MERGER ANTITRUST LAW

Unit 12: The Ice Cream Merger

“Loose Ends”

Class 19

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Table of Contents

Power buyers

U.S. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines § 8 (rev. Aug. 19, 2010) (powerful buyers) ... 4

FTC v. Wilh. Wilhelmsen Holding ASA 341 F. Supp. 3d 27, 70-71 (D.D.C. 2018) (excerpt) ... 6

A note on the power buyers defense ... 8

Failing firm defenses

U.S. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines § 11 (rev. Aug. 19, 2010) (failure and exiting assets) ... 14

U.S. Dep't of Justice & Fed. Trade Comm'n, Merger Guidelines § 3.1 (Dec. 18, 2023) (failing firms) ... 16

United States v. Energy Solutions, Inc. 265 F. Supp. 3D 415, 432-33, 444-45 (D. Del. 2017) (excerpt) ... 19

FTC v. Harbour Grp. Invs., L.P., No. CIV. A. 90-2525, 1990 WL 198819 (D.D.C. Nov. 19, 1990) (excerpt) ... 23

United States v. Jetblue Airways Corp., 712 F. Supp. 3d 109, 159-61 (D. Mass. 2024) (excerpt on the flailing firm defense) ... 31

United States v. Aetna Inc., 240 F. Supp. 3d 1, 91-92 (D.D.C. 2017) (excerpt on flailing company defense) ... 34

A note on the failing firm defense ... 36

Efficiencies

Transcript, United States v. Bertelsmann SE & Co. KGaA, No. 1:21-cv-02886 (D.D.C. Aug. 17, 2022) (excluding defendants' efficiency evidence) ... 45

Power Buyers Defense

Horizontal Merger Guidelines

U.S. Department of Justice

and the

Federal Trade Commission

Issued: August 19, 2010

Buyer characteristics and the nature of the procurement process can affect coordination. For example, sellers may have the incentive to bid aggressively for a large contract even if they expect strong responses by rivals. This is especially the case for sellers with small market shares, if they can realistically win such large contracts. In some cases, a large buyer may be able to strategically undermine coordinated conduct, at least as it pertains to that buyer's needs, by choosing to put up for bid a few large contracts rather than many smaller ones, and by making its procurement decisions opaque to suppliers.

8. Powerful Buyers

Powerful buyers are often able to negotiate favorable terms with their suppliers. Such terms may reflect the lower costs of serving these buyers, but they also can reflect price discrimination in their favor.

The Agencies consider the possibility that powerful buyers may constrain the ability of the merging parties to raise prices. This can occur, for example, if powerful buyers have the ability and incentive to vertically integrate upstream or sponsor entry, or if the conduct or presence of large buyers undermines coordinated effects. However, the Agencies do not presume that the presence of powerful buyers alone forestalls adverse competitive effects flowing from the merger. Even buyers that can negotiate favorable terms may be harmed by an increase in market power. The Agencies examine the choices available to powerful buyers and how those choices likely would change due to the merger. Normally, a merger that eliminates a supplier whose presence contributed significantly to a buyer's negotiating leverage will harm that buyer.

> *Example 22:* Customer C has been able to negotiate lower pre-merger prices than other customers by threatening to shift its large volume of purchases from one merging firm to the other. No other suppliers are as well placed to meet Customer C's needs for volume and reliability. The merger is likely to harm Customer C. In this situation, the Agencies could identify a price discrimination market consisting of Customer C and similarly placed customers. The merger threatens to end previous price discrimination in their favor.

Furthermore, even if some powerful buyers could protect themselves, the Agencies also consider whether market power can be exercised against other buyers.

> *Example 23:* In Example 22, if Customer C instead obtained the lower pre-merger prices based on a credible threat to supply its own needs, or to sponsor new entry, Customer C might not be harmed. However, even in this case, other customers may still be harmed.

9. Entry

The analysis of competitive effects in Sections 6 and 7 focuses on current participants in the relevant market. That analysis may also include some forms of entry. Firms that would rapidly and easily enter the market in response to a SSNIP are market participants and may be assigned market shares. See Sections 5.1 and 5.2. Firms that have, prior to the merger, committed to entering the market also will normally be treated as market participants. See Section 5.1. This section concerns entry or adjustments to pre-existing entry plans that are induced by the merger.

FTC V. WILH. WILHELMSEN HOLDING ASA
341 F. SUPP. 3D 27, 70-71 (D.D.C. 2018)
(excerpt[1])

TANYA S. CHUTKAN, District Judge

The Federal Trade Commission ("FTC") has moved for a preliminary injunction to block a proposed merger between defendants Wilhelmsen Maritime Services AS ("WMS"), Wilhelmsen Ship Services ("WSS") (collectively "Wilhelmsen"), and The Resolute Fund II, L.P., Drew Marine Intermediate II B.V., and Drew Marine Group, Inc. (collectively "Drew"), two large providers of marine water treatment chemicals and related services. The FTC objects to the merger on the grounds that Defendants are each other's closest and only realistic competition for supplying these chemicals and services on a global scale, and the merger threatens to reduce or eliminate tangible consumer benefits resulting from market competition. Having considered the evidence presented through live testimony, as well as extensive pleadings, exhibits, and other submissions, the court hereby GRANTS the motion for preliminary injunction.

[The court found, for the purpose of deciding whether to enter a preliminary injunction, that the supply of marine water treatment (MWT) products and services, including boiler water treatment (BWT) chemicals, cooling water treatment (CWT) chemicals, and associated products and services, to global fleets, constituted a relevant antitrust market and that, within this market, the FTC had established a prima facie case of anticompetitive effect. In response, the merging parties advanced entry, power buyer, and efficiencies defenses.]

. . .

b. *Power Buyers*

1. LEGAL STANDARD

Courts have also noted that the existence of power buyers—sophisticated customers who retain strategies post-merger that "may constrain the ability of the merging parties to raise prices," Merger Guidelines § 8—is a factor that can serve to "rebut a prima facie case of anti-competitiveness." *Cardinal Health*, 12 F.Supp.2d at 59. However, "[t]he ability of large buyers to keep prices down ... depends on the alternatives these large buyers have available to them." *Sysco*, 113 F.Supp.3d at 48. Where mergers reduce alternatives—i.e., prevent the use of certain competitive strategies—"the power buyers' ability to constrain price and avoid price discrimination can be correspondingly diminished." *Id*. (citing Merger Guidelines § 8). Thus, the mere presence of power buyers "does not necessarily mean that a merger will not result in anti-competitive effects." *Cardinal Health*, 12 F.Supp.2d at 59. In assessing a power

1. Record citations omitted

buyer argument, the court should "examine the choices available to powerful buyers and how those choices likely would change due to the merger," keeping in mind that "[n]ormally, a merger that eliminates a supplier whose presence contributed significantly to a buyer's negotiating leverage will harm that buyer." Merger Guidelines § 8. Finally, although the consideration of non-entry factors—including the existence of power buyers—is "relevant, and can even be dispositive, in a section 7 rebuttal analysis," *Baker Hughes*, 908 F.2d at 987, courts have not typically held "that power buyers alone enable a defendant to overcome the government's presumption of anticompetitiveness." *Cardinal Health,* 12 F.Supp.2d at 58; *Chicago Bridge & Iron Co. N.V. v. FTC*, 534 F.3d 410, 440 (5th Cir. 2008) ("[C]ourts have not considered the 'sophisticated customer' defense as itself independently adequate to rebut a prima facie case.").

2. ANALYSIS

Defendants argue that the FTC's Global Fleets construct focuses on the largest shipping companies—those most likely to have the power to constrain the merger's anticompetitive effects. In support of this contention, Defendants point out that customers tend to purchase other goods from suppliers, which permits them to discipline attempted BWT [boiler water treatment chemicals] and CWT [cooling water treatment chemicals] price increases by switching or credibly threatening to switch purchases of these other products to other suppliers or by negotiating price decreases on other products. Defendants further argue that customers could adapt purchases to another supplier's distribution network or shift part of their fleet to another competitor, since many vessels in Global Fleets do not avail themselves of all of Defendants' networks—instead visiting a subset of available ports and picking up MWT from an even smaller subset. Defendants also contend that Global Fleets could stockpile larger quantities of MWT products in order to shift purchases to major ports with lower costs, and that customers can partner with suppliers to sponsor entry or expansion to new ports.

The court is unpersuaded by Defendants' power buyer argument. The evidence is mixed—at best—regarding the effectiveness of each of the Defendants' suggested strategies. Although at least one witness suggested that customers could shift purchases of other products in more competitive markets to other suppliers, there is, as Dr. [Avid] Nevo [the FTC's expert economist] noted, little empirical basis for the notion that this strategy—already available to large customers—would yield any additional benefits beyond those customers currently enjoy. Similarly, while testimony suggested that customers may be able to stockpile product and concentrate purchases in ports where products are cheaper, that same testimony suggests that storage space is often limited and that customers already do so. Defendants have not identified any new strategy or alternative likely to emerge post-merger—instead, they have focused on strategies that are already part of the competitive landscape and which show no promise of becoming more effective. On the other hand, the FTC has shown that the merger will result in the loss of a proven strategy—the ability to leverage one large, global supplier against another—that appears to be the most effective price constraint in the consolidated MWT market. In other words, the FTC has established a reasonable probability that as a result of the merger, sophisticated buyers will have one less alternative strategy through which they can exercise power, and Defendants have not identified any equally or more effective buyer options to counteract that loss. Thus, the reduction of buyer alternatives means that “power buyers’ ability to constrain price and avoid price discrimination can be correspondingly diminished,” *Sysco*, 113 F.Supp.3d at 48, and evidence of buyer power is insufficient to rebut the FTC’s prima facie case.

A NOTE ON THE 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.[1] 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.[2]

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.[3] The question here is two-fold: 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?[4] Moreover, even a particular buyer can protect itself from the exercise of market power, its action may not protect other, less powerful buyers and only result in a regime of price discrimination where some buyers get hurt and

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1. *See* Chicago Bridge & Iron Co. N.V. v. FTC, 534 F.3d 410, 440 (5th Cir. 2008); FTC v. Wilh. Wilhelmsen Holding ASA, 341 F. Supp. 3d 27, 70 (D.D.C. 2018); FTC v. Cardinal Health, Inc., 12 F. Supp. 2d 34, 58 (D.D.C. 1998); U.S. Dep’t of Justice & Fed. Trade Comm’n, DOJ/FTC Horizontal Merger Guidelines § 8 (rev. 2010).

2. *See, e.g.*, United States v. Baker Hughes, 908 F.2d 981 (D.C.Cir.1990) (finding the existence of power buyers along with the ease of entry was sufficient to rebut a prima facie case of anticompetitive effect); United States v. Country Lake Foods, Inc., 754 F. Supp. 669, 675, 679 (D. Minn. 1990) (finding the lack of entry barriers, the potential entry by distant dairies, the power of the fluid milk buyers in the area, the possibility of vertical integration, and efficiencies rebutted a prima facie case of anticompetitive effect).

3. *See, e.g.*, *Wilhelmsen*, 341 F. Supp. 3d at 70; FTC v. Cardinal Health, Inc., 12 F. Supp. 2d 34, 58 (D.D.C. 1998).

4. *See Wilhelmsen*, 341 F. Supp. 3d at 70.

others do not.[5] The 2010 Merger Guidelines recognize the defense and these limiting principles:

> The Agencies consider the possibility that powerful buyers may constrain the ability of the merging parties to raise prices . . . . However, the Agencies do not presume that the presence of powerful buyers alone forestalls adverse competitive effects flowing from the merger. Even buyers that can negotiate favorable terms may be harmed by an increase in market power. The Agencies examine the choices available to powerful buyers and how those choices likely would change due to the merger. Normally, a merger that eliminates a supplier whose presence contributed significantly to a buyer's negotiating leverage will harm that buyer.... Furthermore, even if some powerful buyers could protect themselves, the Agencies also consider whether market power can be exercised against other buyers.[6]

It is important in raising a power buyer defense to present both an explanation and evidence of the mechanics of how the power buyer will constrain the exercise of market power postmerger against itself and how other customers, if any, in the market will be protected.

Self-protection. The first requirement for a power buyer defense is that the putative power buyer be able to protect itself from any anticompetitive effect resulting from the merger. In the absence of a clear mechanism—and the incentive to use it—courts and the enforcement agencies will reject a power buyer defense.[7]

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5. *See* FTC Cardinal Health, Inc., 12 F. Supp. 2d 34, 61 (D.D.C. 1998) (rejecting power buyer defense in a two mergers of mergers of wholesale prescription drug distributors where, although large pharmacy chains had significant bargaining power and likely could protect themselves, the market also contained independent pharmacies and the smaller hospitals that could not protect themselves); United States v. United Tote, 768 F. Supp. 1064, 1085 (D. Del.1991) ("Even if the Court were to accept United Tote's argument that the owners of these large, sophisticated facilities would be able to protect themselves from any anti-competitive price increase, this would still leave at least one hundred nine facilities unprotected in the small market segment alone.").

6. U.S. Dep't of Justice & Fed. Trade Comm'n, DOJ/FTC Horizontal Merger Guidelines § 8 (rev. 2010). For cases recognizing the existence of the defense and applying Section 8 of the guidelines, see FTC v. RAG-Stiftung, 436 F. Supp. 3d 278, 315 (D.D.C. 2020); FTC v. v. Wilh. Wilhelmsen Holding ASA, 341 F. Supp. 3d 27, 70 (D.D.C. 2018); FTC v. Sanford Health, Sanford Bismarck, No. 1:17-CV-133, 2017 WL 10810016, at *16 (D.N.D. Dec. 15, 2017), *aff'd*, 926 F.3d 959 (8th Cir. 2019); United States v. Anthem, Inc., 236 F. Supp. 3d 171, 221 (D.D.C. 2017); FTC v. Sysco Corp., 113 F. Supp. 3d 1, 48 (D.D.C. 2015).

