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THE FAILING FIRM DOCTRINE IN SOUTH AFRICA

by

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ACKNOWLEDGEMENTS

I dedicate this dissertation to my late mother, Paulinah Dikeledi Phashe, I am blessed to have experienced a love like yours. To my Supervisor, WJC Swart, thank you for your patience and guidance throughout this journey. To my aunt, Betty Maredi, thank you for always believing in me, I am because you are. To my family, thank you for cheering me on, your faith and love is appreciated. To my friends, thank you for being there for me, for encouraging me to finish this dissertation and for never letting me give up. Lastly, but most importantly, I would like to thank God for being faithful for his sufficient grace and never-ending mercy. Modimo ke o mogolo.

ABSTRACT

The financial and economic crisis has put businesses all over the world in danger of going out of business leading to the biggest industry restructuring in decades. measures may not be sufficient to ensure a firm's survival and competitiveness. Mergers and acquisitions can be one of the options at the disposal of the distressed firm. The failing firm doctrine or defence allows failing firms to merge or be acquired by a profitable firm in a transaction that would normally be regarded as anti-competitive in a merger review.

The legislative framework that incorporates and applies the failing firm doctrine in South Africa is set out in section 12A(2)(*g*) of the Competition Act. It lists the failing firm doctrine as one of the factors to be considered when determining whether a merger will result in the substantial prevention or lessening of competition. Under the failing firm defence in South Africa, a merger that would be prohibited due to its anti-competitive effect could be permitted if the alleged failing firm (a) is unable to meet its financial obligations, (b) there is no other offer from a firm that would result in less anti-competitive effects, and (c) its assets would exit the market in the absence of the merger.

This dissertation considered the failing firm doctrine in respect of merger evaluation and discussed the objectives set out in the Competition Act 89 of 1998. It has evaluated how the failing firm doctrine is formulated in South Africa aligns with the interpretation and application thereof in foreign jurisdictions such as the United States of America, the European Union, and Canada. It has taken into consideration a variety of case law and secondary sources to explore first, how the defence is approached and applied, and second, whether it is necessary to reconsider the defence in light of the pandemic.

Furthermore, while the defence in general is taken into consideration, the pandemic has highlighted the importance of the defence's role in accomplishing goals in achieving public interest objectives.

This dissertation argued that the substantive assessment test in section 12A of the Competition Act 89 of 1998 is capable of preserving a competitive market structure by

treating the doctrine as a factor, that the flexible approach that competition authorities currently take, is capable of taking into consideration any economic crisis.

This research is limited to the position of the law as of November 2022.

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CHAPTER 1

INTRODUCTION

1.1 Introduction

Mergers and acquisitions are some of the mechanisms used by firms for implementing restructuring transactions.[1] Section 12 of the Competition Act 89 of 1998("Competition Act") makes provision for the competition authorities to use merger control as one of the instruments to assist the government in achieving the objective as set out by the preamble of the Competition Act. The foundation of the Competition Act is rooted in section 9(2) of the Constitution of the Republic of South Africa,[2] which provides that:

"Equality includes the full and equal enjoyment of all rights and freedoms. To promote the achievement of equality, legislative and other measures designed to protect or advance persons, or categories of persons, disadvantaged by unfair discrimination may be taken."[3] Section 1(2)(*a*) of the Competition Act states that the Act should be interpreted in line with the Constitution.[4]

The Competition Act seeks to "promote competition in the interest of transforming ownership of the economy, advancing the social and economic welfare of all South Africans, and safeguarding that small businesses have an equitable opportunity to participate in the economy".[5] South African competition policy therefore seeks to promote and achieve both economic welfare and non-economic welfare objectives as articulated in the Competition Act.[6] The Act require consideration of competition and public interest factors in the determination of mergers.[7] This means that after conducting a competition test, competition authorities must determine whether the merger can or cannot be justified on substantial public interest grounds.[8] Competition law jurisprudence is rooted in economic efficiency and consumer benefits which

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[1] Nzero "Interpretation and application of the failing firm doctrine in merger regulation in South Africa and the US: A comparative analysis" 2014 *THRHR* 44.
[2] The Constitution of the Republic of South Africa 1996.
[3] S 9(2) of the Constitution.
[4] S 2 of the Competition Act.
[5] Preamble of the Competition Act.
[6] *Ibid.*
[7] S 12A(1)(b) of Competition Act, see factors in section 12A(3)(a)-(*e*) of Competition Act .
[8] Magana *Public interest versus competition considerations: a review of merger review guidelines in terms of section 12A of the Competition Act, 1998* (LLM dissertation 2020 University of South Africa) 16.

makes room for flexibility in its application.[9]

The COVID-19 pandemic has resulted in many companies facing financial difficulties and competition authorities around the world had to come up with suitable solutions to better accommodate the predicament of these companies.[10] A surge of proposed merger transactions involving financially distressed firms is anticipated.[11] This has necessitated a worldwide debate as to whether the failing firm doctrine or 'defence' should be reconsidered or amended in light of the pandemic.[12] The failing firm or doctrine defence allows failing firms to merge or be acquired by a profitable firm in a transaction that would normally be regarded as anti-competitive in merger review.

The legislative framework that incorporates and applies the failing firm doctrine in South Africa is set out in section 12A(2)(g) of the Competition Act. It lists the failing firm doctrine as is listed as of the factors to be considered when determining whether a merger will result in the substantial prevention or lessening of competition.[13] Section 12A(g) provides that when determining whether a merger will substantially prevent or lessen competition authorities must consider whether the business or part of the business of a party to the merger or proposed merger has failed or is likely to fail.[14] In South Africa, the failing firm defence is not an absolute defence to anti-competitive merger.[15] This means that it does not guarantee that a merger or acquisition will be approved even if the target firm is in a perilous financial situation. It is one of the factors considered in the determination of whether the merger raises competition concerns.

In this dissertation, the term "failing firm doctrine" is used interchangeably with "failing firm defence".

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[9] Competition Law and Policy in South Africa: An Oecd Peer Review https://www.oecd.org/daf/competition/prosecutionandlawenforcement/2958714.pdf (accessed 2022-10-28).
[10] Darji , Leuner and Paremoer "The failing firm doctrine during COVID-19: A perspective from South Africa" 2020 *Antitrust Chronicle* 5.
[11] Bavasso and Bowring "Pandemic, Economic Crisis, and the Failing Firm Defense" 2020 *Antitrust Chronicle* 20.
[12] Goolabjith and Kariga "Fading Firms And The Evolution Of The Failing Firm Doctrine In South African Competition Law" 2020 http://www.compcom.co.za/wpcontent/uploads/2020/11/Goolabjith-Kariga-Final-Conference-Paper-Failing-Firm-Doctrine-KLG_RK26.10.2020.pdf (accessed 2022-07-28) 3.
[13] S 12(A)(2)(g) of the Competition Act.
[14] S 12 of Competition Act.
[15] Goolabjith and Kariga "Fading Firms And The Evolution Of The Failing Firm Doctrine In South African Competition Law" 2020 http://www.compcom.co.za/wp-content/uploads/2020/11/Goolabjith-Kariga-Final-Conference-Paper-Failing-Firm-Doctrine-KLG_RK26.10.2020.pdf (accessed 2022-07-28) 6.

1.2 Problem statement

This research cogitates how the failing firm doctrine can be developed to accommodate the unfavourable economic environment in which companies find themselves and to enhance the effectiveness of this doctrine in South Africa by considering other jurisdictions. It considers the test employed in South Africa against those set by other jurisdictions.

The failing firm defence has high evidentiary requirements which imply that a high standard of evidence is necessary to establish a fact.[16] The parties relying on defence must provide evidence that is strong, clear, and convincing, which meet a high threshold of credibility.[17] It is not sufficient for a firm to just be in a precarious financial condition. Therefore, this dissertation questions whether the stringent and high evidentiary burden employed by competition authorities should be reconsidered considering the COVID-19 pandemic impact on firms all around the world and if so, how.

1.3 Research objective

The main objective of this study is to evaluate how the failing firm doctrine formulated in section 12 of the Act aligns with the interpretation and application thereof in foreign jurisdiction such as the United States of America, the European Union, and Canada. It will further be considered how this doctrine can be interpreted and applied to promote the objectives of the Act which include, amongst others, to promote competition, protect consumers, encourage efficiency and innovation, facilitate economic growth and development, and protect small businesses.[18]

1.4 Methodology

The failing firm doctrine in South Africa is influenced by foreign jurisdictions.[19] Section

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[16] Goolabjith and Kariga "Fading Firms And The Evolution Of The Failing Firm Doctrine In South African Competition Law" 2020http://www.compcom.co.za/wpcontent/uploads/2020/11/Goolabjith-Kariga-Final-Conference-Paper-Failing-Firm-Doctrine-KLG_RK26.10.2020.pdf (accessed 2022-07-28) 3.

[17] *Ibid.*

[18] Preamble of the Competition Act.

[19] Goolabjith and Kariga "Fading Firms And The Evolution Of The Failing Firm Doctrine In South African Competition Law" 2020 http://www.compcom.co.za/wp-content/uploads/2020/11/Goolabjith-

31(1)(b) of the Constitution provides for the consideration of foreign law.[20] Section 1(3) encourages this by stating that any person interpreting or applying this Act may consider appropriate foreign and international law.[21]

This dissertation will consider the United States of America (US); which is the first country to apply the failing firm 'defence' in the US Supreme Court decision *International Shoe Co. v. Federal Trade Commission*[22] in 1930. It will also consider the European Union (EU); which, influenced by the US, has taken great strides in developing the failing firm doctrine over the years. Finally, it will consider Canada akin to South Africa does not consider failing firm doctrine as a complete defence. This is done in order because this dissertation undertakes a comparative approach to determine how the US, the EU, and Canada approach the failing firm doctrine to determine if South Africa can learn and implement a few lessons from them. Finally, we consider Canada which A literature review will entail a consideration of primary and secondary sources, which would include legislation, case law, guidelines books, and journal articles. This research uses a qualitative literature review research methodology.

1.5 Chapter overview

Chapter 2 provides an outline of the history, nature, and framework of the failing firm doctrine in South Africa through case law. This chapter will include a critical evaluation of the current legal position by considering the strengths and weaknesses of the current application of the failing firm defence in South Africa.

Chapter 3 undertakes a comparative analysis of the approach of the failing firm doctrine in the US, the EU and Canada which will provide insight into the strengths and weaknesses of each jurisdiction and consider how South Africa can be improved, where necessary.

Chapter 4 provides the conclusion and recommendation.

Kariga-Final-Conference-Paper-Failing-Firm-Doctrine-KLG_RK26.10.2020.pdf (accessed 2022-07-28) 3.

[20] The Constitution of the Republic of South Africa 1996.

[21] S1(3) of Competition Act.

[22] *International Shoe Co. v. Federal Trade Commission* 280 U.S. 291 (1930).

CHAPTER 2

FAILING FIRM DOCTRINE IN SOUTH AFRICA

2.1 Introduction

The South African government in its many efforts to curb the spread of the COVID-19 virus announced a hard lockdown which meant the temporary shutdown of many businesses. This resulted in some companies being unable to break even and eventually being unable to meet their financial obligations. This dissertation is necessitated by the anticipation that there might be an increase in financially distressed firms that will want to rely on the failing firm defence in their merger review.[23] A merger is one of the tools at the disposal of a financially distressed firm that allows for business continuity.[24] South African mergers are regulated in terms in Chapter 3 of Competition Act. This chapter discusses South Africa's approach to failing firm doctrine.

