents are "internal" as they were not authored by H&R Block, Inc. or H&R Block Digital employees. Moreover, the documents speak for themselves. To the extent Plaintiff

alleges the quoted statements are admissions by Defendants, these allegations are denied. To the extent that any allegation is not expressly admitted, it is denied.

3. Defendants deny the allegations contained in the first sentence in Paragraph 3, except to the extent that the allegations contain legal conclusions to which no response is necessary. While Defendants admit that a document produced by H&R Block contains the phrase "avoid further price erosion," Defendants note that the document was not authored by an H&R Block or an H&R Block Digital employee, did not use the word "maverick," and does not refer to any other document using the word "maverick." Moreover, the document speaks for itself. Defendants admit that 2SS used the word "maverick" in a 2005 press release. The document speaks for itself. To the extent Plaintiff alleges the quoted statement is an admission by Defendants, this allegation is denied. Defendants admit that 2SS produced documents containing the phrases quoted by Plaintiff in the second sentence of Paragraph 3. Defendants otherwise deny the allegations contained in the second sentence of Paragraph 3. The documents speak for themselves. To the extent Plaintiff alleges the quoted statements are admissions by Defendants, these allegations are denied. Defendants deny the allegations in the third sentence of Paragraph 3. With regard to the fourth sentence of Paragraph 3, Defendants deny that documents produced by H&R Block contain the word "disrupted" in reference to TaxACT's or 2SS' actions in 2005. The documents speak for themselves. To the extent Plaintiff alleges the quoted word is an admission by Defendants, this allegation is denied. Defendants otherwise deny the allegations contained in the fourth sentence of Paragraph 3. Defendants admit the allegation contained in the fifth sentence of Paragraph 3 that Intuit is the industry leader. Defendants otherwise deny the allegations contained in the fifth, sixth, and seventh sentences of Paragraph 3, except insofar as these sentences contain legal conclusions to which no

response is necessary. Defendants admit that a document produced by H&R Block contains the phrase "at risk," as alleged in the eighth sentence of Paragraph 3. The document speaks for itself. To the extent Plaintiff alleges the quoted statement is an admission by Defendants, this allegation is denied. Defendants otherwise deny the allegations contained in the eighth sentence of Paragraph 3. Defendants deny the allegations in the final sentence of Paragraph 3, except to the extent that they contain legal conclusions to which no response is necessary. To the extent that any allegation is not expressly admitted, it is denied.

4. Paragraph 4 contains legal conclusions to which no response is necessary.

II. JURISDICTION AND VENUE

5. Defendants admit that this action was filed by the United States under Section 15 of the Clayton Act, 15 U.S.C. § 25, purportedly to prevent and restrain Defendants from violating Section 7 of the Clayton Act 15 U.S.C. § 18. To the extent that this paragraph contains legal conclusions, no response is necessary.

6. The first and second sentences of Paragraph 6 contain legal conclusions to which no response is necessary. Defendants deny that H&R Block or TaxACT sell Digital DIY Tax Preparation Products. The final sentence of Paragraph 6 contains legal conclusions to which no response is necessary.

7. Defendants deny that either of H&R Block or TaxACT transacts business in the District of Columbia. The remaining allegations in Paragraph 7 are legal conclusions to which no response is necessary.

8. The allegations in Paragraph 8 are legal conclusions to which no response is necessary.

III. THE DEFENDANTS AND THE TRANSACTION

9. Defendants admit the allegations in the first sentence of Paragraph 9. Defendants deny the remaining allegations in Paragraph 9.

10. Defendants admit the allegations contained in the first sentence of Paragraph 10. Defendants deny the remaining allegations in Paragraph 10.

11. Defendants admit the allegations in the first and second sentence of Paragraph 11. Defendants deny that the approximately one-third interest in 2SS Holdings, Inc. not held by TA I.X. L.P. is held wholly by TaxACT executives and employees.

12. Defendants admit the allegations in Paragraph 12.

IV. THE RELEVANT MARKET

A. Description of the Product

13. Defendants are without knowledge and information sufficient to form a belief as to the truth of allegations in Paragraph 13 and therefore deny them.

14. Defendants admit the allegations contained in the first sentence of Paragraph 14. Defendants deny the allegations contained in the second sentence of Paragraph 14.

