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FAILING COMPANIES AND THE ANTITRUST LAWS

Janet L. McDavid*

This is a period of uncertainty for the American economy generally, and for American business in particular. The nation has been suffering under double-digit inflation for several years;¹ unemployment is high and expected to increase;² overall corporate profits have declined;³ and several major corporations have sustained record losses.⁴

The law reacts to such economic difficulties in different ways. In the area of antitrust law, the courts have been willing to give special consideration to financially-troubled companies. Failing companies, under certain circumstances, have been allowed to engage in conduct that, if done by a healthy corporation, would constitute a violation of the antitrust laws. Several rationales for this special treatment exist. The first is the belief that competition may be promoted, or at least not adversely affected, if ar-

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¹ According to the United States Department of Labor, prices for finished goods increased 1.7% in July, 1980, for a compounded annual rate of 22.4%. Wall St. J., Sept. 8, 1980, at 3, col. 1; BUSINESS WEEK, Sept. 1, 1980, at 16. The consumer price index for 1980 rose 12.4%, only slightly better than the 13.3% increase for 1979. Wall St. J., Jan. 26, 1981, at 3, col. 1.

² Between May and August, 1980, the unemployment rate ranged between 7.6 and 7.8%. Wall St. J., Sept. 8, 1980, at 3, col. 1.

³ According to a United States Department of Commerce report, corporate profits declined 18.2% in the second quarter of 1980. Wall St. J., Aug. 20, 1980, at 3, col. 1. In July, 1980, factories operated at 74.2% of capacity, the lowest rate in five years. Wall St. J., Aug. 19, 1980, at 3, col. 1.

⁴ The American automobile manufacturers all sustained record losses in 1980: General Motors, \$762.5 million, Ford Motor Co., \$1.54 billion, Wall St. J., Feb. 20, 1981, at 4, col. 2; American Motors, \$197.5 million, Wall St. J., Feb. 23, 1981, at 8, col. 2. Chrysler Corporation lost \$1.7 billion, the largest annual loss in United States corporate history. Wall St. J., March 2, 1981, at 3, col. 1. Chrysler exists today only because the federal government approved a \$1.5 billion guaranteed loan. Chrysler Corp. Loan Guarantee Act of 1979, P.L. No. 96-185, 93 Stat. 1324 (1979). For a general discussion of Chrysler's financial condition, and the effect of its potential bankruptcy, see H.R. REP. No. 96-690, 96th Cong., 1st Sess. 9-10, reprinted in [1979] U.S. CODE CONG. & AD. NEWS 2787, 2789-91. Since January 1, 1979, Chrysler has eliminated 15,000 jobs and closed half a dozen plants. Wall St. J., Aug. 1, 1980, at 3, col. 1.

During its fourth quarter, United States Steel Corp. lost \$561.7 million, one of the biggest quarterly net losses ever for an American corporation. *Id.* at 3, col. 3. U.S. Steel has closed 15 unprofitable plants and eliminated 10,000 jobs. *Id.*

guably unlawful conduct permits a marginal competitor to remain in the market. Similarly, the courts theorize that the acquisition of a failing company may not result in the lessening of competition that might result from a merger of two profitable companies. Finally, the courts also are aware of the social consequences of business failure.

This article will examine two areas in which the courts have given financially-troubled companies special treatment under the antitrust laws. Part I discusses the acquisition of a failing company, which may constitute a judicially-created exemption from section 7 of the Clayton Act.⁵ Part II considers certain cases involving failing companies whose conduct is challenged under section 1 of the Sherman Act.⁶

I. MERGERS, ACQUISITIONS, AND THE FAILING COMPANY DOCTRINE

Section 7 of the Clayton Act provides in pertinent part that

No corporation engaged in commerce shall acquire, directly or indirectly, the whole or any part of the stock . . . or the whole or any part of the assets of another corporation engaged also in commerce, where in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly.⁷

The courts have interpreted section 7 to apply to horizontal,⁸ vertical,⁹ and, to some extent, conglomerate mergers,¹⁰ as well as

⁵ 15 U.S.C. § 18 (1976).

⁶ 15 U.S.C. § 1 (1976).

⁷ 15 U.S.C. § 18 (1976).

⁸ Section 7 applies to horizontal mergers, that is, mergers between competitors. *See, e.g.,* *United States v. Von's Grocery Co.*, 384 U.S. 270 (1966) (merger of grocery chains with combined market share of 7.5% unlawful where there was a trend toward concentration); *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321 (1963) (merger of two commercial banks with a combined market share of 30% illegal in a concentrated market); *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962) (structure and history of industry, barriers to entry, concentration, and market shares must be considered in evaluating merger of shoe manufacturer with retail chain of shoe stores having some manufacturing capability).

⁹ Section 7 also applies to vertical mergers, that is, mergers between suppliers and customers. *See, e.g.,* *Ford Motor Co. v. United States*, 405 U.S. 562 (1972) (automobile manufacturer's acquisition of supplier of spark plugs and batteries); *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962) (merger between shoe manufacturer and retail shoe store chain); *United States v. E. I. duPont de Nemours & Co.*, 353 U.S. 586 (1957) (auto-

to joint ventures.¹¹ In addition, challenges to mergers are possible under section 1 of the Sherman Act¹² or section 5 of the Federal Trade Commission Act.¹³ The "failing company doctrine" is a defense to such actions.

*A. Judicial Interpretation of the Failing Company Doctrine:
Elements of the Defense.*

The "failing company doctrine" is a judicially created defense, sanctioned by Congress,¹⁴ to actions challenging otherwise un-

mobile paint manufacturer held 23% of stock of General Motors).

¹⁰ Several varieties of conglomerate mergers exist, including product extension mergers, *FTC v. Procter & Gamble Co.*, 386 U.S. 568 (1967) (manufacturer of detergents acquired bleach manufacturers), and market extension mergers, *United States v. Atlantic Richfield Co.*, 297 F. Supp. 1061 (S.D.N.Y. 1969), *aff'd mem. sub nom. Bartlett v. United States*, 401 U.S. 986 (1971) (merger between copper company and oil company which might have entered copper industry). The courts condemn conglomerate mergers because they may prevent a potential entrant from entering a market, *e.g.*, *Procter & Gamble*, or because they create a danger of reciprocal buying, *e.g.*, *FTC v. Consolidated Foods Corp.*, 380 U.S. 592 (1965). Proposals have emerged to impose limitations on acquisitions between major corporations on the ground that mere size and concentration of assets may be undesirable. *See, e.g.*, [1980] 951 ANTITRUST & TRADE REG. REP. (BNA) A-4; [1979] 925 ANTITRUST & TRADE REG. REP. (BNA) A-21 (proposed legislation to prevent oil company acquisitions); [1979] 921 ANTITRUST & TRADE REG. REP. (BNA) A-22 (FTC staff proposals); [1979] 902 ANTITRUST & TRADE REG. REP. (BNA) A-17 (FTC Commissioner Pitofsky favors tougher merger standards for large firms); [1979] 895 ANTITRUST & TRADE REG. REP. (BNA) A-5 (Justice Department proposal to prevent acquisitions by major corporations). The FTC recently rejected a staff recommendation that it adopt a trade regulation rule concerning the standards of proof applicable in potential competition merger cases before the FTC. [1980] 5 TRADE REG. REP. (CCH) ¶ 50,419.

¹¹ *See United States v. Penn-Olin Chemical Co.*, 378 U.S. 158 (1964) (joint venture by two companies illegal where either might have entered the market separately).

¹² *See, e.g.*, *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321 (1963).

¹³ Section 5 of the Federal Trade Commission Act provides in pertinent part, "[u]nfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in commerce, are declared unlawful." 15 U.S.C. § 45(a)(1) (1976). Mergers can be unlawful under Section 5. *See In re Dean Foods Co.*, 70 F.T.C. 1146 (1966), *modified*, 395 F.2d 696 (7th Cir. 1967); *In re Foremost Dairies, Inc.*, 60 F.T.C. 944 (1962). Courts have held that every violation of § 7 is also a violation of § 5. *See, e.g.*, *Stanley Works v. FTC*, 469 F.2d 498, 499 n.2 (2d Cir. 1972), *cert. denied*, 412 U.S. 928 (1973). The Fourth Circuit recently found, however, that a merger may not be enjoined solely under § 5. *FTC v. Atlantic Richfield Co.*, 549 F.2d 289, 291-92 n.1 (4th Cir. 1977).

¹⁴ The Senate Report on the 1950 amendments to § 7 stated:

The argument has been made that the proposed bill, if passed, would have the effect of preventing a company which is in a failing or bankrupt condition from selling out.

The committee are [*sic*] in full accord with the proposition that any firm in such a condition should be free to dispose of its stock or assets. The committee, however, do [*sic*] not believe that the proposed bill will prevent sales of this type.

The judicial interpretation on this point goes back many years and is abundantly clear. According to decisions of the Supreme Court, the Clayton Act does

lawful mergers or acquisitions.¹⁵ The Supreme Court first articulated the doctrine in *International Shoe Co. v. FTC*,¹⁶ which involved a horizontal merger between two shoe manufacturers. The Federal Trade Commission (FTC) had found that the merger violated section 7 of the Clayton Act, but the Supreme Court reversed on two grounds. First, the Court found that the parties to the merger competed in separate markets, and that the merger would not substantially lessen competition.¹⁷ The second basis for reversal was that the acquired company faced "financial ruin".¹⁸ The Court postulated two rationales for the creation of the doctrine. The first emphasized the social consequences of business failure, noting the adverse impact on stockholders, creditors, employees, and others. The second rationale assumed that little lessening of competition would occur if a corporation that otherwise would fail was acquired even by a competitor.

Under the traditional formulation of the failing company doc-

not apply in bankruptcy or receivership cases. Moreover, the Court has held, with respect to this specific section, that a company does not have to be actually in a state of bankruptcy to be exempt from its provisions; it is sufficient that it is heading in that direction with the probability that bankruptcy will ensue.

S. REP. No. 1775, 81st Cong., 2d Sess. 7, reprinted in [1950] U. S. CODE CONG. SERV. 4293, 4299; accord, H.R. REP. No. 1191, 81st Cong., 1st Sess. 6 (1949).

¹⁵ The failing company doctrine is applicable to mergers challenged under either § 7 or § 5. See, e.g., *Citizen Publishing Co. v. United States*, 394 U.S. 131 (1969) (§ 7); *United States Steel Corp. v. FTC*, 426 F.2d 592 (6th Cir. 1970) (§ 5). Some dispute has arisen, however, concerning the extent to which the doctrine is applicable to mergers challenged under § 1 of the Sherman Act. Compare *American Press Ass'n v. United States*, 245 F. 91, 93-94 (7th Cir. 1917) (acquisition of failing company does not violate § 1 of Sherman Act) with *Bowl America, Inc. v. Fair Lanes, Inc.*, 299 F. Supp. 1080, 1092-93 (D. Md. 1969) (doctrine inapplicable to mergers challenged under § 1).

¹⁶ 280 U.S. 291 (1930). An earlier version of the failing company doctrine was the basis for a 1917 circuit court decision permitting the acquisition of a failing company in an action under § 1 of the Sherman Act. *American Press Ass'n v. United States*, 245 F. 91 (7th Cir. 1917).

¹⁷ 280 U.S. at 298-99.

¹⁸ The Court stated:

In the light of the case thus disclosed of a corporation with resources so depleted and the prospect of rehabilitation so remote that it faced the grave probability of a business failure with resulting loss to its stockholders and injury to the communities where its plants were operated, we hold that the purchase of its capital stock by a competitor (there being no other prospective purchaser), not with a purpose to lessen competition, but to facilitate the accumulated business of the purchaser and with the effect of mitigating seriously injurious consequences otherwise probable, is not in contemplation of law prejudicial to the public and does not substantially lessen competition or restrain commerce within the intent of the Clayton Act.

Id. at 302. For a discussion of the financial condition of the acquired company in *International Shoe*, see Blum, *The Failing Company Doctrine*, 16 B.C. INDUS. & COMM. L. REV. 75, 76-81 (1974).

trine, the acquiring company must prove two elements: (1) the probability of imminent business failure of the target company and (2) the unavailability of other purchasers with less anticompetitive impact.¹⁹ Because the doctrine is an exception to the general rules governing acquisitions, the courts have construed the requirements of the defense narrowly. The failing company doctrine is apparently an affirmative defense, and the parties to the acquisition bear the burden of proving that these conditions have been satisfied.²⁰

1. "*Imminent business failure*" — The requirement of imminent business failure has been the subject of extensive judicial interpretation. The courts have interpreted strictly the *International Shoe* requirement of "grave probability of business failure." Courts have not been convinced that business failure is imminent when a company continues to be profitable,²¹ is solvent,²² or has prospects of showing a profit.²³ Likewise, a showing that management of a viable company intends to go out of business or liquidate,²⁴ or that a company has either declining profits or large losses,²⁵ is badly managed,²⁶ lacks capital for moderniza-

¹⁹ See, e.g., *United States v. Greater Buffalo Press, Inc.*, 402 U.S. 549, 555 (1971) (acquisition by newspaper of printing company that was profitable, but which owners chose to sell rather than modernize).

