Failing firms, business rescue and reorganization in antitrust

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In times of economic distress, it is normal to witness firms in financial distress. Adverse economic conditions often lead to the financial distress of firms. Given the numerous effects of Covid19, it is anticipated that firms will experience financial difficulties. To counter the disastrous effects of the covid19 pandemic, financially distressed firms may attempt to salvage themselves through merging with a competitor. The pre-merger competitive conditions may not prevail in the event of the premature exit of a firm. Under the scenario of premature exit, due to financial distress, the relevant counterfactual would need to reflect the consolidation of the market and subsequent loss of rivalry. As with other jurisdictions[2]*, the South African Competition Act 89 of 1998 (Competition Act) provides leeway for a failing firm defence*[3] *to be claimed by parties to a merger. To rely on this defence, parties to a merger would need to satisfy a high evidentiary standard by cumulatively meeting the four layered criteria of the failing firm test. An analysis of recent merger filings with failing firm defences show that the "reorganisation criteria" is seldom assessed by competition authorities. This paper highlights evidence at the Commission's disposal to assess reorganisation. This paper seeks to provide insight into mechanisms that competition authorities and to some extent parties to a merger may rely on when assessing the "reorganisation criteria" of the failing firm defence.*

Introduction

The benefits of competition policy enforcement are particularly relevant during times of economic distress, where demand has been suppressed and consumer confidence is at all-time lows[4]. Through competition policy enforcement, consumers achieve greater savings through reduced prices made so by breaking up cartels and prohibiting anti-competitive mergers. Competition enforcement stimulates demand and leads to improvements in consumer purchasing power. As dire as the covid19 pandemic

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[1] The views contained in this paper are those of the authors and not of the Competition Commission South Africa.
[2] Jurisdictions include the European Commission and the United States Department of Justice and Federal Trade Commission.
[3] Section 12A(2)(g) of the Competition Act 89 of 1998 as amended.
[4] The converse may also be applicable, in respect of essential goods given the hoard purchasing witnessed at the beginning of lockdown. Demand for essential goods still remains steady and vibrant well into lower lockdown levels.

has been, the pandemic has not undermined the economic principle that competition breeds competitiveness. Competition enables an efficient allocation of resources and stimulates technological development and innovation, which in turn, leads to a wider product choice, lower prices and better quality[5].

In assessing mergers that occur against the backdrop of the financial and economic crises, the priority of competition authorities is to ensure that effective scrutiny is maintained under the failing firm test. The purpose of the failing firm test is to ensure that consumer welfare is preserved through the preservation of competitive market structures[6]. In periods of global economic distress, the failing firm defence may be complex and serious consideration should be taken when such a merger is filed with the competition authorities. The failing firm defence is of particular interest because of its role in the counterfactual analysis. The rationale behind is that the consolidation of the market and subsequent loss of rivalry does not directly occur as a result of the merger. This is why an otherwise problematic merger that would otherwise be prohibited based on a substantial lessening of competition may be allowed if a party to the transaction is indeed a failing firm and meets the test criteria as any harm to competition may not be merger specific.[7] It is thus very easy for competition authorities to commit type I and type II errors. A Type I error may occur when competition authorities approve a merger that may appear to be non-problematic, but however is problematic. And Type II error in that a merger may appear to be problematic, but nevertheless compatible as one of the merging parties may be a failing firm.

Although the onus rests with the parties to the merger to show that one of the parties is failing, it is imperative for competition authorities to make the assessment themselves and satisfy themselves that the merging parties have met the test in its entirety in order to prevent the competition authorities from committing type I and type II errors. The competition authorities have, before Covid19 as will be expected during and post Covid19, received a number of merger filings in which merging parties have been relying on the failing firm defence. In these merger filings, the parties to the merger argue that the firm claimed to be failing will imminently exit the market and thus any competition assessment and public interest assessment is not merger specific. Competition authorities must satisfy themselves that the test is fulfilled, particularly that there are no less anti-

[5] Lowe, P. (2009) Competition Policy and the Global Economic Crisis, Competition Policy International, 5(2):1-24.
[6] Ibid.
[7] Ibid.

competitive alternative mergers (or one with more positive public interest) but the one before them and that the firm has tried to reorganise without success. In this paper, we propose the sources of evidence in which the competition authorities and some extent the parties to the merger can rely on when seeking to advance the failing firm defence.

