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Cutting the Financial Fat From the Failing Firm Defense: Refocusing the Failing Firm Defense on Antitrust Law

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CUTTING THE FINANCIAL FAT FROM THE FAILING FIRM DEFENSE: REFOCUSING THE FAILING FIRM DEFENSE ON ANTITRUST LAW

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INTRODUCTION

Firms in danger of failure often hope to sell their assets to a more financially stable entity. Sometimes such sales occur in the context of bankruptcy.[1] However, antitrust law often stands in the way of these transactions when the sale is anticompetitive. This is because Section 7 of the Clayton Act prohibits mergers and acquisitions that may substantially lessen competition, regardless of a firm's financial condition.[2] Instead, anticompetitive sales are permissible only when the requirements of the "failing firm defense" are met. The failing firm defense creates a narrow exception for failing firms to complete an acquisition that would otherwise violate the antitrust laws.

The failing firm defense allows an otherwise anticompetitive merger to go forward if the firm being acquired is "failing" according to antitrust law. Failing in an antitrust sense does not mean losing money alone.[3] Rather, to be considered failing in antitrust, a firm must meet the following conditions: (1) the firm

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[1] Under Chapter 11 of the U.S. Bankruptcy Code, Section 363(b) states that "[t]he trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate." 11 U.S.C.A. § 363(b)(1) (West 2011).

[2] *See* 15 U.S.C.A. § 18 (West 2011).

[3] Carl Shapiro, Deputy Assistant Att'y Gen. for Econ., Antitrust Div., Remarks on Competition Policy in Distressed Industries 21 (May 13, 2009), http://www.justice.gov/atr/public/speeches/245857.htm [hereinafter Remarks by Shapiro].

is "unable to pay its bills in the near future"; (2) the "firm could not successfully reorganize in bankruptcy"; (3) "the firm has tried to sell itself to someone else, in a combination that will not lessen competition as much"; and (4) "the firm's assets will exit the [relevant] market" "without the acquisition."[4] The doctrine is principally founded upon the rationale that "if a firm is failing, then on balance it may be better to allow" a merger with a competitor "than to watch" its "assets leave the market and be unavailable to any competitor."[5] This Note argues that the third and fourth elements are essential to proving the failing firm defense, while showing that the first and second elements are neither necessary nor consistent with antitrust law.

The most widely accepted version of the failing firm defense is the form adopted by the Department of Justice and the Federal Trade Commission ("Antitrust Regulators")[6] in the Horizontal Merger Guidelines.[7] For almost twenty years, the 1992 Horizontal Merger Guidelines ("1992 Merger Guidelines") articulated a rigid test for using the failing firm defense that required not only that a firm be financially distressed, but also that there be no alternative purchasers and that the firm's assets would exit the relevant market absent the acquisition.[8] Although Antitrust Regulators might not have intended for the failing firm defense to be analyzed differently, the 2010 Horizontal Merger Guidelines[9] ("2010 Merger Guidelines"; "1992 Merger Guidelines" and "2010 Merger Guidelines," collectively "Horizontal Merger Guidelines") may have loosened the stringent requirements of the 1992 Merger Guidelines. The 2010 version of the failing firm defense deemphasizes the importance of the "assets exiting the relevant market" requirement by changing it from an

[4] J. Bruce McDonald, Deputy Assistant Att'y Gen., Antitrust Div., Remarks on Antitrust for Airlines 8 (Nov. 3, 2005), http://www.justice.gov/atr/public/speeches/217987.htm.

[5] *Id.*

[6] Hereinafter, the Department of Justice and the Federal Trade Commission will be referred to as the "Antitrust Regulators."

[7] *See* Troy Paredes, Note, *Turning the Failing Firm Defense into a Success: A Proposal to Revise the Horizontal Merger Guidelines*, 13 YALE J. ON REG. 347, 352–53 (1996) (providing an overview of the failing firm defense).

[8] 1992 Horizontal Merger Guidelines, 57 Fed. Reg. 41,552, 41,563 (Sept. 10, 1992).

[9] U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, HORIZONTAL MERGER GUIDELINES 1 n.1 (2010), *available at* http://www.justice.gov/atr/public/guidelines/hmg-2010.pdf [hereinafter 2010 HORIZONTAL MERGER GUIDELINES].

independent element to an element that is automatically satisfied if three other elements are met.[10] If Antitrust Regulators do not analyze separately whether a firm's assets would exit the relevant market, it would be easier for firms only in financial distress to use the failing firm defense.

Recent years have witnessed a trend towards making it easier for financially distressed firms to use the failing firm defense in bankruptcy. Although transactions in bankruptcy are likely to raise failing firm issues,[11] bankruptcy is not enough to invoke the failing firm defense. Today, the Antitrust Regulators' primary, and often exclusive, reliance on the target firm's balance sheet and income statement to determine whether a firm is failing is due to a misunderstanding of the failing firm defense.[12] Failing financially is not the same as failing in the antitrust sense because being unable to pay bills in the short-term and being unable to reorganize in bankruptcy are bankruptcy elements that do not impact antitrust law, which focuses on the protection of competition and consumers.[13] The failing firm defense should rely heavily on the assets exiting the relevant market requirement and the alternative purchaser requirement because they are the only elements that concern antitrust law. Thus, a firm failing financially in bankruptcy cannot automatically use the failing firm defense.

This Note proposes that the failing firm defense be strengthened to an "Assets Exiting Defense,"[14] which would allow an otherwise anticompetitive merger to go forward only if there are no other alternative purchasers that would make the acquisition less anticompetitive and if the target firm's assets would exit the relevant market without the acquisition. A stronger "Assets Exiting Defense" that focuses exclusively on antitrust principles is necessary because in a distressed economy,

[10] *See infra* Section I.

[11] *See* Bernard A. Nigro, Jr. & Jonathan S. Kanter, *The Effect of Market Conditions on Merger Review—Distressed Industries, Failing Firms, and Mergers with Bankrupt Companies*, A.B.A. ANNUAL SPRING MEETING 7–8 (Apr. 2, 2003), http://www.abanet.org/antitrust/at-committees/attelecom/pdf/distressedindustry.pdf.

[12] *See* Paredes, *supra* note 7, at 375.

[13] *See* Brunswick Corp. v. Pueblo Bowl-o-Mat, Inc., 429 U.S. 477, 488 (1977).

[14] The "exiting assets" defense was first suggested by John Kwoka and Frederick Warren-Boulton. *See* John E. Kwoka, Jr. & Frederick R. Warren-Boulton, *Efficiencies, Failing Firms, and Alternatives to Merger: A Policy Synthesis*, 31 ANTITRUST BULL. 431, 446 (1986).

the current failing firm defense could become an escape hatch for anticompetitive transactions involving firms that are only in financial distress. This Note argues that the assets exiting the market requirement is crucial for antitrust purposes, that the requirement has not been consistently considered by Antitrust Regulators, and that removing it from the list of elements in the 2010 merger guidelines makes the failing firm defense easier to use by firms only in financial distress. Part I provides an overview of the failing firm defense and its history. Part II explains the conceptual underpinnings of the failing firm defense and how the elements of the defense have been analyzed. Part III examines the application of the 1992 Merger Guidelines version of the failing firm defense in the Trans World Airlines ("TWA") merger with American Airlines and the future application of the defense after the newly created 2010 Merger Guidelines. This Part concludes that Antitrust Regulators have been allowing firms that are only financially distressed to use the defense, as opposed to firms that are failing in the antitrust sense. Part IV proposes using an "Assets Exiting Defense" to replace the current failing firm defense. An "Assets Exiting Defense" would ensure that Antitrust Regulators focus exclusively on antitrust principles and do not apply the defense too broadly to include anticompetitive transactions involving firms only in financial distress. The purpose of the defense should be to protect competition, not to protect firms from failing in a distressed economy.

I. OVERVIEW OF THE FAILING FIRM DOCTRINE

The failing firm defense is only considered if the prima facie case shows that the transaction is presumptively anticompetitive.[15] "The failing firm doctrine permits an otherwise anticompetitive merger or acquisition if the" defendant or proponent of the merger can demonstrate that the acquired firm would fail absent the transaction.[16] It was judicially created

[15] *See* PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION 273 (3d ed. 2009).

[16] *See* Paredes, *supra* note 7, at 352.

in the 1930 Supreme Court decision *International Shoe Co. v. Federal Trade Commission*[17] in a famous and oft-quoted passage, where Justice Sutherland wrote:

> In the light of the case thus disclosed of a corporation with resources so depleted and the prospect of rehabilitation so remote that it faced *the grave probability of a business failure* with resulting loss to its stockholders and injury to the communities where its plants were operated, we hold that the purchase of its capital stock by a competitor (*there being no other prospective purchaser*), not with a purpose to lessen competition, but to facilitate the accumulated business of the purchaser and with the effect of mitigating seriously injurious consequences otherwise probable, is not in contemplation of law prejudicial to the public and does not substantially lessen competition or restrain commerce within the intent of the Clayton Act.[18]

"The grave probability of a business failure" language is not only the first articulation of the defense, but also led to the development of a two-prong test that was confirmed in *United States v. Greater Buffalo Press, Inc.*[19] in 1971 and in *United States v. General Dynamics Corp.*[20] in 1974.[21] The Court in *Greater Buffalo Press* said that in order to be considered failing, a firm must show "(1) that the resources of [the company] were 'so depleted and the prospect of rehabilitation so remote that it faced the grave possibility of a business failure' and (2) that there was no other prospective purchaser for it."[22] The Court determined that "an acquisition that would otherwise violate the antitrust laws may proceed if the acquired company is a failing firm."[23] Some courts have also added a third element: that the failing firm could not be reorganized successfully.[24] These elements imply that the firm would "very likely disappear from" the

[17] 280 U.S. 291 (1930).

