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THE FAILING COMPANY DEFENSE AFTER THE COMMENTARY: LET IT GO

Oliver Zhong*

This Note proposes the abolishment of the failing company defense in merger control law. This call for reform is based on a comprehensive critique, which consists of a revisit of the doctrinal history, a survey of problems in current practice, and an inquiry into the normative merits of both the status quo and alternative plans. The reform advocated will purify the doctrine and improve the practice with minimum adjustments, in line with the ongoing movement to modernize merger review with the publication of the Commentary to the Merger Guidelines.

INTRODUCTION

The failing company defense is the longest surviving myth in federal merger control jurisprudence. Generally considered a judicial creation of the 1930 Supreme Court decision of *International Shoe*, the defense is older than the modern Section 7 jurisprudence itself. Following its long course of genesis, one would expect it to be either firmly established and embedded in contemporary practice or disfavored and dropped into historical oblivion. Neither is true today. Although the basic import of the defense is simple—it exonerates mergers that are otherwise illegal if one of the parties is “failing”—its application remains ambiguous. It has

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5. *See infra* Part II.B.
been only sporadically tested in litigation, where the courts have not provided helpful clarification. The Supreme Court has never explicitly upheld its application and has not substantively ruled on a related case for thirty-two years. On the other hand, despite being subject to both scorn and indifference, the defense is "alive and well," frequently, if not routinely, raised in the proceedings of the Justice Department and the Federal Trade Commission ("FTC") and often determinative of the agencies' decisions regarding whether to launch a challenge to proposed mergers.

6. Thomas E. Kauper, The 1982 Horizontal Merger Guidelines: Of Collusion, Efficiency, and Failure, 71 CAL. L. REV. 497, 526 n.67 ("Subsequent [to the 1950 amendments to the Clayton Act,] Supreme Court decisions are not particularly helpful on the point, formulating standards for the defense with little or no explanation.") (citations omitted).


10. For example, the FTC has never upheld the defense in a litigated case. "Merging companies should avoid wasting their time with a failing company defense in most cases." Tough Hospital Merger Enforcement to Continue at FTC, Antitrust Division, FTC: Watch, Feb. 25, 1991, at 5 (quoting then FTC Competition Director Kevin Arquit).

11. Lou Whiteman, Failing Airlines Stand Better Chance of Merging, DAILY DEAL, Feb. 8, 2002 (reporting on the successful merger between the AMR Corp., parent of American Airlines, and the TWA Airlines Inc. largely based on the theory that TWA could not survive independently). "There is a myth that the failing firm defense rarely, if ever, succeeds. . . . The reality is that the defense is alive and well." Id. (quoting attorney Joel Chefitz).

12. Kauper, supra note 6, at 529.

Most antitrust observers, especially those not involved directly in the enforcement process, tend to view the failing company defense as a bit of esoterica, a kind of footnote that must be included in any description of merger policy but that is of little real consequence. If my own experience is any measure, the opposite is true. The defense, or something akin to it, is frequently raised before the [Justice] Department. Evaluation of these arguments is something of an institutional nightmare, particularly with respect to the alternative purchaser requirement.

Id.


Federal merger law, in the meantime, has changed fundamentally. The battlefield has shifted from ex post rule of reason inquiries in the courtroom (frequently at the Supreme Court) to ex ante pre-merger filing and investigations at the enforcement agencies, which increasingly employ efficiencies analysis and the technical expertise of economists. As such, the prosecutorial discretion wielded by the Justice Department and the FTC has become highly dispositive of not only individual merger plans, but, more importantly, of the merger jurisprudence proper, because the government sues less frequently (and even less so on the merits) and private suits are extremely difficult. Since 1968, the agencies have introduced more transparency and predictability to the exercise of such powerful discretion over mergers by the adoption of merger guidelines. In March 2006, the agencies published


16. The Hart-Scott-Rodino Antitrust Improvements Act of 1976, Pub. L. No. 94-435, 90 Stat. 1383 (codified as amended in scattered sections of 15, 18 and 28 U.S.C.) provides parens patriae authority to state attorneys general and wider investigation power for the Justice Department, but it was its pre-merger filing requirement that vastly changed the merger law and practice. For a review of the HSR Act's effect on merger practice, see Sims & Herman, supra note 15.


the Commentary on the Merger Control Guidelines (the "Commentary"), marking a solid next step in the merger law enforcement reform process.

The failing company defense fits strangely in this development. A telling indication of the misfit is that the Commentary reaffirms its part in the merger review routine but offers virtually no comment on it. Whatever the reason for this omission, the vacuum is disquieting, particularly in view of the rest of the document, which is otherwise concrete and detail-oriented. The problem is not new. The agencies had accepted the defense as part of established law, but only grudgingly, because the defense would force them to bless mergers which were prima facie illegal and which might not have any valid rebuttal, and to do so without a clear and convincing rationale. As a natural response, the agencies have since interpreted and applied the defense narrowly. However, the real damage of the defense manifests itself not when it "succeeds" in the sense of upholding an otherwise meritless merger, but when it exists. The distortion of antitrust law enforcement will persist should the equivocation about the failing company defense continue. It is time to solve the problem.

This Note develops a renewed criticism of the failing company defense and proposes a three-part approach to prepare for merger jurisprudence without it: abolishing the per se defense; recognizing specific, eligible efficiencies for exiting assets; and adopting ad hoc statutory exemptions. The methodology is largely normative. A major impetus may be necessary in Congress, the courts, the agencies, or the Bar for effecting an ideological realignment that is radical on its face, even if moderate in effect. The goal is, rather,


21. The Commentary itself explains that "application of the Guidelines’ provisions relating to failure and exiting assets is not discussed ... because those provisions are very infrequently applied." Id. at 4. This is probably an honest statement. But see infra note 22.

22. It is remarkable that the failing company defense, one of the five components of the Guidelines review, becomes an empty appendix in a 71-page document aimed at bringing more predictability and transparency to antitrust law application. See Commentary, supra note 21, at v. One is not to blame for keeping a harmless appendix. But if it causes constant problems, no action is not the right solution.

23. The clear exemplar is the fact that the failing company test in the Guidelines is on its face more stringent than the judicial standard. See infra notes 114–117 and accompanying text.

24. See infra Part II.C.

to present a reasoned case to purify the law and at the same time bring more economy and confidence to the existing practice with minimum adjustments.

Part I revisits the doctrinal history of the defense from a contextual perspective and demonstrates that the defense is a legal anomaly that has evaded its exit in the shift of ideological cycles. Part II surveys the defense in contemporary practice and the problems it causes. Part III turns to a pure normative inquiry, seeking reasons why the defense should be supported and finding none. Part IV lays out a reform and explains its consequences.

I. The Failing Company Defense as a Legal Doctrine

There seems little secret left in the doctrinal history of the failing company defense. It is settled hornbook law that the defense was created by the Supreme Court in *International Shoe*, codified by Congress in the Celler-Kefauver Act of 1950, modernized by the Court in *Citizen Publishing*, and readily adopted by the agencies in the Guidelines. It is acknowledged that the defense lacks textual statutory basis, but the standard view holds that the legislative history of the 1950 amendments evinces such a clear intent in favor of the defense that it must be taken as firmly established. A contextual revisit of the history challenges this view.

A. International Shoe: The Doctrine It Did Not Create


29. Guidelines, supra note 19, § 5.

30. 4 Phillip E. Areeda & Herbert Hovenkamp, Antitrust Law ¶ 951, at 243-44 (2d ed. 2006).