The remainder of the paper is organized as follows: Section II discusses the requirements set by the European Commission, the United States Department of Justice (DOJ) and United States Federal Trade Commission (FTC) for assessing the failing firm defence. Section II also discusses the jurisprudence that led to the formation of these requirements in the merger guidelines. Section III provides an overview of recent merger cases assessed under the failing firm defence and describes the Commission's approach and assessment of the requirements of the failing firm defence. Section IV discusses business rescue provisions and reorganisation as per chapter 6 of the Companies Act and compares it to chapter 11 of the US Bankruptcy Act. Section V provides additional tools at the Commission's disposal for assessing failing firms. Section VI concludes.

Failing firm test: European Commission Horizontal merger guidelines and Jurisprudence

In a failing firm transaction, a firm is typically operating at a loss, has large debt or a combination of both. The financial circumstances of the firm do not allow the firm to operate as a going concern. As a result, the firm may exit the market, thus leading to increased concentration in a market. In the horizontal merger guidelines, the European Commission developed guidelines on how to assess failing firm transactions. The guidelines for assessing failing firms were adopted from three European Commission cases involving Aerospatiale-Alenia/de Havilland[8], Kali und Salz/MdK/Treuhand[9] and Basf/Eurodiol/Pantochim[10].

The failing firm defence was initially considered in 1991 in Aerospatiale-Alenia/deHavilland. In this case, the merging parties argued that even though Havilland would not become liquidated immediately, absent the merger, de Havilland's production would be phased out so that it would be eliminated as a competitor in the medium to long term. The European Commission dismissed the

[8]Case No.: IV/M.053.
[9]Case No.: IV/M.308.
[10]Case No.: COMP/M.2314.

argument, in that the exit of de Havilland was not inevitable, and there could be a less anti-competitive acquirer for de Havilland.

In 1994, the European Commission examined the first successful failing firm defence in the case of Kali und Salz/MdK/Treuhand. In this case, the European Commission identified three criteria which, if met, would establish the test for reliance on the failing firm defence. The criteria were as set out in the horizontal merger guidelines as outlined below, however, instead of directly considering the third criterion pertaining to asset exit, the European Commission considered whether the acquirer would gain the entire market share of the target firm, in the event of the target firm exiting the market. The European Commission accepted that these criteria were met in Kali und Salz/Mdk/Treuhand. The European Commission accepted that where the above criteria were met, the failing firm defence was established.

The second case in which the European Commission accepted the failing firm defence was in 2001. The case involved the acquisition of two Belgian chemicals companies Eurodial and Pantochim, by BASF (BASF/Eurodiol/Pantochim). The European Commission dropped the Kali und Salz requirement that in the event of market exit, the acquirer would gain all of the entire market share of the target firm, favouring instead a test based on asset exit. In BASF/Eurodiol/Pantochim, the European Commission accepted that it could not be expected that BASF would absorb all of Eurodiol's market share in the event of market exit, since their main competitors were also likely to gain market share from the exit. The European Commission thus introduced a new requirement that the assets of the failing firm would inevitably exit the market if not taken over by another firm. The rationale for this criterion was that if the assets were to be taken over by other competitors during liquidation proceedings, the economic effects would be similar to a merger of the failing firms being acquired by an alternative purchaser.[11] These cases thus established that the relevant criteria "known as the EU test" for the application of the failing firm defence, which must all be satisfied, were as follows:

(i) *"the acquired undertaking would in the near future be forced out of the market if not taken over by another undertaking; and*

(ii) *there is no less anticompetitive alternative purchase; and*

[11] Ayal, A. and Rotem, Y. (2020). The failing firm defence- An equity-based approach, Journal of Competition Law & Economics, 15(4), 468–499

(iii) *the assets to be acquired would inevitably exit the market if not taken over by another undertaking"*

