IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF MISSOURI

FEDERAL TRADE COMMISSION, Plaintiff, v. **PEABODY ENERGY CORPORATION** and **ARCH COAL, INC.**, Defendants.	Civil Action No. 4:20-cv-00317-SEP **PUBLIC VERSION**

PLAINTIFF'S MEMORANDUM OF LAW ADDRESSING FAILING AND WEAKENED FIRM ARGUMENTS

Defendants have made assertions about recent changes in Arch's financial condition, apparently in an effort to suggest that, absent the JV, Arch will be unable to continue to compete effectively to constrain SPRB coal prices. These arguments are legally and factually insufficient. Defendants have acknowledged that they do not make a failing firm argument—a recognized Section 7 defense with rigorous requirements. Hrg. Tr. Vol. 5A at 94. Instead, Defendants appear to be making a "flailing" or weakened competitor argument, which multiple courts of appeal have described as "probably the weakest ground of all for justifying a merger." *Kaiser Aluminum & Chem. Corp. v. FTC*, 652 F.2d 1324, 1339 (7th Cir. 1981).[1] A weakened competitor theory cannot succeed where, even accepting Defendants' assertions [redacted], the transaction would still exceed the thresholds for presumptive illegality. *See FTC v. Arch Coal, Inc.*, 329 F. Supp. 2d 109, 154 (D.D.C. 2004). Moreover, no court has accepted a weakened competitor theory based on extraordinarily recent events during the pendency of litigation, such as [redacted] that Defendants now claim have permanently diminished Arch's competitive importance. This Court should not be the first, as such an approach would clearly risk creating undesirable incentives for future litigants.[2]

I. Defendants Cannot Meet the Stringent Prerequisites for the Failing Firm Defense

Because the failing firm defense permits transactions that would otherwise violate Section 7, the Supreme Court has "narrowly confined the scope of the doctrine." *Mich. Citizens for an Indep. Press v. Thornburgh*, 868 F.2d 1285, 1288 (D.C. Cir. 1989), *aff'd*, 493 U.S. 38 (1989). The burden of establishing the defense's three elements falls on those who assert it, *Citizen Publ'g Co. v. United States*, 394 U.S. 131, 138-39 (1969), and it is a "heavy burden." *Golden Grain Macaroni Co. v. FTC*, 472 F.2d

[1] *See also ProMedica Health Sys., Inc. v. FTC*, 749 F.3d 559, 572 (6th Cir. 2014); *FTC v. Univ. Health, Inc.*, 938 F.2d 1206, 1221 (11th Cir. 1991); *FTC v. Warner Commc'ns Inc.*, 742 F.2d 1156, 1164 (9th Cir. 1984).

[2] *See, e.g., Chicago Bridge & Iron Co. N.V. v. FTC*, 534 F.3d 410, 435 (5th Cir. 2008) (evidence "deemed of limited value whenever such evidence *could arguably* be subject to manipulation"); *Hosp. Corp. of Am. v. FTC*, 807 F.2d 1381, 1384 (7th Cir. 1986); *United States v. Aetna Inc.*, 240 F. Supp. 3d 1, 88 (D.D.C. 2017) (actions taken to improve litigation position should be discounted).

882, 887 (9th Cir. 1972). First, the allegedly failing firm must face "the grave probability of a business failure." *United States v. Gen. Dynamics Corp.*, 415 U.S. 486, 507 (1974); *see also Dr. Pepper/Seven-Up Cos., Inc. v. FTC*, 991 F.2d 859, 864-65 (D.C. Cir. 1993) (firm must be "in imminent danger of failure"); *Mich. Citizens*, 868 F.2d at 1288 (transaction "must be the 'last straw' at which the company can grasp"). Second, the prospects of successful reorganization under the bankruptcy laws must be "dim or nonexistent." *Citizen Publ'g Co.*, 394 U.S. at 138. Third, it must be "established that the company that acquires the failing company or brings it under dominion is the only available purchaser." *Id.* Thus, the failing firm "must demonstrate that it has made a reasonable, good faith attempt to locate an alternative buyer." *Dr. Pepper/Seven-Up*, 991 F.2d at 865. *See also* Merger Guidelines § 11.

Defendants plainly do not satisfy these requirements. Arch is not on the brink of financial failure; between 2017 and 2019, Arch paid out nearly *one billion* dollars to shareholders through share buybacks and dividends. PX9086-003. Nor is there any evidence that Arch has evaluated reorganization under the bankruptcy laws and that the prospect of such reorganization is "dim or nonexistent." Finally, there is no evidence that Arch made a reasonable, good faith effort to explore an alternative transaction for its SPRB coal assets. Notably, both Cloud Peak and Blackjewel found buyers for their SPRB mines last year, despite being in bankruptcy and despite the inferiority of those mines to Arch's SPRB business. Thus, any claim now that Arch's superior assets would exit the market or stop competing is not credible without an extensive showing that Defendants cannot make.

II. Defendants Cannot Meet the Stringent Prerequisites for the Flailing Firm Defense

The weakened competitor defense is strongly disfavored, as "a weak company defense would extend the failing company doctrine, a defense which the Supreme Court in *General Dynamics* observed has strict limits." *Kaiser Aluminum*, 652 F.2d at 1339 (citing *General Dynamics*, 415 U.S. at 506). As the Seventh Circuit further explained:

> Finally, the financial weakness of the acquired firm, while it may be a relevant factor in some cases, certainly cannot be the primary justification of a merger in resistance to a [Section] 7

> proceeding. History records and common sense indicates that the creation of monopoly and the loss of competition involve the acquisition of the small and the weak by the big and the strong.

