Interpretation and application of the failing firm doctrine in merger regulation in South Africa and the US: A comparative analysis

Ignatious Nzero
LLB LLM
Doctoral Candidate, University of Pretoria
Legal Practitioner of the High Court of Zimbabwe

OPSOMMING

Uitleg en toepassing van die "failing firm"-leerstuk in die regulering van samesmeltings in Suid-Afrika en die VSA: 'n Regsvergelykende ontleding

Die regulering van samesmeltings deur mededingingsowerhede het nie net ten doel om korporatiewe transaksies wat 'n negatiewe impak op mededinging mag hê, te verhinder of te beheer nie. Onderliggend aan sodanige regulering is ook die behoefte om 'n mededingende markstruktuur te bevorder en te handhaaf tot voordeel van die ekonomie en verbruikers. Hierdie oogmerk is gebaseer op die begrip dat samesmeltings sowel antimededingend as pro-mededingend kan wees. Daar is gevolglik 'n behoefte om te verseker dat die regulasie van samesmeltings effektief genoeg is om enige nadelige gevolge van mededinging te verhoed, en terselfdertyd ook buigsaam genoeg is om goedgunstige samesmeltings te bevorder. As sodanig, volg baie mededingingsowerhede die benadering dat 'n samesmelting verhinder word as synde anti-mededingend indien dit tot 'n wesenlike vermindering in of verhindering van mededinging sou lei. Ten einde sodanige vasstelling te doen word verskeie assesseringskriteria gebruik. Bepaalde jurisdiksies oorweeg onder andere die vraag of een van die partye tot 'n samesmelting 'n sogenaamde "failing firm" is of waarskynlik sal word, ten einde te bepaal of 'n samesmelting goedgekeur behoort te word. Hierdie oorweging – waarna in die algemeen verwys word as die " failing firm"-leerstuk – word gebruik om te bepaal of die feit dat die mislukkende of verswakte status van een van die partye tot 'n samesmelting tot gevolg het dat sodanige firma as 'n oneffektiewe mededinger in die relevante mark beskou kan word. Die doel van hierdie bydrae is om ondersoek in te stel na die beginsels onderliggend aan die "failing firm"-leerstuk. 'n Kritiese beskouing van die verskillende benaderings wat die Suid-Afrikaanse en Amerikaanse mededingingsowerhede ten opsigte van die toepassing van die leerstuk volg word verskaf, asook die effek van sodanige benaderings op die goedkeuring al dan nie van 'n bepaalde samesmelting.

1 INTRODUCTION

Mergers and acquisitions are some of the preferred techniques for implementing strategic corporate restructuring transactions.[1] Other techniques include debt restructuring and ownership and operation re-organisation.[2] Corporate mergers and acquisitions, a term that will be used for purposes of this discussion, generally refer to a situation whereby two or more business entities combine parts or their entire businesses.[3] Generally there are three types of mergers, namely, horizontal, vertical and conglomerate mergers.[4] Horizontal mergers occur between firms with one or more products in direct competition. Hence these mergers pose a serious competition concern in that they are likely to 'produce a firm controlling an undue percentage of the relevant market, and result in a significant increase in the concentration of firms in that market'.[5] Vertical mergers occur between firms with one or more product line in a customer-purchaser relationship and are condemned on the basis that, besides their potential to eliminate an effective market participant, they can also foreclose other market participants and result in preferential and often discriminatory distribution between firms having a customer-purchaser relationship.[6] Finally, conglomerate mergers involve firms that do not share any form of economic relation either as direct competitors or customer-purchasers.[7]

The need for merger regulation in competition law is not premised merely on the desire to prevent or control corporate transactions that negatively affect competition, but rather on the need to promote and maintain a competitive market structure for the benefit of the economy and the consuming public. This objective is motivated by a realisation that corporate mergers can be both pro- and anti-competitive. There is thus a need to ensure that merger regulation is effective enough to deter any harm to competition and at the same time flexible enough to promote corporate transactions implemented through benevolent mergers. As

1 See Valentine "Horizontal issues: What's happening and what's on the horizon?" (1995) available at http://1.usa.gov/VVi0vM, accessed 21/10//2010. See also Kokkoris and Olivares-Caminal *Antitrust law amidst financial crises* (2010) 105.

2 See, generally, Gaughan *Mergers, acquisitions and corporate restructuring* (2007).

3 S 12(1)(a) of the Competition Act 89 of 1998. It must be appreciated that this definition is only for purposes of this statute as mergers can be defined in various ways, depending on the purpose of such definition. See eg s 1(3) of the Companies Act 71 of 2008 which defines a merger in a composite definition that also includes an amalgamation as a transaction or a series thereof, pursuant to an agreement between two or more companies which transaction culminates in either (a) the formation of one or more new entities vested with the entire assets and liabilities previously held by the merging parties immediately before the implementation of the agreement and the dissolution of the merging parties, or (b) the survival of at least one of the merging entities with or without a new company being formed. In this case the entire assets and liabilities of the merging parties will be held by the surviving entity. For an in-depth discussion of the definition of mergers and acquisition for purposes of corporate law in South Africa, see Davids, Norwitz and Yuill "A Microscopic Analysis of the New Merger and Amalgamation Provision in the new Companies Act 71 of 2008" 2008 *Modern Company Law for a Competitive South African Economy* 337, 341-343; Mashabane "Mergers and Takeovers under the Companies Act" September 2011 *De Rebus* 30–31.

4 See, generally, Van Kalinowski "Business organisations" 1979 *Antitrust Laws and Trade Regulations* s 19.02.

5 *United States v Philadelphia National Bank* 347 US 321 (1963).

6 Kalinowski (1979) s 19.02 (2)(a).

7 See *FTC v Proctor Gamble Co* 363 US 568 (1967) 577.

such, in determining whether or not to approve a particular merger, many competition authorities employ a rule of reason approach, that is, a merger is blocked as being anti-competitive if it materially lessens or prevents competition.[8] It is thus important during merger assessment to determine whether a merger is likely to "substantially lessen or prevent competition" or "tend to create a monopoly" within the relevant market.[9]

One of the considerations during merger assessment is whether a party thereto is failing or is likely to fail. This consideration, commonly referred to as the "failing firm" doctrine, determines whether the failing or weakened status of a merging party renders it an insignificant competitor within the relevant market.[10] The question is thus posed whether the merger involves a failing firm and, if so, what the competition effects are of allowing or blocking a merger involving such failing firm.

The "failing firm" doctrine originated from the United States Supreme Court decision in *International Shoe Co v FTC*,[11] where it was held that the acquisition by a competitor of a firm with a depleted resource base whose prospects of rehabilitation are remote does not violate antitrust laws if there are no other prospective purchasers for such a firm.[12] The doctrine has been applied, albeit in modified formulations, in a number of decisions,[13] most significantly in *Citizen Publishing Co*[14] where Douglas J formulated a three-pronged applicability criterion to determine whether (i) the acquired firm has failed or is likely to fail absent the merger; (ii) there are no alternative purchasers posing a less competitive threat; and (iii) the alleged failing firm cannot be successfully re-organised under bankruptcy laws.[15] This three-pronged criterion forms the backbone of the merger guidelines currently utilised by US antitrust agencies in scrutinising failing firm claims.[16] If parties cumulatively prove these requirements, then the doctrine is accredited and an otherwise anti-competitive merger is approved.[17] In the US antitrust law the doctrine thus constitutes an absolute defence to an otherwise anti-competitive merger, thereby justifying such a merger.

The failing firm doctrine as established by the US Supreme Court in 1930 and modified in 1969 has also infiltrated the South African merger regulatory framework.[18] Section 12A(2) of the South African Competition Act[19] enjoins the

8 See *Standard Oil Co of New Jersey v US* 221 US 1 (1911) and Bork "The rule of reason and the *per se* concept: Price fixing and market division" 1965 *Yale LJ* 775. Cf *US v Trans-Missouri Freight Ass'n* 166 US 290 (1897).

9 S 7 of the US Clayton Antitrust Act of 1914 as amended and s 12A(1) of the South African Competition Act 89 of 1998.

10 *US v General Dynamics Corp* 415 US 504.

11 *International Shoe Co v FTC* 280 US 291 (1930).

12 302–303.

13 See eg *Brown Shoe Co v US* 370 US 294 (1962) 331 346 (evidence of failing as a mitigatory factor to an anti-competitive merger); *General Dynamics Corp* (fn 10 above).

14 *Citizen Publishing Co v US* 394 US 131 137–138 (1969).

15 *Ibid*.

16 S 11 of the FTC and DOJ's *US Horizontal Merger Guidelines* (2010).

17 *Ibid*.

18 S 12A(2)(g) of the Competition Act. See *Iscor Limited/Saldanha Steel (Pty) Ltd* 67/LM/Dec 01 para 101; *Schuman Sasol (SA) (Pty) Ltd/Price's Daelite (Pty) Ltd* 23/LM/May 01 para 57; *Santam Ltd/Emerald Insurance Co Ltd and Emerald Risk Transfer*

continued on next page

authorities to, *inter alia*, assess "whether the business or part of the business of a party to the merger or proposed merger has failed or is about to fail"[20] in determining a merger's likely competitive effects. As will become clear in the discussion below, this provision renders the doctrine one of the many factors enlisted in section 12A(2) of the South African Competition Act that must be considered in assessing the compatibility of a merger. Even if the criterion for establishing a failing firm is met, the merger must still pass the other legs of the substantive assessment test, most notably, the public interest compatibility leg.[21] This entails that establishing the doctrine is not an absolute defence to an otherwise anti-competitive merger but merely one of the factors that are considered in merger assessment.

It is clear that the US and South Africa approach the failing firm doctrine differently, that is, in the US it is an absolute defence to an anti-competitive merger and in South Africa it is merely one of the many factors to be considered during merger assessment. This distinction results in a materially different interpretation and application of the doctrine in these jurisdictions. The contrasting approaches raise the question as to whether it is necessary to adopt the traditionally narrow and strict criteria which are applied in the US as discussed below, even where the doctrine is utilised as only a factor in merger assessment as opposed to an absolute defence.

