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THE BANKRUPTCY SYSTEM'S CONTRIBUTION TO LESS COMPETITIVE MARKETS

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THE BANKRUPTCY SYSTEM'S CONTRIBUTION TO LESS COMPETITIVE MARKETS

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Laissez faire antitrust attitudes are giving way to a bipartisan appetite for more rigorous antitrust enforcement. Therefore, addressing the bankruptcy system's role in creating more concentrated markets is particularly timely to reduce the need for ad-hoc antitrust litigation in the bankruptcy context. This prevents the uncertainties associated with such litigation from derailing the restructuring of viable yet distressed firms.

This Article fulfills this objective by establishing an empirical relation between bankruptcy volume and market concentration and identifying the two drivers of this relation. The first driver is the debt pricing noise created by the bankruptcy system that disproportionately impacts smaller competitors. This noise is driven by unpredictable deviations from absolute priority as well as the cliff in creditor-debtor relationship created by the collision between the Trust Indenture Act and the Bankruptcy Code.

The second driver is the conflict between restructuring and antitrust considerations. The Failing Company defense and its outgrowths are bankruptcy-driven escape hatches from antitrust scrutiny. Moreover, antitrust enforcement has been neglected in the face of stability and restructuring concerns. These have turned bankruptcy courts into inhospitable venues for antitrust claims and have allowed creditors to reap monopolistic profits.

Two reforms address these issues. First, the underutilized Bankruptcy Appellate Panels should be overhauled to enhance the appellate oversight of bankruptcy cases. Second, the Trust Indenture Act should be amended to lessen its tension with the Bankruptcy Code by allowing bondholders to fully renegotiate bonds without entering bankruptcy as long as they do not jump ahead in the bankruptcy "queue."

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Introduction[1]

Concerns about the concentration of market power in the hand of a few firms and the associated risk of economic rent extraction has renewed calls for more rigorous antitrust enforcement in arenas ranging from information technology[2] to pharmaceuticals[3] and transportation.[4] These calls have been mostly focused on disincentivizing anti-competitive behaviors and the acquisition of competitors. This Article argues that this antitrust drive considerably limits its effectiveness by continuing a historical trend of failing to scrutinize the role of bankruptcy system and the associated restructuring market in reducing market competition.

This historical lack of scrutiny into the bankruptcy system is surprising given the long-standing recognition of the tension between the collective action promoted by the Bankruptcy Code and antitrust law's concern with collusive actions.[5] Congress and courts have developed a patchwork of remedies to address some of the most egregious examples of this

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[1] This paper is accompanied by a data supplement available at < https://data.mendeley.com/datasets/7hgzksb46j/3> [hereinafter Data Supplement].

[2] *See, e.g.*, Majority Staff of the H. Subcomm. on Antitrust, Com. & Admin. L. of H. Comm. on the Judiciary, 116th Cong., Investigation of Competition in Digital Markets (2020).

[3] *See, e.g.*, Lauren Feiner, *A Top Democrat on the House Antitrust Panel Sets Sights on Big Pharma After Wrapping up Tech Probe*, CNBC (Nov. 24, 2020), http://cnb.cx/3ovXaSC; Fed. Trade Comm'n, Report on Standalone Section 5 to Address High Pharmaceutical Drug and Biologic Prices (2019).

[4] *See, e.g.*, Jan K. Brueckner & Ethan Singer, U.S. Dep't of Transp., Pricing by International Airline Alliances: A Retrospective Study Using Supplementary Foreign-Carrier Fare Data (2019); Daniel J. Gifford & Robert T. Kurdle, *U.S. Airlines and Antitrust: The Struggle for Defensible Policy Towards a Unique Industry*, 50 Ind. L. Rev. 539 (2017).

[5] *See, e.g.*, David Hahn, *When Bankruptcy Meets Antitrust: The Case for Non-Cash Auctions in Concentrated Banking Markets*, 11 Stan. J.L. Bus. & Fin. 28, 30–32 (2005); James A. Janaitis, *Bankruptcy Collides with Antitrust: The Need for a Prohibition Against Using § 1110 Protections Collectively*, 25 Emory Bankr. Devs. J. 197, 233 (2008).

tension—such as collusion among creditors to undervalue a debtor's assets[6]—with the Hart-Scott-Rodino Antitrust Improvements Act of 1976[7] being the most prominent example. This Act enhances the antitrust scrutiny of corporate transactions, including those occurring in bankruptcy proceedings, by requiring pre-transfer notices to the Federal Trade Commission (the "F.T.C.") and the Antitrust Division of Department of Justice (collectively, the "Antitrust Agencies") when assets valued more than $92–$368 million change hands.[8] However, this scrutiny has not stopped bankruptcy courts from becoming favorable venues for anticompetitive transactions that would have been challenged by Antitrust Agencies if one of the parties was not in bankruptcy.

The relation between bankruptcy volume and market concentration, outlined in Figure 1 and Appendix, indicates that the bankruptcy system may indeed contribute to higher market concentrations.[9] Two broad observations underline this relation. First, the more revenue attributable to bankrupt firms, the lower the subsequent market concentration. However, there is a time-lag, meaning that enough time must pass for resources to reallocate. Second, the discharge of more liability is associated with market

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[6] *See, e.g.*, 11 U.S.C. § 363(n) (authorizing the avoidance of transactions resulting from collusive agreements among creditors); Class Plaintiffs v. City of Seattle, 955 F.2d 1268, 1281, 1283 (9th Cir. 1992) (noting that an agreement for reduction in bond repayments is not enforceable if the bond's trustee colluded with other stakeholders).

[7] Pub. L. No. 94-435, 90 Stat. 1383.

[8] 15 U.S.C. § 18(a) (requiring pre-acquisition notifications for certain transactions); 11 U.S.C. § 363(b)(2) (recognizing the Act's notification requirement in bankruptcies); *see also infra* note 118 (discussing the Act's reporting thresholds).

[9] One can criticize this model by arguing that there is no relationship between bankruptcy volume and market concentration with both being driven by market distress as the common hidden variable. Analysis completed in Section Supp.II.C. of DATA SUPPLEMENT, *supra* note 1 indicates that this is not a major issue.

stabilization and increasing concentration over the long-term. This discharge is associated with short-term market instability and lower concentration.

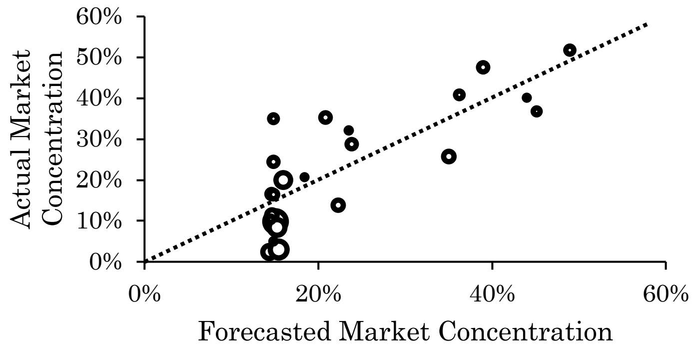

Figure 1. The Market Concentration of the Largest Twenty-Five Sectors of the U.S. Economy in 2019 versus Values Estimated Using Bankruptcy Data and the Regression Model Outlined in Appendix.[10] *The Line is the 45-Degree Line and the Size of Circles Represents the Fraction of 2019 GDP Attributable to Each Sector. The raw and adjusted R^2 values are 0.641 and 0.505.*

The impact of the lack of antitrust scrutiny into the bankruptcy system is only amplified by the volume of assets exposed to it. About $880 billions of liabilities passed through the system from 2015 to 2019.[11] But, this is only a part of the assets exposed to the bankruptcy system. In 2019, about $9.3 trillion of U.S. corporate debt was in circulation.[12] The default risk of these instruments ranges from negligible to more than 20% as shown

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[10] *See* Section Supp.II.A. and Supp.II.B. of *id.* for the background data and a deeper review of this regression model's statistical performance, respectively.

[11] Information obtained from Federal Judicial Center's Bankruptcy Petition NewSTATS Snapshots Database. *See FJC – Litigation – Bankruptcy*, WHARTON RSCH. DATA SERVS., https://whr.tn/3t4USgT (last visited Jan. 28, 2021). About $8.7 trillion of mergers and acquisitions were completed during the same period. SEC. INDUS. & FIN. MKTS. ASS'N, 2020 CAPITAL MARKETS FACT BOOK 25 (2020).

[12] Diane Vazza et al., *U.S. Corporate Debt Market: The State of Play in 2019*, S&P GLOB. (May 17, 2019), https://www.spglobal.com/en/research-insights/articles/u-s-corporate-debt-market-the-state-of-play-in-2019.

in Figure 2. Granted, every default does not lead to a bankruptcy.[13] But, bankruptcy rulings constrain out-of-court negotiations too.[14]

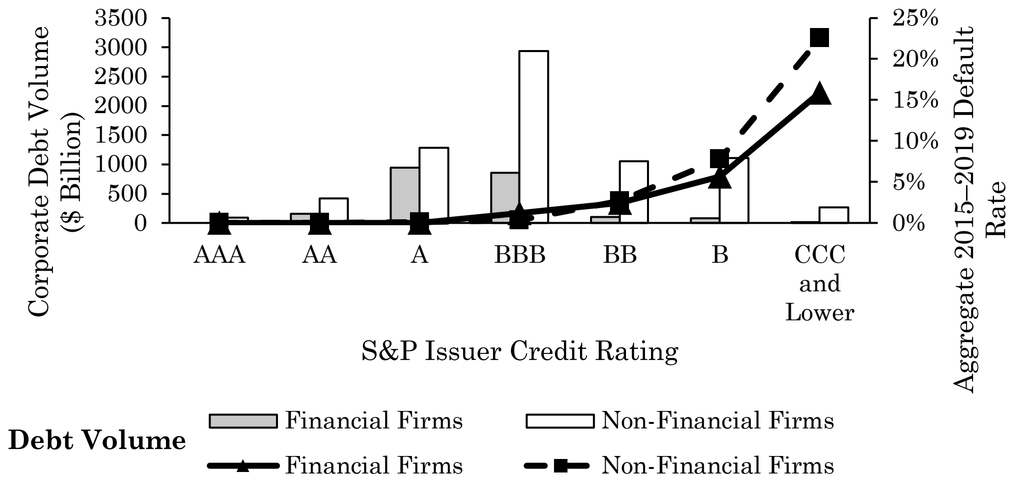

Figure 2. Corporate Debt Instruments in Circulation as of 2019 in the U.S. and Their Estimated Aggregate Default Rate in the 2015 to 2019 Period.[15]

The rest of the Article unpacks two specific mechanisms through which the bankruptcy system contributes to higher market concentrations. Part I focuses on how the bankruptcy system's interference with debt pricing contributes to higher market concentration. Next, Part II analyzes the contribution of the direct conflict between bankruptcy and antitrust laws to

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[13] William W. Bratton & Adam J. Levitin, *The New Bond Workouts*, 166 U. PA. L. REV. 1597, 1601 (2018) ("A substantial portion—around one-fifth of restructuring activity—has shifted from bankruptcy court to out-of-court workouts . . . ."); Sris Chatterjee et al., *Resolution of Financial Distress: Debt Restructurings via Chapter 11 Prepackaged Bankruptcies, and Workouts*, 25 FIN. MGMT. 5, 9 (1996) (finding that about 50% of all restructurings of public firms were completed through workouts).

[14] *See* Zacharias Sautner & Vladimir Vladimirov, *Indirect Costs of Financial Distress and Bankruptcy Law: Evidence from Trade Credit and Sales*, 22 REV. FIN. 1667, 1690–92 (2018); Michelle J. White, *Corporate Bankruptcy as a Filtering Device: Chapter 11 Reorganizations and Out-of-Court Debt Restructurings*, 10 J.L. ECON. & ORG. 268 (1994).

[15] See Part Supp.I of DATA SUPPLEMENT, *supra* note 1 for the background data.

higher market concentrations. Finally, Part III recommends solutions to these issues and the broader tension between bankruptcy and antitrust laws.

I. The Bankruptcy System's Contribution to Concentrated Markets via its Interference with Debt Pricing

As discussed, there appears to be a relation between bankruptcy volume and market concentration. This is no mere correlation. Section A shows that the bankruptcy system is a source of information for capital markets distinct from other sources, such as credit ratings. Sections B and C argue that this information is noisy due to judicial departures from the Bankruptcy Code's absolute priority framework and the incomplete debtor-creditor renegotiation framework of the bankruptcy system. Section D illustrates that this noise contributes to more concentrated markets by disproportionately impacting newer and smaller competitors.

A. A Distinct Source of Information for Capital Markets

This Section provides evidence of the role of the bankruptcy system as a distinct source of information for capital markets. A panel analysis indicates that bankruptcy volume is related with differences in debt yield across credit ratings, but not with differences in debt yields within individual credit ratings. This pattern persists even after the data is further split across economic sectors. This finding is interesting once the broader context is considered. Differences in debt yields across credit ratings should be solely due to those ratings. After all, those ratings are intended to encapsulate the risk associated with debt instruments. Yet, rating misclassifications are not uncommon.[16] Thus, bankruptcy volume influences debt yield by "filling in" the missing information. A treatment test further supports this hypothesis.

The two panels organized in this study are:

- *Panel A* consisting of debt yield and bankruptcy data aggregated across credit ratings annually from 2003 to 2019 used to determine if bankruptcy volume impacts debt yield after accounting for credit ratings and systemic variables such as GDP growth;

[16] *See infra* note 27 and accompanying text.

- *Panel B* consisting of the same data aggregated across credit ratings within economic sectors[17] used to unearth the impact of bankruptcy filings on the debt yield of peer firms—i.e., firms hailing from the same sector and with similar ratings.

The analysis of *Panel A*, as shown in Table 1, indicates that the volume of liabilities and revenues passing through bankruptcy courts is related to debt yields across credit ratings, but not within individual ratings.[18] Specifically, These volumes are statistically significant with the "between" R^2 being about 0.56, far above the "within" R^2 of 0.05.

[17] To ensure that individual panels are not too sparsely populated, credit ratings are aggregated in groups of three. For example, all firms in the construction sector (NAICS Code 23) with debt credit rating of AAA to AA are grouped in a single panel.

[18] The application of the Hausman test to *Panels A & B* indicates that the debt market's reaction to independent variables was not constant during the analysis period. Specifically, the test returned a negative χ^2, meaning that there was insufficient evidence to reject the null hypothesis that the random effects model is preferred. *See generally* Sven Schriber, *The Hausman Test Statistic Can be Negative Even Asymptotically*, 228 JAHRBÜCHER FÜR NATIONALÖKONOMIE UND STATISTIK 394 (2008). Thus, a random effects model is employed to analyze all panels.

