MERGER ANTITRUST LAW

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READING GUIDANCE

Class 11 (October 6): Sanford Health/Mid Dakota Clinic (Unit 8)

I have added and reorganized the materials on defenses in the Unit 8 reading materials. Be sure you use the revised materials for this class (pp. 125-63).

In this class we finish anything we did not cover in Class 10 and then examine defenses to the prima facie case in the context of the Sanford Health/Mid Dakota transaction.

After the Eight Circuit concluded that the district court had properly found that the plaintiffs had made out a prima face case of a Section 7 violation, it turned to the defenses advanced by the defendants. Recall that under Step 2 of the *Baker Hughes* burden-shifting approach the merging parties have the *burden of production* on rebutting the prima facie case. The burden of production requires the defendants to adduce sufficient evidence to create a genuine issue of fact on at least one element of the plaintiffs' prima facie case. In other words, the defendants' evidence must be sufficient to permit the trier of fact to find in favor of the defendants when giving the defendants the benefit of all reasonable inferences and without weighing the evidence. You may think about this as analogous to standard for defeating a motion for summary judgment.

Recall that there are two essential elements of a Section 7 prima facie case: (1) the relevant market, and (2) the requisite anticompetitive effect.[1]

Defenses to market definition are always of the form of a simple denial: either the plaintiff applied the wrong legal principles in its attempt to the define the relevant market, the plaintiff applied the right legal principles but in the wrong way, or the plaintiff's evidence is insufficient to support a finding of the relevant market that the plaintiff is seeking to prove. Since the law of market definition or applied the correct principles in a legally incorrect way are reasonably well-settled, defenses that the plaintiffs applied the wrong legal standard are rare. Sometimes defendants will argue a technicality that a particular economic tool used in market definition was improperly applied, but these types of arguments rarely change the outcome.[2] By far the most frequent defense to a prima facie case of market definition is that the plaintiffs' evidence is insufficient to support a finding of the alleged market. There are two types of defenses here: (1) an argument that the plaintiffs' evidence is legally insufficient without any attempt to prove

[1] As you know, there are other elements of a Section 7 prima facie case: there must be an acquisition, the acquisition must be of stock or assets, and the parties and the transaction must have the requisite connection to interstate commerce. *See* 15 U.S.C. § 18. But these other elements are almost always indisputably present in Section 7 challenges and therefore only infrequently are litigated. Market definition and competitive effect is where the action is.

[2] *See, e.g.*, FTC v. Sysco Corp., 113 F. Supp. 3d 1, 36 & n. 16 (D.D.C. 2015) (where the defendants' argued that the FTC's economic expert used the wrong formula in the critical loss analysis).

an alternative market definition, and (2) an argument that the plaintiffs' evidence is legally insufficient coupled with proof of an alternative market definition in which there is no anticompetitive effect. The first argument relies solely on the allocation of the burden of proof. I have spoken to a number of judges about this and they consistently say that, while they understand that a pure burden of proof defense is technically proper, they do not find it very compelling. The problem is that this type of argument goes only to the "mind" of the judge. If a judge is going to decide for the defendants over the government's evidence, the judge wants to be confident that the merger is in fact not anticompetitive. Providing the judge with a strong argument of an alternative market definition and then show within this market the merger is not anticompetitive goes to "heart" of the judge as well as to the "mind."

Defenses to a prima facie case of anticompetitive effect have the same structure of a simple denial. Here again, the law of prima facie anticompetitive effect is well-established, so defendants rarely argue that the plaintiffs used the wrong legal principles. Since the thresholds to invoke the *PNB* presumption, however, are not particularly well-settled in the case law, one could imagine defenses that the *PNB* presumption was improperly applied because the merger in the plaintiff's alleged relevant market produced a combined market share and a change in the level of market concentration that too low to invoke the presumption. These types of defenses are rare, however, because plaintiffs—and especially the DOJ and FTC—almost always allege relevant markets in which the market share and concentration statistics far exceed the Merger Guidelines thresholds and fall within the range that courts have found the *PNB* presumption to be triggered.

But a very common and very effective form of defense to a prima facie case of anticompetitive effect is that the *PNB* presumption does not apply because the plaintiff failed to make out its prima facie case of market definition and without a relevant market there are no market shares or market concentration statistics to predicate the *PNB* presumption. As noted above, to make this defense even stronger, defendants typically argue for an alternative market definition that yields market shares and market concentration statistics that are too low to trigger the *PNB* presumption. We will see this form of defense in almost every case study we will examine.[3]

A second form of defense to a prima facie case of anticompetitive assumes (*arguendo* at least) that, even if the merger has some anticompetitive tendencies, there are other factors in the market that counteract these gross anticompetitive tendencies and make the merger on balance competitively neutral or even procompetitive. Say that the plaintiff's evidence of changes in market shares and market concentration was sufficient to trigger the *PNB* presumption and that the plaintiff adduced additional evidence that the merged firm will have an incentive to increase prices postmerger, that is, the merger creates some *upward pricing pressure*. Depending on defendants' evidence, the defendant could argue that other factors in the market or with the merger creates sufficient *downward pricing pressure* to counteract the upward pricing pressure, with the result that the merger will not increase prices and may even decrease them.

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[3] We will not see this defense in *Sanford Health*. The product dimensions of medical provider markets are well-established in modern merger antitrust case law and are usually not challenged. We will see cases in which the geographic dimensions were challenged, but the geographic area in which the FTC in *Sanford Health* alleged the likely anticompetitive effect would occur was so isolated from other cities and towns in North Dakota that there was no credible defense that the FTC's geographic market was wrong (or, even if it was improperly drawn, that a proper geographic market could be readily proved on the evidence presented in which the *PNB* presumption applied)

There are four principal types of these downward pricing pressure defense and the defendants in *Sanford Health* argued each one of them: (1) power buyer, (2) entry, (3) efficiencies, and (4) failing firm/weakened company. All four defenses, which sought to rebut the plaintiffs' prima facie showing of anticompetitive effect, are recognized in the 2010 Horizontal Merger Guidelines and by the courts.

