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Cover Page Footnote

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THE FAILING COMPANY DOCTRINE: AN ILLUSIVE ECONOMIC DEFENSE UNDER SECTION 7 OF THE CLAYTON ACT

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I. Introduction

JUDICIAL hostility to mergers has become so intense that this common business practice is on the verge of becoming a per se violation of the antitrust laws. The Supreme Court has held against the defendant in every case involving section 7 of the Clayton Act[1] that has reached it since the merger law was revised in 1950.[2] Yet between 1951 and 1961 the 500 largest industrial companies in the United States made over 3,400 acquisitions, averaging almost seven per firm.[3] Almost one-half of the firms in the $10 to $50 million asset range merge each fifteen years,[4] and the finding and negotiating of mergers has become a regular way of life for many businessmen and lawyers.[5]

In this head-on clash between business practice and judicial hostility, any judicially accepted affirmative defense which can uphold a challenged merger becomes of unique importance, and among the possible affirmative defenses the failing company doctrine enjoys a privileged position. It was awarded supporting dicta in the landmark case of *Brown Shoe Co. v. United States*[6] as follows: "supporters of the [1950] amendments indicated that it would not impede, for example, a merger between . . . a corporation which is financially healthy and a failing one which no longer can be a vital competitive factor in the market."[7] Also supported by Mr. Chief Justice Warren in *Brown Shoe* were the defenses that the merged firm would be able to afford greater competition to larger industry rivals[8]

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1. 64 Stat. 1125 (1950), 15 U.S.C. § 18 (1964).

2. Simon, A Partial Search for Affirmative Antitrust Answers, in National Indus. Conference Bd., 5th Conference on Antitrust Issues in Today's Economy: Basic Antitrust Questions in the Middle Sixties 31, 33 (1966).

3. Staff of Select House Comm. on Small Business, 87th Cong., 2d Sess., Mergers and Superconcentration—Acquisitions of 500 Largest Industrial and 50 Largest Merchandising Firms 22-23 (Comm. Print 1962).

4. Hearings Pursuant to S. Res. 70 Before the Subcommittee on Antitrust and Monopoly of the Senate Committee on the Judiciary, 89th Cong., 1st Sess., ser. 14, pt. 2, at 512 (1965).

5. See Weiner, The Perilous Quest for Acquisitions, Dun's Rev. & Modern Indus., July 1965, p. 32.

6. 370 U.S. 294 (1962).

7. Id. at 319. (Footnote omitted.) Mr. Chief Justice Warren again alluded to the failing company defense later in the opinion. Id. at 346.

8. Id. at 319.

—the "against giants" defense—and that the industry affected is open to such easy entry by new competitors that any anticompetitive effects the merger might have would soon be overcome[9]—the "ease of entry" defense. But the failing company doctrine has survived the half decade since *Brown Shoe,* retaining greater viability than the other defenses.

The ease of entry defense has not been affirmed by the Supreme Court since *Brown Shoe,* and, indeed, has been repudiated as an affirmative defense by the Federal Trade Commission.[10] Its present validity is thus in doubt, although the FTC decision attacking it was restricted to the exact facts of the case when affirmed on appeal.[11] The failing company doctrine and the against giants defense have met no such express opposition, and, rather, were reaffirmed in 1966 by further Supreme Court dictum in the otherwise radically antimerger decision in *United States v. Von's Grocery Co.*[12] The majority, however, there defined the against giants defense in a way which identified it with the failing company doctrine,[13] as aptly pointed out in the dissent,[14] thus leaving the failing company doctrine as the only undisputed section 7 affirmative defense[15] other than the "investment exception" specifically included in the act itself.[16]

Further reference to this defense in concurring[17] and dissenting[18] Supreme Court opinions during the past year seems to leave the failing company doctrine the unchallenged favorite of majority and minority alike. Nor can Mr. Chief Justice Warren's statement that this defense rests on clear congressional intent[19] be disputed. The House Report accompanying the 1950 amendments stated that "it is well settled that the Clayton Act does not apply in bankruptcy or receivership cases."[20] Similarly, the Senate Report, with a notable difference in terminology, approved mergers of companies that were in "failing" or "bankrupt" condition.[21] What "failing" was intended to mean was not indicated.

Six years after the act was passed Representative Emanuel Celler,

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9. Id. at 322.
10. Ekco Prods. Co., Trade Reg. Rep. (F.T.C.) ¶ 16879, at 21900-01 (April 21, 1964).
11. Ekco Prods. Co. v. FTC, 347 F.2d 745, 753 (7th Cir. 1965).
12. 384 U.S. 270 (1966).
13. Id. at 277 (dictum).
14. Id. at 298 n.28 (Stewart, J., dissenting).
15. Id. at 277 (dictum).
16. 64 Stat. 1125 (1950), 15 U.S.C. § 18 (1964); see American Crystal Sugar Co. v. Cuban-American Sugar Co., 259 F.2d 524 (2d Cir. 1958); Hamilton Watch Co. v. Benrus Watch Co., 206 F.2d 738 (2d Cir. 1953).
17. United States v. Von's Grocery Co., 384 U.S. 270, 280 (1966) (White, J., concurring).
18. FTC v. Dean Foods Co., 384 U.S. 597, 634 (1966) (Fortas, J., dissenting).
19. Text accompanying note 7 supra.
20. H.R. Rep. No. 1191, 81st Cong., 1st Sess. 6 (1949).
21. S. Rep. No. 1775, 81st Cong., 2d Sess. 7 (1950).

who was in 1950 and 1956, and is now, chairman of the House Committee on the Judiciary, and whose name graces the first half of the usual name of the bill—Celler-Kefauver—once again endorsed this view and once again did not define it.[22] Further support can be found in the testimony before the congressional committees which proposed the act.[23] Both opposition and definition, which perhaps would be the result of opposition, were completely absent.

