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Mergers of Majors: Applying the Failing Firm Doctrine in the Recorded Music Industry

Joshua R. Wueller

MERGERS OF MAJORS: APPLYING THE FAILING FIRM DOCTRINE IN THE RECORDED MUSIC INDUSTRY

> In favor of the merger is one undeniable fact: EMI is in trouble, and were it not for Katy Perry, David Guetta and Lady Antebellum, there might be an entirely different type of legal procedure taking place—the kind that involves chapters.[1]
>
> It's too far gone. I wonder—where did we go wrong?[2]

INTRODUCTION

To what degree should courts and federal trade regulators concern themselves with the large-scale mergers of multi-national corporate entities in the recorded music industry? The recent merger of Universal Music Group (Universal) with EMI Music (EMI)—respectively the largest and fourth-largest of the major record companies (the Majors)—resulted in stiff governmental antitrust regulations[3] and critical outcries around the world,[4] showcasing society's historically bitter disapproval of the Majors' ongoing consolidation of assets.[5] However, as this note demonstrates in the case of EMI-Universal, many of these concerns are unfounded.

In decades past, the Majors maintained substantial leverage over the recorded music industry, and horizontal mergers between them created real and legitimate antitrust concerns.[6] However, nearly every aspect of the music industry has transitioned to the digital realm, which has largely eliminated artists' reliance on the tangible recording, manufacturing, and distribution capabilities of the Majors.[7] Amid plummeting revenues,

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1. Shirley Halperin, *EMI and Universal Should Merge, Purge and Start Over (Opinion)*, HOLLYWOOD REP. (June 22, 2012, 8:00 AM), http://www.hollywoodreporter.com/earshot/emi-universal-merger-lucian-grainge-irving-azoff-senate-341117.

2. MICK JAGGER, *Too Far Gone*, *on* GODDESS IN THE DOORWAY (Virgin Records 2001). Universal purchased EMI's recorded music division—including Virgin Records and the rights to the master recording of this Mick Jagger song—in September 2011. *See* Tom Pakinkis, *Branson Hopes to Help UMG 'Reinvigorate' Virgin Records*, MUSIC WEEK (Oct. 15, 2012, 2:12 PM), http://www.musicweek.com/news/read/branson-hopes-to-help-umg-reinvigorate-virgin-records/052168.

3. *See infra* Part III.E.

4. *See, e.g., infra* note 154.

5. *See infra* Part III.E.

6. *See* STEVE KNOPPER, APPETITE FOR SELF-DESTRUCTION: THE SPECTACULAR CRASH OF THE RECORD INDUSTRY IN THE DIGITAL AGE 61 (2009).

7. *The Universal Music Group/EMI Merger and the Future of Online Music: Hearing Before the S. Subcomm. on Antitrust, Competition Policy & Consumer Rights*, 112th Cong. 9 (2012) [hereinafter *Hearing on Future of Online Music*], *available at* http://www.gpo.gov/fdsys/pkg/CHRG-112shrg76045/pdf/CHRG-112shrg76045.pdf (statement of Irving Azoff, Executive Chairman, Live Nation Entertainment) ("It used to be that bands could not make a professional album without the backing of a label. Labels used to be THE gatekeepers to fans. . . . The power today rests with consumers, not record labels. So while the Internet has brought challenges for

sizeable cutbacks, and a bungled sales attempt that resulted in financial delinquency and seizure, EMI-Universal should have implemented the failing firm doctrine to avoid invasive antitrust regulation and considerable divestment requirements.

Part I of this note explores the common-law failing firm doctrine in detail and considers its European Union (E.U.) counterpart: the rescue merger. Part II offers a brief history and background of the recorded music industry, and Part III provides an in-depth look at the events that led to the recent merger of EMI and Universal. Part IV applies the various embodiments of the failing firm doctrine to the EMI-Universal merger. Part V explores the practical concerns arising from applying the failing firm doctrine to the EMI-Universal merger, and Part VI suggests other possible uses for the doctrine.

I. LEGAL BACKGROUND INFORMATION

A. THE FAILING FIRM DOCTRINE

Federal antitrust regulations prevent the consolidation of assets that unreasonably restrain competition. However, when a company is on the verge of collapse and the "bankruptcy [attorney] . . . is sharpening her scythe, readying herself for the role of the Grim Reaper,"[8] the firm may have no choice but "to merge, acquire or be acquired, or choose to sell loss-making divisions in order to enhance the firm's viability and profitability."[9] The failing firm doctrine[10] is a narrowly tailored defense for these sorts of companies that are facing antitrust scrutiny from courts and federal regulatory agencies.[11]

The Supreme Court of the United States—not Congress—created the failing firm doctrine in 1930.[12] In *International Shoe Co. v. FTC*, the Court

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many, it has also given bands opportunities, access, and control previously unknown to any generation of artists.").

8. David Lat, *Dewey Have Plans to File for Bankruptcy? Sources Say Yes*, ABOVE THE LAW (May 19, 2012, 10:30 AM), http://abovethelaw.com/2012/05/dewey-have-plans-to-file-for-bankruptcy-sources-say-yes/.

9. JOANNIS KOKKORIS & RODRIGO OLIVARES-CAMINAL, ANTITRUST LAW AMIDST FINANCIAL CRISES 104–05 (2010).

10. Authorities use various names, such as "failing company doctrine" and "failing firm defense," to refer to the doctrine in question, but the most common word choice is "failing firm doctrine," which this note adopts.

11. Marc Paul Blum, The Failing Company Doctrine 1 (1969) (unpublished Ph.D. dissertation, Columbia University) (on file with Off-Site Library Shelving Facility (ReCAP), Columbia University).

12. *Failing Company Defense: Hearing Before the S. Subcomm. on Antitrust, Monopoly & Bus. Rights*, 96th Cong. 15 (1979) [hereinafter *Hearing on Failing Company Defense*] (statement of John Shenefield, Ass't Att'y Gen., Antitrust Div., Dep't of Justice); ABA SECTION OF ANTITRUST LAW, INTELLECTUAL PROPERTY AND ANTITRUST HANDBOOK 436 (2007) [hereinafter INTELLECTUAL PROPERTY AND ANTITRUST HANDBOOK]; ABA SECTION OF ANTITRUST LAW, MERGERS AND ACQUISITIONS 273–74 (3d ed. 2008) [hereinafter MERGERS AND ACQUISITIONS];

held that merging competitors "[do] not substantially lessen competition or restrain commerce within the intent of the Clayton Act"[13] when the following two elements are satisfied: (1) the acquired entity's "resources [are] so depleted . . . that it face[s] the grave probability of a business failure . . . [and (2)] there [is] no other prospective purchaser."[14] Twenty years later, both the House[15] and Senate[16] gave their nods of approval to the failing firm doctrine[17] in the legislative history of the Celler-Kefauver Act, which amended Section 7 of the Clayton Act.[18]

Since *International Shoe*, "[t]he number of cases in which the courts have decided that the failing [firm] doctrine was applicable after suit have been fairly few and far between,"[19] but the doctrine has continued to develop.[20] The two *International Shoe* elements have survived, and the Court may have created an additional one:

> In 1969, in *Citizen Publishing Co. v. United States*, the Supreme Court implied that inability to reorganize a failing company under the bankruptcy laws might be a third requirement of the failing firm doctrine. Later Supreme Court decisions, however, omit any reference to the reorganization possibility as a third requirement, and the few lower courts that have considered the issue are divided.[21]

The Department of Justice (the DOJ) and Federal Trade Commission (the FTC) have expressly recognized the failing firm doctrine and developed standards in their joint *Horizontal Merger Guidelines* (the

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KOKKORIS & OLIVARES-CAMINAL, *supra* note 9, at 172; Robin Mason & Helen Weeds, *The Failing Firm Defence: Merger Policy and Entry* 2 (Ctr. for Econ. Pol'y Res., Discussion Paper No. 3664, 2002); Troy Paredes, *Turning the Failing Firm Defense into a Success: A Proposal to Revise the Horizontal Merger Guidelines*, 13 YALE J. ON REG. 347, 355 (1996). *Cf.* Blum, *supra* note 11, at 29–33 (providing an interesting analysis of *International Shoe*'s predecessors).

13. Int'l Shoe Co. v. FTC, 280 U.S. 291, 302–03 (1930).

14. *Id.* at 302.

15. H.R. REP. No. 81-1191, at 6 (1949).

16. S. REP. No. 81-1775, at 7 (1950), *reprinted in* 1950 U.S.C.C.A.N. 4293, 4299.

17. Brown Shoe Co. v. United States, 370 U.S. 294, 331 (1962); KOKKORIS & OLIVARES-CAMINAL, *supra* note 9, at 170, 172; MERGERS AND ACQUISITIONS, *supra* note 12, at 272–74; Gilbert H. Montague, *The Celler Anti-Merger Act: An Administrative Problem in an Economic Crisis*, A.B.A. J., Apr. 1951, at 253, 324; Blum, *supra* note 11, at 3, 36. *But cf.* William F. Baxter, *Remarks: The Failing Firm Doctrine*, 50 ANTITRUST L.J. 247, 249 (1981–1982) (arguing that "two very superficial paragraphs in the House and Senate reports" do not demonstrate legislative approval).

18. *See* Celler-Kefauver Act of 1950, ch. 1184, 64 Stat. 1125 (codified as amended at 15 U.S.C. §§ 18, 21 (2000)).