7. *See* Chicago Bridge & Iron Co. v. FTC, 534 F.3d 410, 439-40 (5th Cir. 2008) (discussing types of power buyer defense mechanisms); AlliedSignal, Inc. v. B.F. Goodrich Co., 183 F.3d 568, 575 (7th Cir. 1999); FTC v. Cardinal Health, Inc., 12 F. Supp. 2d 34, 58 (D.D.C. 1998); but cf. FTC v. RAG-Stiftung, 436 F. Supp. 3d 278, 315, 317 (D.D.C. 2020) (denying a preliminary injunction where, among other factors, "the hydrogen peroxide industry is marked by sophisticated and powerful customers that are well equipped to defeat coordination" and "there is no reason to suspect that suppliers will not continue to participate in a blind bidding system for long-term and large contracts to win the business of sophisticated buyers" but not further explaining the mechanism).

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:

1. *Share shifting*. When buyers are large relative to the overall market, upstream firms have substantial excess capacity to service new business, marginal costs are low relative to fixed costs, and the costs to the buyers of switching from one supplier to another are low, then price competition for the patronage of these buyers usually is intensive even when the market is highly concentrated. In these circumstances, the upstream firms already have covered their fixed costs, so that—in light of the relatively low marginal costs—the revenues earned on incremental business are almost all profit. Conversely, the loss of one of these buyers to another firm will cost the original supplier heavily, since almost all of the lost revenue is lost profit. As a result, under this theory changes in concentration short of a merger to monopoly are unlikely to disturb price competition in such markets, at least in the absence of explicit collusion.[8] Courts can be skeptical, however, and find that the bargaining power of the putative power buyers declines as the number of the firms with the excess capacity are few in number and become fewer as a result of the merger.[9]

2. *Sponsoring entry*. In markets in which the primary impediment to entry is the risk of not being able to secure enough business to load a minimum efficient scale plant, buyers (who may at collectively though a buying group) that are large relative to the market can protect themselves, at least in the long-run, by inducing entry by third parties by agreeing to purchase enough output to load the new plant. When the time to enter is short and the sunk costs are low, the threat of inducing entry is likely to be a credible one and the threat alone may be sufficient to dissuade the merged firm to raising prices to these buyers. In

8. For cases recognizing a share-shifting argument, see, for example, FTC v. Tenet Health Care Corp., 186 F.3d 1045, 1055 (8th Cir. 1999); *Wilhelmsen*, 341 F. Supp. 3d at 70-71; and presumably FTC v. RAG-Stiftung, 436 F. Supp. 3d 278, 317 (D.D.C. 2020).

9. *See* United States v. Anthem, Inc., 236 F. Supp. 3d 171, 221 (D.D.C. 2017) (rejecting defense where, notwithstanding the substantial sophisticated of large national companies, the "loss of one competitor from the four major carriers alters the RFP and negotiating dynamic, even with strong advocates on the other side" and "[t]his loss of leverage undermines the defense contention that customers will be able to wield their seasoned human resource managers and consultants to counteract the anticompetitive effects of the merger"); *see also* Chicago Bridge & Iron Co. v. FTC, 534 F.3d 410, 440 (5th Cir. 2008) (rejecting share-shifting as defense where the market has had only two dominant players, PDM and CB&I [the merging companies], so buyers cannot now swing back and forth between competitors to lower bids post-acquisition); FTC v. Sysco Corp., 113 F. Supp. 3d 1, 48 (D.D.C. 2015) (finding that large customers premerger have been able "to keep prices down by leveraging the defendant companies against one another," the merger will eliminate that ability); U.S. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines § 8 (rev. 2010) ("Normally, a merger that eliminates a supplier whose presence contributed significantly to a buyer's negotiating leverage will harm that buyer.")

such situations, markets are likely to remain competitive even with significant increases in concentration in upstream markets caused by mergers.[10]

3. *Vertical integration*. Vertical integration is a special case of inducing entry. Here, rather than inducing a third party to enter the upstream market, the downstream buyers (who again may act collectively) may vertically integrate into the upstream market of the merged firm. Essentially the same conditions apply for the defense as for inducing entry.[11]

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

Protection of others. Whenever a power buyer defense is employed, the parties should pay careful attention to the possibility that, although the large firms in the market may be able to protect themselves, the smaller ones may not. The enforcement agencies and the courts will examine closely the possibility that the upstream firms can isolate the smaller firms and discriminate against them while acting competitively toward the larger firms. If some buyers are able to protect themselves from the

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10. *See* Chicago Bridge & Iron Co. v. FTC, 534 F.3d 410, 440 (5th Cir. 2008) (rejecting sponsored entry where "[n]o buyer can assure that a new entrant has 'adequate volume and returns' for meaningful entry into the market); FTC v. Cardinal Health, Inc., 12 F. Supp. 2d 34, 59 (D.D.C. 1998) (finding large pharmacy chains have ability to sponsor entry into drug wholesale distribution to protect themselves but rejecting power buyer defense because of unprotected smaller pharmacies and hospitals); United States v. Baker Hughes Inc., 731 F. Supp. 3, 11 (D.D.C.) (finding the "sophistication" of large customers significant in being able to deter price increases, presumably although not explicitly because they could induce entry by Canadian suppliers) , *aff'd*, 908 F.2d 981, 986 (D.C. Cir. 1990); *see also* FTC v. Sanford Health, Sanford Bismarck, No. 1:17-CV-133, 2017 WL 10810016, at *29 (D.N.D. Dec. 15, 2017) (recognizing mechanism but finding it unsupported by the record), *aff'd*, 926 F.3d 959 (8th Cir. 2019).

11. *See* United States v. Country Lake Foods, Inc., 754 F. Supp. 669, 674, 675, 679 (D. Minn. 1990) (finding capability to vertically integrate); *see also* Sanford Health, 2017 WL 10810016, at *29 (recognizing mechanism but finding it unsupported by the record); United States v. Energy Sols., Inc., 265 F. Supp. 3d 415, 442 (D. Del. 2017) (same).

12. *See Chicago Bridge*, 534 F.3d at 440 (rejecting defense where premerger "[i]nstances of CB&I pressuring customers to offer sole-source contracts by withdrawing its bid and CB&I's success at obtaining sole-source contracts undermine any argument that buyers have the ability to pressure CB&I in contract negotiations").

otherwise anticompetitive effects of a merger but others are not, the defense will fail.[13] This was the case, for example, in *Sanford Health*, where although Blue Cross was a very large firm with a statewide share of the commercial health insurance market of between 55% and 65%, that still left between 35% and 45% of the commercial insurers unprotected from the merger.[14]

Acceptance by courts. To date, courts have been very reluctant to find existence of "power buyers" sufficient by itself to rebut a *prima facie* case of anticompetitive effect,[15] but several courts have noted "power buyers" as one of several factors in a successful rebuttal.[16] The DOJ and FTC are probably more willing to accept the defense, but they will be demanding both in the articulation of precisely why the defense should apply in the case, in the evidence from the customers who are said to be able to exercise this power, and in the ability of all firms in the market to protect themselves.

13. *See* FTC v. Cardinal Health, Inc., 12 F. Supp. 2d 34, 59 (D.D.C. 1998); FTC v. Tenet Healthcare Corp., 17 F. Supp. 2d 937, 941 (E.D. Mo. 1998), *rev'd on other grounds*, 186 F.3d 1045 (8th Cir. 1999); United States v. United Tote, Inc., 768 F. Supp. 1064, 1085 (D. Del. 1991).

14. FTC v. Sanford Health, Sanford Bismarck, No. 1:17-CV-133, 2017 WL 10810016, at *16 (D.N.D. Dec. 15, 2017), *aff'd*, 926 F.3d 959 (8th Cir. 2019).

15. A counterexample may be United States v. Country Lake Foods, Inc., 754 F. Supp. 669, 679 (D. Minn. 1990), where the court denied the government's motion for a preliminary injunction where 90 percent of the market consisted of large customers able to protect themselves individually and that smaller customer could unite through a buying group to protect themselves.

16. *See, e.g.*, United States v. Baker Hughes Inc., 908 F.2d 981, 98687 (D.C. Cir. 1990); United States v. Archer-Daniels-Midland Co., 781 F. Supp. 1400, 1422 (S.D. Iowa 1991) (accepting a power buyers defense where the market for high fructose corn syrup "is populated by very large and sophisticated purchasers and there is a continuing trend toward increasing concentration on the buying side, as large bottlers purchase formerly independent bottling franchises or bring them under their sweetener purchasing wings, and as smaller concerns band together in buying cooperatives to increase their purchasing leverage"). For a case in which the defense was rejected as insufficient on the merits, see FTC v. Cardinal Health, Inc., 12 F. Supp. 2d 34, 5861 (D.D.C. 1998).

Failing Firm Defense

Horizontal Merger Guidelines

U.S. Department of Justice

and the

Federal Trade Commission

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11. Failure and Exiting Assets

Notwithstanding the analysis above, a merger is not likely to enhance market power if imminent failure, as defined below, of one of the merging firms would cause the assets of that firm to exit the relevant market. This is an extreme instance of the more general circumstance in which the competitive significance of one of the merging firms is declining: the projected market share and significance of the exiting firm is zero. If the relevant assets would otherwise exit the market, customers are not worse off after the merger than they would have been had the merger been enjoined.

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.[16]

Similarly, a merger is unlikely to cause competitive harm if the risks to competition arise from the acquisition of a failing division. The Agencies do not normally credit claims that the assets of a division would exit the relevant market in the near future unless both of the following conditions are met: (1) applying cost allocation rules that reflect true economic costs, the division has a persistently negative cash flow on an operating basis, and such negative cash flow is not economically justified for the firm by benefits such as added sales in complementary markets or enhanced customer goodwill;[17] and (2) the owner of the failing division 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 acquisition.

12. Mergers of Competing Buyers

Mergers of competing buyers can enhance market power on the buying side of the market, just as mergers of competing sellers can enhance market power on the selling side of the market. Buyer market power is sometimes called "monopsony power."

To evaluate whether a merger is likely to enhance market power on the buying side of the market, the Agencies employ essentially the framework described above for evaluating whether a merger is likely to enhance market power on the selling side of the market. In defining relevant markets, the Agencies

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16 Any 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. Liquidation value is the highest value the assets could command for use outside the relevant market.

17 Because the parent firm can allocate costs, revenues, and intra-company transactions among itself and its subsidiaries and divisions, the Agencies require evidence on these two points that is not solely based on management plans that could have been prepared for the purpose of demonstrating negative cash flow or the prospect of exit from the relevant market.

Merger Guidelines

U.S. Department of Justice and the Federal Trade Commission

I. Overview

These Merger Guidelines explain how the Department of Justice and the Federal Trade Commission (the "Agencies") identify potentially illegal mergers. They are designed to help the public, business community, practitioners, and courts understand the factors and frameworks the Agencies consider when investigating mergers.

The Agencies enforce the federal antitrust laws, specifically Sections 1 and 2 of the Sherman Act, 15 U.S.C. §§ 1, 2; Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45; and Sections 3, 7, and 8 of the Clayton Act[1], 15 U.S.C. §§ 14, 18, 19. Congress has charged the Agencies with administering these statutes as part of a national policy to promote open and fair competition, including by preventing mergers and acquisitions that would violate these laws.

Section 7 of the Clayton Act is the antitrust law that most directly addresses mergers and acquisitions.[2] Section 7 prohibits mergers and acquisitions where "in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly."[3] Section 7 is a preventative statute that reflects the "mandate of Congress that tendencies toward concentration

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[1] As amended under the Celler-Kefauver Antimerger Act of 1950, Public Law 81-899, 64 Stat. 1125, and the Hart-Scott-Rodino Antitrust Improvements Act of 1976, 15 U.S.C. § 18a.
[2] Mergers may also violate, *inter alia*, Sections 1 and 2 of the Sherman Act or Section 5 of the FTC Act.
[3] 15 U.S.C. § 18.

IV. Rebuttal Evidence Showing that No Substantial Lessening of Competition is Threatened by the Merger.

The Agencies may assess whether a merger may substantially lessen competition or tend to create a monopoly based on a fact-specific analysis under any one or more of the Guidelines discussed above.[92] Supreme Court precedent also examines whether "other pertinent factors" presented by the merging parties nonetheless "mandate[] a conclusion that no substantial lessening of competition [is] threatened by the acquisition."[93]

Several types of rebuttal and defense evidence are subject to legal tests established by the courts. The Agencies apply those tests consistent with prevailing law, as described below.

1. Failing Firms

When merging parties suggest the weak or weakening financial position of one of the merging parties will prevent a lessening of competition, the Agencies examine that evidence under the "failing firm" defense established by the Supreme Court. This defense applies when the assets to be acquired would imminently cease playing a competitive role in the market even absent the merger.

As set forth by the Supreme Court, the failing firm defense has three requirements:

A. "[T]he evidence show[s] that the [failing firm] face[s] the grave probability of a business failure."[94] The Agencies typically look for evidence in support of this element that the allegedly failing firm would be unable to meet its financial obligations in the near future. Declining sales and/or net losses, standing alone, are insufficient to show this requirement.

B. "The prospects of reorganization of [the failing firm are] dim or nonexistent."[95] The Agencies typically look for evidence suggesting that the failing firm would be unable to reorganize successfully under Chapter 11 of the Bankruptcy Act, taking into account that "companies reorganized through receivership, or through [the Bankruptcy Act] often emerge[] as strong competitive companies."[96] Evidence of the firm's actual attempts to resolve its debt with creditors is important.