15. Defendants admit the allegations contained in the first sentence of Paragraph 15, except to the extent that they purport to describe how all digital DIY tax preparation products offered by companies other than Defendants work. Defendants deny the

allegations contained in the second, third, fourth, fifth, and sixth sentences. Defendants admit the allegations contained in the seventh sentence.

16. Defendants admit the allegations contained in first, second, sixth, and seventh sentences of Paragraph 16, except to the extent that they purport to describe how all digital DIY tax preparation products offered by companies other than Defendants work. Defendants admit the allegations in the third sentence, except to the extent that Plaintiff alleges that users of the "software" channel (as defined by Plaintiff) are limited to CD-ROM or DVD, which Defendants deny. Defendants admit that consumers may be sent electronic media containing digital DIY tax preparation products directly from a company, through a distributor, or through a retailer. To the extent that Plaintiff alleges that users of the "software" channel are limited to purchasing products directly or from "retail stores," Defendants also deny this allegation.

17. Defendants deny that "all Digital Tax Preparation Products function in the same way," as alleged in Paragraph 17. Defendants are without knowledge and information sufficient to form a belief as to the truth of the remaining allegations in Paragraph 17 and therefore deny them.

18. Defendants admit the allegations contained in the first sentence of Paragraph 18. Defendants deny the remaining allegations relating to TaxACT and H&R Block. Defendants are without knowledge and information sufficient to form a belief as to the truth of allegations regarding Intuit and therefore deny them.

19. Defendants admit the allegations in Paragraph 19, except Plaintiff's characterization of tax engines as "complicated," which Plaintiff has not defined; Defendants are

without sufficient information to form a belief as to the truth of the allegation and therefore deny it.

20. Defendants are without knowledge and information sufficient to form a belief as to the truth of the allegations contained in Paragraph 20 and therefore deny them.

21. Defendants admit the allegations in Paragraph 21.

22. Defendants admit that 2SS' published prices are generally lower than H&R Block Digital's and Intuit's published prices. Defendants deny the remaining allegations in Paragraph 22.

B. Relevant Product Market

23. Defendants deny the allegations contained in Paragraph 23, except to the extent that these allegations contain legal conclusions to which no response is necessary.

24. Defendants deny the allegations contained in Paragraph 24, except to the extent that these allegations contain legal conclusions to which no response is necessary.

25. Defendants deny the allegations contained in Paragraph 25, except to the extent that these allegations contain legal conclusions to which no response is necessary.

26. Defendants deny the allegations contained in Paragraph 26, except to the extent that these allegations contain legal conclusions to which no response is necessary.

C. Relevant Geographic Market

27. Defendants deny the allegations in the first sentence of Paragraph 27. The final sentence contained in Paragraph 27 is a legal conclusion to which no response is necessary.

Defendants are without knowledge and information sufficient to form a belief as to the truth of the remaining allegations in Paragraph 27 and therefore deny them.

V. TAXACT's ALLEGED HISTORY OF "DISRUPTING" THE MARKET

28. Defendants admit that documents produced by H&R Block contain the word "disrupted" as well as the language quoted at the end of Paragraph 28. The documents speak for themselves. To the extent Plaintiff alleges the quoted statements are admissions by Defendants, these allegations are denied. Defendants deny the remaining allegations contained in Paragraph 28.

29. Defendants are without knowledge and information sufficient to form a belief as to the truth of allegations contained in the first and second sentences of Paragraph 29 to the extent that these allegations pertain to companies other than Defendants, and therefore Defendants deny the allegations to the extent that they pertain to such companies. Defendants also deny the allegations contained in the first and second sentences of Paragraph 29 as they relate to Defendants. Defendants admit the allegations contained in the third sentence of Paragraph 29.

30. Defendants admit that the documents cited in Paragraph 30 contain the language quoted therein. The documents speak for themselves. To the extent Plaintiff alleges the quoted statements are admissions by Defendants, these allegations are denied. Defendants deny the remaining allegations in Paragraph 30.

31. Defendants admit that documents produced by H&R Block to Plaintiff cited in Paragraph 31 contain the language quoted therein. The documents speak for themselves.

To the extent Plaintiff alleges the quoted statements are admissions by Defendants, they are denied. Defendants deny the remaining allegations in Paragraph 31.

