Assessing the developments of the failing firm defence in the present credit crunch situation

VALERIA GRAZIUSSI[1]

This article defines the meaning and the use of "the failing firm defence". After an overview of the present world financial crisis in the US and EU, the article analyses how this defence is being used by Authorities and parties in this delicate period of crisis. Particularly, this article critically discusses the use of the failing firm defence in the current financial climate, its development and adjustments to face the current credit crunch situation. Finally, the developments of the failing firm defence will be assessed on the basis of recent merger transactions and the response from National Authorities and Governments.

1. Introduction: the "failing firm defence"

Competition authorities can decide that a concentration, which in a normal situation would raise concerns from a competition perspective, is compatible with the market if one of the participants to the concentration is failing on the basis of the Failing Firm Defence (FFD). The main requisite is that the deterioration of the market following the concentration is not attributed to the concentration itself. This is possible if, absent the concentration, the structure of the competition on the market would be undermined anyway. The policy governing FFD is quite strict, allowing mergers between competitors only in few cases, when firms face the risk of an imminent bankruptcy. Although competition authorities are quite reluctant to accept the failing firm defence, it is a principle that can be found in many competition regimes. For instance, in US this defence is enclosed in the *Joint Horizontal Merger Guidelines 1992 of the Department of Justice* (DoJ) and the Federal Trade Commission (FTC), whilst in the European Union (EU) the FFD is described in the Horizontal Merger Guidelines. [2]

[1] Valeria Graziussi holds an LL.M degree from Queen Mary College, University of London and is a qualified lawyer in Italy.
[2] Dabbah M., *UK and EC Competition Law,* Oxford University Press 2004.

However, comparing the guidelines of different jurisdictions, it can be noticed that a common *ratio* underlying the polices can be identified: firstly, in the absence of any other benefit, those mergers cannot be cleared if they increase market power, secondly, the failing firm should be genuinely failing, namely the operation should be permitted only when the alternative is immediate bankruptcy, and the failing firm should not receive a significant share of the gains from the merger. If it does, it can be a signal that the firm is not failing. Thirdly, the greater the anticompetitive effects are, the less favourably a failing firm is viewed by regulators.[3]

The failing firm defence is a controversial topic and it has attracted many discussions and debates, especially in relation to the assessment of the benefits from the operation, which in many cases are unpredictable and difficult to be conducted as competition authorities lack the adequate instruments to that effect, and, as a result, they usually decide not to clear the merger. Often, in the uncertainty of the impact of an operation involving a failing firm on the structure of the market and competition, competition authorities prefer not to allow the merger, rather than to take the risk to clear an operation that could be detrimental for the market. This is the reason why there have not been many claims from firms using such a defence so far.

However, many authors have suggested that the FFD discipline should be considered carefully, because, firstly, the majority of these mergers are efficient, and, secondly, these operations generate social and economic benefits. Due to these benefits, jurisdictions around the world have developed some conditions that should be satisfied in order to allow such operations. In the US, where FFD firstly emerged, the Agencies (DoJ and FTC), took in account three elements that trigger the defence: the grave possibility of business failure, the lack of an alternative purchaser, and the slim chances for successful reorganisation. The first criterion is quite difficult to be established, because the decline in sales or profit losses or problems in management are insufficient to claim the defence. Such downturns can be part of the carrying on of a business, therefore, as it is complicated to prove an imminent business failure, only the declaration of insolvency is accepted to invoke the FFD. The second condition excludes the possibility that an alternative less anticompetitive solution could occur, namely an alternative purchaser, whose acquisition of the failing business would not

[3] Mason R., Weeds H., *The failing Firm Defence: merger policy and entry, 2003 http://searchjustice.usdoj.gov/search?q=failing+firm+defense&sort=date%3AD%3AL%3Ad1&output=xml_no_dtd&ie=iso-8859-1&oe=UTF-8&client=default_frontend&proxystylesheet=default_frontend&site=default_collection*

be detrimental for the market. The last requirement regarding the chances of internal reorganisation is heavily criticised by commentators, because a reorganisation under chapter 11 of the Bankruptcy Act, for instance, is difficult to predict ex ante. Even in a different scenario, such as the one in the Community context, the requirement is difficult to be applied, because each member state has different reorganisations policies.[4]

However, paragraph 89 of the Horizontal Merger Guidelines explains that the Commission could find compatible with the common market a merger, when one of the two parties is a failing firm. The Guidelines set out three relevant criteria: the allegedly failing firm would in the near future be forced out of the market because of financial difficulties if not taken over by another firm; there is no less anticompetitive alternative than the notified merger; in the absence of the merger the assets of the failing firm would inevitably exit the market. [5]

