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United States v. H&R Block: The DOJ Invokes *Brown Shoe* to Shed the *Oracle* Albatross

BY JAMES. A. KEYTE

ON NOVEMBER 10, 2011, THE U.S. Department of Justice won its first fully litigated merger challenge since its 2004 defeat in *United States v. Oracle Corp.*[1] In the interim, the Federal Trade Commission had litigated and won—albeit with an arguably lower injunction standard[2]—Section 7 challenges in *FTC v. CCC Holdings Inc.*[3] and *FTC v. Whole Foods Market, Inc.*[4] While the DOJ certainly had its share of abandoned transactions and consent judgments over the past several years,[5] the desire for a litigated win in the shadow of *Oracle* had become palpable in the hallways of the Antitrust Division.

The lesson from *United States v. H&R Block, Inc.* (*HRB*),[6] however, is not just that the DOJ can win a Section 7 case; that was inevitable. Rather, the decision to bring this particular case, as well as the eighty-six-page decision from Judge Beryl Howell, provide the most recent insights into the type of evidence that appears most attractive to a federal judge considering a Section 7 merger challenge: ordinary course business documents, party testimony, and industry perception centered around simple market definitions (coupled with high combined market shares)—i.e., reliance on the same types of "practical indicia" that have been part of merger analysis since *Brown Shoe Co. v. United States*.[7] Perhaps these were the lessons of the FTC's victories since 2000 as well. In other words, while the academic debate concerning the pros and cons of defining markets for Section 7 analysis marches on,[8] the DOJ seems to have realized that embracing a simplified market definition—even if hotly contested by the parties—together with a strong structural presumption of anticompetitive effects, gave it the best chance of winning in court.

This is not to say that the parties, as well as the court, ignored the economic tools for assessing both market definition and competitive effects that were recently highlighted in the Agencies' 2010 Merger Guidelines.[9] For example, the court addressed at length the subject of diversion ratios, an analysis that attempts to answer the ever-elusive question of what consumers would do (e.g., what products they would substitute) if the merged firm—or a hypothetical monopolist of a postulated narrow market—were to raise prices. In *HRB*, as in nearly all merger analysis today, this inquiry turned into a debate about whether sufficient data existed for such an analysis and whether the parties' competing assertions were of significant evidentiary value. The court's view of the diversion ratio issue was critical because these calculations form the basis of other economic expert quantitative analyses, including the hypothetical monopolist test (HMT),[10] "critical loss" analysis,[11] "merger simulation,"[12] and the newest analysis embraced by the Agencies, "upward pricing pressure"[13]—all of which made their way into the court's opinion with varying degrees of attention and success. In fact, the decision is worth analyzing in some detail just to observe how the parties and the court addressed the ongoing quest of economists to measure and quantify the answers to analytical questions that, when closely examined, often remain as subjective and diverse as the spectrum of consumer preferences themselves.

What most practitioners will seek to glean from *HRB*, however, is what it reveals about current merger analysis in the courts—not the economic literature—that will help them better advise clients, especially regarding what the Agencies believe will enable them to win Section 7 cases. For example, does market definition remain a central piece of merger analysis and what kind of qualitative and quantitative evidence was most persuasive to the court on that issue? What weight did the court give to the DOJ's structural case in terms of shifting the burden of proof? In turn, what rebuttal evidence was offered by H&R Block, including ease and likelihood of expansion by rivals, and how did the court analyze this most critical issue in assessing a merger involving differentiated products, especially in the face of a strong structural presumption of anticompetitive harm? What evidence did the DOJ offer regarding coordinated and unilateral effects, and how did the court resolve the debates over ease and likelihood of coordination, the definition and relevance

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of mavericks, the closeness of the merging parties' products and other effects issues? And, finally, how did the court assess the efficiency defenses offered by H&R Block?

Through the lens of these questions, *HRB* demonstrates that the DOJ (whatever its current academic predilections) remains perfectly willing to employ time-tested litigation techniques based on *Brown Shoe* and *United States v. Philadelphia National Bank*,[14] and to do so by relying primarily on ordinary business documents and party admissions. Indeed, in *HRB* the court held that the quantitative expert evidence of both parties could not answer the diversion question, and ultimately found only that the DOJ's economic analyses—at least in comparison to H&R Block's—had some incremental value in light of the documents and testimony that remained the primary basis of the court's decision. In short, bad documents and testimony continue to win cases for the Agencies, even though the battle of the economic experts and their quantitative tools have now firmly found a place in Section 7 analyses and litigation.

The Proposed Transaction

On October 13, 2010, H&R Block (HRB) agreed to purchase 2SS Holdings in a transaction valued at $287.5 million. HRB operates hundreds of retail tax stores and also offers digital do-it-yourself (DDIY) tax software. TaxACT, owned by 2SS Holdings, is the third-largest provider of DDIY tax software, trailing behind HRB and Intuit's TurboTax DDIY tax software. On May 23, 2011, after a seven month review of the transaction, the DOJ filed a complaint alleging that the proposed deal would substantially lessen competition in the growing U.S. DDIY tax preparation software market. The DOJ asserted that the merger would result in higher prices and reduced innovation and quality for the DDIY products used annually by millions of American taxpayers.

Specifically, the DOJ alleged that DDIY was a distinct relevant product market occupied primarily by three relatively large competitors. HRB and TaxACT were two of the three largest online providers of DDIY products, with a combined share of 30 percent in the DDIY market. Intuit's TurboTax product dominated the DDIY market with over 60 percent share; and eighteen other fringe competitors made up the remaining 10 percent of DDIY players. The DOJ argued that the merger was even more likely to result in competitive harm because it would eliminate TaxACT—a maverick—that historically had acted as a forceful competitor in the offering of free services to gain market share.