32. Defendants deny the allegations in the first sentence contained in Paragraph 32, except to the extent that these allegations are legal conclusions to which no response is necessary. Defendants are without knowledge and information sufficient to form a belief as to the truth of the allegations in Paragraph 32 regarding Intuit and therefore deny them. Defendants deny the remaining allegations in Paragraph 32.

33. Defendants admit that documents produced by H&R Block contain the language quoted in Paragraph 33. Defendants deny that an H&R Block executive in January 22, 2009 made the statements quoted by Plaintiff in the third sentence of Paragraph 33. The documents speak for themselves. To the extent Plaintiff alleges the quoted statements are admissions by Defendants, these allegations are denied. Defendants deny the remaining allegations in Paragraph 33.

34. Defendants admit that a document produced by H&R Block contains the phrase quoted in the final sentence of Paragraph 34. The document speaks for itself. To the extent Plaintiff alleges the quoted statement is an admission by Defendants, this allegation is denied. Defendants deny the remaining allegations in Paragraph 34.

35. Defendants admit that a document produced by H&R Block contains the quoted language in Paragraph 35. The document speaks for itself. To the extent Plaintiff alleges the quoted statements are admissions by Defendants, they are denied. Defendants deny the remaining allegations in Paragraph 35.

36. Defendants deny that Lance Dunn authored any documents "based on" facts alleged in the Complaint and denied by Defendants, as alleged in Paragraph 36. Defendants further deny that Lance Dunn based the press release cited in Paragraph 36 on facts post-dating the press release and/or on facts otherwise unknowable to Lance Dunn as alleged by Paragraph 36. Defendants deny the remaining allegations contained in Paragraph 36.

VI. MARKET CONCENTRATION

37. Defendants deny the allegations contained in Paragraph 37.

38. Defendants admit that the Herfindahl-Hirschman Index ("HHI") is cited as a measure of market concentration in the *Horizontal Merger Guidelines* issued by the Department of Justice. The remaining allegations contained in Paragraph 38 are legal conclusions to which no response is necessary.

39. Defendants deny the allegations in the first and second sentences of Paragraph 39. Defendants are without knowledge and information sufficient to form a belief as to the truth of the allegations concerning TurboTax in Paragraph 39 and therefore deny them. Defendants deny that the market alleged in the Complaint is a relevant market. Defendants are without knowledge and information sufficient to form a belief as to the truth of the allegations concerning market share or HHI in the market alleged by the Complaint and therefore deny them. Defendants admit that 399 plus 4,276 is 4,675. Defendants admit that the *Horizontal Merger Guidelines* state that a market with an HHI of 4,675 is highly concentrated. Defendants deny that any properly defined market would become substantially more concentrated as a result of the acquisition. Defendants deny the remaining allegations contained in Paragraph 39.

VII. ALLEGED ANTICOMPETITIVE EFFECTS

A. Alleged Head-to-Head Competition Between H&R Block and TaxACT

40. Defendants deny the allegations in Paragraph 40.

41. Defendants admit the allegations contained in the first and second sentences of Paragraph 41, except insofar as these sentences suggest that (1) all digital tax preparation companies compete with one another, and (2) competition between private companies is the only or primary pricing constraint for Digital DIY tax preparation companies. Defendants deny the remaining allegations contained in Paragraph 41.

42. Defendants admit the allegations contained in the first sentence of Paragraph 42, except insofar as this sentence suggests that all digital tax preparation companies compete with one another. Defendants deny the remaining allegations contained in Paragraph 42.

43. Defendants deny the allegations contained in Paragraph 43. Defendants admit that documents produced by H&R Block contain the language quoted in Paragraph 43. The documents speak for themselves. To the extent Plaintiff alleges the quoted statements are admissions by Defendants, these allegations are denied.

44. Defendants deny the allegations contained in Paragraph 44. Defendants admit that documents produced by H&R Block contain the language quoted in Paragraph 44. Defendants deny that the documents were "internal" as they were not authored by H&R Block or H&R Block Digital employees. Moreover, the documents speak for themselves. To the extent Plaintiff alleges the quoted statements are admissions by Defendants, these allegations are denied.

