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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

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NOTES AND COMMENTS

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

According to a judicially created doctrine,[1] a failing company may be acquired or merged with another company without risk of liability under section 7 of the Clayton Act.[2] With qualifications not here relevant, section 7, as amended in 1950,[3] prohibits a corporation engaged in commerce from acquiring the whole or any part of the stock or assets of another corporation also engaged in commerce, "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."[4]

The broad purpose of the amended section is to prevent mergers or acquisitions which may reduce significantly the level of competition in an industry. The statute outlaws threats to competition in their incipiency, before they reach proportions which would justify proceedings under the Sherman Act. The threat to competition has been determined, for the most part, by a consideration of the individual and resulting market shares of the merged firms.[5] To set the resulting market share in its proper perspective courts have considered criteria such as the market

1. *See* International Shoe Co. v. FTC, 280 U.S. 291 (1930), *discussed in* notes 86-96 *infra* and accompanying text. *International Shoe* is generally considered the seminal case on the doctrine. *But see* notes 97-115 *infra* and accompanying text.

2. 15 U.S.C. § 18 (1974), *formerly* ch. 323, § 7, 38 Stat. 731 (1914). The Act provides in part:

> No corporation engaged in commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital and no corporation subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of another corporation engaged also in commerce, where in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly.

3. Celler-Kefauver Amendments, ch. 1184, 64 Stat. 1125 (1950), *amending* ch. 323, § 7, 38 Stat. 731 (1914) (codified at 15 U.S.C. § 18 (1974)).

4. Clayton Act § 7, 15 U.S.C. § 18 (1974) (see note 2 *supra*). *See also* United States v. Von's Grocery Co., 384 U.S. 270 (1966); United States v. Philadelphia Nat'l Bank, 374 U.S. 321 (1963); Brown Shoe Co. v. United States, 370 U.S. 294 (1962); U.S. DEP'T OF JUSTICE, MERGER GUIDELINES (1968), 1 TRADE REG. REP. ¶ 4510 (1968).

5. *See* authorities cited note 4 *supra*.

shares of other companies in the relevant market, the degree of concentration in the market, and any trends toward further concentration or towards deconcentration.[6]

Recently, the Supreme Court has indicated that the scope of a section 7 suit should be widened to consider nonstatistical evidence which negates the Government's statistical prima facie case of substantially lessened competition.[7] The trial of section 7 suits had increasingly become a manipulation of production and sales statistics disregarding nonstatistical criteria that may also have had an effect on the level of competition in an industry.[8] The recent shift in the Court's approach is based on a recognition that some mergers may not be undesirable even though market statistics indicate otherwise. The purpose of this article is to examine the vitality of the failing company doctrine in light of this and other recent developments. A question which will be discussed is whether the doctrine's requirements, and the underlying rationales upon which they are premised, accurately distinguish between desirable and undesirable acquisitions or mergers involving companies suffering severe financial difficulties. An answer will be sought through an examination of the origins of the doctrine, the legislative comment on it, the policies underlying it, and its economic justification.

The failing company doctrine affords the only "defense" to section 7—other than the investment company defense specified in the statute[9]—that the courts[10] and Congress[11] have specifically recognized. The 1950 Amendment significantly increased the

6. *Id.*

7. United States v. General Dynamics Corp., 415 U.S. 486, 498 (1974), *discussed in* notes 68-81 *infra* and accompanying text; *see* United States v. Citizens & S. Nat'l Bank, 422 U.S. 86, 112, 119 (1975); United States v. Marine Bancorporation, Inc., 418 U.S. 602, 637-39, 641 (1974). *See also* note 159 *infra* and accompanying text.

8. *See, e.g.*, United States v. Von's Grocery Co., 384 U.S. 270 (1966); United States v. Continental Can Co., 378 U.S. 441 (1964); United States v. Aluminum Co. of America, 377 U.S. 271 (1964); United States v. Philadelphia Nat'l Bank, 374 U.S. 321 (1963); *cf.* U.S. DEP'T OF JUSTICE, MERGER GUIDELINES (1968), 1 TRADE REG. REP. ¶ 4510 (1968).

9. Clayton Act § 7, 15 U.S.C. § 18 (1974), *formerly* ch. 323, § 7, 38 Stat. 731 (1914). The Act provides in pertinent part:

> This section shall not apply to corporations purchasing such stock solely for investment and not using the same by voting or otherwise to bring about, or in attempting to bring about, the substantial lessening of competition.

10. *See* cases cited at note 27 *infra.*

11. *See, e.g.*, S. REP. No. 1775, 81st Cong., 2d Sess. 7 (1950); H.R. REP. No. 1191, 81st Cong., 1st Sess. 6 (1949). For a discussion of the congressional view of the "failing company" doctrine see notes 131-49 *infra* and accompanying text.

effectiveness of section 7 in preventing undesirable concentrations of industrial power,[12] and consequently increased the importance of the failing company doctrine. Briefly stated, the doctrine allows an acquiring firm, or an acquired or soon to be acquired firm, to interpose the financial difficulties and near bankruptcy of the acquired or soon to be acquired firm as a defense to a section 7 prosecution. As the doctrine developed, two independent rationales were given for it: (1) that any merger with or acquisition of a company which will shortly leave the market due to its failing condition cannot generate anticompetitive effects;[13] and (2) that courts should protect the stockholders, creditors, and others whose financial interests are tied to a failing concern by allowing the merger or acquisition.[14] It is submitted that the first rationale is economically unsound, and therefore can no longer justify the doctrine, and that the latter is insufficient to be dispositive in all cases.

The doctrine has been viewed as either a per se affirmative defense which relieves the parties of all liability under section 7 whenever its strict requirements are satisfied, notwithstanding the substantiality of the competitive injury that is threatened, or, not as an affirmative defense at all, but one of several considerations which might negate an implication of substantially lessened competition arising from the Government's statistical prima facie case. Under the per se approach, if the requirements of the doctrine are satisfied, the merger or acquisition is permitted irrespective of serious threats to the competitive process. When the doctrine is viewed as bearing directly on the Government's case, the merger or acquisition is invalidated regardless of the seriousness of a company's financial difficulties, if a substantial anticompetitive effect can be shown. The result has been to allow mergers or acquisitions which are undesirable and to invalidate mergers or acquisitions which are desirable. At the expense of clarity, some courts faced with this dilemma have

12. *See* Dooley, *Failing Company Doctrine: Recent Developments*, 47 TEXAS L. REV. 1437, 1439 (1969); Hale & Hale, *Failing Firms and the Merger Provisions of the Antitrust Laws*, 52 KY. L.J. 597 (1964); Handler & Robinson, *A Decade of Administration of the Celler-Kefauver Antimerger Act*, 61 COLUM. L. REV. 629, 629-31 (1961); Comment, *Federal Antitrust Law—Mergers—An Updating of the "Failing Company" Doctrine in the Amended Section 7 Setting*, 61 MICH. L. REV. 566 (1963).

13. *See* notes 116-30 *infra* and accompanying text. Some such acquisitions or mergers may, in fact, generate procompetitive effects by keeping a component of the market alive as a competitive influence thereby avoiding undesirable concentration. *See* notes 100-08 *infra* and accompanying text.

14. *See* notes 116-30 *infra* and accompanying text.

manipulated the strict requirements of the doctrine to achieve an acceptable result. This article posits that neither approach accomplishes the objectives of the doctrine. A third approach is proposed which considers the anticompetitive effect of a merger or acquisition in relation to the severity of a company's financial difficulties. This would accurately identify those mergers with, or acquisitions of, failing companies which are desirable in light of a supportable rationale for the doctrine.

In an attempt to narrow the failing company doctrine the Supreme Court has created strict requirements which must be fulfilled in order to claim the benefits of the doctrine.[15] These strict requirements ignore circumstances which are relevant to a principled application of the doctrine. By proposing an alternate approach to failing company questions this article advocates a broadening of the inquiry involved. Those requirements which continue to have a logical relationship to a supportable rationale should continue to be important in the overall determination, but should not be dispositive in all cases. This approach is consistent with the recent trend to consider all the circumstances of a merger or acquisition in section 7 prosecutions on a case-by-case basis, relying less on rigid formulae such as a narrow statistical analysis.

THE PRESENT REQUIREMENTS OF THE DOCTRINE

The failing company doctrine may be established although the acquired company is not actually in receivership at the time of the merger or acquisition. The troublesome question in this regard is just how close to receivership or bankruptcy the acquired firm must be in order to successfully invoke the defense. Here, the cases are inconsistent and often confusing in their attempts to define and apply the proper criteria. Courts have re-

15. *See* Citizen Publishing Co. v. United States, 394 U.S. 131 (1969); United States v. Diebold, Inc., 369 U.S. 654 (1962), *rev'g and remanding* 197 F. Supp. 902 (S.D. Ohio 1961); *cf.* U.S. DEP'T OF JUSTICE, MERGER GUIDELINES § 9 (1968), 1 TRADE REG. REP. ¶ 4510, at 6881-89 (1968), which states:

> A merger which the Department would otherwise challenge will ordinarily not be challenged if (i) the resources of one of the merging firms are so depleted and its prospects for rehabilitation so remote that the firm faces the clear probability of a business failure, and (ii) good faith efforts by the failing firm have failed to elicit a reasonable offer of acquisition more consistent with the purposes of Section 7 by a firm which intends to keep the failing firm in the market.

See also United States v. Greater Buffalo Press, Inc., 402 U.S. 549 (1971).

quired that the concern be "fac[ing] the grave probability of business failure";[16] "continuing . . . at a loss";[17] "nearly worthless";[18] "in a competitive sense, dead . . . . [or] a shell rapidly falling into decay";[19] "closing out its business because of financial difficulties";[20] "hopelessly insolvent";[21] "deeply in debt";[22] "in a failing or near bankrupt condition";[23] "[not a] viable company—overall";[24] "irretrievably failing without possibility of recovery";[25] and "in such straits that the termination of the enterprise and the dispersal of its assets seems inevitable unless a rival proprietor shall acquire and continue the business."[26]

Generally, the defense has been difficult to establish and courts have not looked favorably upon it.[27] In 1969, the Supreme

16. International Shoe Co. v. FTC, 280 U.S. 291, 302 (1930); *In re* Pillsbury Co., 57 F.T.C. 1274, 1409 (1960), *vacated and remanded on other grounds*, 354 F.2d 952 (5th Cir. 1966).

17. American Press Ass'n v. United States, 245 F. 91, 93 (7th Cir. 1917).

18. United States v. United States Steel Corp., 251 U.S. 417, 446 (1920).

19. Aluminum Co. of America v. FTC, 299 F. 361, 365 (3d Cir. 1924).

20. Beegle v. Thomson, 138 F.2d 875, 881 (7th Cir. 1943), *cert. denied*, 322 U.S. 743 (1944).

21. United States v. Diebold, Inc., 197 F. Supp. 902, 906 (S.D. Ohio 1961), *rev'd on other grounds*, 369 U.S. 654 (1962); United States v. Maryland & Virginia Milk Producers Ass'n, 167 F. Supp. 799, 808 (D.D.C. 1958), *aff'd*, 362 U.S. 458 (1960); *see In re* Farm Journal, Inc., 53 F.T.C. 26, 31 (1956) ("faced with actual or imminent insolvency").

22. United States v. Maryland & Virginia Milk Producers Ass'n, 167 F. Supp. 799, 808 (D.D.C. 1958), *aff'd*, 362 U.S. 458 (1960).

23. Crown Zellerbach Corp. v. FTC, 296 F.2d 800, 831 (9th Cir. 1961); *see* United States v. Diebold, Inc., 197 F. Supp. 902, 906 (S.D. Ohio 1961), *rev'd on other grounds*, 369 U.S. 654 (1962) ("faced with imminent receivership"); United States v. Maryland & Virginia Milk Producers Ass'n, 167 F. Supp. 799, 808 (D.D.C. 1958), *aff'd*, 362 U.S. 458 (1960) ("in fact on the brink of bankruptcy").

24. United States v. Phillips Petroleum Co., 367 F. Supp. 1226, 1260 (C.D. Cal. 1973), *aff'd mem.*, 418 U.S. 906, *rehearing denied*, 419 U.S. 886 (1974).

25. United States v. M.P.M., Inc., 397 F. Supp. 78, 98 (D. Colo. 1975); *see* United States v. Pabst Brewing Co., 296 F. Supp. 994, 1002 (E.D. Wis. 1969).

26. Erie Sand & Gravel Co. v. FTC, 291 F.2d 279, 280 (3d Cir. 1961).

27. Acquisitions or mergers were successfully justified on failing company grounds in: International Shoe Co. v. FTC, 280 U.S. 291, 302 (1930); United States v. United States Steel Corp., 251 U.S. 417, 446 (1920) (a Sherman Act stock acquisition case); Granader v. Public Bank, 417 F.2d 75, 84 (6th Cir. 1969); Beegle v. Thomson, 138 F.2d 875, 881 (7th Cir. 1943), *cert. denied*, 322 U.S. 743 (1944); Aluminum Co. of America v. FTC, 299 F. 361, 365 (3d Cir. 1924); American Press Ass'n v. United States, 245 F. 91, 93 (7th Cir. 1917) (a Sherman Act assets acquisition case); United States v. M.P.M., Inc., 397 F. Supp. 78, 102 (D. Colo. 1975); United States v. Maryland & Virginia Milk Producers Ass'n, 167 F. Supp. 799, 808-09 (D.D.C. 1958), *aff'd*, 362 U.S. 458 (1960); *In re* Occidental Petroleum Corp., 74 F.T.C. 1191 (1968).