This introduction attempts no definition of the failing company doctrine; as the balance of the article should make clear, no definition is possible until considerable clarification has taken place. The first, and, indeed, still the only, Supreme Court case to apply the doctrine—*International Shoe Co. v. FTC*[24]— was decided in 1930 in a case involving a merger caused by the recession following World War I. That famous dissenting trio—Justices Brandeis, Holmes and Stone—believed in 1930 that the acquired firm involved was already rescued from the perils of the 1920 recession by returning prosperity, and that approval of the merger on failing company grounds was incorrect.[25] This is one instance in which the original dissent has not only not become law, but has also failed to keep its ground even as a minority view.

II. Logical Bases of the Doctrine

There are two possible ways to state the failing company doctrine. First, it could be accepted as an exception based on clear congressional intent, and thus not needing a basis of consistent logic to have effect. Any company doing poorly enough (how poorly would still have to be determined) would be free to sell its assets to or to merge completely with any other concern. The merger would simply be exempted from the law. Secondly, it might be accepted that a merger with such a company would be assumed as a matter of law to have neither of the alternate required effects under section 7—a lessening of competition or a tendency toward monopoly.[26] Such a presumption would thus be conclusive, and thereby a rule of substantive law.

Mr. Chief Justice Warren, in *Brown Shoe*, in effect combined both bases by making the congressional intent itself follow from a presumption that a failing company "no longer can be a vital competitive factor in

22. See Celler, Corporation Mergers and Antitrust Laws, 7 Mercer L. Rev. 267, 271 (1956).

23. Hearings on H.R. 2734 Before a Subcommittee of the Senate Committee on the Judiciary, 81st Cong., 1st and 2d Sess. 332-33 (1950); Hearings Before the Subcommittee on the Study of Monopoly Power of the House Committee on the Judiciary, 81st Cong., 1st Sess., ser. 14, pt. 1, at 543 (1949).

24. 280 U.S. 291 (1930).

25. Id. at 306 (dissenting opinion).

26. See generally Markham, The New Antitrust Policy and the Individual Business Firm, 30 Law & Contemp. Prob. 607 (1965).

the market."[27] However, the difference is important. If the defense is based on congressional intent, its position is considerably stronger than if it is based merely on a presumed lack of impact on competition.[28] For, in the latter case, the defense is no stronger than the validity of that presumed lack of impact, and, in the author's view, the presumption is seldom, if ever, valid. Yet, customarily, whenever a reason for the doctrine is demanded, this invalid basis is presented as truth. According to a legal commentator in the *Virginia Law Review*: "It can hardly be said that the acquisition of a company in financial distress could have any detrimental competitive effect."[29] And, according to the district court for the District of Columbia: "The acquisition of capital stock . . . of a failing corporation is not within the ban of Section 7 of the Clayton Act . . . because the acquisition of a failing corporation that is on the verge of going out of business cannot result in lessening competition or in creating a monopoly."[30] The Supreme Court affirmed on other grounds,[31] leaving this statement neither endorsed nor refuted by higher authority. But it has been cited with approval by a former FTC lawyer.[32]

It is difficult to refute an argument whose advocates advance no logical reason in support of it. However, hypothetical examples of failing company mergers with detrimental competitive effects come readily to mind. What of a merger of a company with 10 per cent of a market in which 15 per cent of the business was needed for survival? Would its sale to a competitor with 40 per cent of the market have no anticompetitive effects compared with its going out of business and the division of its former customers among rivals with 20, 30 and 40 per cent of the market? A Supreme Court which places such heavy emphasis on the importance of preventing an industry leader from increasing its market share at all by merger[33] would hardly consider the failing firm's merger with the industry leader as lacking effect on competition. The same would be true of a failing company which owned some desirable asset, such as a

27. 370 U.S. at 319. (Footnote omitted.)

28. For a discussion of tests of probable competitive impact see Edwards, Tests of Probable Effect Under the Clayton Act, 9 Antitrust Bull. 369 (1964).

29. von Kalinowski, Section 7 and Competitive Effects, 48 Va. L. Rev. 827, 841 (1962).

30. United States v. Maryland & Va. Milk Producers Ass'n, 167 F. Supp. 799, 808 (D.D.C. 1958), aff'd, 362 U.S. 458 (1960).

31. Maryland & Va. Milk Producers Ass'n v. United States, 362 U.S. 458, 467 (1960), reversing 167 F. Supp. 45 (D.D.C. 1958), and affirming 167 F. Supp. 799 (D.D.C. 1958), 168 F. Supp. 880 (D.D.C. 1959).

32. Connor, Section 7 of the Clayton Act: The "Failing Company" Myth, 49 Geo. L.J. 84, 92 (1960).

33. See United States v. Aluminum Co. of America, 377 U.S. 271 (1964) (acquired firm having less than 2% of the market).

patent or scarce personnel, without means of raising sufficient capital to develop it.[34]

The unthinking acceptance of this doctrine is the more remarkable in that merging with failing companies was a traditional path toward monopolization in the early days of antitrust, at least according to some authorities. As FTC Chairman Paul Rand Dixon has put the matter, the famous 1911 case of *Standard Oil Co. v. United States*[35] showed "a distinct causal relationship between mergers, price discrimination, and monopolization. . . . [The] receiver of discriminatory concessions builds a treasury at the expense of weak suppliers . . . used . . . to destroy its own weaker rivals and . . . 'merge' them out of existence."[36] The above examples and quotation illustrate the importance of the question of why a company is failing—a question which, to the best of the author's knowledge, has never been seriously considered by a court. The related question of a family firm—and the results of human mortality—is considered further below.

It must be presumed that advocates of this doctrine believe the correct comparison to be between the competitiveness of the industry upon the bankruptcy of the failing company and its competitiveness after the merger. There may be an unspoken assumption that failure does not occur in business until the last customer is lost; such an assumption might justify the doctrine, but its absurdity is clear.

If no merger is allowed, the alternatives are liquidation or new management, with or without the sale of the company to new ownership. The former implies a sale of assets, presumably to more than one purchaser. The buyers could be competitors or, for many assets, concerns from other industries. A sale of all the assets to one buyer from the same industry would resurrect the section 7 question, but the problem of to whom to sell is common in section 7 divestiture orders[37] and seems to be considered soluble.