Regarding the failing firm doctrine under United States Federal Trade Commission (FTC) and the United States department of Justice (DOJ), the doctrine was heard in 1930, where the United States supreme court (Supreme Court) heard the matter involving *international shoe Co. v. FTC.* The Supreme Court held that merging parties do not substantially lessen competition when the following two elements are satisfied (i) the target firm's resources are so depleted that it faces the probability of a business failure and (ii) there is no other prospective purchaser. During 1969, in *Citizen Publishing Co. v. United States*, the Supreme Court added a third requirement to the failing firm doctrine, that the firm would be unable to reorganize successfully under the bankruptcy laws. Therefore, in addition to the initial two requirements set in *International Shoe Co. v FTC*, the FTC and DOJ embraced the *Citizen Publishing* decision that a firm reorganization must be unlikely. Following jurisprudence set in *International Shoe Co. v FTC* and *Citizen Publishing Co. v. United States,* the US horizontal merger guidelines added a fourth requirement to be met, in that "*absent the acquisition, the assets of the failing firm would exit the relevant market*". This gave rise to the four requirements, "known as the US test" for the application of the failing firm defence, to be met, were as follows:

(i) *"the allegedly failing firm would be unable to meet its financial obligations in the near future;*

(ii) *it would not be able to reorganize successfully under Chapter II of the Bankruptcy Act;*

(iii) *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*

(iv) *absent the acquisition, the assets of the failing firm would exit the relevant market"*.

It can be noted that the EU and US tests are very much similar, however the notable difference between the EU and the US tests lie in the second test requirement per the US test, that: *"it* would *not be able to reorganize successfully under Chapter II of the Bankruptcy Act".* The US test criteria therefore places a greater burden of proof on merging parties relying on the failing firm defence.

The Competition Tribunal South Africa (the Tribunal) has in the past considered large mergers filed under the failing firm defence. The failing firm defence was initially considered in the large merger involving ISCOR Limited and Saldanha Steel (Pty) Ltd (Iscor/Saldanha merger)[12], then later in the merger between Santam Ltd and Emarald Insurance Company Ltd and Emarald Risk Transfer (Pty) Ltd (Santam/Emarald merger)[13], and once again in the matter involving CTP Ltd and Another v Competition Commission. In addition to the requirement of "*assets exiting the market*" as laid down in Iscor/Saldanha, in Santam/Emerald the Tribunal laid out the following additional criteria for firms to satisfy when relying on the failing firm defence:

(i) The firm is a failing one;

(ii) The reorganisation of the alleged failing firm is not a realistic option; and

(iii) A less anticompetitive outcome than the proposed transaction is absent.

It can therefore be noted that the Tribunal has combined the requirements of both the US and the EU.

Illustrative assessment of previous merger filings under failed firm doctrine

This section wishes to highlight mergers recently filed under the failing firm doctrine. This section will assess the three cases filed in reliance of the failing firm defence. These mergers were filed during the 2020 financial year. The three cases cited are the Senwes/Suidwesbel transaction, the Kind/Choppies SA transaction and the Alrode/Videx transaction. Below we discuss the assessment conducted by the Commission regarding each criteria of the failing firm test.

(i) "the allegedly failing firm would be unable to meet its financial obligations in the near future"

In the Senwes/Suidwes transaction, the commission assessed financial performance by initially considering its revenue and operating profits. The Commission found that over the period assessed Suidwes revenues remained relatively stable, whilst operating profit plunged. The Commission also assessed the financial performance of Suidwes using different financial metrics such as liquidity, profitability, and solvency analysis. Based on balance sheet analysis, the Commission found that the liquidity of Suidwes was deteriorating indeed. The Commission was further of the view that Suidwes would be unable to pay off its short-term debt in the near future.

[12] Tribunal case number.: 67/LM/Dec01

[13] Tribunal case number.: 57/LM/Aug09.

In the Kind/Choppies SA merger, the Commission assessed Choppies SA's financial statements which indicate that Choppies SA incurred net losses for a sustained period. The Commission concluded that Choppies SA was in financial distress. That conclusion was further buttressed by the fact that the Commission's investigation revealed that Choppies SA's was unable to generate debt capital from capital markets. Moreover, the Commission found that Choppies SA's was unable to keep supply chains open.