19. *Hearing on Failing Company Defense*, *supra* note 12, at 18.

20. Mason & Weeds, *supra* note 12, at 2.

21. MERGERS AND ACQUISITIONS, *supra* note 12, at 279 (referencing Citizen Publ'g Co. v. United States, 394 U.S. 131, 138 (1969) ("The prospects of reorganization of the Citizen in 1940 would have had to be dim or nonexistent to make the failing company doctrine applicable to this case.")).

Guidelines) to facilitate its implementation.[22] Section 11 of the recently amended[23] *Guidelines* states that

> a merger does not enhance market power if . . .
>
> . . . (1) the allegedly failing firm would be unable to meet its financial obligations in the near future; (2) it would not be able to reorganize successfully under Chapter 11 of the Bankruptcy Act; and (3) it has made unsuccessful good-faith efforts to elicit reasonable alternative offers that would keep its tangible and intangible assets in the relevant market and pose a less severe danger to competition than does the proposed merger.[24]

In addition to their incorporation of the *International Shoe* elements, the FTC and DOJ have embraced the *Citizen Publishing* suggestion that a company have dim prospects of reorganization.[25] Although practitioners have questioned the reasonability of the reorganization requirement,[26] "the failing firm [doctrine] is seldom employed outside the context of negotiation with the enforcement agencies."[27] Accordingly, a successful application of the doctrine in the United States would likely satisfy all three DOJ/FTC elements.

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22. KOKKORIS & OLIVARES-CAMINAL, *supra* note 9, at 170–71; MERGERS AND ACQUISITIONS, *supra* note 12, at 280; Paredes, *supra* note 12, at 353; Bernard A. Nigro, Jr. & Jonathan S. Kanter, *The Effect of Market Conditions on Merger Review – Distressed Industries, Failing Firms, and Mergers with Bankrupt Companies* 9 (ABA Ann. Spring Meeting, 2003), *available at* http://apps.americanbar.org/antitrust/at-committees/at-telecom/pdf/distressedindustry.pdf; Lars Persson, The Auctioning of a Failing Firm 2–3, (Nov. 23, 1998) (unpublished Ph.D. dissertation, Stockholm University), *available at* http://swopec.hhs.se/iuiwop/papers/iuiwop0514.pdf.

23. Before 2010, the failing firm doctrine contained an additional element requiring that the firm's assets would leave the relevant market, but the latest version of the *Guidelines* treats the exit of assets from the market less like a requirement and more like a symptom of the doctrine itself. *Compare* U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, HORIZONTAL MERGER GUIDELINES § 11 (2010) [hereinafter MERGER GUIDELINES], *available at* http://www.justice.gov/atr/public/guidelines/hmg-2010.pdf ("The Agencies do not normally credit claims that the assets of the failing firm would exit the relevant market unless all of the following circumstances are met. . . ."), *with* U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, 1997 MERGER GUIDELINES § 5.1 (1997), *available at* http://www.justice.gov/atr/hmerger/11251.pdf (enumerating a fourth element that "absent the acquisition, the assets of the failing firm would exit the relevant market").

24. MERGER GUIDELINES, *supra* note 23, § 11.

25. *Hearing on Failing Company Defense*, *supra* note 12, at 16 ("Thus, the standards that have been developed and that are applied in the Antitrust Division are those found in the 1969 decision in *Citizen Publishing Company* . . . .").

26. *E.g.*, Molly S. Boast, *Hearings on the Changing Nature of Competition in a Global and Innovation-Driven Age*, FED. TRADE COMMISSION (Nov. 15, 1995), http://www.ftc.gov/opp/global/c184104.shtm ("[T]he requirement that the failing firm show it could not emerge successfully from a reorganization proceeding is both elusive and unduly harsh."); Katherine B. Forrest, Remarks at the FTC Horizontal Merger Guidelines Workshop: Minority Interests and Failing Firm Defense 122, (Dec. 8, 2009), *available at* http://www.ftc.gov/bc/workshops/hmg/transcripts/091208transcript.pdf ("[T]he guidelines requirement that you've got to demonstrate that you cannot successfully emerge from Chapter 11 is a very very difficult burden to meet.").

27. Boast, *supra* note 26; *accord* KOKKORIS & OLIVARES-CAMINAL, *supra* note 9, at 170.

B. THE EUROPEAN UNION'S APPROACH: THE RESCUE MERGER

Although official European Commission (EC) regulations are devoid of any reference to the failing firm doctrine, a similar exception—the rescue merger—does exist in Europe, which was born in case law like its American counterpart.[28] In its 1993 *Kali + Salz* decision,[29] the EC established the three elements of a rescue merger:

> [A] merger generally is not the cause of the deterioration of the competitive structure if it is clear that: the acquired undertaking would in the near future be forced out of the market if not taken over by another undertaking, the acquiring undertaking would take over the market share of the acquired undertaking if it were forced out of the market, [and] there is no less anticompetitive alternative purchase.[30]

The EC continues to implement the failing firm doctrine in the European Union.[31]

Both in the European Union and the United States, the failing firm doctrine requires the acquired party to be on the verge of failure.[32] The FTC/DOJ *Guidelines* describe "failure" as an inability to meet one's financial obligations,[33] and the EC focuses on the failing firm's impending ejection from the marketplace.[34] Likewise, both jurisdictions compel acquired parties to make the sale with the least negative effects on competition.[35]

However, several key distinctions exist between the American and European versions of the failing firm doctrine.[36] The American *Guidelines* requirement that a failing firm be unable to reorganize through bankruptcy[37] is absent from the EC standard.[38] In addition, EC case law requires the acquiring party to show that it would have taken the failing firm's market share even if the firm was allowed to fail[39]—an element not found in the United States.

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28. Mason & Weeds, *supra* note 12, at 1; Persson, *supra* note 22, at 3.

29. Commission Decision No. 94/449/EC (*Kali + Salz*), 1994 O.J. L 186/38, *available at* http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:1994:186:0038:0056:EN:PDF.

30. *Id.* ¶ 71.

31. KOKKORIS & OLIVARES-CAMINAL, *supra* note 9, at 111; Neelie Kroes, European Comm'r for Competition Policy, European Comm'n, Dealing with the Current Financial Crisis (Oct. 6, 2008), *available at* http://europa.eu/rapid/press-release_SPEECH-08-498_en.pdf (emphasizing that "the Commission can and will take into account the evolving market conditions and, where applicable, the failing firm defence").

32. *See Kali + Salz*, 1994 O.J. L 186/30, ¶ 71; MERGER GUIDELINES, *supra* note 23, § 11.

33. MERGER GUIDELINES, *supra* note 23, § 11.

34. *Kali + Salz*, 1994 O.J. L 186/30, ¶ 71.

35. *See Kali + Salz*, 1994 O.J. L 186/30, ¶ 71; MERGER GUIDELINES, *supra* note 23, § 11.

36. KOKKORIS & OLIVARES-CAMINAL, *supra* note 9, at 3, 45, 106.

37. MERGER GUIDELINES, *supra* note 23, § 11.

38. *Kali + Salz*, 1994 O.J. L 186/30, ¶ 71.

39. *Id.*

II. THE RECORDED MUSIC INDUSTRY: A BRIEF HISTORY

Although writers and scientists living as early as the sixteenth century theorized fantastical methods for capturing and replaying recorded sound,[40] inventor Thomas Edison first realized the task in 1877 with the phonograph,[41] which created indentations onto metal cylinders wrapped in sheets of tin foil.[42] Edison patented the device[43] and created the Edison Phonograph Company[44] "to take advantage of . . . the public's growing interest in the new-fangled sound machines."[45] His discovery "turned the performance of music into a material object, something you could hold in your hand, which could be bought and sold."[46]

Nearly a decade later, two gentlemen working under the auspices of Alexander Graham Bell created the graphophone.[47] The graphophone was most notable for replacing the phonograph cylinder's "frail and fragile"[48] tin foil component with wax,[49] but "until the introduction of the disc, . . . every recording was an original: there was no means of mass replication."[50]

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40. MICHAEL CHANAN, REPEATED TAKES: A SHORT HISTORY OF RECORDING AND ITS EFFECTS ON MUSIC 1 (1995) (citing FRANÇOIS RABELAIS, THE HISTORIES OF GARGANTUA AND PANTAGRUEL 566–69 (J.M. Cohen trans., Penguin Books 1955) (1532)); Charles Grivel, *The Phonograph's Horned Mouth*, *in* WIRELESS IMAGINATION: SOUND, RADIO, AND THE AVANT-GARDE 31, 43 (Douglas Kahn & Gregory Whitehead eds., Stephen Sartarelli trans., 1992) (citing JOH. JOACHIM BECHERS, NÄRRISCHE WEISSHEIT UND WEISE NARRHEIT 27–28 (J.F.R. 1725) (1683), *available at* http://books.google.com/books?id=yvETAAAAQAAJ); JOH. BAPTISTÆ PORTÆ, NEAPOLITANI MAGIÆ NATURALIS LIBRI VIGINTI 567–69 (Apud Petrum Leffen 1651) (1558), *available at* http://books.google.com/books?id=7MY5AAAAcAAJ (describing "Rabelais's tale of the sea of frozen words, which released voices into the air when it melted[;]" della Porta's "way to preserve words, that have been pronounced, inside lead pipes, in such a manner that they burst forth from them when one removes the cover[;]" and Nuremburg optician Grundel's suggestion of "enclosing echoes inside bottles, where he thought they would keep for a few hours at least").