New management, with or without new ownership would solve the problem where inefficient management is the cause of failure;[38] a conglomerate sale would solve the problem where a higher cost of capital for a small competitor was the cause of failure, if the conglomerate

34. See United States v. El Paso Natural Gas Co., 376 U.S. 651 (1964), in which a merger with a possibly failing company having substantial access to a scarce raw material was held to be violative of § 7 of the Clayton Act.

35. 221 U.S. 1 (1911).

36. Dixon, Price Discrimination and the Sherman Act, 27 ABA Section of Antitrust Law 13, 16-17 (1965).

37. Cf. Simon, supra note 2, at 40.

38. For an account of varying results in the same industry under different managements see Leibenstein, Allocative Efficiency vs. "X-Efficiency," 61 Am. Econ. Rev. 392 (1966).

purchaser were large enough. Both these conditions seem to have been present in the conglomerate merger in *FTC v. Consolidated Foods Corp.*,[39] which is one reason why its narrow reciprocity holding was unfortunate for the development of law in this area.

The conclusion seems inescapable that the failing company doctrine has no logical basis as it is usually stated. When more clearly defined, however, it may be rational, especially in conjunction with other less judicially popular affirmative defenses. Otherwise it would remain only on the basis of congressional intent, and, as a practical matter, the interpretation and application of any doctrine becomes difficult indeed in the absence of a rational basis for it. It is impossible to determine whether any particular factor fits into the doctrine's purpose if that purpose is not known.

III. Relation to Other Affirmative Defenses

The failing company doctrine is most closely related to the against giants defense. The Justice Department approved the Kaiser-Willys, Nash-Hudson, and Studebaker-Packard mergers on what can be called combined failing company and "little fellow" grounds.[40] It would seem that the latter ground was far more relevant since the failing company doctrine applies to the acquisition of such a firm by a prosperous one. If relevant at all to the automobile industry, it perhaps would have justified the acquisition of any of the six automobile companies concerned by General Motors. But the coupling of these two defenses well illustrates the use of the failing company doctrine to justify a merger justifiable, if at all, under some less popular doctrine.[41]

In addition to the distinction between these defenses based upon whether one or both firms is failing, the failing company doctrine differs from the against giants defense in the degree of financial difficulty necessary for a firm to qualify. While the nature of failure under that doctrine is unclear, almost any definition would have to be stricter than under the against giants defense.

39. 380 U.S. 592 (1965).

40. Markham, Merger Policy Under the New Section 7: A Six-Year Appraisal, 43 Va. L. Rev. 489, 496 (1957).

41. A more relevant example can be found in the approval by the Justice Department of the International Press-United Press merger, conveyed in a letter from the then Assistant Attorney General Victor Hansen to the president of United Press. Note, Horizontal Mergers and the "Failing Firm" Defense Under Section 7 of the Clayton Act: A Caveat, 45 Va. L. Rev. 421, 424-25 & n.31 (1959). In granting such approval, the Antitrust Division was implementing a suggestion made during the hearings on the bill by Senator Herbert O'Connor, Democrat of Maryland, who was a member of the subcommittee. Hearings on H.R. 2734 Before a Subcommittee of the Senate Committee on the Judiciary, 81st Cong., 1st & 2d Sess. 332-33 (1950).

The failing company doctrine is also related to the natural monopoly and "efficiency" affirmative defenses and shares with all a logical relationship to ease of entry. In *Union Leader Corp. v. Newspapers of New England Inc.*,[42] which is the only case based directly on the argument of natural monopoly, the argument is parallel to a failing company one.[43] It would seem that the only use for a natural monopoly defense, instead of a failing company one, would be to permit the merger at an earlier stage of company decline.

In regard to efficiency, it could be argued that efficiency would be well served by permitting the acquisition of a less efficient firm by a more efficient one and that failure is good evidence of inefficiency. This argument, if carried to its logical extreme, would justify the acquisition of any firm with smaller profits by a competitor with larger ones.[44] At the other extreme it would justify a failing company merger where the impossibility of sale left the wasting of assets as the only alternative.

This relationship is well illustrated in a recent case, *United States v. Pabst Brewing Co.*[45] The government complaint included what seems to be an efficiency charge by the Justice Department against the merger: "(d) The acquisition alleged herein may enhance Pabst's competitive advantage in the production and sale of beer to the detriment of actual and potential competition."[46] Mr. Justice Harlan's concurring opinion added the details:

> [I]n 1959 [the year after the merger] the Blatz brewery in Wisconsin was closed down, and Blatz beer was brewed in the four Pabst breweries, because 'decentralization' was considered more efficient. To the extent that it is true that local breweries have an advantage in terms of efficiency and thus cost, a significant barrier exists to brewers who wish to sell in Wisconsin but brew their beer in other areas of the country.[47]

But Pabst viewed the merger as an alternative to incipient failure: "[T]he purpose [of the merger] . . . was to avoid the consequences of Pabst's declining sales and increasing losses . . . ."[48] This claim has not yet received judicial consideration since *Pabst* was dismissed by the district court at the end of the plaintiff's case[49] and remanded for a new trial by the Supreme Court last June.[50]

42. 284 F.2d 582 (1st Cir. 1960), cert. denied, 365 U.S. 833 (1961).

43. Id. at 589-90.

44. Since this applies only to intra-industry comparisons, it would lead to easier standards for horizontal than for vertical mergers—the reverse of the usual position.

45. 384 U.S. 546 (1966).

46. Id. at 548 n.2.

47. Id. at 559.

48. United States v. Pabst Brewing Co., 233 F. Supp. 475, 478 (E.D. Wis. 1964).

49. Id. at 495.

50. 384 U.S. at 553.

The against giants, natural monopoly, and efficiency defenses thus can all be viewed as incipient failing company cases, becoming relevant when a firm is doing poorly but not yet poorly enough to warrant the latter defense. It may be that courts will approve mergers officially on failing company grounds which more correctly should be classified under another, but less accepted judicially, defense. This question is explored further below in relation to how serious a company's financial position must be for it to be considered failing.

