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THE FAILING FIRM: RE-EXAMINING CANADA'S APPROACH TO RESCUE MERGERS IN LIGHT OF THE US AND EU EXPERIENCE

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The financial and economic crisis has threatened the existence of firms around the globe, resulting in the most significant restructuring of industries in decades. In some cases, however, restructurings or other typical corporate measures may not be enough for a firm to survive and be competitive. Mergers and acquisitions are a plausible way for failing or threatened firms to survive the initial crisis, regroup, and perhaps build for a brighter future. The failing firm defence, or “rescue merger”, has been developed in both American and European case law to enable failing firms to merge together, or be acquired by a profitable firm, in a transaction that would normally have been blocked by merger review as being anticompetitive. The failing firm defence can be an important tool for entrepreneurs and investors in seizing opportunities given the new business landscape emerging from the current economic crisis: value can occasionally be found in failing and poorly performing companies. While Canada has a failing firm “factor” rather than “defence”, it has been of very limited application in practice, and there is no guidance from the courts regarding its application. Academic discussion regarding the utility and application of the failing firm defence in light of relevant case law is, however, found in the United States and Europe. Canadian competition law can benefit from taking into account the lessons learned and ongoing debates in these two jurisdictions. Indeed, revisions can be proposed for the Canadian Merger Enforcement Guidelines, allowing for a more vigorous yet still cautious consideration of the failing firm factor in Canada. There is a general consensus that the competitively preferable purchaser requirement of the defence contains an inherent bias that may mislead competition authorities in identifying an alternative purchaser that would pose a lower competitive threat than the proposed acquiror. The issue of a rescue merger's effect on market entry and exit is debated among academics, essentially examining the trade-off between the preservation of assets and entry deterrence. Meanwhile, competition

authorities should also take note of research suggesting that a firm may have predatory intentions when first launching a rescue merger. Overall, there appears to be a continued role for the failing firm defence in competition law, and therefore the effectiveness of its general application and content of its criteria must be continually assessed and refined.

La crise financière et économique a menacé l'existence d'entreprises dans le monde entier, se traduisant par la plus importante restructuration d'industries depuis des décennies. Cependant, dans certains cas, les restructurations ou autres mesures typiques prises par les entreprises peuvent ne pas suffire pour assurer leur survie et leur compétitivité. Les fusions et acquisitions sont un moyen plausible pour les entreprises en sérieuse difficulté ou menacées afin de surmonter la crise de départ, se ressaisir et, peut-être construire un meilleur avenir. L'argument de l'entreprise en sérieuse difficulté, ou « fusion de sauvetage », a été élaborée dans la jurisprudence, tant américaine qu'européenne pour permettre aux entreprises en sérieuse difficulté de fusionner ou d'être acquises par une entreprise rentable dans le cadre d'une opération qui devrait normalement être bloquée par le processus d'examen des projets de fusionnement, car contraire à la libre concurrence. L'argument de l'entreprise en sérieuse difficulté peut constituer un outil important pour les entrepreneurs et les investisseurs pour saisir les occasions qui leur sont fournies par le nouvel environnement commercial suscité par la crise économique actuelle : les sociétés qui vivent de sérieuses difficultés et ont de piètres résultats peuvent parfois présenter une certaine valeur. Alors que le Canada possède un « facteur » plutôt qu'un « argument » de l'entreprise en sérieuse difficulté, dans les faits, son application a été très limitée et la jurisprudence n'offre aucune assistance à cet égard. En revanche, les États-Unis et l'Europe disposent d'une certaine doctrine, élaborée à la lumière de la jurisprudence pertinente, au sujet de l'utilité et de l'application de l'argument de l'entreprise en sérieuse difficulté. Le droit de la concurrence au Canada peut profiter de l'examen de l'expérience et des débats en cours dans ces deux régions du monde. D'ailleurs, on pourrait proposer l'apport de modifications au document canadien intitulé Fusionnements, lignes directrices pour l'application de la Loi, qui autoriseraient un examen plus dynamique, mais néanmoins prudent, du facteur de l'entreprise en sérieuse difficulté. On s'accorde à penser que l'exigence d'un acheteur préférable sur le plan de la concurrence contenue dans l'argument comporte un parti pris inhérent qui pourrait conduire

les autorités en matière de concurrence à déterminer, de façon erronée, un autre acheteur qui poserait un risque concurrentiel inférieur à celui de l'acquéreur proposé. La question de l'effet d'une fusion de sauvetage sur les accès et retraits du marché fait l'objet de discussions parmi les universitaires qui se penchent essentiellement sur le pour et le contre du sauvetage des actifs et de la prévention de l'accès au marché. Ce faisant, les autorités en matière de concurrence devraient également tenir compte des recherches suggérant qu'une entreprise pourrait avoir des intentions prédatrices lorsqu'elle s'engage dans un processus de fusion de sauvetage. De façon générale, il semble que l'argument de l'entreprise en sérieuse difficulté puisse continuer à jouer un rôle dans le droit de la concurrence. Par conséquent, l'efficacité de son application, en général, et le contenu des critères qu'il propose doivent constamment faire l'objet d'une évaluation et d'une mise au point.

Introduction

The financial and economic crisis has threatened the existence of firms around the globe, and has had a particularly devastating effect on the economies of the United States and the European Union. Indeed, the global restructuring of industries may represent the most significant economic change of the last decades.² The marketplace is littered with companies on the verge of insolvency, requiring tough business decisions to be made. One strategic response for struggling firms and a means of implementing a successful debt restructuring process is to combine in order to achieve necessary efficiencies.³ Mergers and acquisitions are a plausible way for failing or threatened firms to survive an initial crisis, regroup, and perhaps build for a profitable future. However, such transactions must first undergo an increasingly difficult regulatory approval process.

Merger review by competition authorities is largely focused on determining whether a merger or proposed merger prevents or lessens, or is likely to prevent or lessen, competition substantially. The two principal components of any lessening or prevention of competition resulting from a merger are: (i) the elimination of the actual or potential competitive influence of the acquired firm; and (ii) the additional loss of competition which can be attributed to the entrenched, enhanced, or *de novo* market power of the acquiror.⁴ The failing firm defence has

been developed in both American and European case law to enable failing firms to merge together, or be acquired by a profitable firm, in a transaction that would normally have been blocked by merger review as being anticompetitive. The rationale behind the failing firm defence is that the deterioration of the competitive structure of the market would have occurred even in the absence of the merger through the exit of the failing firm.⁵ The loss of the failing firm's influence in the market cannot be attributed to the merger, since a firm that is facing certain and imminent financial failure will cease to exercise any competitive influence in the market after its failure.⁶ The merger allows the company to survive, with its assets remaining within the market and often adding necessary production. While antitrust law traditionally maintains a disciplined focus on competitive effects, the interests of shareholders, creditors, and employees cannot be entirely ignored when dealing with corporate rescue, and their interests were arguably of primary concern during the initial development of the failing firm defence in US case law.

There was speculation by competition practitioners that the failing firm defence would enjoy increased application during the current economic crisis.⁷ Given the depressed economy, it was predicted that the number of mergers involving firms in financial difficulties and invoking the defence would increase and competition authorities would relax the defence's stringent requirements.⁸ To date, however, this does not seem to be the case, at least in Europe.⁹ The stringent criteria of the failing firm defence in both the US and EU means very few firms can successfully apply such a defence. While Canada uses a failing firm "factor" in its competition legislation and merger review guidelines rather than a formal "defence," it too has been of very limited application in practice. A formal failing firm "defence" in the US and Europe means that upon fulfillment of its criteria an absolute defence exists, allowing the merger to proceed despite antitrust concerns. The failing firm "factor" in Canada is just one of a number of factors that the Competition Bureau considers in determining whether a merger has prevented or lessened competition substantially, or is likely to do so.

The applicability of the failing firm defence, also known as a rescue merger, is quite relevant given the new business landscape emerging from the current economic crisis. Value can occasionally be found in failing and poorly performing companies, and many legendary business

careers have been built on the turnaround and strategic acquisition of such companies.¹⁰ The failing firm defence may be an important tool for entrepreneurs and investors in seizing any opportunities created by the economic crisis. On the other hand, some industries may be permanently declining; the failing firm defence may prove to be useful in addressing the problem of distressed or declining industries as well. A country's economy may benefit, given that successful application of the defence means that some or all of the assets of the failing company are preserved and do not exit the market, often benefiting consumer welfare. Continuity of service, product differentiation, and most importantly employment are other factors to consider as well. However, these considerations must be weighed against any possible anticompetitive effects that may result from the rescue merger.

Lively discussion regarding the utility and application of the failing firm defence, in addition to relevant case law, is found in the US and Europe. Canadian competition law can benefit from taking into account the lessons learned and ongoing discussion in these two jurisdictions. The paper will begin with a brief introduction of the failing firm defence and its rationale, followed by a discussion of its limited application in Canada. The paper then provides a discussion of the development of the failing firm defence in American and European case law, along with the criteria now found in the respective horizontal merger guidelines of the two jurisdictions.

An important element of the paper lies in the academic and practitioner discussion regarding the appropriateness of the failing firm defence criteria, its effect on incentives for market entry and entrepreneurship and improvements that can be made. When asking a competition authority¹¹ to approve the failing firm defence, evidence must be provided that an alternate purchaser is not available to acquire the troubled company instead, resulting in a less anticompetitive merger. There is a general consensus that this competitively preferable purchaser requirement of the defence contains an inherent bias that may mislead competition authorities in identifying an alternative purchaser that would pose a lower competitive threat than the proposed acquiror. Appropriately adjusting this requirement could arguably lead to a more accurate assessment of a rescue merger's impact on competition. Furthermore, competition authorities should be aware of research concluding that the availability of the failing firm defence

could encourage anticompetitive strategic behaviour (predation) by firms. For instance, an acquiring firm could merge with a failing firm using the failing firm defence, knowing that the initial rescue merger will have the effect of subsequently inducing the failure and exit of its competitor firms in the market. In this manner, a sophisticated firm can abuse the failing firm defence to eventually monopolize the market.

Canada has very few contested merger cases, and neither the courts nor the Competition Tribunal have addressed the failing firm factor. Without such consideration or guidance from jurisprudence, the Canadian Merger Enforcement Guidelines¹² (MEGs) play a fundamental role in setting the terms of discussion between private parties and the Competition Bureau with respect to failing firm policy. In order to maintain credibility and effectiveness, the provisions in the MEGs should reflect current practitioner and academic thought with respect to the failing firm factor and its criteria.

Overall, there appears to be a continued role for the failing firm defence in competition law, and therefore the effectiveness of its general application and content of its criteria must be continually reassessed and refined. The paper will conclude with proposals for revisions to the MEGs that would allow for a more vigorous yet still cautious consideration of the failing firm factor in Canada.¹³ Furthermore, Canadian counsel can take note of interesting developments and research, perhaps ensuring that the lessons from this paper do not remain academic for too long.

Brief Introduction of the Failing Firm Defence

The failing firm defence¹⁴ operates as an exception to regular merger review, providing that a merger involving a failing firm may proceed, although under regular circumstances the transaction would have been blocked by competition authorities because it would prevent or lessen competition. The defence facilitates a process of debt restructuring by removing an antitrust impediment, allowing firms to combine in order to achieve competitively necessary efficiencies.¹⁵ A failing firm within a booming industry or firms in a distressed industry will choose to merge, acquire, or be acquired, or even spin-off a loss-making division in order to enhance overall viability and profitability.¹⁶ The rescue merger may enhance general welfare by increasing the efficiency of

existing capacity, redeploying that capacity to socially more valued uses, and even preserving jobs, among other social considerations.¹⁷ On economic grounds, the permitted merger may have beneficial effects resulting from economies of scale,¹⁸ economies of scope¹⁹, or other efficiencies, so that prohibiting the deal could even be detrimental to competition.²⁰ Although the failing firm defence does have social implications, and one rationale for the defence is arguably to protect the interests of creditors, employees, and stockholders,²¹ antitrust law generally holds no place for consideration of any public interest other than competition itself,²² and therefore this paper will focus on that objective in examining the defence.

The basic requirement of the failing firm defence is to demonstrate that the deterioration of the competitive structure that follows the merger cannot be said to be caused by the merger itself because the failing firm would exit the market in any case.²³ The “lack of causality” between the merger and the possible worsening of the competitive structure due to the merger is primordial in accepting a failing firm defence.²⁴ Given that the future market structure would be equally detrimental to competition irrespective of whether the deal is cleared or blocked, there is no basis for prohibiting the merger.²⁵ Relatively little attention has been paid to failing firm rules in economic theory, despite its policy relevance.²⁶ If the firm was allowed to fail, the assets would have either been acquired by competing firms or forced to exit the market. Applying the failing firm defence, the market power effects are the same as if the failing firm were to exit, but there may be offsetting benefits attributable to the assets remaining in the market. An essential step in accepting a failing firm defence is the counterfactual analysis, involving the comparison between the competitive conditions occurring due to the merger and conditions that would prevail if the merger were blocked.²⁷ Since a failing firm is involved, the pre-merger conditions should not be used as a benchmark as it would be used in a merger involving non-failing firms.²⁸ The pre-merger conditions may not prevail even if the merger were prohibited,²⁹ since the failing firm would then exit the market.