2.2 Merger framework

The Competition Act provides that "a merger occurs when one or more firms directly or indirectly acquire or establish direct or indirect control over the whole or part of the business of another firm".[25] The definition of merger in terms of the Competition Act covers three types of mergers, namely, horizontal; vertical and conglomerate mergers. These mergers are listed in the rank of lessening competition.[26] Horizontal mergers are defined as mergers that occur between firms with one or more similar products in a direct line.[27] Vertical mergers occur between firms that have a vertical relationship, for example, a customer-supplier relationship.[28] Lastly, a conglomerate merger occurs

[23] S 128(A)(1) of the Companies Act 71 of 2008 provides **"financially distressed",** as a firm that —
'(i) it appears to be reasonably unlikely that the company will be able to pay all of its debts as they become due and payable within the immediately ensuing six months; or
(i) substituted by s. 81 (a) of Act No. 3 of 2011
(ii) it appears to be reasonably likely that the company will become insolvent within the immediately ensuing six months.
[24] Other options include business rescue provisions under Chapter 6 of the Companies Act 2008, debt restructuring, and ownership and operation re-organisation.
[25] Section 12(1)(a) of Competition Act.
[26] Spoelstra *The role of public interest in merger evaluation in South Africa* (LLM dissertation 2016 University of Pretoria) 11.
[27] Brassey M (ed) *Competition Law* (2002) 225.
[28] *Ibid.*

between firms that do not have a direct economic relationship.[29] Section 11 of the Competition Act further classifies mergers into small, intermediate or large merger according to their total turn-over or assets value of the parties to the merger.[30]

Mergers in South Africa are regulated by three authorities established and constituted by Competition Act, namely the Competition Commission ("the Commission"),[31] the Competition Tribunal (The "Tribunal"),[32] and the Competition Appeal Court.[33] The Commission conducts investigations into mergers with the view to approve the merger, or approve the merger with conditions, or to prohibit the merger where it is found to be anti-competitive.[34] With respect to large mergers, the Commission makes a recommendation accordingly to the Tribunal which adjudicates the merger and decides whether is appropriate to approve, approve with conditions or prohibit the merger.[35] The Competition Appeal Court which considers appeals or reviews against Tribunal decisions.[36]

Section 12(1)(A) provides for a 3-pronged test which states whenever the Commission or Tribunal is required to (a) determine whether or not a merger will substantially lessen or prevent competition,[37] (b) if it does raise competition, determine whether or not the merger will result in any "technological, efficiency or other pro-competitive gain",[38] and (c) whether the merger can or cannot be justified on public interest grounds.[39] Section 12A(2) provides a non-exhaustive list which competition authorities can consider when reviewing whether a merger is likely to substantially prevent or lessen competition.[40]

2.3 Failing firm doctrine

Section 12A(2)(g) of the Competition Act states that " whether the business or part of

[29] *Ibid.*
[30] S 11(a) and (b); s11(5)(a)-(c) of Competition Act.
[31] S 19 of Competition Act.
[32] S 26 of the Competition Act.
[33] S 36 of the Competition Act.
[34] S 21 of the Competition Act.
[35] S 27 of the Competition Act.
[36] S 37 of the Competition Act.
[37] S 12A(1) of Competition Act.
[38] S 12A(1)(a) of Competition Act.
[39] S 12A(1)(b) of Competition Act.
[40] S 12A(2) of the Competition Act.

the business of a party to the merger or proposed merger has failed or is likely to fail".[41] Therefore, the failing firm doctrine is listed as one of the factors to be considered in the determination of whether a merger is likely to substantially prevent or lessen competition in terms of section 12A(2)(g) of the Competition Act.[42] This means that if a firm is failing or is likely to fail, competition authorities may approve the merger even if the merger is likely to substantially lessen or prevent competition.[43] However, the failing firm doctrine is not an absolute defence to justify an otherwise anti-competitive merger but rather a factor to be considered in the determination of whether a merger will substantially lessen or prevent competition.[44] This means even if the failing firm defence is successfully raised, the competition authorities will still need to evaluate whether it will public interest considerations.

The failing firm doctrine in South Africa is developed through case law. It was in *Schuman Sasol/Price's Daelite* where the Tribunal first considered a merger where the parties raised the failing firm defence.[45] In their argument, the parties raised the fact that absent the merger, the target firm would fail, and its asset will exit the market.[46] The tribunal considered their arguments and held that the "failing firm is a term of art in merger regulation" and highlighted that it would be decided on a case-by-case basis as opposed to a fixated set of rule.[47] *Schuman Sasol/Price's Daelite* held in the evaluation of a failing firm defence, it should be determined:[48]

(a) whether the target firm has failed or is likely to fail;[49]

(b) whether there has been any attempt to find an alternative purchaser that would

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[41] S 12(A)(2)(g) of Competition Act.
[42] *Ibid*.
[43] Goolabjith and Kariga "Fading Firms And The Evolution Of The Failing Firm Doctrine In South African Competition Law" 2020 http://www.compcom.co.za/wp-content/uploads/2020/11/Goolabjith-Kariga-Final-Conference-Paper-Failing-Firm-Doctrine-KLG_RK26.10.2020.pdf (accessed 2022-07-28) 10.
[44] Nzero "The implication of public interest consideration in the interpretation and application of the failing firm doctrine in South African merger analysis" 2017 *THRHR* 605.
[45] *Schuman Sasol/Price's Daelite (Pty) Ltd* 10/CAC/Aug01 para 2. The facts are briefly;Schumann Sasol (South Africa) (*Pty*) Ltd, the primary acquiring firm, will acquire one hundred (100) percent share capital of Price's Daelite (*Pty*) Ltd, the primary target firm. Schumann Sasol and Price Daelite are in a vertical supplier/customer relationship in the wax and candle industry in South Africa. The question, in this case, was not whether the competition would have lessened since it is common knowledge that vertical transaction does not necessarily affect concentration and market power. The question, rather, is whether the transaction allows the parties or one of the parties to "prevent competition in the relevant market(s) thus majoring or extending the anti-competitive structure of both or one of the markets.
[46] *Ibid* para 57.
[47] *Ibid* para 59.
[48] *Ibid* paras 60-68.
[49] *Ibid* para 60.

result in a less anti-competitive outcome; [50]

(c) if there are any prospects of re-organising the failing firm besides the merger; [51]

(d) what will happen to the failing firm's market share;[52]

(e) whether the assets of the failing firm will exit the market, absent the merger. [53]

The subsequent paragraphs will discuss these criteria in detail.

2.3.1. The target firm has failed or is likely to fail

This criterion requires an assessment of the failing firm's financial situation. The Tribunal *Schuman Sasol/Price's Daelite* was not only focused on the fact that Price's Daelite was in a dire financial situation, but it was also focused on the cause of the financial failure.[54]

The Tribunal asserted a firm cannot be regarded as failing if it is in a dire financial situation because of a management decision.[55] According to this case, a firm can only be considered to be failing if its dire financial situation that was not self-induced.[56] This highlights the fact that competition authorities may take into consideration whether it was the firms negligence that led to the precarious financial situation or whether it was external factors beyond the firms control such as the Covid-19 Pandemic.

The failing firm doctrine does not require the certainty that a firm has failed, only that it is likely to fail.[57] This was emphasised in *JD Group Limited / Profurn Limited* where the Tribunal,[58] in its assessment of the financial circumstances of the Profurn, considered the deteriorating business environment and lack of strategic management, changes in accounting policy, minutes meetings, and reports regarding that particular industry, amongst others to determine whether it was likely to fail.[59] In essence, the doctrine is not only applicable after a firm has failed, a firm that can demonstrated that it will likely fail, can rely on this defence. This implies that a company that has been

[50] *Ibid para* 64.
[51] *Ibid* para 65.
[52] *Ibid* para 66.
[53] *Ibid* para 67.
[54] *Ibid* paras 61-62.
[55] *Ibid* Para 62.
[56] Nzero 2017 *THRHR* 613.
[57] *Iscor Limited/Saldanha Steel (Pty) Ltd* 67/LM/Dec01 para 109.
[58] *JD Group Limited/ Profurn Limited* 60/LM/Aug02.
[59] *Ibid* paras 112-139.

impacted by the pandemic and is at risk of failing after the pandemic has ended can use this as a defence.

The Commission held in *Phodiclinics (Pty) Ltd & Others* that liquidation amounts to the failing firm.[60] It was further asserted by the Tribunal that the target firm was already a failed firm that was unable to reorganise itself due to the fact that it was already provisionally liquidated.[61] Additionally, a firm that is likely to close down its operations or shut down production can be considered to be in financial distress.[62] However, a firm experiencing financial decline is not considered to be a firm failing or is likely to fail.[63] The Commission in this case took a few steps further in interpreting what constitutes a failing firm. From this case, we can, among other things, narrow it down to the following: liquidation, inability to reorganise after provisional liquidation, and likelihood of closing down.

The assessment of this requirement is strict and places a great evidentiary burden on the parties.[64] It requires that each case be evaluated based on its facts in order to ascertain the true financial position of the allegedly failing firm.[65] The Tribunal in *Santam Limited/Emerald Insurance Company Limited and Emerald Risk Transfer (Pty) Ltd* highlighted that an assessment of whether the firm is indeed failing would entail the assessment of the financial documents such as the income statement and cash flow statement; past and recent performance in comparison with other market participants; the amount of investment required for allegedly failing firm's to address the solvency and other regulatory requirements; the alleged failing firm's relationship with creditors; and allegedly failing firm's access to funds and external capital.[66] This assessment goes beyond insolvency and liquidity. This further emphasises the fact that simply stating financial distress is not enough. Parties relying on this defence must provide factual evidence of the direness of the financial situation.

2.3.2 Any attempt to find an alternative purchaser that would result in a less anti-competitive outcome

[60] *Phodiclinics/Protector Group Medical Services* 122/LM/Dec05.
[61] *Ibid* paras 54-66.
[62] *Boxer Super Stores (Pty) Ltd /The Target Firms under the control of Metcash Trading Africa (Pty) Ltd* 32/LM/MAR12 para 14-15.
[63] *Pioneer Hi-Bred International Inc. and Pannar Seed (Pty) Ltd / Competition Commission CAC* 113/CAC/NOV11;81/AM/DEC10 (28 May 2012) para 3.
[64] *Santam Ltd/Emerald Insurance Co Ltd and Emerald Risk Transfer (Pty) Ltd* 57/LM/Aug02 para 57.
[65] *Ibid.*
[66] *Santam Ltd/Emerald Insurance Co Ltd and Emerald Risk Transfer (Pty) Ltd 57/LM/Aug02* para 59.

The allegedly failing firm must prove that at the time where they accepted an offer, there was no other alternative purchaser offer that would result in a less competitive offer.[67] This means that there should not be an alternative acquirer available whose acquisition would not substantially lessen the competition.[68] The allegedly failing firm must demonstrate that earnest attempts were made to an alternative purchaser.[69] This requirement is aimed at preserving competition in the relevant market and ensuring that the acquisition does not result in an anti-competitive market.