All these defenses are also related to ease of entry in that judicial errors of judgment, and accessions of market power and share through approved mergers, are only temporary where ease of entry exists. This is even true for the natural monopoly or duopoly argument, as shown in the *Consolidated Foods* case.[51] Not only errors in judgment, but future changes in market share and possible company size as well, can be rectified naturally in such industries.

IV. Limitations

A few years ago there were complaints that no recent cases had arisen to show the degree to which our courts, and especially the Supreme Court, still held to the failing company doctrine.[52] While *Brown Shoe* presumably settled that question, the same lack of relevant cases has prevented the doctrine from being spelled out in much judicial detail.

The most important qualification of the doctrine is whether the existence of other bidders is relevant to the legality of the challenged merger. In the fact pattern of the original *International Shoe* case, decided under the old section 7 and first recognizing a failing company exception,[53] there were no other offers.[54] Is this a necessary condition of the doctrine?

Mr. Chief Justice Warren did not answer this question in *Brown Shoe*. According to former Antitrust Division chief Robert Bicks, he was "very careful" not to be more specific in some aspects of his failing company doctrine dicta.[55] It is encouraging to know that sometimes lack of clarity is purposeful. However, Mr. Bicks may have been overly critical in this regard. The failing company doctrine was not relevant to *Brown Shoe*, and the case was not an appropriate vehicle for extensive

51. The relevant markets were characterized by ease of entry and rapid growth, resulting in several new entrants threatening what apparently had been a natural duopoly. See 380 U.S. at 605 (Stewart, J., concurring).

52. Vukasin, The Anti-Merger Law of the United States: Yesterday, Today, Tomorrow, 3 Antitrust Bull. 455, 465 (1958).

53. See Connor, supra note 32, at 85.

54. This distinction has been specifically made by the FTC. Brief for Appellee, p. 14, Erie Sand & Gravel Co. v. FTC, 291 F.2d 279 (3d Cir. 1961).

55. ABA Section of Antitrust Law, Transcript of Panel Discussion on Implications of Brown Shoe for Merger Law and Enforcement 28 (1962).

dicta on the subject. The Supreme Court had endorsed this qualification in the same term of Court as *Brown Shoe.* It did so in a unanimous per curiam reversal and remand of a district court summary judgment in *United States v. Diebold, Inc.*[56]

In 1961 the district court for the Southern District of Ohio granted summary judgment for the defendant because, as a matter of law, the fact that the acquired company had been "hopelessly insolvent and faced with imminent receivorship" for nine months meant that the Justice Department had no case.[57] Despite the fact that one article states that the Supreme Court deliberately refused to review in order not to clarify the doctrine,[58] it did reverse and did clarify the main question in doubt as follows:

> In determining that the acquisition of the assets of Herring-Hall-Marvin Safe Company was not a violation of § 7, the District Court acted upon its findings that "HHM was hopelessly insolvent and faced with imminent receivorship" and that "Diebold was the only bona fide prospective purchaser for HHM's business." The latter finding represents at least in part the resolution of a head-on factual controversy as revealed by the materials before the District Court of whether other offers . . . were actually made.[59]

This Supreme Court position would seem to settle the matter as to the need to show that there were no other bona fide purchasers, although it settles nothing as to what basis, if any, should be used in selecting among possible purchasers. The *Diebold* case itself did not reach a new trial and presumably was settled out of court.

Since the no other purchasers requirement limits the application of the doctrine, it should logically be upheld as necessary by plaintiffs. Thus, it is not surprising that the claim of other "interested" purchasers was recently raised by the FTC in *FTC v. Dean Foods Co.,*[60] now remanded for trial or settlement.[61]

If Mr. Bicks is correct in his statement that the Chief Justice in *Brown Shoe* was "very careful to leave out the 'no other prospective purchasers available' requirement, both times he stated [the doctrine] . . . ."[62] then even the slight clarity of *Diebold* no longer applies. If the question of other bidders has become, or will become, legally irrelevant, then the doctrine is even more economically meaningless.

The absence of no other bidders might be due to a duopoly market structure before the merger, but this could not be common in unregulated

56. 369 U.S. 654 (1962).
57. United States v. Diebold, Inc., 197 F. Supp. 902, 906 (S.D. Ohio 1961).
58. von Kalinowski, supra note 29, at 843.
59. 369 U.S. at 655.
60. 384 U.S. 597 (1966).
61. Id. at 612.
62. ABA Section of Antitrust Law, supra note 55.

industries. It might also be due to the fact that only one other firm has sufficient capital or credit, an unlikely situation as the law is developing.[63] However, where this situation does exist, it would presumably mean acquisition by the industry leader, and thus probably more anticompetitive effects than would be caused by a sale to any other competitor.

No other possible purchasers might result from a situation where buying the company or its assets is a close question as to desirability or where the company's particular assets mean more to one competitor than to another. In the first case, the merger probably would not have much effect on competition; in the second, it could have a great deal.

Although the author assumes that the existence of other bidders is relevant to whether the failing company was sold to the correct purchaser, from the view of minimizing anticompetitive effects, the courts sometimes take it as an indication that a company was prosperous enough to continue on its own.[64] The logic of this is hard to see, and the Supreme Court has not yet indicated its view of the subject.

A note in the *Yale Law Journal* has suggested that public bidding should be required and that the highest bidder might be ruled out and a lower bidder substituted if necessary to minimize anticompetitive effects.[65] Perhaps it would be better to forbid bidding by firms that would not be permitted to buy. That could have unfortunate effects—from the stockholder viewpoint—on the bidding, another example of how the small capital owner can be made to pay for the antitrust laws.[66] Should advanced approval for mergers ever be required by law,[67] this matter could be worked out somewhat more logically.

Several other possible limitations of, or qualifications for, the doctrine also await judicial clarification. In the *Pabst* case, for example, the district court stated that "the plaintiff moved to strike this 'failing enterprise' defense, contending that it was available only when the acquired, not the acquiring entity was failing. This motion was denied."[68] The Supreme Court, in remanding, ignored this problem. There seems to be no particular logic to the Justice Department position here. The fact that the defense is being applied to the acquiring company might be used to question its

63. Section 7 cases have recently involved smaller and smaller companies. E.g., FTC v. Consolidated Foods Corp., 380 U.S. 592 (1965). FTC cases may also involve smaller companies than those brought by the Justice Department.

