COMMENT ON THE JANUARY 2022 DOJ AND FTC RFI ON MERGER ENFORCEMENT: ISSUES RELATED TO FAILURE AND EXITING ASSETS

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1. The Federal Trade Commission and Antitrust Division of the Department of Justice ("the agencies") have recently published a Request for Information ("RFI") on Merger Enforcement in which they "seek public comment on how the agencies can modernize enforcement of the antitrust laws regarding mergers."[2] With the RFI, the agencies invited submissions addressing the following question under item 15. Failing and Flailing Firms: "Is the guidelines' approach to failing firms adequate? If not, what changes should be made?"[3]

2. Section 11 of the Merger Guidelines, which is entitled "Failure and Exiting Assets," provides that "a merger is not likely to enhance market power if imminent failure . . . of one of the merging firms would cause the assets of that firm to exit the relevant market."[4] The Merger Guidelines explain that "[i]f the relevant assets would otherwise exit the market, customers are not worse off after the merger than they would have been had the merger been enjoined."[5]

3. Under the Merger Guidelines, "claims that the assets of the failing firm would exit the relevant market" are "not normally credit[ed]" "unless all of the following circumstances are met":

- "the allegedly failing firm would be unable to meet its financial obligations in the near future;"
- "it would not be able to reorganize successfully under Chapter 11 of the Bankruptcy Act; and"

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[2] U.S. Department of Justice and U.S. Federal Trade Commission, "Request for Information on Merger Enforcement," January 18, 2022 ("RFI"), p. 1.
[3] RFI p. 10.
[4] U.S. Department of Justice & Federal Trade Commission, *Horizontal Merger Guidelines* (2010) ("Merger Guidelines"), § 11 at 32.
[5] Merger Guidelines, § 11, at 32.

- "it has made unsuccessful good-faith efforts to elicit reasonable alternative offers that would keep its tangible and intangible assets in the relevant market and pose a less severe danger to competition than does the proposed merger."[6]

4. While the bar to clear this affirmative defense is high, the guidance provided by the Merger Guidelines consists of 339 words, with the key criteria explained in a mere 98 words. The paucity of information does provide the agencies with significant flexibility to consider each individual set of facts and circumstances, which can be useful as there is no one-size-fits-all solution.

5. Given the focus on the assets of the allegedly failing firm and not necessarily the allegedly failing firm itself, one needs to perform a multi-faceted inquiry to understand the assets themselves as well as the financial incentives of the failing firm to keep these assets in the market.[7] In this respect, economic and financial analysis of the merging parties' financial statements, regulatory filings, internal documents, firm behavior, potential buyers, potential financing, and parties' testimony can be used to evaluate the projected likelihood of "exiting of the assets."

6. From a public policy standpoint, the brevity of the guidance could provide too great an incentive for merging parties to claim a failing firm defense.[8] A potential mitigating factor to this temptation would be for the agenics to provide additional guidance. There are a number of previous cases that provide precedent for the failing firm defense.[9] We propose that the agencies modify the Failure and Exiting Assets guidance to incorporate examples from the prior case law of the types of factors to consider within each of the failing firm prongs. While there are many previous cases to use, we will focus on two recent cases: *U.S. v. Energy Solutions, Inc. and In re Otto Bock HealthCare North America.*[10]

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[6] Merger Guidelines, § 11, at 32.

[7] While the references in this comment are to failing firms, the concepts would also be applied to failing divisions.

[8] See as examples: https://www.ftc.gov/enforcement/competition-matters/2020/05/failing-firms-miraculous-recoveries and https://www.ftc.gov/enforcement/competition-matters/2015/03/power-shopping-alternative-buyer.

[9] A non-exlcusive list of examples include: Citizen Pub. Co. v. U.S., 394 U.S. 131, 137 (1969); Int'l Shoe v. FTC, 280 U.S. 291, 302 (1930); Black & Decker Mfg. Co., 430 F. Supp. 729, 778-81 (D.Md. 1976); Union Leader Corp. v. Newspapers of New England, 284 F.2d 582, 589-90 (1st Cir. 1960); California v. Sutter Health System, 130 F. Supp. 2d 1109, 1133 (N.D. Cal. 2001); Reilly v. Hearst Corp., 107 F. Supp. 2d 1192 (N.D. Cal. 2000); FTC v. Great Lakes Chem. Corp., 528 F. Supp. 94, 96-98 (N.D. Ill. 1981).