Failing company defenses were rejected in the following cases: United States v. Greater Buffalo Press, Inc., 402 U.S. 549, 555-56 (1971); Citizen Publishing Co. v. United States, 394 U.S. 131, 138-39 (1969); United States v. Von's Grocery Co., 384 U.S. 270, Court decided *Citizen Publishing Co. v. United States*[28] in which it narrowed the defense by requiring an additional showing that there be no other "available purchaser" whose acquisition of, or merger with, the failing company would have a lesser anticompetitive effect.[29] This requirement, which concentrates on the com-

277-78 (1966); United States v. El Paso Gas Co., 376 U.S. 651 (1964); United States v. Philadelphia Nat'l Bank, 374 U.S. 321, 372 n.46 (1963); United States v. Diebold, Inc., 369 U.S. 654 (1962), *rev'g and remanding* 197 F. Supp. 902 (D.C. Ohio 1961); Golden Grain Macaroni Co. v. FTC, 472 F.2d 882, 887 (9th Cir. 1972); United States Steel Corp. v. FTC, 426 F.2d 592, 605-09 (6th Cir. 1970); Crown Zellerbach Corp. v. FTC, 296 F.2d 800, 831 (9th Cir. 1961); Erie Sand & Gravel Co. v. FTC, 291 F.2d 279, 280 (3d Cir. 1961); Heatransfer Corp. v. Volkswagenwerk A.G., 1975-1 Trade Cas. ¶ 60,309, at 66,221 (S.D. Tex. April 25, 1975), *appeal docketed*, No. 75-27-79 (5th Cir. July 7, 1975); United States v. American Technical Indus., Inc., 1974-1 Trade Cas. ¶ 74,873, at 95,874 (M.D. Pa.); United States v. Phillips Petroleum Co., 367 F. Supp. 1226, 1260 (C.D. Cal. 1973), *aff'd mem.*, 418 U.S. 906, *rehearing denied*, 419 U.S. 886 (1974); Calnetics Corp. v. Volkswagen of America, Inc., 348 F. Supp. 606, 622 (C.D. Cal. 1972); United States v. G. Heileman Brewing Co., 345 F. Supp. 117, 123 (E.D. Mich. 1972); Automated Bldg. Components, Inc. v. Trueline Truss Co., 318 F. Supp. 1252, 1261 (D. Ore. 1970); United States v. Pabst Brewing Co., 296 F. Supp. 994, 1003 (E.D. Wis. 1969); United States v. Reed Roller Bit Co., 274 F. Supp. 573, 584 (W.D. Okla. 1967); United States v. Third Nat'l Bank, 260 F. Supp. 869 (M.D. Tenn. 1966), *rev'd and remanded on other grounds*, 390 U.S. 171 (1968); United States v. Jos. Schlitz Brewing Co., 252 F. Supp. 129, 144 (N.D. Cal. 1966); United States v. Penzoil Co., 252 F. Supp. 962, 979 (W.D. Pa. 1965); *In re* Pillsbury Co., 57 F.T.C. 1274, 1410 (1960), *vacated and remanded on other grounds*, 354 F.2d 952 (5th Cir. 1966); *In re* Farm Journal, Inc., 53 F.T.C. 26, 31 (1956).

28. 394 U.S. 131 (1969).

29. *Id.* at 138. The Court explained that:

> The failing company doctrine plainly cannot be applied . . . unless it is established that the company that acquires the failing company . . . is the only available purchaser. For if another person or group could be interested, a unit in the competitive system would be preserved and not lost to monopoly power.

Id.; *accord*, United States v. General Dynamics Corp., 415 U.S. 486, 507 (1974)(dictum); United States v. Greater Buffalo Press, Inc., 402 U.S. 549, 555-56 (1971).

The requirement that there be "no other available purchaser" had its origins in International Shoe Co. v. FTC, 280 U.S. 291, 302 (1930), where the Court simply noted that there was "no other prospective purchaser." The requirement was first litigated, however, in United States v. Diebold, Inc., 369 U.S. 654 (1962), *rev'g and remanding* 197 F. Supp. 902 (S.D. Ohio 1961). In *Diebold* the district court granted summary judgment for the defendant because the acquired company had become "hopelessly insolvent and faced with imminent receivership [for nine months]." 197 F. Supp. 902, 906 (S.D. Ohio 1961). In reversing, the Supreme Court observed:

> In determining that the acquisition . . . was not a violation of § 7, the District Court acted upon its findings that "[the defendant] was the only bona fide prospective purchaser . . . ." [This] finding represents at least in part the resolution of a head-on factual controversy as revealed by the materials before the District Court of whether other offers . . . were actually made.

369 U.S. 654, 655 (1962), *quoting* 197 F. Supp. 902, 907 (S.D. Ohio 1961). The requirement voiced in *Diebold* that there be no other bona fide prospective purchaser was made explicit in *Citizen Publishing* where the Court required a specific evidentiary showing that there were unsuccessful efforts to sell to other purchasers. *See* Dooley, *supra* note 12. The Court

petitive effect of an acquisition or merger and directs the inquiry away from the acquired concern's financial difficulties, is now an accepted element of the defense. There must be some showing of an attempt to sell to another party: that other parties were "approached,"[30] that the properties were "put in the hands of a broker,"[31] or that there was at least an invitation for bids from other parties or an attempt to obtain other funding.[32] The requirement can be viewed as one of proof that no other less anticompetitive acquisition was possible and that the acquired and acquiring firms proceeded in good faith.[33] By focusing some attention on the competitive aspects of the acquisition, the requirement has substantially weakened the conceptual basis of the failing company doctrine as a per se affirmative defense.[34]

Citizen Publishing appeared to add another limitation on the

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in Citizen Publishing Co. v. United States, 394 U.S. 131, 138 (1968), stated:

> [N]o effort was made to sell the Citizen; its properties and franchise were not put in the hands of a broker; and the record is silent on what the market, if any, for the Citizen might have been.

The dissent in *Citizen Publishing* was critical of this narrow evidentiary requirement:

> [P]roof of unsuccessful efforts to sell the company is not, as a logical, evidentiary matter, the only possible conclusive proof that it was not marketable. In many cases other evidence might make equally clear that any such efforts would surely have been fruitless.

Id. at 143 (Stewart, J., dissenting). *See also* M. HANDLER, TWENTY-FIVE YEARS OF ANTITRUST 469, 471 (1973). Handler is critical of the requirement on the grounds that (1) there is little significance to whether other purchasers may be interested if the selling company is truly failing; and (2) there are serious practical difficulties in forcing the selling company to make the required investigations of other purchasers when bankruptcy is imminent.

30. United States v. Greater Buffalo Press, Inc., 402 U.S. 549, 556 (1971); *see* Golden Grain Macaroni Co. v. FTC, 472 F.2d 882, 887 (9th Cir. 1972), where the court stated:

> [The defendant] did prove that other companies looked at, but decided not to buy, [the failing company], but [the defendant] did not prove that the owners of [the failing company] had made any affirmative attempt to seek out other purchasers. Merely proving that some or all of the most logical purchasers have declined to buy is not enough to prove that the challenged purchaser was the only prospective purchaser. [Citation omitted.]

31. Citizen Publishing Co. v. United States, 394 U.S. 131, 138 (1969); Calnetics Corp. v. Volkswagen of America, Inc., 348 F. Supp. 606, 622 (C.D. Cal. 1972).

32. United States v. M.P.M., Inc., 397 F. Supp. 78, 101-02 (D. Colo. 1975).

33. *See* Dooley, *supra* note 12.

34. *Id.* Dooley views the requirement as being

> clearly inconsistent with the traditional per se defense view of the doctrine . . . . Although the Court in taking this position apparently indicated a strong bias for preserving competition, it failed to abolish entirely the per se defense concept; instead, the Court merely modified the concept by requiring proof of the lack of alternative purchasers before it becomes applicable.

Id. at 1445.

failing company doctrine. Justice Douglas, writing for the majority, indicated that the defense may not be established unless the defendant proves that the acquired company could not continue to operate under receivership or reorganization:[35]

> [T]he prospects of reorganization [under Chapter X or XI of the Bankruptcy Act] of Citizen in 1940 would have had to be dim or nonexistent to make the failing company doctrine applicable to this case.

This requirement has been specifically followed and applied in two lower court cases[36] and specifically rejected in another.[37] Other cases have simply ignored it.[38] The possible existence of a "third requirement"[39]—that prospects of reorganization of an acquired company must be "dim or nonexistent" before the defense can be invoked—raises serious questions concerning the underlying rationale of the defense and its future application. This article will examine those questions. The imposition of the "third requirement," as a necessary element, will be shown to be

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35. Citizen Publishing Co. v. United States, 394 U.S. 131, 138 (1969). *Citizen Publishing* involved the purchase of stock of one of the two daily newspapers of general circulation in Tucson, Arizona, by the shareholders of the other pursuant to an option in a 1940 joint operating agreement. *Id.* at 133-35. The district court found that the stock acquisition violated section 7 in that it had the proscribed effect of continuing in a more permanent manner the substantial lessening of competition that the joint operating agreement had established. United States v. Citizen Publishing Co., 280 F. Supp. 978, 984 (D. Ariz. 1968). The Supreme Court affirmed, rejecting a failing company defense because there was no evidence "that the joint operating agreement was the last straw," Citizen Publishing Co. v. United States, 394 U.S. 131, 137 (1969), or "[that the acquiring company was] the only available purchaser." *Id.* at 138.

36. United States Steel Corp. v. FTC, 426 F.2d 592, 608-09 (6th Cir. 1970), *final order* 1972 TRADE REG. REP. ¶20,139 (F.T.C. 1972); Heatransfer Corp. v. Volkswagenwerk A.G., 1975-1 Trade Cas. ¶60,309 (S.D. Tex. April 25, 1975), *appeal docketed*, No. 75-27-79 (5th Cir. July 7, 1975). Other cases have merely cited the language in *Citizen Publishing* without giving any special significance to it other than as a general indication of how narrow the defense should be. *See, e.g.*, United States v. Phillips Petroleum Co., 367 F. Supp. 1226, 1259 (C.D. Cal. 1973), *aff'd mem.*, 418 U.S. 906, *rehearing denied*, 419 U.S. 886 (1974). For a discussion of *Heatransfer* and *Phillips Petroleum* see note 46 *infra*.

37. United States v. M.P.M., Inc., 397 F. Supp. 78, 96 (D. Colo. 1975).

38. *See, e.g.*, United States v. General Dynamics Corp., 415 U.S. 486, 507 (1974); United States v. Greater Buffalo Press, Inc., 402 U.S. 549, 555-56 (1971); Golden Grain Macaroni Co. v. FTC, 472 F.2d 882, 887 (9th Cir. 1972); Granader v. Public Bank, 417 F.2d 75, 81 (6th Cir. 1969); United States v. American Technical Indus., Inc., 1974-1 Trade Cas. ¶74,873, at 95,874 (M.D. Pa.); Calnetics Corp. v. Volkswagen of America, Inc., 348 F. Supp. 606, 622 (C.D. Cal. 1972); *In re* Occidental Petroleum Corp., 74 F.T.C. 1191 (1968) (Elman & Jones, Comm'rs, dissenting).

39. "Dim or nonexistent prospects for reorganization" will be referred to as a *third requirement* for purposes of analysis, although the requirement could be considered simply a stricter test of business failure (the first requirement).

an aberration; "dim or nonexistent" prospects for reorganization are, at most, of limited relevance to the failing company doctrine.

CASES SUBSEQUENT TO CITIZEN PUBLISHING

United States Steel Corp. v. FTC[40] set forth the argument that *Citizen Publishing* established a third element essential to proof of the failing company defense. This Sixth Circuit case involved the forward vertical acquisition of the largest nonintegrated customer of portland cement in the New York metropolitan area by the area's largest nonintegrated supplier. The defendant supplier claimed that it was completely immunized by the failing company doctrine. The defendant established (1) that the acquired company was in imminent danger of bankruptcy; and (2) that the defendant was the only available purchaser. The court found this showing insufficient to establish the failing company defense. Relying on *Citizen Publishing*, it held that the defense required a showing that prospects for reorganization of the acquired firm were "dim or nonexistent,"[41] and explained:[42]

> This third requirement may be read as unnecessary to the Court's disposition of [*Citizen Publishing*]. It was, however, clearly intended by the Court to clarify the confines of the "present narrow scope" of the failing company doctrine.

The Sixth Circuit's decision was based on its finding that the requirement "was implicit in the holding of *International Shoe* [*v. FTC*],"[43] the leading case on the defense,[44] and that *Citizen Publishing* had "clarified this inference."[45] *United States Steel* is the only court of appeals case, thus far, to impose the third requirement on the defense.[46]

40. 426 F.2d 592 (6th Cir. 1970).

41. *Id.* at 608. The case was thereafter remanded to the Federal Trade Commission which found a violation of section 7. *In re* United States Steel Corp., 81 F.T.C. 652 (1972).

42. United States Steel Corp. v. FTC, 426 F.2d 592, 608 n.38 (6th Cir. 1970).

43. *Id.* at 608, *explaining* International Shoe v. FTC, 280 U.S. 291 (1930). For a discussion of *International Shoe* see notes 86-96 *infra* and accompanying text.

44. *See* notes 78-88 *infra* and accompanying text.

45. United States Steel Corp. v. FTC, 426 F.2d 592, 609 (6th Cir. 1970).

46. The requirement was also imposed in Heatransfer Corp. v. Volkswagenwerk A.G., 1975-1 Trade Cas. ¶60,309 (S.D. Tex. April 25, 1975), *appeal docketed*, No. 75-27-79, (5th Cir. July 7, 1975). The jury was instructed that: "You may not find that [the acquired company] faced the grave probability of a business failure *unless you find that the prospects of saving the company through re-organization in bankruptcy were dim or nonexistent*." Record at 6503 (emphasis added). The case presented a vertical merger where it was conceded that the acquired company was about to default on $1.3 million in outstanding bank notes. The disputed merger took place after two alternate purchasers

In *United States v. M.P.M., Inc.*,[47] the Colorado district court held that:[48]

> a § 7 defendant need not be required to show that reorganization prospects under the Bankruptcy Act were dim or nonexistent in order to discharge its burden as to the "failing company" defense.