²⁰ See text accompanying notes 156-62 *infra*. See also *Citizen Publishing Co. v. United States*, 394 U.S. 131, 138-39 (1969).

²¹ *United States v. Greater Buffalo Press, Inc.*, 402 U.S. 549, 555 (1971).

²² *FTC v. Food Town Stores*, 539 F.2d 1339, 1345 (4th Cir. 1976) (company had substantial short-term liabilities, but was solvent and operated at a profit); *United States v. Pabst Brewing Co.*, 296 F. Supp. 994, 999-1000 (E.D. Wis. 1969) (company with large losses was solvent and could obtain credit).

²³ *In re Papercraft Corp.*, 78 F.T.C. 1352, 1406-08 (1971) (company had operating losses and management problems, but had significant sales and assets).

²⁴ See, e.g., *Erie Sand & Gravel Co. v. FTC*, 291 F.2d 279, 280 (3d Cir. 1961) (owners of profitable sand company, which was a going concern, wanted to liquidate); *United States v. Phillips Petroleum Co.*, 367 F. Supp. 1226, 1258-60 (C.D. Cal. 1973), *aff'd per curiam*, 418 U.S. 906 (1974) (parts of acquired company were profitable; intention to go out of business irrelevant).

²⁵ See, e.g., *Citizen Publishing Co. v. United States*, 394 U.S. 131, 133, 137 (1969); *F & M Schaefer Corp. v. C. Schmidt & Sons, Inc.*, 597 F.2d 814, 817 (2d Cir. 1979) (large losses and declining sales, but company was rebuilding with support of creditors); *United States v. Pabst Brewing Co.*, 296 F. Supp. 994, 999-1000 (E.D. Wis. 1969) (declining market share and sales, but company had substantial assets and sound credit rating); cf. *In re Dean Foods Co.*, 70 F.T.C. 1146, 1272-84 (1966) (company with declining sales, but was able to meet its short-term debts and had operating profit; was not failing).

²⁶ *United States v. American Technical Industries, Inc.*, [1974] TRADE CAS. (CCH) ¶ 74,873 (M.D. Pa. 1974) (negative cash balance and liabilities exceeded assets, but company operated at a profit in most years); cf. *Crown-Zellerbach Corp. v. FTC*, 296 F.2d 800, 831 (9th Cir. 1961) (death of key officer involved in attempt to rehabilitate company).

tion,²⁷ or has obsolete facilities is insufficient to prove this element of the defense.²⁸ However, the fact that a company is in bankruptcy or imminent danger of bankruptcy, or is unable to pay its debts as they mature, appears to satisfy the requirement of probable business failure.²⁹ Thus, the courts have required that defendants show a strong likelihood of business failure.

The courts' emphasis on evidence of failure seems entirely appropriate. Many businesses experience periods of decline without ever facing any real prospect of bankruptcy.³⁰ Thus, the courts have properly attempted to distinguish financially-troubled companies from failing companies, although in some cases such a distinction may be difficult to draw. As long as any reasonable possibility exists that a company can be rehabilitated, the courts should not permit an anticompetitive acquisition.

2. *No other available purchasers*— The requirement that there be no other available purchasers has been the subject of less judicial interpretation than the imminent business failure requirement. Presumably the requirement is imposed to satisfy the court that less anticompetitive alternatives to the otherwise unlawful acquisition are unavailable. Thus, courts have required that the failing company actively seek alternative purchasers.³¹ As one court stated, the failing company must show that it “undertook a well conceived and thorough canvass of the industry

²⁷ *United States v. Greater Buffalo Press, Inc.*, 402 U.S. 549, 555 (1971).

²⁸ *United States v. Pabst Brewing Co.*, 296 F. Supp. 994, 1001 (E.D. Wis. 1969); *Dean Foods Co.*, 70 F.T.C. 1146, 1280-81 (1966), *modified*, 395 F.2d 696 (7th Cir. 1968).

²⁹ *See, e.g.*, *United States Steel Corp. v. FTC*, 426 F.2d 592, 606 (6th Cir. 1970); *United States v. Culbro Corp.*, [1980-81] TRADE CAS. (CCH) ¶ 63,692 (S.D.N.Y. 1981); *United States v. Black & Decker Mfg. Co.*, 430 F. Supp. 729, 779-81 (D. Md. 1976); *United States v. M.P.M., Inc.*, 397 F. Supp. 78, 98-101 (D. Colo. 1975); *National Tea Co.*, 69 F.T.C. 226, 261, 366 (1966).

³⁰ Although Ford Motor Company has sustained record losses recently, few would suggest that Ford is a failing company. *See note 4 supra*. Ford presumably has the resources necessary to reverse its recent losses. Therefore, Ford's acquisition by a competitor or a potential entrant into the automobile industry would damage competition. If, however, Ford, like Chrysler, were to sustain such losses for a number of consecutive years, and were burdened with obsolete facilities which it was unable to rehabilitate without substantial capital expenditures, the courts might regard Ford as a failing company. Faced with the alternative of bankruptcy or merger, a court might permit Ford to be acquired in an otherwise unlawful acquisition.

³¹ *See, e.g.*, *United States v. Greater Buffalo Press, Inc.*, 402 U.S. 549, 556 (1971); *Golden Grain Macaroni Co. v. FTC*, 472 F.2d 882, 887 (9th Cir. 1972), *cert. denied*, 412 U.S. 918 (1973); *United States v. Black & Decker Mfg. Co.*, 430 F. Supp. 729, 781-82 (D. Md. 1976); *United States v. M.P.M., Inc.*, 397 F. Supp. 78, 101-02 (D. Colo. 1975); *In re Retail Credit Co.*, [1976-79 Transfer. Binder] 3 TRADE REG. REP. (CCH) ¶ 21,446 (FTC 1978). *But see United States v. Culbro Corp.*, [1980-81] TRADE CAS. (CCH) ¶ 63,692 (S.D.N.Y. 1981) (financial difficulties well-known, but no other offer was made).

such as to ferret out viable alternative partners for a merger."³² One failing company, for example, was held not to have made an adequate effort where it had failed to utilize the services of an investment banker to attempt to locate other potential purchasers.³³

Indeed, it would be desirable if the courts required the failing company to prove that no company outside of the industry would consider the acquisition, although such proof would be difficult. From the standpoint of promoting or preserving competition, a purchaser from outside the industry who would be unlikely to enter the industry absent the acquisition would be most desirable. The next best alternative would be a potential entrant, while an acquisition by another competitor would be least desirable. By forcing the failing company to make a diligent search for an alternative purchaser, this requirement permits the courts to attempt to minimize the anticompetitive effect of an acquisition.

3. *Dim prospects of reorganization*— Courts also have discussed requirements other than the two set forth in *International Shoe*. In 1969, in *Citizens Publishing Co. v. United States*,³⁴ the Supreme Court implied that inability to reorganize a failing company under the bankruptcy laws might be a third requirement of the failing company doctrine. Later Supreme Court decisions, however, omit any reference to the reorganization possibility as a third requirement,³⁵ and the few lower courts that have considered the issue are divided.³⁶

³² *United States v. Pabst Brewing Co.*, 296 F. Supp. 994, 1002 (E.D. Wis. 1969).

³³ *Calnetics Corp. v. Volkswagen*, 348 F. Supp. 606, 622 (C.D. Cal. 1972), *rev'd on other grounds*, 532 F.2d 674 (9th Cir. 1976).

³⁴ 394 U.S. 131, 138 (1969). *Citizen Publishing* involved an unlawful joint operating agreement between two newspapers. Following the Supreme Court's decision, Congress passed the Newspaper Preservation Act, 15 U.S.C. §§ 1801-1804 (1976), which was designed to overrule *Citizen Publishing*. The Act created an antitrust exemption for other existing joint operating agreements. It also permits future joint operating agreements if one of the newspapers is "in probable danger of business failure" and the Attorney General determines that such an arrangement would effectuate the policy and purpose of the Act. 15 U.S.C. §§ 1802(5), 1803(b) (1976).

³⁵ See, e.g., *United States v. General Dynamics Corp.*, 415 U.S. 486, 507 (1974); *United States v. Greater Buffalo Press, Inc.*, 402 U.S. 549, 555 (1971).

³⁶ Compare *United States Steel Corp. v. FTC*, 426 F.2d 592, 606 n.30 (6th Cir. 1970) and *United States v. Phillips Petroleum Co.*, 367 F. Supp. 1226, 1259 (C.D. Cal. 1973), *aff'd per curiam*, 418 U.S. 906 (1974) (dictum) with *United States v. Black & Decker Mfg. Co.*, 430 F. Supp. 729, 778 (D. Md. 1976) (dictum) and *United States v. M.P.M., Inc.*, 397 F. Supp. 78, 96 (D. Colo. 1975). In one recent case, *United States v. Culbro Corp.*, [1980-81] TRADE CAS. (CCH) ¶ 63,692 (S.D.N.Y. 1981), unsuccessful attempts had been made to reorganize the failing company under Chapter XI, and unless the acquisition took place it would be liquidated.

Until the Supreme Court hands down a definitive decision, the issue will remain unresolved. The possibility of reorganization should be a factor only in those cases where a healthy competitor is likely to emerge. Arguably, if a company can be reorganized successfully, it may never have been actually failing. Reorganization also might be viewed as an alternative to the "no other purchaser" requirement.³⁷ Clearly, successful reorganization is preferable to an anticompetitive acquisition because reorganization both preserves the competitor and prevents an increase in concentration. However, to predict whether a company can be reorganized successfully is difficult. Refusing to permit the acquisition of a failing company because there is some possibility that it could be reorganized seems extreme and unwise. An unsuccessful reorganization serves neither competition nor society. Such a policy completely ignores the social effects of business failure which the courts should consider, even though such effects are not of primary importance.

4. *The failing division or subsidiary*— The extent to which the failing company doctrine applies to a failing division or subsidiary of an otherwise profitable, viable corporation, is quite controversial. The question has received little attention in judicial decisions, and what little case law exists is divided.³⁸

B. *Administrative Interpretation of the Failing Company Defense*

In addition to being asserted as a defense to actions under section 7, merging companies often raise the failing company doctrine in pre-enforcement review proceedings before the Department of Justice Antitrust Division and the FTC.³⁹ These ad-

³⁷ In *United States v. M.P.M., Inc.*, 397 F. Supp. 78, 96 (D. Colo. 1975), the court concluded that reorganization was an alternative to the "no other purchaser" requirement of the doctrine.

³⁸ Compare *United States v. Reed Roller Bit Co.*, 274 F. Supp. 573, 584 n.1 (W.D. Okla. 1967) (dictum suggesting the doctrine applies to failing subsidiaries) with *United States v. Blue Bell, Inc.*, 395 F. Supp. 538, 550 (M.D. Tenn. 1975) (failing division not within doctrine) and *United States v. Phillips Petroleum Co.*, 367 F. Supp. 1226, 1260 (C.D. Cal. 1973), *aff'd per curiam*, 418 U.S. 906 (1974) (doctrine inapplicable to profitable company with failing division). In *United States v. Lever Brothers Co.*, 216 F. Supp. 887 (S.D.N.Y. 1963), the court permitted the sale of a failing brand of detergent to a competitor.

³⁹ The Hart-Scott-Rodino Antitrust Improvements Act of 1976, 15 U.S.C. § 18a (Supp. III 1979), requires premerger notification filings with both agencies at least 30 days prior to the consummation of certain acquisitions. In addition, the FTC provides advisory opinions on certain transactions, 16 C.F.R. §§ 1.1 *et seq.* (1980), and the Justice Department offers a "business review procedure," 28 C.F.R. § 50.6 (1980). The Justice Depart-

ministrative agency interpretations of the failing company defense can often differ significantly from those of the courts.