In a recent case, business rescue practitioners conducted a bidding process for the sale of the target firm and identified five compliant bids.[70] A merger with two of the bidders would not result in a less anti-competitive outcome, the other two firms had no presence in South Africa and did not meet the Black Economic Empowerment requirements.[71] On this basis, it was found that reasonable, good faith efforts were made to find an alternative purchaser, with the acquiring firm being the most suitable bidder.[72]

An offer is considered a reasonable alternative when the offer is present at the time of the proposed merger and not if it will only be available at an unspecified time in the future.[73] Past offers are also not considered if they are not existing at the time of the merger transaction.[74] Merging parties are not required to continuously search for potential reasonable alternative purchasers but rather what is important to meet this test is evidence of reasonable efforts that were made to find reasonable alternative purchasers.[75] A failing firm must consider all alternative purchase offers which offered a price equal or above liquidation value and not only the most lucrative offer.[76] It can be deduced from this that this requirement is met if serious attempts have been made to find a reasonable alternative offer and no other less competitive alternative is available at the time of the transaction. In certain markets, hard-hit by COVID-19, this

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[67] *Ibid.*
[68] *Phodoclinics/Protector Group Medical Services* para 103.
[69] *Schuman Sasol/Price's Daelite (Pty) Ltd para* 64.
[70] In *K2018239983 (South Africa) (Pty) Ltd & The Business of Hernic Ferrochrome (Pty) Ltd* (LM141Jul19).
[71] *K2018239983 (South Africa) (Pty) Ltd & The Business of Hernic Ferrochrome (Pty) Ltd* para 23.
[72] *Ibid.*
[73] *Phodoclinics/Protector Group Medical Services* para 103.
[74] *Ibid.*
[75] Goolabjith and Kariga "Fading Firms And The Evolution Of The Failing Firm Doctrine In South African Competition Law" 2020 http://www.compcom.co.za/wp-content/uploads/2020/11/Goolabjith-Kariga-Final-Conference-Paper-Failing-Firm-Doctrine-KLG_RK26.10.2020.pdf (accessed 2022-07-28) 21.
[76] Darji , Leuner and Paremoer *Antitrust Chronicle* 49.

may be particularly relevant insofar as the pool of viable prospective acquirers practically able to sustainably save a failing firm may have shrunk.[77]

2.3.3 Any prospects of reorganising the failing firm

The allegedly failing firm must prove that the merger is the only option and that the firm cannot be saved in any other manner.[78] In *Santam*, the Tribunal held that there was documentary evidence submitted that proved that the allegedly failing firm could successfully re-organise in the absence of the merger.[79] In essence, the proposed merger should be the firms last resort in order to stay in business.

2.3.4 failing firm's market share absent the merger

The failing firm must prove that in the event the firm indeed fails and subsequently exits from the market, its market share would inevitably be acquired by the acquiring firm.[80] Essentially, this means that the parties must prove that if the merger is not approved the market share of the failing firm will be acquired by the acquiring firm.

This requirement is considered stringent and is often considered in mergers that pose a greater threat to competitive market structure,[81] competition authorities are scrutinises this kind of proposed merger to ensure that it does not lead to a significant reduction in competition in the relevant market.

2.3.5 Assets of the failing firm will exit the market absent the merger

The merging parties must prove that the assets of the failing firm would not exit the market but will be utilised by the acquiring firm.[82] The Tribunal in *Profurn* found that certain businesses of *Profurn* would have exited the market if there had either not been a merger or if another firm with a less competitively adverse profile had been the purchaser.[83] Absent the merger, the market share of Profurn would have inevitably gone to Joshua Door Group's Ellerines.[84] An allegedly failing firm may be allowed to

[77] Meyer and Barden "The failing firm doctrine during COVID-19: Old medicine or a new cure?"https://www.cliffedekkerhofmeyr.com/en/news/publications/2020/Competition/competition-alert-12-may-The-failing-firm-doctrine-during-COVID19-old-medicine-or-a-new-cure.html (accessed 13 june 2022).
[78] Nzero 2017 *THRHR* 613.
[79] *Santam Ltd/Emerald Insurance Co Ltd and Emerald Risk Transfer (Pty) Ltd* para *77.*
[80] *Ibid*, see *CTP Limited and Compact Disc Technologies (A Division of Times Media (Pty) Ltd) / The Competition Commission* IM232Feb16.
[81] Nzero 2017 THRHR 613.
[82] Nzero 2017 *THRHR* 614.
[83] *JD Group Limited/ Profurn Limited* para 140.
[84] *Ibid* para 109.

fail and exit the market because their assets can easily be transferred to new market participants or existing firms.[85] This suggests that competition authorities may allow a failing firm to exit the market if its assets can easily be transferred to other firms or could be acquired by new entrants to the market. This is in line with one of the objectives of the Act which is to ensure that small and medium•sized enterprises have an equitable opportunity to participate in the economy.[86]

2.3.6 Approach to failing firm doctrine

The approach to the failing firm doctrine was set out in Iscor *Limited and Saldanha Steel (Pty) Ltd.*[87] The Tribunal in the analysis of the failing firm defence began with recognising that the failing firm defence is known to allow a merger that would otherwise be prohibited because of competition concerns.[88] The Tribunal emphasised that the failing firm doctrine is not used as an absolute defence to merger review, but rather one of the list of factors to consider when determining whether a merger is anti-competitive.[89] The fact that a firm is failing will be considered in the cumulative assessment of whether a merger should be approved or not.

The Tribunal summarised its own decision in the following points:[90]

(a) In circumstances where there is another factor or defence that the Competition Act already provides for, a failing firm defence should not be invoked. The Tribunal stated that in cases where the failing firm defence can also be considered an efficiency defence, the merging parties should rather rely on the efficiency defence.[91] This is because the Competition Act adequately provides for these other defences.[92] In short, this effectively implies that the failing firm defence should not be used as a first line of defence, but should only be invoked in cases where no other defence under the Act is applicable.

(b) Foreign jurisdiction tests for failing firms carry great weight in our assessment. As

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[85] *Santam Ltd/Emerald Insurance Co Ltd and Emerald Risk Transfer (Pty) Ltd* para 69.
[86] S 2(e) of the Competition Act.
[87] *Iscor Limited/Saldanha Steel (Pty) Ltd* 67/LM/Dec01.
[88] *Ibid* para 98.
[89] *Ibid* para 101.
[90] Ibid para 110.
[91] *Ibid* para 97.
[92] Ibid para 99.

such, merging parties must provide evidence in order to successfully invoke the failing firm defence.[93] Therefore, competition authorities have included this requirement in line with other jurisdictions, where merging parties are required to provide evidence that proves the financial distress of the firm.[94]

(c) A merger that can satisfy the EU's stringent test will likely not be regarded as anti-competitive.[95] This is because the requirement that the acquirer would gain the market share of the acquired firm if the latter were to exit the market is an EU innovation.[96]

(d) A party that cannot satisfy the requirement that the market share would have gone to the acquiring firm but can satisfy the other US elements of the failing firm test would have reasonable prospects of success depending on the degree of anti-competitiveness.[97] This statement highlights the importance of considering both the elements of the failing firm test and the degree of anti-competitiveness when evaluating a proposed merger under the failing firm defence. While satisfying the elements of the test may provide reasonable prospects of success, the anti-competitive effects of the merger will also be taken into account.

(e) Evidence of a merger that poses an immense anti-competitiveness threat will be weighed against the extent or imminence of failure.[98] This means merging parties may be less exacting in showing all elements of the traditional failing firm if the threat of anti-competitiveness is not great.[99] In other words, if the anti-competitive effects of the merger are deemed to be low, competition authorities may be more lenient in its assessment of the failing firm defense.

(f) There will be no leniency afforded in cases where there is evidence that there is a less anti-competitive alternative.[100] In essence, if competition authority finds that there is a less anti-competitive alternative to the proposed merger, it will reject the failing firm defence even if the target firm is in a failing financial position. The competition authority will prioritise competition in the market.

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[93] *Ibid* para 110.
[94] *Ibid*.
[95] *Ibid.*
[96] Ibid para 82.
[97] *Ibid* para 110.
[98] *Ibid*.
[99] Ibid 110; see *Phodiclinics/Protector Group Medical services* para 51.
[100] *Iscor Limited/Saldanha Steel (Pty) Ltd* 67/LM/Dec01 para 110.

(g) The onus rest on the merging parties to provide evidence that it satisfies the requirements of the failing firm defence.[101] This means that the merging parties must be prepared to provide detailed financial, market, and other relevant information to the competition authority to demonstrate that their proposed merger satisfies the requirements of the failing firm defence.[102]

The approach to the failing firm doctrine is intended to be flexible and the Tribunal provides that it is because a flexible approach, for example, allows the competition authorities to consider some of the rationales for the failing firm defence even if they do not constitute elements of a traditional defense.[103]

2.4 Public interest consideration

The Competition Act expressly provides for public interest consideration in a merger evaluation.[104] It is clear that when evaluating a proposed merger, the competition authorities must consider the public interest factors.

The third leg of the 3-ponged test in section 12A requires a review of the merger in terms of public interest consideration. This means that a merger should not raise public interest issues. Therefore, successful invocation of the failing firm factor is not sufficient to save a merger that would otherwise be considered anti-competitive, the merger will still have to be scrutinised in terms of public interest consideration.[105] In *Shell South Africa (Pty) Ltd / Tepco Petroleum (Pty) Ltd*,[106] the parties argued failing firm defence. The Tribunal concluded that the merger did not pose a great threat to competition and subsequently considered the merger in terms of public interest considerations.[107] The Tribunal considered the fact that Thebe was owned by historically disadvantaged persons amongst other factors and that it is exiting the market will not be in line with public interest consideration.[108] Citing its reasons, the Tribunal held that the Commission is tasked with the protection and promotion of competition and public interest.[109]

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[101] *Ibid*.
[102] See *Santam Ltd/Emerald Insurance Co Ltd and Emerald Risk Transfer (Pty) Ltd 57/LM/Aug02*.
[103] Iscor Limited/Saldanha Steel (Pty) Ltd 67/LM/Dec01 para 107.
[104] Subsection (1A) was inserted by s9 (b) of the Amendment Act No. 18 of 2018 to further emphasise the importance of public interest consideration, see also Spoelstra 3.
[105] Nzero 2017 *THRHR* 616.
[106] *Shell South Africa (Pty) Ltd/ Tepco Petroleum (Pty) Ltd* 66/LM/Oct01 para 33.
[107] *Ibid* para 36.
[108] *Ibid* para 7.
[109] *Ibid* para 57.

The public interest test is a separate and independent task.[110] In the assessment of the substantive public interest consideration, competition authorities will consider the effect that the merger will have on that sector or region,[111] employment,[112] the ability of small firms 'controlled or owned by black persons' to become competitive,[113] and whether national industries can compete in international markets[114]. The public interest consideration allows for mergers to be approved or rejected based on factors beyond competition concerns.[115]

The public interest test is considered to be "Janus-faced" because if met, it can lead to a merger that would have been rejected because it is anti-competitive to be saved or a merger that would have been saved to be rejected.[116] However, there has not been a merger that was approved purely on the basis of public interest consideration.[117] This highlights the dual nature of the public interest test and its role in the merger approval process. The public interest test can play a role in either approving or rejecting a proposed merger.[118] Subsequently, after successfully raising the failing firm defence, the parties must also pass the public interest test.

2.5 Conclusion

This dissertation has considered the current application and interpretation of the failing firm in South Africa in efforts to evaluate whether there are any shortfalls. This dissertation asserts that the fact that in South Africa, the failing firm doctrine is not an absolute defence but considered as a factor in a merger assessment is a strength because it allows competition authorities to employ a flexible approach based on the facts before them.[119] This means failing firm defence is not an absolute defence therefore, even if the failing firm doctrine is successfully invoked, the effect of the merger must still be considered in the terms of efficiencies and public interest

[110] *Harmony Gold mining Co/ Gold Fields Ltd* 93/LM/Nov04.
[111] S 12A(3)(a) of Competition Act.
[112] S 12A(3)(b) of Competition Act.
[113] S12A(3)(c) and (e) of Competition Act.
[114] S 12A(3)(d) of Competition Act.
[115] Spoelstra 20, see cases discussed there.
[116] *Industrial Development Corporation of South Africa v Anglo-American Holdings Ltd in the large merger between Anglo-American Holdings Ltd/Kumba Resources Ltd v Anglo-South Africa Capital (Pty) Ltd/Anglovaaal Mining Ltd* 45/LM/Jan02 and 46/LM/Jun02 para 22.
[117] Spoelstra 16.
[118] *Ibid*.
[119] See *Iscor Limited/Saldanha Steel (Pty) Ltd* 67/LM/Dec01.

considerations.[120] Consequently, the merger can still be approved on the basis of other factors, even if it fails to successful raise the defence.