The case involved M.P.M.'s acquisition of two formerly independent ready-mix concrete firms which were subsequently merged. The evidence left no doubt that one of the acquired companies was underfinanced and that its bankruptcy was imminent.[49] There was no indication in the record, however, that the company's financial difficulties could not be cured by a recapitalization or a suspension of its debt service.[50]

The case was decided on two apparently independent grounds. The court first determined that the merger "carrie[d] with it no threat of substantial[ly] lessen[ed] . . . competition in the ready-mix concrete market, nor [did] it tend to create a monopoly in the market."[51] The court then made a separate determination that:[52]

> Mobile was a "failing company." The officers of Mobile con-

reneged. The court nevertheless held that the defendants "failed to meet the high threshold requirements for a failing company defense. . . . [The acquired company] could have been saved . . . ." Heatransfer Corp. v. Volkswagenwerk A.G., 1975-1 Trade Cas. ¶60,309, at 66,221 (S.D. Tex. April 25, 1975), *appeal docketed*, No. 75-27-79 (5th Cir. July 7, 1975). The plaintiff was in the unhappy position of basing its damages on the allegation that the acquired company would have disappeared from the market if not for the acquisition which saved it. But for the acquisition, plaintiff would have acceded to a pro rata share, based on preacquisition market statistics, of the acquired company's business. The plaintiff maintained that the assumption of the acquired company's continuing decline did not conflict with the jury's determination that the failing company defense was not established by the defendants. It was plaintiff's position that although the acquired company *would* not have been saved, from a purely hypothetical standpoint it *could* have been saved through reorganization. *Id.* at 66,221.

There is dicta in United States v. Phillips Petroleum Co., 367 F. Supp. 1226, 1259 (C.D. Cal. 1973), *aff'd without opinion*, 418 U.S. 906, *rehearing denied*, 419 U.S. 886 (1974), indicating that the "third requirement" language of *Citizen Publishing* is important as an indication of how rigid the test for the defense is. The case was decided on the basis that the acquired firm was a "viable competitor-overall" since it had a net income of $192 million for the five years prior to the acquisition. *Id.* at 1260.

47. 397 F. Supp. 78 (D. Colo. 1975).

48. *Id.* at 96.

49. *Id.* at 100-01.

50. *Id.* at 96.

51. *Id.* at 94-95.

52. *Id.* at 102-03.

> ducted an earnest, wide-ranging, and good faith effort to locate potential investors or purchasers in order to maintain Mobile as a going concern. . . . Thus, we must find that . . . [M.P.M.] was the only prospective purchaser. When the finding is coupled with our conclusion that Mobile faced the grave probability of business failure, we must hold that the defendants in this case have fully satisfied the elements of the "failing company" defense.

The Colorado court would restrict the third requirement in *Citizen Publishing* to the circumstances of that case.[53] Noting that the defendant in *Citizen Publishing* did not offer any evidence to demonstrate that it was the only prospective purchaser,[54] the court reasoned that rather than prescribing a new element of the defense, *Citizen Publishing* "suggest[s] an alternative to the second prong (no other prospective purchaser) of the two-pronged test set forth in *International Shoe*"[55] and made explicit in *Citizen Publishing* itself. The essence of the *M.P.M., Inc.* argument is that even if it cannot be shown—by the type of evidence deemed necessary in *Citizen Publishing* and subsequent cases[56]—that there was no other available or prospective purchaser, the defense nevertheless can be established by a showing that the prospects for reorganization of the acquired company were "dim or nonexistent." It was viewed as simply another way to establish the defense. The court failed to explain the possible relationship between an alternate available purchaser and whether a company could successfully pass through bankruptcy. Arguably, a company facing imminent bankruptcy, with a rapidly approaching debt service, would not have the time to engage a broker or invite bids from prospective purchasers. A showing that chances for a successful reorganization were "dim or nonexistent" would indicate that had the time been available a solicitation of bids would have been unsuccessful because the company lacked any going concern value. Unfortunately, there is little in *Citizen Publishing* to lead one to the conclusion that that is what the majority had in mind.[57] *Citizen Publishing* required the fact

53. *Id.* at 96-97.

54. *See* Citizen Publishing Co. v. United States, 394 U.S. 131, 138 (1969) ("[T]he record is silent on what the market, if any, for the Citizen might have been.").

55. United States v. M.P.M., Inc., 397 F. Supp. 78, 97 (D. Colo. 1975); *cf.* E. KINTNER, PRIMER ON THE LAW OF MERGERS 96-97 (1973); Annot., 11 A.L.R. FED. 858, 872 (1972).

56. *See* notes 29-34 *supra* and accompanying text.

57. It is noteworthy in this regard that *Citizen Publishing* required dim or nonexistent

of "no other available purchaser" to be established by *direct* evidence—that other prospective purchasers were unsuccessfully "approached" or that the company was "put in the hands of a broker."[58] To allow *indirect* proof that there was "no other available purchaser" would circumvent that evidentiary requirement which was clearly announced in the case. In fact, the majority opinion in *Citizen Publishing* was criticized by the dissenting opinion of Justice Stewart for the very reason that its approach does not allow for alternate methods of proof.[59]

The district court in *M.P.M., Inc.* also stressed the fact that more recent Supreme Court cases "omit any reference to this ['dim reorganization prospects'] element."[60] These cases may indicate by way of omission that "dim or nonexistent" prospects for reorganization is not part of the failing company defense.

In *United States v. Greater Buffalo Press, Inc.*,[61] decided two years after *Citizen Publishing*, the Court held that the defense had not been established. Writing for a unanimous court, Mr. Justice Douglas stated:[62]

> The test is met only if two requirements are satisfied: (1) That the resources . . . were "so depleted and the prospect of rehabilitation so remote that it faced the grave probability of a business failure . . ." [citing *International Shoe*] and (2) that there was no other prospective purchaser for it [citing *Citizen Publishing*].

The company's profits had actually increased in the year of the acquisition; its expansion plans had been actively pursued and it was paying dividends to its owners.[63] In addition, although the acquiring firm's major competitor had declined to purchase the company, no other smaller competitor had ever been approached.[64] Therefore, the defendant failed to meet either of the two requirements. Because the company was not facing bankruptcy, the case could be considered to have been decided on the

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prospects for reorganization "to make the failing company doctrine applicable *to this case*." Citizen Publishing Co. v. United States, 394 U.S. 131, 138 (1969) (emphasis added).

58. *See* notes 29-34 *supra* and accompanying text.

59. Citizen Publishing Co. v. United States, 394 U.S. 131, 143 (1969) (Stewart, J., dissenting). *See also* note 29 *supra*.

60. United States v. M.P.M., Inc., 397 F. Supp. 78, 97 (D. Colo. 1975).

61. 402 U.S. 549 (1971).

62. *Id.* at 555.

63. *Id.*

64. *Id.* at 556.

basis of the first requirement alone.[65] As a result, the Court had no occasion to consider the likelihood of a reorganization if bankruptcy were to ensue. Thus, although the Court cited *Citizen Publishing* for the second requirement of no other available purchaser[66] and made no reference to any alternative method of proof or to a separate requirement that prospects for reorganization be "dim or nonexistent," the omission adds little to the argument either way.[67]

The most recent Supreme Court case to refer to the failing company doctrine is *United States v. General Dynamics Corp.*[68] In dictum, the Court restated the requirements for the defense.[69] Citing *International Shoe, Citizen Publishing*, and *Greater Buffalo Press*, the Court again made no mention of the third element of "dim or nonexistent" prospects for reorganization, but merely restated the two-pronged test[70] as had the Court in *Greater Buffalo Press*.[71] The case is, however, of importance to the failing company doctrine because of its significant departure from the previous approach to section 7 suits.

General Dynamics involved the horizontal merger of two coal producers, each of whom enjoyed a substantial share of a concentrated market. The Government's case revealed that a small number of leading producers accounted for the bulk of the coal business and that there had been a trend toward concentration in the industry. Mr. Justice Stewart, writing for the majority, conceded that the statistical showing established a prima facie case of illegality,[72] but found that "other pertinent factors affect-

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65. *Id.* at 555-56.

66. *Id.* at 555.

67. *Cf.* Heatransfer Corp. v. Volkswagenwerk A.G., 1975-1 Trade Cas. ¶60,309, at 66,221 (S.D. Tex. April 25, 1975), *appeal docketed*, No. 75-27-79 (5th Cir. July 7, 1975); United States v. Phillips Petroleum Co., 367 F. Supp. 1226, 1259 (C.D. Cal. 1973), *aff'd mem.*, 418 U.S. 906, *rehearing denied*, 419 U.S. 886 (1974). These cases, decided after *Greater Buffalo Press*, gave weight to the "third requirement." *See* note 46 *supra*.

68. 415 U.S. 486 (1974). For a more complete discussion of *General Dynamics* see Knapp, *General Dynamics, Mirage or Oasis?*, 26 MERCER L. REV. 577 (1975); Moyer, *United States v. General Dynamics Corp.: An Interpretation*, 20 ANTITRUST BULL. 1 (1975); Robinson, *Recent Antitrust Developments: 1974*, 75 COLUM. L. REV. 243 (1975); Williams, *Corporate Mergers and the Antitrust Laws*, 26 MERCER L. REV. 963 (1975); Comment, *Competition, Competitors, and the Political Limits of the Supreme Court's Clayton § 7 Policy*, 50 NOTRE DAME LAW. 693 (1975); 24 DRAKE L. REV. 223 (1974); 53 N.C.L. REV. 535 (1975); 27 U. FLA. L. REV. 281 (1974); 27 VAND. L. REV. 1279 (1974).

69. United States v. General Dynamics Corp., 415 U.S. 486, 507 (1974).

70. *Id.*

71. *See* note 62 *supra* and accompanying text.

72. United States v. General Dynamics Corp., 415 U.S. 486, 496-98, 508 (1974).

ing the coal industry and the business of appellees mandated a conclusion that no substantial lessening of competition occurred or was threatened by the acquisition . . . ."[73] The acquired coal company's reserves were tied up under long-term requirements contracts so that although the company was financially healthy its available reserves were low and it was not in a position to increase them.[74] As a result the Court determined that the acquired company could not compete effectively for the long-term contracts[75] which were the prevalent means of competition in the industry. Thus, the company was a far less significant factor in the coal producing market than the production statistics indicated.[76]

The Government argued that reliance on the fact of depleted and committed resources was essentially the assertion of a failing company defense which, under the circumstances, did not meet the defense's strict requirements. The majority rebuffed this contention:[77]

> The appellees' demonstration of United's weak reserves position, however, proved an entirely different point. . . . [T]he finding of inadequate reserves went to the heart of the Government's statistical prima facie case . . . . The failing-company defense is simply inappropriate to this finding and the failure of appellees to meet the prerequisites of that doctrine did not detract from the validity of the court's analysis.

Justice Stewart seized this opportunity to comment on the ill-defined doctrine:[78]

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73. *Id.* at 498.

74. *Id.* at 502-03.

75. *Id.* at 508.

76. *Id.* at 503. The case is the first to take advantage of the rebuttable presumption expressed in United States v. Philadelphia Nat'l Bank, 374 U.S. 321 (1963):

> [A] merger which produces a firm controlling an undue percentage share of the relevant market, and results in a significant increase in the concentration of firms in that market, is so inherently likely to lessen competition substantially that it must be enjoined *in the absence* of evidence clearly showing that the merger is not likely to have such anticompetitive effects.

Id. at 363 (emphasis added). Justice Brennan significantly expanded the formulation in a footnote. "[I]f concentration is already great, the importance of preventing even slight increases in concentration and so preserving the possibility of eventual deconcentration is correspondingly great." *Id.* at 365 n.42; *accord*, United States v. Continental Can Co., 378 U.S. 441, 461-62 (1964); United States v. Aluminum Co. of America, 377 U.S. 271, 279 (1964).

77. United States v. General Dynamics Corp., 415 U.S. 486, 508 (1974).

78. *Id.* at 507, *quoting* International Shoe Co. v. FTC, 280 U.S. 291, 302 (1930). It is interesting to note that Justice Stewart's "balancing" test would involve the Court in a

> The failing-company defense presupposes that the effect on competition and the "loss to [the company's] stockholders and injury to the communities where its plants were operated," [citation omitted], will be less if a company continues to exist even as a party to a merger than if it disappears entirely from the market. It is, in a sense, a "lesser of two evils" approach, in which the possible threat to competition resulting from an acquisition is deemed preferable to the adverse impact on competition and other losses if the company goes out of business.

General Dynamics appears to be broader than its facts. The Court may be more willing in the future to go beyond the statistical case presented by the Government and consider the future competitive posture of the acquired company in relation to the industry's structure in order to determine effects on competition.[79] By distinguishing that inquiry from a failing company situation, the Court may have made the strict requirements of the failing company doctrine irrelevant.[80] At least one commentator[81] has suggested that the strict requirements of the defense may never be reached under the approach taken in *General Dynamics* since a violation under section 7 could not be established when the acquired firm is in a failing condition and would therefore have an insubstantial effect on future competition. The validity of this analysis depends upon the strength of the underlying

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"rule of reason" approach that the provisions of section 7 were designed to abolish. A similar "balancing" was advocated in *In re* United States Steel Corp., 74 F.T.C. 1270 (1968), *rev'd and remanded*, 426 F.2d 592 (6th Cir. 1970). In that case, the hearing examiner found the acquisition exempted from section 7 because the acquired corporation was in a failing condition. *Id.* at 1275. The Commission, while affirming the examiner's findings, ruled that section 7 proscribed the merger. *Id.* The Commission held that proof of a company's failing condition does not automatically immunize a transaction. There are still anticompetitive effects from the merger which must be balanced against potential adverse effects on the failing company's stockholders, creditors, and employees and on the community in which the company is located. *Id.* at 1280-88. This is a balancing of factors very similar to that suggested in *General Dynamics*. The Supreme Court, however, is likely to weigh the factors differently. *See* notes 157-64 *infra* and the accompanying text.

79. *See* Robinson, *supra* note 68, at 253. *See generally* Knapp, *General Dynamics, Mirage or Oasis?*, 26 MERCER L. REV. 577 (1975); 53 N.C.L. REV. 535 (1975); 27 U. FLA. L. REV. 281 (1974).

80. *See* Robinson, *supra* note 68, at 251 (for a discussion of Robinson's argument see note 158 *infra* and accompanying text). *But see* notes 158-64 *infra* and accompanying text.

The dissent in *General Dynamics* attacked the majority's emphasis on the weakness of the acquired company as a future competitor when the failing company defense had admittedly not been satisfied. *See* United States v. General Dynamics Corp., 415 U.S. 486, 522-23 (1974) (Douglas, J., dissenting).