This contribution primarily seeks to explore the above question and related issues. Despite showing a commendable degree of flexibility, the doctrine is narrowly interpreted in the US, limiting its application. By contrast, the South African approach which interprets the doctrine as one of the factors in merger assessment not only ensures flexibility, but also promotes benevolent corporate restructuring transactions by providing a panacea for failing firms. This is done by subjecting mergers involving failing firm claims to further scrutiny, thereby giving failed claims a second chance at navigating the traditionally strict and narrow criteria synonymous with treating the doctrine as an absolute defence. Accordingly, it will be argued that the substantive assessment test is capable of preserving a competitive market structure by treating the doctrine as a factor and hence it questions the rationale for adopting a strict approach thereto by considering it in isolation in order to decide whether an anti-competitive merger should be approved.

The discussion comprises two sections, namely, the US approach to the failing firm doctrine followed by the South African approach. The first section briefly presents the US merger regulatory framework, particularly section 7 of the Clayton Act which is the primary statute regulating corporate mergers, as well as section 11 of the *Horizontal Merger Guidelines* which provides the criteria for a successful failing firm defence. Selected court decisions are used to discuss and analyse these criteria. It will be demonstrated that the US courts' approach to the doctrine promotes a strict application which renders it almost impossible to successfully invoke the doctrine. It will be argued that although this approach limits

---

(Pty) Ltd 57/LM/Aug 09 para 52; and, generally, *Phodoclinics/Protector Group Medical Services* 122/LM/Dec 05.

19 89 of 1998.

20 S 12(A)(2)(g) of the Competition Act.

21 S 12(A)(a)(ii).

the application of the doctrine, it is necessary and justified to promote and maintain a competitive market structure through ensuring that only genuine failing firm claims are accredited. This is because once the criteria set for assessing mergers involving a failing firm claim are met, an otherwise anti-competitive merger is approved.

The second section of the discussion focuses on the South African approach to the doctrine. Here the substantive test for merger assessment provided in section 12 of the Competition Act is discussed with the aim of demonstrating how it impacts upon the interpretation and application of the failing firm doctrine in South Africa. An argument will be made that treating the doctrine as a factor rather than a defence in merger regulation is commendable as it allows for both the promotion and maintenance of an effective and competitive market structure and at the same time ensures a flexible regulatory system necessary to promote beneficial corporate restructuring transactions implemented through mergers and acquisitions. However, reservations will be voiced as to whether adopting a narrow and strict approach to the failing firm doctrine is justified given that the substantive test for merger assessment is capable of providing the necessary safeguards to ensure that the competitive process is not harmed.

2 FAILING FIRM DOCTRINE IN THE US

2 1 US merger regulatory framework

Corporate mergers and acquisitions in the US are primarily regulated by the Clayton Antitrust Act of 1914, as amended.[22] This Act strengthened the Sherman Antitrust Act of 1890[23] and prohibits mergers that have the effect of substantially lessening competition or tend to create a monopoly.[24] The Act's merger regulatory ambit was extended in 1950 by the Celler-Kafauver Amendment to the Clayton Act[25] so that section 7 of the Clayton Act could now capture not only stock acquisitions between direct competitors, but also acquisitions of assets including those between non-direct competitors that were excluded by the original wording of the latter.[26]

The Hart-Scott-Rodino Act[27] inserted section 7A into the Clayton Act to require parties to certain mergers to notify agencies before implementation.[28] The purpose of the pre-notification requirement is to afford agencies sufficient time to scrutinise and challenge acquisitions deemed anti-competitive before they are

22 The Clayton Act was amended in 1950 by the Celler-Kafauver Amendment to the Clayton Act (15 USC.), and the Hart-Scott-Rodino Antitrust Improvement Act of 1976.

23 Sherman Antitrust Act Ch 647, 26 Stat 209 (1980) (codified as amended at 15 USC). See Ramirez and Eigen-Zucchi "Understanding the Clayton Act of 1914: An analysis of the interest group hypothesis" 2001 *Public Interest* 157 158.

24 S 7.

25 Celler-Kafauver Amendment to the Clayton Act.

26 See *Brown Shoe Co* (fn 13) 311. Cf *US v EL Du Pont De Nemours & Co* 353 US 586. See also *FTC annual report* 6 7 (1929) and "Statement by General Counsel Kelly in hearings before Subcommittee 3 of the House on the Judiciary on HR 2734" 81 ST *Congressional Session* 38.

27 Hart- Scott-Rodino Antitrust Improvement Act of 1976 (15 USC s 18a).

28 See Premerger Notification Rules 16 CFR 801–803 on the notification thresholds.

implemented,[29] because of the challenges in trying to unscramble already-consummated mergers.[30]

2 1 1 Section 7 of the Clayton Act

Section 7 of the Clayton Act provides:

> "No person engaged in commerce or in any activity affecting commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital . . . *or* the whole or any part of the assets of another person engaged also in commerce or in any activity affecting commerce, where in any line of commerce or in any activity affecting commerce, in any section of the country, the effect of such acquisition may be substantially to lessen competition or to tend to create a monopoly."[31]

This provision essentially prohibits corporate mergers that have the effect of substantially lessening competition or tend to create a monopoly within a particular line of commerce. It is at the heart of US merger regulation.[32] Although the section is broadly worded to capture a wide range of transactions,[33] it is not meant to stifle economic and commercial activities[34] but only prohibit such transactions if they are likely to produce one of two results within a particular line of commerce. These are:

(a) "substantially lessen competition", or

(b) that they "tend to create a monopoly".[35]

The use of the word "may" indicates a predictive inquiry in both instances; that is, the probability of whether the merger would produce any of the two results rather than that competition has already been lessened.[36]

A merger may "substantially lessen competition" within a particular line of commerce if, as a result thereof, the post-merger competitive market structure deteriorates significantly.[37] Deterioration is deemed significant if it negatively affects the public.[38] Section 7 is thus violated if a merger materially lessens the degree of competition within the economy by creating a post-merger market structure that is detrimental to public interest.[39] A case in point is where, as a result of a merger an effective competitor is eliminated from the relevant market and in its place a dominant market entity is created with the ability to negatively

---

29 De Pamphilis *Mergers and acquisitions and other restructuring activities: An integrated approach to process, tools, cases, and solutions* (2009) 60.

30 *Idem* 64.

31 S 7 of the Clayton Act as amended.

32 See Blumental "Merger analysis under the US antitrust laws" at http://bit.ly/1dBcXDG, accessed 07/08/2013.

33 This is evident from the frequent use of such terms as "any", "commerce or any activity", "direct and indirectly", or "any section of the country".

34 See eg *International Shoe Co* (fn 11) 298 308.

35 S 7.

36 Kokoris and Olivares-Caminal (2010) 58.

37 *International Shoe Co* (fn 11) 298; *Standard Fashion Co v Magrane-Houston Co* 258 US 346 357.

38 *International Shoe Co* (fn 11) 297; *Standard Oil Co* (fn 8) 81 87 and *FTC v Sinclair Ref Co* 261 US 463 467.

39 *Ibid*.

influence competition through engaging in anti-competitive practices such as output restrictions, discriminatory distribution, price-fixing and hiking.[40]

A merger which tends to create a monopoly within the relevant line of commerce also attracts the wrath of section 7. This is not aimed at blocking monopolies *per se*, but to guard against the potential anti-competitive tendencies of monopolies given their abilities to negate the competitive benefits.[41]

2 1 2 Merger guidelines and failing firm doctrine

The Federal Trade Commission (FTC) and the Antitrust Division of the Department of Justice (DOJ), referred to as "agencies", have since 1968[42] published a set of non-binding administrative guidelines to provide an analytical framework for merger regulation and to provide clarity on antitrust laws and concepts.[43] The guidelines are "revised from time to time as necessary to reflect significant changes in enforcement policy, to clarify existing policy, or to reflect new learning".[44] Crucially, these guidelines recognise that section 7 of the Clayton Act is not violated if "a merger is not likely to enhance market power if imminent failure . . . of one of the merging firms would cause the assets of that firm to exit the relevant market".[45] This failing firm defence is recognised on the basis that the declining fortunes of one of the merging parties would render it an insignificant market participant hence its acquisition by the other party to the merger would not contribute to deterioration in the competitive structure of the market to the detriment of customers.[46]

A criterion is provided that parties wishing to rely on the defence must meet before it is accepted.[47] As indicated above, this criterion was developed from court decisions, most notably *Citizen Publishing Co*.[48] Parties are required to satisfy all of the following requirements, namely:[49]

(a) that the alleged failing firm would be unable to meet its obligations in the near future;

(b) the allegedly failing firm would not be able to reorganise successfully under Chapter 11 of the Bankruptcy Act;[50] and

40 *Philadelphia National Bank* (fn5) 368; *US v Reed Roller Bit Co* 274 FSupp. 573 579 (1967); *FTC v HJ Heinz Inc* 246 FJD 7908 (DC Cir 2001); 2001–2 CCH Trade Cases 73 441 (DC 2001).

41 See eg *US v South-Eastern Underwriters Assn* 322 US 533 553–554 (1944) (monopolies had the power to fix prices, restrict production, crush small independent traders and concentrate large power in the hands of the few to the detriment of many). See also *US v American Oil Co* 262 US 371 388 (1923).

42 US Department of Justice *Horizontal Merger Guidelines* (1968), available at http://1.usa.gov/UiJHZK, accessed 08/10/2012.

43 Eg market definition (s 4) and efficiency claims (s 10) of the 2010 merger guidelines.

44 S 1 fn 1 of the 2010 guidelines. The 1968 guidelines were revised by the 1992 *Horizontal Merger Guidelines* which were, in turn, revised by the 1997 guidelines. These guidelines were replaced by the current 2010 *Horizontal Merger Guidelines*.

45 S 11 of 2010 guidelines. See also para 5 of the 1992/97 *Horizontal Merger Guidelines*.

46 *Ibid*.

47 S 11 of 2010 guidelines.

48 See fn 14.

49 *Ibid*.

50 Bankruptcy Act of 1898.

(c) the allegedly failing firm has made unsuccessful good faith efforts to elicit reasonable alternative offers that would keep its tangible and intangible assets in the relevant market and poses less severe danger to competition than does the proposed merger.[51]

These requirements are discussed in detail below.

