MERGER ANTITRUST LAW

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READING GUIDANCE

Class 7 (September 15): Sanford Health/Mid Dakota Clinic (Unit 3)

Today is the fourth and final class on Sanford Health/Mid Dakota Clinic. In Class 6, we examined the *Philadelphia National Bank* presumption and began the explicit theories of anticompetitive harm with coordinated effects and recapture unilateral effects. Today, we complete the explicit theories discussion with two additional unilateral effects applications—auction unilateral effects and merger-to-monopoly—and the elimination of a maverick firm. We then turn to Step 2 of the *Baker Hughes* burden-shifting framework and examine the principal defenses merging parties raise to rebut the prima facie case: entry/expansion/repositioning, power buyers, efficiencies, the failing firm defense, and the related weakened competitor defense asserted in *Sanford Health*. With that, we complete the *Sanford Health* unit and the foundational framework for horizontal merger antitrust analysis.

Explicit Theories of Anticompetitive Harm

Auction unilateral effects. A second form of unilateral effects arises in winner-take-all markets in which customers award all or nearly all of their business to a single supplier. The basic mechanism is that the winning supplier's price is disciplined by the customer's second-best alternative. When the merging firms are the customer's first- and second-best alternatives, the merger removes that discipline and may allow the merged firm to raise price toward the next-best alternative without any accommodating response by other firms. The cleanest case is one in which the merging firms are the two lowest-cost or otherwise best-positioned suppliers, the third-best alternative is materially worse, and the seller can price discriminate by customer. The theory is unilateral because the competitive harm follows from the merged firm's own profit-maximizing conduct.

Merger-to-monopoly. The limiting case of unilateral effects is a merger that leaves no competitively significant rival. In a market with continuous sales and a downward-sloping aggregate demand curve, the merged firm is constrained after the merger only by demand and entry conditions, rather than by an incumbent competitor. In a winner-take-all market, the same logic applies when the merging firms are the only qualified suppliers capable of meeting the customer's requirements. No coordination with another firm is required; the merger itself removes the competitive constraint.

The Unit 3D class notes emphasize recapture unilateral effects, which we covered in Class 6, and do not separately develop these two variants. For today, the foregoing is sufficient background. We will return to auction unilateral effects in the Unit 8 Sysco/U.S. Foods case study.

Elimination of a maverick. The third commonly recognized theory of anticompetitive harm in horizontal merger analysis is the elimination of a maverick. This theory commonly applies when one of the merging firms plays an outsized role in disrupting or undermining coordination or tacit accommodation in a concentrated market. A "maverick" firm is not necessarily the largest firm or the lowest-cost producer. Rather, it is a firm that makes coordination less likely or less stable, typically by pricing aggressively, expanding output when rivals seek to restrict it, introducing disruptive innovations, or otherwise acting in ways that make the market more competitive. The concern is that eliminating such a firm through merger may significantly increase the risk of postmerger coordination or muted competition among the remaining rivals.

The maverick theory is often characterized as a special case of coordinated effects, since the predicted harm results from the loss of a disruptive force that otherwise impedes coordinated outcomes. In cases where the elimination of a maverick theory posits an increased risk of coordination, the structural conditions necessary for coordinated effects—such as market concentration, transparency, and aligned incentives—must also be satisfied for the theory to apply.

Eliminating a maverick can also generate unilateral anticompetitive effects. This occurs when one of the merging firms—the "maverick"—uniquely constrains its merger partner's ability to exercise market power because of the maverick's aggressive pricing, output expansion, or innovation. That disciplining effect disappears upon merger, allowing the merged firm to worsen the terms of trade even without tacit coordination postmerger with other firms in the relevant market. There is no case law specifying a separate test for this unilateral effects version of the theory. Applying general unilateral effects principles, the following four conditions are relevant:

- The merging firms must be close substitutes, with most other products in the relevant market significantly more distant.
- The maverick must be exerting a significant disciplining effect on the other merging firm, causing it to price more aggressively, innovate more, or otherwise behave more competitively than it otherwise would in the absence of the maverick.
- The merged firm is unlikely to continue the maverick's premerger procompetitive strategy, resulting in a less competitive equilibrium and consumer harm that would not have occurred absent the merger.
- Other firms must not be able to enter, expand, or reposition in a manner that is timely, likely, and sufficient to restore the competitive discipline lost with the maverick's elimination.

