The Practical Dilemmas of the Failing Firm Defense of Merger Review

Liangxuan Dong *

Faculty of Law, Macau University of Science and Technology, Macau SAR, China

* Corresponding Author Email: 604870769@qq.com

Abstract. With economic slowdown pressures added to the increasing number of mergers and acquisitions, merger review will have to balance two functions; ensuring competition regulation and enterprise rescue. As a major tool to reconcile these objectives, the failing firm defense has evolved itself to be an institutional practice in most jurisdictions. The consideration of failing firms started to be mentioned as the provision of the review by the Anti-Monopoly Law of China (amended in 2022). But no comprehensive institutional framework has been achieved and the normative gaps, operational ambiguity, and systemic disconnect has not been formally achieved in practice. It is within this context that the paper begins by clarifying the theoretical basis of the failing firm defense, which demonstrates its main logic, the compromise between two evils and its conception in the functional complementarity of the legal domains. It subsequently examines the institutional merit of the mechanism in the surface of preserving assets and investment of competition. Moreover, it discusses the root causes of the existing dilemmas, as inadequate institutional coordination, technical limitations to processes of reviews, and the deficiency of supportive mechanisms are identified as a major problem. Conclusively, it suggests ways of enhancing it, namely systematized construction of regulation, streamlining of the review operation, reinforcement of the supporting mechanism, and the development in alignment with emerging business models which has a view to contributing to the accuracy and efficiency of merger review system in China.

Keywords: failing firm defense, merger control, review exemption, institutional coordination, Anti-Monopoly Law.

1. Introduction

The merging thrusts of the depressed economy and corporate restructuring call demands has created tension within the framework of merger review between competition regulation and enterprise salvage. Developed in the case of the U.S International Shoe Co. since then, the defense of failing firm has become a properly developed rule regime in other jurisdictions, including the European Union and the United Kingdom, with a clearly defined system of constitutive elements. It has turned out to be a critical institutional mechanism of dampening the effect of economic waves. Following the 2022 amendment of the Anti-Monopoly Law of China, the Provisions on the Review of Operator Concentration included the aspect of failing firms but failed to define and establish the relevant standards. Further, existing gaps in the liaisons between this framework and the Enterprise Bankruptcy Law still exist[1-2]. Such shortcomings have given way to soft review standards in practice, in which it is hard to meet the review requirements of emerging business models like the platform economy and which gives rise to the risk of opportunistic merger. In this regard, it is essential to define the institutional location of the phenomenon of the failing firm defense, examine the practical dilemmas, and identify ways to improve the situation, not only in improving the accuracy of the review of the merger but also in the modernization of the Chinese market economy and the creation of the national market.

2. The Theoretical Undergrounds of the Failing Firm Defense

The failing firm defense is based on the theoretical basis of functional complementarity of various branches of the law. Although antitrust law aims at protecting competition in the market it should consider economic efficiency as well as social stability. Conversely, the goal of the law on bankruptcy is to cover the settlement of debts and rescue an enterprise, and its reorganization or liquidation processes can be directly directed to the conclusion of merger transactions. The clash of values and coordination of these two legal regimes has led to the defense of the failing firm. It is fundamentally based on the judicial concept of selecting the lesser of the two evils, as opposed to a Pareto improvement of the logic of the efficiency defense. Although a merger transaction does not facilitate any high-order efficiency, it may still be left undinterfering in case it can avoid the situation of vacuity in the market or wastage of resources which would arise in the event that a failing enterprise exited the market [3]. Additional experience acquired internationally reveals that the necessary theoretical foundation of the defense of the failing firm is in the solution that no causal relation exists between the merger and the worsening of the market competition. When the withdrawal of the firm out of the market is unpreventable and negative effect on competition is not undertaken by the very transaction, the intervention of the antitrust law is not justified. Such theoretical grounding defines the confusing limits of exemption and offers sensible basis on real review practices.