2 2 Failing firm doctrine in the US: Practice and approach

The declining status of one of the parties to a merger was first accepted as an absolute defence to a charge of violating anti-trust laws in the landmark decision of *International Shoe Co*.[52] Thus, the failing firm doctrine became largely a creature of case law rather than statute.[53] This followed a FTC challenge to a merger involving the then two "largest shoe manufacturers in the world".[54] It was challenged that the merger was illegal and in violation of section 7 of the Clayton Act as it would substantially lessen competition by eliminating a competitor[55] and creating a monopoly that would restrain trade in the shoe business.[56]

The merging parties argued that the acquisition was not in violation of section 7 as no substantial competition existed between the parties prior to the merger.[57] Further, dire financial circumstances of WH McElwin Co, one of the merging firms, necessitated liquidation or sale, thereby eliminating all present or prospective competition or restraint of commerce.[58] In finding for the merging parties, the court held that "evidence establishes the case of a corporation in failing circumstances, the recovery of which to a normal condition was . . . in gravest doubt, selling its capital to the only available purchaser in order to avoid . . . a more disastrous fate".[59]

The court also stated that, although other alternatives have been mooted, they could not be considered with any degree of certainty that they might produce the desired results or would ultimately lead to the failing firm's recovery rather than final and complete collapse.[60]

In conclusion and laying the foundation for the doctrine, Sutherland J stated:

> "In light of the case thus disclosed of a corporation with resources so depleted and the prospects of rehabilitation so remote that it faced the grave probability of a business failure with resulting loss to its stockholders and injury to the communities where its plants were operated, we hold that the purchase of its capital stock by a competitors (there being no other prospective purchaser), not with the purpose to lessen competition, but to facilitate the accumulated business of the purchaser and with the effect of mitigating seriously injurious consequences otherwise probable, is not in contemplation of law prejudicial to the public and does not substantially lessen competition or restrain commerce within the intent of the Clayton Act."[61]

51 S 11 of 2010 guidelines.
52 See fn 4.
53 Kokoris and Olivares-Caminal (2010) 172.
54 Per Stone J dissenting in *International Shoe Co* (fn 11) 304.
55 *International Shoe Co* (fn 11) 294.
56 *Ibid.*
57 *Ibid.*
58 291 294.
59 301.
60 302. Cf Stone J dissenting on 306, insisting that the need to pursue other alternatives poses a lesser competitive threat and enables the firm to operate competitively.
61 302–303.

International Shoe Co thus laid the foundation for the acceptance of the failing firm defence. Significantly, the judgment provides a platform for the recognition of the defence not only as a technical doctrine relevant to merger regulation, but the application of which serves a broader public interest purpose as the Supreme Court held the primary purpose of anti-trust law to be public interest.[62] As such, saving a failing firm would not only avert loss to its stockholders and the communities it serves, but also to its workers who face job losses if it is to fail.[63]

After *International Shoe Co* the doctrine was also considered in *Diebold Inc*[64] where it was confirmed that a finding that the acquired firm "was hopelessly insolvent and faced imminent receivership" and that the acquiring firm "was the only *bona fide* prospective purchaser for its business"[65] would suffice to establish the defence as formulated in *International Shoe Co*. However, the court pointed out that such a finding must be sufficiently supported by factual evidence.[66]

Another decision that dealt with the failing firm doctrine was *Brown Shoe Co*. Here the Supreme Court had to determine whether a proposed merger between a leading manufacturer and third largest shoe seller in the US and the eighth largest shoe manufacturer and seller in the US[67] would "substantially lessen competition or tend to create a monopoly" in violation of section 7 of the Clayton Act. The US government contended that the merger would eliminate an actual or potential competitor in the shoe manufacturing and selling business.[68] In upholding the challenge, the court held that the

> "appellant has presented no mitigating factors, such as the business failure or the inadequate resources of one of the parties that may have prevented it from maintaining its competitive position, nor a demonstrated need for combination to enable small companies to enter into a more meaningful competition with those dominating the relevant markets".[69]

It is submitted that although the failing firm doctrine was not expressly relied upon, the court made reference thereto in accepting that, should parties to a merger alleged to be in violation of section 7 prove business failure on the part of one of the parties thereto, such failure can work to justify an otherwise prohibited merger. *Brown Shoe Co*, thus, accepted failing business as a mitigatory factor to an otherwise prohibited transaction, provided that parties seeking to rely on it meet all the established requirements for the failing firm doctrine.

In *General Dynamics Corp*, the US Supreme Court dismissed the US government's challenge to a merger based on the fact that statistical evidence of past production of the merging parties showed that they were effective and important competitors in the relevant market and that, consequently, the merger would

62 See *International Shoe Co* (fn 11) 297; *Standard Oil Co* (fn 8) 87 and *Sinclair Refineries Co* (fn 38) 476.
63 *International Shoe Co* (fn 11) 302–303.
64 *United States v Diebold Inc* 369 US 654 (1962).
65 655. Italics added.
66 *Ibid*. The Supreme Court *per curiam* in reversing the lower court's decision found that the evidence does not sustain a finding that the criteria for a successful failing firm defence were met.
67 *US v Brown Shoe Co* 179 FSupp 721 (ED Mo 1959).
68 *Brown Shoe Co* (fn 13) 297.
69 346.

substantially lessen competition in violation of section 7 of the Clayton Act.[70] The court cautioned against reliance on statistical evidence of previous competitiveness as a basis for supporting claims that the entities would continue to be future effective competitors.[71]

The merging firms clearly fell short of the *International Shoe Co* requirements that the acquired firm was failing at the time of the acquisition[72] and that the acquiring firm was the only purchaser.[73] The court found that the target firm's resources where inadequate to secure long-term contracts vital to coal mining, thereby diminishing its usefulness as an effective market competitor.[74]

The *General Dynamics* analysis did not exhibit a classic failing firm defence but rather reformulated it as a "weakened firm" defence.[75] By accepting this dimension, the court demonstrated its willingness to adopt a flexible approach to the failing firm defence.[76]

In *Citizen Publishing Co* the US Supreme Court had to determine an appeal against a lower court's decision that upheld a challenge to a stock acquisition of one of Arizona's only two daily newspapers of general circulation as violating section 7 of the Clayton Act in that the acquisition "had the effect of continuing in a more permanent form a substantial lessening of competition in daily newspapers publishing" in Pima County.[77]

In dismissing the appeal the Supreme Court considered the applicability of the failing firm doctrine, stating that it was the "only real defence available to the appellants".[78] The court went on to formulate a three-pronged test to the failing firm criteria,[79] thereby creating the backbone for the presently utilised criteria judicially.[80] This test entails the following;

(a) The acquired firm must be "on the verge of going out of business" or there exists "a serious probability at the time that . . . it would terminate its business and liquidate its assets unless *acquired*".[81] The alleged failing firm is deemed to be failing if evidence indicates that it is contemplating

70 *General Dynamics Corp* (fn 10) 497.
71 501. See also *Brown Shoe Co* (fn 13) 321–322; *US v Continental Can Co* 378 US 441 458.
72 *General Dynamics Corp* (fn 10) 507.
73 *Ibid*.
74 508.
75 Diamant "The failing company doctrine since *General Dynamics*: more than excess baggage" 1979 *Fordham LR* 872 873.
76 The minority position favoured the traditional strict and narrow *International Shoe Co*. See minority decision delivered by Douglas J and dissenting opinion shared by Brennan, White and Marshall JJ in *General Dynamics Corp* (fn 10) 525, labelling the majority decision an "incorrect legal standard".
77 *US v Citizen Publishing Co* 280 FSupp 978 (Ariz 1998).
78 *Citizen Publishing Co* (fn 14) 136.
79 *Ibid*.
80 See Bork "Section 7 of the Clayton Act and the merging of law and economics" 1960 *Harv LR* 226 339; Hale and Hale "Failing firms and the merger provisions of the anti-trust laws" 1964 *Ky LJ* 597 607; and Connor "Section 7 of the Clayton Act: The 'failing company' myth" 1960 *Geo LJ* 84 96.
81 *Citizen Publishing Co* (fn 77) 980. Italics added. See also *International Shoe Co* (fn 11) 302–303; *Diebold Inc* (fn 64) 655.

liquidation hence the merger became "the last straw" at which the company grasped.[82]

(b) The second criterion of the test was formulated as follows by Douglas J:

> "The failing company doctrine plainly cannot be applied in any other case unless it is established that the company that acquired the failing company or brought it under domain is the only available purchaser. For if another person or group could be interested, a unit in the competitive system would be preserved and not lost to monopoly power."[83]

The parties must satisfy this alternative purchaser requirement by, for instance, demonstrating that effort was made to sell its assets through engaging a broker.[84]

(c) Finally, the prospects of successfully reorganising the allegedly failing business under bankruptcy laws must be "dim or non-existent".[85] The rationale therefore is to maintain competition since experience broadly dictated "that companies re-organised through receivership or through Chapter X or Chapter XI of the Bankruptcy Act often emerged as strong competitive companies".[86]

Crucially, "the burden of proving that the conditions of the failing company have been satisfied is on those who seek refuge under it".[87] As if this is not enough of a daunting task, the doctrine is confined to its narrow scope.[88] Before highlighting the implications of the US approach to the failing firm on merger regulation, it is important to consider another crucial aspect of the failing firm doctrine in the US, namely, a variation to the failing firm defence in the form of the "failing divisional assets" defence.

2 3 Failing division defence in the US

Section 7 of the Clayton Act also prohibits the acquisition of "the whole or any part of the assets of one or more persons" by another if "the effect of such an acquisition . . . may be substantially to lessen competition, or tend to create a monopoly".[89] This provision is an acknowledgement of the fact that mergers are not only limited to acquisitions of the entire business of another but might involve only part thereof. Similarly, it is possible to have a merger involving the acquisition of a failing division rather than the entire firm with the potential to violate anti-trust laws in the same manner as the latter.