31. Id. at 243.
The FTC found, as did the First Circuit, that the two companies were in substantial competition, that the acquisition substantially lessened such competition, and that it thus offended Section 7 of the Clayton Act. Justice Sutherland, writing for the Supreme Court, reversed the circuit court for two reasons. First, there was no substantial competition between the two companies. Second, in a frequently quoted passage, Justice Sutherland wrote:

In the light of the case thus disclosed of a corporation with resources so depleted and the prospect of rehabilitation so remote that it faced the grave probability of a business failure with resulting loss to its stockholders and injury to the communities where its plants were operated, we hold that the purchase of its capital stock by a competitor (there being no other prospective purchaser), not with a purpose to lessen competition, but to facilitate the accumulated business of the purchaser and with the effect of mitigating seriously injurious consequences otherwise probable, is not in contemplation of law prejudicial to the public and does not substantially lessen competition or restrain commerce within the intent of the Clayton Act. To regard such a transaction as a violation of law,

32. Int'l Shoe Co. v. Fed. Trade Comm'n, 29 F.2d 518, 520 (1st Cir. 1928). The stock purchase was crucial for the FTC to acquire jurisdiction under the original Section 7, which applied to stock sales only:

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


Interestingly, it may seem curious why International was not astute enough to design an asset acquisition to avoid antitrust problems. According the circuit court's findings, International Shoe realized the difference only after the FTC had instituted proceedings. Int'l Shoe, 29 F.2d at 522-23. Apparently on the advice of counsel, International Shoe then "divested" all its McElwain stock and effectively transmuted the stock acquisition into an asset acquisition. Id. The First Circuit found that this "pseudo purchase of assets" did not affect the FTC's jurisdiction, per Federal Trade Commission v. Western Meat Co., 272 U.S. 554 (1926). Id.

33. Id.

34. Clayton Act, § 7.

35. Int'l Shoe Co. v. Fed. Trade Comm'n, 280 U.S. 291, 298 (1930). Since ninety-five percent of McElwain shoes were sold in "large centers of population to meet a distinct demand for that particular product," and ninety-five percent of International shoes were sold in "the rural sections and the small towns to meet a wholly different demand," to hold them in competition "is to apply the word 'competition' in a highly deceptive sense." Id.
as this Court suggested in United States v. U.S. Steel Corp., would "seem a distempered view of purchase and result." See also American Press Ass’n v. United States.\(^{36}\)

So was born the failing company defense, as the majority sees it. From hindsight, the "grave probability of business failure" language not only is the first articulation of the defense, but has become a lasting expression of it.\(^{37}\) But this emphasis mistakes the facts for the holding of the case and creates a "doctrine" that is repugnant to the original context of International Shoe.

1. Immediate Context

Within Justice Sutherland's second reason, it is obvious that the real holding was based on the Sherman Act jurisprudence. The intent element\(^{38}\) and public cost-benefit balancing test\(^{39}\) are hallmarks of the rule-of-reason analysis.\(^{40}\) The direct references to US Steel and American Press Association, both classic Sherman Act cases, dispel any ambiguity.\(^{41}\) Whatever the facts of the case illuminate, they cannot alter the construct of law that produced the holding.

In addition, the nexus between the first reason and the second one, the former of which was clearly based on Sherman Act methods,\(^{42}\) strengthens the conclusion that both were integral parts of a rule-of-reason holding. Some commentators do not see this nexus because they believe that the first reason was sufficient for the outcome of the case and the second was pure dictum\(^{43}\) or, more

\(^{36}\) Id. at 302-03 (citations omitted) (emphasis added).


\(^{38}\) Int’l Shoe, 280 U.S. at 302 ("[N]ot with a purpose to lessen competition . . . ").

\(^{39}\) Id. ("[W]ith the effect of mitigating serious injurious consequences otherwise probable . . . not . . . prejudicial to the public . . . ").

\(^{40}\) See, e.g., Standard Oil Co. v. United States, 221 U.S. 1 (1911); United States v. Am. Tobacco Co., 221 U.S. 106 (1911).

\(^{41}\) In United States v. U.S. Steel Corp., 251 U.S. 417 (1929), the court found that grave injury would occur to the public if the acquisition was disallowed. In American Press Ass’n v. United States, 245 F. 91 (7th Cir. 1917), the impact on the public was considered insignificant.

\(^{42}\) After finding that International and McElwain did not compete with each other, that part of the holding was reached not on the modern notion of market definition, but on standard Sherman Act language. Int’l Shoe, 280 U.S. at 297-98 (citing Standard Oil Co. v. Fed. Trade Comm’n, 282 F. 81 (3d Cir. 1922); Fed. Trade Comm’n v. Sinclair Ref. Co., 261 U.S. 463 (1923)).

charitably, "unnecessary for the outcome." If this view were accepted, it would virtually destroy the doctrinal underpinnings of the failing company defense. Alternatively, if one holds a temperate reading glass and tries to find meaning in both reasons, there is not only textual support that they are conjunctive, but a strong logical link as well.

While it is undisputed that early Clayton Act jurisprudence borrowed heavily from that of the Sherman Act, mainstream commentators see it as a separate line of interest and ignore its disposition over the presumption of what came to be known as the failing company defense. There was no affirmative defense in International Shoe. The loss to the shareholders and injuries to the community—what Professor Friedman aptly called the "hardship rationale"—was not a justification to an illegality, but only a factor under a rule-of-reason balancing test that absolved a merger from illegality. Unless it comes to terms with this basic fact, any debate regarding the normative justification of an absolute defense would only exacerbate, not ease, the doctrinal confusion.

2. Ideological Context

If there is still doubt as to how to read International Shoe within its text, the largely overlooked ideological context of the Taft Court dispels it. One extraordinary feature of the entire opinion is how the Supreme Court differed with the First Circuit over facts, which had been investigated and presented by the FTC, and effectively relied on its own findings for the ruling. The only way to fully comprehend this rather extraordinary choice is to read it together

44. Kauper, supra note 6, at 526 n.67.
45. Indeed, if International Shoe were tried today, the holding would almost certainly stop at the end of the first part, because the parties apparently did not compete in the same geographic market or in the same product market. At the time International Shoe was decided, it was a fortiori so because then Section 7 was concerned only with competition between the two firms in question. The absence of such would be dispositive as a matter of law.
46. See Int'l Shoe, 280 U.S. at 303 ("For the reasons appearing under each of the two foregoing heads of this opinion, the judgment below must be reversed.") (emphasis added). Some commentators saw these reasons as alternatives. See e.g., Campbell, supra note 18, at 253; Laurenza, supra note 13, at 949.
47. In effect, the first reason establishes that there is no current substantial competition, and the second proves that there is no future substantial competition. Viewed together, these reasons make a full case that there can be no substantial lessening of competition.
49. Friedman, supra note 1, at 1977.
50. This was the main objection of Justice Stone's dissent. Int'l Shoe, 280 U.S. at 303--06 (Stone, J., dissenting).
with *Curtis Publishing*, a case decided seven terms earlier by the same court and cited in *International Shoe*. There, the court effectively dismissed all fact-finding done by the executive agency and gave federal courts the power to probe the evidence anew.

Another notable aspect of *International Shoe* is the Court's deference to private contract. In an almost coaching tone, Justice Sutherland told the First Circuit that it should have recognized McElwin's bona fide search for alternative purchasers. In effect, Justice Sutherland recited his gospel that individuals should be presumed to possess the fine judgment and more importantly the right to dispose of their private property, so long as "not . . . prejudicial to the public," free from undue government second-guessing and paternalistic judgment.

The common theme is clear enough: curtailing the government's power to interfere with private contracts. Such was typical of the antitrust jurisprudence of the time. Simply put, in allowing two large shoemakers to merge, the Taft Court was nowhere near espousing a liberal coup that manipulated antitrust law to ameliorate certain community hardship. Instead, the merger sent the message that the private contract as a whole was not prejudicial enough to the public to justify government interference. Justice Sutherland and his ideological allies on the bench were unrivalled in the entire Supreme Court history in their adherence to this conservative philosophy, one which was intrinsically hostile to the government's power against private persons, notwithstanding

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52. *Int'l Shoe*, 280 U.S. at 297.
53. Chief Justice Taft and Justice Brandeis doubted the wisdom of such a fact-finding role for the courts, albeit via a concurring opinion. *Curtis Publ'g*, 260 U.S. at 582 (Taft, C.J., concurring).
54. *Int'l Shoe*, 280 U.S. at 302.
55. *Id.*
56. Nothing better portrays the justice's philosophy than (and only that philosophy can explain) his citation to *Bank of the United States v. Dandridge*, 25 U.S. (12 Wheat.) 64 (1827), a case endorsing private control over property, written by the great Justice Joseph Story.
the advent of ever-expanding big businesses and the very concentration of wealth and power that many viewed as the chief initial concerns of the Sherman Act and, derivatively, the early Clayton Act. In the end, the anti-regulation philosophy decided *International Shoe*. To read the case otherwise would be, at a minimum, historically disingenuous and fundamentally flawed.

