Introduction

> As freak legislation, the antitrust laws stand alone. Nobody knows what it is they forbid.
>
> Isabelle Paterson (1866–1961)[1]

As result of the recent crisis it has been argued that competition policy may be set aside due to special and exceptional circumstances.[2] These special and exceptional circumstances can be, inter alia, the collapse of a bank that can trigger a systemic crisis. Therefore it is important to have a clear understanding of the rules (i.e. competition law) and the exceptions to those rules, especially in the presence of such exceptional circumstances.[3] In addition, it is important for distressed entities and policy-makers to understand clearly the array of options that they have in advance since these can be used as part of their 'crisis toolkit'. The aim of this book is to provide an analysis of such exceptions to competition law and policy, particularly in the context of a financial crisis.

Promotion of consumer welfare has traditionally been considered one of the aims, not the sole aim, of antitrust, both in the United States and in Europe.[4] In the United States of America the Federal Trade Commission (FTC) acts to ensure that markets operate efficiently to benefit consumers. In the United Kingdom the Office of Fair Trading (OFT) declares that the its goal is to make markets work well *for consumers*. Most

[1] Isabel Paterson was a Canadian-American journalist, author, political philosopher and leading literary critic of her day. Along with Rose Wilder Lane and Ayn Rand, who both acknowledged an intellectual debt to Paterson, she is one of the three founding mothers of American libertarianism.

[2] The views of this book are strictly personal and do not reflect the views of the Office of Fair Trading, UNCTAD or any other affiliated institutions.

[3] This chapter will mainly use the term 'competition', which is interchangeable with 'antitrust' as used in the US for the law or authorities that protect trade and commerce from restraints, monopolies, price-fixing and price discrimination. See *Black's Law Dictionary*, 8th ed., Thomson West, 2004, p. 92, for the definition of antitrust law.

[4] R. Whish, *Competition Law*, 5th ed., Butterworths, 2003, at pp. 15 et seq.

academics seem to agree that consumer protection is the prevailing aim of antitrust legislation.[5] This book will provide a comprehensive understanding of the rationale of competition law in the light of conflicting interests (promoting competition versus the collapse of a firm that might result in a systemic crisis). The key issue that this book aims to address is whether the risk of a systemic crisis can justify the adoption of a more lenient approach to established antitrust legal standards. The European Union, UK and USA perspectives will be analysed to reflect a comprehensive understanding.

Nowadays we face global restructuring of industries that may represent the most significant economic change of the last decades. Fierce competition from imports, severe overcapacity in some industries and technological advancements are only some of the features that characterize markets nowadays. Distressed companies on the verge of insolvency are a common phenomenon that is observed in both developed and developing economies. Companies that are in distressed financial conditions may choose to embark on a merger as a means to ensure their viability and profitability. A strategic response for struggling firms and one of the means of implementing a successful debt restructuring process is to combine in order to achieve competitively necessary efficiencies.[6] Either a failing firm within a booming industry or firms in a distressed industry will choose to merge/acquire/be acquired (or choose to sell loss-making divisions) in order to enhance the firm's viability and profitability. Given these wrenching transformations, the applicability and importance of the failing-firm defence and failing-division defence might be crucial.[7]

The importance of mergers (and thus of the failing-firm defence) for the restructuring process is indicated, inter alia, by the US Supreme Court in the *United States v. General Dynamics Corp.* case.[8] The Court upheld that three groups – private parties, shareholders and creditors – benefit from the merger of a failing firm. The shareholders are unlikely to lose the investment and are likely to reap benefits if the merger proves

[5] The report prepared by the ICN (International Competition Network) Unilateral Conduct Working Group (ICN Report) for the 6th Annual Conference of the ICN in May 2007 includes a table of the objectives of unilateral conduct laws identified in the responses of the jurisdictions which were surveyed as part of the ICN Report.

[6] D. Valentine, 'Horizontal Issues: What's Happening and What's on the Horizon' (1995), available at www.ftc.gov/speeches/other/dvhorizontalissues.htm.

[7] An equivalent term is failing-company defence.

[8] *United States v. General Dynamics Corp.*, (1974) 415 U.S. 486.

profitable. The creditors will benefit as a result of retaining their rights against the debtor and are likely to be reimbursed for the credit they have provided to the firm. On the other hand, in insolvency proceedings they are not as likely to be fully reimbursed.