In the Alrode merger, the Commission assessed the financial performance of Duraset, as Alrode was a failing division within Duraset. The Commission assessed Duraset's costs, revenues, operating profits and Earnings Before Interest Tax Depreciation/Amortization ("EBITDA"). The Commission found that performance as measured by the above metrics was negative and continued to decline. The Commission further found that revenues were in the negative trajectory for a sustained period. Analysing Duraset's balance sheet analysis, the Commission found that Duraset's liquidity deteriorated over the period. The deterioration indicated that Duraset would be unable to pay off its short-term debt. From an income statement perspective using profitability analysis, the Commission found that Duraset's net loss increased significantly. The net losses and low profit margins were also highlighted by private equity investors as the main reason why they did not wish to purchase Duraset. The Commission further assessed asset management ratios using inventory turnover and sales-to-assets. The Commission found that Duraset failed to provide consistent, stable returns. After investigating the financial metrics of Duraset, the team concluded that Duraset was in financial distress.

When assessing the first requirement of the failing firm test, the competition authorities have generally assessed revenues and profitability and in some instances also assessed short-term debt in the form of a current ratio. In addition to the financial information that competition authorities have generally looked at, the Commission can assess ratios that focus more on the ability of a firm to pay its debt, such as Debt ratios and interest cover ratios. The logic behind using these ratios lies in the wording of the test "*obligation*", which based on International Accounting Standard 37: Provisions, contingent liabilities and contingent assets[14] (of which financial statements are prepared in accordance with) stems from the liability definition.

(ii) "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"

In the Senwes/Suidwes merger, the Commission engaged with potential purchasers that had made offers to purchase firms claimed as failing. Some of the purchase offers made guaranteed the salaries and jobs of Suidwes employees for a given period. The Commission found that of the proposals made, most were for certain business units of Suidwes and not the entire Suidwes as a going concern. Few entities made proposals that are comparable to the Senwes offer, although each of those proposals had provisions that dissatisfied Suidwes in one or another. In all, the Commission was of the view that there were no material and significant elements to the Senwes offer that were peculiar to it and would not have been achievable from the other alternative offers that Suidwes received.

In the Kind/Choppies merger, the Commission noted that other retailers made proposals to acquire Choppies SA. However, these offers were rejected as Choppies Enterprises was only prepared to sell Choppies SA in its entirety and the offers received were for certain portions of Choppies SA.

In the Alrode/Videx merger, when assessing whether there were any less anti-competitive buyers, the Commission assessed purchase offers, due diligence documents and equity valuation documents. The Commission found that Aveng approached many potential acquirers. The Commission found that most of the potential acquirers were more interested in purchasing separate parts of the business, as opposed to the Alrode in its entirety. The Commission contacted potential acquirers and found that some potential acquirers withdrew their offers, due to the weak financial performance of Aveng. The Commission found that few potential purchasers expressed their interest in monetary terms. These offers were higher than the offer presented by Videx, however the offers were made on the condition that the purchase exclude debt. The Commission was thus of the view that the Aveng group made reasonable efforts to find an alternative buyer for the firm.

[14] See IFRS 37.10 for definition

When assessing the requirement of the failing firm test regarding alternate buyers, the Commission has contacted alternate/potential acquirers and investigated their offers, reasons for their offers and rationale behind the offers. Competition authorities may wish to consider assessing the valuations undertaken on the target firms relative to bids offered. Economic literature[15] cites "valuations and purchase prices" as one tool for analysing suitable alternative purchasers. In the event of the seller receiving bids from alternative purchasers that are lower than the chosen bidder, the lower bids should at least be deemed reasonable for them to be taken under consideration, as the price paid for those assets should reflect the true competitive bidding market price.

(iii) *"absent the acquisition, the assets of the failing firm would exit the relevant market"*

In the Senwes/Suidwes transaction, the Commission assessed the likelihood of Suidwes productive assets (i.e. its grain storage facilities) being sold in the open market to competitors as well as firms in adjacent markets. The Commission found that the silos were valuable and tradeable assets which were unlikely to exit market under any scenario, i.e whether Suidwes went with business rescue, liquidation, or an alternative transaction.