Power buyers defense. In some markets, large buyers may exist that, because of their bargaining power, are able to protect themselves from the anticompetitive effects that otherwise would result from a merger. These buyers, for example, may be a disruptive force that precludes effective coordinated interaction among incumbent upstream firms or they may have sufficient bargaining power to block the unilateral exercise of market power by the combined firm. The courts and the Merger Guidelines recognize that the bargaining power or firms can play a significant role in assessing the competitive effects of a merger and may act, either alone or in conjunction with other defenses, to rebut a prima facie case of anticompetitive effect. While in a particular case a power buyer defense may not be sufficient to rebut the prima facie case, that defense in conjunction with other defenses may be sufficient.

Simply because a buyer is powerful does not mean that it is able to discipline the collective or unilateral exercise of market power by suppliers postmerger to protect itself. The question here is two-fold:

1. *Self-protection*: Can the putative power buyer protect itself at all, and, if so, can it protect itself sufficiently to completely eliminate the anticompetitive effect of the merger on it? The courts have identified three self-protection mechanisms to prevent the exercise of market power against the putative power buyer, although proving these mechanisms actually operate in a particular case has been problematic: (a) *share-shifting*, where the power buyer can precipitate sufficient local competition among postmerger incumbent firms for its patronage to preserve its premerger prices; (2) *sponsoring entry*, where the power buyer can induce entry by a new supplier by committing to purchase enough output to load at least a minimum efficient scale plant; or (3) *vertical integration*, where the power buyer itself can supply itself by building at least a minimum efficient scale plant.[4]
2. *Protection of others*. Even one or more buyers can protect themselves from the exercise of market power, are there other, less powerful buyers in the market that cannot protect, so that the result of the merger will be a regime of price discrimination where some buyers get hurt and others do not?

In the absence of a mechanism—and the incentive to use it—courts and the enforcement agencies have rejected a power buyer defense. Even when there is an arguable mechanism, the defense is likely to fail for lack of sufficient evidence if (1) the putative buyer does not support the defense, or (2) there is evidence of historical episodes where the putative power buyer (or a similarly situated firm) has not been able to prevent a merged firm from raising prices to it. This was the situation in *Sanford Heath*, where (1) a representative from Blue Cross (the putative power buyer) testified that that postmerger Sanford Heath would be able to force Blue Cross to choose between paying a higher price or exiting the market and (2) there was evidence that Blue

[4] In each situation, the cases also recognize the ability of groups of buyers to collaborate to achieve these outcomes.

Cross in the past had been forced to pay higher prices to a near-monopolist in another part of North Dakota.

Equally, the court could have rejected the defense on the grounds that smaller firms would be left unprotected from the anticompetitive effects of the merger. Blue Cross had a statewide share of the commercial health insurance market of between 55% and 65%, leaving between 35% and 45% of the market for smaller commercial insurers. If the commercial health insurance market in the Bismarck, ND Metropolitan Statistical Area had similar shares, the power buyer defense would have failed even if Blue Cross could have protected itself.

Read Section 8 of the Horizontal Merger Guidelines (p. 124) and the class notes (slides 74-78) on the power buyer defense. Then read the excerpt from *FTC v. Wilh. Wilhelmsen Holding ASA*,[5] which gives a good illustration of a court's analysis of the power buyer defense (pp. 126-28). Finally, read the Eight Circuit's treatment of Blue Cross as a power buyer in *Sanford Health* (pp. 58-59 and again on pp. 59-60). The second treatment was directed to the power buyer defense. I am not sure what was going on in the first treatment.[6]

Entry/expansion/repositioning defense. The merging parties argued that Catholic Health, a competitor of Sanford, was poised to enter and compete in the Bismarck-Mandan market (p. 60). This is an ease of entry/expansion/repositioning defense. In the last 25 years, "ease of entry" has become, after market definition, the most used defense for horizontal mergers and acquisitions, both before the agencies and before the courts.[7] The idea is that any effort by the merged firm to charge supracompetitive prices and earn supracompetitive profits will, in the absence of barriers to entry, attract new firms that will proceed to compete profits back down to competitive levels.[8]

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[5] 341 F. Supp. 3d 27, 70-71 (D.D.C. 2018).

[6] If you want to explore this further, take a look at the Opening Brief of Appellants Sanford Health, Sanford Bismarck, and Mid Dakota Clinic, P.C. (Jan. 30, 2018; Mar. 23, 2018; redacted version filed Jan. 23, 2019), in the supplemental materials.

[7] *See, e.g.*, United States v. Baker Hughes Inc., 908 F.2d 981, 98788 (D.C. Cir. 1990); United States v. Syufy Enterprises, 903 F.2d 659, 664-65 (9th Cir. 1990); California v. American Stores Co., 872 F.2d 837, 842-43 (9th Cir. 1989); United States v. Waste Management, Inc., 743 F.2d 976, 981-84, 1984-2 Trade Cas. (CCH) ¶ 66,190 (2d Cir. 1984); United States v. Waste Mgmt., Inc., 743 F.2d 976, 98184 (2d Cir. 1984); FTC v. Laboratory Corp. of Am., 2011 WL 3100372 , at *19-20 34 (C.D. Cal. 2011); FTC v. CCC Holdings, Inc., 605 F. Supp. 2d 26, 47 (D.D.C. 2009) (but rejecting ease of entry defense on the merits); FTC v. Libbey, Inc., 211 F. Supp. 2d 34, 4748 (D.D.C. 2002) (same); FTC v. Cardinal Health, Inc., 12 F. Supp. 2d 34, 5458 (D.D.C. 1998) (same); FTC v. Staples, Inc., 970 F. Supp. 1066, 1086 (D.D.C. 1997) (same); United States v. Calmar Inc., 612 F. Supp. 1298, 130407 (D.N.J. 1985); *In re* Echlin Mfg. Co., 105 FTC 410, 1985 WL 668902 (1985); see also FTC v. Arch Coal, Inc., 329 F. Supp. 2d 109, 14749 (D.D.C. 2004) (expansion by incumbent fringe firms).