A key issue in applying the defence is not only to prove that the failing firm would exit the market, but also that its productive and specialised assets would exit with it. The operation will be cleared, therefore, on the basis that it is the only way to keep the assets of the target business in the market. The importance of maintaining the assets on the market is highlighted in the US guidelines:

> *"a merger is not likely to create or enhance market power or to facilitate its exercise, if imminent failure (…) of one of the merging firms would cause the assets of that firm to exit the relevant market. In such circumstances, post-merger performance in the relevant market may be no worse than market performance had the merger been blocked and the assets left the market.*

The above shows that the pre-merger conditions of competition are not always the appropriate scenario to assess anticompetitive effects, because in a failing firm situation the business would exit the market anyway, and the current market condition cannot be examined in comparison to the counterfactual. Therefore, establishing the exact counterfactual is crucial, that is asking whether, in absence of the merger, the target firm would exit the market or would recover and become a viable business and competitor in the market.[6]

[4] Monti G., Rousseva E., *failing Firm Defence in the Framework of the EC Merger Control Regulation in European law Review 1999*
[5] Whish R., *Competition Law, Oxford University Press 6th Edition 2004*
[6] *Failing of Flailing? The Failing firm defence in mergers,* Agenda Advancing Economics in Business, Oxera March 2009, ww.oxera.com)

The competition guidelines on the FFD show how the policy adopted by the US and EU competition authorities, albeit sometimes slightly different in analysis or applying more lenient criteria in one jurisdiction, are actually orientated to achieve the same result, namely preventing detrimental effects on competition and ensuring and preserving the adequate level of competition in the market.

2. The use of the failing firm defence during the recent economic downturn

2.1 Recent mergers concerning the Failing Firm Defence (Lloyds/HBOS, HMV/ Zavvi, Fiat/Chrysler)

In this new world financial crisis, it is interesting to analyse the remodelled role of the FFD and the ever more increased use of this practice by parties as well as the different approach of the authorities when a merger with a failing firm is submitted. The criteria and the analysis go beyond the usual parameters and mergers that would not have been allowed in different circumstances, are cleared during this period. This is made possible due to a wave of flexibility in the approach of competition authorities and because, also, of government's interventions.

Lloyds TSB Group Plc/ HBOS Plc

The first case that has drawn public attention around the world and has triggered high pitched debates and clashing opinions among competition authorities and practitioners, has been the Lloyds Group TSB plc/HBOS plc merger, which was cleared on the 31st October 2008 in UK.

The Parties

Lloyds TSB Group plc is a British financial group which provides a vast variety of financial and banking services, offering services from personal to corporate customers and its UK turnover in 2007 was £ 18 billion. The acquiring party is HBOS Plc, a financial group that provides financial services and all related financial activities in UK as well as overseas, and its turnover in 2007 was £4.25 billion.

On the 18 September 2008 the parties reached an agreement about a merger operation, although the terms and conditions were not concluded until 13 October 2008, following a drop in the share price of the acquired company. Eventually, the parties agreed that HBOS 's shareholders, following positive approval, would receive 0.605 Lloyds TSB share per HBOS share; it must be noted that the agreement was reached in a period of high instability for the value of the shares of HBOS, during the period of the global financial market crisis [7].

The operation

The operation concerned a share of 33% in the market of personal current accounts in July 2008 and Lloyds acquired the market leading share of 20% in mortgages, reaching a total market share of 29%. However, in the situation of dramatic crisis, the UK Government was willing to safeguard the stability of the financial system, looking at the operation with an open mind and supporting it. Although the UK competition policy avoids government's intervention in competition operation, in such case, the government's action was deemed necessary to save the market.

The creation of the new Public interest ground concerning the stability of the UK financial system

According to Article 42 of the Enterprise act 2002 (hereinafter EA 2002), an intervention notice by the government to the OFT, can be issued in particular circumstances, interfering in the regular review merger process, usually carried out by the OFT, when a public interest consideration might be relevant to the review. The assessment is carried out by the OFT, but the Government, in the person of the Secretary of State, is allowed to override any competition concerns, when he deems that other public concerns outweigh such negative effects on competition. Public interest might be clarified as required under Section 58 of the EA 2002. In the present case, the Secretary of State promptly submitted that the stability of the UK financial