**B. Celler-Kefauver Act of 1950: "Codification" without Text**

There is reason to believe that the misreading of *International Shoe* was not due to an endemic myopia, but to a practical judgment that, since Congress so clearly intended to favor the defense, the academic niceties in *International Shoe* do not matter. The fact that the "doctrine" received no development in its first twenty years could not mean much, either. This view would have merit

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58. See, e.g., 4 AREEDA & HOVENKAMP, supra note 30, at 243 ("Whether justified or not on administrative or economic grounds, the legislative history of § 7 of the Clayton Act makes it clear that Congress was concerned that merger law not applied too harshly to the acquisition of properly defined ‘failing’ firms."); HOVENKAMP, supra note 26, at 551 ("The legislative history of the 1950 Celler-Kefauver Amendments to § 7 makes clear that Congress intended some kind of exemption for acquisitions of ‘failing’ companies.").

59. See, e.g., 4 AREEDA & HOVENKAMP, supra note 30, at 243 ("Whether justified or not on administrative or economic grounds, the legislative history of § 7 of the Clayton Act makes it clear that Congress was concerned that merger law not applied too harshly to the acquisition of properly defined ‘failing’ firms."); HOVENKAMP, supra note 26, at 551 ("The legislative history of the 1950 Celler-Kefauver Amendments to § 7 makes clear that Congress intended some kind of exemption for acquisitions of ‘failing’ companies.").

60. The defense "underwent no significant judicial development or clarification during the interim between *International Shoe* and the 1950 Clayton Act amendments."
The Failing Company Defense

had Congress explicitly established the defense with a clearly defined purpose, application, and consequence. But the question is different where, as here, the statutory language provided no indication of such defense and what the legislators intended depended on what International Shoe could offer.

The Eighty-first Congress, in passing the Celler-Kefauver Act, made two amendments to federal merger law. It made Section 7 applicable to asset sales in addition to stock transactions. It also redefined the statutory test to prohibit a merger where "in any line of commerce . . . in any section of the country, the effect of such acquisition may be substantially to lessen competition, or tend to create a monopoly."62

Before rushing to the Congressional reports to explore the legislative intent, a serious challenge can be raised: is the legislative history permissible to interpret the meaning of a statute where, as here, the text is clear and unambiguous? Not all commentators turn a blind eye to this apparent conflict. Connor chose to raise the point sotto voce in a footnote,63 which is both understandable and regrettable. Areeda was more constructive, concluding that, "if the failing firm defense is to be justified strictly by the statutory language, it must rest on the ground that the acquisition of a failing firm does not threaten to 'lessen competition' in the same way that a merger of a thriving firm might."64 In other words, there would be no affirmative defense. This finding is exactly right. Had Areeda taken it one step further in his influential treatise, then perhaps a bad doctrine would have been gone long ago. Areeda intimated that the defense "would be a different and narrower defense than the one that speaking members of Congress

Laurenza, supra note 13, at 951 (noting Beegle v. Thompson, 138 F.2d 875 (7th Cir. 1943) as the only case during the period where the per se defense was used).

63. Connor, supra note 1, at 98 n.53

The failing-company problem sought to be resolved by reference to the legislative history of amended section 7 is, in fact, not the product of ambiguity in the statute but of ambiguity in the legislative history itself. In other words, the legislative history is not being used to clarify an ambiguous statute but to introduce an inconsistency into a statute which is, in this one respect at least, clear and unambiguous on its face.

Id. (citing United States v. Mo. Pac. R.R. Co., 278 U.S. 269, 278 (1929) (emphasis omitted)).
64. AR EEDA & HOVENKAMP, supra note 30, at 244.
contemplated,\textsuperscript{65} but he failed to be explicit about how it would be different, explain the difference with the jurisprudential root in \textit{International Shoe}, or put forward the conclusion that whatever came out of the 1950 Congress relying on \textit{International Shoe} could not be a per se defense.

What the speaking members of Congress contemplated has been thoroughly researched.\textsuperscript{66} There is no question that the legislators wanted some better treatment for failing companies.\textsuperscript{67} There is also no question that the legislators had \textit{International Shoe} in mind as they contemplated.\textsuperscript{68} But it is not clear what their true intent was.\textsuperscript{69} The most explicit announcement of an absolute defense could be found in the question and answer appendix to the House report, which stated that the Clayton Act would not apply in bankruptcy or receivership cases.\textsuperscript{70} However, Connor revealed that this passage was copied verbatim from a document accompanying an earlier bill in 1947, which would only amend the Clayton Act to include

\begin{itemize}
\item \textsuperscript{65} \textit{Id.}
\item \textsuperscript{66} \textit{See H.R. REP. No. 81-1191, at 6 (1949); S. REP. No. 81-1775, at 9 (1950).}
\item \textsuperscript{67} \textit{See id.}
\item \textsuperscript{68} \textit{See id.}
\item \textsuperscript{69} At this juncture, this Note wishes to distinguish itself from Professor Bok, who, based on the same Congressional reports, presumes a constructive legislative intent in favor of the defense and only questions the 	extit{rationale} for such intent or the lack of explanation or elaboration thereof. \textit{See Derek C. Bok, Section 7 of the Clayton Act and the Merging of Law and Economics, 74 HARV. L. REV. 226, 339–40 (1960).}
\end{itemize}
asset sales and would not change the statutory test, and its adoption may well be a product of Congressional inadvertence.

This inadvertence is fatal to any argument favoring the defense's doctrinal legitimacy that relies on legislative intent. In amending the statutory test, Congress clearly intended to take the Sherman Act influence out of Clayton Act practice. There is no eliding the illogic of the view that the *International Shoe* holding could be codified into a doctrine while the very same legislation negated its jurisprudential basis—all of which was done without an attempt at a reconciling explanation. The absence of such explanation could only be rationally explained by intentional rejection.

It follows that either Congress misread *International Shoe* and "codified" a doctrine that the case did not create, or based on some independent reason, it intentionally or unintentionally mis-cited *International Shoe* with the practical effect of inserting a foreign doctrine into the American antitrust law. If one has to make an educated guess, in view of Congress's prevailing concern about whether companies in bankruptcy or receivership would be able to sell their assets, the intuitive appeal and the political popularity of the "defense" blinded legislators from seeing its full legal implications. In either case both an impurity and a vacuum were introduced into the law: what mattered as a matter of doctrine now was how the high court would mend the conflict and reinvent the doctrine, if at all, in the amended Clayton Act jurisprudence.


The committee believe that the excessive sweep that has been given to section 7 of the present Clayton Act . . . has been largely responsible for the tendency of the courts in cases under that section to revert to the Sherman Act test. By eliminating the provisions of the existing section that appear to reach situations of little economic significance, it is the purpose of this legislation to assure a broader construction of the more fundamental provisions that are retained than has been given in the past. The Committee wish to make clear that the bill is not intended to revert to the Sherman Act test.

*Id.*

75. *See supra* text accompanying note 70.
It was not without hard feelings\textsuperscript{76} in some quarters that the newly amended Clayton Act had the misfortune of being hijacked by the Warren Court in \textit{Brown Shoe},\textsuperscript{77} which, as the first Supreme Court opinion after the 1950 amendments, became the official interpretation of what the eighty-first Congress intended in its amendment of the Clayton Act.\textsuperscript{78} Had Congress benefited from any substantial development in \textit{Brown Shoe}, the failing company defense would have been on a much more solid doctrinal footing, despite its shaky past.\textsuperscript{79} But \textit{Brown Shoe} mentioned the defense only in passing.\textsuperscript{80}

In the following years, the defense was frequently litigated in lower courts but upheld only twice without development.\textsuperscript{81} When \textit{Citizen Publishing}\textsuperscript{82} came before the bench in 1969, the failing company defense existed in an "amorphous state,"\textsuperscript{83} which the Warren Court, for the first time, had a clear chance to end. The case involved the merger between the only two daily newspapers in Tucson, Arizona—the \textit{Star} and the \textit{Citizen}—who had been vigorous competitors before entering into an expansive joint operating agreement, which included price fixing, profit pooling, market control, and an option to an equity merger, which was later exercised.\textsuperscript{84} The defendant's only real defense was that \textit{Citizen} was a

\textsuperscript{76}. Under the austere jurisprudence of \textit{Brown Shoe}, efficiencies were evidence of anti-competitive behavior. Chicago School scholars vehemently disagree, arguing that the rigid structural approach artificially prevent efficiencies from scale economies. \textit{See}, \textit{e.g.}, Thomas B. Leary, The Essential Stability of Merger Policy in the United States, 70 \textit{Antitrust L.J.} 105 (2002). But some, such as Judge Posner, seem to have agreed with the structural approach, only contending that the threshold was too low. See Kolasky & Dick, \textit{supra} note 17, at 209.