[8] *See* United States v. Baker Hughes, Inc., 908 F.2d 981, 987 (D.C. Cir. 1990) ("In the absence of significant barriers, a company probably cannot maintain a supracompetitive pricing for any length of time."); FTC v. CCC Holdings, Inc., 605 F. Supp. 2d 26, 4647 (D.D.C. 2009) ("Even in highly concentrated markets, if there is sufficient ease of entry, others might enter to compete and undercut the likely anti-competitive effects of a merger."); 1992 DOJ/FTC Horizontal Merger Guidelines § 3.0 (1992) ("A merger is not likely to create or enhance market power or to facilitate its exercise, if entry into the market is so easy that market participants, after the merger, either collectively or unilaterally could not profitably maintain a price increase above premerger levels."); *see also* Chicago Bridge & Iron Co. v. FTC, 534 F.3d 410, 427 (5th Cir. 2008) ("The Commission not only addressed whether existing entry is sufficient to constrain CB&I from raising prices but also used existing entry and the history of entry as evidence in determining whether future entry would be able to counteract a merger's anti-competitive effects, such as a supracompetitive price increase.").

In an Economics 101 sense, think of a firm increasing price by restricting its output: if the firm faces a downward-sloping demand curve, then the inframarginal customers who value the product the most will bid up the price to clear the market and eliminate the excess demand at the original, lower price. The ease of entry/expansion/ repositioning defense is premised on the ability and incentives of other firms—either new, unrelated entrants into the relevant market (entry), incumbent firms already in the relevant market (expansion), or firms in adjacent markets (repositioning)—expanding output in the relevant market to "fill the hole" in output that the merged firm tried to precipitate.

The ability and willingness of fringe competitors to expand their foothold in the market and/or reposition is essentially equivalent to new entry and the agencies and the courts treat entry, expansion, and repositioning in the same analytical fashion.[9] The general idea is that the firms in question (either individually or collectively) must have the ability and profit-maximizing incentive to produce additional output to fill the hole. In particular, the Merger Guidelines require—and the courts have followed suit—that the output expansion be:

1. *Timely*, that is, "must be rapid enough to make unprofitable overall" the output reduction in the relevant market that otherwise would have created the increase in prices.
2. *Likely*, that is, sufficiently profitable when compared to alternative courses of action by the third-party firms that the firms have a high probably of actually expanding their output if the merging firms (and any other tacitly coordinating firms) attempted to reduce output in the relevant market, and
3. *Sufficient*, that is, that the magnitude of the timely and likely output expansion by these third-party firms will be enough to fill the hole.

Although not expressly a requirement, to be cognizable as a defense the output expansion should be *in response* to the merger. Oftentimes (and perhaps as here), the potential entrant would have entered the market with or without the merger. Since competitive effects in merger antitrust law are assessed on a going forward basis, any output expansion that would have occurred in the absence of the merger should be taken as part of the "but for" world (i.e., the market without the merger) and should be part of the baseline against which the merger should be evaluated. For example, if the merger would cause a decreased of 20 units of production by the merging firms and its incumbent competitors and a potential entrant would have entered the market with 100 additional units of production regardless of the merger, the fact that output in the market will increase by a net 80 units should not be a defense to the merger, because in the absence of the merger market output would have increased by 100 units. To be a defense, the potential entrant would have to increase its planned production by at least 20 units (for a total of at least 120 units) in response to the merger in order to offset the decrease in production resulting from the merger and to be a valid merger defense.

Although the Merger Guidelines are not technically binding on courts, the guidelines approach to entry as a defense to a *prima facie* case is being increasingly adopted in judicial opinions. While not citing the Merger Guidelines, the court's analysis of entry in FTC v. Staples, Inc. shows how

[9] FTC v. CCC Holdings, Inc., 605 F. Supp. 2d 26, 57 (D.D.C. 2009); FTC v. Arch Coal, Inc., 329 F. Supp. 2d 109, 115 (D.D.C. 2004).

the elements of the Guidelines can be applied to defeat an ease of entry defense.[10] In recent years, the DOJ and FTC have applied the Guidelines' entry defense requirements strictly and with great skepticism toward the evidence, with the result that entry defenses have very rarely prevailed at the agencies and then in only the most obvious situations. If anything, the changes in the 2010 Guidelines raise the bar even higher on a successful entry defense at the agencies.

Read Section 9 of the Horizontal Merger Guidelines (p. 124) and the class notes (slides 66-72) on the power buyer defense. Then read the excerpt from *United States v. Energy Solutions, Inc.* [11](pp. 133-35) as well as the treatment of entry by Catholic Health in *Sanford Health* (p. 60). We will examine the entry defense in more detail when we discuss the H&R Block/TaxACT merger in Unit 10.