C. "[T]he company that acquires the failing [firm] or brings it under dominion is the only available purchaser."[97] The Agencies typically look for evidence that a company

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[92] *See United States v. AT&T, Inc.*, 916 F.3d 1029, 1032 (D.C. Cir. 2019) (either "short cut" market-concentration presumption or "fact-specific showing" sufficient to establish prima facie case of Section 7 violation).
[93] *See Gen. Dynamics*, 415 U.S. 486, 498 (1974); *United States v. Baker Hughes*, 908 F.2d 981, 990 (D.C. Cir. 1990) (quoting *General Dynamics* and describing its holding as permitting rebuttal based on a "finding that 'no substantial lessening of competition occurred or was threatened by the acquisition'").
[94] *Citizen Publ'g Co. v. United States*, 394 U.S. 131, 138 (1969).
[95] *Citizen Publ'g*, 394 U.S. at 138.
[96] *Id.*
[97] *Id.* at 136-39 (1969) (quoting *Int'l Shoe Co. v. FTC*, 280 U.S. 291, 302 (1930)).

has made unsuccessful good-faith efforts to elicit reasonable alternative offers that pose a less severe danger to competition than does the proposed merger.[98]

Although merging parties sometimes argue that a poor or weakening position should serve as a defense even when it does not meet these elements, the Supreme Court has "confine[d] the failing company doctrine to its present narrow scope."[99] The Agencies evaluate evidence of a failing firm consistent with this prevailing law.[100]

2. Entry and Repositioning

Merging parties sometimes raise a rebuttal claiming that a reduction in competition resulting from the merger would induce entry into the relevant market, preventing the merger from substantially lessening competition in the first place. This claim posits that a merger may, by substantially lessening competition, make the market more profitable for the merged firm and any remaining competitors, and that this increased profitability may induce new entry. To evaluate this rebuttal evidence, the Agencies assess whether entry induced by the merger would be "timely, likely, and sufficient in its magnitude, character, and scope to deter or counteract the competitive effects of concern."[101]

A. ***Timeliness.*** To show that no substantial lessening of competition is threatened by a merger, entry must be rapid enough to replace lost competition before any effect from the loss of competition due to the merger may occur. Entry in most industries takes a significant amount of time and is therefore insufficient to counteract any substantial lessening of competition that is threatened by a merger. Moreover, the entry must be durable: an entrant that does not plan to sustain its investment or that may exit the market would not ensure long-term preservation of competition.

B. ***Likelihood.*** Entry induced by lost competition must be so likely that no substantial lessening of competition is threatened by the merger. Firms make entry decisions based on the market conditions they expect once they participate in the market. If the new entry is sufficient to counteract the merger's effect on competition, the Agencies analyze why the merger would induce entry that was not planned in pre-merger competitive conditions.

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[98] Any 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. Parties must solicit reasonable alternative offers before claiming that the business is failing. Liquidation value is the highest value the assets could command outside the market. If a reasonable alternative offer was rejected, the parties cannot claim that the business is failing.

[99] *Citizen Publ'g Co. v. United States*, 394 U.S. at 139.

[100] The Agencies do not normally credit claims that the assets of a division would exit the relevant market in the near future unless: (1) applying cost allocation rules that reflect true economic costs, the division has a persistently negative cash flow on an operating basis, and such negative cash flow is not economically justified for the firm by benefits such as added sales in complementary markets or enhanced customer goodwill; and (2) the owner of the failing division has made unsuccessful good-faith efforts to elicit reasonable alternative offers that would keep its assets in the relevant market and pose a less severe danger to competition than does the proposed acquisition. Because firms can allocate costs, revenues, and intra-company transactions among their subsidiaries and divisions, the Agencies require evidence that is not solely based on management plans that could have been prepared for the purpose of demonstrating negative cash flow or the prospect of exit from the relevant market.

[101] *FTC v. Sanford Health*, 926 F.3d 959, 965 (8th Cir. 2019).

UNITED STATES V. ENERGY SOLUTIONS, INC.
265 F. Supp. 3d 415, 444 (D. Del. 2017)
(excerpt[1])

[SUE L.] ROBINSON, Senior District Judge

I. INTRODUCTION

The Department of Justice, Antitrust Division (the "government"), seeks to enjoin Rockwell Holdco, Inc. and its wholly owned subsidiary Energy Solutions, Inc. ("Energy Solutions") from acquiring Andrews County Holding, Inc. and its wholly owned subsidiary Waste Control Specialists LLC ("WCS," and collectively with the other defendants, the "defendants"). The government alleges that the acquisition would substantially lessen competition for disposal of low-level radioactive waste in violation of Section 7 of the Clayton Act, 15 U.S.C. § 18.

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II. FINDINGS OF FACT

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E. WCS Financial Situation

WCS has asserted a failing firm defense. The record shows that so far, WCS has not been a profitable enterprise. Because of regulatory requirements, WCS operates with high fixed costs. Meanwhile, the volume of LLRW generated over the past decade has declined. Lower disposal volumes means less coverage for WCS's fixed costs. As a result, WCS has never made an operating profit and consistently misses projections. Even US Ecology has suggested that the amount of Class B/C waste generated annually after the industry became "highly motivated to reduce volumes ... isn't enough to make WCS viable."

The government put forth several facts to rebut defendants' assertion that WCS is at risk of imminent failure. WCS funds its operations through an $85 million revolving credit facility with its parent Valhi. Valhi extended WCS's credit facility until March 31, 2018. As of the end of 2016, WCS had an outstanding balance on that credit facility of $41.7 million. Valhi projects that WCS will borrow an additional [redacted] between the beginning of 2017 and the end of the first quarter 2018, when the current credit facility expires, but the total amount borrowed will still be "below the maximum available."

The government further notes that WCS is a relatively new firm (opened in 2012) still trying to win customers who are under long-term LOP agreements with Energy Solutions. WCS has never defaulted on any debt. It is still current on its lease payments

1. Record citations and footnotes omitted.

and trust fund payments. It is meeting payroll and paying bonuses. And WCS recently executed several long-term disposal contracts. It has also invested in future growth opportunities, including teaming agreements with North Star for decommissioning projects and an application with the NRC seeking approval to construct and operate a consolidated interim storage facility (“CISF”) for spent nuclear fuel. The decommissioning market is expected to grow substantially over the next twenty years, as aging nuclear power plants close, and could reach $53 billion or more. Approximately 10% of the cost of decommissioning goes towards LLRW disposal.

In the CISF application filed in April 2016, WCS represented that its “financial qualifications are adequate to carry out the activities for which the license is sought.”) WCS has filed a number of updates to the application and never changed the representation regarding its financial qualifications. Also in March 2017, WCS’s independent auditor did not issue a going concern qualification, meaning that the auditors believe WCS will be in business twelve months from the date of the report. Finally, WCS has not entered into preliminary discussions with its regulator, the Texas Commission on Environmental Quality (“TCEQ”), about closing the WCS facility, even though it cannot take the first step in that process–i.e., developing a contingency plan for closing–until it consults with the TCEQ.

WCS tries to rebut the government’s picture of its financial health by pointing to several investments in growth opportunities that have not (yet?) proved profitable, including cask rentals, partnerships with processors to offer sorting and segregation, and teaming agreements for bids on decommissioning projects. Opening the exempt cell was a growth initiative but, according to WCS’s chief financial officer, “[r]unning [the exempt cell] full out . . . could never generate enough income to make up the delta on the loss.” WCS’s CEO agrees that decommissioning projects are “good jobs,” but says they are “not a silver bullet for the financial issues of WCS.” WCS needs “near-term cash to survive” and the “decommissioning projects are too far out to save us.” Several witnesses testified that it is difficult to accurately forecast when exactly disposal companies will start to see revenues from decommissioning projects, because those projects are famous for “sliding right on the schedule.” In addition, WCS has “temporarily suspend[ed]” its CISF application “due to substantially increased” costs to have the application reviewed at a time when it “must focus its limited financial resources on those expenditures necessary to safely run and maintain its current facilities.” Valhi has also suspended charges to WCS under their intercorporate services agreement, whereby WCS is supposed to pay for services Valhi employees provide to WCS, including accounting, human resources, legal, tax, risk management, and executive management.

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III. CONCLUSIONS OF LAW

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C. Rebuttal

Once the government establishes a prima facie case, the defendant must “show that the market-share statistics [give] an inaccurate account of the acquisitions’ probable effects on competition." *United States v. Citizens & S. Nat'l Bank*, 422 U.S. 86, 120 (1975). Before trial, defendants asserted that the following factors would rebut the government's prima facie case: (1) customers' ability to substitute defendants' services with self-help; (2) the existence of powerful buyers; (3) the existence of regulatory schemes that constrain anticompetitive effects; (4) efficiencies to be gained from the merger; (5) the weakened competitor doctrine; (6) the ease of entry and expansion into the market; and (7) the failing firm defense.

. . .

2. Failing firm defense

The failing-firm doctrine applies a "choice of evils" approach where "the possible threat to competition resulting from an acquisition is deemed preferable to the adverse impact on competition and other losses if the company goes out of business." *Gen. Dynamics*, 415 U.S. at 507; *Mich. Citizens for an Independent Press v. Thornburgh*, 868 F.2d 1285, 1288 (D.C. Cir. 1989). To successfully assert the defense, defendants have the burden of showing "(1) that the resources of [WCS] were 'so depleted and the prospect of rehabilitation so remote that it faced the grave probability of a business failure,' and (2) that there was no other prospective purchaser for it." *United States v. Greater Buffalo Press, Inc*., 402 U.S. 549, 555 (1971). Because the doctrine is "narrow in scope," *Citizen Pub. Co. v. United States*, 394 U.S. 131, 139 (1969), it "rarely succeeds," Philip E. Areeda & Herbert Hovenkamp, Antitrust Law ¶ 951e (4th ed. 2016).

The parties contest whether WCS is in imminent failure. There is evidence to support both sides of the issue.[20] Ultimately, however, the court need not decide that issue, because defendants have failed to demonstrate that Energy Solutions is the "only available purchaser." "The 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." *Citizen Pub.*, 394 U.S. at 138. For Energy Solutions to be the only available purchaser, defendants must show that WCS made "good faith efforts to elicit reasonable alternative offers ... that would both keep it in the market and pose a less severe danger to competition." *Dr. Pepper/Seven–Up Co. v. Fed. Trade Comm'n*, 991 F.2d 859, 865 (D.C. Cir. 1993); *Joseph Ciccone & Sons, Inc. v. E. Indus., Inc*., 537 F. Supp. 623, 628 (E.D. Pa. 1982) ("Successful invocation of that doctrine requires proof that the defendant acquired the failing company . . . by way of a 'reasonable offer which effects the least anti-competitive result.'").

Defendants have not shown that WCS's parent, Valhi, made a good faith effort as part of its 2015 sale process to elicit reasonable alternative offers. Valhi engaged with one other potential bidder–[redacted]–and left it in the dark about the sale process before abruptly ending discussions without obtaining a bid. Thus, Valhi essentially engaged in a single bidder process and then agreed to several deal protection devices that have made it impossible to entertain other offers once it became known that Valhi was finally serious about selling all of WCS. Delaware courts have found that a no-talk provision without a fiduciary-out, as existed here, "is the legal equivalent of willful blindness" that may prevent a board from meeting its duty to "be informed of all material information reasonably available," which would include reasonable alternative offers. *Phelps Dodge Corp. v. Cyprus Amax Minerals Co.*, 1999 WL 1054255, at *1–2 (Del. Ch. Sept. 27, 1999); *compare In re IXC Commc'ns, Inc. v. Cincinnati Bell, Inc.*, 1999 WL 1009174, at *6 (Del. Ch. Oct. 27, 1999) (finding that a board with a no-talk and no-shop provision adequately informed itself of reasonable alternatives by publicly announcing 6 months before the merger that it had retained an investment banker to consider possible merger or sale options and obtaining a fiduciary-out that allowed it to entertain superior proposals).

WCS argues that it has always had a "for sale" sign hanging out such that if there were another interested party, it would have appeared by now. But the facts suggest otherwise. It was well known in the industry that Energy Solutions made frequent overtures, or "annual calls," to buy WCS and had been repeatedly rebuffed. In addition, the deal on which Valhi focused in 2014 was for a minority equity investment, not a sale of the entire company. There was no clear "for sale" sign until WCS announced its transaction with Energy Solutions and, then, Valhi could neither respond nor share information that would allow another interested party to formulate a credible bid, let alone a bid that provides the "least anti-competitive result." *Joseph Ciccone & Sons*, 537 F. Supp. at 628. Considering the foregoing, the court does not give any weight to the fact that no other company but Energy Solutions has made a firm offer.

Finally, under the horizontal merger guidelines, a reasonable alternative offer is "[a]ny offer to purchase the assets of the failing firm for a price above the liquidation value of those assets." Horizontal Merger Guidelines (2010) § 11 n. 6. Valhi was clearly focused on obtaining what it perceived to be WCS's fair value, not an offer above the liquidation value, which is likely to be less. The court is sympathetic to the fact that if Valhi genuinely wants to exit the LLRW disposal market, there may be few (if any) potential buyers that would not raise some anti-trust concerns. The parties did not address whether the law gives Valhi the ability to sell WCS without it being a failing firm. Nevertheless, under the facts presented here, defendants have not shown that Valhi/WCS made good faith efforts to elicit reasonable alternative offers that would pose a less severe danger to competition.

FTC V. HARBOUR GRP. INVS., L.P.,
No. CIV. A. 90-2525, 1990 WL 198819 (D.D.C. Nov. 19, 1990)
(excerpt on failing firm defense[*])

MEMORANDUM OPINION

THOMAS F. HOGAN, District Judge

On November 8, 1990, the Court issued an order granting plaintiff's motion for a preliminary injunction. The Court held that the defendants had not met their burden in establishing their entitlement to the "failing company" defense. The order stated that a memorandum opinion in support of the Court's order would be forthcoming. This is the memorandum opinion in support of the Court's order of November 8, 1990.

Background

This antitrust action was filed by the Federal Trade Commission ("FTC" or "Commission") on October 15, 1990, pursuant to Section 13(b) of the FTC Act, 15 U.S.C. § 53(b). Section 13(b) of the FTC Act authorizes the FTC to bring an action in federal district court to seek preliminary relief pending the completion of administrative proceedings by the FTC to determine whether the challenged acquisition violates the antitrust laws. The FTC seeks preservation of the status quo pending full consideration by the FTC at an administrative trial. The standard for issuance of a preliminary injunction under Section 13(b) is that "weighing the equities and considering the Commission's likelihood of ultimate success, such action would be in the public interest." 15 U.S.C. § 53(b).[1]

In the interest of time, cost, and simplification of the issues, all parties decided to stipulate, for the purposes of the plaintiff's motion for a preliminary injunction, that the FTC met its burden in proving an adequate prima facie case on all relevant issues. Accordingly, the only issue before the Court is whether defendants have met their burden in establishing their entitlement to the "failing company" defense.[2] The Court

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* Record citations omitted.