Id. at 1341. Other courts of appeal have echoed the Seventh Circuit's reasoning. *See, e.g.*, *ProMedica Health Sys., Inc. v. FTC*, 749 F.3d 559, 572 (6th Cir. 2014); *FTC v. Univ. Health, Inc.*, 938 F.2d 1206, 1220-1221 (11th Cir. 1991); *FTC v. Warner Commc'ns Inc.*, 742 F.2d 1156, 1164-65 (9th Cir. 1984). The courts are likewise in agreement that "a company's stated intention to leave the market or its financial weakness does not in itself justify a merger," and must only be one factor among many that the court evaluates. *Warner Commc'ns Inc.*, 742 F.2d at 1165.

Indeed, the Sixth Circuit has called the weakened competitor argument "the Hail-Mary pass of presumptively doomed mergers," and that is certainly true here. *ProMedica*, 749 F.3d at 572. Defendants did not assert a failing or weakened competitor defense in their Answers, nor in any of their discovery responses, and their 50-page Opposition brief included only two sentences alluding to a weakened competitor argument. The first claims (without citation) that [redacted] Opp. at 5. This claim fails to cast doubt on [redacted]. Defendants' brief next claims that Arch has [redacted]. Opp. at 13.[3] At his May 2020 deposition, Arch CEO Paul Lang testified only that, [redacted]. These references [redacted] are a far cry from Mr. Lang's assertions at last week's hearing that, if

[3] There, Defendants cited only one document, [redacted]. Notably, documents underlying Defendants' efficiencies analysis show [redacted]

the JV doesn't occur, [redacted].

These selective, post-discovery assertions (on which Arch produced no documents) lack crucial context needed to assess Arch's claims. If recent economic developments have negatively affected Arch's SPRB business, there is every reason to think the effect has been even worse for the smaller SPRB competitors with fewer financial resources and lower quality mines. Further, the shale industry on which Defendants have focused so much of their attention has also recently been plagued by layoffs, bankruptcies, and production cuts. *See, e.g.*, PX9207; PX9208; PX9209; PX9210.

In any event, the [redacted] Mr. Lang suggests, taken at face value, is insufficient to invoke the "weakened competitor" defense. *Arch Coal* recognized that "financial difficulties 'are relevant only where they indicate that market shares would decline in the future ***and by enough to bring the merger below the threshold of presumptive illegality***.'" 329 F. Supp. 2d at 154 (quoting 4 Areeda, et al., *Antitrust Law* ¶ 963(a)(3), at 13) (emphasis added); *see also Univ. Health*, 938 F.2d at 1221 ("[W]e will credit [a 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."). Here, [redacted], still rendering the JV presumptively anticompetitive by a wide margin. These figures are in fact overly conservative, because they assume Arch [redacted] despite the economic impacts of coronavirus. (Defendants, which bear the burden of asserting rebuttal arguments, did not offer evidence on the smaller mines' likely responses to coronavirus, and the FTC, which lacked notice that Defendants

would assert a weakened competitor argument, did not seek discovery on this topic.)

Moreover, Arch's new asserted plans come after a historically successful year for Arch's SPRB coal assets in 2019. [redacted].[5] No court has accepted a weakened competitor argument based on claims of poor performance for only a matter of months. Rather, in the rare cases where courts have given weight to this argument, the defendants presented far more extensive evidence of financial weakness and lack of procompetitive alternatives. For example, in *Arch Coal*, the court found in 2004 that, "[s]ince its inception in 1998, Triton has consistently lost money; total losses to date are between $100 and $150 million." 329 F. Supp. 2d at 155. Moreover, the court found that "[o]ver the past three years, Triton has engaged in a comprehensive search for a buyer of its two mines." *Id.* at 156-57. Arch has engaged in no such search process. Likewise, in *FTC v. National Tea Co.*, 603 F.2d 694, 699 (8th Cir. 1979), the defendants showed that National's stores in the relevant market "lost substantial amounts of money in each year between 1974 and 1978," and the district court found that National would exit the relevant market if the merger were enjoined. *Id.* at 699 n.7. Further, National had taken multiple unsuccessful actions to revitalize its stores and had unsuccessfully attempted to secure new store locations. *Id.* at 699.[6]

In sum, the failing and "flailing" firm defenses have been narrowly construed to ensure that an individual firm's transitory business struggles—the kind asserted here—do not permit the permanent concentration of economic power over competitively important assets.

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[4] Indeed, [redacted]

[5] *See also* PX9083-003 ("[B]uying activity for the Powder River Basin coal during the first quarter [of 2019] was the strongest we've seen in over 5 years. We believe these conditions should support an ongoing focus on free cash generation against a very modest capital investment in our thermal portfolio."); [redacted] PX2628-002 (as of February 2020, "Arch's thermal coal business remains free cash flow positive despite the market weakness").

[6] Also, the Eighth Circuit recognized that the relevant market was far less concentrated, with the combined market share of the top four grocery firms predicted to be below 50% post-merger. *Id.* at 701.

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Respectfully Submitted,

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I HEREBY CERTIFY that on the 30th day of July, 2020, I served the foregoing on the following counsel via email:

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