UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA,

Plaintiff,

v.

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

Defendants.

Civil Action No. 11-00948 (BAH)
Judge Beryl A. Howell

PLAINTIFF'S REPLY MEMORANDUM OF POINTS AND AUTHORITIES IN FURTHER SUPPORT OF ITS MOTION FOR A PRELIMINARY INJUNCTION

REDACTED VERSION FOR PUBLIC FILING*

*The United States files this non-confidential redacted version of its Memorandum pursuant to the Protective Order entered on June 15, 2011. The Protective Order requires all information designated "Confidential" or "Highly Confidential" to be redacted from the public version of the pleading filed with the court. Although Defendants designated all information and documents cited in this Memorandum as "Highly Confidential," most of the information does not appear to be commercial information, the disclosure of which would cause injury to Defendants' businesses.

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INTRODUCTION

In our opening brief, we cited voluminous pre-transaction admissions by Defendants' senior executives showing that they have long viewed H&R Block, Inc. ("HRB") and 2SS Holdings, Inc. ("TaxACT") as direct competitors in a distinct market for digital do-it-yourself tax preparation ("Digital DIY"). We included extensive citations to internal analyses and public pronouncements regarding this competition, and we included direct quotations by the CEOs of HRB and TaxACT recognizing and touting TaxACT's "maverick" role as a price discounter and product innovator.

Defendants' response contains virtually no citation to any pre-transaction evidence, and not surprisingly, none of the cited evidence contradicts the prior admissions of vigorous, direct competition in the distinct Digital DIY market. Instead, Defendants suggest that the Court should ignore pre-transaction evidence as nothing more than "snippets," in favor of "deal documents," created specifically to justify a transaction with obvious anticompetitive effects. Of course, Defendants' citation to its purported "post-merger strategy" provides no evidentiary basis to challenge their own pre-transaction admissions.[1] And, in any event, the purported strategy itself is contradicted by the facts and actually highlights the anticompetitive nature of the transaction.

For example, Defendants claim *in the first sentence of their brief*, that HRB is acquiring TaxACT "to offer a competitive low-cost product . . . and to better 'attract and retain clients using the 'free' model.'"[2] [redacted]

[1] *See Hosp. Corp. of Am. v. FTC*, 807 F.2d 1381, 1384 (7th Cir. 1986) (Posner, J.) ("[p]ost-acquisition evidence that is subject to manipulation by the party seeking to use it is entitled to little or no weight.").

[2] Defendants' Memorandum of Points and Authorities in Support of its Opposition to Plaintiff's Motion for a Preliminary Injunction ("Opp. Memo."), at 1.

.[3] Defendants also claim that HRB will use TaxACT as a price leader and product innovator,[4] yet that is exactly what TaxACT is already doing, forcing competitive responses from HRB and Intuit. The transaction is not necessary to create such competition — it must be blocked to ensure that competition is not lessened.

Nor is there any basis in the "deal documents" or any other evidence to contradict the market realities described in pre-transaction documents and recent testimony. There simply is no doubt that pre-transaction, Defendants viewed each other as direct competitors and did not recognize distinct "value" and "premium" markets. As Defendants admit in a footnote, prior to the transaction "HRB [did] not consistently use[] the words 'value' and 'premium' . . . ."[5] Similarly, Defendants' 11th hour argument that assisted and digital tax preparation methods compete with one another is completely belied by the explicit testimony *just two weeks ago* from HRB's president of its digital business: Redacted [redacted] These admissions are indicative of the larger truth that Defendants' arguments in this case are nothing more than "artificial constructs" — a term introduced by HRB's CEO during his deposition while

[3] Redacted [redacted] Redacted [redacted]

[4] Opp. Memo., at 11.

[5] Opp. Memo., at 13 n.48.

[6] GX 296 (Houseworth Aug 4. Dep. 88:4-11). Additionally, Defendants ignore that HRB actually sued Intuit for false advertising merely for insinuating that Digital DIY and assisted tax preparation are competitive alternatives. *See* GX 248 (Complaint, *H&R Block Eastern Enters., Inc. v. Intuit, Inc.*, No. 06-0039-CV-W-SOW ¶¶ 29-30 (W.D. Mo. Jan. 13, 2006).

referencing Defendants' proposed value and premium segments[7] — that completely contradict their business realities.

The business reality is that for the past several years, TaxACT has aggressively competed with HRB, causing HRB to lower its prices and increase the quality of its offerings, while at the same time preventing HRB from turning the Digital DIY market into a duopoly. Through this transaction, HRB aims to end that competition. As Defendants' expert Dr. Meyer tellingly admits, HRB and the acquisition of TaxACT will allow it to achieve that goal.[8] However, competition on price is precisely one of the goals our antitrust laws aim to achieve. *Leegin Creative Leather Prods. v. PSKS, Inc.*, 551 U.S. 877, 895 (2007). And contrary to Defendants' position, decreases in price competition cannot be overcome under our antitrust laws simply through a CEO's promise not to raise prices.

Defendants conclude their brief by threatening to abandon this deal if the Court grants the United States' Motion for a Preliminary Injunction.[9] But that is no threat at all. HRB internally has noted that if this transaction does not go through, it will Redacted [redacted]"[10] In other words, HRB, in the absence of acquiring market share by purchasing TaxACT, plans to compete aggressively to acquire that same share by becoming a better Digital DIY provider. That is exactly what our antitrust laws aim to promote, and why this transaction should be enjoined.