64. Erie Sand & Gravel Co. v. FTC, 291 F.2d 279, 280 (3d Cir. 1961).

65. Notes and Comments, "Substantially To Lessen Competition . . .": Current Problems of Horizontal Mergers, 68 Yale L.J. 1627, 1668 (1959).

66. Kaysen, The Present War on Bigness: I, in National Indus. Conference Bd., 4th Conference on Antitrust in an Expanding Economy: The Impact of Antitrust on Economic Growth 31, 38 (1965).

67. Celler, supra note 22, at 277.

68. 233 F. Supp. at 478 n.2.

failing status, but if that status is authentic the government claim is simply legal gymnastics.

Another possible qualification is as to whether prospective failure qualifies a company. If this future misfortune is simply the result of accumulating losses, then the question becomes the same as the problem of how badly a company must be doing, as discussed below. But presumably, the prospective failure could be expected on the ground of one specific future event. This was argued by the defendant in the *Dean Foods* case, Dean alleging that it was about to lose its biggest customer with the result that the merged concern would be smaller than the pre-merger company.[69]

Ordinarily such a claim could be verified or refuted on the basis of post-merger evidence, the validity of which was recently upheld by the Supreme Court.[70] This did not apply to *Dean Foods*, which came before the Supreme Court on a question of a preliminary injunction.[71] But if the case comes to trial and the expected loss proves to have materialized, the validity of such an argument may then be determined. The case may also resolve the question of failure by the acquiring company, since Dean was the acquiring company in that merger.

Prospective failure might well have a broader context and more importance than at first appears. Companies facing the loss of defense contracts, the expiration of a patent, or similar business disasters might well seek a solution through merger and assert a Dean defense.

Another possible limitation is whether there exists a failing product aspect of the failing company doctrine. In fact, this particular aspect can claim a merger victory for the defendant in *United States v. Lever Bros.*[72] Monsanto had sold a product, the detergent All, to Lever Brothers, or, to be technically correct, had sold the trademark.[73] It had lost $416,000 on the product in 1955. According to Judge Dawson, "it was the desire of Monsanto to get out of a business in which it could only lose money unless it invested continually larger amounts for advertising and promotion to compete with Procter & Gamble and Colgate."[74]

The fact pattern of the case is somewhat complex. It might be thought that Lever Brothers itself might have qualified as a failing company. Its profits in the soap business had declined from $3 million in 1953 to $431,000 in 1956 to $142,000 in 1960, not offsetting its losses in detergents, All excepted.[75] However, Judge Dawson, perhaps because he

69. 384 U.S. at 634 (dissenting opinion).
70. FTC v. Consolidated Foods Corp., 380 U.S. 592, 598 (1965).
71. 384 U.S. at 599.
72. 216 F. Supp. 887 (S.D.N.Y. 1963).
73. Id. at 895.
74. Id. at 896.
75. Id. at 896-97.

assumed the question related to the status of the acquired product's company, dealt with it as a question of a "failing brand."[76]

Monsanto, according to Judge Dawson, had discussed the sale of All with three prospective purchasers before approaching Lever Brothers: General Foods broke off negotiations itself; Purex was rejected because it lacked sufficient capital to effectively promote All; and Armour refused to meet Monsanto's prices for future purchases of raw materials for making the product.[77] Certainly, if there were a no other prospective purchaser qualification of the doctrine based on a sale resulting in the minimization of anticompetitive effects, it is difficult to see that this merger would qualify. However, this was not discussed by the court.

Post-merger evidence was used to show lack of anticompetitive effects,[78] although Judge Dawson's description of a 9.7% to 11.6% rise in the market share of independents as "almost 20 per cent"[79] seems somewhat questionable. The case depends to some degree on line of commerce juggling between all detergents and types of detergents[80] and raises many more questions than it answers—e.g., is the fact, as mentioned by Judge Dawson, that Lever Brothers could advertise All more cheaply than could Monsanto (as a result of its other advertised brands), an efficiency argument for a merger or just an explanation of why All had failed commercially under Monsanto's ownership?[81]

The *Lever* case has a particular distinction in that it upheld a merger. The grounds on which it did are not clear, but seem to be based on a very sweeping and unqualified failing company doctrine. Judge Dawson quotes at length dicta in the Supreme Court on mergers being " 'viewed, in the context of its particular industry.' "[82] He quotes also, and to the same effect, from another district court opinion,[83] his decision coming a year before that case was reversed by the Supreme Court.

Should the judicial atmosphere toward mergers become less harsh, and mergers once again defended with some hope of victory, the *Lever Bros.* case could well become an important precedent, with its dicta

76. Id. at 899.

77. Id. at 896.

78. Id. at 900-01. The use of post-merger evidence has been approved by the Supreme Court. Note 70 supra and accompanying text.

79. Id. at 900.

80. Id. at 897-98.

81. The court stated that "Monsanto, with only one consumer brand, could not afford the heavy costs of network television sponsorship. Lever Brothers . . . has been . . . dividing such sponsorship among several of its brands." Id. at 899.

82. Id. at 898, quoting from Brown Shoe Co. v. United States, 370 U.S. 294, 321-22 (1962).

83. Id. at 901, quoting from United States v. Continental Can Co., 217 F. Supp. 761 (S.D.N.Y. 1963), rev'd, 378 U.S. 441 (1964).

widely quoted and its basis as obscure as ever. Until then it seems to be rather an oddity, applicable as a precedent probably only in situations where the sale of part of a company raises a failing company question.