\textsuperscript{78}. \textit{See 4 Areeda & Hovenkemp, supra} note 90, at 243.

\textsuperscript{79}. For example, one could imagine a fair argument that the defense as repeatedly followed by the agencies in their administrative actions merits deference by the courts. See Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837 (1984).

\textsuperscript{80}. In two passages, \textit{Brown Shoe} briefly mentioned a merger between two small companies and a merger between a financially healthy company and a failing one as examples of "special mergers" Congress recognized, without much elaboration. \textit{Brown Shoe}, 370 U.S. at 319-20, 331. In the latter passage, the opinion mentioned International Shoe, again without meaningful elaboration. Id. at 331. Therefore, Justice Stewart's assertion in \textit{General Dynamics} that the failing company defense was "adopted" in \textit{Brown Shoe} was misplaced—not to mention it was still dictum for that case. \textit{See United States v. Gen. Dynamics Corp.}, 415 U.S. 486, 506 (1974).


\textsuperscript{82}. \textit{Citizen Publ'g Co. v. United States}, 394 U.S. 131 (1969).

\textsuperscript{83}. Laurens, \textit{supra} note 13, at 955.

\textsuperscript{84}. \textit{Citizen Publ'g}, 394 U.S. at 133-34.
failing company, citing heavy financial loss and inability to secure advertising avenues.\textsuperscript{85}

In a three-paragraph footnote,\textsuperscript{86} the court laid out what it was ready to recognize of the failing company defense. In the first, the court cited three authorities,\textsuperscript{87} which, interestingly, were all academic journal articles and represented not a consensus, but a debate: Bok took the realist's middle ground of recognizing the defense but raising many doubts,\textsuperscript{88} Hale and Hale were generally supportive,\textsuperscript{89} while Connor cast strong critiques.\textsuperscript{90} More curiously, no "but see" or "compare" operator was used to separate the citations. If this omission is not sufficient evidence to establish an explicit desire for neutrality, it at a minimum does not constitute a whole-hearted embrace of the defense.

The next two paragraphs intensify the ambiguity. The court cited two cases where the doctrine "was held to justify mergers."\textsuperscript{91} Then, it provided a list of five "cases where the failing company doctrine was not allowed as a defense."\textsuperscript{92} Whether this discussion means the court agreed with the latter cases in rejecting the defense, or only rejected the specific claim before it while approving the doctrine itself can only be ascertained, if at all, upon examining these cases. In \textit{Diebold},\textsuperscript{93} the court in a short per curiam decision reversed a summary judgment upholding the merger because there was genuine dispute of fact whether alternative purchase offers were really made. In \textit{El Paso Gas},\textsuperscript{94} the court

\begin{itemize}
  \item \textsuperscript{85} \textit{Id.} at 133 (Citizen's annual losses averaged about $23,550 and Star sold fifty percent more advertising space than Citizen).
  \item \textsuperscript{86} \textit{Id.} at 137 n.2.
  \item \textsuperscript{87} \textit{Id.}
  \item \textsuperscript{88} Bok, \textit{supra} note 69, at 339-47.
  \item \textsuperscript{90} Connor, \textit{supra} note 1.
  \item \textsuperscript{92} \textit{Citizen Publ'g}, 394 U.S. at 137 n.2.
  \item \textsuperscript{93} United States v. \textit{Diebold}, Inc., 369 U.S. 654 (1962) (per curiam).
  \item \textsuperscript{94} United States v. \textit{El Paso Natural Gas Co.}, 376 U.S. 651 (1964). In furthering its reasoning rejecting the merger, the court first observed Pacific Northwest's great proximity to the California market. \textit{Id.} at 661. It continued to explain:

Pacific Northwest was no feeble, failing company; nor was it inexperienced and lacking in resourcefulness. It was one of two major interstate pipelines serving the trans-Rocky Mountain States; it had raised $250 million for its pipeline that extended 2,500 miles through rugged terrain. It had adequate reserves and managerial skill. It was so strong and militant that it was viewed with concern, and coveted, by \textit{El Paso}. If \textit{El Paso} can absorb Pacific Northwest without violating § 7 of the Clayton Act, that section has no meaning in the natural gas field.
seemed unaware of any doctrine to speak of, using the term “fail-
ing” together with “feeble” in a casual way. In Von’s Grocery, where
the majority famously prohibited a merger between two Los Ange-
les area groceries that would have a combined market share of a
meager 7.5%, the acquired company, Shopping Bag, was nowhere
near failing financial trouble.95 Next, interestingly, the attention
was specifically directed to a footnote in the seminal case of Phila-
delphia National Bank, which turned out to be the last footnote of
the majority opinion and pure dictum.96 The last cited case, Third
National Bank, was a substantive continuation of the Philadelphia
National Bank dictum, finding that, although Congress intended
banks to qualify easier as failing firms to merge despite substantial
anticompetitive effects, the merging banks in question were still
not weak enough to qualify.97 Read together, these cases betrayed
no unified pattern, and the court in so citing demonstrated no clear
purpose. The Citizen Publishing court seemed intent on re-
maining a neutral raconteur without getting itself involved in
substantive ruling on the failing company defense.

The immediate following footnote in Citizen Publishing elevated
and confirmed this attitude. The Court noted that although the
Celler-Kefauver Act amendments to the statutory test might affect
the defense, “[w]e have no occasion, however, to determine what
changes, if any, that amendment had on the failing company doc-

Id. at 661–62.

concurrency by Justice White and the scathing dissent by Justice Stewart seemed to assume
viability of the failing company defense, but without elaboration or apparent relevance to
their arguments. Id. at 280–304.

96. In Philadelphia National Bank the court noted: “Section 7 . . . does not exclude de-
fenses based on dangers to liquidity or solvency, if to avert them a merger is necessary.”
speculated that the contours for failing company defense in the banking industry would be
“somewhat larger.” Id. at 372 n.46.


Congress seems to have felt that a bank failure is a much greater community cata-
trophe than the failure of an industrial or retail enterprise, and that a much smaller
risk of failure than that required by the failing company doctrine should be sufficient
to justify the rather radical preventive step of an anticompetitive merger.

Id.

It is important to note that then bank merger cases were also governed by the Bank
Supp. II), which required that “bank mergers first be subject to the usual antitrust analy-
sis; if a merger fails that scrutiny, it would be permissible only if the merging banks can
establish that the merger’s benefits to the community would outweigh its anticompetitive
disadvantages.” Id. This Note appreciates this rationale in its proposal. See infra Part IV.A.
Despite such apparent evasiveness, the Warren Court held fast to jurisprudence principles. Effectively, the Warren Court made at least two important observations: that the 1950 amendments could not have created and did not create any new defense outside the *International Shoe* precedent; and that it had no desire to rule on the defense. The court was content simply to confine the defense "to its present narrow scope."\(^9\)

The Warren Court's ambivalence is best understood as reconciliation between its sympathy for small social units and its ideal of using government power to achieve social progress,\(^10\) which, in the area of antitrust, was difficult to implement because the dissolution of excessive corporate power rarely came without social casualties. In essence, the Warren Court expressed lukewarm interest in the failing company defense to endorse the government's judgment in the exercise of its prosecutorial discretion.\(^10\) Justice Stewart, after all, may have had a point.\(^10\)

Post *Citizen Publishing*, the Supreme Court would not further develop the failing company defense.\(^10\) From the perspective of doctrinal development, *Citizen Publishing* did not leave us with any more clarity than we had when the case arrived at the Court. This was a disappointing finish. As merger review under the Guidelines came of age, the agencies were left with no clear judicial vector guiding its only affirmative defense.\(^10\) The resulting problems were all but inevitable.