[7] Redacted [redacted]

[8] Expert Report of Dr. Christine Siegwarth Meyer ("Meyer Report") ¶ 76.

[9] Opp. Memo., at 42.

[10] GX 620 (HRB-DOJ-00007730, at -31).

ARGUMENT

I. Defendants Misconstrue the Applicable Legal Standard

Defendants fundamentally fail to understand the interplay of the four-factor preliminary injunction test in *merger cases* where the plaintiff is the Government.[11] To determine whether the United States has a likelihood of success on the merits, a court must find there is a "reasonable probability" that the proposed acquisition substantially lessens competition. *FTC v. Cardinal Health, Inc.*, 12 F. Supp. 2d 34, 45 (D.D.C. 1998). From this finding, it logically follows that absent an injunction, there will be irreparable harm. First, "the threatened violation of the law here is itself sufficient public injury to justify [injunctive] relief. The Congressional pronouncement in § 7 embodies the irreparable injury of violation of its provisions." *United States v. Ivaco, Inc.*, 704 F. Supp. 1409, 1429 (W.D. Mich. 1989).[12] Second, it is nearly impossible to unwind consummated mergers. Thus, if the court denies a preliminary injunction where there has been a showing of a reasonable probability of lessening competition, and the transaction is later found to violate the Act, it will be impossible to remedy the harm to competition. *FTC v. Swedish Match,* 131 F. Supp. 2d 151, 172 (D.D.C. 2000) (failure to enjoin a merger means that "the eggs will be irreparably scrambled").

II. The Relevant Product Market is Digital DIY Tax Preparation

To construct their proposed market definition, Defendants are forced to dismiss over five years of business documents analyzing competition between the companies. But, the facts that matter for product market definition are *pre-litigation* documents of defendants, the testimony of defendants' officials and other industry participants, and the economic analyses conducted by

[11] Opp. Memo., at 24 n.107.

[12] *See also FTC v. Weyerhaeuser*, 665 F.2d 1072, 1082 & n.23 (D.C. Cir. 1981) (R.B. Ginsburg, J.).

expert witnesses.[13] What these all show here is that HRB monitored the number of references to TaxACT on the internet, tracked TaxACT's share of the Digital DIY market, analyzed and compared TaxACT's customer base with its own and studied why customers were switching from HRB's digital products to TaxACT.[14] HRB specifically considered TaxACT's customers to be within HRB's "Addressable Market," lamented that TaxACT was surpassing HRB in the digital marketplace, and frequently changed its business strategies, products and prices in response to TaxACT.[15] Thus HRB and TaxACT were unquestionably significant competitors in the Digital DIY market.[16]

Thus, it is hardly surprising that Defendants never argue that HRB and TaxACT are in different product markets. Instead, Defendants contend the Digital DIY market is too narrow because it does not include "manual filing" and "paid assisted" tax preparation. This assertion is curious in light of the fact that it is wholly inconsistent with how HRB segments its business,[17] and instead is merely based on two fundamentally unreliable documents: a 2011 TaxACT survey that was conducted for purposes of this litigation, and a 2009 HRB "pricing simulator."[18]

2011 Litigation Survey. Defendants' reliance on TaxACT's survey conducted for this litigation[19] is misplaced. As Defendants' expert has written, a survey "must be carefully

[13] *See, e.g.*, *Cmty. Publishers v. DR Partners*, 892 F. Supp. 1146, 1155-56 (W.D. Ark. 1995) (defining narrow product market after weighing testimony from industry participants, pre-litigation records and expert opinion); *cf. Hosp. Corp. v. FTC*, 807 F.2d at 1384 (Posner, J.) ("[p]ost-acquisition evidence that is subject to manipulation by the party seeking to use it is entitled to little or no weight.").

[14] Pl. Mem., at 11.

[15] *Id.* at 11-13.

[16] Indeed, recent deposition testimony from two of Defendants' executives responsible for digital products confirms as clearly as possible that HRB and TaxACT compete in a digital market. [redacted]

[17] GX 532 (Cobb Dep. 142:3-19).

[18] Opp. Memo., at 29.

[19] One factor set forth by the Federal Judicial Center to determine whether a survey is sufficiently trustworthy is

designed if it is to yield reliable and accurate data that are admissible as evidence," and "must surpass high standards if they are to yield data that are admissible in the courtroom."[20] But, as the Government's survey expert, Dr. Ravi Dhar, explains in his expert report, the survey on which Defendants rely falls far short of those standards.[21]

As a threshold matter, the survey is flawed because it both fails to ask a question relevant to any issue in this proceeding, and never gives survey recipients the opportunity to respond "don't know/no opinion."[22] Further, the survey's response rate is astonishingly low (never more than 2.5%), causing bias and further calling into question its reliability.[23] Moreover, because it asks only closed-ended, leading questions, the survey is "not credible." *Novartis Consumer Health, Inc. v. Johnson & Johnson-Merck Consumer Pharm. Co.*, 290 F.3d 578, 591 (3d Cir. 2002). Accordingly, this Court should afford the survey no weight.

