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

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*The authors write in their personal capacity and their views should not be attributed to those of the Competition Commission.

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Abstract

As a result of the COVID-19 pandemic, competition authorities around the globe may be faced with the issue of how best to accommodate the doctrine of the failing firm in merger assessments in a pandemic and in the aftermath of such pandemic. Numerous countries have adopted varying approaches to try to be appropriately responsive to companies affected by the unfavourable economic environment. There still remain difficult questions that need to be answered in cases that raise the failing firm doctrine: How could a firm prove that there is no alternative purchaser? How can it be proved that the merger will have the least anti-competitive effects if approved? How can competition authorities answer those questions in a pandemic where time is of the essence? This paper considers the failing firm doctrine and its origins in international jurisdictions. By tracking the evolution of the failing firm doctrine in South Africa through a chronological review of the case law developed by the competition authorities over the course of almost 20 years, this paper calls for a case by case analysis that takes full cognisance of the challenges that firms may face in a pandemic in the approach to its evaluation and weighting in merger assessments in South Africa. The authors further seek to provide novel approaches on how the failing firm doctrine can develop through a range of moderate changes to radical interventions to enhance its effectiveness.

1. INTRODUCTION

Competition authorities around the globe have been faced with the issue of how better to accommodate the doctrine of the failing firm in merger assessments as a result of the current COVID-19 pandemic that has wreaked havoc in the global and local economy. There have been a variety of responses by competition authorities to the assessment of mergers, both practically in terms of administrative efficiency and substantively in the manner of assessment. The commonality in the reaction of competition authorities is that the current legal frameworks of the respective jurisdictions relating to merger assessments remain intact and will not be relaxed or adjusted as a result of the pandemic. Moreover, the approach of competition authorities to the failing firm doctrine endures as one that requires a stringent application and high evidentiary burden on the merging parties – whether it is a defence or a factor in the merger assessment. This paper will start by setting out the origins of the failing firm doctrine in international jurisdictions and track the evolution of the jurisprudence in South Africa. Thereafter, the paper will reflect the responses of various competition authorities to merger assessment under the COVID-19 pandemic and specifically how the failing firm doctrine has been approached. In conclusion, recommendations of how the South African competition authorities can respond to and utilise the current economic crisis to develop the failing firm doctrine in South Africa through a range of conservative to radical measures will be explored.

2. THE ORIGINS OF THE FAILING FIRM DOCTRINE AND INTERNATIONAL JURISPRUDENCE

The doctrine of the failing firm, or what is commonly referred to as the ‘failing firm defence’, is well-recognised as part of the jurisprudence in competition law relating to mergers. It is imperative to first discuss the failing firm doctrine and its development in other jurisdictions. This is because the failing firm doctrine in South Africa is influenced by foreign jurisdictions.

2.1. The United States

The United States of America ("**US**") was the first jurisdiction to recognise and apply the failing firm 'defence' in the 1930 Supreme Court decision of *International Shoe v FTC*.[3] In that case, the Federal Trade Commission alleged that while International Shoe Company (International Shoe) and the W. H. McElwain Company (McElwain) were engaged in commerce in competition with each other, International Shoe acquired all, or substantially all, of the shares of the McElwain and still owned and controlled them at the time of the hearing. The FTC further alleged that the effect of such acquisition was to substantially lessen competition between the two companies; to 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. In this case, the US Supreme Court ruled that:

> "*In the light of the case thus disclosed of a corporation with resources so depleted and the prospect of rehabilitation so remote that it faced the grave probability of a business failure with resulting loss to its stockholders and injury to the communities where its plants were operated, we hold that the purchase of its capital stock by a competitor (there being no other prospective purchaser), not with a purpose to lessen competition, but to facilitate the accumulated business of the purchaser and with the effect of mitigating seriously injurious consequences otherwise probable, is not in contemplation of law prejudicial to the public and does not substantially lessen competition or restrain commerce within the intent of the Clayton Act*.[4]

In essence the Supreme Court ruled that a corporation with resources so depleted and the prospect of rehabilitation so remote that it faced the grave probability of a business failure with resulting loss to its shareholders and injury to the communities where its plants were operated, the purchase of its shares by a competitor (there being no other prospective purchaser), not with a purpose to lessen competition, but to facilitate the accumulated business of the purchaser and with the effect of mitigating seriously injurious

[3] *International Shoe Co. v. FTC*, 280 U.S. 291 (1930)
[4] *Ibid* at paras 302-303

consequences otherwise probable, is not in contemplation of law prejudicial to the public and does not substantially lessen competition or restrain commerce within the intent of the Clayton Act.[5] Areeda criticises *International Shoe Co*. and states that:

> "*International Shoe suggests two differing and perhaps inconsistent grounds for a failing firm defence:*
>
> *(1) Acquisition of a failing company may have no significant adverse effects on competition; and*
>
> *(2) the interests of stockholders, creditors, employees, and others affected by the fate of the failing company deserve recognition.*
>
> *These propositions are hardly sufficient grounds for making the defence absolute in all circumstances; nor do they point to any unified or simple way of identifying the defence's proper domain.*"

Subsequent decisions of the Supreme Court like *Citizenship Publishing Co*.[6], *General Dynamics Co.*[7], and *Greater Buffalo Press*[8] developed the concept of the failing firm doctrine and reaffirmed the position adopted in *International Shoe*. These cases endorsed the approach in *International Shoe Co.* The *Citizenship Publishing Co.* case established the test of the impossibility of reorganisation through receivership or bankruptcy. *General Dynamics* introduced the concept of the weak competitor which states that since the market shares of the target firm were low compared to its competitors then the merger cannot be considered to be troublesome.

The US doctrine of failing firm was consolidated into the 1992 U.S. Horizontal Merger Guidelines, which were amended in 1997. There is criticism that both the Supreme Court decisions and the guidelines do not clarify how the doctrine of the failing firm should be applied.[9] This has resulted in the competition authorities constantly grappling with

[5] Cf https://www.lexisnexis.com/community/casebrief/p/casebrief-int-l-shoe-co-v-ftc
[6] *Citizen Publishing Co. v. United States,* 394. U.S. 131 (1969)
[7] *United States v. General Dynamics Co.* 415 U.S. 486 (1974)
[8] *United States v. Greater Buffalo Press, Inc.,* 402 U.S. 549 (1971)
[9] Marianela López-Galdos, *Comparing the US & the EU Failing Firm Defense: Reflections from an Economic Perspective*, *Loyola Consumer Law Review*, Issue 2 Volume 28, 2-3 (2016)

questions such as:[10] how could a firm prove that there is no alternative purchaser? How can it be proved that the merger will have the least anti-competitive effects if approved? Another question that has arisen is how can competition authorities answer those questions in a pandemic where time is of the essence?

The approach to the failing firm in the US is found in the *U.S. Horizontal Merger Guidelines*[11] which state that a merger is not likely to create or enhance market power or facilitate its exercise if the following circumstances are met:

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

According to Areeda and Hovenkamp, the well-established failing firm defense is "*not merely a factor to be weighed in approving a merger but is absolute when the requisite conditions are met*".[12] Because it is an absolute defence, satisfying the requisite criteria is not an easy task. In the context of horizontal mergers, Areeda and Hovenkamp explain that:

(i) "failure" is narrowly defined to include only imminent or highly probable insolvency, bankruptcy, liquidation, or withdrawal from the market;[13]

(ii) mere proof of failure validates only those acquisitions that pose lower-order threats to competition. Otherwise, the acquisition of a failing firm would not be permitted

[10] *Ibid* at page 300.
[11] U.S. Horizontal Merger Guidelines at page 30 https://www.ftc.gov/sites/default/files/attachments/merger-review/100819hmg.pdf
[12] Phillip E. Areeda and Herbert Hovenkamp, *Antitrust Law - An Analysis of Antitrust Principles and Their Application*, 1163. Failing Firms accessed through Kluwer Online in October 2020
[13] *Ibid* at 1163b

unless there were no alternative acquirer available whose acquisition would be significantly less threatening to competition;[14]

(iii) a significantly smaller acquirer was to be presumptively preferred over a larger competitor, firms outside the market were preferable to competitors, whilst the most preferred acquirer is the noncompetitor whose acquisition would be lawful without regard to any failing firm defense;[15] and

(i) the practical question is whether the failing firm looked widely enough for a preferred acquirer. An adequate search could be defined as a canvass by the failing firm of other firms in its industry, possibly plus a few vertically related firms or potential entrants.[16]

2.2. The European Union

The European Union ("**EU**") has largely followed the tenets of the failing firm doctrine established in the US. Bellamy and Child explain that "*in exceptional circumstances, an otherwise problematic merger may be compatible with the internal market if one of the merging parties is a 'failing firm'*."[17] This reflects that the doctrine of the failing firm is also a defence in the EU.