41. CHANAN, *supra* note 40, at 1; Kevin J. Harrang, *Challenges in the Global IT Market: Technology, Creative Content, and Intellectual Property Rights*, 49 ARIZ. L. REV. 29, 30 (2007); *The History of the Edison Cylinder Phonograph*, LIBR. OF CONGRESS, http://memory.loc.gov/ammem/edhtml/edcyldr.html (last visited June 5, 2013).

42. *The History of the Edison Cylinder Phonograph*, *supra* note 41; Harrang, *supra* note 41, at 30. The device was aptly nicknamed "the talking tin foil." CHANAN, *supra* note 40, at 1.

43. Improvement in Phonograph or Speaking Machines, U.S. Patent No. 200,521 (filed Dec. 24, 1877); *see also* THE ENCYCLOPEDIA OF RECORDED SOUND IN THE UNITED STATES 512–13 (Guy A. Marco ed., 1993) [hereinafter ENCYCLOPEDIA OF RECORDED SOUND] (listing the most prolific phonograph inventors from 1877–1912 in the order of total patents received—a grouping that Edison clearly dominates).

44. *The History of the Edison Cylinder Phonograph*, *supra* note 41.

45. BRIAN SOUTHALL, THE RISE & FALL OF EMI RECORDS 12 (2009).

46. CHANAN, *supra* note 40, at 7.

47. *See* Recording and Reproducing Speech and Other Sounds, U.S. Patent No. 341,214 (filed June 27, 1885); *The History of the Edison Cylinder Phonograph*, *supra* note 41.

48. CHANAN, *supra* note 40, at 6. The layer of tin foil on Edison's cylinders "would last for only a few playings." *The History of the Edison Cylinder Phonograph*, *supra* note 41.

49. *The History of the Edison Cylinder Phonograph*, *supra* note 41.

50. CHANAN, *supra* note 40, at 5.

Emile Berliner, however, invented the gramophone,[51] founded the United States Gramophone Company in 1893, and replaced the cylinder with a flat, pre-recorded disc[52]—a newfound medium for the distribution of recorded sound that subsequently dominated the recorded music industry for over half a century.[53] Discs were cheaper and easier to produce,[54] and cylinder distributors like Edison were forced to adapt to the new technology.[55]

Following this "mish-mash"[56] of phonographs, graphophones, and gramophones and the ensuing popularity of discs containing pre-recorded music,[57] the music industry grew rapidly.[58] By the beginning of World War I, "Britain . . . had almost eighty record companies, the United States by the end of the same decade almost two hundred,"[59] and "a third of all British households owned some sort of gramophone."[60] "[T]he early recording companies made both phonograph and phonogram, record player and record."[61] However, music companies soon realized that profits from the sale of records were outpacing the smaller profits from talking machine sales.[62] "They accordingly shifted their focus to records, thus creating the music recording industry."[63]

The pioneers of the recorded music industry established "a model of consumption . . . which treated the record like a book, and not like, say, a photograph."[64] These record companies "created revenue-generating assets in the form of copyrights and contracts with artists who would generate copyrights."[65] Music companies exist in two parts—the recording company, which manages the phonorecords and sound recordings contained therein, and the publisher, which controls the rights of the actual musical composition.[66]

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51. *See generally* Gramophone, U.S. Patent No. 372,786 (filed May 4, 1887) (Berliner's patent for the Gramophone).

52. CHANAN, *supra* note 40, at 27–28.

53. *History*, EMI MUSIC, http://www.emimusic.com/about/history/ (last visited June 5, 2013).

54. Harrang, *supra* note 41, at 31.

55. *Id.*

56. SOUTHALL, *supra* note 45, at 12.

57. *The History of the Edison Cylinder Phonograph*, *supra* note 41.

58. CHANAN, *supra* note 40, at 54.

59. *Id.*

60. SOUTHALL, *supra* note 45, at 17.

61. CHANAN, *supra* note 40, at 32.

62. Conrad Shayo & Ruth Guthrie, *From Edison to MP3: A Struggle for the Future of the Music Recording Industry*, INT'L J. CASES ON ELEC. COM., Apr.–June 2005, at 1, 4.

63. *Id.*

64. CHANAN, *supra* note 40, at 28–29.

65. Gerben Bakker, *The Making of a Music Multinational: PolyGram's International Businesses, 1945–1998*, 80 BUS. HIST. REV. 81, 92 (2006); *see also* CHANAN, *supra* note 40, at 15 (describing how the Gramophone Company utilized this rights-based business model in its "training centres").

66. *The History of the Edison Cylinder Phonograph*, *supra* note 41.

The emerging major record companies established offices internationally to reach untapped markets.[67] As Professor Bakker explains,

> A handful of singular firms managed to adapt their strategies and organizational structures to the new environment. Along the way, they combined the assets of firms less able to adapt (such as RCA, Decca, Mercury, and MGM Records) with those of smaller, younger firms, reconfiguring their acquisitions into large international federations.[68]

In the 1950s, 60s, and 70s, "sales of sound recordings grew an average of 20% a year"[69] and the infamous "CD boom" from the mid-1980s to early 2000s produced unimaginable sales[70] and profits[71] figures. While the digitization of music proved immensely valuable until the end of the second millennium, the advent of widely accessible internet access reversed the fortunes of the recorded music industry.[72] Proven distribution and manufacturing methods became immediately outdated,[73] and "a rapidly evolving market [emerged] with an increasing array of choices of consumers."[74]

Apple Inc. released the iPod in 2001[75] and the iTunes store in 2003.[76] Selling physical albums had allowed record companies to bundle a dozen or more songs onto one indivisible unit to maximize profits, but online music stores allowed consumers to pick and choose their favorite songs for a small fraction of the cost of the entire album.[77] Simultaneously, file-sharing websites like Limewire, Kazaa, and Grokster emerged and allowed listeners to share sound recordings without the permission of the record companies.[78] "In 2000, recorded music sales dropped for the first time in over twenty

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67. CHANAN, *supra* note 40, at 5, 29–30; SOUTHALL, *supra* note 45, at 15; Bakker, *supra* note 65, at 82.

68. Bakker, *supra* note 65, at 120. Others are far more critical of consolidation within the recorded music industry. *See, e.g.*, Dan Reese, *Few Survive Heady Days of Independent Record Labels*, MEMPHIS BUS. J., Sept. 7–11, 1987, at 3 (interviewing a Memphis record producer and musician who argues that smaller labels "got co-opted, coerced, swallowed up, recycled and shoved down the throat of the American public by major record companies").

69. M. WILLIAM KRASILOVSKY & SIDNEY SHEMEL, THIS BUSINESS OF MUSIC: THE DEFINITIVE GUIDE TO THE MUSIC INDUSTRY 5 (10th ed. 2007).

70. KNOPPER, *supra* note 6, at 43–44 ("In [1984], sales jumped 625 percent, to 5.8 million; in [2000], with Britney Spears, 'NSync, Eminem, and the Backstreet Boys setting retail records that may stand forever, CD sales reached an unprecedented 942 million.").

71. *Id.* at 54 (describing how Sony's profits increased by 60 percent during the CD boom and Warner's profits doubled).

72. *See* FRED GOODMAN, FORTUNE'S FOOL: EDGAR BRONFMAN JR., WARNER MUSIC, AND AN INDUSTRY IN CRISIS 1 (2010) ("The record industry has become the canary in the internet coal mine.").

73. KNOPPER, *supra* note 6, at 208.

74. Harrang, *supra* note 41, at 43.

75. KNOPPER, *supra* note 6, at 169.

76. *Id.* at 177.

77. KRASILOVSKY & SHEMEL, *supra* note 69, at 2.

78. GOODMAN, *supra* note 7272, at 145; *accord* KNOPPER, *supra* note 6, at 81 ("The least frustrating way to obtain 'I want It That Way' in 1999 or 2000 was to download it for free.").

years,"[79] and it became readily apparent that these new consumption methods for recorded music were "cannibaliz[ing] CD sales."[80] As Edgar Bronfman Jr., former CEO of both Universal and Warner, observed, "The days of the record industry dictating formats to the consumer are gone, and they're not coming back."[81]

III. EMI-UNIVERSAL MERGER

A. FINANCIAL WOES

The recorded music industry continued to suffer as a whole, and EMI took a particularly hard hit.[82] After demerging from its corporate owner Thorn in 1996, EMI became the only publicly traded, stand-alone music company,[83] which left it in a poor position to handle the rapid developments in the industry that followed.[84]

As sales and profits decreased, EMI "look[ed] at the bones of the skeleton and rearrange[d] them"[85] in massive cost-cutting exercises.[86] EMI "slashed A&R" (the division responsible for recruiting new artists), which negatively impacted the influx of fresh hit-makers.[87] The company fired 1800 EMI employees and a quarter of its artist roster in 2002.[88] Another reduction in 2004 dismissed 1500 EMI workers and 20 percent of the remaining musical acts.[89] Workplace morale suffered substantially as a result,[90] and competitors cherry-picked many of the underpaid EMI employees who had survived the onslaught.[91] From 2002 to 2007, the total music market shrank by 40 percent.[92]

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79. GOODMAN, *supra* note 72, at 145.

80. KNOPPER, *supra* note 6, at 208.

81. GOODMAN, *supra* note 72, at 7.

82. SOUTHALL, *supra* note 45, at 61.

83. *See id.* at 11, 61, 63.