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99. *Id.* at 139. But see Correia, *supra* note 43, at 685-86 (arguing that as a result of *Citizen Publishing* there now was a judicially recognized, albeit narrow, defense in addition to strong legislative history). Professor Fox holds the interesting view that "[w]e have a failing firm defense as a matter of Supreme Court case law (*Citizen Publishing*)," but at the same time such *Citizen Publishing* defense is an anomaly." Eleanor M. Fox, *Antitrust, Competitiveness, and the World Arena: Efficiencies and Failing Firms in Perspective*, 64 ANTITRUST L.J. 725, 732 (1996).
100. See G. Edward White, *Earl Warren: A Public Life* 279 (1982) ("The theoretical dimension of Warren’s opinions . . . was largely ethical in nature. He tended to approach cases not from the perspective of political or social theory, but rather with an interest in achieving a fair and humane outcome in a given case.").
101. This view is corroborated by Justices Warren's voting record. See Kauper, *supra* note 6, at 532.
103. See *supra* note 8 and accompanying text; *infra* text accompanying notes 117-121.
104. The failing division defense is the other affirmative defense, with more strict requirements. But since the failing division defense shares the same ideological root with the failing company defense, for the sake of convenience, this Note does not treat it separately. See *Guidelines*, *supra* note 19, § 5.2.
II. THE FAILING COMPANY DEFENSE IN CONTEMPORARY PRACTICE

A. Merger Review under the Guidelines

The pre-merger filing requirement of the HSR Act of 1976 re-shaped contemporary federal merger control practice. Under the HSR Act, if the transaction in question exceeds a certain threshold, the merging parties must notify the agencies prior to the consummation and submit such transaction to an automatic thirty-day wait period. It is during such period that one of the agencies conducts its review, which, at the agency’s election, can be prolonged by the issuance of a second request. In the end, the agency either clears the deal or chooses to challenge the deal, usually by filing for a preliminary injunction in federal court.

Hence, merger review occurs in two fora—either within the agencies or in federal courts. The workings are different, but the government’s substantive review remains the same. Under the Guidelines, such review follows a five-part routine: market definition and concentration; potential adverse competitive effects; entry analysis; efficiencies; and failing and exiting assets. If the matter goes to litigation, the government has the first burden of production. Such proof is usually based on structural statistics that focus upon established market boundaries. Once the government has met its burden and made its prima facie case, the burden is on the defendant to rebut it. Under the current jurisprudence, one must look beyond the statistics and examine the “structure, history and probable future” of the market, which introduces the parties to a balancing test with adverse competitive effects on the one hand and the ease of entry and efficiencies on the other.

107. Id. § 18a(a)-(b).
108. Id. § 18a(f).
109. See Guidelines, supra note 19, § 0.
110. Guidelines, supra note 19, § 0.2.

Statistics reflecting the shares of the market controlled by the industry leaders and the parties to the merger are, of course, the primary index of market power; but only a further examination of the particular market—its structure, history and probable future—can provide the appropriate setting for judging the probable anticompetitive effect of the merger.

Id.
The failing company defense requires a relatively separate inquiry. The test has been articulated in various forms by different courts, but in essence two prongs must be satisfied. First, the failing firm must suffer some serious financial distress (the "financial distress prong"), either having a "grave probability of business failure" under *International Shoe* or being unable to survive bankruptcy per Justice Douglas in *Citizen Publishing.* Second, the firm must have in good faith searched for a less anticompetitive alternative purchaser, which must have failed (the "alternative purchaser prong"). The agencies' Guidelines include a four-prong test for the failing firm, which is facially more stringent than case law. To pass muster under the Guidelines test, the firm must be both insolvent in the near future and unable to successfully reorganize under Chapter 11 of the Bankruptcy Act. The firm still needs to have made unsuccessful good-faith efforts to elicit reasonable alternative offers of asset acquisition that would have kept the assets in the market and would have been less anticompetitive than the proposed merger. Additionally, the firm must show that absent the merger the assets in question will exit the market.

The fact that the failing company defense is listed at the bottom of the Guidelines' five-part analytical structure by no means suggests that it comes into consideration only after the first four parts are completed and generate no definitive answer. The agencies have clarified in the Commentary that the ordering is not itself analytically significant, because they do not apply the Guidelines as a linear, step-by-step progression but as an integrated operation. In fact, when one of the merging parties is financially weak to some degree, the defense often plays an early role; when the merger otherwise does not have a good case against antitrust scrutiny, the defense becomes the central concern. This outcome has been true in recent merger cases across various industries.

112. See *GUIDELINES,* supra note 19, § 5.1.
113. See *id.*
114. See *id.*
116. See *GUIDELINES,* supra note 19, § 5.1.
117. *Id.*
118. See *COMMENTARY,* supra note 21, at 2.
119. See, e.g., Whiteman, *supra* note 11 (discussing the airline industry); Jaret Seiberg, *Aid May Short-Circuit Airline Mergers,* DAILY DEAL, Sept. 23, 2001 (discussing the prospect that post-September 11 federal aid package to the airlines, which keeps the carriers out of bankruptcy, may preempt the failing company defense and prevent airline mergers); Jaret Seiberg, *No Exit: "Failing Firm" Offers No Reprieve for UAL, and Incoming Senate Banking Committee Head Richard Shelby Vows to Continue the Fight Against Corporate Fraud,* DAILY DEAL, Dec. 13, 2002 (discussing the bankrupt UAL Corp.'s chance of merging with another airline) (airlines); *Hurry-up Offense to Halt GE Acquisition of FNN,* FTC: WATCH, Mar. 25, 1991, at 5
B. Practical Confusions

The distinct characteristic of the failing company defense in recent times has been both an increase in usage and an increase in the mutations of its basic form, largely aimed at some relaxation of the financial distress prong. Jurisprudentially, this trend was intertwined with *General Dynamics*, the leading decision from the first year of the Burger Court.

*General Dynamics* approved a prima facie illegal merger between two coal operators, because the court thought the reserves of the parties were depleting, therefore current Herfindahl-Hirschman Index figures could not correctly reflect the competitive picture for the future. The court went to painful (and in this respect unhelpful) details to distinguish its holding from the failing company defense, and one commentator agreed that the two approaches

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120. Arquit, supra note 7.
122. See supra note 80 and accompanying text.

The appellees' demonstration of United's weak reserves position, however, proved an entirely different point. Rather than showing that United would have gone out of business but for the merger with Material Service, the finding of inadequate reserves went to the heart of the Government's statistical prima facie case based on production figures and substantiated the District Court's conclusion that United Electric, even if it remained in the market, did not have sufficient reserves to compete effectively for long-term contracts. The failing-company defense is simply inapposite to this finding and the failure of the appellees to meet the prerequisites of that doctrine did not detract from the validity of the court's analysis.
differed significantly. However, the distinction between a General Dynamics "flailing firm" and a Citizen Publishing failing firm is not factually intuitive, if legally intelligible. Weakness is in any event a welcome factor for the defense, and the bar has pursued it vigorously.

The development culminated into remarkable success in International Harvester, where the Seventh Circuit approved an otherwise illegal merger because one party had difficulty obtaining financing. International Harvester has been criticized for its lack of discipline and on a later occasion, the circuit court had to clarify that it did not wish to create a per se "weak firm defense." However, the impact of International Harvester is broad and lasting. The courts endeavor to tighten the jurisprudence by narrowing General Dynamics, requiring that evidence of financial weakness genuinely undercut the statistical prima facie case. But on the failing firm side, little clarification is made, as the courts disagree over the agencies' stringent requirement of not surviving bankruptcy reorganization as a necessary condition for the failing firm. Arch Coal, a recent case closely watched by the industry, provides a prime example of the entrenching confusion, as the District of Columbia District Court completely mixed up the two theories, while the FTC, for its part, concurred that financial weakness was a permissible rebuttal.

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Id. 124. See generally Roger B. Kaplan, Note, All the King's Horses and All the King's Men: The Failing Company Doctrine as a Conditional Defense to Section 7 of the Clayton Act, 4 Hofstra L. Rev. 643 (1976).


126. The Seventh Circuit attempted to limit its earlier International Harvester ruling by explaining that financial weakness was only "one relevant economic factor among many" that the court considered and adopted in a General Dynamics inquiry. Kaiser Aluminum & Chemical Corp. v. Federal Trade Commission, 652 F.2d 1324, 1339 (7th Cir. 1981). The court then laudably chastised its license in International Harvester.

