Defending the Failing-Firm Defense

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I. INTRODUCTION

In a recent article, Thomas Campbell considers the antitrust law and especially the economics of the “failing-firm” doctrine.1 The doctrine works as an absolute defense when the acquisition of a financially troubled firm by an industry rival is challenged under antitrust law.2 The defense is available whenever the acquired firm faces “the grave probability of a business failure,”3 and “no other acquisition or reorganization [except acquisition by the rival] would keep the failing company in the market with a less significant reduction in competition.”4 The defense originated in the case law, but was later validated

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2. On the failing-firm issue generally, see 4 P. AREEDA & D. TURNER, ANTITRUST LAW §§ 924-31 (1980).
4. Campbell, supra note 1, at 254. See also R. POSNER & F. EASTERBROOK, ANTITRUST CASES, ECONOMIC NOTES AND OTHER MATERIALS 472 (1981): [I]n a curious dictum in Citizen Publ. Co. v. United States, [394 U.S. 131, 138 (1969)], the Court, in an opinion by Mr. Justice Douglas, stated that the defense requires proof not only that the firm is really failing and that no less anticompetitive acquisition offers it a way out . . ., but also that

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Professor Campbell's study is apparently the first attempt at a detailed economic analysis of the failing-firm defense. The prior neglect may be explained by some scholars' and courts' view that the defense rests on non-economic criteria. Campbell presents a series of economic models attempting to illustrate that the failing-firm defense actually does have efficiency and welfare implications, and that under certain conditions courts' acceptance of the defense enhances competition. He also derives an algebraic rule of thumb, using the acquiring and acquired firms' market shares, for appraising the competitive consequences of a rival's acquisition of a failing firm. Though "situations remain in which [the failing-firm defense] is not economically sound," and thus in which "the defense should not be allowed," the acquired firm could not have been successfully reorganized in bankruptcy proceedings. A firm might emerge intact from bankruptcy proceedings yet its creditors and shareholders have been wiped out. The dictum is clearly wrong, and has not been repeated in subsequent statements by the Court of the failing-company defense. [Citations omitted.] However, one court of appeals has followed the Citizen Publishing dictum. See United States Steel Corp. v. FTC, 426 F. 2d 592 (6th Cir. 1970). The 1984 Department of Justice merger guidelines also require that a firm be unable "to reorganize successfully under Chapter 11 of the Bankruptcy Act" before the Department will forebear from challenging a merger because one of the firms is failing. U.S. Department of Justice, Merger Guidelines—1984, 49 Fed. Reg. 26,827 (June 29, 1984).

5. Campbell, supra note 1, at 253-54.
6. Campbell, supra note 1, at 256. Two controversies surround the failing firm defense: whether it is based on an economic rationale; and if so, whether the defense is economically justified. One justification for the defense is based on "social" rather than economic considerations. That view was suggested in the seminal case, where acquisition of a failing firm was allowed, in part to avoid "injury to the communities where its plants were operated." International Shoe v. FTC, 280 U.S. 291, 302 (1930). The holding of the case, however, was on the economic ground that the acquisition did not "substantially lessen competition" under the relevant section of the Clayton Act. Id. at 293, 302-03. Moreover, Muris points out that portions of the legislative history accompanying the Celler-Kefauver Act of 1950 affirm the validity of the failing-firm defense because of perceived possible efficiencies in the acquisition of failed companies. Muris, The Efficiency Defense under Section 7 of the Clayton Act, 30 CASE WES. RES. L. REV. 381, 399-400 (1980). But some recent commentators view the defense as economically malignant. See, e.g., R. Posner & F. Easterbrook, supra note 4, at 472 (defense "one of the clearest examples in antitrust law of a desire to subordinate competition to other values"). Thus, analysts of the failing-firm defense seem to fall into three camps: those who approve of it on non-economic grounds; those who approve of it on economic grounds; and those who disapprove of it, also on economic grounds. Campbell straddles the last two groups, finding efficiency and welfare gains from recognizing the defense in some cases, but claiming at the same time that other acquisitions of failing firms may be welfare-reducing.

7. Campbell, supra note 1, at 257-57.
8. Id. at 266 & Appendix A.
9. Id. at 268.
10. Id. at 269.
algebraic test indicates situations when the defense is economically justified. Finally, Campbell reviews cases where the failing firm defense has been raised, and finds that courts have allowed the defense when the rule of thumb indicates they should have.\footnote{Id. at 267-68.}

This Article demonstrates that in several respects Campbell has made fundamental errors. It shows, first, that he has erred in the welfare analysis of the first two failing-firm situations he identifies, the competitive and monopoly cases. In those situations, neither a failing firm's exit from the market nor the acquisition of its assets has the economic significance that Campbell attributes to it. Especially erroneous is Campbell's analysis of the monopoly case, in which he claims that acquisition of a failing firm by a monopolist reduces economic welfare. In fact, acquisition can only increase welfare. Campbell's error stems from a confusion between cause and effect in the failing-firm context, and a failure to realize that acquisition of a failing firm's assets is not the same as acquisition of its market share.