[7] Decision by Lord Mandelson, the Secretary of State for Business Enterprises and Regulatory Reform 31/10/2008

system was relevant and might have to be considered as a public interest consideration. It is noteworthy to stress that until September 2008, a public interest consideration could have arisen only with regard to national security and media sector, whilst now it can be concern also the stability of the UK financial markets. The EA 2002 sets out the rules on the assessment of the relevant merger situations which might have an adverse effect on competition. Investigation is triggered when as the result of the concentration certain thresholds are overcome. The Office of the Fair Trading and the Competition Commission are the competition authorities in charge of carrying out the operation review. The test they apply is whether, following the operation, a substantial lessening of competition (SLC) on the relevant market or markets occur. The EA 2002, in Section 58 allows a limited power to the Business and Enterprise Secretary of State to intervene to protect public interest considerations: new public considerations can be added by an order that must have the approval of both Houses of Parliament. Of course, the public interest consideration is applicable only when the operation does not fall under the scope of the European Merger Regulation 139/2004.

Eventually, the order was announced on 18 September 2008 and was submitted on 7 October 2008. Pursuing it, the OFT submitted a report to the Secretary of State on 24 October 2008, on the basis of which he issued its final decision. In making the Order, the Secretary was advised by the HM Treasury, Bank of England and the Financial Service Authority.

The Office of Fair Trading's Report to the Secretary of State of the 24 October 2008

The OFT is the competent authority to review the operation, albeit the Secretary of State's action. It is interesting to follow the steps of the OFT in its analysis. The UK authority assessed the operation having regard to the counterfactual, the personal current account markets, the banking sector, the mortgage market, even analysing areas where the competition concerns did not arise, coordinated effects theories, non horizontal effects, efficiencies, the view of the parties regarding both competition concerns and public interest considerations. At the end, remedies were proposed. For the purpose of this article, it is necessary to focus on the analysis of the efficiencies carried out by the OFT. The OFT stated that it would have taken into account whether there were rivalry enhancing efficiencies (two smaller firms merge to create a more competitive entity to a larger rival) that would enable it not to find a realistic prospect of SLC despite the concentration in the market, or customer benefits.

With regard to the rivalry enhancing efficiencies, parties claimed that the acquisition would have brought about significant saving in costs, by creating the largest retail franchising in UK and improving the access and service for customers. The OFT found that this efficiency was theoretically possible, but there was lack of compelling evidence (Merger specificity, the efficiency was not quantified, ability to pass onto customers).

As far as customer benefits were concerned, the parties put forward the argument that the benefits would derive from the increased certainty surrounding the future of HBOS, arguing that the acquisition would have embanked the risk of a deeper crisis in the bank sector, by creating a better quality of service as set out in Section 30 (1)(a) of the Act. However, the OFT rejected the arguments, considering (as the parties themselves observed) that the Government would have not allowed HBOS to fail, but it would have intervened to rescue it. Therefore, if this rescue could have come from the Government, the merger-specific requirement for the efficiency to be allowed, was not met.

Eventually, the OFT stated in the report it believed that the merger was expected to result in a substantial lessening of competition within the relevant markets identified in the UK for goods and services related to the financial sector. Therefore, the OFT deemed that the case should be referred to the Competition Commission for further investigation, as provided by Section 33 EA 2002. By doing this, the OFT completed its task of assessing the merger and advising the Secretary of State as required by Section 44 EA 2002.[8]

Secretary of State's Decision

Following the report of the OFT, the Secretary of State decided not to refer the case for further enquiry to the Competition Commission, which might have come to the same conclusion of the OFT, blocking the merger accordingly. In contrast, he decided to specify the new public interest ground, as mentioned above, under Section 58 EA 2002 and submit it to the Parliament, in order to safeguard the major concerns above specified. In reaching his decision, the Secretary took into account the OFT

[8] Fingleton J., OFT Report , 24/10/2008.

report *Consumer Focus,* and the arguments of the Scottish First Minister, Lloyds TSB, the Chancellor of the Exchequer and of private individuals. The OFT found that the arrangements in progress, if put into effect, would have resulted in a relevant merger situation that might be expected to result into a substantial lessening of competition in the three markets identified: personal current accounts, banking services to small-medium enterprises (SMEs), mortgages.[9] Under the Act, the Secretary of State has to accept these decisions, but in deciding whether the case is to be referred to the Competition Commission, he must decide if the public interest is relevant in the situation at hand and if the creation of the relevant merger situation may be expected to operate against the public interest. The OFT analysis is based on a realistic prospect of a substantial lessening of competition, whilst the CC carries out an analysis on balance of probabilities.