The *raison d'être* of the conditions found in the failing firm defence is to prove the lack of causality between the merger and the worsening competitive structure that it would otherwise create.³⁰ The conditions, which are relatively similar across jurisdictions, are:

- Absent the merger, the failing firm will exit the market in the near future as a result of its financial difficulties;
- There is no feasible alternative transaction or reorganization that is less anti-competitive than the proposed merger; and
- Absent the merger, the assets of the failing firm would inevitably exit the market.³¹

The merging parties use the above cumulative criteria to convince a competition authority that the merger will lead to less (or no worse) anticompetitive effects than a counterfactual scenario in which the firm and its assets exit the market.³²

Countries with a formal failing firm defence consider the test to provide legal certainty. It yields outcomes that are broadly similar to the outcomes that would obtain under the traditional causality test,³³ and provides predictability for firms that are subject to merger control regimes.³⁴ For countries without an explicit failing firm defence, such as Canada, mergers involving a failing firm are reviewed using the standard causality test in merger control.³⁵

The courts and competition authorities are very strict in ensuring that companies invoking the failing firm defence are genuinely failing. This means the company is insolvent, on the verge of insolvency, or in imminent danger of financial collapse.³⁶ Furthermore, there should not be another prospective purchaser for the failing company that would pose a less severe danger to competition than the proposed merger partner.³⁷ The requirement to search for alternative purchasers places a heavy burden on firms going through a crisis, and there is much debate as to how much effort is required in such a search. Firms in financial crisis have especially limited resources, and allocating these resources to the most pressing needs and issues surrounding the company can mean the difference between survival and failure.

Failing Firm “Factor” in Canada

Under Canadian merger review, section 93 of the *Competition Act*³⁸ lists the non-exhaustive factors which the Competition Tribunal can consider in determining whether a merger will prevent or lessen

competition substantially or is likely to do so. Two major themes permeate this list of factors: the extent to which there is likely to be sufficient competition remaining to ensure that competition is not likely to be prevented or lessened substantially; and what, if any, competition may be lost by the merger.³⁹ Section 93(b) of the *Competition Act* considers “whether the business, or a part of the business, of a party to the merger or proposed merger has failed or is likely to fail.”⁴⁰ Therefore, according to Canadian competition legislation, the fact that a firm is failing is a factor rather than part of a formal defence in merger review. This is arguably the major difference Canada has with the treatment of the failing firm defence in the US and EU. Under the *Competition Act*, the fact that a firm is failing is not treated as a defence to an otherwise anti-competitive merger, but is assessed within, and as part of, the competitive effects analysis of a proposed transaction.⁴¹

However, Elliott and Dinning argue that the “factor” versus “defence” concern is only an issue of semantics; although characterizing failing firm as a factor may understate its full significance in merger analysis.⁴² “[B]ecause establishing the elements of the failing firm ‘factor’ is in itself a sufficient basis to allow the merger, business failure functions in practice largely like a defence.”⁴³ Elliott and Dinning assert that the MEGs implicitly recognize that business failure functions as a defence by dedicating a distinct section of the MEGs (Part 13), separate from the discussion of other section 93 factors.⁴⁴

The MEGs *Part 13 — Failing Firms and Exiting Assets* outline the Competition Bureau’s analytical approach to claims made under subsection 93(b) of the *Competition Act*. The MEGs explicitly state that probable business failure does not provide a defence for a merger that is likely to prevent or lessen competition substantially.⁴⁵ Instead, the loss of the actual or future competitive influence of a failing firm is not attributed to the merger if imminent failure is probable and, in the absence of a merger, the assets of the firm are likely to exit the relevant market.⁴⁶ A firm will be considered failing if: it is insolvent or is likely to become insolvent; it has initiated or is likely to initiate voluntary bankruptcy proceedings; or it has been, or is likely to be, petitioned into bankruptcy or receivership.⁴⁷ The considerations regarding a failing firm are also equally applicable to failure-related claims concerning a division or a wholly-owned subsidiary.⁴⁸

Before clearing a merger involving a failing firm as not likely to result in a substantial lessening or prevention of competition, the Bureau must assess if any alternatives to the merger exist and are likely to result in a materially greater level of competition than if the proposed merger proceeds.⁴⁹ These alternatives include acquisition by a competitively preferable purchaser, retrenchment/restructuring, and liquidation.

A competitively preferable purchaser must be willing to pay a price which, net of the costs associated with making the sale, would be greater than the proceeds that would flow from liquidation, less the costs associated with such liquidation (referred to as the “net price above liquidation value”).⁵⁰ Where such a third party exists, it is expected that if the proposed merger under review cannot be completed, the target will either seek to merge with that competitively preferable purchaser, or remain in the market.⁵¹ The burden of showing that no preferable purchaser exists is on the parties, and the Bureau will review documents provided by the parties with respect to the nature and extent of the “shop process.” To ensure that a fair opportunity to bid for the claimant’s business was available, the Bureau will even engage in conversation with bidders and alleged bidders.⁵² If the Bureau is not satisfied that a thorough search for a competitively preferable purchaser has been conducted, it will require the involvement of an independent third party (i.e. investment dealer, trustee or broker) to conduct such a search before the failing firm rationale is accepted.⁵³ The Bureau has even secured orders to obtain documents relating to the shop process from these third parties when necessary.⁵⁴

The retrenchment or restructuring of a failing firm may prevent failure and enable it to survive as a competitor in the market. This can be achieved by narrowing the scope of its operations, downsizing, or withdrawing from the sale of certain products or from certain geographic areas. When it appears that the firm is likely to remain in the market rather than sell to a competitively preferable purchaser or liquidate, the Bureau must determine whether this alternative to the proposed merger is likely to result in a materially greater level of competition than if the proposed merger proceeds.⁵⁵

If no competitively preferable purchasers are identified and there is no feasible or likely retrenchment scenario, the Bureau assesses whether liquidation of the firm is likely to result in a materially higher

level of competition in the market than if the merger in question proceeds. Liquidation can facilitate entry by giving actual or potential competitors the opportunity to compete for the failing firm's customers or assets to a greater degree than if the failing firm merged with the proposed acquiror.⁵⁶

Although subsection 93(b) of the *Competition Act* has never been considered by the Competition Tribunal,⁵⁷ the failing firm factor has been applied to a few mergers. The 1988 Wolverine Tube (Canada) Inc. acquisition of Noranda Metal Industries Ltd. is an example of the application of the failing firm analysis before the Bureau first formalized the concept in the 1991 MEGs.⁵⁸ Although they were the only two Canadian manufacturers of seamless copper tubing, Noranda's business was not a sustainable stand-alone business. A competitively preferable purchaser could not be found, and the only other alternative to the proposed merger was to liquidate the business. The Bureau's analysis determined that liquidation would not likely facilitate future entry into the Canadian market.⁵⁹ The Bureau agreed to the merger, citing their prediction that the seamless copper tube industry in Canada would become a one-firm industry in any case and there would be significant efficiency gains for Wolverine.⁶⁰

The 1989 PWA-Wardair merger further reflected the Bureau's consideration of a yet to be formulated failing firm analysis. PWA, the parent company of Canadian Airlines, proposed a merger with Wardair, given the latter firm's serious financial difficulties and likely failure. Alternative purchasers were not identified, and there were significant barriers to entry, including regulatory restrictions on foreign carriers and slot constraints at Pearson International Airport.⁶¹ Furthermore, liquidation was not seen as a viable alternative, given that the assets would have left the Canadian market due to excess capacity and the Wardair fleet not being compatible with the fleets of other domestic airlines.⁶² The Bureau cleared the transaction as not likely to substantially lessen competition, given Wardair's position as a failing firm.⁶³

In 1996, Canadian Pacific (CP)'s attempted acquisition of Cast North America using the failing firm argument was rejected by the Bureau, citing its staff opinion that Cast was not a failing business, or alternatively, that sale to a third party, liquidation, or retrenchment were better options.⁶⁴ Furthermore, the Bureau charged the Royal Bank of

Canada (RBC), who was acting as Cast's financial advisor, with not properly shopping Cast in the market before Cast made a failing firm claim.⁶⁵

The Air Canada-Canadian Airlines merger would have been a celebrated example of the failing firm defence if a political decision had not interfered with the normal functioning of competition law policy. To this extent, the merger was a missed opportunity for the development of our understanding of rescue mergers in Canada. The federal cabinet, on the recommendation of the Minister of Transport, suspended parts of the *Competition Act* for ninety days, from August 13, 1999 to November 11, 1999. This was done in order to facilitate restructuring alternatives for Air Canada and Canadian Airlines.⁶⁶ Therefore, merger review for the transaction under the *Competition Act* only lasted a month, unlike most mergers raising "complex issues." Even though the merged airline would account for ninety percent of domestic passenger revenues, the Bureau determined that there was not likely to be a competitively preferable purchaser and that the acquisition (with the undertakings made by the parties) was preferable to the liquidation of Canadian Airlines.⁶⁷

Concerning the search for a competitively preferable purchaser, by the time the Bureau conducted the merger review, there had already been extensive canvassing of potential purchasers, especially during the three months the *Competition Act* was suspended.⁶⁸ Furthermore, various policy recommendations were made to the Minister of Transport, including increasing foreign ownership in airlines in Canada or otherwise liberalizing airline competition in Canada. Had these recommendations been adopted, the landscape for assessing alternative purchasers would have shifted significantly.⁶⁹ This is an important example of how rescue merger policy can have direct implications for new entry into the market, especially foreign firms.

Although Air Canada's acquisition of Canadian Airlines would have satisfied the failing firm test under competition law principles, the merger was ultimately allowed under a broader public interest standard employed by the Minister of Transport.⁷⁰ The Minister was concerned that the Bureau's approach to the failing firm analysis did not adequately consider the broader public interest considerations, and therefore the *Competition Act* and the *Canada Transportation Act*⁷¹

were amended to allow the Minister to override competition analysis to effect broader public interest goals.⁷² Indeed, consistent with competition law doctrine, the failing firm factor in Canadian merger review is not a mechanism to balance broad social interests against any lessening of competition associated with a proposed merger.⁷³

The 2004 bid by Rogers Wireless Communications Inc. to acquire Microcell Communications Inc. is another transaction in which the Bureau grappled with issues relating to failing firms and competitive weakness in the mobile wireless industry. Post-merger, Rogers, the third largest firm, would combine with Microcell, the fourth largest (albeit much smaller) firm, to create Canada's largest firm measured nationally by subscriber base.⁷⁴ The proposed merger raised competition issues with respect to the removal of Microcell as a vigorous and effective competitor in the wireless market. The Bureau was concerned with the impact of the transaction on coordinated behaviour and whether Microcell could be considered a "maverick" in the mobile wireless market.⁷⁵ As described in the MEGs, a maverick is a particularly vigorous and effective competitor that can play a disruptive role on coordinated behaviour, and thereby provide a strong stimulus to competition in the market.⁷⁶

The Bureau concluded that there was no increased risk of coordinated effects with the removal of Microcell, as significant factors existed pre-merger that constrained coordination. None of these constraining factors would be affected or diminished by the merger.⁷⁷ Furthermore, to whatever extent Microcell may have played the role of maverick in the past, it was unlikely to do so in the future given the very significant constraints it faced.⁷⁸ One significant disadvantage faced by Microcell was its inability to provide service bundles to its customers based on product offerings from other markets (e.g. cable television, wireless internet) that competitors could offer. Furthermore, Microcell had a significantly smaller coverage area than its competitors.⁷⁹ The Bureau undertook a detailed review of Microcell's financial situation to understand its current and future financial requirements. Although the company had emerged in May 2003 from court protection under the *Companies' Creditors Arrangement Act*,⁸⁰ it was not considered a "failing firm" under section 93(b) of the *Competition Act*.⁸¹ However, the Bureau recognized the significant challenges Microcell faced in implementing its current business plan. The firm needed significant

additional capital investment to support the increased load required for a new wireless product offering, resulting in significant revisions to its projected capital expenditure budget. This would place pressure on its ability to support funding for next generation product and service offerings, as well as other initiatives designed to allow Microcell to effectively compete with the three larger wireless firms, who themselves were investing heavily in newer generations of technology, network enhancements, and product offerings.⁸² Although Microcell did not qualify as a failing firm, the Bureau was mindful of its future competitive weakness, a significant factor in allowing the merger to proceed. As will be discussed in transactions from the US and the EU, although a firm may not qualify as a failing firm, competition authorities may allow a merger to proceed when the current state of the firm does not adequately reflect its future competitive weakness.