Accordingly, merger guidelines acknowledge that a merger "is unlikely to cause competitive harm if the risk to competition arises from the acquisition of a failing division".[90] However, to successfully rely on this failing division defence, parties are required to prove that:

---

82 *Citizen Publishing Co* (fn 14) 137.
83 138. See also *International Shoe Co* (fn 11) 302–303.
84 *Citizen Publishing Co* (fn 14) 138 (requirement not met if not shown that property or franchise of alleged failing firm placed in hands of broker for purposes of securing purchaser).
85 *Ibid*.
86 *Ibid*.
87 138–139; dissenting decision in *General Dynamics Corp* (fn 10) 525.
88 139.
89 S 7 of the Clayton Act 15 USC s 18 (2000). See also *The merger review process* (2001) 1.
90 S 11 of 2010 *Horizontal Merger Guidelines*.

(a) The division in question is failing. The agencies require the application of "cost allocation rules that reflect the economic costs" to demonstrate that "the division has a persistent negative cash flow on an operating basis". The parties must further demonstrate that this negative cash flow still exists regardless of the firm's overall added sales in complementary markets or good standing amongst customers.[91]

(b) The owners of the allegedly failing division must have "made unsuccessful good faith efforts to elicit reasonable alternative offers" capable of ensuring that both the tangible and intangible assets of the failing division remain in the relevant market and at the same time pose less harm to competition as compared to the proposed merger.[92]

Although the requirements for the failing division defence are almost identical to those of the failing firm defence, it is important to consider the two as distinct doctrines. However, in practice, this distinction becomes largely blurred as the "failing division" doctrine has been treated as nothing less than a subsidiary of the more established failing firm doctrine.[93] In cases where the facts point to failing divisional assets, either the litigants had invoked the failing firm doctrine rather than the appropriate failing division defence,[94] or the courts had inappropriately considered the cases under the former instead of the latter.[95] Even where the failing division doctrine has been acknowledged by the courts, the courts still refused to apply it.[96] This sad development can be attributed to the similarities in the requirements for the two defences. On the one hand it may be argued that choosing which defence applies to what situation becomes academic. On the other hand, however, it is submitted that the outcomes of such decisions as *Reed Roller Bit Co* and *Blue Bell Inc*, where the parties failed to demonstrate the failing firm requirements in cases that clearly exhibited failing divisional assets, support a contrary view that advocates for the treatment of the two as separate and distinct defences.

2 4 Interpretation and application of failing firm doctrine in the US: Some concluding remarks

The declining financial condition of a party to a merger is acknowledged both by the courts and enforcement agencies as an exceptional factor that can mitigate a finding that a merger violates anti-trust laws. However, this failing firm doctrine which has been formulated in various ways is interpreted in a narrow sense making it difficult (though not impossible) to prove. The parties claiming the defence are required to cumulatively prove that the target firm is a failing firm on the brink of bankruptcy, that the failing firm could not be successfully re-organised under bankruptcy laws, and lastly that the merging parties had made a good faith unsuccessful attempt to elicit an offer from a reasonable alternative purchaser posing a lesser threat competitively than the acquiring firm.

91 S 11 of 2010 Guidelines. See also para 52 of 1992/97 guidelines.
92 *Ibid*.
93 See, eg, *Reed Roller Bit Co* (fn 40) 584 fn1 and Wait "Surviving the shipwreck: A proposal to revive the failing division defense" 2003 *Will & Mary LR* 429 447.
94 See *FTC v Great Lakes Chemical Corp* 528 FSupp 84 (1981).
95 See *Reed Roller Bit Co* (fn 40); *Great Lakes Corp* (fn 94); *US v Blue Bell Inc* 395 FSupp 583 (MD Tenn 1975).
96 See *Great Lakes Corp* (fn 94) 96; *Reed Roller Bit Co* (fn 40) 584 fn1.

The first requirement regarding the firm being on the brink of bankruptcy is a demonstration that the allegedly failing firm is actually failing. This requires proof that the allegedly failing firm is genuinely failing, that is, it must either be insolvent, on the verge of bankruptcy, or in imminent danger of financial collapse.[97] The merging parties must prove a real risk of business failure, making the requirement difficult to meet.[98]

Proof that a firm is on the brink of bankruptcy is nevertheless not enough. The parties are required to motivate that it cannot be reorganised under bankruptcy laws.[99] This is meant to ensure that the parties exhaust all available avenues necessary to maintain a competitive market structure before resorting to an anti-competitive merger. This is because reorganisations under bankruptcy laws are accepted as ordinarily resulting in a more competitive firm.[100] It must thus be motivated that the contemplated merger is the only option available to save the failing firm from exiting the relevant market.[101]

Lastly, it must be shown that there are no other alternative purchasers besides the acquiring firm. An alternative purchaser is one who, by acquiring the failing firm would pose a less severe danger to competition than the proposed acquiring firm.[102] The prospective alternative purchaser must make a reasonable offer, that is, any offer above the liquidation value of the assets.[103] This requirement presents a number of challenges. It is possible that the price offered by the prospective buyer who qualifies as an alternative purchaser, is too low.[104] Despite the anti-competitive nature of the proposed merger, the proposed acquiring firm might also be willing to pay more than the alternative purchaser. Lastly, it is possible that the only available alternative purchaser might be a non-market participant. The impact of these scenarios is discussed below.

Making a reasonable offer higher than the liquidation value of the failing firm's assets is meant to keep the assets in the relevant market.[105] However, the value may still be low, reflecting the alternative buyer's financial means that might not be in the interests of maintaining strong competition. This is true especially where the proposed acquirer's offer is higher than the liquidation value. The alternative purchaser might not have the capacity to administer the allegedly failing firm as a viable and competent entity as compared to the proposed acquirer.[106] The question then arises as to the motivation of a party to offer a price above the liquidation value for a financially distressed firm.

An acquirer who is a competitor to the failing firm may be motivated by the desire to enhance efficiency as opposed to the mere acquisition of market

97 See *International Shoe Co* (fn 11) 302–303; *Diebold Inc* (fn 64) 655; *Citizen Publishing Co* (fn 14) 280. See also Kokkoris and Olivares-Caminal (2010) 173.
98 See Correia "The failing company defence" (1995) available at http://1.usa.gov/TUEHgB, accessed 20/10/2011 (requiring that the risk of failure be almost 100%).
99 *Citizen Publishing Co* (fn 14) 138. S 11 of *US horizontal merger guidelines*.
100 *Citizen Publishing Co* (fn 714 138.
101 *Ibid*.
102 *Citizen Publishing Co* (fn 14)138.
103 S 11 fn 16 of the *US horizontal merger guidelines*.
104 Correia (1995) (fn 98 above).
105 Kokkoris and Olivares-Caminal (2010) 173.
106 McDavid "Efficiencies, failing firms and the *General Dynamics* defence" (1995) available at http://1.usa.gov/YZIsX5, accessed 20/10/2011.

power.[107] This may not be the same with the alternative purchaser who might not be willing to offer any such efficiency[108] and whose motivation might lie in seeking out a revenue stream without any concerns for maintaining competition.[109] In order to avoid undesired results flowing from the alternative purchaser requirement, the merging parties are required to demonstrate that they have made a good faith effort to explore alternative merger possibilities in seeking *bona fide* offers.[110] Therefore, the good faith attempt requirement provides a safeguard against any possible competition loss.[111] However, it is submitted that the requirement still presents some challenges.

It may be argued that a non-market participant lacks the necessary capacity to maintain competition within the relevant market and is unwilling to retain the assets of the failing firm in the market. There is thus no guarantee that it will maintain the latter's "tangible and intangible assets in the relevant market" and in the process pose a less competitive threat. Since the guidelines are silent on the duration that the acquired assets of the failing firm must be kept within the relevant market, one can surely argue that there is a loophole that can be exploited to the detriment of competition and ask whether this strict criterion serves its intended purpose.

Satisfying all the requirements for a failing firm doctrine is a daunting task as the merging parties are required to meet them cumulatively.[112] Despite a relative degree of flexibility, both the agencies and courts are against relaxing the traditionally narrow and strict criteria as this is seen as lowering the standards of merger regulation and in the process weakening the competition system.[113] A narrow approach to the doctrine thus promotes a strict regime that is assumed to be necessary for the promotion and maintenance of a competitive market structure. The authors accept that this objective is fundamental to competition law and merger regulation in particular, given that where these criteria are met, an otherwise anti-competitive merger is cleared. Although a strict and narrow approach to the failing firm doctrine is justified where the doctrine is regarded as an absolute defence to an otherwise anti-competitive merger, the question may be posed as to whether the same can be said where the doctrine is a mere factor in determining one leg of a substantive test only as opposed to an absolute defence?

It is submitted that a competitive market structure is promoted equally, maintained and protected through a flexible approach to the failing firm doctrine. This approach is epitomised by the South African competition system where establishing that one of the merging parties is a failing firm is not a compete defence

107 See FTC *Competition policy in the new high-tech global marketplace* (1996) 13.
108 Kokkoris and Olivares-Caminal (2010) 174.
109 See Valentine (1995).
110 Kokkoris and Olivares-Caminal (2010) 174.
111 *Idem*175.
112 See Scheffman, Coate and Silva "20 years of merger guidelines enforcement at the FTC: An economic perspective" (2002): "The FTC has successfully challenged a number of mergers where a failing firm defense was alleged" available at http://1.usa.gov/VVi4vK, accessed 20/10/2011; Valentine (1995): "[T]he standards of the defence are strict . . . [and] rarely all are satisfied"; and Friedman "Untangling the failing company doctrine" 1986 *Tex LR* 1375 1376: "[T]he failing firm defense . . . is rarely invoked with success in litigation."
113 *Ibid*.

to justify an otherwise anti-competitive merger, but simply one of many factors in determining whether the merger substantially lessens competition. Accordingly, the discussion will demonstrate that this approach equally promotes and maintains a competitive market structure. However, it will question the rationale of adopting a strict and narrow approach when establishing the criteria for the failing firm doctrine, given the safeguards that are available.

The positions of the US and South Africa on the interpretation and application of the failing firm doctrine in merger control are vary greatly. As will be shown below, this difference is rooted in the policies underlying merger control in the two jurisdictions. However, as much as the approach in the US is strict and narrow, it provides valuable lessons for South Africa, particularly relating to the acknowledgement that businesses are divisible.