In the intermediate case, where a dominant firm (but not a monopoly) acquires a failing firm's assets, a weakness of Campbell's analysis is the failure to specify when and how to apply his algebraic test; indeed, the formula does not appear applicable even to those cases to which he applies it. These shortcomings are largely irrelevant, however, as the economics itself is wrong. In analyzing a dominant firm's acquisition of a failed firm, Campbell repeats most of the mistakes that he made in evaluating the monopoly case. Cause and effect are confused, and acquisition of assets is incorrectly assumed again to result in acquisition of market share.

Finally, this Article raises the question whether a separate model for acquisition of a failing firm is even needed. Existing models of the welfare trade-offs from mergers and acquisitions, though more general, seem sufficient to analyze acquisitions of failing firms. Mergers and acquisitions pose problems for efficiency and competition only under the most extreme assumptions, even when the merged or acquired firm is financially healthy. When the firm was doomed to failure anyway, the already small likelihood that merger or acquisition will be harmful goes to zero. Thus, Campbell's principal conclusion, that acquisition of a failing firm's assets may or may not be efficient, is wrong. Acquisition of a failing firm is always efficient.

II. THE ECONOMIC ANALYSIS

It is useful to restate briefly the economic model from which Professor Campbell's conclusions are derived, with some slight additions to his graphs to facilitate the discussion. He begins with the competi-
tive case shown in Figure 1. Industry supply \((S)\) is the summation of individual firms' marginal cost curves \((S = \Sigma MC)\), which need not be equal for every firm but may be. Supply and demand \((D)\) for the industry intersect at output \(Q_c\), which will be sold at price \(P_c\). Since total costs are described by the area under the supply curve and total consumer value by the area under the demand curve, there is an area of "economic surplus", \(ABC\), representing the excess of value over cost.

![Figure 1](image)

**A. Alternative A: Failing Firm Exits Industry**

Campbell uses the competitive model to contrast the two alternatives posed in the failing-firm cases, departure of the failing firm from the industry versus acquisition of the failing firm by a rival. He

12. *Id.* at 258-59.
13. *Id.* at 258 & nn. 43-44.
14. "Economic surplus" is composed of "producers' surplus" and "consumers' surplus." Producers' surplus, the excess of receipts over costs, is shown by area \(CBP_c\) in Figure 1. Consumers' surplus, the excess of purchasers' valuation over payment for the good or service, is represented by area \(ABP_c\). The presence of producers' surplus indicates that at least some producers are earning quasi-rents, payments above those needed to keep the firm producing in the short run. See generally R. MILLER, INTERMEDIATE MICRO-ECONOMICS 447-48 (1978).
presents the consequences of the first alternative, using Figure 2, as follows:

Now assume that a failing firm departs from the market. The effect of the departure is to reduce the quantity produced by the industry at any given price. Graphically, the supply curve shifts to the left ($S'$). This raises price ($P_f$), lowers the quantity produced ($Q_f$), and reduces economic surplus. The shaded area in Figure 2 is the lost economic surplus. This is incorrect. The loss of surplus is not in any sense an effect of the departure of the firm. The firm's departure must itself be an effect of some exogenous change in firm costs. Exit of the firm here has no particular economic importance.

To see why, consider again Figure 2. With industry supply given by $S$ (itself a summation of the firms' marginal cost schedules), all firms by definition earn at least a normal return, and some earn quasi-rents in addition. There is simply no reason for any firm to depart the industry. It is true that if firms' marginal costs increase, and hence industry supply shifts up to $S'$, some firm(s) may leave the industry.

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15. Campbell, supra note 1, at 260.
16. Id. at 259 (emphasis added, footnotes omitted).
17. See supra note 14.
18. Higher costs are a necessary but not sufficient condition for some firm(s) to fail and exit the industry. It is also necessary that some firm(s) have higher costs than others. If all firms' costs are identical, no firm will exit when new costs are
But that would be the result of the changing cost conditions, which are the cause of the lost surplus.

In other words, the exit of the firm simply manifests a cost increase imposed on the industry. But that cost change, not the firm exit, is the reason for any welfare losses. Exit is simply proof that costs have increased. Suppose, for example, that the product portrayed in Figure 2 is automobiles. Increasing government regulations might substantially increase the cost of producing automobiles, in turn forcing producers to raise prices and thereby decreasing the quantity of autos purchased. As the higher costs shift industry supply from S to S' and fewer cars are bought, some firms may exit the industry. Firm departures follow the loss of surplus, but they can hardly be said to have caused it. It is the regulation or other cost-increasing measures that account for any lost surplus. Once the welfare losses created by the cost increase are recognized, the departure of the now-failing firm has no additional significance. The firm's exit merely confirms the fact that costs have increased.