Table 1. The Coefficients of the Generalized Least Square Regression Model of Panel A Normalized[19] Data.[20]

Independent Variable	Regression Coefficient	Significance P-Value
Bankruptcy Liability[21]	–0.179	0.027
Bankruptcy Revenue[22]	1.644	0.010
10-Year Treasury Yield	–0.0211	0.790
Annual Inflation Rate	1.325	0.013
Annual GDP Growth Rate	0.001	0.996
Annual Gross Sector Product Growth Rate[23]	–0.257	0

These observations largely hold even after the data is further granularized across credit ratings and economic sectors through *Panel B*, as shown in Table 2. In other words, bankruptcy volume is modestly related to debt yield *across* firms situated in different economic sectors and credit ratings. In contrast, this volume is not related to debt yields *within* similar firms situated in similar economic sectors and credit ratings.[24]

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[19] All independent and dependent variables have been normalized to make comparisons easier. The following formula is used to normalize each variable:

$$\text{Normalized Variable} = \frac{(\text{Raw Variable} - \text{Variable Average Across All Entries})}{\text{Variable Average Across All Entries}}$$

[20] See DATA SUPPLEMENT, *supra* note 1, tbl.Supp.10 for a detailed statistical profile.

[21] This metric is calculated in two steps. First, the total volume of bankruptcy liability of each sector is divided by that sector's gross output. Second, these fractional volumes are averaged based on the fraction of gross output within each credit rating category attributable to each sector.

[22] This metric is calculated using the same method as the preceding footnote.

[23] This metric is calculated by averaging sector gross output growth rates based on each sector's relative gross output within each credit rating.

[24] The "within" R^2 of the model is about 0.02 while the "between" R^2 value is 0.144.

Table 2. The Coefficients of the Generalized Least Square Regression Model of Panel B Normalized[25] *Data.*[26]

Independent Variable	Regression Coefficient	Statistical Significance P-Value
Bankruptcy Liability	–0.001	0.705
Bankruptcy Revenue	0.001	0.067
10-Year Treasury Yield	–0.003	0.325
Annual Inflation Rate	0.172	0.282
Annual GDP Growth Rate	–0.115	0.265
Annual Gross Sector Product Growth Rate	–0.033	0.015

Combining the analyses of *Panel A & B* points to a hypothesis: the bankruptcy system influences debt yield by "filling in" the information missed by credit ratings for investors. After all, differences in debt yields across credit ratings should be solely due to different ratings since those ratings are intended to encapsulate the risk associated with debt. However, rating misclassifications rates of up to 5% are not uncommon.[27]

This hypothesis is tested by applying a treatment test to *Panel A*. This test is predicated on the observation in Figure 3 that bankruptcy volume relative to gross output of businesses is generally negligible. Thus, investors pay attention to the information provided by the bankruptcy system only

[25] See, *supra*, note 19 for the normalization approach employed here.

[26] See DATA SUPPLEMENT, *supra* note 1, tbl.Supp.11 for a more detailed statistical profile.

[27] Lynn Bai, *Performance Disclosures of Credit Rating Agencies: Are They Effective Reputational Sanctions?*, 7 N.Y.U. J.L. & BUS. 47, 81 tbl.5 (2010).

when bankruptcies become big enough to "break through" other sources of information[28] because information distribution in markets is incomplete.[29]

Figure 3. Distribution of Aggregate Revenues of Bankrupt Firms of Panel A as a Fraction of Their Sectors' Growth Output During the 2003–2019 Period.

Indeed, the application of a treatment test[30] to *Panel A* lends support to this hypothesis. This analysis indicates that debt yields jump by about

[28] Other have also alluded to the interplay between the bankruptcy system and other sources of information. *See, e.g.*, Nina Baranchuk & Michael J. Rebello, *Spillovers From Good-News and Other Bankruptcies: Real Effects and Price Responses*, 129 J. FIN. ECON. 228 (2018) (discussing the framework under which bankruptcy announcements and other source of information propagate across securities markets); Aigbe Akhigbe et al., *Contagion Effects of the World's Largest Bankruptcy: The Case of WorldCom*, 45 Q. REV. ECON. & FIN. 48 (2005) (discussing how the information coming out of WorldCom's infamous bankruptcy spilled over into the pricing of its creditors and competitors).

[29] *See, e.g.*, Kay Giesecke, *Correlated Default With Incomplete Information*, 28 J. BANKING & FIN. 1521 (2004) (discussing the role of incomplete market information in cascades of multi-firm defaults); Darrell Duffie & David Lando, *Term Structures of Credit Spreads With Incomplete Accounting Information*, 69 ECONOMETRICA 3633 (2001) (discussing the role of incomplete information in credit spreads).

[30] The test applied an exogenous treatment random effects linear regression model to *Panel A*'s data where an entry was deemed treated if the revenues of bankrupt firms relative to their associated sectors' gross outputs exceeded 1%. Under this assumption, 10% of entries were "treated."

20.7 basis points[31] once revenues attributed to bankrupt firms exceed 1% of the sectors' gross output.[32] This effect even modifies the role played by other sources of information. Namely, inflation rate and a sector's gross output growth rate appear to have a statistically significant effect on debt yield in absence of large bankruptcy volumes. In contrast, these variables lose their statistical significance in the presence of a large volume of bankruptcies.

In short, the bankruptcy system influences debt pricing by supplying information not available through other avenues, such as credit ratings. Theoretically, this should not unduly influence debt pricing as long as this information is free of noise. However, this is not the case as discussed in the next two Sections.

B. Noise in This Information: Absolute Priority Deviations

Markets demand a risk premium when faced with uncertainty. The Bankruptcy Code strives to minimize this uncertainty by distributing the estate of the bankrupt through absolute priority rules. Thus, it should not be surprising that deviations from absolute priority creates noise in the information provided by the bankruptcy system to capital markets. Regardless of whether these deviations are grounded in sound policies, their unpredictable nature creates uncertainty that leads to a premium in debt yield.

Absolute priority—the set of rules governing the order of payments out of a bankrupt's estate to creditors—has been a hallmark of bankruptcy law since the common law railroad receiverships of the nineteenth century[33] and the Supreme Court's *Northern Pacific Railway v. Boyd*[34] decision. Absolute priority seeks to ensure that the bankrupt behaves fairly by compensating creditors before equity holders and not squeezing out one group

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[31] Average Treatment Margin × Mean Debt Yield Averaged on the Basis of Amount Outstanding = 0.0265 × 0.078 = 0.002067 ≈ 20.7 basis points.

[32] These observations are only statistically significant at a 90% confidence interval. See DATA SUPPLEMENT, *supra* note 1, tbl.Supp.12 for detailed statistical test results.

[33] Bruce A. Markell, *Owners, Auctions, and Absolute Priority in Bankruptcy Reorganizations*, 44 STAN. L. REV. 69, 74 (1991).

[34] 228 U.S. 482 (1913).

of creditors in favor of others.[35] Both the Court and Congress have considered absolute priority to a bedrock of the Bankruptcy Code.[36]

Absolute priority also plays a crucial role in facilitating debt pricing by allowing parties to understand their position in the bankruptcy "queue" if the worst comes to pass.[37] This certainty facilitates pre-bankruptcy negotiations and workouts that are less disruptive than a bankruptcy.[38] It also reduces the aggregate monitoring cost of creditors. Senior creditors can defer to monitoring by junior ones since junior creditors have more to lose from deterioration in debtors' financial health.[39] Put together, the more certain the enforcement of absolute priority, the lower the associated risk premium.

Despite these benefits of absolute priority, deviations from it are common. Deviations occur in about 50% to 70% of Chapter 11 bankruptcies with the 2% to 9% of the value of the bankrupt's estate shifting as a result.[40]

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[35] Bank of Am. Nat'l Tr. & Sav. Ass'n v. 203 N. LaSalle P'ship, 526 U.S. 434, 444 (1999); Markell, *supra* note 33, at 76–77.

[36] Czyzewski v. Jevic Holding Corp., 137 S. Ct. 973, 984 (2017); H.R. REP. NO. 103–835, at 33 (1994).

[37] *See* Douglas G. Baird, *Priority Matters: Absolute Priority, Relative Priority, and the Costs of Bankruptcy*, 165 U. PA. L. REV. 785, 803–06 (2017); Haluk Unal et al., *Pricing the Risk of Recovery in Default with Absolute Priority Rule Violation*, 27 J. BANKING & FIN. 1001, 1004–10 (2003).

[38] *See* Yaacov Z. Bergman & Jeffrey L. Callen, *Rational Deviations From Absolute Priority Rules*, 4 INT'L REV. FIN. ANALYSIS 1, 3 (1995) ("[W]orkouts are usually far less successful than formal proceedings.").

[39] Andrew Winton, *Costly State Verification and Multiple Investors: The Role of Seniority*, 8 REV. FIN. STUD. 91, 109 (1995).

[40] Stanley D. Longhofer & Charles T. Carlstrom, *Absolute Priority Rule Violations in Bankruptcy*, 31 FED. RSRV. BANK. CLEVELAND ECON. REV., no. 4, 1995, at 21, 22 tbl.1 (collecting statistics reported by other studies); Brian L. Betker, *Management's Incentives, Equity's Bargaining Power, and Deviations From Absolute Priority in Chapter 11 Bankruptcies*, 68 J. BUS. 161, 166 (1995). Courts have attempted to stamp out the most blatant deviations, such as priority-skipping structured

These deviations have made their way into out-of-court workouts too with deviations in the range of 1% to 10% being common.[41]

Deviations from absolute priority are undesirable as they partly reflect rent extraction. Management, who is put in place by equity holders, has an informational advantage about the true value of the bankrupt.[42] Therefore, management and equity holders can withhold this information and use their superior position in the reorganization process[43] to extract rent from creditors who know less about the bankrupt.[44] Additionally, equity holders of insolvent firms benefit from upsides of risky investments, but offload the downsides of those investments on creditors due to their limited liability.[45] Therefore, deviations in their favor only increases their net payouts from risky investments and shifts extra costs to creditors.

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dismissals of bankruptcy petitions. *See Jevic Holding Corp.*, 137 S. Ct. at 978. Nonetheless, practitioners have found other avenues of deviating from absolute priority. *See* Hollace T. Cohen, *Pre-Plan Settlement Post-*Jevic—Jevic*'s Impact on the Absolute Priority Rule and Other Core Bankruptcy Principles*, 27 NORTON J. BANKR. L. & PRAC., no. 1, 2018, art. 1. Moreover, there is evidence of ongoing deviations in favor of equity holders. Pascal François & Alon Raviv, *Heterogenous Beliefs and the Choice Between Private Restructuring and Formal Bankruptcy*, 41 N. AM. J. ECON. & FIN. 156, 161 (2017).

[41] Julian R. Franks & Walter N. Torous, *A Comparison of Financial Recontracting in Distressed Exchanges and Chapter 11 Reorganizations*, 35 J. FIN. ECON. 349, 363 tbl.6. (1994); Elizabeth Tashjian et al., *Prepacks: An Empirical Analysis of Prepackaged Bankruptcies*, 40 J. FIN. ECON. 135, 145 tbl.2 panel C (1996); Marc-Olivier Lücke, Jurisdiction, Deviations from Absolute Priority, and Their Impact on the Valuation of Defaulted Securities 72 tbl.4.6 (Sept. 5, 2011) (Doctor Rerum Politicarum Dissertation, WHU Otto Beisheim School of Management), https://opus4.kobv.de/opus4-whu/frontdoor/index/index/docId/80.

[42] Allan C. Eberhart et al., *Security Pricing and Deviations From the Absolute Priority Rule in Bankruptcy Proceedings*, 45 J. FIN. 1457, 1468 (1990).

[43] The management typically has the right to propose the first reorganization plan in a Chapter 11 bankruptcy. 11 U.S.C. § 1121(b).

[44] Eberhart et al., *supra* note 42, at 1468.

[45] Lucian Arye Bebchuk, *Ex Ante Costs of Violating Absolute Priority in Bankruptcy*, 57 J. FIN. 445, 447–48 (2002).

These deviations are even more problematic because their unpredictability makes debt pricing more uncertain. These deviations move both up and down the absolute priority ladder with senior creditors being overcompensated in some cases and being undercompensated in others.[46] Moreover, these deviations displace explicit contracts between debtors and creditors designed to address the suboptimal risk-shifting created by equity holders' limited liability.[47] Some have argued that markets adequately price-in the uncertainty created by this displacement.[48] However, others note that these deviations increase noise in financial markets and account for 30%–85% of the noise in distressed security prices.[49]

As discussed so far, deviations from absolute priority shifts make the prospect of payoff more uncertain and noisier. The natural response of the market to this increased risk is to demand a higher risk premium. Oftentimes, the burden of this premium fall disproportionately upon new entrants and competitors, thereby handing an advantage to incumbents and contributing to higher market concentrations. This issue is explored in more detail in Section D with Section C focusing on yet another source of noise.

C. More Noise in This Information: The Trust Indenture Act

Another source of noise in the information provided by the bankruptcy system to capital markets is the cliff in the relation between creditors and

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[46] Baird, *supra* note 37, at 824–25.

[47] *See* Allan C. Eberhart & Lemma W. Senbet, *Absolute Priority Rule Violations and Risk Incentives for Financially Distressed Firms*, 22 FIN. MGMT. 101, 103–05 (1993); Michael C. Jensen, *Corporate Control and the Politics of Finance*, 4 APPLIED CORP. FIN. 13, 30 (1991).

[48] *E.g.*, Unal et al., *supra* note 37 (corroborating a pricing model incorporating absolute priority rule deviations with market data); Eberhart et al., *supra* note 42, at 1457 ("[C]ommon share values reflect a significant proportion of value ultimately received in violation of absolute priority . . . .").

[49] Allan C. Eberhart & Richard J. Sweeney, *A Note on Noise in the Market for Bankrupt Firms' Securities*, 20 J. BANKING & FIN. 401, 411 (1996); *accord* Michael Bradley & Michael Rosenzweig, *The Untenable Case for Chapter 11*, 101 YALE L.J. 1043, 1085 (1992).

debtors created by the interactions between the Trust Indenture Act of 1939[50] (the "T.I.A.") and the Bankruptcy Code. This cliff exists because a debtor cannot fully renegotiate its bonds with creditors under the T.I.A. unless it opens all its obligations up to renegotiation through a bankruptcy petition.

The T.I.A. was enacted in response to the capital market's meltdown during the Great Depression.[51] It was a response to a report by the S.E.C. that criticized bond trustees for being passive in the exercise of their fiduciary duties.[52] The T.I.A. establishes a host of rules around how debt debentures are structured and what functions trustees must exercise.[53] However, central to the T.I.A.'s interference with debt pricing is its ban on changes to payment terms of a bond without unanimous consent.[54]

Allowing debtors and creditors to fully renegotiate outside of bankruptcy can enhance their aggregate contractual gain. Debt is a contract under which a debtor receives a capital infusion now in exchange for future payouts. Parties lack complete information[55] and cannot draft an

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[50] 15 U.S.C. §§ 77aaa–77bbbb.