3. The Failing Firm Defense of Value of the Merger Review Exemptions

3.1. Asset Preservation

A market economy should be dependent on optimal and dynamic resource allocation in order to operate efficiently. The process of disposing assets in the context of the bankruptcy proceedings is however not often efficient, and the process normally results in the wasting of resources. Even though the law of bankruptcy offers a legal avenue through which firms can find their way out of the market, liquidation processes which dismember and sell assets in bits often demolishes the integrity of factors of production (Figure 1). This issue is more pronounced in assets specific to the industry where in certain cases just dismantling of technology and equipment can immediately annul their wealth. The pain point of asset disposal issue in the context of bankruptcy, once studied in selected dimensions can be viewed as a problem of resource misallocation. The failing firm defense provides an institutional compromise in which it is permissible to have mergers exemptions during antitrust investigation under which the assets of the bankrupt firm can be transferred holistically. Qualified mergers enable the acquiring party to be in possession of full set of assets of the ailing enterprise and employ its own financial and administrative strengths to rejuvenate the underutilized resources thus ensuring that there will be no devaluation of assets through idleness or fire sales. This system is useful in the effective mobility of the factors of production that are not performing relatively well to those that perform well well to ensure that the resources are regularly moved in the market. It corresponds to the legislative purpose of the bankruptcy law to maximize resource allocation, and to the practical purpose of the supply-side structural reform to enliven the already existing assets.

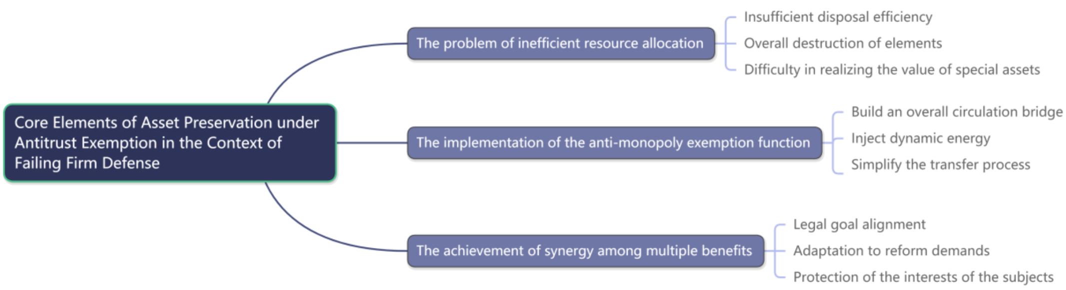

Figure 1. Priminence Assets conservation is an exemption under the antitrust regulations in defence of failing firms.

3.2. Maintaining Competition

Mercer review is aimed to prevent the establishment of market structures that may extinguish or restrain competition, but the chaotic exit of bankrupt companies may indirectly undermine competition. With finite competition in the market structure, the exit of a rival will decrease the market players as a result of heightened constraints of rivalry on the remaining firms and augment risk of unilateral impact or coordinated impacts. As an example, the risk may increase in 2023 because the rate of bankruptcy in the EU retail sector has increased by 35 a year since the year before. An example is Groupe Go Sport of France. The brand ran bankrupt in 2023 and had more than ten million euros in debts [4-5]. The premier company Decathlon which already occupied a 27 percent market share wanted to purchase the company, though this would have brought the company beyond the 35 percent alert threshold. The acquisition was eventually done by a medium sized group instead. The rationale in the review provided in the present situation was the lack of superior alternative purchasers. Once the deal was closed the CR5 (combined market share of the top five firms) grew in the French market only by 42 to 43.5 percent compared to the 51 percent that should have been had had Go Sport left the market completely. This result reduced the amount of harm to competition and limited it to the minimum possible, reflecting the essence of the antitrust law of aiming to eliminate potentially harmful competition.

4. Reasons behind Prudent Practical Dilemmas in the Failing Firm Defense Implementation

4.1. Lack of Co-ordination in Institution

The values and the logic of regulation and regulation in law between bankruptcy law and antitrust law are quite different. The first one will be asset maximization oriented and the latter is centered on the continuation of market competition. The variance of goals has brought about failure of institutional integration. Splitting of legal norms has created an absence of coordination of the systems. In the Anti-Monopoly Law of China, the concept of the failing firm defense and its constitutive elements have not been clearly defined, only mentioning the concept in principle as a part of the merger review. In the meantime, Enterprise Bankruptcy Law does not give guidance about the connection of restructuring of transactions to antitrust review. In addition, there are significant differences in the laws that determine a failing firm. The bankruptcy law evaluates the financial position in a firm and the probability of dealing with the liquidation in an objective way, whereas the antitrust law is based on the unavoidability and irreparability of leaving the market. These conceptual variations cause chaos to implementation and adjudication, but the complementary functionality of the two legal systems.

