THE 14TH ANNUAL COMPETITION LAW, ECONOMICS AND POLICY CONFERENCE:
"Competition in a Crisis:
Competition Policy, Regulation and Enforcement in Unprecedented Times"
3 - 4 November 2020

FADING FIRMS AND THE EVOLUTION OF THE FAILING FIRM DOCTRINE IN SOUTH AFRICAN COMPETITION LAW

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south africa

INTRODUCTION

- Accommodation of the failing firm doctrine in merger assessments in a pandemic and in the aftermath
- Responses by competition authorities
- Stringent application and high evidentiary burden on the merging parties
- Origins of the failing firm doctrine & international jurisprudence
- Evolution of the jurisprudence in South Africa
- Conservative to radical measures of change in approach

ORIGINS

USA:

- **Absolute defence**
- **1930 Supreme Court decision - *International Shoe v FTC***
- **invoked by merging parties as a defence to a finding that a proposed merger will impede competition**
- **Two-stage inquiry:**
  - **determine whether or not the merger will impede competition**
  - **if so, whether one of the merger parties is a 'failing firm', in which event the merger should nevertheless be approved**
- **1992 U.S. Horizontal Merger Guidelines (amended 1997)**

ORIGINS

USA:

- 1992 U.S. Horizontal Merger Guidelines (amended 1997)
- A merger is not likely to create or enhance market power or facilitate its exercise if the following circumstances are met:
  - failing firm unable to meet its financial obligations in the near future;
  - unable to reorganize successfully;
  - unsuccessful good faith efforts to elicit reasonable alternative offers of acquisition and pose a less severe danger to competition than does the proposed merger; and
  - assets of the failing firm would exit the relevant market.

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EU:

- Also an absolute defence
- EU Horizontal Merger Guidelines (cumulative criteria):
  - the allegedly failing firm would in the near future be forced out of the market because of financial difficulties if not taken over by another undertaking;
  - there is no less anti-competitive alternative purchase than the notified merger; and
  - in the absence of a merger, the assets of the failing firm would inevitably exit the market.
- More restrictive than US
- Burden of proof on notifying parties

ORIGINS

EU:

- **Handful of cases**
  - ***KaliSalz/MdK/Treuhand*** **- failing firm defence was successfully raised in part because the merger avoided a large loss of jobs in Eastern Germany**
  - ***France v Commission*** **- a concentration should not be blocked where the target would have failed anyway and its market share would have accrued to the acquirer, since the concentration did not cause the harm to competition**
  - ***Nynas/Shell/Harburg Refinery*** **- division of Shell, rather than Shell itself, that was failing**
  - ***Aegean/Olympic II*** **(2013) - Olympic had become a failing firm since the time of the previous proposed merger in 2011**

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- **S12A(2)(g) - "*whether the business or part of the business of a party to the merger or proposed merger has failed or is likely to fail*"**
- **Statutory recognition to the failing firm doctrine**
- **Not a defence**
- **A factor to be considered in the OVERALL COMPETITIVENESS ASSESSMENT of a merger**
- **Failing firm doctrine has been developed through case law**
- **The onus is on the merging parties**
- **Balancing of interests versus applying rigid formulae**

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- ***ISCOR Limited and Saldanha Steel (Pty) Ltd***

- **Tribunal's 7-point criteria for raising the "failing firm" doctrine:**

1. **A failing firm defence should not be invoked if it amounts in substance to another factor or defence which the Act already provides. In particular we draw attention to the efficiency defence and the public interest criteria.**

2. **The merger criteria for a failing firm set out in the tests of other jurisdictions will carry serious weight in our assessment.**

3. **A merger would not be regarded as lessening competition if the conditions laid out in the more stringent EU test can be satisfied.**

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4. A party falling short of the "*market share would have gone to us*" requirement, but that could satisfy the other elements of the test or the standard in the US test, would have a reasonable possibility of success depending on the degree of the anticompetitive sting. Thus where the anti-competitive effects of the merger are otherwise slight, then the Tribunal might be less stringent in the application of some of the criteria. Here the party should have regard to evidence that establishes some rationale for the existence of the failing firm doctrine.