[51] Stanley E. Howard, *The Trust Indenture Act of 1939*, 16 J. LAND & PUB. UTIL. ECON. 168, 168 (1940).

[52] 6 SEC. & EXCH. COMM'N, *Trustees Under Indentures*, *in* REPORT ON THE STUDY AND INVESTIGATION OF THE WORK, ACTIVITIES, PERSONNEL AND FUNCTIONS OF PROTECTIVE AND REORGANIZATION COMMITTEES 1, 1–6 (1936); Howard, *supra* note 51, at 168–69.

[53] *See generally* Harald Halbhuber, *Debt Restructurings and the Trust Indenture Act*, 25 AM. BANKR. INST. L. REV. 1 (2017).

[54] To be exact, the law bans changes to a bond's payment terms without the bondholder's consent. 15 U.S.C. § 77ppp(b); Mark J. Roe, *The Trust Indenture Act of 1939 in Congress and the Courts in 2016: Bringing the SEC to the Table*, 129 HARV. L. REV. F. 360, 361 (2016). This, in effect, necessitates unanimous consent for changes to payment terms because a bondholder is unlikely to accept a cut unless other bondholders receive the same cut too. *See* Marcel Kahan, *The Scope of Section 316(b) after* Marblegate, 13 CAP. MKTS. L.J. 136, 138 (2018)

[55] Luca Benzoni et al., Incomplete Information, Debt Issuance, and the Term Structure of Credit Spreads 1 (Sept. 25, 2020) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3454816.

economically complete contract without incurring prohibitive costs.[56] Thus, allowing parties to renegotiate improves their aggregate outcome by allowing them to incorporate new information as it becomes available.

Yet, the T.I.A. prevents bondholders and debtors from engaging in this renegotiation, a ban that collides with the Bankruptcy Code's collective renegotiation framework to create a cliff in the debtor-creditor relationship. To start, the T.I.A.'s de facto unanimous consent requirement stops the complete renegotiation of bonds. True, a debtor can aim for unanimous creditor consent. But, the hold-out problem and the differing goals of creditors make this an impossibility.[57] Thus, a cliff in the debtor-creditor relationship forms: a debtor cannot fully renegotiate a bond unless it forces all bondholders to the table through a bankruptcy petition, and in doing so, opens itself up to full renegotiation with all other creditors.

The first source of evidence for the existence of this cliff is the preference for short-term bonds in the U.S. A sequence of short-term bonds allows parties to fully renegotiate more frequently as compared to a single long-term bond.[58] Creditors prefer this over incomplete renegotiation because it gives them more control and exposes them to less risk. Debtors prefer this because it allows them to pay lower interest rates without giving away too much control at the onset of the relationship. However, replacing fully renegotiable long-term bonds with a series of short-term ones is an imperfect solution. In essence, it exchanges a voluntary framework for renegotiation with a compulsory one. This would not be an issue in a world of negligible transaction costs and fully rational actors with access to consistent and symmetric information. But, real world renegotiations are uncertain and costly,[59] meaning that a mandatory renegotiation framework is a departure

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[56] Elisabeth de Fontenay, *Complete Contracts in Finance*, 2020 WIS. L. REV. 533, 540–41 (2020). An economically complete contract is one that outlines how parties will behave under every possible contingency. *Id.*

[57] Roe, *supra* note 54, at 363–365.

[58] Patrick Bolton, *Incomplete Contracts and Renegotiation: Renegotiation and the Dynamics of Contract Design*, 34 EUR. ECON. REV. 303, 309 (1990).

[59] Luca Anderlini & Leonardo Felli, *Costly Bargaining and Renegotiation*, 69 ECONOMETRICA 377 (2001) (discussing various sources of cost in renegotiations).

from the market's equilibrium. This, in effect, interferes with the market's pricing of debt.

Market data corroborate this observation. Debt with investment grade credit rating purportedly carries a lower default risk. Therefore, creditors are more likely to accept longer payment periods without demanding high interest rates because the amount of future risk that needs to be renegotiated is likely little. In contrast, creditors are unlikely to accept such a deal for speculative grade debt because of the higher default risk and the associated amount of future risk that needs to be renegotiated. As Figure 4 indicates, this pattern is evident in the U.S. bond market. In contrast, loans—which are not subject to the T.I.A.'s limitation on renegotiations and are, in fact, often fully renegotiated[60]—exhibit the opposite pattern. One can argue that these differences may be due to self-selection among creditors and debtors across loans and bonds. However, a similar pattern of differences across loans and bonds is much less pronounced in foreign markets where the T.I.A. does not govern bonds.[61] There, the difference in the maturity periods of investment and speculative grade debt across bonds and loans is much smaller, as shown in Figure 4.

Another source of evidence for the existence of this cliff is the unusual reliance on bond covenants and the associated exit consent process in the U.S. At their core, bond covenants seek to address the conflict of interest between owners and creditors where owners receive unlimited benefits from the potential upside of a risky investment while their limited liability shifts the cost of failure to creditors.[62] They can also reduce monitoring costs by coalescing creditors and debtors around a common set of metrics that forecast

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[60] Michael R. Roberts, *The Role of Dynamic Renegotiation and Assymetric Information in Financial Contracting*, 116 J. FIN ECON. 61, 61 (2015) ("[T]he typical bank loan is renegotiated five times, or every nine months.").

[61] The Trust Indenture Act unanimous consent requirement is not present in many other jurisdictions. *E.g.*, Lee C. Buchheit & G. Mitu Gulati, *Exit Consents in Sovereign Bond Exchanges*, 48 UCLA L. REV. 59, 65 n.15 (2000); INT'L MONETARY FUND, THE DESIGN AND EFFECTIVENESS OF COLLECTIVE ACTION CLAUSES 6–9 (2002).

[62] *See supra* notes 45–49 and accompanying text.

the debtor's ability to service its debt.[63] Paradoxically, they can also give more flexibility to owners by obviating the need for more intrusive measures such as security interests.[64]

However, these covenants can also be used as an end-run around the T.I.A. Debtors are ex ante aware that the T.I.A. prevents them from renegotiating their bonds' payment terms. Therefore, they seek to find alternative avenues of renegotiating these terms. Unlike payment terms, bond covenants can be removed after a vote of bondholders through a process known as the "exit consent."[65] This consent process begins with the debtor crafting an offer to exchange the current bond with a new one. The debtor crafts this offer to attract the interest of enough bondholders to meet the current bond's amendment threshold.[66] As a part of the consent solicitation process, bondholders who agree to the exchange also consent to modify the current bond as to strip it of its creditor-protecting covenants in the hope of pushing holdouts to participate in the exchange.[67]

[63] Clifford W. Smith, Jr., *A Perspective on Accounting-Based Debt Covenant Violations*, 68 ACCT. REV. 289, 289 (1993).

[64] *See* Raghuram Rajan & Andrew Winton, *Covenants and Collateral as Incentives to Monitor*, 50 J. FIN. 1113, 1114–15 (1995); George Triantis, *Exploring the Limits of Contract Design in Debt Financing*, 161 U. PA. L. REV. 2041, 2058 (2013).

[65] David J, Billington, *Exit Consents in Restructurings—Still a Viable Option?*, HARV. L. SCH. F. ON CORP. GOVERNANCE (May 22, 2013), https://corpgov.law.harvard.edu /2013/05/22/exit-consents-in-restructurings-still-a-viable-option/.

[66] Keegan S. Drake, *The Fall and Rise of the Exit Consent*, 63 DUKE L.J. 1589, 1599 (2014).

[67] *Id.* at 1599–1600.

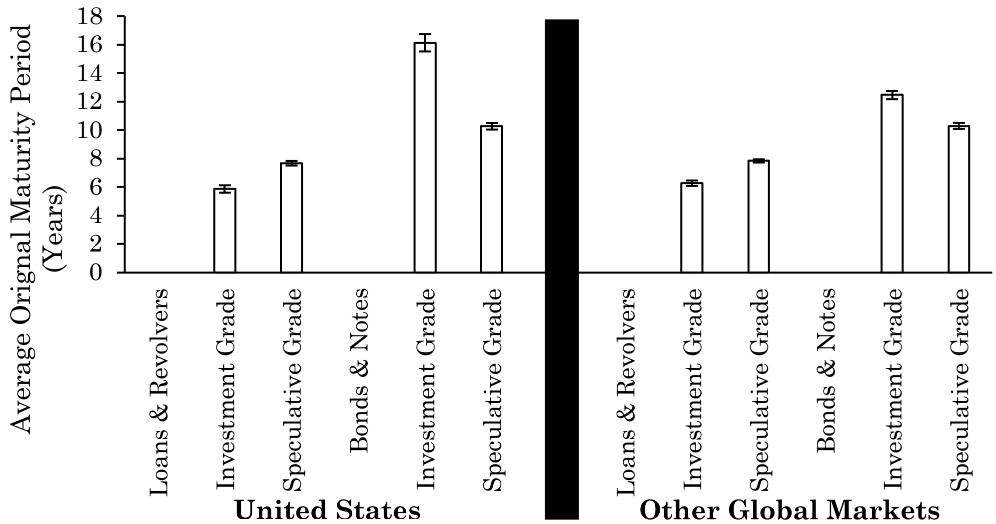

Figure 4. Average Original Maturity Period of Corporate Debt of Nonfinancial Institutions in 2019 Aggregated Based on Face Value.[68] *Error Bars Represent a 95% Confidence Interval.*[69]

Thus, exit consent is an elaborate way of fully renegotiating a bond when the bond's payment terms cannot be negotiated due to the T.I.A.'s limitations. It is complex and has the potential to spiral out of control if holdouts cannot be cajoled.[70] Moreover, its utility as a substitute for full renegotiation is modest since its success and participation rates appear to

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[68] Debt with rating below BB+ is speculative. S&P GLOB. RATINGS, HOW WE RATE NONFINANCIAL CORPORATE ENTITIES 13 (2021), https://www.spglobal.com/ratings/_division-assets/pdfs/041019_howweratenonfinancialcorporateentities.pdf.

[69] See DATA SUPPLEMENT, *supra* note 1, Part Supp.IV for the background data.

[70] Afterall, holdouts can extract the full repayment of their debt. *See, e.g.*, CIBC Bank & Tr. Co. (Cayman) Ltd. v. Banco Central do Brasil, 886 F. Supp. 1105 (S.D.N.Y. 1995).

hover around 50%.[71] Therefore, its use should be common where debt covenants carry a residual renegotiation value because payment terms cannot be modified—i.e., in the U.S.

This appears to be the case. U.S.-based bonds, which cannot be completely renegotiated, rely more extensively on covenants as compared to bonds issued in other jurisdictions.[72] Moreover, the resurgence of "cov-lite"

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[71] András Danis, *Do Empty Creditors Matter? Evidence From Distressed Exchange Offers*, 63 MGMT. SCI. 1285, 1286 (2017) (reporting an average exchange participation rate of 55%); Christopher James, *Debt Restructurings and the Composition of Exchange offers in Financial Distress*, 51 J. FIN. 711, 717 (1996) (pointing to a 40% overall exchange offer success rate by first reporting a 75% exchange offer success rate and next noting that almost half of successful exchanges were technical failures because they failed to reach their original targets).

[72] Hyun A. Hong et al., *The Use of Debt Covenants Worldwide: Institutional Determinants and Implications on Financial Reporting*, 33 CONTEMP. ACCT. RSCH. 644, 653 tbl.1 (2014). Some have gone as far as categorizing this exit consent process as a "US-style exchange offer[]." James Cole, *How to Apply US-Style Exchange Offers in Europe*, 21 INT'L FIN. L. REV. 52 (2009).

The largest corporate bond markets outside of the U.S. are China and Germany. *Bond Market Size*, INT'L CAP. MKT. ASS'N (Aug. 2020), https://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/Secondary-Markets/bond-market-size/. The exit consent process has not been adopted in China with Chinese bond exchange offers typically resembling rollovers. *Chinese Issuers Turn to Bond Exchanges as Repayment Pressures Build*, REUTERS (Mar. 19, 2020), https://reut.rs/37g5jEB; *see also China's First Onshore Bond Exchange Improves Restructuring Path*, FITCH RATINGS (Mar. 16, 2020), https://www.fitchratings.com/research/corporate-finance/china-first-onshore-bond-exchange-improves-restructuring-path-16-03-2020. Likewise, the exit consent process is not widely used in Germany since German bondholders can modify a bond's core terms. *See* Tobias Wetlitzky, *Water Under the Bridge? A Look at the Proposal for a New Chapter 16 of the Bankruptcy Code from a Comparative Law Perspective*, 37 EMORY BANKR. DEVS. J. 255, 278–79 (2021).

speculative bonds[73]—i.e., speculative bonds that lack covenants—has been partly attributed to decreasing utility of these covenants as leverage in renegotiations.[74] This difficulty has been attributed to the increasing diversity of bondholders—including more passive mutual funds—that makes renegotiations more difficult.[75]

How do these debt covenants and the exit consent process add more noise to the system and interfere with the market pricing of debt? As already discussed, covenants and exit consents are imperfect substitutes for a fully renegotiable debt. Moreover, the decision to include these covenants and their pricing are subjective exercises that are more difficult to price than other measures of risk and payment.[76] These covenants create even more noise because they are costly to monitor[77] and generate false positives and negatives.[78] They also reduce the debt market's liquidity—and amplify the

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[73] Alexandra Scaggs, *Loan Covenant Quality Hits Record Low, Says Moody's*, FIN. TIMES (July 24, 2018), https://on.ft.com/3azj7fp; Mayra Rodriguez Valladares, *North American Leveraged Loan Covenants Protections are Practically Useless*, FORBES (Apr. 24, 2019), https://www.forbes.com/sites/mayrarodriguezvalladares/2019/04/24/north-american-leveraged-loan-covenant-protections-are-practically-useless/?sh=4d2a11a0549c.

[74] Bo Becker & Victoria Ivashina, *Covenant-Light Contracts and Creditor Coordination* 5–8 (Sveriges Riksbank, Rsch. Paper Ser. 149, 2016), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2871887.

[75] *Id.*

[76] Laurence Neville, *The Return of COV-LITE Debt*, CREDIT, Nov. 2008, at 20, 22 (emphasizing the subjective nature of covenants and their pricing); Michael Bradley & Michael R. Roberts, *The Structure and Pricing of Corporate Debt Covenants*, 5 Q.J. FIN., no. 2, 2015, art. 1550001, at 1, 31 (reporting a mean R-squared of about 0.52 for a group of equations developed to price debt covenants).

[77] *See* Charles K. Whitehead, *The Evolution of Debt: Covenants, the Credit Market, and Corporate Governance*, 34 J. CORP. L. 641, 650–53 (2009).