The doctrine of the failing firm was first applied in the case of *KaliSalz/ MdK/Treuhand*,[18] where the EU has broadly followed *United States v. General Dynamics Corp.,*[19] in dealing with the failing firm defence. In *KaliSalz*[20] the European Commission ("**EC**") used the failing firm test and approved a merger between the only two German producers of potash. Whilst the transaction led to a high concentration, the failing firm defence was successfully raised in part because the merger avoided a large loss of jobs in Eastern Germany.

The European Court of Justice ("**ECJ**") accepted the failing firm test applied by the EC in *KaliSalz* in the case of *France v Commission*[21]. In *France v Commission*, the Court of

[14] *Supra* note 13 at 1163c
[15] *Supra* note 13 at 1163d and 1163d1
[16] *Supra* note 13 at 1163e
[17] *Bellamy & Child: European Union Law of Competition*, (8th Edition), Oxford Competition Law, Chapter 8 Merger Control at para 8.273
[18] *KaliSalz/ MdK/Treuhand*, Case IV/M308 [1994] 0.J. L186.
[19] *Supra* note 7
[20] Case IV/M308 OJ L186
[21] 1998 (4) CMLR 829

Justice was considering whether a 'failing firm' defence existed under the European Union Merger Regulations ("**EUMR**") and held that 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.[22]

According to the EU Horizontal Merger Guidelines, the EC may decide that an otherwise problematic merger is nevertheless compatible with the common market if one of the merging parties is a failing firm. The basic requirement is that the deterioration of the competitive structure that follows the merger cannot be said to be caused by the merger. This will arise where the competitive structure of the market would deteriorate to at least the same extent in the absence of the merger.[23]

The EC considers the following three criteria to be especially relevant for the application of a 'failing firm defence'[24]:

(i) First, 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.
(ii) Second, there is no less anti-competitive alternative purchase than the notified merger.
(iii) Third, in the absence of a merger, the assets of the failing firm would inevitably exit the market.

As Whish records, the above criteria are cumulative.[25] In addition, the burden of proof to show a lack of causality between the concentration on the one hand and the adverse effect on competition arising from the exit of one party from the market on the other lies with the notifying parties.[26]

Whish[27] provides a quick and useful reference of cases in the EU where the failing firm doctrine was successfully invoked which include *Nynas/Shell/Harburg Refinery*[28], where it was a division of Shell, rather than Shell itself, that was failing; and

[22] Richard Whish, David Bailey, "*Competition Law*", 9th Edition, Oxford Competition Law, 26 July 2018
[23] EU Horizontal Merger Guidelines, OJ 2004 C31/5, VIII, paras 89 - 91
[24] *Ibid*
[25] *Supra* note 23
[26] *Supra* note 18 at para 8.273
[27] *Supra* note 23
[28] Case M 6360, decision of 2 September 2013, paras 312–362

Aegean/Olympic II[29], where Olympic was in a much worse financial state than at the time of the previous proposed merger between Aegean and Olympic in 2011[30] and in 2013, the EC accepted that Olympic had become a failing firm and cleared the merger unconditionally.

2.3. Other jurisdictions

Other jurisdictions like the United Kingdom ("**UK**")[31] and Canada[32] have provisions that are akin to the ones in the US and the EU, albeit with slight variations which are not material to the essence of the failing firm doctrine.

From the above exploration of the origins of the failing firm doctrine, it can be seen that antitrust jurisdictions differ in the way in which they treat the failing firm doctrine. However, there seems to a quasi-identical approach in considering the failing firm doctrine.[33] Under the US regime, a firm could be considered failing just by not being able to meet its financial obligations. In comparison, under the EU regime, the firm has to prove that it would be forced out of the market.[34] The EU thus has a more restrictive interpretation of the failing firm doctrine.

3. FAILING FIRM DOCTRINE IN SOUTH AFRICA

In South Africa, the failing firm doctrine is influenced by developments in foreign jurisdictions. However, its incorporation and application takes cognisance of the unique

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[29] Case M 6796, decision of 9 October 2013
[30] Case M 5830, decision of 26 January 2011
[31] The Competition and Markets Authority ("**CMA**") Merger Assessment Guidelines set out a three-limb framework for assessing the exiting firm scenario, requiring the CMA to consider:
(i) Limb 1: Whether the firm would have exited (through failure or otherwise) absent the transaction;
(ii) Limb 2: Whether there would have been an alternative purchaser for the firm or its assets; and
(iii) Limb 3: What the impact of exit would be on competition compared to the competitive outcome that would arise from the acquisition.

See *Summary of CMA's position on mergers involving 'failing firms'* published 22 April 2020
[32] See Paul S. Crampton, *Mergers and the Competition Act*, 1990, quotes the Competition Authority in the *Wadair/PWA* merger indicating that "*In assessing the failing firm factor in mergers that are otherwise considered to be substantially anticompetitive, the Director requires information relating to two issues: 1) the extent to which failure is, in fact likely to occur; and 2) whether there are alternatives to the merger that would be less restrictive of competition.*" (cf. footnote 59a on p.408)
[33] *Supra* Marianela López-Galdos at page 309.
[34] *Supra* Marianela López-Galdos at page 309.

characteristics of the legislative framework in the Competition Act, No. 89 of 1998 (as amended) ("**Competition Act**")[35].

3.1. The legislative framework

The failing firm doctrine is enshrined in section 12A(2)(g) of the Competition Act where it is listed as one of the factors to be considered when determining whether or not a merger will likely result in the substantial lessening of competition ("**SLC**"). It is not a defence to an otherwise anticompetitive merger.

Section 12A(2)(g) enjoins the competition authorities to 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"* when determining an SLC. As stated above, the failing firm doctrine is thus not a self-standing defence as in other jurisdictions like the US but is one of the factors to be considered when determining whether there is an SLC.

It is the totality of the evidence that the competition authorities have to consider in establishing whether the failing firm 'defence' is applicable in a particular merger.[36] If the competition authorities find that the merger is likely to lead to an SLC, but the target firm is a failing firm, then that merger may be approved.[37] It is thus possible in the South African context that even if it was established that a party to the proposed merger has failed or is likely to fail, the proposed merger may still be found to likely substantially prevent or lessen competition depending on the manner in which this factor is balanced in relation to the other factors forming part of the overall competitiveness assessment. It is

[35] Section 12A(2) states that
"(2) When determining whether or not a merger is likely to substantially prevent or lessen competition, the Competition Commission or Competition Tribunal must assess the strength of competition in the relevant market, and the probability that the firms in the market after the merger will behave competitively or co-operatively, taking into account any factor that is relevant to competition in that market, including –
(a) the actual and potential level of import competition in the market;
(b) the ease of entry into the market, including tariff and regulatory barriers;
(c) the level and trends of concentration, and history of collusion, in the market;
(d) the degree of countervailing power in the market;
(e) the dynamic characteristics of the market, including growth, innovation, and product differentiation;
(f) the nature and extent of vertical integration in the market;
(g) <u>whether the business or part of the business of a party to the merger or proposed merger has failed or is likely to fail</u>; and
(h) *whether the merger will result in the removal of an effective competitor".* (Our emphasis).
[36] See *Iscor Limited and Saldanha Steel (Pty) Ltd* Competition Tribunal Case No: 67/LM/Dec01
[37] See *Phodiclinics (Pty) Ltd & Others* Competition Tribunal Case No: 122/LM/Dec05

therefore a possible eventuality that a failing firm theory may not save a merger if it raises serious competition concerns and cannot be justified on grounds of resulting efficiency or substantial public interest in terms of the Competition Act.[38] For the failing firm doctrine to be applicable, certain criteria must be met which has been developed through case law in various mergers in South Africa.

3.2. Evolution of the Failing Firm Doctrine in South African Case Law

The Competition Tribunal ("**Tribunal**") has applied S12A(2)(g) and developed the failing firm doctrine through its assessment of various large mergers since 2001. A collection of 15 cases are discussed below to provide a broad legal landscape of how the failing firm doctrine has been incorporated and evolved over the course of 19 years in South Africa through case law.