1 This standard places a lighter burden on the FTC than that imposed by the traditional equity standard for issuance of a preliminary injunction. The FTC does not have to show the traditional equity standards of irreparable injury, probability of success on the merits, and that the balance of equities favors the petitioners. *FTC v. Weyerhaeuser Co.*, 665 F.2d 1072, 1081-82 (D.C. Cir. 1981).

2 The stipulation, signed on October 17, 1990, and filed on October 19, 1990, provides, in part:

> 1. For the purposes of determining the motion for preliminary injunction under Section 13(b) of the Federal Trade Commission Act, it is stipulated that plaintiff has offered an adequate prima facie case on all relevant issues except the affirmative defense of failing company, and that defendants will not contest that such prima facie showing meets the standards under 13(b) for issuing a preliminary injunction except for the issue of the failing company defense.

holds that the defendants have not met this burden, and that entry of a preliminary injunction is therefore appropriate.

The Parties and the Challenged Transaction

Defendant Harbour Group Investments, L.P. ("Harbour Group") is a Missouri limited partnership that buys and sells companies. Harbour Group acquired Meade Instruments Corporation ("Meade") in December 1986. Meade, a California corporation founded in 1972, manufactures and sells Schmidt–Cassegrain telescopes ("SCTs"), used by amateur astronomers. Meade is located in Costa Mesa, California.

Defendant Diethelm Holding (USA) Ltd. ("Diethelm"), a Nevada Corporation, is a subsidiary of Diethelm & Co., Ltd., a Swiss company. Diethelm owns Celestron International ("Celestron"), which is located in Torrance, California. Like Meade, Celestron manufactures and sells SCTs.

The proposed transaction involves a joint venture between Harbour Group and Diethelm regarding their two telescope subsidiaries, Meade and Celestron. Meade and Celestron are the two dominant manufacturers in the SCT market in this country. Under the proposed joint venture, Harbour Group and Diethelm will each own 50% of the joint venture, to be named Celestron Meade International ("CMI"). The proposal calls for combining the two businesses at a single production site with centralized management, production and sales. The agreement regarding the joint venture was signed on May 25, 1990.

Analysis

Section 7 of the Clayton Act, 15 U.S.C. § 18, prohibits any acquisition by a corporation of the stock or assets of another corporation "where in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition or to tend to create a monopoly."[3] The "failing company" defense is a judicially created defense to a suit brought under § 7 of the Clayton Act, and was first recognized by the Supreme Court in *International Shoe v. FTC*, 280 U.S. 291 (1930). The defense is to be narrowly construed, see *Citizen Publishing Co. v. United States*, 394 U.S. 131, 139 (1969) ("[w]e confine the failing company doctrine to its present narrow scope."), and the party seeking protection under the defense bears the burden of proof.

Subsequent to its decision in *International Shoe*, the Supreme Court has reiterated the necessary standard to successfully invoke the defense. A company invoking this defense must show that "its resources [are] so depleted and the prospect of rehabilitation so remote that it faced the grave probability of a business failure . . .

2. The failing company defense is the only legal and factual matter at issue in this proceeding, and defendants bear the burden of proof on that issue.

3 In order to determine an acquisition's likely impact on competition, a Court looks to the relevant product market, geographic market, and the transaction's impact on competition. *United States v. E.I. duPont de Nemours & Co.*, 353 U.S. 586, 593–95 (1957). If the acquisition may substantially lessen competition in any market, it violates the law.

[and] that it tried and failed to merge with a company other than the acquiring one." *U.S. v. General Dynamics Corp.*, 415 U.S. 486, 507 (1974), (internal citations omitted). The defense will not succeed "unless it is established that the company that is acquiring the failing company or brings it under dominion is the only available purchaser." *Citizen Publishing Co. v. United States*, 394 U.S. 131, 138 (1969).[4]

Probability of Business Failure

The parties contest how close Meade is to business failure. Indeed, they sharply contest what measurements the Court should use in deciding whether or not a company is near failure.

Harbour Group acquired Meade on December 18, 1986, purchasing approximately 86% of Meade's outstanding shares from its owner, president and chief executive officer, John Diebel, for a purchase price of $6.5 million.[5] The principal lender for the Meade acquisition was the Bank of Boston. Harbour Group used the assets of Meade as collateral for its loan from the Bank of Boston. Meade remains indebted to the Bank of Boston for just over $4 million at this time. Harbour Group claims that the Bank of Boston intends to call in its loan at any moment. The FTC counters that Harbour Group has produced no evidence directly from the Bank of Boston that the loan will be called in immediately.[6]

The telescope industry has experienced an across the board decline in business ever since the public's interest in Halley's Comet waned in 1986. Meade's operating profits reached their highest point in fiscal year 1986. Following 1986, Meade's sales declined. Its operating profits for the first part of this fiscal year showed a loss.

Certainly Meade is not experiencing the best financial health at this time. Its sales are down, it holds considerable debt, and its future is uncertain. Despite these difficulties, the Court finds it unnecessary to decide how close Meade must come to financial failure before it can be considered to be facing the "grave probability of a

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4 In *Citizen Publishing*, 394 U.S. 131 (1969), the Supreme Court, relying on its holding in *International Shoe*, restated a third requirement for a successful invocation of the failing company defense: that the prospects of reorganization through receivership, or through Chapter X or Chapter XI of the Bankruptcy Act, would have to be dim or nonexistent to make the failing company doctrine applicable. *Id*., at 137-138. The viability of this requirement is currently questionable since, in two later decisions, the Supreme Court did not include this requirement while discussing the failing company defense. *See U.S. v. General Dynamics*, 415 U.S. at 507; *U.S. v. Greater Buffalo Press, Inc.*, 402 U.S. 549, 555 (1971). The Court need not decide whether or not defendants must prove that the prospects of reorganization under the bankruptcy laws are dim or nonexistent, since it finds that defendants have failed to show that the merger is the "only available" alternative for Meade. Accordingly, the Court will not reach the issue of reorganization under the bankruptcy laws.

5 Shortly after the purchase, Harbour Group negotiated with Mr. Diebel for a retroactive $1.5 million reduction in the purchase price.

6 Harbour Group presented no affidavit from any official at the Bank of Boston, did not depose any official from the Bank of Boston, and did not file any document from the Bank of Boston which establishes precisely what the Bank of Boston intends to do regarding Harbour Group's loan at the present time.

business failure," since Harbour Group failed to demonstrate that the merger is the "only available" alternative open to Meade.[7]

Only Available Purchaser

The burden is on the party claiming entitlement to the defense that the acquiring company is the "only available purchaser." *Citizen Publishing Co. v. United States*, 394 U.S. 131, 138 (1969) (emphasis supplied). The "only" suggests that the burden on the defendant in proving compliance with this requirement is quite heavy. The Ninth Circuit has stated that "merely proving that some or all of the most logical purchasers have declined is not enough to prove that the challenged purchaser was the only prospective purchaser." *Golden Grain Macaroni v. FTC*, 472 F.2d 882, 887 (9th Cir. 1972), citing *United States v. Greater Buffalo Press, Inc.*, 402 U.S. 549 (1971).

In *U.S. v. M.P.M., Inc.*, 397 F. Supp. 78 (D.Colorado 1975), the District Court found that the failing company defense had been established by the acquiring company. In its review of the company's efforts to find additional sources of funding, the Court found that the company explored "virtually every potential source of funding."[8] The company's president had contacted numerous firms, government agencies, and persons. One of the main stockholders "devoted substantially all of his time toward the task of exploring investment and sales prospects after the Bank threatened drastic action if new funds were not raised immediately. He participated in approaches to as many as 12 persons in an effort to save or sell Mobile." *Id*. at 100-102. The Court found that the "officers of Mobile conducted an earnest, wide-ranging, and good faith effort to locate potential investors or purchasers in order to maintain Mobile as a going concern. The contacts were numerous and varied during time when Mobile faced a grave probability of business failure." *Id*. at 102.

In the instant case, the Court finds that defendants have not shown that the joint venture with Celestron is the only available alternative open to Meade. In reaching this conclusion, the Court looks particularly at the fact that the deal between Harbour Group and Diethelm had already been struck at the time any serious efforts to find alternatives to the joint venture really began.[9]

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[7] Likewise the Court finds it unnecessary to decide the viability of a "failing division" defense. The FTC has urged the Court to hold that Meade is a division of Harbour Group, and that as a division of a healthy company, it is not entitled to protection from the antitrust laws under the "failing company" defense. The Court will not accept FTC's invitation to construe this unsettled area of the law.

[8] The bank had informed the company that it had to raise an additional $200,000 in new capital before it would extend further credit. *Id*., at 101.

[9] Indeed, it appears that Harbour Group's efforts to find alternative purchasers were motivated by advice of legal counsel, after most of the deal with Diethelm had been completed. Ralph Lobdell, the President of Harbour Group, testified by affidavit that "[i]n early May 1990, we were advised by our counsel that if we were going to rely on the fact that Meade was a failing company to protect the contemplated joint venture from any possible antitrust challenge, it would be necessary for us to demonstrate that there were no alternative purchasers who would pay a reasonable price to acquire Meade." Affidavit of Ralph Lobdell at 9.

The evidence shows that a potential merger between Meade and Celestron had been considered by Harbour Group as a possibility as early as 1987. In late 1989, pressured by financial difficulties, Harbour Group attempted to initiate new discussions with Diethelm, and by February 1989, serious discussions were underway regarding the possibility of combining the businesses.[10] The President of Harbour Group testified that "[b]y April of 1990, it seemed likely that a joint venture agreement with Celestron could be achieved on acceptable terms." Id. at 8. Harbour Group and Diethelm signed an agreement on May 25, 1990.

It was not until May 18, 1990, that Harbour Group first contacted Merrill Lynch, the broker which Harbour Group contends handled most of the search, to discuss a possible search for alternative purchasers for Meade.[11] Merrill Lynch only agreed to handle the search the following week. The efforts made by Merrill Lynch on behalf of Harbour Group did not comport with a normal Merrill Lynch exhaustive search. For one, the search was not handled by the division within Merrill Lynch that had expertise in selling small companies. Two, offering materials prepared by Merrill Lynch were minimal, containing a brief two page executive summary, with financial information and product brochures attached. Three, the search consisted of minimal exploratory phone calls, with little follow-up or attention by the brokers who were responsible for the search.

The Court does not find that a company seeking protection under the failing company defense is obligated to hire a big name broker to attempt to sell the company, or to print the most sophisticated materials in an attempt to sell. However, here the departure from the normal business operations at Merrill Lynch supports the FTC's assertions that Harbour Group's search for an alternative to the joint venture with Celestron was characterized by a minimal effort and designed primarily to be perfunctory.

Despite the fact that the agreement between Harbour Group and Diethelm had taken at least five months to work out, Merrill Lynch was advised that Harbour Group was only interested in an alternative purchaser, "if they came up with a purchaser before the joint venture was consummated." The short time frame within which alternative purchasers would be considered is underscored by the deadline imposed in the joint venture agreement itself. The joint venture agreement contained an express provision that either Harbour Group or Diethelm was free to solicit acquisition offers from third

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[10] Ralph Lobdell testified that in the fall of 1989, Harbour Group "went out and made inquiries into several businesses . . . to buy them." Plaintiff's Exhibit 170 at 38. However, it appears that these contacts were to explore the possibility of Harbour Group purchasing another business. Regardless of the purpose for which Harbour Group approached these businesses, the Court finds that the approaches were not matched by the interest and intensity with which Harbour Group approached Celestron.

[11] Although Harbour Group contacted other brokers, most refused to conduct the search, given Meade's small size. Additionally, the Court finds that other brokers contacted by Harbour Group handled the Meade project informally, with a pronounced lack of direction and effort. It is not surprising that this half-hearted effort resulted in no interested purchasers for Meade.

parties and that if a bona fide offer was received by Meade or Celestron by June 29, 1990, the joint venture could be terminated.[12]

Defendants argue that it makes no difference that an agreement between Harbour Group and Diethelm was already pending at the time searches for alternative purchasers took place. In particular, they point to the fact that Harbour Group specifically instructed Merrill Lynch not to reveal the pending joint venture in any of their approaches to potential purchasers. However, regardless of Harbour Group's instructions, the joint venture between Harbour Group and Diethelm was common knowledge among those in the telescopic industry. In June 1990, Meade announced the pending joint venture to its distributors and customers. Plaintiff's Exhibit 110. No mention was made that other purchasers or mergers would still be considered by Meade. The distinct impression given by the memorandum was that the joint venture was a nearly completed deal. Thus, any potential purchaser of Meade that received this memorandum would likely have believed that no opportunity remained to acquire Meade.[13]

Harbour Group suggests that it is unreasonable to require it to approach smaller companies in the industry that could not be expected to have an interest or ability to purchase a larger company such as Meade. The Supreme Court has implied that, at least in some cases, approaching smaller companies in a given industry might be exactly what is required of a company seeking the protection of the failing company defense. In *Greater Buffalo Press*, the Supreme Court reviewed an acquisition by Greater Buffalo Press, Inc., of all the stock of International Color Printing Co. Both companies were in the business of printing comic supplements used on the weekends by most newspapers. In reaching its decision that the District Court had erred in finding that the acquisition in question was within the failing company defense, the Supreme Court pointed to the fact that "only King and Greater Buffalo were considered as prospective purchasers; the numerous other smaller comic supplement printers were never even approached." *Id*. at 555-556.