[78] Thomas P. Griffin et al., Losing Control? The 20-Year Decline in Loan Covenant Restrictions 2–5 (June 11, 2020) (unpublished manuscript),

impact of any additional noise—by making each bond issue more unique and less comparable.[79]

One may point to the precipitous drop in the use of covenants in bonds to argue that the residual renegotiation value of these covenants is so small as to be negligible. However, this trend must be placed within the broader context of capital markets. True, cov-lite bonds and loans have grown to account for more than 80% of the speculative debt market in the U.S.[80] But, yields in the bond market have been at historical lows since the 2008 Financial Crisis.[81] Therefore, returns on various aspects of the debt, including its covenants and underlying risk, have dropped as well. Indeed, there are signs that covenants are making a comeback as the credit market's outlook shifts to one of tighter credit.[82] Moreover, elimination of covenants in

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https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3277570 (attributing the drop in the usage of certain covenants to their false positive rate); Jeffrey Pittman & Yuping Zhao, *Debt Covenant Restriction, Financial Misreporting, and Auditor Monitoring*, 37 CONTEMP. ACCT. RSCH. 2145, 2145 (2020) (arguing that the presence of debt covenants is associated with increasing incidence of financial misstatements intended to prevent costly covenant violations).

[79] *Cf.* Gus de Franco et al., *Similarity in the Restrictiveness of Bond Covenants*, 29 EUR. ACCT. REV. 665, 665 (2020) (noting that bond issuers increasingly demand identical covenant languages to obtain "greater liquidity in the secondary market").

[80] BAIN CAPITAL CREDIT, IMPLICATIONS OF THE GROWTH IN COVENANT-LITE LOANS 1 (2019), https://www.baincapitalcredit.com/sites/baincapitalcredit.com/files/Credit_Market_Insights-Implications_of_Growth_in_Cov-Lite_Loans_060419.pdf; *see also* Tracy Alloway & Vivianne Rodrigues, *Strong Demand for "Junk" Bonds Erodes Investor Protection*, FIN. TIMES (Mar. 12, 2014), https://on.ft.com/3sKIf9p.

[81] *5-Year High Quality Market (HQM) Corporate Bond Spot Rate (HQMCB5YR)*, ECON. RSCH.: FED. RSRV. BANK OF ST. LOUIS (Apr. 15, 2021), https://fred.stlouisfed.org/series/HQMCB5YR.

[82] *North American Loan Covenant Quality Improves Again in Q1 2019, but Remains Week*, MOODY'S INVS. SERV. (July 25, 2019), https://www.moodys.com/research/Moodys-North-American-loan-covenant-quality-

loans—which are not limited by the T.I.A.— have been accompanied by an increase in the adoption of clauses that facilitate renegotiation.[83] This again points to covenants acting as imperfect substitutes for complete renegotiation with market players opting for complete renegotiation where possible.

D. The Disproportionate Impact of This Noise on Smaller Entrants

This Section establishes the final link in the chain between the bankruptcy's system influence on debt pricing and higher market concentrations. It illustrates that new entrants and competitors bear the disproportionate burden of the risk premium demanded by creditors in response to noisy information provided by the bankruptcy system. This, in turn, provides incumbents with a relative advantage.[84]

As a threshold matter, smaller firms and new entrants occupy the speculative niche of capital markets that leaves them more exposed to risk premiums.[85] As a result, they experience more volatile debt yields and are more susceptible to noises that influence financial markets.[86] This volatility

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improves-again-in-Q1--PBC_1187334; *Bond Covenant Protections Tighten in Covid-Impacted Sectors but Remain Weak Overall*, MOODY'S INVS. SERV. (Aug. 17, 2020), https://www.moodys.com/research/Moodys-Bond-covenant-protections-tighten-in-Covid-impacted-sectors-but--PBC_1242047.

[83] Edison Yu, *Banking Trends: Measuring Cov-Lite Right*, 3 FED. RSRV. BANK OF PHILA., no. 3, 2018, at 1, 5, 5 fig.7.

[84] *See, e.g.*, Stephen Gray et al., *The Determinants of Credit Ratings: Australian Evidence*, 31 AUSTRALIAN J. MGMT. 333, 342–43 (2006); Hsing-Hua Huang & Han-Hsing Lee, *Product Market Competition and Credit Risk*, 37 J. BANKING & FIN. 324, 324 (2013).

[85] Doron Avramov et al., *Credit Ratings and the Cross-Section of Stock Returns*, 12 J. FIN. MKTS. 469, 473 tbl.1 (2009). LI-GANG LIU & GIOVANNI FERRI, ASIAN DEV. BANK, RESEARCH PAPER 26, HOW DO GLOBAL CREDIT RATING AGENCIES RATE FIRMS FROM DEVELOPING COUNTRIES? 20 tbl.4 (2001).

[86] Duen-Li Kao, *Estimating and Pricing Credit Risk: An Overview*, 56 FIN. ANALYSTS J. 50, 51 (2000).

is only exacerbated by their more cyclical revenue streams since their smaller size prevents them from effectively diversifying.[87]

Additionally, smaller firms lack other salient sources of information (such as stable cash flows and financing history) that can be used to assess their credit risk unlike their larger and more established competitors.[88] This information imbalance means that smaller firms are more likely to bear the cost of any risk premium that arises from any source of noise.[89]

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[87] Nicolas Crouzet & Neil R. Mehrotra, *Small and Large Firms Over the Business Cycle* 2–3, 53 fig.3 (Fed. Rsrv. Bank of Minneapolis Rsch. Div., Working Paper No. 741, 2017); Charles W. Calomiris & R. Glenn Hubbard, *Firm Heterogenity, Internal Finance, and Credit Rationing* 23 (Nat'l Bureau of Econ. Rsch., Working Paper No. 2497, 1988). This revenue cyclicality is amplified the newer the firm is to a market. Teresa C. Fort et al., *How Firms Respond to Business Cycles: The Role of Firm Age and Firm Size* 2–3 (Nat'l Bureau of Econ. Rsch., Working Paper No. 19134, 2013).

[88] For example, many smaller firms are exempt from financial transparency measures—such as the Sarbanes-Oxley Act—that have led to lower cost of credit for their larger competitors. *See* Sandro C. Andrade et al., *SOX, Corporate Transparency, and the Cost of Debt*, 38 J. BANKING & FIN. 145, 145 (2014) ("Our analysis shows that corporate opacity and the cost of debt decrease significantly after SOX"); Cydney Posner, *SEC's Carve-Out from SOX 404(b) for Low-Revenue Companies*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Apr. 4, 2020), (discussing small business exemptions from the Sarbanes-Oxley Act); *see also* Lance Moir & Sudi Sudarsanam, *Determinants of Financial Covenants and Pricing of Debt in Private Debt Contracts: the UK Evidence*, 37 ACCT. & BUS. RSCH. 151 (2007) ("The ability of the larger firms to avoid giving financial covenants may be a reflection of their lower risk, greater liquidity or *higher reputation*." (emphasis added)).

[89] *Cf.* Bill Hao, *Credit Risk Premium in the Equity Market*, S&P GLOB. (May 20, 2021), https://www.spglobal.com/en/research-insights/articles/credit-risk-premium-in-the-equity-market (reporting that a widely used commercial risk model assigns lower risk premiums to firms that are "larger, more mature, and higher quality"); Josée St-Pierre & Moujib Bahri, *The Determinants of Risk Premium: The Case of Bank Lines of Credit Granted to SMEs*, 16 J. DEVELOPMENTAL ENTREPRENEURSHIP 459, 459 (2011) ("[T]he main determinants of risk premium were firm size . . . , the relationship between banker and entrepreneur, and the length of the relationship with the bank.").

The impact of these factors is further amplified by the reality that debt issued by smaller firms is less traded and more illiquid.[90] This means that creditors are unlikely to be able to diversify the risk associated with lending to smaller firms, further driving up the risk premium they demand from smaller competitors.[91]

Of course, one can counter these points by arguing that not all entrants are smaller firms and that many are established entities expanding into new markets. Examples include Amazon's successful foray into information technology services[92] and Samsung's expansion from the world of computer chips and home appliances into the smartphone market.[93]

This observation is addressed through two points. First, such conglomerates have proven to be historically unstable with the latest wave of them breaking up in the 1980s and 1990s.[94] Second, the entry of these firms will facilitate the exit of vulnerable incumbents exposed to unfavorable debt yields.[95] In other words, the points discussed in this Section still apply to the broader market with smaller and more vulnerable incumbents now bearing

[90] *See* Paul Harrison, *The Impact of Market Liquidity in Times of Stress on Corporate Bond Issuance*, 2002 BANK FOR INT'L SETTLEMENTS RISK MEASUREMENT & SYSTEMIC RISK 166, 166, 168; Yakov Amihud & Haim Mendelson, *The Pricing of Illiquidity as a Characteristic and as Risk*, 19 MULTINATIONAL FIN. J. 149, 158 (2015); Long Chen et al., *Corporate Yield Spreads and Bond Liquidity*, 62 J. FIN. 119, 119 (2007).

[91] Timothy G. Sullivan, *The Cost of Capital and the Market Power of Firms*, 60 REV. ECON. & STAT. 209, 215 (1978).

[92] Amazon Web Services controls about 40% of the public cloud infrastructure market. *Gartner Says Worldwide IaaS Public Cloud Services Market Grew 40.7% in 2020*, GARTNER (June 28, 2021), https://gtnr.it/3zOPIrP.

[93] Samsung is among the top three largest smartphone vendors across the globe. *Smartphone Market Share*, IDC (Apr. 28, 2021), https://www.idc.com/promo/smartphone-market-share.

[94] Gerald F. Davis et al., *The Decline and Fall of Conglomerate Firms in the 1980s: The Deinstitutionalization of an Organizational Form*, 59 AM. SOCIO. REV. 547, 547–48 (1994).

[95] John J. Siegfried & Laurie Beth Evans, *Empirical Studies of Entry and Exit: A Survey of Evidence*, 9 REV. INDUS. ORG. 121, 144–45 (1994).

the disproportionate burden of the noise in the information supplied by the bankruptcy system.

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To recap, the relationship between bankruptcy volume and market concentration is no mere correlation and is driven by the noise in the information supplied by the bankruptcy system to capital markets. Departures from the Bankruptcy Code's absolute priority framework and the incomplete debtor-creditor renegotiation framework created by the collision between the Trust Indenture Act and the Bankruptcy Code are the two primary drivers of this noise. Far from being a neutral force, this noise contributes to more concentrated markets by disproportionately impacting the debt yield of newer and smaller competitors.

II. The Bankruptcy System's Contribution to Concentrated Markets via its Direct Conflict With Antitrust Laws

The evidence reviewed so far indicates that the bankruptcy system contributes to increasing market concentration by acting as an uncertain and noisy source of information. However, the bankruptcy system's contributions are also driven by another more direct factor: bankruptcy and restructuring coming head-to-head with antitrust law in at least two areas. First, under the Failing Company defense, the possibility of the collapse of a firm is sometimes enough to push through an acquisition that would otherwise violate antitrust laws. Second, shocks and externalities created by market failures and bankruptcies have driven authorities to prioritize stability and direct regulation over antitrust enforcement in some contexts.

These conflicts between bankruptcy and antitrust laws are discussed over the next four sections. The first two Sections discuss the Failing Company defense and its expansion in two directions: zooming into a firm to determine that it has been weakened (rather than failed) and zooming out onto an industry to find that consolidation is needed for the industry's survival. The third Section shifts gear and focuses on another source of conflict between bankruptcy and antitrust laws. Specifically, how the desire to stabilize a sector often leads to the de-prioritization of antitrust enforcement. Finally, the last Section discusses practical issues that have arisen out of these conflicts between antitrust and bankruptcy laws: bankruptcy proceedings becoming unfriendly forums for the enforcement of antitrust laws and creditors reaping monopolistic profits in contradiction to the economic foundations of antitrust.

A. A Bankruptcy-Driven Exception to Antitrust Enforcement: The Failing Company Defense

The Failing Company defense is a defense in legal challenges to mergers that substantially "lessen competition" in violation of the Clayton Antitrust Act.[96] The early outlines of this doctrine appeared in *International Shoe Co. v. Federal Trade Commission*.[97] However, it was not until the District of D.C.'s decision in *United States v. Maryland & Virginia Milk Producers Association*[98] and the First Circuit's decision in *Union Leader Corp. v. Newspapers of New England, Inc.*[99] in 1960s that this doctrine achieved widespread judicial acceptance.[100] Simply put, this doctrine is a "lesser of two evils" approach in which a court allows a merger that runs afoul of the Clayton Act to proceed because "the effect on competition and the loss to (the company's) stockholders and injury to the communities where its plants were operated will be less if a company continues to exist even as a party to a merger than if it disappears entirely from the market."[101] The proponents of a merger have to show that the failing company is "in imminent danger of failure" with "no realistic prospect for a successful reorganization" and "no

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[96] 15 U.S.C. § 18.

[97] 280 U.S. 291, 299–301 (1930); *see also* Edward O. Correia, *Re-Examining the Failing Company Defense*, 64 ANTITRUST L.J. 683, 683 (1996).

[98] 167 F. Supp. 799, 808 (D.D.C. 1958), *aff'd*, 362 U.S. 458 (1960).

[99] 284 F.2d 582, 589–90 (1st Cir. 1960).

[100] *See* Citizen Publ'g Co. v. United States, 394 U.S. 131, 136 n.2 (1969). Multiple approving references to this defense in Congressional record during the Clayton Act's amendment process in 1950 further gave credence to it. Marc Blum, *Failing Company Discriminant Analysis*, 12 J. ACCT. RSCH. 1, 2 (1974); *accord* Correia, *supra* note 97, at 684–85.

[101] United States v. Gen. Dynamics Corp., 415 U.S. 486, 507 (1974) (internal quotation marks and citations omitted).

other viable alternative purchaser" as evident through "a reasonable, good faith attempt to locate an alternative buyer."[102]

This defense has been the subject of criticism since inception. Initially, it received a cold reception at the F.T.C.[103] Moreover, it was criticized for lacking any grounding in the Clayton Act[104] and sacrificing the Act's focus on the economics of antitrust.[105] Other critics focused on the difficulty of obtaining the information needed to effectively apply this

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[102] Dr. Pepper/Seven-Up Cos. v. Fed. Trade Comm'n, 991 F.2d 859, 864–65 (D.C. Cir. 1993).

[103] Richard A. Wiley, *The "Failing Company": A Real Defense in Horizontal Merger Cases*, 41 B.U. L. REV. 495, 500 (1961); *see also, e.g.*, U.S. Steel Corp., 74 F.T.C. 1270 (1968), 1968 WL 94773, at *12 (concluding that the Failing Company defense is a "true exception" that may only be invoked in narrow circumstances), *vacated*, 426 F.2d 592, 609–610 (6th Cir. 1970), *aff'd on reh'g*, 81 F.T.C. 629 (1972), 1972 WL 128843; This hostility persisted at least until 1980s. *See, e.g.*, Pillsbury Co., 93 F.T.C. 966 (1979), 1979 WL 44683, at *39 ("There is no such quasi-failing company defense available under Section 7 of the Clayton Act. The market is supposed to determine whether firms fail or not . . . .").

