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Power shopping for an alternative buyer

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Mar 31, 2015

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In recent investigations of hospital mergers, the merging parties often make the argument that the acquired firm is flailing, if not outright failing. Thus, the argument goes, the transaction is necessary to keep the acquired hospital in operation. But courts have set stringent requirements for meeting the failing firm defense, and as set out in the Horizontal Merger Guidelines §11, a company can assert what is known as a "failing firm" defense only if

1. the company is unable to meet its obligations as they come due;
2. would not be able to reorganize successfully in bankruptcy; and
3. it 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 merger.

Elsewhere we have discussed how we consider information about the acquired company's financial status, and under what circumstance an argument that a firm is flailing might suggest that its future competitive significance is less than its past market shares would predict. But that is only part of what we analyze. Critical to our assessment of the issue is whether there is a less problematic acquirer. Yet we have seen cases where the merging parties have done no more than a cursory search for an alternative buyer. Even the most financially challenged firm must do more than window shop the assets.

The case law is clear that in the context of arguing that an otherwise anticompetitive transaction should proceed because the acquired firm is failing, the merging parties must show that the acquiring company is the *only* available purchaser. *Citizen Publishing Co. v. United States*, 394 U.S. 131, 138 (1969). As an illustration, in *FTC v. Harbour Group Investments*, an FTC case involving a languishing telescope company, the district court examined the efforts made by the seller to find an alternative purchaser, one that would not raise the same antitrust issues, before even considering how close the seller was to financial failure. The court rejected a failing company defense because "the deal between Harbour Group and Deithelm had already been struck at the time any serious efforts to find alternatives to the joint venture really began." 1990-2 Trade Cases ¶69,247 (D.D.C. 1990). Moreover, the financial firm conducting the search did not follow its normal process for shopping assets, instead making minimal effort and relying on a truncated time frame that, not surprisingly, did not produce another bona fide offer. In fact, the parties rejected out of hand three potential buyers identified by the FTC.

When hospitals are flailing or failing, the acquisition price may be sufficiently low that the transaction is not reportable under the Hart-Scott-Rodino Act. Yet, we often learn about such transactions from press reports, the state Attorney General, or through third parties. We will then ask the acquired hospital about the search that was done. We will also reach out to other hospitals in the area to learn whether they were contacted and whether they might have interest in acquiring the hospital at issue.

In a recent case, we investigated a transaction with a hospital that was clearly failing. It was in bankruptcy proceedings and the would-be acquirer wanted assurances that the FTC would not challenge the transaction. (While the bankruptcy court process allows other bidders to come forward, a bankruptcy court will focus on the highest bid, rather than on whether a transaction will raise antitrust issues.

The FTC may challenge on antitrust grounds a transaction that a bankruptcy court has approved.) We had good evidence that the firm could not successfully emerge from bankruptcy, but we learned that there was an interested alternate purchaser, one that would not create competitive concerns in the event that it merged with the failing hospital. After hearing our concerns about the original transaction, the acquired firm decided to proceed with the alternate purchaser. The lesson here is that something more than a "perfunctory" search for an alternative purchaser is necessary to invoke a failing company defense.

In some cases, where there is doubt as to the sufficiency of a search and whether alternate purchasers exist, we will require an appropriate search before we decide not to challenge a transaction. In 2009, the Commission voted to close its investigation of Scott & White Healthcare's merger with King's Daughters Hospital in Temple, Texas after determining that all other competitive options had been explored. In a transaction that did not require premerger notification under the HSR Act, Scott & White merged with King's Daughters, eliminating the only other independent provider of hospital services in Bell County, Texas. Evidence showed that the poor, and deteriorating, financial condition of King's Daughters likely would have caused the hospital to close at some point in the future if it was not acquired by another hospital or health system. As a result, the central issue in the Bureau's investigation was whether an alternative purchaser existed at the time of the merger that might have acquired King's Daughters and maintained it as a general acute care hospital in direct competition with Scott & White.

During the investigation, staff learned that another hospital system, Seton, may have been interested in acquiring King's Daughters, but that its opportunity to acquire the hospital was unnecessarily cut short by the agreement between King's Daughters and Scott & White. In order to ensure that all competitive options were explored, staff and the parties agreed in writing that Scott & White would offer to sell King's Daughters to Seton on specific terms relating to the continued operation of King's Daughters as a general acute care hospital. After conducting due diligence, however, Seton decided not to acquire King's Daughters. Without a viable alternative purchaser for King's Daughters, staff closed its investigation.

Somewhere between "perfunctory" and exhaustive lies the happy medium of a search sufficient to identify other potential buyers, give them an opportunity to conduct due diligence, and possibly make an offer. Companies who argue they should be allowed to sell to a competitor because of their weakened financial condition should be prepared to do a little shopping.

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