84. *See id.* at 63 (interviewing Radiohead manager Bryce Edge, who remarks, "The day that EMI demerged from Thorn and became a stand-alone shareholding music company was the beginning of the end").

85. *Id.* at 104.

86. Steve Knopper, *How the Universal-EMI Deal Will Change the Music Industry*, ROLLING STONE (Nov. 23, 2011, 12:30 PM), http://www.rollingstone.com/music/news/how-the-universal-emi-deal-will-change-the-music-industry-20111123.

87. *Id.*

88. SOUTHALL, *supra* note 45, at 141–42 ("[T]hese included 49 artists in Finland, which prompted [CEO] Levy to famously comment, 'I think that's a bit too many; I don't think there are 49 Finns that can sing.'").

89. *Id.* at 165.

90. *See id.* at 173 ("EMI's problems and poor performance had an effect on us because it had an effect on the morale of the staff at EMI. When share prices are falling and there are big questions being asked about the company—which is making big reductions in staff—it absolutely affected us because you went to meetings and met with people with long faces.").

91. *See id.* at 170.

92. *Id.* at 193.

B. TERRA FIRMA

In August 2007, the private equity firm Terra Firma Capital Partners, Ltd. (Terra Firma) purchased EMI for £4.2 billion ($8.3 billion).[93] Terra Firma fronted £1.502 billion in equity,[94] including 60 to 70 percent of the personal assets of its CEO, Guy Hands[95]: "a specialist in buying failing companies and turning them around." [96] Terra Firma "borrowed the remaining £2.74 billion from Citi[bank],"[97] "which was both the seller and the lender" in the transaction.[98]

Terra Firma created a chain of companies as an "investment vehicle" to hold and finance EMI.[99] Maltby Acquisitions, Ltd. (MAL) directly owned all of EMI's shares,[100] and Maltby Investments Ltd. (MIL) owned both MAL and Terra Firma's debt to Citibank from the purchase.[101] MIL was a subsidiary of Maltby Holdings, Ltd. (MHL),[102] Terra Firma's "unsecured

93. *In re* Maltby Invs., Ltd., [2012] EWHC (Ch) 703, [3] (Eng.); Citigroup / Maltby Acquisitions Ltd., Merger Procedure Article 7(3) Decision of 1 Feb. 2011, Case No. COMP/M.6137 ¶ 6 (EC) [hereinafter Derogation Decision], *available at* http://ec.europa.eu/competition/mergers/cases/decisions/m6137_20110201_2014_2682547_EN.pdf; KNOPPER, *supra* note 6, at 88; *The Magical Misery Tour: Terra Firma and EMI*, ECONOMIST, Feb. 5, 2011, at 88 [hereinafter *Magical Misery Tour*], *available at* http://www.economist.com/node/18063824; Chris V. Nicholson, *Terra Firma and Citi to Begin EMI Talks*, N.Y. TIMES (Aug. 19, 2010, 7:30 AM), http://dealbook.nytimes.com/2010/08/19/terra-firma-and-citi-to-begin-emi-settlement-talks/.

94. Terra Firma Invs. (GP) 2 Ltd. v. Citigroup Inc., No. 09 Civ. 10459, 2010 U.S. Dist. LEXIS 118168, at *10 (S.D.N.Y. Nov. 4, 2010).

95. Peter Lattman, *Hands on the Stand: Replaying the EMI Deal*, N.Y. TIMES, (Oct. 20, 2010, 1:35 PM), http://dealbook.nytimes.com/2010/10/20/hands-on-the-stand-replaying-the-emi-deal/; *Citi to Protect EMI Bidders from Terra Firma Action*, ALTASSETS (Sept. 8, 2011), http://www.altassets.net/private-equity-news/citi-to-protect-emi-bidders-from-terra-firma-action.html [hereinafter *Citi to Protect EMI Bidders*].

96. KNOPPER, *supra* note 6, at 231. *See also* TERRA FIRMA, TERRA FIRMA ANNUAL REVIEW 2007, at 2 (2007), *available at* http://www.terrafirma.com/annual-reviews.html?file=assets/downloads/2007_Annual_Review.pdf (describing itself as a company with "[t]he ability to see potential where others see only problems").

97. *Terra Firma Invs.*, 2010 U.S. Dist. LEXIS 118168, at *10.

98. Danny King, *Citigroup Takes Back Record Company EMI from Terra Firma*, DAILY FIN. (Feb. 1, 2011, 7:30 PM), http://www.dailyfinance.com/2011/02/01/citigroup-takes-back-record-company-emi-from-terra-firma/.

99. Derogation Decision, *supra* note 93, ¶¶ 4–5; *accord In re* Maltby Invs., Ltd., [2012] EWHC (Ch) 703, [3] (Eng.).

100. *Terra Firma Invs.*, 2010 U.S. Dist. LEXIS 118168, at *10; *In re* Maltby Invs., Ltd., [2012] EWHC (Ch) 703 at [2]; Derogation Decision, *supra* note 93, ¶ 4; Ed Christman, *How Citigroup Outfoxed Guy Hands in its Takeover of EMI*, BILLBOARD (Feb. 3, 2011), http://www.billboard.biz/bbbiz/industry/record-labels/how-citigroup-outfoxed-guy-hands-in-its-1005020642.story.

101. *In re* Maltby Invs., Ltd., [2012] EWHC (Ch) 703 at [2]; Derogation Decision, *supra* note 93, ¶ 4; Christman, *supra* note 100.

102. *In re* Maltby Invs., Ltd., [2012] EWHC (Ch) 703 at [2]; Derogation Decision, *supra* note 93, ¶ 5; Christopher Spink, *EMI Pre-Pack Bombshell*, INT'L FIN. REV., Feb. 5, 2011, at 68, *available at* http://www.reuters.com/article/2011/02/05/emi-prepack-idUSN0429587820110205.

intercompany creditor,"[103] which in turn was owned by the "ultimate holding company," Maltby Capital, Ltd. (MCL).[104]

Separate boards of directors controlled each of the individual companies.[105] "[T]he Maltby Capital Board had seven directors, five of whom [were] employees of Terra Firma . . . ."[106] The board of MIL consisted of three Terra Firma employees and two EMI executives: the CEO and CFO.[107]

C. CITIBANK

In the summer of 2010, MIL restructured its board of directors by removing the three Terra Firma employees and leaving only two EMI executives: CEO Roger Faxon and CFO Ruth Prior.[108] Although MIL was not due to make its next loan payment until June 2011,[109] "Citigroup reached out to Faxon and Prior in their roles as the only directors of Maltby Investments and asked if there was a balance sheet insolvency/technical default, and the directors had to conclude [that] there was."[110] Three separate valuations of MIL "supported the conclusion that the enterprise value of the business (and thus of EMI Group) was substantially less than the amount owed to Citi."[111] "Following this declaration, Citi called on its right to accelerate the debt owed" under the terms of the loan agreement,[112] which specified that Citigroup could step in if MIL was "deemed to or declared to be unable to pay its debts."[113] On February 1, 2011, with the cooperation of MIL's two-person board,[114] Citigroup foreclosed on EMI.[115]

MIL and Citigroup conducted a surprisingly large amount of business in a matter of hours on that day.[116] With their authority under the U.K.'s

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103. *In re* Maltby Invs., Ltd., [2012] EWHC (Ch) 703 at [21].

104. Spink, *supra* note 102, at 68; *accord* Derogation Decision, *supra* note 93, ¶ 5; MALTBY CAPITAL LIMITED, ANNUAL REVIEW 2009/10 31 (2010), *available at* http://www.emimusic.com/wp-content/uploads/2010/02/MCL_AR_09101.pdf.

105. Christman, *supra* note 100.

106. *Id.*

107. Spink, *supra* note 102, at 68.

108. Christman, *supra* note 100; Spink, *supra* note 102, at 68.

109. Magical Misery Tour, supra note 93, at 88.

110. Christman, *supra* note 100; *accord* Derogation Decision, *supra* note 93, ¶ 10; Spink, *supra* note 102, at 68 ("The move was triggered when Roger Faxon, the chief executive of the struggling music company, declared a holding company insolvent and unable to service its debts.").

111. *In re* Maltby Invs., Ltd., [2012] EWHC (Ch) 703, [27] (Eng.).

112. Derogation Decision, *supra* note 93, ¶ 11.

113. *In re* Maltby Invs., Ltd., [2012] EWHC (Ch) 703 at [12].

114. Derogation Decision, *supra* note 93, ¶ 10; *but see* Christman, *supra* note 100 (positing that Citi and the MIL board "engineer[ed] an earlier-than-expected assumption of EMI ownership").

