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The Failing Company Doctrine

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In conclusion, this decision, if allowed to stand, appears to open to the states an important new method for enforcing their antipollution laws and for preserving and protecting their navigable waters from the discharge and dumping of oil. While the Extension of Admiralty and Maritime Jurisdiction Act[29] will continue to provide a forum in admiralty for oil spill damage cases consummated on land, it is important that there be a remedy to help prevent the far costlier damage to the water itself, and to marine life. The federal district court in *Bournemouth* has provided such a remedy.

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[29] 46 U.S.C. § 740 (1964).

ANTITRUST LAW — THE FAILING COMPANY DOCTRINE

In 1940 the companies publishing *The Tucson Daily Citizen* and *The Arizona Daily Star* entered into a joint operating agreement for the purpose of ending all commercial and business competition between the two papers. Prior to that time, the Star Publishing Company had averaged annual profits of about $25,825, while the Citizen Publishing Company's annual losses averaged about $23,500. It was hoped that the agreement would foster the economic growth and development of both papers. By 1964, prosperity had been achieved. The trial court found that the joint venture's profits had reached $1,727,217.[1] The method employed to obtain this economic stability was a three-fold operation. While each newspaper maintained its own corporate identity and editorial independence, joint control was exercised with respect to each company's printing, advertising and circulation. This

[1] United States v. Citizen Publishing Co., 280 F. Supp. 978, 982 (D. Ariz. 1968), *aff'd*, 394 U.S. 131 (1969).

three-fold operation was later re-defined by the Supreme Court as: price fixing[2]—the subscription and advertising rates were set jointly; profit pooling[3]—all profits realized were pooled and distributed according to an agreed ratio; and market control[4]—it was agreed that neither officers nor stockholders of either company would engage in any other publishing business in the county. The agreement was therefore condemned as an agreement in restraint of trade—a violation of Section One of the Sherman Act.[5] The Court emphatically stated that it did not object to all forms of joint operating agreements but only to such agreements which applied anti-competitive measures to obtain a desired end.[6]

The case was also tried as a violation of Section Seven of the Clayton Act,[7] arising out of Citizen's acquisition of Star stock pursuant to an option in the joint-operating agreement. Section Seven of the Clayton Act prohibits an acquisition of assets or stock where there is a reasonable probability that the effect of the acquisition will be to substantially lessen competition in any line of commerce, in any section of the country.[8] Appellants offered in their defense the failing company doctrine.[9] They asserted that Citizen was in fact a

[2] Price fixing has been declared illegal per se. *See* United States v. Masonite Corp., 316 U.S. 265, 276 (1942).

[3] A violation of Section 1 of the Sherman Act, 15 U.S.C. § 1 (1964). *See* Northern Sec. Co. v. United States, 193 U.S. 197, 328 (1904).

[4] Also, a violation of Section 1 of the Sherman Act, 15 U.S.C. § 1 (1964). *See* Timken Roller Bearing Co. v. United States, 341 U.S. 593 (1951).

[5] 15 U.S.C. § 1 (1964) ("Every contract [or] combination [,] . . . in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal. . . .").

[6] Citizen Publishing Co. v. United States, 394 U.S. 131, 135-36 (1969) (The Court stated that the Section 1 violations were "plain beyond peradventure" of doubt.).

[7] 15 U.S.C. § 18 (1964).

[8] *Id.*

[9] *See Generally* Connor, *Section 7 of the Clayton Act: The "Failing Company" Myth*, 49 GEO. L.J. 84 (1960).

failing company in 1940 and that the effect of the acquisition of such a company did not have the probable effect of substantially lessening competition. However, the Court ruled that appellants had not sustained their burden of proof in showing that they were, in actuality, a failing company.