3 FAILING FIRM DOCTRINE IN SOUTH AFRICA

The aim of this section is to show that it is possible to promote, maintain and protect a competitive market structure through a flexible interpretation and application of the failing firm doctrine. This flexible approach is achieved in a three-pronged substantive merger assessment test that encompasses the failing firm doctrine only as one of a non-exhaustive list of factors that are taken into account in merger assessment. Given the similarities in the criteria adopted by South African competition authorities to establish the failing firm doctrine in merger assessment to the one applied in the US, unnecessary repetition will be avoided. As such, this section focuses on the implications of the three-pronged substantive assessment test for the interpretation and application of the failing firm doctrine in South Africa.

3 1 South Africa's merger regulatory framework

Merger regulation in South Africa is principally governed by the Competition Act of 1998,[114] and is an integral component of the competition law system that seeks to advance a broader policy objective encompassing socio-economic and political goals.[115] A detailed discussion of these objectives is beyond the scope of this article and reference thereto will only be made in as far as it relates to the substantive test and its impact upon the interpretation and application of the failing firm doctrine.

114 Various other statutes such as the Banks Act 94 of 1996 (bank mergers) and the Long-Term Insurance Act 52 of 1998 (insurance companies), regulate aspects of mergers relating to specific sectors and establishes sectoral regulators who work with competition authorities in terms of s 82(1) of the Competition Act. See Competition Commission of South Africa *Media release 30 of 2001*; *New African Investment Ltd/Kagiso Media Ltd; Standard Bank Investment Corporation Ltd v Competition Commission; Liberty Life Association of Africa Ltd v Competition Commission* 2000 2 SA 797 (SCA) (*Nedcor/ Stanbic*).

115 See long title to the Competition Act 89 of 1998; Preamble to the Competition Act 89 of 1998 and s 2 of the Competition Act 89 of 1998; *Explanatory memorandum: Competition Bill* (2008). See further Kemp and Sutherland *Competition Law of South Africa* (Service Issue 12 Lose leaflet) (2009) 4-3 and Hartzenberg "Competition policy in SADC" 2002 *Trade and Industrial Policy Strategies Annual Forum*, available at http://bit.ly/XSDOc0, accessed 23/03/2012.

3 2 Competition Act and merger regulation

The Competition Act requires that any transaction that qualifies as a merger as defined and that meets the set criteria[116] must be reported before it is implemented. This provision is central to merger regulation in South Africa. Section 12(1)(a) defines a merger as any transaction that results in a direct or indirect acquisition or establishment of control over the whole or part of a business of another firm by one or more firms.[117] In addition, certain mergers must be reported before parties thereto implement them.[118]

As the case in most jurisdictions, the Act's intention is not to frustrate beneficial corporate mergers but to provide for a regulatory framework that may curb the potential anti-competitive effects thereof and in the process promote and maintain a competitive market structure for the greater economic good. This principle is the central principle of merger regulation. The maintenance of the balance between the aims of merger regulation, that is, promoting and maintaining a competitive market structure and promoting the benefits of corporate mergers, is of paramount importance to any merger regime. The extent to which the South African system achieves this goal will be explored within the context of its approach to the failing firm doctrine. As such, the discussion below will focus on the substantive test for merger assessment and its role in the interpretation and application of the doctrine.

3 3 Substantive assessment test

The South African Competition Act provides for a three-pronged test to determine whether a proposed merger transaction must be cleared or blocked. It is essentially an inquiry into the effects of the proposed merger on competition and public interest.

3 3 1 First leg: "Pure competition" test

Section 12A(1) requires the competition authorities to make a preliminary determination of "whether or not a merger is likely to substantially lessen or prevent or lessen competition". Section 12(2) provides a non-exhaustive list of factors[119]

116 See fn 118 below and text therein.

117 See fn 3 above.

118 S 11(5) classifies mergers as small, intermediate or large. Intermediate and large mergers must be notified (s 13A(1) and (3)). Small mergers are exempted from compulsory notification (s13(1), unless parties voluntarily file (s 13(2)) or the Commission requires same (s 13(3)).

119 These factors are: "(a) the actual and potential level of import competition in the market; (b) the ease of entry into the market, including tariff and regulatory barriers; (c) the level and trends of concentration, and history of collusion, in the market; (d) the degree of countervailing power in the market; (e) the dynamic characteristics of the market, including growth, innovation, and product differentiate; (f) the nature and extent of vertical integration in the market; (g) whether the business or part of the business of a party to the merger or proposed merger has failed or is likely to fail; and (h) whether the merger will result in the removal of an effective competitor." See *Industrial Development Corporation of SA Ltd v Anglo-American Holdings in the large merger between Anglo-American Holdings Ltd/Kumba Resources Ltd v Anglo-South Africa Capital (Pty) Ltd/Angolvaal Mining Ltd* 45/LM/Jan02 and 46/LM/Jun02 para 35. The word "including" indicates the legislature's intention to create a non-exhaustive list.

that serve as guidelines[120] that must be assessed for purposes of evaluating the likely effect of the merger on competition.[121]

The point of departure is to ascertain the pre-merger competition levels in the relevant market and then to predict the post-merger competitive structure thereof, followed by a theoretical assessment of the post-merger firm's behaviour and its likely impact upon the competitive structure of the market. The listed factors thus help to determine whether or not the post-merger market structure will deteriorate materially, for instance, "whether the merger will result in the removal of an effective competitor".[122] If one of the merging parties was an effective competitor prior to the merger, competition is likely to be substantially lessened if as result of the merger, the former is eliminated. Likewise, competition is substantially prevented if the merger creates a dominant firm capable of dictating market production and supply patterns and creating entry barriers,[123] hence "the ease of entry into the market" as a factor.[124]

The authorities must also consider whether the business or part thereof of a party to the merger has failed or is likely to fail.[125] Section 12A(2)(g) thus requires consideration of the failing firm and the failing division doctrines as merely factors that must be assessed in order to determine the effects of the merger on competition.[126] This is in contrast to the position in the US where it is an absolute defence to an otherwise anti-competitive merger. Thus, in the US the doctrine is an independent consideration whereas in South Africa it is merely a component

120 *Distillers Corporation (SA)/Stellenbosch Famers' WineryGroup Ltd v Blumer (SA) (Proprietary) Ltd and Seagram (Proprietary) Ltd* 08/CAC/May01 23(ref to old s 16(2) now s 12A(2)). See also *Santam Ltd/EmeraldInsurance* (fn 18) para 52; *Schuman Sasol/ Price's Daelite* (fn 18) 5.

121 This involves both a theoretical and practical analysis of the pre- and post-merger market structure. See *Anglo-American Holdings/Kumba Resources (with IDC intervening)* 46/LM/Jun02 paras 108–109; *SchumanSasol/Price's Daelite* (fn 18) 5 (the initial inquiry aimed at predicting whether the merger will have a material effect on competition). In *Mondi Ltd and Kohler Cores and Tubes v Competition Tribunal* [2003] 1 CPLR 25 (CAC) 33c the court clarified that the prediction must not amount to an unsubstantiated speculation.

122 S 12(2)(h) of the Competition Act.

123 Entry barriers can be defined as including any hindrance to entry, be it a result of actions of the incumbents or due to some policy measures. See further, Armentano *Anti-trust policy* (1986) 31–44; Stigler *The organisation of industry* (1968) 67–70; Demstetz "Barriers to entry" 1982 *American Economic R* 47 and generally Bork *The anti-trust paradox: A policy at war with itself (with a new introduction and epilogue)* (1993) 310–329. See also Fox and Sullivan "Anti-trust retrospective and prospective: Where are we coming from? Where are we going?" 1987 *New York U LR* 936 974 (any "instrumental concept that determine the nature and extent of forces outside the market that may increase the reaction of the incumbents to consumer wants and needs"); Bain *Barriers to new competition* (1956) (barriers to entry are factors that allow incumbents to raise prices that are above cost without attracting entry).

124 S 12A(2)(b) of the Competition Act.

125 S 12A(2)(g).

126 This statutory position has been emphasised in almost all the cases in which the failing firm doctrine was considered. See *Iscor Limited/Saldanha Steel* (fn 18) para 101; *Santam Ltd/Emerald Insurance Co* (fn 18) para 52.

of an assessment encompassing various other factors and which, on its own, can never justify a merger.[127]

The South African competition authorities interpret the factors provided by the Competition Act to evaluate the likely effects of a proposed merger widely in order to ensure that the statute is applied to restrain a wide range of anti-competitive practices, including anti-competitive mergers.[128]

Having determined the likely effects of the merger on competition under section 12A(1), the next step is to consider whether there are any pro-competitive grounds that outweigh or offset these anti-competitive effects.[129] This second leg recognises the possibility that there might be some benefits that outweigh and offset the anti-competitive concerns raised by the first leg.

3 3 2 Second leg: "Efficiency defence"

The second leg of the test determines whether substantial benefits exist to justify an otherwise anti-competitive merger. Section 12A(1)(a)(i) provides that, if a merger is found to substantially prevent or lessen competition in terms of section 12A(1) and after assessing the factors set out in subsection (2), the authorities must assess whether the proposed merger will "result in technological, efficiency or other pro-competitive gains which will be greater than, and off-set, the effects of any prevention or lessening of competition that may result or is likely to result from the merger, and would not likely be achieved if the merger is prevented".[130]

By acknowledging that a seemingly anti-competitive merger can still be beneficial, the second leg constitutes a balancing act between "pure competition" and efficiency considerations in a bid to create a workable merger regulation regime.

The assessment is not limited to pure efficiency benefits but extends to any "other pro-competitive gains".[131] A merger that raises competition concerns may thus be approved if merging parties can establish that the merger is likely to result in efficiency or any benefits that might outweigh or set off any likely resultant anti-competitive effects.[132] However, even if efficiency or any other benefits

---

127 Failing firm claims can be used to determine whether a proposed merger will substantially lessen competition through the elimination of an effective competitor. See eg in *Santam Ltd/Emerald Insurance Co* (fn 18) paras 82 84 (target not a failing firm as it fails to demonstrate such hence still regarded as an effective competitor).