Conversely, HRB, as a threshold matter, argued that the relevant market was all tax services including its in-person assisted tax services and other forms of do-it-yourself tax services. HRB argued that prices for its DDIY products were constrained both by these other products and—especially at the lower-priced end—by the option of tax filers to do their own taxes at home for free. Further, HRB argued that, in any event, likely supply responses of smaller DDIY providers would quickly fill any competitive void in the DOJ's proposed market created by the transaction. Finally, HRB argued that the merged firm would generate a number of merger-specific efficiencies that would enable the merged firm to compete more effectively against Intuit's dominant TurboTax product.

The Relevant Market Was the Key Battleground

While the academic debate slogs on concerning the usefulness of market definition (or the Herfindahl-Hirschman Index (HHI), for that matter) in Section 7 analysis, the DOJ did not choose to fight that battle in its case against HRB. Not surprisingly, then, the court's opinion simply states that "'[m]erger analysis begins with defining the relevant product market.'"[15] At the same time, in the context of its unilateral effects analysis, the court noted that market definition does not appear to be required as a matter of applied economics.[16] The court also observed that the 2010 Merger Guidelines reflect the DOJ's view that market definition may be superfluous (observing that the notion of Section 7 analysis without defining markets had some traction with one of the panel members in *Whole Foods*),[17] but nonetheless found that as a legal matter it still appeared necessary. In the end, of course, the DOJ was pleased with the market definition requirement and the significant presumption of anticompetitive effects that it obtained by prevailing on the issue and the resulting concentration analysis. The interesting question is how the DOJ was able to do so in the face of uncontested end-use interchangeability among tax preparation methods used to comply with the tax laws.[18]

The Court's* Brown Shoe *Submarket Analysis. The *HRB* opinion suggests a conscious decision by the DOJ to invoke the often-maligned qualitative approach first laid down by the Court in *Brown Shoe*. Hence, rather than rely primarily on the economic tools underlying the 2010 Merger Guidelines, the DOJ persuaded the court to follow *Brown Shoe* and *FTC v. Staples Inc.*,[19] which discuss interchangeability of use only as a starting point in which to consider the presence of more localized competition.

In line with *Brown Shoe*, the court then found that distinct submarkets could be relevant, which "'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.'"[20] More strikingly, the court adopted the fairly sweeping observation that these "practical indicia" can be viewed as "evidentiary proxies for proof of substitutability and cross-elasticities of supply and demand."[21]

With this expansive framework in mind, the court began its market definition analysis by "pay[ing] close attention to the defendants' ordinary course of business documents," which set the theme for the decision.[22] The court found that "[i]nternal 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."[23] Similarly, HRB's documents described the DDIY segment and referred to HRB, TaxACT, and TurboTax as the "Big Three" within that product space.[24] In the court's view, the documents and testimony also confirmed that "DDIY tax preparation products differ from manual tax preparation and assisted tax preparation products in a number of meaningful ways" including that "DDIY products involve different technology, price, convenience level, time investment, mental effort and type of interaction by the consumer."[25] Thus, the court concluded, "Taken together, these different attributes make the *consumer experience* of using DDIY products quite distinct from other methods of tax preparation."[26]

In reaching this conclusion, the court rejected HRB's broader view of the market, which was based 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."[27] The court similarly rejected evidence that these taxpayers viewed multiple tax preparation products as "reasonably interchangeable" and that there was cross-elasticity of demand across these products.[28] Further, the court implicitly rejected HRB's arguments concerning the complexities of competition within the tax preparation market, including the extent to which competitors offer hybrid products or whether the parties' product offerings were positioned at different ends on a continuum of differentiated DDIY products. For example, HRB asserted that "competitors offer services that blend the methods set forth [for preparing taxes]," including HRB's Best of Both product, TurboTax's Premier Plus Professional Review, and Petz's Full Tax Preparation, as well as "numerous free and online tax preparation assistance sites [that] provide[] guides and tips to facilitate manual tax preparation."[29] The court did not appear to consider or credit the extent to which these hybrid products compete with DDIY products—i.e., were "competitive alternatives that '[had] the ability to take significant business from each other.'"[30]

Nor did the court give credence to differences between "value" customers who "choose their product primarily on price" and "premium" customers who "are willing to pay higher prices for brand reputation, extra services, and expert support."[31] Pricing for DDIY products varied substantially for value and premium products: "[A]s the price of premium federal tax preparation products fluctuated wildly, the prices of value products offered by, for instance, TaxACT, FreeTaxUSA, TaxSlayer and OLT were static."[32] HRB argued that it had long distinguished between value and premium customers and that the merger was intended to "provide[] an opportunity to grow share" in the value segment.[33]

Notwithstanding HRB's arguments and evidence, the court was not troubled by defining a market that included "tax preparation methods and products ranging between 'Free' and over $100," but excluded "other tax preparation products and methods ranging between 'Free' (manual [do-it-yourself] or pencil-and-paper) and over $100 (assisted preparation)."[34] HRB argued that pricing value and premium DDIY products "are highly heterogeneous" and "vary in price by more than 1000% (even excluding Free) ($9.95 for TaxACT Deluxe ($17.95 including state) versus $99.95 for TurboTax Home and Business ($130.90 including state))."[35] The court's market definition analysis appeared to marginalize these issues. Thus, relying on *Brown Shoe* and *Whole Foods*—and without reference to any quantitative analysis—the court simply concluded that the documents and testimony cited by the government were compelling evidence that DDIY was the relevant market in which to assess the proposed transaction.[36]