[18] *Id.* at 302–03 (emphasis added).

[19] 402 U.S. 549, 555 (1971).

[20] 415 U.S. 486, 506–07 (1974).

[21] This language is still used verbatim in describing the financial distress prong of the failing firm test. *See, e.g.*, United States v. Gen. Dynamics Corp., 415 U.S. 486, 507 (1974); United States v. Greater Buffalo Press, Inc., 402 U.S. 549, 555 (1971); Citizen Publ'g Co. v. United States, 394 U.S. 131, 137 (1969).

[22] 402 U.S. at 555; *see also Gen. Dynamics Corp.*, 415 U.S. at 507.

[23] *See* Joel G. Chefitz, *A Tale of Two Mergers: American/TWA and United/USAir*, 14 DEPAUL BUS. L.J. 215, 216 (2002).

[24] *See Citizen Publ'g Co.*, 394 U.S. at 138.

relevant market unless the firm was rescued by a merger.[25] After the Supreme Court's creation of the failing firm doctrine, Congress also explicitly acknowledged the existence of the failing firm defense for actions challenging otherwise unlawful mergers or acquisitions.[26]

While the failing firm defense is well established in United States case law and in Congress, "most merger work is done at the agency level, with only a small percentage reaching the courts."[27] After the Hart-Scott-Rodino Antitrust Improvements Act of 1976,[28] the failing firm defense battleground has shifted from the courtroom to pre-merger filings and investigations by Antitrust Regulators.[29] If in their pre-merger investigations, which include efficiencies analysis and the technical expertise of

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[25] AREEDA & HOVENKAMP, *supra* note 15, at 283.

[26] The Senate Report on the 1950 amendments to § 7 of the Clayton Act stated:

> The argument has been made that the proposed bill, if passed, would have the effect of preventing a company which is in a failing or bankrupt condition from selling out. The committee are [sic] in full accord with the proposition that any firm in such a condition should be free to dispose of its stock or assets. The committee however, do [sic] not believe that the proposed bill will prevent sales of this type. 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.

S. REP. NO. 81-1775, at 7 (1950), *reprinted in* 1950 U.S.C.C.A.N. 4293, 4299; *accord* H.R. REP. NO. 81-1191, at 6–7 (1949).

[27] *See* Lauren N. Norris, *The Failing Firm Defense* (July 2010), *available at* http://www.klgates.com/files/Publication/1ae9fe1f-ab0e-49cb-8527-00ac4fc754e7/Presentation/PublicationAttachment/9c1d5211-abbf-4217-a7ea-0756cc43c192/Norris_Failing FirmDefense.pdf.

[28] The Hart-Scott-Rodino Antitrust Improvements Act of 1976, Pub. L. No. 94-435, §§ 201, 202, 90 Stat. 1383 (codified as amended in scattered sections of 15, 18, and 28 U.S.C.), provides pre-merger filing requirements that vastly changed merger law and practice. For a review of the Hart-Scott-Rodino Act's effect on merger practice, *see* Joe Sims & Deborah P. Herman, *The Effect of Twenty Years of Hart-Scott-Rodino on Merger Practice: A Case Study in the Law of Unintended Consequences Applied to Antitrust Legislation*, 65 ANTITRUST L.J. 865, 866 (1997).

[29] *See* Oliver Zhong, Note, *The Failing Company Defense After the Commentary: Let it Go*, 41 U. MICH. J.L. REFORM 745, 747 (2008) (suggesting that the failing firm defense should no longer be recognized).

economists, Antitrust Regulators determine that the merger will be unlawful according to the Horizontal Merger Guidelines, they will challenge the merger.[30]

Today, the most widely accepted version of the failing firm defense is that created by the Antitrust Regulators in the Horizontal Merger Guidelines.[31] The Horizontal Merger Guidelines were created to "outline how the federal agencies evaluate the likely competitive impact of mergers and whether those mergers comply with U.S. antitrust law."[32] The Horizontal Merger Guidelines were adopted in 1968 and revised in 1982, 1984, 1992, and, most recently, 2010.[33] Revisions in the Horizontal Merger Guidelines are supposed to reflect changes in enforcement policy.[34] For eighteen years the 1992 Merger Guidelines provided that:

> A merger is not likely to create or enhance market power or facilitate its exercise if the following circumstances are met: (1) The allegedly failing firm would be unable to meet its financial obligations in the near future; (2) it would not be able to reorganize successfully under Chapter 11 of the Bankruptcy Act; (3) it has made unsuccessful good-faith efforts to elicit reasonable alternative offers of acquisition of the assets of the failing firm that would both keep its tangible and intangible assets in the relevant market and pose a less severe danger to competition than does the proposed merger; and (4) absent the acquisition, the assets of the failing firm would exit the relevant market.[35]

After the 1992 Merger Guidelines were criticized for being so narrowly defined,[36] the failing firm defense was revised in 2010. The revised guidelines appear to be the same as the 1992 Merger

[30] *See id.*

[31] *See* Paredes, *supra* note 7, at 352–53.

[32] Cecelia M. Assam, *Revised Horizontal Merger Guidelines Offer Glimpse of Premerger Analysis by DOJ, FTC*, 99 ANTITRUST & TRADE REG. REP. 231, 231 (2010) (internal quotiation marks omitted).

[33] *See id.* at 232.

[34] 2010 HORIZONTAL MERGER GUIDELINES, *supra* note 9, at 1 n.1.

[35] 1992 Horizontal Merger Guidelines, 57 Fed. Reg. 41,552, 41,563 (Sept. 10, 1992).

[36] *See* Debra A. Valentine, Deputy Director, *Horizontal Issues: What's Happening and What's on the Horizon*, FED. TRADE COMM'N (Dec. 8, 1995), http://www.ftc.gov/speeches/other/dvhorizontalissues.shtm; Edward O. Correia, *Re-Examining the Failing Company Defense*, 64 ANTITRUST L.J. 683, 691 (1996); J. Bruce McDonald, Deputy Assistant Att'y Gen., Antitrust Div., Remarks on Antitrust for Airlines 8 (Nov. 3, 2005), http://www.justice.gov/atr/public/speeches/217987.htm.

Guidelines, but the 2010 version of the failing firm defense does not explicitly list the fourth element—that absent the acquisition, the assets of the failing firm would exit the relevant market. The 2010 Merger Guidelines provide:

> The Agencies do not normally credit claims *that the assets of the failing firm would exit the relevant market unless all of the following circumstances* are met: (1) the allegedly failing firm would be unable to meet its financial obligations in the near future; (2) it would not be able to reorganize successfully under Chapter 11 of the Bankruptcy Act; and (3) it has made unsuccessful good-faith efforts to elicit reasonable alternative offers that would keep its tangible and intangible assets in the relevant market and pose a less severe danger to competition than does the proposed merger.[37]

While substantively the 1992 and the 2010 Merger Guidelines appear similar, it appears that the 2010 version of the failing firm defense does not require analyzing whether the assets of a firm would exit the relevant market as a separate element. Instead, the 2010 version seems to indicate that the assets exiting the relevant market requirement is automatically met so long as the three other elements are met. This interpretation would substantially loosen the strict requirements of the 1992 Merger Guidelines because instead of analyzing all four elements, Antitrust Regulators may now be implying that if the first three elements are met, the assets exiting the relevant market element is also fulfilled and need not be analyzed separately.

While the wording in the Horizontal Merger Guidelines is slightly different from the case law, the analysis of whether a firm is failing is essentially the same. Thus, Antitrust Regulators and courts have strictly enforced the requirements of the failing firm defense from the Horizontal Merger Guidelines because the failing firm defense is widely believed to be an absolute defense, ending all inquires into the transaction's likely anticompetitive effects.[38] Because the failing firm defense may

[37] 2010 HORIZONTAL MERGER GUIDELINES, *supra* note 9, at 32 (emphasis added).

