

POLICY ROUNDTABLES

Failing Firm Defence

1995

Introduction

The OECD Competition Committee debated the “failing firm” exception, or defence, in merger review in May 1995. This document includes an analytical note by Mr. Gary Hewitt of the OECD and written submissions from Australia, Canada, the European Commission, Germany, Ireland, Japan, Norway, the Slovak Republic, the United Kingdom and the United States and an aide-memoire of the discussion.

Overview

The perilous financial condition of a merging firm may change the analysis by a competition authority of an otherwise anticompetitive merger. The authority should assess not only what will happen if the merger is permitted, but also what will happen if it is blocked. Several questions arise when an anticompetitive merger involves a failing business: i) what constitutes adequate evidence that a firm is actually failing; ii) how much evidence should be demanded that the anticompetitive merger is the best known alternative; iii) what should be done when the failing “firm” is actually a division of a larger; viable enterprise; and iv) should it matter that the failing business is part of a declining industry?

The least complicated approach is simply to reduce the merged entity’s estimated market share in order to reflect its weaker potential. The most demanding approach is to require evidence to show that: i) a party to the merger is insolvent according to normal accounting usage; ii) the failing firm cannot be reorganised into a viable entity; iii) a good faith attempt has been made to identify a less anticompetitive alternative to the merger; and iv) were the merger to be blocked, the failing firm’s assets would exit the industry.

Related Topics

OECD Council Recommendation on Merger Review (2005)
Media Mergers (2003)
Mergers in Financial Services (2000)
Merger Cases in the Real World - A Study of Merger Control Procedures (1994)

General Distribution **OCDE/GD(96)23**

FAILING FIRM DEFENCE

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

Paris 1996

29281

Document complet disponible sur OLIS dans son format d'origine
Complete document available on OLIS in its original format

Copyright OECD, 1996

Applications for permission to reproduce or translate all or part of this material should be made to: Head of Publications Service, OECD, 2, rue André-Pascal, 75775 - Paris Cedex 16, France.

Les demandes de reproduction ou de traduction doivent être adressées à :
M. le Chef du Service des Publications, OCDE, 2 rue André-Pascal, 75775 Paris Cedex 16, France.

FORWORD

This document groups together, in their original language, the papers relating to a mini-roundtable on the failing firm exception/defence in merger review, held in May 1995 in the course of a meeting of the Competition Law and Policy Committee. It is published as a general distribution document under the responsibility of the Secretary General to give a wider hearing to ideas and views related to a difficult competition policy issue arising throughout OECD countries.

This compilation is one of the first of a new publication series entitled: "Competition Policy Roundtables".

PRÉFACE

Ce document rassemble la documentation relative à une mini-table ronde qui s'est tenue, en mai 1995, dans le cadre du Comité du droit et de la politique de la concurrence. Elle porte sur le traitement différencié qui est appliqué à l'argument de l'entreprise défaillante selon que celui-ci est utilisé comme moyen de défense dans la procédure de contrôle des concentrations ou fait l'objet d'une exception à l'application du droit de la concurrence.

Cette compilation est l'une des premières qui sera diffusée dans la nouvelle série intitulée "Les tables-rondes de la politique de la concurrence".

TABLE OF CONTENTS

FOREWORD

AIDE-MEMOIRE

BACKGROUND NOTE BY THE SECRETARIAT

NATIONAL CONTRIBUTIONS:

- **Australia**
- **Australian Trade Practices Division and the New Zealand Commerce Commission**
- **Canada**
- **France**
- **Germany**
- **Ireland**
- **Japan**
- **Norway**
- **Slovak Republic**
- **United Kingdom**
- **United States**
- **European Union**

AIDE-MÉMOIRE

To organize the initial participation from countries who made written submissions in connection with the mini-roundtable, the Chairman introduced a series of issues and called on certain countries for comment.

Definitional Issues

The first question was what exactly constitutes a failing firm. How bankrupt must it be; how soon does it have to be likely to fail; and what are the criteria that one can use to establish that there is a failing as opposed to a "flailing" firm.

Canada was asked for its views on these issues in the context of the computerized airline reservation case featured in its written submission. Canada responded by first pointing out that it has no failing firm defence as such. Instead, the fact that one of the parties is failing or is likely to fail is a statutorily mandated consideration in making the assessment about the risk a merger poses for competition. Canada proceeded to note that in no case to date was the failing factor determinative.

On the issue of what constitutes a failing firm, the Canadian Bureau of Competition Policy uses a likely failure approach (see Canada's written submission for an itemized list of factors considered). It amounts to an accounting insolvency test. The Bureau typically retains third party auditors to review the company's books. Canada explained that it does not regard a firm as failing merely because it is not making what its management considers to be an adequate rate of return. This was an important factor in the computerized airline reservation case covered in the submission.

The Chairman noted that in the Norwegian submission's brewery case, it was critical to decide whether or not a probable inability to recoup in the long run the high costs of a modernization investment amounted to a firm being in the failing category. He then called on Norway for further elaboration. Norway noted that its failing firm defence requires a high probability that absent the merger, the firm will leave the market. The first task then is to assess whether the firm is really failing. In the brewery case, the target company's own financial statements revealed that there were merely transitory difficulties. There was also evidence that the firm could readily have expanded production using its modern production facilities and strong brand names. In addition there were two probable alternative purchasers which would have posed less danger for competition. It was irrelevant to the analysis that they would likely have offered a considerably lower price for the failing firm.

The Norwegian Price Directorate's recommendation to oppose the brewery merger was not followed by the Price Council, partly because the majority on the Council felt that the merger target would not have been able to survive in the long run as an independent agent. Interestingly, such reasoning runs counter to the latest guidelines issued by the Price Directorate which specify that only short term considerations should be taken into account in determining the applicability of the failing firm doctrine. Long term survivability is believed to be too hypothetical to properly assess.

Norway hypothesized that the Price Council may have considered the target firm to be too financially weak to compete vigorously. The Price Directorate would have disagreed with that view in this case. Speaking more generally however, if the Price Directorate were to wrongly conclude that a firm were failing when in fact it was only flailing, such an error would not be overly serious. An almost failing firm may not be an important competitor in the future.

What criteria must be satisfied for the failing firm defence to be admissible?

Many countries apply the failing firm defence only if it can be shown that there are no alternative less anticompetitive mergers. Some go further and require evidence that if the merger were prohibited, the assets of the failing firm would leave the market. The Chairman wanted to delve into these issues and called on Australia to explain the Australian/New Zealand position.

Australia stated that merger review in that country and in New Zealand begins by considering whether a merger is likely to have anticompetitive effects. It is presumed that there are no such effects when the probable consequence of prohibiting a merger would be commercial failure of the target firm with the result that its productive resources are likely to exit the market. The latter element was not satisfied in the Waikato dairy case (see the combined Australian/New Zealand written submission). Where anticompetitive effects are expected, a merger may nonetheless be permitted on wider public benefit grounds including considerations arising out of one of the party's financial health.

Australia then turned to the newspaper case outlined in its written submission. In that case it was argued that if the merger were permitted, efficiency gains would have been made and jobs preserved. The Trade Practices Commission took the view that the merger was anticompetitive because the underlying purpose was to prevent a new entrant from gaining the assets and becoming a more effective competitor for the morning newspaper. In addition it was believed that there was an alternative less anticompetitive purchaser waiting in the wings. The merger was blocked but unfortunately, no one else purchased the firm and the newspaper went out of business.

[Later in the general discussion, the European Commission returned to this case and stated that the actual result may have been better than allowing the merger, because the market would be more contestable with one newspaper compared with two under common ownership.]

The Chairman noted that certain countries go beyond requiring evidence that absent the merger the productive assets will exit the industry. Both Germany and the European Commission for example appear to require evidence that with or without the merger the market shares would accrue to the proposed acquirer. That condition seems to imply that the defence is more easily granted in cases where the acquiring firm enjoys a dominant position than if the market could be characterized as an oligopoly. The Chairman called on Germany to describe the Schott Glaswerke Mainz merger case (see the written submission), and to speculate on how the result might have been different had the buying firm not enjoyed a dominant position.

Germany stated that successful application of its failing company defence requires breaking the causal link between a proposed merger and the creation or strengthening of a dominant position. Absent such a causal link, a merger cannot lawfully be prohibited. Thus, if the same anticompetitive effect would occur with or without the merger, as when market shares will be the same in both instances, the necessary causal link is missing.

Two examples were given, both assuming that there were no preferred alternative purchasers:

1. two competitors, one of which is failing and proposing to merge with the other - since the surviving firm is slated to gain the entire market in any event, the merger cannot be prohibited (see the Schott Glasswerke case); and

2. several competitors, one of which is failing and proposing to merger with an incumbent firm - a serious investigation is required to determine who would get the market share if the failing firm exits.

The Chairman noted that the application of the German failing firm doctrine would seem to be affected by whether or not a jurisdiction adopts a concept of collective rather than merely single firm dominance. In response Germany stated that there is no clear policy on this point. Each oligopoly situation must be analyzed on its own to determine whether the redistribution of market shares consequent on the exit of a failing firm would strengthen or weaken the oligopoly.

The Chairman turned next to the Japanese submission. He noted that in contrast to the German approach, the merger of a failing firm with a dominant producer might pose more difficulty than the same merger not involving a dominant producer.

Japan stated that the fact a firm is failing is one factor that its Fair Trade Commission (JFTC) considers in judging whether or not the merger may substantially restrain competition in the relevant market. Since a failing firm has likely not been performing well for some time, the acquiring firm will suffer somewhat by taking it over. At the same time however it is believed that there is a greater probability of competitive harm if the acquiring firm is an influential firm. Reference was made to one of the bank merger examples in the Japanese written submission. The new bank would have had about 30% of the market share measured in terms of deposits and 40% in terms of loans. The purpose of the merger was to rescue the failing bank. It was difficult to find a more appropriate purchaser and measures were taken to reduce competition problems in certain localized markets. Taken together these considerations led the JFTC to conclude that the merger would not substantially restrain competition.

The Chairman turned next to the economic considerations undergirding the failing firm defence and asked whether the review criteria are substantially the same or somehow looser when one of the parties is failing. He invited the United States to respond.

The United States (Department of Justice) referred to the 1992 combined DOJ/FTC merger guidelines and posed the question - since a merger to monopoly is the classic kind of merger that would normally be prohibited, why are such monopolies suddenly acceptable if one of the parties is failing? At the beginning of the guidelines, some specific cases of imminent failure are identified as situations where a merger is not likely to "...create or enhance market power or to facilitate its exercise". In such situations, post merger market performance might be no worse than it would have been had the merger been blocked and the assets exited the industry. So as with Germany, there is a causation factor featured here. The specific criteria were then reviewed - and the United States especially highlighted the importance of the firm being unable to reorganize and there being no alternative less anticompetitive purchaser. The last factor, exiting assets, illustrates some of the underlying economic rationale.

Two types of assets should be distinguished: those which are specialized to the industry, and those relatively unspecialized. If the transaction is blocked and the firm fails, specialized assets will simply be lost from an economic point of view. Where the assets are unspecialized they could be put to a productive use elsewhere so there would be a need to perform some kind of balancing by comparing how they will be used with or without the merger. As a practical matter, such a balancing is not actually done, i.e. if it can be shown that there is absolutely no other purchaser and the failing firm cannot reorganize, then the merger is permitted.

The United States (Federal Trade Commission) continued by offering what it termed a possibly slightly controversial view of how things might develop in the future. It referred to an increasing number of instances where failing/flailing firms or entire industries are associated with growing global competition, surging imports, falling outputs and rising unit costs. In the future, the U.S. and other countries may want to ensure that capacity is retired and firms exit in a way that enhances an industry’s ability to globally compete. That would lead to a slightly different and perhaps more generous interpretation of a failing or flailing firm defence, one that takes into account industry-wide distress.

The Chairman turned to the United Kingdom and asked whether it took a looser approach to mergers if they involved a failing firm. The United Kingdom noted that its competition law does not prohibit mergers of any sort and does not have a notification system. In practice U.K. authorities are much less concerned about whether a firm is failing or flailing, but instead focus on the underlying causes of the financial distress. A merger involving a failing firm would probably be opposed if it were likely to create a dominant position and if a more competitive outcome might well result by letting the firm fail.

Asked to elaborate on his query to the United Kingdom, the Chairman stated that it was intended to be an open question including whether non-competition factors were taken into account in such cases, things like effects on employment or innovation.

The United Kingdom responded that it applies a public interest test primarily featuring but not restricted to competition effects. In recent practice, employment factors have not featured prominently but that could change. R & D factors are part of the competition analysis. Strategic considerations also apply in certain industries, notably defence where the peace dividend is showing up as a contraction in the market and increased concentration. In sum, cases taking account of non-competition factors are probably very rare but they could exist.

The next issue the Chairman turned to had to do with whether or not countries took account of the intentions of an acquiring firm when assessing a merger involving a failing firm. He called on Ireland to comment on this issue from the perspective of the Irish Distillers/Cooley (IDC) merger described in its written submission.

Ireland stated that the IDC merger was the first one which the Irish competition authority attempted to block using the competition statute. The case clearly involved a failing firm. A key rationale in the failing firm defence is that absent the merger the assets would leave the market causing a greater loss of welfare than would occur if the merger were permitted. The competition authority interpreted this as requiring that the merger would lead to the assets being retained in the market. The acquirer's intention in the IDC case to close down the production capacity therefore nullified the applicability of the defence. Moreover, a price substantially above liquidation value indicated that the acquirer believed there was an alternative buyer. Ireland noted that the Secretariat paper argued that the loss of assets is only significant in cases where they will not easily be replaced. That in fact was true in the IDC case.

Does the failing firm defence apply as well to failing divisions?

The Chairman's last discussion point dealt with whether or not the failing firm defence should be modified according to whether or not the failing firm is independent or forms part of a larger entity. He called on the European Commission to explain what he thought was a lower willingness to accept the defence in cases where the failing entity is part of a larger firm.

The European Commission noted that given the absence of an express legal provision, its approach to the failing firm defence is based on an interpretation of the general test, i.e. whether or not a merger creates or strengthens a dominant position. A failing firm defence is permitted in rare cases where the expected deterioration in the competitive environment would have happened with or without the merger, i.e. there is no causation between the merger and the feared deterioration. Though the test is formally the same for failing firms and failing divisions, the latter case calls for investigating possible strategic reasons at the group level for keeping the entity afloat were the merger to be blocked. In the Aérospatiale de Havilland case covered in the written submission, it was not necessary to get into such evidence because other required elements were not satisfied.

General Discussion

At this point, the Chairman opened the mini-roundtable to general discussion, and Italy was recognized. Italy noted that in the European Union's Kali and Salz case, Goldman Sachs had been assigned the task of inviting tenders. The Commission therefore had a list of alternative buyers it could investigate to determine if any constituted a less anticompetitive merger partner. Where such information is lacking, how do competition authorities satisfy themselves that there are no less anticompetitive potential purchasers? How widely do they search?

Canada volunteered that it insisted on an independent shop by an investment broker or similar company. Only in this way will the competition agency have the requisite confidence in the shop and be able to live with the result. Tangentially Canada noted that the shop must be recent and be conducted at the parties' expense.

On the matter of requiring a fresh search, the Chairman asked whether the canvassed buyers are aware of the circumstances behind the search, and if they are, does that affect their bids. Canada said that this differs from case to case. In any event the firm's poor financial health will soon be known to any serious purchaser. The really strategic information is the identity of the purchaser proposing the merger under investigation.

Later in the discussion, the United Kingdom returned to the issue of identifying alternative buyers. The U.K. was especially concerned about confidentiality problems (share price and labour force issues) and the need for speed. In the light of these difficulties, the United Kingdom believed the Canadian paper set out a very demanding process and invited comment on the confidentiality issue.

Canada acknowledged the potentially serious confidentiality issues, but noted that in the four instances where a shop had been required, the financial ill-health of the affected firm was well known in the market. In one case where there were grave customer loyalty concerns, the Bureau stuck to the shop requirement and the failing firm quietly found an alternative, less anticompetitive purchaser.

The United Kingdom asked if Canada could envisage a situation where the Bureau of Competition Policy would not insist on a full financial analysis or shop. The answer noted that the financial analysis was usually an internal matter. As to the shop requirement, there was a case where an eight month old shop was deemed acceptable because of a desire to avoid an adverse reaction by creditors.

Also later in the discussion, Germany addressed the issue of identifying potential buyers and noted that the net must be cast beyond national boundaries. This applies as well to estimating who would receive market share in the event the merger is blocked and the firm allowed to fail.

France stated that it would soon distribute a text relating to the failing firm issue. France has not yet had to grapple with this in an actual case. French merger law does not provide for special treatment for a failing firm. Firms in perilous financial condition are instead dealt with before specialized commercial tribunals which can take competition concerns into account. The two step procedure begins with an opinion from the Competition Council based on a balance of anticompetitive effects and off-setting contributions to economic progress. Of course there is only a problem where there are in fact competition concerns. Considered among contributions to economic progress are things like the maintenance of existing assets, distribution networks, and the current level of exports. The second step, taken by the Ministry of Economy which makes the final decision, involves considering a broader social balance. Taken together, the economic and social balancing certainly take account of a firm being in serious financial difficulty.

To assess the seriousness of the firm's financial condition a number of factors are considered including over-capacity problems and business cycle indicators. If the difficulties are judged to be cyclical in nature they are not taken into account. The existence of possible alternative purchasers is also

considered, i.e. the alleged anticompetitive effects of the merger may be avoidable. The most difficult issue is to determine whether or not without the merger, the enterprise or a division thereof, would disappear from the market. If there would be such an exit, it cannot be said that the merger hurts competition, hence it should be permitted.

In the case of a merger to monopoly, can one authorize it? That requires a look at other things the state could do to limit the transaction's anticompetitive effects. In less difficult cases, where several firms will remain, it is necessary to consider how the market share released by the failing firm will be reapportioned.

Sweden asked whether there were important differences in treatment accorded to goods producing or service sector mergers involving failing firms. The United States noted that the treatment would be the same in both sectors, but there are fewer instances of the failing firm doctrine being applied in service sector mergers. This is because service sector mergers are simply less likely to threaten significant anticompetitive effects, hence defences of all kinds would not often be needed. The U.S. remarked however that in service sectors it will usually be difficult to satisfy the failing firm defence, because absent the merger, the pertinent assets would not likely exit the market, i.e. they are readily re-deployable within the current market.

The Chairman turned to Canada to discuss Sweden's question in the context of Canada's airline reservation case. Canada reminded participants that in the case in question, the defence was not applicable because the firm was not found to be failing. Canada also agreed with the United States that in service industries, assets are typically more re-deployable than in goods producing sectors.

After stating that all countries appeared to use a narrowly crafted failing firm defence, the United States noted that there were some interesting differences in approach. For instance, some jurisdictions, not including the U.S., require that absent the merger the market share would go in any case to the acquiring firm. This element would easily be satisfied in a case for example, where an acquiring firm has 70% of the market and the failing firm the other 30%. Now consider an alternative scenario where the buyer again has 70% but the other 30% is evenly split among three rivals one of which was failing. In this case, the defence might be refused, even if the other two smaller rivals did not constitute alternative buyers.

Germany admitted that requiring evidence that with or without a merger, market shares would be roughly the same presents some difficult problems requiring a careful practical approach. It is also one reason why there have been few applications of the defence in Germany.

Japan returned to the Chairman's question about how failing firm mergers are essentially different from all other mergers. In Japan, explicit attention is given to the true worth of the assets being acquired. Since the firm is failing it has certain "negative" assets, e.g. poor management. Where a failing firm is being acquired by a non-dominant firm, the merger likely has no anticompetitive effects.

The Chairman closed the session by thanking all concerned and noting that though we had not gotten to the bottom of this question we had made a good start.

AIDE-MÉMOIRE

Afin d'organiser dans un premier temps la participation des pays ayant remis des notes écrites en liaison avec la mini-table ronde, le Président a présenté une série de questions et demandé à certains pays de faire part de leurs commentaires.

Problèmes de définition

La première question a porté sur la définition exacte d'une entreprise défaillante : quelle doit être l'ampleur de sa faillite, quelle doit être la proximité de sa défaillance probable et quels sont les critères qu'il est possible d'utiliser pour établir que l'on se trouve bien en présence d'une entreprise "défaillante" et non d'une entreprise en récession.

Le Canada a été invité à présenter son opinion sur ces questions dans le contexte de l'affaire du système informatique de réservation de billets d'avion exposée dans sa note. Le Canada a répondu en soulignant tout d'abord qu'il n'existait pas dans ce pays de défense reprenant l'argument de l'entreprise défaillante en tant que telle. En réalité, le fait que l'une des parties soit défaillante ou sur le point de l'être constitue un élément qui doit obligatoirement être pris en considération lors de l'évaluation des menaces qu'une fusion fait peser sur la concurrence. Le Canada a fait remarquer qu'à ce jour, le facteur "défaillance" n'avait été déterminant dans aucune affaire.

Sur la question de la définition d'une entreprise défaillante, le Bureau canadien de la politique de la concurrence utilise l'approche de la défaillance probable (voir dans la note du Canada pour la liste des facteurs pris en compte). Cela revient en fait à une vérification comptable d'insolvabilité. En général, le Bureau fait appel à des réviseurs tiers qui examinent les comptes de la société. Le Canada a expliqué qu'il ne considère pas qu'une entreprise est défaillante uniquement parce qu'elle ne parvient pas à réaliser ce que sa direction estime être un taux de rendement approprié. Ce facteur a joué un rôle important dans l'affaire de réservation aérienne informatisée exposée dans la note.

Le Président a noté que dans l'affaire des brasseries citée par la Norvège, il avait été capital de décider si la probable incapacité à récupérer à long terme les coûts élevés d'un investissement de modernisation permettait ou non de qualifier une entreprise de "défaillante". Il a ensuite demandé à la Norvège des explications complémentaires. La Norvège a précisé que pour que l'argument de l'entreprise défaillante soit recevable, il est impératif d'établir qu'en l'absence de la fusion, l'entreprise disparaîtra très probablement du marché. La première tâche dans ce cas consiste à évaluer si l'entreprise est réellement défaillante. Dans l'affaire des brasseries, les états financiers de l'entreprise cible ont montré qu'il ne s'agissait que de difficultés transitoires. Il a été également montré que l'entreprise aurait pu facilement accroître sa production en utilisant ses installations modernes et ses marques bien connues. En outre, il y avait deux autres candidats probables à la reprise qui auraient représenté moins de danger pour la concurrence. Le fait qu'il auraient probablement offert un prix considérablement moins élevé pour l'entreprise défaillante n'était pas pertinent dans le cadre de cette analyse.

La Direction des prix norvégienne avait pris la décision de s'opposer à la fusion entre les brasseries, mais elle n'a pas été suivie par le Conseil des prix, en partie parce que la majorité de ses membres ont estimé que la société cible ne pourrait pas survivre à long terme en restant indépendante. Il est intéressant de noter qu'un tel raisonnement va à l'encontre des dernières directives émises par la Direction des prix, qui spécifient que seules des considérations à court terme doivent être prises en compte lorsqu'il s'agit de déterminer si la doctrine de l'entreprise défaillante est applicable. La capacité de survie à long terme est en effet considérée comme trop hypothétique pour pouvoir être évaluée.

La Norvège a émis l'hypothèse que le Conseil des prix avait peut-être considéré l'entreprise cible comme étant financièrement trop faible pour pouvoir représenter un concurrent solide. La Direction des prix aurait été en désaccord avec cette opinion dans cette affaire. Toutefois, d'une manière plus générale, si la Direction des prix devait à tort conclure qu'une entreprise est défaillante alors qu'elle est simplement en récession, une telle erreur ne serait pas excessivement grave. Une entreprise en quasi défaillance risque en effet de ne pas représenter un concurrent important à l'avenir.

Quels sont les critères qui doivent être respectés pour que l'argument de l'entreprise défaillante soit recevable ?

De nombreux pays ne retiennent l'argument de l'entreprise défaillante que s'il est possible de démontrer qu'il n'existe aucune autre possibilité de fusion qui causerait moins de dommage à l'exercice de la concurrence. Certains vont plus loin et exigent la preuve que si la fusion était interdite, les actifs de l'entreprise défaillante disparaîtraient du marché. Le Président a souhaité approfondir ces questions et a demandé à l'Australie d'expliquer la position australienne/néo-zélandaise.

L'Australie a indiqué que dans ce pays comme en Nouvelle-Zélande, l'examen des fusion commençait par une étude des éventuels effets anticoncurrentiels de l'opération. Il est présumé qu'aucun effet de ce type n'existera lorsque l'interdiction de la fusion aurait pour conséquence probable la défaillance commerciale de l'entreprise cible, entraînant la disparition prévisible de ses ressources productives. Ce dernier critère n'était pas rempli dans l'affaire de la laiterie Waikato (voir la note commune remis par l'Australie et la Nouvelle-Zélande). Lorsque l'opération risque d'avoir des effets anticoncurrentiels, une fusion peut néanmoins être autorisée pour des motifs plus larges d'intérêt général, y compris en vertu de considérations relatives à la santé financière de l'une des parties.

L'Australie a ensuite abordé l'affaire des journaux présentée dans sa note individuelle. Dans cette affaire, il a été soutenu que si la fusion était autorisée, elles entraînerait des gains d'efficience et permettrait le maintien d'emplois. La Commission des pratiques commerciales a estimé que cette fusion était contraire à la concurrence parce que son objectif sous-jacent consistait à empêcher un nouvel entrant de reprendre les actifs et de s'imposer comme un concurrent plus dangereux pour le journal du matin. En outre, il a été estimé qu'un autre acheteur moins menaçant pour la concurrence était aussi sur les rangs. La fusion a été bloquée mais malheureusement, personne d'autre n'a racheté l'entreprise et le journal a cessé son activité.