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***The DOJ Can Live with a Win Based on* Brown Shoe.** Possibly the most interesting aspect of *HRB* is the extent to which the DOJ and the court relied on the "practical indicia" of *Brown Shoe*, when the new Merger Guidelines—as well as the Agencies' 2006 Commentary on the Horizontal Merger Guidelines[37]—appear to have abandoned that approach in favor of new economic tools.[38] Consistent with the broad view of what may constitute probative evidence, the *HRB* court also relied on these practical indicia (evidenced in HRB's ordinary course business documents and testimony) to answer the "hypothetical monopolist test" of the Merger Guidelines—again, without resorting to any data or quantitative analysis. According to HRB, the DOJ conceded that "'in this case . . . the [economics] expert is not central to the [g]overnment's case' despite later noting that '[a]ssessments of the "probable future" of the relevant market rely primarily on economic analysis conducted by expert witnesses.'"[39] Indeed, in its trial brief, the DOJ highlighted that its market definition and structural case were based on the *Brown Shoe* indicia rather than quantitative economic analysis.[40]

This confirms that for many courts—including *HRB*, *CCC Holdings*, *Whole Foods*, and *H.J. Heinz*—contemporaneous business documents, party testimony, and industry perception along the lines of the *Brown Shoe* "practical indicia" will continue to be persuasive evidence of competitive dynamics, including predicted demand and supply reactions to hypothesized, post-merger exercises of market power. The problem, of course, is that neither the DOJ nor merging parties want to take positions on the relevance or weight of such evidence in advance without knowing their impact on the ultimate outcome.

In *HRB*, these documents and testimony overcame the apparent end-use interchangeability of the three main types of tax preparation as an economic matter—the "outer boundaries" of the product market—in favor of what appeared to be a fairly discrete and complex competitive interplay among DDIY products. In fact, the court's consistent reference to the "user experience" as a driving force of consumer choice highlights what appeared to be significant gaps in the chain of functional substitutes—even if such qualitative factors made it almost impossible to assess *why* consumers often switched between and among tax preparation methods. Thus, for the *HRB* court, end-use interchangeability could not trump what appeared to be a distinct competitive interaction among rivals that catered to the DDIY experience, as well as the fact that DDIY companies "primarily compete[]" with each other.[41] Nor, apparently, did it matter to the court that, within DDIY, there appeared to a broad range of products and price points that affected the degree of competitive interaction among suppliers.

The Fight over Diversion Ratios and Critical Loss. To bolster its market definition, but certainly not in place of its particular application of *Brown Shoe*, the DOJ attempted to use switching data from the IRS, capturing changes in the manner in which taxpayers historically file their tax returns. This data was offered to estimate the extent to which customers were likely to switch to other forms of tax preparation methods if prices were raised by a small but significant amount.[42] The DOJ's expert viewed this data as a proxy for diversion ratios, which attempt to measure the extent to which consumers would switch to other products in response to a hypothetical small but significant and non-transitory increase in price (SSNIP).[43] The DOJ's expert then used this data to perform a "critical loss analysis," which in the government's view demonstrated that DDIY was the appropriate product market. The DOJ's expert also used the switching data to perform a merger simulation. Using a Bertrand model, he predicted that post-merger, TaxACT's prices would rise by 83 percent, HRB's prices would rise by 37 percent, and TurboTax's by 11 percent.[44]

While the court recognized the potential flaws in using the switching data—which, most problematically, did not indicate *why* a taxpayer switched methods[45]—as a proxy for diversion ratios, it nonetheless found that the DOJ's expert's testimony "tend[ed] to confirm that DDIY is [the] relevant product market."[46] The court reached this conclusion despite the fact that the IRS switching data "indicate[d] that only 2.6% of TaxACT customers switched to HRB products between 2007 and 200 . . . and only 2.7% of HRB customers switched to TaxACT products," levels "substantially below the switching between [d]efendants' products and competitors outside of [p]laintiff's proposed market."[47] HRB's expert accordingly concluded that "[d]efendants compete on some level . . . [but are not] close competitors."[48] Because, among other things, the DOJ's critical loss analysis could also be used to demonstrate a relevant market of just HRB and Intuit or TaxACT and Intuit, the court "appreciate[d] the defendants' point that the critical loss test *alone* could not answer the relevant market inquiry."[49]

Notably, the court was even less persuaded by the defendants' 2011 email survey, which attempted to determine why customers switched between tax preparation methods, or HRB's April 2009 survey, which attempted to determine the level of competition between the defendants for internal pricing purposes.[50] While the defendants' expert "opined that '[the 2011] survey is closer to the concept of a diversion ratio than are data on overall switching between products,'" the court concluded that "almost any reason for switching from a product could be characterized as dissatisfaction with the 'functionality' or 'quality' offered by the product."[51]

Ultimately, despite recognizing that the opinions of experts of both the DOJ and the defendants were based on flawed data, the court held that the DOJ's expert was more persuasive than the defendants' expert.[52] This conclusion perhaps again is attributable to the fact that the DOJ expert's conclusions corresponded to what the court gleaned from the defendants' documents and testimony.[53]