2009 Pricing Simulator. Defendants also place substantial reliance on a study performed by HRB in 2009 that Defendants claim "show[s] that [they] are not close competitors."[24] While

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whether "the survey was conducted in anticipation of litigation and by persons connected with the parties or counsel or by persons aware of its purpose in litigation." *Manual for Complex Litigation* § 11.493 (4th ed. 2004); *see also Leelenau Wine Cellars, Ltd. v. Black & Red, Inc.*, 452 F. Supp. 2d 772, 778 (W.D. Mich. 2006) (citing *Manual for Complex Litigation* factors).

[20] GX 622 (Christine Meyer, *Designing and Using Surveys to Define Relevant Markets, in Economics of Antitrust: Complex Issues in a Dynamic Economy*, at 101, 108 (2007)).

[21] *See* GX 623 (Expert Report of Dr. Ravi Dhar).

[22] *Id.* By not giving respondents a "don't know/no opinion" option, a survey artificially inflates the proportion of respondents willing to guess or speculate. *See* GX 624 (Shari Seidman Diamond, *Reference Guide on Survey Research, in Reference Manual on Survey Evidence*, at 229, 249-51 (Federal Judicial Center 2d ed. 2000), *available at* http://www fjc.gov/public/home nsf/autoframe?openform&url_l=/public/home.nsf/inavgeneral?openpage&url_r=/public/home nsf/pages/610). Courts have held that "the reliability of the answers" to a survey is "undermined" when respondents are not informed they have the option of responding don't know/no opinion. *See, e.g.*, GX 625 (*Procter & Gamble Pharms. v. Hoffman-LaRoche Inc.*, N. 06 Civ. 0034 (PAC), 2006 WL 2588002, at *23-24 (S.D.N.Y. Sept. 6, 2006)) (citing cases).

[23] *See, e.g.*, *Beacon Mut. Ins. Co. v. OneBeacon Ins. Grp.*, 376 F. Supp. 2d 251, 261 n.4 (D.R.I. 2006) (noting that the Guidelines for Statistical Surveys issued by the former U.S. Office of Statistical Standards provide that "in the case of probability samples, potential bias should receive greater scrutiny when [the] response rate drops below 75%, and if the response rate drops below 50%, the survey should be regarded with significant caution.").

[24] Opp. Memo., at 15.

Defendants exclusively focus on the favorable results from a single scenario within a single version of this study, they ignore the study's methodology and ignore other results showing just how unreliable the study truly is. For example, when the price of TaxCut online Basic is raised in the model from to (holding all other prices constant) its own market share increases dramatically. A increase in the price of HRB's Basic product should not cause *growth* in its share of the market. There simply is no economic explanation for this result.[25] Accordingly, this simulator also deserves no weight.

A. Manual Filing is Not Part of the Relevant Product Market Because Digital DIY Products are Not Reasonably Interchangeable with Manual Filing

Products are said to be interchangeable where they are "similar in character or use." *FTC v. Staples*, 970 F. Supp. 1066, 1074 (D.D.C. 1997). The three "most relevant factors to determine reasonable interchangeability are use, quality and price." *United States v. Archer-Daniels-Midland Co.*, 866 F.2d 242, 246 (8th Cir. 1988). So-called "manual filing" is not similar in use, quality or price to Digital DIY preparation. Indeed, manual filing is no more of a "constraint" on Defendants than a legal pad is a "constraint" on Microsoft Word, or a ledger book is a "constraint" on Microsoft Excel.[26] *See United States v. Visa*, 163 F. Supp. 2d 322, 336-38 (S.D.N.Y. 2001) (holding that "although it is literally true that, in a general sense, cash and checks compete with 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*," the products are still in different markets because "cash and checks do not drive many of the means of

[25] *See* Rebuttal Report of Dr. Fredrick Warren-Boulton; *see also* GX 660 (Second Expert Report of Ravi Dhar).

[26] Defendants incorrectly contend that "as a matter of law," manual preparation must be in the same market as Digital DIY preparation. *See* Opp. Memo., at 28. The sole basis for Defendants' claim is an incomplete and irrelevant quote about "captive output." Defendants fail to note, however, that "captive output" can "only be considered [in the relevant product market] to the extent that 'such inclusion reflects [its] competitive significance in the relevant market prior to the merger.'" *Cardinal Health*, 12 F. Supp. 2d at 48 (*quoting* U.S. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines (2010), *available at* http://www.justice.gov/atr/public/guidelines/hmg-2010.pdf ("Merger Guidelines")).

competition in the general purpose card market." (emphasis added)).

Several industry participants have testified that "manual filing" simply does not drive competition with Digital DIY tax preparation. Bert DuMars, formerly of the IRS, testified that the number of customers who switched from e-filing to pen-and-paper was "insignificant."[27] Mr. DuMars noted that error rates with pen-and-paper filing were 20 times higher than those associated with Digital DIY, and that taxpayers do not receive refunds from paper returns as quickly as from e-filed returns.[28] Consistent with the above, industry participants have testified that they do *not* consider the prices of manual filing when setting their own digital prices.[29] Indeed, when questioned as to whether pen-and-paper was a constraint on HRB's digital business, HRB's president of its digital business

[30]

As for free fillable forms, Mark Ernst, HRB's former CEO (who later worked at the IRS) testified that they are [redacted]"[31] In

[27] Redacted [redacted]

[28] GX 569 (DuMars Dep. 18:24-19:1; 18:21-23).