To make the distinction between prior market changes and subsequent firm exits even clearer, consider another failing-firm scenario not presented by Campbell. Figure 2A presents the demand (D) and supply (S) for a different product, say horseshoes at the turn of the century. As the automobile's popularity increases, the demand for horses, and hence horseshoes, falls from D to D'. Once again, less of the product (Q₂ rather than Q₁) is sold, and some producer(s) may be forced to exit the industry. But any departure is hardly the cause of lost surplus in the horseshoe market. Rather, exit just manifests a)

imposed on the industry. Instead, each firm will reduce the quantity of the good or service in question that it produces or sells and shift a portion of its assets into production or investment elsewhere. If firm exit does occur, the highest-cost firm will be the first to leave, all other things equal.

19. The failing firm may have assets that are more valuable when used in the particular industry in question than in any other pursuit. Economists refer to these as "specific assets." See generally O. WILLIAMSON, MARKET AND HIERARCHIES: ANALYSIS AND ANTITRUST IMPLICATIONS (1975); Klein, Crawford & Alchian, Vertical Integration, Appropriable Rents and the Competitive Contracting Process, 21 J. L. & ECON. 297 (1978). If such assets exist, therefore, they will be purchased either by an outsider who will use them in the same industry, or by an incumbent firm in that industry: no exit will occur in either event. If an outsider bids for the assets, no issue arises under the failing firm doctrine or antitrust law generally. The defense applies only when the acquiror of the failed firm's assets is a current competitor. See supra text accompanying note 4. If acquisition is by an industry incumbent, the issue is whether the value saved by permitting the acquisition exceeds welfare losses from any increase in the incumbent's market power, the point discussed, infra text accompanying notes 27-48.

20. Indeed, there is a presumptively a welfare gain overall, if one shifts temporarily from partial- to general-equilibrium analysis. As consumer demands increase for automobiles and fall for horses, it is desirable that resources currently engaged in producing horseshoes (hammers, steel, manpower) shift into production of cars.
change in underlying market conditions, in this case a shift in demand as opposed to the shift in supply shown in Figure 2.

![Figure 2A](image)

In short, there are no economic welfare implications to the failing firm's departure in the first situation Campbell has described. Firm exits, if they occur, only reflect prior changes in the market. It is true that there may be a perfect correlation between some earlier change in supply or demand and the subsequent departure of some firm. But as the saying goes, correlation is not causation. If a firm's exit from the market after a cost increase were truly a source of inefficiency, an efficiency-maximizing antitrust system would force the firm to remain

While the shaded area of Figure 2A measures welfare changes in the horse-shoe market, these changes are really without economic significance. Exit of firms from markets for goods that consumers no longer value as highly as before simply means that more resources are available to satisfy increased demands for other goods that consumers value more highly. Overall, economic welfare rises, rather than falls, as the result of a new, more highly-valued, product being available.

21. Even were Professor Campbell correct about the welfare decreases represented in Figure 2 by firm exits, the situation portrayed in Figure 2A indicates that exits may equally well be associated with welfare increases in a general-equilibrium setting. See supra note 20. Operationally, then, it would be difficult to judge merely from the exit of firms from a market whether economic welfare had risen or fallen. Departure of firms from a market is a phenomenon consistent with hypotheses of both a welfare increase and a welfare decrease.
in business, sustaining losses. Such a policy would strike most people as nonsensically welfare-reducing, which doubtless reflects an awareness that firms’ market entries and exits are responses to changes in underlying market conditions, not their cause. A firm’s departure is no more the cause of any welfare loss than the *Titanic* sank because the life-boats pulled away.

B. Alternative B: Failing Firm Acquired by Rival

1. *Acquisition by Monopolist*

What if, instead of exiting the industry, the failing firm is acquired by a rival, one that is now a monopolist? Campbell illustrates this alternative in Figure 3, and explains:

Suppose, however, that the failing firm is acquired by a dominant firm. For purposes of illustration, further assume that this acquisition *causes the dominant firm to become a monopolist*. A monopolist can set its level of production on the basis of the market’s marginal revenue curve (MR), which reflects the additional amount of revenue produced by each unit of output. Because the supply curve in a monopolistic market is the monopolist’s marginal cost curve, the monopolist will set the quantity produced based on the intersection of its marginal revenue and marginal cost curves. Thus, the monopolist produces less (Q<sub>m</sub>) and charges more (P<sub>m</sub>) than the firms in a competitive market. The shaded area in Figure 3 is the economic surplus lost when an acquiring firm gains monopoly power from the acquisition.