[Plus tard au cours de la discussion générale, la Commission Européenne devait revenir sur cette affaire, déclarant que le résultat finalement obtenu était peut-être meilleur que si la fusion avait été autorisée, parce qu'un marché est plus concurrentiel avec un seul journal qu'avec deux appartenant à un même propriétaire.]

Le Président a noté que certains pays font plus qu'exiger la preuve qu'en l'absence de la fusion, les actifs productifs disparaîtraient. Il apparaît en effet que l'Allemagne et la Commission Européenne par exemple demandent la preuve qu'avec ou sans la fusion, les parts de marché finiraient par revenir au candidat à l'acquisition. Cette condition semble impliquer que l'argument de l'entreprise défaillante est plus aisément accepté dans les affaires où le repreneur occupe déjà une position dominante que dans celles où le marché peut être qualifié d'oligopole. Le Président a demandé à l'Allemagne d'expliquer l'affaire de la fusion Schott Glaswerke Mainz (voir note) et d'essayer de définir à quel point les résultats auraient pu être différents si l'entreprise ayant procédé au rachat n'avait pas occupé une position dominante.

L'Allemagne a indiqué que pour être retenu, l'argument de l'entreprise défaillante doit briser le lien de causalité entre une proposition de fusion et la création ou le renforcement d'une position dominante. S'il n'existe pas de relation de cause à effet de ce type, une fusion ne peut pas être légalement interdite. Ainsi, si l'impact anticoncurrentiel reste le même avec ou sans la fusion, par exemple si les parts de marché restent identiques dans les deux cas, il manque le nécessaire lien de causalité.

Deux exemples ont été cités, supposant tous les deux qu'il n'existait pas d'autres candidats au rachat susceptibles d'être privilégiés :

1. deux concurrents, dont l'un est défaillant et propose de fusionner avec l'autre : puisque l'entreprise survivante est appelée de toute façon à obtenir l'intégralité du marché, la fusion ne peut pas être interdite (voir l'affaire Schott Glaswerke) ; et

2. plusieurs concurrents, dont l'un est défaillant et propose de fusionner avec une autre : dans ce cas, une enquête sérieuse est requise afin de déterminer qui obtiendrait la part de marché si l'entreprise défaillante disparaissait.

Le Président a noté qu'il semblerait que l'application de la doctrine allemande de la firme défaillante puisse être affectée par l'adoption éventuelle, dans une juridiction, du concept de domination collective au lieu de la simple domination par une seule entreprise. En réponse, l'Allemagne a indiqué qu'il n'existait pas de stratégie claire sur ce point. Chaque situation d'oligopole doit être analysée de manière individuelle afin de savoir si la redistribution des parts de marché consécutive à la disparition d'une entreprise défaillante aurait pour effet de renforcer ou d'affaiblir l'oligopole.

Le Président est ensuite passé à la note du Japon. Il a noté qu'à la différence de l'approche allemande, la fusion d'une entreprise défaillante avec un producteur qui détient une position dominante risquait de poser davantage de problèmes que la même fusion n'impliquant pas un producteur dominant.

Le Japon a expliqué que le fait qu'une entreprise soit défaillante était l'un des facteurs pris en compte par sa Fair Trade Commission (JFTC) pour établir si une fusion risquait ou non de restreindre de manière substantielle la concurrence sur le marché concerné. Etant donné qu'il est probable qu'une entreprise défaillante connaisse des difficultés depuis déjà un certain temps, son acquéreur souffrira quelque peu en la rachetant. Toutefois, l'on estime en même temps que la probabilité d'une menace pour la concurrence est plus grand si le repreneur est influent. La note du Japon citait à ce propos un exemple de fusion entre banques. La nouvelle banque devait détenir une part de quelque 30 pour cent du marché des dépôts et de 40 pour cent des prêts. La fusion avait pour objectif le sauvetage de la banque défaillante. Il a été difficile de trouver un repreneur plus approprié et des mesures ont été prises pour réduire les problèmes de concurrence sur certains marchés localisés. Toutes ces considérations ont conduit la JFTC à conclure que la fusion n'aurait pas pour effet de restreindre la concurrence de manière substantielle.

Le Président a ensuite abordé les considérations économiques qui sous-tendent l'argument de l'entreprise défaillante et demandé si les critères d'examen étaient pour l'essentiel les mêmes, ou au contraire quelque peu moins stricts, lorsque l'une des parties était défaillante. Il a invité les Etats-Unis à répondre à cette question.

Les Etats-Unis (Département de la Justice) ont fait référence aux lignes directrices sur les fusions édictées conjointement en 1992 avec la Federal Trade Commission et posé une question : si une fusion aboutissant à un monopole constitue l'exemple classique d'une fusion qui serait normalement interdite, pourquoi de tels monopoles deviendraient-ils soudainement acceptables lorsque l'une des parties est défaillante ? Au début des directives, certains cas spécifiques de défaillance imminente sont identifiés comme des situations dans lesquelles une fusion n'est pas susceptible de "...créer ou d'améliorer une influence sur le marché, ou d'en faciliter l'exercice". Dans de tels cas, la situation de marché après la fusion risque de ne pas être pire que si la fusion avait été bloquée et les actifs disparus. Ainsi, comme dans le cas de l'Allemagne, un lien de causalité est évoqué. Les critères spécifiques ont ensuite été passés en revue et les Etats-Unis ont spécialement insisté sur l'importance de l'incapacité de l'entreprise à se restructurer et sur l'absence d'un autre acheteur menaçant moins l'exercice de la concurrence. Le dernier facteur, la disparition des actifs, permet d'illustrer une partie du raisonnement économique sous-jacent.

Il convient de distinguer deux catégories d'actifs : ceux qui sont spécifiques au secteur d'activité concerné, et les actifs relativement non spécialisés. Si la fusion est bloquée et que la firme est défaillante, les actifs spécialisés seront simplement perdus du point de vue économique. Les actifs non spécifiques pourraient au contraire être affectés à un usage productif ailleurs, si bien qu'il est nécessaire de faire une sorte de bilan en comparant leur utilisation si la fusion a lieu ou si elle n'a pas lieu. Dans la pratique, une telle comparaison n'est pas effectuée, c'est-à-dire que s'il est possible de montrer qu'il n'existe absolument aucun autre acquéreur et que l'entreprise défaillante ne peut pas se restructurer, la fusion est autorisée.

Les États-Unis (Federal Trade Commission) ont poursuivi en émettant une opinion qui pourrait être qualifiée de légèrement sujette à controverse sur la manière dont les choses pourraient évoluer à l'avenir. Ils ont fait mention du nombre croissant de cas dans lesquels des entreprises défaillantes/en récession ou des secteurs d'activité entiers sont confrontés à une augmentation de la concurrence mondiale, à une explosion des importations, à une baisse de leur production et à la hausse de leurs coûts unitaires. A l'avenir, les Etats-Unis et d'autres pays pourront vouloir s'assurer que des capacités soient supprimées et que des entreprises se retirent du marché de manière à ce qu'un secteur d'activité puisse être mieux armé pour affronter la concurrence mondiale. Ceci conduirait à une interprétation légèrement différente et peut-être plus généreuse de l'argument de l'entreprise défaillante ou en récession, qui prend en compte les difficultés à l'échelle d'un secteur.

Le Président a passé la parole au Royaume-Uni et lui a demandé s'il adoptait une approche moins stricte en matière de fusion impliquant une entreprise défaillante. Le Royaume-Uni a fait remarquer que son droit de la concurrence n'interdisait les fusions d'aucune sorte et ne prévoyait pas de système de notification. En pratique, les autorités britanniques accordent beaucoup moins d'importance au fait qu'une entreprise soit défaillante ou en récession, mais se concentrent plutôt sur les motifs de la débâcle financière. Il est probable qu'une fusion impliquant une entreprise défaillante sera bloquée si elle est susceptible d'aboutir à la création d'une position dominante et si la situation concurrentielle peut être améliorée en laissant disparaître l'entreprise défaillante.

Invité à donner des précisions sur la question posée au Royaume-Uni, le Président a déclaré qu'il s'agissait d'une question ouverte, permettant notamment de savoir si des facteurs étrangers à la concurrence étaient pris en compte dans ce cas, par exemple l'impact sur l'emploi ou l'innovation.

Le Royaume-Uni a indiqué qu'il procédait à une étude de l'intérêt général principalement consacrée, mais non limitée, aux effets sur la concurrence. Dans les affaires récentes, les facteurs relatifs à l'emploi n'ont pas joué un rôle prépondérant, mais cela pourrait changer. Les facteurs touchant à la recherche-développement font également partie de l'analyse de la concurrence. Des considérations stratégiques s'appliquent également dans certains secteurs, notamment dans l'industrie de la défense où les dividendes de la paix se traduisent par une contraction du marché et une hausse de la concentration. En résumé, les affaires prenant en compte des facteurs autres que la concurrence sont probablement très rares, mais peuvent exister.

La question suivante évoquée par le Président portait sur la nécessité, pour les pays, de prendre ou non en compte les intentions d'un repreneur lors de l'examen d'une fusion impliquant une entreprise défaillante. Il a demandé à l'Irlande de commenter cette question en se référant à la fusion Irish Distillers/Cooley (IDC) décrite dans sa note.

L'Irlande a indiqué que la fusion IDC était l'une des premières que les autorités irlandaises de la concurrence avaient essayé de bloquer en arguant de l'état de la concurrence. L'affaire impliquait sans équivoque une entreprise défaillante. L'un des éléments clés de l'argument de l'entreprise défaillante était qu'en l'absence de la fusion, les actifs disparaîtraient du marché, causant une perte de bien-être plus grande que si la fusion était autorisée. Les autorités de la concurrence ont interprété ceci comme signifiant que si la fusion avait lieu, les actifs devaient rester sur le marché. L'intention du repreneur de fermer une capacité de production l'a donc empêché de se prévaloir de l'argument de l'entreprise défaillante. En outre, le prix

offert, considérablement supérieur à la valeur de liquidation, indiquait que l'acheteur pensait qu'il existait un autre candidat à la reprise. L'Irlande a fait remarquer que la note du Secrétariat soutenait que la perte d'actifs n'était significative que dans les cas où ils ne pouvaient pas être facilement remplacés. Ceci n'était en fait pas vrai dans l'affaire IDC.

L'argument de l'entreprise défaillante s'applique-t-elle également aux divisions défaillantes ?

Le dernier point de discussion soulevé par le Président concernait la nécessité éventuelle d'une modification de l'argument de l'entreprise défaillante selon que l'entreprise défaillante était indépendante ou fait partie d'une entité plus large. Il a demandé à la Commission Européenne d'expliquer ce qui, à ses yeux, constituait une propension moindre à accepter l'argument de l'entreprise défaillante dans les affaires où l'entité défaillante faisait partie d'une entreprise plus grande.

La Commission Européenne a indiqué qu'en l'absence de dispositions juridiques expresses, son approche se fondait sur une interprétation de la vérification générale, c'est-à-dire qu'il s'agit de savoir si une fusion va ou non créer ou renforcer une position dominante. L'utilisation de l'argument de l'entreprise défaillante est autorisée dans de rares cas où la détérioration prévue de l'environnement concurrentiel se serait produite, que la fusion ait lieu ou non, c'est-à-dire lorsqu'il n'y a pas de lien de cause à effet entre la fusion et la détérioration redoutée. Bien que la procédure de vérification générale soit officiellement la même, que l'entité défaillante soit une société indépendante ou la division d'une entreprise, dans le dernier cas, il est nécessaire d'étudier les possibles motifs stratégiques à l'échelle du groupe pour assurer la survie de l'entité au cas où la fusion serait bloquée. Dans l'affaire Aérospatiale-de Havilland exposée dans la note, il n'a pas été nécessaire de recueillir une telle preuve parce que d'autres critères obligatoires n'étaient de toute façon pas respectés.

Discussion générale

A ce stade, le Président a invité la mini-table ronde à engager une discussion générale et l'Italie a pris la parole. L'Italie a noté que dans l'affaire Kali+Salz, Goldman Sachs s'était vu confier la responsabilité de solliciter des offres de reprise. La Commission disposait donc d'une liste de repreneurs potentiels qu'elle pouvait étudier afin de déterminer si l'un d'entre eux constituait un partenaire de fusion menaçant moins que les autres l'exercice de la concurrence. En l'absence d'une telle information, comment les autorités de la concurrence s'assurent-elles qu'il n'existe pas d'acheteurs potentiels moins dangereux du point de vue concurrentiel ? Quelle est l'ampleur de leurs recherches ?

Le Canada est intervenu, précisant qu'il insistait pour qu'une prospection du marché des repreneurs soit entreprise par une société de bourse ou entreprise similaire. Ce n'est que de cette manière que les autorités de la concurrence peuvent avoir la confiance nécessaire dans la prospection et peuvent se satisfaire du résultat obtenu. Au passage, le Canada a précisé que la prospection devait être récente et réalisée aux frais des parties concernées.

Sur la question de l'obligation d'une prospection récente, le Président a demandé si les acheteurs sollicités avaient connaissance des circonstances entourant la prospection et si oui, est-ce que cela avait un impact sur leurs offres. Le Canada a indiqué que cela dépendait des cas. De toute façon, la mauvaise santé financière d'une entreprise est rapidement connue de n'importe quel repreneur sérieux. La seule information réellement stratégique est l'identité de l'acheteur proposant la fusion en cours d'examen.

Plus loin dans la discussion, le Royaume-Uni est revenu sur la question de l'identification d'autres acheteurs. Ce pays s'est dit particulièrement préoccupé par les problèmes de confidentialité (prix de l'action et main-d'oeuvre) et par l'impératif de rapidité. A la lumière de ces difficultés, le Royaume-Uni a estimé

que la note du Canada exposait un processus très contraignant et sollicité des commentaires sur la question de la confidentialité.

Le Canada a reconnu l'existence de problèmes de confidentialité potentiellement sérieux, mais indiqué que dans les quatre affaires dans lesquelles une prospection avait été demandée, la mauvaise santé financière des entreprises concernées était notoire sur le marché. Dans l'une des affaires pour laquelle il existait des inquiétudes graves en matière de loyauté des clients, le Bureau a maintenu son obligation de prospection et l'entreprise défaillante a pu facilement trouver un autre repreneur moins menaçant pour la concurrence.

Le Royaume-Uni a demandé si le Canada pouvait envisager une situation dans laquelle le Bureau de la politique de la concurrence pourrait ne pas insister pour qu'une analyse financière complète ou une prospection soit effectuée. La réponse a indiqué que l'analyse financière était généralement une affaire interne. En ce qui concerne l'obligation de prospection, il y a eu un cas dans lequel une enquête datant de huit mois a été considérée comme acceptable afin d'éviter une réaction négative des créanciers.

Plus loin dans la discussion, l'Allemagne a évoqué la question de l'identification des repreneurs potentiels et noté que la recherche devait s'étendre au-delà des frontières nationales. Ceci concerne également l'estimation du bénéficiaire de la part de marché au cas où la fusion serait bloquée et où l'on laisserait l'entreprise faire faillite.

La France a indiqué qu'elle allait bientôt distribuer un texte relatif à la question des entreprises défaillantes. Elle n'a pas eu encore à traiter une telle affaire dans les faits. La loi française sur les fusions ne prévoit pas de traitement spécial pour les entreprises défaillantes. Les cas des sociétés en péril financier sont au contraire portés devant des tribunaux de commerce spécialisés qui peuvent prendre en compte les inquiétudes liées à la concurrence. La procédure, en deux étapes, commence par une opinion du Conseil de la concurrence fondée sur un équilibre entre les effets anticoncurrentiels et les contributions aux progrès économiques susceptibles de les compenser. A l'évidence, un problème ne se pose que lorsqu'il existe réellement des inquiétudes en matière de concurrence. Parmi les facteurs considérés comme contribuant au progrès économique, on peut citer le sauvetage d'un outil de travail existant, de réseaux de distributions ou le maintien d'un courant d'exportations. La deuxième étape, qui voit intervenir le Ministère de l'Economie auquel revient la décision finale, consiste à prendre en compte un équilibre social plus large. Il est certain que la prise en compte de tous les aspects économiques et sociaux ne peut ignorer le fait qu'une entreprise connaisse de graves difficultés financières.

Afin d'évaluer la gravité de la situation financière d'une entreprise, il convient de prendre en compte un certain nombre de facteurs, notamment les problèmes de surcapacité et les indicateurs des cycles d'activité. Si les difficultés sont jugées de nature cyclique, elles ne sont pas prises en compte. L'existence d'autres acquéreurs possibles entre également en ligne de compte, parce qu'elle signifie que les effets anticoncurrentiels supposés de la fusion peuvent peut-être être évités. Le plus difficile consiste à déterminer si oui ou non l'entreprise ou l'une de ses divisions risque de disparaître du marché au cas où la fusion n'aurait pas lieu. Si elle devait disparaître, il est impossible d'affirmer que la fusion menace la concurrence, en conséquence, elle doit être autorisée.

Si la fusion aboutit à un monopole, faut-il l'autoriser ? Cette question suppose l'examen d'autres mesures que l'Etat pourrait prendre pour limiter les effets anticoncurrentiels de la fusion. Dans les cas moins difficiles, lorsque plusieurs entreprises vont subsister, il est nécessaire d'étudier comment la part de marché libérée par l'entreprise défaillante va être redistribuée.

La Suède a demandé s'il existait des différences importantes de traitement entre les fusions impliquant des entreprises défaillantes dans le secteur de la production et dans celui des services. Les Etats-Unis ont répondu que le traitement serait le même dans les deux secteurs, mais qu'il existait moins d'exemples dans lesquels la doctrine de l'entreprise défaillante avait été appliquée aux fusions dans le

secteur des services. Ceci s'explique par le fait que les fusions dans le secteur tertiaire sont tout simplement moins susceptibles d'avoir des effets anticoncurrentiels graves, si bien que les arguments de défense, quels qu'ils soient, sont souvent inutiles. Les Etats-Unis ont fait toutefois remarquer que dans le secteur des services, il était généralement difficile d'utiliser l'argument de l'entreprise défaillante, car si la fusion n'a pas lieu, les actifs concernés ne quitteront probablement pas le marché, c'est-à-dire qu'il est facile de les redéployer sur le marché existant.

Le Président a passé la parole au Canada afin qu'il réponde à la question posée par la Suède dans le contexte de l'affaire de réservation aérienne présentée dans sa note. Le Canada a rappelé aux participants que dans l'affaire en question, l'argument de l'entreprise défaillante n'était pas recevable, parce qu'il avait été démontré que l'entreprise n'était pas défaillante. Le Canada est également convenu avec les Etats-Unis que dans le secteur des services, les actifs étaient généralement plus facile à redéployer que dans les secteurs de la production.

Ayant fait remarquer que tous les pays semblaient utiliser une définition étroite des entreprises défaillantes en tant qu'argument de défense, les Etats-Unis (Federal Trade Commission) ont noté qu'il existait toutefois des différences d'approche intéressantes. Par exemple, certaines juridictions, dont les Etats-Unis ne font pas partie, imposent que si la fusion n'a pas lieu, la part de marché revienne de toute façon à l'acquéreur. Ce critère serait facile à respecter dans un cas où par exemple l'entreprise acheteuse détient 70 pour cent du marché et l'entreprise défaillante 30 pour cent. Prenons maintenant un exemple où le repreneur détient toujours 70 pour cent du marché, mais les 30 pour cent restants sont répartis entre trois concurrents, dont l'un est défaillant. Dans ce cas, l'argument pourrait être refusé, même si les deux autres concurrents plus petits ne peuvent pas constituer des repreneurs potentiels.

L'Allemagne a admis que le fait d'exiger la preuve qu'avec ou sans la fusion, les parts de marché resteraient sensiblement les mêmes, présente quelques difficultés qui requièrent une certaine prudence dans l'approche pratique. Ceci est également l'une des raisons pour lesquelles l'argument l'entreprise défaillante a été peu utilisé en Allemagne.

Le Japon est revenu sur la question du Président demandant en quoi les fusions impliquant des entreprises défaillantes différaient, sur le fond, de toutes les autres fusions. Au Japon, une attention particulière est accordée à la valeur réelle des actifs rachetés. Puisqu'une entreprise est défaillante, elle possède certains actifs "négatifs", par exemple une direction médiocre. Si une entreprise défaillante est reprise par une société n'occupant pas une position dominante, il est probable que la fusion n'aura pas d'effet anticoncurrentiel.

Le Président a clos la session en remerciant tous les participants et indiqué que si la question n'avait pas été résolue complètement, ce débat constituait déjà un bon début.

BACKGROUND NOTE
(by the Secretariat)

Introduction and Definitions

In vigorously competitive markets, mergers involving failing firms will often enhance general welfare either through increasing the efficiency of existing capacity, redeploying that capacity to socially more valued uses, or preserving jobs and having other socially beneficial impacts. Unfortunately, there will also be cases where the highest price for a failing firm's business or assets comes from a purchaser who expects the acquisition will create, preserve or facilitate the use of market power. If that happens, competition authorities will be faced with two important questions:

-- should such a merger be treated exactly the same as any other merger;

-- if special treatment is warranted, what should it consist of.

Before exploring possible answers to those questions, it is necessary to make some preliminary definitions. Throughout what follows, the word "merger" will refer to the sale of all or a portion of a business, rather than mere plant and equipment. It will usually involve the sale of intangible as well as tangible assets, and result in a direct and immediate transfer of market share. The word "liquidation" will refer to all non-merger sales of failing firm assets. Another key word is "failing". It will refer here to a situation where it is virtually certain that, absent a merger, the failing firm will be forced to liquidate. A failing firm cannot continue in business merely by reorganizing, with or without the protection of some bankruptcy or creditor arrangement statute.

There are three subsequent sections to this note. The first contains a general analysis addressing the appropriateness of applying standard merger review to cases where one of the parties is a failing firm, and sets forth three basic scenarios. The second section provides further detail on a number of specific concerns germane to designing policies to deal with anti-competitive mergers involving failing firms. The note ends with a short conclusions section.

General Analysis

As a general rule, merger review begins by asking whether a proposed merger significantly reduces competition in one of the affected markets. If not, no steps are taken to block it. If there is such a problem, some countries proceed to apply a total welfare (i.e. consider claimed efficiencies) and/or a broader public interest test to determine whether or not the merger should be blocked. With or without such additional steps, merger review does not normally include identification or examination of possible alternatives to a proposed merger. In effect the only comparison made is between pre-merger and expected post-merger competitive conditions.[1]

Where a party to a merger is failing it no longer makes sense to use pre-merger competitive conditions as a sort of benchmark and to omit serious consideration of what would likely develop if the merger were blocked. It might happen that there is a competitively acceptable merger waiting in the wings. But if there is not, and the competition authorities reject one or more mergers falling below an unsustainable benchmark, the result could well be a liquidation expected to produce greater harm to competition than is predicted to result from one or more of the rejected mergers. It would therefore be better to explicitly examine realistic alternative possibilities before blocking a merger involving a failing firm.

Business failure can be traced to managerial inefficiency (broadly defined), market-wide excess capacity[2], or some mixture of the two.[3] Generally speaking, inefficiency should be cured with a reorganization or a takeover designed to improve the firm's management. Significant redeployment of capacity to uses outside the failing firm's current market will not usually be necessary. Just such a redeployment is the optimal solution however if a firm is failing because of a market-wide excess capacity situation.

We will now proceed to consider how to deal with three general cases all assumed to involve a merger which normally would be blocked were it not for the fact that one of the parties to the merger is a failing firm. The first of those covers situations where a firm is failing essentially because of inefficient management. The second and third cases are addressed to the assumed alternative possibility, namely failure due to market-wide excess capacity.

1. Case One - the reason for failure is managerial inefficiency (there is no excess capacity in the industry)[4]

Such cases should be reviewed by analysing and comparing all available alternatives (including liquidation) being put forward in the market. Each of those alternatives should be examined in the normal fashion to estimate its competitive effects. Finally, the proposed merger should be blocked only if it is inferior to one or more of the assessed alternatives. Several practical points should be borne in mind as the review proceeds.

In the first place, though liquidation will change the relative market shares of surviving firms less than would various mergers, the surviving firms' shares will tend to rise, and they will increase most for the enterprises whose products are the closest substitutes for those of the failing firm.

Secondly, some jurisdictions pay special attention to whether or not assets are likely to exit the currently served market if a proposed anti-competitive merger involving a failing firm is blocked. In particular, they are willing to allow such a merger only if, among other things, there is evidence that were the merger to be blocked, the failing firm's assets would exit its present market. This condition reveals a probably justifiable exclusive focus on the failing firm's market.[5] There is another aspect to it however that merits further probing.

If the failing firm's assets exit its market, there will be a tendency for supply in that market to be decreased. Such reductions and the welfare reducing price increases they normally entail are virtually certain where there was little or no excess capacity in the pre-merger situation. Furthermore, the negative effects of decreased supply are not likely to be quickly reversed through the addition and use of new capacity.[6] These valid and serious observations do not automatically establish however that exiting assets should be avoided by permitting a merger that would otherwise be blocked. There is little reason to assume that the decrease in supply resulting from exiting assets will always be greater than the decrease in supply expected following a competition reducing merger.[7] Of course none of this means abandoning the exiting assets condition.[8] Instead, it should be supplemented where practicable with some consideration of how much supply will be reduced were the merger to be permitted.

Before leaving this case, it is worth noting that it involves a situation where it is particularly appropriate to balance efficiencies against the merger's expected anti-competitive impact, i.e. to apply a producer plus consumer surplus analysis instead of concentrating only on the latter. The efficiencies may be more significant and believable if the merger should enhance the managerial capacities of the failing firm.