[10] Cornerstone Research was involved in both cases.

7. We are providing potential questions that could be used to identify the types of factors that would be considered for each of the prongs. These are not meant to be exhaustive, nor would they be applicable in all circumstances as each case has different facts and circumstances. But are instead the types of exemplars that the agencies could use to provide additional guidance.

8. Failing Firm Criterion #1 – Firm would be able to met its financial obligations in the near future

a. Has the firm been successful in investing in future?[11] Has the firm decreased research and development and sales and marketing spending?[12]

b. Has the firm been able to meet its debt obligations as they have come due or has it defaulted on debts?[13]

c. Is the firm current on lease payments?[14]

d. Has the firm discussed restructuring existing debt with its creditors?[15]

e. Has the firm calculated liquidation value of the company?[16]

f. What does the firm's audited financial statements say about it meeting its financial obligations and continue as a going concern in the future, absent the Acquisition?[17]

g. What kind of public declarations have the firm made regarding its financial health? Has the firm made any recent public declarations of sound financial health?[18]

h. What is the trajectory of firm's financial prospects in recent history?[19] Has the firms' financial momentum slowed?[20]

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[11] *U.S. v. Energy Solutions, Inc.*, July 13, 2017 ("Energy Solutions"), p. 7.
[12] *In re Otto Bock HealthCare North America*, (F.T.C. May 6, 2019) ("Otto Bock"), p. 67; nn. 831, 834.
[13] Otto Bock, p. 61. Energy Solutions, p. 7.
[14] Energy Solutions, p. 7.
[15] Otto Bock, p. 66; nn. 746–747, 751, 757.
[16] Otto Bock, p. 66; nn. 823–825.
[17] Otto Bock, p. 64; Energy Solutions, p. 7.
[18] Energy Solutions, p. 7.
[19] Otto Bock, p. 63; nn. 781–797; Energy Solutions, p. 7.
[20] Otto Bock, p. 63; nn. 781–782; Energy Solutions, p. 7.

i. What is the trajectory of the market the firm operates in? Is the market projected to grow or decline?[21]

j. Has the firm missed payroll?[22] Has it failed to pay discretionary bonuses?[23] Has it reduced headcount?[24]

k. (if applicable) Firm's parent company stopped supporting the firm financially and organizationally[25]

9. Failing Firm Criterion #2 – Firm would not be able to organize successfully under Chapter 11 of the Bankruptcy Act

a. Has the firm entered into discussions about closing facilities?[26]

b. Would the firm be able to reorganize successfully under Chapter 11 of the Bankruptcy Act, if needed?[27]

10. Failing Firm Criterion #3 – Firm has made unsuccessful good-faith efforts to elicit reasonable alternative offers that would keep its tangible and intangible assets in the relevant market and poses a less severe danger to competition than does the proposed merger

a. Did the firm's sales process has included all viable options?[28]

b. Does the firm have access to further funding, including from its parent company?[29]

c. Did the firm engage in a multi-bidder process?[30]

d. Did the firm rejecte alternate bids above the liquidation value of its tangible and intangible assets?[31]

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[21] Energy Solutions, p. 7.
[22] Otto Bock, p. 67; n. 837; Energy Solutions, p. 7.
[23] Otto Bock, p. 67; n. 837; Energy Solutions, p. 7.
[24] Otto Bock, n. 771.
[25] Energy Solutions, p. 7.
[26] Energy Solutions, p. 7.
[27] Otto Bock, p. 68.
[28] Otto Bock, pp. 68–69.
[29] Energy Solutions, p. 7.
[30] Energy Solutions, p. 12.
[31] Energy Solutions, p. 13.

e. Did the firm make reasonable inquiries within its market?[32]

f. Does the firm's sale process focus on one bidder?[33]

g. Does the proposed merger deal protection devices preclude reasonable alternative offers?[34]

h. Has the firm instructed an investment banker to lead a complete search process?[35]

i. Has the firm explored diverse financing options?[36]

j. Has the firm rejected alternate bids from purchasers that would produce a less anticompetitive outcome?[37]

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[32] Otto Bock, p. 69.
[33] Otto Bock, p. 70; nn. 849–850, 853, 856, 859.
[34] Energy Solutions, p. 12.
[35] Otto Bock, p. 69.
[36] Otto Bock, pp. 69–70; nn. 841, 853.
[37] Otto Bock, p. 71.