As previously mentioned, the lack of judicial consideration of the failing firm defence in Canada means the MEGs arguably set the grounds for discussion between private parties and the Competition Bureau. Yet new thought regarding the application and effectiveness of the failing firm factor and its criteria must find a way into these discussions for the MEGs to remain relevant. If new developments based on academic consensus are introduced into the MEGs, perhaps rescue mergers can find renewed life, providing more opportunities for entrepreneurs to find value in the damaged business landscape emerging from the economic crisis. Although there is currently no wide criticism of the failing firm factor by the Canadian competition bar, developments in American and European case law and academia can offer guidance in improving our approach to the concept of rescue mergers.

In order to provide context to the academic discussion regarding the failing firm defence, a study of American and European case law and the development of their respective failing firm defence criteria is necessary. Nevertheless, it is the academic discussion that likely holds the most value in possibly improving Canada's approach to antitrust treatment of failing firms.

Development of the Failing Firm Defence in the US and EU

(i) United States

In the United States, the failing firm defence becomes relevant after a merger has been found to be *prima facie* unlawful on ordinary concentration-increasing grounds.⁸³ The defence is an exemption from what would be a violation of section 7 of the *Clayton Act*,⁸⁴ which prohibits acquisitions that may substantially lessen competition or tend to create a monopoly. Since the failing firm defence is viewed as being absolute in the US (and Europe) when the requisite elements of the test are proved, a more cautious approach to defining the test is required than if facts pertaining to “failure” are simply to be “taken into account” in analyzing a merger,⁸⁵ as they are in Canada.

The US Supreme Court first developed the failing firm defence in the 1930 case *International Shoe Co. v. FTC*.⁸⁶ The W.H. McElwain Company was in a dire financial situation, and International Shoe sought to purchase the firm in order to secure additional factories, which it could not itself build with sufficient speed to meet requirements. All other alternatives for McElwain were speculative, and the decision-makers at International Shoe and McElwain decided to pursue the acquisition.⁸⁷ In overruling the decision by the FTC to prevent the transaction, Supreme Court Justice Sutherland stated:

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. To regard such a transaction as a violation of law [...] would ‘seem a distempered view of purchase and result’.⁸⁸

International Shoe required two elements to satisfy the failing firm defence: the acquired firm would go bankrupt but for the merger, and the acquiror was the only available purchaser.⁸⁹ Interestingly, this decision clearly took into consideration the interests of the stockholders and the public—interests outside the traditional scope of competition law.

The Supreme Court later refined the failing firm criteria in *Citizen Publishing*,⁹⁰ which ultimately became very similar to the criteria adopted in the US Horizontal Merger Guidelines.⁹¹ The Court held that an otherwise unlawful acquisition of a failing firm could be permitted if three general requirements were met by those claiming the failing firm defence:

- (1) the acquiring company must show that the target is in imminent danger of failure;
- (2) the failing firm must have no realistic prospect for successful reorganization; and
- (3) the failing firm must show that it has made reasonable, good-faith attempts to locate an alternative buyer and there is no viable alternative purchaser that poses a less anti-competitive risk.⁹²

The criteria that emerged from *Citizen Publishing* rejected the non-competition considerations that had been discussed in *International Shoe*. The current Horizontal Merger Guidelines⁹³ largely follow the failing firm defence criteria established by *Citizen Publishing*, although it makes the ultimate test whether the assets of the failing firm would otherwise exit the market.⁹⁴ This means that if the failing company were liquidated, would other firms within the market buy these assets piecemeal and keep them in the market, or would the assets not be purchased and therefore exit the market? A liquidation that kept the assets within the market, even if split up, would likely be less anticompetitive than if those assets were all transferred to a single firm with market power.⁹⁵ On the other hand, allowing the firm to fail and liquidate risks inefficiently sacrificing the going-concern value of the firm⁹⁶ and losing any technical or productive achievements.⁹⁷

The failing firm defence has been criticized, since it is very rarely accepted by competition authorities in either the US or EU. It is often proclaimed by both commentators⁹⁸ and occasionally a representative of an enforcement agency to be a waste of litigants' time.⁹⁹ Furthermore, it can greatly increase the institutional costs of evaluating a merger.¹⁰⁰ Since few failing firms can afford the delays in fully litigating the failing firm issue, it has been argued that the defence only benefits players with deep pockets and large interests to get the leverage in their bargains with administrative agencies.¹⁰¹ However, recent examples in the US demonstrate the continued value of the failing firm defence in certain circumstances where a firm is bound to fail and requires a rescue merger in order to keep its assets within the market.¹⁰² In 2011, the Department of Justice accepted the failing firm defence in connection with Hercules Offshore Inc.'s \$172 million acquisition of the assets of Seahawk Drilling Inc., giving it a post-merger share of an estimated eighty percent of the drilling rigs used in the soft seabeds in the Gulf of Mexico.¹⁰³

A Houston-based company founded in 2008, Seahawk operated twenty shallow-water jackup drilling rigs, offering contract drilling to the oil and natural gas exploration and production industry in the Gulf of Mexico. Industry demand for these services declined drastically due to the global financial crisis and the federal moratorium on offshore drilling in the aftermath of the Deepwater Horizon (BP) disaster.¹⁰⁴ Liquidity problems forced Seahawk to consider strategic alternatives, including seeking additional funding, recapitalization, the sale of assets, or a sale or merger of the business. An investment banker was retained, contacting more than one hundred potential merger partners over a three-month period.¹⁰⁵ Hercules, a global provider of offshore contract drilling, liftboat, and inland barge services for exploration and production companies, was ultimately determined to be the only viable purchaser of Seahawk's assets. An asset purchase agreement was negotiated, and Seahawk subsequently filed for bankruptcy on February 11, 2011.¹⁰⁶

Given the high concentration resulting from the merger, an extensive merger review was likely, yet time was of critical importance to the failing company. Seahawk had run out of cash, and would have been forced into liquidation if the transaction was not quickly consummated,¹⁰⁷ likely forcing its assets out of the market.¹⁰⁸ Since the assets

were being purchased under section 363 of the *Bankruptcy Code*,¹⁰⁹ a shortened fifteen-day initial waiting period applied.¹¹⁰ If the Department of Justice had not finished its review by this time, it would have had to issue a second request for information,¹¹¹ which may have killed the deal. In order to mitigate the risk of a protracted merger review, counsel for Hercules pulled and refiled its notification after the first fifteen days to provide the DOJ with an additional two weeks to review the deal.¹¹² The DOJ expedited review and accepted the parties' contention that Seahawk was a failing firm. The *Hart-Scott-Rodino*¹¹³ pre-merger notification waiting period was terminated before the end of the second fifteen-day waiting period, and the transaction was closed shortly thereafter. The most contentious requirement in question, as is often the case with the failing firm defence,¹¹⁴ was the alternative purchaser provision. Seahawk's extensive shop of its assets and the lack of a viable alternative purchaser were critical in obtaining approval from the DOJ.¹¹⁵

The American failing firm defence requires evidence that the assets of the failing firm would otherwise exit the relevant market in the absence of the proposed rescue merger. For this to be accepted, the allegedly failing firm must be unable to: (1) meet its financial obligations in the near future; (2) reorganize successfully under Chapter 11 of the *Bankruptcy Code*; and (3) find a less anticompetitive purchaser for the company or its assets.¹¹⁶ The concept, developed in US case law and now formalized in the Horizontal Merger Guidelines, provides an absolute defence to a merger that would otherwise violate section 7 of the *Clayton Act* as being anticompetitive. Although the criteria are extremely stringent, and the failing firm defence is often raised in inappropriate circumstances¹¹⁷ by creative (or desperate) counsel, it continues to be relevant to genuinely failing firms whose assets would exit the market without a rescue merger.

(ii) European Union

Article 2 of the *European Community Merger Regulation*¹¹⁸ (ECMR) lists the substantive merger test upon which concentrations are appraised as compatible with the common market, determining whether a merger would "significantly impede effective competition [...] in particular as a result of the creation or strengthening of a dominant position."¹¹⁹ The failing firm defence in Europe was developed and

refined through case law, which led to the maturity of its doctrine and formulation of the criteria in the 2004 Horizontal Merger Guidelines.¹²⁰ However, the defence has arguably been applied in a more restrictive manner than in the US. The failing firm defence was discussed and established in the *Kali und Salz*¹²¹ decision, concerning the joint venture between Kali, Salz, and Treuhandanstalt (hereafter Treuhand), involving the combination of the potash and rock salt activities of Kali and Salz with Mitteldeutsche Kali AG (MdK). MdK was a state-owned company of the former German Democratic Republic (East Germany), whose sole shareholder Treuhand was given the mandate to restructure and privatize the former GDR's state-owned enterprises.¹²² MdK was on the verge of bankruptcy due to the firm's operating structure and a crisis in sales attributable primarily to the collapse of markets in Eastern Europe.¹²³ The rescue merger would create a monopoly, giving the combination 98 percent in the German market for potash products.¹²⁴

The parties argued that without the merger, MdK would be forced out of the market, and its market share would essentially accrue to Kali and Salz. Under these circumstances, it was argued that the dominant market position of the acquiror should be permitted under the failing firm defence.¹²⁵ The Commission ruled that such a merger would not be the cause of the deterioration of the market structure if the following criteria were fulfilled:

- the acquired undertaking would in the near future be forced out of the market if not taken over by another undertaking;
- the acquiring undertaking would take over the market share of the acquired undertaking if it were forced out of the market;
- there is no less anticompetitive alternative purchaser.¹²⁶

This criteria being met by the parties, the Commission concluded that the lack of causality between the concentration and the deterioration of the market structure meant that the merger, despite the creation of a dominant position, was compatible with the common market.¹²⁷

The second criterion above, in which the acquiring firm should absorb *all* the market share of the acquired undertaking if it were

forced out of the market, was considered to be too restrictive by the French government in its appeal against the *Kali und Salz* decision.¹²⁸ The Court of Justice of the European Communities upheld the Commission's failing firm analysis, holding that the criterion was intended to ensure there was no causal link between the concentration and the deterioration of the market structure.¹²⁹

Ultimately, the absorption of *all* the market share criterion was indeed judged to be too restrictive in the *BASF/Eurodiol/Pantochim*¹³⁰ decision. In this case BASF could not be expected to absorb all the market share of the failing Eurodiol, since its main competitors were likely to gain market share as well. However, since the assets of the failing firm were definitely going to exit the market in the absence of the proposed transaction and most likely lead to a considerable deterioration of market conditions, the Commission held that the situation in *BASF/Eurodiol/Pantochim* equally merited the application of the rescue merger concept.¹³¹ The Commission distinguished *Kali und Salz* by noting the particularities of that case, including the fact that the acquiring and failing firm exercised a duopoly, thereby ensuring that the acquiror would have absorbed the market share of the failing firm whether the merger had been permitted or not.¹³² Consequently, the absorption of *all* the market share of the failing firms (Eurodiol and Pantochim) was no longer a required criterion of the failing firm defence.

The Commission now had to establish new criteria for the failing firm defence. The application of the two remaining criteria alone could not rule out the possibility of the assets of the failing firms being purchased by third parties in a bankruptcy sale. If the assets were taken over by competitors in a bankruptcy sale the economic effects would be similar to a takeover of the failing firms by an alternative purchaser.¹³³ Therefore, the Commission determined it necessary to replace the absorption of *all* the market share criterion with the requirement of establishing that the assets to be purchased would inevitably disappear from the market in the absence of the rescue merger.¹³⁴ The refined failing firm defence emerging from the BASF case is as follows:

- (a) the acquired undertaking would in the near future be forced out of the market if not taken over by another undertaking;

- (b) there is no less anti-competitive alternative purchase; and
- (c) the assets to be acquired would inevitably exit the market if not taken over by another undertaking.¹³⁵

Overall, the application of the failing firm defence requires that the deterioration of the competitive structure through the merger is at least no worse than in the absence of the merger.¹³⁶ The Commission's current position in connection with the defence, based on the criteria established in *BASF*, can be found in sections 89-91 of the Horizontal Merger Guidelines.¹³⁷

The European failing firm defence evolved into nearly the same defence existing in the US; the one difference being the US test requires proof that the failing firm would not be able to reorganize successfully under Chapter 11 of the *Bankruptcy Code*. Although the UK has applied the failing firm defence five times since its formalization in its own Merger Guidelines in 2003,¹³⁸ Europe, until recently,¹³⁹ only had the *Kali und Salz* and *BASF* examples as precedents of a successful failing firm defence. Given the stringent criteria on both sides of the Atlantic, it is important to look at the situation of companies that are declining and have bleak prospects for the future, yet cannot qualify under the failing firm defence. Having a strict failing firm defence, as in the US and Europe, means certain companies will not be able to qualify for a rescue merger despite their bleak future prospects. Yet distressed industries are one of the primary concerns of failing firm policy. As demonstrated below, competition authorities have allowed such mergers to proceed despite not qualifying under the failing firm defence.