81. Robinson, *supra* note 68, at 251 (arguing that under Justice Stewart's approach the failing company doctrine "might well become a piece of excess baggage").

premise: that such an acquisition cannot have significant anticompetitive effects.

Justice Stewart did not give any indication that *Citizen Publishing* had established a new requirement for the defense. In fact, the Court's somewhat liberal approach to section 7 indicates that it would not wish to narrow the defense any further than it already has. Thus, although not a failing company case, *General Dynamics* may have a significant impact on the future of the doctrine.

The cases following *Citizen Publishing* indicate that the confusion of the courts in dealing with the failing company doctrine results from the lack of a clearly articulated policy governing its elements.[82] There is a substantial split of opinion over whether it should be a per se affirmative defense or merely one factor in the overall determination of probable anticompetitive effect.[83] Underlying this conceptual controversy is a split concerning the doctrine's economic rationale. It has been justified purely on the theory that competition cannot be lessened to any appreciable degree when a competitor acquires a company which will disappear from the market in any event, and alternatively on the basis of benefit to the failing concern, its stockholders, creditors, and other interested parties.[84] A critical examination of these justifications is necessary in order to determine the proper role of the failing company doctrine in a section 7 suit.

If it is presumed that the acquisition of a firm about to leave the market cannot generate anticompetitive effects, the actual anticompetitive consequences of an acquisition will be disregarded and the doctrine will be given a per se application, stressing the strict requirements which arguably maintain the validity and narrow scope of the presumption. As the presumption is recognized as increasingly rebuttable, the doctrine will focus to a greater extent on the actual anticompetitive consequences—thus bearing directly on the Government's prima facie case.

82. *See* Low, *The Failing Company Doctrine: An Illusive Economic Defense Under Section 7 of the Clayton Act*, 35 FORDHAM L. REV. 425, 430 (1967).

83. *See* Bok, *Section 7 of the Clayton Act and the Merging of Law and Economics*, 74 HARV. L. REV. 227, 339-47 (1960); Dooley, *supra* note 12; Low, *supra* note 82. *See also* Connor, *Section 7 of the Clayton Act: The "Failing Company" Myth*, 49 GEO. L.J. 84 (1960) (arguing that financial difficulties are relevant only to the substantive determination); von Kalinowski, *Section 7 and Competitive Effects*, 48 VA. L. REV. 827, 841 (1962) (maintaining that failing conditions only "negate" the showing of anticompetitive consequences).

84. *See* notes 116-30 *infra* and accompanying text.

Judicial concern for the interests tied to a failing company, if so great as to be dispositive, will also make the doctrine a per se defense. If the judicial concern is not dispositive, then the competitive consequences of the acquisition should be considered in determining what weight is given to that concern. The doctrine, however, would not bear directly on the Government's prima facie case. The end product would be a balancing along the lines suggested by Justice Stewart in *General Dynamics*.[85] Before defining a failing company, however—in terms of "dim or nonexistent prospects for reorganization," "actual insolvency," "imminent bankruptcy," or another standard—a court must decide the policy and purpose of the doctrine. The inquiry should begin with a study of the doctrines origins.

INTERNATIONAL SHOE CO. V. FTC AND THE ORIGINS OF THE FAILING COMPANY DOCTRINE

In the leading case, *International Shoe Co. v. FTC*,[86] the stock of W. H. McElwain Company, a shoe manufacturer experiencing extreme financial difficulties, was acquired by International Shoe Company, a firm in excellent financial condition.[87] The Supreme Court held that the acquisition did not violate section 7.[88] The Court set forth two grounds for its decision. First, since the companies were not competitors, the acquisition could not substantially lessen competition within the meaning of the statute then in effect.[89] Second, the Court decided that

85. *See* note 78 *supra* and accompanying text.

86. 280 U.S. 291 (1930). *International Shoe* was the first Supreme Court case to rule on the failing company doctrine. It remains the only Supreme Court case to apply the doctrine in a defendant's favor. The merger involved was a result of the recession following the First World War. Justices Stone, Holmes, and Brandeis dissented on the ground that application of the failing company doctrine was mistaken, because they believed that the company was on the road to recovery at the time of the acquisition, and because there was no reason to believe that the company could not have been successfully rehabilitated through a receivership. *Id.* at 306 (Stone, J., dissenting). *See also* note 96 *infra* and accompanying text.

87. For a more detailed discussion of the facts of *International Shoe*, see Connor, *supra* note 83, at 85-90; Comment, *Federal Antitrust Law—Mergers—An Updating of the Failing Company Doctrine in the Amended Section 7 Setting*, 61 MICH. L. REV. 566, 569-71 (1963).

88. International Shoe Co. v. FTC, 280 U.S. 291, 302-03 (1930).

89. *Id.* at 299. Section 7 of the Clayton Act, before it was expanded by amendment in 1950, forbid any acquisition of the *stock* of one competitor by another where the effect might be to substantially lessen competition *between the two corporations*. Clayton Act § 7, ch. 323, § 7, 38 Stat. 731 (1914), *as amended*, 15 U.S.C. § 18 (1974); *see* G. HENDERSON, THE FEDERAL TRADE COMMISSION: A STUDY IN ADMINISTRATIVE LAW AND PROCEDURE 36

section 7 is not applicable when the acquired company is in a failing condition. In a widely quoted passage the Court stated:[90]

> 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 trade within the intent of the Clayton Act. To regard such a transaction as a violation of law, as this Court suggested in *United States* v. *U.S. Steel Corp.* . . . would "seem a distempered view of purchase and result."

International Shoe offers strong support for each of two broad propositions. The first is that it may be presumed that the acquisition of a failing company by a competitor does not substantially lessen competition or restrain trade within the intent of the Clayton Act. The second is that the defense is designed to afford the shareholders, creditors, and personnel of a failing corporation an opportunity to avoid the consequences of a grave situation. The two requirements outlined in *International Shoe*— (1) resources so depleted and the prospect of rehabilitation so remote that the company faced the grave probability of business failure and (2) no other prospective purchaser—although imprecisely drawn, remained the standard for the failing company defense for about 40 years until *Citizen Publishing* was decided.[91]

(1924). The Court held that, because of differences in appearances and workmanship, the products of the two shoe manufacturers appealed to the tastes of entirely different classes of consumers and that, while a portion of the product of each company went into the same states, generally the product of each was in fact sold to different classes of dealers and found its way into distinctly separate markets. Therefore, with respect to 95 percent of the business there was no competition between the companies. Such competition as there was or might have been was of too slight a consequence to support a finding of substantial competition between the two companies. International Shoe Co. v. FTC, 280 U.S. 291, 296, 298 (1930). *But see id.* at 303-06 (Stone, Holmes, Brandeis, J.J., dissenting) (taking exception to the Court's analysis of what constitutes competition).

90. International Shoe Co. v. FTC, 280 U.S. 291, 302-03 (1930), *quoting* United States v. United States Steel Corp., 251 U.S. 417, 446-47 (1920).

91. In the 39 year interval between *International Shoe* and *Citizen Publishing* the Supreme Court decided the landmark case of Brown Shoe Co. v. United States, 370 U.S.

International Shoe is a case that can be all things to all people. One section of the opinion emphasizes the need to protect the interests of the personnel and shareholders of the corporation and of the communities likely to be affected,[92] while another sec-

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294 (1962). In *Brown Shoe* Chief Justice Warren reviewed the legislative history of section 7 (*id.* at 311-23) and noted that "supporters of the [1950] amendments indicated that [the amendments] would not impede, for example, a merger between . . . a corporation which is financially healthy and a failing one which no longer can be a vital competitive factor in the market." *Id.* at 319. After condemning the merger as tending to unduly increase concentration in the industry, Chief Justice Warren alluded to the failing company doctrine:

> At the same time appellant has presented no mitigating factors, such as the business failure or the inadequate resources of one of the parties that may have prevented it from maintaining its competitive position, nor a demonstrated need for combination to enable small companies to enter into a more meaningful competition with those dominating the relevant markets [sometimes referred to as the "against giants" defense].

Id. at 346. Inadequate resources was a critical consideration in United States v. General Dynamics Corp., 415 U.S. 486 (1974). *See* notes 68-77 *supra* and notes 157-67 *infra* and accompanying texts. The *General Dynamics* Court, however, made a definite distinction between inadequate resources and business failure, a distinction which was crucial to the decision of the case. *See* notes 75-77 *supra* and notes 157-64 *infra* and accompanying texts. *Brown Shoe*, on the other hand, appeared to equate the two. The opinion in *Brown Shoe* is unclear concerning whether a business failure should be viewed as "mitigating" the effect of the acquisition on competition (an approach similar to the one taken by the Court in *General Dynamics* with respect to the inadequate resources of the acquired company), or as "mitigating" an established violation under section 7 (an approach consistent with a per se application of the defense). What all this means for the future of the defense is as yet unclear. *See* notes 161-76 *infra* and accompanying text.

In United States v. Von's Grocery Co., 384 U.S. 270 (1966) the Court again mentioned the failing company defense in passing: "This merger cannot be defended on the ground that one of the companies was about to fail or that the two had to merge to save themselves from destruction by some larger and more powerful competitor." *Id.* at 277. The case involved a large retail grocery chain's acquisition of its direct competitor. After hearing evidence, the district court concluded as a matter of law that there was no reasonable probability that the merger would tend to substantially lessen competition or create a monopoly in violation of section 7 since the resulting firm would occupy only 7.5 percent of the market. United States v. Von's Grocery Co., 233 F. Supp. 976 (C.D. Cal. 1964). The Supreme Court reversed in a decision marked by a somewhat arbitrary statistical analysis through which the Court concluded that there was a trend toward concentration in the industry. *See* United States v. Von's Grocery Co., 384 U.S. 270, 281 (1966) (Stewart & Harlan, J.J., dissenting). Professor Low views the case as effectively destroying the "against giants" defense, alluded to in *Brown Shoe*, and leaving the failing company doctrine as "the only undisputed section 7 defense other than the 'investment exception' specifically included in the act itself." Low, *supra* note 82, at 426. The purely statistical approach taken by the Court in *Von's Grocery* appears to have been effectively rejected in *General Dynamics*. *See* Robinson, *supra* note 68, at 244-45. If the Court has truly changed its approach to section 7 suits then Low's predictions may have been prematurely made. Under the rationale of *General Dynamics* weight should be given to nonstatistical evidence supporting an "against giants" defense.

92. International Shoe Co. v. FTC, 280 U.S. 291, 301 (1930). "The transaction took

tion suggests that due regard must be given to the discretion of the board of directors to choose between the alternatives of a possible bankruptcy and an outright sale.[93] There are portions of the opinion that concentrate on the necessity of a liquidation or an outright sale[94] and can be taken to support the argument that *Citizen Publishing*'s requirement that prospects for reorganization be "dim or nonexistent" was implicit in *International Shoe*. It is unlikely, however, that the Court intended this. In fact, there is a great deal of evidence that the issue was before the Court and that such a standard was rejected as too speculative.[95] One of the principal grounds for the dissent focused

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the form of a sale of stock instead of assets. . . . because by that means the personnel and organization of the McElwain factories could be retained, which . . . was regarded as vitally important." The Court characterized the defense as avoiding "loss to stockholders and injury to the communities where its plants were operated . . . ." *Id.* at 302.

93. *Id.* at 302. The Court noted:

> As between these and all other alternatives, and the alternative of a sale such as was made, the officers, stockholders and creditors, thoroughly familiar with the factors of a critical situation and more able than the commission or the court to foresee future contingencies, after much consideration, felt compelled to choose the latter alternative. There is no reason to doubt that in so doing they exercised a judgment which was both honest and well informed; and if aid be needed to fortify their conclusion, it may be found in the familiar presumption of rightness which attaches to human conduct in general.

Id.

94. *Id.* at 299-302. The Court noted that the officers of McElwain reasonably concluded "that the company was faced with financial ruin, and that the only alternatives presented were liquidation through a receiver or an outright sale." *Id.* at 299. The Court noted further that "the company had reached the point where it could no longer pay its debts as they became due. . . . [I]ts annual financial statement . . . would disclose a condition of insolvency . . . and thus bring the company to the point of involuntary liquidation." *Id.* at 300. These portions of the opinion appear to support that aspect of Citizen Publishing Co. v. United States, 394 U.S. 131, 138 (1969), which requires a finding that prospects for reorganization be "dim or nonexistent."

95. The Federal Trade Commission argued that proof that the company could not successfully pass through receivership was "essential" to an application of the defense:

> Petitioner does not contend, and there is nothing in the record to show, that the McElwain properties would have been more valuable if dismantled than if operated so that a receiver appointed to conserve the assets for the benefit of creditors and stockholders would have disbanded the organization and permanently closed down plants. Such proof, however, is essential to a showing that the financial difficulties would have terminated competition between the companies.
>
> It is a matter of common knowledge that many large and successful industrial concerns, as well as numerous railroads, have at one time or another passed through receiverships.

Brief for the Federal Trade Commission at 23-24, International Shoe Co. v. FTC, 280 U.S 291 (1930). The petitioner argued in turn against the application of this standard:

> [I]t is submitted that the true test was solely one of commercial and financial

on precisely this point:[96]

> Nor am I able to say that the McElwain Company . . . was then in such financial straits as to preclude the reasonable inference . . . that its business, conducted either through a receivership or a reorganized company, would probably continue to compete . . . . [Citation omitted.] It plainly had large value as a going concern, there was no evidence that it would have been worth more or as much if dismantled . . . .

The dissent would apparently have limited the doctrine to companies that have little if any residual going concern value, that is, those without reasonable prospects for reorganization. In contrast, the majority's approach did not focus on the likelihood of a successful reorganization, but on the probability that such proceedings would be commenced. When the Court referred to "the prospect of rehabilitation" as "remote," it was referring to rehabilitation prior to bankruptcy.

Cases Preceding International Shoe

The Supreme Court's decision in *International Shoe* has been called the "seminal" case on,[97] and the "genesis" of,[98] the failing company doctrine. Reliance solely on *International Shoe* has done as much to blur as to clarify the policies underlying the doctrine. Reference to the case law preceding *International Shoe*—the doctrine appeared as early as 1910[99]—reveals that it

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> capacity to survive the embarrassments which confronted the corporation and its management.