The FTC contends that there are at least three purchasers who are interested in buying Meade, and that they represent viable alternatives to the Meade/Celestron joint venture. Harbour Group's response to these assertions by the FTC has not been to

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[12] Harbour Group contends that the June 29, 1990, date was chosen to comply with the Hart–Scott–Rodino waiting period, which would expire on that date. They further imply that Harbour Group's hands were tied by Governmental regulation, suggesting that it is impossible to seek out alternative purchasers and obtain FTC approval of a proposed merger simultaneously. The FTC's rules require attestation that a contract, agreement in principle or letter of intent to merge be executed before the FTC's process of antitrust review commences. Harbour Group misses the point. Before it was close to reaching a final agreement with Diethelm, Harbour Group should have conducted the bona fide search for an alternative purchaser required by the antitrust laws. Waiting to commence the search until the deal is near completion and until the process of governmental review begins will unlikely result in a search that will pass muster under the "failing company" defense.

[13] According to the FTC, potential alternative purchasers, knowing of the pending deal between Harbour Group and Diethelm, would unlikely take steps toward structuring an alternative purchase, for fear of liability for interference with a preexisting agreement, akin to the liability recognized in *Texaco v. Pennzoil*, 729 S.W.2d 768 (Tex. Ct. App. 1987).

approach the potential purchasers seriously to determine if a successful agreement could be reached. Instead, defendants have spent substantial energy in trying to disprove the FTC, and show why these potential alternatives are not options at all.

The Court has reviewed the depositions filed at the time of the hearing. In both the depositions, the tenor of the testimony is that these people would consider purchasing Meade, have financial backers in mind that they would approach if they were to pursue such an option, but that they lack sufficient financial information about Meade to entertain seriously such a purchase. The lack of information known by such potential purchasers regarding Meade points not to a weakness in the FTC’s case, but to the fact that prospective alternatives to the merger exist which have never been seriously contacted by Harbour Group. Such lack of information in the hands of potential purchasers undermines the defendants’ position that they are entitled to exception from the antitrust laws under the failing company defense. The FTC is not obligated to prove that these companies are immediately ready and willing to purchase Meade. Instead, it is Harbour Group’s burden to show that the Meade–Celestron joint venture is the “only” available alternative. The FTC’s revelation regarding these companies points only to the fact that Harbour Group’s search has been narrowly structured, and still has not seriously considered options within the very industry occupied by Meade.

Certainly Celestron thought other companies might be interested in acquiring Meade. Indeed, it appears that one of the primary reasons that Celestron was interested in Meade was its concern that if it did not acquire Meade, another company might. A memorandum obtained from Diethelm during discovery reviewed the opportunity provided to Celestron by Meade’s financial difficulties. The memorandum states, in pertinent part:

> [I]t appears we have made progress over our competitor during the last twelve months. My major concern with this situation is the possibility of someone else acquiring MI [Meade] that is willing to invest more money to maintain their market share. One such company could be Vixen. . . . Vixen is extremely interested in distributing more of their own products in the U.S. Meade could be the opportunity Vixen is looking for to expand their sales in the U.S. Such an acquisition by Vixen could be extremely detrimental to our domestic sales as well as significantly reduce our sales in Japan. Of course, Vixen is the obvious company that comes to mind that could see the acquisition of MI as an opportunity but I am sure there are several others that may also fall into this category.
>
> I believe it would be in CI’s [Celestron’s] best interest to ask Willi to contact the Harbour Group to explore the purchase of MI. It would be extremely difficult to another company to seriously compete against us if we were able to acquire MI.

The Court does not, in its ruling today, create a per se rule that all small companies within a given industry must be contacted before one can successfully invoke the failing company defense. Instead, the Court holds that, in the case before it, Harbour

Group's invocation of the failing business defense cannot succeed, in part because the evidence shows that it made minimal efforts, if any, to contact obvious companies in its own industry that appear to be willing to at least entertain the notion of purchasing Meade. Additionally, the search that was conducted by Harbour Group was perfunctory, was commenced after the deal with Diethelm was close to finalization, and was not designed to result in serious alternatives to the joint venture between Meade and Celestron that was near fruition.

Conclusion

One can wonder why the FTC has chosen to sink such a substantial amount of its resources into blocking a merger of two small subsidiaries in an industry that makes hobby telescopes for a minuscule part of the population. On the scale of consumer goods, it does not strike the Court as crying out for such substantial governmental attention. However, the Court acknowledges that this decision lies within the Government's prosecutorial discretion. The Court cannot create a small company defense to the antitrust law, nor is it inclined to rewrite the failing company defense, which has rightly been construed very narrowly. As antitrust law now stands, the effect of the proposed joint venture between Harbour Group and Diethelm "may be substantially to lessen competition or to create a monopoly." The defendants have not met their burden in showing that they are entitled to the narrowly construed failing company defense, even though this may well mean the demise of the defendants, and a concomitant take-over of the market by foreign competition. Accordingly, the FTC is entitled to a preliminary injunction.

For the foregoing reasons, the Court finds that defendants are not entitled to the failing company defense, and the FTC's motion for a preliminary injunction shall be granted.

UNITED STATES V. JETBLUE AIRWAYS CORP., 712 F. Supp. 3d 109, 159-61 (D. Mass. 2024) (excerpt on the failing firm defense[1])

YOUNG, JUDGE of the United States[1]

[In July 2022, Spirit Airlines accepted a $3.8 billion topping bid from JetBlue Airways, terminating its prior agreement to be acquired by Frontier Airlines. JetBlue is known as a low-cost carrier (LCC), offering affordable fares with enhanced services, while Spirit is the largest and fastest-growing ultra low-cost carrier (ULCC), focused on providing bare-bones, no-frills travel at the lowest possible price. JetBlue planned to discontinue Spirit's ULCC business model, refit Spirit's planes with JetBlue's trade dress and cabin configurations, and position the merged company to better compete with the "Big Four" legacy carriers to the benefit of airline consumers.

In March 2023, after a lengthy second-request investigation, the Department of Justice, together with the Attorneys General of the Massachusetts, New York, and the District of Columbia, filed a civil antitrust lawsuit to block the acquisition. The plaintiffs alleged that the merger would harm consumers by raising prices and reducing choices, particularly for budget-conscious travellers. JetBlue countered that the merger would strengthen its ability to compete with larger airlines, offering consumers a higher-quality, low-cost option. JetBlue also pointed to Spirit's financial challenges as a justification for the merger.

The court ultimately ruled in favor of the government, rejecting JetBlue's arguments about Spirit's financial difficulties and the potential benefits to consumers. The judge determined that the merger would likely reduce competition, especially on routes where both airlines currently operate. Importantly, the court found that it could take more than 15 years for other ultra-low-cost carriers to fully replace Spirit's capacity on these routes, and so rejected the airlines' ease of entry defense. The decision underscores Spirit's unique role in the market as a disruptive force with its ultra-low-cost business model.]

3. Pro-Competitive Effects of the Proposed Acquisition

Finally, the Defendant Airlines present various pieces of evidence to establish that the proposed acquisition is in fact pro-competitive. Again, they do this in two ways: 1) with evidence that Spirit is struggling financially, suggesting that the proposed acquisition would in fact protect consumers from facing a weakened, failing Spirit;

[1] Most footnotes omitted.

[1] This is how my predecessor, Peleg Sprague (D. Mass. 1841-1865), would sign official documents. Now that I'm a Senior District Judge I adopt this format in honor of all the judicial colleagues, state and federal, with whom I have had the privilege to serve over the past 45 years.

and 2) with evidence that the combined firm would provide a stronger competitive counterpart to the Big Four, who control 80% of the market, than either JetBlue or Spirit could do on its own.

There are two legal doctrines relevant to an acquired firm's financial performance. The first is the "failing company" doctrine. This defense, as explained above, takes a "lesser of two evils approach." [*United States v.*] General Dynamics [*Corp*.], 415 U.S. [486,] at 507 [(1974)]. The rationale is that, if a company is on the brink of failing, "the possible threat to competition resulting from an acquisition is deemed preferable to the adverse impact on competition and other losses if the company goes out of business." *Id*.; *accord* [*United States v.*] *Energy Sol*[*utions, Inc.*], 265 F. Supp. 3d [415,] at 444 [(D. Del. July 13, 2017)]. Numerous Spirit witnesses explained at trial that Spirit is struggling financially—including that Spirit anticipates a $467,000,000 loss for 2023 (on top of prior losses over $1,000,000,000) and has not been profitable since 2019. These losses, though significant, do not, on their own, provide an affirmative defense to the Government's prima facie case.

A defendant asserting the failing firm defense bears the "burden of proving" three distinct elements: (1) the acquired firm "face[s] the grave probability of a business failure," (2) "[t]he prospects of reorganization" under the bankruptcy laws are "dim or nonexistent," and (3) "the company that acquires the failing company . . . is the only available purchaser." *Citizen Publ'g Co. v. United States*, 394 U.S. 131, 137-38 (1969) (internal citations and quotations omitted); *accord Dr. Pepper/Seven-Up Cos. v. F.T.C.*, 991 F.2d 859, 864-65 (D.C. Cir. 1993); *Steves & Sons, Inc. v. JELD-WEN, Inc.*, 290 F. Supp. 3d 507, 511-12 (E.D. Va. 2018). These requirements reflect the "strict limits placed on [the] defense" by the Supreme Court in several of its cases. *See General Dynamics*, 415 U.S. at 506 (citing cases). Although Spirit is struggling, its executives testified that the airline had a long-term plan to return to profitability. JetBlue is also far from the only available purchaser, should Spirit find itself in dire need.

The second doctrine that can be relevant to an acquired firm's financial performance is the so-called "weakened competitor" or "flailing firm" defense. Courts view such a defense skeptically, in part because a "'weak company' defense would expand the failing company doctrine, a defense which has strict limits." *F.T.C. v. Warner Commc'ns, Inc.*, 742 F.2d 1156, 1164 (9th Cir. 1984) (citations omitted). One court has described this defense as "probably the weakest ground of all for justifying a merger," *Kaiser Alum. & Chem. Corp. v. F.T.C.*, 652 F.2d 1324, 1339–41 (7th Cir. 1981), and another dismissed it as "the Hail-Mary pass of presumptively doomed mergers," *ProMedica* [*Health Sys., Inc. v. FTC*], 749 F.3d [559,] at 572 [(6th Cir. 2014)]. Courts credit the weakened-competitor defense "only in rare cases, when the defendant makes a substantial showing that the acquired firm's weakness, which cannot be resolved by any competitive means, would cause that firm's market share to reduce to a level that would undermine the Government's prima facie case." *F.T.C. v. University Health, Inc.*, 938 F.2d 1206, 1221 (11th Cir. 1991). "This argument is disfavored because it fails to account for the fact that 'financial difficulties not raising a significant threat of failure are typically remedied in a moderate length of time,' whereas a merger is a relatively permanent action that eliminates the potential for future competition between the merging parties." *Aetna*, 240 F. Supp. 3d at 92 (citing Phillip E. Areeda & Herbert Hovenkamp, Antitrust Law ¶ 963a3 (4th ed. 2016) ("Areeda & Hovenkamp")).

The Defendant Airlines argue that because Spirit is struggling financially, its "market share [is reduced] to a level that would undermine the Government's prima facie case." *University Health*, 938 F.2d at 1221. But as the *ProMedica* Court observed, this argument is a "Hail-Mary pass," and it misses the mark. The requirement that an acquired firm's weakness "cannot be resolved by any competitive means," *University Health*, 938 F.2d at 1221, means that the weakness cannot merely involve poor financial performance. It must involve a firm no longer able to access resources that are necessary to compete. *See, e.g.*, *General Dynamics*, 415 U.S. at 501-04 (coal producer had "neither the possibility of acquiring more reserves nor the ability to develop deep coal reserves, and thus was not in a position to increase its reserves"); *F.T.C. v. Arch Coal, Inc.*, 329 F. Supp. 2d 109, 155-57 (D.D.C. 2004) (noting that the acquired firm's mines would produce less than they had in the past, and there were not good prospects for acquiring new mines); [*New York v.*] *Deutsche Telekom* [*AG*], 439 F. Supp. 3d [179,] at 218-24 [(S.D.N.Y. 2020)] (wireless provider had "no clear path to obtaining" necessary assets, including no alternative acquirer, and therefore had "no convincing prospects for improvement") (internal citations omitted). The Defendant Airlines presented no evidence that Spirit was in such a dire financial situation that it had no hope for the future; instead, multiple Spirit executives testified that the airline had a plan to return to profitability.

UNITED STATES V. AETNA INC.,
240 F. Supp. 3d 1, 91-92 (D.D.C. 2017)
(excerpt on "failing company"*)

JOHN D. BATES, United States District Judge

[On July 2, 2015, Aetna Inc. and Humana Inc., two major U.S. health insurance companies, agreed to merge. After reviewing the transaction, the Department of Justice, eight states, and the District of Columbia, filed a complaint alleged that the $37 billion merger would violate Section 7 in two areas: (1) the sale of Medicare Advantage plans in each of 364 countries across 21 states, and (2) the sale of health insurance on public exchanges in 17 states across 3 states. After a 13-day trial, the court found for the plaintiffs and entered an injunction permanently enjoining the merger.]

Aetna and Humana point to two rebuttal arguments in an attempt to show that "the market-share statistics give an inaccurate account of the merger's probable effects on competition." *See* [*FTC v. H.J.*] *Heinz* [*Co*.], 246 F.3d [708,] at 715 [(D.C. Cir. 2001)] (internal quotation marks and alterations omitted). First, they raise the weakened firm defense: that one of the merging parties (Humana) is in a weakened position such that its "market share [will] reduce to a level that would undermine the government's prima facie case." *FTC v. Univ. Health, Inc.*, 938 F.2d 1206, 1221 (11th Cir. 1991). The companies argue that Humana's price increases for 2017 indicate that Humana's future market share will be too small for the merger to lead to an increase in market concentration that is presumptively unlawful. Humana increased its prices in the 17 complaint counties to be, on average, 58% above the lowest-priced silver plan in that county. This was a reaction to losses on the exchanges, and an attempt to become profitable (or less unprofitable) in that market. Orszag[1] did a regression analysis showing that such a large increase in price relative to its competitors' prices will reduce Humana's average share in these counties below 1-2%. He then conducted an HHI analysis assuming a 1-2% market share for Humana, and found that the proposed merger would not lead to an HHI or an increase in HHI above the presumptively unlawful levels in the 17 complaint counties.