[38] *See, e.g.*, Dr. Pepper/Seven-Up Cos. v. FTC, 991 F.2d 859, 864–65 (D.C. Cir. 1993); FTC v. Univ. Health, Inc., 938 F.2d 1206, 1220 n.28 (11th Cir. 1991); United States v. Syufy Enters., 903 F.2d 659, 673 n.24 (9th Cir. 1990); Mich. Citizens for an Indep. Press v. Thornburgh, 868 F.2d 1285, 1288 (D.C. Cir. 1989), *aff'd by an equally divided court*, 493 U.S. 38 (1989); Erie Sand & Gravel Co. v. FTC, 291 F.2d 279, 280

allow an anticompetitive merger or acquisition, the burden of proof falls on the defendant or proponent of the merger to prove all of the elements.[39]

"[I]t is not surprising that the failing firm defense has become well-established in antitrust law" because "mergers and acquisitions often involve firms that are financially weak."[40] Because firms that are financially weak usually file for bankruptcy, it is no wonder why the failing firm defense is often raised in bankruptcy. However, the defense should focus solely on antitrust principles and should not be applied too broadly to include anticompetitive transactions involving firms only in financial distress. The purpose of the defense should be to protect competition, not to protect firms from failing in a distressed economy.

II. CONCEPTUAL UNDERPINNINGS

Antitrust Regulators analyze four main elements when applying the failing firm defense. Part II of this Note explains how each element of the failing firm defense is analyzed and briefly examines the approaches used by bankruptcy courts and Antitrust Regulators when reviewing offers for a failing company. Part II.A through II.D will provide an in-depth analysis of each element of the failing firm defense. Part II.E examines the standards used by Antitrust Regulators and the bankruptcy courts when reviewing offers for a failing company through *Dr. Pepper/Seven-Up Companies, Inc. v. Federal Trade Commission.*[41] The facts of *Dr. Pepper* show that a firm can be failing financially in bankruptcy, but still not meet all the requirements necessary for the failing firm defense because two of the elements do not focus on bankruptcy at all.

(3d Cir. 1961); FTC v. Harbour Grp. Invs., Civ. A. No. 90-2525, 1990 WL 198819, at *2 (D.C. Cir. Nov. 19, 1990); Joseph Ciccone & Sons, Inc. v. Eastern Indus., 537 F. Supp. 623, 628 (E.D. Pa. 1982); United States v. M.P.M., Inc., 397 F. Supp. 78, 95 (D. Colo. 1975); United States v. Md. & Va. Milk Producers Ass'n, 167 F. Supp. 799, 808 (D.D.C. 1958), *aff'd in part*, *rev'd in part on other grounds*, 362 U.S. 458 (1960).

[39] *See* Paredes, *supra* note 7, at 353.

[40] *Id.* at 354.

[41] 798 F. Supp. 762 (D.D.C. 1992).

A. The Inability To Meet Financial Obligations in the Near Future Requirement

First, the failing firm defense requires the allegedly failing firm to prove that it is unable to meet its financial obligations in the near future. There is no checklist to determine if a firm cannot meet its financial obligations in the near future.[42] This requirement must be carefully analyzed on a case-by-case basis.[43] However, "negative current profits" or "a decline in sales" are "insufficient to demonstrate that a firm would be unable to meet its financial obligations" in the near future.[44] The main concern when determining whether a firm can meet its financial obligations is whether the firm has sufficient cash flow.[45] Other factors that Antitrust Regulators consider include:

1) Whether a company's costs are greater than its revenue[46]
2) Whether total liabilities exceed total assets over a period of time[47]
3) Whether a company's short term losses are likely to be repeated[48]
4) Whether a company has the ability "to obtain new revenues or . . . customers"[49]
5) Whether the company's "productivity is declining"[50]
6) Whether the "supply of key inputs . . . is being exhausted"[51]
7) Whether the company is being run poorly by current management[52]
8) Whether a company's financial problems are part of "an irreversible downward trend"[53]

[42] ORG. FOR ECON. CO-OPERATION AND DEV., POLICY ROUNDTABLES: THE FAILING FIRM DEFENCE 2009 177 (2009), http://www.oecd.org/dataoecd/16/27/45810821.pdf [hereinafter THE FAILING FIRM DEFENCE].

[43] *Id.*

[44] *Id.*

[45] THE FAILING FIRM DEFENCE, *supra* note 42, at 177.

[46] *Id.*

[47] *See* California v. Sutter Health Sys., 130 F. Supp. 2d 1109, 1134–35 (N.D. Cal. 2001).

[48] *See* KEN HEYER & SHELDON KIMMEL, ECONOMIC ANALYSIS GROUP DISCUSSION PAPER: MERGER REVIEW OF FIRMS IN FINANCIAL DISTRESS 4–6 (2009), http://www.justice.gov/atr/public/eag/244098.pdf.

[49] THE FAILING FIRM DEFENCE, *supra* note 42, at 177.

[50] *See* HEYER & KIMMEL, *supra* note 48, at 4.

[51] *Id.*

[52] *Id.*

9) Whether the firm is more attributable to the "general, and temporary, depressed state of the economy"[54]
10) "[W]hether the company's pre-merger, ordinary course of business documents reveal an imminent financial failure, or if the claims of failure appear to be invented to help defend the merger"[55]

None of these factors is determinative, but antitrust regulators will consider them when analyzing whether the firm is unable to meet financial obligations in the near future. Because being unable to meet financial obligations in the near future focuses solely on whether a firm is financially distressed, this element by itself has no implication on antitrust law.

B. The Inability To Reorganize in Bankruptcy Requirement

Second, the failing firm defense requires that the allegedly failing firm prove that it is unable to reorganize in bankruptcy.[56] To determine whether a company is unable to reorganize in bankruptcy, antitrust regulators consider "whether the elimination of the company's debt through a bankruptcy proceeding could correct the company's financial problems."[57]

[53] THE FAILING FIRM DEFENCE, *supra* note 42, at 177.

[54] *Id.*

[55] *Id.* at 177–78.

[56] THE FAILING FIRM DEFENCE, *supra* note 42, at 178 n.23 (2009).

> [U]nder Chapter 11 of the U.S. Bankruptcy Code, 11 U.S.C. §§ 1101–1116, any company may initiate a bankruptcy reorganization proceeding. Once it files its reorganization petition, the company continues to operate, typically under the control of current management, and is given a wide variety of statutory powers to cancel or renegotiate contracts, use collateral to borrow additional funds, rescale its operations, and modify its debt and equity structure. Creditors may not initiate legal action against the company outside the bankruptcy process. Ultimately, the company will propose a plan of reorganization to keep its business alive and pay creditors over time. The court must approve the plan, and certain debts incurred prior to the filing of the bankruptcy petition will be discharged. The turnaround period may involve years of operation in Chapter 11 reorganization, until an economically viable business can be assured. If no feasible reorganization plan can be formulated, then, under a Chapter 7 liquidation proceeding, the assets of the company may be liquidated by a trustee, and the proceeds distributed pursuant to the priorities set forth in Chapter 7 of the Bankruptcy Code. 11 U.S.C. §§ 701–716.

Id.

[57] *See id.* at 178; *see also* United States v. Reed Roller Bit Co., 274 F. Supp. 573, 584 (W.D. Okla. 1967) (finding that although a company's poor performance made it an unattractive subsidiary, "it was not near bankruptcy, and it does not appear that it would have been in the absence of merger").

"[R]eorganization may not be possible" if "the company is unable to meet its current and expected operating expenses from its expected revenues, or [if its] capital has been exhausted."[58]

Antitrust Regulators will also "consider the company's projections for improving its condition and whether the company has a viable plan going forward."[59] A company's decision to liquidate is not enough to create a failing firm situation unless the company's economic condition is beyond the prospect of liquidation.[60] Antitrust Regulators may also "talk to the company's creditors to determine whether they can or will work out a plan to restructure the company's debts."[61] If a company's future prospects are promising, creditors may be willing to restructure loans, or loan additional funds to keep it in business.[62] Because being unable to reorganize in bankruptcy focuses solely on whether a firm is financially distressed, this element by itself does not concern antitrust law.

C. The No Alternative Purchaser Less Detrimental to Competition Requirement

Third, the failing firm defense requires that the allegedly failing firm prove that there are no other reasonable alternatives less detrimental to competition. The Supreme Court has stated that "[t]he failing company doctrine plainly cannot be applied in a merger or in any other case unless it is established that the company that acquires the failing company or brings it under dominion is the only available purchaser."[63] Courts interpreting this requirement describe its burden as "quite heavy,"[64] and hold litigants asserting the defense to a showing that good faith efforts were made to find an alternative purchaser.[65] The guidelines state that "[a]ny offer to purchase the assets of the failing firm for a price above the liquidation value of those assets

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[58] *See* THE FAILING FIRM DEFENCE, *supra* note 42, at 178.

[59] *Id.*

[60] *See Reed Roller Bit Co.*, 274 F. Supp. at 584 (citing Erie Sand & Gravel Co. v. FTC, 291 F.2d 279 (3d Cir. 1961)).

[61] THE FAILING FIRM DEFENCE, *supra* note 42, at 178.

[62] *See* HEYER & KIMMEL, *supra* note 48, at 6.

[63] Citizen Publ'g Co. v. United States, 394 U.S. 131, 138 (1969) (emphasis added).