The Quasi-failing Firm Defence and Distressed Industries

A firm may be destined to exit the market even though insolvency or bankruptcy is unlikely. Financial failure results from the inability to pay debts as they mature, and this can be due to many reasons.¹⁴⁰ Due to the inability of proving impending insolvency or bankruptcy, or that the firm will exit the market in the near future due to financial difficulties, the failing firm defence cannot be used by owners preferring to sell their firm rather than undertake a prospectively profitable modernization. However, if alternative modes of revival are not available or had reasonably been rejected by the firm, then the firm may

properly be classified as failing.¹⁴¹ Although it is extremely challenging to convince the courts that failure can be established without imminent insolvency,¹⁴² a few instances have been accepted by courts in the US and EU whereby an otherwise anticompetitive merger was allowed to proceed despite the rejection of a formal failing firm defence. This lends credence to Mason and Weeds' (contested) position, touched upon in the academic discussion below, that a more lenient merger policy for rescue mergers should be adopted.

*General Dynamics*¹⁴³ demonstrated the US Supreme Court's willingness to make a realistic evaluation of antitrust concerns in a merger involving a firm that was neither failing nor a strong competitor. The Government brought an action requiring the divestiture of a strip mining coal operation which had been acquired by a deep shaft coal mining corporation. The Supreme Court upheld the decision of the District Court rejecting the action, stating that while the government's statistical evidence supported the finding of undue concentration, other pertinent factors affecting the coal industry and business in question required a ruling that the acquisition would not substantially lessen competition. The acquisition was ruled not to violate section 7 of the *Clayton Act* despite the merger producing a company with a large market share in an already concentrated industry.¹⁴⁴ The company's large market share did not reflect its competitive condition, as its coal reserves were either depleted or committed under long-term contracts.¹⁴⁵ Furthermore, the acquired entity would not meaningfully contribute to further competition since it possessed neither the capability to obtain more strip reserves nor the expertise to develop its deep reserves.¹⁴⁶ In this manner, the company's future competitive weakness undermined the government's *prima facie* statistical case.¹⁴⁷ Although mere competitive weakness was not sufficient to prove the failing firm defence since the acquired company was both profitable and efficient, the court determined that the acquisition would not substantially lessen competition.¹⁴⁸

The approach taken in *General Dynamics* became known as the "flailing," "quasi-failing," or "weakened firm" defence. The defence applies to target firms that are not in immediate danger of insolvency or market exit, yet are unlikely to represent a significant competitive constraint in the future due to financial and/or economic weakness.¹⁴⁹ The major outcome is that current market conditions may not accurately reflect

future competition in an industry, and this line of thought was followed in other decisions such as *US v International Harvester Co.*¹⁵⁰ and *FTC v Arch Coal Inc.*¹⁵¹ In Europe, the *Newscorp/Telepiù*¹⁵² decision is regarded as giving rise to a quasi-failing firm defence similar to the concept developed in *General Dynamics*.¹⁵³ The Commission cleared a merger between Telepiù and Stream, two competing satellite operators in the Italian pay-TV market, despite a near monopoly being created and the failing *division* defence not being accepted. Stream was controlled by Newscorp and Telecom Italia. Telepiù and Stream both incurred heavy losses from 1991 to 2001, and Newscorp argued that in the absence of the merger, it was likely to close Stream, and thereby argued for merger approval under the failing firm defence.¹⁵⁴ Newscorp was relying on the failure of its *division* that was part of the acquiring company (rather than the target, which is the usual situation).¹⁵⁵ The Commission declared that “[t]he importance of proving lack of causality is even greater in the case of a claimed ‘failing division’, which is actually the acquiring company.”¹⁵⁶

The Commission held that the criteria for the failing firm defence had not been met, yet added:

[T]he risk of Stream exiting the market, if it were to materialise, would be a factor to take into account when assessing the present merger. The Commission further considers that an authorisation of the merger *subject to appropriate conditions* will be more beneficial to consumers than a disruption caused by a potential closure of Stream.¹⁵⁷

The above reasoning can be described as one in which a merger to near monopoly *as amended by the commitments* was less harmful to consumers than the counterfactual, in which there was a risk that Stream would exit the market, giving Telepiù a monopoly.¹⁵⁸ The merger was therefore approved on the basis of a counterfactual analysis, taking account of the customer benefits *brought about by the commitments*,¹⁵⁹ including the regulatory regime (behavioural undertakings) that would bind the merged entity going forward.¹⁶⁰ The Commission was pragmatic in accepting that a regulated “quasi-monopoly” in Italian pay-TV was better than the most likely alternative absent the merger: Stream filing for bankruptcy, current providers and consumers

suffering from the disruption, and Telepiù emerging as an unregulated de facto monopolist.¹⁶¹

General Dynamics, Newscorp/Telepiù, and the previously discussed 2004 merger in Canada between Rogers and Microcell are examples of transactions in which the requirements of the failing firm defence have not been met, and yet the proposed mergers were allowed to proceed, taking into account the competitive weakness of the firms, realities of the market, and consumer welfare. The competition authorities were mindful that due to the future competitive weakness of the firms, allowing the proposed mergers would not substantially lessen competition. There may indeed be instances, particularly with respect to distressed industries, where a flexible application of the failing firm defence can produce the best outcome for consumer welfare.

Academic Discussion regarding the Effectiveness of the Failing Firm Defence: What can Canada Learn?

Now that a sufficient basis for the development of the failing firm defence has been established, an examination of the academic discussion regarding the effectiveness of the defence can be set out. These lessons and considerations, in light of the case law discussion, may be useful to both the Competition Bureau and the Canadian competition bar, and may eventually prompt discussion about possible revisions to Canada's Merger Enforcement Guidelines. The same analysis may provide legal counsel with possible avenues of dialogue or negotiation with the Bureau when dealing with a potential failing firm case. The main topics of discussion include: the competitively preferable purchaser requirement, implications for market entry and exit, the failing firm defence promoting strategic behaviour and predation by firms, the role of rescue mergers in declining markets, and finally, the incentives that motivate a healthy firm to acquire a failing firm via a rescue merger. It is important to note that the academic critiques of the failing firm defence only address competition law concerns, consistent with the scope of this paper.

(i) Competitively Preferable Purchaser Requirement

The most important requirement for the failing firm defence to date, at least in the United States and arguably Canada, is the requirement

for a failing firm to search for a less anticompetitive purchaser. This is often the main battlefield on which a failing firm defence is won or lost.¹⁶² In a mid-2009 application, this requirement was debated between the Bureau and an applicant. The Bureau received sufficient evidence that firm failure was likely and imminent, yet disagreed with the applicant regarding whether an appropriate “shop” had been conducted to identify a possible competitively preferable purchaser.¹⁶³ The Bureau then identified a third party whose purchase of the troubled firm was likely to result in a materially higher level of competition in a substantial part of the market. The third party was willing and able to offer a net price above liquidation value, indicating to the Bureau that in the absence of the proposed transaction, the acquiree was not likely to exit the market given this desirable alternative to liquidation. Moreover, the alternative purchaser was a new entrant into the relevant market, whereas the proposed acquiror was a competitor of the failing firm, thereby raising serious competition concerns. The Bureau conducted interviews and determined that enough time remained for a transaction to be concluded with the alternative purchaser, and a transaction was ultimately consummated.¹⁶⁴

However, academics challenge what actually constitutes a competitively preferable purchaser on several grounds. How should small differences in purchase price offers between the proposed acquiror and the alternative purchaser be dealt with? Furthermore, what if an alternative purchaser ultimately plans (unknown to the competition authority at the time) to take the assets and exit the market anyway? Even the size of the proposed acquiror and alternative purchaser seem to affect the efficiencies that can be gained from such a merger, ultimately influencing consumer welfare. Areeda and Hovenkamp even challenge the need that a search be required for *all* failing firm mergers. Instead, as discussed below, they propose that varying proof requirements are appropriate; elements of the failing firm defence may adequately be varied depending on the competitive danger proposed by a merger.¹⁶⁵

In determining whether an alternative buyer exists, competition authorities require that a shop be made of the alleged failing firm, and if necessary, that bids are collected in relative secrecy and assessed.¹⁶⁶ In short, there is an auction where firms simultaneously post bids and the competition authority decides which firm can obtain the assets.¹⁶⁷

As discussed below, there may be inherent problems with this process, given that the failing firm defence criteria may systematically prefer alternative purchasers that may offer less efficiencies and therefore arguably less beneficial to competition and consumer welfare.¹⁶⁸

Persson investigates the welfare consequences of the failing firm defence using two specific Cournot models in an oligopoly setting. The failing firm defence is shown to work reasonably well from a consumer surplus perspective — unless the acquiring firm in the industry is too small. Persson demonstrates that the failing firm defence “implies that small firms can preempt acquisitions that would lead to a higher producer surplus (and consumer surplus) due to a ‘least danger to competition’ (LDC) condition,¹⁶⁹ i.e. there must be no alternative buyer who might cause less harm to competition.”¹⁷⁰ A buyer who might cause less danger to competition is often interpreted as a buyer with a smaller market share. Therefore, the LDC condition present in the failing firm defence of both the US and Europe implies that smaller, and possibly less efficient, firms are favoured in the bidding process.¹⁷¹

The consumer surplus objective and the total surplus objective, i.e. the sum of consumer and producer surpluses, are the two main objectives of competition law that Persson focuses on in his study.¹⁷² It is accepted that the small firm may not necessarily be the most preferred buyer, since the producer surplus might be higher if a larger firm obtains the assets.¹⁷³ Persson argues the LDC condition might also prevent the most consumer surplus enhancing acquisition from taking place:

To see this, consider a situation where the smallest firm’s cost savings from obtaining the failing firm’s assets are very small. Thus, the smallest firm would not be willing to pay a great deal for the assets, if these would otherwise exit. Furthermore, assume that a larger firm would substantially reduce its variable costs if obtaining the assets. Let the cost savings be so large that the larger firm expands its output so that the market price will be lower than if the smallest firm obtains the assets. The smallest firm’s profit will then substantially decrease, however, and consequently, it will be willing to pay for preventing the larger firm from obtaining the assets. The LDC condition implies that this could be achieved by the small firm simply by overbidding the outside firm.¹⁷⁴

Therefore, when competition authorities have a preference for smaller firms purchasing the failing firm target, in some situations, this may prevent a large firm from reducing costs substantially, thereby lowering market prices and ultimately benefiting consumer surplus.

Kokkoris and Olivares-Caminal also criticize the alternative purchaser requirement. The current policy of the defence may systematically prefer alternative purchasers that are unlikely to offer the same efficiencies that a competitive purchaser can offer.¹⁷⁵ For this reason, competition authorities should consider whether the alternative purchaser has the capability of running the acquired firm competitively, which may entail injections of capital to ensure the viability of the failing firm.¹⁷⁶ Furthermore, the alternative purchaser is only required to make a “reasonable offer” in order to be selected as the purchaser posing a less severe danger to competition. “Any offer to purchase the assets of the failing firm for a price above the liquidation value of those assets will be regarded as a reasonable alternative offer. Liquidation value is the highest value the assets could command for use outside the relevant market.”¹⁷⁷ In this manner, an alternative purchaser need only offer more than the liquidation value in order to gain control of the assets, despite the proposed purchaser perhaps being better able to improve the efficiency of the failing firm.¹⁷⁸ Kokkoris and Olivares-Caminal argue that by rating the least anticompetitive alternative in terms of liquidation value, the failing firm defence criteria is biased in favour of non-market participants, ignoring the potential efficiencies a competitor purchaser may offer.

While competitor purchasers usually offer higher bids than out-of-market firms due to the market-power premium, it is possible that this price difference includes an efficiency premium as well. It is often hard to separate them, and overestimating the market-power premium means underestimating the efficiency premium. Kokkoris and Olivares-Caminal argue that the willingness of the acquiror to buy a company that is heading towards failure justifies placing more emphasis on the efficiency premium.¹⁷⁹

The shop process may be commercially difficult for a failing firm as well. Asking the firm to enter into a beauty parade before its competitors may harm its ability to sell on the market and accelerate exit. Time and resources are extremely limited and precious for a failing firm,

and devoting these to an alternative purchaser search further diverts resources away from more productive activities¹⁸⁰ often crucial to the survival of the firm. Requiring a failing firm to make a public request for offers is likely unreasonable, since widespread disclosure of the firm's serious difficulties may lead to a rapid decline in market share and thereby the firm's value to potential acquirors.¹⁸¹ Additionally, search requirements for a competitively preferable purchaser can be susceptible to rent-seeking behaviour by competitors whose interests are not aligned with those of customers. Competitors can indicate interest in assets with little cost and no commitment, even if they do not have a sincere interest or ability to act. A third party with an interest in delaying the merger could bid in bad faith, with the goal of extending the merger review, perhaps to the point of triggering a liquidation of the distressed company.¹⁸² So how should the competitively preferable purchaser requirement be altered, if at all? The purpose of the search is to identify if there indeed exists another purchaser that will satisfy the interests protected by the failing firm defence, yet pose a less significant threat to competition.¹⁸³

Areeda and Hovenkamp suggest that the elements of the failing firm defence may appropriately be varied depending on the competitive danger posed by a merger. When competition concerns are low, proof that one of the merging firms is failing is sufficient in itself. However, in cases where the probabilities of competitive harm appear more substantial, proof that no preferred purchasers exist or that survival from reorganization proceedings is improbable should be required from the applicant parties.¹⁸⁴

Areeda and Hovenkamp provide an outline for a variation approach that has not been applied in case law, and suggest that the failing firm defence be deemed established:

- (1) merely by proof that a firm is "failing" where the post-merger HHI¹⁸⁵ is less than 1800 and the HHI increment caused by the merger is less than 100; or where the post-merger HHI exceeds 1800 but the merger adds fewer than 50 points to the HHI.
- (2) by proof that a firm is "failing" *and* that there are no "preferred" purchasers where the post-merger HHI falls between

1000 and 1800 and the merger adds more than 100 points; or where the post-merger HHI exceeds 1800 and the merger adds more than 50 points.