2. Case Two - the acquired firm is failing because of market-wide excess capacity, the acquiror is not an actual or potential competitor of the failing firm, and after the merger all acquired assets will be redeployed outside the failing firm's current market

It is unlikely that competition authorities will have to deal with many Case Two situations since such "redeployment" mergers will rarely present significant competition problems. The case is still worth considering in order to shed light on some interesting policy issues.

Case Two is best considered in three possible variants.

a. The merger's anti-competitive effects are expected to occur in the failing firm's present market; there are no significant effects anticipated as regards competition in the market which will experience an increase in capacity

The merger under investigation will of course reduce the number of sellers in the failing firm's current market. In addition, except in the case of homogeneous products, it will produce a reapportionment of market shares among the surviving firms. One or both of those factors are presumably responsible for the expected significant reduction in competition.[9] The essence of the transaction is a transfer of assets to a more productive use which happens to leave a reduction in competition in its wake.

The modified merger review prescribed for Case One, i.e. careful comparison of the proposed merger with all reasonable alternatives (including liquidation), is equally applicable to the present case. Paradoxically however, as seen above, some countries block anti-competitive failing firm mergers unless they are satisfied that absent the merger, the failing firm's assets will leave the currently served market. Case Two mergers would consistently fail to meet that test. Presumably this result is either unintentional, or countries imposing an exiting assets condition believe that the treatment accorded to an anti-competitive redeployment merger should be the same whether or not one of the parties is failing.

b. The anti-competitive effects are expected to show up in the new use market, or in both old and new markets

Such a situation is possible but probably rare because capacity to serve the new market is being increased. That will usually have the pro-competitive effect of increasing supply and reducing price in the new use market. It could happen however that a merger is being proposed in order to cheaply add to or create excess capacity used to produce or protect an anti-competitive situation in the new use markets. This seems so unlikely that it should cause no practical concern unless there is direct evidence supporting it.[10]

The approach to follow in this case is similar to what was described above except that the competitive impact in both capacity losing and gaining markets should be considered.

c. A significant reduction in competition is expected in the capacity losing market but an improvement in competitive conditions is predicted in the capacity gaining market

The possibility of such a situation supports the advisability of considering effects in both markets rather than exclusively concentrating on the market currently served by the failing firm.

3. Case Three - the acquired firm is failing because of market-wide excess capacity, but the proposed merger involves no immediate redeployment of capacity outside the market currently served by the failing firm

In all probability, both parties to a Case Three merger will have excess capacity, but that capacity will not be equally efficient. Indeed, the main rationale for the merger will usually be to facilitate a more cost effective redeployment of excess capacity than would occur without the merger. Much of what was said in the Case Two analyses could therefore be applied to Case Three mergers if the latter are analysed using a long term perspective.

A key difference between Case Two and Three mergers is that the expected anti-competitive effects of mergers falling in the latter group are much more likely to be bound up with an anti-competitive intention as regards the failing firm's assets. For example, the acquiring firm may have no intention of using those assets. Instead it may merely wish to deny them to possible new entrants or fast growing rivals. Alternatively or in addition, the assets may be acquired merely to create or improve on a threat to greatly increase output as a means to deter new entrants or discipline rivals.[11]

The basic approach to Case Three mergers is the same as was outlined in previous cases, i.e. a careful consideration and comparison of the competitive impacts of all realistic alternatives to the merger.

Specific Policy Considerations

1. What to do if a failing firm defence/exception is not provided for in the law or regulations

Given the advisability of a well-crafted exception as regards problem mergers involving failing firms, it is good that there are three ways in which policy makers can carve out or recognize a failing firm defence/exception even when the law is seemingly silent on the matter. The first is simply to make an appropriate downward adjustment in the estimated market share effectively being transferred through the merger. This is especially appropriate where prior to the merger proposal, the failing firm's market share appeared to be in long term decline. Another method might be to grant particularly generous treatment to claimed efficiencies when a failing firm is involved in a merger.

In many jurisdictions, the competition statute prohibits a merger only where there is a clear causation between it and a significant reduction in competition. Such a causation is arguably absent if the competitive conditions expected post-merger are believed to be better or at least not significantly worse than what is predicted to happen were the merger to be blocked.[12] Openly adopting the view that the necessary causation is absent in such cases would amount to the merger authority recognizing a failing firm defence/exception.

2. The "flailing" firm

There are several reasons why competition authorities may be unwilling to extend the failing firm defence/exception to firms which are clearly ceasing to be effective competitors, but have not yet technically failed. The first is a desire to avoid evidentiary disputes they are poorly situated to resolve, i.e. whether the "flailing" firm is truly likely to fail. An anti-competitive merger almost by definition produces extra profits. If a flailing firm defence/exception exists, parties to competition reducing mergers would naturally have a strong tendency to claim that one (or both) of them are flailing when in fact any financial problems are minor or strictly temporary.

Even if flailing firms could be reliably identified, competition authorities may take the view that the competition such firms provide, albeit weak or weakening, benefits consumers and should be allowed to continue as long as possible. That view makes sense, but should be tempered with considerations of longer term competitive effects. A merger involving a flailing firm might foster a considerably better competitive environment than a similar merger occurring only after one of the parties has sunk into irreversible failure, i.e. there is a tradeoff between present and future levels of competition.

3. Declining industry considerations

Some countries who question the wisdom of widening the failing firm defence/exception to include flailing firms, might be willing to do so in cases where the flailing firm is part of a declining industry, i.e. an industry characterized by universally low profitability (at least among the domestic

producers) and imminent or actual, reductions in capacity. Incorporating a reference to objective, easily verifiable factors outside the control of the merging parties would lower the evidentiary risk of applying the same merger review regime to failing and flailing firms. Moreover, in declining industry situations it is more likely that firms flailing today will be failing tomorrow. Consequently, declining industry conditions would make it more necessary to consider whether or not the flailing firm issue involves a tradeoff between present and future levels of competition.

4. Identifying alternatives

It is one thing to require consideration of merger alternatives before approving a merger featuring both a failing firm and an expected negative effect on competition, but quite another to determine how alternative buyers should be identified. Not much assistance should be expected from the failing firm; it has little interest in pointing out less anti-competitive solutions involving, in all likelihood, a lower selling price for the failing firm. This explains why certain jurisdictions withhold a failing firm defence/exception unless the parties demonstrate that serious third party efforts have been made to "shop the firm", and have failed to produce a less anti-competitive reasonable offer. It is also the reason why the authorities should explicitly state that they will regard any merger offer setting a price above the net liquidation value of the assets as constituting a reasonable offer.

5. Applying the defence/exception to parts of a firm

In principle, there seems to be no good reason for treating the sale of part of a firm (i.e. a "division") any differently than the sale of an entire firm. In practice though, it will be wise to insist on some assurance that the division's failing status is not merely a reflection of creative accounting as regards things like transfer payments and the allocation of common costs.

6. Should the defence/exception apply whether the failing firm is the acquired or acquiring party?

The simple answer to this question is "yes".[13]

Conclusions

There are several general conclusions which can be drawn from the above discussion. The first and most important is that when a party to a merger is failing, competition authorities are right to modify their normal approach to merger review. In particular, estimates of competitive conditions after a proposed merger involving a failing firm should be compared not to the pre-merger situation, but rather to what is expected to happen should the merger be blocked, i.e. how would competition fare under each of the reasonable alternatives to the merger. Such alternatives ought to include liquidation as well as less anti-competitive mergers.

To fully compare alternatives, it is necessary to take a detailed look at how they would employ the failing firm's assets. That may well require examining markets outside those currently served by the failing firm, especially in cases involving "redeployment" mergers or taking place against a backdrop of considerable market-wide excess capacity.

On the rather contentious issue of whether flailing as well as failing firms should enjoy special treatment in merger review, countries could reasonably adopt different approaches. It should be noted though that the arguments in favour of blurring the distinction acquire greater force in the context of a declining industry.

It is probable that all jurisdictions can adopt or recognize a failing firm defence/exception even if the law does not explicitly provide one. Whatever the legal situation, it is wise to adopt an explicit policy regarding the review of anti-competitive mergers involving a failing firm. That policy could be included in any published merger guidelines.

NOTES

1. This approach seems to be based on an implicit or explicit policy decision that such review should have a minimalist, basically non-interventionist stance. In particular, it should be applied to protect rather than improve existing levels of competition.

2. This refers to a situation in which total installed capacity (the sum of outputs assuming each supplier produces at the minimum point of its average cost curve) exceeds the quantity demanded at the equilibrium competitive price.

3. For the purposes of this note, it is appropriate to assume that predatory pricing and other abuses of dominance are being effectively dealt with by the non-merger provisions of a country's competition statute.

4. Most such mergers will be horizontal in nature. This is because competitors should be uniquely well qualified to understand and correct the acquired firm's management problems. Furthermore, horizontal mergers are more likely to significantly reduce competition than are vertical or conglomerate mergers.

5. Such a focus is likely based on a reluctance to engage in what would often be a highly hypothetical balancing of expected anti-competitive effects in the market where capacity will be decreased against expected pro-competitive effects in the market where it will be increased.

6. As mentioned in n.4 supra, the common case of an inefficient failing firm involved in a competition reducing merger is a horizontal merger. In such an instance, it is safe to assume that there are considerable barriers to entry. Otherwise, there would not be a competition reducing effect worth worrying about.

7. In the aftermath of a competition reducing merger, all firms could decide to reduce their outputs, not merely the firm which acquired the failing firm's assets.

8. As we will see below however, this may be advisable in certain, probably rare, cases.

9. The merger will also directly reduce the capacity dedicated to the failing firm's existing market, but that should not present a competition problem given the presumed pre-merger excess capacity.

10. For excess capacity to be used to preserve or create an anti-competitive situation, such excess capacity should presumably be able to produce at unit costs below the competitive price - see John E. Kwoka, Jr. and Frederick R. Warren-Boulton, "Efficiencies, Failing Firms, and Alternatives to Merger: A Policy Synthesis", U.S. Department of Justice, Antitrust Division, Economic Analysis Group Discussion Paper, EAT 86-14 (August 29, 1986), p. 18. This is quite unlikely as regards capacity originally constructed to serve a totally different market.

11. See Ibid., pp. 17-18 for a list of references discussing such a possibility.

12. Roughly equivalent competitive conditions will be expected for example in cases where it is clear that the acquiring firm is set to obtain in a short time virtually the entire market share of the failing firm with or without the merger.

13. In normal cases, merger authorities should assume that post-merger decisions to improve the firm's efficiency or to redeploy its assets will be the same regardless of who takes over whom.

NOTE DE RÉFÉRENCE
(par le Secrétariat)

Introduction et définitions

Sur des marchés extrêmement compétitifs, les fusions dans lesquelles sont impliquées des entreprises défaillantes ont souvent pour effet d'accroître le bien-être général soit en augmentant l'efficience de la capacité existante qui se trouve redéployée à des utilisations plus utiles pour la collectivité, soit en préservant les emplois et en ayant d'autres incidences bénéfiques sur le plan social. Malheureusement, il est également des cas dans lesquels le prix le plus élevé proposé pour les activités ou les actifs d'une entreprise défaillante émane d'un acheteur qui voit dans l'acquisition le moyen de créer, de maintenir un pouvoir de marché ou d'en faciliter l'emploi. Dans ces cas, les autorités de la concurrence devront répondre à deux questions importantes :

-- convient-il de traiter une fusion de ce genre exactement de la même façon que n'importe quelle autre fusion ;

-- si un traitement spécial se justifie, quel devrait-il être.

Avant d'examiner les réponses qui peuvent être apportées à ces questions, il est nécessaire de formuler quelques définitions préliminaires. Dans le texte qui suit, on entendra par "fusion" la vente de la totalité ou d'une partie d'une entreprise, et pas uniquement celle de ses installations et de son équipement. Cette définition couvrira la vente d'actifs tant incorporels que corporels, et aura pour résultat de transférer directement et sans délai une part de marché. Par "liquidation", on entendra toutes les ventes hors fusion des actifs de l'entreprise défaillante. Autre terme-clé, l'adjectif "défaillante". Dans le présent document, il définira une situation dans laquelle il est pratiquement certain que, faute d'une fusion, l'entreprise défaillante sera contrainte à la liquidation. Une entreprise défaillante ne peut poursuivre ses activités uniquement par une réorganisation, avec ou sans la protection de quelque statut organisant la banqueroute ou un concordat.

La présente note comprendra trois sections. Dans la première, on procédera à une analyse générale sur l'opportunité d'appliquer l'examen type des fusions à des cas où l'une des parties est une entreprise défaillante, cela à partir de trois scénarios de base. Dans la deuxième, on fournira davantage de détails sur un certain nombre de préoccupations spécifiques concernant l'élaboration de politiques permettant d'examiner les fusions anticoncurrentielles dans lesquelles sont impliquées des entreprises défaillantes. La note se terminera par une courte section contenant des conclusions.

Analyse générale

En règle générale, en procédant à l'examen d'une fusion, on commence par se poser la question de savoir si un projet de fusion réduit sensiblement la concurrence dans l'un des marchés concernés. Dans la négative, il n'est pris aucune mesure pour s'y opposer. Dans l'affirmative, certains pays appliquent alors une procédure qui consiste à appliquer un critère de bien-être global (c'est-à-dire à examiner les efficiences attendues) et/ou un critère d'intérêt général plus large pour déterminer s'il convient ou non de stopper la fusion. Qu'il y ait ou non des étapes supplémentaires de ce genre, le contrôle de la fusion ne comporte pas normalement d'identification ou examen d'autres solutions que le projet de fusion. En fait, sont comparées uniquement les conditions de la concurrence existant avant la fusion avec celles que l'on escompte après la fusion[1].

Lorsque l'une des parties à une fusion est une entreprise défaillante, il ne sert plus à rien de prendre pour critère les conditions de concurrence avant fusion et de ne pas procéder à un examen sérieux de ce qui se produirait probablement si la fusion était stoppée. Il pourrait arriver qu'une fusion acceptable sur le plan de la concurrence soit imminente. Mais s'il n'y en a pas, et si les autorités de la concurrence refusent une ou plusieurs fusions en deçà de conditions non soutenables, il pourrait fort bien en résulter une liquidation plus préjudiciable à la concurrence que n'auraient pu l'être une ou plusieurs des fusions rejetées. Il serait donc préférable d'examiner expressément d'autres possibilités réalistes avant de bloquer une fusion mettant en cause une entreprise défaillante.

La défaillance d'une entreprise peut être due à l'inefficience de sa gestion (au sens large), à une capacité excédentaire[2], ou encore à ces deux facteurs associés[3]. D'une façon générale, il conviendrait de remédier à l'inefficience par une réorganisation ou une prise de contrôle propre à améliorer la gestion de l'entreprise. Un redéploiement important de la capacité en vue d'utilisations dépassant le marché actuel de l'entreprise défaillante ne seront en général pas nécessaires. Mais ce seul redéploiement constitue la solution optimale si l'entreprise est défaillante en raison d'une situation excédentaire sur le marché.

Examinons maintenant comment agir dans les trois cas types qui sont tous présumés mettre en cause une fusion, laquelle serait normalement stoppée, n'était le fait que l'une des parties à la fusion est une entreprise défaillante. Le premier de ces scénarios vise les situations dans lesquelles la cause essentielle de la défaillance d'une entreprise est l'inefficience de sa gestion. Dans les deuxième et troisième scénarios, on supposera une autre possibilité, à savoir la défaillance due à une capacité excédentaire à l'échelle du marché.

1. Premier scénario -- la défaillance de l'entreprise tient à l'inefficience de la gestion (il n'y a pas de capacité excédentaire dans la branche d'activité)[4]

Pour examiner ces scénarios, il conviendrait d'analyser et de comparer toutes les solutions (y compris la liquidation) possibles sur le marché. Chacune de ces solutions devrait être examinée dans les conditions normales pour en apprécier les effets sur la concurrence. Enfin, le projet de fusion ne devrait être stoppé que s'il se situait en-deçà d'une ou plusieurs des solutions évaluées. Au cours de l'examen, il conviendrait de ne pas oublier plusieurs points d'ordre pratique.

En premier lieu, bien que la liquidation va modifier les parts de marché des entreprises qui subsisteront moins que ne le feraient diverses fusions, les parts de ces entreprises vont avoir tendance à augmenter et elles augmenteront surtout pour les entreprises dont les produits peuvent se substituer le mieux à ceux de l'entreprise défaillante.

En second lieu, certains pays cherchent surtout à déterminer si les actifs pourraient ou non sortir du marché actuellement desservi si un projet de fusion anticoncurrentiel qui met en cause une entreprise défaillante se trouvait stoppé. Ils sont en particulier disposés à autoriser une fusion de ce genre uniquement si des faits montrent, entre autres, que dans le cas où la fusion serait stoppée, les actifs de l'entreprise défaillante se retireraient du marché où elle opère. Cette condition révèle que l'attention est focalisée sur le marché de l'entreprise défaillante, ce qui peut probablement se justifier[5]. Toutefois, un autre aspect de la question mérite qu'on procède à une évaluation plus poussée.

Si les actifs de l'entreprise défaillante sortent de son marché, l'offre sur ledit marché aura généralement tendance à diminuer. Ces réductions, ainsi que les hausses des prix qu'elles vont normalement entraîner et qui vont diminuer le bien-être, sont pratiquement certaines dans les cas, où avant fusion, il n'y avait peu ou guère de capacité excédentaire. Par ailleurs, les effets négatifs de la diminution de l'offre ne devraient pas être rapidement compensés du fait de l'apport et de l'utilisation d'une nouvelle capacité[6]. Toutefois, ces remarques sérieuses et valables ne prouvent pas nécessairement qu'il conviendrait d'éviter la sortie des actifs en autorisant une fusion qui sans cela serait stoppée. Il n'y a guère de raisons de

supposer que la diminution de l'offre résultant de la sortie des actifs sera toujours plus importante que la diminution de l'offre escomptée à l'issue d'une fusion qui réduit la concurrence[7]. Bien entendu, cela ne veut pas dire qu'il faille renoncer au critère visant la condition des actifs sortant du marché[8]. Il conviendrait plutôt de le compléter, lorsque cela est possible, d'un examen permettant de déterminer de combien l'offre sera réduite si la fusion est autorisée.

Avant de passer au deuxième scénario, il convient de noter qu'il s'agit là d'une situation dans laquelle il n'est pas nécessairement opportun de mettre en balance les efficiences et les incidences présumées anticoncurrentielles de la fusion, c'est-à-dire d'analyser la rente du producteur de préférence à celle du consommateur et ne pas s'en tenir à cette dernière. Les efficiences peuvent être plus importantes et plus vraisemblables si la fusion devait accroître les capacités de gestion de l'entreprise défaillante.

2. Deuxième scénario -- l'entreprise acquise est défaillante en raison de la capacité excédentaire à l'échelle du marché, l'acquéreur n'est pas un concurrent réel ou potentiel de l'entreprise défaillante et après la fusion, tous les actifs acquis seront redéployés sur un marché différent du marché actuel de l'entreprise défaillante.

Il est peu probable que les autorités de la concurrence aient à examiner de nombreux scénarios de ce genre car les fusions de "redéploiement" poseront rarement des problèmes de concurrence importants. Il est pourtant utile d'examiner ce scénario afin d'éclairer certaines questions intéressantes sur le plan de l'action.

C'est avec ces trois variantes possibles qu'on peut le mieux examiner le deuxième scénario.

a. Les effets anticoncurrentiels de la fusion devraient être ressentis sur le marché actuel de l'entreprise défaillante ; il n'est pas prévu d'effets importants en ce qui concerne la concurrence sur le marché où l'on va enregistrer un accroissement de la capacité.

La fusion soumise à l'enquête va bien entendu réduire le nombre de vendeurs sur le marché actuel de l'entreprise défaillante. De plus, sauf s'il s'agit de produits homogènes, les parts de marché vont être redistribuées entre les entreprises qui subsistent sur le marché. C'est à l'un de ces facteurs ou aux deux que l'on peut sans doute imputer la réduction importante de la concurrence, qui est attendue[9]. L'essentiel de l'opération consiste à transférer les actifs à un usage plus productif, ce qui va aussi se traduire par une réduction de la concurrence.

L'examen modifié de la fusion, indiqué pour le scénario 1, c'est-à-dire la comparaison attentive du projet de fusion avec toutes les solutions raisonnables possibles (y compris la liquidation) vaut également pour ce scénario. Mais comme on l'a vu plus haut, certains pays bloquent paradoxalement les fusions impliquant une entreprise défaillante, qui sont anticoncurrentielles, sauf s'ils sont convaincus qu'en l'absence de fusion, les actifs de l'entreprise défaillante sortiraient du marché où elle opère actuellement. Les fusions dans le scénario 2 ne satisferaient jamais à ce critère. On peut penser ou bien que ce résultat n'est pas intentionnel, ou bien que les pays qui imposent une condition concernant la sortie des actifs estiment que le régime accordé à une fusion assurant un redéploiement contraire à la concurrence devrait être identique, que l'une des parties soit défaillante ou non.

b. Les effets anticoncurrentiels devraient être ressentis sur le nouveau marché, ou à la fois sur l'ancien marché et le nouveau

Cette situation est possible mais elle sera probablement rare car la capacité pour desservir le nouveau marché va augmenter. Généralement, ceci aura pour effet favorable à la concurrence d'accroître l'offre et de réduire les prix sur le nouveau marché. Toutefois, il pourrait arriver qu'une fusion soit proposée pour accroître ou créer à bon compte une capacité excédentaire qui sera utilisée pour créer ou

protéger une situation contraire à la concurrence sur les nouveaux marchés d'utilisation. Cela paraît si peu probable que les responsables ne devraient pratiquement pas s'en alarmer sauf si des preuves directes confortent cette situation[10].

La méthode à suivre dans ce cas est analogue à celle qui a été décrite plus haut sauf qu'il conviendra d'examiner les incidences sur le plan de la concurrence tant sur les marchés où la capacité augmente que sur ceux où la capacité diminue.

c. On s'attend à une réduction importante de la concurrence sur le marché où la capacité diminue mais on prévoit une amélioration des conditions de la concurrence sur le marché où elle augmente

Dans ce cas, il serait opportun d'examiner les effets sur les deux marchés plutôt que de concentrer son attention exclusivement sur le marché desservi actuellement par l'entreprise défaillante.

3. Scénario trois -- La cause de la défaillance de l'entreprise acquise tient à l'excédent de capacité à l'échelon du marché, mais le projet de fusion n'implique pas un redéploiement immédiat de la capacité en dehors du marché actuellement desservi par l'entreprise défaillante

Selon toute probabilité, les deux parties à une fusion correspondant à ce scénario trois détiendront une capacité excédentaire mais l'efficience de cette capacité ne sera pas identique pour chacune d'elle. De fait, les principaux arguments invoqués en faveur de la fusion seront en général qu'elle facilite un redéploiement de la capacité excédentaire, plus efficace par rapport au coût, que si la fusion n'avait pas lieu. Par conséquent, bon nombre des arguments avancés dans les analyses du deuxième scénario pourraient s'appliquer aux fusions du scénario trois si ces dernières sont analysées dans une perspective à long terme.

L'une des principales différences entre les fusions des deuxième et troisième scénarios est que les effets anticoncurrentiels escomptés des fusions entrant dans ce dernier groupe seront probablement davantage liés à un objectif contraire à la concurrence en ce qui concerne les actifs de l'entreprise défaillante. Par exemple, l'entreprise qui prend le contrôle peut n'avoir pas l'intention d'utiliser ces actifs. Au lieu de cela, elle peut simplement vouloir refuser l'accès du marché à de nouveaux concurrents éventuels ou à des concurrents qui connaissent un développement rapide. Ou bien, ou de surcroît, les actifs peuvent être acquis simplement pour créer ou renforcer une menace d'intensifier la production de façon à interdire l'accès du marché à de nouveaux entrants ou mettre au pas des concurrents[11].

Il faut, pour ce scénario, adopter la même méthode que pour les deux précédents, c'est-à-dire examiner et comparer soigneusement les incidences sur la concurrence de toutes les autres possibilités, autres que la fusion, qui peuvent être mises en oeuvre.

Considérations spécifiques quant à l'action des pouvoirs publics

1. Que faire si l'argument de l'entreprise défaillante n'est pas prévu par la loi ou les réglementations

Etant donné qu'il est souhaitable de bien définir le moyen de défense de l'entreprise défaillante lorsqu'il s'agit de fusions discutables, il existe heureusement trois façons pour les décideurs de rejeter ou de retenir l'argument de l'entreprise défaillante même si la loi paraît silencieuse en la matière. Le premier est simplement d'ajuster correctement à la baisse la part de marché dont on peut attribuer le transfert à la fusion. Ce moyen convient surtout lorsqu'avant le projet de fusion, la part du marché de l'entreprise

défaillante paraissait depuis longtemps en voie de diminution. Un autre moyen consistera à considérer favorablement les efficiences attendues de la fusion qui met en cause une entreprise défaillante.

Dans plusieurs pays, les lois sur la concurrence n'interdisent les fusions que s'il existe un lien de causalité évident entre celles-ci et une diminution sensible de la concurrence. On peut supposer que ce lien de causalité est absent si les conditions de concurrence escomptées à l'issue de la fusion sont jugées préférables ou à tout le moins pas sensiblement pires que celles auxquelles on pourrait s'attendre au cas où la fusion serait stoppée[12]. Adopter ouvertement le point de vue selon lequel le lien de causalité indispensable est absent dans les cas de ce genre signifierait que l'autorité chargée des fusions admet l'argument/l'exception de l'entreprise défaillante.