[64] FTC v. Harbour Grp. Invs., Civ. A. No. 90-2525, 1990 WL 198819, at *3 (D.D.C. Nov. 19, 1990) (citing *Citizen Publ'g Co.*, 394 U.S. at 138).

[65] *See id.* at *3, *6.

will be regarded as a reasonable alternative."[66] Additionally, the alternative purchaser should appear willing and able to keep the assets operating in the market in order to be preferred over the competitor.[67] Antitrust Regulators might also "require a less anticompetitive purchaser, even if it offers a lower price than the proposed" merger.[68]

Determining whether a company sufficiently pursued alternative purchasers can be difficult. Antitrust Regulators require that the assets of the allegedly failing company be "shopped" before determining that a company is entitled to the failing firm defense.[69] This sends a "signal to prospective sellers that the search must be thorough and genuine."[70] Requiring a genuine effort to find an alternative purchaser ensures that there is "a good picture of the prospects for another buyer" by the time the proposed merger reaches the stage of review by Antitrust Regulators.[71] The nature and size of the relevant market will determine the scope of the "shopping."[72] Antitrust Regulators require: (1) that a number and variety of companies be contacted, including investment groups or companies from related industries," (2) that sufficient information be provided to companies expressing interest," and (3) "that legitimate expressions of interest be pursued seriously."[73]

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[66] 2010 HORIZONTAL MERGER GUIDELINES, *supra* note 9, at 32 n.16.

[67] *See* 1992 Horizontal Merger Guidelines, 57 Fed. Reg. 41,552, 41,563 (Sept. 10, 1992).

[68] ABA SECTION OF ANTITRUST LAW, MERGERS AND ACQUISITIONS: UNDERSTANDING THE ANTITRUST ISSUES 282 (3d ed. 2008).

[69] *See* HEYER & KIMMEL, *supra* note 48, at 5.

[70] Correia, *supra* note 36, at 693. Cases such as *FTC v. Harbour Group Investments L.P.*, 1990 WL 198819 (D.D.C. 1990), which resulted in a preliminary injunction because of an inadequate search, make the point well. *See also* Olin Corp. v. FTC, 986 F.2d 1295, 1307 (9th Cir. 1993) (requiring a search for an alternative purchaser even though assets would have exited the market in the absence of merger).

[71] *See* Correia, *supra* note 36, at 693–94.

[72] THE FAILING FIRM DEFENCE, *supra* note 42, at 179. For example, "contact[ing] only a few purchasers when the relevant market was small and unattractive to potential purchasers," and requiring many purchasers when the relevant market was large and more attractive to potential purchasers, are factors that determine the scope of "shopping." *Id.* n.29.

[73] *See* THE FAILING FIRM DEFENCE, *supra* note 42, at 179.

The burden is on the defendant or proponent of the merger to demonstrate that there are no reasonable alternative purchasers less detrimental to competition.[74] Antitrust Regulators are not obligated to find another willing purchaser.[75] However, the fact that Antitrust Regulators "cannot . . . find another interested purchaser may be persuasive evidence that the merging firm's unsuccessful 'shop' was adequate."[76] General expressions of interest from alternative purchasers do not constitute reasonable alternative offers, unless there are extensions of an actual offer.[77] Because finding an alternative purchaser less detrimental to competition affects competition, this element directly concerns antitrust law.

D. The Assets Exiting the Relevant Market Requirement

Lastly, the failing firm defense requires that, absent the acquisition, the assets of the firm would exit the relevant market. Should that occur, then "by definition [the firm's] assets would be providing no competitive [re]straint [on] the market at all."[78] Simply showing that no alternative purchaser can be found does not prove "that the allegedly failing firm would itself liquidate rather than continue to operate the assets in the [relevant] market."[79] Because the evidence given to Antitrust Regulators "often rests largely in the hands of the allegedly failing firm," "it can be difficult to determine whether the assets would exit the market."[80]

The allegedly failing firm should be able to provide Antitrust Regulators with "objective evidence sufficient to show that it is not more profitable for it to continue to operate the assets in the market than to have them employed elsewhere—such as through liquidation."[81] Some courts require evidence that the firm made a decision to close its business in the near future.[82] The fact that a firm with market power offers to buy it might be

[74] *See* Paredes, *supra* note 7, at 353.
[75] THE FAILING FIRM DEFENCE, *supra* note 42, at 179.
[76] *Id.*
[77] *See* California v. Sutter Health Sys., 130 F. Supp. 2d 1109, 1137 (N.D. Cal. 2001); United States v. Culbro Corp., 504 F. Supp. 661, 669 (S.D.N.Y. 1981).
[78] HEYER & KIMMEL, *supra* note 48, at 6.
[79] *See* THE FAILING FIRM DEFENCE, *supra* note 42, at 179.
[80] *See id.*
[81] *See id.*
[82] Olin Corp. v. FTC, 986 F.2d 1295, 1307 (9th Cir. 1993).

"evidence that its assets are in certain ways useful."[83] If a firm's assets still have value they will likely not leave the market absent the acquisition and therefore the failing firm defense would not apply. Because determining whether a firm would exit the relevant market affects competition, this element has strong antitrust implications.

E. The Different Standards Used by Antitrust Regulators and Bankruptcy Courts When Reviewing Offers for a Failing Firm

Bankruptcy alone is not enough to invoke the failing firm defense. A firm in bankruptcy is financially distressed, but that only satisfies the first two elements of the failing firm defense. The confusion arises from the fact that being unable to pay obligations in the near future and unable to reorganize successfully ("bankruptcy elements") concern bankruptcy, whereas the alternative purchaser requirement and assets exiting the relevant market requirement ("antitrust elements") concern antitrust law. The inherent conflict between the bankruptcy elements and the antitrust elements makes the failing firm defense, as it currently stands, problematic for Antitrust Regulators and bankruptcy courts.

Antitrust Regulators and bankruptcy courts use very different standards when reviewing offers for a failing firm.[84] "[A]ntitrust [R]egulators tend to favor the deal that best protects competition and keeps assets in service, even if that means creditors reclaim less money."[85] On the other hand, bankruptcy courts "usually favor the offer that returns the most money to the company's creditors and other stakeholders, unless there is clear evidence that the deal would violate the antitrust laws."[86]

The inherent conflict between the bankruptcy elements and the antitrust elements of the failing firm defense makes it difficult for bankruptcy courts to determine what evidence would clearly show violation of the antitrust laws. In *Dr. Pepper/Seven-Up Companies, Inc. v. Federal Trade*

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[83] *See* Zhong, *supra* note 29, at 772.

[84] *See* Charles Sisk, *Rival Bids Imperil AMR Deal for TWA*, DAILY DEAL (Feb. 14, 2001), http://www.law.com/jsp/article.jsp?id=900005527280&hbxlogin=1.

[85] *Id.*

[86] *Id.*

Commission,[87] the owner of Canada Dry Bottling Company of New York and Pepsi Cola Bottling Company of New York, Inc. acquired Seven-Up Brooklyn's soft drink franchises.[88] Seven-Up Brooklyn had been "financially troubled for many years" until it filed for bankruptcy protection under Chapter 11.[89] The bankruptcy court issued an order finding that "Seven-Up Brooklyn was a failed business unable 'to recommence operations or continue in its normal course of business,' " and that the deal for the owner of Canada Dry Bottling Company and Pepsi Cola Bottling Company of New York "to acquire Seven-Up Brooklyn was 'the only proposal that might provide for distribution to the unsecured creditors or the estate, even with the FTC approval process taken into consideration.' "[90] Conversely, when the FTC challenged the acquisition in the district court, the court found that it was clear from the record that the FTC could rationally conclude that Seven-Up Brooklyn had failed to meet the requirements of the failing firm doctrine.[91] The court held that Seven-Up had failed to establish that the proposed purchaser of Seven-Up Brooklyn's soft drink franchises was the "only available purchaser" and rejected the merger.[92] The district court acknowledged that although the company was bankrupt and had met the first two requirements of the failing firm defense, it did not meet the antitrust elements and, therefore, could not take advantage of the defense.[93]

Dr. Pepper shows that a firm can be failing financially in bankruptcy, but still not meet all the requirements necessary for the failing firm defense.[94] Failing financially is insufficient, as a matter of law, to sanction a merger shown by other evidence to be likely to lessen competition.[95] This is because a firm's financial failings have essentially no effect on its competitive position in

[87] 798 F. Supp. 762 (D.D.C. 1992).

[88] *See id.* at 764.

[89] *See id.* at 765.

[90] *Id.* at 778–79.

[91] *Id.* at 779.

[92] *Id.*

[93] *See id.* at 778–79.

[94] *See* United States v. Pabst Brewing Co., 296 F. Supp. 994, 1003 (E.D. Wis. 1969) (finding that even though the defendants "were in a very serious, even precarious, financial position at the time of the merger," they nonetheless "failed to satisfy their burden of proving the material elements of the failing firm defense").