- (3) by additional proof that the firm faces liquidation when the HHI numbers are significantly higher than the numbers given in (2), particularly where the post-merger HHI is significantly higher than 1800, and the merger adds significantly more than 100 points. This classification would include all cases where the merger produces a monopolist or dominant firm.¹⁸⁶

By adding threshold elements to the failing firm analysis, the requirements needed to fulfill the failing firm defence can be adjusted to match the perceived competitive threat. Furthermore, it is argued that since the thresholds are not firmly established in law, when a merger with a failing firm is modestly above the threshold in (1), an “adjustment” sufficient to bring it below the threshold would not be unreasonable. Little would be lost and administrative simplification would be gained by making impending failure a sufficient defence in these cases.¹⁸⁷ However, the Areeda and Hovenkamp varying proof requirements approach and HHI thresholds refer to the old US Merger Guidelines before they were revised in 2010, and therefore require updating. Additionally, the HHI thresholds would need to be adjusted to take into account the size of the Canadian market.

Even when an alternative purchaser is identified should it automatically be given “preferred” status simply because competition concerns seem to be lower? The value of the bid, whether a material difference exists between the bids of the proposed and alternative purchaser, and the alternative purchaser’s intended use of the failing firm’s assets are all important considerations.

Non-material differences in market share between the proposed and alternative purchaser should not be determinative in awarding the alternative purchaser the preferred status. Areeda and Hovenkamp suggest that an alternative purchaser should be deemed preferred only if the HHI increase under the alternative acquisition is at least 50 points less than the HHI under the challenged acquisition.¹⁸⁸ They further argue that a preferred purchaser is one who would remain in the given

market with the assets.¹⁸⁹ If the preferred purchaser withdrew from the market using the failing firm's assets elsewhere, the consequences for the market are similar to liquidation; the competitive gain being wider dispersal of the failing firm's customers among the remaining rivals, yet costing the proposed acquiror any advantages from the proposed merger. Instead, a proposal by an alternative purchaser to withdraw the assets from the market is actually evidence that the failing firm indeed faces liquidation, that the proposed acquiror would not gain any substantial advantage from the acquisition, and that accordingly the alternative purchaser should not be preferred.¹⁹⁰

Areeda and Hovenkamp do not however suggest that the alternative purchaser must agree to keep all the assets in that market, nor that commitments (or undertakings) to remain in the market for a specified time are appropriate since circumstances may change. The requirement can only be that the acquiror intends to remain.¹⁹¹ This suggestion has implications for the market entry/exit aspect of the failing firm defence. Entrepreneurial activity requires that efficient market entry and exit avenues are available to both short- and long-term investors; the failing firm defence, its policy and criteria, directly affect how failing firms may exit and non-market firms may enter a new market.

Although the academics offer different insight on the problems with the competitively preferable purchaser requirement, there is consensus that the status quo is not appropriate. Persson demonstrates that the 'least danger to competition' (LDC) condition implies that smaller, and possibly less efficient firms are favoured in the bidding process. The LDC condition may prevent the most consumer surplus enhancing acquisition from taking place; competition authorities having a preference for smaller firms purchasing the failing firm target may prevent a large firm from reducing costs substantially, thereby lowering market prices and ultimately benefiting consumer welfare. Kokkoris and Olivares-Caminal add that the competitively preferable purchaser requirement may systematically prefer alternative purchasers that are unlikely to offer the same efficiencies that a competitive purchaser can offer. Furthermore, by rating the least anti-competitive purchaser in terms of liquidation value, the requirement is biased in favour of non-market participants, again ignoring the efficiencies that a competitive purchaser may offer. Areeda and Hovenkamp's suggested

outline for a variable approach based on the HHI index has not yet been applied in case law, but perhaps offers a flexible approach that would be welcome by both the Competition Bureau and competition bar. Considering that the competitively preferable purchaser requirement is the main battlefield on which the failing firm defence is won or lost, not to mention that a “shop” process is commercially difficult for a failing firm to undertake, appropriate changes to the MEGs may lead to greater application of the failing firm defence in Canada. Therefore, the Competition Bureau and/or competition bar could start with this requirement in proposals for revisions to the MEGs.

(ii) Implications for Market Entry and Exit

The effect of the failing firm defence on issues of market entry and exit is debated among scholars with no clear answer to date. The issue of entry deterrence is a crucial matter for competition authorities to assess during merger review. Fedele and Tognoni determine through their economic modeling that entry is deterred if a failing firm defence merger is approved. The study focuses on the asset exit requirement of the European failing firm defence, assessing potential anticompetitive effects of a horizontal merger on entry in a Cournot oligopoly model with a failing firm.¹⁹²

Returning to *BASF/Eurodiol/Pantochim*,¹⁹³ the Commission decided that preservation of the assets in the industry justified the use of a rescue merger; absent the merger, the exit of Eurodiol and Pantochim assets would have caused a capacity shortage for products already under tight capacity constraints. Initial compensation for this capacity would have been impossible, and a strong price increase was likely to result given the capacity constraints and almost inelastic demand for those products. A rescue merger was required to preserve the assets, resulting in a better competitive structure than if the merger were prohibited.¹⁹⁴

Fedele and Tognoni study this trade-off between preservation of assets and entry deterrence, arguing that competition authorities should consider the potential efficiency gain resulting from a merger against the risk that a merged entity will use those efficiencies to monopolize the market in the long-run.¹⁹⁵ The study concludes that a rescue merger resulting in an incumbent owning a significant amount

of capacity increases the height of entry barriers because the merged firm can increase output at a lower marginal cost. This reduces prospective profits of new entrants and can harm consumer welfare when entry is actually deterred.¹⁹⁶

Mason and Weeds studied the failing firm defence's influence on entry and ultimately overall entrepreneurial activity. Rational entrants into a market consider possible exit routes should profitability prove poor. Mason and Weeds argue that a more lenient merger policy would be beneficial by facilitating exit and thus raising the value of entry, which can stimulate entry sufficiently that welfare is increased overall.¹⁹⁷ In this manner, merger policy has an impact on *ex ante* decisions, such as market entry or expansion, affecting competition in the long run. *Ex post*, horizontal mergers result in increased concentration and reduce consumer surplus, yet the possibility of future merger raises the expected value of entry. Competition is then increased through firms' increased willingness to enter or expand. Mason and Weeds find the optimal merger policy balances the welfare loss from concentration *ex post* with the welfare gain from entry *ex ante*.¹⁹⁸ This would entail clearing some mergers that would normally cause a substantial lessening of competition (SLC). They argue that this could be interpreted as an extension of the failing firm defence to include ailing as well as imminently failing firms. Whereas the failing firm defence is interpreted strictly, the optimal policy in their model takes the form of a low, but positive, profitability threshold below which a merger is to be permitted despite having a negative impact on post-merger competition.¹⁹⁹ This research could give added weight to the quasi-failing firm defence emerging from *General Dynamics* and *Newscorp/Telepiù*, thereby permitting mergers of firms that are not quite failing yet perceived to be uncompetitive for the future.

Mason and Weeds highlight the importance of prospective exit routes for investors and entrepreneurs. These exit routes include acquisitions by a buyer within the same industry,²⁰⁰ highlighting an important policy aspect of the failing firm defence. The identification of exit routes is an important aspect of the due diligence process that venture capitalists undertake before entering a market. Given that these investors often seek to cash in on a project within three to five years, and that their investments initially do not earn positive cash flows, exit is an important method in which to realize a return. Data²⁰¹ supports the view that

acquisition by an industry player is a very common exit route in both the US and Europe, illustrating the importance of failing firm defence policy on market entry and entrepreneurialism.

Mason and Weeds' advocacy of a more lenient merger review policy to encourage entry and entrepreneurialism is heavily contested by Heyer and Kimmel, who argue that such a policy would instead encourage inefficient entry decisions. Entry behaviour is based on potential entrants' expected profits.²⁰² Offering a cheap exit route and limiting their costs via a lenient application of the failing firm defence may truncate the losses an entrant would expect to incur upon failure. This would artificially reduce the cost of entry, perhaps encouraging entry by inefficient competitors. Furthermore, this could skew entry decisions towards markets where investors expect a more lenient failing firm defence, thereby distorting normal market functioning.²⁰³

A lenient approach could also promote inefficient exit decisions. A desirable feature of a competitive economy is that it leads to the exit of inefficient firms, ensuring that production is conducted at the minimum possible cost. During times when funding is scarce, e.g. an economic crisis, it is important that funds get to the companies with greater growth opportunities. A narrow application of the failing firm defence is arguably necessary to weed out weak and inefficient firms and foster long-term growth.²⁰⁴

There is no consensus among researchers as to the effects the failing firm defence has on issues such as entry and entrepreneurialism. The findings by Mason and Weeds will surely encounter strong opposition from competition authorities, who are known to have a bias towards preventing type II errors in merger policy, even at the expense of committing more type I errors.²⁰⁵ Type I errors refer to prohibition decisions involving mergers that in reality would not have caused anticompetitive effects, even possibly contributing to increased competition. Type II errors refer to decisions approving mergers that ultimately caused harm to competition. Type I errors are often considered more serious than type II errors in merger control.²⁰⁶ More research will be needed to support Mason and Weeds' position before merger policy gravitates towards their viewpoint. Considering the lack of consensus with respect to the effect of the failing firm defence on market entry and exit, no recommendations can currently be made with respect to proposed

changes to the MEGs. However, the research of Fedele and Tognoni, Mason and Weeds, and Heyer and Kimmel, can offer possible avenues of negotiation with the Bureau. Rescue mergers are very fact specific and the research of the above scholars is based on economic modeling; it is uncertain as to whose research may be most applicable to a future failing firm defence scenario.

(iii) Failing Firm Defence Promoting Strategic Behaviour and Predation

Another concern is that the availability of the failing firm defence can promote strategic anticompetitive merger behaviour by firms. Vasconcelos argues that when the failing firm defence is available, firms can strategically embark on a merger that causes other firms to fail, and then buy out the failing outsider firm(s), leading to a monopolization of the industry. He concludes that in some circumstances, a consumer-surplus-maximizing market structure cannot be achieved if the failing firm defence concept is available, whereas it can if the concept is ruled out.²⁰⁷ The paper arguably offers a theoretical explanation of why competition authorities are so reluctant to accept the failing firm defence in the merger control process.²⁰⁸

The study reveals important findings on the dynamic of the policy of a competition authority towards horizontal mergers:

First among these is that if the merger policy is focused on the effects of a single merger proposal, the FFD may enhance consumer-surplus for certain parameter values, but be counter-productive for others. In particular, the possibility under the FFD regime of firms embarking on a two-step merger that leads to a monopoly market structure implies that, under certain circumstances, a consumer-surplus-maximizing market structure cannot be achieved if the FFD concept is available, whereas it can if the FFD concept is ruled out. Secondly, and perhaps most importantly, a more dynamic view of sequential mergers shows that the FFD rule can only affect consumer-surplus negatively. In other words, the FFD rule can only have a negative influence.

The use of the FFD in the present context is still of benefit to consumers because industry specific capital (which enhances

firm efficiency) remains in the industry rather than leaving it. However, because merger policy cannot be fully contingent on the strategies of the firms, the FFD can also trigger strategic mergers that become profitable because of subsequent rescue mergers, and end up being counterproductive. Thus, if the FFD were not an option, other mergers associated with a higher consumer-surplus would take place, which provides a theoretical rationale for the fact that 'competition authorities have in several cases shown some reluctance to accept the failing firm defense'.²⁰⁹

Vascancelos' key argument is that if merger policy allows rescue mergers to proceed *ex post* under the failing firm defence, this would influence the *ex ante* merger incentives of firms.²¹⁰ Firms may initially embark on mergers with the strategic knowledge that rivals would be vulnerable to a subsequent rescue merger due to a weak financial position. Specific merger patterns can be used to induce rival firms that were assumed to be viable in the initial industry structure to fail.²¹¹ Due to this counterproductive possibility, Vasconcelos advocates that it is important to ensure that the strategic adoption of specific merger patterns by an acquiror at an early stage is not the reason the target firm involved in a rescue merger is failing.²¹² While most research has focused on the immediate competitive impact of a rescue merger, Vasconcelos offers needed insight into the long-term implications underlying failing firm defence policy.