1. *"Imminent business failure"*—As described in recent testimony before a congressional committee,⁴⁰ the two federal anti-trust enforcement agencies appear to approach the issue of imminent business failure in a similar manner. Both agencies conduct a detailed investigation of the financial condition of the parties.⁴¹ For example, the Antitrust Division obtains information from creditors and other financial institutions, trade associations, and other firms in the industry.⁴² The FTC analysis typically includes examination of trends in financial statements, profitability, liquidity, a comparison with other firms in the industry, and the company's efficiency.⁴³ The two agencies appear to differ, however, in the extent to which they are willing to accept the defense, although there is no clear explanation or justification for those differences.⁴⁴

2. *No other available purchaser*—Like the courts, the Justice Department and the FTC consider whether the acquiring company is the only available purchaser. The Department looks for "a bona fide attempt to find a less anticompetitive purchaser, such as the use of an investment banker or extensive search."⁴⁵ It prefers that this search be conducted prior to negotiating an otherwise unlawful merger.⁴⁶ The FTC views a lower offer from a

ment's Merger Guidelines provide that a merger ordinarily will not be challenged "if . . . the firm faces the clear probability of business failure . . ." [1980] 1 TRADE REG. REP. (CCH) ¶ 4510.

⁴⁰ *Hearings on the Failing Company Defense Before the Subcomm. on Antitrust, Monopoly and Business Rights of the Sen. Judiciary Comm.*, 96th Cong., 1st Sess. (1979) [hereinafter cited as *Failing Company Hearings*]. Assistant Attorney General John Shenefield testified on behalf of the Department of Justice, and Daniel C. Schwartz, Deputy Director of the FTC Bureau of Competition, testified on behalf of the FTC.

⁴¹ *Failing Company Hearings*, *supra* note 40, at 34 (testimony of John Shenefield); *id.* at 48-49 (testimony of Daniel C. Schwartz).

⁴² *Id.* at 34 (testimony of John Shenefield).

⁴³ *Id.* at 48-49 (testimony of Daniel C. Schwartz).

⁴⁴ According to Shenefield, in the period 1975-78, 22 companies raised the defense before the Justice Department, which accepted it in 17 cases. *Failing Company Hearings*, *supra* note 40, at 18 (testimony of John Shenefield). In contrast, an average of six companies per year raise the defense before the FTC. *Id.* at 44 (testimony of Daniel C. Schwartz). Most, however, are found not to be failing. *Id.* at 49.

⁴⁵ *Failing Company Hearings*, *supra* note 40, at 31 (testimony of John Shenefield). For example, in one instance the Department required the failing company to consider "any good faith offer from any company capable of operating . . . [the failing company] as a viable competitive entity regardless of how that offer compared to the present [outstanding] offer." Dept. of Justice Business Review Letter to Motorola, Inc., *reprinted in* 5 TRADE REG. REP. (CCH) ¶ 50,209 (1974). The acquisition was approved after an investment banker contacted thirty-eight alternative purchasers who expressed no interest in the acquisition and two more anticompetitive offers had been received. *Id.* at ¶ 50,212.

⁴⁶ *Failing Company Hearings*, *supra* note 40, at 32 (testimony of John Shenefield).

less anticompetitive purchaser as preferable to a higher offer from a competitor, who probably is willing to pay a premium to increase its market share.⁴⁷ The FTC also regards community and employee groups as alternatives to acquisition by a competitor.⁴⁸

3. *Dim prospects of reorganization*— The Justice Department and the FTC have taken somewhat different positions on the question whether it must be proved that the failing company could not be reorganized. The Antitrust Division recognizes the uncertainties present in attempted reorganizations, stating that it has found the availability of bankruptcy as an alternative to a merger as creating “especially close judgment calls.”⁴⁹ The Antitrust Division does “not view the possibility of a technically successful reorganization as an inflexible barrier to invocation of the defense, but a consideration to be taken into account in determining its appropriateness.”⁵⁰

In contrast, the FTC regards the possibility of reorganization as an essential third part of the failing company doctrine.⁵¹ The fact is, however, that both alternatives, acquisition and bankruptcy, might be anticompetitive. The courts, the FTC, and the Antitrust Division must decide which is preferable. The FTC's position seems to ignore the practical problems of reorganization as well as the societal impact of business failure if reorganization is unsuccessful.

4. *The failing division or subsidiary*— Although there are few judicial opinions dealing with the failing subsidiary or division, the FTC and the Justice Department have taken somewhat different approaches to this question, as demonstrated by their decisions in three recent controversial acquisitions. The Justice Department Merger Guidelines provide that the failing company doctrine should apply to a failing division or subsidiary “only in the clearest of circumstances.”⁵² The Department acknowledges that it is difficult to determine whether or not a division actually

⁴⁷ *Id.* at 47 (testimony of Daniel C. Schwartz).

⁴⁸ *Id.* at 37. A recent attempt by a community group to purchase a plant that United States Steel Corporation intended to close resulted in litigation when the company refused to negotiate with the group. Local 1330, United States Steel Workers v. United States Steel Corp., [1980-2] TRADE CAS. (CCH) ¶ 63,486 (6th Cir. 1980).

⁴⁹ *Failing Company Hearings*, *supra* note 40, at 32 (testimony of John Shenefield).

⁵⁰ *Id.*

⁵¹ See, e.g., Retail Credit Co. [1976-79 Transfer Binder] 3 TRADE REG. REP. (CCH) ¶ 21,446 (F.T.C. 1978); United States Steel Corp., 81 F.T.C. 629, 653 (1972); Papercraft Corp., 78 F.T.C. 1352, 1406-08 (1971); *Failing Company Hearings*, *supra* note 40, at 47 (testimony of Daniel C. Schwartz).

⁵² [1977] 1 TRADE REG. REP. (CCH) ¶ 4510.

is failing. In making that evaluation, it claims to consider the financial condition of the parent corporation as well,⁵³ although in practice it appears that it decides only whether the parent actually intends to close the division or subsidiary.⁵⁴ Thus, the Antitrust Division decided not to challenge the sale of General Motors' Frigidaire Division to White Consolidated Industries.⁵⁵ GM had determined that Frigidaire was not producing sufficient revenues and decided to convert the Frigidaire plant to truck production.⁵⁶ Faced with GM's decision, the Antitrust Division required a search for alternative purchasers, and ultimately permitted the acquisition.⁵⁷

The FTC, on the other hand, has been reluctant to permit conglomerates to dispose of subsidiaries that are not producing a satisfactory profit. According to the FTC, consolidated financial statements make it difficult to determine whether a division is failing or whether losses and liabilities are being allocated to the division to create the appearance of failure.⁵⁸ Thus, the FTC refused to approve either the sale of the Federal Glass Division of Federal Paperboard Company to Lancaster Colony Corporation⁵⁹ or the sale of American Safety Razor, a Philip Morris subsidiary, to BIC, a French razor manufacturer.⁶⁰ The FTC be-

⁵³ *Failing Company Hearings*, *supra* note 40, at 18 (testimony of John Shenefield).

⁵⁴ *Id.* at 19-20, 33.

⁵⁵ *Id.* at 18; [1979] 910 ANTITRUST & TRADE REG. REP. (BNA) A-27.

⁵⁶ *Failing Company Hearings*, *supra* note 40, at 18-20 (testimony of John Shenefield).

⁵⁷ *Id.* Senator Metzenbaum (D-Ohio) was critical of the Department's decision because he viewed the acquisition as anticompetitive and felt that no adequate search for alternative purchasers had been made. *Id.* at 18-24. The Department also authorized a controversial merger between Ling-Temco-Vought and Lykes, both of which had subsidiaries involved in steel manufacturing. [1978] 5 TRADE REG. REP. (CCH) ¶ 50,381.

⁵⁸ *Failing Company Hearings*, *supra* note 40, at 50-51 (testimony of Daniel C. Schwartz).

⁵⁹ The FTC obtained an injunction against the acquisition. *FTC v. Lancaster Colony Corp.*, 434 F. Supp. 1088 (S.D.N.Y. 1977). In 1978, Federal Paper Board threatened to close Federal Glass, but because the FTC concluded that the division was profitable and that an inadequate search had been made for alternative purchasers, it refused to permit the sale. *Failing Company Hearings*, *supra* note 40, at 50 (testimony of Daniel C. Schwartz). The FTC withdrew its complaint only after the plant had closed and alternative purchasers had rejected the acquisition. *Id.*; *Lancaster Colony Corp., Inc.*, [1979] 3 TRADE REG. REP. (CCH) ¶ 21,538 (F.T.C. 1979). During the recent Congressional hearings, Senator Metzenbaum was critical of the FTC's decision, but the FTC defended it on the ground that at the time the FTC first disapproved the sale Federal Glass was not a failing division. *Failing Company Hearings*, *supra* note 40, at 37-41 (testimony of Daniel C. Schwartz).

⁶⁰ BIC and American Safety Razor (ASR) were the second and third largest manufacturers, respectively, in a highly concentrated industry. The FTC felt that ASR was not failing and that Philip Morris had not sought alternative purchasers. *Failing Company Hearings*, *supra* note 40, at 49 (testimony of Daniel C. Schwartz). Philip Morris threatened to close ASR and laid off 250 workers, but eventually ASR was purchased by

lieves that a conglomerate with a failing subsidiary has three alternatives: liquidation, rehabilitation, or acceptance of a lower overall profit level.⁶¹ The FTC fears that extension of the failing company doctrine to failing divisions will mean that "a conglomerate . . . can simply write off a line of business, a plant, a work force, or a whole community, and can turn its attention elsewhere, leaving others to pick up the pieces."⁶²

The views of the Justice Department and the FTC represent two extremes, but neither position is completely acceptable. The Justice Department recognizes that a genuinely failing division poses a real problem to its parent corporation, which may regard the alternatives of a large investment for rehabilitation or continuing losses as unacceptable. The Justice Department's practical approach does mean, however, that although a division is not failing, if the parent insists on liquidation, the Department will acquiesce in an acquisition. The Department requires a failing company to prove that it actually is failing, but does not seem to require the same showing in the case of a subsidiary. It appears that the Department's position concerning the application of the failing company doctrine to subsidiaries could be improved by a more rigorous examination of the actual financial condition of the subsidiary and the prospects of rehabilitation, as well as insistence on compliance with the alternative purchaser requirement. In short, the Justice Department should apply the failing company doctrine to a failing division as strictly as it applies the doctrine to a failing corporation.

On the other hand, the FTC's apparent insistence that the failing company doctrine is inapplicable to a failing division inevitably will lead to harsh results, as in the case of Federal Glass. A realistic evaluation of the difficult situation faced by a parent corporation with a genuinely failing subsidiary should temper the FTC's position.⁶³

ASR's management. *Id.* at 49-50.

⁶¹ *Id.* at 51.

⁶² *Id.* at 50-51. In *Farm Journal, Inc.*, 53 F.T.C. 26 (1956), the FTC concluded that the failing company doctrine did not permit a publisher to sell an unprofitable publication to a competitor when its other publications were profitable.

⁶³ Professors Areeda and Turner recognize the difficulty of applying the failing company doctrine to a failing subsidiary or division. IV P. AREEDA & D. TURNER, *ANTITRUST LAW* ¶ 926e at 112 (1980). As they note, a parent can manipulate the capital structure of a wholly-owned subsidiary to create the appearance of failure. *Id.* Nonetheless, they conclude that the defense should not necessarily be inapplicable to a failing subsidiary. "It would be unfair to force parent companies to absorb losses that independent companies can avoid, or to take risks which independent lenders would deem improvident. At the least, the parent should be permitted to make a showing that would establish a 'failing division.'" *Id.*

C. A Complete Defense or a Balancing Test?

The courts generally regard the failing company doctrine as a complete defense to an action under section 7.⁶⁴ Because the doctrine is interpreted narrowly and applied strictly, few companies are able to convince the courts that all elements of the defense have been satisfied. Assuming that the burden of proof can be met, however, the issue remains whether the defense should be absolute or whether the courts should engage in a balancing of various interests.

One suggested absolute approach is that a "flexible per se" approach be used which adjusts the burden of proving "no alternative purchasers" with the probable anticompetitive effect of the acquisition.⁶⁵ Supporters of this approach cite the difficulty of balancing various interests, and suggest that under a balancing test, the doctrine would be almost impossible to prove. This analysis, however, ignores the fact that the courts routinely balance various interests in antitrust cases. For example, in evaluating vertical trade restraints the courts must weigh the reduction of intrabrand competition against the enhancement of interbrand competition resulting from the restraint.⁶⁶ While such balancing is difficult, it can be achieved through the use of expert testimony and sophisticated economic analysis.

Federal enforcement agencies, on the other hand, do not appear to treat the failing company doctrine as a complete defense. The Justice Department acknowledges that it engages in a balancing analysis. For example, if anticompetitive impact is minimal, concern about the impact of business failure on the community may prevail.⁶⁷ The FTC takes a slightly different view. After it has been established that conditions of the defense have been fulfilled, the FTC analyzes the potential anticompetitive effect of the acquisition in determining whether the acquisition is lawful.⁶⁸ Thus, in *United States Steel Corp.*, although the traditional elements of the failing company defense were satis-

⁶⁴ See generally Laurenza, *Section 7 of the Clayton Act and the Failing Company: An Updated Perspective*, 65 VA. L. REV. 947 (1979).