Prior decisions have asserted that a company claiming such a defense must prove that its resources are so depleted and its prospects for rehabilitation so remote that the firm faces a clear probability of business failure.[10] Mere proof that business has been unprofitable for a period of time, or that it has suffered under poor management will not suffice.[11]

At the time of the joint operating agreement, Citizen's liabilities exceeded its assets by some $53,000, and it had $420 in bank deposits and $66.28 in cash on hand. Yet, the Supreme Court found that Citizen was not a failing company. It was, the Court argued, an effective competitor and a significant threat to the Star. Citizen had a circulation equal to the Star's; and, of equal significance, it had failed to act as would a firm on the brink of business disaster. No effort had been made to sell the Citizen, and its owners were not contemplating liquidation.[12] Nor was the joint operating agreement "the last straw at which the Citizen grasped."[13] Even assuming, the Court states, that the Citizen was a failing company, it had not made any *substantial affirmative effort* to sell to an outsider—a requisite for a company claiming a failing company exemption.[14]

[10] International Shoe Co. v. FTC, 280 U.S. 291, 302 (1930).

[11] *See* U.S. DEP'T OF JUSTICE, ANTITRUST DIV. MERGER GUIDELINES, TRADE REG. REP. (No. 363, June 3, 1968).

[12] 394 U.S. at 137-38.

[13] 394 U.S. at 137 (Douglas, J., majority opinion).

[14] *Id.* at 138. Prior decisions have established that a failing company could not be sold to a competitor if there was another "prospective purchaser" in the market. International Shoe Co. v. FTC, 280 U.S. 291, 302 (1930); *cf.* United States v. Diebold, Inc., 369 U.S. 654, 655 (1962). However, until the *Citizen Publishing Company* opinion was rendered, a failing

Mr. Justice Stewart in his dissenting opinion attacked the Court's new *affirmative effort* guideline as unreasonable. He asserted that a company should not be required to forfeit its failing company defense merely because it had not made a substantial affirmative effort to sell to a noncompetitor. Also he noted that testimony was introduced which showed that, in the prevailing business climate, the Citizen could not possibly have been sold to an outsider.

Nevertheless, the basis for the Court's decision is a rational one. The purpose of the antitrust laws is to preserve the competitive process and to prevent the rising tide of economic concentration. And the failing company doctrine arose from the theory that the merger of the weak can do no harm to the competitive process. However, this exemption is dependent upon the company seeking its protection truly being a failing company. Therefore, if the doctrine is to be invoked, it would not seem harsh that such a company be required to prove that its prospects for reorganization were "dim or non-existent."[15] Otherwise, it would be fairly easy for a relatively healthy firm to assume the appearance of a failing company for the purpose of avoiding an antitrust suit. Likewise, it is not unreasonable to require a company seeking protection of the doctrine to make a substantial and affirmative effort to sell to a non-competitor before it claims exemption as a failing company.

There appears to this writer a certain fallacy in the theory that the sale of the weak can not have the probable

company was never expressly required to make an effort *to find* such a prospective purchaser.

[15] 394 U.S. at 138 (Mr. Justice Douglas noted that companies have reorganized through receivership or through the Bankruptcy Act and emerged as strong competitive companies. The Citizen made no effort of any kind to reorganize. The Court stated that for the failing company doctrine to apply the prospects for reorganization of the Citizen would have had to be "dim or nonexistent.").

effect of substantially lessening competition. This would appear to be especially true in the instance of newspaper mergers.[16] With the advent of the joint agreement between the Citizen and the Star, only one newspaper operation remained in Tucson. Thus, even the merger of a failing company may contribute to the rising tide of economic concentration and foreclose a substantial market which was available to the acquiring corporation's competitors or potential competitors. If a failing company is required to make an affirmative effort to sell to a noncompetitor, there is a chance, as Mr. Justice Douglas states, that another purchaser could be found; and thus, the competitive process could be preserved and not sacrificed to a monopoly power.[17] Such a requirement is more in line with the purpose of antitrust policy. The failing company exemption should not be employed by healthy firms as a device to reap merger profits and escape antitrust violations. In light of the *Citizen Publishing Company* case, the failing company exemption has been more definitely narrowed; it need now only be enforced.

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[16] Economic concentration is very high in the newspaper industry. It has been reported that competition in newspapers survives in only about fifty cities today. *See* Roberts, *Antitrust Problems in the Newspaper Industry*, 82 HARV. L. REV. 319, 320 (1968).

[17] 394 U.S. at 138.