In the Kind/Choppies SA merger, the Commission considered whether absent the merger, the assets of Choppies SA (such as stock in trade, retail stores, vehicles and equipment) would exit the relevant market. In this regard, the Commission noted that it was unlikely that absent the merger, the assets of Choppies would exit the relevant market as bids to acquire parts of Choppies SA's business had been received.

In the Alrode/Videx transaction, The Commission found that if Alrode was liquidated, the assets of the business would not exit the relevant market post liquidation. The conclusion was drawn from the appetite that potential bidders had for the assets of Alrode, as well as the fact that there were markets for second-hand machinery and equipment.

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[15] Areeda and Hovenkamp; May 2019. 952. Appropriate Rationales and Limits of a Failing Firm Defense Antitrust Law - An Analysis of Antitrust Principles and Their Application

The Commission has in the past contacted and sought the views of market participants. It is worth noting that of all the three mergers cited, none of the assets would exit the market in the event the failing firm exits.

(iv) "it would not be able to reorganize successfully under Chapter 11 of the Bankruptcy Act"

In the Senwes/Suidwes transaction, the Commissions' investigation revealed that Suidwes implemented various measures to turn around its financial performance. Measures involved adjustments to the budget through costs savings, as well as placing a freeze on salary increases, in an attempt to minimize the losses which were anticipated. In addition, an independent consultant was appointed to investigate possible solutions for turning around the Suidwes operations. The Commission was thus satisfied with the internal interventions by Suidwes and appreciated that these measures were inadequate to turn the Suidwes business around. The other two mergers do not test the "reorganization criteria".

Previously, the reorganisation requirement has sometimes gone unassessed by merging parties, one of the reasons may be that the requirement makes mention of the Bankruptcy Act. However, it is important to note that in Santam/Emerald[16], the Tribunal laid the requirement for reorganisation to be applied when assessing the failing firm defence. This may be a difficult arm to meet, however this does not absolve merging parties from conducting this assessment. As will be shown, reorganisation can be assessed outside the ambits of the Bankruptcy Act with the assistance of the Companies Act.

Business Rescue & Reorganisation

Competition authorities and to some extent parties to a merger have in many instances dismissed this criterion as reference was made that the Bankruptcy Act applies to the US jurisdiction and not to South Africa. We note that we have synonymous provision in South Africa captured in the South African Companies Act 71 of 2008 (Companies Act).

The purpose of Chapter 11 of the Bankruptcy Code of 1978 (chapter 11), is to restructure a firm's finances that the firm may continue to operate as a going concern, provide its employees with jobs,

[16] Tribunal case number.: 57/LM/Aug09.

pay its creditors and generate a return for shareholders. The US Supreme Court said the main purpose of chapter 11 was to prevent a company from going into liquidation[17]. Therefore, the ultimate goal of chapter 11 is that the firm must come out of reorganization as a going concern.[18]Similarly, under the Companies Act business rescue consists of proceedings directed at facilitating the rehabilitation of financially distressed firms. The main objective of chapter 6 of the Companies Act (chapter 6) is therefore to assist firms to continue as a going concern.

Reorganization aims to restructure an ailing business's operations and preserving value that may be lost through liquidation.[19] Reorganization cases under chapter 11 of the Bankruptcy Act may be voluntary or involuntary. A voluntary filing involves the firm in question filing a petition in the bankruptcy court on its own free will. An involuntary filing involves creditors of the firm in question approaching the bankruptcy court to file a petition against the firm.[20] Similarly, under the Companies Act, firms are able to file for business rescue on a voluntarily basis or creditors of the firm may approach the courts seeking to have the firm in question placed under business rescue.