⁶⁵ *Id.* at 965.

⁶⁶ See notes 140-44 and accompanying text *infra*.

⁶⁷ *Failing Company Hearings*, *supra* note 40, at 32 (testimony of John Shenefield).

⁶⁸ See, e.g., *Retail Credit Co.*, 3 TRADE REG. REP. (CCH) ¶ 21,446 (F.T.C. 1978); *Paper-craft Corp.*, 78 F.T.C. 1352 (1971); *United States Steel Corp.*, 74 F.T.C. 1270, 1280-88 (1968), *remanded on other grounds*, 426 F.2d 592 (6th Cir. 1970), *on remand*, 81 F.T.C. 629 (1972); *Dean Foods Co.*, 70 F.T.C. 1146, 1283 (1966), *modified*, 395 F.2d 696 (7th Cir. 1967).

fied, the FTC nonetheless compelled United States Steel to divest itself of the acquired company because of a trend toward concentration and high barriers to entry in the industry.⁶⁹ The FTC concluded that the anticompetitive effects of the acquisition were not outweighed by the harms resulting from business failure.⁷⁰

In the absence of congressional action, the doctrine should remain as an absolute defense which few companies can satisfy since the defense applies only to otherwise anticompetitive acquisitions. It has long been true that the failing company defense is seldom asserted successfully, but Congress is aware of the problem. One of the questions addressed during a recent congressional hearing on the defense was whether the defense is too difficult to establish.⁷¹ If Congress believes that a less rigid test should be used, it certainly is capable of changing the rules.

D. Observations and Conclusions

The Supreme Court has described the failing company doctrine as a "lesser of two evils" approach.⁷² The Court has apparently considered the possible threat to competition resulting from an acquisition more acceptable than the adverse impact on competition and other losses if the company goes out of business. The Court has thus preserved the dual rationale for the doctrine articulated in *International Shoe*. These rationales, however, may be simpler on their face than they are in fact. Even under the failing company doctrine, in the absence of new legislation the principal concern of the courts and enforcement agencies should remain the acquisition's effect on competition, rather than social impact of business failure. The acquisition of a failing company by a large competitor may lead to an expansion of single-firm market power and entrenchment. In such circumstances, even the loss of a competitor through business failure, with the corresponding increase in concentration, may be preferable from the standpoint of preserving competition. For example, the acquisition of even a failing company by a strong competitor may further strengthen that competitor's position.

⁶⁹ 74 F.T.C. 1270, 1303-4 (1968).

⁷⁰ *Id.* at 1304.

⁷¹ *Failing Company Hearings*, *supra* note 40, at 2.

⁷² *United States v. General Dynamics Corp.*, 415 U.S. 486, 507 (1974). Although the Court did not rely on the failing company doctrine in *General Dynamics*, it did discuss the doctrine at some length.

In the absence of serious anticompetitive effect, however, the social policy implications of business failure seem an appropriate consideration. There have been suggestions that the courts should consider social impact regardless of anticompetitive effect. Congressional debates, for example, emphasize the need to protect the interests of stockholders, employees, and the community in which a failing firm is located.⁷³ Business failure adversely affects many people, including employees, stockholders, creditors, and the local governments that lose tax revenues. Employees and local communities are especially unprotected in the event of business failure. As a result, in several cases, employees, unions, or local governments have attempted to acquire closed plants and failing companies.⁷⁴

In general, both the courts and the federal enforcement agencies appear to approach the problem of the acquisition of a failing company from the proper perspective. They should continue to emphasize the traditional elements of probable failure and no alternative purchasers. Unless a company actually is failing, an otherwise unlawful acquisition should not be permitted. To decide when a firm is "failing" is somewhat difficult, but discovery in litigated actions or pre-enforcement requests for information should develop sufficient financial data.⁷⁵ The premerger notification process required by the Hart-Scott-Rodino Antitrust Improvements Act of 1976⁷⁶ presumably facilitates this evaluation of potentially unlawful mergers by the FTC and the Antitrust Division.

Similarly, the courts, the FTC, and the Justice Department should continue to insist that failing companies attempt to lo-

⁷³ See, e.g., *Corporate Mergers and Acquisitions: Hearings on H.R. 2734 Before a Subcomm. of the Senate Comm. on the Judiciary*, 81st Cong., 1st & 2d Sess. 79-81 (1949 & 1950); *Amending Sections 7 and 11 of the Clayton Act: Hearings on H.R. 515 Before Subcomm. No. 2 of the House Comm. on the Judiciary*, 80th Cong., 1st Sess. 9-12 (1947); 96 CONG. REC. 16445 (1950) (remarks of Sen. Thye); 96 CONG. REC. 16435 (1950) (remarks of Sen. O'Connor); 95 CONG. REC. 11490 (1949) (remarks of Rep. Michener); 95 CONG. REC. 11487-88 (1949) (remarks of Rep. Goodwin).

⁷⁴ Local 1330, *United States Steel Workers v. United States Steel Corp.*, [1980-2] TRADE CAS. (CCH) ¶ 63,486 (6th Cir. 1980), involved United States Steel's refusal to negotiate to sell a closed plant to such a group. The district court dismissed a complaint filed by the disappointed buyers alleging a violation of the Sherman Act and breach of contract on the grounds that no contract existed and that the Sherman Act did not apply. The Sixth Circuit reversed and remanded for additional proceedings to supplement the record, although it agreed that the complaint raised novel issues.

⁷⁵ The Department of Justice can compel the production of documents at the investigative stage before a complaint has been issued. 15 U.S.C. §§ 1311-14 (1976).

⁷⁶ See note 39 *supra*. The Hart-Scott-Rodino Act authorizes both the FTC and the Department of Justice to require the parties to a merger to produce various types of information concerning the parties and the transaction. 15 U.S.C. § 18a (1976).

cate the least anticompetitive purchaser. Only when it has been established that no alternative purchaser can be located should a competitor be permitted to acquire a failing company. If a substantial possibility exists that a failing company can be reorganized successfully, the courts or federal agencies should explore that alternative. Again, it may be difficult to determine whether reorganization is possible or whether there are no alternative purchasers. The burden of proving the lack of alternative purchasers should continue to rest on the failing company. It can meet that burden by showing that it made genuine efforts to locate other purchasers. The FTC takes the correct position when it contends that a failing company cannot reject an offer from an alternative purchaser simply because the offer is lower than the offer made by a competitor. To permit such a rejection would relegate protection of competition to secondary importance behind protecting stockholders and others.

The failing subsidiary or division problem poses difficult issues. As noted above, neither the FTC nor the Antitrust Division has found an adequate solution to the problem. They should approach the failing subsidiary or division as they approach the failing company: the parent corporation should be required to prove both failure and an inability to locate alternative purchasers. Because of the difficulty of determining whether a subsidiary is failing or merely producing an inadequate profit, the emphasis should be on locating the least anticompetitive purchaser.

E. The "General Dynamics" Defense

In *United States v. General Dynamics Corp.*,⁷⁷ the Supreme Court concluded that the acquisition of a coal company did not violate section 7, despite the fact that the acquisition produced a company with a large market share in a concentrated industry. One of the factors the Court emphasized was that in this case large market share did not accurately reflect the acquired company's competitive weakness because its coal reserves were either depleted or committed under long-term contracts.⁷⁸ The acquired company's future competitive weakness undermined the government's *prima facie* statistical case. The Court made it clear that mere competitive weakness was not sufficient to prove the failing company defense because the acquired company was

⁷⁷ 415 U.S. 486 (1974).

⁷⁸ *Id.* at 503-04.

both profitable and efficient. Rather, the Court determined that the acquisition would not substantially lessen competition.⁷⁹ The Court believed that present combined market shares did not accurately reflect future competitive weakness.⁸⁰

In *General Dynamics*, the Court did not intend to loosen the requirements of the failing company doctrine. Indeed, the dicta in *General Dynamics* concerning the failing company doctrine emphasizes the traditional elements of the doctrine. The true significance of *General Dynamics* is that the Court made a realistic evaluation of the competitive effect of the acquisition of a company that was not a strong competitor but was not failing.

Lower courts have not only accepted, but have even expanded the *General Dynamics* defense. Some of these decisions, however, reveal a serious misunderstanding of *General Dynamics*. Some decisions have created a quasi-failing company defense for companies that are merely faltering. In *United States v. International Harvester Co.*,⁸¹ for example, the court held that the acquisition did not violate section 7 because the acquired company did not have sufficient financial resources to compete effectively.⁸² A similar conclusion was reached in *United States v. Consolidated Foods Corp.*,⁸³ where technological difficulties and limited product variety had resulted in a decline in sales and an impaired ability to compete on the part of the acquired company.

Not all decisions, however, have followed the trend begun in *International Harvester*. Some lower courts have applied *General Dynamics* only in evaluating competitive strengths and weaknesses. Thus, in *FTC v. National Tea Co.*,⁸⁴ the Eighth Circuit applied *General Dynamics* in concluding that because the acquired company was such an ineffective competitor and so likely to depart from the market that its present market share inaccurately reflected its future competitive position, the merger should not be enjoined. Similarly, in *United States v. Amax*,⁸⁵

⁷⁹ *Id.* at 507-08.

⁸⁰ *Id.* at 510-11.

⁸¹ 564 F.2d 769, 774 (7th Cir. 1977).

⁸² In *F & M Schaefer Corp. v. C. Schmidt & Sons, Inc.*, 597 F.2d 814 (2d Cir. 1979), the Second Circuit avoided deciding whether to follow *United States v. International Harvester Co.*, 564 F.2d 769 (7th Cir. 1977), by concluding that the acquired company was an effective competitor. *International Harvester* was cited favorably in a recent district court decision, *Lektro-Vend Corp. v. Vendo Corp.*, No. 65-C-1755 (N.D. Ill., filed July 22, 1980), where the court found that management problems undermined a company's competitive position. Slip op. at 63-66.

⁸³ 455 F. Supp. 108 (E.D. Pa. 1978).

⁸⁴ 603 F.2d 694 (8th Cir. 1979).

⁸⁵ 402 F. Supp. 956 (D. Conn. 1975).

the defendant argued that its costs were so high that it might be forced to leave the market and that, like *General Dynamics*, it lacked access to essential resources. Although the court in *Amax* recognized the validity of the *General Dynamics* analysis, it concluded that the test was not met, particularly because, even under defendant's assumed facts, the merger would result in an unlawfully large market share.

The judicial expansion of *General Dynamics* in cases such as *International Harvester* has been roundly criticized. The Anti-trust Division, for example, believes that *International Harvester* is "a misapprehension of appropriate antitrust law."⁸⁶ Then-Assistant Attorney General Shenefield testified before a Senate Subcommittee that the Division will not be receptive to claims of "financial weakness."⁸⁷ In a recent decision,⁸⁸ the FTC expressly refused to follow *International Harvester*.⁸⁹ The FTC correctly contends that the Supreme Court's decision in *General Dynamics* did not create a new defense, but merely emphasized that consideration should be given to the probable competitive effect of the acquisition.⁹⁰ This appears to be a correct interpretation of *General Dynamics*. Although some companies are attempting to use *International Harvester* to expand *General Dy-*

⁸⁶ *Failing Company Hearings*, *supra* note 40, at 25 (testimony of John Shenefield).

⁸⁷ *Id.* at 34.

⁸⁸ *In re Pillsbury Co.*, [1976-79 Transfer Binder] 3 TRADE REG. REP. (CCH) ¶ 21,710 (F.T.C. 1979).

⁸⁹ Commissioner Pitofsky wrote:

Inclusion of financial weakness as a separate factor or defense—other than in a failing company situation, of course—raises serious antitrust policy problems. First, there may be a sort of double counting in that financial weaknesses may already be reflected in a market share of the troubled company that is lower than it would have been but for the financial problems. Second, the issue of financial weakness is extremely difficult to handle in court, and susceptible to invented claims and vague expert testimony generating factual issues that the courts are not well equipped to measure. Third, if all sorts of company "weaknesses" or structural market changes operating to the disadvantage of particular companies, can overcome a *prima facie* case of illegality, then the whole valuable trend in merger enforcement toward streamlining cases by concentrating on properly measured market shares and concentration ratios will be undermined. This is not to say that in a close case, financial weakness cannot be taken into account along with many other factors in predicting the market consequences of a merger, but rather that there ought not be a broad "*General Dynamics*" defense that may be relied upon to overcome clear instances of illegality based on market shares and concentration ratios.