[95] *See* Kwoka & Warren-Boulton, *supra* note 14, at 450.

the relevant market.[96] In fact, a firm in bankruptcy "may remain in business indefinitely although it fails to cover total costs."[97] Thus, "impending [financial] failure does not necessarily mean that a firm would in fact disappear from the market without the particular merger in question."[98]

III. PRACTICAL APPLICATION OF THE FAILING FIRM DEFENSE

A recession causes many firms to experience financial distress. Naturally, there are likely to be more bankruptcies during a recession than in years when the economy is stronger.[99] A bankruptcy sale is often the "exit strategy of choice for distressed companies and their suitors."[100] Bankruptcy sales also tend to raise failing firm issues.[101]

Given the state of the economy, much merger and acquisition activity in the near future may involve companies in dire financial straits, raising the issue of whether antitrust regulators will be more sympathetic to the acquisition of failing firms.[102] "[T]here was speculation that the failing firm defense would be invoked more often and [that antitrust regulators] would relax the defense's stringent requirements."[103] If the defense is relaxed, some firms might attempt to use poor economic conditions as a way to secure approval of what would otherwise be judged an anticompetitive merger.[104]

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[96] *See* Zhong, *supra* note 29, at 772.

[97] G.E. Hale & Rosemary D. Hale, *Failing Firms and the Merger Provisions of the Antitrust Laws*, 52 KY. L.J. 597, 601 (1964).

[98] AREEDA & HOVENKAMP, *supra* note 15, at 275.

[99] *See* Remarks by Shapiro, *supra* note 3, at 13. Between 2007 and 2008, about 35,000 firms filed for bankruptcy. *See Business and Nonbusiness Bankruptcy Cases Commenced, by Chapter of the Bankruptcy Code, During the Twelve Month Period Ended Sept. 30, 2008*, http://www.uscourts.gov/uscourts/Statistics/BankruptcyStatistics/BankruptcyFilings/2008/0908_f2.pdf; *Business and Nonbusiness Bankruptcy Cases Commenced, by Chapter of the Bankruptcy Code, During the Twelve Month Period Ended Sept. 30, 2007*, http://www.uscourts.gov/uscourts/Statistics/BankruptcyStatistics/BankruptcyFilings/2007/0907_f2.xls. This data includes bankruptcies leading to both liquidations and reorganizations. The number of bankruptcies rose from about 26,000 in 2007 to about 39,000 in 2008.

[100] *See* Ryan K. Cochran, et. al., *Antitrust Concerns May Block Section 363 Sales Bankruptcy Court Orders May Not Be as Bulletproof as They Seem* (May 14, 2009), http://www.turnaround.org/publications/articles.aspx?objectID=10957.

[101] *See* Nigro & Kanter, *supra* note 11, at 11.

[102] *See* Remarks by Shapiro, *supra* note 3, at 20.

[103] *See* Norris, *supra* note 27.

[104] *See* Remarks by Shapiro, *supra* note 3, at 20.

Part III of this Note explores how the 1992 version of the failing firm defense has been applied by antitrust regulators in a proposed bankruptcy merger, and how the failing firm defense may be applied after the new 2010 Merger Guidelines. Specifically, this section analyzes how antitrust regulators interpreting the failing firm defense have been deemphasizing the importance of the antitrust elements of the failing firm defense, thereby allowing firms that are only financially distressed to use the defense. Part III.A explores the TWA and American Airlines merger and illustrates how the failing firm defense has been misapplied by antitrust regulators to allow firms that are only financially distressed to use the failing firm defense. Part III.B explores how the 2010 Merger Guidelines will likely be interpreted by antitrust regulators and how the new guidelines might make it easier for firms which are failing financially to use the failing firm defense.

A. Application of the 1992 Version of the Failing Firm Defense in the TWA and American Airlines Merger

One of the leading sources of the failing firm confusion was the TWA and American Airlines merger. The highly publicized merger proved that the failing firm defense was "alive and well,"[105] but also that antitrust regulators are putting too much emphasis on bankruptcy to prove the defense. This section analyzes the TWA and American Airlines merger, the antitrust regulators' rationale for allowing the merger, and the bankruptcy test antitrust regulators used, which resulted in a misapplication of the 1992 version of the failing firm defense.

1. Factual Background of the TWA and American Airlines Merger

In early 2001, the plan for American Airlines to acquire the critically ailing TWA was confirmed after successful use of the failing firm defense.[106] "TWA was in dire financial straits and American Airlines appeared to be its only and last financial hope before it succumbed to liquidation."[107] At the time, American Airlines was already the second-largest U.S. airline carrier, while

[105] Chefitz, *supra* note 23, at 219.
[106] *See id.*
[107] Bensel v. Allied Pilots Ass'n, 675 F. Supp. 2d 493, 494–95 (D.N.J. 2009).

TWA was the eighth-largest.[108] According to the deal, American agreed "to pay approximately $500 million for about 190 TWA aircraft, 175 gates, and 173 slots across the country."[109] As part of the arrangement, TWA filed for Chapter 11 bankruptcy protection from creditors.[110] This marked the third time that cash-strapped TWA had filed for bankruptcy protection.[111]

TWA's bankruptcy filing sharply increased pressure on Antitrust Regulators to approve the deal because allegedly no other buyers had expressed interest and "TWA [was] one way or another going to disappear as a corporate entity."[112] Supporters of the merger looked at the deal not as a merger, but as a "rescue mission," because "TWA [could not] be saved without America's help."[113] The proponents focused primarily on saving jobs rather than the competitive consequences of the deal.[114] Critics of the merger said that the deal was "unchecked airline arrogance and blatant disregard for the principles of competition."[115] Those opposing the merger were concerned that the deal would leave two dominant airlines in the U.S. air travel industry[116] that would lead to higher airfares for consumers.[117]

2. Antitrust Regulators Misapplied the 1992 Version of the Failing Firm Defense Because TWA Was Only Failing Financially

Antitrust Regulators allowed the TWA and American Airlines merger to go forward without challenge although TWA was only financially distressed. TWA was able to use the failing

[108] *See* Brian Knowlton, *TWA's Farewell Will Radically Alter U.S. Airline Market*, N.Y. TIMES, Jan. 11, 2001, *available at* http://www.nytimes.com/2001/01/11/news/11iht-twa.2.t_1.html?pagewanted=print.

[109] Tim Johnson & Kim Khan, *AMR Takes TWA Aboard*, CNN MONEY (Jan. 10, 2001), http://money.cnn.com/2001/01/10/deals/amr_twa/. *See also* Jim Abrams, *Congress Weighs American-TWA Merger Fallout*, ABC NEWS (Feb. 1, 2001), http://abcnews.go.com/US/story?id=94229&page=1.

[110] *See* Johnson & Khan, *supra* note 109; *see also* Knowlton, *supra* note 108.

[111] "TWA filed its first chapter 11 bankruptcy petition in 1992. It filed its second chapter 11 bankruptcy petition in 1995. TWA filed . . . its third chapter 11 bankruptcy [petition] on January 10, 2001." *In re* Trans World Airlines, Inc., No. 01-00056(PJW), 2001 WL 1820326, at *2 (Bankr. D. Del. Apr. 2, 2001).

[112] Johnson & Khan, *supra* note 109; Knowlton, *supra* note 108.

[113] Abrams, *supra* note 109.

[114] *See id.*; *see also* Johnson & Khan, *supra* note 109.

[115] Johnson & Khan, *supra* note 109.

[116] *See id.; see also* Abrams, *supra* note 109.

[117] *See* Johnson & Khan, *supra* note 109; *see also* Knowlton, *supra* note 108.

firm defense because Antitrust Regulators misapplied the alternative purchaser and the assets exiting the relevant market requirements. The bankruptcy court found:

> TWA was and has been in dire financial straights [sic] for a considerable period of time. It had no real prospect for a standalone reorganization. This is TWA's third chapter 11 case in less than ten years and a sale of its business as a going concern is its only real hope for significant recoveries for significant segments of its creditor constituencies.[118]

In this case, Antitrust Regulators were more concerned with the loss suffered by creditors instead of the potential loss of competition.[119] In doing so, Antitrust Regulators misapplied the alternative purchaser requirement and the assets exiting the relevant market requirement of the failing firm defense. These two requirements are the only requirements that have antitrust consequences.[120] If Antitrust Regulators do not analyze the antitrust elements of the failing firm defense correctly, there is a risk that an anticompetitive merger will be approved wrongfully because "the financial condition of a firm is neither necessary nor sufficient" to use the failing firm defense.[121] Loosening the strict requirement that a firm meet each element of the failing firm defense creates confusion in the doctrine. Although TWA was financially distressed,[122] it should not have been able to use the failing firm defense because there were alternative purchasers available and TWA's assets would not have left the air transportation market.

[118] *In re* Trans World Airlines, Inc., No. 01-00056(PJW), 2001 WL 1820326, at *7 (Bkrtcy. D. Del. 2001). "TWA has not earned a profit for over a decade" prior to the bankruptcy proceedings; "[i]t incurred operating losses of $29.26 million in 1997, $65.16 million in 1998, and $347.64 million in 1999." *Id.* at *2.

[119] *See id.* at *6–7.

[120] *See supra* Part II.C–D.