Id. at 45-46. The Court rejected the Commission's argument:

> It was suggested by the court below, and also here in argument, that instead of an outright sale, any one of several alternatives might have been adopted which would have saved the property and preserved competition; but, as it seems to us, all of these may be dismissed as lying wholly within the realm of speculation. . . . It might have availed itself of a receivership, but no one is wise enough to predict with any degree of certainty whether such a course would have meant ultimate recovery or final and complete collapse. If it had proceeded, or been proceeded against, under the Bankruptcy Act, holders of the preferred stock might have paid or assumed the debts and gone forward with the business; or they might have considered it more prudent to accept whatever could be salvaged from the wreck and abandon the enterprise as a bad risk.

International Shoe Co. v. FTC, *supra* at 301-02.

96. International Shoe Co. v. FTC, 280 U.S. 291, 306 (1930) (Stone, Holmes, Brandeis, J.J., dissenting).

97. 16B Business Organizations, J. VON KALINOWSKI, ANTITRUST LAWS AND TRADE REGULATION § 19.03(1)(b) (1971).

98. *See, e.g.*, Dooley, *supra* note 12, at 1438.

99. Northwestern Consol. Milling Co. v. William Callam & Son, 177 F. 786 (E.D.

was not the genesis of the doctrine, but rather the leading case which was a culmination of several earlier cases. A thorough analysis of the earlier cases, especially those specifically relied upon in *International Shoe,* clarifies the policies expressed in that case.

In *American Press Association v. United States,*[100] the Court of Appeals for the Seventh Circuit granted a petition (for modification of a consent decree under the Sherman Act) to permit the sale of a printing plant to the company's only competitor. This was the first appellate opinion in which the failing company defense was recognized and the first to specifically rely upon it.[101]

Mich. 1910). This case contained the first reference to the concept of a failing company. The defendant claimed that the plaintiff's flour milling company, a consolidation, had been organized as a monopolistic combination in violation of the Sherman Act, Michigan statutes, and the common law. *Id.* at 788. The facts indicate that the plaintiff attempted to overcome the defendant's argument by showing that three of the companies consolidated were in a failing condition when acquired. The court disposed of the question as irrelevant. *Id.*; *accord,* United States v. Quaker Oats Co., 232 F. 499, 503 (N.D. Ill. 1916) (Mack, J., concurring), *appeal dismissed on motion,* 253 U.S. 499 (1920). The court in *Quaker Oats* stated:

> While on the facts presented it seems clear that the Quaker Oats did not go out with any intent to destroy Great Western [the acquired company], to buy it off, and while it seems clear that the Great Western was anxious to sell out because of its actual insolvent condition, I do not think that that affects the question, either under section 1, or under the monopolization clause of section 2.

Id. The issue was not central to the case because the decision actually turned on the Government's inability to sustain its burden of proof that a monopoly had been established in the manufacture and sale of the products involved. *Id.* at 504.

United States v. International Harvester Co., 214 F. 987 (D. Minn. 1914), *appeal dismissed on motion,* 248 U.S. 587 (1918), was the second case to consider the failing company concept. In dicta, the court recognized the possibility of the defense:

> Suppression of competition, where the parties to a combination control a large portion of the interstate or foreign commerce in the article, and where there is no *obligation* to form the combination arising out of the fact that the parties to the same are losing money, or the like, has been held an undue restraint of trade.

Id. at 998 (emphasis added).

The failing company concept was also considered prior to *International Shoe* in cases decided under state law, *see* Lumbermen's Trust Co. v. Title Ins. & Inv. Co., 248 F. 212 (9th Cir. 1918). The court, sitting in diversity, denied a defense, based on antimonopoly provisions of state law, on the grounds that the acquired companies all faced losses and possible insolvency. *See also* City Ice Co. v. Easton Merchants' Ice Co., 267 Pa. 500, 504-06, 110 A. 350, 351-52 (1920), where the failing company concept was used to reject a defense of monopoly through merger in a suit for specific performance of a contract to purchase.

100. 245 F. 91 (7th Cir. 1917).

101. *American Press* is historically significant for several additional reasons. It was cited and relied upon in International Shoe v. FTC, 280 U.S. 291, 303 (1930). Twenty-five years after the decision it was reaffirmed in Beegle v. Thomson, 138 F.2d 875, 881 (7th Cir. 1943), *cert. denied,* 322 U.S. 743 (1944), one of the few cases to uphold and apply

The American Company could not conduct its operations without loss, had little going concern value, and was about to go out of business. The court found that its sale would be advantageous to, and would not injure, the public.[102] The Seventh Circuit reasoned:[103]

> [T]he American Company [the acquired company] is forced to go out of the plate business. No decree can stop that. And after the American Company quits, if the Western is left alone in the field, the ultimate situation of the country newspapers would be the same whether the plant be scrapped or sold as an integer. Neither the decree nor, in our judgment, the Sherman Law, prevents the Western from buying the scraps piecemeal. If it did buy, it could organize them anew. If it be permitted to buy the integer, it would save the expense of reorganization. If the plant be scrapped, two injuries result: One to the public from the destruction of a usable and useful plant; the other to the stockholders of the American Company.

Thus, the court took a position closely analogous to the imposition of the "third requirement" announced in *Citizen Publishing*. The American Company was headed toward inevitable dismemberment and liquidation. The court concluded that the ultimate

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the doctrine as a per se affirmative defense. *See* note 118 *infra*. Four years after that, in House subcommittee hearings considering amendments to sections 7 and 11 of the Clayton Act, the case was mentioned with approval in a letter-memorandum written by W. T. Kelly, then Chief Counsel to the Federal Trade Commission. *Hearings on H.R. 515 Before a Subcomm. of the House Comm. on the Judiciary*, 80th Cong., 1st Sess. 10-11 (1947). Senator Kefauver, the sponsor of the bill eventually enacted, introduced the letter-memorandum in support of his position that the sponsored amendments would not apply to companies in a failing or bankrupt condition. The memorandum refers to *American Press Association* as "authority that an acquisition of a corporation, not yet insolvent, does not violate the Sherman Act if business cannot continue without a loss." *Id.* at 11. In conclusion it stated that

> it follows that the latter type of purchase of stock or assets would be held not to violate Section 7 of the Clayton Act as now proposed to be amended . . . . The bill incorporates no amendment which would make the authorities above cited inapplicable as precedents.

Id. at 11. H.R. 515 eventually became H.R. 3736, on which a House subcommittee report, H.R. REP. No. 596, 80th Cong., 1st Sess. (1947), was written later in the year. These were the forerunners of the 1950 amendments to the Clayton Act.

102. American Press Ass'n v. United States, 245 F. 91, 93-94 (7th Cir. 1917). The Seventh Circuit granted the modification on the ground that the Association was losing about $3,000 per month and there could be no violation of the antitrust laws when the acquired firm was in such a failing condition. "[Antitrust law] does not require the stockholders of a company . . . to sustain a loss . . . if that loss can be prevented . . . ." *Id.* at 94.

103. *Id.* at 93.

competitive situation would be the same whether the company was scrapped or sold to its competitor before liquidation and considered this fact dispositive. The court's position—that there are no anticompetitive effects from sale of the integer when liquidation is inevitable—underlies a "third requirement" approach. "Dim or nonexistent" prospects for reorganization supplies a degree of certainty that the failing company would have been liquidated. While *American Press* also expressed some concern with the ability of the owners of the failing company to avoid economic injury, this concern was limited to the injury following an inevitable liquidation—injury which would to a substantial certainty occur if a sale were not permitted. The likelihood of such injury is directly dependent upon the likelihood of liquidation itself; thus, the court's concern for the company's owners played a subsidiary role in the decision.

United States v. United States Steel Corp.[104] held that certain acquisitions by the defendant did not create a monopoly in violation of section 2 of the Sherman Act. United States Steel Corporation was a holding company formed by the acquisition of 180 operating companies. The district court dismissed the suit on various grounds which were not related to the failing company doctrine.[105] In affirming, the Supreme Court did not rely specifically on a failing company doctrine, but was "unable to see that the public interest [would] be served by yielding to the contention of the Government respecting the dissolution of the company . . . ."[106] In a general discussion the Supreme Court recognized the existence of the defense for the first time.[107] The

104. 251 U.S. 417 (1920).

105. United States v. United States Steel Corp., 223 F. 55 (D.N.J. 1915), *aff'd*, 251 U.S. 417 (1920).

106. United States v. United States Steel Corp., 251 U.S. 417, 457 (1920).

107. *Id.* at 446-47. The Court stated:

> And he testified he was not deceived and that he believed that "the Tennessee Coal and Iron people had a property which was almost worthless in their hands, nearly worthless to them, nearly worthless to the communities in which it was situated, and entirely worthless to any financial institution that had the securities the minute that any panic came, and that *the only way to give value to it was to put it in the hands of people whose possession of it would be a guarantee that there was value to it.*" Such being the emergency it seems like an extreme accusation to say that the Corporation which relieved it, and, perhaps, rescued the company and the communities dependent upon it from disaster, was urged by unworthy motives. Did illegality attach afterwards and how? And what was the Corporation to do with the property? Let it decay in desuetude or develop its capabilities and resources? In the development, of course, there would be

Court's discussion indicates a concern not only for the seller of the failing business, but also for the communities dependent upon the business—its employees and the local commerce. This policy is reflected in *International Shoe* which quoted from and relied upon *United States Steel Corp.*[108]

The failing company doctrine, which has become associated primarily with actions under section 7 of the Clayton Act, was not directly referred to in a section 7 suit until *Aluminum Co. of America v. FTC*[109] was decided in 1922. In that case, the Third Circuit did not consider the failing condition of the acquired company relevant to a section 7 suit.[110] The dissent, however, argued in favor of permitting the merger based on the fact that the company would have failed but for the defendant's acquisition of it.[111] In a later case the Third Circuit permitted the same merger on the ground that the acquired company could not otherwise pay its substantial accumulated debts.[112] The court held that section 7 did not prohibit the defendant, although a former violator of section 7, from acquiring the property of the competing corporation by "proceeding in any manner provided by law for the collection [of a debt not shown to have been fraudulently contracted]."[113] Since it was the defendant to whom the substantial sums were owed, the acquisition was akin to foreclosure by a creditor. The court asked: "Does the Clayton Act . . . nullify other laws and deprive such a creditor of the right to resort to them?"[114] It found nothing to indicate that the Act should have that effect. Thus, in the first case in which a court dealt with the failing company doctrine in a section 7 context, the rationale for the decision was the protection of creditors' rights. This view is not very different from the one expressed in *American Press*

> profit to the Corporation, but there would be profit as well to the world. . . . [I]t would seem a distempered view of purchase and result to regard them as violations of law.

Id. (emphasis added).

108. International Shoe Co. v. FTC, 280 U.S. 291, 303 (1930). *See also* note 90 *supra* and accompanying text.

109. 284 F. 401 (3d Cir. 1922), *cert. denied*, 261 U.S. 616 (1923).

110. *Id.* at 408.

111. *Id.* at 410 (Buffington, J., dissenting).

112. Aluminum Co. of America v. FTC, 299 F. 361, 365 (3d Cir. 1924). This decision was cited with approval in the letter-memorandum written by W. T. Kelly, Chief Counsel to the Federal Trade Commission, and introduced at the House hearings on the amendment of section 7. *Hearings on H.R. 515, supra* note 101, at 10-11.

113. Aluminum Co. of America v. FTC, 299 F. 361, 365 (3d Cir. 1924).

114. *Id.*

where the Seventh Circuit found a close relationship between the equitable remedies available in a bankruptcy proceeding and in a sale prior to bankruptcy.[115] While *Aluminum Co. of America* presents the somewhat unique circumstance of an acquiring firm which is also the major creditor of the failing company, logically the absence of this particular circumstance should not affect the creditors' rights. It certainly does not affect the creditors' expectations of receiving additional value from their investment by the sale of the company as a going concern prior to bankruptcy.

In determining the true scope of the failing company doctrine, it is important to bear in mind that the defense was not invented in *International Shoe*. The major policy in the earlier cases appears to have been protection of creditors' interests in the failing concern—a purchase being the only way to give value to the creditors' investment. These cases can be said to view the sale of such a company as an extension of equity's power to liquidate a bankrupt concern, which is a power immune to the antitrust laws. Most of the cases viewed acquisition of the failing concern as only one step prior to a liquidation or scrap sale. In this respect there is support in those cases for a requirement that prospects for reorganization of the acquired company be "dim or nonexistent." There would be no harm in allowing the interests tied to a failing concern to realize whatever going concern value was present in the integer, rather than dissipating this value in a bankruptcy sale. This analysis is based on a belief that there could be no public harm if the company were to leave the "field" in any case. If this is also the basis of *International Shoe* then its approach is internally consistent: the Court's concern with a failing company's creditors, stockholders, and the surrounding community is to allow those interests to profit by a prebankruptcy sale without risk of injury to the public. In fact, the public is benefited by the avoidance of a wasteful equitable proceeding. The underlying premise, hinted at in *International Shoe*, is that a concern which is forced out of the market can no longer have an effect upon it, and hence, its acquisition by a competitor can have no anticompetitive consequences. The requirement that prospects for reorganization be "dim or nonexistent" serves the purpose of determining to a substantial certainty that the company could never again surface as a going concern. Whether this

115. *See* note 103 *supra* and accompanying text.

inquiry is relevant depends upon the strength of the underlying premise.

THE DOCTRINE'S ECONOMIC JUSTIFICATION

The economic rationale of the failing company doctrine, as first formulated, was that because the failing company would shortly be unable to compete, its sale to a competitor could not result in a substantial lessening of competition.[116] Thus the interests tied to the concern could reap whatever value remained through a sale whose prohibition would have resulted in a wasteful withdrawal of the failing company's intact assets from the market.[117] The uncritical acceptance of the doctrine so formulated

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116. *See* International Shoe Co. v. FTC, 280 U.S. 291, 302 (1930); American Press Ass'n v. United States, 245 F. 91, 93 (7th Cir. 1917); von Kalinowski, *Section 7 and Competitive Effects*, 48 VA. L. REV. 827, 841 (1962) ("It can hardly be said that the acquisition of a company in financial distress could have any detrimental competitive effect."); Comment, *"Substantially to Lessen Competition . . .": Current Problems of Horizontal Mergers*, 68 YALE L.J. 1627, 1662-63 (1959); *cf.* Connor, *supra* note 83, at 87, 90; Dooley, *supra* note 12, at 1439; Low, *supra* note 82, at 427-28; Markham, *The New Antitrust Policy and the Individual Business Firm*, 30 LAW & CONTEMP. PROB. 607 (1965).