128 Preamble to the Competition Act 89 of 1998. See *IDC (SA)/Anglo-American Holdings* (fn 119) para 37; *Distillers Corporation (SA)* (fn 120) para 358. See further on purposive interpretation through the preamble, *Stopforth v Minister of Justice* 2000 1 SA 113 (SCA) 122 (interpreting the Promotion of National Unity and Reconciliation Act 34 of 1995); *Throroughbreeders' Association v Price Waterhouse* 2001 1 SA 551 (SCA) 623–624 (interpreting the Apportionment of Damage Act 34 of 1956). See, generally, Kellaway *Principles of legal interpretation statutes, contracts and wills* (1995) 69.

129 S 12A(1)(a)(ii) of the Competition Act. See *IDC (SA)/Anglo-American Holdings* (fn 119) para 22.

130 S 12A(1)(a)(i) of the Competition Act.

131 *Ibid*.

132 See *Tiger Brands Ltd/Ashton Canning Co (Pty) Ltd Newco and Langeberg Foods International* 46/LM/May05 paras 112 113 (parties must not merely allege efficiency gains but must prove that the latter will outweigh the anti-competitive effects of the merger and further that the benefits can only be achieved through the merger). The onus of proving the above is on merging parties. See also *Trident Steel (Pty) Ltd/Dorbyl Ltd* 89/LM/Oct00.

can be established, the merger is still subjected to a further scrutiny under the final leg of the test, namely, the public interest leg.

3 3 3 Final leg: Public interest test

If the merger raises competition concerns, the authorities must consider "whether the merger can or cannot be justified on substantial public interest grounds".[133] The authorities are further enjoined to "otherwise" have regard to specified public interest grounds in order to determine whether or not a merger can be justified after making a determination on its competition effects.[134] These public interest grounds are specified as the effects of the merger on:

(a) a particular industrial sector or region;[135]

(b) employment;[136]

(c) the ability of small-sized businesses or firms previously owned or controlled by historically disadvantaged groups to compete;[137] and

(d) ability of national industries to compete internationally.[138]

The public interest test is the ultimate test in determining the fate of a merger.[139] The significance of this is that the merger still needs to be scrutinised for public interest compatibility regardless of the results of the first two legs. The public interest leg can thus result in either the approval of a merger that would have failed the first two hurdles or the prohibition thereof in spite of it having passed the first two legs. The extent to which this "Janus-faced"[140] quality of the test impacts on the interpretation and application of the failing firm doctrine in South Africa forms the basis of this section and will be explored below.

3 4 Substantive test and failing firm doctrine

As indicated above, the Competition Act provides a three-pronged substantive assessment test to determine whether a merger is likely to substantially lessen or prevent competition. The initial leg of the test is a "pure competition" inquiry to determine whether a merger is likely to negatively affect competition. This is done through assessing the non-exhaustive list of factors provided in section 12A(2).[141]

If the initial inquiry reveals that the merger is likely to raise competition concerns, the second step is to determine whether or not these concerns can be outweighed or offset by any technological, efficiency of other pro-competition gains.[142] This balancing act includes a consideration of whether the merger can or cannot be justified under specific public interest grounds

133 S 12(1)(a)(ii) of the Competition Act.
134 S 12(1)(b).
135 S12A(3)(a). See *Nasionale Pers Ltd/Education Investment Corporation Ltd* 24 LM/May03 para 23 (effect of the merger on the education sector); *PSG Investment Bank Holdings Ltd/Real Africa Durolink Holdings Ltd* 31/LM/May01 (effect of bank exit on that particular sector).
136 S 12A(3)(b). See eg *Wal-Mart Stores Inc/Massmart Holdings Ltd* 73/LM/Nov10.
137 S 12A(3)(c).
138 S 12A(3)(d).
139 *IDC (SA)/Anglo-American Holdings* (fn 119) para 22.
140 *Ibid*. See also Kemp and Sutherland (2009) 10-93.
141 See fn 119.
142 S 12A(1)(a)(i).

provided in section 12(3).[143] The ultimate test is an assessment of the public interest compatibility of the merger regardless of the outcomes of the first two legs of the test.

It appears that only a finding that the merger raises competition concerns would necessitate a further inquiry into whether there are any grounds, either efficiency or public interest, to justify its approval. However, even if the merger raises no competition concerns upon a preliminary assessment, the authorities are still required to consider whether the merger can or cannot be justified on substantial public interest grounds.

At first glance there appears to be a repetition of the public interest requirement in paragraphs (a)(ii) and (b) of section 12A(1). Both provisos refer to the determination of whether the merger can or cannot be justified on substantial public interest grounds listed in subsection (3). There are, however, material differences in the application of these different legs of the test. On the one hand, section 12A(1)(a)(ii) is applicable only if the initial determination reveals competition concerns. The use of the word "otherwise" in section 12A(1)(b), on the other hand, makes a scrutiny for substantial public interest compatibility applicable notwithstanding the outcome of the initial inquiry. The authorities can thus still subject a merger to a public interest scrutiny even if it has been found to raise no competition concerns following the initial test or, alternatively, is justified under the second leg.[144] Lastly, the public interest test "must" be applied, that is, the authorities are not at liberty to do away with these considerations in merger assessment. How do these observations impact on the interpretation and application of the failing firm doctrine?

An assessment of whether the business or part thereof of a party to the merger has failed or is likely to fail is one of the factors that must be considered in determining the likely effects of a merger on competition. Recently, in *Pioneer/Pannar*[145] the Competition Appeals Court noted that "where the demise of one of the competitors is inevitable, albeit that the precise time when this occurs, is uncertain", constitutes an exception to the presumption that competition would be substantially lessened when the number of market participants are reduced from three to two (as in this case).[146] However, this does not in any way entail that such a finding justifies an outright approval of the merger. In other words, the authorities must go beyond determining whether the failing firm doctrine is applicable. Although the doctrine is given express statutory recognition[147] there are no further statutory or administrative guidelines on what must be proven to

143 S 12A(1)(a)(ii).
144 See *IDC (SA) v Anglo-American Holdings* (fn 119) para 138.
145 *Pioneer Hi-Bred International Inc/Pannar Seed (Pty) Ltd v The Competition Commission/African Centre for Biosafety* 113/CAC/Nov11 para 29.
146 *Ibid*. The merger between Pioneer, a US-based international developer and supplier of plant genetics and Pannar, a local firm, would have resulted in the creation of Pioneer/Pannar and eliminated Pannar, leaving only the newly merged entity and Monsanto South Africa as the competitors. See a similar approach in the EU in the *Arthur Andersen* Cases, Case COMP/M.2810, *Deloitte & Touché/Andersen UK* 01.07.2002 and Case COMP/M 2824, *Ernest & Young/Andersen Germany* 27.08.2002; Case COMP/M. 2816 *Ernst & Young France/Andersen France*, Commission decision of 5 September 2002.
147 *Santam Ltd/Emerald Insurance Co* (fn 18) 52.

make a successful failing firm claim.[148] South African authorities have acknowledged this lack of statutory guidelines, hence the use of criteria developed elsewhere.[149] This entails that parties need to successfully establish the criteria formulated, *inter alia*, in the US as discussed above, as well as the modified version of the EU test.[150] The EU test requires a demonstration that should the failing firm exit the relevant market, the acquiring firm would take over its assets and market share.[151] This stricter EU requirement is preferred by the Tribunal.[152] However, a look at both the statutory framework and decisions of the competition authorities provides useful insight into how the doctrine is interpreted and applied in South Africa.

3 5 Establishing failing firm doctrine

3 5 1 When is a firm deemed failing or likely to fail?

Section 12A(2)(g) provides that a determination must be made to assess whether the business, or part of it, has failed or is likely to fail. In the first instance, all that is needed is proof that the party's business has failed, meaning that it is no longer a market participant. Issues are raised in respect of the "likely to fail" requirement. The authorities employ a factual analysis that goes beyond a determination of the firm's financial distress.[153] Failure, thus, is not equal to inability to meet financial obligations, meaning that it goes beyond ordinary insolvency.[154] The rationale is that a firm that is able to pay its debts can still decide to withdraw from the market and hence cannot be deemed to have failed.[155] Parties must support claims of likeliness to fail by documentary evidence.[156] Failure is deemed imminent if the evidence shows that the risk of failure is greater than the anti-competitive effects of the merger.[157] Parties also need to clarify the causes

148 Cf the US where despite no statutory recognition, the agencies had developed guidelines from case law. See discussion in text 2.2.

149 See *Santam Ltd/Emerald Insurance Co* (fn 18) para 55*; Schuman Sasol/Price's Daelite* (fn 18) para 59 (decision overturned upon appeal, tribunal's principles on the failing firm doctrine remained unchanged); *Iscor/Saldanha Steel* (fn 18) para 101.

150 EC "Guidelines on the assessment of horizontal mergers under Council Regulation on the control of concentrations between undertakings" [2004] *OJ* C31/5 paras 89–90; *Kali und Salz/MdK/Treuhand* IV/M308 [1994] *OJ* L186; Joined Cases C-68/94, and 30/95 *France v Commission*, *Societe Commerciale es Potasses et de l'Azore (SCPA) v Commission* [1998] ECR I-1375; [1998] 4 CMLR 829 and further Kokkoris (2006) 499.

151 Para 90 of the *EU horizontal Merger Guidelines*; *Kali und Salz* (fn 150); *Saint-Gobain/Waker-Chemie*/NOM [1997] OJ l 247/1 247.

152 See *Iscor/Saldanha Steel* (fn 18) para 110(3). See *Pioneer/Pannar* (fn 145) paras 3 28 where the CAC utilised the EU approach that a finding that one of the merging party's (the target firm's) weakened competitive status would inevitably result in it failing and exiting the relevant market with the result that competition would decline in a similar manner as the merger.

153 *Santam Ltd/Emerald Insurance Co Ltd* (fn 18) paras 56 58.