Id. at ¶ 21,709. *Accord*, *Kaiser Aluminum & Chemical Corp.*, [1976-79 Transfer Binder] 3 TRADE REG. REP. (CCH) ¶ 21,578 (F.T.C. 1979); *Reichold Chemicals, Inc.*, 91 F.T.C. 246, 289-90 (1977), *aff'd mem.*, 5 TRADE REG. REP. (CCH) ¶ 21,566 (4th Cir. 1979).

⁹⁰ *Failing Company Hearings*, *supra* note 40, at 52 (testimony of Daniel C. Schwartz). According to Schwartz, between five and eight firms a year unsuccessfully ask the FTC to accept a *General Dynamics* defense. *Id.*

namics and the failing company doctrine, the FTC intends to resist these efforts.⁹¹ The FTC is particularly concerned that under *General Dynamics* the acquired company need not search for other, less anticompetitive purchasers.⁹² Although the FTC generally seems to understand *General Dynamics*, its concern about alternative purchasers seems inapposite because the focus of *General Dynamics* is that competitive weakness may result in an acquisition that does not substantially lessen competition. The alternative purchaser issue is relevant to the failing company doctrine, not to the analysis required by *General Dynamics*. Finally, Professors Areeda and Turner have voiced similar concerns. They believe that *General Dynamics* simply involved "determining the proper measure of past market shares."⁹³ They note that in *International Harvester* it was not evident that financial difficulties would lead necessarily to a decline in market power.⁹⁴

In general, the criticisms of attempts to expand the *General Dynamics* defense are well-founded. The Supreme Court did not intend to create a new defense or to modify the failing company doctrine. It merely held that the courts must realistically evaluate competitive strength. Thus, the decisions in *Amax*, *National Tea*, and *Pillsbury* appear to have applied the proper standard. In *International Harvester*, on the other hand, the acquired company lacked only financial resources, which it presumably could have obtained through other less anticompetitive means. A simple infusion of capital would have rehabilitated the company. Moreover, unlike *General Dynamics*, the court in *International Harvester* made no attempt to evaluate future competitive effectiveness. There may be instances, such as in *National Tea*, where financial and other difficulties seriously undermine competitive ability. In such cases the requirements of the failing company doctrine may not be satisfied. Nonetheless, the acquisition may not be anticompetitive because without the merger the acquired company lacked the means to compete effectively although it could have survived.

Because both the FTC and the Antitrust Division are hostile to attempts to expand *General Dynamics*, that decision will have little practical effect at the pre-enforcement stage. Indeed, both agencies presumably will challenge acquisitions in which

⁹¹ *Id.* at 53.

⁹² *Id.*

⁹³ IV P. AREEDA & D. TURNER, ANTITRUST LAW ¶ 934a at 134 (1980).

⁹⁴ *Id.* ¶ 935b at 140-41. *Accord*, Note, *Horizontal Mergers After United States v. General Dynamics*, 92 HARV. L. REV. 491, 509-11 (1978).

the defense is asserted. Thus, in pre-enforcement proceedings merging companies probably will have to meet the more stringent requirements of the traditional failing company doctrine. The courts, however, have shown greater willingness to consider a *General Dynamics* defense, although some have misapplied it.

II. THE FAILING COMPANY DOCTRINE UNDER SECTION 1

The failing company exemption from section 7 is well established, having emerged over 50 years ago. Many judicial decisions, as well as legal scholars, have analyzed the doctrine. However, the financial condition of a competitor may be relevant to alleged violations of other provisions of the antitrust laws as well, such as section 1 of the Sherman Act.⁹⁵ Unlike the failing company exemption from section 7, this is a new and relatively uncharted area. Few decisions have discussed the effect of financial failure on an alleged section 1 violation. Nonetheless, there is reason to believe that financial difficulties are an appropriate matter for courts to consider in analyzing section 1 cases as well.

A. *The Rule of Reason and the Per Se Test*

Section 1 of the Sherman Act provides that "every contract . . . in restraint of trade or commerce . . . is declared to be illegal"⁹⁶ The courts soon recognized, however, that a literal approach to antitrust issues was inappropriate. Under such an approach section 1 would invalidate all contracts because, as Justice Brandeis noted, "[e]very agreement concerning trade, every regulation of trade, restrains. To bind, to restrain, is of their very essence."⁹⁷ As a result, in *Standard Oil Co. v. United States*,⁹⁸ the Supreme Court concluded that section 1 should be interpreted to prohibit only "unreasonable" restraints.⁹⁹

⁹⁵ 15 U.S.C. § 1 (1976).

⁹⁶ *Id.*

⁹⁷ *Chicago Board of Trade v. United States*, 246 U.S. 231, 238 (1918). The Supreme Court arguably first applied the rule of reason in *United States v. Trans Missouri Freight Ass'n*, 166 U.S. 290 (1897).

⁹⁸ 221 U.S. 1 (1911).

⁹⁹ *Id.* at 58. Justice Brandeis' opinion in *Chicago Board of Trade v. United States*, which involved a challenge to a commodity exchange rule designed to create an orderly market, contains the classic formulation of the rule of reason. 246 U.S. 231 (1918).

The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may

In contrast, certain restraints, such as price fixing and other horizontal restraints, are regarded as so inherently damaging to competition that they have been classified as per se unreasonable.¹⁰⁰ The courts presume that the only purpose that could underlie such restraints is the elimination of competition.¹⁰¹ The use of the per se standard simplifies the trial court's task. Although the rule of reason requires a detailed inquiry into the history, purpose, and effect of the restraint, the per se standard completely forecloses such analysis.¹⁰² A per se test, however, is somewhat rigid, making it difficult for lower courts to uphold a practice that arguably falls within one of the per se categories, but nonetheless seems reasonable on its face.¹⁰³

suppress or even destroy competition. To determine that question the court must ordinarily consider the facts peculiar to the business to which the restraint is applied; its condition before and after the restraint was imposed; the nature of the restraint and its effect, actual or probable. The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be attained, are all relevant facts. This is not because a good intention will save an otherwise objectionable regulation or the reverse; but because knowledge of intent may help the court to interpret facts and to predict consequences.

Id. at 238. Thus, the rule of reason requires an analysis of the industry, the nature of the defendant's business, the history of the restraint, the reasons why that restraint was imposed, and the effect of the restraint. *National Soc. of Prof. Engrs. v. United States*, 435 U.S. 679, 692 (1978).

¹⁰⁰ See, e.g., *Catalano, Inc. v. Target Sales, Inc.*, 100 S. Ct. 1925 (1980) (per curiam) (price fixing); *United States v. Topco Associates, Inc.*, 405 U.S. 596 (1972) (horizontal market division); *Albrecht v. Herald Co.*, 390 U.S. 145 (1968) (resale price maintenance); *Klor's, Inc. v. Broadway-Hale Stores*, 359 U.S. 207 (1959) (group boycotts); *Northern Pacific Ry. v. United States*, 356 U.S. 1 (1958) (tying arrangements); *Timken Roller Bearing Co. v. United States*, 341 U.S. 593 (1951) (horizontal market division); *International Salt Co. v. United States*, 332 U.S. 392 (1947) (tying arrangements); *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150 (1940) (price-fixing). The Court first found that certain violations are so unreasonable that they cannot be justified in *United States v. Trenton Potteries Co.*, 273 U.S. 392 (1927). The Court first expressly applied the per se test in *Socony-Vacuum*, *supra*.

¹⁰¹ As the Court stated in *Northern Pacific*, certain agreements "because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use." 356 U.S. at 5 (1958). In *United States v. Trenton Potteries Co.*, 273 U.S. 392, 397 (1927), the Court first used a per se analysis, without using the term "per se."

¹⁰² *Northern Pacific Ry. v. United States*, 356 U.S. 1, 8 (1958).

¹⁰³ A good example is the Supreme Court's recent decision in *Broadcast Music, Inc. v. Columbia Broadcasting System, Inc.*, 441 U.S. 1 (1979). The Court of Appeals, feeling constrained by the sweeping language of decisions holding that any agreement tending to raise, lower, stabilize, or otherwise affect price constitutes unlawful price fixing, held that blanket licensing of music was a per se violation of section 1. 562 F.2d 130, 140 (2d Cir. 1977), *rev'd*, 441 U.S. 1 (1979). The Second Circuit recognized the practical difficulties in licensing music in any other way, but nonetheless found that the practice was unlawful. The Supreme Court, however, concluded that the blanket license was not a naked restraint with no purpose except eliminating competition because individual licenses were

B. Horizontal Restraints: The Effect of Financial Difficulties

In only one case, *Appalachian Coals, Inc. v. United States*,¹⁰⁴ has a court considered economic difficulties in a case involving a horizontal restraint. The Supreme Court held that the conduct at issue did not violate section 1 because of the economic difficulties faced by defendants. The focus of the Supreme Court's opinion in *Appalachian Coals* was not the financial condition of a single competitor but, rather, the condition of an entire industry. Nonetheless, *Appalachian Coals* represents a major foray by the Supreme Court into consideration of a section 1 defendant's economic well-being and, therefore, deserves further discussion.

The defendants were 137 producers of coal in Appalachia who had formed a joint exclusive agency to sell their coal. The agent established standard product classifications and sold coal at prices fixed by the agent's officers.¹⁰⁵ The Government challenged the arrangement because of its tendency to stabilize the price of defendants' coal. Defendants claimed that the joint sales agency was necessary to achieve marketing economies and to eliminate destructive trade practices. They particularly emphasized the depressed economic condition of the coal industry; in Appalachia, many coal companies were forced into bankruptcy or receivership, while others simply closed mines.

Ignoring the obvious price fixing implications of the joint sales agency, Chief Justice Hughes' opinion assumed that the appropriate standard to be applied was whether the joint sales agency was "reasonable."¹⁰⁶ Significantly, Hughes focused on the eco-

a virtual impossibility. 441 U.S. at 20. The Court noted that "easy labels do not always supply ready answers," *id.* at 8, and that "[l]iteralness is overly simplistic and often overbroad." *Id.* at 9. Justice Stevens' dissent agreed that a *per se* analysis was inappropriate, but argued that the blanket license could be held unreasonable on the record before the Court. *Id.* at 25-26 (Stevens, J., dissenting). On remand, the Second Circuit upheld the blanket license under the rule of reason. 620 F.2d 930 (2d Cir. 1980), *cert. denied*, 49 U.S.L.W. (U.S. Mar. 2, 1981) (No. 80-323).

¹⁰⁴ 288 U.S. 344 (1933).

¹⁰⁵ *Id.* at 356-58. During World War I, coal production capacity was expanded to meet a temporary increase in demand. After the War, there was surplus coal production and excess capacity. Moreover, substitute energy forms, such as oil, natural gas, and electricity, were competing with coal and claiming a large share of the energy market. An additional factor that received little attention in the Court's opinion, but which probably exacerbated the problem, was the general depression that began in 1929. As industrial output declined, demand for raw materials, such as coal, necessarily declined as well.

¹⁰⁶ As discussed at notes 98-99 and accompanying text *supra*, in 1911 the Supreme Court held that only "unreasonable" restraints of trade violated § 1. However, in *United States v. Trenton Potteries Co.*, 273 U.S. 392 (1927), the Court held that price-fixing agreements are "in themselves unreasonable or unlawful restraints, without the necessity of minute inquiry whether a particular price is reasonable or unreasonable as fixed

conomic distress of the coal industry in assessing reasonableness.¹⁰⁷ He accepted defendants' claims concerning the depressed condition of the coal industry.¹⁰⁸ Hughes stressed "the evils at which defendants' plan was aimed," asserting that the joint sales agency was "an honest effort to remove abuses" and would eventually promote the interests of commerce.¹⁰⁹

In retrospect, the Court's decision in *Appalachian Coals* seems extraordinary.¹¹⁰ The district court correctly found that the joint sales agency necessarily eliminated competition among the 137 participants and that the sales price of their coal was stabilized. The fact that other coal companies competed with defendants should not have been significant. The Court has held on several subsequent occasions that the presence of some competition is irrelevant if competition is restricted in part of the market.¹¹¹ The desperate condition of the Appalachian coal in-

. . . " *Id.* at 397.

¹⁰⁷ Chief Justice Hughes wrote:

It is therefore necessary in this instance to consider the economic conditions peculiar to the coal industry, the practices which have obtained, the nature of defendants' plan of marketing sales, the reasons which led to its adoption, and the probable consequences of carrying out that plan in relation to market prices and other matters affecting the public interest in interstate commerce in bituminous coal.

Appalachian Coals, 288 U.S. at 361.