4.2. Weaknesses of Review Techniques

The complexity of the failing firm defense problems contributes to the multidimensionality of the defense approach that involves a complex and intertwined review method that incorporates both a legal and economic analysis. Review agencies would have to make concurrent decisions on whether the exit of the firm in the market is unavoidable, whether or not there is an alternative buyer and whether the merger will have no causal significant action to decline in competition. The initial review is based on financial status, industry outlook, and possibilities of restructuring, which calls on the incorporation of the legal logic and economic modeling. Nevertheless, the existing review practices have no unified analytical framework of the interpretation of financial information, thus, it is unlikely to establish precisely the imminence of exit. The second decision is potential alternative buyers research, but since the information is asymmetrical and markets are volatile, the authorities are not always able to completely determine the intentions and capabilities of other companies to make an acquisition, decreasing the reliability and plausibility of the review result.

4.3. Lack of Backing Excellence

The operations of the failing firm defense require the integration of a variety of actors and systems, and the support system that is previously disorous does not allow a consistent regulation. The mechanisms of information disclosure are still not efficient because in the case of insolvent companies, the authorities of the review can hardly gain access to full financial and functional data. Parties to transactions may also falsify important information in order to receive the exemption, and this raises the cost of verification and the likelihood of false defenses. Another big problem is the absence of professional assistance. Moving the failing firm defenses review is an expertise population not only in the field of competition economics but also in financial accounting and technology in the industry, but current teams which are in charge of enforcing the approach have not been normalized and internalized, and external expert consultation mechanisms have not been institutionalized. Moreover, the flaw of having mechanisms of effective relief makes the situation even worse: as parties are not satisfied with the decisions of the reviews, there are no clear rules of appeals in this case, and the procedural guarantees of the review are not provided, which may negatively affect the apparent impartiality and validity of decisions made by the control of mergers.

5. Ways out and escape routes through the Failing Firm Defense Practical Dilemmas

5.1. The systematic and coherent institutional framework is to be established

Currently, the Enterprise Bankruptcy Law of China is being revised and the antitrust regulators are still polishing the merger review regulations. Inconsistent standards in review and challenges in ensuring the uniformity in enforcement have been brought up by the failure of the two regimes to coordinate the defense of failing firms [6]. The deficiency of institutional supply is the basic factor that makes the practice of a failing firm defense to be in a state of disorder. With this background of significant overhaul of the Enterprise Bankruptcy Law and continuous enhancement of antitrust laws, there has been an increasing demand to reinforce normative coordination. In legislative terms, the two laws are supposed to exactly be in harmony. The Anti-Monopoly Law ought to include these aspects of a formal recognition of the legal position of the defense of failing firms, as well as the formulation of the fundamental ideas of the phenomenon of a failing firm and the exit of the market that is inevitable. This would do away with disparities in the two laws in their points of determination. Coupled with judicial interpretations, operations guidance should be further refined to include operational factors of an abstract nature (e.g. degree of economic decline), which are immeasurable such as the percentage of debt to asset ratio or elapse of time to exhaust cash flow, which are to be measured. Practically, the burden of proof assocation must be defined: the parties to the transaction are required to demonstrate the presence of bankruptcy and impossibility to exit, and review authorities are required to confirm the validity of other acquisition plans and their relations to competitive implications. By means of a hierarchical and systematic structure, the whole institutional cycle may be constructed to establish clear references to be applied to the enforcement practice.

5.2. Optimization of the Operational Framework of Review Practice

As the cases of mergers increase annually, a larger portion of cases inclusive of the failing firm defense are more complicated and may encompass financial, market and competition aspects. Existing review procedures do not include standard procedures, the use of which causes inefficiency of the processes, and the probability of conflict increases. Due to the technical constraints of review methods, judgement frequently has a say in deciding cases of failure of the firms [7-8]. This means that creating a universal system of operation would be critical towards enhancing the success and effectiveness of reviews. The logic of the Guidelines in the Review of Horizontal Mergers can be used by the enforcement agencies and construct a specific review manual constructed on the basis of three-level analysis a requirement identification, multi-dimensional verification, and effect analysis. The initial step that the authorities must undertake is to strive to identify the major defense claims by screening financial indicators in an attempt to give a preliminary assessment on whether the enterprise matches the minimum requirements of the failing firm defense. The second stage entails inviting third party professional institutions to undertake independent assessments of the feasibility of reorganization and stability of asset values. The industry associations may also be beneficial in the sense that they can create a verification platform to the potential buyers in order to reduce information asymmetry. In the third phase, the authorities have the opportunity to integrate unilateral and coordinated effects assessment paradigm within the EU concept of causality exclusion to contrast the competitive situation in the market in the merger and non-merger condition. Performance benchmarks can be achieved by regular publication of typical cases, identification of the major analysis procedures and review priorities can be improved and normalized over a period (Table 1).