It is interesting to report also the opinion submitted by the Bank of England and the Financial Service Authority. Both of them expressed a positive view about this controversial operation. The Bank of England considered that the failure or delaying of the merger would have been detrimental for the financial stability of the UK system, because HBOS played a big role in providing financial services to corporate as well as to single private customers, and that a merger with a stronger competitor is seen as the right way to strengthen the liquidity and the funding provision of HBOS, improving and maintaining confidence in the UK banking sector.

On the other hand, the Financial Service Authority noted that, absent the proposed merger by Lloyds TSB, a temporary public ownership could have been considered absent, even though the EU state aid rules prevent a public–owned entity to compete *"aggressively with private sector bank"*. This would have eventually reduced the capability of HBOS of providing loans and services, restraining its competition power. Furthermore, the Financial Service Authority had talked with other potential acquirers of HBOS, but none of them actually showed the ability to acquire it, therefore the Authority came to the conclusion that the proposed merger was the best solution to keep the financial stability and to sustain the confidence of HBOS creditors, providing also a sensitive medium-term future for HBOS, that it seemed impossible to maintain differently.

[9] The case does not fall under Para. 3 of Schedule 7 of the EA 2002.

The third Authority to express its opinion on the subject matter was the HM Treasury, which actually summarised the views of the two abovementioned authorities. However, it stressed that the merger would bring about improved confidence, business model and credit rating, better capital base, reduced reliance on wholesale funding, broader business base and it would address funding issues.

Having had regard to the findings of the OFT, the merger would have likely raised competition concerns, but having regard also to the opinions expressed by the other authorities, the operation was seen as essential for the UK financial stability. Therefore the Secretary of State had to consider if the anticompetitive effects would have been outweighed by the public interest concern, namely the financial UK stability. Eventually, he concluded that the financial stability have to be safeguarded and cleared the merger.[10]

As a conclusion, having analysed the issues related to the Lloyds/HBOS merger, it should be stressed that, although the OFT would have referred the case to the Competition Commission, in the crisis scenario, the UK Government intervened and created a new public interest (the UK's financial stability), against the concerns of the OFT, that actually deemed that the merger would have created a substantial lessening of competition. This has been a particular merger operation which has made experts think about a new and may be more relaxed approach to mergers involving a failing firm in a near future. In order to better understand the current approach towards merger assessment under UK competition law, it is interesting to analyse the recent acquisition of 15 Zavvi's stores by HMV Plc.

Zavvi /HMV Merger

The Parties

HMV Group plc is active in the entertainment products market, selling DVDs, CDs, books related to music artists, games and MP3 players. Zavvi retail Limited was active in the same market until it went under administration on 24 December 2008. Zavvi was not able to meet its creditors' liabilities after Zavvi's supplier went into administration in late November 2008.

[10] Lord Mandelson, Decision 31/10/2008.

Transaction

HMV acquired 15 Zavvi's stores, the last one in March 2008. The investigation about the takeover was carried out by the OFT on its own initiative. The turnover of the acquired stores between December 2007 and November 2008 did not meet the criteria set out in the EA 2002. However, HMV and Zavvi stores overlapped in the bricks and mortar supply of home entertainment products, therefore the share of supply test in section 23 of the EA 2002 was met in those markets. Moreover, the OFT considered whether the acquired stores were enterprises within the meaning of the Act and whether they should be aggregated together as required by Section 27(5) of the Act and treated as a single relevant merger situation. After having carried out the investigation and having had consultations with Zavvi's administrators, the OFT deemed that arrangements in progress resulted in the creation of a relevant merger situation.

Competition Assessment

The fact that Zavvi went into administration raised the question if the counterfactual scenario was the appropriate one to start the competitive analysis. The OFT considered that the pre-merger conditions of competition were not the appropriate counterfactual in this case on the basis that the acquired stores would have inevitably exited the market in the near future, and that there was no other realistic and substantially less anti-competitive purchaser for the stores. Furthermore, according to HMV, the correct counterfactual for the consideration of the acquisition of the overlapping stores should be that, absent the merger, Zavvi would cease to operate, at least as a retailer of entertainment products. It argued that the operation was not the cause of the competitive harm, because this would have taken place in any event.

On the other hand, the OFT position on the failing firm defence was restated in December 2008, stressing that the OFT would clear a merger involving a failing firm only when sufficient compelling evidence was submitted. Furthermore, the OFT stated in its guidance that *"it may also be better for competition that the firm fails and the remaining players compete for its shares and assets than that the failing firm shares and assets are transferred wholesale to a single purchaser"*. However, in this case, the OFT did not believe that the closure of the overlapping stores and the exit of the assets in the local markets would have been a substantially

better outcome than the acquisition of the stores by HMV. The post merger outcome did not, therefore, result in a reduction of competing fascia, not, in any event, if the assets were to exit the market.