The restructuring process can thus be used as a tool to determine if a division of a firm or the whole firm must be merged or acquired by another undertaking in order to maintain its viability and its future prospects for profitability. In such a case the only possible means of restructuring is through a successful merger/acquisition. This merger may need to be assessed by the relevant competition authorities. If the authorities consider that the merger will have anti-competitive effects, they may block it, thus resulting in the unsuccessful completion of the restructuring procedure. The US and the EU have their own criteria for assessing the argument of failing-firm defence. The satisfaction of these criteria is an essential factor for a merger which is likely to have anti-competitive effects to be allowed to proceed. The failing-firm defence refers to the supposedly neutral effect on competition of concentrations where one (or both) of the merging parties (the acquirer and/or the target) are failing or will fail due to poor financial performance.[9]

As mentioned above, a significant and frequent, in certain economies, reason for engaging in mergers is the restructuring of debt of a company which is on the verge of insolvency. There is a growing literature on the effect of insolvency procedures on *ex ante* decisions by firms and shareholders. The restructuring of the debt may entail the sale of a loss-making division and, if the company has subsidiaries, the sale of the subsidiary or subsidiaries as a whole. Thus the failing-firm defence and failing-division defence can be invoked in cases where this sale is assessed by the relevant competition authorities. However, the failing-division defence has not been given much acceptance and accreditation by the above-mentioned competition authorities and courts.

Turning to efficiencies, there can be cases where efficiencies are being alleged and the mergers are occurring in a period of crisis. Important questions are being asked regarding whether the assessment of efficiencies should be different in these cases. Mergers can induce both beneficial and adverse effects in a market. The importance of considering efficiencies in mergers cannot be underestimated.

Efficiencies contribute a great deal towards achieving the goals of a

[9] V. Baccaro, 'Failing Firm Defence and Lack of Causality: Doctrine and Practice in Europe of Two Closely Related Concepts' (2004) 1 *ECLR* 11, at p. 11.

competition system – promoting consumer welfare and total welfare, and providing a genuine benefit to society. In addition, efficiencies which increase competition in the market should unambiguously be encouraged. Mergers consolidate the ownership and control of business assets, including physical assets (for example, a plant) and intangibles (for example, brand reputation). They can enhance corporate (and wider economic) performance by improving the efficiency with which business assets are used. Further reasons for firms to engage in mergers and acquisitions include efficiencies arising from the mergers,[10] and the tendency of some countries to endorse the concept of 'national champions'.[11] In the absence of the European Commission's ('the Commission') decisions and of judgments of the Community courts that would clarify problematic issues of the practical application of the efficiency defence,[12] the parties and their advisers rely on guidelines. In order to successfully present and sustain their efficiency claims, merging parties should have a clear understanding of at which stage of the merger assessment they should be introduced, how efficiencies will be assessed in relation to anti-competitive concerns and what kind of evidence should be produced.

Advocates of a more lenient approach advocate placing increased emphasis on preventing inefficiencies that may result from the

[10] In the form of, inter alia, economies of scale and economies of scope. 'Economies of scale' refers to the situation where long-run average costs of production decrease as output rises. See further D. Begg, S. Fischer and R. Dornbusch, *Economics*, 5th ed., McGraw-Hill, 1997, p. 109. The term applies to efficiencies associated with increasing or decreasing the scale of production and refers to changes in the output of a single product type. 'Economies of scope' refers to situations where the joint output of a single firm is greater than the output that could be achieved by two different firms each producing a single product (with equivalent production inputs allocated between the two firms). See further R. Pindyck and D. Rubinfeld, *Microeconomics*, 4th ed., Prentice Hall International, 1998, p. 227. The term refers to efficiencies associated with increasing or deceasing the scope of marketing and distribution and to changes in the number of different types of product. In addition, economies of scale relate primarily to supply-side changes (such as level of production) whereas economies of scope relate to demand-side changes (such as marketing and distribution).

[11] The concept of 'national champion' refers to domestic firms that are able, post-merger, to successfully compete in international markets.