2. L'entreprise "en perdition" ("flailing firm")

Il existe plusieurs raisons pour lesquelles les autorités de la concurrence peuvent ne pas souhaiter élargir l'argument de l'entreprise défaillante aux entreprises qui ont à l'évidence cessé d'être des concurrents effectifs, mais qui n'ont pas encore été déclarées techniquement en faillite. La première de ces raisons est qu'elles souhaitent éviter les conflits en matière de preuves qu'elles sont mal placées pour résoudre et pour déterminer notamment si l'entreprise en perdition va véritablement à la faillite. Une fusion contraire à la concurrence génère presque par définition des bénéfices supplémentaires. Si existait l'argument faisant état d'une entreprise en perdition, les parties qui procèdent à des fusions qui restreignent la concurrence auraient naturellement tendance à alléguer que l'une des deux (ou les deux) sont en perdition alors qu'en fait il pourrait s'agir de problèmes financiers mineurs ou strictement temporaires.

Même si les entreprises en perdition pouvaient être identifiées à coup sûr, les autorités de la concurrence pourraient estimer que, si faible ou si affaiblie soit-elle, la concurrence entre ces entreprises assure des avantages aux consommateurs et qu'il conviendrait de les maintenir aussi longtemps que possible. Ce point de vue est plausible mais il conviendrait de le tempérer par des considérations concernant les effets à plus long terme sur la concurrence. Une fusion dans laquelle est impliquée l'entreprise en perdition pourrait donner lieu à des conditions de concurrence bien supérieures à celles d'une fusion analogue qui ne serait réalisée qu'après la faillite irrémédiable de l'une des parties, c'est-à-dire lorsqu'il y a une mise en balance entre les niveaux présents et futurs de la concurrence.

3. Considérations concernant la branche d'activité en récession

Certains pays qui doutent de l'opportunité d'élargir l'argument de défense de l'entreprise défaillante aux entreprises en perdition pourraient vouloir souhaiter le faire dans le cas où celles-ci font partie d'une branche d'activité en voie de récession, c'est-à-dire où la rentabilité est faible pour tous (du moins parmi les fabricants nationaux) et où les réductions de capacité sont imminentes ou réelles. En faisant référence à des facteurs objectifs facilement vérifiables qui échappent au contrôle des parties procédant à la fusion, on diminuerait, en matière de preuves, le risque d'appliquer aux entreprises défaillantes et aux entreprises en perdition le même régime pour le contrôle des fusions. De plus, lorsqu'il s'agit d'une branche d'activité en récession, il n'est pas du tout exclu que des entreprises, qui sont aujourd'hui en perdition, soient défaillantes demain. Par conséquent, il serait davantage nécessaire de déterminer si oui ou non l'entreprise en perdition introduit une différence entre les niveaux présents et futurs de la concurrence.

4. Identification d'autres solutions

Exiger que soient examinées les solutions autres que la fusion avant d'approuver une fusion caractérisée à la fois par la présence d'une entreprise défaillante et par des effets qui devraient être négatifs sur la concurrence est une chose, mais c'en est une autre de déterminer comment il convient d'identifier les autres acheteurs. Il ne faut pas s'attendre à beaucoup d'aide de la part de l'entreprise défaillante ; elle n'a guère intérêt à indiquer des solutions moins contraires à la concurrence qui impliquent, selon toute

vraisemblance, que son prix de vente sera moins élevé. Cela explique que certains pays refusent l'argument de l'entreprise défaillante à moins que les parties ne prouvent qu'une tierce partie a sérieusement tenté d'acheter l'entreprise et n'est pas parvenue à faire une offre raisonnable ayant moins d'effets contraires à la concurrence. C'est également la raison pour laquelle les autorités devraient indiquer expressément qu'elles considéreront comme constituant une offre raisonnable toute offre de fusion proposant un prix supérieur à la valeur nette de liquidation des actifs .

5. Application de l'argument de défense à certaines parties d'une entreprise

En principe, il parait n'y avoir aucune raison valable de traiter la vente d'une partie d'une entreprise (c'est-à-dire de ses "divisions") différemment de la vente de l'entreprise toute entière. Mais dans la pratique, il serait sage d'obtenir réellement quelque assurance que le statut de la "division" défaillante ne reflète pas simplement une comptabilité fantaisiste à partir de certaines opérations telles que des paiements de transfert et la répartition des coûts communs.

6. L'argument de défense devrait-il s'appliquer, que l'entreprise défaillante soit la partie acheteuse ou la partie achetée ?

La réponse à cette question est affirmative[13].

Conclusions

L'examen ci-dessus conduit à formuler plusieurs conclusions générales. La première, qui est aussi la plus importante, est que lorsqu'une partie à une fusion est une entreprise défaillante, les autorités responsables de la concurrence ont raison de modifier la position qu'elles adoptent normalement en matière de contrôle des fusions. En particulier, il conviendrait de comparer les conditions de concurrence après un projet de fusion mettant en cause une entreprise défaillante non à la situation avant fusion mais plutôt à ce qui arriverait au cas où la fusion serait stoppée, d'examiner comment la concurrence se comporte dans chacune des situations raisonnables autres que la fusion. Ainsi, ces autres solutions devraient figurer la liquidation ainsi que des fusions moins contraires à la concurrence.

Pour comparer réellement les diverses solutions, il est nécessaire d'examiner dans le détail la façon dont seraient utilisés dans chaque cas les actifs de l'entreprise défaillante. Peut-être faudra-t-il alors examiner d'autres marchés que ceux sur lesquels opère actuellement l'entreprise défaillante, surtout lorsqu'il s'agit de fusions de redéploiement ou de fusions intervenant alors qu'il existe une capacité excédentaire considérable sur l'ensemble du marché.

A la question, plutôt controversée, de savoir si les entreprises en récession devraient, à l'instar des entreprises défaillantes, bénéficier d'un régime spécial lors du contrôle des fusions, les pays pourraient raisonnablement adopter des approches différentes. On notera cependant que les arguments qui préconisent d'atténuer la distinction prennent plus de force lorsqu'il s'agit d'une branche d'activité en récession.

Il est probable que tous les pays peuvent adopter ou reconnaître l'argument faisant état de l'entreprise défaillante même si la loi ne le prévoit pas expressément. Quelle que soit la situation juridique, il est raisonnable d'adopter une politique transparente lors de l'examen des fusions anticoncurrentielles mettant en cause une entreprise défaillante. Cette politique pourrait être incorporée dans des directives officielles sur les fusions.

NOTES

1. Cette méthode paraît fondée sur une décision de principe implicite ou explicite selon laquelle la position à adopter devrait être minimaliste, c'est-à-dire fondamentalement non interventionniste. En particulier, cette méthode devrait être appliquée pour protéger et non améliorer la concurrence à son niveau existant.

2. Il s'agit là d'une situation dans laquelle la capacité installée totale (somme des productions, en supposant que chaque fournisseur produise au point minimum de sa courbe de coûts moyens) dépasse le volume auquel se situe le prix concurrentiel d'équilibre.

3. Aux fins de la présente note, il est convenu de supposer que les prix d'éviction et autres abus de position dominante relèvent en fait des dispositions d'une loi nationale sur la concurrence qui ne visent pas les fusions.

4. La plupart des fusions de ce genre sont de caractère horizontal. La raison en est que les concurrents devraient être uniquement bien qualifiés pour comprendre les problèmes de gestion de l'entreprise acquise et y remédier. Par ailleurs, il est probable que les fusions horizontales réduiraient plus sensiblement la concurrence que ne le feraient des fusions verticales ou des conglomérats.

5. Il est probable que cette attention particulière s'explique par la réticence à procéder à ce qui constituerait souvent une comparaison, extrêmement hasardeuse, entre les effets anticoncurrentiels attendus sur le marché dont la capacité diminuera et les effets pro-concurrentiels espérés sur le marché où la capacité va augmenter.

6. Comme indiqué dans la note 4 ci-dessus, il s'agit souvent d'une fusion horizontale. Dans ce cas, on peut supposer sans risque d'erreur qu'il existe des obstacles importants à l'accès au marché. Sans cela, il n'y aurait pas à se préoccuper d'un effet limitant la concurrence.

7. A la suite d'une fusion qui réduit la concurrence, toutes les entreprises pourraient décider de réduire leur production, et pas uniquement celle qui a acquis les actifs de l'entreprise défaillante.

8. Toutefois, comme on le verra ci-après, cela peut être souhaitable dans certains cas, probablement peu fréquents.

9. La fusion réduira aussi directement la capacité attribuée au marché existant de l'entreprise défaillante, mais cela ne devrait pas constituer un problème pour la concurrence étant donné la capacité excédentaire qui est censée exister avant la fusion.

10. Pour que la capacité excédentaire puisse être utilisée pour créer ou maintenir une situation anticoncurrentielle, on peut penser qu'elle devrait être en mesure de produire à des coûts unitaires inférieurs au prix de concurrence -- voir John E. Kwoka, Jr. et Frederick R. Warren-Boulton, "Efficiencies, Failing Firms and Alternatives to Merger : A Policy Synthesis", Ministère de la justice des Etats-Unis, Division antitrust, Economic Analysis Group Discussion Paper, EAT 86-14 (29 août 1986), p. 18. Cela paraît exclu en ce qui concerne la capacité qui a été mise en place au départ pour alimenter un marché totalement différent.

11. Voir Ibid., pp. 17-18, où figure une liste de références où une possibilité de ce genre est examinée.

12. On peut penser que les conditions de concurrence seront à peu près les mêmes, par exemple dans les cas où l'entreprise absorbante va à l'évidence obtenir très vite pratiquement toute la part de marché de l'entreprise défaillante, qu'il y ait ou non fusion.

13. Dans les cas normaux, les autorités chargées de la fusion devraient supposer que les décisions prises après la fusion pour améliorer l'efficience de l'entreprise ou redéployer ses actifs seront identiques, quelque soit l'entreprise qui prend le contrôle de l'autre.

CONTRIBUTION BY THE AUSTRALIAN DELEGATION

Joint discussion paper

The Australian Trade Practices Commission submits a discussion paper jointly prepared with the New Zealand Commerce Commission on the topic of "Acquisitions and the failing company argument" prepared in October 1993. The paper seeks to provide information on the Commissions' consideration of the failing company argument in relation to mergers and acquisitions.

Case example

Application for Authorisation by West Australian Newspapers Ltd (1990) ATPR (Com.) 50-101

In January 1990, the Trade Practices Commission ("the Commission") became aware of the proposed acquisition by West Australian Newspapers Limited ("WAN") of all the issued share capital in United Media Limited ("United Media").

At the time WAN was the publisher of the only morning metropolitan daily newspaper in Perth, The West Australian, in addition to a number of regional newspapers. It also owned 49.99 per cent of issued share in Community Newspapers (1985) Limited ("Community Newspapers").

The remaining 50.01 per cent share in Community Newspapers was held by United Media.

Community Newspapers published a number of free suburban newspapers in Western Australia as well as holding all the shares in Daily News Pty Limited ("Daily News") - publisher of the Daily News, Perth's only afternoon metropolitan daily newspaper.

The Daily News had a history of large losses, very much in line with afternoon newspapers all over the world. In late 1989, WAN expressed interest in acquiring United Media, and effectively wholly owning and controlling the Daily News. This would have the anticompetitive effect of making WAN the owner and controller of the only morning and afternoon daily metropolitan newspapers in Perth.

The Commission formed the view that the proposed acquisition would result in WAN being placed in a position to dominate the market for metropolitan newspapers in Perth and the market for advertising therein, in contravention of section 50 (the merger provision) of the Australian Trade Practices Act ("The Act")..[1].

The Commission sought and obtained an ex parte interim injunction on 19 January 1990 restraining the parties from proceeding with the acquisition, and on 29 January 1990, commenced injunction proceedings in the Federal Court.

WAN then sought statutory authorisation of the proposed acquisition on public benefit grounds[2], relying in part on the failing company argument.

There is no statutory recognition in the Act of the failing company argument[3]. However, the financial viability of a company is relevant in assessing:

a) whether an acquisition by a competitor would substantially lessen competition (or lead to market dominance)[4] in breach of section 50; or

b) whether there is sufficient public benefit basis to authorise the acquisition, notwithstanding the substantial lessening of competition (or market dominance).

On 5 July 1990, the Commission denied the authorisation application. It was of the view that insufficient public benefits would result from the acquisition to outweigh its anticompetitive detriment. The reasons for the Commission's decision are discussed below.

After the failure of appeals to the Trade Practices Tribunal against the Commission's decision not to authorise, the Daily News management decided to close the Daily News immediately afterwards, and WAN withdrew its appeal to the Tribunal. In December 1990 the Commission was informed by the liquidator that Daily News Pty Ltd's masthead and library had been sold to HMR Engine Co Pty Ltd, which intended to relaunch the paper.

However, this never occurred - The West Australian remains the only daily metropolitan newspaper in Perth.

West Australian Newspapers' arguments

Public benefits which were claimed and which the Commission recognised to be of relevance to the application included:

. the continued operation of the Daily News;
. prevention of unemployment;
. the continued provision of an advertising source; and
. greater efficiency of operation.

WAN argued in their defence that the acquisition would result in the very evident public benefit of some 200 jobs being protected. It also argued that, without the acquisition, the paper would close, with a resulting loss of readership and advertising space. WAN had specific plans for the paper designed to revive its performance and certain economies of scale, resulting from integration of some operations, were also expected to result.

WAN said that the anticompetitive detriment was low because the relevant product markets - news, information, entertainment and advertising - embraced other media, not just newspapers. Any monopolistic pricing or deterioration in product quality would be inhibited by competition from other sources, such as print or electronic media.

WAN also claimed that the proposed acquisition would not alter its competitive position in the relevant markets in which the newspaper completed. It said that with 49.99 per cent of the shares in Community Newspapers and an equal vote on its board, its market position was already aggregated with that of the *Daily News* by operation of s.50(aH) of the Act[5], so acquiring the remaining 50.01 per cent would have no market consequences. WAN submitted that Community Newspapers was already an associated company as WAN was allegedly already in a position to exert a substantial degree of influence over the activities of Community Newspapers.

The Commission's assessment

In denying authorisation, the Commission stated that it:

".. had serious difficulty in balancing the social costs against the anticompetitive consequences... the anticompetitive effect that would flow from the creation of the dominant firm, if the

acquisition, subject to this application, was allowed, would make competitive entry for a new metropolitan paper difficult by virtue of the barriers created."

The Commission stated that in the Australian context, its consideration of the issues relevant to the failing company argument should include the following:

-- Is the potentially failing firm going to fail irrespective of whether or not authorisation is granted?

-- What are the real causes of the failure of the firm (rather than concentrating on the current financial status of the firm)?

-- What alternative solution to a merger are available, for example,
   - can the firm be successfully reorganised?
   - can new management be hired?
   i.e. are there any less anticompetitive solutions internal to this firm?

-- Is the proposed acquirer the only available purchaser?

-- Have all good faith efforts have been made to find other potential acquirers, which might pose a less severe danger to competition?

-- Is the proposed acquirer the least anticompetitive acquirer available, in order to prevent assets leaving the industry?

-- Will the apparent cause of the failure of the firm be addressed by the new acquirer?

The Commission in its decision did not specify that an alternative purchaser be bona fide. Even a very low offer had to be seriously considered as the first step in negotiations.

The Commission felt that Community Newspapers had not given adequate consideration to the single alternative bid made by a potential competitor prepared to pay a price based on its best commercial assessment (which was actually much less than the price offered by WAN). The Commission noted the large discrepancy between the two amounts (some $13 million), but attributed this to WAN's willingness to pay any amount in order to reinforce its position of dominance in the relevant markets. It also believed that such a refusal could well have implications concerning the directors' fiduciary duties.

The Commission also rejected the argument that a change in shareholding from 49.99 percent to 100 percent of Community Newspapers or a move from Joint control to full control by WAN would have no implications for competition.

As a result, public benefit flowing from the acquisition was seen to be minimal, and anticompetitive detriment, particularly from high barriers to entry, was seen as substantially increased. Therefore the Commission concluded that there were insufficient public benefits to justify granting authorisation to WAN for the acquisition of United Media.

The decision was the first in Australia which comprehensively considered whether the Act's anti-monopoly code should be relaxed where the target was likely to be wound up unless the acquisition was allowed to proceed - that is, whether to allow the acquirer to utilise the "failing company" argument.

NOTES

1. Since January 1993, the test of market dominance in section 50 of the Act has been replaced with one that prohibits acquisitions that would "substantially lessen competition in a market".

2. Under section 90(9) of the Act, the Commission cannot grant authorisation unless it is satisfied that the proposed acquisition would result in such a benefit to the public that it should be allowed to take place.

3. A statutory form of the "failing company" argument was recommended by the Trade Practices Act Review (Swanson) Committee in 1976. It stated that a failing company should be defined so as to cover only those companies imminently likely to go out of business, for which there have been no alternative buyers on similar terms to those offered by the offeror. It said:

   > "... To provide the statutory defence that we have recommended will minimise the general social cost of business failures and give reasonable consideration to the position of employees, creditors and others who might suffer from complete failure of the target company".

   However, no such concept has been included in the Act.

4. See n. 1

5. That is, the market positions of "associated" bodies corporato were aggregated for the purposes of the dominance test under section 50. With the new substantial lessening of competition test, there is no need for a market aggregation provision and this, therefore, has now been repealed.

CONTRIBUTION BY THE AUSTRALIAN TRADE PRACTICES COMMISSION AND THE NEW ZEALAND COMMERCE COMMISSION

Introduction

As part of the moves toward closer collaboration between the two bodies, the Australian Trade Practices Commission and the New Zealand Commerce Commission have agreed to issue joint papers from time to time in order to provide guidance on specific aspects of competition law in the two countries. This joint paper examines the so-called 'failing company' argument in relation to acquisitions.

The choice of topic for this paper is based on the desire to clarify an aspect of the Commissions' consideration of mergers and acquisitions. The Commissions from time to time receive arguments that acquisitions should be allowed as the company being acquired is on the verge of commercial failure. The business community and its advisers have an interest in knowing how the Commissions will analyse these arguments and the criteria that will be used to determine whether the argument will carry weight in the consideration of acquisitions. This paper seeks to provide this information.

The law relating to mergers and takeovers

Mergers, takeovers and acquisitions are covered in s.50 of Australia's Trade Practices Act 1974 and ss 47-48 and ss 66-69 of New Zealand's Commerce Act 1986.

Section 50 of the Australian Trade Practices Act states:

(1) A corporation must not directly or indirectly:

(a) acquire shares in the capital of a body corporate; or
(b) acquire any assets of a person;

if the acquisition would have the effect, or be likely to have the effect, of substantially lessening competition in a market.

(2) A person must not directly or indirectly:

(a) acquire shares in the capital of a corporation; or

(b) acquire any assets or a corporation;

if the acquisition would have the effect, or be likely to have the effect, of substantially lessening competition in a market.

(3) Without limiting the matters that may be taken into account for the purposes of subsections (1) and (2) in determining whether the acquisition would have the effect, or be likely to have the effect, of substantially lessening competition in a market, the following matters must be taken into account:

(a) the actual and potential level of import competition in the market;

(b) the height of barriers to entry in the market;

(c) the level of concentration in the market;

(d) the degree of countervailing power in the market;

(e) the likelihood that the acquisition would result in the acquire being able to significantly and substantially increase prices or profit margins;

(f) the extent to which substitutes are available in the market or are likely to be available in the market;

(g) the dynamic characteristics of the market, including growth, innovation and product differentiation;

(h) the likelihood that the acquisition would result in the removal from the market of a vigorous and effective competition;

(i) the nature and extent of vertical integration in the market.

Sections 66 and 67 of the Commerce Act set out tests that refer to s.47(1) of the Act which states:

[Dominant position] No person shall acquire assets of a business or shares if, as a result of the acquisition -

(a) That person or another person would be, or would be likely to be, in a dominant position in a market; or

(b) That person's or another person's dominant position in a market would be, or would be likely to be, strengthened.

Dominant influence is then indicated, in s.3(9) of the Act, to cover:

-- for the purposes of determining whether a person is, or 2 or more persons that are interconnected or associated, are, in a position to exercise a dominant influence over the production, acquisition, supply, or price of goods or services in a market regard shall be had to:

(a) the share of the market, the technical knowledge, the access to materials or capital of that person or those persons;

(b) The extent to which that person is, or those persons are, constrained by the conduct of competitors or potential competitors in that market;

(c) The extent to which that person is, or those persons are, constrained by the conduct of suppliers or acquirers of goods or services in that market.

In both jurisdictions mergers which would otherwise contravene these provisions can be authorised on public benefit grounds.

The 'failing company' issue

The 'failing company' argument relates to the substantial lessening of competition and dominance tests set out in those sections of the two Acts dealing with acquisition of a company. If a company is likely to fail, or has already failed (and, for example, is in receivership) could its acquisition create or strengthen dominance or substantially lessen competition?

To oversimplify the issue a little, the question is whether the acquisition of a company that has no market influence due to its commercial failure will cause the acquire to move into a dominant position or strengthen a dominant position (New Zealand) or substantially lessen competition or be likely to substantially lessen competition (Australia).

The response to this question must, therefore, look at two factors:

(1) whether the supposedly 'failing company' is likely to experience commercial failure;

(2) whether, if the company does fail, the resources employed by the company will exit the market and so cease to represent an actual or potential source of supply (or other constraint) on the market?

If the answer to both these questions is yes, then the competitive effect of the company being acquired by another market participant will probably be no worse than if the resources were allowed to exit the market. A competitive influence that would otherwise have been removed by failure is to be removed by acquisition. Thus the acquisition will probably not cause concerns under either test in the two Acts.

Overseas approaches

The failing firm 'defence' is well established in United States antitrust law although its application takes place in a highly structured form geared to litigation as it is a 'defence'. A suspect merger may be allowed to proceed where the resources of the target are 'so depleted and the prospect of rehabilitation so remote that it faced the grave possibility of a business failure with resulting loss to its stockholders and injury to the communities where its plants were operated'. (International Shoe Co v. FTC). The rationale for the exemption is that it is unwise to force a firm to leave the market, because of the market's possible loss of a productive asset and the ensuing social costs to the community. Thus, both market power and public benefit considerations are mixed up in this United States concept.

The United States Department of Justice, Merger Guidelines (1982) attempt to clarify the situation:

> The failing firm 'defence' is a long established, but ambiguous doctrine under which an anticompetitive merger may be allowed because one of the merging firms is 'failing'. Because the defence can immunize significantly anticompetitive mergers, the Department will construe its elements strictly.
>
> ***The guidelines add:***
>
> At a minimum, the Department will require clear and convincing evidence that the merger will produce substantial cost savings resulting from the realization of scale economics, integration of production facilities, or multi-plant operations which are already enjoyed by one or more firms in the industry and that equivalent results could not be achieved within a comparable period of time through internal expansion or through a merger that threatened less competitive harm. In any event, the Department will consider such efficiencies only in resolving otherwise close cases.

The Canadian Bureau of Competition Policy Merger Enforcement Guidelines 1991 state:

> Assessing Failure -- a firm is considered to be failing where: (i) it is insolvent within six months; (ii) it has initiated or is likely to initiate voluntary bankruptcy proceedings within six months; or (iii) it has been petitioned into bankruptcy or receivership, or is likely to be within six months. Technical insolvency is considered to occur when liabilities exceed the realizable value of assets, or where a firm is unable to pay its liabilities as they come due. In the assessment of whether insolvency is indicative of likely failure, an evaluation is made of the firm's prospects of raising new equity, raising funds (through the sale of assets that are not essential to continued viability at its current level of operations, or through the encumbrance of essential assets) and other relevant matters. In general, the greater period of time between the Bureau's assessment and the point at which failure is likely to occur, the more likely it is that a successful defence can be made out.

Canadian competition law (Competition Act 1986) has the failing company issue as a factor (amongst others) that is to be taken into account when determining whether or not the merger will substantially lessen competition. Unlike the United States situation the Canadian position is not geared to litigation and is a factor in the initial merger review process. It is to be noted that whilst the factors in the new s 50 of the Australian Act are similar to Canadian law the 'failing company' factor is not included.

Updated United States position

> The United States Government has recently revisited its merger guidelines. This work has included a clarification of the standing of failing company considerations. The following quotation provides a useful coverage.
>
> Notwithstanding the analysis of Section 1-4 of the Guidelines, a merger is not likely to create or enhance market power or to facilitate its exercise, if imminent failure, as defined below, of one of the merging firms would cause the assets of that firm to exist the relevant market. In such circumstances, post-merger performance in the relevant market may be no worse than market performance had the merger been blocked and the assets left the market.

A merger is not likely to create or enhance market power or facilitate its exercise if the following circumstances are met:

> (1) the allegedly failing firm would be unable to meet its financial obligations in the near future;
>
> (2) it would not be able to reorganise successfully under Chapter 11 of the Bankruptcy Act[1];
>
> (3) it has made unsuccessful good-faith efforts to elicit reasonable alternative offers of acquisition of the assets of the failing firm[2], that would both keep its tangible and intangible assets in the relevant market and pose a less severe danger to competition than does the proposed merger; and
>
> (4) absent the acquisition, the assets of the failing firm would exit the relevant market.

Australian and New Zealand precedents

The failing company argument has most recently been addressed by the Commerce Commission (in Decision 264; NZ Co-operative Dairy Co. Ltd and Waikato Valley Co-operative Dairies Ltd). The relevant paragraphs are:

12.03 No failing company exemption exists, as such, in the Commerce Act. The potential failure of the 'target' company may, however, raise issues relevant to the Commission's considerations. The rationale for the failing company doctrine is that, in the absence of the proposed acquisition, the supply from the target company would disappear from the market in any form and so would never represent any competition to the acquire. As noted in Watti/Jim Bull (Decision 85), the doctrine does not encompass the case in which the company continues to provide significant competition, albeit on a less vigorous basis, by being able to reorganise its affairs by selling off unprofitable assets, obtaining extra equity capital, or otherwise restructuring.