[104] Initially, practitioners pointed to references to this defense in congressional record to infer that Congress "clearly incorporated a failing company exception into the meaning (*although not into the language*)" of the Clayton Act. Richard E. Low, *The Failing Company Doctrine Revisited*, 38 FORDHAM L. REV. 23, 27 (1969) (emphasis added). However, others began to criticize this reliance on legislative record because it was used to develop a defense in face of contrary statutory language even though the relevant legislative history was "ambiguous" and seemed to attribute to Congress an intent to abandon doctrines that long underpinned antitrust law without any sound justification. Paul M. Laurenza, *Section 7 of the Clayton Act and the Failing Company: An Updated Perspective*, 65 VA. L. REV. 947, 952 (1979); *accord* Martin F. Connor II, *Section 7 of the Clayton Act: The Failing Company Myth*, 49 GEO L.J. 84, 97–98 (1960).

[105] Thomas J. Campbell, *The Efficiency of the Failing Company Defense*, 63 TEX. L. REV. 251, 251 (1984). Others argued that this defense has a solid economic basis because it leads to less reduction in total economic welfare as compared to when a failing firm collapses. William F. Shughart II & Robert D. Tollison, *The Welfare Basis of the "Failing Company" Doctrine*, 30 ANTITRUST BULL. 357, 359–60 (1985).

doctrine[106] because even some of the most basic data—i.e., the pricing of a firm's debt and equity—is a poor indicator of the firm's chances of failure.[107] By 1970s and 1980s, this criticism caught up with the defense and it fell out of favor in judicial proceedings as courts began to construe it more strictly.[108]

Despite this judicial winter, the Failing Company defense is alive and well in the Executive branch. The defense appeared in the Antitrust Agencies' horizontal merger guideline in 1992[109] and was carried over in

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[106] *See* Derek C. Bok, *Section 7 of the Clayton Act and the Merging of Law and Economics*, 74 HARV. L. REV. 226, 228 (1960).

[107] Blum, *supra* note 100, at 11–12.

[108] Starting from 1970, proponents of a merger had to establish that not only "resources of acquired corporation are so depleted and prospective rehabilitation so remote that it faces grave probability of business failure," but also that "there is no other prospective purchaser for it." United States v. Greater Buffalo Press, Inc., 402 U.S. 549, 555 (1971) (first citing Int'l Shoe Co. v. Fed. Trade Comm'n, 280 U.S. 291, 302 (1930); and then citing Citizen Publ'g Co. v. United States, 394 U.S. 131, 138 (1969)). Courts interpreted the latter requirement—i.e., the absence of other purchasers—as a "heavy burden" that required "affirmative attempt[s] to seek out other purchasers." Golden Grain Macaroni Co. v. Fed. Trade Comm'n, 472 F.2d 882, 887 (9th Cir. 1972); *accord* United States v. Black & Decker Mfg. Co., 430 F. Supp. 729, 781–82 (D. Md. 1976). *But see* United States v. Culbro Corp., 504 F. Supp. 661, 669 (S.D.N.Y. 1981) (finding that the widespread knowledge of a firm's financial difficulties in a concentrated industry combined with lack of any acquisition offer was enough to indicate that no other purchaser was forthcoming). Courts also interpreted the first requirement—i.e., depleted resources and remote prospects of rehabilitation—to require more than temporarily weakened finances. Kaiser Aluminum & Chem. Corp. v. Fed. Trade Comm'n, 652 F.2d 1324, 1339 (7th Cir. 1981); *see also* F. & M. Schaefer Corp. v. Schmidt & Sons, Inc., 597 F.2d 814, 817–18 (2nd Cir. 1979). Evidence of an imminent Chapter 11 bankruptcy is generally not enough. U.S. DEP'T OF JUST. & FED. TRADE COMM'N, HORIZONTAL MERGER GUIDELINES § 5.1 (1992) [hereinafter 1992 MERGER GUIDELINES].

[109] 1992 MERGER GUIDELINES, *supra* note 108, § 5.2. The Failing Company defense was also recognized in earlier versions of the merger guidelines as early as 1968. 1 FED. TRADE COMM'N, *The Analysis of Failing Firm and Distressed Industries Claims in Merger Analysis*, *in* ANTICIPATING 21ST CENTURY: COMPETITION POLICY IN THE NEW HIGH-TECH, GLOBAL MARKET PLACE ch. 3, at 9 n.43 (1996).

subsequent revisions.[110] In addition, the post-1997 versions of the merger guideline adopted an increasingly generous view of the "efficiencies generated through a merger [that] can enhance the merged firm's ability and incentive to compete."[111] This demonstrates a further receptiveness toward this defense given that such efficiency justifications underpinned the development of the Failing Firm defense as well.[112] As a sign of the continuing relevance of this defense, the Department of Justice indicated in 2020 that this defense is likely to be carried over into the forthcoming vertical merger guidelines as well.[113]

The F.T.C. has changed its posture from one of cold reception toward this defense to a recognition of its role as well.[114] As a part of this shift, the agency recognized that "[a]bsent a legitimate competition concern, antitrust should not obstruct efforts by failing or near failing firms, or strapped firms

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[110] U.S. DEP'T OF JUST. & FED. TRADE COMM'N, HORIZONTAL MERGER GUIDELINES § 11 (2010) [hereinafter 2010 MERGER GUIDELINES]. This carryover was accompanied with favorable modifications. It de-emphasized the explicit requirement of "absent the acquisition, the assets of the failing firm would exit the relevant market," 1992 MERGER GUIDELINES, *supra* note 108, § 5.2, by no longer listing it as a standalone requirement and instead mentioning it as a factor within the overall claim. 2010 MERGER GUIDELINES, *supra*, § 11; *accord* Kyle Digangi, *Cutting the Financial Fat From the Failing Firm Defense: Refocusing the Failing Firm Defense on Antitrust Law*, 86 ST. JOHN'S L. REV. 277, 279 (2012).

[111] 2010 MERGER GUIDELINES, *supra* note 110, § 10.

[112] *See, e.g.*, United States v. Syufy Enters., 903 F.2d 659, 673 n.24 (9th Cir. 1990) (noting that the fulfilling all requirements of the Failing Company defense may not be necessary since "the ability to buy out competitors who are merely ailing may well promote market *efficiency*" (emphasis added)); United States v. LTV Corp., No. 84-884, 1984 WL 21973, at *14 (D.D.C. Aug. 2, 1984) (noting the benefit of *efficiencies* that arise from the acquisition of a failing company in reinvigorating competition in the market); Marianela López-Galdos, *Comparing the US & the EU Failing Firm Defense: Reflections From an Economic Perspective*, 208 LOY. CONSUMER L. REV. 297, 321–26 (2016) (arguing that "the failing firm defense itself represents an efficiencies-based approach to the analysis of mergers").

[113] U.S. DEP'T OF JUST. & FED. TRADE COMM'N, VERTICAL MERGER GUIDELINES § 1 (2020).

[114] *See* FED. TRADE COMM'N, *supra* note 109, ch. 3, at 15.

within distressed industries, to reorganize, become more efficient, and compete more effectively globally."[115] To this end, the F.T.C. relies on a "dynamic rather than a static analysis" when it is faced with a Failing Company argument to determine if the purported efficiencies that arise from the acquisition of the failing firm "will improve the competitive performance of the market" as compared to other alternatives.[116]

Before delving deeper into the approach of Antitrust Agencies to the Failing Company defense, a discussion of why this approach is even more crucial to the vitality of this defense than its judicial reception is warranted. The primary avenue of antitrust enforcement in the merger arena is the F.T.C.'s premerger Hart-Scott-Rodino ("H.S.R.") notification system.[117] Under this system, a notice has to be filed with the F.T.C. for all acquisitions meeting certain thresholds.[118] This notice triggers a thirty-day toll on the acquisition during which Antitrust Agencies may ask for more information or initiate appropriate antitrust actions.[119] As Figure 5 illustrates, thousands of notices are filed annually. About 3% of these notices lead to a request for additional information. However, this small number of administrative investigations still compares favorably with the even smaller number of lawsuits initiated by the federal government, fewer than half of which end

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[115] *Id.*, at 21.

[116] Richard G. Parker, Director, Bureau of Competition, Fed. Trade Comm'n, Address at the Annual Briefing for Corporate Counsel: Trends in Merger Enforcement and Litigation (Sept. 16, 1998), *reprinted in* Richard G. Parker & David A. Balto, *The Merger Wave: Trends in Merger Enforcement and Litigation*, 55 BUS. LAWYER 351, 372 (1999).

[117] *See* William J. Baer, *Reflection on Twenty Years of Merger Enforcement Under the Hart-Scott-Rodino Act*, 65 ANTITRUST L.J. 825, 825–26 (1997). *See generally* 15 U.S.C. § 18a (establishing the notification system).

[118] These thresholds were, in 2003 dollars, the transfer of (i) $200 million of assets; or (ii) $50–$200 million of assets when either party has significant assets or sales as defined in the statute. 15 U.S.C. § 18a(a). These thresholds are indexed to the gross national product. *Id.* § 18a(a)(2). Thus, they currently sit at $368 million and $92–$368 million, respectively. Revised Jurisdictional Thresholds for Section 7A of the Clayton Act, 86 Fed. Reg. 7870 (Feb. 2, 2021).

[119] 15 U.S.C. § 18a(b), (e), (f).

with a contested outcome or settlement. Therefore, the approach taken by Antitrust Agencies in evaluating this defense during administrative investigations plays an even bigger rule than its invocation in courts.[120]

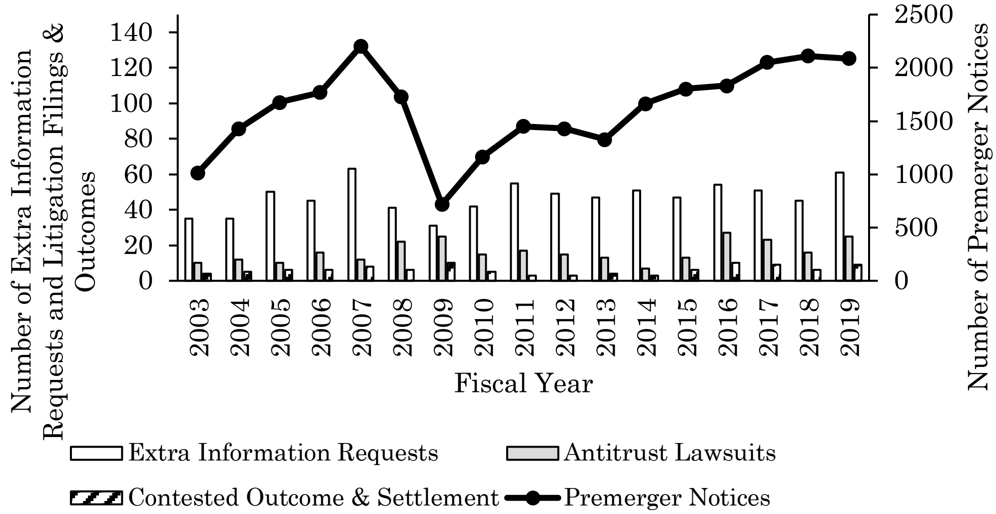

Figure 5. Summary of H.S.R. Premerger Notices Filed, Subsequent Extra Information Requests,[121] and Antitrust Litigation Involving the Federal Government.[122]

[120] *See* Daniel A. Crane, *Technocracy & Antitrust*, 86 TEX. L. REV. 1159, 1178 (2008); *see also* Malcolm b. Coate et al., *Fight, Fold or Settle?: Modelling the Reaction to FTC Merger Challenges*, 33 ECON. INQUIRY 537, 550 (1995) (analogizing Antitrust Agencies to regulatory, rather than enforcement, agencies because to the rarity of judicial challenge to their actions).

[121] *HSR Transactions Filings and Second Requests by Fiscal Year*, FED. TRADE COMM'N, https://www.ftc.gov/system/files/attachments/data-sets/hsr_transactions_filings_second_requests_by_fy_q3_year_2020.csv (last visited Mar. 5, 2021)

[122] *Westlaw Edge Litigation Analytics*, THOMSON REUTERS, https://1.next.westlaw.com/Analytics/Home?transitionType=Default&contextData=(sc.Default)#/ (last visited Mar. 5, 2021). Only cases classified as antitrust with the

B. The Expansion of the Failing Company Defense

The Failing Company defense is a powerful indicator of the conflict between bankruptcy and antitrust statutes. However, this conflict becomes even clearer once the extensions of the defense are considered. As discussed in Subsection 1, the Failing Company defense has evolved into a more lenient "Weakened Company" defense when the firm is not so injured as to be failing, but is considerably weakened. As discussed in Subsection 2, the Failing Company defense gives way to a "Failing Industry" argument when individual firms are not failing, but the broader sector is under distress. Taken together, these two outgrowths of the Failing Company defense indicate how concerns about the survival and rejuvenation of debtors—which have long underpinned the Bankruptcy Code[123]—have come to subsume antitrust concerns too.

1. <u>The "Weakened Company" Defense</u>

As discussed in Subsection A, policy pronouncements of Antitrust Agencies have increasingly been favorable toward the Failing Company defense. This receptiveness is not mere rhetoric and has manifested itself through more lenient definitions of the Failing Company defense to such an extent that some now call these lenient definitions the "Weakened Company" defense. Most mergers proceed without any investigation and even few of those that are investigated are challenged.[124] Therefore, written evidence on

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"United States" or the "Federal Trade Commission" as a party are included. The Contested Outcome & Settlement category encompasses all cases closed through settlements, contested dispositive motions, and verdicts. Uncontested dismissals, transfers, and other outcomes are excluded from this category, but are included in the broader Antitrust Lawsuit category. These numbers broadly agree with those reported in other publications. *See, e.g.*, Thurman Arnold Project at Yale, *Antitrust Enforcement Data*, YALE SCH. OF MGMT., https://som.yale.edu/faculty-research-centers/centers-initiatives/thurman-arnold-project-at-yale/antitrust-enforcement-data-0 (last visited Mar. 5, 2021); U.S. DEP'T OF JUST., ANTITRUST DIVISION WORKLOAD STATISTICS FY 2010–2019 at 5–6 (2020).

[123] Wright v. Union Cent. Life Ins. Co., 304 U.S. 502, 514 (1938); Williams v. U.S. Fidelity & Guar. Co., 236 U.S. 549, 554–55 (1915).