When these conditions are met, the merger eliminates a uniquely vigorous competitive force, thereby softening unilateral constraints on the merging partner. This typically results in higher prices, reduced output, lower product or service quality, or a lower rate of technological innovation or product improvement than would have occurred absent the merger.

Agencies identify potential mavericks by examining premerger conduct, such as resistance to price leadership, willingness to expand capacity, aggressive entry into new product or geographic segments, or pursuit of disruptive innovations. In litigation, they typically support this theory with both economic analysis and internal documents showing that rivals regarded the maverick as uniquely destabilizing, and courts evaluate these claims in that evidentiary framework. While invoked less often than generalized unilateral or coordinated effects theories, the elimination of a maverick has played a central role in several high-profile enforcement actions, and it remains an explicit concern in the DOJ and FTC Merger Guidelines.

Now read the class notes on the elimination of a maverick (Unit 3D slides 46-50). This theory does not appear in *Sanford Health*.

Defenses

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

Recall that the two essential substantive components of a Section 7 prima facie case are (1) the relevant market and (2) the requisite anticompetitive effect. Unit 3E slides 4-7 provide a short refresher and emphasize an important point: the defenses we examine are negative defenses, not affirmative defenses. They seek to show that the merger is not anticompetitive in the first instance, rather than to excuse a merger that is anticompetitive.[1]

Defenses to market definition. These defenses are always of the form of a simple denial: either the plaintiff applied the wrong legal principles in its attempt to define the relevant market, the plaintiff applied the correct legal principles but in the wrong way, or the plaintiff's evidence is insufficient to support a finding of the relevant market that the plaintiff is seeking to prove under the correct legal principles. Since the law of market definition is reasonably well-settled, defenses that the plaintiffs applied the wrong legal standard are rare. Sometimes, defendants will argue a technicality that a particular economic tool used in market definition was improperly applied, but these types of arguments rarely change the outcome.[2]

By far, the most frequent defense to a prima facie case of market definition is that the plaintiffs' evidence is insufficient to support a finding of the alleged market. There are two types of defenses here:

- An argument that the plaintiffs' evidence is legally insufficient without any attempt by the defendants to prove an alternative market definition, and
- An argument that the plaintiffs' evidence is legally insufficient, coupled with the defendants' proof of an alternative market definition in which there is no likely anticompetitive effect.

The first argument relies solely on the allocation of the burden of proof. I have spoken to several judges about this, and they consistently say that, while they understand that a pure burden of proof defense is technically proper, they do not find it very compelling. The problem is that this type of argument goes only to the "mind" of the judge. If a judge is going to decide for the defendants over the government's evidence, the judge wants to be confident that the merger is, in fact, not anticompetitive. Thus, providing the judge with a strong argument of an alternative

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

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

market definition and then showing, within this market, that the merger is not anticompetitive goes to the "heart" of the judge as well as to the "mind."

Defenses to anticompetitive effect. Defenses to a prima facie case of anticompetitive effect have the same structure as a simple denial. Here again, the law of prima facie anticompetitive effect is well established, so defendants rarely argue that the plaintiffs applied the wrong legal principles. Since the thresholds to invoke the *PNB* presumption, however, are not particularly well-settled in the case law, one could imagine defenses that the plaintiffs improperly invoked the *PNB* presumption because the merger in the plaintiff's alleged relevant market produced a combined market share and a change in the level of market concentration that was too low to trigger the presumption. These types of defenses are rare, however, because plaintiffs—especially the DOJ and FTC—almost always allege relevant markets in which the market share and concentration statistics far exceed the Merger Guidelines thresholds and fall within the range that courts previously have found the *PNB* presumption to be triggered (see Unit 3D slides 22-25).

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

A second form of defense to a prima facie case of anticompetitive effect assumes (*arguendo* at least) that the plaintiff has established the factual predicates on which its prima facie case rests but introduces additional facts showing that the merger nevertheless is not likely to have the alleged anticompetitive effect. The four principal negative defenses we will examine are (1) entry/expansion/repositioning, (2) power buyers, (3) efficiencies, and (4) failing firm. The defendants in *Sanford Health* asserted the first three and a related weakened competitor defense. Unlike the failing firm defense, the weakened competitor defense does not contend that the acquired firm and its productive assets would leave the market absent the merger. Instead, it argues that the firm would remain in the market but would exert materially less competitive force going forward than its current market share and historical performance suggest. The firm's expected future competitive significance therefore should be discounted in determining the competitive effect of its acquisition. Courts recognize each of the four principal defenses; the 2010 Horizontal Merger Guidelines address all four, while the 2023 Merger Guidelines omit the power buyer defense but address the other three (Unit 3E slides 4-7). Now read the Answer in *Sanford Health* to see how the merging firms invoked these defenses (pp. 44 and 63-64).