12.04 The Commission notes that the above concerns relate not to the potential failure of the target company per se, but to the potential withdrawal from market supply in the future of supply presently being channelled through the target company. In other words, the concern of the failing company argument is not with a specific competitor, but with the competitive process. The failing company test requires that the supply presently offered through the company in question would cease.

12.30 The Commission acknowledges that Waikato Valley has financial difficulties. However, it does not accept that, in the absence of a merger with NZ Dairy, the supply of Waikato Valley would disappear from the market in any form and thereby never represent any competition to NZ Dairy. The Commission emphasizes that its concern is with competition, not with a specific competitor. The Commission must look beyond the commercial future of Waikato Valley and instead look to whether the supply presently channelled through Waikato Valley would continue to be placed in the markets involved. While recognising the uncertainty that inevitably surrounds an forecast of future outcomes, the Commission is of the opinion that the likely outcome is that this supply would in the future continue to be placed in the markets, whether through Waikato Valley, a restructured Waikato Valley, or through other channels and organisations. The Commission does not consider that the acquisition of Waikato Valley by NZ Dairy is the only means by which the continuation of supply from the farmers now supplying Waikato Valley can be secured. Thus, the test implied by the failing company argument - that the supply would disappear without the acquisition - is not satisfied. Accordingly, the Commission concludes that the failing company argument cannot be construed to support the proposed acquisition or to remove competition concerns about this acquisition.

The Commission's decision in this case was overturned by the High Court of New Zealand but the Court left untouched the principles to be applied to the failing company issue. The Commerce Commission's reasoning is in line with that of the Trade Practices Commission in the WA News authorisation decision of 1990.

The failing company test

The essence of these various approaches to the failing company argument can be distilled into a simple test. The relevant test is not whether a company is likely to fail. The test is whether, without the acquisition, the supply presently coming from the company would no longer come to the market and its resources would no longer be employed in that market as a result of the failure of the company. If these resources would not continue to provide an actual or potential constraint in the market, allowing their acquisition by another market participant probably will not enhance the market power of the acquiring

company. In such a case, the acquisitions are unlikely to raise dominance or competition concerns under the Acts.

Investigation procedures

The following considerations provide an analytical framework for considering the failing company argument.

Is there a likely competition concern about the proposed acquisition? If the acquiring and acquired companies, after the acquisition, and without taking potential failure into account, are not dominant, or likely to be, or do not lead or are not likely to lead to a substantial lessening of competition then there is no need to eve look into failing company issues. The acquisition would not be opposed under either Acts.

(1) The analysis proceeds to the following steps only if the acquisition would appear to create or strengthen dominance or substantially lessen competition and so, prima facie, not meet the threshold tests set out in the Acts.

(2) Is the company being acquired already experiencing severe financial problems or likely to experience such problems? If so, are the problems of sufficient magnitude as to have the likely effect of causing the company to commercially fail and to cease operating?

(3) If the company is likely to continue operating - placing supply on the market and so representing a competitive presence - then the failing company argument stops here. It is only if the company is likely to cease operations that the analysis continues.

(4) Are the resources presently supplying the market via the target company, but likely to be released by the cessation of operations by this company, likely to exit the industry entirely or otherwise likely to cease to bring supply to the market in any form or through any channel?

(5) If the resources are likely to completely exit, to have no likely presence relative to the market of concern, then the failing company test is satisfied. Competition concerns that might in other circumstances have arisen from the acquisition can now be disregarded since the likely competitive effect of the acquisition, after detailed analysis, has been concluded to be no worse than if the acquisition did not proceed and the resources exited the market.

(6) The failing company argument can be accepted only if all of the requirements are present. In particular, both company failure and exit of resources from the industry must be satisfied before dominance or substantial lessening concerns from the acquisition can be dismissed. In any other circumstances, the failing company argument must be rejected.

Factors to be investigated

The investigation of company failure and of resource exit are matters for judgment, based on commercial fact and experience, rather than matters of formula. Nonetheless, there are factors that might be checked in the investigation. These factors are neither necessary nor exhaustive but they may be helpful in establishing directions for inquiry.

(1) In the Trade Practices Commission's decision relating to the proposed acquisition of the Daily News by Western Australian Newspapers Ltd (A90502, 10 September 1990) the Commission set out factors that it considered relevant to the investigation of the likelihood of commercial failure. These are:

(a) Is the potentially failing firm going to fail irrespective of whether or not authorisation is granted?

(b) What are the real causes of the failure of the firm (rather than concentrating on the current financial status of the firm)?

(c) What alternative solutions to a merger are available, e.g.
-- can the firm be successfully reorganised?
-- can new management be hired?
i.e. are there any less anti-competitive solutions internal to this firm?

(d) Is the proposed acquire the only available purchaser?

(e) What evidence is there that all good faith efforts have been made to find other potential acquirers, which might pose a less severe danger to competition?
(f) In order to prevent unique assets leaving the industry is the proposed acquire the least anti-competitive acquire available?

(g) Will the apparent cause of failure of the firm be addressed by the new acquire?

The Trade Practices Commission applied these factors in the context of authorisation. In a more general context a number of additional factors, some of which have been raised in the United States, may also have application. These are:

- Has the target neglected to take all possible measures to redeem itself, in the expectation of being able to take advantage of a failing company defence?
- Is the target insolvent in a bankruptcy sense (no net worth) or an equity sense (unable to meet its debts as they fall due)?
- What pre-existing links are there (for example, commercial, ownership) between the target and the acquire?
- Has there been a marked decline in sales which makes failure likely?
- Has the target sustained continuous losses and hence is it unlikely to trade out of its difficulties?
- Is the target a poor credit risk and unable to borrow funds in order to avert failure?
- How soon is the target likely to fail?
- Did the target make the first approach rather than the acquiring firm?
- Is the target being offered for sale as a liquidation prospect rather than a going concern?
- Are there reasonable alternatives other than outright sale?
- What is the general position of the industry, for example, is it a sunset or growth industry, and hence are there likely to be other buyers at a 'price'.
- Is the ultimate owner of the target viable?

(2) Questions that might be asked concerning exit include:

- Are there interested buyers waiting in the wings for the failing company?
- Are there recent instances of comparable companies being purchased and maintained as going concerns?
- Is it likely that existing revenues cover all except capital servicing costs so that a sale or a recapitalisation, by reducing such costs, would result in a viable company?
- Is it likely that, after sale or after restructuring and with new management, the company will increase revenues, reduce costs, or otherwise change so as to become commercially viable?
- Are critical resources, such as human resources, intellectual capital and technology, specific to the industry, likely to be available for use independently of the failing company?

(3) The time frame for the forecast must be specified. It is considered that forecasts of failure should be limited to the short-term future, the particular period being determined by the state of the firm and the industry and the typical parameters for transfer of resources.

Public benefit - authorisation

The failure of a company might be judged to involve public benefit considerations. For example, the closure of a plant might involve significant unemployment and disruption to an important industry or large city or region. Another issue could be that important technology could be threatened or leave the country. The Commissions might consider that the avoidance of such effects were public benefits.

Public benefit enters the acquisition test via the authorisation mechanism - s.67 of the Commerce Act allows authorisation if the net public benefit is judged to be positive, despite adverse dominance effects being judged to be likely. The Australian Act s.88 does likewise but with a substantial lessening of competition threshold.

Little more can be said in a general sense other than to note that if company failure is judged to have public benefit effects, then in an authorisation consideration, these effects must be taken into account together with the lessening of competition or dominance effects of the acquisition of the (possibly) failing company (as considered above).

NOTES

1. USC. 1101-1174 (1988).

2. Any offer to purchase the assets of the failing firm for a price above the liquidation value of those assets -- the highest valued use outside the relevant market or equivalent offer to purchase the stock of the failing firm -- will be regarded as a reasonable alternative offer.

   Source: US Merger Guidelines 1992; US Department of Justice and F.T.C.

CONTRIBUTION BY THE CANADIAN DELEGATION

Response of the Director of Investigation and Research Bureau of Competition Policy Canada

Question 1: Does your country have a statutory definition of the failing firm defence/exception? If yes, what is it?

There is no statutory definition of a failing firm in the Competition Act .However, Section 93 of the Act stipulates that in determining whether or not a merger or proposed merger prevents or lessens or is likely to prevent or lessen competition substantially, the Competition Tribunal may have regard to a number of factors. Subsection 93(b) specifically identifies one factor as whether the business, or a part of the business, of a party to the merger or proposed merger has failed or is likely to fail.

Question 2: If your country has merger guidelines please provide a copy of what they state concerning how the failing firm defence/exception will be interpreted and applied?

See Consumer and Corporate Affairs Canada, Merger Enforcement Guidelines, Director of Investigation and Research, Competition Act, Information Bulletin No. 5 (March 1991) (MEGS). Treatment of the failing firm is set out in section 4.4 (starting on page 26).

Question 3: If the answers to the above two questions do not sufficiently describe how case officers deal with the failing firm issue in the context of merger review, kindly outline your policy?

See the appropriate sections of the MEGS referred to in response to question 2.

Question 4: What is the economic rationale behind your country s treatment of allegedly failing firms in the context of merger review?

It is important to assess the financial health of the parties to a merger from a competition perspective because the loss of the actual or future competitive influence of the failing firm cannot be attributed to the merger or proposed merger where this competitive influence would have been eliminated by virtue of the failure. However, probable failure of a party to a merger is not sufficient to warrant a conclusion that the merger is not likely to prevent or lessen competition substantially. An assessment must be made of whether acquisition of the failing firm by a third party, retrenchment by the failing firm, or liquidation would likely result in a materially higher level of competition in the relevant market than if the merger proceeded.

While consideration of a failing firm is normally given in the context of the failing firm being acquired, the Canadian treatment of the failing firm issue as provided for in the Act, makes no distinction between this situation and one where the failing firm is the acquirer. Consequently, the underlying rationale of subsection 93(b) is equally applicable where the failing firm is the acquirer.

Question 5: What do case officers consider to be adequate proof that a firm is failing? Are third party opinions (accountants etc.) required? To what extent is the defence/exception wide enough to include "flailing" firms i.e. can it be successfully argued, for example, that without the merger one or more parties would be unable to raise required capital or to innovate sufficiently to remain an effective competitor in the future?

As specified in the MEGS, a firm is considered to be failing where it is insolvent or likely to become insolvent; it has initiated or is likely to initiate voluntary bankruptcy proceedings; or it has been, or is likely to be, petitioned into bankruptcy or receivership. Technical insolvency is considered to have

occurred when the liabilities of the firm exceed the realisable value of assets, or where a firm is unable to pay liabilities as they come due.

In assessing the likelihood of failure of a firm the Bureau of Competition Policy staff typically seek the following information:

-- the most recent audited financial statements, including notes thereto and qualifications in the auditor's report;

-- projected cash flows;

-- whether any of the firm's loans have been called, or further loans/credit advances at viable rates have been denied and are unobtainable elsewhere;

-- whether suppliers have curtailed or completely eliminated trade credit;

-- whether there have been persistent operating losses or a serious decline in the net worth or in the firms assets. Of course consideration has to be given to the fact that persistent losses may not be indicative of failure in situations where the firm has recently entered the market or in periods of significant economic recession, where losses are transitory;

-- whether such losses have been accompanied by an erosion of the firm‘s relative position in the market;

-- the extent to which the firm engages in off-balance sheet financing such as leasing;

-- whether the value of publicly traded debt of the firm has significantly dropped; and

-- whether the firm is unlikely to be able to successfully reorganise pursuant to Canadian or foreign bankruptcy legislation or through some voluntary arrangement with creditors.

Objective verification of theses matters is crucial. Independent auditing and preparation of financial statements of the failing firm are normally required. The Bureau will generally hire accountants on contract to provide the Director of Investigation and Research (the Director) with an independent assessment of the financial viability of the firm and an assessment of the party s claims with respect to failure.

The latitude afforded in assessing the likely failure of the firm is confined primarily to its current financial health and its expected viability in the near future. Considerations with respect to the ability of the firm to remain sufficiently innovative to remain competitive are normally outside the assessment of failure. It would be more appropriate to take such considerations into account when assessing whether the merger will lead to the removal of an effective and vigorous competitor (which is another factor to be considered by the Competition Tribunal that is set out in section 93(f) of the Act).

Question 6: Does your country's failing firm defence/exception apply to sales of divisions or other clearly separable portions of a business? If not, why not?

Yes.

Failing firm considerations are equally applicable to divisions or wholly-owned subsidiaries of a larger enterprise. However, in assessing claims of failing divisions or subsidiaries, particular attention is paid to transfer pricing, intra-corporate cost allocations, management fees, royalty fees, and other matters that may be particularly relevant in this context.

Question 7: When applying the failing firm defence/exception, do case officers restrict their attention to effects within the failing firm's market, or is the net cast wider to include all markets (i.e. the general equilibrium effects)?

The merger provisions of the Competition Act provide the Director with the mandate to examine mergers or proposed mergers to determine whether they will substantially lessen or prevent or are likely to substantially lessen or prevent competition in the relevant anti-trust markets affected by the transaction. Consequently from a practical standpoint, it is only relevant to assess the impact of failure of the firm on competition in those markets. Attempting to measure the full economy-wide welfare effects of a firm's failure is both difficult and unnecessary from an antitrust standpoint.

Question 8: In the same context as the previous question, in addition to competition effects, is account taken of the impact on factors such as employment, regional development , technological progress, etc. If the menu extends beyond competitive impact , is the range of concerns identical to factors considered at other points of the merger review ? If not, please explain?

See the answer to question 7.

Question 9: In order to benefit from a failing firm defence/exception, must the parties to a merger demonstrate that it is the least anti-competitive means available to keep failing firm assets dedicated to the market(s) where the merger would presumably have an anti competitive effect? If so, are those alternative means restricted to other mergers, or do they include liquidation of the firm? As regards alternative mergers, how well developed must those alternatives be, i.e. how vigorously and widely must the failing firm have been shopped around and by whom? If being shopped around is required , how are legitimate confidentiality concerns protected?

The fact that a firm which is party to a merger or proposed merger is failing is only relevant from the Canadian antitrust perspective if it has first been determined that, independent of the issue of failure, the proposed transaction would lead to a substantial lessening or prevention of competition in the affected markets. Once this and the fact that the firm in question is failing have been established to the Director's satisfaction, a deliberate effort is made to determine whether there exists alternatives to the merger or proposed merger which have a less anti-competitive effect on these markets. As mentioned earlier, an assessment must be made of whether acquisition of the failing firm by a third party, retrenchment by the failing firm, or liquidation would likely result in a materially higher level of competition in the relevant market than if the merger proceeded.

In assessing these options the Director will evaluate the efforts by the current owners of the failing firm to shop the firm. Where the Director is of the view that an adequate shop has not been undertaken he will compel the owners of the firm to perform such a shop. Normally the shop process will be conducted at the parties' expense by an independent agent approved by the Director. In determining whether an alternative purchasers exists, it is only necessary to establish that the alternative buyer would be willing to pay a price which net of the costs associated with making the sale, would be greater than the proceeds that would flow from liquidation, less the costs associated with such liquidation. This is generally referred to as the net price above liquidation value.

While every effort to maintain confidentiality would be made, clearly some important information would have to be disclosed. This would include the fact that the owners of the firm were seeking a buyer for the firm. It would also be necessary to provide some relevant financial data concerning the firm to prospective purchasers. While these purchasers can be bound by some confidentiality agreement, they normally will require access to enough information regarding the firm to determine whether they will make a bona fide offer to purchase.

Question 10: Is the Bureau of Competition Policy considering proposals to change either the legal basis for or current enforcement practice relating to the failing firm defence/exception? If so, please briefly describe the proposed reforms and outline what seems to have motivated them.

No.

Example 1:

Gemini Group Automated Distributions Systems Inc. and a Limited Partnership formed to combine the operations of the Reservec and Pegasus computer reservation systems

On June 1, 1987 Air Canada (AC) and PWA Corporation (PWA) merged their respective computer reservation systems (CRS) through a limited partnership. The management of this partnership was the responsibility of The Gemini Group Automated Distribution Systems Inc. (Gemini)., a wholly owned subsidiary of AC and PWA. Computer reservation system are a critical component of the distribution and sale of airline passenger seats to travel agents and the travelling public and have no effective substitutes.

At the time AC and PWA (through its subsidiary Canadian Airlines International limited (CAIL) operated the two largest scheduled airlines in Canada which collectively accounted for 93 percent of the Canadian market.1 Prior to the proposed transaction Reservec with approximately 72 percent of the CRS market (based on travel agent locations and CRS terminals) and Pegasus with approximately 18 percent were the largest CRS vendors in Canada. The three remaining CRS vendors were reported to collectively account for approximately 10 percent of the market.

On March 3, 1988 the Director filed a notice of application with the Competition Tribunal pursuant to section 64(1), now 92(1), for an order dissolving the limited partnership on the grounds that it substantially lessened or prevented competition in the provision of CRS services to airlines, travel agents and consumers in Canada. In support of this position the Director argued that:

-- The merger resulted in a substantial increase in market concentration, had reduced the number of significant CRS competitors in Canada from 3 to 2 and in many non-urban areas had eliminated competition completely.

-- This market dominance combined with the vertical integration of Gemini with AC and CAIL would ensure that Gemini would have a relative advantage over all other CRS vendors because AC and CAIL were hosted only on Gemini and there were no direct access links between these carriers and other CRSs.

-- Gemini could ensure its market dominance by blocking the entry and expansion of CRS vendors through its control of information regarding fares, schedules and seat availability on AC and CAIL flights and by refusing to pay booking fees for AC and CAIL flights booked on another CRS.

-- There were no effective substitutes with respect to the distribution of airline information to travel agents.

-- The merger eliminated the competitive pressure generated by Pegasus and Reservec. Additionally, it reduced the ability of Sabre to maintain or expand its market position 2.

-- The merger was also considered to have a significant impact on the level of competition in the Canadian scheduled airline industry. It was feared that competing airlines would have to host on the Gemini system and as a result face some bias in treatment and other disadvantages associated with hosting with a company owned and operated by the two largest airlines in the market.

-- The ability of Gemini to exclude, deter or raise the costs of entry for airline competitors of the partners Gemini was increased by virtue of the merger. Furthermore if this market power was exercised, the result would likely be a reduction in competition in Canadian airline markets.

In addition to other claims regarding the competitive effect of the merger, the parties responded to the application by claiming that Canada could only sustain one CRS vendor, and that Pegasus was a failing firm. In support of this claim they argued that:

-- within two years of its entry Pegasus had only been able to achieve a 7 percent market share, based on airline bookings. Even with an enhanced market share it could not achieve the critical mass necessary to survive.

-- in years prior to the merger Pegasus lost approximately $15 million and that additional losses of $7 million were projected for 1987.

-- converting Pegasus to a profitable business was not possible and if the merger had not occurred most of Pegasus business would have moved to Reservec.

In dismissing these claims that Pegasus was a failing firm the Director argued in reply that:

-- losses incurred by Pegasus were to be expected given the capital intensive nature of this industry which meant that firms entering this market required a period of years before a return on investment could be expected. Furthermore, the company had estimated that it would require three years and 1000 travel agents to break even back in 1984 when Pegasus entered the market. By June 1987 it had achieved 72 percent of this goal.

-- Pegasus actually achieved 16 to 18 percent market share within the three year period since it entered the market.

-- at the time of the Pegasus entry into the Canadian CRS market its owner CPAL had no more than 21 percent of the RPK market in Canada. The subsequent take-over of CPAL by PWA in 1986 gave Pegasus access to the CAIL market share which was estimated to be 44 percent in January 1988. The reported Pegasus losses and revenues described by PWA were questionable.

-- the agreement between PWA and AC to merge their CRS vendors was indicative that Pegasus had substantial value. Pegasus assets transferred to Gemini were estimated to be worth approximately $18.7 million.

-- Finally, if the Tribunal were to find that Pegasus was a failing firm, little weight should be given to this factor in this case because there was an alternative merger which was clearly less anti-competitive. This was a joint-venture between Sabre and Pegasus.

Ultimately the matter was resolved through a Consent Order agreed to by the parties and issued by the Competition Tribunal on July 7, 1989. The Consent Order set out a number of behavioural-type orders regarding the operation of Gemini and the rights of access by competitors and consumers to the services offered by Gemini.

Example 2:

Proposed acquisition of PWA Corporation (PWA) by Air Canada (AC)

On September 9, 1992 PWA accepted a merger proposal from Air Canada. This proposal was examined under the merger provisions of the Competition Act. Given the extremely high market share of the combined firm in the domestic airline market (about 96 percent of domestic airline passengers), combined with relatively high barriers to entry, the Director immediately initiated an inquiry under section 10 of the Act.

The most important question to be answered in this inquiry was whether or not PWA was a failing firm and if so, whether other alternatives existed to the proposed merger which were less restrictive of competition. The Director engaged a team of outside accountants to provide advise on the financial state of PWA, including the possibilities of downsizing operations or selling of international routes as alternatives to the proposed transaction. In addition, PWA was required to engage an investment banker to solicit interest among likely investors, as well as document its own efforts over the past two years to find additional investment capital.

Before the Director's examination was complete, AC abandoned the proposed transaction in November, 1992 on the basis that the combined debt load of the merged company would be unmanageable. PWA then turned to a proposed transaction with American Airlines which involved PWA withdrawing its hosting services from the Gemini partnership. After an intense legal battle, the PWA/American Airlines transaction was concluded in March, 1993.

CONTRIBUTION DE LA DÉLÉGATION FRANÇAISE

La réglementation française en matière de concentration ne comporte pas de dispositions spécifiques concernant les entreprises en difficulté. Toutefois cela ne signifie pas que cet aspect n'est pas pris en compte lors de l'examen des opérations de concentrations par les deux instances concernées, le Ministre de l'Economie et le Conseil de la Concurrence.

La procédure prévoit que le Ministre de l'Economie et lui seul peut saisir pour avis le Conseil de la concurrence d'une opération de concentration de nature à porter atteinte à la concurrence. Le Conseil doit apprécier si l'opération qui lui est soumise apporte au progrès économique une contribution suffisante pour compenser les atteintes à la concurrence.

C'est donc dans ce cadre que le Conseil de la concurrence peut examiner les cas de rachat d'entreprises en difficulté. L'aspect social est également central en ce qui concerne les entreprises en difficulté s'il n'entre pas dans les attributions du Conseil d'examiner cet aspect, le Ministre de l'Economie peut le prendre en compte dans le cadre de la subordination de l'opération à l'observation de prescriptions particulières.

En ce qui concerne le seul aspect économique, le sauvetage d'un outil de travail existant, de réseaux de distribution, ou le maintien d'un courant d'exportation sont incontestablement des facteurs à prendre en compte dans un bilan économique dans la mesure où ils apportent une contribution au progrès économique.

S'il n'existe pas de jurisprudence en la matière, tant issue d'avis du Conseil de la Concurrence que de décisions du ministre de l'Economie, la pratique ne diffère pas de celle d'autres organismes nationaux ou européens chargés d'examiner les opérations de concentration au regard des règles de concurrence.

Les parties à une concentration peuvent, en effet, mettre en avant, dans le cadre d'une notification ou à l'occasion des observations qu'elles sont amenées à déposer auprès du Conseil de la Concurrence de la Concurrence, que l'opération en question soit sauvera un fonds de commerce, soit assurera la pérennité d'une activité sur le territoire national.

Avant de prendre en compte une telle affirmation, il convient de s'assurer que le dommage effectivement causé à l'exercice d la concurrence sur le marché ou les marchés concernés n'est pas supérieur à l'avantage qui en résultera pour l'économie.

Dans ce but, avant d'examiner si la reprise d'une société en difficulté peut constituer un élément de progrès économique, il convient de s'assurer qu'il n'existe pas d'autres repreneurs avérés ou potentiels qui seraient en mesure d'assurer la survie de l'entreprise concernée à un moindre coût concurrentiel.

Il convient également de contrôler que la mauvaise situation financière mise en avant par les parties n'est pas conjoncturelle. Elle peut en effet être liée à des pertes exceptionnelles qui pourront être résorbées sans la nécessité de la prise de contrôle par l'entreprise candidate au rachat.

Enfin, et c'est un point essentiel, il convient de considérer si, en l'absence de la concentration, l'entreprise ou l'activité concernée disparaîtrait du marché, ce qui revient à dire que dans ce cas, la concentration ne modifiera pas la situation de la concurrence sur le ou les marchés concernés et peut donc être autorisée.

La situation précédemment décrite concerne les seules opérations qui ont fait l'objet d'une notification et/ou d'une saisine du Conseil de la Concurrence.

Le rôle de l'administration chargée de la surveillance de la concurrence est toutefois plus large puisqu'elle peut également proposer son expertise en matière de concurrence aux tribunaux de commerce lorsqu'ils sont chargés de trouver un repreneur à des entreprises en règlement judiciaire ou en liquidation.

CONTRIBUTION BY THE GERMAN DELEGATION

German competition law, unlike U.S. antitrust law, does not provide for a specific failing firm defence.

In a competition-based market economy, the market exit risk is a basic feature of the market process as is the chance of profit. Consequently, from a competition point of view, the market exit of any company is not to be seen in a more unfavourable light than a takeover.
Mergers where (at least) one of the enterprises involved would otherwise exit the market are therefore subject to the same legal provisions as all other mergers. In spite of the fact that (as a rule) they need to be dealt with speedily, the general procedural and notification requirements apply to them as well.