[124] *See supra* Figure 5.

this point is relatively rare. Nevertheless, Antitrust Agencies have relied on the concept of competitive significance to accept more marginal invocations of the Failing Company defense claims "even when the facts would not support a strict 'failing firm' defense."[125]

Broadly speaking, the concept of competitive significance is a pragmatic recognition that today's market share may not necessarily translate into tomorrow's market power.[126] For example, the company's finances may be strong enough to cover its operations, but too weak to invest in efforts to maintain a competitive edge.[127] Alternatively, the company may be operating at near capacity in a long lead-time industry while its competitors have ample idle capacity to capture new demand.[128]

To be sure, Antitrust Agencies do not rely on competitive significance to merely waive a Failing Company claim through. Instead, they consider elements of the Failing Company defense—such as a firm's financial health—in light of that firm's declining competitive significance to conclude that its acquisition does not impact the market.[129] Consequently, there is no longer a need to rule on the Failing Company defense because the proposed merger no

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[125] Debbie Feinstein, *Caretaking Competition in Health Care Markets*, FED. TRADE COMM'N: COMPETITION MATTERS (June 20, 2014), https://www.ftc.gov/news-events/blogs/competition-matters/2014/06/caretaking-competition-health-care-markets.

[126] *See* Hosp. Corp. of Am. v. Fed. Trade Comm'n, 807 F.2d 1381, 1385–86 (7th Cir. 1986). Analytical roots of this approach can be traced back to Supreme Court's decision in *United States v. Gen. Dynamics Corp. See* 415 U.S. 486, 497–501 (1974).

[127] Feinstein, *supra* note 125.

[128] Fed. Trade Comm'n v. Arch Coal, Inc., 329 F. Supp. 2d 109, 125 n.9 (D.D.C. 2004),

[129] *E.g.*, Steves & Sons, Inc. v. Jeld-Wen, Inc., 290 F. Supp. 3d 507, 513 (E.D. Va. 2018); United States v. Aetna Inc., 240 F. Supp. 3d 1, 91–92 (D.D.C. 2017). But others have disputed the categorization of this approach as a standalone defense. Kaiser Aluminum & Chem. Corp. v. Fed. Trade Comm'n, 652 F.2d 1324, 1339 (7th Cir. 1981); *See also* New York v. Deutsche Telekom AG, 439 F. Supp. 3d 179, 218 (S.D.N.Y. 2020) (finding that this defense is among "the weakest grounds for rebuttal" of a violation of antitrust laws).

longer poses an anticompetitive threat. This approach has been repeatedly invoked in recent administrative investigations.[130]

2. The "Failing Industry" Defense

The "Weakened Company" expansion of the Failing Company defense discussed above focuses on individual circumstances of a battered firm. However, practitioners have moved beyond the individual circumstances of a firm and have relied on the broader health of a sector to expand the limits of the Failing Company defense in another dimension. This approach has been labeled as the "Failing Industry"[131] defense.

The early versions of the Failing Industry defense can be traced back to the Supreme Court's decision in *Appalachian Coals, Inc. v. United States*.[132] This case, which was decided in the midst of the Great Depression,

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[130] *See* Julie Elmer & Meredith Mommers, *Is a Merging Company Failing, Flailing, or Just Ailing?*, BLOOMBERG L. (Nov. 20, 2020), https://news.bloombergtax.com/pharma-and-life-sciences/is-a-merging-company-failing-flailing-or-just-ailing ("Recently, firms have had more success with . . . the weakened competitor, or 'flailing firm,' argument."); J. Thomas Rosch, Commissioner, Fed. Trade Comm'n, Remarks at the George Mason Law Review's 14th Annual Symposium on Antitrust Law: Theoretical and Practical Observation on Cartel and Merger Enforcement at the Federal Trade Commission (Feb. 9, 2011), 2011 WL 489825, at *6 ("Notwithstanding the mixed treatment of the [weakened company] defense in the case law, our staff gives serious consideration to such arguments."); J. Bruce McDonald, Deputy Assistant Att'y Gen., Antitrust Div., U.S. Dep't of Just., Remarks at the Regional Airline Association President's Council Meeting: Antitrust for Airlines (Nov. 3, 2005), https://www.justice.gov/atr/speech/antitrust-airlines ("[T]he poor condition of a firm that is not to the point of failing may be a sign that the firm is not going to be as much of a competitive factors in the future as in the past, and our mergers analysis will take that into account."); Carl Shapiro, Deputy Assistant Att'y Gen. for Econ., Antitrust Div., U.S. Dep't of Just., Remarks at the ABA Antitrust Symposium: Competition Policy in Distressed Industries (May 13, 2009), https://www.justice.gov/atr/speech/competition-policy-distressed-industries ("One can also ask whether some mergers may be pro-competitive, even if the acquired firm does not meet the failing firm test . . . .").

[131] Richard M. Brunell, *Editor's Note*, 64 ANTITRUST L.J. 571, 573 (1996)

[132] 288 U.S. 344 (1933).

was about the formation of a marketing cartel by miners that controlled more than 70% of Appalachian coal production.[133] The federal government sued, alleging that the cartel violated the Sherman Act's ban on agreements that restrain competition.[134] The Court disagreed and allowed the producers to proceed by extensively relying on the evidence of the sector's significant duress.[135] However, the days of this defense as a standalone argument in courts were numbered. Less than a decade later, the Court gave a cold shoulder to it in *United States v. Socony-Vacuum Oil Co.*[136]

Yet, Antitrust Agencies stayed receptive to this argument. In 1980s, the F.T.C.'s Bureau of Economics was advocating for formalizing the Failing Industry defense because "the market solution to the declining industry problem . . . may not be efficient."[137] Indeed, the 1984 Merger Guidelines embraced this approach.[138] Likewise, the Department of Justice incorporated the considerations of "weakened and deteriorating condition[s]" of the overall market in consent decrees negotiated with merging firms.[139]

[133] *Id.* at 356–57, 375.

[134] *Id.* at 358.

[135] *Id.* at 361–64, 372. The Court also relied on a host of other grounds. For example, customers testified that the cartel would have benefitted the wider economy without restraining competition. *Id.* at 370. The Court further noted that coal produced by the cartel was sold in "a highly competitive" market where it competed with other sources of energy. *Id.* at 361–62, 368.

[136] 310 U.S. 150, 221–22 (1940).

[137] Malcolm B. Coate & Andrew N. Kleit, *Antitrust Policy for Declining Industry* 1–2 (Fed. Trade Comm'n Bureau of Econ., Working Paper No. 175, 1989).

[138] U.S. DEP'T OF JUST. & FED. TRADE COMM'N, HORIZONTAL MERGER GUIDELINES § 3.22 (1984). The Merger Guideline no longer focuses on the health of the sector as a distinct factor. Instead, this factor is considered as an element of "recent or ongoing changes in market conditions." *See* 2010 MERGER GUIDELINES, *supra* note 110, § 5.2.

[139] United States v. LTV Corp., No. 84-884, 1984 WL 21973, at *14 (D.D.C. Aug. 2, 1984).

To be clear, Antitrust Agencies have rejected calls for the adoption of formal policies to relax antitrust enforcement in distressed industries.[140] Nevertheless, they have relaxed the analytical framework used to evaluate antitrust claims when faced with mergers in distressed industries, particularly when third parties would be hard hit by the failure of one of the merging parties. For example, they took a more expansive view of when a firm qualifies for the Failing Firm defense and relied on less invasive remedies when the failure of one of the merging parties likely would have disrupted the delivery of crucial services, such as healthcare.[141] In another example, Antitrust Agencies credited claims of unquantifiable efficiencies that may flow to customer over the long-term in face of evidence that the merger is likely to increase consumer prices where "reduction in competition [was purportedly] necessary for industry survival."[142]

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[140] *E.g.*, Ian Conner, *Antitrust Review at the FTC: Staying the Course During Uncertain Times*, FED. TRADE COMM'N (Apr. 6, 2020), https://www.ftc.gov/news-events/blogs/competition-matters/2020/04/antitrust-review-ftc-staying-course-during-uncertain; Organization for Economic Co-operation and Development [OECD], *Roundtable on Failing Firm Defense: Contribution by the United States*, at 9, OECD Doc. DAF/COMP/WD(2009)99 (Oct. 6, 2009).

[141] For example, in one case the F.T.C. relied on the decision of a single alternate buyer to not acquire the firm as evidence of the absence of alternate buyers in general. *See* Richard Feinstein, Fed. Trade Comm'n, Statement of Bureau of Competition Director Richard Feinstein on the FTC's Closure of its Investigation of Consummated Hospital Merger in Temple, Texas (Dec. 23, 2009), 2009 WL 10739757. In another example, the F.T.C. relied on less invasive remedies instead of blocking the merger because the failure of one of the entities would have disrupted the delivery of healthcare in a distressed market. *See* CentraCare Health, F.T.C. Docket No. C-4594, 2016 WL 5930294, at *6–13 (Oct. 5, 2016) (summarizing the order); Press Release, Fed. Trade Comm'n, Healthcare Provider in St. Cloud, MN Settles FTC Charges That its Acquisition of Rival Provider Would Likely Lessen Competition for Certain Physician Services (Oct. 6, 2016), 2016 WL 5845166 (expanding on the reasoning for the order).

[142] *See* Darren Bush, *Too Big to Bail: The Role of Antitrust in Distressed Industries*, 77 ANTITRUST L.J. 277, 300–03 (2010); Press Release, U.S. Dep't of Just., Statement of the Department of Justice's Antitrust Division on its Decision to Close its Investigation of the Merger of Delta Air Lines Inc. and Northwest Airlines Corporation (Oct. 29, 2008), 2008 WL 4726508.

C. Another Area of Conflict Between Restructuring and Antitrust: Overlapping Regulators

The Failing Company defense and its outgrowth are strong indicators of the supremacy of restructuring concerns over antitrust laws. Yet, they are surpassed by the actions of Antitrust Agencies and other agencies that prioritize the stability of incumbents over competition concerns as the largest source of interference with antitrust enforcement when bankruptcy and restructuring concerns are at play.

Sometimes this prioritization is explicitly dictated by state and federal legislatures.[143] This practice has deep historical roots with the formation of "Crisis Cartels" during the Great Depression[144] and newspapers' antitrust exemption enacted in 1970s[145] being prime examples. A more longstanding example was the antitrust exemption granted to health insurers under the McCarren-Ferguson Act of 1945[146] that was only repealed in 2021.[147] Even though such direct interventions "threaten[] to institutionalize anticompetitive conduct,"[148] Congress has carried them out in multiple

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[143] States may grant antitrust exemption to certain entities under the doctrine of state-action immunity. Parker v. Brown, 317 U.S. 341, 351–52 (1943); Fed. Trade Comm'n v. Phoebe Putney Health Sys., Inc., 568 U.S. 216, 224–25 (2013).

[144] The most explicit attempt at establishing such cartels was the National Industrial Recovery Act of 1933 that allowed for direct price and output controls. *See* National Industrial Recovery Act of 1933, Pub. L. No. 73-67, 48 Stat. 195, *partially invalidated by* Schechter Poultry Corp. v. United States, 295 U.S. 495 (1935). Even though parts of this Act were invalidated by the Supreme Court, its policies and effects "relegated [competition] to the sidelines, as the welfare of firms took priority over the welfare of customers." Organisation for Economic Co-operation and Development [OECD], *Global Forum on Competition: Crisis Cartels*, at 9, OECD Doc. DAF/COMP/GF/WD(2011)11 (Jan. 17, 2011).

[145] Newspaper Preservation Act of 1970 § 4, 15 U.S.C. § 1803.

[146] 15 U.S.C. §§ 1012(b), 1013(a).

[147] Competitive Health Insurance Reform Act of 2020 § 2, Pub. L. No. 116-327.

[148] John Roberti et al., *The Role and Relevance of Exemptions and Immunities in U.S. Antitrust Law*, 2018 ROUNDTABLE ON EXEMPTIONS & IMMUNITIES FROM ANTITRUST L. 1, 11.

sectors and is considering to do so in others.[149] Moreover, states have granted similar exemptions in multiple circumstances.[150]

Despite these numerous examples of explicit prioritization of stability and bankruptcy concerns over antitrust, the prioritization is often implicit. The first avenue for such an implicit de-prioritization is the judicially imposed immunity from antitrust laws if those laws directly interfere with another regulatory framework.[151] This interference must meet a high bar; it must be "clear" and any consequent immunity is limited "only to the minimum extent necessary."[152] Still, more and more sectors of the economy are benefitting from this implied immunity. Examples includes certain securities markets,[153] certain regional healthcare planning activities,[154] and other sectors in which regulatory agencies have developed comprehensive regulatory schemes.[155]

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[149] *See, e.g.*, Capper-Volstead Cooperative Marketing Associations Act, 7 U.S.C. § 291–92 (granting antitrust exemption to agricultural cooperatives); Journalism Competition and Preservation Act of 2019, H.R. 2054, 116th Cong. (2019) (granting antitrust exemption to news firms to collectively negotiate with online platforms).

[150] *E.g.*, City of Columbia v. Omni Outdoor Advert., Inc., 499 U.S. 365 (1991) (restricting outdoor advertising); Fred J. Hellinger & Gary J. Young, *An Analysis of Physician Antitrust Exemption Legislation: Adjusting the Balance of Power*, 286 JAMA 83 (2001) (allowing physicians to collectively negotiate with insurers).

[151] United States v. Nat'l Ass'n of Sec. Dealers, Inc., 422 U.S. 694, 719–20 (1975).

[152] Credit Suisse Sec. (USA) LLC v. Billing, 551 U.S. 264, 271, 275 (2007).

[153] *E.g., id.* at 279 (initial public offerings); *Nat'l Ass'n of Sec. Dealers, Inc.*, 422 U.S. at 729–30 (certain trades in shares of mutual funds); Gordon v. N.Y. Stock Exch., Inc., 422 U.S. 659, 689–90 (1975) (certain stock exchange transactions).

[154] *See* Nat'l Gerimedical Hosp. & Gerontology Ctr. v. Blue Cross of Kan. City, 452 U.S. 378, 393 n.18 (1981); Hosp. Bldg. Co. v. Trs. of Rex Hosp., 791 F.2d 288, 291–92 (4th Cir. 1986).

[155] *See* Verizon Commc'ns Inc. v. Law Offs. of Curtis V. Trinko, LLP, 540 U.S. 398, 406, 411–12 (2004) (finding that the duty to deal with competitors created by the Federal Communications Commission cannot be enforced via antitrust laws due to, among other things, the presence of an alternative regulatory framework). Richard M. Brunell, *In Regulators We Trust: The Supreme Court's New Approach to Implied Antitrust Immunity*, 78 ANTITRUST L.J. 279, 286–88 (2012).

The second avenue for the implicit de-prioritization of antitrust laws is the deference given by Antitrust Agencies to actions of other agencies even when such a deference is not mandated. This can come in the form of open-ended and flexible antitrust provisions being replaced with more categorical and easier to plan around ones,[156] anticompetitive advantages that inherently arise from rigid regulatory requirements,[157] and competition being viewed as a secondary objective when crafting sector-specific rules.[158]

Three parameters significantly magnify the risk of erosion of antitrust laws in distressed or heavily regulated industries through the two avenues discussed above. First, industry-specific agencies are more prone to becoming myopically focused on the interests of incumbents and, in the extreme,

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[156] Banking is an illustrative example of this approach. *Compare* U.S. DEP'T OF JUST., BANK MERGER COMPETITIVE REVIEW 5–7 (2000) (using a set of mechanical calculations to screen bank mergers), *and Banking Information & Regulation FAQs*, BD. OF GOVERNORS OF THE FED. RSRV. SYS. (Oct. 9, 2014), https://www.federalreserve.gov/bankinforeg/competitive-effects-mergers-acquisitions-faqs.htm#faq31 (same), *with* 2010 MERGER GUIDELINES, *supra* note 110, §§ 4–5 (adopting flexible rules for defining markets and market participants).