Power buyers defense. In some markets, large buyers may exist that, because of their bargaining power, can 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 combined firm's unilateral exercise of market power. The courts and the 2010 Merger Guidelines recognize that the bargaining power of buyers can play a significant role in

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

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. The 2023 Merger Guidelines omit the power buyer defense, but the defense remains part of the case law. While in a particular case a power buyer defense may not be sufficient to rebut the prima facie case, that defense, in conjunction with other defenses, may be sufficient.

Simply because a buyer is powerful does not mean that it can discipline the collective or unilateral exercise of market power by suppliers postmerger to protect itself. Two questions are central to the defense:

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

Power buyer defenses work best, if they work at all, against postmerger price increases or output reductions; they are much more difficult to apply to reductions in innovation, quality, or product improvement. In the absence of a mechanism—and the incentive to use it—courts and the enforcement agencies have rejected a power buyer defense. Even when there is an arguable mechanism, the defense is likely to fail for lack of sufficient evidence if (1) the putative buyer does not support the defense, or (2) there is evidence of historical episodes where the putative power buyer (or a similarly situated firm) has not been able to prevent a merged firm from raising prices to it. This was the situation in *Sanford Health*, where (1) a representative from Blue Cross (the putative power buyer) testified that postmerger *Sanford Health* 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 another near-monopolist in another part of North Dakota.

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

Read Section 8 of the 2010 Merger Guidelines (pp. 252-53) and the Unit 3E class notes (slides 16-21) on the power buyer defense. Then read the excerpt from *FTC v. Wilh. Wilhelmsen Holding ASA*, which gives a good illustration of a court's analysis of the power buyer defense

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

(pp. 254-55), and the accompanying note (pp. 256-61). If you want more detail on the power buyer argument in *Sanford Health*, the Eighth Circuit opinion and the appellants' opening brief are in the supplemental materials.[5] As a general rule, power buyer defenses are rarely, if ever, successful.[6]

Entry/expansion/repositioning defense. The merging parties argued that Catholic Health, an existing competitor of Sanford, was poised to enter or expand in the relevant physician service markets in Bismarck-Mandan (p. 64). The FTC preemptively sought to challenge this defense in its complaint (pp. 13-14 and 34-37). This is an ease of entry/expansion/repositioning defense. In modern merger practice, "ease of entry" has become, after market definition, the most frequently used defense for horizontal mergers and acquisitions, both before the agencies and before the courts.[7] The idea is that any effort by the merged firm to charge supracompetitive prices and earn supracompetitive profits will, in the absence of barriers to entry, attract new firms that will compete those supracompetitive profits back down to competitive levels.[8]

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

The ability and willingness of fringe competitors to expand their foothold in the market and/or reposition are essentially equivalent to new entry, and the agencies and the courts treat entry,

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

6 For cases rejecting the defense, see, for example, Chicago Bridge & Iron Co. N.V. v. FTC, 534 F.3d 410, 439-40 (5th Cir. 2008); FTC v. Wilh. Wilhelmsen Holding ASA, 341 F. Supp. 3d 27, 70-71 (D.D.C. 2018); 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). *But see* FTC v. RAG-Stiftung, 436 F. Supp. 3d 278, 315 (D.D.C. 2020) (noting role of sophisticated customers in disrupting collusion or tacit coordination in a bidding market).