Financial weakness, while perhaps relevant in some cases, is probably the weakest ground of all for justifying a merger. The acquisition of a financially weak company in effect hands over its customers to the financially strong, thereby deterring competition by preventing others from acquiring those customers, making entry into the market more difficult. Moreover, a weak company defense would extend the failing company doctrine, a defense which the Supreme Court in General Dynamics observed has strict limits.


129. See id. at 153 ("A 'failing' or even 'flailing' company defense has evolved from the Supreme Court's decision in General Dynamics.").

130. Id. (citing FTC's post-hearing brief).
Problems with the other prong of the defense—the alternative purchaser requirement—are less dogmatic than mechanical, engendering more suits but less remarkable litigation. Two categories of questions are contested. First, how much effort to seek an alternative purchaser is enough? This requirement often creates difficult managerial problems for the merging parties and evidentiary problems for the adjudicators. There is a thin line between fulfilling one's fiduciary duty in protecting the value of the business concern and soliciting wider offers, particularly from outside the industry. Moreover, merger planning is often a time-consuming matter, and the late appearance of a "more competitive" suitor can be dramatically disruptive. Second and relatedly, what price must the company accept? In the face of competing offers, should the firm be forced to be sold to the less anticompetitive buyer even if the offer is extremely low? The failing firm should not benefit from the failing status by being allowed to auction for the highest bidder, and that any price above liquidation value is permissible. But the field is still largely under-defined by court decisions.

C. The Cause and the Cost

To be fair, the failing company defense did not by itself cause all the confusion. The General Dynamics jurisprudence superposed an anomalous proposition that a weak firm would be better off than a failing one, if the agencies' strict failing-company test is to be faithfully applied. But at the core, it is the lack of solid independent doctrinal footing of the failing company defense that makes it hard to distinguish the failing company defense from General Dynamics.

The doctrinal deficiency also injects inherent logical flaws in each of the two prongs of the test. If the rationale is to prevent assets from leaving the market, why deny the benefit to less failing firms? After all, from an economic point of view, there is no real difference between exiting assets and under-utilized assets in less profitable but still viable firms. If the "stockholders and communities" in International Shoe truly merit concern, why force the firm to accept offers that may be substantially lower? All things considered, wouldn’t a sliding scale make more sense? The courts have no an-

131. Arquit, supra note 7.
132. Id. at 2–3. Note that there could also be potential conflict with state corporate law. See, e.g., Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986) (holding that once a Delaware corporation is up for sale, the directors have a fiduciary duty to search for the highest bidder).
swer because they cannot find a convincing and consistent rationale from the long-standing doctrine. The agencies have no answer either because the rigid nature of the per se defense allows them little prosecutorial discretion to fashion unilateral, more sensible approaches to failing firm claims.

The major cost of this confusion is not the loss of consumer welfare from glaring examples of mistake, i.e., mega mergers that unjustly escaped antitrust regulation on the failing firm bandwagon and struck back by harming consumers. The defense, after all, is rigorously applied and does not appear harmful. The real toll is on prosecutorial-judicial economy as enforcers seek to constrain strategic behavior and the incremental encroachment of anticompetitive mergers, which occur in connection with borderline failing firm claims, or where prosecution could be more effective with more resources. Theoretically, it may happen that the defense benefits some bona fide failing firms, but in reality, because life and death are not clearly distinguishable events in the business world, evidence is highly malleable and within the control of the management, and there is no reward for appearing strong—strategic behavior is inevitable. Such behavior is particularly hard to distinguish during periods of economic downturn, when waves of bankruptcies are filed, or in certain industries, such as high technology, where the balance sheet says little of the true business strength. Mr. Baker provided a seasoned, if cynical, view of how the defense had been abused. Indeed, "few truly failing companies can afford the delays of fully litigating the issue." The doctrine can only benefit players with deep pockets and large interests to get leverage in their bargains with the administrative agencies.

III. RETHINKING THE FAILING COMPANY DEFENSE

The preceding Parts illustrate the failing company defense's historical doctrinal deficiencies and (quite consequently) current

133. Fox, supra note 99, at 782.
134. Baker's playbook includes such strategies for the seller: (a) hire a good economist to make a persuasive argument for a larger market to contest the government's prima facie case; (b) pay heed to internal documents which the government is likely to acquire in the HSR process, particularly the overly optimistic business plans; (c) hire a good investment banker to make an alternative purchaser search that the government is likely to find persuasive; (d) keep track of and follow up on "all the nibbles"; (e) be open to accept an early out-of-market offer ("don't wait till the last minute and have your top choice blocked by antitrust agencies"); (f) when failure is real, consider declaring bankruptcy. Donald I. Baker: How to Play the Failing Company Merger Game with the Bureaucrats in Washington, FTC: WATCH, Oct. 21, 1991, at 13-15.
135. Id.
practical problems. It does not follow, however, that such facts alone require that the defense must go. Mr. Baxter's unflattering comment that "[the defense] has become acceptable to all of us only by virtue of constant repetition and the passage of time,"\textsuperscript{136} which contains a lot of truth, harbors its own counterargument. Time heals many wounds, and tradition is a formidable force in law. Even seeing the misgivings of the defense, a plausible argument can still be made that it should nonetheless be "acceptable" because it is \textit{normatively} desirable, in which case the practical difficulties surveyed in Part II, without more, would be goals of reform instead of cases for removal, and the legal deficit established in Part I could, indeed should, be repaired in exchange for the doctrine's longevity and good health, not demise. A normative inquiry of the defense is, therefore, in order.

\textbf{A. Theoretical Reconstruction}

Why is change better than the status quo? Why is one proposal of change superior to another? In order for any normative comparison to achieve meaning, one must first establish a value standard. Competition, of course, has always been the pronounced aim of antitrust law.\textsuperscript{137} But competition itself cannot be the appropriate standard, not because it is hard to measure, which it is, but because it is not a pure concept.\textsuperscript{138} Competition must be deconstructed into more basic values, which in this case results in an equity standard and an efficiency standard.\textsuperscript{139}

\begin{footnotesize}
137. No matter the prevailing ideological climate, the text of Section 7 requires that competition, however defined, remain the law's ultimate concern, however interpreted. \textit{See} 15 U.S.C. § 18 (2000) ("may be substantially to lessen competition").
138. Professor Friedman, in his thoughtful analysis, was fully aware of the shortcomings of using "competitiveness" indiscriminately and of the necessity of finding a pure value anchor. Professor Friedman used efficiency as the one and only proxy for competitiveness, citing the ideological climate, but he did not, however, seem to appreciate that there was an equity component to the competition goal. Friedman, \textit{supra} note 1, at 1384–85.
139. The efficiency aspect may be easier to understand as more competition creates more efficiencies—allocative, productive, or dynamic. For an excellent summary of the taxonomy of efficiencies, \textit{see} Kolasky & Dick, \textit{supra} note 17, at 242–51. The equitable aspect, less obvious, is rooted in the two traditional concerns of antitrust law—consumer welfare
\end{footnotesize}
The consumer equity standard cannot help the failing company defense, which by definition tolerates a post-merger market with prima facie undue market power. It therefore cannot ipso facto be deemed inequitable in all cases.\footnote{40} But what about equity for other constituencies? The term may not readily belong to the antitrust law lexicon, but if one recalls the "hardship rationale" in \textit{International Shoe} and the prevalent use of equitable relief in this area, it may seem inviting to argue that some loosely-defined "social equity" concerns are not only permissible in merger review, but desirable.\footnote{41} Indeed, social goals are traditionally accepted in substantive laws such as corporate law\footnote{42} or financial regulations.\footnote{43} There is no a priori reason why social goals are not permissible as \textit{one} parameter in antitrust.\footnote{44} This Note takes the position that social equity concerns can be considered only in exceptional cases.\footnote{45}

and small business. First, the more competitive the market, the closer the price to the marginal cost and the more even how much consumers pay for the product to how much the producer pays. \textit{Id.} Second and arguably, the more competitive the market, the more equal access to consumers small businesses are able to enjoy. \textit{Id.} Together, the market may be called more "fair."