154 *Iscor/Saldanha Steel* (fn 18) para 109; *Santam Ltd/Emerald Insurance Co* (fn 18) para 56. In *Schuman Sasol/Price's Daelite* (fn 18) para 68, claims that the target firm was a failing firm were dismissed (mere parlous financial circumstances not conclusive of failure). Cf s 11 of the 2010 US guidelines requiring proof of factual insolvency.

155 *Iscor/Saldanha Steel* (fn 18) para 109.

156 *Idem* para 110(5); *Santam Ltd/Emerald Insurance Co Ltd* (fn 18) para 65 (held no evidence to support failing firm claims).

157 *Iscor/Saldanha Steel* (fn 18) para 110(5).

of the alleged failure to enable authorities to assess how the merger will address them.[158] Ultimately, parties must show a genuine failing firm rather than merely an "ailing"[159] business or part thereof.

As noted above, the requirement of failure in South Africa is a purely factual analysis that must be supported by documentary evidence. This position must not be confused with the solvency and liquidity requirement in corporate law, whereby an entity is deemed to be failing if it cannot pass the solvency and liquidity test, that is, 'if considering all the reasonably foreseeable financial circumstances of the company", firstly, "the total assets of the company equal or exceed the liabilities of the company as fairly valued", and secondly, "it appears that there will be able to pay its debts as they become due in the ordinary course of business".[160] Failure in merger control envisages more than an inability to pay debts but is the actual or likelihood of the business exiting from the relevant market.

3 5 2 No prospect of reorganising failing firm

After proving that failure is imminent, it must be demonstrated that the merger is the only option to revive the waning fortunes of the troubled firm. There must be no other available options for re-organising the failing firm. It is assumed that this re-organisation is the "business rescue" mechanism provided under the new Companies Act,[161] given that the insolvency laws do not provide for corporate re-organisation mechanisms. The parties must demonstrate that the merger, though anti-competitive, is the only available option to save the failing firm so that it can continue as part of a competitive unit.[162] Alternatively, if the troubled firm is to be eliminated, there must be no prospects of reviving it to continue operating as a viable and competitive stand-alone entity.[163] The merger becomes a necessity to rescue the failing firm.[164] This requirement is met if parties can show that there are no other options, besides the merger, that might rescue the troubled firm so that it remains within the relevant market.[165]

3 5 3 Alternative purchaser requirement

Even if the parties can prove the two requirements above, they must still demonstrate that there are no alternative purchasers whose acquisition of the failing target might produce less anti-competitive results.[166] The merging parties must

158 *Schuman Sasol/Price's Daelite* (fn 18) para 62.

159 Kokkoris "Failing firm defence in the European Union: A panacea for mergers?" 2006 *ECLR* 494 495. A firm is genuinely failing if bankruptcy is the only alternative to failure. It is merely "ailing" where other revival alternatives exist. See *Schuman Sasol/Price's Daelite* where the failing firm claim was rejected *inter alia* because it was not shown that there were no options besides the merger.

160 See s 4 of the new Companies Act of 2008.

161 Ss 128–155 of the new Companies Act of 2008.

162 *Santam Ltd/Emerald Insurance Co Ltd* (fn 18) para 76.

163 *Ibid*.

164 See Kokkoris (2006) 494: the failing firm must not significantly benefit from the merger besides surviving. If it stands to benefit, then it is not failing. However, this might present challenges in evaluating its actual worthiness given that its real value lies not in its debt but rather its assets.

165 See fn 158.

166 *Santam Ltd/Emerald Insurance Co Ltd* (fn 18) para 66; *Schuman Sasol/Price's Daelite* (fn 18) para 64.

show that they made a good faith effort to elicit alternative purchasers[167] and such claims must be verifiable and not mere assertions.[168]

In *Iscor/Saldanha Steel*, the Competition Tribunal expressed its willingness to apply the EU approach to the alternative purchaser requirement.[169] This approach requires a demonstration that, should the failing firm exit the market, its productive assets will exit the market and fall into the hands of the acquiring firm,[170] as there would be no other market incumbents to take over the void left by the exiting firm.[171] The parties must show that absent the merger, the productive assets of the failing firm would invariably exit the market.[172] Additionally, the primary acquiring firm would nonetheless acquire the exiting firm's market share.[173] The merger thus ceases to be anti-competitive despite the acquisition of market dominance given that the market structure would have deteriorated anyway as the failing firm ceased to be an effective competitor.[174]

In assessing the effect of failure on the competitive structure, the authorities need to ask questions as to what will happen to the failing firm's market share post-merger rather than as to where the failing firm's market share will go.[175] Asking the latter will provide an obvious answer: it will be acquired by the acquiring firm. In case of the former, if it can be shown that the acquiring firm will absorb the failing firm's market share with or without the merger, prohibiting the merger on the basis that the acquiring firm will acquire a dominant market position will not make sense as the market situation was going to deteriorate anyway. This requirement is not present in the US but was first formulated in the EU in *Kali und Salz*.[176] The merger will thus not have caused a deterioration in market conditions.[177]

3 5 4 Burden of proof

Merging parties seeking to rely on the doctrine bear the burden of proving the criteria set out above.[178] Interestingly, the Act provides that the competition authorities must take into account the failing firm doctrine as a factor in

167 See *Schuman Sasol/Price's Daelite* (fn 18) para 38 (on making a good faith attempt at eliciting alternative purchasers, held that an exorbitant purchase price that can only be met by the acquiring firm is not a reasonable offer made in good faith).

168 *Santam Ltd/Emerald Insurance Co Ltd* (fn 18) para 67 (claims for good faith efforts to elicit alternative offers must be verifiable and not merely bold, unsubstantiated statements).

169 See *Santam Ltd/Emerald Insurance Co Ltd* (fn 18) para 58. See also *Schuman Sasol/Price's Daelite* (fn 18) para 67.

170 See authorities cited in fn 134.

171 In *Schuman Sasol/Price's Daelite* (fn 18) paras 67 68.

172 Para 67.

173 Para 66.

174 See *EU horizontal merger guidelines* para 89. See further Kokkoris (2006) 495 and Baccaro "Failing firm defence and lack of causality: Doctrine and practice in Europe of two closely related concepts" 2004 *ECLR* 11 23.

175 *Schuman Sasol/Price's Daelite* (fn 18) para 66.

176 *Kali und Salz* (fn 150) para 78. See also Case 1V/M 1221 *Rewe/Menl* [1999] OJ L274/1 para 63.

177 See fn 158 and 171 above.

178 *EC horizontal merger guidelines* (2004) para 91. See also *Iscor/Saldanha Steel* (fn 18) para 110 (7); *Santam Ltd/Emerald Insurance Co* (fn 18) para 50 and Kokkoris (2006) 497.

determining the likely effect of the merger on competition.[179] This raises the question as to whether the authorities must also raise the doctrine should they consider it necessary for merger assessment. This approach was adopted by the Competition Commission in *Santam Ltd/Emerald Insurance Co Ltd* in recommending to the Tribunal that the merger be approved since it involved a failing firm.[180] However, despite exploring the doctrine in *Tiger Brands Ltd/Ashton Canning Co (Pty) Ltd Newco* even though the parties had expressed no intention to rely on it as the basis for seeking approval,[181] the Tribunal required the merging parties to establish the grounds to justify the doctrine's applicability.[182]

The high evidentiary burden in establishing the doctrine makes it difficult to successfully invoke it.[183] This high standard is aimed at ensuring that only mergers involving genuine failing firm claims get the authorities' approval.[184] Thus it is aimed at ensuring that a competitive market structure is maintained in recognition of the fact that even mergers involving failing firms might create an uncompetitive market structure. Accordingly, failing firm claims are not a basis for parties to expect leniency from competition authorities[185] as they are not simply a "panacea"[186] for anti-competitive mergers.

3 6 Impact of substantive test on failing firm doctrine

The failing firm doctrine is but one of many factors that are assessed in determining a merger's likely competition effects. The story does not end with either a successful or failed failing firm claim. A successful failing firm claim only assists the authorities in making a determination on the likely effects of the merger on competition under the first leg of the test. Similarly, the merger is not prohibited merely because the parties failed to establish the doctrine. The merger is still subject to further scrutiny.

A successful failing firm claim in South Africa does not justify approval of an otherwise anti-competitive merger. It is not an absolute defence to the latter.[187] Given the strict criteria for establishing the doctrine, it is difficult to imagine a merger where it has been established that a party thereto is a failing firm as being anti-competitive. However, this does not mean it is impossible.[188] For instance, a genuinely failing firm, established after complying with rigorous criteria, cannot qualify as an effective competitor, hence its removal from the market does not

179 S 12A(2)(g).
180 *Santam Ltd/Emerald Insurance Co* (fn 18) para 50.
181 *Tiger Brands/Ashton Canning* (fn 132) paras 71–79.
182 *Santam Ltd/Emerald Insurance Co* (fn 18) para 50.
183 See Webber Wentzel "The failing firm: A bridge too far" (2001), available at http://bit.ly/UTJlfv, accessed 26/10/2011. The high burden is also a feature of the EU approach where the requirements must as a general rule, be established cumulatively. See Case IV/M. 993 *Bertelsmann/Kirsch/Premiere* (1999) OJ L53/1.
184 *Santam Ltd/Emerald Insurance Co Ltd* (fn 18) paras 53 57.
185 Webber Wentzel (2001). See eg *Schuman Sasol/Price's Daelite* (fn 18) para 57 (parties argued for a lower standard); *Iscor/Saldana Steel* (fn 18) para 110(6) (parties must not expect leniency if they fail to meet the alternative purchaser requirement).
186 Kokkoris (2006); *Iscor/Saldana Steel* (fn 18) para 77 (doctrine is recognised as a sanitiser to mergers that might otherwise raise competition concerns).
187 *Iscor/Saldanha Steel* (fn 18) para 101; *Santam Ltd/Emerald Insurance Co* (fn 18) para 52.
188 See generally *International Shoe Co* (fn 11) and *Kali und Salz* (fn 150). See also Hewitt "The failing firm defence" 1999 *OECD J of Competition L and Policy* 113 115.

deprive it of an effective competitor to materially alter the competitive market structure.[189] Furthermore, the strict requirements vindicate the conclusion that mergers involving failing firms are only anti-competitive in extreme cases.