7 *See, e.g.*, United States v. Baker Hughes Inc., 908 F.2d 981, 987-88 (D.C. Cir. 1990); United States v. Syufy Enterprises, 903 F.2d 659, 664-65 (9th Cir. 1990); California v. American Stores Co., 872 F.2d 837, 842-43 (9th Cir. 1989); United States v. Waste Management, Inc., 743 F.2d 976, 981-84 (2d Cir. 1984); United States v. Energy Sols., Inc., 265 F. Supp. 3d 415, 443-44 (D. Del. 2017) (but rejecting ease of entry defense on the merits); United States v. Anthem, Inc., 236 F. Supp. 3d 171, 221-22 (D.D.C. 2017) (same); Saint Alphonsus Med. Ctr. - Nampa, Inc. v. St. Luke's Health Sys., Ltd., No. 1:12-CV-00560-BLW, 2014 WL 407446, at *22*-23 (D. Idaho Jan. 24, 2014) (same), aff'd, 778 F.3d 775 (9th Cir. 2015); FTC v. Laboratory Corp. of Am., 2011 WL 3100372 , at *19-20, *34 (C.D. Cal. 2011) (same); FTC v. CCC Holdings, Inc., 605 F. Supp. 2d 26, 47 (D.D.C. 2009) (same); FTC v. Libbey, Inc., 211 F. Supp. 2d 34, 47-48 (D.D.C. 2002) (same); FTC v. Cardinal Health, Inc., 12 F. Supp. 2d 34, 54-58 (D.D.C. 1998) (same); FTC v. Staples, Inc., 970 F. Supp. 1066, 1086 (D.D.C. 1997) (same); United States v. Calmar Inc., 612 F. Supp. 1298, 1304-07 (D.N.J. 1985); In re Echlin Mfg. Co., 105 FTC 410, 1985 WL 668902 (1985); *see also* FTC v. Arch Coal, Inc., 329 F. Supp. 2d 109, 147-49 (D.D.C. 2004) (expansion by incumbent fringe firms).

8 *See* United States v. Baker Hughes, Inc., 908 F.2d 981, 987 (D.C. Cir. 1990) ("In the absence of significant barriers, a company probably cannot maintain a supracompetitive pricing for any length of time."); FTC v. CCC Holdings, Inc., 605 F. Supp. 2d 26, 46-47 (D.D.C. 2009) ("Even in highly concentrated markets, if there is sufficient ease of entry, others might enter to compete and undercut the likely anti-competitive effects of a merger."); 1992 DOJ/FTC Horizontal Merger Guidelines § 3.0 (1992) ("A merger is not likely to create or enhance market power or to facilitate its exercise, if entry into the market is so easy that market participants, after the merger, either collectively or unilaterally could not profitably maintain a price increase above premerger levels."); *see also* Chicago Bridge & Iron Co. v. FTC, 534 F.3d 410, 427 (5th Cir. 2008) ("The Commission not only addressed whether existing entry is sufficient to constrain CB&I from raising prices but also used existing entry and the history of entry as evidence in determining whether future entry would be able to counteract a merger's anti-competitive effects, such as a supracompetitive price increase.").

expansion, and repositioning in the same analytical fashion.[9] The general idea is that the firms in question (either individually or collectively) must have the ability and profit-maximizing incentive to produce additional output to fill the hole in market output. In particular, the Merger Guidelines require—and the courts have followed suit—that the output expansion be:

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

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

Although the Merger Guidelines are not technically binding on courts, the guidelines' approach to entry as a defense to a prima facie case has been largely adopted in judicial opinions. While not citing the Merger Guidelines, the court's analysis in FTC v. Staples, Inc., demonstrates how courts apply the elements of the Guidelines to defeat an ease of entry defense.[10] In recent years, the DOJ and FTC have applied the Guidelines' entry defense requirements strictly and with great skepticism toward the evidence. The result is that entry defenses have rarely prevailed at the agencies, and then only in the most obvious situations. If anything, the changes in the 2010 Guidelines raised the bar for a successful entry defense at the agencies, and the 2023 Guidelines retain a demanding approach.

Read Section 9 of the 2010 Merger Guidelines (pp. 262-64), Section 3.2 of the 2023 Merger Guidelines (pp. 265-67), and the class notes (Unit 3E slides 8-15) on the entry/expansion/repositioning defense. Use the *Sanford*-specific allegations and defense described above as the case application; the treatment of entry by Catholic Health in *Sanford Health* is also discussed in the Eighth Circuit opinion in the supplemental materials. We will

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

[10] FTC v. Staples, Inc., 970 F. Supp. 1066, 1086-88 (D.D.C. 1997). For other judicial examples, see Chicago Bridge & Iron Co. v. FTC, 534 F.3d 410, 434-40 (5th Cir. 2008); FTC v. ProMedica Health Sys., Inc., 2011 WL 1219281, at *57 (N.D. Ohio 2011); FTC v. CCC Holdings, Inc., 605 F. Supp. 2d 26, 47-60 (D.D.C. 2009) (extensive analysis); FTC v. Cardinal Health, Inc., 12 F. Supp. 2d 34, 54-58 (D.D.C. 1998) (explicit use of Guidelines).

examine the entry defense in more detail when we discuss the H&R Block/TaxACT merger in Unit 5.