Given the similarities outlined above, it appears that there are no compelling reasons as to why the reorganisation requirement is often dismissed. In assessing whether this requirement has been met, the Competition authorities should consider whether the firm has engaged in any internal restructuring. In evaluating internal restructuring, it may be argued that prior to filing a merger under the failing firm defence, failing or more so "*distressed*" firms should have engaged with the business rescue provision under the Companies Act. In 2011, the Companies Act introduced a business rescue provision under chapter 6 of the Companies Act for financially distressed firms.

The Companies Act[21] defines business rescue as:

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[17] Jensen-Conklin, S. (1992). "Do confirmed Chapter 11 plans consummate: The results of a study and analysis of the law", Commercial Law Journal, 97: 297–331.
[18] Conradie, S. and Lamprecht, C, (2015). Business rescue: How can its success be evaluated at company level? *Southern African Business Review*,19(3)
[19] Foohey, P. (2012). "Chapter 11 Reorganization and the Fair and Equitable Standard: How the Absolute Priority Rule Applies to All Non-profit Entities", Articles by Maurer Faculty, Paper 1274.
[20] Trost, R. (1979). Business Reorganizations Under Chapter 11 of the New Bankruptcy Code. *The Business Lawyer*, 34(3): 1309-1346.
[21] See Section 128(1)(b) of the Companies Act

"proceedings to facilitate the rehabilitation of a company that is financially distressed by providing for—

(i) the temporary supervision of the company, and of the management of its affairs, business and property;

(ii) a temporary moratorium on the rights of claimants against the company or in respect of property in its possession; and

(iii) the development and implementation, if approved, of a plan to rescue the company by restructuring its affairs, business, property, debt and other liabilities, and equity in a manner that maximises the likelihood of the company continuing in existence on a solvent basis or, if it is not possible for the company to so continue in existence, results in a better return for the company's creditors or shareholders than would result from the immediate liquidation of the company"

An efficient and well-functioning business rescue procedure has advantages, one of which being the preservation of jobs, more so for small businesses, as small businesses are crucial for the creation and expansion of employment opportunities[22].

Business rescue occurs under the temporary supervision of an approved business rescue practitioner. The business rescue practitioner is appointed with specific powers and duties[23] and takes full management control of the firm. The business rescue practitioner is responsible for developing a business rescue plan to be considered by affected persons[24]. The business rescue practitioner attempts to rescue the business through reorganisation of the firm's business activities namely, property, debt, other liabilities and equity is developed and implemented in a manner that maximises the likelihood of the company continuing to operate on a solvent basis, as a going concern into the foreseeable future. In the event of the firm being unable to restructure, the business rescue practitioners should place the firm in a position that results in a better return for the company's creditors or shareholders than would result from the immediate liquidation.[25] Business rescue may

[22] Mahadea, D. (1994) Achievement motivation and small business success in Transkei, Development Southern Africa, 11:1, 91-98.
[23] See Companies Act 71 of 2008, available at: https://www.saica.co.za/Portals/0/Technical/LegalAndGovernance/Act%2071%202008%20Companies%20Act.pdf
[24] Ibid.
[25] Ibid.

also involve the disposal of non-core assets and operations, so the business can focus on its core activities.

Sources of evidence for Competition authorities to assess reorganization

There are a number of sources through which competition authorities can obtain evidence of any attempts by the firm claimed to be failing. As we suggest in this paper, an approved business rescue plan which was implemented and failed would be the first point of call. An additional piece of evidence for competition authorities may be the cash flow from investing activities of a firm, as this section details the purchase and disposal of assets in the firm. A historic account of the cash flows from investing activities should ordinarily depict how and through what means the firm has attempted to restructure its business operations. Further evidence on restructuring can be found in the Balance Sheet. Competition authorities may assess whether any Non-Current Assets have been reclassified. The International Financial Reporting Standard 5: Non-Current Assets Held for Sale and discontinued operations[26], allows for the reclassification of Non-Current Assets and business operations to be recognized and measured as being held for disposal, thus showing attempts to restructure a firm.

Ideally, to assess this criteria point, it may be useful for the firm to show it has enlisted the services of a business rescue practitioner, the mechanics of business rescue as detailed in chapter 6 of the Companies Act. As the name suggests, business rescue is an attempt by the owners of the firm to salvage the firm from financial distress.