This, too, is wrong. Once again, Campbell confuses causation and correlation. For the dominant firm to become a monopoly with the departure of a failed firm, the industry must currently be a duopoly. Regardless whether the failing firm exits the industry or sells its assets to its only rival, the failing firm ceases to exist. Its competitor becomes a monopolist in either event. The acquisition in no way *causes* the acquiring firm to become a monopolist.

Consider an actual case, the market for daily newspapers in Wash-

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23. *Id.* at 260 (footnotes omitted) (emphasis added). It might be observed parenthetically that Professor Campbell errs in defining the supply curve in a monopolistic industry as the monopolist’s marginal cost curve. In a competitive industry one is able to derive an industry supply curve by the horizontal summation of all individual firms’ marginal cost curves above average variable cost. It would seem, then, that the monopolist’s supply curve would be its marginal cost curve because this is how the perfectly competitive supply curve was found.

Even though it would seem so, it turns out not to be so. The monopolist has no supply curve. A supply curve is defined as the locus of points showing the minimum price at which a given quantity will be forthcoming. . . . Any particular monopoly price can result in a wide variety of rates of output, depending on the price elasticity of demand and the position of the demand curve. Thus, for a monopolist there is no unique relationship between price and quantity forthcoming—no supply curve.

Washington, D.C. in 1981. At that time The Washington Post and The Washington Star were the only two papers published in the market. After years of losses, the Star went out of business. The Post eventually purchased some of the Star's capital assets, including its printing plant, and hired many of its writers. Did this increase the Post's market power one iota? Of course not. It had been a monopolist since the day the Star disappeared, and would be one with or without the acquisition of the failed firm's assets.

The example is helpful in illustrating a second point of confusion in Campbell's article, and ultimately a more important one. Acquisition of a firm (or of its assets) obtains for the purchaser only the failed firm's capacity to produce, which is not the same as an acquisition of its market power. The distinction between assets and market power is of equal importance in the case where the acquiring firm is relatively large but still not a monopolist, as discussed below.\textsuperscript{24} Here, the distinction is clear from the fact that acquisition of the Star's assets would only increase the Post's capacity to serve the market it henceforth monopolizes. Its market share, however, is 100 percent with or without the acquisition. It confronts the same industry demand curve, and has the same market power, whether or not it is allowed to acquire the failing firm's assets.

Thus, it is hardly acquisition of the failing firm that causes a mo-

\textsuperscript{24.} See infra text accompanying notes 46-48.
opoly in Campbell's hypothetical case. The monopoly exists because only the surviving firm can profitably provide the product: the other firm has failed trying to do so, and by hypothesis no one else wishes to purchase its assets in order to enter the industry.\(^2\) Either way, the surviving firm confronts the (unchanged) industry demand curve, and will produce the quantity at which marginal revenue and cost are equal, charging the monopoly price. The sole issue presented by the failure of its only rival is whether the surviving monopolist wishes to purchase that firm's assets, and whether the law will permit it to do so.

The surviving monopolist will only be interested in an acquisition when the purchase lowers its costs. This can be seen from Figure 3A. With marginal costs at MC before any acquisition of a failed firm's assets, the surviving monopolist produces quantity Q of the goods in question, and sells it at unit price P. The producer thus earns monopoly profits of AFG, the difference between the areas under the marginal revenue and the marginal cost schedules. If an acquisition raises the costs of producing as a monopolist to MC', profits fall to ACD, a loss in profits of FCDG. But if the acquisition lowers costs to MC'', the monopolist maximizes profits by expanding output to Q'' and lowering price to P''. Total monopoly profits rise to AIJ, a difference of FGJI. The moral of the story is critical: the acquisition of assets is only of benefit to the monopolist when it lowers his costs. And of course, allowing the monopolist to sell more goods at lower prices is socially desirable.

Thus, to talk of welfare losses caused by the departure of the failing firm in the monopoly situation, as Campbell does, is wrong for two reasons. First, there is no sense in claiming that the failure in any sense causes the monopoly. Given that one of two firms is about to fail, and that only a single firm will remain, monopoly is a fact of life.\(^2\) But low-cost production is still a matter of real interest. Here, Campbell errs a second time. A monopolist will only acquire a failed firm's assets when acquisition lowers its costs of production. This, in turn, can only increase welfare by inducing expansion of output.

25. Purchase of the failing firm's assets may not be the only way to enter the industry, though it will be the most efficient (least costly) way if the firm owned specific assets. See supra note 19. If some new firm later enters the industry even without purchasing the failing firm's assets, there is of course no monopoly as a result of the failing firm's exit. The ultimate result is simply the substitution of a new firm in place of the failed firm to compete with the surviving firm.