\footnote{140} Note that the defense may well leave the market with \textit{less} market power than there would otherwise be, i.e., with the assets in question exiting the market. When this result occurs, there is less efficiency loss and therefore net efficiency (allocative) gain. This Note considers this point in an integrated efficiencies critique, \textit{infra} \textit{III.B.}

\footnote{141} One difficulty with this proposition could be the danger of a logical trap that fairness, an endogenous element in law, is used to measure the progress of the failing company defense, which would be either circular or arbitrary. This difficulty may be one reason why Chicago School scholars consider efficiency the sole goal of antitrust laws. \textit{See generally} Robert H. Bork, \textit{The Antitrust Paradox: A Policy at War with Itself} (2d ed. 1993).

\footnote{142} Leo E. Strine, Jr., \textit{Toward a True Corporate Republic: A Traditionalist Response to Bebchuk's Solution for Improving Corporate America}, 119 HARV. L. REV. 1759, 1769 (2006) ("Most U.S. states permit corporate directors to consider the interests of constituencies other than stockholders." (quoting Mark J. Roe, \textit{Delaware's Politics}, 118 HARV. L. REV. 2491, 2525–26 (2005)) ("Even Delaware law has long made clear that directors have wide leeway to pursue the course of action") (citing Paramount Commc’ns., Inc. v. Time, Inc., 571 A.2d 1140 (Del. 1989))).

\footnote{143} Howell E. Jackson, \textit{An American Perspective on the U.K. Financial Services Authority: Politics, Goals & Regulatory Intensity} 16 (Harvard John M. Olin Ctr. for Law, Econ., & Bus., Discussion Paper No. 522, 2005), \textit{available at} http://www.law.harvard.edu/programs/olin_center/papers/pdf/Jackson_522.pdf (discussing redistributive policies and other equitable norms as the less well publicized objectives of financial regulations in the United States) ("A good example of this phenomenon is the Community Reinvestment Act for depository institutions, but analogs also exist in the insurance industry and, to a limited extent, the securities field.").

\footnote{144} Professor Fox may have meant a similar point when she argued that "[the failing firm defense] case law may seem of questionable wisdom to those who believe that the job of antitrust is antitrust." Fox, \textit{supra} note 99, at 732.

\footnote{145} Because this Note believes that antitrust law differs from substantive economic laws in that antitrust law sets the basic rules rather than refereeing specific plays, it is preferable to maintain a lean, Constitution-like structure rather than keeping a claims department for reconciling broad-ranging constituency interests.
Efficiencies, on the other hand, are no light topic in antitrust law. Fortunately, the sufficiency, let alone supremacy, of efficiencies need not be decided here. The only pertinent question at this juncture is: is it permissible to use efficiencies as a factor to establish the normative desirability of a faulty legal doctrine? Given today's jurisprudence, the answer is affirmative.

It follows that if the failing company defense were to have sufficient normative merit to overcome its doctrinal deficiency, it can only be based on an efficiencies argument.

B. The Efficiencies of the Defense

The naive belief that exiting assets pose no efficiency impact has been long discredited as bad economics. In most cases, one firm's failing reduces aggregate economic welfare. It does not follow, obviously, that all failing firms ought to be salvaged at all costs. It is imperative to consider the net balance of efficiencies, i.e., those gained through assets staying in the market less those lost from competitive harm. Early empirical analysis focused on

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146. The ideological war over the role of efficiencies has been the most important theme of the antitrust law. See, e.g., William F. Baxter, Responding to the Reaction: The Draftsman's View, 71 Calif. L. Rev. 618, 621 (1983) (arguing that non-efficiency goals are hard to quantify, subjective, and, alas, inefficient). For an energizing counterargument, see Herbert Hovenkamp, Antitrust Policy After Chicago, 84 Mich. L. Rev. 213 (1985).

147. The relevance of economic efficiency to antitrust analysis is now agreed on by all schools of antitrust thinking. See, e.g., Joseph F. Brodley, Proof of Efficiencies in Mergers and Joint Ventures, 64 Antitrust L.J. 575 (1996).


149. In a fine analysis, Professor Campbell corrected Judges Posner and Easterbrook's view that the market output would stay constant and the failing firm's share would be shared pro rata by surviving firms. See Campbell, supra note 18, at 261–62 (citing Richard A. Posner & Frank H. Easterbrook, Antitrust: Cases, Economic Notes, and Other Materials 471 (2d ed. 1981)). Such scenario can happen only when the marginal cost curves for all remaining firms are horizontal, so that the remaining firms will increase output to keep the market level constant. See id. Otherwise only a higher price can lure remaining firms to increase output, in which event demand will be driven lower, and some surplus will be lost at equilibrium. See id.

150. Sheldon Kimmel raised the fine point that in calculating such efficiencies one should consider the total welfare of consumers, shareholders, and society as a whole. See Sheldon Kimmel, The Supreme Court's Efficiency Defense, 12 S. Ct. Econ. Rev. 209, 211–12 (2004) (promoting a Williamsonian efficiencies defense trade-off). Through this lens the entire line of cases from International Shoe to General Dynamics can be unified under one efficiencies defense. While analytically consistent, this Note considers such a universal efficiencies defense ahead of its time and unhelpful for its inquiry.
finding such efficiencies to make the defense make sense. Professor Campbell's cautious study demonstrated that the defense is economically sound in many but not all cases.\textsuperscript{151} He then questioned the absolute defense in favor of a case-by-case measurement.\textsuperscript{152} This view is now widely shared by commentators advocating a liberalization of the defense, seeking flexibility in both prongs of the test. A sliding scale approach in lieu of the Guidelines' bright lines is suggested as a better means of assessing the likelihood of business failure.\textsuperscript{153} The wisdom of the alternative purchaser requirement is also challenged by the argument that an acquisition by a closer competitor is likely to generate more efficiencies.\textsuperscript{154}

This sentiment is at least correct on one point, which is crucial: the complacency in the status quo is misplaced. Bearing in mind the mission of this normative inquiry, it is not sufficient that the defense be efficient from time to time, in some cases but not in others. It is necessary that the defense be efficient to justify its existence in at least most cases, if not always. As surveyed,\textsuperscript{155} the inherent conflicts of the defense determine that this result cannot be the case. The failing company defense, as is, promises no consistent efficiencies. An almost failing firm might benefit from efficiencies from a merger while a 100% failing firm might not. An acquisition by a dominant rival firm may generate efficiencies while that by a weak non-rival might not.

Now that reform is due, the question becomes: in which direction? Should the defense simply be abolished? Or should the defense be relaxed so that its satisfaction is contingent upon efficiencies being realized more often? The key to the answer is what efficiencies one may consider. Not just any efficiency may be allowed to justify the defense for jurisprudential reasons. The \textit{Brown Shoe} court could not have thrown efficiencies out of the front door, yet rolled out a welcome mat at the back door. Even today, when efficiencies are routinely considered in merger review, the agencies are very careful and strict about what kind of efficiencies they admit, an effort that would be largely frustrated if "failing firms" were to enjoy an absolute exemption. Under the Guidelines and the

\textsuperscript{151} This finding may have been all but inevitable given the strong conditions imposed on data. In the end, the sample only consisted of data from four cases. Campbell, \textit{supra} note 18, at 267-68.

\textsuperscript{152} \textit{Id.} at 269-70.

\textsuperscript{153} See, \textit{e.g.}, \textit{Failing Firms and Industries}, FTC: \textit{Watch}, Nov. 22, 1995, at 5-6 (quoting attorney Molly Boast).

\textsuperscript{154} See \textit{e.g.} Correia, \textit{supra} note 43, at 693-95.

\textsuperscript{155} See \textit{supra} Parts II.B-C.
Commentary, efficiencies are considered only if they are merger-specific and cognizable. The exact same eligibility requirements must be in place for the failing firm efficiencies probe.

Once under the Guidelines efficiencies paradigm, mergers with a failing firm may in fact present clearer analytical cases. First, the alternative prospect of the assets exiting the market may serve as a convincing argument that the projected efficiencies are merger-specific, against the presumptive regulatory suspicion that the same efficiencies could always be achieved through internal expansion. Second, such efficiencies may be more cognizable. A company's failing finances often have little bearing on its competitive position. The fact that a firm with market power offers to buy it is the most solid and reliable evidence that its assets are in certain ways useful. Those assets may be key intellectual properties such as brands or patents, or other intangible assets such as the distribution network or locations, or simply capacity. Such assets can only be used in two ways, either competitively, producing efficiencies, or anticompetitively, generating coordinated or unilateral effects. When a firm is under the pressure of creditors and the capital markets, its more attractive assets are often more conspicuous, and the true motive and probable effects of the merger are often harder to disguise.