Efficiencies defense. Efficiencies that reduce marginal production costs, enhance product quality, or accelerate the rate of innovation or product improvement can make the market more competitive and increase consumer welfare. Reductions in fixed costs may benefit the firm, but standing alone they ordinarily do not change its profit-maximizing price or output and therefore do not create direct downward pricing pressure. In the proper circumstances, efficiencies can negate the likelihood that a merger would be anticompetitive. Under this idea, the greater the likely anticompetitive effect in the absence of efficiencies, the greater the efficiencies must be to offset it. Likewise, the more certain the likelihood of an anticompetitive effect in the absence of efficiencies, the more certain the offsetting efficiencies must be.[11]

The Supreme Court has rejected efficiencies as an affirmative defense that can save a merger that otherwise substantially lessens competition.[12] Modern lower courts, however, generally permit efficiencies to be considered as a negative defense—that is, as evidence that the merger will not be anticompetitive in the first instance.[13] No court has yet held that efficiencies were sufficient to defeat a merger challenge on the merits.[14]

To be "cognizable" under the Merger Guidelines, efficiencies must be *verifiable*, *merger specific*,[15] *sufficient in scope*, and *not result from an anticompetitive reduction in output or service*.[16] Cognizable efficiencies may include, for example, shifts in production across the facilities of the merging firms that enable the combined firm to reduce its marginal production costs. Efficiencies relating to research and development may be substantial, but they are often difficult to predict, let alone measure and verify. When claimed R&D efficiencies take the form of cost savings or redirected expenditures, they may be anticompetitive if they lead to changes in

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11 *See* FTC v. University Health, Inc., 938 F.2d 1206, 1223 (11th Cir. 1991); FTC v. Arch Coal, Inc., 329 F. Supp. 2d 109, 150-51 (D.D.C. 2004).

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

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

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

15 2010 DOJ/FTC Horizontal Merger Guidelines § 10 n.13 ("The Agencies will not deem efficiencies to be merger-specific if they could be attained by practical alternatives that mitigate competitive concerns, such as divestiture or licensing. If a merger affects not whether but only when an efficiency would be achieved, only the timing advantage is a merger-specific efficiency.").

16 2010 DOJ/FTC Horizontal Merger Guidelines § 10; 1992 DOJ/FTC Merger Guidelines § 4; *see* FTC v. ProMedica Health Sys., Inc., 2011 WL 1219281, at *57 (N.D. Ohio 2011); United States v. Oracle Corp., 331 F. Supp. 2d 1098, 1175 (N.D. Cal. 2004).

the rate or direction of innovation that harm customers. Efficiencies related to procurement, management, or capital costs may not be verifiable, merger specific, or substantial.

Under the modern lower court and Guidelines approach, efficiencies are relevant only to the extent that they ultimately benefit customers in the relevant market.[17] As a result, efficiencies that reduce costs, for example, will be considered only to the extent that the cost savings are passed on to customers. This "passing-on" requirement adds another significant hurdle in establishing an efficiencies defense. The merging parties will have to show not only that the efficiencies exist but also that it is in the profit-maximizing interest of the combined firm to pass on some of the benefits of the efficiencies to customers in the form of lower prices or increased quality, as opposed to retaining the benefits for the combined firm's owners.[18] In at least one investigation, however, the Antitrust Division found it sufficient that the significant cost savings that likely result from the transaction would enable the combined firm to compete more effectively.[19]

Historically, the agencies have applied the efficiencies requirements skeptically and have rejected claimed efficiencies either because, in the view of the investigating agency, the putative efficiencies are not sufficiently verifiable,[20] they are not merger specific,[21] they are not sufficiently large to overcome the likely anticompetitive effect of the transaction,[22] or the resulting benefits will not be passed on to customers sufficiently, if at all. Even when the efficiencies are cognizable, however, the parties would be well advised not to rely too heavily on an efficiencies defense. Indeed, the 1997 amendment to the DOJ/FTC Horizontal Merger Guidelines notes that, in the experience of the Antitrust Division and the FTC, efficiencies are most likely to make a difference in the analysis when the likely adverse competitive effects,

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

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

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

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

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

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

absent the efficiencies, are "not great."[23] The amendment also observes that "[e]fficiencies almost never justify a merger to monopoly or near-monopoly."[24]