[121] *See* Kwoka & Warren-Boulton, *supra* note 14, at 450.

[122] TWA showed that it was unable to meet its financial obligations in the near future and that it likely could not reorganize in bankruptcy. In re *Trans World Airlines*, 2001 WL 1820326, at *2 (Bankr. D. Del. 2001). TWA could not meet its operating expenses and "[t]he airline had less than a day's cash flow on hand at the time of its bankruptcy filing." Chefitz, *supra* note 23, at 223. Furthermore, "[TWA] evaluated various options, some very severe options that might have permitted TWA to survive as a going concern but as a scaled back airline" that were ultimately unsuccessful. *Id.* at 222.

a. *Antitrust Regulators' Misapplication of the Alternative Purchaser Requirement*

Antitrust Regulators found that there were no other alternative purchasers. TWA was able to convince Antitrust Regulators of a well-documented "shopping story" to other less competitive purchasers in the pre-bankruptcy period.[123] TWA contacted airline buyers and several non-airline buyers that might have an interest in purchasing TWA.[124] TWA also explored "combinations such as . . . partnerships, and other strategic alliances."[125] Antitrust Regulators were also persuaded by TWA's evidence that "the solicitations of potential bidders included a possible bankruptcy sale."[126] In the pre-bankruptcy period, the advantages of a potential bankruptcy sale were pointed out to all of the prospective purchasers that were contacted.[127] In post-bankruptcy, TWA was able to supplement its pre-bankruptcy "shopping story" with an argument that there were no viable purchasers available because they "suffered from the same systemic deficiencies" that TWA faced, "and thus were neither viable nor credible."[128]

Antitrust Regulators misapplied the alternative purchaser requirement. According to the 2010 Merger Guidelines, "[a]ny offer to purchase the assets of the failing firm for a price above the liquidation value of those assets will be regarded as a reasonable alternative offer."[129] Here, a number of alternative purchasers seemed to be available and sought opportunities to submit meaningful bids.[130] It is well-documented that Carl Icahn submitted a competing bid for TWA and the bankruptcy court

[123] Chefitz, *supra* note 23, at 223.

[124] *Id.* at 222. "In their effort to find a strategic partner, TWA . . . approached more than seven airlines, including Delta, Continental, United and U.S. Air." In re *Trans World Airlines*, 2001 WL 1820326, at *2.

[125] Chefitz, *supra* note 23, at 222.

[126] *Id.* at 223.

[127] *Id*.

[128] *See* In re *Trans World Airlines*, 2001 WL 1820326, at *8, *10; *see also* Chefitz, *supra* note 23, at 223.

[129] 2010 HORIZONTAL MERGER GUIDELINES, *supra* note 9, at 32 n.16.

[130] Once the deal was announced, Continental Airlines said it would pay between $300 and $400 million for certain gates, slots and other assets, while Jet Acquisitions said it had planned to offer nearly $1 billion to keep TWA "independent and financially viable." Sisk, *supra* note 84. Moreover, Northwest Airlines had said it wanted TWA's stake in Worldspan L.P., a reservation service. *Id.*

rejected that proposal as not being a "viable" offer.[131] Instead of determining if the bid price was above the liquidation value, Antitrust Regulators decided to look at whether the bids were viable or meritorious.[132] Antitrust Regulators, like the bankruptcy court, determined that if competing bids would suffer from the same systemic deficiencies that TWA suffered from, it was not a valid offer.[133] Evaluating whether an offer is viable directly conflicts with the explicit wording of the 2010 Guidelines, which states "[*a*]*ny offer* . . . above the liquidation value . . . will be regarded as a reasonable alternative offer."[134] This would also disregard the fact that it would defy reasonable business judgment for a firm to make an offer that is not viable. As a less detrimental alternative purchaser, Carl Icahn should have been free to make structural changes to TWA or sell TWA's assets piecemeal, and his bid should have been accepted. Thus, Antitrust Regulators misapplied the alternative purchaser requirement to the failing firm defense.

b. Antitrust Regulators' Misapplication of the Assets Exiting Requirement

Antitrust Regulators found that the assets-exiting-the-relevant-market requirement was satisfied. TWA was able to convince Antitrust Regulators that, "but for th[e] merger between American and TWA and American's assumption of [TWA's] St. Louis hub and some of the other markets and services offered by TWA, many assets would exit the market [for consumer air transportation in the United States] entirely."[135] TWA claimed that the deal would preserve twenty thousand jobs and retiree benefits that would otherwise be lost.[136] Moreover, TWA claimed that if it "were split up and . . . its assets were sold piecemeal, . . . [the] hub in St. Louis would disappear" from the air transportation market.[137]

[131] *See* In re *Trans World Airlines*, 2001 WL 1820326, at *10.
[132] *See id.*
[133] *See id.*
[134] 2010 HORIZONTAL MERGER GUIDELINES, *supra* note 9, at 32 n.16 (emphasis added).
[135] Chefitz, *supra* note 23, at 224.
[136] *See* In re *Trans World Airlines*, 2001 WL 1820326, at *3, *5.
[137] Chefitz, *supra* note 23, at 224.

Antitrust Regulators also misapplied the requirement that the allegedly failing firm's assets would have exited the relevant market without the acquisition. If assets could be expected to remain in the market in any way, "then acquisition of those assets by a leading firm would raise conventional antitrust concerns."[138] Here, TWA admits that it was only able to prove that "many" assets would exit the air transportation market.[139] This is not enough to prove that the assets of a firm would exit the market absent the acquisition because there are assets that would likely not exit the market.

First, TWA's airplanes would not have exited the air transportation market. A commercial airplane will not disappear from the air transportation market because another airline or an independent company that sells used airplanes and airplane parts would purchase it. "If [a] firm owns important assets whose value is greatest in their current use, these assets are unlikely to exit the market, even if the firm cannot meet its financial obligations in the near future."[140] Rather than exit, productive assets like airplanes are likely to continue serving their productive function.[141] It follows that airplanes will not "disappear from the face of the earth," but will instead "fly until they die." [142] Thus, the airplanes from TWA would have been used in the air transportation market by competitors who bought airplanes piecemeal or by independent dealers who would sell airplanes in the air transportation market had the merger not taken place.

Second, TWA employees would not have all lost jobs and disappeared from the air transportation market. There is no reason to believe "that in any aggregate sense jobs are lost or communities necessarily disrupted" when a firm fails financially.[143] If there are still productive assets like airplanes, the assets will tend to continue to serve their productive function and "continue to employ roughly as many people as they employed before."[144] Thus, most of the former TWA employees

[138] *See* Kwoka & Warren-Boulton, *supra* note 14, at 445.

[139] Chefitz, *supra* note 23, at 224.

[140] *See* Remarks by Shapiro, *supra* note 3, at 21.

[141] *See* William F. Baxter, *Remarks: The Failing Firm Doctrine*, 50 ANTITRUST L.J. 247, 249 (1982).

[142] *Id.*

[143] *Id.*

[144] *Id.*

would likely still be employed to support the airplanes that would be used in the air transportation market by other competitors. Even if some jobs were lost, not all twenty thousand jobs would have disappeared and therefore exited the market.

3. What Should Have Happened with the TWA and American Airlines Merger

Because the TWA and American Airlines merger did not satisfy all of the requirements of the failing firm defense, it would have been preferable to allow TWA to fail and have its assets more widely dispersed throughout the market.[145] TWA's assets could have been poached piecemeal by smaller competitors keeping those assets in the relevant market.[146] While American may have had sufficient resources to acquire TWA in its entirety, "many competitors may have [had] the resources to acquire the strategic assets" from TWA "that they value[d] the most."[147] The bankruptcy court even stated, "[t]he sale of TWA as a going concern avoided the most likely alternative, which was the piecemeal liquidation of individual assets."[148] If TWA was "forced to liquidate in a bankruptcy sale and sell its assets piecemeal to the highest bidder, smaller competitors [might have] purchase[d] and more productively use[d] [TWA's] assets, which in turn [would have] enabled them to compete away market share from the market leader," American Airlines.[149] Moreover, smaller competitors and new entrants might have benefitted from TWA's assets being sold piecemeal because they would be in a better position to compete with American for TWA's released customers.[150]

B. Potential Confusion From the Revised 2010 Merger Guidelines

The 2010 Merger Guidelines have seemed to relax the stringent requirements of the failing firm defense in the 1992 Merger Guidelines. Revisions in the Horizontal Merger

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[145] *See* AREEDA & HOVENKAMP, *supra* note 15, at 275–76.
[146] *See* Johnson & Khan, *supra* note 109.
[147] *See* Paredes, *supra* note 7, at 369–70.
[148] *In re* Trans World Airlines, Inc., No. 01-00056(PJW), 2001 WL 1820326, at *5 (Bkrtcy. D. Del. 2001).
[149] *See* Paredes, *supra* note 7, at 369–70.
[150] *See id.* at 370.