The South African failing firm defence incorporates both the US test and EU test in its approach to a failing firm defence. This has its advantages and disadvantages. This is advantageous because it reinforces the idea that competition authorities' approach to the failing firm doctrine is flexible.[121] A flexible approach allows for consideration failing firm defence, even in case where the rationale does fit the traditional definition of a defence.[122] This gives more room for a comprehensive evaluation of the situation. This is evident in that each merger is considered based on the facts surrounding the merger.[123] It is not a strict application of the test.[124] The disadvantage to the incorporation both the US test and EU test it may result in increased risk-taking by parties who want to rely on the defence. They may interpret flexibility as leniency.

In a nutshell, successful failing firm defence is established when the target firm shows that it is unable to meet its financial obligations, has made genuine efforts to find other offers that have less anti-competitive effects to no avail, has no prospect of successful re-organisation; and that absent the market, its asset will exit the market. This is a factual analysis that requires evidence from parties that seek to rely on this defence.

[120] Meyer and Barden "The failing firm doctrine during COVID-19: Old medicine or a new cure?"https://www.cliffedekkerhofmeyr.com/en/news/publications/2020/Competition/competition-alert-12-may-The-failing-firm-doctrine-during-COVID19-old-medicine-or-a-new-cure.html (accessed 13 june 2022).
[121] *Iscor Limited/Saldanha Steel (Pty) Ltd* 67/LM/Dec01 para 107.
[122] *Ibid.*
[123] Goolabjith and Kariga "Fading Firms And The Evolution Of The Failing Firm Doctrine In South African Competition Law" 2020 http://www.compcom.co.za/wp-content/uploads/2020/11/Goolabjith-Kariga-Final-Conference-Paper-Failing-Firm-Doctrine-KLG_RK26.10.2020.pdf (accessed 2022-07-28) 26.
[124] *Ibid.*

CHAPTER 3

COMPARATIVE STUDY ON FAILING FIRM DOCTRINE

3.1 Introduction

The United States Supreme Court in the *International Shoe Co v FTC*[125] introduced the failing firm doctrine which was later adopted across various jurisdictions. This was the first case to set out what would be considered when determining whether a merger that would ordinarily be prohibited due to its anti-competitive effects be permitted.[126]

The failing firm doctrine has been at the centre of riveting discourse across various jurisdictions. This chapter considers how this doctrine is formulated in different jurisdictions. It will do so by analysing how it is approached in the United States of America ("US"), the European Union ("EU") and Canada.

3.2 Part A: United States

3.2.1 Merger Regulatory framework

In the US, mergers and acquisitions are primarily regulated by the Clayton Antitrust Act of 1914, as amended.[127] The Federal Trade Commission and the Antitrust Division of the Department of Justice (hereinafter "Antitrust Agencies"), are agencies that regulate mergers in the US. Section 7 of the Clayton Act, which is considered the heart of US merger regulation, makes provision for stock acquisitions not only between direct competitors but also the acquisition of assets between non-direct competitors.[128]

Section 7A of the Clayton Act[129] as inserted by the Hart-Scott-Rodino Act[130], requires notification from parties that wants to enter into certain a merger to notify agencies before implementation.[131] This allows Agencies adequate time to scrutinise and

[125] *International Shoe v. FTC*, 280 U.S. 291 (1930.
[126] *International Shoe v. FTC* 302-303.
[127] Clayton Antitrust Act of 1914.
[128] Nzero 2014 *THRHR* 444.
[129] Section 7A (a) Except as exempted pursuant to subsection (c), no person shall acquire, directly or indirectly, any voting securities or assets of any other person, unless both persons (or in the case of a tender offer, the acquiring person) file notification pursuant to rules under subsection (d)(1) and the waiting period described in subsection (b)(1) has expired.
[130] *Hart-Scott-Rodino Antitrust Improvements Act* of 1976.
[131] Nzero 2014 *THRHR* 444.

challenge mergers that may be considered anti-competitive before they are implemented.[132]

Section 7 of the Clayton Act states:

> "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 and no person subject to the jurisdiction of the Federal Trade Commission shall acquire 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".[133]

It is not the intention of this section to repress commercial and economic activities but to prohibit acquisitions that "may substantially lessen competition or tend to create a monopoly".[134] A merger is considered to have "substantially lessened competition" in a particular market if, post-merger,[135] the result thereof is a competitive market structure that has deteriorated significantly.[136] If there is a negative impact on the public, then deterioration is deemed significant. In essence, a merger contravenes section 7 of the Clayton Act if, post-merger, it significantly lessens competition in the market structure to a point that it is disadvantageous to the public.[137] On the other hand, a merger that tends to create a monopoly within a particular market will likely be in violation of section 7 of the Clayton Act.[138]

3.2.2 Merger guidelines

In 1968 Antitrust agencies published a set of guidelines seeking to provide clarity on antitrust laws and to provide a framework for merger regulation.[139] These guidelines were revised by the 1992 Horizontal Merger Guidelines, as revised in 1997.[140] After

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[132] *Ibid.*
[133] S7 Clayton Antitrust Act.
[134] *Ibid.*
[135] *Ibid.*
[136] *International Shoe v FTC* para 297.
[137] Nzero 2014 *THRHR* 445.
[138] S7 Clayton Antitrust Act.
[139] US Department of Justice Horizontal Merger Guidelines (1968).
[140] 1992 Horizontal Merger Guidelines, 57 Fed. Reg. 41,552, 41,563 (Sept. 10, 1992).

eighteen years, the 1992 Merger Guidelines were criticised for being stringently defined and subsequently replaced by the 2010 Horizontal Merger Guidelines.[141]

These guidelines envisage a set of non-binding guidelines that provide for merger regulation in an analytical framework and provide clarity on antitrust concepts and laws.[142] Section 11 of the Guidelines essentially means that section 7 of the Clayton is not contravened if a merger is not likely to improve market power since the impending failure of the target firm would cause the assets of that firm to exit that particular market.[143]

The recognition of the failing firm defence rests on the premise that the financial direness of one of the merging firms would render it an insignificant market participant to the point that its acquisition by the other firm would not contribute to the deterioration in the competitive market structure to the detriment of consumers post-merger.[144] The 2010 Guidelines do not expressly provide for the requirement that "absent the acquisition, the assets of the failing firm would exit the market".[145]

In terms of the 2010 Horizontal Merger Guidelines, parties must first meet these requirements before a failing firm defence can be successful.[146] It must prove that:

(a) it would be unable to meet its obligations in the near future;
(b) it will not be able to re-organise successfully under Chapter 11 of the Bankruptcy Act;[147] and
(c) it has made unsuccessful good faith efforts to elicit reasonable alternative efforts that would keep its tangible and intangible assets in the relevant market and poses less severe danger to competition than does the proposed merger.[148]

3.2.3 Analysis of failing firm defence requirements

The failing firm defence was first accepted as an absolute defence in the landmark

[141] See footnote 1 of the United States Department of Justice *Horizontal Merger Guidelines* (08/19/2010).
[142] Nzero 2014 *THRHR* 446.
[143] S 11 of 2010 Horizontal Merger Guideline.
[144] Nzero 2014 *THRHR* 446; see S 11 of Horizontal Merger Guidelines.
[145] DiGangi "Cutting the Financial Fat from the Failing Firm Defense: Refocusing the Failing Firm Defense" on Antitrust Law" 2012 *St. John's Law Review* 283.
[146] S 11 of 2010 Horizontal Merger Guidelines.
[147] Bankruptcy Act of 1898
[148] S 11 of 2010 Horizontal Merger Guidelines.

case of *International Shoe Co.*[149] An absolute defence means that if all the requirements of the failing firm have been met, Antitrust agencies cannot challenge the proposed merger.[150] The requirements are explored in detail below.

3.2.3.1 Inability to meet financial obligation

A firm is considered a failing firm if the firm is "hopelessly insolvent"[151] and faces "imminent receivership".[152] Firms on the brink of bankruptcy can also be considered failing firms. Currently, there is no standard list of conditions that a firm can meet in order to demonstrate that it is unable to meet its financial obligations in the near future.[153] Antitrust Agencies may consider, amongst others, whether the firm's current financial position can be attributed to the current economic state,[154] the firm's management capabilities,[155] or whether its financial problems are a result of "irreversible downward trend".[156] Furthermore, in the assessment of the financial position of the firm, Antitrust Agencies may consider ability of a firm to obtain new revenues or new customers, whether there is a production decline, whether there is an exhaustion of the supply of key inputs, and whether its decline is as a result of poor management.

Areeda and Hovenkamp posit that "failure" is narrowly defined to include imminent or insolvency, liquidation, bankruptcy, or withdrawal from the market.[157] They assert that in the case of merger that do not present a great threat to competition, the mere proof

[149] The facts of this case are as follows:
International Shoe Company and the W. H. McElwain Company (McElwain) were competitor International Shoe acquired all, or substantially all, of the shares of McElwain and still owned and controlled them at the time of the hearing. The FTC further alleged that this merger would substantially lessen competition between the two companies; restrain commerce in the shoe business in the localities where both were engaged in business in interstate commerce; and to tend to create a monopoly in interstate commerce in such business. The FTC challenged this merger arguing that it is illegal and in violation of section 7 of the Clayton Act as the merger will substantially lessen competition and create a monopoly, subsequently restraining trade in the shoe business. The parties argued that acquisition was not in violation of section 7 since there was no substantial competition between the merging parties prior to the merger. The parties then argued that the severity of financial circumstances of the target firm, McElwain Co, necessitated liquidation or sale, thereby eliminating all present or prospective competition or restraint of commerce. The US supreme court found in favour of the merging parties and held that the resources of McElwain are depleted, that chances of rehabilitations are slim and that its assets would exit the market in the absence of the merger.
[150] OECD Competition Committee "Roundtable on Failing Firm Defence" 2009 *DAF/COMP* 177.
[151] *United States v. Diebold* Inc., 369 US 654 (1962.
[152] *United States v. Diebold* Inc., 369 US 654 (1962).
[153] OECD Competition Committee 2009 *DAF/COMP* 177.
[154] DiGangi 2012 *St. John's Law Review* 287.
[155] DiGangi 2012 *St. John's Law Review* 286.
[156] ibid.
[157] Areeda and Hovenkamp *Antitrust Law: An Analysis of Antitrust Principles and their Application* (2009) 293.

of failure should result in the approval of the merger.[158]

3.2.3.2 Inability to reorganise in terms of the Bankruptcy Act

It is not sufficient that a firm is failing, the second leg of the test requires that the merging parties show the court that there is no possibility of reorganisation under bankruptcy law.[159] This means that there must an assessment of whether the firm's current financial predicaments can be eliminated through bankruptcy proceedings.[160] It should be clear that the allegedly failing firm has exhausted all other avenues which would not result in an anti-competitive market before initiating an anti-competitive merger.[161]

3.2.3.3 No other reasonable alternative offer

The general approach to the third requirement of the failing firm defence is that the defence cannot be accepted unless the acquiring firm is the only available purchaser. There should be no other reasonable alternative purchaser.[162] Firms are required before instituting the failing firm defence to "shop" the assets.[163] An adequate search would mean a wide range search conducted by the failing firm of other firms the same industry, or consider even vertically related firms or potential market entrants.[164]