Decision

After a careful analysis, the OFT decided that the usual counterfactual scenario to assess mergers effects did not apply in the *Zavvi/HMV* merger, and it was satisfied that there were no realistic prospect of any alternative buyer for the overlapping stores, nor for any other outcome that would be substantially better for competition than an acquisition by HMV. Therefore, the right scenario to assess the merger was the one in which the competitive threat from Zavvi was lost in any event. Accordingly, the merger itself could be regarded as the cause of any lessening of competition. For all these reasons, the OFT decided not to refer the case to the Competition Commission under Section 33(1) EA 2002[11].

The OFT decision on Zavvi/HMV merger has been very controversial and has provoked debates on the OFT analysis about the issues concerned. Furthermore, the fact that the investigation was started by the OFT independently is a sign of the prompt response from the UK Authority.

One of the most interesting merger cases that has been concluded in June 2009 and has attracted the world attention is the Fiat/Chrysler merger. The US Government and the US President Barack Obama personally played a big role in the conclusion of the deal.

Chrysler/Fiat merger

The parties

Fiat S.p.a. is an Italian auto manufacturer, active in the car production market. Chrysler, a US based company is active in the same market.

The transaction

The negotiation between the two auto manufacturers started in early 2009, when the firms agreed on the acquisition by Fiat of stake in Chrysler. On 30 March, Barack Obama expressed a favourable opinion on the merger stating, that the operation was a *condicio sine qua non* to obtain state aids up to six billion dollars for Chrysler.

[11] Decision OFT 29/4/2009

On 9 April, Sergio Marchionne, Fiat chief executive started negotiations with the United Auto Workers (Uaw) to reduce the labour force cost; being it part of the agreement with the banks to meet their credits. On 13 April, Marchionne was viewed as a possible candidate to serve as Chrysler's executive director. In late April Marchionne participated at a meeting with syndicates and financial analysts. On 24 April, a first agreement with the Canadian syndicate (Caw) was reached. Soon after the Canadian syndicate signed the agreement to reduce the work force cost. On 28 April 28, the US Treasury reached an agreement with Chrysler's four main creditors to manage the company's debts. Then the negotiations went on only with small creditors. On 30 April, members of Chrysler's Uaw syndicate ratified the agreement. President Obama announced it on the same day.

In May, Chrysler's retailers, through a legal advisor, defended their rights. Meanwhile, three pensions funds in Indiana asked the tribunal to block the merger because it violated their rights. The judge rejected the instance; the funds appealed to the US Supreme Court. In the interim, Fiat announced that it would wait until 15 June, otherwise the terms and condition should have been reviewed. The Supreme Court rejected the appeal. On 10 June, Fiat and Chrysler sealed the deal; Sergio Marchionne was designated as executive director.

The Competitive assessment

The operation was the rescue of Chrysler; it was clearly facing the bankruptcy, when the negotiations with the Italian company were announced. In order to have the merger cleared it invoked Chapter 11 of the Bankruptcy Act, one of the conditions to get a merger with a failing firm cleared in the US. In this particular case even Obama pushed in favour of the operation. He wanted to give a start to a major rescue operation involving the car-manufacturing sector in the US; General Motors was also facing problems during this economic downturn period.

The decision

As it is mentioned above much opposition was made to the agreement from different stakeholders. Nevertheless, eventually the agreement was reached in June 2009, following the Supreme Court's rejection of the appeal put forward by the Indiana funds[12].

[12] Tomasetti P., Chrysler/Fiat merger

This operation has occurred in this particular period and has made some experts reflect on the use of the failing firm defence around the world to rescue companies facing bankruptcy. Likely, in the Lloyds/HBOS and Chrysler/Fiat there has been an explicit political intervention. It was put forward in the course of the operation in order to try to pave the way for the rescue of the failing companies and easing the takeover.

In front of large companies failures, governments around the world have chosen not to set aside but to push and support the operation in order to save the national economy as in UK, or a particular economic sector as in US.

3. New trends/adjustments in the failing firm defence (ex.: the OFT Restatement)

In the previous part three controversial merger operations have been analysed. This has been done to turn to the analysis on the drawbacks that those major operations have brought about, with particular regard to the response of the competition authorities and the interest of the practitioners around the world.