Efficiencies defense. Efficiencies that permit a firm to lower its costs of production, increase its product quality, or accelerate its rate of innovation or product improvement can make the market more competitive and increase consumer welfare. In the proper circumstances, efficiencies can negate the likelihood that a merger would be anticompetitive. Under this idea, the greater the magnitude of the likely anticompetitive effect in the absence of efficiencies, the greater the efficiencies must be to offset it. Likewise, the more certain the likelihood of an anticompetitive effect in the absence of efficiencies, the more certain the offsetting efficiencies must be.[12]

There is no accepted judicial rule as to whether, and in what circumstances, efficiencies can justify an otherwise anticompetitive merger or acquisition. Older courts rejected efficiencies as a defense.[13] Modern courts, however, if presented with the right case, probably would accept the

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[10] FTC v. Staples, Inc., 970 F. Supp. 1066, 108688 (D.D.C. 1997). For other judicial examples, see Chicago Bridge & Iron Co. v. FTC, 534 F.3d 410, 43440 (5th Cir. 2008); FTC v. ProMedica Health Sys., Inc., 2011 WL 1219281, at *57 (N.D. Ohio 2011); FTC v. CCC Holdings, Inc., 605 F. Supp. 2d 26, 4760 (D.D.C. 2009) (extensive analysis); FTC v. Cardinal Health, Inc., 12 F. Supp. 2d 34, 54-58 (D.D.C. 1998) (explicit use of Guidelines).

[11] 265 F. Supp. 3d 415 (D. Del. 2017).

[12] *See* FTC v. University Health, Inc., 938 F.2d 1206, 1223 (11th Cir. 1991); FTC v. Arch Coal, Inc., 329 F. Supp. 2d 109, 15051 (D.D.C. 2004).

[13] *See* FTC v. Procter & Gamble Co., 386 U.S. 568, 580 (1967) ("[P]ossible economies cannot be used as a defense to illegality. Congress was aware that some mergers which lessen competition may also result in economies but it struck the balance in favor of protecting competition."); United States v. Philadelphia Nat'l Bank, 374 U.S. 321, 371 (1963) (observing that an otherwise anticompetitive merger "is not saved because, on some ultimate reckoning of social or economic debits or credits, it may be deemed beneficial.").

defense.[14] The right case, however, has yet to appear.[15]

To be "cognizable" under the Merger Guidelines, efficiencies must be *verifiable*, *merger-specific*,[16] and *not result from an anticompetitive reduction in output or service*.[17] Cognizable efficiencies may include, for example, shifts in production among the facilities of the merging firms that enable the combined firm to reduce its marginal costs of production. Efficiencies relating to research and development may be substantial, but are often difficult to verify and may be the result of anticompetitive reductions in output (presumably R&D output). Efficiencies related to procurement, management, or capital costs may not be verifiable, merger-specific or substantial.

Agency practice since the 1997 amendments make clear that the federal enforcement agencies will consider efficiencies only to the extent that they ultimately benefit customers in the relevant market.[18] As a result, efficiencies that reduce costs, for example, will be taken into account to the extent that the cost savings is passed on to customers. This adds another significant hurdle in establishing an efficiencies defense, because the merging parties will have to show not only that the efficiencies exist but also that it is in the profit-maximizing interest of the combined firm to

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[14] *See* FTC v. H.J. Heinz Co., 246 F.3d 708, 715 (D.C. Cir. 2001) (recognizing that "the trend among lower courts is to recognize the defense"); FTC v. University Health, Inc., 938 F.2d 1206, 1222 (11th Cir. 1991) (recognizing efficiencies defense but finding it inapplicable on the merits); FTC v. CCC Holdings, Inc., 605 F. Supp. 2d 26, 72-73 (D.D.C. 2009) (recognizing defense, but finding it inapplicable on the merits); FTC v. Cardinal Health, Inc., 12 F. Supp. 2d 34, 61-63 (D.D.C. 1998) (noting judicial uncertainty, but appearing to accept the principle of an efficiencies defense); United States v. Long Island Jewish Med. Ctr., 983 F. Supp. 121, 146-49 (E.D. N.Y. 1997) (factor in denying preliminary injunction); FTC v. Staples, Inc., 970 F. Supp. 1066, 1088-90 (D.D.C. 1997) (noting judicial uncertainty, but appearing to accept the principle of an efficiencies defense but finding it inapplicable on the facts); *see also* FTC v. Coca-Cola Co., 641 F. Supp. 1128, 1141 (D.D.C. 1986); United States v. Baker Hughes, Inc., 908 F.2d 981, 992 (D.C. Cir. 1990) (assuming the validity of an efficiencies defense but not ruling on it). *But see* FTC v. Procter & Gamble Co., 386 U.S. 568, 580 (1967) (possible economies cannot be used as a defense to illegality in Section 7 merger cases); RSR Corp. v. FTC, 602 F.2d 1317, 1325 (9th Cir. 1979). Properly construed, the *Procter & Gamble* ruling appears to be a correct one: efficiencies cannot be used as an affirmative defense to justify an anticompetitive merger, but they can be used as part of a negative defense to show that the merger will not be anticompetitive in the first instance.

[15] *See* FTC v. ProMedica Health Sys., Inc., 2011 WL 1219281, at *57 (N.D. Ohio 2011) ("No court in a 13(b) proceeding, or otherwise, has found efficiencies sufficient to rescue an otherwise illegal merger.").

[16] 2010 DOJ/FTC Horizontal Merger Guidelines § 10 n.13 ("The Agencies will not deem efficiencies to be merger-specific if they could be attained by practical alternatives that mitigate competitive concerns, such as divestiture or licensing. If a merger affects not whether but only when an efficiency would be achieved, only the timing advantage is a merger-specific efficiency.").

[17] 2010 DOJ/FTC Horizontal Merger Guidelines § 10; 1992 DOJ/FTC Merger Guidelines § 4; *see* FTC v. ProMedica Health Sys., Inc., 2011 WL 1219281, at *57 (N.D. Ohio 2011); United States v. Oracle Corp., 331 F. Supp. 2d 1098, 1175 (N.D. Cal. 2004).