[29] Redacted [redacted]

[30] GX 296 (Houseworth Aug. 4 Dep. 89:2-90:1).

[31] GX 572 (Ernst Dep. 31:23-32:7).

other words, free fillable forms are simply electronic versions of pen-and-paper that have remained a „[32]

It is beyond dispute that the overwhelming flow of filers has "most definitely" been from manual filing to Digital DIY — and HRB never was concerned about a reversal of that trend.[33]

B. Assisted Preparation is Not Part of the Relevant Market Because It is Not a Constraint on Digital DIY Products

In a written submission to the Department of Justice at the conclusion of the TaxACT investigation, Defendants stated that HRB

„[34] This admission is based on the simple fact that over the past decade, while Digital DIY tax preparation has undergone explosive growth, the number of taxpayers utilizing paid assisted tax preparation has remained largely *unchanged*.[35] It is difficult to fathom how this could be true if the products were in the same product market.

To the extent there is switching between Digital DIY and assisted preparation, industry participants and HRB's own documents confirm that the main reason for that switching is due to changes in complexity in an individual's tax returns, and not because of competition between Digital DIY and assisted. As T. Rufe Vanderpool, COO of Liberty Tax, testified,

[32]

[33]

[34] GX 629 (Joint Submission on Behalf of H&R Block, Inc. and 2nd Story Software, Inc. in Support of the Proposed Acquisition of 2SS Holdings, Inc. by H&R Block, Inc. ("White Paper"), at 92).

[35]

.[36] HRB's own studies confirm that

to assisted tax preparation.[37]

Industry practice further proves that paid assisted preparation is not a constraint on the Digital DIY market. For example, HRB's former CEO Mark Ernst testified that he does not believe HRB's retail stores are a constraint on its Digital products, or vice versa.[38] Similarly, TurboTax does not consider the price of paid assisted preparation when setting its digital prices

„[39]

In addition, Defendants' position in this case flies in the face of its business practices as well as the beliefs of HRB's own executives.

[40] And, in 2006, HRB sued Intuit for false advertising merely for insinuating that Digital DIY and assisted tax preparation are competitive alternatives.[41] Consistent with the above, HRB's president of its digital business testified:

„[42] And, in announcing this deal to his company,

[36] GX 607 (Vanderpool Dep. 79:5-80:8). Liberty Tax is the nation's third-largest assisted tax preparation business, which also sells a separate digital product.

[37] GX 128 (HRB-DOJ-00359542, at 29).

[38] GX 572 (Ernst Dep. 57:8-25).

[39] Redacted

[40] GX 616 (HRB-DOJ-50168750). If HRB truly believed that Digital and assisted competed with one another, then its investment in the Digital DIY market would make no sense, since they would simply be attempting to cannibalize customers from their more profitable retail business.

[41] *See* GX 248 (Complaint, *H&R Block Eastern Enterprises, Inc. v. Intuit, Inc.*, No. 06-0039-CV-W-SOW ¶¶ 29-30 (W.D. Mo. Jan. 13, 2006)).

[42] GX 532 (Cobb 57:2-59:6).

HRB's CEO proclaimed that

"[43] As such, Defendants' current market definition is yet another artificial construct engineered by counsel in the hope of getting this deal approved.

III. The Proposed Transaction Violates Section 7 of the Clayton Act

A. The Challenged Acquisition is Presumptively Unlawful

The Digital DIY market was highly concentrated prior to the proposed acquisition with an HHI of 4,291, and will increase by approximately 400 if this acquisition is approved. This change alone establishes that the acquisition should be presumed illegal. *FTC v. H.J. Heinz Corp.*, 246 F.3d 708, 716 (D.C. Cir. 2001).

Defendants' contention that Plaintiff has not demonstrated undue concentration because there is no "mention of any state return numbers"[44] in the market shares Plaintiff alleges is nothing more than a red herring. Not breaking out the numbers by state is insignificant. HRB's own study showed that [redacted]"[45] Thus, there is no reason to expect that the market share numbers would be any different if state return numbers were included. Indeed, the law in this Circuit and elsewhere makes clear that market share *estimates* are sufficient. *See, e.g., FTC v. PPG Indus., Inc.*, 798 F.2d 1500, 1505 (D.C. Cir. 1986) (reversing district court decision that denied preliminary injunction based on inability to

[43] GX 621 (HRB-DOJ-60214885).

[44] Opp. Memo., at 32.

[45] GX 600 (HRB-DOJ-00626841, at 8).

calculate exact market shares).[46]

Defendants' argument is particularly disingenuous because Plaintiff's market share numbers are based on precisely the same methodology *Defendants* use to look at the market — *i.e.*, IRS e-filing data.[47] As HRB's head of Corporate Analytics testified, IRS e-filing numbers were for the Digital DIY providers.[48] In fact, the digital sales figures cited in the Complaint that form the basis for the HHI calculations come from Defendants' own White Paper, submitted to the Department of Justice at the conclusion of the investigation into the TaxACT transaction.[49]

B. Removing TaxACT From the Market is Likely to Result in Unilateral Anticompetitive Effects

1. There is No Market-Share Threshold for Unilateral Effects

Defendants' contention that, as a matter of law, the United States must show that, post-merger, Defendants will have dominant power in the relevant market, is not the law in this Circuit. Defendants' entire argument is based on a passage from *United States v. Oracle Corp.*, 331 F. Supp. 2d 1098, 1123 (N.D. Cal. 2004), that has been subject to intense criticism.[50] In this

[46] *See also* GX 633 (*Korea Kumho Petrochem. v. Flexsys Am. L.P.*, No. C07-01057 MJJ, 2008 WL 686834, at *9 (N.D. Cal. Mar. 11, 2008)) (antitrust plaintiff "need not necessarily quantify [defendant's] market share with precision").