(iv) Rescue Mergers in Declining Markets

Declining markets offer an important example of the failing firm defence's continuing relevance in competition law policy, especially given the speed with which new technologies can render certain industries or businesses obsolete. Bouckaert, Kort, and Petrova study the strategic and welfare effects of the failing firm defence in declining oligopolistic markets. In a declining market, the least efficient firms become insolvent as a result of decreasing demand. This leaves the failing firm with the option of leaving the market or being acquired. The study demonstrates that the acquisition of the insolvent firm using the failing firm defence increases total welfare whenever horizontal product differentiation is sufficiently high and the rescue merger does not result in a monopoly.²¹³ Furthermore, the solvent firms prefer the

clearing of the rescue merger to the failing firm exiting the market. The merger effect of the failing firm defence relaxes overall competition, despite the fact that the exit of a failing firm elevates the prices and profits of all remaining firms.²¹⁴

Consumers benefit from the rescue merger as well when consumer surplus from maintained product variety outweighs the higher prices resulting from the clearing of the rescue merger. This occurs when product differentiation is sufficiently important and the rescue merger does not result in a monopoly. Importantly, the study confirms that the failing firm defence does not alter the break-even point of the solvent firms.²¹⁵ In declining markets, the firms' revenues are larger after the merger, but as the market declines further, profits decrease again over time. Ultimately, the least efficient firm will still exit the market at some point in time. How long the merger will last and which firm will exit first from a market with a merged firm is determined by the firms' total profits.²¹⁶ The failing firm defence may be an important tool in dealing with declining industries, as technology and global competition may have eliminated the *raison d'être* of certain industries. The failing firm defence may be an effective private sector solution (or band-aid) to a problem that often requires government intervention and subsidies.

(v) Merger Incentives for using the Failing Firm Defence

Little has been said about the actual motivation for a healthy firm to acquire a failing firm. The incentives for merger are shown to be quite different than those behind the merger of two healthy firms. Bouckaert and Kort investigate whether firms competing on prices or quantities have an incentive to acquire a failing firm or not. While there is a private incentive for two profitable firms to merge whenever each firm's profits increase as a result of the merger, this does not hold true for a merger with a failing firm. They find that remaining profitable firms have no strategic incentives to acquire the failing firm; they prefer the failing firm to disappear from the market instead of rescuing it. This result implies that other reasons such as important economies of scope²¹⁷ in their fixed and variable operation costs must be looked at to explain why healthy firms merge with failing firms using the failing firm defence. Bouckaert and Kort also find that there is a consumer welfare incentive to merge with a failing firm if goods are sufficiently heterogeneous. This is due to rescue mergers maintaining product

variety and lowering prices as compared to a market structure without the failing firm.²¹⁸

(vi) OECD Recommendations

The 2009 OECD Roundtable proposed an alternative failing firm defence test. The Effects-Based Alternative involves a two stage effects-based counterfactual analysis to assess the competitive effects of mergers involving failing firms. During the first stage, competition agencies would assess evidence presented by merging parties, their competitors, and customers to determine what the most likely counterfactual scenario is without any presumptions. Second, competition authorities would compare the post-merger and the counterfactual scenarios, deciding which scenario proved best for competition. Mergers would be approved without remedies only if the post-merger scenario proved superior.²¹⁹

The Canadian submission to the 2009 OECD Roundtable contained an interesting proposal for the need to coordinate the definition and application of the failing firm concept in multi-jurisdictional cases.²²⁰ Considering that the definition and assessment of the failing firm criteria is highly similar across jurisdictions, competition authorities could coordinate efforts in failing firm assessments in order to accommodate the tight timeframe and urgency surrounding such an application. Furthermore, such coordination could decrease the possibility that different jurisdictions reach different conclusions with respect to a failing firm defence application made by a global firm. Given the precedent of the *Boeing/McDonnell Douglas*²²¹ merger and the different conclusions reached by the Federal Trade Commission (FTC) and the European Commission,²²² such coordination could increase certainty for business and decrease the prospect of inconsistent results. With this goal, competition authorities can align their respective frameworks, communicate the details of their assessments and preliminary conclusions, and share conclusions regarding alternatives to the merger and determinations of competitively preferable purchasers.²²³ Furthermore, given the failing firm defence's applicability to market entry, coordination between competition authorities could also be helpful in identifying foreign firms that may have an interest in entering a market via the rescue merger of an incumbent. A failing firm does not have the resources to search the entire globe for a suitor, and

therefore such coordination would be of benefit to all jurisdictions. The Canadian OECD proposal will certainly be more applicable during the global restructuring of companies facing both multinationals and local players over the next decade.

(vii) Summary

The academic discussion reveals there is still much to learn about the application of the failing firm defence. Although there is a consensus that the selection of alternative purchasers is currently biased, the debate regarding market entry and exit, effects on entrepreneurialism, predatory behaviour, and the role of rescue mergers in declining markets is quite lively. Nevertheless, these developments are available for parties to discuss with the Competition Bureau; some can even be introduced into the MEGs, either as formal provisions, footnotes, or even appendices. The academic literature seems to show that the applicability of the failing firm defence should be highly sensitive to the facts of each case, but does suggest which facts are most relevant in analysis. Although the failing firm defence has neither been considered by Canadian courts nor the Competition Tribunal, debating revisions to the MEGs promotes the exchange of new ideas and encourages further legal and economic research. Most of the current economic research with respect to rescue mergers is from Europe. Both Canada and the United States should perhaps encourage more economic research in this area, given its importance to our understanding of rescue mergers, the need for research specific to the North American market, and relevance of the failing firm defence in possibly giving struggling businesses and industries an avenue to emerge from the current economic crisis.

Conclusions

This paper has argued that there appears to be a continued role for the failing firm defence in competition law, although its current criteria likely need to be adjusted. Canada differs from the US and Europe in that it has a failing firm “factor” rather than absolute “defence.” However, as suggested by Elliott and Dinning, this is arguably only an issue of semantics.²²⁴ US and European criteria evolved out of case law; Canada will unlikely have the same opportunity to litigate the application of the failing firm defence. The failing firm factor in the MEGs

needs to be frequently updated given the absence of case law continually developing rescue merger doctrine. Furthermore, a formal defence requires extremely stringent standards, whereas a factor approach can be a bit more flexible. In light of the quasi-failing firm examples in US and European case law, along with the research by Mason and Weeds advocating for a more lenient merger policy for rescue mergers to encourage market entry and entrepreneurialism, a bit of flexibility may be welcomed by both parties and the Competition Bureau. Case law can be extremely constraining, and parties may feel more confident in negotiating with the Bureau, rather than taking their chances with the uncertainty of court. Furthermore, litigating issues before the courts can be extremely expensive and time consuming; luxuries that most failing firms cannot afford. Meanwhile, competition authorities, including the Competition Bureau, are quite sensitive and accommodating to the timing pressures faced by parties. If the MEGs are continually updated to reflect contemporary thought on rescue merger application, Canada's "factor" approach may have many advantages over the formal "defence" approach in the US and Europe. In this manner, novel arguments can be made by the parties, while granting the Bureau freedom to manoeuvre since the MEGs are non-binding.

The Hercules rescue merger of Seahawk in 2010 demonstrates the continued applicability of the failing firm defence, especially for industries that may have experienced a shock, such as the drilling industry in the Gulf of Mexico following the BP disaster. The failing firm defence also can be applied to declining industries, and the research of Bouckaert, Kort, and Petrova demonstrates that rescue mergers of a failing incumbent are favoured by solvent firms in that declining industry. Although a rescue merger may lead to higher prices, consumers often benefit overall from the maintained product variety. Bouckaert and Kort, in a separate study, demonstrate that healthy firms pursue a rescue merger for non-strategic reasons, and therefore economies of scope²²⁵ in fixed and variable operational costs can be argued to be the real incentive behind a rescue merger.

A general consensus for change is called for in the competitively preferable purchaser requirement of the failing firm defence. As demonstrated by Persson, the "least danger to competition" (LDC) element of the failing firm defence may indeed prefer alternate purchasers that are smaller and potentially less efficient than the proposed acquiror.

The LDC condition may prevent the most consumer surplus enhancing acquisition from taking place, inconsistent with competition law's mandate to improve and protect consumer welfare. The Bureau should take into account this preference in assessing the benefits of purchases by such firms before placing demands on a failing firm to search for a competitively preferable purchaser, and in actually giving a third party the status of a "preferred" purchaser.

Areeda and Hovenkamp's proposal that varying proof requirements be introduced into the failing firm defence should certainly be looked into by the Bureau. All mergers implicating a failing firm will not raise the same competitive dangers, and therefore the failing firm defence can be varied to address the level of competitive threat raised by a proposed rescue merger. While the HHI thresholds would need to be adjusted to reflect the size of the Canadian market, Areeda and Hovenkamp's proposal²²⁶ would incorporate a threshold element into the failing firm defence, using HHI as the measuring tool as to which mergers require particular proof requirements of the failing firm defence. HHI can also be a means of comparing the bids of the proposed acquiror and an alternative purchaser, thereby giving the Bureau more credibility in determining whether the proposed acquisition or alternative acquisition should prevail. Since the MEGs do not bind the Bureau, new ideas can be conservatively tested through their introduction in the MEGs. In fact, ideas can even be introduced into the MEGs through footnotes. Consistent with past practice, new draft MEGs will likely be sent out for comment by the competition bar before finalizing them.

The failing firm defence's influence on market entry and exit requires more research, as there is no consensus among academics. The trade-off between the preservation of assets and entry deterrence, as identified by Fedele and Tognoni, is an essential relationship that must be considered in merger review of failing firms. Mason and Weeds' position that a more lenient merger policy will lead to greater market entry and entrepreneurialism will require more academic support before being accepted. However, their research may lend credence to allowing mergers of more quasi-failing firms to proceed in the future. Perhaps the MEGs should include provisions regarding the assessment of market entry and exit in *Part 13 – Failing Firms and Exiting Assets*.

This would at least make it easier to get the Bureau to take such policy issues into account when assessing a rescue merger application.

The Competition Bureau should be aware that Vasconcelos' research forewarns that the availability of the failing firm defence can promote predation. Firms can undertake a rescue merger with the strategic knowledge that it may induce failure in market competitors, thereby threatening the monopolization of the market in the future. For this reason, the Bureau should look carefully at the incentives motivating an acquiror to undertake a rescue merger and ensure that the above-mentioned specific merger patterns are not the true reason behind the transaction. A provision could be formalized within the MEGs to guard against this predation threat, or at least minimize its possibility by putting the onus on the rescue merger applicant to demonstrate that it is not motivated by predation. Undertakings could be another way in which to guard against the threat of predation.

Overall, the failing firm defence seems to maintain its relevance as an exception to an otherwise anticompetitive merger. It is to be used in exceptional circumstances only, and the difficulty in meeting its criteria reflects this reality. Given that the alternative purchaser requirement is the most contested aspect of the failing firm defence and there seems to be a consensus in academia as to its weakness, the Bureau and the competition bar can start discussing possible revisions to this criterion as a starting point in improving the application of the rescue merger concept. Given the speed in which firms may go from a profitable business to failure, not to mention the pressures of technology advancements, globalization, and threats of external shocks (e.g. natural disasters or accidents), the failing firm defence needs to be given renewed credibility in order to ensure that it can be effectively applied in the global restructuring of business.

Endnotes

¹ Of the bars of Québec and Ontario, and graduate of the J.D. National Program (2013) at the University of Ottawa. Correspondence: tmathews23@gmail.com. The author is grateful to Professor J. Anthony VanDuzer for his guidance and insightful feedback throughout the duration of this research project. All errors, omissions, and opinions are the author's own.

² Ioannis Kokkoris & Rodrigo Olivares-Caminal, *Antitrust Law amidst Financial Crises* (Cambridge: Cambridge University Press, 2010) at 2.

³ *Ibid* at 104.

⁴ Paul S Crampton, *Mergers and the Competition Act* (Toronto: Carswell, 1990) at 407.

⁵ Barry J Rodger & Angus MacCulloch, *Competition Law and Policy in the EC and UK*, 4th ed (New York: Routledge-Cavendish, 2009) at 299.

⁶ Consumer and Corporate Affairs Canada, *Background: Information Document on the Proposed Acquisition of Wardair Inc. by PWA Corporation*, CCAC No. 189 10234 E89-04 (undated) at 6 [*Proposed Acquisition of Wardair*].