[12] The European Commission is the executive body of the European Union. Alongside the European Parliament and the Council of the European Union, it is one of the three main institutions governing the Union. Its primary roles are to propose and implement legislation, and to act as 'guardian of the treaties' which provide the legal basis for the EU. The Commission consists of twenty-seven commissioners, one from each member state of the EU.

prevention of the merger. Thus, rather than an efficiency defence, we may need to consider an inefficiency defence as well. This is an important consideration that was clearly taken into account in a number of cases. In the penultimate chapter, we shall analyse the circumstances under which the authorities should place significant emphasis on the continuity of service or product, so significant that in certain cases even if the criteria of efficiency defence may not be strictly satisfied, the merger should be cleared on the basis of the prevention of the resulting inefficiencies from discontinuing the product or service. This argument is similar to that analysed in the discussion of the failing-firm defence regarding circumstances in which the authorities should be more lenient towards accepting arguments based on the failing-firm defence.

The book will also address cartel agreements. Such agreements generally involve price-fixing, market division, control of output, mitigation of technological improvement and limitation of production. Through cartels, 'private' interests may determine the level and distribution of the national income, the level of employment and the stability of markets, as well as general economic and political stability. Cartel justifications that have been proposed include that a cartel will prevent cut-throat competition. In industries where fierce competition would yield below-cost pricing, the cartel guarantees a 'reasonable' price. In addition, it has been argued that a cartel sustains needed capacity and prevents excess capacity. Furthermore, a cartel reduces uncertainty as regards the average price of a product. It also assists in financing desirable activities, such as research and development (R & D), and in providing countervailing power, since if there is a single buyer (monopsonist/oligopsonist) or supplier (monopolist/oligopolist), there is unequal bargaining power that a cartel can address.

Without the industry-wide agreement on capacity reduction that can be achieved through a crisis cartel, smaller firms may exit the market, thus leaving a limited number of choices for customers as well as inducing unemployment. In such conditions, undertakings may operate at inefficient output levels and may even incur losses. The Treaty of Rome did not contain any clauses regarding crisis conditions. When the Treaty of Rome was signed, economic expansion seemed to be likely to continue. Due to the lack of express clauses in the Treaty of Rome the Commission could not justify applying the Article 81(3) criteria.[13] Thus

[13] Pursuant to the Treaty on the Functioning of the European Union (Lisbon Treaty) (EC Official Journal C 306/2 of 17 December 2007, p. 1) the provisions on

the Commission initially reduced fines on cartels existing in situations of crisis. German legislation, the Treaty of Rome and the Treaty of Paris had adopted different attitudes to the existence of crises in the economy. The German statute was more lenient towards crisis cartels by allowing structural crisis agreements. The Treaty of Paris, although not exempting crisis cartels, allows for intervention by Community institutions to ensure minimum prices.[14] In contrast, the Treaty of Rome adopts a stricter approach and does not contain any exemptions for crisis cartels.

As the case law illustrates, crisis cartels are likely to appear in industries where production facilities are durable and specialized and consumer demand falls due to adverse market conditions. The Commission and the Court of First Instance (CFI) or European Court of Justice (ECJ) will authorize a restructuring plan involving sectoral agreements if it is believed that the Article 101(3) criteria are met. These criteria will be met if the reduction in the capacity of the sector will, in the long term, lead to more efficent capacity utilization enhancing the competitiveness of the sector and thus benefiting consumers. In addition, the Commission interestingly argues that a factor that will be taken into account is the impact of the capacity co-ordination on the mitigation of the adverse impact of the crisis on employment.[15] The Commission explicitly states that reorganization operations should also be used to stabilize and secure the employment situation in the sector concerned.[16] Again, the Commission uses the positive impact on employment of the co-ordination of the business conduct of competitors as a factor favouring exemption. Thus a detailed plan of plant closures as well as avoidance of the creation of new capacity are also necessary factors in the agreement being accepted by the Commission.

In addition, the agreement must constitute indispensable means of achieving the necessary capacity reduction. The limited duration of the agreement, the existence of firms in the industry which are not party to

Footnote 13 (*cont.*)
anticompetitive agreements (formerly Article 81) are now in Article 101, abuse of dominance (formerly Article 82) now in Article 102, public undertakings (formerly Article 86) now in Article 106, and state aid (formerly Articles 87–8) now in Articles 107–8. The European Court of Justice is now the Court of Justice, and the Court of First Instance is now the General Court. The terms European Court of Justice or ECJ and Court of First Instance or CFI will be used herein.