Guidelines are supposed to reflect changes in enforcement policy.[151] The 2010 revisions will create much confusion in the failing firm doctrine because they differ from the 1992 Merger Guidelines on the interpretation of the assets-exiting-the relevant-market requirement.[152] This section will analyze the difference between the 1992 and 2010 Horizontal Merger Guidelines, and briefly explore why the Horizontal Merger Guidelines should not be loosened in a distressed economy.

1. Difference Between the 1992 and the 2010 Merger Guidelines

The main difference between the 1992 and the 2010 Merger Guidelines is that the 2010 Merger Guidelines do not explicitly list as an element that absent the acquisition, the assets of the failing firm would exit the relevant market.[153] Instead, the 2010 Merger Guidelines say "[t]he Agencies do not normally credit claims that the assets of the failing firm would exit the relevant market" unless the firm is "unable to pay its financial obligations in the near future," "would not be able to reorganize successfully," and could not find an alternative purchaser that would pose a less severe danger to competition.[154] Although all of the elements from the 1992 Merger Guidelines seem to be present in the 2010 Merger Guidelines, there may be two interpretations of the new guidelines.

One interpretation of the 2010 Merger Guidelines is that nothing has changed. All of the elements seem to be included in the guidelines and Antitrust Regulators may not change the way they analyze the failing firm defense at all. Antitrust Regulators may interpret the guidelines to mean that if the first three elements are met, then Antitrust Regulators will take those three elements into account when analyzing whether the assets of the failing firm would exit the relevant market absent the acquisition. If nothing has changed in the failing firm defense, it is confusing why Antitrust Regulators changed the wording of the 1992 Merger Guidelines.[155]

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[151] 2010 HORIZONTAL MERGER GUIDELINES, *supra* note 9, at 1 n.1.
[152] *See supra* Part I.
[153] *See supra* Part I.
[154] 2010 HORIZONTAL MERGER GUIDELINES, *supra* note 9, at 32.
[155] *See supra* Part I.

Another more likely interpretation of the 2010 Merger Guidelines is that the defense has changed significantly. While substantively the 1992 and 2010 Merger Guidelines appear similar, the change in wording alone signals that something is different or else Antitrust Regulators would not have changed the wording from the 1992 version.[156] Antitrust Regulators may interpret the guidelines to mean that the failing firm defense does not require analyzing whether the assets of a firm would exit the relevant market as a separate element. Instead, Antitrust Regulators may determine that if the three elements in the 2010 Guidelines are met, then the assets-exiting-the-relevant-market element is automatically met. This interpretation would confirm the holding of the TWA case and substantially loosen the strict requirements of the 1992 Merger Guidelines because now one less requirement of the 1992 Merger Guidelines needs to be met. More importantly, the assets-exiting-the-relevant-market requirement is an antitrust element,[157] which would tilt the balance of the failing firm defense toward a bankruptcy application. If the assets-exiting-the-relevant-market requirement is not included in Antitrust Regulators' analysis, the defense only requires a firm failing financially to prove that there is no alternative purchaser that is less detrimental to competition. This would allow a firm to use poor economic conditions as a way to secure approval of what would otherwise be judged an anticompetitive merger.[158]

Because the Horizontal Merger Guidelines have been "revised from time to time . . . to reflect changes in enforcement policy [or] to clarify aspects of existing policy,"[159] confusion has occurred not just for lawyers, but for the courts as well. Even in bad economic times, the "strict requirements" of the failing firm defense "should not be loosened to address the circumstances of a distressed [economy or] industry."[160] Critics of the 2010 Merger Guidelines say that the guidelines are "neither a complete and accurate description of what [the] enforcement staff considers in

[156] *See id.*
[157] *See supra* Part II.E.
[158] Remarks by Shapiro, *supra* note 3, at 20.
[159] 2010 HORIZONTAL MERGER GUIDELINES, *supra* note 9, at 1 n.1.
[160] *See* Nigro & Kanter, *supra* note 11, at 2.

merger investigations, nor a helpful guide to courts."[161] Although the purpose of the Horizontal Merger Guidelines is to "provide more clarity and transparency,"[162] they seem to have done the opposite in regards to the failing firm defense.

2. Applying the Failing Firm Defense in a Bad Economy

An economic downturn may lead to more proposed mergers between financially distressed firms, but it does not imply that looser standards ought to be applied when analyzing them.[163] Firms that are losing money have to satisfy the conditions demanded by the failing firm defense "even when the overall economy is going through very difficult times."[164] Antitrust Regulators should apply a rigorous failing firm defense during a downturn because a recession can facilitate strong growth in long-term productivity.[165] An economic downturn tends to drive out the less efficient market players, unlike a boom, where inefficient players may not only survive, but grow.[166]

Antitrust Regulators "cannot and should not look the other way when faced with practices or proposed combinations that will harm competition and consumers in the long run."[167] Keeping markets competitive during hard economic times is no less important than during normal economic times.[168] "Although a weak economy may mean that more transactions will pass muster" under the failing firm defense, "those that do not should be blocked in troubled economic times for the same reasons they

[161] *See* Sheri Qualters, *New Merger Guidelines Will Likely Lead to a More Fluid Review Process*, NAT'L L. J. (Aug. 23, 2010), http://www.law.com/jsp/nlj/PubArticleNLJ.jsp?id=1202470948967&slreturn=1. Conversely, Department of Justice Antitrust Chief Christine Varney said that the guidelines "better reflect the agencies' actual practices," and FTC Chairman Jon Leibowitz "praised their ' clarity and predictability.' " Jenna Greene, *New Merger Guidelines Prompt Harsh Response from FTC's Rosch*, THE BLT: THE BLOG OF LEGAL TIMES (Aug. 19, 2010, 4:08 PM), http://legaltimes.typepad.com/blt/2010/08/new-merger-guidelines-prompt-harsh-response-from-ftcs-rosch.html.

[162] Assam, *supra* note 32, at 231.

[163] The same basic principles of antitrust economics apply during a recession as apply during an economic expansion. *See* Remarks by Shapiro, *supra* note 3. Additionally, the ultimate goals of the antitrust laws protecting competition and consumers do not change during an economic downturn.

[164] *See* HEYER & KIMMEL, *supra* note 48.

[165] Remarks by Shapiro, *supra* note 3, at 18 n.34.

[166] *Id.*

[167] *Id.* at 17.

[168] *Id.* at 2.

should be blocked in more 'normal' times."[169] If not, "[there] would be a reduction in competition and harm to consumers and the economy as a whole."[170]

While recessions are temporary, mergers can permanently eliminate competitors.[171] "[T]here is always harm from blocking a merger that would have cut the costs of the firm that had been failing."[172] "[B]ecause it is easier to redeploy assets in booming times than in downturns," "such a cost is relatively high during an economic downturn."[173] Alternatively, "the cost of allowing a merger to create market power is greater during a downturn . . . since entry may be likelier during a boom."[174] Because of the high costs associated with rejecting a merger during an economic downturn, Antitrust Regulators must analyze the failing firm defense carefully and consistently.

IV. EXITING ASSETS DEFENSE

The change in the 2010 Merger Guidelines will lead to continued problems for Antitrust Regulators when applying the elements of the failing firm defense. Moreover, the 2010 Merger Guidelines show that the defense is beginning to look more like a bankruptcy test when the defense should instead be focused on antitrust law. The fact that the failing firm defense continues to create confusion indicates that some modifications to the 2010 Merger Guidelines are in order. The inquiry should not include whether the target is failing financially. A failing firm defense that focuses on financials ignores the more critical antitrust questions. Because the failing firm defense is firmly engrained in antitrust law, the defense should focus solely on antitrust principles. Thus, an "Exiting Assets Defense" is needed to ensure competitive markets and that the defense is applied consistently by Antitrust Regulators.

Particularly in a time when Antitrust Regulators will be faced with a large number of proposed mergers where the failing firm defense may be offered, it is important to understand the principles underlying the defense and the appropriate framework

169 HEYER & KIMMEL, *supra* note 48, at 1.
170 *Id.*
171 Remarks by Shapiro, *supra* note 3, at 15.
172 HEYER & KIMMEL, *supra* note 48, at 11.
173 *Id.*
174 *Id.*

for analyzing merging firms in some form of financial distress.[175] This Part proposes a three-step solution to the failing firm defense confusion. Part IV.A discusses why it is necessary to change the name of the failing firm defense to the "Exiting Assets Defense." Part IV.B explains why the failing firm defense should remove the bankruptcy elements. Part IV.C explains why the failing firm defense should only include the antitrust elements of the defense. Finally, Part IV.D suggests how the guidelines should be revised to include the "Exiting Assets Defense."

A. *Step 1 - Change the Name of the Failing Firm Defense to the "Exiting Assets Defense"*

The actual failing firm defense title should be changed to the "Exiting Assets Defense."[176] It is perhaps more accurate to refer to the failing firm defense as an "Exiting Assets Defense" because "permitting [a] merger may . . . be anticompetitive" "[i]f the assets would likely remain in the market—even if in the hands of some other player."[177] Additionally, the defense will not apply unless the assets-exiting-the-relevant-market requirement is met.