115. King, *supra* note 98.

116. *See In re* Maltby Invs., Ltd., [2012] EWHC (Ch) 703 at [21] (providing an hour-by-hour breakdown of the day's proceedings); Email from Roger Faxon, Chief Exec., EMI Music, to EMI Music Staff (Feb. 1, 2011), *in EMI's Email to Staff on Citigroup Takeover*, GUARDIAN (Feb. 7, 2011, 8:29 AM), http://www.guardian.co.uk/media/2011/feb/07/emi-roger-faxon-email [hereinafter Faxon Email].

insolvency laws,[117] Faxon and Prior appointed two administrators to conduct a pre-pack administration proceeding,[118] which is the U.K. counterpart of a pre-packaged Chapter 11 bankruptcy.[119] "In this type of insolvency, a business is marketed prior to an [administrator's] appointment. The sale is arranged before the company enters administration and sold immediately after."[120] As MIL's only secured lender, Citigroup opted to acquire 100 percent of Maltby's share capital,[121] making Citigroup the new owner of EMI.[122]

The pre-pack, which was the largest in U.K. history,[123] amounted to a debt-for-equity swap.[124] In exchange for full ownership of MIL (and its asset, EMI), Citigroup slashed around £2 billion of EMI's debt[125]—a 65 percent reduction[126]—and "provid[ed] it with a cash balance of more than 300 million pounds."[127] The deal artificially restored EMI to balance-sheet solvency.[128]

Citigroup may have made financial sacrifices in the pre-pack with MIL,[129] but Terra Firma was the biggest loser. "With the value of the business worth less than the 3.4 billion pounds of debt, Guy had no more economic interest in the business; Terra Firma's investment had no value . . . ."[130] As an unsecured creditor in the boardroom coup,[131] Terra Firma lost "the entirety of its investment of about £1.85bn,"[132] and Guy Hands fled to

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117. Insolvency Act, 1986, c. 45, sch. B1, ¶ 22 (U.K), *available at* http://www.legislation.gov.uk/ukpga/1986/45/schedule/B1/data.pdf ("The directors of a company may appoint an administrator.").

118. *In re* Maltby Invs., Ltd., [2012] EWHC (Ch) 703 at [4].

119. Christman, *supra* note 100.

120. Rachael Singh, *EMI's Pre-Pack Could Be the Start of Things to Come*, ACCOUNTANCY AGE (Feb. 11, 2011), http://www.accountancyage.com/aa/analysis/2025777/emis-pre-pack-start; *accord* Faxon Email, *supra* note 116.

121. CITIGROUP INC., 2010 ANNUAL REPORT 290 (2011), *available at* http://www.citigroup.com/citi/investor/quarterly/2011/ar10c_en.pdf.; *accord In re* Maltby Invs., Ltd., [2012] EWHC (Ch) 703 at [4]; Juliette Garside, *EMI Chiefs Forfeited £41m in Bonuses After Collapse into Administration*, GUARDIAN (Jan. 4, 2012, 2:06 PM), http://www.guardian.co.uk/business/2012/jan/04/emi-chiefs-forfeited-bonuses; Singh, *supra* note 120; Spink, *supra* note 102, at 68.

122. Zack O'Malley Greenburg, *Citi's EMI Sale to Blavatnik on Hold?*, FORBES (Oct. 30, 2011, 11:58 PM), http://www.forbes.com/sites/zackomalleygreenburg/2011/10/30/citi-emi-sale-to-blavatnik-on-hold/.

123. Spink, *supra* note 102, at 68.

124. Derogation Decision, *supra* note 93, ¶ 13.

125. Christman, *supra* note 100; Faxon Email, *supra* note 116; Garside, *supra* note 121; Helen Power, *Pre-Packs: EMI First in a Wave of Restructures*, LONDON TIMES, Feb. 3, 2011, at 32.

126. King, *supra* note 98.

127. *Id.*; *accord* Christman, *supra* note 100.

128. Derogation Decision, *supra* note 93, ¶ 13.

129. Garside, *supra* note 121.

130. Christman, *supra* note 100.

131. *In re* Maltby Invs., Ltd., [2012] EWHC (Ch) 703, [30] (Eng.); Singh, *supra* note 120.

132. *In re* Maltby Invs., Ltd., [2012] EWHC (Ch) 703 at [6]. Others estimate that the loss was notably less. *See, e.g.*, Christman, *supra* note 100 (quipping that "[w]hen all is said and done, it

the island of Guernsey as a "tax exile"[133] after losing over half of his personal net worth.[134] Justice Warren of the High Court of Justice in London describes the legal challenges that spawned from Terra Firma's frustrations with Citigroup:

> [T]here is enormous hostility between [Terra Firma] and Citi with two battle-zones in place: first, the New York courts where [Terra Firma] seek to recover their investment and, potentially at least, in London where they may seek to say that the [administrators] were not validly appointed and that there has been a sale at undervalue.[135]

Terra Firma's litigation was initially unsuccessful both in the United States[136] and England,[137] but the Second Circuit Court of Appeals has remanded Terra Firma's New York case for further proceedings.[138]

D. CITIGROUP SPLITS UP EMI AND SELLS TO UNIVERSAL

The "banking behemoth" Citigroup[139] never intended to maintain ownership of EMI.[140] Four months after gaining control of EMI from Terra Firma, Citigroup placed the music company up for auction.[141] EMI's newfound solvency made it more appealing,[142] and potential buyers began to emerge.[143] Despite Roger Faxon's insistence that EMI would remain more valuable as a single entity,[144] Citigroup stood to make greater profits on the sale by splitting EMI into its recording and publishing divisions and selling the two pieces separately.[145]

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looks like Terra Firma paid a whopping 1.6 billion pounds to rent EMI for three and a half years"); Garside, *supra* note 121 (quoting a £1.75 billion loss).

133. Dan Sabbagh, *EMI's Downfall: Will the Hits Keep Coming?*, TIME (Feb. 9, 2010), http://www.time.com/time/business/article/0,8599,1962165,00.html.

134. Lattman, *supra* note 95; *Citi to Protect EMI Bidders*, *supra* note 95.

135. *In re* Maltby Invs., Ltd., [2012] EWHC (Ch) 703 at [10].

136. Terra Firma Invs. (GP) 2 Ltd. v. Citigroup Inc., 725 F. Supp. 2d 438 (S.D.N.Y. 2010).

137. *In re* Maltby Invs., Ltd., [2012] EWHC (Ch) 703.

138. Terra Firma Invs. (GP) 2 Ltd. v. Citigroup Inc., No. 11-126 (2d Cir. May 31, 2013), *available at* http://www.ca2.uscourts.gov/decisions/isysquery/c452a13a-fc2c-489b-87c1-a136f0f95fd8/2/doc/11-126_complete_opn.pdf.

139. *See* Andre Yoskowitz, *Record Label EMI Faces Bank Takeover Due to Debts*, AFTERDAWN (Apr. 1, 2010, 11:49 PM), http://www.afterdawn.com/news/article.cfm/2010/04/02/record_label_emi_faces_bank_takeover_due_to_debts.

140. Faxon Email, *supra* note 116.

141. Dana Cimilluca, *Citigroup Betting on High EMI Bids*, WALL ST. J., Oct. 5, 2011, http://online.wsj.com/article/SB10001424052970203791904576611143998633526.html.

142. *Magical Misery Tour*, *supra* note 93, at 88.

143. Ed Christman, *EMI: With Bids Low, Company Considers Whether to Split Up or Postpone Sale*, BILLBOARD (Oct. 17, 2011), http://www.billboard.biz/bbbiz/industry/record-labels/emi-with-bids-low-company-considers-whether-1005416972.story.

144. Faxon Email, *supra* note 116 ("I have no doubt that the best possible way to yield the highest value for EMI is to keep our businesses together in pursuit of our strategy.").

145. Christman, *supra* note 143.

On November 11, 2011, "Vivendi and its subsidiary, Universal Music Group (UMG), announced . . . a definitive agreement to purchase EMI's recorded music division for a total consideration of £1.2bn [$1.9 billion]."[146] Three days later, Citigroup sold EMI's publishing division for $2.2 billion (£1.4 billion) to a consortium led by the Sony Corporation that included the estate of Michael Jackson, entertainment mogul David Geffen, and several private investment firms.[147]

The combined $4.1 billion deal "le[ft] Citigroup as arguably the biggest winner, as the bank [recovered] all of the money it lent Mr. Hands."[148]

E. EMI-UNIVERSAL MERGER UNDERGOES ANTITRUST SCRUTINY

Both EMI and Universal control subsidiaries all around the world,[149] and the announcement of their merger prompted numerous national regulatory agencies to analyze the acquisition for anticompetitive effects.[150] Among other governments, the United States and European Union chose to conduct full investigations.[151] In the United States, the merger was assigned to the FTC.[152] Many interested organizations advocated for either the approval[153] or rejection[154] of the consolidation, and both houses of Congress probed the two music companies with questions and concerns.[155]

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146. Press Release, Vivendi, Vivendi and Universal Music Group (UMG) to Purchase EMI (Nov. 11, 2011) [hereinafter Vivendi Press Release], *available at* http://www.vivendi.com/wp-content/uploads/2011/11/pr111111-vivendi-umg.pdf.

147. Laura Board, *Sony Consortium Buys EMI Music Publishing*, DEAL (Nov. 14, 2011, 5:22 AM), http://www.thedeal.com/content/tmt/sony-consortium-buys-emi-music-publishing.php.

148. Andrew Edgecliffe-Johnson, *Vivendi/EMI Deal Hits High Notes for Bankers*, FIN. TIMES (Sept. 5, 2012, 6:39 PM), http://www.ft.com/intl/cms/s/0/e6f44232-f761-11e1-8c9d-00144feabdc0.html#axzz2CR9wQc00.

149. Press Release, Universal Music Grp., Universal Music Group (UMG) to Sell EMI's European Stake in NOW THAT'S WHAT I CALL MUSIC! to Sony Music Entertainment (Feb. 27, 2013) [hereinafter UMG Press Release], *available at* http://www.universalmusic.com/corporate/detail/2440.

150. Georg Szalai, *Universal Music Gets U.S. Approval for EMI Acquisition*, HOLLYWOOD REP. (Sept. 21, 2012, 8:43 AM), http://www.hollywoodreporter.com/news/universal-music-emi-deal-us-approval-372941.