[14] R. Joliet, 'Cartelisation, Dirigism and Crisis in the European Community' (1981) 3 *World Economy* 403, p. 405.

[15] Twenty-third Report on Competition Policy, para. 85.

[16] Twenty-third Report on Competition Policy, para. 88.

the agreement and the fact that the co-ordinated reduction in capacity is only an element in the business strategy of firms constitute reassurances that competition will not be eliminated.

In addition, the 'financial constraints' consideration reflects a concern that high fines might force an offending firm into insolvency. The European Commission and the US antitrust authorities have wide discretion and apparent lack of transparency in awarding discounts. However, factors external to competition policy – in particular the social objectives of the Treaty on the Functioning of the European Union (TFEU) – may determine how they are granted. Thus firms can be involved in cartels and not end up paying a fine in crisis situations, increasing both their profits from collusion and their tendency to be in cartels (in the absence of criminal sanctions like those the UK's competition authorities can impose).

In the past, economic recessions have often been followed by efforts to change the legal framework of competition, in order to preserve people's faith in the free-market system. Perhaps the most prominent example of such efforts was the National Industrial Recovery Act (NIRA) in the United States at the time of the Great Depression in the early 1930s. In trying to contain the damage of the Great Depression, this Act allowed hundreds of industries legally to meet and agree upon rules limiting 'excessive' competition. However, subsequent historical analysis has shown that some serious harm to the economy was the actual result of these efforts.[17] Pursuant to this legislation, there was a full suspension of the enforcement of competition law, combined with collective bargaining in setting wages. Had there not been full suspension and had the EC policy on crisis cartels of the 1980s and 1990s been followed, the recovery of the economy might not have been so slow.

Turning to state aid enforcement, the control of state aid is an important component of the competition policy of the European Union. State intervention influences the way markets operate by favouring certain undertakings and causing, as a result, serious damage to their competitors operating in the same and/or different member states. State intervention may thus undermine the achievement of a market economy with free and undistorted competition. Indeed, Protocol 27 of the Treaty on the European Union (TEU) and TFEU recognizes that the establishment of an internal market, as provided by Article 3 TEU, requires 'a system

[17] See K. Heyer and S. Kimmel, 'Merger Review of Firms in Financial Distress' (2009), available from: www.usdoj.gov/atr/public/eag/244098.htm.

ensuring that competition is not distorted'. Therefore the state aid policy of the EU prohibits in principle state aid and allows exceptionally only the kind and amounts of state aid that pursue common policy aims and do not cause excessive distortion between member states.

The concept of state aid is evolving. Public authorities have been quite adept in devising new measures to support companies or whole industrial sectors. As a consequence, EU courts have had to refine the definition of what constitutes state aid and the Commission has had to sharpen its investigative methods. Not surprisingly, state aid policy has played an important role during the financial crisis. It has allowed member states to support, initially, financial institutions and then the real economy while at the same time it has strived to prevent excessive distortion of competition and disruption to the flow of resources between member states.

Member states have not been allowed to discriminate in favour of their banks. They have not been allowed to grant unlimited amounts of aid. They have been required to submit realistic restructuring plans which in some cases have led to the sale of the beneficiaries or even to their closure.[18] The Commission has issued special rules as a result of this crisis. These rules are without doubt accommodating. Given that similar and even more generous measures have been adopted by countries outside the European Union, it is not unreasonable to conclude that the special rules merely reflected the exceptional nature and unprecedented magnitude of the crisis.

In every crisis, there will be a push for a regulatory response and a political response, which would lead to a restructuring of regulation but may restrict competition even further.[19] It is obvious that the European Commission (and all competition authorities in the EU), under the current economic crisis, have to be cautious with the application of competition rules. They must consider not only the short-term restabilization of the economy but the long-term development of competition as well.

According to Nadia Calvino, deputy director-general for competition at the European Commission,

[18] For example, the liquidation aid to Roskilde Bank in Denmark (NN 39/2008).