It follows that liberalization is, indeed, a plausible plan to give the failing company defense the efficiency legitimacy it needs. The problem with liberalization is, however, that only a "perfect" one can suffice. It is not enough to lower the requisite level of the probability of failing; there must be a complete sliding scale. It is not enough to allow more leeway to find a non-least-anticompetitive-alternative purchaser; there must be complete freedom to choose the highest efficiency-creating suitor. The reasons are two. Doctrinally, only a perfect liberalization can provide a constant efficiencies justification for the defense. Practically, since the incentives for strategic behavior are inversely correlated with

156. See GUIDELINES, supra note 19, § 4; Commentary, supra note 21, at 49–59.
157. See, e.g., Fox, supra note 99, at 731 ("Firms almost always can achieve all available economies of scale and scope without making anticompetitive mergers. This is particularly so in the global marketplace, where competition by effective foreign firms may destroy the possibility of the domestic firms' power.").
158. Kimmel has proven if the acquired assets don't generate efficiencies, the merger would not have been necessary to keep the assets in the market. Kimmel, supra note 150, at 214–21. When this situation occurs, it can be good evidence that the merger was done for no competitive reason, or to no competitive effect, or often both. Id.
159. The adverse competitive effects of acquiring a failing firm are not particularly different from those of any merger. The strengthened market power could be used to raise prices unilaterally, or fashion more effective oligopolistic behaviors in a coordinated fashion. See GUIDELINES, supra note 19, § 2; Commentary, supra note 21, at 17–36.
the conditions imposed on the defense, only a perfect liberalization can reduce such behavior to the normal level.\footnote{160}{To illustrate, suppose a proposed merger that can be cleared in two ways: the normal review process where the defense need to overcome $x$ amount of difficulties, which would include establishing a broader market definition, easier entry, more efficiencies, etc.; and the "defense review" process, which requires $y$ amount of difficulties to establish. Resources will be devoted in pursuing both ways. But as long as $x > y$, more resources will be diverted from the normal review to the defense review. As the defense review becomes broader, which means more conditionals, $y$ increases, and only when $x = y$ will the diverting flow of resources stop.}

Finally, even if such a perfect liberalization were practically feasible, which is unlikely, it would no longer be necessary. The review necessary to satisfy the defense's conditions and trigger its consequence would in effect become an integrated subset of the efficiencies review. For all practical purposes, the defense would cease to exist. It would make no sense to hold on to an anachronistic name.

IV. MERGER REVIEW WITHOUT THE FAILING COMPANY DEFENSE

The case for exorcising the failing company defense from federal merger review is already evident. This Note proposes a three-part approach to mergers concerning failing companies. First, there would be no per se defense for the failing status. Second, there would be a pointed awareness toward exiting assets within the current framework of efficiencies analysis. Third, Congress would adopt ad hoc exemption statutes to further social goals it desires to address.\footnote{161}{This Note aims at an intellectual reconstruction, and the implementation of the proposal is not a major concern. Briefly, the difficulty in effecting the change by the agencies in the GUIDELINES is that the agencies may be reluctant to change unless there is some reassurance that the inclusion will not work against them in court. The easiest implementation, theoretically, is for the Supreme Court to explicitly reject the defense. But this scenario is impractical because the opportunity for a perfect case to emerge is slim. Therefore, an act of Congress by the recommendation of the agencies seems the most sensible approach.}
government and the defense will debate over the anticompetitive impact, the ease of entry, and efficiencies. It is only the efficiencies section that will require some more nuanced adjustments.

The extreme cases would be easy. If the defense can prove no efficiency and relies solely on the contention that assets would otherwise exit the market, the merger should be enjoined. On the other hand, if the agencies are satisfied that the merger would generate cognizable efficiencies not available via other means, other things being equal, the merger should be cleared. The difficult case would be, of course, the one in which the parties project certain substantial efficiencies, e.g., cost synergies, which fail to convince the agencies as being merger-specific or cognizable. Here, the agencies will exercise their discretion, based on the totality of evidence they possess. The degree of financial distress and the availability of alternative purchasers will be of high evidentiary value at this point, as they will often reliably corroborate the strength of the projected efficiencies figures. But these factors will no longer lead to a dispositive outcome.

The agencies will be familiar with such discretion and welcome it. It is, after all, just about all the agencies really do in a merger review. Antitrust is a fact-intensive discipline; the analysis of any particular merger or even any particular industry can always be translated into a general rule. The agencies routinely use discretionary general assumptions along industry lines and use further discretion to accommodate particularities of individual cases. Not at all coincidentally, the use of such sector-based discretion has been particularly pronounced in industries most cited for more flexibility in applying the failing company defense, such as health care and defense.


In industries in which scale economies are significant, the agencies have routinely, and quite correctly, adjusted the numerical presumptions of the Horizontal Merger Guidelines to accommodate the scale of enterprise needed to attain efficiency ... whether that scale is based on research and development efficiencies, production efficiencies, or even (in the health care area) administrative and overhead efficiencies.

\[Id.\]

\[164.\] See *id.* ("It is no accident that we seldom see a challenge of a defense industry merger, hospital merger, or software merger where four or more surviving competitors remain in the relevant market.").

Finally, this Note has earlier made the judgment that social goals should be considered in merger law only in exceptional cases. Such exceptionality is generally decided by Congress and sometimes by the courts. Congress has on numerous occasions passed legislation to exempt industries from the general application of the antitrust laws, such as the newspaper industry, the insurance industry, the banking industry, and professional sports. The newspaper example is particularly pertinent here, because the explicit and only purpose of the Newspaper Preservation Act was exactly to facilitate the consolidation of failing newspapers, largely in small towns where often only one general news daily can survive. Even in the absence of direct Congressional mandate, where in a specialized field of law there is a detailed regulatory scheme in place, there is a narrowly-interpreted judicial assumption that the regulated entities are shielded from antitrust law by virtue of the implied immunity doctrine. This assumption will continue to be the right approach once the failing company defense is struck from antitrust law. If Congress considers that the failing firms in certain industries merit special treatment, some tailored solution will be appropriate, because it is preferable to carve exemptions out of the general rule, rather than to change the antitrust law to accommodate particular constituencies.

B. Important Benefits

The fact that minimum adjustments are required under this proposal does not mean it is mere rhetoric. Merger review without the failing company defense has many important benefits. The primary advantage is simply doctrinal purity. This Note has demonstrated that the case generally considered the fountainhead of the

doctrine could not have created it, the legislative session thought to have codified it could not have done so, and the modern cases purported to have revived it have not in fact repaired its doctrinal deficiency.

Practical benefits are as important as doctrinal gains. Confusions over the defense have unnecessarily channeled resources from the defense, the agencies, and the courts, to a process bizarrely outside an integrated review process that is currently undergoing a constructive and fruitful modernization. Without the failing company defense, merger review will become a unified and streamlined process, the agencies will more accurately exercise their prosecutorial discretion, and ultimately, economic resources will be saved.

CONCLUSION

This Note advocates that the failing company defense be abolished under federal merger law. The inquiry is not a myth-debunking expedition. The fundamental defects of the defense are not entirely unknown. Rooted in a misreading of a conservative Supreme Court decision, glossed over by a careless session of Congress, and entangled in the ideological war started in a progressive era, the doctrine has had a long life but very few proud moments. However, it is the costly operational confusions of the defense and the fact that such confusions are inalienable from its doctrinal deficiency that make reform a current interest. "If one hundred years of federal antitrust policy have taught us anything, it is that antitrust is both political and cyclical." The failing company defense had its day. It's time to let it go.

171. Is it a pure coincidence that the failing company defense's Supreme Court appearance is sandwiched between the two greatest periods of judicial activism of the twentieth century? This Note ventures no answer. For a discussion of judicial activism during such periods, see Frederick P. Lewis, The Context of Judicial Activism: The Endurance of the Warren Court Legacy in a Conservative Age (1999).

172. Hovenkamp, supra note 26, at 213.