Schumann Sasol (South Africa) (Pty) Ltd / Price's Daelite (Pty) Ltd[39]

This was the first merger in South African competition case law that dealt with the failing firm doctrine. The merging parties raised the failing firm 'defence'. The Tribunal mused that "*the 'failing firm' is a term of art in merger regulation*" and correctly insisted, that "*the facts of the specific case will take precedence over the application of a derived formula.*"[40] The Tribunal enquired into whether failure was necessarily imminent; whether there had been an attempt to find an alternative suitor that raises fewer competition concerns; the prospects of re-organisation; what would transpire to the failing firm's market share post-failure as opposed to post-merger; and, what will happen to the failing firm's assets post-failure.[41]

It ultimately found that the failing firm defence did not support approval of the transaction for the following reasons: Firstly, it was not clear that the firm would actually fail despite its uncertain circumstances. Secondly, the extent of excess capacity in the industry and ease of entry suggested that the competitive situation would not deteriorate in consequence of the exit of the target (or its assets) – quite the contrary, there was likely to be an intensification in competition. Thirdly, if the acquirer had a pro-competitive strategy for

[38] Supra note 37 at para 104
[39] Competition Tribunal Case No: 23/LM/May01 (18 July 2001)
[40] *Ibid* at para 59
[41] *Supra* note 41 at paras 63 - 67

reviving the target, it was not clear why this could not be pursued through means other than the merger. Finally, while the Tribunal was persuaded that the merging parties had sought alternative purchasers, the success of their search would, in a relatively stable industry, depend on price and that, in turn, will depend on the quantum of the target's debt that the acquirer was willing to assume.[42]

Iscor Limited and Saldanha Steel (Pty) Ltd[43]

This is one of the leading cases which enumerates the requirements for a failing firm in South Africa. In this large merger, Iscor sought to purchase the IDC's half share in Saldanha Steel so that Saldanha would become a wholly owned subsidiary of Iscor.[44] The Tribunal conditionally approved the merger and found that Saldanha was a failing firm within the meaning of section 12A(2)(g) of the Competition Act. It also found that prohibiting the merger would in all probability lead to the closure of the Saldanha plant which was an outcome that could not be justified on substantial public interest grounds because of the adverse effect on the Saldanha region.[45] The Tribunal concluded that the merger will have an anti-competitive effect both because of the removal of Saldanha as a potential competitor to Iscor and the vertical effects on Duferco Steel Processing (a customer and a potential competitor of Iscor) but was of the view that the vertical issue could be addressed by conditions. In respect of the horizontal effects, the Tribunal engaged in an exercise of balancing the loss of potential competition with the prospect of Saldanha failing and concluded the failing firm concerns outweigh the loss to potential competition that might otherwise be occasioned by the transaction and that accordingly the merger does not substantially lessen or prevent competition in the relevant market.[46] Moreover, from a public interest perspective, the Tribunal came to the same finding that the failure of the transaction would in all probability lead to a closure temporarily or permanent of the firm, and with that a devastating impact on the region. It is worth noting that the Tribunal did not conflate the competitiveness assessment with that of the public interest inquiry when applying the failing firm doctrine. Following from the way in which the Tribunal maintained discrete assessments, it is the authors' view that the results or

[42] *Supra* note 41 at para 68
[43] Competition Tribunal Case No: 67/LM/Dec01 (4 April 2002)
[44] *Ibid* at para 139 – "*What distinguishes this case from the typical failing firm case, is that the buyer is not an arms-length independent firm, but a 50% shareholder seeking to reduce the loss it has incurred to date*."
[45] *Supra* note 45 at para 6
[46] *Supra* note 45 at para 142

effects of a failing firm may be better assessed in the public interest leg of the merger evaluation, for example, loss of employment.[47] .

The Tribunal correctly pointed out that there is an important contextual difference between the way the South African competition authorities should apply the failing firm doctrine versus the way it is applied in other jurisdictions as "*the danger of following some overseas jurisdictions uncritically, is that they may recognise under a failing firm defence, factors that we, with our more extensive merger regime, might recognise under another classification, employment loss being a good example.*"[48] In South Africa, the failing firm doctrine is not used as a 'defence' to a merger that has been found on an initial market analysis to be anti-competitive. Rather it is recognised as one of list of 'factors' that one takes into account before one can determine whether a merger is likely to substantially prevent or lessen competition. In the United States, the competition authorities would first determine whether a merger was anticompetitive and then only if it was, consider the failing firm doctrine as a defence.[49]

This case is particularly instructive on the process of the merger assessment:

> "*The way section 12A(2) is drafted, the consideration of whether a merger is anti-competitive involves as part of that inquiry a consideration of a non-exhaustive list of factors, one of which is whether a party to the merger is a failing firm. In contrast to this, our 'efficiency defence' is a real defence to an anti-competitive merger and for this reason is located in a self-standing subparagraph of section 12A, as a reading of section 12A(1)(a)(i) makes clear. To invoke the efficiency defence one first has to conclude that the merger is anticompetitive. This one does by first conducting the inquiry into the factors contained in section 12A(2). Then, and only if that inquiry leads*

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[47] See paragraphs 97 – 99 of the *Iscor* decision:
"97. *If we follow the Areeda approach and look at the failing firm defence in the context of our Act, then there may be other aspects of a failing firm defence that can more appropriately be assumed under other sections provided expressly for by the Act. Thus as is the case with the Kali und Salz merger, although the transaction led to unacceptably high concentration, the failing firm defence was successfully raised in part because the merger obviated a large loss of jobs in Eastern Germany.*
98. In our statute there would be no need to invoke the failing firm doctrine to such a situation when the adjudicator can have regard to the employment effect in terms of the public interest criteria.
99.Similarly, where the failing firm defence is in reality an efficiency defence, the merging parties should rely on the efficiency defence in section 12 (A) (1)(a)(i). This is not to say that alternatives cannot be alleged, but it is important that we avoid conceptual confusion…"
[48] *Supra* note 45 at paras 99 - 100
[49] *Supra* note 45 at paras 101 - 102

to the conclusion that the merger is anticompetitive, does one go on to enquire whether the efficiencies gained outweigh the anticompetitive effects."[50]

This explanation is especially useful to understand why the failing firm doctrine is not an absolute defence in South African law as it is under the US and EU competition regimes.[51]

The Tribunal opined that "*where the competitive loss is low, then one may be less exacting in requiring a showing of all the elements of the traditional failing firm defence*"[52] which allows the competition authorities the scope "*to achieve real interest balancing*" contrasted with applying a test strictly. The Competition Act is also clear that it is not necessary to show that a firm has failed only that it is likely to fail, and that failure does not need to equate to insolvency.[53]

South African jurisprudence therefore allows for a flexible approach which is apparent by the summary of the Tribunal's view on the failing firm doctrine and its application under 12A(2)(g) of the Competition Act as follows:

"1. A failing firm defence should <u>not be invoked if it amounts in substance to another factor or defence</u> 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 <u>tests of other jurisdictions will carry serious weight</u> in our assessment. Organising ones evidence on the basis of these criteria would thus be useful and instructive to the Tribunal.
3. A merger would <u>not be regarded as lessening competition if the conditions laid out in the more stringent EU test can be satisfied</u>.
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 <u>where the anticompetitive effects of the merger are</u>

[50] *Supra* note 45 at para 103
[51] See *Iscor Limited* at para 104 - "If the failing firm doctrine was a "true defence", then if all the elements of the defence could be established, an anticompetitive merger would have to be approved. However if it is just one of a list of factors to be taken into account, in the list set out in section 12A(2), then even if it was established, that the firm was failing, by say the application of the US or EU tests, one might nevertheless still find a merger to be anticompetitive because of the way one balances this failing firm factor in relation to all the others."
[52] *Supra* note 45 at para 105
[53] *Supra* note 45 at para 109

<u>otherwise slight, then the Tribunal might be less stringent in the application of some of the criteria.</u> Here the party should have regard to evidence that establishes some rationale for the existence of the failing firm doctrine. We have referred to some of these in our discussion although we do not suggest that this is an exhaustive list.