[19] See Professor Petzman's speech at the OECD, Summary Record of the Discussion on Competition and Financial Markets, DAF/COMP/M(2009)1/ANN5, 10 April 2009, Roundtable 4 on Going Forward: Adaptation of Competition Rules, Processes and Institutions to Current Financial Sector Issues, available at www.oecd.org.

> There are clear challenges in the policy landscape: there is a financial crisis which leads to systemic risks and is now turning also into a real economic recession. The European Commission has a significant role to play in the current economic environment, but we have to protect the short-term stability of markets while also keeping in mind the importance of a long-term perspective.[20]

Competition authorities should be pragmatic in enforcing competition legislation against mergers, cartels and state aid in periods of crisis. In adopting a pragmatic approach, competition authorities should aim at minimizing adverse precedential issues as well as adverse effects on competition, effects that can sustain after the crisis is over. Competition policy needs to be pragmatic, and flexible enough to address sudden exogenous shocks and the wide-ranging implications of such shocks to whole markets. After all, the ultimate and undoubted aim of the Commission should be to enhance the degree of competition in a market, leading to improvement of consumer welfare. On a number of occasions, it is thus essential to subordinate competition policy if such an approach will ensure sustainability and enhancement of consumer welfare, or alternatively if such an approach will prevent a deterioration of consumer welfare through means irrelevant to competition policy (e.g. systemic crisis, macroeconomic instability and so on).

Turning to each chapter in detail, the first chapter will present an overview of competition law and policy and will place significant emphasis on US and EU legislation regarding mergers and cartels. This chapter will not purport to provide an exhaustive analysis, but an overview of the legislative means that are employed in these jurisdictions to address anti-competitive conduct. The origin of the competition legislation in these jurisdictions is essential to understanding the approach that they take in dealing with mergers, cartels and state aid in periods of crisis. This approach will be the subject of the chapters that will follow.

The second chapter will address the occurrence of a crisis. The origins and causes of crises can be quite diverse and they pose serious threats to the economy of a country or region or to the entire world. Therefore this chapter will try to identify a working matrix to understand the different

[20] EU, Competition and Public Law Report, Brussels focus (2009), 'Brussels: Part of the Problem or Part of the Cure', available from www.abreuadvogados.com/xms/files/05_Comunicacao/Artigos_na_Imprensa/Iberian_Lawyer_Artigo_MMP_Fev.2009.pdf.

types of crisis and their common factors. Also, this chapter will attempt to demonstrate the detrimental effects of financial and other crises in the economy.

The third chapter will then present the application of the failing-firm defence. This chapter will address in detail one of the main considerations (defences) which competition authorities can take into account in assessing an anti-competitive merger. The failing-firm defence refers to the supposedly neutral effect on competition of concentrations where one (or both) of the merging parties (the acquirer and/or the target) are failing due to poor financial performance. There is a growing literature on the effect of insolvency procedures on *ex ante* decisions by firms and shareholders. Restructuring of a company may entail the sale of a loss-making division, and if the company has a subsidiary, the sale of the subsidiary as a whole. Thus the failing-firm defence and the failing-division defence can be invoked in cases where this sale is assessed by the relevant competition authorities. However, the failing-division defence has not been given great acceptance and accreditation by competition authorities and courts. We should note that in declining-industry conditions it is more likely that firms which are currently failing will continue to be in an adverse financial situation and will not be viable at all in the near future, thus causing an industry-wide crisis.

The fourth chapter will present the efficiency defence, which is relevant in the enforcement of merger legislation. Mergers may eliminate any competition that exists between the merging parties and may lead to a reduction in the number of firms competing in the market. Where this reduction has a substantial adverse effect on overall market competition, the market will be less oriented to consumer and efficiency goals, even in the absence of breaches of competition legislation. The importance of considering efficiencies in mergers cannot be underestimated. Efficiencies contribute a great deal towards achieving the goals of an antitrust system – whether promoting consumer welfare or total welfare, or providing genuine benefit to society. In addition, efficiencies which increase competition in the market should unambiguously be encouraged.

The term 'efficiency defence' is a statutory defence whereby a merger must be permitted – even if it will lessen competition – if efficiency gains due to the merger exceed or offset the effects of reduced competition. The efficiency defence is closely related to the welfare standard. In reality, however, the choice of a welfare standard does not reflect the findings of economic science, but rather has the nature of a political