The Federal Cartel Office prohibits a merger only where it is likely that a market dominating position will be created or strengthened as a result of this merger, i.e. the merger is deemed to be the cause of the deterioration in the market structure. But if the enterprises concerned demonstrate that the merger also brings about improvements in the conditions of competition that outweigh the disadvantages of market dominance, the conditions for prohibition are not satisfied (weighing clause).
The main criteria for determining whether a merger based on the failing firm defence is admissible despite the creation or strengthening of a market dominating position are the requirement of a causal connection and the weighing clause.

Causal connection:

The failing firm defence argument is usually used in the context of the examination whether there is a causal connection between the merger and the anticipated worsening of the market structure: If a deterioration in the market structure takes place also without the merger, the merger obviously is not the cause of that deterioration.

In the Federal Cartel Office's view and according to its enforcement practice, a merger based on the failing firm defence can only be deemed not to be the cause of the anticipated worsening of the market structure, if the following conditions are met:

(a) the only alternative to a merger is the market exit of the failing company and
(b) it is to be expected that the market shares of the exiting firm will accrue to the acquirer in whole or to a considerable extent anyway and
(c) no alternative merger is possible that would pose a less severe threat to competition.

The burden of proving that those conditions are satisfied rests with the enterprises involved. Particularly in the case of friendly takeovers, the Federal Cartel Office has set high standards for the enterprises involved to prove that all conditions are met. Often it has been very difficult to demonstrate in a particular case that the conditions set out under (b) and (c) are satisfied.

As a rule a merger involves a situation where all market shares of the failing firm accrue to the acquirer. Where the only two competitors in a market merge, the Federal Cartel Office as a rule has held that the market shares of the failing firm can be assumed to accrue to the acquirer even without the merger. If more than two competitors are active in a market, this cannot be assumed that easily: for if one of the competitors disappears from the market, it is likely that his market shares will fall to all the remaining competitors, who can then compete for the orders formerly placed with their former competitor.

A crucial factor in the examination of the proposed merger finally is whether a competitively less harmful merger with another enterprise, which is willing and able to avoid the collapse of the failing firm, is possible. For this purpose, also potential competitors are taken into consideration that would possibly

enter the market only as a result of the merger. If there is a competitor posing a less severe threat to competition, the proposed merger is deemed to be the cause of the deterioration of the market structure.

Weighing clause:

For a merger to be authorised under the weighing clause provisions, the enterprises involved must prove that the proposed merger results in improvements in the conditions of competition that are so decisive as to outweigh the disadvantages of market dominance.

Only very rarely can it therefore be assumed that mergers based on the failing firm defence that result in market dominating-positions will bring about an improvement in the conditions of competition. As a rule such an improvement can be ruled out where instead of a smaller competitor the most powerful competitor in terms of market share or resources acquires the failing firm.

But also here the circumstances of each case and the pre- and post-merger market positions held by the merging competitors have to be considered.

CASE STUDY
SCHOTT GLASWERKE, MAINZ

Merger based on failing firm defence:

Acquisition of 100 percent share in Fernsehglas Tschernitz GmbH

In 1991, the west German firm Schott Glaswerke (Schott) notified its intention of acquiring all shares in the east German firm Fernsehglas Tschernitz GmbH (Tschernitz).

Set up in 1990, Tschernitz traces its origins to a state-owned firm in the former GDR. In 1991, Tschernitz was the property of Treuhandanstalt in Berlin, the trust agency in charge of privatisation. Schott belongs to Carl Zeiss Stiftung (with 1990 worldwide sales of DM 3.4 billion). Like Tschernitz, Schott, inter alia, manufactures glass for display screens, i.e. for colour TV screens and PC monitors.

Accounting for some 72 per cent of the relevant screen glass market, Schott occupied a dominant position in Germany in 1991, whereas Tschernitz had a market share of some 24 per cent (the remaining 4 per cent market shares were accounted for by imports). Even on the basis of a wider European market Schott had a high market share in absolute terms, with a considerable lead over its competitors.
Moreover, owing to product experience and diversification, Schott had a considerable lead in know-how. In addition, since market entry require high initial investments, entry barriers are high. Since the measurements of screen glass have to be tailored to the final products, very close relations have developed between the suppliers of screen glass and their tube producing customers, which further discourages market entry by potential newcomers.

The acquisition of Tschernitz would have strengthened Schott's dominant position in the market for screen glass and consequently would have had to be prohibited.

However, Schott's market dominance would have been strengthened even without the proposed merger:

On its own, Tschernitz was no longer viable. Its products no longer met technological and quality standards. Moreover, the firm's production facilities were obsolete, requiring high expenditure on replacement and new know-how. In 1991, Tschernitz products would not have sold unless its then owner, Treuhandanstalt, had accepted high losses. Considering its tasks, Treuhandanstalt was neither willing nor in a position to make available finance any longer. Without the merger with a viable firm, Tschernitz would have exited the market.

Schott was the only potential buyer of Tschernitz. Treuhandanstalt had a management consultant prepare a list of all essential company data to be mailed to all potential buyers (TV glass, glass, tube and TV set manufacturers). However, none of the domestic and foreign firms contacted signalled its readiness to take over Tschernitz. In spite of repeated follow-ups and press reports, Schott was the only potential buyer left. At the time, no domestic or foreign competitors were considered to be able to compete for what used to be orders or customers of Tschernitz. Schott alone would have been able to occupy the market position so far held by Tschernitz; in other words, following Tschernitz' market exit, its market shares would have fallen to Schott anyway.

In view of this situation the Federal Cartel Office held that the necessary causal connection between the proposed merger and the strengthening of Schott's market dominating position was absent. Therefore, the merger was not prohibited.

CONTRIBUTION BY THE IRISH DELEGATION

Background

In Ireland the control of mergers is subject to the provisions of the Mergers Acts 1978-87 as amended by the Competition Act 1991. The Mergers Acts do not contain any specific provisions for the failing firm defence. Under the Act responsibility for deciding whether or not to permit mergers involving firms above a certain size lies with the Minister for Enterprise and Employment. There are in fact no specific criteria set out in the Act on which the Minister must base his decision. Over the years the Department has published relatively little information regarding its assessment of mergers. Undoubtedly the threat that in the absence of a proposed merger, a firm might close down with a corresponding loss of employment is a factor which is taken into account when considering the proposed merger.

Where the Minister has asked the Authority to investigate a proposed merger under the Mergers Act, the Authority is required to give its opinion as to whether or not the 'proposed merger or takeover would be likely to prevent or restrict competition or restrain trade in any goods or services and would be likely to operate against the common good.' In addition the Authority is required to give its views on the likely effect of the merger or takeover on the common good in respect of:

(i) continuity of supplies or services;
(ii) level of employment;
(iii) regional development;
(iv) rationalisation of operations in the interests of greater efficiency;
(v) research and development;
(vi) increased production;
(vii) access to markets;
(viii) shareholders and partners;
(ix) employees;
(x) consumers.

This is clearly a rather diverse list although some of these factors would raise failing firm type issues. The only merger to be examined by the Authority since 1991 did involve the failing firm issue. Some details of this case are set out below.

There is some uncertainty as to whether mergers in Ireland might also be subject to the provisions of the Competition Act prohibiting anti-competitive agreements and abuse of dominance. The Authority, in a number of decisions, has indicated that it believes that mergers are subject to the Act and, to date, this view has not been challenged in the courts. In assessing mergers notified to it under the Competition Act, the Authority has, on several occasions considered the failing firm issue. As a result of these decisions it has set out, to some extent, its approach to this issue. Each of these cases is summarised below.

The Sunday Tribune Case

This is the only merger which has been investigated by the Authority following a referral by the Minister under the provisions of the Mergers Acts as amended by the Competition Act. The Authority submitted its report to the Minister on 20 March 1992. The case involved a proposal by Independent Newspapers plc to increase its shareholding in the Sunday Tribune newspaper from 29.9 percent to more than 50 percent. Independent Newspapers is the largest newspaper group in the State. The Tribune had been in a parlous financial position for some time. Over the previous 12 to 18 months its situation had worsened drastically due to the ill-fated launch of a weekly freesheet newspaper. In the absence of new sources of funding there was a distinct possibility that the Tribune would be forced to close.

The Authority concluded that the relevant market was that for Irish Sunday newspapers. Within this market it noted that the two largest selling newspapers were those already owned by Independent Newspapers and that together these accounted for 60 percent of Irish Sunday newspaper sales. It noted that, if the Tribune was added to this, the combine share of the three newspapers would increase to 71 percent. Although almost one third of newspapers sold on Sunday were UK newspapers, the Authority believed that these were not part of the same market. Multiple newspaper purchase was a common feature particularly in the case of Sunday newspapers so that in effect many UK Sunday newspapers were purchased as a second paper to an Irish newspaper.

The majority of the Authority concluded that the proposal would prove to be anti-competitive and recommended to the Minister that he make an Order preventing Independent Newspapers from increasing its shareholding. The majority recognised that, on the basis of the information supplied, there was a real risk that the Tribune would be forced to close. A considerable amount of financial information had been presented indicating the serious financial difficulties facing the Tribune. These indicated that it was losing considerable amounts of money and it appeared that there was a distinct possibility that the newspaper might cease trading. The majority of the Authority concluded, however, that even were it to close there was a strong possibility that the niche which it had occupied in the market would be filled by the emergence of a new paper not subject to the control of Independent Newspapers. Were the Tribune to be acquired by Independent the majority felt that the prospects for the emergence of a new newspaper would be greatly reduced. It was felt that, under the circumstances closure was preferable to a further increase in market concentration.

The Minister made an Order preventing Independent Newspapers from increasing its shareholding in the Tribune. This has been appealed to the courts by Independent Newspapers and the Tribune but this appeal has yet to be heard. The Tribune has continued to record substantial losses, but these have been largely financed by loans from Independent Newspapers.

Irish Distillers Group plc/Cooley Distillery plc

This involved a decision by the Competition Authority under Section 4 of the Competition Act concerning an agreement whereby Irish Distillers Group (IDG) agreed to make an offer for the whole of the existing share capital of Cooley, subject to obtaining valid acceptances for shares representing more than 50 percent of such issued share capital and to certain other conditions. (Authority decision no.285, 25 February 1994). The letter of agreement was 'agreed and accepted for and on behalf of Cooley Distillery plc' by its directors.

IDG is a wholly owned subsidiary of Pernod Ricard and is the major producer of Irish whiskey. Indeed prior to the advent of Cooley, IDG had been the only producer of Irish whiskey for many years. Cooley was incorporated on 30 September 1987 and acquired an alcohol plant owned by a state company, Ceimici Teo, which was in liquidation. It began distilling whiskey and other spirits with whiskey being its major product. The development of the Cooley distillery was, in large part, financed by raising equity finance under the Business Expansion Scheme which provided tax incentives for individuals to invest in certain types of business. Essentially Cooley sold whiskey to these firms and they stored it until maturation. After a period of five years the BES companies were to sell the matured whiskey back to Cooley. The funding raised by such companies under the BES scheme provided the working capital for Cooley to produce and mature its whiskey. Changes introduced to the BES regulations in 1991 prevented Cooley and the BES companies from raising further funds from this source. As a result both Cooley and the BES companies had to rely on bank borrowing for their ongoing working capital requirements. This had the effect of increasing Cooley's funding costs and depriving it of necessary cash. The distilling operations were closed down in early 1993 due to the company's financial problems. At that stage 5.8m litres of whiskey had been distilled and warehoused.

Total losses up to December 1992 were £695,000. Cooley was due to buy back whiskey stocks from the first of the BES companies in early 1994 but its financial problems meant that it was unlikely to be able to do so. The parties argued that Cooley was in financial difficulties and that it had been for sale at various stages since 1991. They submitted a number of articles from various newspapers in support of these claims. At meetings with the Authority the Directors of Cooley and their financial advisors stated that numerous attempts had been made to find buyers for the firm but these had proved unsuccessful. They submitted that the working capital requirements for maturing whiskey stocks were particularly onerous. Although Cooley had made extensive use of the BES scheme to finance its operations, changes in the legislation had forced it to incur substantial borrowing and its ability to obtain additional funding was severely constrained. It was argued that to obtain markets and contracts for its new brands Cooley would have required considerable additional financial resources. It was also submitted that Cooley could not survive unless it was purchased by a major international drinks company. Its efforts to find a partner or to secure additional long term funding had not proved successful and, given its obligations to the BES companies, this had encouraged the directors to negotiate the sale of the business.

IDG expressed concern that the financial difficulties besetting Cooley could lead to the disposal of whiskey stocks which could be sub standard and that this would damage the image of Irish whiskey overseas, thereby having an adverse effect on IDG itself. IDG argued that Cooley, together with the BES companies, had accumulated substantial stocks of whiskey for which no significant market had been developed. They stated that, in their view, the stock was not suitable for any purpose other than sale as a bulk ingredient product. IDG's stated intention was that the Cooley plant should remain closed. IDG's Chief Executive was asked by the Authority to explain why IDG had chosen to pay a total of £24.5m for plant it would not use, brand names it would not use, and whiskey stocks which they expected would inevitably come on the market at a lower price. He agreed that IDG did not need and could not use the plant, but wanted to stop anyone else using it. The Authority concluded that the arrangements had the object and the effect of preventing or restricting competition.

The Authority recognised that the situation was complicated by Cooley's financial difficulties. It cited the US Department of Justice Merger Guidelines on the failing firm defence. It was clear that there was virtually no prospect of Cooley raising the necessary funds to continue in operation and to promote its products on international markets. Nevertheless, the Authority concluded that, if the arrangements proceeded, any possibility of Cooley becoming a competitor would have been eliminated, while it was unlikely that any other new entrant would emerge. It noted that the acquisition would not result in the retention of the assets within the industry since IDG's stated intention was to close Cooley's production and storage facilities. In the Authority's view, if Cooley were to survive this would certainly enhance competition in the whiskey market. On the basis of various submissions received and newspaper reports, the Authority concluded that there was a very real possibility that, in the absence of its acquisition by IDG, Cooley would be able to secure distribution deals for a number of major international markets and that such deals would provide additional funding for the company. It also received a submission from parties representing an alternative buyer of the company. The Authority recognised that Cooley had previously failed to attract a partner to provide the necessary funds to develop its business but that this may have been due to the fact that it was worth more to IDG than to any other drinks producer. This did not mean that if the arrangement did not go ahead no other buyer would be found for Cooley and it would inevitably close. In the Authority's opinion, there was a reasonable prospect that an overseas drinks producer would be interested in having an Irish whiskey operation within its portfolio of activities and, if IDG were not a potential buyer, Cooley could be acquired by another firm, albeit at a lower price. Indeed the fact that IDG was prepared to pay an inflated price to acquire Cooley and its assets and the fact that among the reasons given by its Chief Executive for doing so was to ensure that no one else could acquire the plant, suggested that IDG at least considered that there was a possibility of Cooley being purchased by someone else. On balance, while the Authority recognised that the survival of Cooley was by no means certain, it remained a distinct possibility.

Following the Authority's decision the proposed arrangement did not proceed. While it appears that other parties have looked at the possibility of acquiring Cooley, no one has yet done so. Cooley has continued to trade, however, and over the past 12 months has concluded distribution deals in respect of the domestic market and a number of major international markets including the US, Germany and France.

Barlo/Veha

This decision related to an agreement notified to the Authority for the sale by Veha of its business of designing and manufacturing radiators for use in central heating systems in domestic and commercial premises to Barlo. (Authority decision no. 302, 25 March 1994). Under the terms of the sale, Barlo purchased the property, business assets and goodwill of the business together with the benefit of certain contracts, but not the actual company or its liabilities. The business assets essentially consisted of the plant and equipment.

Both Barlo and Veha accounted for more than 30 percent of the market for radiators within the State and their combined market share exceeded 70 percent. No other supplier accounted for more than 10 percent of the market. In the Authority's opinion, however, there were no particular barriers to entry in this market. Nor did the Authority believe that, in this instance, transport costs would be such as to create a barrier to entry for imported products. It was relevant that Veha and Barlo exported a significant proportion of their output to other EU countries and that a significant proportion of sales in Ireland was attributable to imports. The Authority believed therefore, that the presence of other producers located within Ireland, and in other EU countries would be sufficient to maintain competition in spite of the fact that, following the acquisition, Barlo would have a preponderant share of the market. The Authority did not believe that the acquisition would have the effect of preventing, restricting or distorting competition within the State.

The Authority noted that Veha was in financial difficulties and that Kingspan was disposing of the business because it did not wish to incur further losses. In effect Veha was a failing division. In the absence of the sale of the business to Barlo, the closure of the plant was a likely prospect. Were Veha to close then the degree of market concentration would increase anyway, although perhaps not to the same degree as was likely as a result of the acquisition. The Authority accepted that, given its continuing losses, were Veha not to be acquired by Barlo then it would have faced imminent closure. The plant had a chequered history, with a number of owners having failed to operate it profitably. In these circumstances the Authority believed that there was little prospect of the plant being acquired by someone other than Barlo, or of it continuing in operation under its present ownership. In addition the Authority believed that the acquisition of Veha by Barlo would result in the assets of the business being retained in the radiator industry. Although the failing firm issue was not decisive in this instance it nevertheless was a factor in the Authority's decision.

Conclusions

Although there is no legislative basis for the so-called failing firm defence, the Competition Authority has indicated, both in respect of investigations referred to it by the Minister under the Mergers Act, and in its own decisions under the Competition Act, that it is a relevant factor that needs to be considered in deciding whether or not a merger might be regarded as anti-competitive. In its decisions under the Competition Act the Authority has sought to provide business with some indication of how it considers such arguments. In the case of Cooley and of Veha the Authority took account of the likelihood of an alternative buyer being found. It was clear in Cooley that, in the Authority's view, an alternative buyer, albeit one offering a lower price would be preferable to an acquisition by a dominant firm. The Authority also concluded in that case that it was preferable to have a weak firm remain in business if possible. Thus it did not widen the scope of the failing firm defence to include the 'flailing' firm, i.e. one

that could not compete effectively due to lack of resources as opposed to one that was likely to become bankrupt. The Authority has indicated that the prospects that the assets of the failing firm will be retained in the industry as a result of the merger are a factor to be taken into account. It has not considered the failing firm argument in a general equilibrium context.

The Authority's views have evolved on an ad-hoc basis in a number of individual cases. These decisions are all of relatively recent origin. It may be that the Authority's views will be subject to further refinement in the future.

CONTRIBUTION BY THE JAPANESE DELEGATION

1. Does your country have a statutory definition of the failing firm defence/exception? If yes, what is it?

The Japanese Antimonopoly Act (hereinafter referred to as the "AMA") has no provision for defining the failing firm defence/exception.

2. If your country has merger guidelines, please provide a copy of what they state concerning how the "failing firm" defence/exception will be interpreted and applied.

The JFTC discloses its policy for treating failing companies in the "Administrative Procedure Standards for Examining Mergers, etc. by Companies" (The Executive Bureau, Fair Trade Commission, July 15, 1980, revised on August 18, 1994, hereinafter referred to as the "Administrative Procedure Standards") as follows:

"III. Matters to be considered in the examination of selected mergers

1. Horizontal mergers

(2) Situation regarding competition, etc., in the relevant market where the parties concerned operate

c. Overall business capabilities, etc., of the companies concerned

The degree of effect on competition in the relevant market by:

- the overall business capabilities of the merging companies such as their ability to procure raw materials, technical resources, marketing capabilities and access to credit;

- their business situation (including their degree of poor business performance);

- their efficiency.

(Note 2) 'Their business situation' will note the degree of competitiveness of the merging companies by measuring their financial conditions including whether their business performance is good or poor.

Furthermore, should there be a good probability of one of the merging companies going bankrupt in the near future, obliging it to withdraw from the market after various means for financial recovery were found to be difficult, there is usually little fear that such a merger, as help to the failing company, would pose a problem under the Antimonopoly Act. However, if the other party to the merger is an influential company, it is possible that the merger may pose a problem under the Antimonopoly Act.

VI. Application *mutatis mutandis* to acquisition of business, etc.

1. The preceding Parts, from I to V, are applied *mutatis mutandis* to acquisitions of business, etc."

The Administrative Procedure Standards for Examining Stockholding by Companies (The Executive Bureau, Fair Trade Commission, September 11, 1981, revised on August 18, 1994) states that it also employs the same principle.

4. What is the economic rationale behind your country's treatment of allegedly failing firms in the context of merger review?

The fact that the companies concerned have failed does not mean that the merger and acquisition should be exempted from the application of the AMA but merely that it should be one factor that the JFTC takes into consideration when it judges whether the merger may substantially restrain competition in the relevant market.

Although in some cases the bankruptcy of a firm not accorded a relief merger may serve to promote market competition, there are other cases where relief mergers are unlikely to substantially restrain competition. This is because the pre-merger market share of the absorbed company will not necessarily increase the share of the absorbing company, given that the performance of the absorbed company has normally declined and because the absorbing company will be adversely affected by taking over the defects of the failed company such as excessive equipment and employment, causes of the absorbed company's failure. The Administrative Procedure Standards, referring to the latter case, says, "there is little fear that such a merger, as help to the failing companies, would pose a problem under the Antimonopoly Act. However, if the other party to the merger is an influential company, it is possible that the merger may pose a problem."

5. What do case officers consider to be adequate proof that a firm is failing? Are third party opinions (accountants etc.) required? To what extent is the defence/exception wide enough to include "flailing" firms, i.e. can it be successfully argued, for example, that without the merger, one or more parties would be unable to raise required capital or to innovate sufficiently to remain an effective competitor in the future?

The JFTC judges whether there is a good probability of the company going bankrupt in the near future, obliging it to withdraw from the market after various measures for financial recovery were found to be difficult, taking into consideration the financial situation, future prospects, etc., of the company.

The JFTC does not require a third party's opinion on its judgement.

6. Does your country's failing firm defence/exception apply to sales of divisions or other clearly separable portions of a business? If not, why not?

With respect to merger and acquisition of the entire part of a business, the JFTC judges whether there is a good probability that the company, as a whole, will go bankrupt in the near future, obliging it to withdraw from the market after various means for financial recovery were found to be difficult. On the other hand, regarding acquisition of a part of the business, the JFTC judges whether there is a good probability of the division withdrawing from the market in the near future after various means for financial recovery were found to be difficult.

7. When applying the failing firm defence/exception, do case officers restrict their attention to effects within the failing firm's market, or is the net cast wider to include all markets (i.e. the general equilibrium effects)?

As described above, the JFTC judges whether the proposed merger and acquisition may substantially restrain competition in the "relevant market". Therefore, it limits its examination to considerations of the effects on the market of the failing company.

8. In the same context as the previous question, in addition to competition effects, is account taken of impact on factors such as employment, regional development, technological progress, etc. If the menu extends beyond competitive impact, is the range of concerns identical to factors considered at other points of the merger review? If not, please explain.

The JFTC does not take into consideration such political factors as employment, regional development and technological progress.

9. In order to benefit from the failing firm defence/exception, must the parties to a merger demonstrate that it is the least anti-competitive means available to keep failing firm assets dedicated to the market(s) where the merger would presumably have an anti-competitive effect? If so, are those alternative means restricted to other mergers, or do they include liquidation of the firm? As regards alternative mergers, how well developed must those alternatives be, i.e. how vigorously and widely must the failing firm have been shopped around and by whom? If being shopped around is required, how are legitimate confidentiality concerns protected?

The companies concerned are not obliged to demonstrate that the merger would have the least anti-competitive effects.

As mentioned above, the JFTC examines and judges whether the proposed merger may substantially retrain competition "in the relevant market".

In the course of the examination, the JFTC considers possible reconstruction of the failing company through measures provided by the related laws such as the Company Reorganization Act or through alternative mergers by other companies, after examining its effect on market competition, as a means of judging whether "various means for financial recovery are found to be difficult" as described in the Administrative Procedure Standards.

10. Is the competition agency seriously considering proposals to change either the legal basis for or current enforcement practice relating to the failing firm defence/exception? If so, please briefly describe the proposed reforms and outline what seems to have motivated them.

The JFTC is not considering changing its legal treatment or its enforcement policy regarding the failing company defence/exception.

ATTACHMENTS

Administrative Procedure Standards for Examining Mergers, etc. by Companies

(Extracts)

III. Matters to be considered in the examination of selected mergers

1. Horizontal mergers

(2) Situation regarding competition, etc., in the relevant market where the parties concerned operate

c. Overall business capacities, etc. of the companies concerned

The degree of effect on competition in the relevant market by:

- the overall business capabilities of the merging companies such as their ability to procure raw materials, technical resources, marketing capabilities and access to credit
- their business situation (including their degree of poor business performance)
- their efficiency

(Note 2) "Their business situation" will note the degree of competitiveness of the merging companies by measuring their financial conditions including whether their business performance is good or poor.

Furthermore, should there be a good probability of one of the merging companies going bankrupt in the near future, obliging it to withdraw from the market after various means for financial recovery were found to be difficult, there is usually little fear that such a merger as to help the failing company would pose a problem under the Antimonopoly Act. However, if the other party to the merger is an influential company, it is possible that the merger may pose a problem under the Antimonopoly Act.

1. Acquisition of stock in Shinano Tokki Ltd., by Nippon Densan, Ltd. (1989)

This was a case in which Nippon Densan, Ltd., which holds an influential position in the market for motors used in magnetic disk drives, intended to acquire 100 percent of the stock in Shinano Tokki Ltd., a competitor which had run into financial difficulties, to support the latter's restructuring efforts.

While the acquisition would result in a joint relationship between the two companies and they would together almost completely monopolize the market for hard disk drive motors (hereinafter referred to as "HDD motors"), manufacturers that are engaged in in-house production of HDD motors are active in selling their products to outside customers and there are specific plans for new entries from other industries. Additionally, there are influential domestic competitors in the combined market for magnetic disk motors, including both floppy disk drive motors and HDD motors, and the two companies' share in total domestic shipments would be no more than about 15 percent. Finally, no other enterprise is likely to be able to provide support for Shinano Tokki Ltd.