[18] *See* 2010 DOJ/FTC Horizontal Merger Guidelines § 10 (recognizing efficiencies as a defense only to the extent that the "efficiencies likely would be sufficient to reverse the merger's potential to harm customers in the relevant market, e.g., by preventing price increases in that market.") (footnote omitted); 1992 DOJ/FTC Horizontal Merger Guidelines § 4 (same); *see also* FTC v. CCC Holdings, Inc., 605 F. Supp. 2d 26, 74 (D.D.C. 2009) (rejecting cost-savings efficiency defense where there was "no evidence to suggest that a sufficient percentage of those savings will accrue to the benefit of the consumers to offset the potential for increased prices"); FTC v. University Health, Inc., 938 F.2d 1206, 1223 (11th Cir. 1991) (holding that defendant asserting an efficiency defense "must demonstrate that the intended acquisition would result in significant economies and that these economies ultimately would benefit competition and, hence, consumers").

pass on some of the benefits of the efficiencies to customers in the form of lower prices or increased quality, as opposed to retaining the benefits for the combined firm's owners.[19] In at least one investigation, however, the Antitrust Division found it sufficient that the significant cost savings that likely result would enable the combined firm to compete more effectively.[20]

Experience teaches that the efficiencies "defense" is viewed by the agencies with hostility and is likely to be rejected either because, in the view of the investigating agency or the court, the putative efficiencies are not sufficiently verifiable,[21] they are not merger specific,[22] they are not sufficiently large to overcome the likely anticompetitive effect of the transaction,[23] or the resulting benefits will not be passed on to customers sufficiently, if at all. Even when the efficiencies are cognizable, however, the parties would be well advised not to rely too heavily on an efficiencies defense. Indeed, the 1997 amendment to the DOJ/FTC Horizontal Merger Guidelines notes that, in the experience of the Antitrust Division and the FTC, efficiencies are most likely to make a difference in the analysis when the likely adverse competitive effects, absent the efficiencies, are "not great."[24] The amendment also observes that "[e]fficiencies almost never justify a merger to monopoly or near-monopoly."[25]

The efficiencies defense has fared no better in the courts. In the 1960s, the Supreme Court not only rejected the idea that efficiencies could be used to defend a merger or acquisition against a merger antitrust attack, but also indicated that efficiencies could be part of the unlawful

[19] The courts, to the extent that they consider efficiencies, are also adopting the view that efficiencies should be considered only to the extent that they benefit customers. *See* FTC v. Swedish Match, 131 F. Supp. 2d 151, 172 (D.D.C. 2000).

[20] *See* U.S. Dep't of Justice, Press Release, Statement of the Department of Justice's Antitrust Division on its Decision to Close its Investigation of the Joint Venture Between SABMiller plc and Molson Coors Brewing Company (June 5, 2008) ("In one of the key parts of the investigation, the Division verified that the joint venture is likely to produce substantial and credible savings that will significantly reduce the companies' costs of producing and distributing beer. These savings meet the Division's criteria of being verifiable and specifically related to the transaction and include large reductions in variable costs of the type that are likely to have a beneficial effect on prices. The large amount of these savings and other evidence obtained by the Division supported the parties' contention that the venture should make a lower-cost, and therefore more effective, beer competitor.") (paragraph break omitted).

[21] *See* FTC v. University Health, Inc., 938 F.2d 1206, 1223 (11th Cir. 1991) (noting that a defendant cannot "overcome a presumption of illegality based solely on speculative, self-serving assertions"); FTC v. H.J. Heinz Co., 246 F.3d 708, 721 (D.C. Cir. 2001) (noting that efficiencies evidence cannot be "mere speculation and promises about post-merger behavior").

[22] The D.C. Circuit apparently also takes the view that cognizable efficiencies must be merger-specific. *See* FTC v. H.J. Heinz Co., 246 F.3d 708, 721-22 (D.C. Cir. 2001); FTC v. CCC Holdings, Inc., 605 F. Supp. 2d 26, 75 (D.D.C. 2009) (finding that any efficiencies resulting from claimed increases by the combined firm in R & D spending are not merger-specific, since acquiring company could increase spending to a similar extent notwithstanding merger); *see also* FTC v. Arch Coal, Inc., 329 F. Supp. 2d 109, 150 (D.D.C. 2004) (noting that the Guidelines require efficiencies be merger-specific).

[23] *Cf.* FTC v. H.J. Heinz Co., 246 F.3d 708, 721-22 (D.C. Cir. 2001) (noting that efficiencies must be "extraordinary" to overcome the anticompetitive effect suggested by high postmerger concentration levels).

[24] U.S. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines § 4 (rev. Apr. 8, 1997

[25] *Id.*; *see* FTC v. H.J. Heinz Co., 246 F.3d 708, 721-22 (D.C. Cir. 2001).

anticompetitive effect to the extent they threatened the viability of less efficient rivals.[26] Although courts today rarely take the harsh view that efficiencies are irrelevant to the competitive effects analysis of a transaction, no decision yet has held that an otherwise unlawful transaction was excusable because of efficiencies.[27]

Read Section 10 of the Horizontal Merger Guidelines (pp. 137-39) and the class notes (slides 79-97) on the efficiencies defense. Then read the excerpt from Saint Alphonsus Med. Ctr.-Nampa Inc. v. St. Luke's Health System[28] and the accompanying notes. (pp. 133-36) as well as the Eight Circuit's treatment of the efficiency defense in Sanford Health (pp. 61-62). As you will see, the contours of the efficiencies are far from clear. Read Commissioner Wright's dissent in *Ardagh/St. Gobain* for a criticism of how the FTC applies the efficiencies defense in practice (pp. 144-51) and the majority commissioners' response to his criticism (pp. 152-54).