26. Because a monopoly results, regardless whether the failed firm's assets are acquired by the surviving firm, the situation is different from that discussed in section II.B.2, in which acquisition allegedly can increase market power.
The sole issue, then, is whether the monopolist can produce more efficiently by acquiring the failed firm's assets. There is no reason in this situation for antitrust law to oppose any acquisition. The surviving firm's desire to acquire its former rival can only indicate cost reductions and so welfare gains. The monopolist has no more interest in producing at a higher cost than society does in forcing him to undertake more costly production.

2. Acquisition by Dominant Firm

This does not dispose of the case where one firm, though not a complete monopolist, has significant market power, and that power allegedly can be increased by acquisition of the failed firm's assets. One well-known source illustrates this case as follows:

Imagine a market in which there are six firms. One has a 50% market share and each of the others 10%. One of the small firms goes bankrupt and the only offer that the trustee in bankruptcy receives for purchase of the firm as a going concern is from the dominant firm. The alternative to acceptance of the
offer is liquidation of the business. . . . The result [of purchase] is to increase [the largest] firm's market share from 50 to 60%. Now consider what would have happened had the [failing] firm been liquidated rather than acquired. Presumably its sales would have been divided up by the remaining firms in proportion to those firms' shares of the remainder of the market. The dominant firm would have picked up a little more than half of the bankrupt's sales; the rest would have been divided evenly among the remaining sellers. The result would be an increase in the dominant firm's market share to a little more than 55%—a much smaller increment than if the dominant firm is permitted to acquire the bankrupt. . . .

Using a model of price leadership by the dominant firm, Campbell attempts to show how acquisition of the failing firm can be efficient in this situation, even if it converts a competitive market into one in which the acquirer becomes a dominant price-setting firm. Whether the acquisition on net adds to consumer welfare or detracts from it, he says, depends on a particular relationship between the market shares of the acquiring and failing firms. Assuming that certain conditions are present, Campbell concludes that the failing firm defense is efficient "if the market share of the failing firm is greater than the square of the sum of the failing and acquiring firms' market shares. . . ." This rule of thumb is then applied in an attempt to show that courts have in fact allowed the failing firm defense when they should have.

Figure 3B illustrates the cases Campbell is analyzing. The industry consists of a dominant firm (d) and several smaller (or "fringe") firms. One smaller firm (f) has recently failed. The dominant firm takes the existence of fringe firms' productive capabilities as given by the sum of their marginal cost curves (ΣMC, fringe firms), and produces and prices as a monopolist with regard to its own residual demand (RDd) and residual marginal revenue (RMRd) and its own marginal costs (MCd).

27. R. POSNER & F. EASTERBROOK, supra note 4, at 471-72.
29. Campbell, supra note 1, at 264-67 & Appendix A.
30. Id. at 266. Algebraically, Campbell's formula states that the acquisition is efficient when $(A + F)^2 < F$, where A and F are the market shares of the acquiring and failed firms, respectively. The inequality Campbell uses in this algebraic version of his rule of thumb ("greater than or equal to") is slightly different from the one he states verbally ("greater than"). In view of the fundamental deficiencies of Campbell's theoretical models, this Article does not analyze the technical accuracy of Campbell's formula. In a forthcoming article, Professor Richard Friedman criticizes Campbell's mathematics and argues that market shares are irrelevant: "increasing one firm's capacity will always increase market efficiency, no matter what the firm's prior or posterior market share." Friedman, Untangling the Failing Company Doctrine, 64 TEX. L. REV. — (1986).
31. Campbell, supra note 1, at 267-68.
The issue is whether to allow the dominant firm to acquire the failed firm's assets. Professor Campbell assumes first that the dominant firm is already pricing as a monopolist, even before the failure of the other firm. Thus, it is producing $Q_d$ and leaving the remainder of the full industry output ($Q_f$) for the fringe firms to produce. Price is
set by the dominant firm at $P_d$, a monopoly price for it, but a competitive price for fringe firms. Campbell shows that allowing acquisition of the failed firm's assets, such that the dominant firm's marginal costs fall (from $MC_d$ to $MC_{d+f}$) can only increase economic welfare. Quantity produced expands to $Q_d'$ for the dominant firm and $Q_f'$ for the industry, and price falls to $P_d'$.32

But what if the industry had been competitive, and acquisition of a failing firm enables the acquirer to begin acting as a dominant-firm price leader? In this case, Campbell claims that acquisition may be welfare-decreasing. In a competitive industry, price and quantity produced are determined by intersection of the supply ($S = \Sigma MC$) and demand ($D$) curves. Acquisition of the failed firm by hypothesis allows the newly-dominant firm to price for the first time with respect to its own residual marginal revenue and marginal cost curves, increasing price from $P_c$ to $P_d'$ and lowering quantity from $Q_d$ to $Q_i'$. Economic welfare declines. Thus, if this latter model is applicable, the failing firm defense should not be allowed.33