V. Tests of a Failing Status

The fact that the failing company doctrine is so widely and so highly endorsed has prevented consideration of which standards to apply from being completely a defendants' problem. The Federal Trade Commission did argue once that *Hamilton Watch Co. v. Benrus Watch Co.*[84] had destroyed this defense,[85] but it has not taken that position recently. In *A.G. Spalding & Bros. v. FTC*,[86] it even endorsed it,[87] perhaps because the doctrine was irrelevant in that litigation. In *Crown Zellerbach Corp. v. FTC*,[88] it struck a happy compromise. As the defendant's brief well put it, the FTC found against Crown Zellerbach: "without reversing the hearing examiner [on the failing condition of the acquired company] or making an additional finding."[89]

The Justice Department, in addition to granting advanced approval to some mergers on at least partially failing company grounds,[90] has also conceded the validity of the defense in a case in which it did not apply.[91] It considers the financial condition of a merging firm as one factor as to whether or not it should file a complaint—a merger involving a firm not doing badly enough to come within the narrow Justice Department definition of failing[92] may still not be challenged if it has a serious financial problem.[93]

Six different standards as to what constitutes a failing company are suggested in the cases, other than the last extremity of bankruptcy or insolvency. To insist on the last extremity seems rather severe on the stockholders and creditors and may be contrary to the purpose of the exception, should it be based on the non-economic consideration of protecting stockholder or creditor interests.

The most popular test seems to be the existence or absence of a profit. The existence of profits may, indeed, be enough to rule out the failing

84. 206 F.2d 738 (2d Cir. 1953).

85. Brief for Appellee, p. 13, Erie Sand & Gravel Co. v. FTC, 291 F.2d 279 (3d Cir. 1961).

86. 301 F.2d 585 (3d Cir. 1962).

87. Record, p. 253 (Initial Decision).

88. 296 F.2d 800 (9th Cir. 1961), cert. denied, 370 U.S. 937 (1962).

89. Brief for Petitioner, pp. 32-33, Crown Zellerbach Corp. v. FTC, 296 F.2d 800 (9th Cir. 1959).

90. Jacobs, Merger Clearance Problems, 2 Antitrust Bull. 187 (1956).

91. Brown Shoe Co. v. United States, 370 U.S. 294, 319 (1962).

92. Vukasin, supra note 52, at 463.

93. Jacobs, supra note 90, at 193-94.

company doctrine in law. In *Erie Sand & Gravel Co. v. FTC*,[94] both the FTC[95] and the Third Circuit[96] took this position, the profits not being specified but described by the FTC as "nice."[97] In fact, they seem to have been reasonable and here this standard does work. But it works primarily because there was no evidence at all that the acquired company was a "failing" one under any standard. It was a matter of voluntary liquidation.[98]

The *Crown Zellerbach* case and *United States v. El Paso Natural Gas Co.*[99] present closer questions. In *Crown Zellerbach*, for example, it was true both that St. Helens, the acquired company, made a profit of approximately $1,250,000 in 1952, and that it was running at a loss during the last quarter of 1952.[100] However, in the author's judgment this approach was really irrelevant since by better standards, discussed below, St. Helens was a failing company.[101]

In *El Paso*, Pacific Northwest had made a profit, but it was much too small a profit to stay in business. In 1959, for example, it made a profit of approximately $3,600,000, while its projected profit under its Federal Power Commission certification, presumably an equitable one, was much greater.[102] Once again an existence of profit test seems irrelevant. A rate of profit test might work, but would apparently require a much higher level of judicial sophistication than now exists. At least it is not argued in the cases.

Both *Crown Zellerbach* and *El Paso* also raise an access to capital test for failing company status. According to Crown Zellerbach, St. Helens had been compelled to cancel its modernization program[103] through inability to raise the necessary funds—" 'the available capital St. Helens needed was not available.' "[104] But again Crown Zellerbach was not

94. 291 F.2d 279 (3d Cir. 1961).

95. Brief for Respondent, pp. 13-15, Erie Sand & Gravel Co. v. FTC, 291 F.2d 279 (3d Cir. 1961).

96. 291 F.2d at 280-81.

97. Brief for Respondent, p. 13, Erie Sand & Gravel Co. v. FTC, 291 F.2d 279 (3d Cir. 1961).

98. The court found that "Sandusky was a profitable enterprise and it was offered for sale as a going concern. . . . [P]receding the decision to liquidate, the business earned substantial profits." 291 F.2d at 280.

99. 376 U.S. 651 (1964).

100. Brief for Petitioner, p. 4, Crown Zellerbach Corp. v. FTC, 296 F.2d 800 (9th Cir. 1961).

101. See text accompanying notes 115-29 infra.

102. Record, vol. 68, pp. 53-54, United States v. El Paso Natural Gas Co., 376 U.S. 651 (1964).

103. Brief for Petitioner, p. 69, Crown Zellerbach Corp. v. FTC, 296 F.2d 800 (9th Cir. 1961).

104. Id. at 72.

convincing. The myopic Ninth Circuit stated in *Crown Zellerbach* that "'there are no facts in this record to clearly indicate that St. Helens would have been unable to complete its modernization program.'"[105] However, the court did not deny that this approach might have been valid if it had found such evidence.

In the *El Paso* case, the question was whether Pacific Northwest would have had the financial strength to expand into the Southern California market on its own. No, said El Paso.[106] Yes, said the Justice Department, whose answer was from two viewpoints. First, it denied that any particular financial strength was even necessary for such expansion—Pacific had excess pipeline capacity (but where?) already.[107] Secondly, it argued that raising funds was no problem anyway.[108] According to Mr. Justice Douglas, speaking for the Supreme Court, "Pacific Northwest was no feeble, failing company . . . . It had raised $250 million for its pipeline . . . ."[109] Pacific Northwest's success in raising its original capital—that very capital whose unsatisfactory return was a matter of unquestioned record—was thus considered evidence by the highest court of that firm's capacity to raise new capital. What can be said of such an opinion? According to Mr. Justice Harlan's separate opinion, it was against all tradition and law.[110] It seems equally against all economics and common sense.

Both cases appear, however, to uphold the test of access to capital needed for expansion; at least neither denies the argument, both only deny the facts. Therefore, they seem to be valid precedents for an access to capital or ability to expand approach to the failing company doctrine.

Both the Justice Department in *El Paso*[111] and the FTC in *Crown Zellerbach*[112] objected to the courts' even investigating the matter. After all, said the Justice Department in *El Paso*, such an inquiry is appropriate only with a "failing company." It has no place in an affair concerning "this young and vigorously-competing company."[113] Here, the Justice Department seems to be trying to have its cake and eat it too, since the very fact that suit had been brought showed that Pacific Northwest did not qualify under its own standard as a failing company. Fundamentally,

105. 296 F.2d at 832, quoting from 54 F.T.C. 769, 806 (1957).