¹⁰⁸ *Id.* at 372. The district court's opinion also recognized the special problems facing the coal industry, but, nonetheless concluded that the effect of defendants' practices was to raise prices to a level higher than the competitive price. 1 F. Supp. 339 (D. W. Va. 1932), *rev'd*, 288 U.S. 344 (1933). The district court entered an order enjoining defendants from utilizing a joint sales agency. 1 F. Supp. at 347-49.

¹⁰⁹ 288 U.S. at 372. The district court had found that the joint sales agency necessarily would eliminate competition among defendants themselves. 1 F. Supp. at 348. The Supreme Court, however, glossed over that finding; because defendants faced competition from other producers, "the selling agency will not be able, we think, to fix the market price of coal." 288 U.S. at 373.

The evidence leaves no doubt of the existence of the evils at which defendants' plan was aimed. The industry was in distress. It suffered from overexpansion and from a serious relative decline through the growing use of substitute fuels. It was afflicted by injurious practices within itself — practices which demanded correction. If evil conditions could not be entirely cured, they at least might be alleviated. The unfortunate state of the industry would not justify any attempt unduly to restrain competition or to monopolize, but the existing situation prompted defendants to make, and the statute did not preclude them from making, an honest effort to remove abuses, to make competition fairer, and thus to promote the essential interests of commerce.

Id. at 372.

¹¹⁰ In 1958, the Fourth Circuit examined a similar joint selling agency and found that, notwithstanding *Appalachian Coals*, it constituted a per se violation of § 1. *Virginia Excelsior Mills, Inc. v. FTC*, 256 F.2d 538 (4th Cir. 1958). The court indicated that *Appalachian Coals* "has not survived the strong and consistent course of subsequent decision." *Id.* at 540-51.

¹¹¹ See, e.g., *United States v. General Motors Corp.*, 384 U.S. 127 (1966); *United*

dustry, and perhaps the nation's general depression, must have influenced the Supreme Court's decision. Although *Appalachian Coals* has little precedential value,¹¹² the case is of interest because it indicates the extent to which the courts may be willing to allow depressed economic conditions to influence their decisions, even in the most egregious cases of price-fixing. As such, it represents a high-water mark in the Court's consideration of economic distress in section 1 cases. Although the Court is unlikely to take such an extreme position in a future horizontal restraint case, *Appalachian Coals* still stands as precedent for renewed consideration of this defense.

C. Vertical Restraints: The Effect of Financial Difficulties

Non-price vertical restraints¹¹³ have had a somewhat tortuous

States v. Socony-Vacuum Oil Co., 310 U.S. 150, 224-26 (1940).

¹¹² Six years before *Appalachian Coals*, the Supreme Court had held a price-fixing agreement unreasonable without the necessity of a detailed inquiry into the reasonableness of the prices fixed. See *United States v. Trenton Potteries Co.*, 273 U.S. 392, 397 (1927). The Court in *Appalachian Coals* simply ignored this precedent. Only seven years later, in *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150 (1940), the Court reviewed an arrangement which had the tendency to raise and stabilize the price of gasoline, but was claimed to be necessary to eliminate a "competitive evil." Justice Douglas' opinion rejected defendants' arguments concerning "destructive competition" and their attempted reliance on *Appalachian Coals* on the grounds that in that case the joint sales agency did not involve price fixing and because of the plight of the coal industry. The Court in *Socony-Vacuum* held that "a combination formed for the purpose and with the effect of raising, depressing, fixing, pegging, or stabilizing the price of a commodity in interstate or foreign commerce is illegal *per se*." *Id.* at 223.

Justice Douglas' initial basis for distinguishing *Appalachian Coals* seems inaccurate because the joint selling agency fixed the price at which 137 producers sold coal. Apparently the second ground, *i.e.*, the economic condition of the coal industry, was the real distinction. The Court in *Appalachian Coals* used economic difficulties to justify the application of the rule of reason rather than a *per se* test. In *Socony-Vacuum*, however, the Court rejected similar arguments concerning financial difficulties. The Court in *Socony-Vacuum* thus limited *Appalachian Coals* to its facts. This failure to follow *Appalachian Coals* so soon after it was decided indicates that the Supreme Court's application in that case of the rule of reason to a price fixing conspiracy was an aberration.

¹¹³ Generally, the rule of reason is applied to vertical arrangements, *i.e.*, agreements between a manufacturer and its distributors, suppliers and manufacturers, or wholesalers and retailers, rather than to horizontal agreements between competitors. Thus, it is in the area of vertical restraints that the courts have been able to consider such factors as the economic condition of the entity imposing the restraint. The exception is resale price maintenance, a vertical restraint which constitutes a *per se* violation of § 1. See, *e.g.*, *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 51 n.18 (1977) (*dicta*); *Albrecht v. Herald Co.*, 390 U.S. 145 (1968); *Dr. Miles Medical Co. v. John D. Park & Sons*, 220 U.S. 373 (1911). Indeed, the Department of Justice recently instituted the first criminal felony prosecution of resale price maintenance. *United States v. Cuisinarts, Inc.*, Crim. No. H-80-49 (D. Conn., filed Sept. 17, 1980). On December 19, 1980, Cuisinarts entered a *nolo contendere* plea and was fined \$250,000. [1979-80 Transfer Binder] 4 TRADE REG.

history in the courts. The Supreme Court's approach to such restraints has come full-circle in less than fifteen years. Prior to 1963, the Supreme Court had never even considered a non-price vertical restraint. Several major vertical restraint cases decided thereafter present interesting implications for the failing company defense under section 1.

In the first litigated case involving non-price vertical restraints, *White Motor Co. v. United States*,¹¹⁴ the Government asked the Supreme Court to affirm a district court decision holding that a manufacturer's arrangement restricting the territory of its dealers was per se illegal.¹¹⁵ The defendant in *White Motor* was not a failing company, but in dictum the Court analogized to the "failing company doctrine" and noted that in such instances a merger that would otherwise offend the antitrust laws may be given immunity, implying that business failure might immunize an otherwise unlawful vertical restraint.¹¹⁶

In the wake of *White Motor*, the FTC challenged vertical territorial restraints under section 5 of the Federal Trade Commission Act in *Sandura Co. v. Federal Trade Commission*.¹¹⁷ Sandura was a small floor covering manufacturer that suffered several product failures which nearly forced it into bankruptcy. Its market share was declining in an industry dominated by large firms, and it had difficulty attracting new distributors. The FTC attacked Sandura's policy of assigning its distributors exclusive territories and requiring its distributors to sell only to retailers. The FTC considered Sandura's marginal position, but concluded that because it was not a failing company, it could not justify its use of vertical restraints.¹¹⁸ The FTC found that forbidding distributors from selling in each other's territory re-

REP. (CCH) ¶ 45,080. Certain commentators, however, have questioned the continuing validity of the per se status of resale price maintenance. See, e.g., Posner, *The Rule of Reason and the Economic Approach: Reflections on the Sylvania Decision*, 45 U. CHI. L. REV. 1, 7-10 (1977); Note, *Sylvania and Vertical Restraints on Distribution*, 19 B.C.L. REV. 751, 769-71 (1978). The commentators have suggested that resale price maintenance may promote interbrand competition by encouraging dealers to provide pre-sale services.

¹¹⁴ 372 U.S. 253 (1963).

¹¹⁵ The district court in *White Motor* had made such a finding. 194 F. Supp. 562 (N.D. Ohio 1961), *rev'd*, 372 U.S. 253 (1963); See also ABA ANTITRUST LAW SECTION, VERTICAL RESTRICTIONS LIMITING INTRABRAND COMPETITION 7-8 (Monograph No. 2 1977). Because *White Motor* was the first vertical territorial restraint case to reach the Supreme Court, it refused to apply a per se test. 372 U.S. at 261, 263.

¹¹⁶ 372 U.S. at 263-64.

¹¹⁷ *In re Sandura Co.*, 61 F.T.C. 756 (1962), *rev'd*, 339 F.2d 847 (6th Cir. 1964). Section 5 provides in pertinent part "[u]nfair methods of competition in commerce, and unfair or deceptive acts or practices in commerce, are hereby declared unlawful." 15 U.S.C. § 45(a)(1) (1976).

¹¹⁸ 61 F.T.C. at 809-16.

strained competition among them and held that the vertical territorial restraints imposed by Sandura was an "unfair method of competition" under section 5 of the Federal Trade Commission Act.¹¹⁹

The Sixth Circuit reversed.¹²⁰ Making it clear that it was using a rule of reason approach¹²¹ and relying on *White Motor*,¹²² the court held that Sandura's territorial restrictions were justified.¹²³ The court emphasized Sandura's faltering financial condition and marginal competitive status¹²⁴ in holding that Sandura would have been unable to market its products successfully in the absence of its closed territories policy.¹²⁵ The result would have been a decline in interbrand competition, because Sandura would have ceased competition with other manufacturers.¹²⁶

Only four years after it declined to find that vertical territorial restraints were per se unlawful in *White Motor*, the Supreme Court adopted a per se rule for vertical territorial restraints in *United States v. Arnold Schwinn & Co.*¹²⁷ In adopting a per se

¹¹⁹ *Id.* at 809.

¹²⁰ 339 F.2d at 858-59.

¹²¹ *Id.* at 849.

¹²² *Id.* at 853-54.

¹²³ *Id.* at 857.

¹²⁴ *Id.* at 851-53. The court agreed with the FTC that Sandura was not a "failing company." *Id.* at 855-56.

¹²⁵ *Id.* at 857.

¹²⁶ *Id.* A similar conclusion was reached in *Snap-On Tools Corp. v. FTC*, 321 F.2d 825 (7th Cir. 1963), which involved a small manufacturer in a highly competitive industry. The court accepted Snap-On's claim that territorial restraints were necessary to limit dealer turnover. *Id.* at 831-32.

¹²⁷ 388 U.S. 365 (1967). Schwinn had adopted its distribution plan, which assigned dealers to specific territories and barred them from acting as wholesalers, when Schwinn was the nation's largest bicycle manufacturer. *Id.* 368, 370-71. Justice Fortas noted that Schwinn therefore did not fall within the failing company example used in *White Motor*. *Id.* at 374. Although the opinion noted that the Court should focus on the competitive effect of the restraint, *id.* at 374, 379-80, no detailed economic analysis was used. In fact, Justice Stewart's opinion notes that the Court has adopted a per se rule without considering the "function, purpose or effect" of the restraint. 388 U.S. at 388 (Stewart, J., concurring in part and dissenting in part). Justice Stewart noted that the district court had found that Schwinn's distribution restraints enhanced competition. *Id.* at 386. He was particularly critical of the Court for adopting a per se rule only four years after concluding in *White Motor* that it lacked sufficient experience with non-price vertical restraints to use a per se test. *Id.* at 389. Instead, the Court assumed that such restraints were anticompetitive when the manufacturer sold the product to a distributor: "Under the Sherman Act, it is unreasonable without more for a manufacturer to seek to restrict and confine areas or persons with whom an article may be traded after the manufacturer has parted with dominion over it." *Id.* at 379.

Although the Government had not argued for a per se rule, *id.* at 373, the Court nonetheless adopted one and declined to follow its earlier decision in *White Motor* that it did not know enough about the competitive effect of vertical restraints to hold them unreasonable on their face. The Government had argued that vertical restrictions should be

rule, however, the *Schwinn* Court referred to the "failing company" example used in *White Motor*, and thereby preserved an exception to its new per se test: vertical restrictions might be justifiable if imposed by a manufacturer who would be unable to compete without them. Several lower courts recognized the validity of the failing company justification in dicta.¹²⁸ Even the Department of Justice indicated that that *Schwinn* left some room for special economic justifications of vertical restraints:

The law as it stands does not, it seems to us, bar all consideration of special economic justification for territorial restraints. First of all, the cases establishing so-called per se rules against exclusive territory agreements, *Schwinn* and *Topco*, appear to leave room for exceptions. The Court in *Schwinn* mentioned "possible factors" which might "shelter" vertical restraints from the per se rule. The Court said that in the Schwinn Company's own context the territory and customer restrictions were "unreasonable *without more*" (emphasis added). What "more" might suffice was not fully explained, but the Court did note its *White Motor Co.* decision, in which the existence of a failing company or a newcomer seeking to break into a market were mentioned as possible justifications for territorial agreements.¹²⁹

Nonetheless, no court actually relied on a manufacturer's faltering economic condition in upholding non-price vertical re-

presumed illegal unless the manufacturer could justify the restraint. See Posner, *The Rule of Reason and the Economic Approach: Reflections on the Sylvania Decision*, 45 U. CHI. L. REV. 1, 2-3 (1977) (Professor Posner argued *Schwinn* for the United States).