151. Press Release, European Comm'n, Mergers: Commission Opens In-Depth Investigation into Proposed Acquisition of EMI Recorded Music Business by Universal 1 (Mar. 23, 2012) [hereinafter EC Mar. 2012 Press Release], *available at* http://europa.eu/rapid/press-release_IP-12-311_en.pdf; Claire Atkinson, *Citi's EMI Deal on FTC Stage*, N.Y. POST (Dec. 22, 2011, 3:16 PM), http://www.nypost.com/p/news/business/citi_emi_deal_on_ftc_stage_rpGU1IuzrZLe2hXHeHNbYN.

152. Atkinson, *supra* note 151.

153. *See, e.g.*, Geoffrey Manne & Berin Szoka, *UMG-EMI Deal Is No Threat to Innovation in Music Distribution*, INT'L CENTER L. & ECON., http://laweconcenter.org/component/content/article/82-umg-emi-deal-is-no-threat-to-innovation-in-music-distribution.pdf (last visited June 5, 2013) ("UMG's ability to raise prices on Lady Gaga's music is hardly affected by the fact that it might also own Lady Antebellum's music . . . .").

154. *See, e.g.*, *Groups Warn Congress of Dangers in Universal Music Group-EMI Merger*, PUB. KNOWLEDGE (Apr. 26, 2012), http://www.publicknowledge.org/groups-warn-congress-dangers-universal-music-group ("With a post-merger three-firm market share of 90%, and with

The EMI-Universal merger was especially troubling to the EC, which began its own in-depth investigation into the acquisition in March of 2012 "to make sure that consumers continue to have access to a wide variety of music in different physical and digital formats at competitive conditions."[156] Six months later, following confidential negotiations between the European Union and music companies, the EC announced that it would contingently approve the merger upon Universal's completion of several conditions.[157]

Most important, the EC required Universal to divest a slew of successful EMI artists and subsidiary labels[158] that amounted to approximately one-third of EMI's assets.[159] In addition, "Universal committed to selling EMI's 50 percent stake in the popular *Now! That's What I Call Music* compilation"[160] and agreed to exclude "Most Favoured Nation" clauses from its digital contracts worldwide for a period of ten years.[161]

The FTC "worked closely with the EC throughout the investigation,"[162] and that same day, it announced its approval of the merger in light of the EC's divestment requirements.[163] Subsequently, EMI sold its stake in the *Now!* compilation series to Sony Music Entertainment[164] and Warner Music

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one or two companies following the lead of the dominant firm, the market would be vulnerable to anticompetitive harm resulting from conscious parallelism.").

155. *Hearing on Future of Online Music*, *supra* note 7; Ben Sisario, *House Subcommittee Wades into the Universal-EMI Deal*, N.Y. TIMES BLOG (Aug. 22, 2012, 5:06 PM), http://mediadecoder.blogs.nytimes.com/2012/08/22/house-subcommittee-wades-into-the-universal-emi-deal/ (reporting that "the House Judiciary Subcommittee on Intellectual Property, Competition and the Internet sent a letter to executives at Universal and two other major labels, asking pointed questions about how the merger would affect competition in the music industry").

156. EC Mar. 2012 Press Release, *supra* note 151, at 1.

157. *See* Press Release, European Comm'n, Mergers: Commission Clears Universal's Acquisition of EMI's Recorded Music Business, Subject to Conditions 2 (Sept. 21, 2012) [hereinafter EC Sept. 2012 Press Release], *available at* http://europa.eu/rapid/press-release_IP-12-999_en.pdf.

158. *Id.*

159. Ryan Bort, *Universal's Takeover of EMI Approved*, PASTE (Sept. 21, 2012, 12:55 PM), http://www.pastemagazine.com/articles/2012/09/universals-takeover-of-emi-approved.html.

160. EC Sept. 2012 Press Release, *supra* note 157 at 2.

161. *Id.*

162. Press Release, Fed. Trade Comm'n, Statement of Bureau of Competition Director Richard A. Feinstein *In the matter of* Vivendi, S.A. and EMI Recorded Music 2 (Sept. 21, 2012) [hereinafter Feinstein], *available at* http://www.ftc.gov/os/closings/comm/120921emifeinsteinstatement.pdf.

163. Press Release, Fed. Trade Comm'n, FTC Closes its Investigation into Vivendi, S.A.'s Proposed Acquisition of EMI Recorded Music (Sept. 21, 2012), *available at* http://www.ftc.gov/opa/2012/09/emi.shtm; Feinstein, *supra* note 162, at 2 (noting that "the remedy obtained by the European Commission to address the different market conditions in Europe will reduce concentration in the market in the United States as well").

164. UMG Press Release, *supra* note 149.

Group purchased the legendary Parlophone label.[165] The required divestments totaled around $350 million—more than Universal had anticipated.[166]

IV. APPLICATION OF THE FAILING FIRM DOCTRINE TO EMI-UNIVERSAL

The sizeable divestment that regulatory agencies hoisted upon Universal counteracted the careful planning of the music company and disregarded its calculated negotiations with Citigroup. Hundreds of millions of dollars of assets that Universal strategically acquired on the open market were scattered among Universal's competitors under obligations to the EC. EMI's dire situation within the music industry was no secret, and Universal might have avoided its setbacks and retained full ownership of EMI's recorded music component by utilizing the failing firm doctrine.

A. EMI WAS A FAILING FIRM

As the doctrine's name suggests, a failing firm must be failing—"a corporation with resources so depleted that it face[s] the grave probability of a business failure."[167] By the DOJ/FTC *Guidelines* standard, the firm must be "unable to meet its financial obligations in the near future,"[168] and an EC rescue merger requires that the firm "would in the near future be forced out of the market if not taken over by another."[169] Neither *International Shoe*, the *Guidelines*, nor *Kali + Salz* requires that the company in question actually fail,[170] and EMI's acquisition appears to qualify as failing.

The market collapsed after Terra Firma bought the debt-ridden EMI in 2007 at a premium price of £4.2 billion ($6.4 billion), and the private equity firm had no realistic prospect of crawling out of that hole.[171] Referencing the purchase, Citigroup allegedly "described EMI as 'a terminally ill cancer

165. Helienne Lindvall, *Warner Buys Parlophone: Why Didn't Artists and Indies Put Up a Fight?*, GUARDIAN (Feb. 15, 2013, 11:52 AM), http://www.guardian.co.uk/media/2013/feb/15/warner-parlophone-artists-indies.

166. Foo Yun Chee & Diane Bartz, *Europe, U.S. Approve Universal Purchase of EMI Unit*, REUTERS (Sept. 21, 2012, 4:11 PM), http://www.reuters.com/article/2012/09/21/us-universal-emi-eu-idUSBRE88K0DD20120921.

167. Int'l Shoe Co. v. FTC, 280 U.S. 291, 302 (1930).

168. MERGER GUIDELINES, *supra* note 23, § 11.

169. Commission Decision No. 94/449/EC (*Kali + Salz*), 1994 O.J. L 186/38, ¶ 71, *available at* http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:1994:186:0038:0056:EN:PDF.

170. *See supra* notes 32–34 and accompanying text.

171. Chris Blackhurst, *Investors in Debt-Ridden EMI Must Stump Up £100m or Call it Quits*, LONDON EVENING STANDARD, Feb. 4, 2010, http://www.standard.co.uk/news/investors-in-debtridden-emi-must-stump-up-100m-or-call-it-quits-6769750.html ("Unfortunately, they will not get anything like the £4.2 billion that Hands paid. Of all the deals done in the last boom, EMI represents the high-water mark. It was right at the very end of the golden period . . . .").

patient on chemotherapy'"[172] and remarked that "[CEO] Guy [Hands] stepped into one of the highest profile piles of doo doo out there."[173] Financial journalist Felix Salmon explained the implications of Terra Firma's insistence on a debt write-down from Citigroup:

> Terra Firma [asked] Citi to write down the principal amount owed, in return for Terra Firma injecting hundreds of millions of dollars of new money into EMI. . . .
>
> . . . But any such option carries an implicit ultimatum: if you don't write down your loan, Terra Firma [said], then we won't inject any more money, and EMI will be forced into bankruptcy. . . .
>
> . . . When a company declares bankruptcy, it essentially gets taken over by its creditors. In this case, the creditor [was] Citi, . . . [but] the obvious Plan A for *any* creditor faced with Terra Firma's ultimatum is to seize the company and sell it . . . .[174]

Peter Spratt, EMI's own administrator in the transition of ownership to Citigroup, acknowledged that the insolvent music company was in a state of financial collapse.[175]

Impending liquidation is the surest sign that a firm is failing.[176] Ultimately, Citigroup split the proverbial baby and auctioned off EMI's recording and publishing components individually, but a real possibility existed that the creditor would liquidate EMI's assets in Chapter 7 bankruptcy or some equivalent[177]—that undeniable point at which a failing company becomes a failed one.

Perhaps most significantly, the EC acknowledged EMI's dismal financial situation at length in a derogation proceeding during the pre-pack administration.[178] The EC explained how rarely it derogates from its obligation to suspend concentrations,[179] and it deemed such a decision

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172. Brief of Plaintiff-Appellant at 4, Terra Firma Invs. (GP) 2 Ltd. v. Citigroup Inc., No. 11-0126-cv (2d Cir. April 25, 2011).