The failing company defense. In 1930, during the Great Depression, the Supreme Court in *International Shoe Co. v. FTC*[29] held that when the acquired company's resources were depleted, business failure was a grave possibility, and no noncompetitor was willing to purchase the failing firm, an acquisition by a competitor that otherwise might threaten competition would not violate the Clayton Act.[30] The legislative history of the 1950 amendments to the Clayton Act specifically recognized this "failing company" defense.[31] In *General Dynamics*, the Supreme Court characterized the defense as a "lesser of two evils" approach, in which the possible threat to competition resulting from the acquisition was preferable to the adverse competitive impact and other losses that would be incurred if the failing company failed.[32]

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[26] *See* Brown Shoe Co. v. United States, 370 U.S. 294, 344 (1962); *see also* FTC v. Procter & Gamble Co., 386 U.S. 568 (1967) ("[p]ossible economies cannot be used as a defense to illegality" in Section 7 merger cases); RSR Corp. v. FTC, 602 F.2d 1317, 1325 (9th Cir. 1979) ("RSR argues that the merger can be justified because it allows greater efficiency of operation. This argument has been rejected repeatedly."); International Tel. & Tel. Corp. v. General Tel. & Elecs. Corp., 518 F.2d 913, 936 (9th Cir. 1975) United States v. Rice Growers Ass'n of California, 1986-2 Trade Cas. (CCH) ¶ 67,287, at 61458, 1986 WL 12561 (E.D. Cal. 1986); United States v. Manufacturers Hanover Trust Co., 240 F. Supp. 867, 943 (S.D.N.Y. 1965); United States v. Kennecott Copper Corp., 231 F. Supp. 95, 102 (S.D.N.Y. 1964); United States v. Bethlehem Steel Corp, 168 F. Supp. 576, 617 (S.D.N.Y. 1958).

[27] For modern cases analyzing efficiencies, see, for example, FTC v. H.J. Heinz Co., 246 F.3d 708, 717 (D.C. Cir. 2001); FTC v. Tenet Health Care Corp., 186 F.3d 1045, 1054 (8th Cir. 1999); FTC v. University Health, Inc., 938 F.2d 1206, 1223 (11th Cir. 1991); FTC v. CCC Holdings, Inc., 605 F. Supp. 2d 26, 72 (D.D.C. 2009); United States v. Oracle Corp., 331 F. Supp. 2d 1098, 1175 (N.D. Cal. 2004); FTC v. Arch Coal, Inc., 329 F. Supp. 2d 109, 150-53 (D.D.C. 2004); FTC v. Swedish Match, 131 F. Supp. 2d 151, 171-72 (D.D.C. 2000); FTC v. Cardinal Health, Inc., 12 F. Supp. 2d 34, 61-63 (D.D.C. 1998); FTC v. Staples, Inc., 970 F. Supp. 1066, 1088-90 (D.D.C. 1997); FTC v. Butterworth Health Corp., 946 F. Supp. 1285, 1300 (W.D. Mich. 1996); FTC v. Alliant Techsystems Inc., 808 F. Supp. 9, 21 (D.D.C. 1992); United States v. Country Lake Foods, Inc., 754 F. Supp. 669, 680 (D. Minn. 1990).

[28] 778 F.3d 775 (9th Cir. 2015).

[29] International Shoe Co. v. FTC, 280 U.S. 291 (1930).

[30] *Id*. at 300-03; *see* United States v. General Dynamics Corp., 415 U.S. 486, 506-08 (1974); Citizen Publ'g Co. v. United States, 394 U.S. 131, 137-38 (1969).

[31] S. REP. NO. 1775, 81st Cong., 2d Sess. 7 (1950); H.R. REP. NO. 1191, 81st Cong., 1st Sess. 6 (1949).

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

The failing company defense is frequently invoked in transactions that are *prima facie* unlawful under the *Philadelphia National Bank* presumption, almost always without success.[33] Likewise, although the 2010 DOJ/FTC Horizontal Merger Guidelines acknowledge that the failing company doctrine is at least a factor in the competitive analysis, if not a standalone defense, the Guidelines employ the doctrine restrictively.

The traditional judicial formulation of the failing company defense is straightforward: (1) the acquired firm must be failing or its failure must be imminent; and (2) there must be no alternate purchasers whose acquisition of the acquired firm would be less anticompetitive than the one proposed.[34] Some courts have added a third requirement: a reorganization of the acquired firm into a viable economic enterprise is not realistic.[35] The defense has been narrowly construed, and the company invoking it has the burden of establishing each element of the defense.[36]

Under the Supreme Court's *Citizen Publishing* decision, a failing company within the meaning of the defense is one whose "resources are so depleted and the prospects of rehabilitation so remote that it faces grave probability of business failure."[37] The failure requirement is established through an analysis of the allegedly failing company's financial condition prior to and at the time of acquisition, together with an examination of its future business prospects, its relationships with banks and other potential creditors, and its available working capital. The