The EU and UK response

It is noteworthy to observe that the OFT has (18 December 2008) restated its position on the failing firm defence issue. According to practitioners, there is no doubt that the failing firm defence will be raised much more frequently in the current economic climate. Also, the authorities will be much more prone to giving confidential informal advice. The European Commission has explicitly stated that it will take full account of the economic environment in assessing failing firm defence cases.

The OFT restatement was laid out just after the Lloyds/HBOS operation, as the authority wanted to shed light on the failing firm issue. The UK authority after having pointed out that *"meritorious failing firm cases should be allowed to proceed relatively swiftly through clearance by OFT,"* noticed that only few FFD cases had been cleared so far under the EA 2002.

This means that it would have cleared cases in which there were facts and evidence produced. However, the OFT is willing to consider applications *"where the acquired company is not yet in liquidation or administration."* In its restatement, the OFT has firstly cleared its position on the assessment of a causal link between the merger and any competitive harm. It points out that the requirement of compelling evidence where merging parties put forward arguments such as the prevailing conditions of competition are not the appropriate scenario to assess the operation because the acquired business would have exited the market anyway. Moreover, the OFT has clarified that it will only clear transactions when: (1) the target business will inevitably exit the market in the near future; and (2) there is no realistic and substantially less anticompetitive alternative purchaser. However, in some cases it is better for competition that the failing firm's assets are left in the market and the players compete to acquire shares. This position stresses how the OFT - not barely - takes into account the fact that the firm would exit the market, but also that the operation does not result in a substantive lessening of competition; as compared to other realistic scenario following exit of the target business. Furthermore, the OFT remarked that it will not treat completed acquisitions more leniently than anticipated ones. According to the decision in *Thermo/GVI* case, completed mergers could be referred to the CC and no regard was to be taken of the costs for the parties, if remedies were proportionate.

The most interesting part of the restatement regards the application of the failing firm criteria during the prevailing economic and market conditions. It stresses the fact that the OFT will not relax the sufficient compelling evidence standard required to demonstrate that a merger between close competitors is not itself the cause of any SLC. The OFT has observed that:

> *"Although merging parties may find their business under financial pressure as a result of changing conditions, their customers may well be in a similar position. Weakening evidentiary standards to allow anticompetitive mergers is likely to bolster operators with market power at one level of the supply chain, only to increase pressure downstream as result of anticompetitive price increases, or other anticompetitive conduct, resulting from the merger. The creation of, or increase in, market power in UK markets, where this is far from inevitable, will also fail to serve productively of the UK economy."*

There is no reason why owners of struggling business should be permitted to sell to another close competitor simply because it is prepared to pay the highest price for the target business. Business wishing to exit the market must be aware that to advance a failing firm argument, they will need to adduce evidence to demonstrate the absence of any realistic and substantially less anti competitive purchaser".

However, in the last part of the restatement document the OFT showed itself aware of the significant changing in the economic market conditions. The OFT is willing to provide assistance and guidance in term of the regulatory assessment where it is opportune. It stresses the fact that with regard to FFD, it is already providing informal advice and inviting parties to provide as much information about the merger as possible, in order to assist them with the most punctual informal advice, which are non binding of course[13].

Notably, the FFD cannot be applied in every acquisition but only in appropriate cases. In the UK's *Lloyds/HBOS* the government decided to introduce a new intervention category, namely the stability of the UK financial system (legislation passed on 24 October 2008). This means that the government would be able to decide whether to clear the transaction, falling outside the EC Merger Regulation, rather than leaving it to the merger authorities (the OFT). According to Matthew Hall this new public interest consideration could be used to override the competition analysis; enabling the transaction to proceed despite competitions concerns, as it happened in *Lloyds/HBOS* merger. As it has been observed, the operation fell outside the competence of the EC Merger Regulation 139/2004 and it was reviewed under the UK merger regulation. It was convenient for the parties, because, UK merger review avoided difficulties that could have arisen between national and EC provisions on the subject matter.

In fact in the ECMR there is no public interest contemplated. The Commission applies a standard review of the operation. Thus the merger would have likely been blocked. However, lately the Commission has stated that it will operate under the ECMR to allow derogations from the normal suspension obligation. Therefore, it will allow full or partial completion before clearance. In order to do that, the Commission must balance the interests involved in the operation to consider: (1) the effects of the suspension obligation on the parties of the transaction (if a party is going outside of the market if not acquired); (2) third parties; and (3) the threat of competition deriving from the transaction.