[47] *See, e.g.*, GX 182 (HRB000439); GX 617 (HRB-DOJ-00944528); GX 27 (HRB-DOJ-00012327).

[48] GX 21 (Newkirk Dep. 126:7-19).

[49] *See* GX 629 (White Paper, at 11 n.24); Compl. ¶¶ 9-10.

[50] *See, e.g.*, Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶ 914a1 (court in *Oracle* "erred in concluding" that dominant market shares were required for a finding of likely unilateral effects because "the concern of merger law is impermissible price increases, something which can be achieved on far lower market shares"); GX 634 (Jonathan B. Baker & Carl Shapiro, *Detecting and Reversing the Decline in Horizontal Merger Enforcement*, *Antitrust*, Summer 2008, at 29, 34 ("[c]ontrary to what the court required in *Oracle*, we would not insist that the merged firm have a dominant or near-dominant market share [to prove likely unilateral effects]"); GX 627 (*Roundtable Discussion: Unilateral Effects after Oracle*, *Antitrust*, Spring 2005, at 8, 15) (statement of George Cary: "Where, in my view, the *Oracle* opinion goes wrong is to assume that there just cannot possibly be an anticompetitive effect if the firm is not dominant. The law is, or should be, quite different from what the *Oracle* opinion found it to be."). The Merger Guidelines state that "[a]dverse unilateral price effects can arise when the acquisition 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

Circuit, courts do not apply a market-share threshold before considering the likelihood of unilateral effects. *See, e.g., FTC v. CCC Holdings Inc.*, 605 F. Supp. 2d 26, 68 (D.D.C. 2009) (listing prerequisites for likely unilateral effects without including dominant market-share threshold).

2. The Facts Reveal that a Unilateral Price Increase is Likely

Defendants' argument that the clear factual record of competition between HRB and TaxACT can be ignored because of some artificially constructed value and premium segmentation simply is incorrect. *See United States v. United Tote, Inc.*, 768 F. Supp. 1064, 1070-71 (D. Del. 1991) (rejecting argument that parties competed in different segments where there was "aggressive[]" competition between the parties and the acquiring company referred to the acquired firm as a "primary competitor"). The evidence in this case, as set forth in Plaintiff's opening brief, strongly supports both that HRB and TaxACT have been close and direct competitors for the better part of a decade, and that, if this transaction goes through, a unilateral price increase is likely.[51]

Evidence newly developed through discovery as well as analyses in the parties' expert reports further supports these points. For example, [redacted] [52] Similarly, Jonathan Baron of Thomson Reuters testified that [redacted]

products." Merger Guidelines § 6.1.

[51] *See* Pl. Mem., at 10-15, 23-29, 33-35.

[52] GX 607 (Vanderpool Dep. 90:6-9; 88:5-89:17). Even if Intuit is the *closest* substitute for either HRB or TaxACT, the merger may still produce significant unilateral effects. *See* Fed. Trade Comm'n & U.S. Dep't of Justice, *Commentary on the Horizontal Merger Guidelines*, at 28 (2006), *available at* http://www ftc.gov/os/2006/03/CommentaryontheHorizontalMergerGuidelinesMarch2006.pdf.

[53] And the Vice President of Corporate Development for Wolters Kluwer, provider of CompleteTax,

[54] [55].

The closeness of competition between HRB and TaxACT is confirmed by the similarities in the Defendants' advertising messages. As one HRB employee testified, HRB and TaxACT both focus their messaging heavily on „[56] Accordingly, it is unsurprising that Dr. Warren-Boulton found that when TaxACT increased its advertising expenditures in certain marketing areas, TaxACT's increase in sales from that area came, in part, at the expense of HRB sales.[57]

Undoubtedly, the similarity in Defendants' advertising is because HRB and TaxACT compete for so many of the same customers. As an HRB document confirms, as of 2008, the average HRB online user was under the age of [redacted], with an average income under with a basic tax situation.[58] This is hardly the profile of a "premium" customer.[59] Instead, HRB's customer demographics closely match the demographics of TaxACT's customers.[60]

When not constructing surveys for this case, Defendants' ordinary course of business documents reveal that the HRB and TaxACT brands are viewed comparably by consumers. HRB's 2010 "Brand Health Study" revealed that

[53] GX 606 (Baron Dep. 70:9-11; 78:9-11).

[54] GX 26 (WK-DOJ-000001 (CCH Decl.) ¶ 4).

[55] GX 573 (Tennola Dep. 108:10-13).

[56] GX 294 (Simone Dep. 207:7-22).

[57] GX 121 (Expert Report of Dr. Frederick Warren-Boulton, at 42-43).