The word "failing" also causes confusion. One definition of "fail" is "to become bankrupt or insolvent."[178] Although this is only one definition of the word "failing," it explains why judges, lawyers and even Antitrust Regulators believe that a firm in bankruptcy can use the failing firm defense. Thus, simply changing the name from the failing firm defense to the "Exiting Assets Defense" would provide more clarity to the defense. Moreover, the name change could lead to judicial economy through less litigation on the failing firm defense issue. Currently, the failing firm defense is often raised, but it is rarely successful.[179] Under the new "Exiting Assets Defense," however,

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[175] *Id.* at 1.

[176] In *Olin Corp. v. FTC*, 986 F.2d 1295, 1307 (9th Cir. 1993), Olin proposed the use of an "exiting assets" defense. The court stated that "The key element of such a defense is proof that, without the merger, the assets owned by the acquired firm would *shortly* be leaving the market." *Id.*

[177] HEYER & KIMMEL, *supra* note 48, at 5.

[178] *Failing Definition*, MERRIAM-WEBSTER.COM, http://www.merriam-webster.com/dictionary/fail?show=0&t=1287343247 (last visited Feb. 9, 2012).

[179] The defense has proven successful in only a small number of court cases. *See, e.g.*, Union Leader Corp. v. Newspapers of New England Inc., 284 F.2d 582, 589–90

lawyers would understand that the defense requires the assets of the firm to exit the market rather than the firm to be merely financially distressed. A greater understanding of the limitations of the defense will lead to less litigation on whether a firm is failing.

B. *Step 2 - Remove the Bankruptcy Elements from the Failing Firm Defense*

The bankruptcy elements of the failing firm defense, which focus on whether a firm is financially distressed, should be removed from the Horizontal Merger Guidelines. A firm is financially distressed if: (1) it is "unable to meet its financial obligations in the near future" and (2) it is unable "to reorganize [in bankruptcy] successfully."[180] These two elements of the failing firm defense do not have any effect on antitrust law because a firm's financial failing has little impact on a firm's competitive position.[181] Indeed, "[f]inancial weakness, while perhaps relevant in some cases, is probably the weakest ground of all for justifying a merger," and "certainly cannot be the primary justification" for permitting one.[182] While being unable to pay bills or to reorganize is often a precursor to a firm's assets potentially exiting the relevant market, financial distress alone is not an antitrust defense.[183] "It is, therefore, apparent that the financial condition of a firm is neither necessary nor sufficient for a per se defense for merger."[184]

C. *Step 3 - Keep the Antitrust Elements from the Failing Firm Defense*

The failing firm defense should focus solely on the requirements that have antitrust implications. The elements of the failing firm defense that have an antitrust effect are: (1) the alternative purchaser requirement and (2) the assets-exiting-the-

(1st Cir. 1960); California v. Sutter Health Sys., 130 F. Supp. 2d 1109, 1133 (N.D. Cal. 2001); Reilly v. Hearst Corp., 107 F. Supp. 2d 1192, 1205 (N.D. Cal. 2000); FTC v. Great Lakes Chem. Corp., 528 F. Supp. 84, 96–98 (N.D. Ill. 1981).

180 2010 HORIZONTAL MERGER GUIDELINES, *supra* note 9, at 32.

181 *See* Zhong, *supra* note 29, at 772; *see also supra* Part II.A–B.

182 Kaiser Aluminum & Chem. Corp. v. FTC, 652 F.2d 1324, 1339, 1341 (7th Cir. 1981).

183 *See* Remarks by Shapiro, *supra* note 3, at 19.

184 *See* Kwoka & Warren-Boulton, *supra* note 14, at 450.

relevant-market requirement.[185] Unlike the bankruptcy elements of the failing firm defense, these elements have a direct effect on antitrust regulation.[186] Thus, the failing firm defense should weigh heavily, if not exclusively, on these two elements. These two elements are essential to the failing firm defense because they help focus the defense on protecting competition rather than protecting anticompetitive transactions involving firms in financial distress.

1. The Importance of the Alternative Purchaser Requirement

The requirement to make a good-faith effort to find an alternative purchaser protects against the loss of competition.[187] If an alternative purchaser could be interested, "a unit in the competitive system would be preserved and not lost to monopoly power."[188] The main way the alternative purchaser requirement protects against the loss of competition is by rejecting market power premiums.

The alternative purchaser requirement protects against "market power premiums." A market power premium is "a payment for anticipated gains in market power."[189] "An acquiring company willing to pay a market power premium [is] betting on higher prices from increased concentration through oligopolistic interdependence . . . ."[190] Competitor-purchasers will likely argue that they are willing to pay a higher premium because it is actually an efficiency premium.[191] Some of these offers may include efficiency premiums, but it is difficult to separate a market power premium from an efficiency premium.[192] Although the alternative purchaser requirement may block some mergers that could potentially lead to efficiencies, conventional

[185] 2010 HORIZONTAL MERGER GUIDELINES, *supra* note 9, at 32.
[186] *See supra* Part II.C–D.
[187] *See* Correia, *supra* note 36, at 693.
[188] Citizen Publ'g Co. v. United States, 394 U.S. 131, 138 (1969).
[189] Correia, *supra* note 36, at 694.
[190] *Id.* An "oligopoly" is "a market situation in which each of a few producers affects but does not control the market." *Oligopoly* Definition, MERRIAM-WEBSTER.COM, http://www.merriam-webster.com/dictionary/oligopolistic (last visited Feb. 9, 2012).
[191] *See* Correia, *supra* note 36, at 694.
[192] *See* William Blumenthal, *Thirty-One Merger Policy Questions Still Lingering After the 1992 Guidelines*, 38 ANTITRUST BULL. 593, 638 (1993).

merger analysis is based on "probabilities, not certainties."[193] Thus, even a significant risk of interdependence warrants blocking a merger.

2. The Importance of the Assets-Exiting-the-Relevant-Market Requirement

The requirement that the allegedly failing firm's assets will exit the relevant market absent the acquisition is the best protection against the loss of competition. This is a difficult requirement to meet because "impending [financial] failure does not necessarily mean that the firm would in fact disappear from the market without the particular merger in question."[194] This is because a firm "might survive bankruptcy reorganization with little or no durable loss in market position, or it might be purchased by outside interests that would preserve or even enhance its competitive impact, particularly if the outside interests purchased it at a lower price than its current burden of debt."[195] In looking at whether a firm will exit the relevant market, Antitrust Regulators should consider whether a firm can pay its obligations in the near future and reorganize in bankruptcy. Although Antitrust Regulators should consider the bankruptcy elements when determining whether the assets-exiting-the-relevant-market requirement is met, they are not necessary to prove the new defense.

Under this requirement, the assets should be certain to exit the relevant market. The acquisition of assets by a leading firm would raise antitrust concerns "[i]f those assets could be expected to remain in the market in some other hands—either a somehow rejuvenated original firm, a new firm, or even a firm with a smaller market share."[196] "But if the assets of the failing firm would otherwise leave the market, the effect of the acquisition is to increase capacity in the market relative to the alternative of exit."[197] This is important because antitrust law would prefer the assets to stay in the relevant market in any capacity, rather than to allow an anticompetitive merger.

[193] Brown Shoe Co. v. United States, 370 U.S. 294, 323 (1962).
[194] *See* AREEDA & HOVENKAMP, *supra* note 15, at 275.
[195] *See id.* at 275–76.
[196] Kwoka & Warren-Boulton, *supra* note 14, at 445.
[197] *Id.* at 445 (emphasis omitted) (internal quotation marks omitted).

Requiring exit from the relevant market is also a bright line rule that may avoid some of the confusion associated with the failing firm defense. Because the failing firm defense is a narrow exception, complete exit from the market would be the most drastic and least plausible scenario.[198] If some assets were able to stay in the relevant market in any way, then the failing firm defense should not be applicable at all. Thus, a bright line rule that requires complete collapse is probably more predictable than slow decline and future estimates.[199]

D. *Revised Horizontal Merger Guidelines*

The current failing firm defense should be abolished, and the new "Assets Exiting Defense" premised upon a two-prong analysis should be incorporated into the Guidelines:

Section 11: Exiting Assets

A merger is not likely to create or enhance market power or facilitate its exercise if the following circumstances are met by the target firm:

> (1) it has made unsuccessful good-faith efforts to elicit reasonable alternative offers of acquisition of the assets that would both keep tangible and intangible assets in the relevant market and pose a less severe danger to competition than does the proposed merger, and
> (2) absent the acquisition, its assets would exit the relevant market.

CONCLUSION

The failing firm defense has been firmly embedded in antitrust law since its creation in *International Shoe* in 1930. The defense should focus exclusively on antitrust principles and not become an escape hatch for anticompetitive transactions of firms that are in financial distress. The purpose of the failing firm defense should be to protect competition, not to protect firms from failing in a distressed economy. A stronger "Assets Exiting Defense" would ensure that Antitrust Regulators do not apply the defense too broadly and refocus the current failing firm defense on its original purpose, to protect competition.

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198 *See* Correia, *supra* note 36, at 686, 689.
199 *See id.* at 689.