¹²⁸ See *Copper Liquor, Inc. v. Adolph Coors Co.*, 506 F.2d 934, 945 (5th Cir. 1975); *Ammerman v. Bestline Products, Inc.*, 352 F. Supp. 1077, 1080 (E.D. Wis. 1973).

Dissatisfaction with *Schwinn* led lower courts to develop several exceptions to the per se rule, including: health and safety, e.g., *Tripoli Co., Inc. v. Wella Corp.*, 425 F.2d 932 (3d Cir.), cert. denied, 400 U.S. 831 (1970); exclusive distributorships imposed unilaterally, e.g., *Colorado Pump & Supply Co. v. Febco, Inc.*, 472 F.2d 637 (10th Cir.), cert. denied, 411 U.S. 987 (1973); or restrictions that were not enforced, e.g., *Janel Sales Corp. v. Lanvin Parfums, Inc.*, 396 F.2d 398 (2d Cir.), cert. denied, 393 U.S. 938 (1968). See generally ABA ANTITRUST LAW SECTION, VERTICAL RESTRICTIONS LIMITING INTRABRAND COMPETITION 14-20 (Monograph No. 2 1977); Note, *Exceptions to Schwinn's Per Se Rule: Their Validity and Implications for the Future*, 31 WASH. & LEE L. REV. 643 (1974).

¹²⁹ *Proposed Amendments to the Federal Trade Commission Act: Hearings Before the Subcomm. on Consumer Protection of the House Comm. on Interstate and Foreign Commerce on Exclusive Territorial Franchises*, 94th Cong., 1st Sess. 51 (1975); accord, *Hearings Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce on Exclusive Territorial Franchise Act*, 93d Cong., 2d Sess. 18 (1974).

straints until *GTE Sylvania Inc. v. Continental T.V., Inc.*¹³⁰ Sylvania, a subsidiary of General Telephone & Electric Co., manufactured televisions. The domestic television industry was dominated by two giants, RCA and Zenith, and Sylvania found itself unable to compete. In 1962, with a market share of approximately one or two percent, Sylvania instituted a selective distribution system designed to develop aggressive, effective dealers.¹³¹ Continental, a former Sylvania dealer, alleged that Sylvania's location restriction constituted a per se violation of section 1.¹³² The trial court instructed the jury that it could not consider the reasonableness of Sylvania's location clause. Relying on *Schwinn*, the court rejected a proposed Sylvania instruction that would have allowed a finding of a violation only if the location clause unreasonably restrained competition.¹³³ The district judge also rejected a proposed Sylvania "failing company" instruction to the effect that the location clause was reasonable if it enabled Sylvania to remain in the industry or to compete effectively.¹³⁴ Not surprisingly, the jury returned a verdict for Continental.¹³⁵

On appeal, the Ninth Circuit concluded that the district court erred in rejecting Sylvania's proposed rule of reason instructions.¹³⁶ The court distinguished *Schwinn* based on the size and

¹³⁰ 537 F.2d 980 (9th Cir. 1976), *aff'd*, 433 U.S. 36 (1977).

¹³¹ 537 F.2d at 984. Sylvania dealers were authorized to sell Sylvania products only at designated locations and were unable to move Sylvania merchandise to a new location without prior approval. No dealer was given an exclusive territory, however, and no dealer was able to veto the establishment of a new dealer in its market. Through the use of this new distribution system, Sylvania's market share increased to approximately five percent, making it the eighth largest domestic television manufacturer.

Continental T.V. was a successful Sylvania dealer in Northern California. When Sylvania franchised a new dealer near one of Continental's stores, Continental objected and reduced its orders from Sylvania. In 1965, Continental opened a new store in Sacramento and sought Sylvania's approval to sell there, but Sylvania denied the request. When Continental ignored Sylvania's refusal and sold Sylvania merchandise in Sacramento, Sylvania terminated Continental's franchise and Sylvania's finance company sued Continental for unrepaid loans. Continental counterclaimed alleging a violation of § 1.

¹³² 537 F.2d at 985.

¹³³ *Id.* at 987. The trial court judge was Associate Justice Tom C. Clark (Ret.), sitting by designation. *Id.* at 987 n.10. Justice Clark had dissented in *White Motor* and argued for a per se rule invalidating all vertical restraints. *White Motor Co. v. United States*, 372 U.S. 253, 275-83 (1963) (Clark, J., dissenting).

¹³⁴ 537 F.2d at 987.

¹³⁵ *Id.* at 986.

¹³⁶ *Id.* at 988. The Ninth Circuit distinguished *Schwinn* on its facts because *Schwinn's* territorial restrictions required dealers to sell only in their exclusive territories and prevented dealers from competing for customers outside their territories. Sylvania dealers, on the other hand, could advertise in any area and could sell to anyone as long as they sold from an approved location. *Id.* at 989-90. Moreover, Sylvania had at least two dealers in every market. *Id.* at 990. In separate opinions, Judge Kilkenny and Judge Brown-

effectiveness of the two manufacturers.¹³⁷ Schwinn was the largest domestic bicycle manufacturer, while Sylvania, at the time it instituted the location clause, had less than a two percent market share. Sylvania's location clause enabled it to grow to a respectable five percent market share, thereby permitting it to remain in the market as a viable interbrand competitor, while preserving some intrabrand competition.¹³⁸ Although the Ninth Circuit found it unnecessary to decide whether the proposed "failing company" instruction should have been given, the language of the opinion indicates approval of the concept of such an instruction:

[Schwinn] indicates that the [failing company] defense is also available in cases wherein a vertical restraint is being challenged. The Court in *Schwinn* clearly indicated its intent that the failing company defense, once shown, would then subject the case to the rule of reason and the per se rule would not be applicable.¹³⁹

The Supreme Court's opinion in *Sylvania* focused principally on two points: the importance of interbrand competition and the need to overrule *Schwinn*. Justice Powell's opinion recognized that *Schwinn* allowed an exception to the per se rule for failing companies,¹⁴⁰ but held that "the advantages of vertical restric-

ing disagreed with the majority's efforts to distinguish *Schwinn*. *Id.* at 1008-12 (Kilkenny, J., dissenting); *id.* at 1021-25 (Browning, J., dissenting).

¹³⁷ *Id.* at 991.

¹³⁸ *Id.* at 991, 1000-2. The Ninth Circuit relied on Justice Brennan's concurrence in *White Motor* in which he emphasized that some vertical restraints promote competition by permitting products to be marketed effectively. *Id.* at 990-91, citing *White Motor Co. v. United States*, 372 U.S. 253, 269, 272 (1963) (Brennan, J., concurring). It also cited an FTC report that stated "in *Schwinn*, the Court left enough leeway in its initial threshold test of the overall reasonableness of vertical arrangements to enable a manufacturer to justify such an arrangement by establishing that it could not have entered the market or expanded its market share" 527 F.2d at 996-97, citing FTC, REPORT OF AD HOC COMM. ON FRANCHISING 30 (1969).

¹³⁹ 537 F.2d at 1004 n.41.

¹⁴⁰ *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 353-54 n.22 (1977). The Supreme Court chose to use *Sylvania* to reconsider *Schwinn*. Justice Powell noted that in *White Motor*, decided only four years before *Schwinn*, the Court refused to adopt a per se test. *Id.* at 47. Powell's opinion utilized the detailed economic analysis that *Schwinn* had endorsed but not applied. See also *United States v. General Dynamics Corp.*, 415 U.S. 486 (1974), and *United States v. Container Corp.*, 393 U.S. 333 (1969), where the Court also emphasized the importance of detailed economic analysis. While recognizing that vertical restrictions reduce intrabrand competition, Justice Powell chose to emphasize the primary importance of interbrand competition and noted that vertical restraints can promote efficiencies and aggressive marketing. 433 U.S. at 54-55. The marketing efficiencies recognized by the Court included: inducing retailers to make the investments necessary to permit manufacturers to enter new markets, encouraging retailers to pro-

tions should not be limited to the categories of new entrants and failing firms. Sylvania was faltering, if not failing, and we think it would be unduly artificial to deny it the use of valuable competitive tools."¹⁴¹ Thus, the Court acknowledged the special problems of failing companies, but also concluded that many companies, even those that are successful, may compete more effectively by imposing vertical restraints. As a result, the Court overruled *Schwinn* and returned to a rule of reason analysis of non-price vertical restraints.¹⁴²

The Court could have stressed the failing company aspect of *Sylvania* to a greater degree. Justice White, in an opinion concurring in the judgment, argued that by relying on the language in *Schwinn* concerning failing companies, the Court could have upheld Sylvania's marketing restraints by "refusing to extend *Schwinn* to a vertical restraint that is imposed by a 'faltering' manufacturer with a 'precarious' position in a generic product market dominated by another firm."¹⁴³ Sylvania's faltering condition had been part of the Ninth Circuit's basis for distinguishing *Schwinn*. The fact that the Court failed to adopt Justice White's argument suggests that the Court was looking for an opportunity to overrule *Schwinn*. Justice Powell's majority opinion cited the criticism of *Schwinn* by both lower courts and legal scholars.¹⁴⁴ This criticism, together with the Court's new emphasis on the importance of economic analysis, may have led to the decision to overrule rather than distinguish *Schwinn*.

Nonetheless, on remand, the district court relied principally on Sylvania's faltering financial status at the time the restraint was imposed in granting Sylvania's motion for summary judgment.¹⁴⁵ The court stated that "prior to 1965, defendant was a

vide product service and repair facilities, encouraging retailer promotion, eliminating "free-rider" distributors who provided no services to customers, limiting product liability problems, and compliance with federal laws concerning product safety and warranties. *Id.* at 54-55 & n.23.

¹⁴¹ *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. at 58 n.29.

¹⁴² *Id.* at 57-59. The Court left open the possibility that certain vertical restraints might be illegal per se provided that such a finding was "based upon demonstrable economic effect rather than — as in *Schwinn* — upon formalistic line drawing." *Id.* at 58-59.

¹⁴³ Justice White's concurring opinion agreed with the Ninth Circuit that *Schwinn* could be distinguished on the grounds that Sylvania's location clause imposed fewer restrictions on retailers. 433 U.S. at 59-61 (White, J., concurring). He also agreed that Sylvania's status as a faltering competitor with a small market share brought it within the exceptions to the per se rule for failing companies suggested in *Schwinn*. *Id.* at 64-65.

¹⁴⁴ 433 U.S. at 47-48 and nn.13, 14.

¹⁴⁵ *Continental T.V., Inc. v. GTE Sylvania Inc.*, 461 F. Supp. 1046 (N.D. Cal. 1978), appeal docketed, No. 79-4131 (9th Cir. 1978).

'faltering, if not a failing,' firm in the television industry," and that Continental had become an effective interbrand competitor¹⁴⁶ by implementing vertical territorial restrictions.¹⁴⁷ Thus, the failing company aspect of *Sylvania* did not go unnoticed.¹⁴⁸

The failing company defense in vertical restraint cases has been considered elsewhere, as well. In *Beltone Electronics Corp.*,¹⁴⁹ an FTC administrative law judge rejected a hearing aid manufacturer's claim that its "faltering" company status justified its assignment of exclusive territories to its dealers, which was found to limit both intrabrand and interbrand competition.¹⁵⁰ The administrative law judge discounted Beltone's showing that its sales and market share had declined and that it had sustained operating losses in recent years, because, among other factors, it remained the largest domestic hearing aid manufacturer.¹⁵¹ He found that its sales decline and losses could be due to non-competitive factors.¹⁵²

Although no other recent cases consider the effect of a manufacturer's failing condition on a rule of reason analysis of vertical restrictions, the Department of Justice's enforcement policy takes a competitor's financial condition into consideration. Richard J. Favretto, Deputy Director of Operations of the Antitrust Division, identified three factors that the Department will consider in deciding whether to challenge non-price vertical re-

¹⁴⁶ *Id.* at 1052.

¹⁴⁷ The conclusion that its restricted marketing program made *Sylvania* an effective competitor may have been premature. GTE has announced its intention to sell its television business, including both *Sylvania* and *Philco*. *Wall St. J.*, Oct. 3, 1980, at 4, col. 2. GTE's president commented, "we aren't viable in the marketplace as a competitor and we're prepared to exit the business if this doesn't go through." *Id.*

¹⁴⁸ Balancing the benefits to interbrand competition against the damage to intrabrand competition presumably will be achieved through expert economic testimony and analysis of the special competitive problems of the industry in question.