173. Memorandum of Law of Terra Firma Investments (GP) 2 Ltd. and Terra Firma Investments (GP) 3 Ltd. in Opposition to Defendants' Motion for Summary Judgment at 22, Terra Firma Invs. (GP) 2 Ltd. v. Citigroup Inc, 725 F. Supp. 2d 438 (S.D.N.Y. 2010) (No. 09-CV-10459).

174. Felix Salmon, *Guy Hands and Citi's Chinese Walls*, REUTERS (Dec. 16, 2009, 6:43 PM), http://blogs.reuters.com/felix-salmon/2009/12/16/guy-hands-and-citis-chinese-walls/.

175. *See* Power, *supra* note 125, at 32.

176. *See Hearing on Failing Company Defense*, *supra* note 12, at 36 (statement of Daniel C. Schwartz, Deputy Director, Bureau of Competition, Federal Trade Commission).

177. Blackhurst, *supra* note 171 (explaining how Terra Firma might avoid cash injections on its loans, "say 'enough' to throwing good money after bad[,] and try and claw something back from EMI going into administration and being broken up"); Zé Pequeno, *2010: The Inevitable Fall and Destruction of EMI*, TINY MIX TAPES (Dec. 2010), http://www.tinymixtapes.com/features/2010-inevitable-fall-and-destruction-emi ("Total liquidation would certainly clear Guy Hands of the billions in debt he faces . . . .").

178. *See* Derogation Decision, *supra* note 93.

179. *Id.* ¶ 22.

appropriate when "the target is on the brink of bankruptcy and only immediate implementation of the deal would avoid a further grave deterioration of the situation."[180] The EC recognized "the risk of [a] cascade of bankruptcies of the 270 EMI group operating companies all over the world"[181] and waived the suspension of the purchase to avoid "further financial difficulties . . . and the decline of EMI's business."[182]

Less than one year passed between the derogation decision and EMI-Universal merger.[183] Considering the EC's grim financial forecast for EMI in the derogation decision, EMI-Universal could have made a strong argument that EMI was failing and that the purchase was a rescue merger. EMI's "balance sheet insolvency . . . reflect[ed] the enormous gulf between the value of the Company's assets and the extent of its liabilities"[184]—a recipe for financial failure under any standard.

B. EMI COULD NOT HAVE SUCCESSFULLY REORGANIZED

The *Guidelines* state that, in order for the failing firm doctrine to apply, the firm must not "be able to reorganize successfully under Chapter 11 of the Bankruptcy Act,"[185] a requirement reflected in the Court's *Citizen Publishing* decision—"[t]he prospects of reorganization . . . would have to be dim or nonexistent."[186] This element is absent from the E.U. standard.[187] Scholars have proffered two varying explanations of what constitutes an "unsuccessful" Chapter 11 reorganization,[188] and under either standard, an EMI reorganization would have been unsuccessful.

One standard for a failed Chapter 11 bankruptcy proceeding is a "return[] to [C]hapter 11 within a set period of time."[189] According to Professor Edward Altman, "[I]t seems clear that if a firm is forced to seek another distressed restructuring within a relatively short period of time after emerging, the process was not a success at all."[190] It is important to emphasize that the FTC and DOJ consider the likely success of a *prospective* hypothetical reorganization of an allegedly failing firm's

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180. *Id.* ¶ 27.
181. *Id.* ¶ 32.
182. *Id.* ¶ 18.
183. *Compare* Derogation Decision, *supra* note 93 (taking place on January 2, 2011), *with* Vivendi Press Release, *supra* note 146 (announcing the purchase of EMI on November 11, 2011).
184. *In re* Maltby Invs., Ltd., [2012] EWHC (Ch) 703, [31] (Eng.).
185. MERGER GUIDELINES, *supra* note 23, § 11.
186. Citizen Publ'g Co. v. United States, 394 U.S. 131, 138 (1969).
187. *See* Commission Decision No. 94/449/EC (*Kali + Salz*), 1994 O.J. L 186/38, ¶ 71, *available at* http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:1994:186:0038:0056:EN:PDF.
188. Stephen J. Lubben, *Chapter 11 'Failure'* 3 (Seton Hall Pub. Law, Research Paper No. 1375163, 2009), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1375163.
189. *Id.*
190. Edward I. Altman et al., *Post-Chapter 11 Bankruptcy Performance: Avoiding Chapter 22*, 21 J. APPLIED CORP. FIN. 53, 53 (2009).

debt.[191] Accordingly, under the failing firm doctrine, these government entities deem the *prospective* Chapter 11 reorganization of the failing firm unsuccessful if the firm would prospectively return to a *second*, imaginary reorganization.[192] The further down this rabbit hole of hypothetical reorganizations one goes, the easier it becomes to understand the rarity of the doctrine's usage[193] and the rightful criticism that the "unsuccessful reorganization" requirement has drawn.[194]

The case of EMI is unique because the music company *already underwent* the U.K. equivalent of a pre-packaged Chapter 11 bankruptcy only nine months before it was sold to Universal,[195] which provides additional insight into the "Return to Chapter 11" analysis. Any subsequent Chapter 11 proceeding (hypothetical or not) would signal the failure of EMI's pre-pack, especially considering that a company is significantly less likely to succeed in a second round of Chapter 11 proceedings.[196] The very fact that EMI had recently undergone the U.K. equivalent of Chapter 11 bankruptcy indicates that a later reorganization would fail.

Conversely, other scholars "argue that [C]hapter 11 fails if the debtor liquidates rather than reorganizes."[197] Using this draconian logic, an onlooker might have deemed the rearrangement of the Titanic's deck chairs unsuccessful when the ship sank to the bottom of the ocean. Of course, one can safely say that a business method is unsuccessful when the business itself fails, but the standard for an unsuccessful restructuring under Chapter 11 of the Bankruptcy Code should be much less stringent. The failing firm doctrine does not require a firm to completely fail—rather, it seeks to *prevent* both the exit of the company's assets from the market and the social consequences of a complete failure.[198] Once again, the prospective nature of this element of the failing firm defense renders an actual analysis of Chapter 11 failure impossible.

As previously mentioned, despite the overly strict nature of a liquidation standard and its arguable inapplicability to a failing firm analysis, a real possibility existed that Citigroup would liquidate EMI under Chapter 7.[199] "In a typical Chapter 7 liquidation case, the trustee collects the nonexempt property of the debtor, converts that property to cash, and distributes the cash to the creditors."[200] "In return the debtor is discharged

191. Citizen Publ'g Co., 394 U.S. at 138; MERGER GUIDELINES, *supra* note 23, § 11.
192. *See supra* Part I.A.
193. MERGERS AND ACQUISITIONS, *supra* note 12, at 283; Nigro & Kanter, *supra* note 22, at 8.
194. *See supra* note 26.
195. Christman, *supra* note 100.
196. Altman, *supra* note 190, at 53.
197. Lubben, *supra* note 188, at 3.
198. MERGERS AND ACQUISITIONS, *supra* note 12, at 274–75.
199. Blackhurst, *supra* note 171; Pequeno, *supra* note 177.
200. DAVID G. EPSTEIN ET AL., BANKRUPTCY 8 (1993).

from all liabilities and is granted [a] 'fresh start.'"[201] In the strict sense of the word, Citigroup did liquidate EMI's assets following EMI's previous U.K. pre-pack. Citigroup became both the owner and sole secured creditor of EMI, which entitled Citigroup to convert EMI to cash and distribute that cash as it saw fit (i.e., to take the money and run).[202] In addition, Citigroup sold EMI's recorded music component to Universal—a competitor who would incorporate the assets into its pre-established business model[203] as opposed to another private equity firm, which would have dumped the purchase price back on top of EMI as debt like Terra Firma did.[204] Through a combination of the pre-pack administration and the sale of EMI to Universal, Citigroup satisfied itself as the creditor and gave EMI the "fresh start" that it needed.[205]

Because "the Chapter 11 of a big business usually leads to some form of reorganization of the company that is 'successful' at least in the sense that some part of the business continues as a going concern,"[206] some might argue that EMI would have survived without merging. However, as already explained, the facts surrounding EMI's sale to Universal are far from usual.[207] Many have also opined that "the potentially rewarding but notoriously unpredictable international music business"[208] is a different animal entirely from typical large corporations and deserves separate considerations not present in most industries.[209]

Because EMI underwent a U.K. pre-pack administration, which closely resembles Chapter 11 bankruptcy in the United States, others might argue that a U.S. Chapter 11 proceeding would be successful. This logic assumes that *applying* for bankruptcy makes it successful,[210] but post-Chapter 11 companies statistically face significant hardships in the years following reorganization.[211] In the case of EMI, Citigroup sold the music company as soon as possible after the pre-pack, and onlookers can only speculate as to

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201. *Id.* at 449.
202. CITIGROUP INC., *supra* note 121, at 290.
203. *See supra* Part III.D.
204. *See supra* Part III.B.
205. *See supra* Parts III.C–D.
206. EPSTEIN, *supra* note 200, at 734–35.
207. *See supra* Parts III.B–D.
208. SOUTHALL, *supra* note 45, at 11.
209. *See, e.g., Hearing on Future of Online Music*, *supra* note 7, at 22 (Mr. Azoff states: "I think that we are a very unique industry, . . . [s]o I do not think you can apply [normal antitrust principles]—you know, we are a quirky, crazy industry . . . .").
210. Altman, *supra* note 190, at 53–54 ("[U]nless there is convincing opposition from interested parties, the bankruptcy court has little choice but to sanction the plan as presented. Since most corporate advisors and relevant stakeholders have a bias toward emerging as soon as possible, opposition is fairly rare.").
211. *Id.* at 54 ("[M]ore than two-thirds of those companies underperformed their industry peers for up to five years following bankruptcy. And some studies reported that as many as 40% of those companies continued to experience pre-interest operating losses in the first three years after emergence.").

how successful the reorganization would have been if EMI had filed for Chapter 11 bankruptcy.[212] Considering the financial struggles and loss of key artists that EMI suffered prior to administration in the United Kingdom,[213] it is likely that the corporation would have continued to struggle in the industry.

