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Antitrust - Merger - Divestiture Action

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Recent Decisions

ANTITRUST—MERGER—DIVESTITURE ACTION—The Supreme Court of the United States has held that the failing company doctrine cannot successfully be invoked as a defense to an anti-merger action unless defendant establishes both that the acquiring company is the only available purchaser and that there is dim or non-existent hope for reorganization of the failing company through bankruptcy procedures.

Citizen Publishing Company v. United States, 89 S. Ct. 927 (1969).

Two daily newspapers, the Citizen and the Star, are published in Tucson, Arizona. Prior to 1940 each was wholly independent; there was vigorous competition between them; they had entered into no agreements or accommodations which would cushion the effects of that competition upon them. In 1940, while the two papers enjoyed almost equal circulation, the Citizen found itself to be suffering average annual losses of about $24,000 while the Star's average annual profit approximated $26,000. In that year a joint operating agreement was concluded between the competitors whereby Tucson Newspapers, Inc., wholly owned by the stockholders of the Citizen and the Star, was formed to manage all the business of both papers; only their news and editorial departments retained independence. In addition to this joint operating agreement, a Stock Agreement was entered into by the terms of which the stockholders of each newspaper were given the option to purchase should the stockholders of the other desire to sell.[1] In 1964 the owners of the Star decided to sell their newspaper and received an offer to buy from Brush-Moore Newspapers, Inc.[2] Stockholders of the Citizen prevented sale of the Star to Brush-Moore by exercising their option under the Stock Agreement, becoming themselves owners of the Star.[3] Citizen stockholders formed Arden Publishing Company as the vehicle for acquisition of the Star stock, and Arden was publisher of that paper at the time of the instant litigation. The Department of Justice brought suit under sections 1 and 2 of the Sherman Act[4] and under section 7 of the Clayton Act[5] seeking mod-

1. United States v. Citizen Publishing Company, 280 F. Supp. 978 (D. Arizona 1968).
2. *Id.*
3. *Id.*
4. 15 U.S.C. §§ 1, 2 (1890).

ification of the joint operating agreement and divestiture of Star stock by the stockholders of the Citizen.

The Supreme Court, Mr. Justice Douglas speaking for the Court, affirmed the order of the lower court requiring modification of the joint operating agreement and divestiture of the Star and its reestablishment as an independent entity. The judgment of the District Court that the joint operating agreement constituted a *per se* violation of section 1 of the Sherman Act[6] was affirmed with minimal comment by the Supreme Court. The remainder of the high Court's brief opinion was taken up in consideration of the so called "failing company" defense to the alleged violations of section 2 of the Sherman Act[7] and of section 7 of the Clayton Act.[8] In concluding that the failing company defense was not applicable, the Court focused its attention on two heretofore unsettled propositions,[9] that the defense does not apply, "unless it is established that the company that acquires it . . . is the only available purchaser"[10] and that the defense does not become available until it is made to appear that the prospect for reorganization of the putative failing company either through receivership or through Chapter X[11] or Chapter XI[12] of the Bankruptcy Act is "dim or non-existent".[13]

The failing company doctrine has had a long but relatively uneventful judicial history characterized by prolonged silences punctuated only infrequently by an opinion which serves to shed light on the subject. Only once prior to the instant case has a Supreme Court ruling turned on the doctrine.[14] In that case a complaint was brought by the Federal Trade Commission under the original section 7 of the Clayton Act[15] alleging that a violation of the Act had resulted from

5. 15 U.S.C. § 18 (1964), formerly 38 Stat. 631 (1914).
6. 15 U.S.C. § 1 (1890).
7. 15 U.S.C. § 2 (1890).
8. 15 U.S.C. § 18 (1964), formerly 38 Stat. 631 (1914).
9. *See* Low, *The Failing Company Doctrine: An Illusive Economic Defense under Section 7 of the Clayton Act*, 35 FORDHAM L. REV. 425 (1966).
10. Citizen Publishing Company v. United States, 89 S. Ct. 927 (1969) at 931.
11. Chandler Act 11 U.S.C. § 501 *et. seq.*
12. Chandler Act 11 U.S.C. § 701 *et. seq.*
13. 89 S. Ct. at 931.
14. International Shoe Co. v. F.T.C., 280 U.S. 291 (1930).
15. As enacted in 1914, section 7 provided:

No corporation . . . shall acquire . . . stock or other share capital of another corporation where the effect of such acquisition may be to substantially lessen competition between the corporation whose stock is so acquired and the corporation making the acquisition. . .