5. Evidence of the extent of failure or its imminence, would be weighed up against the evidence of the anticompetitive effect. The <u>greater the anticompetitive threat the greater the showing that failure is imminent.</u>

6. <u>No leniency</u> would be afforded to the requirement that there be <u>evidence that there is no less anticompetitive alternative.</u>

7. The <u>onus</u> is <u>on the merging firms to establish the evidence necessary</u> to invoke the doctrine of the failing firm."[54]

[Underlining authors' own emphasis]

Shell South Africa (Pty) Ltd / Tepco Petroleum (Pty) Ltd[55]

The Tribunal accepted that Tepco was a failing firm without elaborating further in its decision on which test was applied to establish that the target was a failing firm. However, the rationale for the transaction provides context as to why Tepco was failing. The facts before the Tribunal was that Tepco had incurred a net loss exposing its shareholders to increased risk in the event of Tepco being liquidated. There was also an absence of alternative funding solutions and in order to remain a player in the industry Thebe decided to sell Tepco to Shell South Africa.[56] In its assessment of whether the merger is likely to substantially prevent or lessen competition, the Tribunal noted that "*although Tepco will exit the market, an effective competitor will not have exited the market in light of the fact that Tepco is a failing firm.*"[57]

Edgars Consolidated Stores Limited / Central News Agency (Pty) Ltd & Consolidated News Agency (Pty) Ltd[58]

In this large merger, the Tribunal stated that it did not need to consider the additional fact that CNA was also a failing firm as the merger will not adversely affect competition. This is in line with the Tribunal's sentiments in Iscor where it had indicated that "*where the competitive loss*

[54] *Supra* note 45 at para 110
[55] Competition Tribunal Case No: 66/LM/Oct01 at para 33 (22 February 2002)
[56] *Ibid* at para 11
[57] *Supra* note 57 at para 33
[58] Competition Tribunal Case No: 81/LM/Nov02 (18 November 2002)

is low, then one may be less exacting in requiring a showing of all the elements of the traditional failing firm defence".[59]

JD Group Limited / Profurn Limited[60]

The merging parties alleged that the target was a failing firm. According to the Tribunal, "*if Profurn was failing, and its market share then went to the remaining firms in the market, in some permutation leading to concentration levels in the market and an increase in market share by the merged firm no worse than they would be in the post-merger scenario if the merger goes ahead, then at least on one version of the failing firm doctrine the merger should not be enjoined because of its lack of causative effect*."[61]

This case turned on a dispute of facts surrounding the analysis of whether the target was a failing firm or not. In its assessment, the Tribunal considered the deteriorating business environment and the lack of strategic management, including changes in accounting policy, minutes of board meetings, an industry report as well as oral testimony.[62]

The Tribunal did not, on the facts, find that all the elements of the failing firm doctrine had been established. The Tribunal was however convinced by the evidence 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.*"[63] It was of the view that "*the inevitable exit of some of Profurn's stores in the LSM 3-5 segment of the market, suggests this would have occurred in all probability absent the merger. Consequently that market share would inevitably have gone to the remaining chains, with Ellerines best placed to be the major beneficiary. The merger is thus not the causative effect of the present state of the market*."[64] The Tribunal's assessment of the failing firm doctrine in this merger is illustrative of the flexibility that can be used in evaluating the evidence and determining whether to apply the failing firm test rigidly or, preferably, contextually.

The merging parties appealed the Tribunal's decision to conditionally approve the merger. The appeal turned on the Tribunal's assessment of the vertical effects of the merger and the

[59] *Supra* note 45 at para 105
[60] Competition Tribunal Case No: 60/LM/Aug02 (12 December 2002)
[61] *Ibid* at para 109
[62] *Supra* note 62 at paras 112 - 139
[63] *Supra* note 62 at para 140
[64] *Supra* note 62 at para 141

relevant market definition.[65] Whilst the CAC upheld the appeal and ordered that the order of the Competition Tribunal should be set aside and be replaced with an order that the merger be approved without conditions, the Tribunal's assessment of the failing firm factor appeared to be accepted in the horizontal evaluation of the merger.[66]

Bytes Technology Group SA (Pty) Ltd / CS Computer Services Holdings Ltd[67]

The Tribunal found that the target firm was in dire financial straits and was indeed a failing firm.[68] In its reasons for decision, the Tribunal explained that the merger would not result in the removal of an effective competitor as the target was a failing firm and that, "*in fact, after the merger, the status quo would remain. BTG, the large player, and BMS, a new emerging player, will remain in the market as competitors, hence competition would not be intensified but will be maintained.*"[69] In summary, the ultimate finding was that the transaction in question would not substantially prevent or lessen competition in the relevant market nor would it have an adverse effect on any public interest issues.[70]

Tiger Brands Ltd; Ashton Canning Company (Pty) Ltd; and Newco / Langeberg Foods International and Ashton Canning Company (Pty) Ltd[71]

In this merger, at the commencement of the Tribunal hearing, the merging parties confirmed that they did not intend to rely on the failing firm defence. However, the Tribunal still elected to consider this aspect.[72] This consideration reveals that it is not only the merging parties that can raise the failing firm doctrine in a merger assessment. Relying on *Iscor*, the Tribunal pointed out that both in South African law and in the comparative case law, "*a failing firm defence will only succeed if the merging parties can demonstrate that there is another buyer whose acquisition of the target would raise less competition concerns*".[73]

[65] *JD Group Limited and Profurn Limited in Re: Competition Tribunal Republic of South Africa* - In the Large Merger between: JD Group Limited and Profurn Limited, Case No. 28/CAC/May at page 4 and 8
[66] *Ibid* at page 1 - 2
[67] Competition Tribunal Case no.: 66/LM/Sep04 (17 January 2005)
[68] *Ibid* at para 17
[69] *Supra* note 69 at para 17
[70] *Supra* note 69 at para 19
[71] Competition Tribunal Case no.: 46/LM/May05 (30 September 2005)
[72] *Ibid* at para 71
[73] *Supra* note 73 at para 76

The Tribunal remarked that it did not appear that either target firms were about to exit the market "*despite the gloomy picture painted by the figures*".[74] In addition, no evidence that the target "*either had sought a less objectionable buyer or indeed wanted to sell*".[75] The failing firm consideration was therefore not a factor that the Tribunal considered in relation to the competition assessment although they referred to this evidence when they dealt with the public interest, and specifically employment. The claim of imminent failure was not credible and the Tribunal again rejected the failing firm possibility and commented that "*That is not to say that if the merger is not proceeded with, that there may not be employment consequences if the firm's scale back production, but there is no evidence on record that this has been contemplated and that this would dwarf the employment consequences of those employment losses that the merger will bring about*."[76]

The Tribunal's evaluation of this merger reflects that evidence relating to a firm failing does not technically have to fall within the assessment of section 12A(2)(g) – there is scope to assess the evidence under the public interest leg as the resultant effects of the failing firm may actually fall under the public interest inquiry and not the competitiveness assessment. Again, it must be emphasised that there are separate inquiries – the failing firm factor will be assessed under section 12A(2)(g), but the effects of a failing firm may fall under the public interest evaluation. As the Tribunal stated in Iscor, "*a failing firm defence should <u>not be invoked if it amounts in substance to another factor or defence</u> which the Act already provides*".[77] The Tribunal highlighted the efficiency defence and the public interest criteria in this regard.

Phodiclinics (Pty) Ltd & Others[78]

The Tribunal unconditionally approved this large merger that consisted of Phodiclinics (Pty) Ltd ("**Phodiclinics**") together with DJH Defty (Pty) Ltd ("**Defty**") acquiring the assets owned by New Protector Group Holdings (Pty) Ltd ("**New Protector**"), a company that was placed under provisional liquidation on 2 September 2004. The Commission was of the view that because New Protector was in liquidation, it amounted to a failing firm for purposes of merger assessment.[79] The Tribunal not only found that New Protector was a failing firm, it used a

[74] *Supra* note 73 at para 75
[75] *Supra* note 73 at para 76
[76] *Supra* note 73 at para 137
[77] *Supra* note 45 at para 110
[78] Competition Tribunal Case No: 122/LM/Dec05 (21 February 2006)
[79] *Ibid* at para 9

more precise categorisation of "*a failed firm within the meaning of the Competition Act at the time of the merger transaction."*[80] In attributing the weight to be placed on this factor, the Tribunal further considered that "*the failing firm consideration outweighed any potential loss to competition that may arise as a result of the transaction*".[81] The Tribunal therefore established that if a firm is *de facto* in liquidation, it falls squarely within the meaning of 'failing firm' and more accurately, a 'failed' firm.