¹⁴⁹ Dkt. No. 8928 (F.T.C. filed June 27, 1980) [hereinafter cited as *Beltone Initial Decision*]. In an earlier decision based on *Schwinn*, Beltone's distribution system had been held to violate § 5 of the FTC Act. *Beltone Electronics Corp.*, Dkt. No. 8928 (F.T.C. Initial Decision, filed Sept. 7, 1976), summarized in [1976-79 Transfer Binder] *TRADE REG. REP. (CCH)* ¶ 21,198. After the Supreme Court overruled *Schwinn* in *Sylvania*, the FTC remanded the case to the Administrative Law Judge for a thorough examination of effects of Beltone's distribution plan on interbrand and intrabrand competition. 91 F.T.C. 84, 85 (1978). An appeal of the Administrative Law Judge's supplemented Initial Decision is pending before the FTC.

¹⁵⁰ *Beltone Initial Decision*, *supra* note 149, at 23-28.

¹⁵¹ From 1972 to 1977, Beltone's market share fell from 21% to 16%. *Id.* at 15. During the last five years, domestic hearing aid sales, not including Beltone, declined 4.5%, while Beltone's sales declined 22%. *Id.* at 13. Beltone sustained operating losses for 1976-79. *Id.* The FTC staff claimed that because Beltone was closely-held, it had little pressure to show a profit, and that a large portion of its losses were attributable to excessive officers' salaries. 99 FTC: Watch 1-3 (June 27, 1980).

¹⁵² *Beltone Initial Decision*, *supra* note 149, at 26.

straints: the market power of the company imposing the restraint, the extent to which the restraint impedes intrabrand competition, and its justification in terms of enhanced interbrand competition.¹⁵³ He also stated:

I think the Division is not likely to challenge non-price vertical restraints being used by new entrants or by marginal competitors like Sylvania who may be akin to the failing company found in merger law. It seems to be generally accepted among many economists and businessmen that vertical restraints can facilitate entry and continued market presence of small manufacturers by permitting them to secure the services of capable dealers and to build a favorable image. This promotes interbrand competition while imposing limitations on intrabrand competition that are not particularly significant.¹⁵⁴

D. Applying the Failing Company Doctrine in Section 1 Actions: Problem Areas

For purposes of section 1, financial difficulties will be relevant principally as an element to be considered in applying the rule of reason in contrast with the use of the failing company doctrine as an affirmative defense in merger litigation. It seems unlikely that a company can successfully use financial difficulties to justify a per se violation.¹⁵⁵

The failing company doctrine as applied in section 1 cases, however, does bear some resemblance to an affirmative defense, raising questions as to allocating the burden of proof. Traditionally the plaintiff in an antitrust case bears the burden of proving that certain conduct is unreasonable. The defendant (or respondent in an FTC case), however, presumably would raise the issue of financial difficulties in the first instance in an attempt to rebut such a showing and to justify any restraint it had imposed. Thus, in *Sandura* the respondent established that product fail-

¹⁵³ Speech given by Richard J. Favretto on May 12, 1978, before the Southwestern Legal Foundation Symposium on Antitrust Law in Dallas, Texas, reprinted in 5 TRADE REG. REP. (CCH) ¶ 50,370 at 55,801.

¹⁵⁴ *Id.* at 55,803.

¹⁵⁵ The Court hinted in *Schwinn* that the per se rule concerning vertical restraints might be inapplicable to a failing company, thus raising the possibility that failing companies might raise the doctrine as a defense to a per se charge. It seems unlikely, however, that even business failures could justify price-fixing or a tying arrangement. See *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 216 (1940).

ures threatened its competitive viability and that territorial restraints were necessary to build an effective distribution system. Similarly, Sylvania established that it was a "faltering, if not a failing, firm,"¹⁵⁶ and that its use of vertical restraints permitted it to become a real competitor in the television industry.¹⁵⁷ Information concerning financial difficulties or other business problems is known principally by the defendant company. Presumably the courts will require the defendant to make whatever showing is necessary to establish that its imposition of marketing restraints was reasonable. This approach seems more appropriate than requiring a plaintiff to establish that the defendant is not a failing company as part of its case.

The issue then becomes what the defendant company must prove. In *Sandura* the respondent was a small competitor in a field dominated by large companies. Its product failures nearly forced it into bankruptcy before it began to market a new product successfully through the use of territorial restraints on distributors. The court found that Sandura's position was even more precarious than that of a new entrant because it had to overcome the reputation of its past product failures.¹⁵⁸ Sylvania's competitive position was similar to Sandura's — a small competitor (between one and two percent of the market) in an industry dominated by a large competitor with a 60 percent market share.¹⁵⁹ Sylvania's market share was so small that it was threatened with expulsion from the television market.¹⁶⁰ Sylvania's limited distribution system enabled it to raise its market share to five percent.¹⁶¹

Under the failing company defense as applied in merger cases, the defendant must prove that the acquired company faced the imminent danger of business failure.¹⁶² In *Sandura* and *Sylvania* a less rigorous standard was applied: the defendants were faltering rather than failing. Thus, a defendant can justify certain non-price vertical restraints by establishing that it is a marginal competitor and need not prove that it actually is failing. This standard seems appropriate because the principal concern

¹⁵⁶ *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 461 F. Supp. 1046, 1052 (N.D. Cal. 1978), *appeal docketed*, No. 79-4131 (9th Cir.).

¹⁵⁷ *GTE Sylvania Inc. v. Continental T.V., Inc.*, 537 F.2d 980, 991 (9th Cir. 1976), *aff'd*, 433 U.S. 36 (1977).

¹⁵⁸ *Sandura Co. v. FTC*, 339 F.2d 847, 851 (6th Cir. 1964).

¹⁵⁹ *GTE Sylvania Inc. v. Continental T.V., Inc.*, 537 F.2d 980, 982 (9th Cir. 1976), *aff'd*, 433 U.S. 36 (1977).

¹⁶⁰ *Id.* at 983 n.2.

¹⁶¹ *Id.* at 984.

¹⁶² See notes 21-30 and 40-44 and accompanying text *supra*.

under section 1 is interbrand competition. The continued viability or strengthening of a marginal competitor promotes interbrand competition and may reduce industry concentration, or at least prevent increased concentration through the loss of a competitor. Thus, a company with a small share of a concentrated market that is experiencing financial difficulties may be allowed to impose restraints that would be unlawful if imposed by a larger, financially-secure competitor.

The question arises whether a defendant would lose its financial difficulties justification if, as a result of the restraint, it became tremendously successful. It is unlikely that such a radical alteration in competitive strength could occur within even the extended period of time required to try an antitrust case. But assuming, however, that a defendant's competitive position improved significantly, the courts should not necessarily hold any restraints it utilized to become a strong competitor to be unreasonable. The restraint might nonetheless promote interbrand competition. Moreover, nothing in *Sylvania* suggests that a firm with a significant market share cannot impose non-price restraints, provided some legitimate justification exists.¹⁶³

E. Interpretation by Federal Enforcement Agencies

As discussed in Part IB above, the FTC and the Department of Justice Antitrust Division have different interpretations of the failing company defense in merger actions.¹⁶⁴ The testimony given by the two federal enforcement agencies before a Subcommittee of the Senate Judiciary Committee highlighted those differences.¹⁶⁵ Although less evidence exists of the manner in which the FTC and Justice Department will deal with a financially-

¹⁶³ Several commentators have suggested that market power may be a basis for finding certain vertical restraints to be unlawful. See, e.g., Louis, *Vertical Distribution Restraints After Sylvania: A Postscript and Comment*, 76 MICH. L. REV. 265, 272 (1977); Pitofsky, *The Sylvania Case: Antitrust Analysis of Non-Price Vertical Restrictions*, 78 COLUM. L. REV. 1, 35-36 (1978); Posner, *The Rule of Reason and the Economic Approach: Reflections on the Sylvania Decision*, 45 U. CHI. L. REV. 1, 17-18 (1977). In one recent case, however, the court upheld territorial restraints imposed by a manufacturer with a 70% market share without even discussing the problem of market power. *Crowley v. Braden Indus.*, [1980-1] TRADE CAS. ¶ 63,134 (9th Cir. 1980).

In *United States v. Jerrold Electronics Corp.*, 187 F. Supp. 545 (E.D. Pa. 1960), *aff'd per curiam*, 365 U.S. 567, the court permitted a new entrant to utilize an otherwise unlawful tying arrangement, but noted that if such restraints were continued beyond the time reasonably necessary to protect the new entrant's business interests, they would become illegal.

¹⁶⁴ See notes 39-70 and accompanying text *supra*.

¹⁶⁵ See *id.*

troubled company that is charged with a violation of section 1, some of the differences that characterized their approaches to merger issues may be equally applicable under section 1.

The FTC generally construes the requirements of the failing company defense in merger cases more strictly than does the Antitrust Division. On the basis of the FTC's decisions in *Sandura*¹⁶⁶ and *Beltone*,¹⁶⁷ it appears that the FTC is not receptive to claims of financial difficulties. In *Sandura* the FTC rejected Sandura's argument that its marketing restraints were justified by its precarious financial condition.¹⁶⁸ Similarly, an FTC administrative law judge discounted Beltone's claim that its recent marketing losses and declining sales justified the territorial restraints it imposed on dealers.¹⁶⁹ These decisions indicate that the FTC is generally skeptical about attempts to justify marketing restraints on grounds of financial difficulties.

The only evidence to date of the Antitrust Division's position on this question is the public statements made by Justice Department officials. In the wake of *Schwinn*, the Department recognized that although territorial restraints were per se illegal, *Schwinn* left "some room . . . for consideration of the economic exigencies of particular situations."¹⁷⁰ In a speech given after *Sylvania* overruled *Schwinn*, a spokesman for the Antitrust Division indicated that the Division is not likely to challenge vertical restraints imposed by marginal competitors "who may be akin to the failing company found in merger law."¹⁷¹ Thus, the Antitrust Division's interpretation of the failing company doctrine for purposes of section 1, like its interpretation of the doctrine in merger cases, may be less strict than that of the FTC.

The Antitrust Division's views seem more consistent with both the tone of the Supreme Court's decision in *Sylvania* and the competitive realities that the Court indicated should be of primary importance under the rule of reason. The Supreme Court's opinion in *Sylvania* shows a clear appreciation of the special problems confronting a marginal company in a competitive industry. The Court recognized that vertical restraints may promote interbrand competition by allowing a marginal competitor

¹⁶⁶ *Sandura Co.*, 61 F.T.C. 756 (1962), *rev'd*, 339 F.2d 847 (6th Cir. 1964).

¹⁶⁷ *Beltone Electronics Corp.*, Dkt. No. 8928 (F.T.C. filed June 27, 1980).

¹⁶⁸ *Sandura Co.*, 61 F.T.C. 756, 809-16 (1962), *rev'd*, 339 F.2d 847 (6th Cir. 1964).

¹⁶⁹ *Beltone Initial Decision*, *supra* note 149, at 23-28.

¹⁷⁰ *Hearings on Exclusive Territorial Franchise Act Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce*, 93d Cong., 2d Sess. 18 (1974) (statement of Bruce B. Wilson, Deputy Assistant Attorney General).

¹⁷¹ See notes 153-54 and accompanying text *supra*.

to attempt to develop an aggressive, effective distribution system.

Thus the failing company presumably will find it much easier to justify marketing restrictions than a successful competitor. Failing companies lack the market power that could make vertical restraints imposed by dominant companies seem unreasonable. As in the case of *Sylvania* or *Sandura*, vertical restraints may permit a manufacturer to remain in the market and perhaps to become a significant, viable competitor. When faced with the alternative of some restriction on intrabrand competition or the reduction of interbrand competition through the loss of a competitor, the courts should and probably will allow failing companies to utilize vertical restraints, perhaps even in circumstances where a more successful competitor would not be allowed to do so.

CONCLUSION

The continuing controversy surrounding the application of the failing company doctrine under section 7 of the Clayton Act, and the revitalization of the rule of reason analysis under section 1 of the Sherman Act, indicate that the financial condition of a company charged with violating the antitrust laws will remain a significant factor in judicial evaluation of such conduct. In fact, there are indications that the courts today are especially conscious of the special problems facing a failing company. The courts' sympathetic response to the plight of the failing company seems legitimate and appropriate, provided that the courts remain aware that the primary concern of the antitrust laws must remain the preservation of competition, not the implementation of social policy, a matter for Congress, not the courts. The courts have recognized that in some instances permitting a failing company to engage in arguably unlawful conduct may promote rather than restrain competition. The majority of the cases in which a company's financial condition has operated as an exception to the antitrust laws appear to have been decided correctly. In most such cases, the courts have focused first on the competitive effect of the practice, and merely included the defendant's faltering financial condition as one element in that analysis. Thus, assuming that they apply the proper standards,

the courts can and should give consideration to the economic condition of litigants in interpreting the antitrust laws.