Table 1. Three-stage Review Process Design

Review stage	Core task	Specific operation methods
Element identification stage	Screen out enterprises that meet the basic conditions for bankruptcy defense	Focus on the core defense reasons, screening through financial indicators such as balance sheet and cash flow
Multidimensional verification stage	Verify facts and alternative solutions, and bridge the information gap	Introduce third-party assessment of the feasibility of reorganization; build an information verification platform for potential acquirers based on industry associations
Effect prediction stage	Evaluate the impact of concentration on market competition	Draw on the EU theory, combine the unilateral / coordinated effect model, and compare the differences in competitive states regarding "whether to consolidate or not"

5.3. Enhancement of Supportive Mechanisms

The failure to stop the implementing of the failing firm defense entangles several participants, which comprise antitrust bodies, the courts, the bankruptcy administrators, and industry associations. Nonetheless, poor exchange of information, disjointed expertise and lack of sufficient channels of aid have negated proper coordination. To make proper functioning possible, it is necessary to have a multidimensional system of support [9]. The information disclosure mechanism must provide a clear understanding of what is required to be disclosed on a mandatory basis with the parties able to provide audited financial reports of the last three years, creditors meeting resolutions and reorganization plans. Administering credit penalties together with administrative penalties should be enforced over concealment of important information. To provide professional support, one of them should be a composite review team consisting of the representatives of enforcement officials and professional consultants which will create a dynamic pool of the specialists of the competition law, accounting, and the industry-specific technology. Complex cases can be assessed by expert panels; the experience of Jiangsu Provincial Administration of Market Regulation of employing expert consultations to solve inconvenient cases can be used as an example. Institutional mechanisms should also be the use of cross-departmental coordination to guarantee constant exchange of information between the antitrust agencies, courts, and bankruptcy administrators. The information sharing and clue transfer model used in Guangxi can be used as a good evaluation point the efficiency and accuracy of the review. Also, the introduction of formal reconsideration procedure should be induced to determine the power and conditions of appeals, procedural fairness, and safeguarding the legitimate rights of the parties in the course of such a review.

5.4. Enhancement of Mechanisms of new economic models

Data-driven and network effect platform enterprises have established unique competitive forms in the era of the digital economy. Mersgers among such firms are particularly problematic in areas like the monopolization of data and the spreading of network effects when these firms themselves are victims of financial strains until it becomes apparent that they present themselves in the case of a bankruptcy that limits the deployment of the existing proponents of the defense of failing firms theories. The increased presence of digital business models needs specific changes in the priorities of review. Asset preservation evaluations should include the integrity and usability of the data assets and competitive impact of the exit of a bankrupt platform should be reviewed in the context of potential ripple effects created by network externalities. This is aimed at stopping the entrenchment of data monopolies by large companies in their takeovers [10]. To upgrade the technical facilities, big data analytics should be introduced to profile the potential acquirers to correctly determine the market participants who could take the assets of the failing firms. The algorithmic simulation models that are developed must also be used to predict post-merger competitive dynamics so as to identify the possible killer acquisitions in platform markets. The regulatory design must be flexible and lay the broad guidelines on how to treat the data heavy enterprise, the general requirements that must obtain clear compliance weight and have an awareness of how to clear data asset disposal. They should also establish a fast track system of responding to any emerging industries to instill practical experiences into rule based guidance, making sure that the system is flexible towards the digital economy and yet this should be without creating new types of monopolies.

6. Conclusion

Failing firm defense that can be adopted during the merger review is valuable in balancing dynamically between competition and enterprise rescue. It represents the reasonableness of the antitrust law and is used as a significant tool of the resources optimization and preservation of the larger interests of the society. The issues that the system is experiencing in China are essentially as a result of institutional design failures, technical capability and facilitating infrastructure. These barriers can be efficiently overcome with the help of systematic rulemaking, optimization of procedures, strengthening supporting mechanisms, and the ability to adapt to new economic models. It is undertaken through simultaneous legislative and administrative initiatives, which are allowed through the continuous professional growth and modernization of institutions. The defective firm defense should be refined to aid the accuracy and sanity of the merger overview to offer better institutional assurances on cultivating the excellence of China market economy.

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