HRB *Is Not a Ringing Endorsement of the Agencies' Quantitative Tools.* Notwithstanding the court's frequent reference to the 2010 Merger Guidelines, practitioners might ask whether the court in *HRB* would have obtained the same result if the documents were *not* in the DOJ's favor (or ambiguous), and the DOJ had to rely primarily on diversion ratios, critical loss analysis, Bertrand merger simulation, and UPP to prove market definition or likely anticompetitive effects. In answer, the most that can be said is that, in comparison to HRB's simulated diversion ratios based on survey data (which the court found to be defective in design),[54] the DOJ's use of IRS switching data had only "some" probative value in that it was consistent with the documents. Even this observation, however, is undermined by the court's finding that the switching data offered by the DOJ could not capture *why* people switch among tax preparation methods; nor is it consistent with the court's finding that user experience likely dictates choices, an apparent subjective decision that certainly could not be quantified by any of the available data. Suffice it to say that while the DOJ attempted to put its entire economic tool kit to work in *HRB*, none of those tools (through no fault of its own) were decisive or even persuasive to the court. This suggests that we could be a long way from seeing decisions that will rely on these economic techniques and analyses *without* accompanying ordinary business documents and testimony providing the primary basis for a Section 7 injunction.

In addition, on the issue of market definition, there appears to be a middle ground in the analysis that was not explored by the court in assessing submarkets. Many courts only uphold such narrower markets within the outer boundaries of interchangeability—undisputed in terms of end use in *HRB*—where certain, identifiable consumers effectively are locked into the narrower product category and are incapable

of easy switching. This also appeared to be the driving analytical force behind *Whole Foods* and its discussion of "core" consumers. *HRB* is somewhat troubling in that it found a distinct DDIY submarket—creating a strong presumption of anticompetitive effects—without at least engaging in this analytical inquiry. At a minimum, the *HRB* court's easy acceptance of submarkets in the face of end-use interchangeability should have highlighted the need to give careful consideration to the potential supply responses of those competitors—both "in" and "out" of the market—who were already offering tax-filing services to consumers, including DDIY.

The Structural Presumption and Burden Shifting

Once the court accepted the DOJ's market definition, the case became a serious uphill battle for HRB. Because three competitors dominated this product space, the HHI was 4291, indicating a highly concentrated DDIY market. The merger, which the court found would "result in an effective duopoly,"[55] would increase the HHI by approximately 400.[56] In the court's view, HRB's ordinary course business documents also confirmed that the merger would significantly impact HRB's share of the DDIY market: "[T]he documents show[ed] that, in connection with a proposed acquisition of TaxACT, HRB identified the proposed transaction as a way to grow its digital 'market share' and ha[d] measured TaxACT's market share in a DDIY market."[57] Under both court precedent and the 2010 Merger Guidelines, these HHI levels and changes created a strong presumption of anticompetitive effects.[58]

Judge Howell explicitly adopted the burden-shifting paradigm set forth in *United States v. Baker Hughes Inc.*[59] Under this approach, the government can "'establish[] a presumption that the transaction will substantially lessen competition'" by demonstrating 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."[60] The court emphasized that "[o]nce 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.'"[61] If the defendants can show that the government's market share statistics do not accurately portray the competitive landscape, the burden shifts back to the government to produce "additional evidence of anticompetitive effect."[62] The court noted that "'[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.'"[63]

While grounded in precedent, the court's application of the presumption is worth highlighting. The court did not find that the burden shifted in an amorphous manner; rather, it placed what appears to be a substantial evidentiary burden, in light of the strong structural case, on HRB to show market structure and facts that tend to disprove the presumed likelihood of coordinated or unilateral effects—namely, ease of entry or repositioning. Further, as discussed below, the court did so under a standard that remains difficult for many parties to meet.

HRB's Rebuttal: Likely Supply Responses of Other Competitors

Defendants attempted to rebut the government's case by referring to the likelihood that other DDIY companies would expand post-merger. HRB argued that supply responses from these other competitors would be highly likely—new firms had entered the market easily, there were low barriers to entry, and brand recognition did not play a large role in customer decision making.[64]

The court found that, under both the Merger Guidelines and precedent, such expansion would have to be "'timely, likely, and sufficient in its magnitude, character, and scope to deter or counteract the competitive effects of concern.'"[65] The court then discussed the testimony from the two (of eighteen) most significant DDIY companies currently in the market, which presumably were in the best position to expand in the event of any exercise of market power, post-merger. The court found that these two companies were not likely to expand, both because of their idiosyncratic corporate culture and their branding and reputational challenges. Based primarily on those findings, the court could not "find that expansion is likely to avert anticompetitive effects from the transaction."[66] Likewise, the court essentially trivialized the other competitors in the DDIY market who were well-positioned to enter the market, as well as "an IRS-sponsored website promoting competition and free offers to the public."[67]

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A Dynamic Analysis of Supply Responses? For some, the court's analysis of potential supply responses is perhaps the most troubling aspect of the opinion, especially in the context of differentiated products and end-use interchangeability. Not only did the court fully adopt the relatively onerous "timely, likely and sufficient" standard of the Merger Guidelines, it seemed to ignore the dynamic hypothetical nature of the analysis required, as well as the requisite focus on economic incentives of potential supply responders. For exam-

ple, in its discussion of TaxHawk and TaxSlayer—both small, but successful DDIY sellers—the court appeared to limit its analysis to conduct that the companies engage in under *current* competitive conditions and outcomes. Thus, while TaxHawk certainly may wish to maintain its "relaxed lifestyle" and TaxSlayer may have "reputation and brand" challenges under current market conditions, the court appeared not to ask whether and to what extent sustained anticompetitive pricing by the merged firm and Intuit—especially in the "value" segment of DDIY—would alter the economic incentives and ability of these or other small rivals to expand when they already are in the DDIY market space.[68]