106. Record, vol. 68, p. 65, United States v. El Paso Natural Gas Co., 376 U.S. 651 (1964).

107. Brief for Appellant, pp. 33-34.

108. Record, p. 25.

109. 376 U.S. at 661. (Footnote omitted.)

110. See 376 U.S. at 664.

111. Record, p. 23-24.

112. Brief for Respondent, p. 17, Crown Zellerbach Corp. v. FTC, 296 F.2d 800 (9th Cir. 1961).

113. Record, vol. 69, p. 31, United States v. El Paso Natural Gas Co., 376 U.S. 651 (1964).

however, the Justice Department is probably correct here; a failing company would have to be very liberally defined to include a concern like Pacific Northwest, which showed every prospect of continued, although small, profits.[114] In fact, the case seems to be an example of an efficiency argument being given a failing company cover, as discussed above.

The FTC, in objecting to court inquiry into St. Helens as a possible failing company, was on much weaker ground. Although St. Helens was not yet in bankruptcy or insolvent, it had avoided insolvency only by cancelling orders upon finding itself unable to pay for them.[115] It would be difficult to find any failing company definition, short of bankruptcy, which would not include a company whose solvency was so tenuous.

There is also a suggestion in the cases of an "existence" or "going concern" test. In *Erie*, the FTC argued that the fact, claimed to be such by the FTC, that the acquired company would have stayed in business by itself (possibly under different management) if the merger had not occurred, and would resume business if it were disallowed, eliminated the failing company approach.[116] In this fact pattern, it appears to have been true that the acquired company had the ability to continue if it had the will to do so. According to the Third Circuit, "had Erie not bid, the prospect was not the elimination of a competing enterprise but merely its continuation under some new proprietorship."[117] That is one extreme. The other is St. Helens. As Crown Zellerbach expressed it, "the Commission . . . equated 'competition' with mere existence [and] concluded that its absence would substantially lessen 'competition.' "[118]

It would seem equitable to state that although the failing company doctrine clearly cannot be applied to a concern with fair prospects of competitive profits, only the strictest "bankruptcy" or "insolvency" test would include a "going concern" concept. To make the doctrine inapplicable to any company that was doing business at the moment of the merger or asset sale would not only go much further than any case has so far, but also would encourage waste and the defrauding of creditors by forcing a company to close down before it could merge. Most companies presumably can be sold for a greater sum when in operation than in liquidation.

Rising or falling sales have also been advanced as a test, or at least

114. These were derived from a continuing factor—special access to Canadian reserves. Id. at 6.

115. Brief for Respondent, p. 69, Crown Zellerbach Corp. v. FTC, 296 F.2d 800 (9th Cir. 1961).

116. Brief for Respondent, p. 15, Erie Sand & Gravel Co. v. FTC, 291 F.2d 279 (3d Cir. 1961).

117. 291 F.2d at 280.

118. Brief for Petitioner, pp. 80-81, Crown Zellerbach Corp. v. FTC, 296 F.2d 800 (9th Cir. 1961).

as an indication of a company's position. Crown Zellerbach's attempt to use that standard availed it no more than did its other suggested tests. According to Crown Zellerbach's figures, St. Helens' sales fell from 65,000 tons in 1951 to 52,500 tons in 1952.[119] However, this did not impress the FTC, which, with an utter disregard of inflation, the Korean War, and common sense, argued on its side that St. Helens' sales had risen from $5,400,000 in 1943 to $9,200,000 in 1952.[120] The details of the individual years were apparently not within the world view, but Crown Zellerbach's figures would have been more convincing here if they had covered more than two years. Some fluctuations in sales presumably can result from normal competitive factors.[121]

In that golden year of 1952, according to the FTC, St. Helens, far from failing, had assets of $15,200,000 and equity of $9,400,000.[122] It is the view of one legal commentator that the law today is that the failing company doctrine will not be applied where there is any substantial equity.[123] There is no particular evidence that this is the law, although it would explain the *Crown Zellerbach* decision. To make the existence of substantial equity the test would be to make the doctrine's purpose the protection of creditors and bondholders, leaving stockholders to their fate. Such a distinction is explicitly drawn in no case and would result in forcing a company to waste its assets before selling out. The doctrine is illogical enough without this added handicap.

It would appear, according to the FTC, that the fact that a company pays dividends removes it from the failing company category. According to the FTC in *Crown Zellerbach*, St. Helens had paid dividends every year since 1929, except in 1932.[124] These views were all endorsed by the Ninth Circuit.[125]

It would be hard to deny that any firm, except in a declining industry, which loses sales over an extended period of time is in a bad way. The only real question in regard to St. Helens was whether such declining sales were likely to continue. This apparently depended upon the modernization program, which in turn depended upon the availability of new capital.[126] It is difficult to conceive of any firm with declining sales over

119. Id. at 4.

120. Brief for Respondent, p. 7. This language was quoted with approval by the court in the Crown Zellerbach case. 296 F.2d at 831-32.

121. 1955 Att'y Gen. Nat'l Comm. Antitrust Rep. 318-39.

122. Brief for Respondent, p. 8, Crown Zellerbach Corp. v. FTC, 296 F.2d 800 (9th Cir. 1961).

123. Wiley, The "Failing Company": A Real Defense in Horizontal Merger Cases, 41 B.U.L. Rev. 495, 503 (1961).

124. Brief for Respondent, p. 8.

125. 296 F.2d at 831-32.

126. Brief for Petitioner, p. 72.

a period of time—except when it is a reflection of an industry decline—which would not raise the question of why the decline was taking place and whether a cure was possible, rather than simply accepting it as an inevitable failure. Here again, the complete ignoring by the courts of the question of why a firm is failing tends to make this defense difficult to define logically.

The payment of dividends, except as an aspect of a profits test, does not seem a valid standard, unless the argument is followed that the firm need not be failing if properly run and the dividends taken as evidence of bad management. But again the government has not pursued this possible development of the doctrine.