The Tribunal found that the merging parties had discharged the onus required in the Competition Act in relation to what is often called the failing firm defence, also satisfying the criteria applicable in the US in relation to that defence.[82] The Tribunal relied on the precedent in *Iscor* when making its finding. The merging parties submitted that while they were not able to discharge the onus of the EU requirement of "*market share will go to us*" (a more stringent test), they have been able to discharge the onus pertaining in the US test.[83]

The Tribunal quoted Paragraph 5.1 of the Revised Guidelines April 8, 1997 issued by the U.S. Department of Justice and the Federal Trade Commission in the application of the failing firm doctrine in this case:

> *1) the allegedly failing firm would be unable to meet its financial obligations in the near future;*
>
> *2) it would not be able to reorganize successfully under Chapter II of the Bankruptcy Act;*
>
> *3) it has made unsuccessful good faith efforts to elicit reasonable alternative offers of acquisition of the assets of the failing firm that would both keep its tangible and intangible assets in the relevant market and pose a less severe danger to competition than does the proposed merger; and*
>
> 4) *absent the acquisition, the assets of the failing firm would exit the relevant market."*[84]

The Tribunal reiterated from its decision in *Iscor* that when the competitive loss is low, the requirement to show that all the elements of the traditional failing firm defence is less rigorous.[85] In considering the circumstances of the target's failure, the Tribunal assessed:

[80] *Supra* note 80 at para 19
[81] *Supra* note 80 at para 19
[82] *Supra* note 80 at para 20
[83] *Supra* note 80 at para 49
[84] *Supra* note 80 at para 50
[85] *Supra* note 80 at para 51

(i) The target's inability to meet financial obligations and reorganise successfully and concluded that "*there was no doubt that the target was already a failed firm and was unable to reorganise itself successfully by the time it was provisionally liquidated*".[86]

(ii) Good faith efforts into finding reasonable alternatives that would have a less detrimental effect on competition by reviewing the efforts of the liquidator and the offers received. The evidence clearly demonstrated that "*the liquidator took great pains and made more than reasonable efforts in good faith to elicit interest in the sale of the hospitals and to contact all potential buyers he could identify*".[87]

(iii) Whether the assets will exit the market absent the acquisition and was satisfied that, absent the acquisition by the acquirer, the assets of the target were likely to exit the private hospital market.[88]

The Tribunal also considered the offer tabled by Netcare and Tradeworx during the course of the merger hearing – the competition evaluation stage.[89] The Tribunal clearly stated that the existence and the terms of the belated offer are irrelevant to the proceedings before it and the Tribunal "*does not regard it as a valid offer existing at the time when the merger transaction was concluded. "Reasonable alternatives" as contemplated in the Iscor case must exist at the time when offers are procured by the liquidator and a transaction is concluded, not at some indeterminate time in the future.*"[90] In reaching this view, the Tribunal referred to the EU and US guidelines which require that a failing firm demonstrate, at the time when the transaction is being evaluated for competition implications, to the competition authority that it "*<u>has made</u> unsuccessful good faith efforts".* According to the Tribunal, the word "has" is the singular *present* tense of the word "have". The Tribunal firmly held the view that the parties are required to show that *at the time at which they seek approval from the Competition Authorities* [Tribunal's emphasis], they "have made" good faith efforts to find reasonable alternatives to the offer they have accepted and for which they seek approval. In explaining its position in the context of the merging parties' bearing the onus to prove the failing firm factor, the Tribunal held that "*such an interpretation would lead to an absurdity, since the authority would never*

[86] *Supra* note 80 at paras 54 - 66
[87] *Supra* note 80 at paras 68 - 89
[88] *Supra* note 80 at paras 90 - 98
[89] *Supra* note 80 at para 101
[90] *Supra* note 80 at para 103

be able to approve a transaction to which a party must continuously strive to find an alternative offer."[91]

On the facts of the case, the Tribunal found that "*at the time that the Phodiclinics offer was accepted by the liquidator there was no other offer capable of being accepted by the liquidator on the table, let alone an offer that was a reasonable alternative that would pose a less severe danger to competition than does the proposed merger.*"[92]

The Tribunal found that the target was a failing firm, that the merging parties discharged the onus as required in the US test, and there was only one offer that was capable of being accepted by the liquidator.[93]

Phodiclinics is an important precedent on the issue of <u>when</u> alternative offers to purchase need to be on the table. It is too little too late for a prospective purchaser to arrive after the time at which the merging parties seek approval from the competition authorities and state that they would have been able to purchase the failing firm with a less competitive outcome. This case assists merging parties as it is authority for the position that merging parties are not required to continuously search for a potential buyer with a less anti-competitive outcome. However, reasonable efforts must have been made and evidenced in order for the competition authorities to perform the assessment.

Santam Limited / Emerald Insurance Company Limited and Emerald Risk Transfer (Pty) Ltd[94]

The Competition Commission recommended to the Tribunal that the proposed transaction be approved, *inter alia*, because of the likely failure of Emerald and the resultant effect on the market. Interestingly, it was the Commission that raised the argument in this case. As was the case in *Tiger Brands Ltd*, it can again be seen that it is not only the merging parties that can raise the failing firm doctrine in a merger assessment. The Tribunal confirmed that the South African jurisprudence highlights the fact that "*it is not necessary to show that a firm has already failed and that failure also need not equate to insolvency. Evidence is key to*

[91] *Supra* note 80 at para 104
[92] *Supra* note 80 5 at para 106
[93] *Supra* note 80 at para 107
[94] Competition Tribunal Case No: 57/LM/Aug09 (27 January 2010)

substantiate likely failure".[95] The Tribunal highlights that "*likely failure is a complex factual analysis and amounts to showing much more than a degree of financial distress.*"[96]

The first enquiry related to the financial position of the target firm. The Tribunal stressed that "*a strict evidentiary approach to likely firm failure is entirely justified given the alleged failing firm's distinct and substantial incentive to establish the semblance of a failing firm in order to alleviate competition authorities' opposition to an ordinarily anticompetitive merger*."[97] The Tribunal's guidance is that "*proper scrutiny*" is required of the true financial position of the alleged failing firm and must be done on a case-by-case basis.[98]

The second leg of inquiry by the Tribunal, assuming that the firm in question is indeed likely to fail, was whether or not there was an alternative buyer whose purchase of the target firm(s) would raise less competition concerns than the transaction under evaluation. The Tribunal explained that for a successful failing firm contention, the merging parties must show that there is "*no less anti-competitive purchaser than the acquiring firm*".[99] The Tribunal reiterated that no leniency would be afforded to this requirement.[100] The Tribunal reaffirmed that it is required that the assumed failing firm "*demonstrate inter alia that it has made reasonable and verifiable good faith attempts to elicit reasonable alternative offers and, furthermore, that there is no viable alternative purchaser that poses less anticompetitive risk than does the proposed transaction*".[101] It noted that a less anticompetitive alternative may also include the counterfactual scenario where the target is allowed to fail and exit the relevant market(s) and some or all of its assets are transferred to new or incumbent firms.[102]

The third issue that the Tribunal considered was whether or not any realistic prospect existed for the target firms' successful reorganisation to address its alleged failure and enable it to survive as a meaningful competitor in the relevant market(s). In other words, whether there was any prospect of the target "*surviving as a stand-alone player without the merger*".[103]

[95] *Ibid* at para 56
[96] *Supra* note 96 at para 56
[97] *Supra* note 96 at para 57
[98] *Supra* note 96 at para 57
[99] *Supra* note 96 at para 66
[100] *Supra* note 96 at para 66
[101] *Supra* note 96 at para 67
[102] *Supra* note 96 at para 69
[103] *Supra* note 96 at para 72

In summary, the Tribunal found no evidence in support of a valid failing firm argument in this merger. First, there was no evidentiary basis to conclude that the target was likely to fail. Secondly, an alternative purchaser made a reasonable offer as a going concern and this deal would highly unlikely give rise to any competition concerns – a material fact that was not disclosed to the Competition Commission. Third, there was documentary evidence unambiguously stating that the target firm could be successfully reorganised absent the proposed deal. Of note, the Tribunal voiced its criticism of the merging parties for non-disclosure of a material fact and that they had only relied on the failing firm doctrine toward the end of the hearing.

Pioneer Hi-Bred International Inc. and Pannar Seed (Pty) Ltd / Competition Commission[104]

The Competition Appeal Court accepted that a merging party who is in decline is not a failing firm. It was accepted by all of the parties that the target did not fall into the category of a failing firm.[105] This case law provides clarity that financial decline of a firm does not equate to a firm failing, or being likely to fail. This finding must be borne in mind when evaluating whether a firm is likely to exit the market.

Boxer Super Stores (Pty) Ltd / The Target Firms under the control of Metcash Trading Africa (Pty) Ltd[106]

In its application of the failing firm test as set out in *Iscor*, the Tribunal accepted the failing firm defence advanced at the hearing by the Commission because the target firm was incurring losses, would have closed if it was not sold to the acquirer and there were no alternative purchasers.