But there is insufficient evidence for the Court to conclude that this argument applies. The "weakened competitor" argument is only persuasive when the defendants "make[ ] a substantial showing that the acquired firm's weakness, which cannot be resolved by any competitive means, would cause that firm's market share to reduce to

*. Record citations and footnotes omitted.

[1] [WDC: Jonathan Orszag, the defendants' economic expert, at the time was Senior Managing Director at Compass Lexecon. Orszag holds an A.B. in economics from Princeton University and an M.Sc. in Economics and Social History from Oxford University. He has testified in multiple antitrust cases.]

a level that would undermine the government's prima facie case." *Univ. Health*, 938 F.2d at 1221 (emphasis added). "Courts 'credit such a defense only in rare cases.'" *ProMedica Health Sys., Inc. v. FTC*, 749 F.3d 559, 572 (6th Cir. 2014) (quoting *Univ. Health*, 938 F.2d at 1221). Indeed, it has been described as "the Hail-Mary pass of presumptively doomed mergers," *ProMedica Health* [*Sys., Inc. v. FTC*], 749 F.3d [559,] at 572 [(6th Cir. 2014) *ProMedica Health*, 749 F.3d at 572; *see also* [*FTC v.*] *Arch Coal*, [*Inc.*,] 329 F. Supp. 2d [109,] at 154 [(D.D.C. 2004)] (describing it as the "'weakest ground of all for justifying a merger'" (quoting *Kaiser Alum. & Chem.* [*Corp. v. FTC*], 652 F.2d [1324,] at 1339 [(7th Cir. 1981)])). This argument is disfavored because it fails to account for the fact that "financial difficulties not raising a significant threat of failure are typically remedied in a moderate length of time," whereas a merger is a relatively permanent action that eliminates the potential for future competition between the merging parties. 4A Phillip E. Areeda & Herbert Hovenkamp, Antitrust Law ¶ 963a3 (4th ed. 2016). There is no argument here that Humana faces a "significant threat of failure"—if so, it could raise the failing firm defense (a separate, and entirely different, theory), which it does not.

Indeed, Humana has indicated that it is remedying its current weakness in the exchange markets. Humana's CEO testified that it is taking "corrective actions" to improve its business. It has adopted "a more insurance focused approach," is using narrower networks, and is featuring "leaner product design." It also recently met with CMS to learn about ways to improve this product line. Thus, Humana expects to offer "a high-quality and ultimately stable individual commercial health plan" despite the price increase. These are exactly the type of remedies one would expect a weakened, but not failing, firm to take—which is why the failing firm defense is only available if the firm "cannot resolve" its weaknesses. The defendants have not pointed to any evidence that Humana cannot remedy its current market weakness. Hence, the Court finds this rebuttal argument unpersuasive.

A NOTE ON THE FAILING FIRM DEFENSE

In 1930, the Supreme Court in *International Shoe Co. v. FTC*[1] 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.[2] The legislative history of the 1950 amendments to the Clayton Act specifically recognized this "failing company" defense.[3] 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.[4]

The failing company defense is frequently invoked in transactions that are *prima facie* unlawful under the *Philadelphia National Bank* presumption. It has been invoked on numerous occasions in the courts, usually without success.[5] Likewise, although the 2023 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.

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1 International Shoe Co. v. FTC, 280 U.S. 291 (1930).

2 *See* United States v. General Dynamics Corp., 415 U.S. 486 (1974); Citizen Publ'g Co. v. United States, 394 U.S. 131, 137-38 (1969).

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

4 *General Dynamics*, 415 U.S. at 507.

5 The successful cases include *International Shoe*, 280 U.S. 291; 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); ProMedica Health Sys., Inc. v. FTC, 749 F.3d 559, 572 (6th Cir. 2014) (denying petition for review and sustaining Commission's cease and desist order); Michigan Citizens for an Independent Press v. Thornburgh, 868 F.2d 1285, 128788, (D.C. Cir. 1989) (Newspaper Preservation Act); United States v. Energy Sols., Inc., 265 F. Supp. 3d 415, 444-45 (D. Del. 2017); FTC v. ProMedica Health Sys., Inc., 2011 WL 1219281, at *57 (N.D. Ohio 2011) (granting Section 13(b) preliminary injunction); 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* ProMedica, 2011 WL 1219281, at *57.

Judicial approach

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.[6] Some courts have added a third requirement: a reorganization of the acquired firm into a viable economic enterprise is not realistic.[7]

The defense has been narrowly construed, and the company invoking it bears the burden of establishing each element of the defense.[8] This allocation of the burden of persuasion appears to be an exception to the *Baker Hughes* three-step burden-shifting approach, although no court has directly addressed this issue. The exception is justified, since the evidence required to satisfy the failing company defense requirements is uniquely within the control of the defendants.

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."[9] Declining sales and/or net losses, standing alone, are insufficient to show this requirement.[10] 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 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.

[6] *See Citizen Publ'g*, 394 U.S. at 136-39; *International Shoe*, 280 U.S. at 302; Dr. Pepper/Seven-Up Cos. v. F.T.C., 991 F.2d 859, 864–65 (D.C. Cir. 1993); 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); United States v. JetBlue Airways Corp., 712 F. Supp. 3d 109, 160 (D. Mass. 2024); Steves & Sons, Inc. v. JELD-WEN, Inc., 290 F. Supp. 3d 507, 511-12 (E.D. Va. 2018); 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).

[7] *See, e.g.*, *Dr. Pepper/Seven-Up*, 991 F.2d at 864-65; 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) (stating that "[t]he prospects of reorganization of [the failing firm are] dim or nonexistent"). 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).

[8] *See, e.g.*, *JetBlue*, 712 F. Supp. 3d at 160; *Harbour Group*, 1990 WL 198819; United States v. G. Heileman Brewing Co., 345 F. Supp. 117, 123 (E.D. Mich. 1972). As discussed below, this element is required for the failing company defense under the 2010 and 2023 Merger Guidelines.

[9] *Citizen Publ'g*, 394 U.S. at 137.

[10] *See JetBlue*, 712 F. Supp. 3d at 160; *accord* 2023 Merger Guidelines § 3.1

The alternative purchaser requirement is usually the reason that the defense fails.[11] The difficulties in establishing this element may be illustrated by contrasting *United States v. M.P.M., Inc.*[12] with *FTC v. Harbour Group Investments, L.P.*[13] 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."[14] 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.[15]

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

[11] *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).

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

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

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

[15] *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).

complicated. In many 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.[16] 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.[17]

The DOJ/FTC Guidelines approach

The DOJ and FTC always have been antagonistic to the failing company doctrine, but in deference to its long judicial acceptance the 2023 DOJ/FTC Horizontal Merger Guidelines, as have the earlier guidelines, include a section on failing companies.[18] 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

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

[17] 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).

[18] 2010 DOJ/FTC Horizontal Merger Guidelines § 11.

relevant market and pose a less severe danger to competition than does the proposed merger.[19]

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 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.

Weak and competitively disadvantaged companies

In *United States v. General Dynamics Corp.*,[20] the DOJ challenged a merger between two coal companies that substantially increased market concentration. The Supreme Court held that the government's statistics on concentration did not accurately forecast competitive conditions in the relevant market. The focus of competition in the coal market was found to be the procurement of new long-term supply contracts. Because the acquired coal company's available reserves had already been committed to long-term supply contracts, the Court concluded that its probable future ability to compete had been exhausted and that its removal by merger would not adversely affect competition in the future. The Court supported its conclusion with the following observation:

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[19] *See* 2010 DOJ/FTC Horizontal Merger Guidelines § 11. 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. 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 2010 Guidelines adopted the current three-part test in fairly precise prescriptive language. As with the previous guidelines, the 2010 Guidelines did not cite cases. 2010 DOJ/FTC Horizontal Merger Guidelines § 11. The 2023 Guidelines adopted the 2010 Guidelines test but, like other parts of the 2023 Guidelines, revised the language through quotes *Citizen Publishing*. 2023 Merger Guidelines 3.1. The substance of the three-element test, however, is identical to the test in the 2010 Guidnelines.

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

> Evidence of past production does not, as a matter of logic, necessarily give a proper picture of a company's future ability to compete . . . Irrespective of the [acquired company's] . . . size when viewed as a producer, its weakness as a competitor . . . fully substantiated [the district court's] . . . conclusion that its acquisition . . . would not substantially . . . lessen competition.[21]

Since the *General Dynamics* decision, some courts have relied, at least in part, on evidence of a company's weak financial condition to permit a merger, notwithstanding a *prima facie* proof of anticompetitive effect based on the *Philadelphia National Bank* presumption using current market shares.[22] This is commonly known variously as the "flailing company" or "weakened competitor" defense. The general idea is that the financial condition of the weak firm indicates that its market share and more generally its competitive significance in the marketplace would rapidly decline in the future absent the merger, so that on a forward-looking basis the merger today would have little likelihood of an anticompetitive effect.[23] As the Eleventh Circuit observed in *University Health*, courts credit the failing company defense "only in rare cases, when the defendant makes a substantial showing that the acquired firm's weakness, which cannot be resolved by any competitive means, would cause that firm's market share to reduce to a level that would undermine the Government's prima facie case."[24] The requirement that an acquired firm's weakness "cannot be resolved by any competitive means" means that the weakness cannot merely involve poor financial performance. Rather, as *JetBlue* held, "[i]t must involve a firm no longer able to access resources that are necessary to compete."[25]

Under this logic, the flailing company defense is not a defense per se, but rather a recognition that the financial condition of a company can be a factor in a rebuttal to

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[21] *General Dynamics*, 415 U.S. at 501, 503-04.

[22] *See, e.g.*, FTC v. Nat'l Tea Co., 603 F.2d 6 (8th Cir. 1979) (preliminary injunction denied because acquiring company was weak competitor and market was relatively competitive); United States v. Consolidated Foods Corp., 455 F. Supp. 108, 13537 (E.D. Pa. 1978) (declining sales and lack of technical ability of acquiring company); *see also* FTC v. Arch Coal, Inc., 329 F. Supp. 2d 109, 153 (D.D.C. 2004); FTC v. Tenet Healthcare Corp., 17 F. Supp. 2d 93 (E.D. Mo. 1998); United States v. Federal Co., 403 F. Supp. 161, 16669 (W.D. Tenn. 1975); United States v. M. P. M., Inc., 397 F. Supp. 78 (D. Colo. 1975).

[23] *See Arch Coal*, 329 F. Supp. 2d at 157; Dr. Pepper/Seven-Up Cos. v. FTC, 991 F.2d 859, 864-65 (D.C. Cir. 1993); Lektro-Vend Corp. v. Vendo Co., 660 F.2d 255, 276-77 (7th Cir. 1981); *Nat'l Tea*, 603 F.2d at 699-700.

[24] FTC v. University Health, Inc., 938 F.2d 1206, 1221 (11th Cir. 1991); *accord* New York v. Deutsche Telekom AG, 439 F. Supp. 3d 179, 218 (S.D.N.Y. 2020); United States v. Aetna Inc., 240 F. Supp. 3d 1, 92 (D.D.C. 2017).

[25] United States v. JetBlue Airways Corp., 712 F. Supp. 3d 109, 160 (D. Mass. 2024); *see* ProMedica Health Sys., Inc. v. FTC, 749 F.3d 559, 572 (6th Cir. 2014) (rejecting defense where "[t]he record demonstrates that St. Luke's market share was increasing prior to the merger; that St. Luke's had sufficient cash reserves to pay all of its obligations and meet its capital needs without any additional borrowing; and that, according to St. Luke's CEO, 'we can run in the black if activity stays high.'").

the *Philadelphia National Bank* presumption.[26] As the *University Health* court observed:

> We are not prepared, on the strength of this language, to hold that the acquisition of a "weak company" is absolutely immune from section 7 scrutiny. Rather, we view *General Dynamics* as standing for the unremarkable proposition that a defendant may rebut the government's prima facie case by showing that the government's market share statistics overstate the acquired firm's ability to compete in the future and that, discounting the acquired firm's market share to take this into account, the merger would not substantially lessen competition.[27]

To be successful the defendant must show that the weakness of the firm (together with any other relevant factors) not only results in the firm's nominal market share overstating its future competitive significance but also that the firm's expected future share absent the merger would be low enough so as not to trigger the *Philadelphia National Bank* presumption.[28] In this sense, the failing company defense is simply an application of *General Dynamics* in showing that the government's statistical market share evidence is misleading because, for example, the firm lacks the resources required to compete long-term, financial difficulties constrain the firm from improving its competitive position, or poor brand image and sales performance.[29]

The federal antitrust enforcement agencies and the courts have been very skeptical of arguments seeking to justify prima facie anticompetitive transactions on the grounds that one of the merging companies is financially weak or otherwise competitively

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[26] *See Deutsche Telekom*, 439 F. Supp. 3d at 217 ("Evidence that a merging party is a 'weakened competitor' that cannot compete effectively in the future may serve to rebut a presumption that the merger would have anticompetitive effects.").

[27] *University Health*, 938 F.2d at 1221.

[28] *University Health*, 938 F.2d at 1221 (holding that the failing firm defense requires the defendant to show that "the government's market share statistics overstate the acquired firm's ability to compete in the future and that, discounting the acquired firm's market share to take this into account, the merger would not substantially lessen competition"); *accord* FTC v. ProMedica Health Sys., Inc., 2011 WL 1219281, at *58 (N.D. Ohio 2011) (granting Section 13(b) preliminary injunction).