Under the Merger Guidelines and case law, the question of supply responses focuses on just these objective factors.[69] For example, in *United States v. Gillette Co.*,[70] the court considered that the relevant market may be limited to "premium pens" (in which the defendants had higher concentration ratios). However, the court rejected the notion that the defendants would be able to substantially lessen competition in that market post-merger for several reasons (many of which were relevant in *HRB*), including: first, if Gillette raised prices, it would likely lose customers to non-premium pen products; second, there were no barriers to entry; and third, other companies were free to enter the market.[71] The court concluded that "[w]hile some users are devoted to fountain pens to such a degree that they are captive to non-trivial, non-transitory price increases, a broader market enjoys active competition among all modes of premium writing instruments."[72]

As in *Gillette*, the evidence in *HRB* indicated that there was wide price variation even among the narrow market proposed by the government, and this price variation would make it difficult for the post-merger HRB generally to raise prices for DDIY tax products without losing some "value" customers to lower cost products, while losing other "premium" customers to assisted tax preparation products. Nevertheless, the court focused on historical or current trends in the market, which tend to ignore the necessarily dynamic focus of potential supply responses. Practitioners should recognize that size apparently does matter to some courts, especially if each member in the group of potential entrants is relatively small.

Coordinated Effects

Defendants also tried to argue that coordinated effects would be unlikely because Intuit would still have incentives to compete vigorously, post-merger. However, the DOJ pointed to a "highly persuasive historical act of cooperation between HRB and Intuit" that supports the position that they may coordinate in the future.[73] Additionally, the court found that because of price transparency, "DDIY firms can easily monitor their competitors' offerings and pricing."[74]

The DOJ also argued that TaxACT was a maverick that disrupted the market with lower pricing, and the court found that TaxACT had an "impressive history of innovation and competition in the DDIY market."[75] HRB countered that the government's contention was factually unsupported because the products of the three major competitors were extremely diverse, which typically makes it difficult to coordinate. HRB also argued that "widespread free offers in tax preparation arose [only] in response to the IRS Restructuring and Reform Act of 1998 and instructions from the Office of Management and Budget's Quicksilver Task Force (2001), which collectively required that the IRS dramatically increase the rate of e-filing and establish some form of free tax preparation."[76] Accordingly, TaxACT was not "competitively unique" and could not be considered a maverick.[77]

However, the court gave little credence to HRB's coordination arguments, finding that HRB and Intuit will still have disincentives to compete as aggressively as they do, premerger. Somewhat surprisingly, the court also found that it was unnecessary to determine whether TaxACT should be labeled a maverick or merely a particularly aggressive competitor; in the court's view, the only relevant question was: "Does TaxACT consistently play a role within the competitive structure of this market that constrains prices?"[78] Because even the defendants conceded that TaxACT was an aggressive competitor, the court found it implausible that the merger would not result in anticompetitive effects.[79]

The Role/Importance of Mavericks? Much of the court's discussion of coordinated effects, correct or not, is not unusual. Observations about market structure that is conducive to coordination are common in Section 7 cases, as is the notion that a larger player may have the incentive to be less competitive in a market determined to be going from three to two meaningful competitors. What is unusual, however, is the ease with which the court dispatched the debate over TaxACT's maverick status. There are very few cases discussing the definition and relevance of mavericks, and for most practitioners a maverick needs, at a minimum, to be a unique, disruptive force in the marketplace—even the Merger Guidelines suggest as much.[80] In *HRB*, however, the court found that the label mattered much less than the fact (in the court's view) that TaxACT consistently played a role in constraining prices in the market, and that, pre-merger, it was the only remaining large competitor to embrace a low price strategy.[81] In short, *HRB* is likely to be used by the Agencies in the future to argue that the removal of *any* aggressive price competitor or innovator from a highly concentrated market is evidence of likely coordinated effects.

Unilateral Effects

Though less significant to its analysis, the court also discussed the unilateral effects theories put forth by the DOJ.[82] The issue should have been interesting, particularly because the parties' products largely occupied different ends of the value spectrum and diversion ratios between them were relatively small[83]—i.e., the quantitative evidence did not reflect that the products were particularly close competitors. Further, HRB argued that the DOJ could not show unilateral effects where Intuit was each party's largest competitor or where the

merged firm would not meet the presumptive 35 percent market share threshold discussed in the *Oracle* case.[84] Rather, relying again on documents and testimony—as well as the DOJ expert's merger simulation using the IRS switching data as a proxy for diversion ratios—the court found that the DOJ had satisfied its burden of showing a reasonable likelihood of unilateral effects.[85] Finally, although the decision referenced "UPP" from the 2010 Merger Guidelines, the concept played no independent role in the court's analysis.[86]

The DOJ's Conceptual Gains on Unilateral Effects Should Not Be Overlooked. While dicta, perhaps the most provocative aspect of the court's unilateral effects analysis is that it started by reciting the *CCC Holdings* elements or conditions for the theory to apply—requiring the merging parties to be "close substitutes," and other products being too different to defeat a SSNIP—but then settled on the notion that the parties need only be "head-to-head" competitors, including only the "second closest" rivals.[87] In this respect, the 2010 Merger Guidelines, which espouse this more flexible standard concerning the closeness of the parties' products, seem to have influenced the court's thinking. Moreover, it is troubling to see the court accept the proposition that a merger simulation can be of even "some" probative value where the model predicts price increases whenever there are "any positive diversion ratios," i.e., any time the parties are more than de minimis competitors.[88] In fact, this is precisely the type of analytical defect that led the *CCC Holdings* court to reject the merger simulation in the bidding context at issue there.[89] Again, the *HRB* court's over-simplified treatment of these complex issues reveals the power of simple documents and testimony that describe consistent head-to-head competition between merging firms (even if in just a broad sense), especially where the court has found that the remaining large player has the incentive to coordinate in some aspects of post-merger rivalry.