The substantive test impacts on the failing firm doctrine: Firstly, in respect of the interpretation of the doctrine and, secondly, on its subsequent application. Section 12A(1)(a)(ii) requires the competition authorities, after determining that the merger is likely to substantially lessen or prevent competition, to determine whether it can or cannot be justified on specified public interest grounds. If a merger raises competition concerns and the doctrine is successfully invoked, it can neutralise the anti-competitive effects but is still subjected to further scrutiny. The fact that the doctrine is successfully raised does not justify approving the merger if the other conditions of the test are not met. The authorities employ a standard analysis approach to merger evaluation, compelling them to thoroughly scrutinise a merger. This entails assessing the competition effects and performing a balancing act to determine whether the merger can be justified on either substantial gains or public interest grounds. The authorities can thus still subject a merger to all the legs of the test, irrespective of whether they have exhausted the failing firm doctrine.[190]

The "Janus-faced" quality[191] of the three-pronged substantive assessment test enables a merger that might have failed to pass the competition muster; that is, the first leg, to be authorised if it can be justified on either public interest grounds or efficiency gains. Similarly, a merger that raises no competition concerns can still be prohibited if it is not compatible with public interest.[192] It is thus possible for a merger involving a failed "failing firm" claim to be authorised if it raises neither competition concerns nor public interest issues.[193] However, the question is whether the position would be different if serious competition or public interest concerns were raised.

Theoretically, the public interest leg of the test can operate to either sanction an anti-competitive merger or block one that raises no such concerns.[194] The former can be a "panacea"[195] for a failed failing firm claim, given that the Act enjoins in no uncertain terms that the authorities must consider an otherwise anti-competitive merger to see if it can be justified on substantial public interest grounds.[196] This is further supported by the use of the term "can" in section 12A(a)(ii), implying that the legislature intended the public interest scrutiny to go beyond mergers raising no competition concerns, thereby proving a theoretical possibility for approving otherwise anti-competitive mergers. However, practice shows otherwise as the authorities have hardly ever approved anti-competitive mergers on public interest grounds alone.[197]

---

189 *Santam Ltd/Emerald Insurance Co* (fn 18) para 82.

190 See *Santam Ltd/Emerald Insurance Co* (fn 18) para 101; *Schuman Sasol/Price's Daelite* (fn 18) paras 73–76.

191 *IDC (SA) v Anglo-American Holdings* (fn 119) para 22.

192 *Anglo-American Holdings Ltd/Kumba Resources Ltd* (fn 121) para 137.

193 See *Santam Ltd/Emerald Insurance Co* (fn 18) paras 56 65 76 102.

194 *Anglo-American Holdings Ltd/Kumba Resources Ltd* (fn 121) para 137.

195 See Kokkoris (2006).

196 S 12A(a)(ii).

197 Moodaliyar "Competition policy in the SADC: A South African perspective" in Drexl *et al* (eds) *Competition policy and regional integration in developing countries* (2012) 66–85 69.

The second possibility, relating to the substantive test, is that a merger that raises no serious competition concerns can still be blocked if it "cannot" be justified on substantial public interest grounds since it is subjected to further scrutiny under section 12A(1)(b). The legislature clearly intended this further scrutiny as it could simply have limited the inquiry to the one provided under paragraph (a)(ii). This is evidenced by the use of the terms "otherwise" and "cannot" in section 12 A(1)(b). If a merger raises no competition concerns, the inquiry will be whether it "cannot" be justified.[198] The implication of this approach to the application of the failing firm doctrine is that even if parties succeed in establishing the failing firm claim, thereby rendering the merger free of competition concerns, the authorities still may prohibit it if it cannot be justified under public interest grounds. Equally true is that, if the merger raises serious competition concerns and there exist no public interest grounds to justify it, then it can be prohibited.

A construction that requires parties to positively prove public interest justifications where no serious competition concerns are raised can lead to drastic and undesired results. This might create unnecessary anxiety and hardships for merging parties, as well as requiring the authorities to engage in the rather daunting task of determining the feasibility of such claims. Accordingly, the authorities have imposed certain conditions prior to approving such mergers in order to ensure that they are compatible with public interest goals.[199] These measures includes holding parties to their public interest commitments and in certain cases making sure that the transaction is not implemented until parties demonstrate a willingness to abide by such conditions.[200]

It is submitted that the three-pronged substantive assessment test incorporating a public interest component enables authorities to avoid an unnecessarily rigid and formalistic approach to merger evaluation that could potentially block certain socially beneficial transactions. The test thus promotes a flexible approach to the application of the failing firm doctrine in South Africa through a comprehensive standard merger analysis. This answers a number of critics of the

198 *Anglo-American Holdings Ltd/Kumba Resources Ltd* (fn 121) para 139.

199 See generally *DB Investments SA v De Beers Consolidated Mines Ltd* [2001–2002] CPLR 172 CCT (merger approved on condition that the merging parties undertake not to change the conditions of employment for a specified period); *Duan et Cien AG/Kolosus Holdings Ltd* 10/LM/Mar03 (Tribunal imposed conditions requiring parties to limit the number of job losses to 150 for a year post-merger); *Tiger Brands/Ashton Canning* (fn 125) (merger approved on condition that the parties would not, *inter alia*, retrench more than 45 employees from the aggregate number of those employed by both firms immediately prior to the decision). However, cf *Shell South Africa (Pty) Ltd/Tepco (Pty) Ltd* 66/LM/Oct 01: in unconditionally approving the merger, the Tribunal criticised the Commission's conditions holding that "empowerment is not furthered by obliging firms controlled by historically disadvantaged persons to continue to exit on a life support machine". See similarly *Wesbank*, *a division of First Rand Bank Ltd/Industrial Machinery Finance Book (owned by Barloworld Equipment Finance*, *a division of Barloworld Capital (Pty) Ltd)* 2004 2 CPLR 337 CCT; *Glaxo Wellcome plc/Smithkline plc* 58/AM/May01 para 20 and *Gold Fields Ltd/Harmony Gold Mining Co Ltd* 93/LM/Nov 04 para 33.

200 See eg *DB Investments SA v De Beers Consolidated Miners Ltd* [2001-2002] CPLR 172 CCT (merger approved on condition that the merging parties undertake not to change the conditions of employment for a specific period post-merger); *Duan et Cie AG/Kolosus Holdings* (fn 199) (approved on condition that parties limit the number of job losses to a specified figure per year).

doctrine in its traditional formulation and promotes an effective merger regulatory framework.

Critics of the doctrine have ranged from those calling for its total denunciation to those calling for the relaxation of the traditional criteria. The former argue that in the event of a failing firm claim exhibiting some efficiency claims, it must then be treated as an efficiency defence.[201] Similarly, if the merger exhibits some public interest benefit then it must be considered under public interest.[202] However, this approach has been flatly rejected in South Africa because considerations of efficiency and public interest are adequately provided for elsewhere. Bringing them under the doctrine would only cloud issues.[203] The only public interest benefit in the context of the failing firm doctrine seems to lie in ensuring that the merger would not negatively affect competition but rather enhance it.[204] This ensures that authorities maintain their focus, especially when dealing with public interest considerations.[205]

4 CONCLUSION

In the US, establishing the set criteria for a failing firm doctrine constitutes an absolute defence to an otherwise anti-competitive merger. This largely justifies insisting on a narrow and strict approach thereto in order to promote and maintain a competitive market structure. Unfortunately, this approach renders it difficult for parties to successfully invoke the defence. The US Supreme Court in such decisions as *General Dynamics* has adopted a flexible approach that demonstrates that it is not entirely impossible to meet the failing firm criteria. However, if such decisions are treated as an isolated incident, the story is different. The guidelines clearly require a strict approach. Given that clearing an otherwise anti-competitive merger poses anti-competitive threats, it is submitted that a strict though flexible approach is justified where the doctrine is interpreted as an absolute defence.

The US's approach to the failing firm and failing division doctrines continues to influence the development of the doctrines in many jurisdictions. The South African merger control system, by contrast, is underpinned by policies that are distinct from that of the US as the South African system is part of a broader competition system that was formulated as part of a comprehensive socio-economic policy.

---

201 See Valentine (1995).

202 *Ibid*. See also *Iscor/Saldanha Steel* (fn 18) para 110(1) (parties must not bring a failing firm claim if it amounts to other factors) and *Tiger Brands/Ashton Canning* (fn 132) para 71 (failing firm doctrine considered under public interest, employment in para 128).

203 *Iscor/Saldanha Steel* (fn 18) paras 95 96 99 110(1). Dragging public interest and efficiency issues into the failing firm doctrine would not only cloud issues, but also result in the possibility of anti-competitive mergers being authorised on sympathy grounds.

204 See *Pioneer/Pannar* (fn 145 above) paras 22 28 (although the case was not decided on the failing firm doctrine, see para 3).

205 See Manoim Presiding Member of the Panel of the Competition Tribunal of South Africa in *Wal-Mart Stores Inc/Massmart Holdings Ltd* (fn 136) para 32 ("Tribunal's job in merger control is not to make the world a better place, *but* only to prevent it becoming worse as a result of a specific transaction") and also *Natal Association of Pharmaceutical Wholesalers v Glaxo Wellcome (Pty) Ltd* CT 68/IR/Jun00 para 64.

Whereas the US position is that the failing firm doctrine is an absolute defence to an otherwise anti-competitive merger, the South African system provides an alternative approach to the doctrine where establishing that a party to a merger is a failing firm does not justify approval thereof. The merging parties must still successfully satisfy other requirements of a three pronged substantive assessment test, notably, whether the merger can be justified under substantial public interest grounds. It is still required that the parties successfully meet the failing firm criteria that have been formulated in other jurisdictions. This means that the strict and narrow criteria must be satisfied before failing firm claims can be justified. The rationale is that this is meant to promote and maintain a competitive market structure. However, given that the substantive assessment test provides enough safeguards to ensure that this is achieved, it becomes difficult to justify a requirement that parties must meet a strict failing firm criterion. It is submitted that a relative degree of flexibility in this regard will not harm competition, given that the substantive test and, in particular, the public interest requirement, can provide safeguards to ensure that only genuinely failing firm claims are credited.