Navigating Mergers & Acquisitions in Times of Economic Crisis in the U.S. – The Failing Firm Defense

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The COVID-19 pandemic has inflicted a heavy toll on lives and economic activity around the world. Companies are being challenged by economic turmoil and a downturn in the economy. For some companies, the downturn may create M&A growth opportunities. For others, the downturn may lead to consolidation and retrenchment.

The Financial Condition of a Party May Facilitate Antitrust Clearance of a Transaction That Would Otherwise Raise Competitive Concerns

Where the likely alternative to an anticompetitive merger is the **financial failure** of one of the merging parties and its exit from the market, the merger will not violate Section 7 of the Clayton Act. This is known as the "failing firm" defense and is recognized by the U.S. antitrust agencies in the 2010 *Horizontal Merger Guidelines*. Related concepts of "failing division" and "flailing" firm or weakened firm defenses may also be recognized and accepted for deals that enforcers would otherwise consider anticompetitive and challenge. Similar defenses exist in the EU and the UK.

Practical Tips

During past economic crises, the antitrust agencies have generally refused to expand the failing firm defense or to reduce its requirements. In the current crisis, the FTC has noted that it will not relax the intensity of its scrutiny or the vigor of its merger control enforcement. That said, the current economic and health crisis may mean that more firms can avail themselves of these defenses when contemplating mergers that may otherwise have anticompetitive effects. As a practical matter, the "flailing" firm or weakened competitor defense is more readily established than a failing firm or failing division defense.

Overview of the Defenses

Failing Firm Defense: The 2010 *Horizontal Merger Guidelines* set forth a three-part test for a party invoking the failing firm defense. The evidentiary burden for the failing firm defense is substantial and requires the parties to show that the firm:

1. Is unable to meet its financial obligations in the near future;
2. Is unable to reorganize successfully under Chapter 11 of the bankruptcy code; and
3. Has made unsuccessful, good faith efforts to elicit reasonable alternative offers that would keep its assets in the market and that pose less anticompetitive risk.

Failing Division Defense: The 2010 *Horizontal Merger Guidelines* provide that a proposed acquisition of a corporate division that the agencies might otherwise challenge as anticompetitive may be cleared if a two-part test is met:

1. there is proof of persistently negative cash flow that does not benefit the firm, and
2. the owner of the failing division has made unsuccessful good faith efforts to find an alternative, less anticompetitive buyer.

"Flailing" or Weakened Firm Defense: Even when a firm is not on the verge of failure, the antitrust agencies recognize that a declining position or financial weakness may reduce competitive concerns arising from a merger. A firm's weakened position suggests that it may not be able to compete effectively, rebutting high market shares and the resulting presumption that a merger will have anticompetitive effects.

How Baker Botts Can Advise You

With over 70 antitrust lawyers based in Washington D.C., Brussels, London, San Francisco, Houston and New York, Baker Botts' antitrust team has the experience and bench strength to take on our clients' most significant challenges. Our skilled lawyers and competition professionals are dedicated exclusively to the area of antitrust and competition law globally.

Our antitrust attorneys have invoked the failing firm, failing division and flailing firm defenses and assisted with cleared transactions that otherwise would have been challenged by the antitrust agencies in a wide range of industries including petrochemicals, energy, oilfield services, waste disposal, body worn camera systems, wholesale books and submersible electric motors. Our attorneys have recently litigated two failing firm cases in federal district court.

Baker Botts' extensive knowledge of various sectors allows us to effectively develop strategies and persuasive advocacy. We understand and closely engage with the competition agencies in the U.S., Europe, the UK and other jurisdictions worldwide that are regularly involved in these transactions, and are knowledgeable about their precedents and how the agencies analyze transactions and other industry-specific issues.

> ***'Given their speed and ability to balance risk in a way that makes sense, they are our go-to firm for antitrust counseling in M&A transactions.'***
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> *– The Legal 500, 2020*

> ***"Their knowledge of local law and global processes is excellent. The guidance they give is in-depth yet to the point," states a client.***
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> *– Chambers Global, 2020*

Representative experience:

- AXON Enterprise, Inc. / **Safariland**
- **National Oilwell Varco** / Vallourec
- Energy Solutions, Inc. / **Waste Control Specialists**
- **Indorama Ventures** / Alpek, S.A.B. de C.V. and Far Eastern Investment (Holding) Ltd.
- **Hercules Offshore** / Seahawk Drilling
- **Arch Coal** / Triton Coal
- **Confidential Client** / Potential acquisition of failing competitor
- **First Reserve and Dresser Inc.** / Tokheim North America
- **Franklin Electric** / SPX Corporation
- Coflexip / **Wellstream**

Selected Antitrust Rankings

***Global Competition Review* 2020**

- ✓ Global Elite: Antitrust and Competition
- ✓ 5th in Global 100 Rankings: Litigation

***Chambers & Partners* 2020**

- ✓ USA: Antitrust and Competition: National
- ✓ USA: Antitrust and Competition: DC
- ✓ Global: Competition/Antitrust
- ✓ Europe: Competition EU: Brussels

***The Legal 500 US* 2020**

- ✓ Antitrust - Merger Control
- ✓ Antitrust - Cartel
- ✓ Antitrust - Civil Litigation/Class Actions

For additional guidance on this or other antitrust merger issues, please contact a member of our Antitrust and Competition Law practice group.

Catriona Hatton
Practice Chair, Antitrust & Competition
T: +32.2.891.7310
catriona.hatton@bakerbotts.com

Maureen Ohlhausen
Practice Chair, Antitrust & Competition
T: +1.202.639.7726
maureen.ohlhausen@bakerbotts.com

John Taladay
Practice Chair, Antitrust & Competition
T: +2.202.639.7909
john.taladay@bakerbotts.com

Stephen Weissman
Practice Chair, Antitrust & Competition
T: +1.202.639.1313
stephen.weissman@bakerbotts.com