Crown Zellerbach also offered another test in its brief before the Ninth Circuit, a reverse of the other possible purchasers qualification. According to Crown Zellerbach, St. Helens' management had offered to sell the firm to two other companies, both of which had investigated and refused—whether absolutely or because of the price demanded does not appear.[127] However, the argument did not help Crown Zellerbach, since the circuit court ignored this, as well as other convincing arguments, in finding for the FTC.[128]

Other tests which have been suggested, although not much explored in the cases, are the rate of operations compared to capacity, the condition of the plant (rather similar to access to capital since obsolescence need not otherwise be permanent), poor management caliber, and unit operational costs compared to the competition.[129]

VI. The One-Man Firm

A problem closely related to the failing company doctrine is that of the family firm, or, put somewhat differently, of one-man firms which pass to non-business or incapable heirs. This problem may be solved in practice by the fact that when professional management fails to develop the concern is usually too small to come within the compass of the federal antitrust laws. However, there is a grey area consisting of companies not large enough to attract capable outsiders and not small enough to hide behind the protection of limited size. This problem was raised at the hearings on the Celler-Kefauver Bill, but was brushed aside as being ruled out by smallness.[130]

However, like many other problems brushed aside during the passage

127. Id. at 4.

128. 296 F.2d at 832.

129. Wiley, supra note 123, at 507-08.

130. Hearings on H.R. 2734 Before a Subcommittee of the Senate Committee on the Judiciary, 81st Cong., 1st & 2d Sess. 99-105 (1950).

of the Celler-Kefauver Bill,[131] this one is still with us. Indeed, it enjoys a current illustration in the *Von's Grocery* case.

According to Mr. Justice Stewart's dissenting opinion, "Mr. Hayden, the president and principal stockholder of Shopping Bag [the acquired company], was advanced in years and was concerned over the absence of a strong management staff that could take over his responsibilities."[132] It should be noted that in this particular application of the failing company doctrine, the firm need not be in bad financial straits at all; it need only have no system of management recruitment. If such a defense were to be allowed, it would presumably be in the form of certain management characteristics being taken as evidence of future failure. Certain industries, including retailing, probably are more liable to such factors, and the fact of a firm's still being headed by its founder would be relevant evidence.

In the *Von's Grocery* case, this future failure had some past and present evidence. Again, according to Mr. Justice Stewart's dissent:

> Von's was a considerably more successful competitor than Shopping Bag. Shopping Bag's net income as a percentage of total sales declined from 1.6% in 1957 to 0.9% in 1959, and its net profit as a percentage of total assets declined from 6.6% to 3.2%. During the same period, the net income of Von's increased from 2.1% to 2.3%, and its net profits declined from 12.7% to 10.8%.[133]

It is a change indeed to pass from a concern like Olin Mathieson, which considered, in another section 7 case,[134] a projected after-tax profit of 10 per cent too small an inducement to undertake a new investment,[135] to Shopping Bag, whose octogenarian president saw his profits decline from 6.6 to 3.2 per cent.[136] A fact pattern similar to the *Von's Grocery* case, considered in a less antimerger atmosphere, could well give birth to some useful standards in this area.

It is illustrative of the way in which economic problems are influenced by national mores that a prominent French economist believes that the strength of the family firm is a barrier against the merger movement in his country.[137] The son and grandson, presumably, would never so dilute

131. Two related questions—the failing company doctrine and bank coverage by the act—were ignored and are still in relative confusion. The Supreme Court has stated that "thus, arguably, the so-called failing-company defense . . . might have somewhat larger contours as applied to bank mergers . . . ." United States v. Philadelphia Nat'l Bank, 374 U.S. 321, 372 n.46 (1963). (Citation omitted.)

132. 384 U.S. at 298 n.29.

133. Id. at 298 n.30.

134. United States v. Penn-Olin Chem. Co., 378 U.S. 158 (1964).

135. Record, vol. 116, p. 135.

136. See text accompanying note 133 supra.

137. Monopoly and Competition and Their Regulation 502 (Chamberlin ed. 1953).

the family honor as to sell out. However, French peasant blood is not predominant in this country and a special exception here, based on the difficulty or impossibility of recruiting new executives, might be indicated —at least if it can be shown that the firm was offered for sale as a separate concern without an acceptable offer. Nor should it be thought that such an exception would be based on sentiment or political considerations. Lucrative sales under such conditions would presumably encourage entry and aid in maintaining the independent entrepreneur as a factor in the economy.[138]

VII. Conclusions

It has been suggested—by both the friends[139] and the enemies[140] of a rational interpretation of section 7—that the failing company doctrine should give way to the consideration of a firm's financial condition as one of several relevant factors bearing on the legality of a merger rather than as a limited, separate defense. In an atmosphere favorable to the development of a rational law of mergers the author would strongly favor such a transition.

At present, the failing company doctrine serves primarily as a shield behind which advocates of specific mergers can advance arguments more correctly belonging to against giants, efficiency, natural monopoly, or, if it be considered separately, one-generation company defenses. This confusion of thought may help specific mergers win approval. But it greatly harms constructive thought in this field. It would seem to the author that judicial repudiation of the failing company doctrine may be a necessary prerequisite to the recognition of the other affirmative defenses.

If the basis of the failing company doctrine is not, in fact, a rational belief in an absence of effect on competition, but simply original congressional intent, then it would be helpful to limit such exceptions to cases of real financial extremity. Then, wherever the line may be drawn, it would be possible to resume arguments based on more rational defenses for those mergers concerning companies on the brighter side of whatever judicial definition of "failing" finally emerges.

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138. Kaysen, The Present War on Bigness: I, in National Indus. Conference Bd., 4th Conference on Antitrust in an Expanding Economy: The Impact of Antitrust on Economic Growth 31, 38 (1965).

139. Levi, The du Pont Case and Section 7 of the Clayton Act, 3 Antitrust Bull. 3, 11 (1958).

140. Connor, Section 7 of the Clayton Act: The "Failing Company" Myth, 49 Geo. L.J. 84, 99 (1960).