In 1950 section 7 was amended by the Cellar-Kefauver Act to its present form which provides:

the acquisition by International Shoe of the stock of the W. H. McElwain Co., like International, a producer of men's shoes. After extended consideration of the amount of competition between the two manufacturers the Court looked to the financial status of McElwain for an alternative ground for its holding against the Government. It was in this discussion that the first and fullest judicial statement of the doctrine appeared:

> In 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.[16]

The doctrine thus enunciated had had its origins in the opinions in two Sherman Act cases decided prior to *International Shoe*, one delivered by the Supreme Court,[17] the other by the Court of Appeals for the Seventh Circuit.[18] In the *U. S. Steel* litigation, decided by the Supreme Court, the Government sought the dissolution of the United States Steel Company on the grounds that practices surrounding its organization and its operating practices violated the Sherman Act. In one portion of its opinion the Court was called upon to determine whether U.S. Steel's acquisition of the Tennessee Coal and Iron Company had been accompanied by the intent to monopolize and, thus, was in violation of the provisions of the Act; the Court found no monopolistic intent, recalling that the acquisition had been sanctioned by President Theodore Roosevelt, that the property was nearly worthless in the hands of the Tennessee Company because of its financial straits and that, under such circumstances, public interest would be served by allowing the Steel Company to take possession of

. . . [N]o corporation engaged in commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital . . . of another corporation engaged also in 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.

16. 280 U.S. at 302, 303.
17. United States v. United States Steel, 251 U.S. 417 (1920).
18. American Press Association v. United States, 245 F. 91 (7th Cir. 1917).

the property, thereby insuring its value and protecting the interests of creditors and the local community.[19]

American Press Association, like *U.S. Steel,* involved the Sherman Act. The parties defendant to that litigation, American Press Association and Western Newspaper Union, had, in 1912, entered into a consent agreement which forbade Western's acquisition of American. In 1917, however, American petitioned for a modification of the decree to allow its purchase by Western. The Circuit Court, in approving the petition, noted that due to World War I conditions were depressed in the newspaper industry, that American's monthly losses exceeded $3000 and that American's directors had determined to wind up its business. Noting that "No one outside the business would be likely to buy a demonstrated loss"[20] the court decided that public interest and that of American's stockholders and creditors would both be served by allowing Western to purchase American.

After 1930, the year of the *International Shoe* decision, the courts had no further occasion to flesh out the skeletal doctrine which they had developed and so it remained, until the flurry of anti-merger activity which followed the 1950 amendment to the Clayton Act,[21] a judicial creation made up of parts (whether equal or not could not be known) of depleted resources, remote prospects of rehabilitation, grave probability of business failure, maximization of public welfare, and, parenthetically, absence of alternate prospective purchasers. Meanwhile, the precise meaning of those parts which had become parts of

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19. We may pause here for a moment to notice illustrations of the Government of the Corporation, instancing its acquisition after its formation of control over the Shelby Steel Tube Company, the Union Steel Company, and, subsequently the Tennessee Company. There is dispute over the reasons for these acquisitions which we shall not detail. There is, however, an important circumstance in connection with that of the Tennessee Company which is worthy to be noted. It was submitted to President Roosevelt and he gave it his approval. His approval, of course, did not make it legal, but it gives assurance of legality, and we know from his earnestness in the public welfare he could have approved of nothing that had even a tendency to its detriment. And he testified he was not deceived and he believed that "the Tennessee Coal and Iron people had a property which was almost worthless in their hands, nearly worthless to them, nearly worthless to the communities in which it was situated, and entirely worthless to any financial institution that had the securities the minute that any panic came, and that the only way to give value to it was to put it in the hands of people whose possession of it would be a guarantee that there was value to it." Such being the emergency it seems like an extreme accusation to say that the Corporation which relieved it, and, perhaps, rescued the company and the communities dependent upon it from disaster, was urged by unworthy motives . . . and it would seem a distempered view of purchase and result to regard them as violations of the law.

251 U.S. at 446.

20. 245 F. at 93.

21. *Supra* note 16.

the doctrine and their relative importance in the eyes of the Court remained uncertain.

Passage of the Cellar-Kefauver Amendment to section 7 of the Clayton Act in 1950 was accompanied by indications in both the House[22] and the Senate[23] of legislative intent to preserve the failing company doctrine as a defense to anti-merger prosecutions. Nowhere in the Congressional debates, however, was the intended scope of the defense determined.[24] With the quickening pace of anti-merger prosecutions after 1950 courts were again confronted with cases in which it was suggested that the doctrine should be applied. In 1962 any doubts which had arisen concerning the continued viability of the defense were apparently silenced. In the course of his opinion in the leading case of *Brown Shoe Co. v. United States*[25] Mr. Chief Justice Warren had occasion to write,

> supporters of the [1950] amendments indicated that it would not impede, for example, a merger between . . . a corporation which is financially healthy and a failing one which no longer can be a vital competitive factor in the market.[26]