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[33] The successful cases include International Shoe Co. v. FTC, 280 U.S. 291 (1930); Union Leader Corp. v. Newspapers of New England, Inc., 284 F.2d 582 (1st Cir. 1960); Reilly v. Hearst Corp., 107 F. Supp. 2d 1192, 120305 (N.D. Cal. 2000); FTC v. Great Lakes Chem. Corp., 528 F. Supp. 84, 96-98 (N.D. Ill. 1981); United States v. M. P. M., Inc., 397 F. Supp. 78 (D. Colo. 1975). *See* Granader v. Public Bank, 417 F.2d 75 (6th Cir. 1969) (summary dismissal of Section 7 complaint affirmed after state court receivership proceedings had found Public Bank insolvent and acquirer only prospective purchaser). For cases in which the defense was unsuccessful, see, for example, United States v. Greater Buffalo Press, Inc., 402 U.S. 549 (1971); Citizen Publ'g Co. v. United States, 394 U.S. 131 (1969); United States v. Third Nat'l Bank in Nashville, 390 U.S. 171 (1968); United States v. Von's Grocery Co., 384 U.S. 270 (1966); United States v. El Paso Natural 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); Michigan Citizens for an Independent Press v. Thornburgh, 868 F.2d 1285, 128788, (D.C. Cir. 1989) (Newspaper Preservation Act); FTC v. ProMedica Health Sys., Inc., 2011 WL 1219281, at *57 (N.D. Ohio 2011); FTC v. Harbour Group Invs., L.P., Civ. No. 90–2525, 1990 WL 198819 (D.D.C. Nov. 19, 1990); FTC v. Bass Bros. Enters., Inc., 1984 WL 355 (N.D. Ohio 1984). The failing-firm defense has never succeeded in a Section 13(b) proceeding. *See* FTC v. ProMedica Health Sys., Inc., 2011 WL 1219281, at *57 (N.D. Ohio 2011).

[34] *See* Citizen Publ'g Co. v. United States, 394 U.S. 131, 136-39 (1969); International Shoe Co. v. FTC, 280 U.S. 291, 302 (1930); FTC v. University Health, Inc., 938 F.2d 1206, 1220 n.28 (11th Cir. 1991); Michigan Citizens for an Independent Press v. Thornburgh, 868 F.2d 1285, 1287-88 (D.C. Cir. 1989); California v. Sutter Health Sys., 130 F. Supp. 2d 1109, 1133 (N.D. Cal. 2001); Reilly v. Hearst Corp., 107 F. Supp. 2d 1192, 1203 (N.D. Cal. 2000); FTC v. Harbour Group Invs., L.P., Civ. No. 90–2525, 1990 WL 198819 (D.D.C. Nov. 19, 1990).

[35] *See, e.g.*, Dr. Pepper/Seven-Up Cos., v. FTC, 991 F.2d 859, 86465 (D.C. Cir. 1993); U.S. Steel Corp. v. FTC, 426 F.2d 592, 608-09 (6th Cir. 1970); *In re* The Pillsbury Co., 93 F.T.C. 966, 1031-33, 1979 WL 44683 (1979); *In re* Reichhold Chems., Inc., 91 F.T.C. 246, 289-91, 1978 WL 206094 (1978). The requirement appears to have been suggested, but not formalized, in Citizen Publ'g Co. v. United States, 394 U.S. 131, 138 (1969). Two courts have suggested that the *Citizen Publishing* language did not add a new element to the failing company defense. *See* United States v. Black & Decker Mfg. Co., 430 F. Supp. 729, 778 (D. Md. 1976); United States v. M. P. M., Inc., 397 F. Supp. 78, 96 (D. Colo. 1975).

[36] *See, e.g.*, FTC v. Harbour Group Invs., L.P., Civ. No. 90-2525, 1990 WL 198819 (D.D.C. Nov. 19, 1990); United States v. G. Heileman Brewing Co., 345 F. Supp. 117, 123 (E.D. Mich. 1972).

[37] Citizen Publ'g Co. v. United States, 394 U.S. 131, 137 (1969).

objective facts must support the conclusion that the company is failing or that its failure is imminent; the company's good faith intention to go out of business because its return is subjectively insufficient will not establish the failure requirement.

The alternative purchaser requirement is usually the reason that the defense fails.[38] The difficulties in establishing this element may be illustrated by contrasting United States v. M.P.M., Inc.,[39] with FTC v. Harbour Group Investments, L.P.[40] In MPM, the district court found that the parties had discharged their burden, because immediately after Mobile's bank had informed the company that it had to raise $200,000 in new capital before further credit would be extended, the company embarked on exploring "virtually every potential source of funding."[41] Mobile's president contacted numerous firms, government agencies and other possible funding sources. One of the major shareholders devoted virtually all of his time to finding new funding in order to maintain the company as a viable enterprise. The court found that not only were the contacts numerous, but also that each person approached was a credible potential source of new capital. Only Pre-Mix, whose combination with Mobile was challenged, was willing to become involved with the company; the others declined because they considered Mobile an unacceptable business risk. Moreover, Pre-Mix had emerged as a candidate months after many of the other contacts had been made.[42]

By contrast, in *Harbour Group* the search for alternative acquirers did not begin until after an agreement had been struck on the challenged acquisition. Moreover, although an investment bank was retained to perform the search, it was contacted by the acquiring company, not the acquired company, and was given only a few weeks to conduct the search despite the fact that the original purchase agreement took months to negotiate. Nor did the investment bank's efforts comport with its usual manner of searching for potential acquirers. The investment bank team handling the search was not one experienced in selling small companies, the investment bank distributed only minimal offering materials, and the search consisted of a few exploratory telephone calls with little or no follow-up. The *Harbour Group* court concluded that the merging parties did not fulfill their burden of proving that no alternative purchaser existed.

The requirement added by some courts that the acquired firm must not be able to reorganize under the bankruptcy laws into a viable economic enterprise has two significant implications for the failing company defense.

First, it may almost be impossible for the merging companies to discharge their burden of proof under this requirement. Reorganization proceedings can be extremely complicated. In many

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[38] *See, e.g.*, Dr. Pepper/Seven-Up Cos., Inc. v. FTC, 991 F.2d 859, 862 (D.C. Cir. 1993) (rejecting failing company defense because it "had no adequate basis to determine whether Honickman [was] the sole plausible acquirer") (citation omitted).

[39] United States v. M.P.M., Inc., 397 F. Supp. 78 (D. Colo. 1975).

[40] FTC v. Harbour Group Invs., L.P., Civ. No. 90–2525, 1990 WL 198819 (D.D.C. Nov. 19, 1990).