HRB's Efficiencies Defense

The defendants also tried to rebut the government's case by relying upon procompetitive efficiencies. HRB emphasized that its primary motivation for merging with TaxACT was to achieve cost-saving synergies.[90] HRB argued that it was "a tax company[,] not a software company" (with 94 percent of its revenue derived from assisted tax preparation); thus, the acquisition of TaxACT, which specialized in the digital space, would result in significant synergies because of the complementary strengths of the merging parties.[91] These million-dollar synergies would in turn allow HRB to compete more effectively with lower prices against its main rival, Intuit's TurboTax.[92]

The court was not persuaded by this argument. Foremost, the court noted the extremely high bar that the defendants would have to hurdle to win on efficiencies: "High market concentration levels require 'proof of extraordinary efficiencies'" and "'The 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.'"[93] The court found that against this standard, HRB's arguments fell flat. HRB failed to show that the purported efficiencies would be merger-specific, and even if they were merger-specific, the defendants' cost-savings estimates were not independently verifiable.[94] Thus, the court found that the defendants failed to rebut the presumption of illegality put forth by the DOJ.

HRB aptly demonstrates that an efficiencies rebuttal or defense will continue to be difficult in any case in which the court adopts the Merger Guidelines' strict standards for proving efficiencies. In *HRB*, as in previous cases, the main problem is merger specificity: Can the parties obtain the same or similar efficiencies by any means short of merger? Practitioners should anticipate that the lack of flexibility reflected in *HRB* on this subject, as well as on the additional requirement of verifiability, will continue to preclude efficiencies as a viable argument to save an otherwise suspect merger.

Practical Advice Following HRB

For Practitioners. For practitioners, *HRB* is another wake-up call, much like *Whole Foods*, to be cautious about pursuing horizontal transactions where business documents, testimony, and industry perception are consistent with traditional *Brown Shoe* "submarkets," especially where there arguably are significant gaps in the chain of substitutes and the narrower markets involve high combined shares. At trial, neither the DOJ nor the FTC (in a preliminary injunction) are likely to risk relying solely on economic tools unless there is sufficiently robust elasticity data (which is very rare) to support diversion ratios.

In the wake of *HRB*, practitioners also need to take a sober look at the most likely rebuttal arguments for mergers involving differentiated products—supply responses and efficiencies. Courts should look seriously at both the economic incentives for supply responses (especially if coordinated effects is a serious risk), as well as the ability of other competitors to respond in terms of existing assets, mobility barriers, and incremental costs. *HRB* shows that a strong structural case, and provocative documents and testimony, can influence the objectivity of this analysis. Indeed, the court's implicit rejection of the objective economic evidence concerning likely supply responses seems particularly out of sync where smaller rivals already operate in the DDIY space. Moreover, in the context of the often-applied "timely, likely and sufficient" paradigm of the Merger Guidelines, the risk that courts will minimize the import of economic incentives for supply responses is particularly acute.

Finally, for any potentially problematic transaction, practitioners should hire economic experts as early as possible, both to assess the qualitative evidence and to undertake the same quantitative analyses that the Agencies will be doing. This will enable the parties to have an early assessment of the viability of calculating robust diversion ratios or undertaking

meaningful quantitative HMT, critical loss, merger simulation, and UPP analysis—which, again, is likely to depend on the existence and reliability of rarely available, useful elasticity data. In fact, in some instances, the parties may find that the data cuts their way.

For the Agencies. The lesson of *HRB* for the Agencies is that, for the most part, judges understand and trust documents, testimony, and their own common sense more than they do hypothetical economic exercises based on data "proxies" that themselves are merely proxies for likely consumer behavior. No doubt, Section 7 involves predictions of effects and customer responses that necessarily are hypothetical, but as with the rejection of the unilateral effects model in *CCC Holdings*, *HRB* suggests caution in overplaying the reliability and predictive value of economic tools and models. In fact, the day that courts begin to rely exclusively on direct effects and economic modeling for assessing mergers involving differentiated products may just be the day courts determine that diversion ratios are rarely reliable. At that point, the Agencies may long for the good old days of "practical indicia," bad documents, and executives who just can't keep their mouths shut. ■

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[1] 331 F. Supp. 2d 1098 (N.D. Cal. 2004).

[2] In *FTC v. Whole Foods Market, Inc.*, 548 F.3d 1028 (D.C. Cir. 2008), the appeals court discussed this injunction standard, finding that the FTC did not need to show irreparable harm, nor was the FTC required to prove a likelihood of success on the merits. *Id.* at 1034–35.

[3] 605 F. Supp. 2d 26 (D.D.C. 2009).

[4] 548 F.3d 1028.

[5] For example, AT&T and T-Mobile recently abandoned their proposed transaction after the government scrutinized the deal.

[6] No. 11-00948 (BAH), 2011 WL 5438955 (D.D.C. Nov. 10, 2011).

[7] 370 U.S. 294 (1962).