[29] *Deutsche Telekom*, 439 F. Supp. 3d at 218-24 (S.D.N.Y. 2020) (finding that wireless provider had "no clear path to obtaining" necessary assets, including no alternative acquirer, and therefore had "no convincing prospects for improvement"). For cases finding market share evidence misleading, see, for example, *General Dynamics*, 415 U.S. at 501-04 (noting that while coal company had been and remained " 'highly profitable' and efficient," its lack of and inability to acquire scarce uncommitted coal reserves limited its future ability to compete); Nat'l Tea, 603 F.2d at 699-700 (describing company that had "an extremely poor image among consumers" and "lost substantial amounts of money" for five straight years, despite attempts to revitalize through structural and operational changes and new, low-priced promotional offers); United States v. Int'l Harvester Co., 564 F.2d 769, 774-76 (7th Cir. 1977) (discussing "precarious" financial situation of company that struggled to secure financing and had insufficient cash or other assets to balance its liabilities); *Arch Coal*, 329 F. Supp. 2d at 155-57 (finding coal company with currently viable mines would become "less and less of an active competitor" where financing difficulties prevented it from securing long-term coal resources).

disadvantaged.[30] As a matter of principle, a failing company argument "is disfavored because it fails to account for the fact that financial difficulties not raising a significant threat of failure are typically remedied in a moderate length of time, whereas a merger is a relatively permanent action that eliminates the potential for future competition between the merging parties."[31] Equally significant, much of the skepticism appears to derive from the frequency with which somewhat less than believable claims of this sort historically have been advanced. Even when the claims of weakness or competitive disadvantage are believed, the agencies insist that the parties prove that the impediment cannot be overcome by some less anticompetitive means than the proposed acquisition. In effect, the agencies adopt a standard very similar to the standard they employ in the failing company defense.

[30] *See* ProMedica Health Sys., Inc. v. FTC, 749 F.3d 559, 572 (6th Cir. 2014) (observing that the defense is "the Hail-Mary pass of presumptively doomed mergers"); FTC v. Warner Commc'ns Inc., 742 F.2d 1156, 1164-65 (9th Cir. 1984) (noting that other cases have provided "persuasive reasons for rejecting or attaching little weight to a defense of financial plight as a ground for justifying a merger"); "probably the weakest ground of all for justifying a merger," Kaiser Alum. & Chem. Corp. v. FTC, 652 F.2d 1324, 1339 (7th Cir. 1981) (noting the defense as "probably the weakest ground of all for justifying a merger"); *Aetna*, 240 F. Supp. 3d at 92.

[31] *Aetna*, 240 F. Supp. 3d at 92 (internal quotation marks omitted).

Efficiencies

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

THE UNITED STATES OF AMERICA, Plaintiff(s), vs. BERTELSMANN SE & CO. KGAA, et al, Defendant(s).	Civil Action No. 21-02886 Washington, D.C. August 17, 2022 9:30 a.m. **Morning Session**

TRANSCRIPT OF BENCH TRIAL
BEFORE THE HONORABLE FLORENCE Y. PAN
UNITED STATES DISTRICT JUDGE

APPEARANCES:

FOR THE PLAINTIFF:	John R. Read, Esquire Ihan Kim, Esquire Melvin A. Schwarz, I, Esquire Ethan Stevenson, Esquire United States Department of Justice Antitrust Division 450 Fifth Street, Northwest Washington, D.C. 20530
FOR THE DEFENDANTS BERTELSMANN and PENGUIN RANDOM HOUSE:	Daniel M. Petrocelli, Esquire M. Randall Oppenheimer, Esquire Megan Smith, Esquire O'Melveny & Myers, LLP 1999 Avenue of the Stars Eighth Floor Los Angeles, California 90067

THE COURT: I understand that. Thank you.

MR. FRACKMAN: Thank you.

THE COURT: Anything else from you, Mr. Schwarz?

MR. SCHWARZ: No, Your Honor. Just for the record I would like to say that the Peabody Energy case, which he cited, there was an expert in that case, and the court still rejected most of the efficiencies in any event.

And I think the law is clear from the D.C. Circuit in Anthem on the fact that these cannot be vague, speculative, or otherwise cannot be verified by reasonable means. That's at 359. And I don't think this is reasonable at all.

THE COURT: Okay. Thank you.

The Court has heard the evidence on this issue and the arguments of the parties and is prepared to rule.

Dr. Snyder is an expert witness for the defendants who is offered to testify on merger-related efficiencies. His expert opinion relies on a projection of synergies produced in November of 2020 by Manuel Sansigre, a senior vice president at Penguin Random House who's in charge of mergers and acquisitions.

Mr. Sansigre produced his synergy projections to help Random House evaluate whether it should acquire Simon & Schuster.

Dr. Snyder's expert report offers three primary conclusions about Mr. Sansigre's projections.

First, that the projected synergies are the type that economists would recognize given the features of the publishing industry.

Second, that the projected synergies are merger-specific efficiencies.

Third, that the projected synergies would benefit authors through higher income and consumers through greater availability of books.

Significantly, however, Dr. Snyder concedes that he did not, quote, independently verify specific dollar amounts, unquote, and did not, quote, independently derive estimates, unquote, of Mr. Sansigre's projected synergies. Thus, the parties agree and stipulate that Dr. Snyder did not verify the projections from the November 2020 model that form the basis of his expert opinion on efficiencies.

The government filed a motion in limine to exclude Dr. Snyder's testimony on efficiencies under Federal Rule of Evidence 702. The government argued, among other things, that Dr. Snyder's reliance on unverified projections rendered his efficiencies testimony inadmissible under Rule 702, the horizontal merger guidelines, and cases applying the horizontal merger guidelines.

The Court essentially deferred ruling on the motion to preclude the expert testimony on efficiencies determining that it should hear the evidence about Mr. Sansigre's projections before deciding whether the alleged efficiencies are verifiable and verified as required by the horizontal merger guidelines and persuasive case law.

The Court decided to hear the evidence during the trial given that this is a bench trial but instructed the parties to arrange the presentation of evidence so that the verifiability of Mr. Sansigre's projected synergies could be considered and argued and the Court could then rule on the government's motion before hearing the totality of Dr. Snyder's expert testimony on efficiencies.

The Court determined that it would be more efficient to proceed in this fashion because if defendants were unable to meet their burden to show that the efficiencies were substantiated, verifiable, and verified under the horizontal merger guidelines, then it would be unnecessary to consider any of the other aspects of the efficiencies evidence.

The Court has now heard the evidence on the projected efficiencies and arguments from the parties, and it will grant the motion to preclude the efficiencies evidence because the efficiencies projected by Penguin Random House are not substantiated and verified.

Although many of the projections may be verifiable, some are not verifiable. Moreover, the efficiencies have not, in fact, been independently verified by anyone, and they, therefore, are not cognizable under the horizontal merger guidelines and are not reliable under Rule 702.

Finally, the Court concludes that the efficiencies projections in the November 2020 model are unreliable because they are out of date and include 2021 projections that have been proved to be inaccurate.

The applicable legal standards are as follows:

Federal Rule of Evidence 702 concerning testimony by expert witnesses provides, quote, a witness who is qualified as an expert by knowledge, skill, experience, training, or education may testify in the form of an opinion or otherwise if, A, the expert's scientific, technical, or other specialized knowledge will help the trier of fact to understand the evidence or to determine a fact in issue; B, the testimony is based on sufficient facts or data; C, the testimony is the product of reliable principles and methods; and D, the expert has reliably applied the principles and methods to the facts of the case, unquote.

Rule 702 incorporates the Supreme Court's guidance in Daubert versus Merrell Dow Pharmaceuticals, Inc. which called upon trial judges to serve a gatekeeping role in ensuring that an expert's testimony both rests on a reliable foundation and is relevant to the task at hand.

Also in Kumho Tire Company, Limited versus Carmichael, the Supreme Court clarified that the gatekeeper role extends to all expert testimony.

And this is confirmed by Rule 702's advisory committee note to the 2000 amendment.

The party seeking to introduce expert testimony must demonstrate its admissibility by a preponderance of the evidence. Courts take a flexible approach to deciding Rule 702 motions and have broad discretion in determining whether to admit or exclude expert testimony.

Horizontal merger guideline section 10.

The horizontal merger guidelines outline the analysis and enforcement practices of the Department of Justice and the Federal Trade Commission with respect to horizontal mergers under the federal antitrust laws including section 7 of the Clayton Act. See horizontal merger guideline section 1.

Federal courts frequently use the guidelines to develop legal standards in antitrust litigation. See, for example, FTC versus H.J. Heinz Company, 246 F.3d 708. That's a D.C. Circuit case from 2001.

Section 10 of the horizontal merger guidelines discusses efficiencies. The guidelines observe that efficiencies are difficult to verify and quantify in part because much of the information relating to efficiencies is uniquely in the possession of the merging firms. Moreover, efficiencies projected reasonably and in good faith by the merging firms may not be realized.

Therefore, the merger guidelines say, it is incumbent upon the merging firms to substantiate efficiency claims so that the agencies can verify by reasonable means the likelihood and magnitude of each asserted efficiency.

Courts interpret this requirement of substantiation and verification to encompass, quote, how and when each efficiency would be achieved and any costs of doing so, how each efficiency would enhance the merged firm's ability and incentive to compete, and why each would be merger specific, end quote. That's from United States versus H&R Block, 833 F.Supp.2d 36 at 89. That's a D.D.C. case from 2011, and it is quoting the horizontal merger guidelines section 10.

Under the guidelines, projected efficiencies are generally less credible when generated outside the usual business planning process, and they are more credible when substantiated by analogous past experience.

Ultimately, efficiencies must be cognizable to be considered under the guidelines. Quote, cognizable efficiencies are merger-specific efficiencies that have been verified and do not arise from anticompetitive reductions in output or service.

A cognizable efficiency claim must represent a type of cost saving that could not be achieved without the merger, and the estimate of the predicted saving must be reasonably verifiable by an independent party. And that's quoting the horizontal merger guidelines and also, I believe, H&R Block.

Case law provides that the Court must undertake a rigorous analysis of the kinds of efficiencies being urged by the parties in order to ensure that those efficiencies represent more than mere speculation and promises about post-merger waiver. That's H&R Block at 89.

So, thus, in sum, the foregoing legal standards and precedents place the burden on defendants to establish that the projected efficiency relied upon by Dr. Snyder are substantiated, that they are reasonably verifiable by an independent party, and that they are, in fact, verified.

Where efficiencies are not independently verifiable and verified, no court in this jurisdiction has ever given any weight to such efficiencies evidence. See H&R Block, 833 F.Supp.2d 36, D.D.C. 2011; United States versus Aetna, 240 F.Supp.3d, D.D.C. 2017; FTC versus Sysco Corporation, 113 F.Supp.3d, 1, D.D.C. 2015; FTC versus Wilhelmsen Holding, ASA, 341 F.Supp.3d 27, D.D.C. 2018; FTC versus Staples, 970 F.Supp 1066, D.D.C. 1997.

This is because it is the parties' interest to be aggressive and optimistic in the projection of efficiencies to justify their own merger. Because courts are not well-positioned to verify such projections, independent verification is critical in order to allow a court to determine whether such projections are reliable.

Without verification, the efficiencies analysis could swallow the analytical framework required by the Clayton Act. See H&R Block at 91.

The Court's findings and conclusions are as follows:

Number one, many of the projected efficiencies in the November 2020 model may be verifiable, but at least some are not verifiable.

According to the testimony of Mr. Sansigre, he and his team worked very hard to derive the efficiencies model. They began in March 2020 by including detailed data about Penguin Random House. When data became available from Simon & Schuster in September 2020, he added that data to the model. When additional data became available in October 2020, he included that data as well. The data and assumptions in the model were closely checked by executives in the Bertelsmann M&A group and the ZI risk management group including Markus Dohle and Nihar Malaviya.

Mr. Sansigre estimates that the model was revised a hundred times before it became final. All of Mr. Sansigre's judgments and assumptions were based on his broad experience in M&A and in particular in M&A in the publishing industry.

And the Court has no doubt that Mr. Sansigre is very competent, an expert in these matters.

Mr. Sansigre uses the term synergies and efficiencies interchangeably. His model identified four categories of synergies; real estate, operating expenses, variable costs, and revenue.

The real estate efficiencies were largely based on expected consolidation of Simon & Schuster's New York headquarters with Penguin Random House's New York headquarters. Mr. Sansigre consulted with managers within Penguin Random House and determined that the personnel of Simon & Schuster could be accommodated in Penguin Random House's New York office space. He then examined Simon & Schuster's lease and consulted with real estate experts who advised him that he could sublet Simon & Schuster's office space for 50 percent of the rental payments owed under the lease. He also examined other real estate holdings and estimated some additional savings from allowing other leases to expire. Based on those calculations, he projected approximately $10 million in savings per year, almost all of which are from consolidating the New York office space.

The operating expense synergies reflect efficiencies in headcount and non-headcount expenses, essentially personnel costs.

Mr. Sansigre's November 2020 model projected $[redacted] in annual operating expense synergies in 2025.

You know, I didn't think of this before, parties, but I do have numbers in this. Is it okay for me to be reading this publicly?

MR. FRACKMAN: As the Court knows, we actually made quite an effort to keep the numbers confidential. And I think both Simon & Schuster and Penguin Random House believe they are confidential. They affect personnel issues and subsequent events.

THE COURT: I am going to black out the numbers then, and we will issue a blacked out -- I will just black out the numbers and then read on the record. Thank you. I'm sorry about that.

Okay. So Mr. Sansigre's November 2020 model projected a certain amount in annual operating expense synergies in 2025. Mr. Sansigre began by predicting a percentage decrease in operating expenses. And this figure was based on prior operating expense synergies in 26 prior acquisitions including the 2013 Penguin Random House merger which had operating expense synergies of a certain percentage as well as consultation with Penguin Random House executives like Mr. Malaviya and Mr. Dohle.

Then Mr. Sansigre looked at the data examining costs department by department to identify where operating expense synergies actually might be achieved.

In some departments such as sales, IT, and administration, Mr. Sansigre looked at specific employee roles and third party contracts to determine which kinds of positions or contacts might be redundant to estimate headcount and non-headcount savings.