The efficiencies defense has fared no better in the courts. In the 1960s, the Supreme Court not only rejected the idea that efficiencies could be used to defend a merger or acquisition against a merger antitrust challenge, but also indicated that efficiencies could constitute an unlawful anticompetitive effect to the extent they threatened the viability of less efficient rivals.[25] Modern lower courts generally consider efficiencies as part of the competitive effects analysis, but no court has yet held that the merging parties successfully defended a merger through a showing of efficiencies.[26]

Read Section 10 of the 2010 Merger Guidelines (pp. 269-71), Section 3.3 of the 2023 Merger Guidelines (pp. 272-74), and the Unit 3E class notes (slides 22-45) on the efficiencies defense. For the Sanford application, the Eighth Circuit's discussion of efficiencies in *Sanford Health* is in the supplemental materials.

The failing company defense. In 1930, during the Great Depression, the Supreme Court in *International Shoe Co. v. FTC*[27] 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.[28] The legislative history of the 1950 amendments to the Clayton Act specifically recognized this "failing company" defense.[29] 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 were to fail.[30]

The failing firm defense is rarely raised in modern merger cases and almost always fails when it is raised.[31] Both the 2010 and 2023 Merger Guidelines recognize the failing firm defense but apply it restrictively.

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

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

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

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

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

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

[29] S. Rep. No. 1775, 81st Cong., 2d Sess. 7 (1950); H.R. Rep. No. 1191, 81st Cong., 1st Sess. 6 (1949).

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

[31] The successful cases include International Shoe Co. v. FTC, 280 U.S. 291 (1930); Union Leader Corp. v. Newspapers of New England, Inc., 284 F.2d 582 (1st Cir. 1960); Reilly v. Hearst Corp., 107 F. Supp. 2d 1192, 1203-05 (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

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.[32] Some courts have added a third requirement: a reorganization of the acquired firm into a viable economic enterprise is not realistic.[33] Courts have narrowly construed the defense, and the company invoking it bears the burden of establishing each element.[34]

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 a grave probability of business failure."[35] The failure requirement is established by analyzing the allegedly failing company's financial condition before and at the time of acquisition, as well as its future business prospects, relationships with banks and other potential creditors, and 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 returns are subjectively insufficient will not establish the failure requirement.

The alternative purchaser requirement is usually the reason that the defense fails. 36 The difficulties in establishing this element may be illustrated by contrasting *United States v. M.P.M., Inc.*,[37] with *FTC v. Harbour Group Investments, L.P.*[38]

In *M.P.M.*, 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."[39] Mobile's president contacted numerous firms, government

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(D. Colo. 1975). *See* Granader v. Public Bank, 417 F.2d 75 (6th Cir. 1969) (summary dismissal of Section 7 complaint affirmed after state court receivership proceedings had found Public Bank insolvent and acquirer only prospective purchaser). For cases in which the defense was unsuccessful, see, for example, United States v. Greater Buffalo Press, Inc., 402 U.S. 549 (1971); Citizen Publ'g Co. v. United States, 394 U.S. 131 (1969); United States v. Third Nat'l Bank in Nashville, 390 U.S. 171 (1968); United States v. Von's Grocery Co., 384 U.S. 270 (1966); United States v. El Paso Natural Gas Co., 376 U.S. 651 (1964); United States v. Philadelphia Nat'l Bank, 374 U.S. 321, 372 n.46 (1963); United States v. Diebold, Inc., 369 U.S. 654 (1962); Michigan Citizens for an Independent Press v. Thornburgh, 868 F.2d 1285, 128788, (D.C. Cir. 1989) (Newspaper Preservation Act); 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); FTC v. Harbour Group Invs., L.P., Civ. No. 90–2525, 1990 WL 198819 (D.D.C. Nov. 19, 1990); FTC v. Bass Bros. Enters., Inc., 1984 WL 355 (N.D. Ohio 1984). The failing-firm defense has never succeeded in a Section 13(b) proceeding. *See FTC v. ProMedica Health Sys., Inc.*, 2011 WL 1219281, at *57 (N.D. Ohio 2011).