Taking these points into consideration, the JFTC held that the intended acquisition would not substantially restrain competition in their particular field of trade.

2. Merger of San-in Godo Bank, Ltd. and Fuso Bank Ltd. (1990)

In this case, San-in Godo Bank Ltd. and Fuso Bank Ltd., both regional banks, were to merge for the purpose of reinforcing their business structure by streamlining and integrating their branch networks.

The merged company, in terms of its share in the total financial market, would be in the top position in Shimane Prefecture in deposits, with a 32.8 percent share (an increase of 1.5 percent) and in lending, with a 49.4 percent share (an increase of 2.8 percent), and also the top position in Tottori Prefecture in deposits, with a 30.6 percent share (an increase of 6.6 percent) and in lending, with a 47.8 percent share (an increase of 11.5 percent). It would also substantially expand its share in 13 cities, towns and villages. But, the branches of the banks which were to merge in the cities, tows and villages where their combined share would substantially increase were scheduled to be transferred to other financial institutions, and the Ministry of Finance decided to be flexible when considering the opening of new branches by financial institutions other than the banks which were to merge. This merger was largely intended to help out Fuso Bank Ltd., whose prospects for future business had become precarious due to the increasing liberalization of the financial market, and it would be very difficult to find any other appropriate merger partner than San-in Godo Bank Ltd.

Taking these points into consideration, the JFTC held that the intended merger could not be expected to restrain competition substantially in the particular field of trade.

3. Acquisition of business by Yanmar Noki Ltd. from Ishikawajima Shibaura Kikai Ltd. concerning the marketing of agricultural machinery (1991)

Yanmar Noki Ltd. would acquire the marketing end of the agricultural machinery business from Ishikawajima Shibaura Kikai Ltd. with the aim of working together in the development, production and marketing of agricultural machinery in Japan, and also consolidating marketing activities in the hands of Yammar Noki, Ltd.

Yammar Noki, Ltd. is a major manufacturer in the agricultural machinery industry, and Ishikawajima Shibaura Kikai Ltd. is a specialized manufacturer mainly of tractors, among other agricultural machinery.

After the intended acquisition of business, the resulting increase in market share would be slight, although Yamnar Noki, Ltd. would have more than 25 percent share in the markets in four main categories of agricultural machinery (tractors, cultivators, combines and binders), and more than 20 percent share in the market for rice planting machines, and its position would rise to the second or third place in each market. Furthermore, there were influential domestic competitors, and the domestic sales of Ishikawajima Shibaura Kikai Ltd. were declining.

Taking these points into consideration, the JFTC held that it could not be expected to substantially restrain competition in this particular field of trade.

4. Merger of Iyo Bank Ltd. and Toho Sogo Bank Ltd. (Mutual Savings Bank)

In this case, Iyo Bank and Toho Sogo Bank, both with head offices and main business activities in Ehime Prefecture, merged for the purpose of relieving and rescuing the Toho Sogo Bank which was floundering. While the post-merger bank would have the highest market share in terms of total deposits (29.6 percent) and balance of loaned money (41.3 percent) within Ehime Prefecture, the increase in market share was not large as a whole. The purpose of the merger was to avoid the bankruptcy of the Toho Sogo Bank; it would be very difficult to find any other appropriate merger partner than Iyo Bank. In specific local areas where the new bank's market share would rise substantially, measures would be implemented

for the transfer of branches to other financial institutions. Taking these points into consideration, the JFTC held that the merger would not substantially restrain competition in any specific field of trade.

5. Merger of satellite communications operators

In this case, the satellite communications operators, Japan Communication Satellite Co., Ltd., (JCSAT) and Satellite Japan Ltd., (SAJAC) intended to merge with a view to rationalize their equipment, among other purposes. There are three satellite communications operators in Japan, including JCSAT, Satellite Communications Co., Ltd. (SCC) and the still-inoperative JCSAT, along with Nippon Telegraph and Telephone Corporation (NTT), which utilizes JCSAT's lines and also provides satellite communications services.

Regarding this case, the JFTC considered that, although the merged company would hold the top position among satellite communications operators, the merger would not significantly restrict competition in certain areas of transactions, particularly in view of the following three points:

(1) Judging from the business prospects of SAJAC, it would have been difficult for SAJAC to independently maintain the necessary equipment and engage in business activities, and this case can be seen as being a rescue of SAJAC, whose business prospects had become rather difficult. Moreover, there would have been little likelihood of finding a more suitable merger partner than JCSAT.

(2) An examination of the specific satellite communications service offered by JCSAT, in the context of its competition with other satellite communication operators, reveals that SCC is in a superior position in a number of areas.

(3) The merged company would still be in competition with NTT's satellite communications service as well as with services utilizing ground lines.

CONTRIBUTION BY THE NORWEGIAN DELEGATION

Under the Norwegian Competition Act, the Norwegian Competition Authority may intervene against acquisition of enterprises if the acquisition will create or strengthen a significant restriction of competition contrary to the objective of the Act. The objective of the Act is to achieve economic efficiency by providing the necessary conditions for effective competition.

The merger guidelines

The Norwegian Competition Authority recently issued Merger Guidelines. By merger is also meant acquisition of all or parts of the shares of enterprises. The Guidelines are fashioned as a procedure where the merger in question must pass through four stages in order for the Competition Authority to take action against the merger.

At stage one the relevant market is delineated and the market concentration calculated. If the market concentration is lower than certain thresholds the investigation will normally end and no intervention will be undertaken against the merger.

At stage two the competitive effects of the merger is analysed under the presumption that no market entry or exit will take place. If the merger is not likely to create or strengthen a significant restriction of competition in the relevant market, unilaterally or through increased ability of the remaining independent firms to co-ordinate their activities, no intervention will be undertaken.

At stage three entry and exit conditions in the market are analysed. If new entry to the market is likely to occur within two years on a large enough scale to make a non-transitory price by the merged entity unprofitable, the merger will not create or strengthen a significant restriction of competition and the Competition Authority will not intervene against the merger. Similarly, no intervention will be undertaken if it is unlikely that the merger will restrict competition because one of the merging firms is failing.

At stage four efficiencies through mergers are evaluated. If the efficiency gains (mainly in production and distribution) are considered to be bigger than the (allocative) efficiency losses, the merger will not lead to a decrease in overall economic efficiency, and the Competition Authority will not intervene against the merger.

The failing firm defence is described in chapter seven of the merger guidelines:

"The term ’failing firm’ is used to denote an acquired firm which is about to exit the market due to financial problems. If the acquired firm is in a position where sustained operation is impossible, the merger will probably not create or strengthen a significant restriction of competition, since the acquired firm in any event will exit the market in the near future.

Indications of failure is that the firm:

-- is insolvent or is likely to become insolvent,
-- has initiated or is likely to initiate voluntary bankruptcy proceedings, or has been, or
-- is likely to be, petitioned into bankruptcy.

The merging parties must establish the likelihood that a cessation of the activities of the failing party will soon occur, and there must be no other buyers of the assets that are deemed to be preferable from a competition policy point of view.

Even if the acquired firm will not become bankrupt in the near future it may wish to exit the relevant market for other reasons, for instance because of unsatisfactory profit margins. However, it will be difficult for the parties to demonstrate that the acquired firm is likely to exit the market or that it is not possible to sell the assets to a third party. Assertions of exit on such grounds will normally not qualify for the firm to be called failing."

Even though the failing firm defence enters into the analysis at stage three, it is sometimes considered at the beginning of the investigation. If a possible anti-competitive merger is proposed and the failing firm defence invoked, the Competition Authority will normally start by considering whether one of the merging parties is failing. If the firm is failing the analysis will end. If there are some doubts about the failing firm defence, the analysis will go on. The doubts might later on add to other doubts, e.g. doubts about the anti-competitive effects of the merger, possibly leading to a conclusion that the overall effects of the merger do not warrant an intervention.

This means that even if the guidelines' strict indications of a failing firm are not fulfilled, any doubts about the failing firm defence might play a role in the analysis of the overall competitive effect of a merger. This was exactly what happened in the following case example.

A case example from the beverage market[1]

In the Norwegian beverage market all breweries also produce soft drinks and the largest breweries are also the largest soft drink producers.

In 1988 Nora, the largest Norwegian producer of beer and soft drinks, held a market share of 62 percent in the Norwegian beer market and 52 percent in the soft drink market. Nora was particularly dominant in the eastern part of Norway (the Oslo region). Tou was a smaller producer of beer and soft drinks, having 8 percent of the Norwegian market for both beer and soft drinks. However, Tou was a dominant producer in the Norwegian south-western markets (the Stavanger region), having market shares of 80 percent for beer and 60 percent for soft drinks. Nora and Tou were competitors in the eastern and south-western parts of Norway.

In 1990 Nora and Tou agreed to merge. The Price Directorate held that because the merger eliminated an existing or a potential competitor, the merger would strengthen a significant restriction of competition both for beers and soft drinks, and in some regional markets even create a monopoly.

Both the managers and the employees of Tou were in favour of the merger. It was argued that Tou was a failing firm. Even if the operation of the firm for the moment yielded a surplus, it would allegedly be impossible in the long run to recoup the high financial costs due to a recent investment in modern brewery facilities. The board of Tou had concluded that the firm would not survive unless it merged with another firm as soon as possible.

The Price Directorate considered a cessation of production to be unlikely in the foreseeable future. In its annual report Tou had indicated that last year's deficit was likely to be turned into a surplus in 1990. Their brewing facilities were modern, enabling low-cost production of beers and soft drinks. Through the introduction of Carlsberg, a Danish beer produced on license, and by taking advantage of idle production capacity, Tou was supposed to be able to expand geographically. The Price Directorate did not consider Tou to be a failing firm.

Even if the failing firm defence should apply, the Price Directorate considered Tou to be an attractive investment for other investors. If the price was low enough Carlsberg was willing to take over Tou. Hansa, the beer and soft drink producer located in the western parts of Norway (the Bergen region), had previously proposed to take over Tou. The Directorate held both Carlsberg and Hansa to be preferable

investors from a competition policy point of view, irrespective of the possibility that the intervention might mean that the owners would get a considerably lower bid for Tou.

Under the former Act the Price Council, an independent collegial body, had a vested authority to intervene against mergers. The Price Directorate recommended that the Council intervene against the merger. A majority of the Council disagreed. Even if Tou was not failing for the moment, the majority considered that Tou in the long run would not be able to survive as an independent company. The only realistic alternative was a take-over by Hansa. Both alternatives would mean a strengthening of a significant restriction of competition. However, a merger between Tou and Nora would not be substantially worse in this respect than an acquisition by Hansa of Tou.

Consequently, the Price Council did not intervene against the merger.

NOTE

1. The Price Act of 1953, which from 1988 contained provisions on merger control, was in force at the time the case below was being considered. Under the statute currently in force, the Competition Act of 1993, the Competition Authority has the power to intervene and make decisions which can be appealed to the Ministry of Government Administration.

CONTRIBUTION BY THE SLOVAK REPUBLIC

The Antimonopoly Office of the Slovak Republic (the Office) has not yet considered a concentration where the failing firm defence had to be considered. In the Slovak Republic this issue is closely linked to privatisation and firm restructurings. The future viability of firms or threat of failing is considered in privatisation plans both for whole sectors and individual firms. Since the transition to a market economy will unavoidably lead to the bankruptcy of certain inefficient firms, a failing firm defence should probably not be accepted in all cases where it is pleaded.

Answers to the Secretariat's questions follow.

Q1: Does your country have a statutory definition of the failing firm defence/exception? If yes, what is it?

R1: The act No. 188/1994 Coll. of Laws on Protection of Economic Competition (Competition Act) does not explicitly provide a failing company defence. The test to be applied to prospective mergers involves balancing the effects on competition and the overall economic advantages resulting from a concentration. In the framework of this general regulation it is possible to consider a failing firm defence in exceptional cases.

Q2: If your country has merger guidelines, please provide a copy of what they state concerning how the "failing firm" defence/exception will be interpreted and applied?

R2: See R 3, 5 and 6 below.

Questions 3, 4, 5, 6 and 7:

Q3: If the answers to the above two questions do not sufficiently describe how case officers deal with the failing firm issue in the context of merger review, kindly outline your policy.

Q4: What is the economic rationale behind your country's treatment of allegedly failing firms in the context of merger review?

Q5: What do case officers consider to be adequate proof that a firm is failing? Are third party opinions (accountants etc.) required? To what extent is the defence/exception wide enough to include "flailing" firms, i.e. can it be successfully argued, for example, that without the merger one or more parties would be unable to raise required capital or to innovate sufficiently to remain an effective competitor in the future?

Q6: Does your country's failing firm defence/exception apply to sales of divisions or other clearly separable portions of a business? If not, why not?

Q7: When applying the failing firm defence/exception, do case officers restrict their attention to effects within the failing firm's market, or is the net cast wider to include all markets (i.e. the general equilibrium effects)?

R 3, 5 and 6:

The Office is currently elaborating Guidelines for assessing concentrations based on the new Competition Act. The proposed policy is as follows:

-- parties must prove that a concentration (between a failing firm and its acquirer) is not the cause of an adverse change in market structure. Specifically, they must establish that:

a) The allegedly failing firm would disappear in future if it did not merge with some other enterprise. This being the case, the creation or strengthening of a dominant position is not a consequence of the merger under examination; it results instead from the disappearance of a failing company.

When assessing whether a firm is in a critical financial state, the analysis begins by examining the firm's solvency (i.e. its ability to meet its debts), dividend record, total losses in previous years (their importance and permanency), sales trends, capacity utilization, and any obvious signs that a restructuring is necessary. The analysis must show that the firm will indeed likely exit the market in the near future.

b) It is proven that the failing firm's market share will pass to the proposed acquirer should the concentration be blocked and the target firm be forced to leave the market.

The Office will make this assessment by considering the number of existing competitors, their respective market shares and the possibility for expanded imports.

c) There is no less anti-competitive alternative purchaser for the failing firm.

The Office tries to assess the probability that other offers will materialize for all or a portion of the failing business and what impact each such alternative would likely have on competitive conditions. The same enquiry is made in the case of concentrations arising from the privatisation process.

In assessing evidence supporting a failing firm defence, the Office will require the opinion of objective third persons, i.e. it will not rely exclusively on what the parties provide.

R4: The failing firm defence can be addressed in the context of determining a merger's probable effects on competition and its overall economic advantages.

R6: Yes. As the term is used in the law, a concentration occurs whether the whole or just a part of an enterprise is being acquired.

For concentrations involving only a portion of a business, the Office will assess a failing firm defence in an analogous fashion seeking to determine whether absent the concentration the part or division will actually fail, who will acquire its market share in the event of failure, and whether there are less anti-competitive alternatives to the merger.

R7: When analysing the effects of a concentration on competition, the Office takes account of all its horizontal, vertical and conglomerate effects. In particular it considers:

-- the market position that would be enjoyed by the new firm, and how that compares with the closest competitors,

-- how the offer is structured and the possibility of a rise of collective dominance - oligopoly,

-- demand structure, i.e. the size and economic power of customers,

-- the height of barriers to entry, as a measure of the constraining power of potential competition,

-- whether the new merged entity would have some extraordinary competitive advantage (patents, licensees, trademarks, technological head start, breadth of product range, benefits accruing from past advertising expenditures, vertical integration),

-- whether the concentration will create or strengthen a dominant position in the market and the extent and strength of remaining competition.

-- any vertical foreclosure effects or anticompetitive impacts in pertinent complementary markets.

Q8: In the same context as the previous question, in addition to competition effects, is account taken of impact on factors such as employment, regional development, technological progress, etc. If the menu extends beyond competitive impact, is the range of concerns identical to factors considered at other points of the merger review? If not, explain?

R8: When analyzing the overall economic advantages of any merger, the Office begins by considering evidence provided by the parties as to cost reductions (including economies of scale in purchasing, production, distribution, advertising or general administration), enhancements in the price/quality ratio of the firm's offerings, and improved capacity to innovate. Effects on the firm's ability to compete in foreign markets is also examined including looking at the relative size of its foreign competitors. In a handful of joint-venture cases
the Office considered the fact that foreign investments might be needed to ensure enterprise restructuring.

The Office assigns paramount importance to the parties being able to show that the concentration will produce benefits for third parties, i.e. consumers and other producers.

The Office assesses the strength of the link between a concentration and the claimed net improvement in economic welfare, and whether the benefits are obtainable in ways that do not reduce competition. In addition, the Office evaluates whether the net benefits are sufficient to outweigh the concentration's anti-competitive effects. To ensure an overall positive effect, conditions could be imposed in order to reduce a merger's anti-competitive effects.

The same general approach is applied in cases involving a failing firm.

Q9: In order to benefit from a failing firm defence/exception, must the parties to a merger demonstrate that it is the least anti-competitive means available to keep failing firm assets dedicated to the market(s) where the merger would presumably have an anti-competitive effect? If so, are those alternative means restricted to other mergers, or do they include liquidation of the firm? As regards alternative mergers, how well developed must those alternative be, i.e. how vigorously and widely must the failing firm have been shopped around and by whom? If being shopped around is required, how are legitimate confidentiality concerns protected?

R9: In the case of failing firms, the satisfaction of creditors' claims is governed by the Act on Bankruptcy and Settlement No. 328/1991 Coll. of laws as amended (Bankruptcy Act). This Act provides a legal basis for liquidation and a variety of acquisitions of failing firms.

The Bankruptcy Act defines what constitutes a failing firm plus the circumstances under which one can launch a bankruptcy proceeding and begin to make forced settlement of creditors' claims. The Bankruptcy Act does not contain special rules of defence or exceptions applying to failing firms participating in a concentration. It also does not exclude applying special provisions of the Competition Act for this situation (see R2 supra where reference is made to that Act's concentration provisions).

Protection of information of a failing firm is based on these legal principals:

a) bankruptcy administrators are obliged to protect confidential information learned in connection with the conduct of their functions:

b) members of the councils of creditors and other individuals who participate in the proceedings on bankruptcy are obliged to observe secrecy as regards all facts (including commercial secrets of companies) which they learned during the proceedings. This duty applies for five years after the procedure has been completed. Only a court can cancel this obligation.

The competent court acting under the Bankruptcy Act is under a similar duty.

The obligation to observe secrecy does not override the legal duty to frustrate, or report perpetration of criminal offenses to the pertinent bodies.

c) Office staff are obliged to preserve the confidentiality of commercial secrets of companies which they learned in connection with mergers and failing companies.

Q10: Is the competition agency seriously considering proposals to change either the legal basis for or current enforcement practice relating to the failing firm defence/exception? Is so, please briefly describe the proposed reforms and outline what seems to have motivated them.

R10: The Office has not yet dealt with cases in which entrepreneurs would have presented a failing firm defence. The general legislation on concentration control is considered to be satisfactory in this regard and there are no plans to amend it.

CONTRIBUTION BY THE UNITED KINGDOM DELEGATION

Responses to the Questionnaire

Q1. Does your country have a statutory definition of the failing firm defence/exceptions? If yes, what is it?

A1. No. Under the United Kingdom administrative system of merger control failing firm arguments will only become relevant if the analysis of the effects of a merger suggest that some further action is required, such as reference to the Monopolies and Mergers Commission (MMC) for a full investigation or a finding by the MMC that a merger is against the public interest. In those circumstances we consider arguments that a firm may fail and whether the firm's failure would change the perception of the effect of the merger on the public interest. It is therefore possible that a merger that otherwise would be referred, or prohibited after an MMC investigation would be allowed or cleared if the target was shown to be a failing firm.

Q2. If your country has merger guidelines, please provide a copy of what they state concerning how the "failing firm" defence/exception will be interpreted and applied?

A2. The United Kingdom does not have merger guidelines. Published guides to the legislation and procedures do not deal expressly with the "failing firm" defence but the approach adopted by the United Kingdom authorities can be discerned, particularly, from decisions and statements in reports of the Monopolies and Mergers Commission on particular cases.

Q3. If the answers to the above two questions do not sufficiently describe how case officers deal with the failing firm issue in the context of merger review, kindly outline your policy?

A3.1. In the absence of guidelines and procedures the practical application of failing firm arguments to actual cases may vary from case to case and, given that a number of separate authorities are involved in the merger control process, from authority to authority. The question whether a firm is failing and whether that impacts upon the analysis of a merger can be considered at several points in the assessment of particular mergers. It will be relevant to the advice the Director General of Fair Trading gives to the Secretary of State for Trade and Industry on whether or not a merger should be referred to the Monopolies and Mergers Commission(MMC) for a full investigation; to the Secretary of State's decision; to the question of interim action following a decision to make such a reference (such interim action may require that while a merger is under consideration the parties to it do not take action which would prevent the unwinding of the merger in the event of an adverse report on its effect); to the assessment by the MMC; and to the Secretary of State's decisions on remedies to any adverse effect of the merger identified by the MMC.The failing firm arguments are considered whether or not the merger is completed (United Kingdom merger control does not require regulatory approval before completion of a merger) .

A3.2. Prior to a decision on reference to the MMC (and assuming that a prospective merger is under consideration) the Office of Fair Trading will consider failing firm arguments as a reason why a merger should not be referred. As the initial investigator, however, the OFT is reluctant to conclude that the failing firm defence is a reason against recommending reference except in exceptional circumstances - if, for instance, the harm to the public interest of a firm's failure would be greater than the potential anti-competitive consequences of allowing the merger to proceed and if the firm would be likely to fail during the course of investigation by the MMC (normally a three month period). The final judgement is the Secretary of State's; if he decides on reference he might, nonetheless, for failing firm reasons allow at least partial integration of the merging companies while the MMC investigation takes place. Following reference the MMC will consider failing firm arguments in more detail and comment on them in its report. If the MMC concludes, on the basis of such arguments, that a merger has no adverse effect the Secretary of State

is unable to prohibit a prospective merger or seek divestment of one which is completed, or seek any other remedies. If the MMC concludes that a merger has adverse effects the Secretary of State might nonetheless decide not to impose certain remedies if he is convinced, contrary to the views of the MMC, by failing firm arguments.

A3.3. In assessing whether failing firm arguments are a reason for allowing a merger it would generally be necessary for four main criteria to be met:

(i) the financial position of the company illustrates that failure is imminent and/or inevitable;

(ii) a re-organisation of the business would not be feasible;

(iii) that there are no alternative purchasers of the business or its assets whose acquisition of the business or parts of it would raise fewer concerns on competition grounds; and

(iv) allowing the acquisition of the business would raise no greater concerns on competition or wider public interest grounds than allowing it to fail.

Q4. What is the economic rationale behind your country's treatment of allegedly failing firms in the context of merger review?

A4.1. The failing firm argument does not become relevant unless the authorities have reached, or are likely to reach, the conclusion that a proposed or completed merger appears likely to have a significant adverse effect on the public interest, generally because of its effect on competition in a particular market or markets. They are, of course, generally unlikely to reach such an adverse view unless a merger produces some significant concentration in an already concentrated market or markets.

A4.2. The main circumstances in which the authorities are likely to conclude that the acquisition of a failing firm has no adverse effect are those set out in A3.3 above. These circumstances are most likely to arise when there has been or is currently some change in the nature of the market (for instance, if it is declining in absolute terms) and when the acquiring company is dominant (and so could be expected to secure most of the share of the target if the target was allowed to fail).

Q5. What do case officers consider to be adequate proof that a firm is failing? Are third party opinions (accountants etc) required? To what extent is the defence/exception wide enough to include "flailing" firms, ie can it be successfully argued, for example, that without the merger, one or more parties would be unable to raise required capital or to innovate sufficiently to remain an effective competitor in the future?

A5.1. There are different standards of proof depending on the stage of the proceedings. In determining whether the failing firm defence is relevant to the question of reference to the MMC the OFT's accountants would examine the firm's accounts and consider other evidence such as short term cash flow details and may seek corroboration from bankers that they are not prepared to support the business. Following reference the MMC would consider these questions in more detail. The authorities would consider the extent to which the firm's problems arose from structural difficulties within the industry rather than mismanagement. On the question of the inclusion of "flailing firms", the fact that a company is in difficulties would not normally be seen as a reason for making no reference to the MMC. For the MMC, the reasons for the company's difficulties are relevant. If these difficulties are thought to derive from an unsustainable market structure that might be considered a reason for clearance.

Q6. Does your country's failing firm defence/exception apply to sales of divisions or other clearly separable portions of a business? If not, why not?

A6.1. Yes, the scope of United Kingdom legislation is sufficiently wide to include divisions or other separable parts of a business. However, such possibilities are approached more cautiously, particularly at the OFT's preliminary investigation stage. Because of the difficulty of establishing the financial position of the division concerned, there may be scope for misrepresenting the financial position of part of the business within a corporate body.

Q7. When applying the failing firm defence/exception, do case officers restrict their attention to effects within the failing firm's market, or is the net cast wider to include all markets (ie the general equilibrium effects)?

A7.1. As already noted, the test is of the effects of a merger on the public interest; competition is stated to be the main concern but other public interest issues are relevant. The legislation appears to allow the effect of a firm's failure on other markets to be taken into account, though we are not aware of any precedent for this.

Q8. In the same context as the previous question, in addition to competitive effects, is account taken of impact on factors such as employment, regional development, technological progress etc. If the menu extends beyond competitive impact, is the range of concerns identical to factors considered at other points of the merger review? If not, please explain.

A8.1. In the absence of legislation or guidance on the failing firm defence, there are no special provisions for taking other factors into account. However, because the general test of the impact of a merger is of its effect on the public interest, these other factors would, in any case, be taken into account in the analysis of a merger whether or not it is a "failing firm". As already noted, however, the prime concern in considering a merger, whether or not failing firm arguments are relevant, will normally be the effect of a merger on competition.

