

H&R Blocked: The Department of Justice Blocks the Acquisition of TaxACT

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Score one for the Department of Justice. After several unsuccessful trips to court over the last decade to block large business combinations, the DOJ prevailed in its attempt to prevent H&R Block Inc.'s \$287.6 million acquisition of 2SS Holdings Inc., the maker of TaxACT software. The DOJ trial team persuaded Judge Howell of the District Court for the District of Columbia that the relevant product market is limited to online do-it-yourself tax products rather than all preparation methods. The court found that the merger would leave only two significant competitors controlling 90 percent of the market, which could permit anticompetitive effects from both coordinated and unilateral conduct. This is a significant win for the DOJ. In this client alert, we discuss the decision and its implications for merger review going forward.

The Decision

In important ways, the H&R Block/TaxACT case is a throw-back, turning on traditional issues of market definition and concentration. Once the court determined that the relevant market was limited to online tax services (which includes, e.g., Intuit's market-leading Turbo Tax), it was all down hill, as the DOJ coasted to victory and the defendants stumbled to defeat.

Within the online market, the proposed acquisition would lead to very high concentration levels, with the top two firms controlling over 90 percent of the market. Such concentration levels, were "high enough," the court said, "to create a presumption of anticompetitive effects."

Faced with the burden of toppling the government's *prima facie* case, the merging parties' rebuttal arguments were inadequate to the task. Entry and expansion, the court found, would not avert anticompetitive effects arising from both coordinated and unilateral conduct. Thus, once Judge Howell was convinced that assisted and manual preparation were not part of the relevant product market, there was little the defense could do.

How did the court get to an online market? As the young ones might put it, by kickin' it old school. After recognizing that the purpose of antitrust market definition is to assess reasonable interchangeability of use and cross elasticity of demand, the court appealed to the so-called practical indicia from the venerable but dated – and often criticized – Supreme Court decision in *Brown Shoe*. The *Brown Shoe* decision focuses largely on qualitative factors – some of which go to the issue of substitutability and some of which do not – resulting in giving courts significant leeway in defining markets based on subjectivity, rather than objectivity.

The court, recognizing the criticism of *Brown Shoe*, however, did not rest entirely on that decision. Instead, it also adopted – as most modern courts have – the hypothetical monopolist test from the joint DOJ/FTC Horizontal Merger Guidelines. Under that test, the relevant question is whether a monopolist of online services could "profitably raise prices for those products by five percent or more; or whether, to the contrary, there would be no reason to monopolize all [such services] because [of] substitution and price competition with other methods of tax preparation."

Ultimately, the court sided with the government, primarily because it found the government's expert to be "generally more credible" than the defense expert. The court acknowledged that it was "beyond debate ... that all methods of tax preparation are to, some degree, in competition," since they all "provide taxpayers with a means to perform the task of completing a return." But, the court concluded, that "each method is starkly different," and so, the fact that each "may compete at some level ... does not necessarily require that they be included in the relevant market for antitrust purposes."

Following the DOJ's economic expert, the court noted colorfully that the defendants' market definition was so broadly defined that "there are no conceivable alternatives besides going to jail, fleeing to Canada, or not earning any taxable income." The court was unwilling to extend the market so far.

The Evidence

Much of the evidence in this case consisted in conventional, ordinary course business documents. In addition to internal TaxACT and H&R Block documents, the court also considered documents created by TaxACT's investment bankers for the benefit of potential buyers of the company. These documents showed that the defendants' own view was that it competes primarily in an online marketplace against Turbo Tax and H&R Block's digital offering, and that this was an important factor to highlight to potential buyers. The court's reliance on ordinary course documents, including those of investment advisors created even before the companies signed a definitive merger agreement, highlights the importance of involving antitrust counsel early in the process.

When the court scrutinized the testimony of the parties' economic experts, it found problems with the underlying data on both sides; the defendants' expert relied on data that was – well – unreliable, while the government's expert, Dr. Warren-Bolton, relied on data that didn't address the right question, namely, whether online customers would switch to offline products in the face of a small but significant price increase. Dr. Warren-Boulton's use of modern approaches such as critical loss analysis and merger simulation, though important to the court's decision, played mainly a supporting role. Though not conclusive, the court sided with Dr. Warren-Boulton's hypothetical monopolist analysis, but treated it as "another data point suggesting" that online services constitute "the correct relevant market."

The Implications

The court's opinion may generate some controversy. Because the court found there to be an absence of credible and probative economic data, it began its analysis with an old-school qualitative approach straight out of *Brown Shoe*, a 1960s-era case that predates the law and economics revolution that swept through the antitrust world in the years since. By relegating the economics to a supporting role, this decision threatens to turn the clock back to a results-oriented time when qualitative factors reigned supreme. It also suggests a willingness by courts to slice-and-dice markets narrowly based on perceived differences in product offerings, which may make it increasingly difficult for firms who are each others' closest substitutes to merge.

Beyond that, the decision is also one of the first tests of the government's recently revised Horizontal Merger Guidelines. How did those revisions fare? Just after the decision was announced, the head of the DOJ's Antitrust Division touted the case as a vindication of the revised guidelines and the DOJ's current approach to merger review. In reality, the 2010 revisions scored one win and one loss.

In the win column, the court adopted the new Guideline's approach to "unilateral effects." Under the old guidelines, it was presumed that merging parties would only have the power to unilaterally raise prices if they were each other's closest substitute, and they had a combined market share of 35 percent. These dual requirements were responsible for a number of DOJ losses in prior litigated matters, and the new merger guidelines simply omitted them. In this case, the government conceded that it could satisfy neither. Nonetheless, the court sided with the government and the new guidelines. In doing so, the court not only "decline[d] defendants' invitation ... to impose a market share threshold for proving a unilateral effects claim," it also held that failure to satisfy the closest substitute test "does not necessarily prevent a finding of unilateral effects." What does this mean? It means that mergers between relatively small firms are subject to challenge if they offer very similar products.

In the loss column, the court rejected the new Guideline's suggestion that market definition plays a subsidiary, and perhaps, unnecessary role in merger analysis. In the DOJ's view, if there is economic evidence that the merger would be anticompetitive, that should be the end of the story. The court, however, was unwilling to go so far, noting that "no modern [merger] case dispensed with the requirement to define a relevant market." What this confirms is that market definition, far from playing a subsidiary role, will frequently remain outcome dispositive, as it was in this case.

Ultimately, the impact of the decision on merging parties remains to be seen. Certainly, the decision will embolden the Antitrust Division; and certainly, the decision increases the antitrust risk inherent in many strategic mergers. But the government track record remains mixed, especially in high-tech mergers. Given the notoriously fact-specific nature of merger analysis, this decision will hardly be the last chapter when it comes to mergers of online service providers.

- **Colin Kass**

Partner