A similar economic theory underlies some cases not involving the failing company doctrine, but having some important parallels to it. *See, e.g.*, Union Leader Corp. v. Newspapers of New England, Inc., 284 F.2d 582 (1st Cir. 1960), *cert. denied*, 365 U.S. 833 (1961), *aff'g* 180 F. Supp. 125 (D. Mass. 1959); United States v. Aluminum Co. of America, 148 F.2d 416 (2d Cir. 1945) (en banc); United States v. Harte-Hanks Newspapers, Inc., 170 F. Supp. 227 (N.D. Tex. 1959). *See also* von Kalinowski, *supra* at 844-45.

Union Leader involved, in part, the acquisition of a local newspaper operating in a natural monopoly market. The court stated, "If competition is doomed by market conditions, it cannot be 'lessened' by a change of ownership." *Union Leader, supra* at 589. *Alcoa* involved an allegation of monopolization of the aluminum industry under section 2 of the Sherman Act. Judge Learned Hand, writing for the Second Circuit en banc, foresaw a defense to a charge of monopolization under circumstances where "[a] market . . . [is] . . . so limited that it is impossible to produce at all and meet the cost of production except by a plant large enough to supply the whole demand. Or . . . [where] . . . changes in taste or in cost . . . drive out all but one purveyer." *Alcoa, supra* at 430. *Harte-Hanks* involved the acquisition by a chain of strong newspapers of its sole competitor in a town of 17,000 after each paper had lost a considerable amount of money in a fight for survival. The court stated, "[t]here must be space and room and subject matter involved to afford a competition such as the law requires and where these things do not exist then discontinuance of competition . . . is not a violation of the antitrust law." *Harte-Hanks, supra* at 229.

Union Leader, Alcoa, and *Harte-Hanks* stand for the proposition that where it is inevitable due to economic conditions and the *market structure* for one company to absorb a failing competitor, or its share of the market, because the market can support only one firm, there necessarily can be no adverse effect from such an absorption. The economic theory is sound, in this context, because it involves an inquiry into the peculiar facts of the case to determine an actual effect on competition, and is not a broad statement of policy as in the cases dealing with the failing company doctrine.

117. *See* Comment, *"Substantially to Lessen Competition . . .": Current Problems*

has resulted in its per se application in cases permitting acquisitions.[118] Even in cases where the defense was defeated, the courts usually viewed their primary inquiry as whether the company would continue as a competitor or be dismembered and liquidated, thereby disappearing totally from the market.[119]

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of Horizontal Mergers, 68 YALE L.J. 1627, 1663-64 (1959). *See also* notes 97-115 *supra* and accompanying text.

118. *See, e.g.*, Granader v. Public Bank, 417 F.2d 75, 83 (6th Cir. 1969); Beegle v. Thomson, 138 F.2d 875 (7th Cir. 1943), *cert. denied*, 322 U.S. 743 (1944); United States v. Maryland & Virginia Milk Producers Ass'n, 167 F. Supp. 799 (D.D.C. 1958), *aff'd on other grounds*, 362 U.S. 458 (1960); *cf.* United States v. M.P.M., Inc., 397 F. Supp. 78 (D. Colo. 1975) (once the elements are shown "then the 'failing company' defense has been satisfactorily established," *id.* at 97); United States v. Diebold, Inc., 197 F. Supp. 902 (S.D. Ohio 1961), *rev'd on other grounds*, 369 U.S. 654 (1962) (granting summary judgment on the sole ground that the acquired concern "could not long have survived as an independent competitor in its line of business," *id.* at 907).

In Beegle v. Thomson, 138 F.2d 875 (7th Cir. 1943), the first case to enunciate the failing company doctrine in a private section 7 action, the court found no violation on three alternate grounds: (1) there had been no competition between the acquired and acquiring company; (2) there was no allegation of injury to the plaintiff's business; and (3) the acquired company was in a failing condition and "a firm closing out its business because of financial difficulties may sell its plant even to a competitor without violating the Anti-Trust Law." *Id.* at 880-81. *Beegle* thus treated the failing condition of the acquired company as an absolute defense; the decision is criticized for this reason, and because "there was no reference to, nor application of, the elaborate criteria set out in *International Shoe.*" Connor, *supra* note 83, at 91.

In *Maryland & Virginia Milk Producers* the failing condition of two of three acquired companies was claimed as a defense by an agricultural cooperative supplying 86 percent of all milk purchased by suppliers in the Washington, D.C. metropolitan area. Distinguishing the two failing companies from the other company, the court held their acquisition to be valid. United States v. Maryland & Virginia Milk Producers Ass'n, 167 F. Supp. 799, 808-09 (D.D.C. 1958), *aff'd on other grounds*, 362 U.S. 458 (1960). The court held:

> The acquisition of capital stock or assets of a failing corporation is not within the ban of Section 7 of the Clayton Act. While the statute does not expressly so provide, this conclusion is inherent in the statutory provision because the acquisition of a failing corporation that is on the verge of going out of business cannot result in lessening competition or in creating a monopoly. *Be that as it may*, the Supreme Court so held in *International Shoe* [citation omitted].
>
> The Court concludes, therefore, that the acquisition of the capital stock [of the two failing companies] . . . was not violative of Section 7 of the Clayton Act.

Id. (emphasis added). *Maryland & Virginia Milk Producers* and *Beegle* present the most persuasive authority that the failing company defense is a per se defense. *See* Connor, *supra* note 83, at 92.

119. *See, e.g.*, Crown Zellerbach Corp. v. FTC, 296 F.2d 800 (9th Cir. 1961), *cert. denied*, 370 U.S. 937 (1962); Erie Sand & Gravel Co. v. FTC, 291 F.2d 279 (3d Cir. 1961). In *Crown Zellerbach* the court pointed out that although the acquired company had overextended itself in an expansion program and was experiencing difficulty in obtaining financing, it nevertheless had substantial net worth. *Crown Zellerbach*, *supra*, at 831. In *Erie Sand & Gravel* the court described the defense as applicable "to the acquisition of a

Although this economic basis for the doctrine has been set forth and repeated many times, practically every commentator dealing with the subject has indicated that a merger or acquisition, even though involving a firm that would otherwise certainly have disappeared from the market, can still have anticompetitive effects.[120] One writer has formulated a list of six anticompetitive effects which may flow from the acquisition of a failing company.[121] It appears that the economic rationale originally used to justify the defense was simplistic and to some degree inconsistent with antitrust policy.[122] Many authorities would now invalidate

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competitor which is in such straits that the termination of the enterprise and the dispersal of its assets seems inevitable unless a rival proprietor shall acquire and continue the business." *Erie Sand & Gravel, supra*, at 280. The court found that "had [the defendant] not bid, the prospect was not the elimination of a competing enterprise, but merely its continuation under some new proprietorship." *Id.* The opinion indicates that if the acquired company was shown to be sufficiently likely to disappear totally from the market, then its acquisition would have been valid regardless of the actual effect on competition. *Id.*

See also Golden Grain Macaroni Co. v. FTC, 472 F.2d 882 (9th Cir. 1972); Heatransfer Corp. v. Volkswagenwerk A.G., 1975-1 Trade Cas. ¶60,309 (S.D. Tex. April 25, 1975), *appeal docketed*, No. 75-27-79 (5th Cir. July 7, 1975); United States v. Phillips Petroleum Co., 367 F. Supp. 1226 (C.D. Cal. 1973); Calnetics Corp. v. Volkswagen of America, Inc., 348 F. Supp. 606 (C.D. Cal. 1972); United States v. Pabst Brewing Co., 296 F. Supp. 994 (E.D. Wis. 1969).

120. *See, e.g.*, Bok, *supra* note 83, at 340; Dooley, *supra* note 12, at 1439-40; Low, *supra* note 82, at 428; Note, *Horizontal Mergers and the "Failing Firm" Defense Under Section 7 of the Clayton Act: A Caveat*, 45 VA. L. REV. 421, 425-27 (1959).

121. Comment, *Federal Antitrust Law—Mergers—An Updating of the "Failing Company" Doctrine in the Amended Section 7 Setting*, 61 MICH. L. REV. 566, 577-78 (1963). The following anticompetitive effects were listed: (1) enabling the acquiring firm to move quickly into a new market; (2) increasing the acquiring firm's capacity to fill orders it would otherwise be unable to meet, thereby preventing competitors from handling the overflow; (3) removing facilities from the market, thereby forestalling a potential entrant if the cost of building new facilities was prohibitive; (4) enabling the acquiring firm to obtain more of the failing company's business than would have been possible had the firm totally collapsed due to the acquisition of whatever good will is left in the failing company; (5) totally integrating and thereby eliminating a customer or supplier of its competitors; and (6) eliminating a component of the relevant market, thereby allowing the acquiring firm to obtain an increased percentage of, and dominance in, the market without the need for internal expansion. *Id.*

122. *Cf.* Standard Oil Co. v. United States, 221 U.S. 1 (1911), in which the defendants' monopoly practices consisted, in part, of contributing to the economic collapse of its competitors—"many, if not virtually all, competitors were forced either to become members of the combination or were driven out of business." *Id.* at 33. To allow the failing condition of the defendants' competitors to be interposed as a defense in such a suit would wholly defeat antitrust policy.

In other instances, mergers have been scrutinized even where the acquired company has almost no market power. In this respect, it is antitrust policy to prevent even slight accretions in market power. *See* United States v. Philadelphia Nat'l Bank, 374 U.S. 321 (1963). The Supreme Court stated: "[I]f concentration is already great, the importance any merger as a section 7 violation, regardless of the market share or the size and strength of the acquired firm, if the resulting firm would occupy a given percentage of the market.[123]

United States v. General Dynamics Corp.[124] indicates that depleted reserves or financial reversals are nonstatistical market evidence relevant to competitive effect. The severity of a company's financial difficulties, therefore, could be considered in determining whether there is a substantive violation. Thus, the probability that a company could not be reorganized in receivership, and the likelihood that it would disappear from the market, might bear directly on the Government's case, but categorical statements concerning competition in such cases cannot serve as the basis for the failing company defense.

Because the rationale which had been given for the failing company defense does not jibe with known economic facts and theory, one writer has said that "[t]he conclusion seems inescapable that the failing company doctrine has no logical basis as it is usually stated."[125] Recognizing the inconsistencies, other writers have proposed alternate theories upon which to base the defense. For example, it has been justified "on the ground that it

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of preventing even slight increases in concentration and so preserving the possibility of eventual deconcentration is correspondingly great." *Id.* at 365 n.42; *accord,* Brown Shoe Co. v. United States, 370 U.S. 294, 343-44 (1962); *see, e.g.,* United States v. Von's Grocery Co., 384 U.S. 270 (1966); United States v. Continental Can Co., 378 U.S. 441 (1964); United States v. Aluminum Co. of America, 377 U.S. 271 (1964). In *Von's Grocery* a merger was condemned where it produced a firm with 1.4 percent of the grocery stores and 7.5 percent of grocery sales in what the Court characterized as an increasingly concentrated market. The dissenting opinion by Justice Stewart vigorously attacked this result as being statistically arbitrary. *Von's Grocery, supra,* at 290, (Stewart, J., dissenting). In *Continental Can* an acquisition was held to substantially lessen competition where the acquiring firm occupied 21.9 percent of the market and the acquired firm occupied only 2.1 percent of the market. In *Alcoa* an acquisition was also condemned where the acquired firm had approximately 2 percent of the market, and the acquiring firm had 27.8 percent of the market. In *Continental Can* and *Alcoa* the Court appeared to be concerned more with the share that the resulting firm would have in a concentrated market, than with the contribution of the acquired firm to the consolidation.

Similar concern has been shown in exclusive dealings cases where the result would be the functional equivalent of a vertical merger. *See, e.g.,* FTC v. Brown Shoe Co., 384 U.S. 316 (1966); FTC v. Motion Picture Advertising Serv. Co., 344 U.S. 392 (1953); Standard Oil Co. v. United States, 337 U.S. 293 (1949); Standard Fashion Co. v. Magrane-Houston Co., 258 U.S. 346 (1922). *See also* Kessler & Stern, *Competition, Contract and Vertical Integration,* 69 YALE L.J. 1, 53 (1959).

123. *See, e.g.,* Bok, *supra* note 83, at 308-29. Professor Bok would invalidate any merger by a dominant firm if its market share would be increased by more than two or three percent of its premerger share.

124. 415 U.S. 486 (1974).

125. Low, *supra* note 82, at 430.

prevents potential bankruptcies . . . [which] is desirable because . . . [it] thus prevents adverse repercussions throughout the economy."[126] Professor Bok has suggested the most appealing justification for the doctrine, in light of economic realities: a concern for the interests of creditors, owners and employees interested in realizing the highest possible selling price and avoiding a total collapse and disruption of the enterprise.[127] This view finds some support in *International Shoe*,[128] in the cases preceding *International Shoe*,[129] and in the legislative history of the 1950 Celler-Kefauver Amendments to section 7 of the Clayton Act.[130]

Legislative Consideration of the Policies Underlying the Defense

As originally enacted in 1914, section 7 of the Clayton Act forbade only certain acquisitions of a competitor's *stock*.[131] The statute was easily evaded by direct purchase of *assets*.[132] To plug this "loophole"[133] Congress amended section 7 in 1950 to prohibit any stock or asset acquisition when "the effect of such acquisition

126. Note, *Horizontal Mergers and the "Failing Firm" Defense Under Section 7 of the Clayton Act: A Caveat,* 45 VA. L. REV. 421, 425 (1959); *see* Dooley, *supra* note 12, at 1442. Professor Dooley maintains: "It can be contended that allowing the merger is preferable to forcing the failing company to sell its assets as scrap since it is likely that the bidding competitor will expand internally anyway to meet postulated demand." But Dooley himself admits that "the economic justifications for the doctrine are not overwhelming." *Id.* at 1443.