A reasonable alternative offer includes any offer to purchase the assets the failing firm for an amount above the liquidation value.[165] The rationale for purchasing of assets for above market value is to ensure that the assets are kept in the relevant market.[166]

The Antitrust Agencies require actual offers as opposed to expressions of interest, in order to ascertain that there are reasonable alternative offers.[167] Additionally, the alternative purchaser should be willing to keep the "assets in operation" to become a

[158] *Ibid.*
[159] Nzero 2014 *THRHR* 452.
[160] *United States v. Reed Roller Bit Co.*, 274 F. Supp. 573,584 (W.D. Okla. 1967).
[161] Nzero 2014 *THRHR* 452.
[162] *Ibid.*
[163] OECD Competition Committee 2009 *DAF/COMP* 179.
[164] Goolabjith and Kariga "Fading Firms And The Evolution Of The Failing Firm Doctrine In South African Competition Law" 2020 http://www.compcom.co.za/wp-content/uploads/2020/11/Goolabjith-Kariga-Final-Conference-Paper-Failing-Firm-Doctrine-KLG_RK26.10.2020.pdf (accessed 2022-07-28).
[165] OECD Competition Committee 2009 *DAF/COMP* 178.
[166] Goolabjith and Kariga "Fading Firms And The Evolution Of The Failing Firm Doctrine In South African Competition Law" 2020 http://www.compcom.co.za/wp-content/uploads/2020/11/Goolabjith-Kariga-Final-Conference-Paper-Failing-Firm-Doctrine-KLG_RK26.10.2020.pdf (accessed 2022-07-28).
[167] DiGangi 2012 *St. John's Law Review* 290; see also *California v. Sutter Health Sys.*, 130 F. Supp. 2d 1109, 1137 (N.D. Cal.
2001); *United States v. Culbro Corp.*, 504 F. Supp. 661, 669 (S.D.N.Y. 1981).

preferred purchaser.[168]

In *United States v Energy Solutions*,[169] two radioactive waste disposal companies failed to show that the buyer was the "only available purchaser".[170] The court maintained that the merging parties must demonstrate that the seller made a bona fide effort to get the best offer that safeguards the interests of the consumers and the market. [171] The court emphasised that the foremost important interests of the consumer and the market are fair competition and the longevity of the business within the market.[172] Moreover, the court found that the target firm did not make bona fide attempts to find reasonable alternative offers because it entered "no-talk" and "no-shop" agreements with the buyer that severely restricted the seller's ability to seek alternative buyers.[173]

Fundamentally, the acquisition of a failing firm would be prohibited unless no other acquirer was available whose acquisition would be significantly less damaging to competition.[174] This would mean that in other cases a smaller acquirer will be presumably preferred over a larger competitor. Firms outside the market will be preferable to competitors. Essentially, the most ideal acquirer is a non-competitor whose acquisition would be lawful without any regard to any failing firm defence.[175] The practical question is whether the failing firm looked widely enough for a preferred acquirer.[176] However, the fact that Antitrust Agencies cannot through their investigation find another alternative purchaser may be persuasive evidence that the allegedly failing firm's unsuccessful search was adequate.[177] The acquiring firm must be "the only bona fide prospective purchaser".[178]

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[168] DiGangi 2012 *St. John's Law Review* 289.
[169] *United States v. Energy sols*.,265 F.Supp. 3d.
[170] Ibid para 2.
[171] *Ibid* para 445.
[172] *Ibid* para 445.
[173] *Ibid*.
[174] Goolabjith and Kariga "Fading Firms And The Evolution Of The Failing Firm Doctrine In South African Competition Law" 2020 http://www.compcom.co.za/wp-content/uploads/2020/11/Goolabjith-Kariga-Final-Conference-Paper-Failing-Firm-Doctrine-KLG_RK26.10.2020.pdf (accessed 2022-07-28).
[175] Goolabjith and Kariga "Fading Firms And The Evolution Of The Failing Firm Doctrine In South African Competition Law" 2020 http://www.compcom.co.za/wp-content/uploads/2020/11/Goolabjith-Kariga-Final-Conference-Paper-Failing-Firm-Doctrine-KLG_RK26.10.2020.pdf (accessed 2022-07-28).
[176] *Ibid*.
[177] OECD Competition Committee 2009 *DAF/COMP* 179.
[178] *United States v Diebold* para 655.

3.2.3.4 Other considerations

The allegedly failing firm should be able to provide evidence that the assets will not continue to be in operation or be used profitably by a third party in the market.[179] It must be clear that absent the merger, the assets of the firm will leave the market.[180]

The court can still consider the failing firm defence even in the event that the parties do not rely on the defence.[181] This indicates that competition authorities are prepared to employ a more proactive approach if necessary. In *FTC v. Arch Coal/Triton*, the court refused to enjoin a merger between two competing coal suppliers because the seller was a weak competitor with had no real prospect of improvement convincing.[182] Furthermore, the court held that even though the failing firm defence did not apply, the target firm's uncertain future competitive prospects, weak financial position, and no realistic prospects for alternative buyers remained important in the examination of whether substantial anti-competitive effects exits.[183] This is in line with US Horizontal Merger Guideline, which considers past and present changes in the market conditions to demonstrate that the current market share of a firm is either overstated or understated in respect of the firms future competitive impact.[184]

Even if a firm does not meet the stringent requirements of the failing firm defence, its financial position may still be significant in determining whether the merger is anti-competitive.[185] This is when a firm is "flailing" and cannot be considered that it will be as competitive in the future as it was in the past.[186] A firm in a weak financial position may imply that it will unlikely to compete effectively in the future.[187] This means a firm is likely to be an ineffective competitor without the merger then it is considered that the merger will not substantially lessen future competition.[188]

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[179] DiGangi 2012 *St. John's Law Review* 290.
[180] OECD Competition Committee 2009 *DAF/COMP* 179.
[181] See *Brown shoe Co v United States 394* US 137(1969) para 297.
[182] *Federal Trade Commission v. Arch Coal, Inc.*, D.D.C., No. 04CV00535 (JDB*).*
[183] *Ibid.*
[184] Fishkin, Rafkin and Kuykendall "Epic Fail: Why It Is Better To Focus On A Competitive Effects Analysis Than The Failing Firm Defense" 2020 *Antitrust Chronicle* 6*;* See also Horizontal Merger Guidelines § 5.2.
[185] OECD Competition Committee 2009 *DAF/COMP* 180.
[186] *Ibid.*
[187] Ibid
[188] *Ibid.*

The Court in *Diebold Inc*[189] emphasised that reliance on the failing firm defence must be sufficiently supported by factual evidence.[190]This was confirmed by the Supreme Court in *General Dynamics Co*,[191] where it was maintained that the reliance on statistical evidence of previous is not sufficient to support claims that merging parties would continue to be effective competitors.[192]

In summary, the failing firm defence in the US requires evidence that the assets of the failing firm, absent the proposed merger, would otherwise exit the relevant market.[193] For this to be accepted, the allegedly failing firm must be unable to meet its financial obligations soon; is unable to successfully reorganize under Chapter 11 of the Bankruptcy Act*,* must have made earnest attempts to find other reasonable offers.[194]

3.2.4 Concluding remarks

In order to successful raise a failing firm defence in the US, the allegedly failing firm must be unable to meet its financial obligations soon, successfully reorganize under Chapter 11 of the Bankruptcy Act*,* must have made earnest attempts to find other reasonable offers.[195] The failing firm defence is absolute defence in the US. It requires factual evidence that the assets of the failing firm, absent the proposed merger, would exit the relevant market.[196] This is the same position in South Africa.[197]

The burden of proof that these cumulative criteria are satisfied falls on the notifying parties.[198] A failing firm has to not only prove that it is on the brink of bankruptcy but that it cannot be reorganised in terms of bankruptcy laws.[199] A merger must be the only option that will ensure that the assets do not exit the market.[200]

Furthermore, the US recognises the failing division and the same principles that apply

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[189] *Ibid*.
[190] *United States v. Diebold* Inc para 655.
[191] *United States v. General Dynamics Co*. 415 U.S. 486 (1974).
[192] *Ibid p*ara 501.
[193] Mathews "The Failing Firm: Re-Examining Canada's Approach to Rescue Mergers in Light of the US and EU Experience" 2014 *Canadian Competition Law Review* 18.
[194] S 11 of 2010 Horizontal Merger Guidelines.
[195] S 11 of 2010 Horizontal Merger Guidelines.
[196] Mathews "The Failing Firm: Re-Examining Canada's Approach to Rescue Mergers in Light of the US and EU Experience" 2014 *Canadian Competition Law Review* 18.
[197] See *Iscor Limited/Saldanha Steel (Pty) Ltd* 67/LM/Dec01 para 110.
[198] Fountoukakos, Barraud and Barrio 2020 *CPI Antitrust Chronicle* 29.
[199] Nzero 2014 *THRHR* 452.
[200] *Ibid*.

to the failing firm apply as well in the failing division defence.[201] Anti-trust Agencies will consider the failing firm defence even when parties do not rely on it. This is a proactive stance, which South Africa can consider.

While the US applies this test based on the merits of each case, Federal Trade Commission ("FTC") stated in a press release that it should not be expected that these requirements will be relaxed in a distressed economy.[202] This was in response to whether it would be reconsidering the Failing firm defence in light of the COVID-19 pandemic.

3.3 Part B: European Union

3.3.1 Merger regulatory framework

The European Commission ("EC") is the institution responsible for maintaining effectiveness in the European market. In 2004, EC developed EC Merger Regulations that would deal with the control of concentration between undertakings.[203] The EC Regulation does not make provision for the failing firm doctrine.[204] It is, however, recognised in the EU Horizontal Merger Guidelines, which were introduced to provide clarity on the application of the failing firm doctrine. In terms of the EU Horizontal Merger Guidelines, a merger that would ordinarily be considered problematic may be accepted in the market if one of the merging parties is a failing firm , provided there is a lack of casualty between the merger and the deterioration of the competitive structure.[205] The EU Horizontal Merger Guidelines do not provide factors to consider when assessing at what point a firm considered failing or how to determine that there is no other alternative to the Merger to avoid the exit of the company.[206]

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[201] US Horizontal Merger Guidelines S 5.2; See also *FTC v. Great Lakes Chem. Corp.* , 528 F. Supp. 84, 96 (N.D. Ill. 1981); *United States v. Reed Roller Bit Co.*, 274 F. Supp. 573, 584 n.1 (W.D. Okla. 1967).

[202] OECD Competition Committee 2009 *DAF/COMP* 182; See FTC Press Release. 6 April 2020 "Antitrust review at the FTC: staying the course during uncertain times" https://www.ftc.gov/news-events/blogs/competition-matters/2020/04/antitrust-review-ftc-staying-courseduring-uncertain (accessed 2022-10-25).

[203] *Council Regulation* (EC) No 139/2004 of 20 January 2004 (OJ L 24, 29.1.2004.

[204] López-Galdos "Comparing the US & the EU Failing Firm Defense: Reflections from an Economic Perspective" 2016 *Loyola Consumer Law Review* 302.

[205] *Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings* (2004/C 31/03) [Hereinafter "EU horizontal Merger Guidelines"] para 89.