⁷ Jurgita Malinauskaitė, “The failing firm defence in EU merger control: The story of Sisyphus?” (2012) 23:9 Int’l Co & Com L Rev 308.

⁸ *Ibid.*

⁹ *Ibid* at 308, 314 (In Europe, the decision not to relax the failing firm defence’s stringent requirements is arguably one of the reasons for a low number of mergers invoking this defence).

¹⁰ In Canada, the career of Paul Desmarais Sr. of Power Corporation of Canada comes to the forefront. Desmarais’ meteoric rise in the corporate world was largely due to his ability to turn around bankrupt, failing, and under-performing companies, and then use this success and momentum to acquire larger companies. See e.g. Dave Greber, *Rising to Power: Paul Desmarais & Power Corporation* (Toronto: Methuen, 1987).

¹¹ Competition authority will refer to a nation’s main competition regulator, e.g. Competition Bureau (of Canada).

¹² Canada, Competition Bureau, *Merger Enforcement Guidelines* (2011), online: Competition Bureau <<http://www.competitionbureau.gc.ca>> [MEGs].

¹³ The value of guidelines is in the credibility of their commitment. The credibility of the Competition Bureau’s guidelines is an ongoing issue given the Bureau’s behaviour, starting with *Canada (Commissioner of Competition v Superior Propane*, 2000 Comp Trib 16, 18 CPR (4th) 417, aff’d 2003 FCA 53, 223 DLR (4th) 55.

¹⁴ The failing firm defence is also known as the failing company defence and a rescue merger.

¹⁵ Kokkoris & Olivares-Caminal, *supra* note 2 at 104.

¹⁶ *Ibid.*

¹⁷ Ioannis Kokkoris, “Failing Firm Defence in the European Union: A Panacea for Mergers?” (2006) 27:9 Eur Comp L Rev 494 at 496.

¹⁸ Gregory J Werden & Luke M Froeb, “Unilateral Competitive Effects of Horizontal Mergers” in Paolo Buccirossi, ed, *Handbook of Antitrust Economics* (Cambridge, Massachusetts: MIT Press, 2008) 43 at 91 (“[e]conomies of scale arise if firms can lower their marginal costs by investing in greater capacity, or if firms can acquire larger blocks of capacity at lower costs per unit.”)

¹⁹ Economies of scope refer to the lowering average cost for a firm in producing two or more products.

²⁰ Werden & Froeb, *supra* note 18 at 91.

²¹ Thomas E Sullivan & Jeffrey L Harrison, *Understanding Antitrust and its Economic Implication*, 5th ed (Newark, New Jersey: LexisNexis, 2008) at 336.

²²Eleanor Fox & Daniel Crane, *Global Issues in Antitrust and Competition Law* (St. Paul, Minnesota: Thomson Reuters, 2010) at 304.

²³Kokkoris, *supra* note 17 at 496; Kokkoris & Olivares-Caminal, *supra* note 2 at 112.

²⁴*Ibid.*

²⁵*Ibid.*; Kokkoris & Olivares-Caminal, *supra* note 2 at 113.

²⁶Lars Persson, "The Failing Firm Defense" (2005) 53:2 J Ind Econ 175 at 177.

²⁷Kokkoris, *supra* note 17 at 496; Kokkoris & Olivares-Caminal, *supra* note 2 at 112.

²⁸Kokkoris, *supra* note 17 at 494.

²⁹*Ibid.*

³⁰Kokkoris, *supra* note 17 at 496; Kokkoris & Olivares-Caminal, *supra* note 2 at 112.

³¹"The Failing Firm Defence 2009" (Executive summary and written submissions delivered at the OECD Policy Roundtables discussion, October 2009), online: OECD <<http://www.oecd.org>> at 11 [*OECD Roundtable 2009*].

³²*Ibid.*

³³*Ibid* at 11 (The standard/traditional causality test in merger control examines the causal link between the merger and its anticipated harm to competition).

³⁴*Ibid* at 12.

³⁵*Ibid.*

³⁶Kokkoris & Olivares-Caminal, *supra* note 2 at 173.

³⁷*Ibid.*

³⁸RSC 1985, c C-34 [*Competition Act*].

³⁹Paul Crampton, "Substantive Merger Review" in James B. Musgrove, ed, *Fundamentals of Canadian Competition Law*, 2d ed (Toronto: Thomson Reuters, 2010) 183 at 186.

⁴⁰*Supra* note 38 at s 93(b).

⁴¹*OECD Roundtable 2009, supra* note 31 at 84.

⁴²Richard Elliott & Jim Dinning, "Failing Firm Analysis in Canadian Merger Review" (Paper delivered at the CBA Competition Law 2009 Spring Forum, Toronto, 12 May 2009), online: CBA <<http://www.cba.org>> at 10.

⁴³*Ibid.*

⁴⁴*Ibid.*

⁴⁵*MEGs, supra* note 12 at para 13.2.

⁴⁶*Ibid.*

⁴⁷*Ibid* at para 13.3.

⁴⁸*Ibid* at para 13.5.

⁴⁹*Ibid* at para 13.7.

⁵⁰*Ibid* at para 13.8.

⁵¹*Ibid.*

⁵²*OECD Roundtable 2009, supra* note 31 at 84.

⁵³*MEGs, supra* note 12 at para 13.8.

⁵⁴*OECD Roundtable 2009, supra* note 31 at 84.

⁵⁵ *MEGs*, *supra* note 12 at para 13.9.

⁵⁶ *Ibid* at para 13.10.

⁵⁷ Elliott & Dinning, *supra* note 42 at 2.

⁵⁸ Calvin S Goldman & John D Bodrug, eds, *Competition Law of Canada* (New York, Juris Publishing, 2012) vol 2 at 10-65.

⁵⁹ *Ibid* at 10-65, 10-66.

⁶⁰ *Ibid*.

⁶¹ *Proposed Acquisition of Wardair*, *supra* note 6 at 4-5.

⁶² *Ibid* at 6.

⁶³ *Ibid* at 8.

⁶⁴ Elliott & Dinning, *supra* note 42 at 7.

⁶⁵ *Ibid* (RBC refused to allow access to information normally needed by an acquiror; it actively dissuaded the Cast management from pursuing a third party merger, believing top price would be offered by CP and a minimum purchase price of \$35 million was set for Cast).

⁶⁶ *Ibid* at 8.

⁶⁷ Mark Katz, Anita Banicevic & Jim Dinning, "Antitrust in a Financial Crisis: A Canadian Perspective" (April 2009), online: American Bar Association <<http://www.americanbar.org>> at 8.

⁶⁸ Elliott & Dinning, *supra* note 42 at 9.

⁶⁹ *Ibid*.

⁷⁰ *Ibid*.

⁷¹ SC 1996, c 10.

⁷² Elliott & Dinning, *supra* note 42 at 14.

⁷³ *OECD Roundtable 2009*, *supra* note 31 at 85.

⁷⁴ Canada, Competition Bureau, *Acquisition of Microcell Telecommunications Inc. by Rogers Wireless Communications Inc.: Technical Backgrounder* (April 2005), online: Competition Bureau <<http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/00257.html>> [*Acquisition of Microcell*].

⁷⁵ *Ibid*.

⁷⁶ *MEGs*, *supra* note 12 at para 6.38.

⁷⁷ *Acquisition of Microcell*, *supra* note 74 (The rapid rate of growth in the wireless industry and ambition of the remaining three wireless firms (Rogers, Bell, and Telus) to increase their market share was a significant disincentive for industry participants to act in a coordinated fashion. Second, markets with rapid and frequent product or service innovations are less conducive to coordinated behaviour. Finally, the history and nature of competition between the remaining competitors in the wireless market and other markets was a further indication that coordinated behaviour was unlikely).

⁷⁸ *Ibid*.

⁷⁹ *Ibid*.

⁸⁰ RSC 1985 c C-36.

⁸¹ *Acquisition of Microcell*, *supra* note 74.

⁸² *Ibid*.

⁸³ Phillip Areeda & Herbert Hovenkamp, *Antitrust Law: An Analysis of Antitrust Principles and their Application*, 3d ed (Austin, Texas: Wolters Kluwer, 2009) vol 4 at 273.

⁸⁴ 15 USC §§ 12-27 (1914).

⁸⁵ Areeda & Hovenkamp, *supra* note 83 at 273.

⁸⁶ *International Shoe Co. v Federal Trade Commission* (1930), 280 US 291, 50 S Ct 89 [*International Shoe*].

⁸⁷ Einer Elhauge & Damien Geradin, *Global Competition Law & Economics*, 2d ed (Oxford: Hart, 2011) at 1016-1017.

⁸⁸ *Supra* note 86.

⁸⁹ Elhauge & Geradin, *supra* note 87 at 1018.

⁹⁰ *Citizen Publishing Co. v United States*, 394 US 131 (1969) [*Citizen Publishing*].

⁹¹ Kokkoris & Olivares-Caminal, *supra* note 2 at 183.

⁹² *Ibid* at 184.

⁹³ US Department of Justice and Federal Trade Commission, Horizontal Merger Guidelines (August 19, 2010), online: <<http://www.justice.gov/atr/public/guidelines/hmg-2010.pdf>> [*US Merger Guidelines*].

⁹⁴ Elhauge & Geradin, *supra* note 87 at 1023.

⁹⁵ *Ibid*.

⁹⁶ *Ibid*.

⁹⁷ Ioannis Kokkoris, "Failing Firm Defence: A Success or Failure for Corporate Restructuring?" (2007) *International Corporate Rescue* 4:3 149 at 153.

⁹⁸ See Oliver Zhong, "The Failing Company Defense after the Commentary: Let It Go" (2007-2008) *U Mich JL Ref* 745.

⁹⁹ Areeda & Hovenkamp, *supra* note 83 at 274.

¹⁰⁰ Thomas E Kauper, "The 1982 Horizontal Merger Guidelines: Of Collusion, Efficiency, and Failure" (1983) 71:2 *Cal L Rev* 497 at 529 ("[e]valuation ... [of the failing firm defence] is something of an institutional nightmare, particularly with respect to the alternative purchaser requirement"). Kauper is a former DOJ assistant attorney general in charge of the Antitrust Division.

¹⁰¹ Donald I Baker, "How to Play the Failing Company Game with the Bureaucrats in Washington" *FTC: WATCH*, 21 October 1991 at 13-15, cited in Oliver Zhong, "The Failing Company Defense after the Commentary: Let It Go" (2007-2008) *U Mich JL Ref* 745 at 767.

¹⁰² Only one transaction will be discussed in the paper, due to space constraints. Another recent US transaction utilizing the failing firm defence, a 2009 non-reportable transaction, involved the merger of Scott & White Healthcare with Texas-based King's Daughter Hospital. For details of this transaction, see Fina & Mehta, *infra* note 103.

¹⁰³ Thomas D Fina & Vishal Mehta, "The Failing Firm Defense: Alive and Well" (August 2011), online: American Bar Association <http://www.americanbar.org/content/dam/aba/publishing/antitrust_source/aug11_fullsource.authcheckdam.pdf>.

¹⁰⁴ *Ibid* at 3.

¹⁰⁵ *Ibid* at 4.

¹⁰⁶ *Ibid.*

¹⁰⁷ Bill McConnell, “Failing Upward,” *The Deal Magazine* (April 25, 2011) online: The Deal Magazine <<http://www.thedeal.com/magazine/ID/039139/2011/failing-upward.php>>.

¹⁰⁸ Fina & Mehta, *supra* note 103 at 4.

¹⁰⁹ USC tit 11.

¹¹⁰ Fina & Mehta, *supra* note 103 at 4.

¹¹¹ Second requests for information are sometimes demanded by competition authorities during complicated mergers in order to thoroughly investigate the transaction, thereby further delaying the closing of the deal.

¹¹² McConnell, *supra* note 107.

¹¹³ 15 USC § 18a (1976).

¹¹⁴ McConnell, *supra* note 107 (Steven Newborn, Weil, Gotshal & Manges LLP: “The battleground over a failing firm defense is often over how good the search was”).

¹¹⁵ Fina & Mehta, *supra* note 103 at 4.

¹¹⁶ *US Merger Guidelines*, *supra* note 93 at para 11.

¹¹⁷ See e.g. Zhong, *supra* note 98 at 767; Baker, *supra* note 101.

¹¹⁸ EC, *Council Regulation (EC) 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EC Merger Regulation)*, [2004] OJ, L 24/1 [ECMR].

¹¹⁹ *Ibid* at Article 2(2).

¹²⁰ Kokkoris, *supra* note 17 at 495.

¹²¹ IV/M.308 *Kali und Salz/MdK/Treuhand*, [1994] OJ L186/30.

¹²² EC, *Commission Decision 94/449/EC of 14 December 1993 relating to a proceeding pursuant to Council Regulation (EEC) No 4064/89 (Case NoIV/M.308 — Kali + Salz/MdK/Treuhand)*, [1994] OJL, L186/38 at 38 para 4 [*Kali + Salz*].