[13] OFT Restatement, 18/12/2008

The Commission is known to be, against its normal practice, giving non-binding advices about its own likely assessment to a particular purchaser of assets or business. Most importantly, it must be stressed that there is no public interest test, which has been or will be applied in relation to transactions reviewed under the ECMR. Although there might be political pressure on rescue's operation during this particular period, the competition analysis may not be overruled. According to Matthew Hall, it is even difficult to introduce a similar "test" for emergency situations, because it would be hard to identify who - on EC wide basis - would be able to take a decision as to what can be considered a "public interest exemption".

However, Hall points out a recent Commission position to keep its standard competition analysis of the financial sector; including rescue and mergers notified during the economic downturn. However, the timeline in which the Commission has operated in certain transaction was very unusual and demonstrates the lengths to which the Commission has gone to assist in relation to issues arising out of the credit crunch (such as the *Banco Santander* case and *BNP Paribas*). According to Hall the general framework of competition law has not changed, but the current conditions are making the old rules adapting to the new scenario [14] .

The US Response

With regard to the United States, Botti in his comment has pointed out the different procedure for the notification process in the US, which has a "file and wait" pre-merger notification system. If the parties reach a predetermined threshold as set out in the Clayton Act, they must file a notification with the Federal Trade Commission and the Department of Justice, Antitrust Division (The Agencies). Subsequently after which they might wait 30 days, which are compulsory before implementing the deal. Thus, to allow the agencies to start a deeper investigation if any competition concern arises. However, the 30 days waiting period can in certain circumstances be reduced by a discretionary decision of an "early termination".

[14] Hall M., *Competition law and the Credit Crunch; do the usual merger control rules still apply?*, PLC magazine March 2009

Obviously, parties tend to get the early termination, but to obtain that, they need a prompt collaboration by the agencies. In order to do that, parties should try to involve both Agencies in the process before filing the notification; making presentation rather than waiting for clearance. According to Botti, in order to clear operations, during the financial crunch the agencies have been very engaged so far in the early termination process. From Botti's point of view, sometimes even too early, such was the case when Wells Fargo & Company acquired Wachovia Corporation. The transaction cleared the day following the notification. Similarly, in Mitsubishi UFJ Financial Group's $9 Billion equity investment in Morgan Stanley for 21% interest in the company, the clearance was passed in just four days.

Although it could be seen as a "relaxation" of the strict competition rules, actually merging parties still need to submit all the compelling evidence proving that the operation does not affect the competition. According to Botti, although authorities are facing even more failing firm cases the financial crisis does not change the rules.

Currently, there are three particular scenarios that authorities are examining. First, the failing firm defence in which the focus is on the fact that acquiring the failing firm does not cause harm to competition. Second, General Dynamics defence, often claimed when the struggling firm is unlikely to play an important competitive role in the future. Third, invoking the failing firm defence when a merging company is in financial distress, but not exiting the market and its competitive constraints will be reduced to such extent that its elimination from the market will not have a deep impact [15].

The *Fiat/Chrysler* merger represents a complex operation; prompt intervention from the authorities as well as government was needed to save the Detroit car manufacturer. Not clearing the transaction would have had a worst impact in the sector. On the other hand, for the Italian company it represented a great deal both in terms of business itself and pride; to undertake and lead one of the largest American auto manufacturers.

[15] *Botti M., Competition law and Credit Crunch: do the usual merger control rules still apply?, PLC magazine March 2009*

3.1 Assessment of the Authorities' approach: need for further reform?

The issue of the failing firm defence and its application by competition authorities around the world has taken the interest of practitioners who are advising failing firms in the current economic crisis. They have the tasks of dealing with and seeking clearance from the authorities. In fact, they provide significant and more practical comments about the authorities' approach on the renovating and ever more increasing failing firm defence practice.

A lawyer from Stevens Bolton LLP, Rebecca Holmes-Siedle, reflects in one of her comments; whether the OFT is more likely to relax its requirements for maintaining competition in the market. Particularly, when there is evidence that, absent the operation, a competitor is unlikely to stay in the market. What Rebecca Holmes-Siedle really wants to shed some light on, is whether, except for the Lloyds/HBOS takeover, in which there has been the intervention of the Secretary of State, the OFT is willing to offer a *green light* to takeovers, in the attempt to avoid insolvency.

She remarks that – post-Lloyds/HBOS - the OFT, foreseeing a wave of FFD notifications, has published the restatement on the failing firm defence. However, Holmes-Siedle, notes that, since enactment of the EA 2002, the OFT has cleared only four cases claiming a failing firm defence. In the OFT restatements, the UK authority makes it clear that it will not relax its criteria in light of the current economic and market conditions. Rather, the OFT is willing to provide informal advice to parties in cases that are deemed appropriate[16].