In further reference to the doctrine the Chief Justice said,

> The importance which Congress attached to economic purpose is further demonstrated by the Senate and House Reports on H. R. 2734, which evince an intention to preserve the "failing company" doctrine of International Shoe Co. v. Federal Trade Comm'n, 280 U. S. 291.[27]

Brown Shoe served notice that the Court was prepared to hear the failing company defense; it gave no indication of how closely the doctrine would be limited to the *International Shoe* fact situation. In particular, *Brown Shoe* gave no hint of the weight to be attached to the parenthetical limitation regarding absence of alternative prospective purchasers which the Court included in its 1930 definition of the doctrine.[28] The vigor of this limitation had been at issue in *United States v. Diebold, Inc.*,[29] a *per curiam* decision remanding to the District Court which had entered a summary judgment against the

22. H.R. Rep. No. 1191, 81st Cong., 1st Sess. 6 (1949).
23. S. Rep. No. 1775, 81st Cong., 2nd Sess. 7 (1950).
24. *See* Low, *op. cit.*
25. 370 U.S. 294 (1962).
26. *Id.* at p. 319.
27. *Id.* at p. 331.
28. 280 U.S. at 302.
29. 369 U.S. 654 (1962).

Goverment. The Court's basis for remanding was that the determination by the lower court in this anti-merger action that Diebold, the acquiring firm, was the only bona fide prospective purchaser of the allegedly failing company was not properly made in light of the conflicting inference which could be drawn from data upon which the court based its decision to grant summary judgment and that, therefore, it was appropriate to have evidence presented on this issue.[30]

As the pivotal question in *Diebold* had been the relevance of the "no alternative purchaser" requirement, that decision, although less than a definitive statement by the Court, gave at least some support to the belief that such a requirement would be enforced. However, at least one commentator has expressed doubt as to the precedental importance of *Diebold* as it was followed almost immediately by the rather vague dicta in *Brown* in which there was no mention of the requirement, especially in light of the existence of some evidence that that imprecision had been intentional.[31] It seems clear that any lingering doubt on this point has now been removed by the decision in *Citizen Publishing.* In the Court's view, if an alternative to the absorption of a firm by its competitor exists it must be utilized in order that "a unit in the competitive system would be preserved and not lost to monopoly power."[32]

The *Brown Shoe* discussion not only was mute regarding the alternative purchaser requirement, it also ignored the possibility that other methods of saving a failing company might exist which would have to be shown to have been exhausted before a lawful sale or merger could be consummated. This possibility had been raised in *International Shoe* but the Court then rejected the establishment of such a test of legality saying "but; as it seems to us, all of these [suggested requirements] may be dismissed as lying wholly within the realm of speculation."[33] The alternatives to outright sale or merger which had

30. "In determining that the acquisition of the assets of Herring-Hall-Marvin Safe Company was not a violation of § 7, the District Court acted upon its findings that "H.H.M. was hopelessly insolvent and faced with imminent receivership" and that "Diebold was the only bona fide prospective purchaser for H.H.M's business." The latter finding represents at least in part the resolution of a head-on factual controversy of whether other offers for H.H.M.'s assets or business were actually made. . . . The materials before the District Court having thus raised a genuine issue as to the ultimate facts material to the rule of *International Shoe Co. v. Federal Trade Comm'n,* it was improper for the District Court to decide the applicability of the rule on a motion for summary judgment. Fed. Rules Civ. Proc., 56(c).
369 U.S. at 654.

31. Low, *op. cit.*

32. 89 S. Ct. at 931.

33. 280 U.S. at 301.

been there suggested to the Court included borrowing from banks, receivership and proceedings under the Bankruptcy Act. The Court specifically objected to the receivership suggestion on the grounds that the success or failure of the receivership could not be forecast: the suggestion that bankruptcy proceedings be employed was rejected as leaving the fate of the failing company in the hands of its preferred stockholders.

After *International Shoe* no mention was made of the role, if any, to be played by reorganization on bankruptcy proceedings in section 7 litigation until the instant decision was handed down. The high Court now appears to have taken the position that success in reorganization under the bankruptcy laws is sufficiently probable to invalidate the objections which had been voiced in *International Shoe* and that the failing company doctrine will only be honored upon a showing by the party who seeks to invoke its protection that successful reorganization is a remote possibility.