¹²³ Kokkoris, *supra* note 2 at 116.

¹²⁴ *Ibid*; *Kali + Salz*, *supra* note 122 at 45 para 46.

¹²⁵ *Ibid* at 49 para 70.

¹²⁶ *Ibid* at 49 para 71.

¹²⁷ *Ibid* at 53 para 95-96.

¹²⁸ Joined cases *French Republic v. Commission*, C-68/94; *Société Commerciale des Potasses et de l’Azote (SCPA) and Entreprise Minière et Chimique (EMC) v Commission*, C30/95, [1998] ECR I-1375.

¹²⁹ *Ibid* at para 113-116.

¹³⁰ COMP/M.2314 *BASF/Eurodiol/Pantochim*, [2002] OJ L132/45.

¹³¹ EC, *Commission Decision 2002/365/EC of 11 July 2002 declaring a concentration to be compatible with the common market and the functioning of the EEA Agreement (Case COMP/M.2314 — BASF/Eurodiol/Pantochim)*, [2002] OJL, L 132/45 at 62 para 151 [*BASF*].

¹³² *Ibid* at 62 para 150.

¹³³ *Ibid* at 61 para 141.

¹³⁴ *Ibid.*

¹³⁵ *Ibid* at para 142.

¹³⁶ *Ibid* at para 143.

¹³⁷ EC, Commission, Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between the undertakings, [2004] OJ C 31/5.

¹³⁸ *OECD Roundtable 2009, supra* note 31 at 36.

¹³⁹ In the latter half of 2013, after this paper was originally written, the European Commission made two consecutive clearance decisions under the failing firm defence. In September 2013, the Commission cleared the proposed acquisition by Nynas of certain refinery assets of Shell Deutschland Oil GmbH, despite leaving the acquiror as the only European Economic Area-based producer of the relevant products. In October 2013, the Commission applied the failing firm defence to clear the merger between Aegean Airlines and Olympic Air, despite previously rejecting and prohibiting the deal. The Commission's decisions for these two cases have yet to be published. See e.g. Kyriakos Fountoukakos & Lisa Geary, "Time to Bid Farewell to the Failing Firm Defense: Some Thoughts in the Wake of Nynas/Shell and Olympic/Aegean" in Anna Tzanaki, ed, *Competition Policy International Europe Column* (December 20, 2013), online: Competition Law International <<https://www.competitionpolicyinternational.com/assets/Uploads/EuropeDecember2.pdf>>.

¹⁴⁰ Areeda & Hovenkamp, *supra* note 83 at 287 ("[a] firm's capital structure may consist entirely or almost entirely of equity. Its current and prospective revenues may be adequate to cover out-of-pocket costs but fall well short of covering the cost of capital. In that event, the firm simply will not replace physical assets as they wear out and will cease operations when not enough facilities are left to support them. A multiproduct company, though profitable overall, may confront the same prospect with respect to an unprofitable subsidiary").

¹⁴¹ *Ibid.*

¹⁴² *Ibid.*

¹⁴³ *United States v General Dynamics Corp.*, 415 US 486 (1974) [*General Dynamics*].

¹⁴⁴ ABA Section of Antitrust Law, *Mergers & Acquisitions: Understanding the Antitrust Issues*, 2d ed (Chicago: ABA Publishing, 2004) at 214 [ABA].

¹⁴⁵ *Ibid.*

¹⁴⁶ *General Dynamics, supra* note 143 at 523; Kokkoris & Olivares-Caminal, *supra* note 2 at 184.

¹⁴⁷ *General Dynamics, supra* note 143 at 523; ABA, *supra* note 144 at 214.

¹⁴⁸ ABA, *supra* note 144 at 214.

¹⁴⁹ *OECD Roundtable 2009, supra* note 31 at 38.

¹⁵⁰ 564 F (2d) 769 (7th Cir 1977).

¹⁵¹ 329 F Supp (2d) 109 (DDC 2004).

¹⁵² COMP/M.2876 *Newscorp/Telepiù*, [2004] OJ L110/73.

¹⁵³ *OECD Roundtable 2009, supra* note 31 at 25.

¹⁵⁴ Alistair Lindsay & Alison Berridge, *The EU Merger Regulation: Substantive Issues*, 4th ed (London: Sweet & Maxwell, 2012) at 562.

¹⁵⁵ *Ibid.*

¹⁵⁶ EC, *Commission Decision 2004/311/EC of 2 April 2003 declaring a concentration to be compatible with the common market and the EEA Agreement (Case COMP/M.2876 — Newscorp/Telepiù)*, [2004] OJL, L 110/73 at 106 para 212.

¹⁵⁷ *Ibid* at 108 para 221; Lindsay & Berridge, *supra* note 154 at 563 [emphasis added].

¹⁵⁸ Lindsay & Berridge, *supra* note 154 at 563 [emphasis in the original].

¹⁵⁹ *Ibid* [emphasis in the original].

¹⁶⁰ Cristina Caffarra & Andrea Coscelli, “Merger to Monopoly: NewsCorp/Telepiù” (2003) 24:11 Eur Comp L Rev 625 at 627.

¹⁶¹ *Ibid.*

¹⁶² *Supra* note 114.

¹⁶³ *OECD Roundtable 2009, supra* note 31 at 85.

¹⁶⁴ *Ibid.*

¹⁶⁵ Areeda & Hovenkamp, *supra* note 83 at 294.

¹⁶⁶ “Failing Firm Defence 1995” (Analytical note and written submissions delivered at the OECD Competition Committee Policy Roundtable, May 1995), online: OECD <<http://www.oecd.org/competition/mergers/1920253.pdf>> at 49.

¹⁶⁷ Persson, *supra* note 26 at 180.

¹⁶⁸ Kokkoris & Olivares-Caminal, *supra* note 2 at 397 (The three components of consumer welfare include the value for money (lower prices), consumer choice, and innovation. Price and quality are connected).

¹⁶⁹ See the competitively preferable purchaser requirement in both the US and European failing firm defence.

¹⁷⁰ Persson, *supra* note 26 at 177.

¹⁷¹ *Ibid* at 177-178.

¹⁷² *Ibid* at 184.

¹⁷³ See J Farrell & C Shapiro, “Asset Ownership and Market Structure in Oligopoly” (1990) 21:2 RAND Journal of Economics 275 cited in Persson, *supra* note 26 at 185.

¹⁷⁴ Persson, *supra* note 26 at 185.

¹⁷⁵ Kokkoris & Olivares-Caminal, *supra* note 2 at 174.

¹⁷⁶ *Ibid.*

¹⁷⁷ *US Merger Guidelines, supra* note 93 at § 11 footnote 16.

¹⁷⁸ Kokkoris & Olivares-Caminal, *supra* note 2 at 173-174.

¹⁷⁹ *Ibid* at 412-413.

¹⁸⁰ Emily F Clark & Celia E Foss, “When the Failing Firm Defence Fails” (2012) 3:4 Journal of European Competition Law & Practice 317 at 324.

¹⁸¹ Areeda & Hovenkamp, *supra* note 83 at 301-302.

¹⁸² Ramsey Shehadeh, Joseph Larson & Ilene K Gotts, “The Effect of Financial Distress on Business Investment: Implications for Merger Reviews” (2009) 23:2 Antitrust Magazine 12 at 13-14.

¹⁸³ Areeda & Hovenkamp, *supra* note 83 at 293.

¹⁸⁴ *Ibid* at 294.

¹⁸⁵ The Herfindahl-Hirschman Index (HHI) is a commonly accepted measure of market concentration. Unlike concentration ratios, the HHI increases with any decline in the number of firms or with rising inequality among any given number of firms. Any merger, no matter how small, will affect the HHI. An absolute monopoly would have an HHI of 10,000. Areeda & Hovenkamp, *supra* note 83 at 179.

¹⁸⁶ Areeda & Hovenkamp, *supra* note 83 at 295 [emphasis in the original].

¹⁸⁷ *Ibid* at 295-296.

¹⁸⁸ *Ibid* at 300.

¹⁸⁹ *Ibid* at 298.

¹⁹⁰ *Ibid*.

¹⁹¹ *Ibid* at 299.

¹⁹² Alessandro Fedele & Massimo Tognoni, “Failing Firm Defence with Entry Deterrence” (2010) 62:4 B Econ Res 365.

¹⁹³ *Supra* note 130.

¹⁹⁴ Fedele & Tognoni, *supra* note 192 at 367.

¹⁹⁵ *Ibid*.

¹⁹⁶ *Ibid* at 376-377 (conclusion continued: “[w]hen the merger is allowed, we find that losses due to reduced competition dominate gains due to no shortage of output only if the market is highly concentrated. In such a case, deterring entry is harmful from the consumer welfare viewpoint since beneficial effects of entry on industry output increase along with the market concentration. Furthermore, if the failing firm’s assets are small, prohibiting the merger turns out to be preferable even if the market is less concentrated because limited shortage of output is expected in the short run, so that only the concerns about long-run reduced competition are relevant. Therefore strict application of the requirement (iii) of the FFD may lead to a lower consumer surplus, which is an increasing function of the industry output, than what would be obtained by prohibiting the merger”).

¹⁹⁷ Robin Mason & Helen Weeds, “Merger Policy, Entry, and Entrepreneurship” (2012) Centre for Economic Policy and Research online: <http://privatewww.essex.ac.uk/~hfweeds/ffd_2012-09_26.pdf>

¹⁹⁸ *Ibid* at 2.

¹⁹⁹ *Ibid* at 2-3.

²⁰⁰ *Ibid* at 8.

²⁰¹ Armin Schwienbacher, “Venture Capital Exits” in Douglas Cumming, ed, *Venture Capital: Investment Strategies, Structures, and Policies* (Hoboken, New Jersey: Jon Wiley & Sons, 2010) 389, cited in Mason & Weeds, *supra* note 197 at 8-9 (“[d]ata on exit routes in Europe show that divestment by trade sale or ‘acquisition exit’ to an existing firm, often one that operates in the same

industrial sector as the target firm, was a more common exit route than initial public offering (IPO) throughout the period 1998-2005 [...] for the U.S., the ratio of trade sales to IPOs is 1.3-1.6 on average (measured in number of exits”).

²⁰² Ken Heyer & Sheldon Kimmel, “Merger Review of Firms in Financial Distress” (Discussion paper delivered for the Economic Analysis Group – Department of Justice Antitrust Division, March 2009), online: <<http://www.justice.gov/atr/public/eag/244098.pdf>> at 11.

²⁰³ *Ibid* at 12; *OECD Roundtable 2009*, *supra* note 31 at 43.

²⁰⁴ *OECD Roundtable 2009*, *supra* note 31 at 43-44.

²⁰⁵ *Ibid* at 42-43.

²⁰⁶ *Ibid* at 42.

²⁰⁷ Helder Vasconcelos, “Can the failing firm defence rule be counterproductive?” (2012) Oxford Econ Pap at 1, 3.

²⁰⁸ *Ibid* at 2.

²⁰⁹ *Ibid* at 3-4.

²¹⁰ *Ibid* at 4-5.

²¹¹ *Ibid* at 5.

²¹² *Ibid* at 23 (Vasconcelos adds that more stringent conditions need to be met for rescue mergers in industries characterized by fixed capacity and barriers to entry, and that competition authorities should reject small merger proposals for which divestitures cannot be demanded).

²¹³ Jan Bouckaert, Peter M Kort, & Stefka Petrova, “The Failing Firm Defense in Declining Markets” (2011) [unpublished] at 2, online: <http://www.cresse.info/uploadfiles/2011_BOUCKAERT,%20KORT&PETROVA.pdf>.

²¹⁴ *Ibid* at 2-3 (“The reasoning is that merged firms strive to maximize the sum of their profits, implying that a price increase of one of their goods has the advantage that it raises demand of the other good produced by the merged entity”).

²¹⁵ *Ibid* at 3.

²¹⁶ *Ibid* at 16.

²¹⁷ *Supra* note 19.

²¹⁸ Bouckaert, Kort & Petrova, *supra* note 213 at 4.

²¹⁹ *OECD Roundtable 2009*, *supra* note 31 at 44.

²²⁰ *Ibid* at 87; Kokkoris & Olivares-Caminal, *supra* note 2 at 404.

²²¹ Case No IV/M.877, Boeing/McDonnell Douglas, [1997] OJ L 336/16 (Both parties invoked the failing firm defence in their applications to the FTC and European Commission. The EC rejected the application of the failing firm defence due to the profitability of McDonnell Douglas, whereas the FTC approved the merger primarily on US defence interest grounds).

²²² Kokkoris & Olivares-Caminal, *supra* note 2 at 120-121.

²²³ *OECD Roundtable 2009*, *supra* note 31 at 87.

²²⁴ *Supra* note 42.

²²⁵ *Supra* note 19.

²²⁶ Areeda & Hovenkamp, *supra* note 83 at 295.