[58] GX 602 (HRB-DOJ-50010961, at -63); *see also* GX 294 (Simone Dep. 88:12-91:15).

[59] *See* Meyer Report, at 30.

[60] GX 635 (HRB000123, at -79-82).

„[61]

.[62] In the mind of consumers, HRB's brand is no more "premium" than TaxACT's.

Thus, Defendants incorrectly assert that TaxACT products serve a "value" market and HRB's products serve a "premium" market. Both companies are competing for the same customers, including free and low-cost customers. HRB needs to aggressively market its free offering and offer significant discounts off the list price. Without doing so, few customers would buy its products. Indeed, it is hard to understand how HRB can classify itself as a premium product when nearly of all returns it processed in the most recent year were totally free.[63]

As HRB admits, it expects that the transaction will alleviate price pressure on HRB products. [redacted] „[64] Implicit in this argument, of course, is that currently HRB is forced to compete by offering low-cost products — a fact that explains [redacted] [65] [redacted] [66]

[61] GX 601 (HRB-DOJ-60152201, at 10).

[62] Redacted *Id.*

[63] *See* GX 296-7 (HRB-DOJ-60099526).

[64] Meyer Report, at 78.

[65] *See supra* n.3.

[66] [redacted]

C. The Acquisition of TaxACT Will Eliminate a Maverick

Defendants acknowledge "TaxACT's rise in popularity, aggressive marketing, sustained low prices, and its introduction of an entirely free product,"[67] but claim TaxACT is not a maverick because that is all "old news."[68] In making this argument, Defendants ignore that the number of free filers continues to grow each year and that the cumulative industry price change since 2004 is [redacted][69] — trends resulting from TaxACT's maverick conduct.[70]

Contrary to Defendants' position, TaxACT is no less of a maverick today. TaxACT's recent aggressive entry into the boxed software segment mirrors how it shook up the online segment of the market. In 2010, TaxACT began selling its software at Staples,[71] [redacted][72] [redacted][73]. [redacted][74], [redacted][75] [redacted][76] — yet

[67] Opp. Memo., at 40.

[68] *Id.*; *see also* Pl. Memo., at 5-10, 34-35 for a detailed account of TaxACT's history as a maverick.

[69] GX 121 (Expert Report of Dr. Frederick Warren-Boulton, at 57).

[70] Redacted

[71] GX 294 (Simone Dep. 85:17-20; 240:6-11).

[72] GX 65 (HRB-DOJ-00337419, at -20).

[73] GX 608 (2SS-MRKTe-0664736).

[74] GX 603 (AQ 112).

[75] GX 294 (Simone Dep. 23:13-15).

[76] GX 294 (Simone Dep. 134:11-136:12).

another benefit to consumers generated by TaxACT.[77]

TaxACT also has been a maverick innovator in terms of its online marketing. As Daniel Maurer of Intuit testified, TaxACT's

[redacted]"[78] Maurer acknowledged that TaxACT's innovation resulted in TurboTax becoming [redacted].[79]

D. The Digital DIY Market is Vulnerable to Tacit or Actual Coordination

Contrary to Defendants' contention,[80] the Digital DIY market is already vulnerable to coordinated effects, and HRB's acquisition of TaxACT will only make it more so.[81]

The core of Defendants' argument in opposition is that the Digital DIY product market is differentiated. This misses the point. That a product market is differentiated "does not eliminate" the potential for coordinated effects. Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶ 942b. This is particularly true when the main elements of differentiation — here, brand and quality extras — are not "disruptive to oligopolistic coordination or collusion."[82] Indeed, courts have long recognized — and expressly found — a likelihood of anticompetitive coordinated effects in differentiated product markets.[83]

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[77] [redacted]

[78] GX 293 (Maurer Dep. 162:18-23).

[79] *Id.* at 163:10-18.

[80] Opp. Memo., at 38-39.

[81] *See* Pl. Memo., at 36-38.

[82] *Id.* Indeed, HRB and Intuit each sell four basic Digital DIY products that have similar features, and thus it would not be difficult for them to coordinate or collude with respect to these products. *See* GX 294 (Simone Dep. 72:18-73:12) (describing how HRB and TurboTax SKUs line up with one another).

[83] *See, e.g.*, *Interstate Circuit, Inc. v. United States*, 306 U.S. 208 (1939) (describing express collusion in differentiated product market); *Heinz*, 246 F.3d at 716 (finding a likelihood of coordinated effects in differentiated

The Digital DIY market is ripe for coordination if TaxACT is acquired. A market is vulnerable to coordination where producers recognize their "shared economic interests and their interdependence with respect to price and output decisions." *Brooke Group v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 227 (1993). Here, the ability to collect and verify pricing information,[84] the fact that transactions in the market are small and numerous,[85] regular communications between HRB and Intuit,[86] past coordination on rationalizing industry pricing,[87] and HRB's recognition that acquiring TaxACT will discourage the "[88] all suggest that coordinated effects are likely post-acquisition.

IV. Defendants Fail to Rebut the United States' *Prima Facie* Case Through Claims of Easy Entry or Efficiencies Arising from the Transaction

A. Expansion by Fringe Competitors Will Not Offset the Anticompetitive Effects of the Proposed Transaction

Entry or expansion is sufficient to rebut the Government's *prima facie* case only if Defendants can show that entry or expansion is likely to occur in a timely fashion, and such entry would be sufficient to deter or counteract the transaction's anticompetitive effects.[89] Entry or expansion is likely only if Defendants can show that it "reaches a threshold ranging from [a]

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product market).