Before evaluating Campbell's claim that acquisition of a failing firm may be undesirable, one should be aware that his use of a dominant-firm model limits the applicability of his analysis. As Campbell notes, his conclusions depend in part on the use of straight-line schedules for demand, supply, marginal cost, and marginal revenue, but this is a relatively minor point.34 There are other, more restrictive and debatable assumptions needed for a model of dominant-firm price leadership to apply in the first place, only some of which Professor Campbell makes explicit.35 These assumptions go both to the structure of the market and behavior of firms in it,36 and the model has

32. Careful readers will have noted that Campbell’s analysis of the case where an already-dominant firm acquires the failed firm contradicts his treatment of acquisition by a monopolist. See supra text accompanying notes 22-26. In both situations, the firm prices as a monopolist and can lower costs by acquiring the assets of the failed firm. Lower costs by a monopoly pricer must by definition increase economic welfare. See Figure 3A above. Campbell reaches this conclusion for monopoly pricing by a dominant firm, but quite erroneously argues just the reverse for a “pure” monopolist.

33. For a discussion of the circumstances in which the model will apply, see infra note 40.

34. Campbell, supra note 1, at 266 (“more exotic curves would yield differing results”).

35. Id. at 262.

36. It is sometimes alleged that pricing in oligopolistic industries is controlled by the dominant firm, that is, the largest firm in the industry. The basic assumption in this model is that the dominant firm sets the price and allows other firms to sell all they want at that price. The dominant firm then sells the remainder of the market quantity demanded at that price.

K. Clarkson & R. Miller, supra note 28, at 189 (citations omitted). For price leadership by dominant firms to work, a number of implicit assumptions must
frequently been criticized for the realism of those assumptions.\textsuperscript{37} Indeed, if one is to judge from its use to analyze particular markets, price leadership by a dominant firm is apparently regarded as the exception rather than the rule by most economists. To illustrate the rather unusual workings of the price-leadership model, consider again how an already-dominant firm responds to its increased market share by selling more of the product and by lowering its price.\textsuperscript{38} This is surely an odd result. If increases in market power were normally followed by increases in quantities sold and falling prices, there would be no need for antitrust in the first place. Campbell recognizes that his result is “slightly counter-intuitive.”\textsuperscript{39} But the result follows ineluctably once the industry is postulated to exhibit dominant-firm price leadership.\textsuperscript{40}

If dominant-firm price leadership is the economic exception rather than the rule, one should be able to identify those exceptional cases when the model will in fact be applicable. How to determine whether a market in which a failing-firm acquisition is proposed can be charac-

\textsuperscript{37} The dominant-firm price leadership model is stable only as long as smaller firms are passive price-takers, meaning they cease to act as rivals to the dominant firm. R. MILLER, supra note 14, at 349. Empirically, “[t]he erratic behavior of the competitive fringe around the oligopoly core directly contradicts the implicit assumption of the models that fringe firms will accept the leader’s prices in a manner similar to the pure competitor.” Lanzillotti, Competitive Price Leadership: A Critique of Price Leadership Models, 39 REV. ECON. & STAT. 55, 63 (1957). Once the other firms cease to follow the leader, the model of price leadership by a dominant firm disintegrates. K. CLARKSON & R. MILLER, supra note 28, at 191.

\textsuperscript{38} See supra text accompanying note 32.

\textsuperscript{39} Campbell, supra note 1, at 265.