127. Bok, *supra* note 83, at 340. Bok suggests that "[p]rotecting these interests, moreover, would coincide to some extent with the rather obvious legislative bias in favor of small businessmen and tradespeople." *Id.* He cites two other possible considerations: (1) efficiency, since a failing company might be improved by a change of management (this he regards as unlikely due to the past treatment of "efficiency" arguments) and (2) belief that the disappearance of a failing company from the competitive markets would not lessen competition (this too he regards as unlikely since the assets of a failing company in the hands of a strong acquirer could considerably improve its market position). *Id.* at 340; *accord,* Hale & Hale, *supra* note 12, at 598, which noted that:

> It is easy to envisage customers, creditors and employees caught in a catastrophe. Judicial liquidation evokes a picture of drastic shrinkages in values. Costs of administration appear high [footnote omitted] and probable diversion of assets to other uses may involve shocking losses [footnote omitted].

Id. at 598.

128. *See* notes 86-97 *supra* and accompanying text.

129. *See* notes 98-115 *supra* and accompanying text.

130. *See* notes 131-49 *infra* and accompanying text.

131. Clayton Act § 7, ch. 323, § 7, 38 Stat. 731 (1914), *as amended,* 15 U.S.C. § 18 (1974). *See also* note 89 *supra.*

132. Brown Shoe Co. v. United States, 370 U.S. 294, 313-14 (1962); *see* S. REP. No. 1775, *supra* note 11, at 2; *Hearings on H.R. 515, supra* note 101, at 4.

133. Brown Shoe Co. v. United States, 370 U.S. 294, 314 (1962).

may be substantially to lessen competition, or to tend to create a monopoly."[134] During consideration of the Amendments beginning in 1947, many references were made to *International Shoe* in Congress; the now famous passage from that decision[135] appears repeatedly in the legislative record.[136] The legislative history does not reveal what, according to congressional opinion, constitutes a failing company, whether the defense is absolute, qualified, or part of the overall determination of competitive effect, or precisely why the defense exists.[137] The record does show that Congress anticipated some exception to section 7 for the acquisition of a company suffering financial difficulties and expressed a policy of protection for the various interests that would be adversely affected were the exception unavailable.

The chief concern of the amendment's opponents was that immediate or long range financial problems may very likely "militat[e] an immediate sale"[138] of the physical properties of a company at salvage or, at best, forced sale prices.[139] They argued that the only available market for such sales is found among competitors in the same field.[140] They urged that the failing company should be allowed "to offer itself as a going concern to the highest bidder . . . [because, in a forced sale] good will and the repute it may have earned as a going business would be lost to

134. Clayton Act § 7, 15 U.S.C. § 18 (1974), *formerly* ch. 323, § 7, 38 Stat. 731 (1914). *See also* note 2 *supra*.

135. *See* text accompanying note 90 *supra*.

136. *See* S. REP. No. 1775, *supra* note 11, at 7; H.R. REP. No. 1191, *supra* note 11, at 6; H.R. REP. No. 596, *supra* note 101, at 5-6; *Hearings on H.R. 2734 Before a Subcomm. of the Senate Comm. on the Judiciary*, 81st Cong., 2d Sess. at 80, 312 (1950)(remarks of Representative Celler and Senator Kefauver); *Hearings on H.R. 515, supra* note 101, at 10-11 (remarks of Senator Kefauver and letter-memorandum by W. T. Kelly, Chief Counsel to the Federal Trade Commission); 96 CONG. REC. 16435 (1950)(remarks of Senator O'Conor); 96 CONG. REC. 16440 (1950) (remarks of Senator Donnell); 96 CONG. REC. 16444 (1950)(remarks of Senator Kefauver).

137. There is, however, congressional support for the proposition that the "dim or nonexistent" prospects of reorganization, mentioned in Citizen Publishing Co. v. United States, 394 U.S. 131, 138 (1968), was never meant to be an element of the defense. Numerous references support the view that it is sufficient if a corporation is merely heading for bankruptcy, without regard to the outcome of such a proceeding. Nor does the corporation have to be in a state of bankruptcy or receivership for the "failing company" defense to apply. *See* S. REP. No. 1775, *supra* note 11, at 7. *Hearings on H.R.* 515, *supra* note 101, at 10 (remarks of Senator Kefauver); 96 CONG. REC. 16435 (1950) (remarks of Senator O'Conor).

138. S. REP. No. 1775, *supra* note 11, at 22 (minority report).

139. *Id.*

140. *Id.*

its stockholders."[141] The proponents of the amendment stated that they were "in full accord with the proposition that any firm in [a failing or bankrupt] condition should be free to dispose of its stock or assets [and] that the proposed bill would not prevent sales of [that] type."[142]

Other sources indicate that the overriding legislative view was not that such a sale or merger would have no anticompetitive effect, but that stockholders have a right to sell a failing company to avoid economic waste and harm to creditors and employees.[143] There are also legislative materials which indicate that one basis upon which a failing company defense should rest is that businessmen faced with a company in financial straits should be able to react to the situation without being second-guessed in subsequent litigation regarding the effect of the acquisition on competition.[144] A problem closely associated with the failing company doctrine and considered by Congress in 1950 was the one-man firm whose "proprietor" either dies or retires leaving the business in incapable hands. The consideration of this problem during the hearings[145] is further evidence of congressional concern with the

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141. *Id.*

142. *Id.* at 7 (majority report). The Report continued:

> The judicial interpretation on this point goes back many years and is abundantly clear. According to decisions of the Supreme Court, the Clayton Act does not apply in bankruptcy or receivership cases. Moreover, the Court has held, with respect to this specific section, that a company does not have to be actually in a state of bankruptcy to be exempt from its provisions; it is sufficient that it is heading in that direction with the probability that bankruptcy will ensue.

Id.

143. *See* H.R. REP. NO. 596, *supra* note 101, at 6; *Hearings on H.R.* 2734, *supra* note 136, at 79 (remarks of Senator Donnell and Representative Celler); 96 CONG. REC. 16444-45 (1950) (remarks of Senators Thye, Kefauver, and O'Mahoney).

144. *Hearings on H.R. 2734, supra* note 136, at 79-80:

> Sen. DONNELL: . . . Suppose that your company would become in failing circumstances and you wanted to sell your assets, sell the physical assets to some other concern. Now, the question I want to ask you: First, how could you be sure, without some prior litigation of some kind how could you be sure or the purchasing company be sure, that they could safely acquire your assets of the company . . . ?"
>
> Rep. CELLER: The present Act and my Bill would have no application whatsoever to a corporation in a failing or bankrupt condition.

Such remarks, together with Congress' realization that the company "does not have to be actually in a state of bankruptcy to be exempt from [the section 7] provisions" (S. REP. No. 1775, *supra* note 11, at 7) are evidence that Congress envisioned the failing company doctrine as allowing owners to act freely in an emergency situation, if one truly exists, without fear of being second-guessed by a judge or jury.

145. *Hearings on H.R. 2734, supra* note 136, at 99-105. The problem was dismissed as too small to come within the ban of the Clayton Act; *see* United States v. Von's Grocery

interests tied to a company for which sale is a viable alternative to business failure.

The legislative statements could be interpreted to mean that Congress considered the defense to be "unconditional" and intended it as an *exception* to the antitrust laws.[146] At various points, legislators did clearly state that the Clayton Act would be inapplicable to a company in a failing condition.[147] It has been argued, on the other hand, that Congress could not have intended this result.[148] In light, however, of the great stress placed upon the circumstances of a failing company, and the repeated references to the right of owners of a failing concern to sell, it must be admitted that Congress intended the failing condition of an acquired company to be more than a factor in determining the impact on competition. Thus, once the economic justification for the doctrine is discredited, if it is to remain a viable affirmative defense, the best ground upon which to base it is the legislative concern for the various interests tied to the failing company.[149]

GENERAL DYNAMICS, CITIZEN PUBLISHING AND THE FUTURE OF THE DOCTRINE

The view that the failing condition of an acquired firm is a per se affirmative defense—arguably expressed in *International*

Co., 384 U.S. 270, 298 nn.29 & 30 (1966) (Stewart, Harlan, J.J., dissenting).

146. *See* M. HANDLER, TWENTY-FIVE YEARS OF ANTITRUST 472 (1973).

147. *See Hearings on H.R. 2734, supra* note 136, at 79-80 (remarks of Representative Celler)("no application whatsoever"); 96 CONG. REC. 16435 (1950) (remarks of Senator O'Conor) ("as already mentioned, the bill would not apply to a company in a failing or bankrupt condition"); 96 CONG. REC. 16445 (1950), where, in the congressional debates, it was stated:

> Mr. THYE: Then, as I understand, there is nothing in the bill which would prevent a corporation which might be classed as big business from . . . buying out a little [business] which had been in operation for 50 years or more, but which was forced to discontinue operations because of changes in conditions . . . .
>
> Mr. O'MAHONEY: There would be nothing which would prevent that.

See also 96 CONG. REC. 11504 (1949) (remarks of Representative O'Conor).

148. *See* Connor, *supra* note 83, at 98, which states that:

> Congressional accord with the proposition that a failing firm should be free to dispose of its stock or assets must mean, in the absence of any specific reference to such a situation in the statute itself, that the failing or bankrupt condition of an acquired firm is to be one of the factors used in defining the impact of an acquisition on competition. Thus the intent of Congress is not to create an exception to the test of amended section 7, but merely to point out a specific situation to which the test will be applied.

149. *See* Bok, *supra* note 83, at 340; Low, *supra* note 82, at 430.

Shoe[150]—has been weakened[151] by the establishment in recent years of the no other "available purchaser" requirement announced in *Citizen Publishing*.[152] The demise of a per se approach is consistent with the discrediting of the traditional economic justification for the defense.[153] The only alternative rationale which has support in the case law and the legislative history is a concern for the owners, creditors, and employees of the failing enterprise. The strength of that concern and the degree to which the courts allow it to mitigate the policies of the antitrust laws should determine how the defense is applied in the future. One extreme, with some support in the legislative record[154] and in the case law,[155] is to give paramount consideration to these mitigating circumstances. It can be argued that the officers of the company should be able to react to the situation without being second-guessed by an agency or a court with respect to the effect of the acquisition or the likelihood of bankruptcy.[156] It is a fact of life that management must often move quickly when faced with imminent bankruptcy. Due regard should be given to the exigencies of the moment without asking for impossible evaluations by the officers who must appraise the situation. Taken to its outer limits this approach could require the courts to uphold the defense on the basis of a business judgment rule, deferring to the discretion of the failing company's board of directors. That this would wreak havoc on the policies of the antitrust laws cannot be doubted. The other extreme is to give no controlling consideration to the interests tied to the company. This would effectively destroy the doctrine as an affirmative defense and would result in consideration of the acquisition from the perspective of the *actual* anticompetitive effects, thereby merging the doctrine with the substantive offense.

United States v. General Dynamics Corp.[157] falls somewhere between these extremes and should have the effect of reconciling the defense with economic reality and the policies underlying it.

150. *See* notes 92-96 *supra* and accompanying text.
151. *See* Dooley, *supra* note 12.
152. *See* notes 28-34 *supra* and accompanying text.
153. *See* notes 116-30 *supra* and accompanying text.
154. *See Hearings on H.R. 2734, supra* note 136, at 79-80. *See also* note 144 *supra* and accompanying text.
155. *See* notes 93 & 108 *supra.*
156. *See* notes 93 & 144 *supra* and accompanying text.
157. 415 U.S. 486 (1974). *See also* notes 68-81 *supra* and accompanying text.

One commentator has argued that the case may have the effect of merging the doctrine with the substantive offense, thus making it "a piece of excess baggage."[158] *General Dynamics*, however, does not stand for the broad proposition that a company with depleted reserves, or one that is irretrievably failing, will never have a substantial future competitive influence on the market. If the case did, then the strict requirements of the failing company doctrine would, indeed, be irrelevant. Justice Stewart clearly indicated, however, that competitive effects can only be judged on a case-by-case basis.[159] Under the Court's analysis, depleted re-

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158. *See* Robinson, *supra* note 68, at 158. Robinson argues:

> [The Court's] logic is fine as far as it goes. If the acquired company does not have the wherewithal to be an effective competitive factor in the future, how can it be said that its elimination by merger will substantially lessen competition? On the other hand, under [the Court's] approach the failing company defense might well become a piece of excess baggage.

Id. See also notes 80 & 81 *supra* and accompanying text. This was one aspect of the dissent in United States v. General Dynamics Corp., 415 U.S. 486, 522 (1974) (Douglas, J., dissenting).

159. 415 U.S. 486, 498 (1974). *General Dynamics* represents a significant return to the approach taken in Brown Shoe Co. v. United States, 370 U.S. 294, 321-22, & n.38 (1962), which put great stress on the particular circumstances involved in each section 7 case:

> "Congress indicated plainly that a merger had to be functionally viewed, in the context of its particular industry." [Citation omitted.]
>
> ". . . [O]nly [an] 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." [Citation omitted.]

United States v. General Dynamics Corp., 415 U.S. 486, 498 (1974), *quoting* Brown Shoe Co. v. United States, 370 U.S. 294, 321-22 & n.38 (1962).

In United States v. Marine Bancorporation, Inc., 418 U.S. 602 (1974), the Court reaffirmed its unwillingness to accept economic theory and mere possibilities of anticompetitive effect as dispositive of a section 7 case. Briefly, *Marine Bancorporation* involved an acquisition by a Seattle bank, the second largest bank in Washington, of the state's eighth largest bank, the third largest in Spokane (18.6 percent of the market). The acquisition was a market extension merger into the Spokane market, which was the only method under Washington law—state regulations forbade de novo entry into other banking markets—by which the Seattle bank could operate a branch in any city or town outside its principal place of business. In addition, once the acquisition was made, the Seattle bank could not, under Washington law, expand by establishing additional branches in the Spokane market. The thrust of the Government's case was that the merger eliminated the possibility of the Seattle bank's entry into the Spokane market de novo through a sponsorship program (circumventing state law) or through a toehold acquisition, thereby eliminating any possibility of deconcentration in the future. In light of Washington's strict regulatory scheme, Justice Powell, speaking for the majority, found that it was highly unlikely that a de novo entry would have been feasible and that a toehold entry offered "little realistic hope of ultimately producing deconcentration of the Spokane market." *Id.* at 636. The majority warned against substituting mere speculation for actual proof of anticompetitive effect. Justice Powell observed that "it blinks reality . . . to conclude that the opportunity for entry through sponsorship, assuming its availability, is comparaserves and severe financial difficulties are relevant to the ultimate determination of competitive effect, but no categorical statements should be made concerning their significance. The present economic understanding[160] supports this position.