[157] For example, the "statutory and regulatory requirements, established to ensure the safety and quality of drugs approved by FDA, may also be leveraged—or 'gamed'—in an effort to delay generic drug approvals beyond the timeframe the law has intended." *Antitrust Concerns and the FDA Approval Process: Hearing Before Subcomm. on Regul. Reform, Com. & Antitrust L. of the H. Comm. on the Judiciary*, 115 Cong. 2 (2017) (written statement of Scott Gottlieb, Comm'r of Food and Drugs, Food and Drug Administration); *accord* Stacey L. Dogan & Mark A. Lemley, *Antitrust Law and Regulatory Gaming*, 87 TEXAS L. REV. 685, 691 (2009).

[158] Foreign trade is rife with illustrative examples. For example, the International Trade Commission may restrict imports if "an article is being imported . . . in such increased quantities as to be a substantial cause of serious injury, or the threat thereof, to the domestic industry . . . ." 19 U.S.C. § 2251(a). There is no requirement to consider antitrust concerns and reviewing courts have adopted a highly deferential posture. *See, e.g.*, Maple Leaf Fish Co. v. United States, 762 F.2d 86, 90 (Fed. Cir. 1985). Domestic incumbents have been accused of using proceedings before the Commission to limit competition. *See* Thomas J. Schoenbaum, *The International Trade Laws and New Protectionism: The Need for a Synthesis with Antitrust*, 19 N.C.J. INT'L & COM. REG. 393, 415 (1994).

becoming "captured" by those incumbents.[159] Second, the reach of administrative agencies is growing in some sectors. For example, the Executive branch has leveraged "fusion" rulemaking[160] to implement new regulatory frameworks without an explicit Congressional mandate. Third, recent crises have led to bursts of legislative action that have pressured administrative agencies to rely on procedural improvisations to comply with aggressive timelines demanded by Congress.[161] Such shortcuts limit the ability of Antitrust Agencies to influence new rules to account for antitrust concerns that are "secondary" to the immediate Congressional demand.

Nonetheless, concerns about antitrust laws being drowned out by an expanding bureaucracy should not be overstated since the evidence of a vast expansion of the regulatory state is, at best, mixed. Granted, there are a few examples of such an expansion—such as the Dodd-Frank Act.[162] Yet, as Figure 6 indicates, secondary indicators of the reach of the regulatory state—i.e., the size of the Code of Federal Regulation and the Federal Register as well as the budget of regulatory agencies—have been stable. Moreover,

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[159] *See* Joshua D. Wright, Commissioner, Fed. Trade Commission, Remarks at Clemson University: Regulation in High-Tech Markets: Public Choice, Regulatory Capture, and the FTC (Apr. 2, 2015), 2015 WL 1641275, at *5; N.C. State Bd. Of Dental Exam'rs v. Fed. Trade Comm'n, 574 U.S. 494, 495 (2015) (noting that antitrust laws are "most essential when the State seeks to delegate its regulatory power to active market participants, for established ethical standards may blend with private anticompetitive motives . . . .").

[160] This type of administrative action consists of traditional regulations being augmented by voluntary collaboration with private firms. Christopher DeMuth, *Can the Administrative State be Tamed?*, 8 J. LEGAL ANALYSIS 121, 146–47 (2016). One example was the coordinated action of various public agencies and private banks in promoting subprime mortgages to incentivize home ownership. *Id.* at 148.

[161] *See* Michael S. Greve & Ashley C. Parrish, *Administrative Law Without Congress*, 22 GEO. MASON. L. REV. 501, 523–24 (2105).

[162] Pub. L. No. 111-203, 124 Stat. 1376 (2010).

Congress has protected the reach of antitrust laws in face of regulatory expansions by including "antitrust saving" clauses in major legislations.[163]

D. The Resulting Erosion of Antitrust Enforcement

The conflict between bankruptcy and antitrust laws discussed so far has led to two practical consequences that contribute to more concentrated markets. First, bankruptcy proceedings have thwarted the enforcement of antitrust laws from time to time. Second and more problematically, the conflict between antitrust and bankruptcy laws has enabled investors to reap monopolistic gains as creditors, an outcome denied by antitrust statutes to investors acting as equity holders.

[163] *E.g.*, Dodd-Frank Wall Street Reform and Consumer Protection Act § 6, 12 U.S.C. § 5303; Telecommunications Act of 1996 § 601(b), 47 U.S.C § 152 note. Despite the clear language of these clauses, their interpretation has been nuanced. *See generally* Howard A. Shelanski, *The Case for Rebalancing Antitrust and Regulation*, 109 MICH. L. REV. 683 (2011).

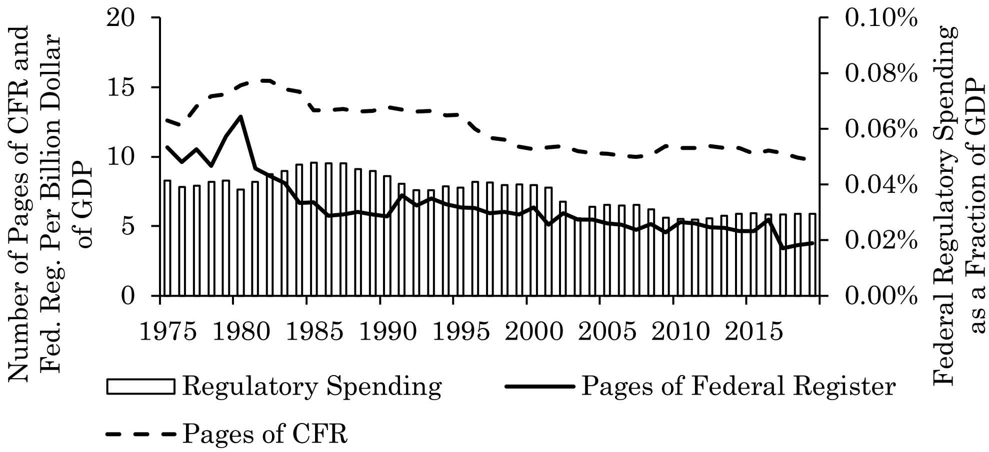

Figure 6. Pages of the Code of Federal Regulations and the Federal Register[164] Relative to Real GDP[165] and Annual Expenditure on Federal Regulatory Agencies as a Fraction of GDP.[166]

1. Bankruptcy Courts as Unfriendly Forums for Antitrust

A core objective of antitrust law is to safeguard "the benefits of price competition"[167] in order to limit the ability of dominant market players to extract monopolistic economic rent.[168] Stated another way, antitrust laws seek to outlaw certain anticompetitive activities that "promote [a producer's]

[164] *Reg Stats*, REGUL. STUD. CTR.: THE GEO. WASH. UNIV. (July 9, 2020), https://regulatorystudies.columbian.gwu.edu/reg-stats.

[165] *Table 1.1.6. Real Gross Domestic Product, Chained (2012) Dollars*, BUREAU OF ECON. ANALYSIS (Mar. 25, 2021), https://apps.bea.gov/iTable/iTable.cfm?reqid=19&step=3&isuri=1&nipa_table_list=6&categories=survey.

[166] The nominal value of federal spending, Mark Febrizio & Melinda Warren, REGUL. STUD. CTR.: THE GEO. WASH. UNIV., REGULATORS' BUDGET 42, REGULATORS' BUDGET: OVERALL SPENDING AND STAFFING REMAIN STABLE 25 tbl.A-4 (2020), is divided by the nominal GDP, *Gross Domestic Product (FYGDP)*, ECON. RSCH.: FED. RSRV. BANK OF ST. LOUIS (Feb. 12, 2020), https://fred.stlouisfed.org/series/FYGDP.

[167] Associated Gen. Contractors of Cal., Inc. v. Cal. State Council of Carpenters, 459 U.S. 519, 538 (1983).

[168] *See* Viamedia, Inc. v. Comcast Corp., 951 F.3d 429, 462 (7th Cir. 2020).

selfish interests" by "increase[ing] the profits of the producer at the cost of the consumer."[169] Therefore, by suppressing such monopolistic profits, antitrust laws also suppress the price of assets used to extract those profits.

This position becomes untenable when these assets enter the bankruptcy system. After all, the Bankruptcy Code aims to "maximiz[e] property available to satisfy creditors."[170] A dominant market player can offer a higher price for those assets due to its ability to extract monopolistic rent from them. Consequently, bankruptcy courts have been receptive toward offers submitted by dominant market players as noted by Antitrust Agencies[171] and academic scholars.[172] Antitrust Agencies have sought to

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[169] 21 CONG. REC. 2,457 (1890) (statement of Sen. John Sherman, the primary sponsor of the Sherman Antitrust Act of 1890); *accord* Apple Inc. v. Pepper, 139 S. Ct. 1514, 1525 (2019).

[170] *In re* Integrated Telecom Express, Inc., 384 F.3d 108, 119 (3d Cir. 2004) (quoting Bank of Am. Nat'l Tr. & Sav. Ass'n v. 203 N. LaSalle St. P'ship, 526 U.S. 434, 453 (1999)); *accord* Toibb v. Radloff, 501 U.S. 157, 163–64 (1991).

[171] *See, e.g.*, J. Thomas Rosch, Commissioner, Fed. Trade Comm'n, Remarks at New York Bar Association Annual Dinner: Implications of the Financial Meltdown for the F.T.C. (Jan. 29, 2009), 2009 WL 271996, at *5 (noting that a monopolistic buyer can "offer[] more money for the assets to the bankruptcy court . . ." whereas "[t]he most the agency [can] do [is to] explain to the bankruptcy court which of two bidders for the failed firms' assets appeared to be the least anticompetitive . . ."); FED. TRADE COMM'N, *supra* note 109, at 17 (arguing that bankruptcy courts "focus[] more on obtaining a return for creditors than on preserving competition . . ."); *cf.* R. Hewitt Pete, Acting Assistant Att'y Gen., Antitrust Div., Dep't of Just., Address Before the Association of the Bar of the City of New York: Antitrust Enforcement at the DOJ—Issues in Merger Investigations and Litigation (Dec. 10, 2002), 2002 WL 34170827, at *8 (discussing the constraints on antitrust actions within bankruptcy proceedings).

[172] *See, e.g.*, James M. Spears, *Federal Merger Enforcement in Bankruptcy*, 6 ANTITRUST 19, 19 (1992); Max Huffman, *Worlds Colliding: Competition Policy and Bankruptcy Asset Sales*, 60 VILL. L. REV. 839, 841–42 (2016).

reach agreements with parties[173] or obtain court orders[174] to mitigate this tension between antitrust and bankruptcy laws. While this approach has borne some fruit, it has also been rebuffed by courts from time to time.[175]

2. Rewarding Creditors With Monopolistic Returns

As noted by Judge Learned Hand[176] and reiterated by the Supreme Court,[177] policy decisions lay at the heart of antitrust law. Chiefly, antitrust law classifies certain anticompetitive behaviors as "inherently undesirable"[178] and seek to deter firm owners from benefitting from those behaviors by imposing a host of remedies, such as treble damages.[179] However, these policy objectives lose their vigor when antitrust and bankruptcy laws collide.

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173 *See, e.g.*, Spears, *supra* note 172, at 19 (discussing the agreement of parties to a bankruptcy proceeding to delay their transaction in response to a request from the F.T.C.); Fidelity Nat'l Fin., Inc., 150 F.T.C. 202 (2010), 2010 WL 9549981; Hertz Glob. Holdings, Inc., Docket No. C-4376 (Fed. Trade Comm'n Sept. 2, 2014), https://www.ftc.gov/system/files/documents/cases/140905hertzletter.pdf.

174 *See, e.g.*, United States v. Tribune Publ'g Co., no. CV 16-01822-AB (PJWx), 2016 WL 2989488 (C.D. Cal. Mar. 18, 2016).

175 *See, e.g.*, Fed. Trade Comm'n v. Lab'y Corp. of Am., no. SACV 10-1873 AG (MLGx), 2011 WL 3100372, at *22–23 (C.D. Cal. Mar. 11, 2011); United States v. Sungard Data Sys., Inc., 172 F. Supp. 2d 172, 193 (D.D.C. 2001).

176 United States v. Aluminum Co. of Am., 148 F.2d 416, 428 (2d Cir. 1945).

177 United States v. Topco Assocs., Inc., 405 U.S. 596, 610 (1972) ("[Antitrust laws] are as important to the preservation of economic freedom and our free-enterprise system as the Bill of Rights is to the protection of our fundamental personal freedoms."); *see also* Nat'l Soc'y of Pro. Eng'rs v. United States, 435 U.S. 679, 692 (1978) (noting that Congress already made the competition policy decisions and "whether a policy favoring competition is in the public interest, or in the interest of the members of an industry" should not be litigated in courts).

178 *Aluminum Co. of Am.*, 148 F.2d at 428.

179 Clayton Antitrust Act § 4, 15 U.S.C. § 15; *see* Robert H. Lande, *Are Antitrust "Treble" Damages Really Single Damages?*, 54 OHIO ST. L.J. 115, 115 (1993); PHILIP AREEDA & DONALD F. TURNER, ANTITRUST LAW 149–50 (1978) (noting that the treble damages provision of antitrust law seeks to both punish defendants and incentivize plaintiffs to "detect, disclose, attack, and end violations of the antitrust laws").

Specifically, the bankruptcy system's focus on maximizing creditor recovery translates into providing creditors with monopolistic gains denied to the original owners by antitrust laws. One may argue that this inconsistency is based on the inability of creditors to influence a firm's management as compared to its owners. However, evidence of creditors' extensive control over debtors, particularly a financially distressed one, belies this argument.

The bankruptcy system's focus on maximizing creditor recovery leaves the door open for creditors—who are the new owners of the bankrupt[180]—to reap monopolistic gains from the bankrupt's assets denied to original equity holders by antitrust laws.[181] This gain often comes out of the pockets of consumers who experience less welfare in a more concentrated market.[182] Simply put, the laxer enforcement of antitrust laws in bankruptcies means that the remedy for risk taken by a bankrupt is to compensate creditors at the cost of third-party consumers. This is especially problematic since markets generally signal the unfavorable risk profile well in advance of a bankruptcy, meaning that creditors are unlikely to be caught off-guard.[183]

One can argue that this arrangement of denying monopolistic profits to equity holders but not to creditors has a more realistic prospect of deterring anticompetitive behavior given that corporate leaders are likely to be more responsive to equity holders. However, evidence of equity holders

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[180] *See* 11 U.S.C. § 541 (assigning a bankrupt's assets to the bankruptcy estate); 11 U.S.C. §§ 507, 701–784, 1101–95 (Distributing the estate among creditors).