[8] *See, e.g.*, James A. Keyte & Kenneth B. Schwartz, *"Tally-Ho!": UPP and the 2010 Horizontal Merger Guidelines*, 77 Antitrust L.J. 587, 591 n.19, 592 nn.23–24 (2011) (collecting articles); Herbert Hovenkamp, *Markets in Merger Analysis* (Oct. 18, 2011), *available at* http://papers.ssrn.com/sol3/papers.cfmabstract__id=1945964.

[9] U.S. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines (2010) [hereinafter 2010 Guidelines], *available at* http://ftc.gov/os/2010/08/100819hmg.pdf.

[10] As the 2010 Guidelines explain: "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," and they "employ the hypothetical monopolist test to evaluate whether groups of products in candidate markets are sufficiently broad to constitute relevant antitrust markets." *Id.* § 4.1.1; *see also* Gregory J. Werden, *The 1982 Merger Guidelines and the Ascent of the Hypothetical Monopolist Paradigm*, 71 Antitrust L.J. 253, 264–65 (2003) (discussing the cases that cited to the Areeda or Sullivan treatises on the hypothetical monopolist test without further analysis).

[11] *See* Joseph Farrell & Carl Shapiro, *Upward Pricing Pressure and Critical Loss Analysis: Response*, CPI Antitrust J., Feb. 2010, at 6, https://www.competitionpolicyinternational.com/assets/Free/Shapiro-FarrellFEB10.pdf

[12] *See* Roy J. Epstein & Daniel L. Rubinfeld, *Merger Simulation: A Simplified Approach with New Applications*, 69 Antitrust L.J. 883, 886 (2001).

[13] The 2010 Merger Guidelines reference UPP briefly as follows:

> Adverse unilateral price effects can arise when the merger gives the merged entity an incentive to raise the price of a product previously sold by one merging firm and thereby divert sales to products previously sold by the other merging firm, boosting the profits on the latter products. Taking as given other prices and product offerings, that boost to profits is equal to the value to the merged firm of the sales diverted to those products. The value of sales diverted to a product is equal to the number of units diverted to that product multiplied by the margin between price and incremental cost on that product. In some cases, where sufficient information is available, the Agencies assess the value of diverted sales, which can serve as an indicator of the upward pricing pressure on the first product resulting from the merger. Diagnosing unilateral price effects based on the value of diverted sales need not rely on market definition or the calculation of market shares and concentration.

2010 Guidelines, *supra* note 9, § 6.1 (emphasis added).

This test, along with unilateral effects analysis more generally, has come under considerable scrutiny. For example, as one leading treatise describes, "Literally, the theory of unilateral effects is consistent with condemnation of mergers even in unconcentrated markets." 4 Phillip E. Areeda & Herbert Hovenkamp, Antitrust Law ¶ 913a (3d ed. 2009); *see also* John D. Harkrider, *A Return to* Von's Grocery*?*, Antitrust Source, Oct. 2010, at 1–4, http://www.abanet.org/antitrust/at-source/10/10/Oct10-Harkrider10-21f.pdf; Carl Shapiro, *The 2010 Horizontal Merger Guidelines: From Hedgehog to Fox in Forty Years*, 77 Antitrust L.J. 49, 68 (2010) ("The express acknowledgement that HHI levels typically are not very helpful diagnostics in [unilateral effects] cases has led to concerns that the valuable screening role played by the HHI thresholds since 1982 has been reduced or lost.").

[14] 374 U.S. 321 (1963).

[15] United Staes v. H&R Block, Inc., No. 11-00948 (BAH), 2011 WL 5438955, at *8 (D.D.C. Nov. 10, 2011) (quoting FTC v. Swedish Match, 131 F. Supp. 2d 151, 156 (D.D.C. 2000)).

[16] *Id.* at *40 n.35.

[17] *Id.*

[18] *Id.* at *5–7.

[19] 970 F. Supp. 1066 (D.D.C. 1997).

[20] *H&R Block*, 2011 WL 5438955, at *9 (quoting FTC v. Whole Foods Mkt., Inc., 548 F.3d 1028, 1037–38 (D.C. Cir. 2008)).

[21] *Id.* (citing Rothery Storage & Van Co. v. Atlas Van Lines, Inc., 792 F.2d 210, 218 (D.C. Cir. 1986)).

[22] *Id.* at *10.

[23] *Id.*

[24] *Id.* at *11. Interestingly, the court ignored HRB's claim that the government pulled single words and phrases from multiple unrelated documents to construct its position that the deal was intended to block competition between HRB and TaxACT. *See* Defendants' Memorandum of Points and Authorities in Support of Its Opposition to Plaintiff's Motion for a Preliminary Injunction at 9, *H&R Block*, 2011 WL 5438955 (No. 11-00948 (BAH)) [hereinafter Defs.' Opp. Br.

[25] *H&R Block*, 2011 WL 5438955, at *12.

[26] *Id.* (emphasis added).

[27] *Id.* at *8.

[28] Defs.' Opp. Br., *supra* note 24, at 27.

[29] *Id.* at 6.

[30] *Id.* at 26 (quoting FTC v. Arch Coal, Inc., 329 F. Supp. 2d 109, 119 (D.D.C. 2004)).

[31] *Id.* at 12.

[32] *Id.* at 15.

[33] *Id.* at 14 (citation omitted) (internal quotation marks omitted).

[34] *Id.* at 27.

[35] *Id.* at 39.

[36] *H&R Block*, 2011 WL 5438955, at *8.