In distinguishing a failing company situation from one where the acquired firm is unable to compete due to structural changes in the market,[161] the Court in *General Dynamics* seems finally to have accepted the proposition that the acquisition of a company on the brink of bankruptcy can carry with it serious anticompetitive effects.[162] By doing so, it has placed the defense on its only supportable rationale: judicial concern for the interests tied to the company.[163] Where an acquisition of a company on the brink of bankruptcy has serious anticompetitive consequences, the ratio decidendi of *General Dynamics* is inapplicable. It is to just such a situation that the failing company doctrine should be addressed. Thus, the defense has not been undermined by *General Dynamics*, rather its relevance has been more precisely drawn. The defense has been kept distinct from the substantive offense, but by suggesting a balancing approach to the doctrine,[164] the Court has indicated a willingness, consistent with the second requirement of no other available purchaser, to depart completely from a per se application of the defense. Its future application

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ble to the entry alternatives open to unregulated industries," *id.* at 637, and that the Government "failed to demonstrate that the alternate means [of entry] offer a reasonable prospect of long-term structural improvement." *Id.* at 638-39. He concluded that "[t]he Government's argument . . . is little more than speculation. It provides no sound basis for overturning the District Court's holding [of no violation]." *Id.* at 641.

More recently, the Supreme Court decided United States v. Citizens & S. Nat'l Bank, 422 U.S. 86 (1975). The case involved the de facto branching program of the defendant bank, which circumvented state law forbidding de jure branching by Atlanta banks into the Atlanta suburbs. The program consisted, in part, of a holding company forming de facto branch banks in the suburbs. After Georgia State law was amended to allow de jure branching on a countywide basis, the defendant absorbed the de facto branches and made them true branches. The Government alleged a violation of section 1 of the Sherman Act involving a conspiracy between the defendant and the de facto branches, and a violation of section 7 of the Clayton Act involving the absorption of the de facto branches by the defendant. The Supreme Court held for the defendant in an opinion in which Justice Stewart warned against "highly technical" (*id.* at 112) arguments for antitrust liability that betray a "total lack of realism" about the circumstances surrounding a challenged practice (*id.* at 119).

160. *See* notes 116-30 *supra* and accompanying text.

161. *See* notes 75-82 *supra* and accompanying text.

162. United States v. General Dynamics Corp., 415 U.S. 486, 507 (1974). *See also* text accompanying notes 77 & 78 *supra*.

163. *See* text accompanying note 78 *supra*.

164. *Id.*

may very well consist of balancing the probability and degree of serious injury to the interests tied to the failing company against the likelihood and extent of anticompetitive effects resulting from the acquisition.

What, then, is the relevance of "dim or nonexistent" prospects of reorganization?[165] The inquiry can only be important in assessing whether, if bankruptcy ensued, the company would to a substantial certainty have been liquidated and, therefore, have disappeared from the market. This determination, in turn, is relevant only if the acquisition of a company which would have definitely disappeared from the market can have no anticompetitive effect—an economic theory which has been discredited. The requirement, when viewed in this light, constitutes a per se approach inconsistent with the second requirement of *Citizen Publishing* itself, which moves the defense away from a per se application.[166]

A per se application of the doctrine has always been viewed with enthusiasm by defendants, but an extension of the per se approach through the "third requirement" would be unduly burdensome to the defendant and unfair to the interests concerned with the life of the failing company. Bankruptcy causes trepidation in all those associated with the firm;[167] creditors, owners, employees, and customers can easily be caught in a catastrophe. The mere prospect of judicial liquidation causes drastic shrinkage in values. Costs of administration are high and diversion of assets to other uses by way of liquidation sale can involve severe losses.[168] If a merger or acquisition is not allowed, the prospects for the enterprise are either a liquidation or, at best, a recapitalization resulting in new ownership, theoretically preserving the interests of the creditors *pari passu*.[169] In any case, the costs of administration will deprive the owners and possibly the creditors of value even if there is a successful reorganization. If there is

165. *See* text accompanying note 35 *supra*.

166. *See* note 34 *supra* and accompanying text.

167. *See* Bok, *supra* note 83, at 244-45; Hale & Hale, *supra* note 12, at 598; Ryehm & Billyou, *A Comment on the Proposed Notice Legislation*, 2 ANTITRUST BULL. 195, 197-98 (1956); *cf.* United States v. Columbia Pictures, 169 F. Supp. 888, 896 (S.D.N.Y. 1959).

168. *See* Laugharm, *Costs of Bankruptcy Administration and the Effect of the Present Economic Trend Thereon*, 32 REP. J. 50 (1958) (bankruptcy involves frictions which may prove extremely costly).

169. *See* Consolidated Rock Prods. Co. v. Du Bois, 312 U.S. 510 (1941); Missouri Pac. R.R. Reorganization, 291 I.C.C. 477, 555 (1954), *plan approved*, 129 F. Supp. 392 (E.D. Mo.), *aff'd*, 225 F.2d 761 (8th Cir. 1955), *cert. denied*, 350 U.S. 959 (1956).

judicial concern for these interests, a sale should be allowed in order to realize the values that exist prior to a bankruptcy proceeding. The "third requirement" assumes an investigation by the officers of the failing company, and by those of the purchasing company (who may not be intimate with the facts) into the possibility of a successful recapitalization under the bankruptcy laws. The result is to discourage—based solely on the speculative outcome of a purely hypothetical bankruptcy proceeding—acquisitions which would put value in the hands of the owners and creditors of the failing concern.

Problems of administration are also an important consideration. The standard suggested by *Citizen Publishing* would require some kind of inquiry into solvency, liquidity, and going concern value, involving factors such as capitalization rates and projected cash flow.[170] In effect, an antitrust court faced with an asserted failing company defense would have to examine not only the multitude of relevant economic factors that go into a section 7 determination,[171] but would have to make, in addition, the same kind of inquiry a bankruptcy court is required to make.[172] In a case before the Federal Trade Commission, such as *United States Steel Corp. v. FTC*,[173] this arguably is a feasible inquiry due to the Commission's presumed expertise. It does not necessarily follow that a court administering the Clayton Act, with or without a jury, would be capable of making the same inquiry. Consistent administration of the antitrust laws is an important objective and the result should not be made to depend upon the forum. The average antitrust trial is already a complex affair.[174] An inquiry

170. *See* authorities cited at note 172 *infra*.

171. *See* Brown Shoe Co. v. United States, 370 U.S. 294 (1962).

172. *See, e.g.*, Consolidated Rock Prods. Corp. v. Du Bois, 312 U.S. 510 (1941); Case v. Los Angeles Lumber Prods. Co., 308 U.S. 106 (1939); *In re* Inland Gas Corp., 241 F.2d 374 (6th Cir.), *cert. denied*, 355 U.S. 838, *rehearing denied*, 355 U.S. 879 (1957), *construed in* 262 F.2d 510 (6th Cir.), *cert. denied*, 359 U.S. 979 (1959); Horowitz v. Kaplan, 193 F.2d 64 (1st Cir. 1951), *cert denied*, 342 U.S. 946 (1952); *In re* Atlas Pipeline Corp., 9 S.E.C. 416, *recommendation rejected and plan approved*, 39 F. Supp. 846 (D. La. 1949). *See generally* 6A COLLIER ON BANKRUPTCY ¶¶ 11.01-.21 (14th ed. 1975); 11 REMINGTON ON BANKRUPTCY §§ 4568-4606 (1961), *and* (Supp. 1975); Blum, *The Law and Language of Corporate Reorganization*, 17 U. CHI. L. REV. 565 (1950); Blum, *Full Priority and Full Compensation in Corporate Reorganization: A Reappraisal*, 25 U. CHI. L. REV. 417 (1958); Brudney, *The Investment-Value Doctrine and Corporate Readjustments*, 72 HARV. L. REV. 645 (1959).

173. 426 F.2d 592 (6th Cir. 1970). *See also* notes 42-46 *supra* and accompanying text.

174. *See* JUDICIAL CONFERENCE OF THE UNITED STATES, REPORT ON PROCEDURE IN ANTITRUST AND OTHER PROTRACTED CASES, 13 F.R.D. 62 (1951); McAllister, *The Big Case: Procedural Problems in Antitrust Litigation*, 64 HARV. L. REV. 27 (1950).

into the outcome of a hypothetical bankruptcy would tend to make a case of this kind so complicated that any judge might well wonder whether the controversy is in fact justiciable.[175] It is doubtful that Congress intended that a court—or a business concern which is contemplating either acquiring or selling to another company—make the investigations and analysis which the "third requirement" demands in order to determine if the plans may be carried out.[176]

A strong argument can be made that, under the analysis in *General Dynamics*, prospects of reorganization should be examined in assessing an acquisition's effect on competition. This inquiry is one factor in determining the likelihood and extent, if any, of competitive injury. The inquiry might also be useful in determining the probability and degree of injury to the interests tied to the company—against which the likelihood and extent of competitive injury will be balanced. Viewed in this light, however, the "third requirement" should not be made a *necessary* element of the defense. Its relevance varies on a sliding scale, depending upon the circumstances of each particular case. In light of the problems of judicial administration and the difficulty

175. *See, e.g.*, Heatransfer Corp v. Volkswagenwerk A.G., 1975-1 Trade Cas. ¶ 60,309 (S.D. Tex. April 25, 1975), *appeal docketed*, No. 75-27-79 (5th Cir. July 7, 1975).

This sort of difficulty was foreseen in Standard Oil Co. v. United States, 337 U.S. 293, 310 (1949), where the Court was critical of a "standard of proof, if not virtually impossible to meet, at least most ill-suited for ascertainment by courts." In a footnote, the court added:

> The dual system of enforcement provided for by the Clayton Act must have contemplated standards of proof capable of administration by the courts as well as by the *Federal Trade Commission* and other designated agencies. . . . Our interpretation of the Act, therefore, should recognize that an appraisal of economic data which might be practicable if only the latter were faced with the task may be quite otherwise for judges unequipped for it either by experience or by the availability of skilled assistance.

Id. at 310 n.13; *see* United States v. Philadelphia Nat'l Bank, 374 U.S. 321, 362 (1963), in which the Court noted:

> [U]nless businessmen can assess the legal consequences of a merger with some confidence, sound business planning is retarded. . . . So also, we must be alert to the danger of subverting congressional intent by permitting a too-broad economic investigation. . . . And so in any case in which it is possible, without doing violence to the congressional objective embodied in § 7, to simplify the test of illegality, the courts ought to do so in the interest of sound and practical judicial administration.

See also Bromley, *Business' View of the Du Pont-General Motors Decision*, 46 GEO. L.J. 646, 653-54 (1958) (indicating the difficulty in unscrambling a completed merger and the need for businessmen to be able to make at least some predictions of the legality of their actions when formulating future market plans).

176. *See* discussion note 175 *supra*.

of the determination which the imposition of this inquiry would demand of the businessmen involved, notwithstanding its relevance, the prospects of reorganization should not, in most cases, be litigated.

CONCLUSION

The basic stumbling block in defining the failing company doctrine is the failure of the courts to confront the traditional economic explanation and to develop a viable alternative rationale. The statement in *International Shoe*[177]—that the purchase of a failing company could not reasonably be held to lessen competition—has been thoroughly discredited.[178] The lower court cases have dealt with the defense in various ways and at times inconsistently.[179] In the few cases in which the Supreme Court has considered the doctrine since *International Shoe* it has made no attempt to coordinate the elements of the defense with any underlying purpose.[180] *General Dynamics* is the first attempt to supply a viable rationale. In addition, the problem of how to define the doctrine has been complicated by the controversy over whether it should be given a per se application or considered only as it bears on the substantive offense.

The policy behind the failing company doctrine should be to allow the stockholders, creditors, employees, and community of a firm on the brink of bankruptcy to avoid the waste and expense of a bankruptcy proceeding by selling the firm as a going concern prior to actual bankruptcy or insolvency and its dissipating consequences.[181] The defense exists *notwithstanding* the economic fact that such acquisitions may carry with them consequences that would otherwise invalidate the acquisition. Since the defense cannot be grounded upon the economic consequences of a merger with a failing company, but is applied *in spite of* those consequences, it should not be required that the prospects for reorganization of the failing company be "dim or nonexistent"[182] for the defense to be established.

177. International Shoe v. FTC, 280 U.S. 291, 302-03 (1930).

178. *See* notes 116-30 *supra* and accompanying text.

179. *See* notes 16-27 *supra* and accompanying text.

180. *See* United States v. Greater Buffalo Press, 402 U.S. 549, 555 (1971); Citizen Publishing Co. v. United States, 394 U.S. 131, 136-37 (1969); Brown Shoe Co. v. United States, 370 U.S. 294, 319, 346 (1962); United States v. Diebold, Inc., 369 U.S. 654, 655 (1962). *But see* United States v. General Dynamics Corp., 415 U.S. 486, 507 (1974).

181. *See* notes 116-49 *supra* and accompanying text.

182. Citizen Publishing Co. v. United States, 394 U.S. 131, 138 (1969).

The Supreme Court's opinion in *General Dynamics* indicates that the failing company doctrine is neither a per se affirmative defense, nor limited to its bearing on the Government's prima facie case. It is a true affirmative defense with some qualifications. Its underlying policy is to allow the interests tied to the failing concern to recoup part of their investment before it is dissipated further in receivership. This may result in some injury to the competitve process. In some cases this injury to the public will outweigh the injury to the private interests benefited by the doctrine. Thus, future application of the doctrine should consist of balancing the financial difficulties of the concern—the likelihood of bankruptcy, and the likelihood of losing substantial value during or due to a bankruptcy—against the likelihood and extent of injury to competition if the acquisition is allowed.

Roger B. Kaplan