\textsuperscript{40} Another oddity in Campbell’s dominant-firm model is the rather unusual circumstance in which acquisition of a failing firm supposedly can reduce efficiency and economic welfare. These adverse consequences occur only when the acquisition converts a purely competitive market into one where a dominant firm can price as a monopolist. See supra text accompanying note 33. To use the same numbers employed above (see supra text accompanying note 27), suppose that the largest firm’s 50 percent market share rises to 55 percent if it does not acquire the failing firm, but 60 percent with an acquisition. Campbell in effect is suggesting that no adverse consequences arise as the firm moves from a 50 to a 55 percent market share, but that in the 55-60 percent range the heretofore competitive pricer becomes “dominant” and acquires the ability to price like a monopolist. The inefficiency case that Campbell posits thus depends on the existence of some discontinuity in the relationship between size and market power. Up to some percentage, the large firm’s market share does not enable it to act in any way but competitively; once over that percentage, it abruptly acquires dominance. Why or how this would happen is unexplained. But the more fundamental error in Campbell’s model is the fact that acquisition of assets cannot increase market share in any way that reduces efficiency in the first place. See infra text accompanying notes 46-48. Thus Campbell’s discontinuity, while curious, is irrelevant.
terized as one with dominant-firm price leadership is something that Professor Campbell ignores, however. It would be especially interesting to know whether the markets in the four cases analyzed by Campbell could be characterized as actually exhibiting price leadership by a dominant acquiring firm, even after the acquisition. From the information he presents it seems dubious that three of them could be so characterized. In *Granader v. Public Bank*, the acquiring firm had a 61 percent market share, and the failing firm a 14 percent share. Neither before nor after the merger would the acquiring firm seem large enough to be regarded as a dominant firm capable of price leadership. In *In re National Tea Co.*, the market shares were somewhat bigger (9.9 and 5.6 percent), but apparently still not big enough to justify an inference of dominant-firm price leadership. In *United States v. Lever Brothers Co.*, the combined market share of the acquiring and acquired firm was 21 percent. But the acquiring firm was Lever Brothers, which could hardly be considered the leader in an industry dominated by Procter & Gamble. The sole case presented by Professor Campbell that might be characterized as presenting a dominant-firm situation is *United States v. M.P.M., Inc.*, where the post-acquisition market share exceeded 30 percent.

The limited applicability of Campbell's dominant-firm model and its dubious value in analyzing the cases he discusses are not the major problems with his analysis, however. The principal problems are errors identical to those that doom his evaluation of failing-firm acquisitions in the monopoly case: confusion of cause and effect, and the failure to realize that acquiring a failed firm's assets can only affect a firm's costs of production but not its market share.

If a firm with some percentage of the market fails and is acquired by a healthy rival with a larger market share, how does the rival also acquire the failing firm's customers? Assets can be bought and sold, but customers or market shares cannot. Certainly, the dominant firm can expect to pick up some of the failed firm's customers. But—and again, this point is critical—the dominant firm will pick up the new clientele anyway, whether or not it acquires the assets of the failed

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43. 216 F. Supp. 887 (S.D.N.Y. 1963) (upheld the sale of "All" detergent by Monsanto Chemical Co. to Lever Brothers).
45. Even if the acquiring firm was dominant after the acquisition, this does not answer the dispositive question under Campbell's model, whether it was dominant before the acquisition. If so, the acquisition was necessarily welfare-increasing; if not, it supposedly might reduce economic welfare.
firms. Campbell once more confounds correlation with causation. The
realignments of demand and increases in market shares occur in any
event, solely because one firm has gone out of business. Why would
more of the failed firm’s customers patronize the dominant firm just
because it acquired the former firm’s idle assets?

In some unusual situation, the failing firm may have long-term
contracts with its customers, such that it possibly could “sell” its cus-
tomers to the acquiring firm. But ordinarily, acquisition of assets
cannot affect a firm’s market power or market share. Parallel to what
happens in the monopoly case, the demand curve facing the dominant
firm will increase as the old customers of the failed firm shift their
patronage to the remaining firms. But the dominant firm’s new de-
mand curve is the same, with or without acquisition of failing-firm as-
sets. So is the number of other firms competing with it. How, then,
can acquisition enhance market power?

The failing firm may also possess a valuable trade name or cus-
tomer goodwill that will bind customers informally to any firm that
acquires the assets. But even if true, the implications are no different
from those discussed in the monopoly context. If the assets will lower
the dominant firm’s costs, it is socially desirable that the assets remain
in the industry, rather than pass out of the industry to less valued
uses. Lower prices and greater output must result from acquisition. A
dominant or monopoly firm’s ability to outbid those outside the indus-
try (to whom, by hypothesis, the assets will pass if the failing-firm
defense is not recognized) indicates that the firm is the highest-valu-
ing user of the assets. And if so, there is simply no reason for antitrust
law to contest the acquisition.

In summary, the sole issue in the failing-firm context is whether
more or less capacity in the industry is desirable. When additional
capacity is available to lower a firm’s costs, it is unobjectionable that
the new owner of that capacity will be a monopolist or a dominant
firm. Acquisition of assets simply has nothing to do with demand con-
ditions facing acquiring firms—be they competitive, monopolist, or

47. It is by no means clear that the contracts would survive the extinction of the
original contracting party. Even if they did remain in force, the contracts’ limited
duration would mean that the “purchase” of customers could only increase a
firm’s market share temporarily. And as long as the contracts or previous
courses of dealing established the prices charged to customers, the firm that ac-
quired a failed firm’s clientele could not take advantage of any increase in market
power to raise the prices customers would pay.