Kenilworth Racing (Pty) Ltd / Gold Circle (Pty) Ltd[107]

The Tribunal stated that "*in the absence of the likelihood of a significant lessening of competition to result from the merger, there is no need to consider the merits of the merging parties failing firm defence.*"[108] It did however comment that it is unlikely that the arguments raised by the merging parties would have met the requirements of the test set out in *Iscor*,

[104] CAC Case No.: 113/CAC/NOV11; Competition Tribunal Case No: 81/AM/DEC10 (28 May 2012)
[105] *Ibid* at para 3
[106] Competition Tribunal Case No.: 32/LM/MAR12 (014787) at para 15 (19 July 2012)
[107] Competition Tribunal Case No:36/AM/Apr12 (7 February 2013)
[108] *Ibid* at para 106

should there have been a likelihood of a significant lessening of competition. Its reasoning was based on the fact that there was no convincing evidence that the target's assets would exit the market, and, possible alternatives had not been explored appropriately.[109]

The Real Beverage Company (Pty) Ltd / DairyBelle (Pty) Ltd's Yoghurt and Ultra High Temperature Milk Business[110]

The Tribunal dealt with the issue of the relevant counterfactual in this large merger and in doing so, considered the failing firm doctrine. The merging parties did not clearly indicate in their merger filing that they will be relying on the so-called "failing firm defence", but indicated that *"it is pointed out that but for Real Beverages purchase of the Target Firms, it is likely that they would have otherwise been shut down. This is because the target firms are operating at a loss"*.[111] The merging parties put up no actual evidence in support of a failing firm defence or of DairyBelle dismissing workers absent the proposed merger, other than indicating the past financial losses being made by the Target Businesses. However, information on financial losses alone does not satisfy the failing firm doctrine.[112]

CTP Limited and Compact Disc Technologies (A Division of Times Media (Pty) Ltd) / The Competition Commission[113]

In an application for the reconsideration of an intermediate merger, the Commission had rejected the merging parties' failing firm defence as they had not presented proof that there was no other buyer for the target firm and was not satisfied that the target had taken sufficient steps to rationalise its business.[114] The Tribunal revisited and applied its precedent as set out in *Iscor*, specifically that "*A merger would not be regarded as lessening competition if the conditions laid out in the more stringent EU test [for a failing firm] can be satisfied*" and that even where EU test conditions were not met, the fact that a party to the merger was generally failing "*may still be sufficient to justify the approval of an anti-competitive merger, depending on the anti-competitive sting of the merger*".[115]

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[109] *Supra* note 109 at para 107
[110] Competition Tribunal Case No.: 018879 (19 January 2005)
[111] *Ibid* at para 61
[112] *Supra* note 112 at para 62
[113] Competition Tribunal Case No.: IM232Feb16 (11 May 2016)
[114] *Ibid* at para 10
[115] *Supra* note 115 at paras 20 - 21

After hearing oral testimony, the Tribunal found on a balance of probabilities that the target firm was a failing firm as it met the requirements of the EU test for failing firms. The Tribunal considered the nature and characteristics of the market as to why another firm was unlikely to purchase the target as well as that the Commission had not identified a likely candidate in its attempts. Further, the facts showed that if the target exited, the market share would have gone to the acquirer. In terms of the target's financial position, the Tribunal considered its recent performance in the market and steady loss of customers.

Senwesbel Limited & Senwes Limited / Suidwes Holdings (RF) Proprietary Limited[116]

In terms of this transaction, Senwesbel Limited ("**Senwesbel**") and its subsidiary, Senwes Limited ("**Senwes**"), intended to acquire the entire issued share capital of Suidwes Holdings (Ring Fenced) (Pty) Ltd ("**Suidwes**") and thus exercise sole control over Suidwes. The merging parties submitted that Suidwes was in severe financial distress and had suffered significant financial losses in the last few years. It argued that it was unable to pay its short-term financial obligations and its business may collapse in near future if the proposed merger was not approved. In that regard, Senwes and Suidwes requested the Commission, and subsequently, the Tribunal, to consider the proposed merger on an expedited basis.

The Commission found that there was a significant lessening of competition in the market for grain storage, which would arise if the merger was approved. The Commission did not find SLC in the other markets. The most prized assets in the Suidwes business were the silos which are used for storing grain.

The Commission applied the failing firm test, which included assessing (i) the financial position of Suidwes, (ii) whether other internal reorganisation endeavours were employed, (iii) whether other less anti-competitive alternatives were considered; and (iv) ultimately whether the productive assets of Suidwes would exit the market if the proposed merger does not take place. The Commission concluded that although Suidwes was in dire financial straits and had unsuccessfully attempted to reorganise the business, there was a less anticompetitive credible offer from a company called OVK. That offer had been initially accepted by Suidwes before opting to go with Senwes. The Commission further concluded that the productive assets of Suidwes, which are the silos, would not exit the market as they will remain in the

[116] Competition Tribunal Case No.: LM001APR20 (Hearing was concluded in 2020. Order issued. Await reasons for decision)

market whether there is business rescue or they are sold piecemeal in the event of liquidation. The Commission argued that the previous suitors of Suidwes may resuscitate their interests, and, at the time of the hearing, OVK stated that it was still interested in purchasing Suidwes - and especially the silos. The merging parties argued that the OVK was inadequate and incomparable to the Senwes offer, and that the productive assets of Suidwes were to exit the market if business rescue was to be conducted or if Suidwes was to go into liquidation. The Tribunal approved the merger subject to conditions and its written reasons may shed more light on the evaluation of the failing firm doctrine and what constitutes a likely failing firm in South Africa under section 12A(2)(g).

4. SUMMARY OF THE REQUIREMENTS FOR FAILING FIRM IN SOUTH AFRICA

From the above case law, the requirements to invoke the failing firm doctrine in South Africa can be summarised as follows:

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

Succinctly stated, the established jurisprudence of the Tribunal is relatively flexible allowing for a balancing of interests and not merely applying rigid formulae. It appears that the Tribunal leans towards the less stringent US test but has also considered the EU test in the matters that have come before it. The Tribunal has also accommodated nuances the application of the tests by allowing for a contextual assessment on a case-by-case basis by evaluating the factors set out above.

5. WHAT IS THE “CORRECT” COUNTERFACTUAL – ECONOMIC CRISIS OR NOT?

The counterfactual is an analytical tool used to help answer the question of whether a merger has or may be expected to result in a substantial prevention or lessening of competition in a relevant market. The counterfactual is used to compare the competitive effect on a relevant market with the merger taking place, contrasted against the future competitive situation on a relevant market without the merger. Assessments of the failing firm are premised on the notion that 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.

The U.S Horizontal Merger Guidelines state that 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.[117] In that case the projected market share and significance of the exiting firm is zero.[118] If the relevant assets would otherwise exit the market, customers are not worse off after the merger than they would have been had the merger been enjoined.[119] This sentiment was echoed in the *Iscor/Saldanha* and *Phodiclinics* cases.

The analysis of the counterfactual in the EU is essential in assessing the acceptance of failing firm defence.[120] The EU has "*progressed from a restrictive interpretation of the failing firm defense (based on the concept of causality) to a more flexible one, which involves comparing different possible counterfactuals*."[121]

In the UK, in Phase 1, the CMA will select the most competitive counterfactual, provided that situation is a realistic prospect. In Phase 2, the CMA will ultimately select the counterfactual it considers would be the most likely scenario to have arisen absent the merger.[122]

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117 *Supra note* 12 at page 30
118 *Ibid*
119 *Ibid*
120 See Ioannis Kokkoris, Howard Shelanski, "*EU Merger Control: A Legal and Economic Analysis*", Chapter 13 – Failing Firm Defence, accessed online through Oxford Competition Law where the authors reflect at 13.116 that "*the assessment of a merger involving a failing firm should not be assessed in the same way as a merger which does not involve failing firms. Where a merging firm is failing pre-merger competitive conditions should not be used as a benchmark. If the competition authorities reject one or more mergers falling below an unsustainable benchmark, the result could well be a liquidation expected to produce greater harm to competition than is predicted to result from one or more of the rejected mergers. If one of the parties to a merger is failing, pre-merger conditions of competition might not prevail even if the merger were prohibited. In such case, the counterfactual might need to be adjusted to reflect the likely failure of one of the parties and the resulting loss of rivalry. However, what should be taken into consideration is that in declining industry situations it is more likely that firms which may be currently flailing may continue to be in an adverse situation and may not be viable at all in the near future*.
121 For an analysis of the counterfactual of the failing firm in the EU, please refer to Damien Geradin & Ianis Girgenson, "*The Counterfactual Analysis in EU Merger Control*", a paper prepared for the Conference "The Pros and Cons of Counterfactuals", Swedish Competition Authority, Stockholm, 6 December 2013
122 Refer to note 31 - *The CMA's approach to the analysis of 'failing firm' claims – Framework for assessment*:

More often than not, merging parties would argue that the counterfactual is a world in which the failing firm exits that market completely. This occurred in the recent case of *Senwes/Suidwes*. The Commission argued that the correct counterfactual in that case 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. The Commission also argued for a correct counterfactual which is one which takes into account the alternative transactions, to test their viability against the Suidwes farmers, not just the proposed merger against immediate liquidation of Suidwes; and that liquidation was not the correct counterfactual, certainly not the only counterfactual. The Tribunal approved the merger conditionally and its reasons are still outstanding at the time of writing this paper.