[206] *Loyola Consumer Law Review* 302

3.3.2 Failing firm defence requirements

The EU Horizontal Merger Guidelines provide for a three-pronged test, which provides that to successfully invoke the defence, the allegedly failing firm must prove that:

(a) It would be forced out of the market due to financial difficulties if it is not absorbed by another firm;

(b) there is no less anti-competitive alternative purchaser; and

(c) the assets of the firm will exit the market, absent the merger.[207]

3.3.2.1 Exit out of the market due to financial difficulties

In order met this requirement, the allegedly failing firm needs to demonstrate that the company is unlikely to meet its financial obligation in the near future.[208] The financial difficulties must be such that there is no shareholder or investor that would be willing to provide financial assistance to ensure business continuity.[209] There is no need to show that there has been an initiation or institution of bankruptcy proceedings to pass this first leg of the test.[210] Instead, it is sufficient to show that, absent the merger, there is a likelihood that the firm will enter such proceedings.[211] This was demonstrated in 2002, in the *BASF/Eurodiol /Pantochim,*[212] when Eurodiol and Pantochim were replaced under the pre-bankruptcy regime and argued that the companies would have been declared bankrupt if they were not acquired**.**

The assessment of the financial distress will also depend on the different industries.[213] This might include an examination of the firm's financial statements to determine the extent of the financial distress. This is demonstrated in the two *Olympic/Aegean* cases.[214] In 2011, the EC prohibited a merger between Olympic Air and Aegean Airlines stating that none of the three failing firm criteria applied to Olympic.[215] Two years later, the EC unconditionally cleared the merger between the two firms

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[207] López-Galdos 2016 Horizontal Merger Guidelines para 90.
[208] OECD Competition Committee 2009 *DAF/COMP* 183.
[209] *Ibid.*
[210] See *JCI/FIAMM* (Case COMP/M.4381) Commission Decision 139/2004/EC [2007] OJ C241/1.
[211] OECD Competition Committee 2009 *DAF/COMP* 184.
[212] *BASF/Eurodiol/Pantochim* (COMP/M.2314) Commission Decision 2002/365/EC [2001] OJ L132/45.
[213] OECD Competition Committee 2009 *DAF/COMP* 184.
[214] *Olympic/Aegean I EC* decision in Case No COMP/M.5830 of January 26, 2011; *Olympic/Aegean II* EC decision in Case No COMP./M.6796 of October 9, 2013.
[215] *Olympic/AegeanI* para 2068.

concluding that the criteria were met. Pertaining to the question of whether the firm would exit in the absence of a merger, in 2011 the EC looked at the financials of Olympic and concluded that in the absence of the merger Olympic Air would "most likely continue domestic operations and retrench from international operations rather than exit entirely".[216] The EC re-examined the financial statement of both parties as they were then.[217] Taking into account the Greek economic crisis at the time, it was concluded that without the merger, Olympics' holding company was likely to be unable to continue to support Olympic,[218] and neither was there any strategic or financial benefit to keep funding Olympic.[219]

3.3.2.2 No less anti-competitive alternative purchaser

The notion of 'no less anti-competitive alternative purchaser' is a test that entails a counterfactual analysis on what the market structure would look line if there were other alternative purchasers.[220] Efficiencies may play a role in the assessment of this test; this is because a merger with a new market entrant or a smaller competitor may not achieve the same efficiencies as a larger competitor.[221]

The EC will confirm whether indeed there were no other firms willing to make an offer by doing a market investigation.[222]In *Olympic/Aegean* on the question of whether there is no less anti-competitive purchaser, in 2013, the EC reviewed extensively reviewed the target firm's emails to verify that no other less competitive purchasers had been interested.

An allegedly failing firm must demonstrate that it has made an actual effort to solicit alternative offers.[223] In *Olympic/Aegean*, it was established that credible alternative purchaser was unlikely to find an alternative purchaser in the near future, since the target firm had tried to sell Olympic numerous times before and the only interested parties had been the seller of Olympic and Aegean; furthermore, the EC's market investigation also did not reveal any other alternative purchaser.[224]

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[216] *ibid.*
[217] *Ibid.*
[218] Olympic/Aegean II para 751.
[219] *Olympic/Aegean II* para 805.
[220] OECD Competition Committee 2009 *DAF/COMP*183.
[221] OECD Competition Committee 2009 *DAF/COMP*184.
[222] OECD Competition Committee 2009 *DAF/COMP* 185, see *BASF/Eurodiol/Pantochim..*
[223] OECD Competition Committee 2009 *DAF/COMP* 183.
[224] *Olympic/Aegean II* paragraph 816.

3.3.2.3 Assets of the firm will exit the market

It was outlined in *BASF/Eurodiol/Pantochim* that the other two requirements do not rule out the favourable outcome which would be the possibility of a third party taking over the productive assets of the failing firm.[225] Therefore, in order to meet this requirement, the allegedly failing firm demonstrate that the assets of firm will inevitably exit the market, absent the merger.

It can be interpreted that if there are firms that are willing to take-over the assets failing firm, there would be no reason to authorise a merger as the liquidation would cause less harm to competition than a merger.[226]

In *Olympic/Aegean*, concerning the exit of assets from the market, the EC conducted a market investigation that confirmed that there was no third party interested in would in acquiring the Olympic brand and its aircraft.[227] The EC was satisfied with this assessment and concluded that, absent the transaction, the assets would have exited the market or been acquired by the acquiring firm in any event.[228]

The EC emphasised in *Olympic/Aegean* that the defence had only succeeded "under the particular and exceptional circumstances of the present case, which is characterised by the protracted adverse economic conditions in Greece, significant decline in passenger numbers on Greek domestic routes, historic unprofitability of Olympic without conceivable prospects for reversal in the near future, difficult finances of the parent company and its limited ability and incentive to further financially support Olympic".[229]

In the event that the assets do inevitably leave the market, it is further assessed whether their exit would cause such a disruption in the market that it would cause harm to consumers.[230]

3.3.3 EU counterfactual analysis

The counterfactual analysis takes place when the failing firm defence has not been

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[225] *BASF/Eurodiol/Pantochim* para 141.
[226] Winkley *The Failures of the Failing Firm Defence – An Analysis into Whether the EU Failing Firm Defence Requires Reform* (LLB Dissertation 2021 University of Leeds) 26.
[227] *Olympic/Aegean* II, para 823 and 829.
[228] *Ibid*.
[229] *Olympic/Aegean II* para 833.
[230] OECD Competition Committee 2009 *DAF/COMP* 184.

successful.[231] This analysis will consider factors customarily associated with merger control, which include but are not limited to, efficiencies, supply, demand, and customer buying power.[232] Counterfactual is used as a tool to analytically assist in answering the question of whether the merger will substantially prevent or lessen competition in the relevant market.[233] This has been demonstrated in *Newscorp*,[234] where the merger was authorised after a counterfactual analysis even though it did not meet the requirements of the failing firm defence based on the fact that it was a failing division and not a failing firm.

The EU Horizontal Merger Guidelines point out that a counterfactual analysis should be conducted by the EC to evaluate the effects of the transaction.[235] Therefore, the most important consideration in a counterfactual situation, is what the impact of the absence of the firm is on the market if the merger is not accepted.[236] This is called a market exit counterfactual, which is an analysis of what will happen in the absence of the transaction, if the failing firm would go bankrupt or is acquired by a third party,[237]

The *JCI/FIAMM* case illustrates this approach.[238] Even though FIAAM was in the process of entering into insolvency procedures and there were no other alternative purchasers, it could not establish that absent the merger, FIAAM's assets would exit the market.[239] As such, the parties could not establish the failing firm defence but the EC did a counterfactual analysis and concluded that there would be short-term

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[231] Winkley 29.

[232] OECD Competition Committee 2009 *DAF/COMP* 187, See *Ernst & Young/Andersen Germany* (Case COMP/M.2824) Commission Decision 4064/89/EEC [2002] OJ C246/21.

[233] Goolabjith and Kariga "Fading Firms And The Evolution Of The Failing Firm Doctrine In South African Competition Law" 2020 http://www.compcom.co.za/wp-content/uploads/2020/11/Goolabjith-Kariga-Final-Conference-Paper-Failing-Firm-Doctrine-KLG_RK26.10.2020.pdf (accessed 2022-07-28) 27.

[234] *Newscorp/Telepiu* (Case COMP/M.2876) Commission Decision No 2004/311/EC [2003] OJ L110/73.

[235] *Horizontal Merger Guidelines* para 9—
"In assessing the competitive effects of a merger, the Commission compares the competitive conditions that would result from the notified merger with the conditions that would have prevailed without the merger. In most cases the competitive conditions existing at the time of the merger constitute the relevant comparison for evaluating the effects of a merger. However, in some circumstances, the Commission may take into account future changes to the market that can reasonably be predicted. It may, in particular, take account of the likely entry or exit of firms if the merger did not take place when considering what constitutes the relevant comparison."

[236] Fountoukakos, Barraud and Barrio "The failing firm defense in times of (the covid-19) crisis: is it worth revisiting?" 2020 *CPI Antitrust Chronicle* 29.

[237] Geradin and Girgenson "The Counterfactual Analysis in EU Merger Control" 2013 http://dx.doi.org/10.2139/ssrn.2357026 (accessed 2022-09-27).

[238] *JCI/Fiamm* (Case Comp /M.4381).

[239] *Ibid.*

disruption in the market and held that this would expand the market and encourage new market participants.[240] This case illustrates that the Commission is prepared to do a counterfactual analysis even in cases where the failing firm test is not met.

This counterfactual assessment indicates that if an allegedly failing firm inevitably exits the market in the near future, the merger can have no negative impact on competition.[241]

3.3.4 Concluding remarks

At the heart of the failing firm in the EU, is the causal link between the merger and the competitive market structure.[242] The failing firm defence has also been accepted as an absolute defence in the EU. It is also a three-pronged test which must be cumulatively met for the defence to be accepted.[243] This test requires that the allegedly failing firm must be in imminent financial crisis that would result in being forced out of the market, there should be no other anti-competitive alternative offer, and that assets of the firm certainly exit the market if the merger is not allowed.[244] The EU considers whether the acquiring firm would gain the market share of the target firm post-merger when examining the failing firm defence.[245] In South Africa, this is considered a stringent requirement.[246]

The EU also recognises the failing division defence but the burden of proof in the latter is greater.[247] The burden of proof that these cumulative criteria are satisfied falls on the notifying parties. The EU in the consideration of the reason alternative offer takes into account efficiencies, social and public policy.[248] In competition authorities in South Africa not only concerned with efficiencies but other factors as set out in section 2 of the Act, which include amongst other, entry and expansion of Small-Medium

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[240] *Ibid*.
[241] Goolabjith and Kariga "Fading Firms And The Evolution Of The Failing Firm Doctrine In South African Competition Law" 2020 http://www.compcom.co.za/wp-content/uploads/2020/11/Goolabjith-Kariga-Final-Conference-Paper-Failing-Firm-Doctrine-KLG_RK26.10.2020.pdf (accessed 2022-07-28) 27.
[242] OECD Competition Committee 2009 *DAF/COMP* 183.
[243] *Ibid.*
[244] EU Horizontal Merger Guidelines para 90.
[245] See *KaliSalz/ MdK/Treuhand, Case IV/M308 [1994] 0.J. L186.*
[246] See Iscor Limited/Saldanha Steel (Pty) Ltd 67/LM/Dec01 para 110.
[247] OECD Competition Committee 2009 *DAF/COMP 186.*
[248] Kokkoris "Failing firm defence in the European Union. A panacea for mergers?" 2006 *European Competition Law Review* 12.

Enterprises and Historically disadvantaged persons given its historical context.[249]

The EU makes provision for a counterfactual analysis in cases where the failing firm defence has failed to determine the outcome of market structure absent the merger. This allows the EC to compare different scenarios and provide remedies. Authors have criticised the need to apply the counterfactual test as an indication that the failing firm defence is applied stringently.[250] However, this dissertation posits that this is an indication that, while the EC maintains a strict and narrow approach to the requirement, it leaves room for flexibility which allows it to accommodate the rapidly changing economic conditions.[251]

3.4 Part C: Canada

3.4.1 Merger Regulatory framework

The merger review under the Canadian Competition Act of 1985[252] is a substantive test of whether the merger is likely to "prevent or lessen competition substantially".[253] Section 93 of this Act provides for a non-exhaustive list of factors to be considered when carrying out competition assessments.[254] One of these is Section 93(b), which considers "whether the business or part of the business, of a party or proposed merger has failed or is likely to fail".[255] This a recognition of the failing firm doctrine.