In another comment to the recent OFT restatement, two other practitioners have noted that in the current economic downturn, there is an increase in the likelihood of circumstances that will support claims regarding the first two conditions: (1) inevitable exit; and (2) absence of an alternative purchaser. In this regard the OFT has stated that it will not relax the sufficient compelling evidence standard. It does not consider the FFD a free pass, but a counterfactual submission against which a merger must be judged. However, the OFT has also stated that it will be prone to give informal guidance on the application of FFD[17].

On the other hand, as it has been argued in the previous section, the European Commission does not provide with a ground for public interest to be claimed in order to clear a rescue operation falling within the ECMR 2004 (even though the Commission feels the pressure of Member State governments to introduce it as *ultima ratio*.) However, during this period, the Commission is expecting more cases invoking the failing firm defence.

[16] Holmes Siedle R., *Will the failing Firm Defence help you to acquire your competitor in credit crunch times,* Insolvency Intelligence Magazine, 2009.
[17] Brophy V., Guyett J., *United Kingdom codifies" Failing Firm Defence to Mergers,* Jones day, 24/12/2008

Therefore, Members States, practitioners, and parties are expecting further relaxation of the rules, if not reform; at least an increase in cooperation by the Authorities. Thus, more increased flexibility in a way or in another [18].

4. Conclusions

This work has had the aim of providing an insight on the controversial and ever more utilised issue of the failing firm defence and its use in this period of financial crisis. It has been shown that, for one reason or another, the failing firm defence has never been an instrument very much utilised. On one hand, because it is difficult to meet the criteria needed to obtain it. On the on the other hand, because the impact and the equilibrium in the market can be easily altered by these complex operations, authorities have always been slightly suspicious or reluctant to accept and implement it. Therefore, if the authorities are not 100% sure of the positive outcome (in the sense of no harm to competition), they do not clear the operation.

Moreover, the article has focused on the evolution of the defence by comparing the European/UK way to deal with the defence and the US method. Furthermore, this work has had the scope of analysing the current use of the FFD in the current financial scenario, where it is being invoked ever more often in order to rescue firms that otherwise face the risk of failure. For this purpose, in order to focus on the adjustments, transformations, adaptation and evolutions of the FFD, some controversial and criticised mergers have been discussed. The British government's intervention in the clearance of Lloyds/HBOS merger has been an important sign in a period of great instability to save the British economy. The government interfered into the analysis carried out by the UK competition authority. It has been a phenomenon that has caught the attention and comments of the world as well as the governmental intervention in US for the Chrysler/Fiat operation.

[18] Hall M., Competition Law and Credit crunch : do the usual merger control rules still apply?, PLC magazine March 2009

Since the strong impact of those political interventions, it could be argued that the restatements published by the OFT on 18 December 2008 can be seen not only as a non-binding clarification of the OFT practice, but also as a sort of reaffirmation of authority. The OFT carefully examined the operation; it issued its relation on the competitive concerns and the consequential harms to competition in the UK. Following the merger between Lloyds and HBOS, the OFT was overruled its opinion in few days by the British Secretary of State. Although this is allowed by a special provision under Section 23 EA 2002, it could be argued that the OFT has felt a diminution in its power and therefore has needed to clarify its views on the Failing Firm issue. For this reason, many practitioners have pointed out the fact that the OFT has stressed that it will require the compelling evidence to clear a merger with a FFD and that it does not intend to relax the stringent rules on the issue. However, the fact that the OFT is willing to provide informal advice allows parties to hope that the OFT is accepting a wave of flexibility on the argument.

As a conclusion, the debate on whether authorities should or should not relax their rules to allow mergers that might cause harm to competition, to save companies, employees, stakeholders and the economy in general, is still ongoing. The right answer to this can be predicted only to some extent. Still, for a precise assessment of the effects post-merger on competition, it is necessary to wait.

It could be argued that authorities should slightly relax their provisions during this critical period bearing in minds the competition outcomes of the operations on the relevant markets, and should issue recommendations which pave the way to a stronger collaboration between parties and authorities.

Furthermore, authorities could invite parties to submit research and predictions on the possible outcomes of the prospected merger. This would create a common platform on the basis of which a common understanding would be reached as well as an agreed and rational plan to rescue the firm. Only when the situation stalls should the government step in and give a solution as *deus ex machina*.