Regarding the issue of business rescue, although the success rate of businesses emerging from it are somewhat low,[123] there is hope that the businesses can be rescued and the assets can continue to be in the market. The competition authorities will have to consider the totality of evidence in making a decision in that regard.

Even if business rescue does not succeed and a firm is finally liquidated, the productive assets of a company may not exit the market. They may be sold off piecemeal. Though that may be undesirable, those assets would not exit the market. This was the case argued by the Commission in the *Senwes/Suidwes* case that other market players were interested

One example of a situation where the CMA may select a counterfactual different from the prevailing conditions of competition is where one of the merging parties is likely to exit the market absent the transaction under review. The exiting firm scenario is most commonly considered when one of the firms is said to be failing financially, and would have exited the market without the merger because of financial failure. This is commonly referred to as a 'failing firm' scenario.
The CMA seeks to avoid importing into the assessment of the appropriate counterfactual any spurious claims to accurate prediction or foresight. Given that the counterfactual incorporates only those elements of scenarios that are foreseeable, it will not in general be necessary to make finely balanced judgements about what is and what is not included in the counterfactual.
Events which occur during the CMA's review of a transaction (such as the business impact of Coronavirus (COVID-19), but which are not a result of the merger, can be incorporated into the counterfactual.[7] Where future events or circumstances are not certain or foreseeable enough to include in the counterfactual, the analysis of such events can take place in the assessment of competitive effects.[8] Accordingly, where a business's financial difficulties do not meet the conditions of the exiting firm counterfactual (as described further below), the implications of those financial difficulties (where appropriately evidenced) could still be considered within the CMA's competitive assessment.
[123] http://www.cipc.co.za/files/2615/6326/6395/Status_of_Business_Rescue_Proceedings_in_South_Africa_June_2019.pdf

particularly in the productive assets of Suidwes (the silos) and were likely to buy them even if liquidation ensued.

6. MERGER ASSESSMENT UNDER COVID-19

During the current COVID-19 pandemic, the Federal Trade Commission ("**FTC**"), EC, the CMA and the Australian Competition and Consumer Commission ("**ACCC**") have not lowered the high evidentiary burden on the merging parties to prove that they do indeed meet the test for a failing firm under the respective legislative frameworks.

6.1. FTC

On 6 April 2020, responding to the COVID-19 pandemic, the FTC advised that it will not suspend its "*usual rigorous approach to ferreting out anticompetitive harm and seeking appropriate relief, even in the face of uncertainty.*" Interestingly, the FTC made reference to the 2008 economic crisis and affirmed its position that "*emergency exceptions to antitrust laws are not needed*" and that a relaxation of rules would open the gates to likely negative long-term consequences, including fewer competitors, reduced innovation, and higher prices. In fact, the FTC was adamant that it is during times of crisis that it is even more important to conduct thorough due diligences in order to ensure that competitive harm will not result from a merger.[124]

6.2. CMA

On 22 April 2020, the CMA published its guidance on merger assessments during the Coronavirus (COVID-19) pandemic.[125] According to this guidance, the CMA's overall approach to assessing whether a merger gives rise to competition concerns remains unchanged and the Coronavirus pandemic has not brought about any relaxation of the standards by which mergers are assessed or the CMA's investigational standards. The CMA's rationale for this 'non-negotiable' approach lies in protecting the interests of consumers in the long term by preserving competition in markets. In the CMA, the impacts

[124] FTC Press Release. 6 April 2020, "Antitrust review at the FTC: staying the course during uncertain times", Available at: https://www.ftc.gov/news-events/blogs/competition-matters/2020/04/antitrust-review-ftc-staying-course-during-uncertain

[125] https://www.gov.uk/government/publications/merger-assessments-during-the-coronavirus-covid-19-pandemic

of Coronavirus will be factored into the substantive assessment of a merger where appropriate. Because the CMA needs to ensure its decisions are based on evidence and not speculation, it has stated that it will carefully consider the available evidence in relation to the possible impacts of Coronavirus on competition on a case-by-case basis.

In relation to the failing firm doctrine, the CMA recognised that firms may submit that they are failing financially and would have exited the market absent the merger in question given the current economic climate. The CMA has placed importance on evaluating these submissions in a fair and transparent manner that will protect consumers' interests. The failing firm mergers are assessed on a case-by-case basis and the CMA issued a short reference guide on how it will likely approach mergers involving 'failing firm' claims. 'Failing firm' claims are typically evaluated as part of the CMA's assessment of the counterfactual. The 'failing firm' scenario is considered where one of the firms claims to be failing financially and would have exited the market without the merger because of financial failure. According to its 'refresher', events which occur during the CMA's review of a transaction (such as the business impact of Coronavirus (COVID-19), but which are not a result of the merger, can be incorporated into the counterfactual. In addition, where a business's financial difficulties do not meet the conditions of the exiting firm counterfactual, the implications of those financial difficulties (where appropriately evidenced) could still be considered within the CMA's competitive assessment. The CMA recognises that the conditions for the failing firm scenario are stringent, and the CMA's experience to date (consistent with the experience of other competition authorities, such as the European Commission) has been that relatively few cases have met the criteria to be cleared on the basis of the failing firm counterfactual.

6.3. EC

On 24 April 2020, the EC Executive Vice President communicated the EC position that the market conditions caused by the COVID-19 pandemic would not be sufficient to slacken merger control rules or to allow more liberal interpretations of the failing firm defence. According to Vestager, "*Crises pass but mergers remain*" and it would not be necessary for the EC to be more receptive to failing firm mergers. The crux is that the

EC's approach to assessing mergers, including that of failing firms, would largely remain stable in the COVID-19 pandemic.[126]

6.4. ACCC

On 27 March 2020, the ACCC published a media release detailing its response to the COVID-19 pandemic.[127] The ACCC's core objective is to maintain competition in the long term as this will be critical to benefit both consumers and the economy. More detailed guidance was provided in relation to mergers as the ACCC expected that the current market environment was likely to result in additional merger proposals related to concerns and uncertainty regarding the ongoing financial health of some firms. The ACCC advised that where mergers involving firms that are under financial difficulty, they will assess each on a case-by-case basis. Notably, this will take into account not only the present situation but also the longer-term impact on competition of any change in the structure of markets. This assessment by the ACCC would go beyond the current impact of the crisis on the profits and share value of the merger parties.[128]

7. MERGER ASSESSMENT IN A PANDEMIC - RECOMMENDATIONS ON THE EVOLUTION OF THE FAILING FIRM DOCTRINE IN SOUTH AFRICA

The failing firm doctrine may be raised more often by merging parties in the near future given the unprecedented economic devastation brought about by the COVID-19 pandemic. However, a pandemic or economic crisis, including the impact of COVID-19, does not change the evidentiary burden of the failing firm doctrine on the merging parties. This is in line with jurisdictions and regulators worldwide where the strict application has been consistently used, even in past economic crises. The crisis of COVID-19 is arguably different from a 'traditional' economic crisis where overnight lockdowns of entire countries and continents were implemented causing economies to come to an unprecedented level

126 MLex (2020), '*Failing firms won't get more EU leeway to plead for mergers, Vestager says*', 24 April 2020, https://www.mlex.com/GlobalAntitrust/DetailView.aspx?cid=1181672&siteid=190&rdir=1

127 '*ACCC response to COVID-19 pandemic*' published on 27 March 2020. Available at: https://www.accc.gov.au/media-release/accc-response-to-covid-19-pandemic

128 '*COVID-19 pandemic - what it means for ACCC merger clearances, authorisations, notifications and CTMs*' published on 27 March 2020. Available at: https://www.accc.gov.au/update/covid-19-pandemic-what-it-means-for-accc-merger-clearances-authorisations-notifications-and-ctms

of standstill. COVID-19 has affected economies in a way that has never been experienced in recent history and will continue until a vaccination is formulated and becomes easily available.

Whilst a strict application of the failing firm doctrine has been maintained during economic crises, the authors are of the view that there is scope for the evolution of the failing firm doctrine. The South African legal framework does not provide for an absolute defence for a failing firm. Instead, the failing firm is one factor in a range of factors to be considered in the section 12(A)(2) competitiveness assessment. In addition, the effects of the failing firm may be better assessed under the technological, efficiency or other pro-competitiveness leg of the inquiry, or, the public interest justification inquiry. There are various ways in which the South Africa competition authorities can advance the evolution of the failing firm doctrine under the current unparalleled COVID-19 pandemic because of the current legal framework. A range of conservative to radical measures are explored below.