According to the wording from this section, the Competition Bureau ("the Bureau") will not allow a merger only on the premise that it is failing but is instructed rather, to consider whether because of the failure will affect competition conditions.[256] The Bureau regulates competition in Canada.

Unlike other jurisdictions, the Canadian merger review on the failing firm doctrine is

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[249] See S 2(e) and (g) of the Competition Act.
[250] Winkley 29.
[251] OECD Competition Committee 2009 *DAF/COMP* 188.
[252] Competition Act (R.S.C., 1985, c. C-34).
[253] Elliot and Dinning "Failing Firm Analysis in Canadian Merger Review" 2009 (Paper delivered at the CBA Competition Law 2009 Spring Forum, Toronto, 12 May 2009) http://www.cba.org (accessed 2022-09-30).
[254] Competition Act (R.S.C. 1985, c.C-43).
[255] S 92(b) Competition Act R.S.C.
[256] Musgrove and Chad "Opportunities in Challenging Times: The Failing Firm Provision of Canada's Competition Act" 2020 https://mcmillan.ca/insights/publications/opportunities-in-challenging-times-the-failing-firm-provision-of-canadas-competition-act/ (accessed 2022-10-25).

not developed through case law and relies on the Bureau's 2004 Merger Enforcement Guidelines ('the MEGs'').[257] This is an amendment and refinement of the 1991 MEGs.

These MEGs which are enacted in terms of section 93(b) focus on two issues, firstly it considers the likeliness of a business failure and exit o of assets from the market; and whether there is an alternative to the merger that would lead to better competition.[258]

3.4.1.1 Likeliness of a business failure and exit of assets

According to the MEGs, it is not business failure itself that is significant but rather what is pertinent is whether such failure will result in the exit of the failing firm's assets from the market.[259] The determination of whether a firm is likely to fail serves to provide a tangible basis for assessing whether assets are likely to exit the market.[260]

A firm is considered failing if it is insolvent, undergoing voluntary bankruptcy or "petitioned into bankruptcy or receivership''.[261]

The MEGs provide a list of things to submit as evidence to the Bureau in order to prove business failure.[262] The allegedly failing firm must provide to the Bureau with, amongst others, the latest audited financial statements as well as projected cash flows which must indicate loans, credit and suppliers.[263]

3.4.1.2 Alternatives to the merger

The question of whether a merger is likely to prevent or lessen competition is not concluded before the Bureau is satisfied that there are no alternative buyers that would increase competition in the market.[264] The MEGs consider acquisition by a

[257] Competition Bureau, "Merger Enforcement Guidelines" (2011-10-06) at Part 13.
[258] Elliot and Dinning "Failing Firm Analysis in Canadian Merger Review" 2009 (Paper delivered at the CBA Competition Law 2009 Spring Forum, Toronto, 12 May 2009) http://www.cba.org (accessed 2022-09-30).
[259] Merger Enforcement Guidelines 2004 part 13.3.
[260] Elliot and Dinning "Failing Firm Analysis in Canadian Merger Review" 2009 (Paper delivered at the CBA Competition Law 2009 Spring Forum, Toronto, 12 May 2009) http://www.cba.org (accessed 2022-09-30).
[261] Merger Enforcement Guidelines 2004 part 13.3.
[262] Merger Enforcement Guidelines 2004 part 13.4.
[263] *Ibid.*
[264] Elliot and Dinning "Failing Firm Analysis in Canadian Merger Review" 2009 (Paper delivered at the CBA Competition Law 2009 Spring Forum, Toronto, 12 May 2009) http://www.cba.org (accessed 2022-09-30).

competitively preferable purchaser;[265] retrenchment or restructuring,[266] liquidation as alternatives to a merger.[267]

A competitively preferable purchaser is a purchaser whose acquisition of the company would likely result in the material increment of competition in the relevant market.[268] This preferable purchaser must be willing to pay a price greater than the price the failing firm would have received in a liquidation.[269] Therefore, the Bureau will evaluate the documents provided by the merging parties in order to determine the degree at which they engaged with bidders and alleged bidders to ascertain that they were provided with a fair opportunity to bid for the target firm's business.[270]

If The Bureau is not convinced that a thorough search for a preferred competitive purchaser was carried out.,[271] the Bureau request an independent third party to conduct such a search before the failing firm defence is accepted.[272]

The Bureau also considers retrenchment and/ or restructuring and liquidation as other alternatives to a merger.[273] This is to determine if either of these options will lead to a "assesses whether liquidation of the firm is likely to result in a materially higher level of competition in the market than if the merger in question proceeds".[274] This was demonstrated in *Canadian Pacific/Cast North America*.[275] Canadian Pacific argued that Cast North America was a failing firm in terms of section 93(b) ,however, the Bureau held that a merger would not be approved as there were other alternatives available to Cast North America.[276] The Bureau held that there were at least four other potential purchasers and that retrenchment was a preferable alternative to a

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[265] Merger Enforcement Guidelines 2004 part 13.8.
[266] Merger Enforcement Guidelines 2004 part 13.9.
[267] Merger Enforcement Guidelines 2004 part 13.10.
[268] Merger Enforcement Guidelines 2004 part 13.8, see Elliot and Dinning 2009.
[269] *Ibid*.
[270] OECD Competition Committee 2009 *DAF/COMP* 83.
[271] such as an investment dealer, trustee or broker who has no material interest in either of the merging parties or the proposal in question.
[272] Reisler and Margison "Refresher on the Failing Firm Defence" https://www.competitionchronicle.com/2020/03/refresher-on-the-failing-firm-defence/ (accessed 2022-06-13).
[273] *Ibid.*
[274] Merger Enforcement Guidelines 2004 part 13.9 and 13.10.
[275] *Canada (Director of Investigation and Research) v. Canadian Pacific, Docket* No. CT-1996-002(Comp. Trib.); see Competition Bureau, Competition Bureau requests a stay of proceedings challenging the merger between Cast North America Inc. and C.P. Limited (Sept. 9, 1997), available at http://www.cb-bc.gc.ca/eic/site/cb-bc.nsf/eng/00681.html .
[276] *Canada (Director of Investigation and Research) v. Canadian Pacific, Docket* para 35-38.

merger.[277]

Recently, the Bureau evaluated the failing firm doctrine in *American Iron & Total Metal Recovery*,[278] an acquisition of Total Metal Recovery ("TMR") by American Iron & Metal Company Inc. ("AIM").[279] The Bureau initiated a formal inquiry into the transaction, 2019, AIM entered into a court enforceable Consent Preservation Agreement with the Commissioner to preserve and maintain the assets of TMR for 60 days following the closing of the transaction.[280] Thereafter, the Bureau obtained orders to compel the parties to provide information on third parties who had shown interest in purchasing TMR.[281] Upon receipt of the information, the Bureau assessed the likelihood of the following counterfactual scenarios, whether restructuring or retrenchment of the failing firm, the sale of the firm to a competitively preferable purchaser, and liquidation of the failing firm's assets.[282]

In the first counterfactual, the Bureau concluded, based on the information obtained, that if TMR had opted for retrenchment or restructuring, they would not have prevented its failure nor assisted it to continue as a significant competitor.[283]

The second counterfactual entailed the Bureau's examination of the extent of interest expressed by alternative buyers in buying the failing firm; evidence submitted indicates that the failing firm has taken steps to negotiate or attempted to finalise the deal with third parties.[284] This evidence can be obtained from an interested purchaser to demonstrate how effective or competitive that interested party would have been had the transaction been successful; and evidence highlighting an alternative buyer' ability to finalise a transaction in a timeously in to evaluate the viability as an alternative to a merger review that could be potentially anti-competitive merger under review.[285] The Bureau concluded that a thorough search for potential alternative purchasers had been conducted and that there was no competitively preferable

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[277] *Ibid.*
[278] See Media Statement issued by the Bureau at https://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/04528.html#fn (accessed 28 July 2022).
[279] *Ibid.*
[280] *Ibid.*
[281] *Ibid.*
[282] *Ibid.*
[283] *Ibid.*
[284] *Ibid.*
[285] *Ibid.*

purchaser.[286]

Pertaining to the last counterfactual, the Bureau determined whether liquidation of the failing firm's assets would lead to a better alternative that would not raise the same or even less competition issues.[287] the Bureau held that liquidation of TMR's assets would not have been a determining factor in facilitating a new market entrant and was not likely to result in a materially higher level of competition than if the merger was not allowed to proceed.[288] The Bureau concluded that the failing firm factor was met, and the merger was allowed to proceed.[289]

The significance of this case is that despite the COVID-19 pandemic, the Bureau has not altered its position on its approach to the failing firms doctrine.[290] Firms that wish to invoke the failing firm defence factor will be required to meet the same stringent standards that the Bureau has applied in the past.[291] This is consistent with the Bureau's general message that the substantive competitive effects test remains the same and that businesses should not expect a more lenient approach to merger review as the pandemic continues.[292] This means the Bureau will not reconsider its approach towards the failing firm defence In light of the pandemic. The requirements will not be amended to accommodate firms that could be adversely affected by the Covid-19 pandemic.

3.4.1.3 Public interest considerations

In *Air Canada/Canadian Airlines,* the parties relied on a failing firm defence factor and the Bureau allowed it although there were no preferable alternative purchasers and acquisition of the Canadian Airlines by Air Canada meant the monopoly of the Canadian airline market and indeed.[293] While it was important for the Bureau to ascertain that indeed Canada Airline was failing, public interest review was the overriding premise of the Bureau decision.[294] This is an important consideration

[286] *Ibid.*
[287] *Ibid.*
[288] *ibid*
[289] *Ibid.*
[290] Pratt and Shevchenko "Canadian Merger Review: Assessing Failing Firm Claims In Market Conditions Disrupted By Covid-19" 2020 *CPI Antitrust Chronicle* 40.
[291] *Ibid.*
[292] Margison and Reisler "Canada: Competition Bureau Provides Guidance On Failing Firm Analysis" https://www.mondaq.com/canada/antitrust-eu-competition-/932172/competition-bureau-provides-guidance-on-failing-firm-analysis(accessed 28 July 2022).
[293] *Air Canada/Canadian Airlines* (20 December 1996), CT-1996/002 (Comp. Trib.)
[294] *Ibid.*

because it is important that tangible assets do not exit the market as it would be detrimental to consumers. This is similar to South Africa's position where the interests of the consumers are considered under the public interest consideration.

3.4.2 Concluding remarks

Canadian Competition Act statutorily recognise the failing firm doctrine as one of the factors to be taken into consideration when determining whether a merger prevents or lessens competition. This same position in South Africa.

The MEGs highlight that the focus is not on whether the business would fail but rather on the resulting exit of assets is important. This means that the exit of assets should be attributed to the imminent business failure, it cannot be based on unsatisfactory profit or a desire to branch into new business ventures.[295] This is similar to South Africa in that competition authorities also consider what led to the financial difficulties.[296] The MEGs also set a list of particulars you need to furnish the competition authorities with, as opposed to the US and EU. This ensures efficiency and takes into consideration firms that may not have the necessary resources or time to embark on a lengthy process.