Altman and Hotchkiss (2006, p. 8[27]) postulate that:

> *"If an entity's intrinsic or economic value is greater than its current liquidation value, then from both the public policy and entity ownership viewpoints, the firm should attempt to reorganize and continue. If, however, the firm's assets are worth more dead than alive – that is, if liquidation value exceeds economic value – liquidation is the preferable alternative."*

[26] See IFRS 5: Non-Current Assets Held for Sale, paragraph 6.
[27] Altman, E., & Hotchkiss, E. (2006). Corporate financial distress and bankruptcy: Predict and avoid bankruptcy, analyse and invest in distressed debt (Vol. 289). Hoboken, NJ: Wiley.

Competition authorities should note that after applying valuation techniques, in certain instances, the net present value of a distressed firm as a going concern may be less than the value of the firm's assets sold separately. The net present value principle presents an approximation of the best course for a firm to follow, which may assist competition authorities. Numerous financial techniques can be used to calculate net present value[28] of a firm[29], the most notable being the discounted cash flow valuation based on the Income Statement approach to valuing a firm[30]. In addition, any further value that is derived from the going concern of the firm should be included in the firm's value[31].

According to LoPucki and Whitford[32], a reorganisation would be considered a success if the firm were to emerge from bankruptcy with less debt, improved profitability, or a combination of the two. This indicates that debt profitability ratios may be used in the assessment of the success of a reorganisation. Aivazian and Zhou[33] found that reorganised firms reduced their debt significantly, so as to assist in boosting their cash flows. Ratios used in their investigation include the acid test ratio, interest cover ratio, market value of equity over total liabilities, secured debt over total liabilities and trade credits over total assets.

Conclusion

The purpose of this paper was to provide mechanisms and sources of evidence to which the competition authorities and to some extent parties to a merger can rely on when filing a failing firm defence. An analysis of merger filings that relied on the failing firm defence showed that competition authorities rely generally on revenue and profitability to ascertain whether the firm claimed to be failing is facing financial difficulties; relied on alternative bids to determine whether there are alternative purchasers whose purchase would yield a less competitive outcome than the proposed merger; relied on the existence of secondary markets to determine whether the assets of the firm claimed to failing will exit the market.

[28] Kim, J. (2009). Bankruptcy law dilemma: Appraisal of corporate value and its distribution in corporate reorganization proceedings. Northwestern Journal of International Law and Business, 29(1), 119–194.
[29] King, D. R. (1975). Feasibility in chapter x reorganizations. Villanova Law Review, 20(2), 302–370.
[30] See IFRS 13: Fair Value Measurement, Paragraph B10.
[31] King, D. R. (1975). Feasibility in chapter x reorganizations. Villanova Law Review, 20(2), 302–370.
[32] LoPucki, L.M. & Whitford, W.C. 1992. 'Patterns in the bankruptcy reorganization of large publicly held companies', Cornell Law Review, 78: 597–618.
[33] Aivazian, V.A. & Zhou, S. 2012. 'Is Chapter 11 efficient?', Financial Management, 41(1): 229–253.

We note common similarities with the mergers analysed, namely (i)that potential acquirers may only be interested in purchasing separate parts of the firm, as opposed to purchasing the firm in its entirety; (ii)that firms may be receiving offers to purchase the firm claimed to be failing, however the potential acquirers wish to purchase the firm *net of debt* i.e. without any debt obligations attached to the purchase (iii) that the assets of the firm claimed to be failing are unlikely to exit the market due to the existence of business line bids and/or secondary markets and (iv) that none of the mergers met the failing firm defence. We also noted that competition authorities and parties to the merger generally tend to shy away from testing the "reorganization criteria" of the failing firm test.

We suggest in this paper that competition authorities must, to test the failing firm defence in its entirety, dive deep into the financial statements and valuation reports and get an understanding of the firm performance; alternative purchasers and asset allocations should it fail. We also note as a possible area of further research and possible adjustment to the failing firm test the criteria on the allocation of assets as it appears this is the biggest hurdle of meeting the failing firm test for most mergers in which the firm claimed to be failing is really in dire financial stress.

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