[37] U.S. Dep't of Justice & Fed. Trade Comm'n, Commentary on the Horizontal Merger Guidelines 2 (2006), *available at* http://www.ftc.gov/os/2006/03/CommentaryontheHorizontalMergerGuidelinesMarch 2006.pdf.

[38] *See* Keyte & Schwartz, *supra* note 8, at 592.

[39] Defs.' Opp. Br., *supra* note 24, at 2 (first and fourth alterations in plaintiff's original) (footnote omitted) (quoting Plaintiff's Memorandum of Points and Authorities in Support of Its Motion for a Preliminary Injunction at 3, 31, *H&R Block*, 2011 WL 5438955).

[40] Pl.'s Mem. of P. & A. in Supp. of Its Mot. for a Prelim. Inj. at 19–20, *H&R Block, Inc.*, No. 11-00948 (BAH) 2011 WL 5438955 (D.D.C. Nov. 10, 2011), ECF No. 40.

[41] *H&R Block*, 2011 WL 5438955, at *11.

[42] *Id.* at *20. The court used this information to answer what it posed as the fundamental question to its analysis: "[W]hether 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 . . . . would restrain any potential DDIY monopolist from profitably raising prices." *Id.* at *10.

[43] *Id.* at *19–20.

[44] *Id.* at *21.

[45] *Id.* at *19.

[46] *Id.* at *18.

[47] Defs.' Opp. Br., *supra* note 24, at 16.

[48] *Id.* (emphasis omitted).

[49] *H&R Block*, 2011 WL 5438955, at *21 (emphasis added).

[50] *Id.* at*25–26; Defs.' Opp. Br., *supra* note 24, at 16.

[51] *H&R Block*, 2011 WL 5438955, at *26 (citation omitted).

[52] *Id.* at *27.

[53] *Id.*

[54] *Id.* at *26—27.

[55] *Id.* at *2.

[56] *Id.* at *29.

[57] *Id.* at *11.

[58] *See, e.g.*, FTC v. H.J. Heinz Co., 246 F.3d 708 (D.C. Cir. 2001); United States v. Baker Hughes, Inc., 908 F.2d 981 (D.C. Cir. 1990); United States v. Sungard Data Sys., Inc., 172 F. Supp. 2d 172 (D.D.C. 2001); *see also* 2010 Guidelines, *supra* note 9, § 5.3.

[59] *H&R Block*, 2011 WL 5438955, at *8.

[60] *Id.* (second and third alterations in original) (citations omitted) (internal quotation marks omitted).

[61] *Id.* (second alteration in original) (quoting *H.J. Heinz*, 246 F.3d at 715).

[62] *Id.* (citation omitted) (internal quotation marks omitted).

[63] *Id.* (quoting *Baker Hughes*, 908 F.2d at 984).

[64] Defs.' Opp. Br., *supra* note 24, at 36–37.

[65] *H&R Block*, 2011 WL 5438955, at *29 (quoting 2010 Guidelines, *supra* note 9, § 9) (citing FTC v. CCC Holdings Inc., 605 F. Supp. 2d 26, 47 (D.D.C. 2009)).

[66] Id. at *33.

[67] Defs.' Opp. Br., *supra* note 24, at 5.

[68] *H&R Block*, 2011 WL 5438955, at *30–31.

[69] *See, e.g.*, 2010 Guidelines, *supra* note 9, §§ 5.1, 10.

[70] 828 F. Supp. 78 (D.C.C. 1993). The author represented Gillette in this case.

[71] *Id.* at 84–85.

[72] *Id.* at 86.

[73] *H&R Block*, 2011 WL 5438955, at *34.

[74] *Id.* at 84–85.

[75] *Id.* at *35.

[76] Defs.' Opp. Br., *supra* note 24, at 21.

[77] *Id.* at 40.

[78] *H&R Block*, 2011 WL 5438955, at *36.

[79] *Id.* at *37.

[80] *See* 2010 Guidelines, supra note 9, § 2.1.5; *cf.* Jonathan B. Baker, *Merger Simulation in an Administrative Context*, 77 ANTITRUST L.J. 451, 467–68 (2011) (discussing the role of a maverick in constraining coordination).

[81] *H&R Block*, 2011 WL 5438955, at *35–36.

[82] *Id.* at *38 (noting that "the Court need not reach the issue of unilateral effects").

[83] *Id.* at *39.

[84] *Id.* at *40 ("[A] presumption of anticompetitive effects from a combined share of 35% in a differentiated products market is unwarranted. Indeed, the opposite is likely true." (citation omitted) (internal quotation marks omitted).

[85] *Id.* at *41–44.

[86] *Id.* at *41,*47 (noting upward pricing pressure but reaching a decision based on market share and concentration).

[87] *Id.* at *37–39.

[88] *Id.* at *43.

[89] FTC v. CCC Holdings Inc., 605 F. Supp. 2d 26, 70–72 (D.D.C. 2009) (considering the FTC's simulation model, which always predicted a price effect whenever the largest competitor was the third alternative in any particular bid event, and concluding that it could not credit the simulation because "the absence of any evidence of identifiable characteristics of [the merging] firms' products or their customers that might make [the top competitor in the market] a more distant third option.").

[90] *H&R Block*, 2011 WL 5438955, at *44; *see also* Defs.' Opp. Br., *supra* note 24, at 1.

[91] Defs.' Opp. Br., *supra* note 24, at 2, 6.

[92] *See H&R Block*, 2011 WL 5438955, at *44–45.

[93] *Id.* at (citations omitted).

[94] *Id.* at *45–46.