(i) The South African context can be distinguished from other jurisdictions in that the failing firm doctrine is not a defence but part of a list of factors for merger assessment. The competition authorities, in its assessment under section 12A of the Competition Act, may place more weight on the failing firm factor given the context of the impact of COVID-19 on the already dire state of the South African economy. This may be a more appropriate manner in which to take into account the impact of the pandemic. Public interest considerations become key in the merger assessment, employment to be specific. It is crucial to keep businesses afloat during a pandemic and to be cognisant of government's policy of rebuilding what has been dubbed a 'failing economy'. The mandate of the competition authorities is to promote and protect competition, not competitors. The question of effective competition post COVID-19 and the aftermath of the pandemic arises in any assessment. The economic impact of COVID-19 can be differentiated from other jurisdictions given that the state of the national disaster has been managed differently with a hard lockdown and staged levels of re-opening the economy in South Africa. In addition, the South African economy and its markets are not the same as other jurisdictions pre COVID-19 and the impact of the pandemic will be nuanced - different sectors of the economy will be impacted and recover differently because of the restrictions lifting in various levels.[129] The competition authorities should evaluate the financial circumstances of the firm prior to lockdown and the impact of the lockdown on the firm, given the graded opening of the economy. The merging parties may have to show the pandemic and resultant lockdown had a worse impact on them than their competitors and provide some evidence of other strategies could they have used to survive if their competitors are still afloat.

(ii) The competition authorities should be weary of the dangers of speeding up the timeframes for assessment, especially considering that the short-term impact of COVID-19 may create a seemingly false impression of whether a firm is failing and thereby result in undesired long-term and enduring effects in various markets.

In this regard, the CMA's preliminary and final decision on the issue of the failing firm in the *Amazon/Deliveroo* merger is instructive. During the investigation of this merger, Deliveroo informed the CMA that the impact of the coronavirus pandemic on its business meant that it would fail financially and exit the market without the Amazon investment. Deliveroo's submission was supported by evidence from the company's financial advisers. In its provisional finding published on 17 April 2020, the CMA concluded that Deliveroo's exit from the market would be inevitable without access to significant additional funding. The CMA took into consideration that the COVID-19 pandemic has severely limited the availability of finance for early-stage businesses such as Deliveroo whereas before the pandemic outbreak, securing additional funding from other sources may have been possible. The CMA concluded that Deliveroo met the criteria for a 'failing firm' and that its exit from the market would have been worse for competition and customers than allowing the investment to go ahead. The deal was provisionally cleared on that basis. However, just less than 4 months later, the CMA issued its final decision and concluded that Deliveroo could no longer be considered a failing firm as the restaurant food delivery market had recovered much more sharply than had been expected and the restaurant 'mix' had also shifted towards smaller, independent restaurants and away from large fast food chains, several of which closed or stopped offering home delivery. Both factors contributed to a rapid and significant

[129] Raksha Darji, Rahma Leuner & Tamara Paremoer, "*The Failing Firm Doctrine During COVID-19: A Perspective from South Africa*", Competition Policy International, Antitrust Chronicle, September · Summer 2020, Volume 3(1) at page 46

turnaround in Deliveroo's financial position. The CMA then went on to complete its substantive assessment of whether the transaction would lead to a substantial lessening of competition. This decision is clearly illustrative of the point that the failing firm factor cannot be used to address short term financial difficulties – there needs to be a history of financial 'demise' and evidence to support this.

(iii) With regard to what is seen as the most difficult test to meet in the failing firm test - whether the assets exit in any event or acquired by the acquiring firm in any event - a question arises as to whether the regulator would rather preserve the business and jobs of the failing firm. The impact on consumers is also of concern if the decision-making process is accelerated and leads to undesirable consequences in markets that have enduring effects. As a stakeholder in government economic policy, the competition authorities will have to be aware of how its merger decisions will affect the policy of rebuilding the economy and how approving a merger on the failing firm doctrine versus an overall competitiveness assessment will create the future in that sector of the market. The economic agenda of the Ministry and ultimately the Presidency should also be considered.

(iv) The Commission could consider is issuing a set of guidelines on what evidence should be submitted and how a merger relying on the failing firm doctrine will likely be assessed. This would provide a level of certainty to the merging parties on what evidence to submit in support of its reliance on the failing firm doctrine. Determining the correct counterfactual is key in an assessment. The Commission should always base a counterfactual on available evidence and facts. For the failing firm doctrine, the merging parties need to provide a fully detailed disclosure upfront in the merger filing. This will greatly assist the Commission in meaningfully engaging in an in-depth and robust assessment of the failing firm factor as well as the overall counterfactual. Since there is a high burden of proof on the merging parties, they should be willing to co-operate and provide the information they wish to rely on without fuss or delay. The guidelines could make provision that the merging parties' legal advisors should be appraised of the legal test and criteria and submit documentation in the initial merger filing before the Commission starts its investigation. With regard to time being of essence, it is not for the Commission to make the legal test for the failing firm easier, but rather that the merging parties make it easier for the Commission to perform the required assessment by providing the supporting evidence to sustain their allegation.

(v) A more sweeping and swift approach, given the urgent nature of mergers relying on the failing firm doctrine, is for the Minister of the DTI to issue regulations allowing a less stringent assessment of the failing firm doctrine for a predetermined period. It is apparent that government's initiatives have been steered towards preserving businesses and livelihoods as well as rebuilding the economy. A set of regulations incorporating this rationale may prove to be effective for a limited time. Whilst the legal test for the failing firm doctrine should remain, the regulations could allow a less stringent evidentiary burden. The regulations could list the bare minimum evidence required to be placed before the competition authorities, including historic information, financial statements, forecasts, business plans, strategic documents, investment reports and prospects of recovery. The regulations should take into account the position of the firm prior to lockdown and the impact of the lockdown on the firm. These regulations would need to take into account expert forecasts of the length of time it would take for the economy and specific markets to recover from the impact of COVID-19 in South Africa. Since various industries opened in different stages of lockdown, the regulations would have to cater for a graded system of leniency in the application of the failing firm doctrine also based on the phasing of the merger notification. The regulations could also set a reasonable time in which the target firm should approach viable purchasers, given the urgency of the financial distress and ultimate failure of the firm. The reality is that it may be difficult to get a competitively good offer in the current economic climate of the pandemic. In addition, the regulations could include the issue of government funding – what options have been available and utilised by the target firm? The consideration of state aid and how business have used it to survive should form part of the assessment – either in the failing firm factor or the overall counterfactual. Again, the burden is on the merging parties to provide the relevant information. Whilst the pandemic cannot be used as a "get out of jail free" card as it may lead to cunning strategic acquisitions by bigger players in a market and have an irreversible impact on the sector in question, issuing regulations may assist to better assess mergers that originate from the dire financial impact of COVID-19 on businesses.

(vi) The most radical approach is to amend the current legislation to better clarify the test to be met under the failing firm doctrine and set a statutory standard contextual to the South African economy for merging parties. This would involve engaging robustly with the already well-established tests in the US and EU as well as other jurisdictions to determine what would best suit the South African landscape, given the preamble of the Competition Act and the statutory mandate of the competition authorities. The other factors to take into account would relate to policy issues and high-level governmental strategy for the economy as well as the agenda of the Presidency in relation to the South African economy.

8. CONCLUSION: IS CHANGE NECESSARY?

In conclusion, it is not all doom and gloom for merging parties seeking to rely on the doctrine of the failing firm. Given that there is legal certainty on the test and high evidentiary burden on the merging parties to be able to make a finding of a failing firm, they must be able to support their claim with relevant and substantial facts. The competition authorities can then perform their functions under the Competition Act through an assessment of the evidence and take account of the impact of the pandemic in making a recommendation on the merger. The assessment is always performed on a case-by-case assessment based on the available and verified information in a relevant product and geographic market evaluated on a balance of probabilities. The consideration of the failing firm factor is a balancing exercise – a flexible and dynamic process within the framework of legislation and established case law precedent. The Commission will be in a position to conduct a rigorous and robust investigation and assessment in order to make a fully informed and evidence-based recommendation if the merging parties provide full disclosure of information timeously under the current economic climate. The failing firm doctrine can certainly continue its slow evolution through case law. However, given that the failing firm is a factor in a merger assessment not a “home run” defence, it may just be time for a revolutionary approach to allow the failing firm doctrine to be more accessible to merging parties in the future – pandemic or not.

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