The theoretical justification for the failing company doctrine is to be found in the belief that the passing of a firm in dire financial straits into the hands of a competitor could be marked by little anti-competitive effect[34] and should not, therefore, be prohibited by the antitrust laws. Maintaining the doctrine as an exception provides a solution to several knotty problems which would inhere in following a policy of unrelieved rigor in application of the Clayton Act. The desirability of providing an exception which would enable the assets of the failing firm to be transferred to a new owner as a productive unit, the retention of an exception to facilitate the transfer of ownership from the hands of the sole proprietor whose desire is to be freed of his responsibilities, and the interests of stockholders and creditors of the failing company in avoiding anti-trust complications in attempting to realize the "going concern" value of the failing company are all said to provide cogent reasons for the retention of a loophole in the coverage of the anti-merger laws through which the failing company can pass.[35] In the main it can be said that the commentators have viewed their role as calling for a search for the limits of the doctrine, a search for the balance point where the private benefits of extending the reach of the doctrine are outweighed by harm to the public interest. In this search, facilitating the quick expansion of dominant firms, increasing the reve-

34. G.E. Hale and Rosemary D. Hale, *Failing Firms and the Merger Provisions of the Antitrust Laws*, 52 KENTUCKY L.J. 597 (1962).
35. Derek C. Bok, *Mergers and the Clayton Act*, 74 HARV. L. REV. 226 (1960).

nue producing facilities of dominant firms, forestalling of potential entry, acquisition of sales lists and competitive data by dominant firms, and enhanced potential for vertical integration and market foreclosure have been identified as elements harmful to the public interest which must be weighed against the private benefits realized from application of the doctrine.[36]

Notwithstanding differences among the writers as to its scope, the existence of the doctrine has remained a virtual article of faith, however, at least one recent author has labelled the doctrine a myth,[37] regarding the adoption of the 1950 amendment to section 7 as a death knell. Rather than announcing a "doctrine," the courts, in this analysis, have decided a small group of cases without establishing any generally applicable standard and in their deliberations have applied Sherman Act tests of public interest which are no longer relevant to Clayton Act determinations.

Prior to 1950 Section 7 forbade mergers which had the effect of lessening competition between the merging parties. Since strict application of the statute would have precluded all mergers between competitors, the courts were compelled to apply the rule of reason when called upon to pass judgment on such transactions.[38] In 1950 the amendment to section 7 changed the status of liability from the lessening of competition between competitors to one of lessening of competition in any section of the country.[39] This, it has been suggested, coupled with an indication that Congress' purpose in amending the Clayton Act was to eliminate the reliance on Sherman Act tests,[40] means that Congress has declared that there is to be no judicial modification, no application of the rule of reason, to its prohibition against mergers which lessen competition in any section of the country.

As pointed out in the dissenting opinion by Mr. Justice Stewart, the Court in *Citizen Publishing* sets forth evidentiary requirements which must be met by one invoking the failing company doctrine.[41] In so doing it does not directly comment upon the theoretical dispute as to the dimensions of the doctrine nor does it pass upon the theory that the

36. Philip Sotiroff, *Federal Antitrust Law—Mergers—An Updating of the "Failing Company" Doctrine in the Amended Section 7 Setting.*
37. Martin F. Connor III, *Section 7 of the Clayton Act: The Failing Company Myth,* 49 GEORGETOWN L.J. 84 (1960).
38. *Id.* at p. 94.
39. *Supra* note 15.
40. S. Rep. No. 1775, 81st Cong., 2d Sess. 4 (1950).
41. 89 S. Ct. at 933.

doctrine may be no more than a myth. The Court has, however, for this case resolved the conflict between the Congressionally determined public interest in preserving competition by the prevention of mergers and the private interests of the parties to this merger in favor of the public interest. It is submitted that while the Court has not formally retreated from its contention that the failing company doctrine is a Congressionally mandated exception to the rule against mergers, this case, with all others decided by the Supreme Court in which the failing company doctrine was determinative of the outcome, strongly indicates that should the Court be placed in the position of having to define the scope of the doctrine with precision, that definition will be of a class which has no members.

Although it was the purpose of the Court to "confine the failing company doctrine to its present narrow scope,"[42] *Citizen Publishing*, because of the new importance attached to efforts short of merger to save the failing company, represents a considerable narrowing of the doctrine as it was announced in *International Shoe*.

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TORTS—NEGLIGENCE—LIABILITY OF A LESSOR OF PERSONAL PROPERTY—The Pennsylvania Supreme Court held that the lessor of a truck is not liable to lessee's passenger for injuries which resulted from acts of the lessee, and that Section 390 of the *Restatement (Second) of Torts* is not applicable.

Littles v. Avis Rent-A-Car System, 433 Pa. 72, 248 A.2d 837 (1969).

Plaintiff, a minor, brought an action for injuries suffered while a passenger in a truck leased from defendant, Avis. The truck was leased by one Kemp, who was driving at the time the plaintiff suffered her injuries.

The truck was twenty-four feet long, eight feet wide, approximately eleven feet high[1] and weighed eight tons. Kemp was asked by defendant's agent if he had driven a truck before, and he stated he

42. *Id.* at 931.

1. There is some disagreement in the report as to the height of the truck. The majority referred to a receipt which recited a height of twelve feet. 433 Pa. 72 at 74, 248 A.2d 837 at 838. The dissent stated the truck was eleven feet high. 433 Pa. at 76, 248 A.2d at 839.