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

33 *See, e.g.*, Dr. Pepper/Seven-Up Cos., v. FTC, 991 F.2d 859, 864-65 (D.C. Cir. 1993); U.S. Steel Corp. v. FTC, 426 F.2d 592, 608-09 (6th Cir. 1970); In re The Pillsbury Co., 93 F.T.C. 966, 1031-33, 1979 WL 44683 (1979); In re Reichhold Chems., Inc., 91 F.T.C. 246, 289-91, 1978 WL 206094 (1978). The requirement appears to have been suggested, but not formalized, in Citizen Publ'g Co. v. United States, 394 U.S. 131, 138 (1969). Two courts have suggested that the Citizen Publishing language did not add a new element to the failing company defense. *See* United States v. Black & Decker Mfg. Co., 430 F. Supp. 729, 778 (D. Md. 1976); United States v. M. P. M., Inc., 397 F. Supp. 78, 96 (D. Colo. 1975).

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

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

36 *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).

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

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

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

agencies, and other possible funding sources. One of the major shareholders devoted virtually all his time to securing new funding to keep the company viable. The court found that the contacts were numerous and that each person approached was a credible potential source of new capital. Only Pre-Mix, whose combination with Mobile was the subject of the Section 7 challenge, 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.[40]

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 conduct the search, it was contacted by the acquiring company, not the acquired company, and given only a few weeks to complete it, despite the original purchase agreement having taken 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 experienced in selling small companies; it 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 failed to meet their burden of proving that no alternative purchaser existed.

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

First, it may be almost impossible for the merging companies to discharge their burden of proof under this requirement. Reorganization proceedings can be extremely complicated. In many situations, reorganization plans have been confirmed after lengthy negotiations, despite initial expectations that the plan would fail and the company would be liquidated. Indeed, perhaps the only way to meet this requirement is to show that the company's going concern value is less than its 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. The inability to reorganize effectively converts the failing company defense from an affirmative defense to a negative defense. An *affirmative defense* justifies 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* negates an essential element of the plaintiff's case, in this instance, the requirement that the transaction will threaten future competition. 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 after the transaction than it would be without it.

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[40] *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).

The courts have held that the failing company defense applies equally whether the failing firm is the buyer or the seller.[41] The courts are split on whether the failing company defense may be invoked in an acquisition of the failing part of a profitable company.[42]

The DOJ and FTC have long applied the failing firm doctrine narrowly; both the 2010 and 2023 Merger Guidelines recognize the defense but impose demanding requirements.[43] Like the more demanding courts, the 2010 Guidelines recognize the defense only when: (1) the firm is failing in the sense that it is unable to meet its financial obligations in the near future; (2) the firm is unable to reorganize successfully under Chapter 11 of the Bankruptcy Act; and (3) the firm has made unsuccessful good-faith efforts to elicit reasonable alternative offers that would keep its tangible and intangible assets in the relevant market and pose a less severe danger to competition than does the proposed merger.[44]

There have been very few successful invocations of the failing company defense before either the DOJ or the FTC. Although it has been relatively easy to show that the company or division is failing, historically it has been challenging to convince the agencies that the requisite effort has been made to find a less anticompetitive purchaser. Unless investment bankers have been retained and conducted a thorough but unsuccessful sales process, the agencies almost conclusively presume that the failure to find a less anticompetitive purchaser results from a lack of effort rather than a genuine 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 failing firm's assets 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. However, they emphasize that great care must be taken when analyzing the division's cash flow to ensure it is negative in an economically meaningful sense and not merely an artifact of financial accounting. In analyzing divisional cash flow and determining whether the division's assets will leave the market if the acquisition cannot proceed, the agencies will require evidence beyond business plans or management-prepared financial statements.

Read Section 11 of the 2010 Merger Guidelines (p. 276), Section 3.1 of the 2023 Merger Guidelines (pp. 277-79), and the Unit 3E class notes (slides 46-49) on the failing firm defense. Then read the excerpt from United States v. Energy Solutions, Inc.,[45] for a judicial application (pp. 280-81). The two FTC blog posts illustrate the FTC staff's historically skeptical approach to the failing-firm defense and are concise and easy reads (pp. 282-85).

Weakened competitor defense. A weakened competitor is different from a failing firm. A failing firm will leave the market absent the challenged acquisition, so the relevant counterfactual is acquisition versus exit. A weakened competitor, by contrast, remains in the market absent the

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41 *See* United States v. M.P.M., Inc., 397 F. Supp. 78, 97-98 (D. Colo. 1975).

42 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).

43 2023 DOJ/FTC Merger Guidelines § 3.1; 2010 DOJ/FTC Horizontal Merger Guidelines § 11.

44 *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).