In some other departments such as fulfillment, Mr. Sansigre used his judgment to project a percentage of savings based on considerations like Penguin Random House's ability to scale its distribution to meet a portion of Simon & Schuster's distribution demand.

After reviewing the department-by-department data, Mr. Sansigre compared the cumulative projected synergies of that analysis with the expected percentage of synergies that he had used based on prior transactions and management judgment, and the two projected synergies number matched.

Mr. Sansigre's November 2020 model projected a certain amount of annual variable cost synergies in 2025. As part of the variable costs, Mr. Sansigre considered return rates. He found that Penguin Random House had lower return rates than Simon & Schuster by certain percentage points between 2017 and 2021. He reviewed records of improved rates from the 2013 merger from Penguin and Random House, the acquisition of smaller publishers like Little Tiger, and experiences of Penguin Random House's third party distribution clients. He also consulted Simon & Schuster and Penguin Random House management.

Based on those considerations, Mr. Sansigre used his judgment to predict a certain percentage of improvement in Simon & Schuster's post-merger return rate by 2025. Penguin Random House's investments in a supply chain were a significant factor in those projections.

Mr. Sansigre's November 2020 model projected a certain amount of annual revenue synergies in 2025. The most significant projected revenue synergies came from gross physical sales and audio. After accounting for certain rising costs, most significantly royalties and advance write-offs, he came up with a particular number that was a projected increase in sales. And the sales projections are based on Mr. Sansigre's judgment and experience.

Penguin Random House's large sales force was a significant factor in Mr. Sansigre's gross physical sales projections. He believed this large sales force would get Simon & Schuster books into more stores and, thus, increase sales, namely in independent books stores, specialty stores, and international retailers.

Simon & Schuster relies on its top customers for a greater proportion of its sales than Penguin Random House does. Mr. Sansigre interpreted this to mean that Penguin Random House could improve Simon & Schuster's sales among it's non-top customers.

Considering past acquisitions, Mr. Sansigre noted that Penguin Random House doubled the sales of Little Tiger's imprints within two years after acquiring the smaller publisher.

Notably, however, Mr. Sansigre's sales projections do not align with the historical data from the 2013 merger of Penguin and Random House which is more similar in scale to the proposed merger of Penguin Random House and Simon & Schuster.

After the 2013 merger, sales declined. Mr. Sansigre discounts the sales results of the 2013 merger because of changed market conditions including the decline of commercial fiction around 2013 in which Penguin was heavily invested at the time.

In audio Mr. Sansigre predicted that Penguin Random House's significant investments in in-house audio production would let it improve Simon & Schuster's audio revenue because Simon & Schuster relied on third parties for much of its audio revenue.

Mr. Sansigre used his judgment to predict that Simon & Schuster would have a certain percentage increase in audio revenue post merger through essentially growing with the market and benefiting from Penguin Random House's in-house capabilities.

Mr. Sansigre discounted Simon & Schuster's management's relatively high predictions for a Simon & Schuster standalone future audio revenue because he wanted to independently analyze the value of the merger.

So in sum, Mr. Sansigre's projected synergies are based on educated management judgments mostly based on past experience and applied to whatever detailed data about the businesses of Penguin Random House and Simon & Schuster that was available to him.

Many of the projections about cost savings are arguably verifiable because theoretically an independent party could look at all the underlying data about the costs of each entity that Mr. Sansigre compiled and inputted into his spreadsheets. They could get detailed explanations about the assumptions that Mr. Sansigre made in coming up with his percentage estimates of savings, and they could determine whether those assumptions were reasonable and based on past experience. Relying on past experience is favored by the horizontal merger guidelines.

Some of the projections, however, most notably the revenue projections, are not verifiable and are not based on past experience.

The November 2020 model projects sales synergies after the merger even though past experience does not support any sales synergies because after Penguin and Random House merged in 2013, they experienced a decrease in sales.

There were other merger experiences of Penguin Random House that supported the idea of sales synergies, but Mr. Sansigre picked and chose among the different precedents and he justified his sales projections not relying on Penguin and Random House merger based on his evaluation of changed marketing conditions.

Therefore, the actual percentages that Mr. Sansigre chose to apply to revenues as synergies are not verifiable.

Indeed, the defendants have conceded that revenue synergies are the least easy to predict, and one of Mr. Sansigre's own emails in the record acknowledges that the sales efficiencies are difficult to predict.

Ultimately, however, the projected sales synergies are derived from Mr. Sansigre's personal judgment, and they are not consistent with the most prominent past experience and, thus, the projected sales synergies in particular are not verifiable.

Number two, none of the efficiencies are independently verified.

The parties agree and stipulate that, regardless of whether the model was verifiable, it was not, in fact, verified by anyone outside of Penguin Random House. Thus, there was no independent verification as the horizontal merger guidelines and prior case law contemplate.

Defendants argue that the Court may verify the projections by hearing how they were derived and satisfying itself that Mr. Sansigre put in a lot of work and made reasonable assumptions, but the Court strongly disagrees that this is what is contemplated by horizontal merger guidelines and the case law.

The Court is not in a position to fact-check what Mr. Sansigre says that he did or to determine whether his assumptions were reasonable. Notably, none of the cases that have considered this issue support the notion that the Court should provide the independent verification necessary to support efficiencies evidence proffered by defendants.

Defendants have said that there's no case that says an expert is necessary. And I think that's true. Nobody has said that explicitly. But the defendants have the burden to establish that these efficiencies were independently verified, and they assume a risk in litigation in arguing to a court that a court should do that work that in many precedents was performed by experts with much more knowledge about the industry and expertise in dealing with financial models and assumptions than a court could reasonably be expected to have.

This Court notes that in the Sysco case, that court found that the expert had not verified whether efficiencies predicted by a consulting company were merger specific and for that reason among others declined to consider the efficiencies evidence. That court did not attempt to verify the merger specificity on its own. And this Court is not aware of any other precedent where a court has undertaken the kind of rigorous verification that is necessary in order to rely on efficiencies in an antitrust case.

Number three, subsequent updates of the November 2020 model undermine its reliability.

After the November 2020 model was created, Mr. Sansigre continued to update and refine the model. Most notably, new iterations of the model were created in June 2021 and January 2022. The new iterations have some drastically different projections with respect to efficiencies. The Court focuses on the January 2022 model because defendants contend that the June 2021 model was about a special circumstance, a possible large infusion of cash to the business.

Looking at the January 2022 model, that model predicts an increase in gross physical sales of [redacted] as compared to [redacted] in the November 2022 model.

The January 2022 model predicts -- I'm sorry, I should not have said those numbers.

The January '22 model predicts a certain number in fulfilling savings as compared to a much larger number predicted in November 2020, and savings on administration in the 2022 model is far larger as compared to the number in the November 2020 model. And I understand that that includes editorial and art, but the additions of those lines does not account for the magnitude of the change.

Furthermore, certain projections of the November 2020 model were proved inaccurate by the actual performance of Simon & Schuster in 2021.

While the November 2020 model made certain predictions of synergies for a merged company based on inputs regarding Simon & Schuster's expected performance as a standalone company, the actual standalone performance of Simon & Schuster exceeded the predictions.

This indicates that the November 2020 model is both out of date because it does not include actual updated performance numbers and also that the November 2020 model relied on proveably wrong projections and predictions.

Mr. Sansigre testified that the November 2020 model is still the most reliable because it reflects pre-pandemic market conditions. It appears to be his judgment that the future will look more like the pre-pandemic world than the present world.

The Court rejects that testimony because Mr. Sansigre cannot possibly know what the post-pandemic world will be like and whether the book industry will revert to pre-pandemic levels of sales and costs. Even with the benefit of industry expertise, it is clear to this Court that we are in uncharted waters.

Thus, the Court concludes that the November 2020 model is unreliable because its inputs are not updated and its projections are proveably inconsistent with actual numbers for Simon & Schuster in 2021. The Court finds that Mr. Sansigre's justifications for continuing to use the November 2020 model are unpersuasive.

The Court, thus, finds that the November 2020 efficiencies model contains some projected efficiencies that are not verifiable and that, in any event, none of the efficiencies have been verified as required by the horizontal merger guidelines and persuasive case law.

Moreover, the model is unreliable because it is not updated and makes proveably inaccurate projections. As a result, Dr. Snyder's expert report based on the November 2020 model is not based on sufficient facts and data under Rule 702 and must be excluded.

Five precedents in this jurisdiction unanimously support this conclusion. Those precedents are H&R Block, Wilhelmsen, Staples, Aetna, and Sysco.

In United States versus H&R Block, the court rejected efficiencies evidence where the projected efficiencies, quote, were largely premised on defendant's managers' experiential judgment about likely costs rather than a detailed analysis of historical data.

The court noted that, while reliance on the estimation and judgment of experienced executives about costs may be perfectly sensible as a business matter, the lack of a verifiable method of factual analysis resulting in the cost estimates renders them not cognizable by the court.

If this were not so, then the efficiencies defense might well swallow the whole of section 7 of the Clayton Act because management would be able to present large efficiencies based on its own judgment and the court would be hard pressed to find otherwise.

In this case, many of the efficiencies projections are also premised on management expectations and judgment.

In FTC versus Wilhelmsen Holding ASA, the court rejected efficiencies evidence where the projected efficiencies were based on, quote, a series of significant assumptions, percentage reductions in cost, percentage increases in productivity, or assumed cost product equivalencies that were doing all the work in calculation of the estimates.

There the critical issue was that because the bases for the assumptions the expert identified and their role in the efficiencies analysis were unclear, the reasonableness of the assumptions along with the ultimate determinations could not be verified with any degree of rigor.

Significantly, the court in that case noted that, quote, references to the merging parties' past practices, managerial expertise, and incentives or internal verification processes, unquote, could not, quote, serve to substantiate any efficiencies, unquote, because a court cannot substitute defendants' assessments and projections for independent verification.

So here, while Penguin Random House's internal process was rigorous, that internal process cannot substitute for independent verification.

In FTC versus Staples, the court rejected efficiencies evidence where, quote, the defendants' projected base case savings of $5 billion were in large part unverified or at least the defendants failed to produce the necessary documentation for verification, unquote.

Here the efficiencies also are unverified. And although the defendants will say that they produced the documentation for verification, as the Court has already stated, the Court does not have the capability, the time, or resources to perform the verification.

In United States versus Aetna, the court rejected efficiencies evidence where the defendants' experts failed to review the underlying provider contracts after the merging parties approached -- after the merging parties projected efficiencies based on the contracts, and that was criticized.

Instead, the expert noted simply that a third party consultant had taken a large haircut to the total savings estimated and without much analysis concluded that the savings were verifiable.

The court deemed that insufficient. The court said, without a more robust analysis which the companies have not provided, the court cannot conclude that these network efficiencies are verifiable and likely to be passed on to consumers.

Here, like in that case, Dr. Snyder also failed to look closely at the underlying data and did not do any robust analysis to verify the efficiencies.

Finally, in FTC versus Sysco, the court rejected efficiencies evidence where defendants' expert relied on synergy projections made by McKinsey, the consulting firm which was hired by Sysco to determine the prospective value of acquiring U.S. Foods.

The court there did not question the rigor and scale of the analysis conducted by McKinsey but noted that the expert had not verified that the synergies were merger specific.

The court stated that it was not clear what independent analysis the expert did to reduce McKinsey's projected savings to merger-specific savings.

The court also noted that in one example, the expert relied exclusively on documents created by either McKinsey or defendants. He performed no independent analysis to verify those numbers.

Again, similarly in this case, Dr. Snyder did not perform any independent analysis to verify the numbers. And in that case, the court did not undertake to do the verification itself.

As a result, the Court will exclude Dr. Snyder's testimony on efficiencies. No independent party could reasonably verify the magnitude of at least some of the asserted efficiencies in Mr. Sansigre's projected model, especially the sales synergies, and Dr. Snyder made no attempt to provide a quantitative verification of the synergies.

Because Dr. Snyder's testimony was not based on sufficient facts and data, that testimony cannot help the trier of fact to determine a fact at issue and, therefore, is not admissible under Rule 702.

Although the Court's reasoning is firmly grounded in precedents applying the horizontal merger guidelines, it bears mentioning that the Court's analysis under Rule 702 is also consistent with the application of that rule in other contexts. It is well established that expert testimony may be excluded under Rule 702 where the expert relies uncritically on information provided to them by the party or parties for whom they are working.

In the Title VII case, Campbell versus National Railroad Passenger Corporation, the court excluded the testimony of plaintiffs' expert who relied on a summary of testimony prepared by plaintiffs' counsel to form his opinions without independently reviewing or verifying that testimony. That case is at 311 F.Supp.3d 281 from 299 to 300. That's D.D.C. 2018.

The court reasoned, quote, such blind reliance on facts provided by plaintiff's counsel combined with his failure to review other sources of information renders his expert report unreliable, unquote. That's at 300.

See also McReynolds versus Sodexho Marriott Services, Inc., 349 F.Supp.2d 30 at 38, D.D.C. 2004, allowing in a

Title VII case testimony of plaintiffs' expert who relied on data prepared by the opposing party instead of by the same party who retained the expert.

And see also United States ex rel Morsell versus NortonLifeLock, Inc. That's 568 F.Supp.3d 248 at 276, D.D.C. 2021, where expert and false claims case explicitly disclaimed verification of assumptions, the expert was allowed to opine only conditionally assuming the government succeeds in proving the assumptions upon which the opinions rely.

All of these cases support the proposition that an expert's opinion may be excluded as unreliable when the opinion blindly rests on evidence provided by the party that retains the expert. A party may not cloak unexamined assumptions in the authority of expert analysis. See Ask Chemicals, LP versus Computer Packages, Inc, 593 F.Appx. 506, 510, Sixth Circuit, 2014.

For all the foregoing reasons, the Court grants the government's motion to exclude the defendants' efficiencies evidence.

Does any party want any additional findings or conclusions for the record?

MR. SCHWARZ: No, Your Honor.

MR. FRACKMAN: I think that covers it, Your Honor.

THE COURT: Okay. Thank you.

So we were in the midst of Dr. Snyder's testimony.