45. Defendants deny the allegations contained in Paragraph 45.

B. Alleged Increase in the Likelihood of Anticompetitive Coordination

46. Defendants deny the allegations contained in Paragraph 46.

47. Defendants deny the allegations contained in Paragraph 47.

48. Defendants deny the allegations contained in Paragraph 48. Defendants admit that documents produced by H&R Block contain the language quoted in Paragraph 48. Defendants deny that the language quoted in Paragraph 48 was authored by an H&R Block executive or by any person with authority or input on the transaction or decisions regarding post-transaction planning. The documents speak for themselves. To the extent Plaintiff alleges the quoted statements are admissions by Defendants, these allegations are denied.

49. Defendants deny the allegations contained in Paragraph 49.

C. Alleged Lack of Countervailing Factors

50. Defendants are without knowledge and information sufficient to admit or deny allegations concerning other companies in Paragraph 50. Defendants deny the remaining allegations contained in Paragraph 50.

51. Defendants deny the allegations contained in Paragraph 51.

52. Defendants admit that H&R Block asserts that the acquisition will produce efficiencies. Defendants deny the remaining allegations contained in Paragraph 52.

VIII. VIOLATION ALLEGED

53. Defendants incorporate their admissions and denials from Paragraphs 1 through 52 as set forth above in response to Plaintiff's incorporation of said paragraphs in Paragraph 53.

54. Defendants deny the allegations contained in Paragraph 54.

55. Defendants admit that the United States requests in Paragraph 55 that the proposed acquisition be adjudged to violate Section 7 of the Clayton Act, 15 U.S.C. § 18. Defendants further admit that the United States requests that Defendants be permanently enjoined and restrained from carrying out the Agreement and Plan of Merger dated October 13, 2010, or from entering into or carrying out any agreement, understanding, or plan by which H&R Block would acquire TaxACT, its stock, or its assets. Defendants also admit that the United States requests that it be awarded costs of this action and that the United States requests that it be awarded such other relief as the Court may deem just and proper. Defendants deny that the United States is entitled to any of the relief it is seeking.

IX. AFFIRMATIVE DEFENSES

The inclusion of any ground within this section does not constitute an admission that Defendants bear the burden of proof on each or any of the matters, nor does it excuse Plaintiff from establishing each element of its purported claim for relief.

56. The Complaint fails to state a claim on which relief can be granted.

57. The contemplated relief would not be in the public interest because it would, among other things, harm consumers.

58. Efficiencies and other pro-competitive benefits resulting from the acquisition outweigh any and all proffered anticompetitive effects.

59. Defendants reserve the right to assert any other defenses as they become known to Defendants.

WHEREFORE, Defendants respectfully request that the Court (i) deny Plaintiff's contemplated relief, (ii) dismiss the Complaint in its entirety with prejudice, (iii) award Defendants their costs of suit, including attorneys' fees, and (iv) award such other and further relief as the Court may deem proper.

Dated: July 7, 2011

Respectfully submitted,

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Minute Order, United States v. H&R Block, Inc., No. 11-00948 (BAH) (D.D.C. Aug. 4, 2011)

MINUTE ORDER (paperless) granting in part and denying in part Joint Motion for Order Regarding Proposed Hearing Length and Findings of Fact. For the hearing set to commence on September 6, 2011, the plaintiff and the defendants will each be limited to twenty-five (25) total hours of testimony for their respective cases-in-chief, which will not include their opening and closing statements, but will include direct testimony, cross-examination, and argument before the Court during the hearing. Additionally, the plaintiff will be entitled to no more than six (6) hours of total combined time for its rebuttal witnesses; defendants will have no more than three (3) hours of total combined time to cross-examine plaintiffs rebuttal witnesses. Each side shall have no more than one (1) hour for their respective opening statements and one (1) hour for their respective closing statements. The Court will not waive the requirements of Paragraph 11(a)(ix) of the Court's Standing Order, which requires the parties to submit, as part of the Joint Pre-Hearing Statement, a statement of facts that the parties have stipulated to, or have agreed are undisputed, or that the parties propose for stipulation. Such a statement will help the Court identify the areas of factual dispute and agreement in advance of the hearing. Finally, unless the parties are otherwise notified, the Court will convene the hearing from 9:30 AM to 12:30 PM and 1:45 PM to 5:00 PM, Monday through Friday, except that on September 13 and September 14, 2011, court will not be held due to the necessary attendance of the Judge at a meeting of the United States Sentencing Commission. Signed by Judge Beryl A. Howell on 8/4/2011. (lcbah2) (Entered: 08/04/2011)

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

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[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

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[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).

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[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.

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[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.*

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.*

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[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

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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.