Cooley

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The U.S. Department of Justice (DOJ) and Federal Trade Commission (FTC) regularly review proposed mergers and acquisitions. They typically resolve competition concerns through negotiated consent decrees, instead of suing to block transactions. As a result, the court decision in the government's recent successful antitrust challenge to H&R Block's proposed acquisition of 2SS Holdings, Inc. (TaxACT)—the first antitrust merger case litigated by the DOJ since the DOJ/FTC *Horizontal Merger Guidelines* were updated in 2010—provides rare and useful guidance for companies considering a transaction with a competitor.

In particular, companies should take away from the decision:

- The D.C. District Court enjoined the proposed acquisition, finding that the merger was likely to substantially lessen competition for digital do-it-yourself tax preparation products
- The decision focuses heavily on market definition, despite efforts by antitrust regulators to downplay market definition in the 2010 DOJ/FTC *Horizontal Merger Guidelines*
- The court places considerable emphasis on ordinary course of business documents and expert testimony.

The decision is also significant as the first litigated challenge to a high-tech merger since the DOJ's failed efforts to stop the SunGard/Comdisco (2001) and Oracle/PeopleSoft (2004) mergers. The decision may embolden the government to challenge future mergers.

Market definition remains central to merger challenges

The DOJ and FTC issued new *Guidelines* in 2010 in part to downplay the importance of defining markets, focusing instead on direct evidence of anti-competitive effects of proposed transactions. **As we explained shortly after their issuance**, in those *Guidelines* the government moved away from relying on market definition towards a more flexible, fact-specific inquiry that focuses on actual competitive effects likely to result from the transaction.

Earlier guidelines set forth a step-by-step framework—market definition, concentration, entry, unilateral and coordinated effects, and efficiencies—while the revised *Guidelines* establish a more holistic, flexible, and arguably subjective approach. The new *Guidelines* contemplate direct evidence and other economic tools playing a more central role, with market definition relevant only once the agencies "identify a potential competitive concern."

Instead of adopting the *Guidelines'* approach, the *H&R Block* court adheres to the old framework. The court begins by citing a 1962 Supreme Court opinion: "[m]erger analysis begins with defining the relevant product market." The decision spends the next 35 pages analyzing the relevant market, and the ultimate conclusions flow largely from that definition.

Perhaps in anticipation of this, and despite the new *Guidelines*, the DOJ did not abandon market definition as the keystone of merger analysis in its argument. Instead, the DOJ argued that H&R Block's proposed acquisition of the maker of TaxACT software would substantially lessen competition in the market for digital do-it-yourself (DDIY) tax preparation products, including Intuit's TurboTax, H&R Block's H&R Block At Home (formerly TaxCut), and TaxACT, in violation of the Clayton Act. According to IRS data, those three products accounted for approximately 90% of DDIY-prepared federal returns in tax season 2010. In the same year, however, fewer than 30% of the Americans that filed tax returns used DDIY software.

H&R Block's proposed market definition included: (1) the "pen and paper" or manual method and (2) the assisted method or hiring a tax professional, as well as (3) the DDIY method of using personal software to prepare a return. After reiterating the importance of defining a relevant product market, the court turned to its conclusion that, as the DOJ argued, the DDIY market alone is the relevant market, despite recognizing that "[i]t is beyond debate … that all methods of tax preparation are, to some degree, in competition."

In rejecting H&R Block's proposed definition, the court considered whether the products were reasonably interchangeable and whether a hypothetical monopolist would be able to profitably raise prices, two traditional market definition analyses. The court looked closely at (1) the business documents from the defendants and others, (2) the testimony of fact witness, and (3) the analyses of economic experts.

The court began by paying "close attention" to the defendants' "ordinary course of business documents," which the court said indicated that the defendants viewed DDIY offerings as the "primary competitors" and their "perception of a discrete DDIY market," even though documents also discussed the broader tax preparation industry. The court recognized that all methods of tax preparation "compete with each other for the same overall pool of potential customers," but emphasized "significant price disparities" and "deep functional differences" between the different methods. The court noted that DDIY tax preparation products differ from manual and assisted tax preparation in "meaningful ways" as DDIY software provides customers with tax preparation services through "an entirely different method, technology, and user experience." The court also noted that H&R Block's DDIY and assisted businesses are run as separate business units.

The court analyzed the testimony of economic experts presented by both the government and defendants, and found the analysis of the government's expert "tends to confirm that DDIY is a relevant market," but that the data "limited the predictive power of the … expert's economic models." The Court said it could not draw any conclusions from the defendants' expert's analysis because of "severe shortcomings" in the underlying consumer survey data on which the expert relied. Although not a focus of the opinion, the court made reference to several of the economic tools highlighted in the *Merger Guidelines,* including diversion ratios, merger simulation, and critical loss analysis.

The court's decision should remind companies that internal documents are critical in directing merger analysis and that employees must be careful in preparing documents when contemplating a transaction. It is also a reminder that markets may be defined narrowly even when companies face competition in the broader marketplace.

Competitive effects also important to analysis

Following the traditional framework, once the court settled on a market definition, it concluded that the government had shown that the firms controlled an "undue percentage share of the relevant market" and that the merger would result in "a significant increase" in the concentration of firms in the market. The court explained that with Intuit's 62% share of the DDIY market and H&R Block and TaxACT's combined 28% share, the Herfindahl-Hirschmann Index or HHI, used to measure concentration would increase approximately 400 points to 4,691, well over the 2,500 threshold for "highly concentrated" markets in the *Merger Guidelines* at which an increase of more than 200 points is "presumed likely to enhance market power."

The burden then switched to the 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 or that the procompetitive effects of the merger are "likely to outweigh any potential anticompetitive effects."

H&R Block argued that expansion by fringe firms would offset any potential anticompetitive effects from the merger, pointing to eighteen other companies that offer DDIY products. The court rejected this theory, noting that most of the companies were "very small-time operators" and finding that "building a reputation that a significant number of consumers will trust requires time and money." The court pointed out that as the market has matured, the "low hanging fruit" of DDIY customers had dwindled, and that growing market share had become harder as the ability to import data from previous tax returns into a program "lends a ‘stickiness' to each particular DDIY product once a customer has used it."

With Intuit remaining as a major competitor, the government argued that the proposed merger would facilitate tacit coordination. The court noted that the merger would result in the elimination of a particularly aggressive competitor, which it considered an important factor in analyzing possible anti-competitive effects. The court emphasized TaxAct's history of innovation and competition in the DDIY market, bucking prevailing pricing norms, offering free products, and pushing the industry toward lower pricing. Even while recognizing that TaxAct was a vigorous competitor, though, the court chastised the parties for over-emphasizing TaxAct's "maverick" status.

Because the DOJ alleged, and provided evidence to support, a relevant market, the willingness of courts to rely on "new" concepts set forth in the 2010 *Merger Guidelines* remains to be seen. The *H&R Block* decision does suggest, however, that while courts will continue to look to the revised *Merger Guidelines* for guidance (the *H&R Block* court cited the *Merger Guidelines* over fifteen times throughout its opinion), courts will likely continue to put market definition first and that the government will be required to do the same or, at the very least, will not entirely turn its back on what courts continue to view as the cornerstone of merger analysis.

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