[84] [redacted]

[85] Consequently, the incentive to cheat on a collusive scheme would be small, as the gains through cheating would be minimal. *See* Merger Guidelines § 7.2.

[86] [redacted] *See Marathon Oil Co. v. Mobil Corp.*, 669 F.2d 378, 383 (6th Cir. 1981) (joint operations between members of industry "may provide the opportunity for collusion").

[87] GX 121 (Expert Report of Dr. Warren-Boulton at 73-75).

[88] GX 18 (HRB-DOJ-00355217).

[89] *Cardinal Health*, 12 F. Supp. 2d at 55-58.

'reasonable probability' to 'certainty.'" *Chicago Bridge & Iron Co. v. FTC*, 534 F.3d 410, 430 n.10 (5th Cir. 2008).

In their Opposition, Defendants argue that fringe competitors TaxSlayer, TaxHawk, Thomson Reuters (maker of TaxSimple), Petz Enterprises (maker of TaxBrain), On-Line Taxes (maker of OLT.com), as well as other FFA participants, could easily reposition their respective products to undermine any price increase imposed by the merged firm. But, the evidence clearly shows that marketing expense and brand awareness issues are substantial impediments to Digital DIY firms quickly gaining additional customers and share.[90] Indeed, the evidence demonstrates that the acquisition will create higher marketing barriers to entry. An HRB document analyzing the proposed transaction concludes that it will result in

„[91]

The history of the Digital DIY market illustrates just how substantial barriers to expansion truly are. Over the past decade, no firm other than TaxACT has been able to garner any significant market share. TurboTax (62.2%), HRB (15.6%), and TaxACT (12.8%) are by far the three largest firms, and even if all of the smaller firms in the market added up their shares, the combined company still would not exceed or even match TaxACT's share.[92] While Defendants point to TaxACT as the perfect example of a company that can quickly rise to the top, Defendants ignore that TaxACT's repositioning to become a significant competitor in the Digital DIY market was time-consuming and expensive.[93] In fact, HRB executives rejected

[90] *See, e.g.*, *Cardinal Health*, 12 F. Supp. 2d at 57 ("[T]he fact [that fringe firms] are so small suggests that they would incur sharply rising costs in trying to [significantly increase] their output.").

[91] GX 630 (HRB-DOJ-00321954, at 4).

[92] GX 27 (HRB-DOJ-00012327).

[93] Redacted

offering their own new Digital DIY brand because they concluded that it would take

[redacted][94]

None of the fringe competitors identified by Defendants are likely to expand in a timely, likely and sufficient manner to impose a competitive constraint on HRB and TurboTax.

TaxSlayer. TaxSlayer began selling its Digital DIY product in 2003. In 2011, TaxSlayer products were used to prepare approximately [redacted].[95] TaxSlayer recognizes that it has not been able to significantly increase its market share due to its [redacted],"[96]

TaxSlayer's marketing and advertising budget last year was [redacted][97] compared to [redacted] million for TaxACT, [redacted] million for HRB and [redacted] million for TurboTax.[98] Data from this past tax year indicates that TaxSlayer [redacted]

[redacted][99]

TaxHawk. TaxHawk began selling its Digital DIY product in 2002, and in 2010 had [redacted] in revenues.[100] TaxHawk acknowledges that, [redacted]

[redacted]

[94] GX 146 (HRB-DOJ-00319797, at 21).

[95] GX 113 (RHO-DOJ-000121 (TaxSlayer Decl.) ¶ 5).

[96] [redacted]

[97] *Id.* at ¶ 12.

[98] GX 151 (Defendants 2SS Holdings, Inc. and TA IX L.P. Responses to Plaintiff's First Set of Interrogatories, at 6); GX 152 (Defendant H&R Block, Inc.'s Response to Plaintiff's Third Set of Interrogatories to Defendant H&R Block, Inc., Ex. 4); GX 29 (DOJ-INT-000001 (Intuit Decl.) ¶ 38).

[99] [redacted]

[100] *Id.* ¶ 10. TaxHawk also does not offer functionality for all 43 states with income taxes, nor does it offer support for all forms in the other states. *Id.* ¶ 9.

„[101]

„[102]

Thomson Reuters. Last year, Thomson Reuters' Digital DIY products were used to prepare only approximately and its marketing budget was [103] Mr. Baron testified that to compete in the Digital DIY market, Thomson Reuters would have to invest „[104]

.[105]

Petz Enterprises. After eleven years in the industry, TaxBrain, Petz's product, is only used to process approximately individual tax returns each year, translating into a market share. Over the past two years, despite what Petz's CFO described as improved marketing, Petz has [106] Nonetheless, if HRB acquires TaxACT, Petz's CFO believes that he could [redacted] [107] His projections are, at best, speculative,[108] and are based in

[101] [redacted]

[102] GX 25 (THK-DOJ-000001 (TaxHawk Decl.) ¶ 14) (emphasis added).

[103] GX 156 (TR-DOJ-000001 (Thomson Reuters Decl.) ¶¶ 5, 9).