[41] United States v. M.P.M., Inc., 397 F. Supp. 78, 101 (D. Colo. 1975).

[42] *See* California v. Sutter Health Sys., 130 F. Supp. 2d 1109, 1136-37 (N.D. Cal. 2001) (finding an adequate search was undertaken and that no reasonable alternative purchaser existed). Where one party to a joint venture is failing and the other joint venture partner wishes to acquire it, the failing venturer does not have to be marketed with the venture intact if the terms of the joint venture agreement permit the successful joint venture partner to terminate the venture if the failing firm is sold to someone else. Reilly v. Hearst Corp., 107 F. Supp. 2d 1192, 1205 (N.D. Cal. 2000).

situations, reorganization plans have been confirmed after lengthy negotiations, despite expectations at the beginning of the process that the plan would fail and the company would be liquidated. Indeed, perhaps the only good way to prove this requirement is to show that the going concern value of the company is less than the company's liquidation value.

Second, when coupled with the first two requirements, the inability to reorganize implies that the acquired firm's assets will quickly exit the market absent the challenged transaction or an alternative buyer. This effectively converts the failing company defense from an affirmative defense to a negative defense. An affirmative defense is one that provides a justification for a transaction that threatens competition, but as to which the public interest in permitting the transaction outweighs the public interest in preventing any anticompetitive effects. A negative defense is one that negates an essential element of the plaintiff's case, in this instance the requirement that the transaction will threaten competition in the future. If a failing company merges with a competitor, the immediate economic effect will be to make the market marginally less competitive than it was before the transaction. However, if the transaction is disallowed, the failing company will exit the market, thereby making the market even less competitive through the loss of its productive capacity. From a forward-looking perspective, the market is more competitive with the transaction than it would be without the transaction.

The courts have held that the failing company defense applies equally whether the failing firm is the buyer or the seller.[43] The courts are split as to whether the failing company defense may be invoked with respect to the acquisition of the failing part of a profitable company.[44]

The DOJ and FTC always have been antagonistic to the failing company doctrine, but in deference to its long judicial acceptance the 2010 DOJ/FTC Horizontal Merger Guidelines, as have the earlier guidelines, include a section on failing companies.[45] Like the more demanding courts, the Guidelines recognize the defense only when: (1) the firm is failing in the sense that it is unable to meet its financial obligations in the near future; (2) the firm is unable to reorganize successfully under Chapter 11 of the Bankruptcy Act; and (3) the firm 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.[46]

There have been very few invocations of the failing company defense that have been successful before either the DOJ or the FTC. As before the courts, although it is relatively easy to show that the company or division is failing, historically it has been difficult to convince the agencies that the requisite effort has been made to find a less anticompetitive purchaser. Success means that

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[43] *See* United States v. M.P.M., Inc., 397 F. Supp. 78, (D. Colo. 1975).

[44] For cases finding the defense applicable to failing divisions, see FTC v. Great Lakes Chem. Corp., 528 F. Supp. 84, 96 (N.D. Ill. 1981); United States v. Reed Roller Bit Co., 274 F. Supp. 573, 584 (W.D. Okla. 1967); United States v. Lever Bros. Co., 216 F. Supp. 887, 898-99 (S.D.N.Y. 1963). For cases finding the defense inapplicable to failing divisions, see United States v. Blue Bell, Inc., 395 F. Supp. 538, 550 (M.D. Tenn. 1975); United States v. Phillips Petroleum Co., 367 F. Supp. 1226, 1260 (C.D. Cal. 1973).

[45] 2010 DOJ/FTC Horizontal Merger Guidelines § 11, Appendix 3-1.

[46] *See* 2010 DOJ/FTC Horizontal Merger Guidelines § 11, Appendix 3-1. The 1992 Guidelines included a fourth requirement: absent the acquisition under investigation, the assets of the failing firm would exit the relevant market. 1992 DOJ/FTC Horizontal Merger Guidelines § 5.1, Appendix 3-2. The four-part 1992 Guidelines test has been adopted by some courts. *See* FTC v. Arch Coal, Inc., 329 F. Supp. 2d 109, 154 (D.D.C. 2004).

the challenged transaction cannot go forward, and the agencies almost conclusively presume that the failure to find a less anticompetitive purchaser is the result of a failure of effort, not a real absence of alternative purchasers. This skepticism is compounded by the agencies' view, expressed in a footnote in the Guidelines, that any offer to purchase the assets of the failing firm or division at a price above liquidation value is a reasonable alternative offer that vitiates the defense.

The Guidelines, like many courts, extend the defense to failing divisions of otherwise healthy companies, although they emphasize that great care must be exercised in analyzing the division's cash flow to ensure that it is negative in an economically meaningful sense and not just an artifact of financial accounting. In analyzing divisional cash flow, as well as in determining whether the division's assets will leave the market if the acquisition is unable to proceed, the agencies will require evidence beyond business plans or financial statements prepared by management.

Read Section 11 of the Horizontal Merger Guidelines (p. 156) and the class notes (slides 98-101) on the efficiencies defense. Then read the excerpt from *FTC v. Wilh. Wilhelmsen Holding ASA*[47] for a judicial application (pp. 157-59). The two posts from the FTC blog speak to how the agencies view the failing company defense and are quick and easy reads (pp. 160-64). Also, take a look at the paragraph in *Sanford Health*

on the "weakened competitor" or "ailing firm" defense (p.62).

Finally, if you have the time and the interest, take a look at what happened in the wake of the Eight Circuit's decision: the parties abandoned the deal and the FTC dismissed the complaint as moot (pp. 64-75).

Enjoy the reading! Email me if you have any questions.

[47] 341 F. Supp. 3d 27, 70-71 (D.D.C. 2018).