In essence, the Bureau requires that before a merger can be allowed that the failing firm considers entering a transaction with a competitively preferable purchaser, examine the prospects of retrenchments or restructuring and some case, consider liquidation.[297] The Bureau may in exceptional circumstances determine that liquidation is the most favourable outcome.[298] The Bureau examines each proposed merger on its merits and conducts thorough searches to ascertain that there is no other alternative to a merger.[299]

3.5 Lessons

This chapter explores the interpretation of the failing firm defence in the US, the EU, and Canada to determine if there are any lessons for South Africa to learn. The main

[295] *Ibid.*
[296] See Nzero 2017 *THRHR* 613.
[297] *Ibid.*
[298] Pratt and Shevchenko 2020 *CPI Antitrust Chronicle* 42.
[299] Elliot and Dinning "Failing Firm Analysis in Canadian Merger Review" 2009 (Paper delivered at the CBA Competition Law 2009 Spring Forum, Toronto, 12 May 2009) http://www.cba.org (accessed 2022-09-30).

takeaway from the US is that competition authorities take a proactive approach towards the failing firm defence. They can consider the defence even if the parties do not raise it.

South Africa can learn from the EU to employ the counterfactual analysis in the event that the parties fail to successfully raise the failing firm defence. This could help to determine the outcome of market structure absence of the merger and be done while taking into consideration other factors that the Act requires.

The lesson from Canada is to consider consolidating the factors and principles that have been laid down by competition authorities and courts over the years into a set of merger regulations for the sake of clarification and consistency, as Canada has done with the MEGs.

The general consensus among competition authorities is that the existing legal framework for merger evaluations in their respective jurisdictions will remain unchanged and will not be altered due to the pandemic.[300] They will continue to follow established procedures and guidelines. South Africa should adopt this position to protect competition structures and to uphold rationale behind this defence. Which is, the failing firm defence should only be used in exceptional circumstances.[301]

[300] Goolabjith and Kariga "Fading Firms And The Evolution Of The Failing Firm Doctrine In South African Competition Law" 2020 http://www.compcom.co.za/wp-content/uploads/2020/11/Goolabjith-Kariga-Final-Conference-Paper-Failing-Firm-Doctrine-KLG_RK26.10.2020.pdf (accessed 2022-07-28) 3.

[301] *Ibid.*

CHAPTER 4

CONCLUSION AND RECOMMENDATIONS

The Competition Act sets out factors to be considered by competition authorities in an inquiry on whether or not a merger is likely to substantially prevent or lessen competition. One of the facts considered is whether "a firm or a part of has failed or is likely to fail".[302] This is an express incorporation of the failing firm doctrine in South African competition law. [303]

In South Africa, the analysis of failing firm factor is a flexible and dynamic process within the legislative framework and established case law precedent.[304] The fact that this is a factor and not a defence, affords competition authorities an opportunity to flexibly apply narrow and strict approach in order to protect a competitive market structure from an anti-competitive merger.[305] The three-pronged substantive assessment test acts as a barrier against the approval of an anti-competitive merger.[306] This is because the Competition Act requires that a public interest test is conducted in every proposed merger.[307] Therefore, a successful failing firm defence still needs to pass the public interest consideration muster. Inversely, a merger that does not pass the failing firm test can still be allowed on public interest grounds.[308] Pertaining to the point that public consideration prolong merger reviews. Nzero submits that the real solution is to change the merger provisions to allow for exemptions from interventions in mergers involving failing firms, or to empower competition authorities to issue preliminary approvals of mergers that raise no serious competition concerns.[309]

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[302] S 12A(2)(g) of Competition Act.
[303] Balkin "'Failing firm defence' defence in SA competition law" 2004 *SA media- The University of Free state* 1.
[304] Goolabjith and Kariga "Fading Firms And The Evolution Of The Failing Firm Doctrine In South African Competition Law" 2020 http://www.compcom.co.za/wp-content/uploads/2020/11/Goolabjith-Kariga-Final-Conference-Paper-Failing-Firm-Doctrine-KLG_RK26.10.2020.pdf (accessed 2022-07-28) 36.
[305] Nzero 2017 *THRHR* 621.
[306] Nzero 2014 *THRHR* 247.
[307] Tavuyanago *Public interest considerations and their impact on merger regulation in South Africa* (LLM Dissertation 2014 University of Pretoria) 31.
[308] *Industrial Development Corporation of South Africa v Anglo-American Holdings Ltd para 22.*
[309] *Ibid.*

South African competition authorities acknowledge that this doctrine is well embedded in foreign jurisdiction.[310] The failing firm defence test in South Africa is an infusion of the US and the EU tests.[311] In foreign jurisdictions, such as the US and the EU, the failing firm defence is an absolute defence. While in Canada and South Africa, it is a factor to be considered when evaluating whether a merger that will ordinarily be prohibited should be allowed due to financial difficulties.

There are similarities in how these four jurisdictions approach the failing firm defence. Common in these jurisdictions, amongst others, is that the parties invoking the failing firm defence must demonstrate good faith efforts to elicit alternatives purchaser or options that pose less anti-competitive effects. Where there are alternative reasonable purchasers or alternative options, competition authorities will not accept a failing firm defence. Another similarity in these jurisdictions is the high evidentiary burden placed upon the merging parties. The failing firm must adduce facts, documents, and data to prove its financial position and to assist competition authorities and courts in determining and concluding that the proposed merger is ultimately good for its customers This is to ensure that only genuinely failing firms can rely on this defence. This is in line with proponents of the narrow approach who assert that the failing firm defence is not a 'panacea' or a fortune cookie that affords merging parties leniency.[312] The narrow approach entails a strict assessment of requirements to ensures that the defence is permitted only in exceptional circumstances. This is to discourage firms from invoking the defence at the slightest financial inconvenience.

The EU test requires that if the allegedly failing firm does exit the market, its market share would have gone to the acquiring firm anyway in the absence of a merger. This requirement can be incorporated in South Africa where the merger would result in extensive anti-competitive effects.

The EU test requires that the financial distress must be so severe that the firm would be forced out of the market.[313] This different to South Africa, where competition

[310] *Iscor Limited/Saldanha Steel (Pty) Ltd* para 104.
[311] *Ibid.*
[312] Heyer and Kimmel "Merger Review of Firms in Financial Distress" 2009 *Competition Policy International* https://www.justice.gov/sites/default/files/atr/legacy/2009/03/31/244098.pdf (accessed 2022-10-28).
[313] López-Galdos 2016 *Loyola Consumer Review* 309.

authorities also consider the likelihood of financial distress. The EU requirement for severity when determining financial distress can be used in South Africa where the merger would lead to extensive anti-competitive effect In South Africa, akin to the EU regime, this criterion does not merely assess whether there is an alternative purchaser but rather that the alternative purchaser should have less effect of anti-competitiveness. Except, the EU regime requires that in the event the failing firm exits the market, the assets of the failed firm will fall into the hands of the acquiring firm.[314]

In the US, the alternative offer or purchaser must be reasonable. This means that the merger must make commercial sense.[315] This aspect can be considered in South Africa where there is an alternative offer, but it is not reasonable. This could assist in further determining what constitute a reasonable offer.

Canada also conflates the financial failure requirement and exit of assets into a single requirement. Essentially, this is an assumption that if a firm fails, the assets would also leave the market, this approached can be employed in South Africa where the exit of the firm from the market would mean customers would not be able to fairly access the product or service. Canada utilises MEGs to provide guidelines on mergers. South African competition authorities can issue guidelines on the particulars and requirements of the failing firm doctrine. This codified document on the failing firm defence would provide certainty to parties on what evidence to adduce in support of their reliance on the failing firm doctrine.[316] This would entail a consolidation of the principles and requirements that have been set out in case law into a consolidated document. This would provide more certainty and clarity. Canada's MEGs may be used as a template in the development of these guidelines.

This dissertation was necessitated by the worldwide debate on whether the failing firm defence should be reconsidered in light of the Covid-19 pandemic. Goolabjith and Kariga argue there is room for to further develop the failing firm defence and provide numerous measures that can be considered when considering a failing firm defence

[314] Kokoris *European Competition Law Review* 497.
[315] López-Galdos 2016 *Loyola Consumer Review* 332
[316] Goolabjith and Kariga "Fading Firms And The Evolution Of The Failing Firm Doctrine In South African Competition Law" 2020 http://www.compcom.co.za/wp-content/uploads/2020/11/Goolabjith-Kariga-Final-Conference-Paper-Failing-Firm-Doctrine-KLG_RK26.10.2020.pdf (accessed 2022-07-28) 34.

in light of the pandemic crisis in South Africa.[317] They suggest that in consideration of the whether a firm prevents or lessens competition, competition authorities can place more weight can be placed on the failing firm factor in the substantive assessment test.[318] They propose that this could be done by assessing the financial situation of the firm prior to the lockdown and the impact of the Covid-19 pandemic.[319] The parties would have to provide evidence that the deterioration of the financial circumstances is the result of lockdown.[320] They further suggest that the question should move from "whether the assets will exit the market" to a question as to "whether the regulator would rather preserve the business and jobs of the failing firm".[321] This dissertation does not agree with this last suggestion because job preservation is public interest issue and is adequately regulated as such in our competition law. Employment is listed in the Act as one of the public interest ground which competition authorities must consider in the evaluation of a merger.[322] Public interest considerations should not be disguised as failing firm defence requirements mainly because it would be redundant at that this stage since all mergers are subject to public interest.

Many competition law scholars argue that the failing firm doctrine should not be amended to accommodate these unprecedented times.[323] In fact, there are those who are calling for a more rigorous approach to avoid the abuse of this defence. This is evidenced by the statements issued by competition authorities around the world stating that this is not the first economic crisis and therefore, should be no leniency.[324]

This dissertation considered the question of whether the current stringent and high evidentiary burden used by competition authorities in the assessment of the failing firm defence should be reconsidered considering the COVID-19 pandemic in South Africa. It considered the current position and concludes that the failing firm defence is one of the many factors considered in a merger evaluation and is subject to public interest

[317] Goolabjith and Kariga "Fading Firms And The Evolution Of The Failing Firm Doctrine In South African Competition Law" 2020 http://www.compcom.co.za/wp-content/uploads/2020/11/Goolabjith-Kariga-Final-Conference-Paper-Failing-Firm-Doctrine-KLG_RK26.10.2020.pdf (accessed 2022-07-28) 32.
[318] *Ibid.*
[319] *Ibid.*
[320] Goolabjith and Kariga "Fading Firms And The Evolution Of The Failing Firm Doctrine In South African Competition Law" 2020 http://www.compcom.co.za/wp-content/uploads/2020/11/Goolabjith-Kariga-Final-Conference-Paper-Failing-Firm-Doctrine-KLG_RK26.10.2020.pdf (accessed 2022-07-28) 33.
[321] *Ibid.*
[322] S 12(A)(3)(b) of the Competition Act.
[323] OECD Competition Committee 2009 *DAF/COMP* 188.
[324] *Ibid.*

consideration. It further undertook a comparative analysis to determine to what South Africa can take away from the different jurisdiction and to what extend it is similar to these jurisdictions. In conclusion, this dissertation posits that South Africa's current approach to the failing firm defence is in line with the objectives of the Competition Act. There is no need to narrow or widen the approach in light of the current predicament, as "crises pass, but mergers remain".[325] This emphasises that the purpose of the failing firm doctrine is not to protect firms from economic distress but to protect competition.[326] Therefore, the current strict regime should be preserved and flexibly applied to the facts of each case.[327]

[325] Wiener "Crises pass but mergers remain: EU merger control during the COVID-19 pandemic" 2022 European *Competition Law Review* 1.
[326] DiGangi 2012 *St. John's Law Review.*
[327] OECD Competition Committee 2009 *DAF/COMP* 188.

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