C. EMI MADE GOOD-FAITH OFFERS AND HAD NO OTHER PURCHASERS

The *Guidelines* require a failing firm to make "unsuccessful good-faith efforts to elicit reasonable alternative offers that . . . pose a less severe danger to competition."[214] In the European Union, rescue mergers are only allowed if "there is no less anticompetitive alternative purchase."[215] Citigroup satisfied both of these requirements during its sale of EMI to Universal.

EMI was less attractive to other purchasers during the auction; because of past "massive restructure[s] to take costs out, . . . the fat had already been removed."[216] As the music company fell further into debt and became less and less of a competitor in the recorded music industry, "the well of potential buyers for EMI [began to] dry[] up."[217] Universal emerged as the only legitimate bidder, and Citigroup capitalized on the opportunity to sell.[218]

In addition, "companies in the technology industries . . . see no real need to be content owners."[219] The only interested parties to a transaction of the magnitude of EMI's sale were direct competitors who could create synergies between the acquired business and cut costs.[220] "There was no one else out there."[221] Although Warner Music Group was predicted to be the high bidder, it withdrew from the auction.[222] Universal was the only

212. *See supra* Part III.D.
213. *See supra* Part III.A.
214. MERGER GUIDELINES, *supra* note 23, § 11.
215. Commission Decision No. 94/449/EC (*Kali + Salz*), 1994 O.J. L 186/38, ¶ 71.
216. SOUTHALL, *supra* note 45, at 142.
217. *Id.* at 98.
218. *See supra* Part III.D.
219. SOUTHALL, *supra* note 45, at 116.
220. *See Update on EMI Auction*, AL LINDSTROM (Oct. 7, 2011), http://allindstrom.com/2011/10/news-update-on-emi-auction/ ("The turbulent capital markets have supposedly chased away the other private equity bidders.").
221. SOUTHALL, *supra* note 45, at 103.
222. Halperin, *supra* note 1 (quoting Mr. Azoff, who stated that "Warner had the chance to outbid Universal in this process—but chose to walk away"); *Universal, Sony Trump Rival Companies' Bids in EMI Auction Victory*, SMART BUSINESS (Nov. 11, 2011), http://www.sbnonline.com/2011/11/universal-sony-trump-rival-companies%E2%80%99-bids-in-emi-auction-victory/ (describing how "in a surprise, Warner Music walked away from the auction after failing to agree to terms for taking over EMI's pension liabilities").

legitimate bidder, and Citigroup made a good-faith effort to elicit other bids when it held an open auction for EMI.[223]

V. PRACTICAL APPLICATION AND CONCERNS

Stubbornness and large egos have plagued mergers of recorded music companies in the past.[224] When record executives can hardly agree to join forces with one another, it becomes a practical issue that many would never admit that their company is on the verge of economic collapse. To be fair, calling oneself a failing firm is not the most majestic way to go gentle into that good night.

At least one government official expressed interest about whether EMI could utilize the failing firm doctrine. In June 2012, during a meeting of the Senate Subcommittee on Antitrust, Competition Policy and Consumer Rights, Gigi Sohn—president of the public interest group Public Knowledge and adamant opponent of the Universal-EMI merger—made a statement[225] and submitted written testimony.[226] In her thorough application of the *Guidelines* to the merger, Ms. Sohn included a one-paragraph disposal of the failing firm doctrine.[227] During Ms. Sohn's statement to the Subcommittee and in the presence of the CEOs of both EMI and Universal, Senator Michael Lee acknowledged that Sohn had discarded the failing firm doctrine and stated that as far as he knew, no one had bothered to claim the defense.[228] Neither Gigi Sohn, Roger Faxon (CEO of EMI), nor Lucian Grainge (CEO of Universal) responded to Senator Lee's remark about the failing firm doctrine's absence.[229]

In addition, as discussed above, the failing firm doctrine is largely an educated prediction of hypothetical outcomes and very little precedent exists for the defense's utilization. In most circumstances, merging corporations would find little refuge in the strict elements of the doctrine and would be well advised to focus on more traditional means to show a lack of anti-competitive effects.[230] The prospective nature of the U.S. element requiring a company's failure during a hypothetical Chapter 11 bankruptcy creates a significant level of uncertainty for the minority of firms who do raise the defense.[231] However, the unique circumstances of the EMI-Universal merger suggest that the parties could have beaten the odds and prevailed under the failing firm doctrine.

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223. *See supra* Part III.D.
224. KNOPPER, *supra* note 6, at 206.
225. *Hearing on Future of Online Music*, supra note 7, at 13 (statement of Gigi Sohn, President, Public Knowledge).
226. *Id.* at 190.
227. *Id.* at 203.
228. *Id.* at 18.
229. *See id.*
230. *See supra* note 19 and accompanying text.
231. *See supra* Part IV.B.

VI. FAILING FIRM DEFENSE: OTHER APPLICATIONS

"The . . . *Guidelines* provide explicitly that transfers of intellectual property are to be analyzed under [its] standards . . . ."[232] However, in the over eighty years that it has existed, "the failing firm [doctrine] has not been yet applied in a reported merger involving intellectual property."[233] With the ongoing rapid advancements in technology and the copyrights, patents, trademarks, and other forms of intellectual property that protect them, companies that work with intellectual property and find themselves on the brink of failure should consider the failing firm doctrine.

As an analysis of EMI demonstrates in the case at hand, even large corporations owning millions of works of intellectual property may fall from power and need to join forces with a competitor to avoid complete failure. Although the various elements of the failing firm doctrine demand that qualifying firms meet very particular circumstances, it is likely that many companies involved in technology and intellectual property that have undergone antitrust scrutiny and faced burdensome divestment requirements have overlooked the failing firm doctrine.

It is already commonplace in mergers and acquisitions to specify in the sale which company will bear the risks of antitrust enforcement agency investigations.[234] Where applicable, it follows that the weaker, acquired firm could use its consent or refusal to undergo failing firm analysis during antitrust scrutiny as a point of negotiation. Such a provision is justified because a would-be failing firm risks a botched antitrust clearance, which would cast it back out into the marketplace with the "failing firm" stigma over its head. In the case at hand, for example, Citigroup could have agreed with Universal to cooperate completely with a full-fledged implementation of the failing firm doctrine in exchange for more favorable merger terms. Although such a provision would not apply to run-of-the-mill mergers, the failing firm doctrine is strong medicine, and a deteriorating company that is being acquired would be wise to consider advocating for such a provision in its merger agreement.

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232. INTELLECTUAL PROPERTY AND ANTITRUST HANDBOOK, *supra* note 12, at 410.

233. *Id.* at 437.

234. *See* Scott A. Sher & Valarie Hogan, *Getting the Deal Done: Antitrust Risk-Shifting Provisions in Merger Agreements*, 12 THRESHOLD 65, 65 (2011), *available at* http://www.wsgr.com/PDFSearch/sher_fall11.pdf ("As competition agencies around the world have increased their scrutiny of mergers and acquisitions, businesses and their antitrust counsel must increasingly pursue strategies to manage merger-related antitrust risk. . . . After properly assessing risk, counsel can help their clients mitigate their risk exposure by drafting merger agreements that anticipate and provide for the repercussions each party may face if the deal is blocked or must be altered to gain antitrust approval.").

CONCLUSION

For the greater part of a century, the failing firm doctrine has perplexed the regulatory agencies and practitioners tasked with decrypting it[235] and has evaded the corporations hoping to utilize it. A separate version of the doctrine—the rescue merger—has emerged in the European Union, which contains its own unique oddities but is at least as difficult to actualize as its American counterpart.[236] Antitrust authorities have reassured the mergers and acquisitions community that the failing firm doctrine is still good law, but they are always quick to illustrate how limited of a defense it actually is.

The Court has remained silent in regards to the failing firm doctrine for nearly half of a century, but the DOJ and FTC have continued to look to its opinions and the resultant passages of their *Guidelines* to enforce the common-law defense.[237] With the increased usage of the doctrine, the Court might feel more inclined to clarify which elements it endorses and how to apply them more effectively.

This critical analysis of a recorded music company that had fallen on hard times demonstrates that, though restrictive, the failing firm doctrine still has a place in today's society. Subjecting corporations and their employees to complete catastrophe is not always necessary, and the purchasers of failing firms need not be punished in the form of large divestments or barred mergers. The failing firm doctrine was applicable to the EMI-Universal merger, and future failing companies undergoing antitrust scrutiny should consider dusting off the defense to avoid similar oversight.

Joshua R. Wueller[*]

235. *See* Baxter, *supra* note 17, at 248 ("The more one thinks about it, or at least the more I think about it the less sense it makes. Indeed, it seems to me that it has become acceptable to all of us only by virtue of constant repetition and the passage of time.").

236. *See supra* Part I.B.

237. *See supra* Part I.A.

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