45 265 F. Supp. 3d 415, 444-46 (D. Del. 2017).

merger but, because of financial, structural, or other constraints, is likely to compete materially less effectively in the future than its current market share or historical performance suggests. The relevant comparison therefore is acquisition versus continued but weakened competition.

Analytically, the weakened competitor defense is best understood as an application of *United States v. General Dynamics Corp.*[46] The competitive significance of a firm for purposes of Section 7 is forward looking. Current market shares, historical performance, or other evidence of present competitive significance may overstate a firm's likely future competitive force if circumstances have materially impaired its ability to compete.[47] The question is whether, after properly discounting the firm's expected future competitive significance, the acquisition still presents a reasonable probability of substantially lessening competition.

Courts treat weakened competitor arguments skeptically. Financial weakness alone is not enough. In *FTC v. University Health, Inc.*,[48] the Eleventh Circuit required a substantial showing that the acquired firm was materially weakened, that its weakness could not be resolved by competitive means, and that the weakness would reduce the firm's future competitive significance enough to undermine the plaintiff's prima facie case.[49] "Competitive means" includes, among other things, new financing or acquisition by a firm other than the leading competitor.[50] As with the failing company defense, a successful restructuring through bankruptcy should also qualify as a "competitive means," although no court appears to have addressed the issue.

The defense nevertheless has succeeded in rare cases where structural or resource constraints convincingly demonstrated that current market shares materially overstated the acquired firm's future competitive significance.[51]

The defense is also subject to the *Baker Hughes* sliding scale: the stronger the plaintiff's prima facie case, the more substantial the defendants' evidence of weakened future competitive significance must be to rebut it.

Sanford Health illustrates the problem. The defendants argued that Mid Dakota Clinic had only "dim long-term prospects" and therefore would not remain as competitively significant in the future as its historical performance suggested. The district court rejected the factual premise. It found that MDC was financially healthy, that its revenues had increased during the three years preceding the FTC action, that physician compensation was 32% above the national average, and that contemporaneous shareholder minutes indicated that the motivation to sell was Sanford's attractive purchase price rather than concern about MDC's long-term financial viability. The

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46 415 U.S. 486, 503-08 (1974).

47 *See* United States v. Int'l Harvester Co., 564 F.2d 769, 773-74 (7th Cir. 1977); FTC v. Arch Coal, Inc., 329 F. Supp. 2d 109, 154, 157-58 (D.D.C. 2004).

48 938 F.2d 1206, 1221 (11th Cir. 1991).

49 *See* FTC v. Edwards Lifesciences Corp., No. 25-2569 (RC), 2026 WL 228723, at *36-*37 (D.D.C. Jan. 9, 2026) (applying *University Health* and rejecting weakened-competitor defense where defendants failed to show that JenaValve's manufacturing, financial, and personnel constraints were sufficiently severe to prevent effective future competition or could not be resolved through competitive means). For other cases on point, see ProMedica Health Sys., Inc. v. FTC, 749 F.3d 559, 572 (6th Cir. 2014); FTC v. Warner Commc'ns Inc., 742 F.2d 1156, 1164 (9th Cir. 1984); Kaiser Aluminum & Chem. Corp. v. FTC, 652 F.2d 1324, 1339-41 (7th Cir. 1981); United States v. JetBlue Airways Corp., 712 F. Supp. 3d 109, 162-63 (D. Mass. 2024); and United States v. Aetna Inc., 240 F. Supp. 3d 1, 93-94 (D.D.C. 2017).

50 *Edwards Lifesciences*, 2026 WL 228723, at *37, *41-*44 (finding that even if JenaValve's weaknesses impaired its ability to compete, defendants had not shown that those weaknesses could not be resolved competitively through acquisition by another strategic buyer or additional financing).

51 *See* New York v. Deutsche Telekom AG, 439 F. Supp. 3d 179 (S.D.N.Y. 2020); FTC v. Arch Coal, Inc., 329 F. Supp. 2d 109, 154, 157-58 (D.D.C. 2004).

Eighth Circuit found no clear error in that determination. Thus, the defense failed at the threshold: the defendants had not shown that MDC was materially weakened.

After reading the failing firm materials, read the Unit 3E class notes (slides 50-54) on the weakened competitor defense and the Eighth Circuit's treatment of MDC's weakened competitor argument in the supplemental materials.

Finally, if you have the time and the interest, take a look at what happened in the wake of the Eighth Circuit's decision: the parties abandoned the deal, and the FTC dismissed the administrative complaint as moot (pp. 109-21).

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

Dale Collins