48. This statement assumes that it is certain the acquired firm will eventually fail. It
is not always true, however, that an ailing firm becomes a failing firm. This prob-
lem is treated in Friedman, supra note 30. If the probability that the ailing firm
will ultimately recover its health is relatively high, a proposed merger or acquisi-
tion of its assets can be evaluated under the more traditional Clayton Act analysis
discussed in Section II.C., infra.
dominant firms—and in particular cannot create market power. Campbell is wrong in claiming that an acquisition of assets can create market power, and thus that acquisitions of failed firms' assets can be welfare-reducing. A firm will only acquire a failed rival's assets to lower its costs, which always makes the acquisition socially desirable.

C. An Alternative Justification of the Failing-Firm Defense

This same conclusion can be reached by resort to more familiar and more general models of merger and acquisition. The problem that Professor Campbell poses in the failing-firm context, the tradeoff between efficiency and market power, is posed for any horizontal combination. That tradeoff has been analyzed extensively. If a failing firm acquisition poses similar welfare tradeoffs, how is Campbell's model an improvement over existing models of mergers and acquisitions? Professor Campbell does not discuss the relationship of his failing-firm model to existing analyses of mergers and acquisitions generally. But some note must be taken of the most important prior work in this area, that of Oliver Williamson.49

Williamson's geometric analysis is so familiar that the graphs need not be repeated here. Several points made by Williamson are relevant. First, most mergers do not raise problems of significant welfare loss due to increasing market power to begin with.50 Second, in the "occasional case"51 where some increase in market power results from a merger or acquisition, Williamson proves that only a small cost saving from the combination will suffice to outweigh any welfare loss from increased market power: "a relatively modest cost reduction is usually sufficient to offset relatively large price increases. . . . [A] merger which yields non-trivial real economies must produce substantial market power and result in relatively large price increases for the net allocative effects to be negative."52 From Williamson's analysis Muris has argued that mergers and acquisitions should be deemed efficient, and hence presumed to be legal under antitrust law, unless demonstrably anti-competitive.53 Recent cases suggest that this is, indeed, the direction of antitrust law: "What is emerging in [Federal

51. Id. at 18.
52. Id. at 22-23.
53. Muris, supra note 6, at 399-400.
Trade Commission merger decisions is by and large the rule that, according to the 'new' economic learning, a merger is almost always legal.54

Williamson does not distinguish failing from healthy merger/acquisition partners. But the welfare trade-off between market power and efficiency that characterizes the union of two healthy firms by definition does not arise when one firm is about to fail. Union of two healthy firms causes a competitor to disappear; in the failing-firm context, however, the competitor will disappear whether or not the healthy rival acquires its assets. Acquisition, therefore, can impart no additional market power in the failing-firm case. As was discussed in connection with the monopoly and dominant-firm cases above,55 obtaining a firm's assets has nothing to do with acquiring its customers. Except in highly unusual situations, acquisition of assets cannot augment further the increased demand surviving firms will experience anyway, once the failed firm disappears.

Few acquisitions or mergers, even between healthy firms, raise market-power issues in the first place. In those few that do, efficiency gains almost certainly outweigh welfare losses. The presumption of efficiency must be strengthened when the acquired firm is failing and therefore cannot add to the acquiring firm's market power. Considering the judicial and error costs of case-by-case investigations of particular acquisitions, there is no reason to believe that the absoluteness of the current failing-firm defense is inappropriate. Acquisition of a failing firm's assets should always be deemed efficient.

III. CONCLUSION

Commendably, Professor Campbell has placed the failing-firm defense where it belongs, in an economic context. But, as this Article has tried to show, defense of the failing-firm merger in some cases cannot rest on Campbell's analysis, and in other cases it need not and should not. His welfare analysis of both the failed firm's exit from a competitive market and its acquisition by a monopolist is simply incorrect. Contrary to Campbell's claims, acquisition of a failed firm cannot create a monopoly, nor can it reduce economic welfare. Indeed, acquisition can only increase welfare. His analysis of the intermediate case, in which the acquiring firm supposedly obtains some but not complete market power, depends on a particular market structure and restrictive assumptions about firm behavior not likely to be validated empirically, and seemingly not present in cases Campbell himself uses.

These failings are less important though, than his repetition of the same errors that invalidate Professor Campbell's analysis of the monopoly case. Acquisition of a failing firm's assets cannot enhance market power, nor can it reduce economic welfare. Further, the intermediate case seems tractable under Williamson's more general model. In general, mergers and acquisitions are presumptively pro-competitive. Failed-firm acquisitions cannot convey market power, and so must be presumed to be even more pro-competitive.

In short, Professor Campbell has shifted the venue of the case for the failing firm to the court of economics. But counsel for the defense presents a needlessly weak and erroneously equivocal case. The economic strength of the failing-firm doctrine, once correctly analyzed, is seen to justify fully the absolute defense that antitrust law has created.