[104] GX 606 (Baron Dep. 72:21-73:4).

[105] [redacted]

[106] GX 571 (Petz Dep. 87:25-88:17).

[107] *Id.* at 22:4-10.

[108] [redacted]

part on conjecture about HRB's post-acquisition plans — which he has no knowledge of.[109]

On-Line Taxes.

„[110]

[111]

FFA. Defendants also point to the the FFA as providing opportunities for robust competition. But the FFA has been limited in its recent ability to attract taxpayers. As Bert DuMars, a former IRS executive, noted, the FFA is only able to attract "a small number" of taxpayers because individuals are generally unaware of the program and do not feel comfortable dealing directly with the IRS.[112] HRB's former CEO Mr. Ernst testified that by the time he left HRB in 2007, Redacted „[113]

B. Defendants' Claimed Efficiencies Do Not Immunize This Transaction

Defendants' efficiencies claims are unsupported, not merger-specific, and do not save this otherwise anticompetitive transaction. In fact, Defendants' claimed efficiencies only prove the iron law at the crux of this case, *i.e.*, that more competition, not less, is what drives true efficiency and consumer welfare.

First, as the United States will show, Defendants' million in annual claimed

Redacted

[109] GX 571 (Petz Dep. 98:8-10).

[110] GX 154 (OLT-DOJ-000001 (On-Line Taxes Decl.) ¶ 4).

[111] GX 570 (John Dep. 48:18-49:2).

[112] GX 569 (DuMars Dep. 119:13-120:17).

[113] GX 572 (Ernst Dep. 90:10-13).

efficiencies are unverified. Though there is doubtless some overlap between the two Defendants' operations — indeed, one would expect as much from two close competitors who offer the same product to the same customers in exactly the same way — courts require more than merging parties' "plans" and "commitments" in order to consider, much less to accept, their claims of merger-specific efficiencies.

As this Circuit held in *Heinz,* any claimed efficiencies in a concentrated market must not only be "extraordinary," but they must also be "verifiable" after "rigorous analysis," rather than "represent[ing] mere speculation and promises about post-merger behavior." 246 F.3d at 721. The reason for this standard is simple: corporate history is littered with examples of mergers gone bad, where promised synergies did not live up to the hype offered by company managers.[114] Yet, Dr. Meyer, Defendants' expert, does not describe in her report *any* independent analysis that she conducted to verify her clients' efficiency claims. In contrast, the testimony and analysis of Plaintiff's accounting expert, Dr. Mark Zmijewski, will demonstrate that Defendants' efficiency claims do not come close to being objectively verifiable by a third-party. Rather, those claims are based on estimates of post-merger expenses from TaxACT that are concededly "back of the envelope"[115] and rely on the personal judgments of interested managers rather than objective calculations that can be verified through traditional accounting methods.[116]

Second, the big-ticket "efficiencies" claimed here are not specific to the TaxACT merger, but simply represent competitive adjustments that HRB could make, and indeed was making on

[114] [redacted]

[115] [redacted]

[116] The shortcomings of the Defendants' projections are too numerous to catalog in this brief but are described in Dr. Zmijewski's expert report.

its own, before the opportunity for this "defensive"[117] transaction arose. Take, for example, the savings HRB hopes to achieve from its proposal to

[118]

[119] Other efficiency claims are subject to a similar critique, in that Defendants have failed to show they cannot be achieved absent the merger and "without the concomitant loss of a competitor." *Heinz*, 246 F.3d at 722.[120] There is no reason to doubt Mr. Bennett's assessment that

"[121] and that his successor would do the same, because that is how competition works.

Additionally, Defendants have made no showing that any claimed efficiency's merger-specific effects will actually benefit competition and thus consumers. *See FTC v. Univ. Health, Inc.*, 938 F.2d 1206, 1223 (11th Cir. 1991). HRB makes a vague claim that it will offer a and expenditures after the merger,[122] but again, HRB elsewhere acknowledges that it not only can, but should and likely will, take these same

[117] GX 129 (HRB-DOJ-00576608, at -13).

[118] GX 605 (Agar Dep. 36:6–15; 40:2-16; 44:1-7; 48:19–49:4).

[119] Redacted

[120] Redacted

[121] GX 620 (HRB-DOJ-00007730, at -31).

[122] GX 15 (Defendants' Response to Plaintiff's First Set of Interrogatories to All Defendants, at 16).

steps without the merger.[123] Moreover, innovation-related efficiency claims are "often a speculative proposition," and are "looked upon with skepticism" because when two firms are already among the largest in a market, there is no empirical basis to believe that an even larger firm would produce more innovation. *See CCC Holdings*, 605 F. Supp. 2d at 74. In that respect, this market is no different from any other: in competition, HRB and TaxACT are likely to continue innovating their products, marketing aggressively, and providing services that consumers have come to appreciate and depend on at low prices. Defendants' "commit[ent]" to continue doing so[124] is worth far less than the competition that will effectively force them to.

CONCLUSION

For the foregoing reasons, as well as those set forth in Plaintiff's opening brief, the United States respectfully requests that this Court grant the United States' Motion for a Preliminary Injunction.

[123] Redacted [redacted]

[124] *See* Opp. Memo., at 1

Dated this 18th day of August 2011.

Respectfully Submitted,

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