[181] *See* Ill. Brick Co. v. Illinois, 431 U.S. 720, 746 (1977).

[182] *See* United States v. Anthem, Inc., 855 F.3d 345, 366 (D.C. Cir. 2017) (discussing the relationship between high market concentrations & consumer welfare); Pool Water Prods. v. Olin Corp., 258 F.3d 1024, 1034 (9th Cir. 2001) (categorizing the aim of antitrust laws as maximizing consumer welfare by ensuring that markets operate efficiently and prices remain close to their competitive levels).

[183] Joseph Aharony et al., *An Analysis of Risk and Return Characteristics of Corporate Bankruptcy Using Capital Market Data*, 35 J. FIN. 1001, 1014–16 (1980).

punishing management for antitrust violations is mixed.[184] Moreover, creditors—particularly those specialized in bankruptcies—exercise an outsized role in controlling a bankrupt's management during and after a bankruptcy.[185] Indeed, some argue that these specialized creditors have, in effect, become "creditor[s] in possession"[186] as compared to the Bankruptcy Code's presumption of the management acting as the "debtor in possession."[187] This power is further bolstered by the perspective of some

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[184] Antitrust actions depress defendants' share prices in some cases. William L. Huth & Don N. MacDonald, *The Impact of Antitrust Litigation on Shareholder Return*, 37 J. INDUS. ECON. 411, 411 (1989); Luca Aguzzoni et al., *The Effect of EU Antitrust Investigations and Fines on a Firm's Valuation*, 61 J. INDUS. ECON. 290, 290 (2013). Share price and management tenure are positively correlated. Gerald R. Salancik & Jeffrey Pfeffer, *Effects of Ownership and Performance on Executive Tenure in U.S. Corporations*, 23 ACAD. MGMT. J. 653, 660 (1980); Steven N. Kaplan & Bernadette A. Minton, *How Has CEO Turnover Changed?*, 12 INT'L REV. FIN. 57, 58 (2012). Therefore, effective management deterrence may be achieved by imposing antitrust liability on firms and depressing their share prices. However, the impact of a successful antitrust action on a firm's share price is short lived. John S. Thompson & David L. Kaserman, *After the Fall: Stock Price Movements and the Deterrent Effect of Antitrust Enforcement*, 19 REV. INDUS. ORG. 329, 329 (2001). Moreover, shareholders may view antitrust lawsuits as a sign of aggressive management devoted to shareholder value. Daniel A. Crane, *Optimizing Private Antitrust Enforcement*, 63 VAND. L. REV. 673, 695 (2010).

[185] Michelle M. Harner, *Trends in Distressed Debt Investing: An Empirical Study of Investors' Objectives*, 16 AM. BANKR. INST. L. REV. 69, 76–77 (2008) (discussing the increasing ability of distressed debt investors to effectively control a bankrupt debtor); Jay Krasoff and John O'Neill, *The Role of Distressed Investing and Hedge Funds in Turnarounds and Buyouts and How This Affects Middle-Market Companies*, 9 J. PRIV. EQUITY 17, 19–20 (2006) (analogizing the distressed debt market to a "loan-to-own" arrangement).

[186] Harvey R. Miller & Shai Y. Waisman, *Is Chapter 11 Bankrupt?*, 47 B.C. L. REV. 129, 154 (2005); *see also* Kenneth M. Ayotte & Esward R. Morrison, *Creditor Control and Conflict in Chapter 11*, 1 J. LEGAL ANALYSIS 511 (2009) (discussing various facets of "pervasive creditor control").

[187] 11 U.S.C. § 1101(1).

courts that the fiduciary duties of a corporation's management shift from shareholders to creditors once a firm is in financial distress.[188]

This increasing power of distressed debt investors is further evident in their active role in bankruptcies.[189] In a survey, a plurality of distressed debt investors indicated that they use their debt holdings to influence a bankrupt's management or outright acquire the bankrupt.[190] Most of these investors further indicated that often succeed in achieving these objectives.[191]

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In short, the bankruptcy system's contributions to increasing market concentrations is not limited to the noise and uncertainty in the data supplied by it to capital markets. A more direct contribution is the neglection of antitrust in the face of bankruptcy and restructuring concerns. One direct evidence of this tension is the Failing Company defense and its extensions that allow an acquisition to proceed even though it violates antitrust laws. Another evidence is the judicial, legislative, and regulatory supremacy of schemes setup to stabilize and oversee a sector over antitrust enforcement.

The tension between antitrust and bankruptcy laws has led to two outcomes. First, antitrust enforcement has become increasingly difficult in

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188 This view traces its roots to the *Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Corp.* decision of Delaware's Chancery Court. No. 12150, 1991 WL 277613 (Del. Ch. Dec. 30, 1991); *see also* Jonathan C. Lipson, *Directors' Duties to Creditors: Power Imbalance and the Financially Distressed Corporation*, 50 UCLA L. REV. 1189, 1191 n.1 (2003) (collecting cases that embraced *Credit Lyonnais*). However, Delaware courts have repudiated broad interpretations of this perceived duty. In *Quadrant Structured Products Co. v. Vertin*, the court found that a corporation's insolvency does not shift fiduciary duties of is board to creditors. 102 A.3d 155, 176 (Del. Ch. 2014). Instead, creditors merely gain derivative standing to enforce the longstanding fiduciary duties of directors to corporations. *Id.*

189 Edward I. Altman, *The Role of Distressed Debt Markets, Hedge Funds, and Recent Trends in Bankruptcy on the Outcomes of Chapter 11 Reorganizations*, 22 AM. BANKR. INST. L. REV. 75, 85–86 (2014) (reviewing studies that have found that distressed debt creditors play a role in up to 60% of Chapter 11 bankruptcies).

190 Harner, *supra* note 185, at 84–87.

191 *Id.*

bankruptcy proceedings. Second, investors can masquerade as creditors to reap monopolistic returns denied to them by antitrust laws had they acted as equity holders.

Conclusion and Next Steps

This Article sat out to argue that the failure to apply antitrust scrutiny to the bankruptcy system and the associated restructuring market has left a weak point in antitrust enforcement. This lack of scrutiny is surprising given the long-standing recognition of the tension between the collective action promoted by the Bankruptcy Code and the antitrust statutes' concern with collusive actions. Moreover, the value of assets exposed to the bankruptcy system is considerable.

There appears to be a relationship between bankruptcy volume and increasing market concentration driven by two phenomena. First, the bankruptcy system influences debt pricing by supplying noisy information to capital markets. This noise is created by unpredictable deviations from absolute priority and the cliff in the creditor-debtor relation formed by the collision of the Trust Indenture Act and the Bankruptcy Code. This noise creates risk premium in debt yield that falls disproportionately on smaller and newer competitors. Second and more directly, bankruptcy and restructuring concerns relegate antitrust enforcement to a lower priority.

The path toward addressing this contribution of the bankruptcy system to more concentrated markets starts by recognizing that these two areas of law pursue goals that are in inherent conflict, a conflict that needs to be managed as legal and economic doctrines evolve. After all, bankruptcy law promotes collective action and seeks to maximize the return on a bankrupt's assets while antitrust law dissuades collective action and limits returns on assets if they arise from monopolistic power.

Reform efforts should first look at enhancing the uniformity of bankruptcy proceedings through more consistent appellate review by statutorily authorized Bankruptcy Appellate Panels ("B.A.P.s").[192] Currently,

[192] Each circuit may establish a B.A.P. that hears appeals from bankruptcy courts with the consent of all parties. 28 U.S.C. § 158(b). This appeal replaces district court review and is subject to further review by circuit courts. *Id.* §158(c)–(d).

many circuit courts—particularly the influential Second and Third Circuits[193]— have not established B.A.P.s even though these panels can enhance both the predictability of departures from absolute priority and the uniformity of adjudication of antitrust claims in bankruptcy settings by shifting some first-level reviews from individual district judges.[194] This uniformity is even more crucial since the appellate review of bankruptcy courts are more limited than federal district courts due to their vaguely defined jurisdiction as Article I tribunals[195] and statutory limits on appellate reviews of their rulings.[196]

Reforms to improve the quality of the information supplied by the bankruptcy process to debt markets have to be even more nuanced and careful. Reforms to address deviations from absolute priority have to recognize the purported benefits of those deviations. Absolute priority is based on assumptions about the value of the bankrupt that is highly uncertain. Therefore, deviations from absolute priority have been justified as

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[193] The bankruptcy courts in the District of Delaware and the Southern District of New York dominate the large corporate bankruptcy market. Jared A. Ellias, *What Drives Bankruptcy Forum Shopping? Evidence From Market Data*, 47 J. LEGAL STUD. 119, 126 tbl.1 (2018).

[194] B.A.P.s decisions are perceived to be of higher quality than district court decisions based on citation frequency and reversal rate. Jonathan R. Nash & Rafael I. Pardo, *An Empirical Investigation Into Appellate Structure and the Perceived Quality of Appellate Review*, 61 VAND. L. REV. 1745, 1747 (2008). Their role in the stabilization of bankruptcy law through specialized appellate review has been recognized. *See* JUDITH A. MCKENNA & ELIZABETH C. WIGGINS, FED. JUD. CTR., ALTERNATIVE STRUCTURES FOR BANKRUPTCY APPEALS 6, 7–8 (2000).

[195] Because bankruptcy courts are limited to cases that (i) arise under the Bankruptcy Code, (ii) arise in a proceeding under the Code, or (iii) are related to a proceeding under the Code. Stern v. Marshall, 564 U.S. 462, 473–75 (2011). They may hear other disputes, but they must submit the proposed ruling to district courts to enter a judgment. *Id.*

[196] *E.g.*, 11 U.S.C. § 363(m) (limiting the impact of a reversal upon appeal of certain bankruptcy transactions).

parties allocating this uncertainty[197] or protecting the interests of junior and often unsophisticated claimants such as tort victims and trade.[198] Moreover, deviations from absolute priority can act as an incentive for lower priority creditors and equity holders to fund high-risk, high-reward projects.[199] Such an incentive may be socially optimal in areas where large challenges loom such as in food supply security. Therefore, a blunt reinforcement of absolute priority may not be economically and socially beneficial even though it may address the extra noise created by the bankruptcy system. Instead, more careful appellate review of deviations, such as through B.A.P.s discussed above, can strike the right balance by limiting the unpredictability in deviations rather than eliminating the deviations altogether.

Likewise, reforms to the Trust Indenture Act to address the cliff created in the relationship between creditors and debtors have to recognize the Act's underlying goals. The Act was a response to the failure of bond trustees to exercise their fiduciary duties toward their investors.[200] While there is no reason to doubt the sincerity of current bond trustees, it is worth noting that they rely on scale to generate income.[201] Therefore, they may not be able to exercise the same degree of oversight over their bond portfolios as a firm's board of directors does over the corporation. Additionally, there are

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[197] Eberhart et al., *supra* note 42, at 1458–59; Douglas G. Baird & Donald S. Bernstein, *Absolute Priority, Valuation Uncertainty, and the Reorganization Bargain*, 115 YALE L.J. 1930, 1935 (2006)

[198] *Cf., e.g.*, Barry E. Adler, *Bankruptcy Primitives*, 12 AM. BANKR. INST. L. REV. 219, 242–43 (2004) (arguing that law and economics theories support granting higher priority to tort victims which violates the current absolute priority regime).

[199] *Cf.* Alan Schwartz, *A Normative Theory of Business Bankruptcy*, 91 VA. L. REV. 1199, 1219 (2005) (highlighting the ability of absolute priority deviations to incentivize investments in higher-risk projects).

[200] *See supra* notes 51–54 and accompanying text.

[201] Largest bond trustees in the U.S. manage hundreds of bond issues. *Top of the Trustee List*, THE BOND BUYER (Oct. 16, 2006), https://www.bondbuyer.com/news/top-of-the-trustee-list. One institution controls 25% of the market. *U.S. Bank Keeps Trustee Crown*, U.S. BANK, https://usbtrustgateway.usbank.com/portal/public/marketNews.do?sectionType=NEWS&pageID=DS&item=1 (last visited Apr. 11, 2021).

benefits in pushing a distressed firm to enter the bankruptcy system rather than engage in an unending debt renegotiation. The bankruptcy process will eliminate the firm's debt overhang, thereby allowing it to focus on its operations instead of servicing its creditors.[202] It also internalizes the costs of redistribution of bankrupt's assets rather than allowing the creditor who is engaged in renegotiation to externalize that cost onto other claimants.[203] In case of a distressed and insolvent firm, these other claimants are often tort victims, trade creditors, or junior claimants.[204] Lastly, the bankruptcy petition will put all creditors on notice and will prevent creditors from "racing to renegotiate" like it prevents them from "racing to the courthouse."

Therefore, this Article proposes a more cautious and incremental amendment of Section 316(b) of the T.I.A.[205] The current version of Section 316(b) bars modifications to a bond's payment terms without the unanimous consent of bondholders.[206] This ban should be modified to allow a supermajority to modify a bond's payment terms as long as this modification does not move them up the bankruptcy priority ladder. This amendment ensures that creditors and debtors can fully renegotiate their relationship without externalizing the costs of such renegotiations onto others. If such renegotiations do not bear fruit, then debtor can enter bankruptcy, which will put other creditors on notice to defend their interests.

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[202] *See generally* George G. Triantis, *Financial Slack Policy and the Laws of Secured Transactions*, 29 J. LEGAL STUD. 35 (2000) (discussing the business implications of the debt overhang problem).

[203] Bolton, *supra* note 58, at 309.

[204] *See* Yeon-Koo Che & Kathryn E. Spier, *Strategic Judgement Proofing*, 39 RAND J. ECON. 926 (2008) (discussing the phenomenon of "strategic judgement proofing" where a firm raises senior debt to shield assets from tort victims).

[205] 15 U.S.C. § 77ppp(b).

[206] *Id.*; *see also supra* note 54.

Appendix

Table 3. The Coefficients of the Linear Regression Model Constructed Using Sector Market Concentration[208] as the Dependent Variable.[209]

Independent Variable (Normalized)	Regression Coefficient	Significance P-Value
Total Liability as a Fraction of Sector's Total Gross Output (Basis Point)		
1990–2009	+0.053	0.10
2010–2014	+0.13	0.01
2015–2019	–0.17	0.01
Total Revenues as a Fraction of Sector's Total Gross Output (Basis Point)		
1990–2009	–0.091	0.06
2010–2014	–0.40	0.02
2015–2019	+0.61	0.01

[208] Defined as the market share of the largest four firms.

[209] As shown in Figure Supp.1. of DATA SUPPLEMENT, *supra* note 1, the model's residuals are neither skewed nor correlated with the size of sectors. Data is available in Tables Supp.3–Supp.5 of *id.*