5. Evidence of the extent of failure or its imminence, would be weighed up against the evidence of the anti-competitive effect. The greater the anticompetitive threat the greater the showing that failure is imminent.

6. No leniency would be afforded to the requirement that there be evidence that there is no less anti-competitive alternative.

7. The onus is on the merging firms to establish the evidence necessary to invoke the doctrine of the failing firm.

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Other relevant case law:

- **Schumann Sasol (2001) – *"the facts of the specific case will take precedence over the application of a derived formula."***

- ***Tiger Brands Ltd; Ashton Canning Company (Pty) Ltd; Newco* (2005) and Santam Limited (2010)**
  - **it is not only the merging parties that can raise the failing firm doctrine in a merger assessment – can be the Tribunal or the Commission**

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Other relevant case law:

- ***Phodiclinics* (2006) –**
  - **If a firm is *de facto* in liquidation, it falls squarely within the meaning of 'failing firm' and more accurately, a 'failed' firm.**
  - **Important precedent on the issue of when alternative offers to purchase need to be on the table - at the time when the merger transaction was concluded, not at some indeterminate time in the future**
- ***Pioneer Hi-Bred International Inc. and Pannar Seed (Pty) Ltd* (2012) –**
  - **CAC accepted that a merging party who is in decline is not a failing firm**

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- **Summary of requirements:**
  - **the firm is likely to fail or has failed;**
  - **other alternatives to save the firm were properly exploited before the merger was concluded;**
  - **there was no alternative purchaser that would result in a less anti-competitive outcome; and**
  - **the assets of the failing firm would exit the relevant market absent the merger.**

COUNTERFACTUAL

- **Failing firm counterfactual: if a party to a merger will, but for the merger, inevitably exit the market in the short-term, the merger can have no adverse impact on competition**

- **U.S. Horizontal Merger Guidelines: a merger is not likely to enhance market power if imminent failure of one of the merging firms would cause the assets of that firm to exit the relevant market**

- **EU: progressed from a restrictive interpretation (based on the concept of causality) to a more flexible one, which involves comparing different possible counterfactuals**

- **CMA:**
  - **Phase 1: select the most competitive counterfactual**
  - **Phase 2: select the counterfactual that would be the most likely scenario to have arisen absent the merger**

COUNTERFACTUAL

South Africa: The relevant counterfactual where a merging party is in decline and may exit

- ***Pioneer Hi-Bred International Inc & Pannar Seed (Pty) Ltd / The Competition Commission, African Centre for Biosafety & Biowatch SA*** **[113/CAC/Nov11]**
  - ***"…it is of little assistance, on the unique facts of the present case to approach the issue of whether the proposed merger will lessen competition by simply focussing upon possible post-merger price increases, whether these would be off-set by any dynamic efficiencies flowing from the merger and whether any adverse effects can be resolved by way of the proposed remedies, and to turn a blind eye to the reality of the situation."***

COUNTERFACTUAL

- **South Africa: Recent merger raising the failing firm argument**

  Primary Acquiring firm: Senwesbel Limited & Senwes Limited
  Primary Target firm: Suidwes Holdings (Ring Fenced) (Pty) Ltd

- **The Commission argued that:**
  - **the correct counterfactual was not a situation where the assets of Suidwes would exit the market, but one where the assets would be bought by an alternative buyer**
  - **there were other alternatives like business rescue and even liquidation which would ensure that the productive assets (the silos) of Suidwes would remain in the market**

- **The merging parties posited a situation where:**
  - **business rescue would fail; and**
  - **liquidation would not ensure that the productive assets would not exit the market**

RECOMMENDATIONS

- **Place more weight on the failing firm factor in the assessment under section 12A(2)(g) of the Competition Act**
- **Maintain timeframes for assessment**
- **Guidelines (section 79)**
- **Regulations (section 78)**
- **Amend the current legislation**

CONCLUSION

- Not all doom and gloom for failing firms
  - Certainty on the legal test and criteria to meet
  - Certainty on the evidentiary burden
  - Certainty on the onus
- Case-by-case assessment
- Balancing exercise
- Flexible and dynamic process within the framework of legislation and established case law precedent
- Time for a revolutionary approach?

THANK YOU!

Please direct any queries, suggestions and/or comments to:

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