Q9. In order to benefit from the failing firm defence/exception, must the parties to a merger demonstrate that it is the least anti-competitive means available to keep failing firm assets dedicated to the market(s) where the merger would presumably have an anti-competitive effect? If so, are those alternative means restricted to the mergers, or do they include liquidation of the firm? As regards alternative mergers, how well developed must those alternatives be, ie, how vigorously and widely must the failing firm have been shopped around and by whom? If being shopped around is required, how are legitimate confidentiality concerns protected?

A9.1. The fact of failure is not, by itself, generally considered a sufficient reason to justify a merger; as noted above, the authorities would normally expect to be satisfied that the merger does not, overall, lead to an adverse effect on the public interest and they may conclude that liquidation of the firm will lead to fewer adverse effects. In its initial investigation the OFT would not itself expect to establish by active enquiry whether or not there are robust alternative partners - failing firms will sometimes offer anecdotal evidence of their search for alternative partners and third party views would also be taken into account but the OFT's view is most likely to be based on its own assessment. In the MMC's fuller investigation it would examine each of the main alternatives directly wherever this is feasible.

Q10. Is the competition agency seriously considering proposals to change either the legal basis for or current enforcement practice relating to the failing firm defence/exception? If so, please briefly describe the proposed reforms and outline what seems to have motivated them.

A10. There are no current proposals for changes to merger control legislation.

Annex

A case study from the pharmaceutical wholesaling sector

Summary

An acquisition of one pharmaceutical wholesaler by another was the subject of investigation by the competition authorities in 1991-92. Two-thirds of the market was already in the hands of two companies, with an even higher proportion in some regions. The merger was the result of financial difficulties, mainly those of the parent company rather than the subsidiary that was divested. There were two alternative offers for the subsidiary, though neither was as attractive as the offer that was accepted. The competition authorities concluded that in the absence of that offer the subsidiary could not have survived in the same form, but that this latter path would have been a preferable one for competition. Subsequently, however, a new company was established by ex-employees of the subsidiary that had been taken over, and this new entry limited the need for action by the competition authorities to preventing (by the use of undertakings) any predatory action against the new company.

The legal framework

The competition authorities of the United Kingdom fall into three parts: the Secretary of State for Trade and Industry ("the Secretary of State"), the Office of Fair Trading ("OFT") and the Monopolies and Mergers Commission ("MMC"). The main roles of the three are that the OFT carries out preliminary investigations, the MMC carries out in-depth investigations and the Secretary of State determines remedies. The legal basis for merger control lies in provisions in the Fair Trading Act 1973 ("the Act").

The basic procedures are as follows. The OFT carries out a preliminary investigation of a merger (whether in prospect or completed), and if there is cause for concern recommends to the Secretary of State that there should be further investigation by the MMC. Assuming that the Secretary of State agrees with the recommendation the MMC carries out a full investigation and reports its conclusions and any recommendations for remedies to the Secretary of State. If the MMC does not find against the merger, the DTI has no power to take action. In the case where the MMC does reach an adverse finding, the OFT provides further advice to the Secretary of State on both finding and remedies and the Secretary of State takes decisions on both.

As explained in the accompanying note, there is no reference to a failing firm defence in the Act, but such a defence has to be assessed by the competition authorities since the Act requires the MMC to identify the ‘adverse effects’ that arise out of the merger, if there is to be a finding against. In practice this means that the MMC (and the OFT at the preliminary stage) have to compare the likely effects of the merger against what would have happened in the absence of the merger, and this involves assessing the ‘failing firm defence’.

In the case that is the subject of this note a preliminary investigation by the OFT was followed by a reference to the MMC; the MMC reached an adverse finding; and the Secretary of State determined remedies. The ‘failing firm defence’ was considered at both investigatory stages.

The case also involved a complex legal argument as to whether a merger within the terms of the Act had occurred. The companies argued that there had been only a sale of assets, and not for sale of a business as is required for a merger under the Act. The MMC concluded that the transaction did in fact constitute a merger within the terms of the Act, and hence that there was jurisdiction for the authorities to apply remedies. This aspect of the case will not be considered further in this note.

Market background

In 1991 there were around 30 pharmaceutical wholesalers that carried a full product range (so called 'full-line wholesalers'). In addition there were a large number of wholesalers carrying a limited range ('short-line wholesalers'). Out of total supplies to pharmacies, hospitals and doctors wholesalers in accounted for around three-quarters, with the rest being supplied either direct from manufacturers or through distribution agencies or importers. For the purpose of market definition distinctions needed to be made both between ethical and over-the-counter pharmaceuticals and between the three main categories of purchaser. Over the previous decade the number of wholesalers had fallen substantially, and there remained only three wholesalers with significant shares. These were Unichem (with 31 per cent), AAH (30 per cent) and Medicopharma United Kingdom (8 per cent). In some segments of the market shares were larger, particularly for AAH. In geographical terms it was important to analyse the market both nationally and regionally. In some regions the two main companies had particularly large shares, for example a combined 80 per cent in the Grampian region of Scotland.

There are a number of features of the market that gave rise to competition concern, in addition to the concentrated structure and the fall in the number of participants in the market. Vertical integration between wholesaling and retailing had been increasing; entry into both of these sectors was subject to regulation by the health authorities; and national wholesalers had advantages over regional ones arising out of economies of scale in the construction of distribution networks.

The merger that took place (in November 1991) was between AAH and Medicopharma United Kingdom.[1] The company was a subsidiary of Medicopharma NV, based in the Netherlands but operating in a number of other countries. Medicopharma United Kingdom was seen as playing a significant role in competition as it had been offering substantial discounts to customers. The assets acquired by AAH were primarily three depots, the pharmaceutical stock and some other assets, which collectively had formed the majority of the assets of Medicopharma United Kingdom.

Preliminary investigation

AAH announced its acquisition on the day it completed the transaction. Other wholesalers and retailers in the sector saw the move as the removal by AAH of an active competitor in a way that prevented the reconstruction of the Medicopharma business in another form. A press release from Medicopharma NV described the transaction as arising out of financial difficulties and indebtedness.

The merger was considered against a background of concern about the possible development of a duopoly in pharmaceutical wholesaling (between AAH and Unichem). A few months earlier two other mergers (neither involving Medicopharma) had been referred to the MMC because of a concern that they might strengthen the position of the two leading firms.

The OFT carried out an investigation into the circumstances of the transaction and its likely impact on the market. OFT found that the transaction had followed a series of discussions between Medicopharma NV on the one hand and AAH and (separately) a number of others on other about the possible purchase of the United Kingdom business. One of these offers came from the management of Medicopharma United Kingdom. Two preliminary findings were reached:

(a) there was considerable doubt that the closure of Medicopharma's United Kingdom business was inevitable; and

(b) the merger might lead to adverse effects on competition given the structure of the market and other factors.

Accordingly OFT recommended that the merger should be referred to the MMC for further investigation, and this was accepted by the Secretary of State and a reference made on 21 November 1991.

MMC investigation

The MMC carried out a three month investigation into the merger. This note will focus on three aspects of that investigation:

-- the extent to which there was a 'failing firm';
-- the alternatives available to Medicopharma NV;
-- a comparison between the effects of the merger with those of the most likely alternative scenario.

The 'failing firm'—to the extent one existed—was Medicopharma NV rather than Medicopharma United Kingdom, but the financial position of the latter was inevitably affected by the former. By the time of the transaction Medicopharma NV had been trading at a loss for several months and its main banker was unwilling to provide additional working capital. The position of Medicopharma United Kingdom was not entirely clear, as its long term funding was provided by its parent in a less than transparent form. It appeared that at the start of 1991 the subsidiary had positive, if low, profitability, but its financial position worsened when suppliers hardened their terms following rumours of Medicopharma NV's financial difficulties.

The MMC found that, apart from receivership, there had been three alternatives to the AAH proposal:

(a) an offer from an American company (McKesson) that was a minority shareholder in Medicopharma NV;

(b) a proposal from a German company (Ratiopharm), and

(c) the Management Buy Out proposal.

The MMC found that the AAH offer was financially superior to the other three proposals, both in terms of the amount offered for the business and a number of additional elements. The three alternative offers were however significantly higher than the estimated value of the assets if the business were liquidated.

The existence of alternative offers indicated that in the absence of the AAH proposal the business of Medicopharma United Kingdom could have continued, albeit in a different form and with a more limited scope. In order to assess what the effect on competition might have been in the absence of the AAH proposal the MMC considered the likely scenario if the business had been put into receivership. The MMC accepted that because of a lack of working capital the Medicopharma United Kingdom business could not have continued as a going concern and hence that the receiver would have had to sell its assets. However, as depots, stock and customer lists were all available it should have been possible to sell off as separate businesses those depots (together with stock and customer lists) that were profitable on their own. The MMC then estimated how much of the Medicopharma United Kingdom business was likely under this scenario to have been won by the various competitors, and in particular AAH. The conclusion was that, on this relatively pessimistic scenario (compared to the three alternative offers for purchase), the AAH share would have been around 30 per cent—instead of the 50 per cent of sales (and more in particular areas) that it actually obtained as a result of the merger.

The MMC therefore concluded that the effect of the merger had been that AAH gained a higher market share than it would otherwise have done. The question was then whether this extra gain of market share was likely to be harmful to competition. The conclusion was that the gain at the national level was too small to have any such effects but in the Grampian region of Scotland the effect was much larger and likely to damage competition. The MMC therefore found against the merger.

Remedies

The remedy recommended by the MMC related to the adverse finding on competition in the Grampian region of Scotland. This area had been supplied by the depot of Medicopharma United Kingdom in Aberdeen. The recommended remedy was that AAH should divest itself of a business similar to that carried on by Medicopharma United Kingdom from its depot in Aberdeen before the merger took place.

However, shortly after the MMC reported a new company was set up by ex-employees of Medicopharma's Aberdeen depot with the support of local pharmacists. The competition authorities considered that this new entry was likely to prove an effective remedy to the weakening of competition brought about by the merger provided that it was able to grow into a mature business. Certain undertakings were therefore obtained from AAH about potential predatory behaviour in order to prevent action that might endanger the survival and effectiveness of the new company.

NOTE

1. Medicopharma United Kingdom is the name used in this note (and also in the MMC report) for two sister companies that were sold to AAH.

CONTRIBUTION BY THE UNITED STATES DELEGATION

1992 Horizontal Merger Guidelines
Department of Justice/Federal Trade Commission

5. Failure and Exiting Assets

5.0 Overview

Notwithstanding the analysis of Sections 1-4 of the Guidelines, a merger is not likely to create or enhance market power or to facilitate its exercise, if imminent failure, as defined below, of one of the merging firms would cause the assets of that firm to exit the relevant market. In such circumstances, post-merger performance in the relevant market may be no worse than market performance had the merger been blocked and the assets left the market.

5.1 Failing Firm

A merger is not likely to create or enhance market power or facilitate its exercise if the following circumstances are met:

(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 II of the Bankruptcy Act;

(3) it has made unsuccessful good-faith efforts to elicit reasonable alternative offers of acquisition of the assets of the failing firm[1] that would both keep its tangible and intangible assets in the relevant market and pose a less severe danger to competition than does the proposed merger; and

(4) absent the acquisition, the assets of the failing firm would exit the relevant market.

5.2 Failing Division

A similar argument can be made for "failing" divisions as for failing firms. First, upon applying appropriate cost allocation rules, the division must have a negative cash flow on an operating basis. Second, absent the acquisition, it must be that the assets of the division would exit the relevant market in the near future if not sold. Due to the ability of the parent firm to allocate costs, revenues, and the intracompany transactions among itself and its subsidiaries and divisions, the Agency will require evidence, not based solely on management plans that could be prepared solely for the purpose of demonstrating negative cash flow or the prospect of exit from the relevant market. Third, the owner of the failing division also must have complied with the competitively-preferable purchaser requirement of Section 5.1.

When the 1992 Guidelines were issued, James F. Rill, who was Assistant Attorney General in charge of the Antitrust Division at the time, stated:

> "The new Guidelines' treatment of the failing firm and failing division defenses also eliminates language that has been interpreted as suggesting a hostility to such arguments. In addition, the new Guidelines add the notion that in order to prove the defense, failure must result in the exiting of the tangible or intangible assets of the failing firms from the relevant market. Finally, the new Guidelines clarify that liquidation value is the minimum price defining a reasonable alternative offer."

Kevin Arquit, then Director of the Federal Trade Commission's Bureau of Competition, made the following observations in an April 24, 1992 speech about the sections of the Guidelines reproduced above:

> "As for the failing firm arguments, this too remains an area where the burden remains with the merging parties. The only substantive changes here are the formal addition of the requirement that the proponents of the merger demonstrate that the failing firm's assets would exit the market absent the merger, and the definition of a 'reasonable' alternative offer for the assets as a price above liquidation value. These refinements in our analysis of failing firm arguments had been presaged in earlier speeches. The other requirements have been retained from the 1984 Guidelines, i.e., imminent failure, the inability to reorganize in bankruptcy, and the absence of alternative purchasers.
>
> The new Guidelines eliminate the "Financial Condition of Firms in the Relevant Market" section of the 1984 Guidelines, which led some to assert the misguided 'flailing firm' defense. The elimination from the Guidelines of the section that formed the asserted basis for the 'flailing firm' defense should dispel any notion that such a defense is meritorious or that a firm's financial weakness, standing alone and short of imminent failure, is likely to be a 'changing market condition' causing the firm's market share to be discounted."

THE FAILING FIRM DOCTRINE AND TRANSNATIONAL MERGERS

Consider the following scenario, which is inspired by (but not intended to be identical to) more than one actual case of which we are aware:

Firm A is among the world's leading widget producers. Its principal manufacturing facilities are in Country A, and it markets its products worldwide. The company is in financial trouble, and its survival -- including the continued operation of its manufacturing facilities in Country A -- is in question. It agrees to be acquired by Company B, another leading widget producer that is based in Country B.

The proposed acquisition has been examined by the antitrust authorities in Country A and Country B. Country B's antitrust authorities have concluded that the acquisition would lead to the creation of a dominant position in the widget market worldwide and in Country B, and proposes to prohibit the transaction.

Country B's antitrust authorities have also examined the companies' claims that Company A is a failing firm, and have concluded that:

- although Company A is financially weak and probably cannot avoid bankruptcy, its operations are viable and probably would continue during and after a reorganization, and

- even if Company A went out of business entirely, the outcome would be less anticompetitive than an acquisition by Company B.

Country A's antitrust authority, which is part of that country's Ministry of Industry, has also examined the transaction. The government of Country A has advised the government of Country B that:

- Country A's antitrust authorities have concluded that the acquisition is not likely to have substantial lasting anticompetitive effects in the world widget market or the widget market of Country A, and that it does not violate Country A's merger control law, and

- If Company B is not allowed to acquire Company A, it is likely that Company A's production facilities will close, causing a severe loss of employment and damage to the technology base as well as other important industrial policy interests of Country A.

The government of Country A has urged that it has the greater interest in the transaction, and that Country B should defer to its analysis and interest in the matter and should allow the transaction to proceed.

How should these differences be resolved?

NOTE

1. Any offer to purchase the assets of the failing firm for a price above the liquidation value of those assets -- the highest valued use outside the relevant market or equivalent offer to purchase the stock of the failing firm -- will be regarded as a reasonable alternative offer.

CONTRIBUTION BY THE EUROPEAN COMMISSION DELEGATION

Introduction

Council Regulation EEC no. 4064/89 ("the Merger Regulation") is the specific legal instrument enabling the European Commission to vet all mergers and acquisitions of a Community Dimension[1] from the point of view of their effect on the structure of competition. The Commission has the power and the obligation to prohibit all mergers that create or strengthen a dominant position in the European Union ("EU") as a whole or in a substantial part thereof (Article 2 of the Merger Regulation). In order to assess the impact of a merger on the structure of competition, a number of elements are taken into account, including the market position of the merging companies, the existence and degree of actual and potential competition, demand and supply trends, barriers to entry, buying power of the customers of the relevant goods and services.

Neither Article 2 of the Merger Regulation nor any other provision of the Community merger legislation contain an express reference to the "failing firm defence" as a ground for authorising a merger that would create or strengthen a dominant position in the EU. Despite the lack of statutory definition, the Commission has developed in its case-law the concept of a "rescue merger", which can be regarded as a version of the "failing firm defence". From a legal point of view, this concept is based on an interpretation of Article 2 of the Merger Regulation.

The concept of a "rescue merger" in EU merger control

Under Article 2 of the Merger Regulation, a merger must be prohibited if it results in the creation of a dominant position or the strengthening of pre-existing dominance. In other words, there must be a causal link between the merger and the creation or strengthening of dominance.

In this context, the Commission has developed the concept of the "rescue merger" to deal with those exceptional cases, where the merger cannot be considered as the cause of the deterioration in the competitive structure of a market, because even if the companies did not merge, dominance would still be created or strengthened. According to this line of argument, a merger or acquisition which would normally lead to the creation or strengthening of dominance, cannot be regarded as causing this result, if:

-- in the absence of the merger or acquisition, the merging or acquired company would disappear from the market in the near future ("failing firm");

-- merger with or acquisition by another company which would result in less damage to the competitive structure of the market can be practically ruled out;

-- there is evidence that, if the merging or acquired company were to disappear from the market, virtually all of its market share would go to the its merger partner or acquirer.

According to the Commission, there is a presumption that a creation or strengthening of dominance that would follow a merger, is caused by that merger. Consequently, the burden of proof for the existence of the requirements of a "rescue merger" lies with the merging firms.

Kali and Salz/MdK/Treuhand

In several cases before the Commission, the concept of the "rescue merger" was invoked by the parties as a ground for authorising the notified transaction. However, Kali and Salz/MdK/Treuhand is the only case to-date where this concept is discussed at length in the Commission's decision. It is also the only case where the Commission authorised the acquisition of a failing firm.

This case concerned the concentration of the salt and potash activities of Kali and Salz (K+S), a subsidiary of the German chemical company BASF, and MdK, a State-owned company of the former German Democratic Republic (GDR). After German re-unification and prior to the concentration, Mdk's shares had been transferred to the Treuhand, a public institution (trustee) charged with the re-organisation and privatisation of former GDR companies. The specific concentration would take place by means of the transfer of the relevant activities to a new company jointly controlled by K+S and the Treuhand[2].

One of the relevant markets affected by the concentration was the German market for potash fertilisers. Following the concentration, K+S's pre-existing dominance would be strengthened by the acquisition of the only other significant competitor on that market, MdK. High barriers to entry -including local demand for a specific type of potash that was only produced in German mines, the long-established links between German suppliers and German agricultural co-operatives, lower transport costs and logistical advantages resulting from the proximity of German mines to the main distribution points- made effective new entry unlikely.

Following the concentration, a situation of *de facto* monopoly would thus be created on the market. On the other hand, MdK's economic situation was critical and its future survival on the market on a stand-alone basis was extremely unlikely. In this context, the Commission examined whether the above-mentioned requirements for the application of the "failing firm defence" or "rescue merger" were met. More specifically:

(i) MdK's survival

Unlike the typical failing firm of the private sector, MdK was a company held in trust by a public body, the Treuhand, which had covered all its losses in the period between the German re-unification and the date of the Commission's decision. However, the Commission considered that even if the Treuhand were willing to continue providing financial aid in the future, MdK was not competitive by normal standards and constituted a failing firm, for the purposes of the application of the "rescue merger" principle. In particular, continuing support by the Treuhand without a realistic prospect of successful re-organisation, e.g. through an appropriate industrial partnership, would be against the European State Aids rules and thus not allowed under the Treaty.

(ii) Alternative acquirers

As part of the privatisation procedure, Goldman Sachs was assigned the task of inviting tenders for MdK. As a result, an extensive and detailed record of all alternative buyers contacted prior to MdK's privatisation was available in this case. During the investigation of the merger, the Commission examined the record and contacted all companies that had expressed some interest in acquiring MdK. None of the companies contacted by Goldman Sachs or the Commission was prepared to acquire MdK in its present condition, even combined with a substantial financial aid by the Treuhand. This negative response was objectively justified by a number of factors, including the operating structure of MdK, the existence of overcapacities and the generally depressed state of the potash market and the absence of significant synergies as a result of the acquisition - by contrast, K+S's geographical location and product range made such synergies possible.

(iii) Market shares

As explained above, structural factors of the German potash market isolated it from outside supplies. As a result, it could reasonably be expected that if MdK no longer existed as a competitor, virtually all of its market share would go to K+S.

On this basis, the Commission concluded that all requirement for the application of the concept of a "rescue merger" were met in this case.

Other considerations (e.g. employment, regional development, technical progress etc.)

The three above-mentioned requirements are both necessary and sufficient conditions for the application of the "rescue merger" principle. Other considerations are not relevant in this context.

Two factors are, however, worth mentioning in more detail. Article 2 of the Merger Regulation mentions the development of technical and economic progress as one of the criteria for assessing dominance. According to Article 2, technical and economic progress are relevant only when it can be shown that they will benefit consumers and that they will not form an obstacle to competition. In any case, these factors are general criteria for assessing dominance and they are not linked with the application of the "rescue merger" principle.

Finally, in the context of merger appraisal, Recital 13 to the Merger Regulation mentions the objective of strengthening the Community's economic and social cohesion, as provided in Article 130a of the Treaty. In the Kali and Salz/MdK/Treuhand decision, after concluding that the "rescue merger" principle applied, the Commission stated that given the severe structural weakness of the regions in East Germany which were affected by the merger and the likelihood of serious consequences for them of the closure of MdK, this conclusion would also be in line with the objective mentioned in Recital 13. Again this was not a criterion for the application of the"failing firm defence", whose requirements were anyway met in this case, but an additional factor pointing in the same direction.

Aérospatiale-Alénia/De Havilland

Only in one other case (the De Havilland case[3], two years before the above mentioned decision Kali and Salz/MDK/Treuhand) did the Commission examine whether a notified concentration would constitute a "rescue merger". As the Commission concluded that the concept of a "rescue merger" did not apply to the case, it was left open whether this concept was relevant pursuant to article 2 of the Merger Regulation. However, the analysis carried out in the decision clearly follows the same line as in the Kali and Salz case.

The case concerned the joint acquisition by Aérospatiale and Alenia of De Havilland, the regional aircraft division of Boeing. Aérospatiale and Alenia were already active through ATR in the relevant markets for regional turbo-prop aircrafts (three different markets were defined according to the size of the aircrafts). The activities of ATR and De Havilland were overlapping in one of these markets (the market for medium-size turbo-prop) where the new entity would have reached a 64 percent share worldwide. In addition, the operation would have allowed the parties to be substantially present in all three markets and therefore to offer a full range of turbo-prop aircrafts (prior to the operation only De Havilland was present in the market for small-size turbo-prop aircrafts while only ATR was present in the market for large-size turbo-prop).

(i) lack of necessary conditions for the "rescue merger to apply

The parties argued that if the proposed operation would not have taken place, De Havilland's production might have been phased out by Boeing. However, on the evidence made available, the Commission assessed that there was no such likelihood.

In assessing the likelihood of De Havilland leaving the market in the absence of the merger, the Commission took into account a number of factors. Inter alia: De Havilland produced good quality, well known and highly respected products; the net selling price of its aircrafts had increased and the production costs had decreased while there was still room for further increase of the productivity.

In addition, although Boeing had expressed its preference to sell rather than to continue to operate De Havilland, it did not confirm the parties' claim that it would definitely close down De Havilland if the operation failed to materialise. Moreover, it would not be sufficient in any case that a management decision is said to be made, but the decision to close down must be inevitable in view of economic and financial factors such as those indicated above for the "merger rescue" concept to apply,.

The basic conditions for applying the concept of a rescue merger (ie: in the absence of the merger the acquired company would leave the market) were therefore lacking in this case. It is worth mentioning that another of the three conditions previously mentioned for applying this concept was also lacking as Aerospatiale-Alenia were not the only potential buyers for De Havilland.

(ii) "failing division"

De Havilland was a division of the Boeing group. Although the Commission did not expressly mention this aspect, it appears that the situation is different where the target is an independent company and where it is part of a large group. In the latter case, as it is evidenced by Boeing's position, it is in principle unlikely, that a large group close down activities. This is all the more true where the group is financially strong, exit costs are high, and productivity gains are possible through investments. In this respect, the burden of proof is certainly heavier for the merging firms in the case of a "failing division" than in the case of a "failing firm".

The economic rationale of "rescue mergers"

The basic principle underlying the "rescue merger" concept is that the future market structure would be equally detrimental to competition irrespective of whether the deal is cleared or blocked. Thus, there is no link of causality between the merger and the negative effects on competition and therefore no legal ground for prohibiting the merger. Moreover, there might be, on economic grounds beneficial effects resulting from, inter alia: economies of scale, economies of scope, or other efficiencies, so that prohibiting the deal would add new detrimental economic and social effects to the effect on competition which would exist in any case.

NOTES

1. The concept of a merger of "Community dimension" is the criterion for allocating responsibilities for merger control between the Commission and the competition authorities of Member States. According to this criterion, a merger has a Community dimension and thus falls under the exclusive jurisdiction of the European Commission if: (i) the world-wide turnover of all companies involved in the merger exceeds ECU 5 billion; and (ii) the Community turnover of at least two of the companies exceeds ECU 250 million; unless (iii)all companies involved realise more than two-thirds of their Community turnover in one and the same Member State.

2. In exchange for MdK plus a cash contribution of DM1.044, Treuhand obtained 49% of the shares in the joint venture plus some veto rights. KtS received the other 51% of the shares.

3. Decision in case n˚IV/M.053- Aérospatiale-Alenia/De Havilland (OJ L 334/42 05.12.91)